

# Wells Fargo and Trust Issues: Impact on Financial Banking

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## ABSTRACT

The key issues that Wells Fargo is dealing with in this case is where to go after the Great Recession. Coming out of the Great Recession Wells Fargo was in a dominant position due to expanding their retail network during that time and because they had just taken over Wachovia. The takeover of Wachovia was very important to the long-term success of Wells Fargo during 2010-2013 because Wachovia had loans that Wells Fargo could prevent from defaulting. This allowed Wells Fargo to have mortgage-lending take up 65% of their profits in the late 2000's. With this large portion of their profits coming from mortgage lending, management knew they needed to continue to expand their mortgage lending to continue to see profits. The recent loss of public trust has greatly complicated their desire for increased profits.

## INTRODUCTION

### *Company History*

The case at hand, Wells Fargo put in place to obtain Wachovia and become a major banking superpower. When the 2008 great recession hit, Wachovia Corporation was in a great deal of financial trouble. Wachovia had made several attempts to save the company by talking to Morgan Stanley and Citigroup for a bailout and or merger. However, Wells Fargo made a bid in September 2008 to purchase Wachovia Corporation. Wells Fargo had offered a higher price than the other companies this allowed them to purchase the Wachovia's mortgage businesses. Wells Fargo was then able to make mortgages and loans to almost anyone. A reporter wrote that "If you can leave fog on a mirror after breathing, you qualified for a loan." When rebuilding after the Great 2008 Recession this left Wells Fargo in a very powerful position. Wells Fargo accounted for 28.8% of house loans and mortgages in 2008 resulting in \$524 billion in accounted credit. This was record largest annual total a bank has ever received in the housing market. This pushed Wells Fargo Bank into the 3<sup>rd</sup> largest bank in the United States by market capitalization. Wells Fargo did this by focusing in the San Francisco and New York city markets. Wells Fargo had continued to take advantage of the slowed down market and was able to profit during the recession.

Wells Fargo had been able to understand making the correct decisions at the correct time to boost themselves to the forefront of the banking industry. In September 2015, Wells Fargo had

become the nation's largest bank by market capitalization. However, in 2016, it was found the Wells Fargo had created false Credit lines for its customers. These practices go as far back as 2011. Wells Fargo management had been forcing employees to create false accounts for their customers. They forced customers to buy fake or unnecessary insurance policies. Because of this Wells Fargo today remains under view of the Consumer Financial Protection Bureau. Wells Fargo faces up to fines of US\$1.1 billion the most any banking company has been fined for fraudulent accounts. JPMorgan has become the largest bank that surpassed Wells Fargo since then.

Time after time it seems Wells Fargo has made the right decisions in the banking industry. Other than the most recent scandal, Wells Fargo has put up the right strategies to place themselves at the front as the highest in banking services in America. After this fake account scandal and closing 400 banks nationwide it's a question of whether Wells Fargo will make the right choices again. The past seems to tell the story of their successes of bad situations maybe the future will repeat the past.

## Purpose Objectives

Their goal is to become the financial services leader in the following areas; customer service and advice, team member engagement, innovation, risk management, corporate citizenship and shareholder value. They will become the leader in customer service and advice by listening to and understanding their customers and their financial goals. They want to provide exceptional service and guidance to help them succeed financially. They will become the leader in team member engagement by making Wells Fargo the employer of choice. They want it to be a place where people feel included, valued, and supported; everyone is respected; and they work as a team. They will become the leader in innovation through innovative thinking, industry-leading technology, and a willingness to test and learn. They want to create lasting value for customers and increased efficiency for our operations. They will become the leader in risk management by working to set the global standard in managing all forms of risk. They want to serve customers' needs and protect their assets, information, and privacy. They will become the leader in corporate citizenship by making a positive contribution to communities through philanthropy, advancing diversity and inclusion, creating economic opportunity, and promoting environmental sustainability. They will become the leader in shareholder value by wanting to deliver long-term value for shareholders through a balanced business model, strong risk discipline, efficient execution, and a world-class team.

## STRATEGIC ANALYSIS

### *Key Issues*

The key issues that Wells Fargo is dealing with in this case is where to go after the Great Recession. Coming out of the Great Recession Wells Fargo was in a dominant position due to

expanding their retail network during that time and because they had just taken over Wachovia. The takeover of Wachovia was very important to the long term success of Wells Fargo during 2010-2013 because Wachovia had loans that Wells Fargo could prevent from defaulting. This allowed for Wells Fargo to have mortgage lending take up 65% of their profits in the late 2000's. With this large portion of their profits coming from mortgage lending, Wells Fargo knew they needed to continue to expand their mortgage lending to continue to see profits.

In the beginning of 2012, Wells Fargo began to cultivate relationships with real estate agents and brokers in major cities like New York city and San Francisco. Wells Fargo created these relationships in order to become their preferred lender during this time. The main reason for Wells Fargo wanting to become a major lender in these two cities was due to the demand for housing in these areas. In San Francisco and New York city, the housing prices are the highest of almost any other city in the U.S. In order to become a dominant mortgage lender, Wells Fargo understood that they needed to get their foot in the door in these two cities. The aggressive networking in these two cities lead Wells Fargo to account for 20% of the loans in these two areas by the end of 2012. The reason for Wells Fargo major increase in these two areas in the year 2012, was because Wells Fargo created a joint venture with the largest brokerage in New York city at the time DE Capital. Also, Wells Fargo became the preferred mortgage lender of two other large brokerages in New York city, Halstead Brothers and Brown Harris Stevens. These relationships helped Wells Fargo gain the dominant market share in New York city by the end of 2013.

Another issue that Wells Fargo faced was their loan application requirements in cities like San Francisco. In San Francisco, there are many young tech entrepreneurs who go from not making a lot of money to making an excess of money in a short time. This comes from the young technology entrepreneurs whose companies blow up in a short amount of time. Wells Fargo was forced to change their loan application requirements because these newly wealthy people could not qualify for loans under Wells Fargo's requirements. This severely hurt Wells Fargo in the San Francisco area because these young technology entrepreneurs were able to buy million even billion dollar homes and they could not run through Wells Fargo. Wells Fargo quickly changed their requirements for loan applicants in these areas and moved to a plan where these applicants were accepted. Wells Fargo heavily increased their focus in San Francisco over the late 2000's and it shows through the fact that in 2001, Wells Fargo had just 150 loan salespeople in the Bay area. In 2013, Wells Fargo registered around 600 loan salespeople in the bay area. Wells Fargo understands the importance of having a strong housing position in major cities like San Francisco and New York city. Wells Fargo has used a very well planned strategy to become one of the most dominant mortgage lenders from 2008-2013. Wells Fargo understood the need to continue to emphasize the mortgage lending side of the business because of how much it affects their profit and the overall success of the company.

## Internal Analysis (SWOT Analysis)

Wells Fargo has many strengths that put them in a good competitive position. Wells Fargo achieved its success by being a trustworthy custodian of its customers' wealth. They aim to offer a wide range of financial services and try to cater to all their customers' financial needs. They also pride themselves on their products which include banking, insurance, trusts and investments, mortgage banking, investment banking, retail banking, and customer finance. Most of their business comes from commercial banking which includes maintain customer accounts and servicing individuals and firm accounts. They do offer a diverse product line, however, and that is another one of the strengths that sets them apart from other large banks. Another strength that they have is that they are large and can take advantage of their economies of scale over smaller banks. This often means they can provide lower interest rates on loans and can offer higher returns on portfolio investments. It also means they have more branches with more employees throughout the US and worldwide. This especially makes it more convenient for their customers. For example, if people go out of town and need to go the bank, there is likely a Wells Fargo location nearby. Another strength is their grasp on technology. Like many other banks, they offer online banking where customers can quickly access their accounts, investments, mortgages, loans, etc. This especially appeals to the younger generations as the world is becoming more digital. People do not even need to go to the bank but can have most of their banking needs met.

Even though Wells Fargo has many strengths and are in a strong financial position, they have a few weaknesses that may cause harm to their company in the future. One of their strengths can also be a weakness and that is that they try to be too large or have a broad scope that makes it hard to have a personal touch with customers. They essentially try to be a jack of all trades and some customers may change their bank if they feel that other banks can offer better services for what the customers need specifically. For example, Wells Fargo is mostly a commercial bank but they still offer opportunities to invest in mutual funds or otherwise. If a company decides they want a bank that is better suited to service their portfolio, they may switch banks thinking that Wells Fargo is not concentrated on their needs. Another issue is that they are in a relatively unstable industry. Federal interest rates can change and the economy, although recently on the rise, has proven to be relatively unstable. The US economy is so large and is comprised of many factors so there is a lot that can affect it and this directly relates to the banking industry. The final weakness they face is a higher amount of bad loans than other big banks. Wells Fargos' loan specialists may be too liberal when offering loans and may see a higher amount of these uncollected.

Wells Fargo could go a few opportunities after. One of those being implementing a better global strategy. Wells Fargo is well known in the US but they are large enough to be syndicated around the world. If they could implement a better global plan, especially in Europe, they could go after more markets than ever before and have potential to grow even larger. They could also

pursue possible future acquisitions. Recently they acquired Wachovia which turned out to be bad timing as they had to take a \$25 billion bailout from the federal government during the recession. However, they have learned from this mistake and could certainly acquire smaller institutions that possibly have a loyal customer base in a local market. This would increase their market share and could help them grow into an even larger bank.

With their opportunities comes a few important threats. One being online scams and fraud. Since a large portion of their banking is done online, customers can often fall for phishing scams or succumb to other fraudulent activity. This can often lead to customers wondering how these scammers were able to access their accounts or investments and push for higher security measures. It is very important to protect customer information especially when it is tied to their finances. So, when managing customers' money, it is a very real risk that their information could fall into the wrong hands and leave customers out to dry. Wells Fargo has a responsibility to protect this information and even if it was not their fault, they must insure their finances will stay safe. Another threat is changing regulations from the federal government. Since the recession, there have been laws put in place that force banks to liquidate or downsize so that they don't become too powerful and essentially cause a financial disaster if foreign markets implode or if our economy suffers another downturn. This could also work in their favor if other banks are forced to downsize and they are able to grab customers who left their old banks.

Overall, Wells Fargo is in a much better financial position now than it was 10 years ago. They have many strengths that work in their favor and they have several opportunities that could help them grow even larger than they are now. They have a few weaknesses and threats but these are mostly manageable and should not affect their business much.

## FINANCIAL ANALYSIS

In 2007, Wells Fargo was financially stable. They were amongst the top of their competition, stakeholders were happy, and more individuals jumped on board with investing into Wells Fargo. According to Wells Fargo Annual report for the 2007-08 year, expenses declined by 1% compared to the year prior. With more than eight billion dollars in annual income, Wells Fargo produced the best revenue/expense ratio among its competitors. In turn, even more individuals began investing into Wells Fargo.

With the acquiring of Wachovia Corporation, Wells Fargo pushed into third in terms of the largest banks in the United States. This made investors more attracted to Wells Fargo. The acquisition increased net total assets by almost 100 billion dollars. This increase is equal to 16%.

However, in 2008 the Great Recession took place. The house market bubble had burst, and millions of people had been foreclosed on their homes. For Wells Fargo, this meant less income due to individuals not being able to pay their mortgages. In accordance to Wells Fargo's 2008-

09 annual report, annual net incomes decreased by almost six billion dollars. After the acquisition of Wachovia Corporation and the beginning of the Great Recession, Wells Fargo had poor return on total assets.

However, in 2009, Wells Fargo had bounced back better than ever. The company had expanded their target market and total annual income had jumped almost four times more than the previous year. The company was stable and was one of few mortgage loaners to succeed financially during the Great Recession. Total annual revenues had more than doubled, and the company began to grow even larger. Total net assets had more than doubled, and their total return on assets neared 1%, more than double the previous year.

In the years following, Wells Fargo's mortgage market business had increased at an accelerated rate. According to Strategic Management – Planning for Domestic & Global Competition, 14<sup>th</sup> edition, in 2012, Wells Fargo's mortgage business accounted for 28.8% of the nationwide issued home loans. This amount was determined as the most in the nation. Additionally, Wells Fargo held the title as being the largest lender in the country with a loan portfolio equal to \$524 billion. This was the largest total ever recorded by a bank, and the amount was greater than the next top five lenders combined. In addition, Wells Fargo's net incomes for 2012 totaled \$18.9 billion. This amount was more than 2 times greater than the 2007 profits.

In recent years, Wells Fargo has experience financial success. According to Wells Fargo's 2017 annual reports, annual net income resembles more than 22 billion dollars. Wells Fargo's net total assets have rose by 53% since 2009 in accordance to 2017 annual reports. This indicates that Wells Fargo is growing and achieving success.

Since 2009, Wells Fargo's book value on common share has increase 187% to \$37.44. Individuals are still continuing to hold stake in the organization. Stakeholders are aware that the organization is continuing to grow. More investment opportunities are becoming present because of Wells Fargo. The organization is financially stable and is on track to continue experiencing financial success in upcoming years.

The following financial ratios are conducted in accordance to Wells Fargo's financial reports. The ratios are also exemplified by the use of Nasdaq reports, Macro Trends, and Strategic Management – Planning for Domestic and Global Competition. The following ratios will portray the financial status of Wells Fargo. The following ratios include leverage ratios, efficiency ratios, profitability ratios, and market value ratios. These ratio types will be defined by the literary terms described by, Investopedia and Accounting Tools.

Leverage, ratios are financial measurements that look at how much capital comes in the form of debt, or assesses the ability of a company to meet its financial obligations (Investopedia). The debt to equity ratio is one which falls within the leverage ratio category. The ratio is calculated

by dividing the organizations total amount of debt by the total amount of equity. According to Wells Fargo’s 2017 annual report, the organization experienced \$225.02 billion in debt, and \$208.08 billion in equity. This produced a debt to equity ratio of 1.08%. Considering this organization inquires large amounts of debt, this is a good number for the organization to produce.

Efficiency ratios are typically used to analyze how well a company uses its assets and liabilities internally (Investopedia). An efficiency ratio of Wells Fargo is exemplified by the organizations 2017 annual report. The efficiency ratio is calculated by dividing non-interest expense by total annual revenues. According to the 2017 annual report provided by Wells Fargo, the organization experienced an efficiency ratio of 66.2%. This indicates that the organization is good at managing its assets and liabilities.

According to Accounting Tools, the literary term of market value ratios is the evaluation of the current stock price of a publicly held company’s stock. The price to earnings ratio is one which falls within the market value category. The price to earnings ratio is a simple calculation. The formula for the ratio is calculated by dividing the market value per share by the earnings per share. According to NASDAQ, Wells Fargo experience a price to earnings ratio of 12.79% for the 2017 year.

Lastly, profitability ratios are used to assess a business’s ability to generate earnings compared to expenses and other relevant costs incurred during a specific period of time (Investopedia). The return on assets ratio is one which falls within the profitability ratio category. In accordance with multiple annual reports, the following table (Table 1) represents the return on assets ratio experienced by Wells Fargo.

Profitability Ratio - Wells Fargo			
	Net Income (Millions)	Net Total Assets (Millions)	Return on Assets Ratio
2007	\$8,057	\$520,752	1.55%
2008	\$2,655	\$604,396	0.44%
2009	\$12,275	\$1,262,354	0.97%
2017	\$22,183	\$1,933,005	1.15%

Figure 5: Profitability Ratios

In 2007, Wells Fargo experience quality returns. However, in 2008 the housing bubble burst, and the organization saw a major loss in return on assets. However, with the purchase of Wachovia Corporation and the expansion of target markets did the organization experience success during the Great Recession into the following year. Since then, the organization has

experienced increasing returns with no signs of slowing down. The organization is financially stable and should be expected to thrive for years to come and outperform its competitors in a number of financial areas.

### External Analysis/Industry Analysis/Competitive Analysis

The current position of Wells Fargo is a reflection of the external analysis, the industry analysis and the competition in their industry. The external analysis begins with Wells Fargo's social responsibility that they incur as a business. Social responsibility is an unwritten set of rules that a company must abide by to maintain reputation but more importantly to aid the local community. In their mission statement, they say "Wells Fargo believes it is important to act ethically and with integrity to all customers". Wells Fargo had supported their statement of social responsibility by donating \$226 million dollars to nonprofit organizations and educational institutions. Economic Factors also play a role in a company's external analysis. In the case of Wells Fargo, the financial industry is extremely susceptible and influential to change in the economy. As a result, Wells Fargo's profitability is directly influenced by the economy.

Industry analysis is a major factor on the current position of a firm. The financial industry is very susceptible to change in a changing economic climate. The industry has been a roller coaster ride since 2005 as institutions have experience huge amounts of earnings as well as major losses. The world-wide economic recession in 2008 has largely been blamed on the financial industry. The recession has created a need for the government to supervise the financial industry, and as a result many of the major "too big to fail" companies have received many millions of dollars in bailout. In the years since, industry has slowly regenerated. Customers have started to buy common stock of major US banks which shows that consumer confidence has started to return. As the industry regains stability the surviving banks enter a long period of transition from survival back into growth. Even with the newly found stability in the industry, new entry is extremely doubtful as more than two hundred small banks have closed since the recession and top level competition is far too large to immediately compete with, without merger.

The competitive analysis of Wells Fargo in the financial industry consists of their position in relation to the performance of their top four competitors. These competitors are the massive "too big to fail" banks. Their first and largest competitor in terms of market capitalization is JPMorgan Chase. As of April 2018, JPMorgan Chase has a market capitalization of \$387 billion dollars which is greater than Wells Fargo's 2018 market cap by more than \$100 billion dollars. JPMorgan Chase came to existence through the 2000 merger of JP Morgan Bank and Chase Manhattan Bank, which propelled them to be the fourth largest bank at the time. Since then, further acquisitions of notable banks such as Bank One, the Bank of Chicago and Bear Stearns have been made. JPMorgan Chase's ROE ratio is 15% and has a B/P ratio of 1.71

Wells Fargo's next competitor also has a larger market capitalization than them. Bank of America is Wells Fargo's second biggest competitor with a market cap of \$306 billion dollars in April of 2018. They are headquartered in Charlotte, North Carolina unlike many of the other New York city competitors. Bank of America has reach this size through a vast series of mergers. They have acquired many banks such as NationsBank and Fleet Boston but their merger with Merrill Lynch in 2008 made them the third largest company in the United States. After the recession hit, the U.S. government bailed out Bank of America with more than \$45 billion dollars of aid. They currently employ more 20,000 financial advisors and serve more than 59 million consumers and small businesses. They are a worldwide company with operations in more than 40 countries and have more than \$2.5 trillion dollars in Assets. Current ROE is at 6.84% and has a rather low P/B of 1.26.

Citigroup comes next in line as the third largest competitor for Wells Fargo. Their market capitalization is at \$184.6 billion dollars as of April 13, 2018. Citigroup was formed through one of the largest work mergers of all time with Citicorp bank and Travelers Group merging together. The recession hit them extremely hard as they were ranked as the largest worldwide bank prior to 2008. Citigroup was unfortunately very involved with toxic mortgages which led to their struggles as the economy crashed, dropping them to be ranked last of the big four. Currently, Citigroup has significantly recovered and operates in more than 16,000 offices in more than 140 countries worldwide. They employ more than 300,000 people and manage more than 200 million customer accounts. They have a tier 1 capital ratio of 14.7%, ROE of -3.10% and a P/B ratio of 1.035.

The last high-end competitor to Wells Fargo is PNC Financial Services. They are the fifth largest US bank and the third largest provider of off-premise ATMs. When the recession hit, PNC avoided the brute of the impact as they focused mostly on risk management. They gained their size from a previous acquisition of National City. Currently, PNC Financial Services manages approximately \$290 billion dollars in assets with more than 60,000 employees worldwide and over 2,600 branches in the United States.

## STRATEGIC RECOMMENDATIONS

### *Alternatives*

Since becoming one of the largest lenders in the United States following the Subprime mortgages housing crash from 2007-2009, Wells Fargo has attempted to expand their options for financing consumers beyond the realm of home mortgages. Along with offering home financing, Wells Fargo looks to provide financial services (including loans) for tech businesses. In particular, Wells Fargo is especially interested in funding tech start-ups, even going so far as to set-up a technology, media, and telecommunications office in Silicon Valley, the hub for technological innovation in the United States. Wells Fargo has also evolved into a multinational corporations, with many subsidiaries operating around the globe. It's North American foreign

subsidiaries include locations such as Montreal, Vancouver, Calgary, and Toronto in Canada, and Mexico City in Mexico. It's European subsidiaries include locations in Dublin, Ireland, London, England, and Frankfurt, Germany. It's East Asian and Oceanic subsidiaries include Sidney, Australia, Hong Kong and Shanghai in China, Mumbai, India, Singapore, Taipei, Taiwan, Seoul, South Korea, and Tokyo, Japan.

As of 2009, Wells Fargo has acquired approximately 119 companies, including the failed Wachovia Financial firm. Recently, Wells Fargo has been looking to expand its middle market banking in the New England area, leading commercial lending operations in Central and Western Massachusetts. Offices have been opened up in locations such as Providence, Rhode Island, Portland, Maine, and Manchester, New Hampshire. This is important seeing as how middle market banking is a prominent industry for job creation, with 200,000 (mostly private) firms generating \$10 trillion in annual revenues. Wells Fargo serves as the leader in middle market banking share for firms with \$25 million to \$500 million in annual revenues.

Wells Fargo has also proven to have a vested interest in higher education, being one of the major underwriters of a \$96.7 million bond issue for the development of the University of New Haven campus, whose yearly campus attendance has increased 63% since 2005. The University of New Haven has been able to successfully use bank debt to transform its campus from a commuter school to a large residential campus in order to accommodate its spike in student population, which has more than tripled for first-year applicants (including its largest incoming class ever for the Fall 2017 semester) and more than doubled for its full-time undergraduate enrollment. Through Wells Fargo's underwriting of the debt, The University of New Haven has been able to utilize capital on the construction of new facilities, including residence halls, a recreation center, and the state-of-the-art Henry C. Lee Institute of Forensic Science building. The university has been able to successfully complete \$250 million worth of construction over the past decade. Wells Fargo structured the debt issue through serial tax-exempt bonds that amortize from 2021 to 2039 and serial taxable bonds that amortize from 2018 to 2020. High investor demand for the tax exempt bonds pushed the orders to \$423 million, resulting in the aggregate oversubscriptions of maturities by 4.9 times. The University of New Haven also plans to raise another \$25 million of bonds to fund the construction of the Bergami Center for Science, Technology, and Innovation as part of the University's Charger Challenge, which aims to \$100 million by the year 2020 to invest in student scholarships and enhance the university's culture of innovation and collaboration.

## Strategic Recommendations

Wells Fargo needs the company's growth strategy to win the competition in the industry and to keep stronger their position in the market. Wells Fargo can use an incentive strategy by doing market penetration and integrated strategy by doing horizontal integration. Market penetration is the selling of a product in a specific market. Horizontal integration is the

increasing production of goods or services at the same part of the supply chain. They could do any of these implementation strategies; developing competitor's acquisition program, developing international offices abroad, developing insurance business entry program, or developing marketing & publicity program.

The action plan we suggest they follow is to develop a competitor's acquisition program. They can acquire Wachovia and start negotiation and an agreement. As well as preparing the takeover funds. They should also develop a marketing and publicity program by setting up the organization and resources, set up the 10-year business plan, and start the promotion of the business. We believe they should finally develop international offices abroad. They can do this by targeting new markets in Europe, Asia, and Australia.

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*Keywords:* Banking industry, business finance, marketing management, public trust, Wells Fargo.

*Relevance to Marketing Educators, Researchers, and Practitioners:*

This case study illustrates the importance of public trust and proper marketing management in light of mismanagement of financial aspects.

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