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FRANCES X. FREI

Commerce Bank

The hardest thing about becoming a big bank is not becoming a big bank.
—Douglas Pauls, chief financial officer

Introduction

Deborah Jacovelli looked up from her desk as a big pumpkin, a Dalmatian, and a masked crusader ran by her office. It was business as usual at Commerce University, Commerce Bank's Cherry Hill, New Jersey training center, but it was also Halloween on a rainy day in 2002 and the employees were getting into it with their usual enthusiasm. As dean of Commerce University, Jacovelli had witnessed the development of many innovative methods for energizing the company's employees. Halloween costumes and people decorating their cubicles, hardly typical bank behavior, were not at all strange at Commerce. Jacovelli noticed that someone had adorned the giant "C" character outside her office with a cape.

It took a special kind of person to deliver the high-quality customer service Commerce Bank promised. Happy customers were the bank's top priority. An internal system of incentives and cultural training implemented by Jacovelli and her coworkers to reinforce a deep commitment to "*WOW!*ing" customers included awards, commendations, and compensation, as well as intense training and education. "We want to exceed customers' expectations every time they visit our bank," insisted Commerce Chairman and CEO Vernon W. Hill II. Commerce referred to its branches as "stores" and looked for operational comparisons to retailers such as Starbucks and Home Depot rather than the bank next door. "How does Starbucks get you to pay $6 for a cup of coffee?" mused Hill. "It's the retail experience. That's what we care about and it's paying off. Some critics say our stock price is high for the banking sector, but if you look at other power retailers and compare our multiples, we are undervalued." Since 1990, Commerce's stock price had increased twenty-fold (**Exhibits 1** and **2** present company financials.)

Because Commerce encouraged customers to visit its branches, or stores, it wanted the experience to be positive even when the branch was busy. A handful of competitors were beginning to copy some of Commerce's extra service features, such as weekend and evening hours, prompting the bank to be mindful of staying one step ahead. With coffee and newspapers already available to waiting customers, the bank considered adding entertainment to the lobbies of its stores. "Retailtainment," proposed in 2002, was Commerce's latest idea for "*WOW!*ing" customers. Among the ideas piloted

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Professor Frances X. Frei and Research Associate Corey Hajim prepared this case. HBS cases are developed solely as the basis for class discussion. Cases are not intended to serve as endorsements, sources of primary data, or illustrations of effective or ineffective management.

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as part of this "atmosphere enhancement" concept were free hot dogs, a guitar player and juggler, and an employee on roller blades dressed as a big "C" character. While not completely off the map for a bank that encouraged its employees to dress up in costume, this latest program concerned Jacovelli. She wondered whether customers really wanted to be entertained when they visited a bank branch. Even with a program limited to Fridays, if execution at different branches varied, would the consistency of great service be put at risk? Had the bank, Jacovelli worried, finally taken the retail experience a step too far?

The Banking Industry

Products

Retail banks offered deposit and loan products, which were widely considered to be commodity products. Deposit products were a way for customers to store their money with the institution in exchange for access to the payment system (through electronic transfers and checks), interest on their money, and contact with the bank service infrastructure (branches, ATMs, call center, and Internet). Deposit products tended to be more transaction oriented than loan products, although not every deposit product was associated with ongoing transaction. For example, in the case of certificates of deposit, a customer agreed to store money with the bank for a set amount of time at a higher interest rate than a typical, "demand" deposit account.

Banks typically had a dozen or more types of checking accounts distinguished by a variety of characteristics including minimum balance required to avoid fees, channel access, checks that could be written free of charge, and overdraft protection.[1]

In 2001, the banking industry loaned almost 90% of its deposit base. In addition, growth in both deposits and loans was about 20% over the period of 1998 to 2001. (See **Exhibit 4a** for the consolidated balance sheet for the banking industry.) Large institutions that experienced larger than average growth typically accomplished this through mergers and acquisitions.

Two important trends in the industry had evolved. The first was a push to increase the "cross-sell" of products—the number of products each customer used. Although the industry did not formally track this number, on average, customers tended to hold 1.5-2.5 products at an institution. Most companies had cross-sell goals that were significantly higher than this level. The second trend was towards growing revenues from fees customers paid for certain transactions and functionality. From 1998 to 2001, fee revenue, also known as non-interest income, had increased at 27%, a much higher rate than interest revenue, or interest income, which grew at 11% (**Exhibit 4**).

Service

Banks typically used demographics such as age, income, and geographic location to help segment customers. More recently, many banks had been calculating individual customer profitability, used in part to help determine how to differentiate service amongst customers. Customer satisfaction with the banking industry had historically been quite low, with satisfaction being significantly higher for the smaller credit unions (**Exhibit 5**).

[1] Overdraft protection allowed customers to write a check over their current account balance, whereby the bank then made a short-term loan to cover the difference.

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A retail bank could lose up to a third of its customer base each year to attrition. Even the best performers lost 15%. By far the largest attrition occurred in the first year of a banking relationship. A study of the banking industry found that 34% of customers that leave a bank indicated that they did so out of dissatisfaction with steep fees and fee surprises, poor service, and errors. Thirty-four percent left as a result of a geographic move, primarily because they were outside the reach of current bank branch locations. Fifteen percent of customers left because of availability of more convenience elsewhere such as longer hours.[2]

Distribution

Customers selected their bank for a variety of reasons. The decision was often heavily influenced by proximity of a local branch. In response, banks created enormous branch networks, with the number of branches increasing even as the number of banks decreases (see **Exhibit 3b**). Many branches changed hands as banks merged, either becoming part of the merged entity, or sold off to another bank after a merger due to redundancy.

Banks also created large ATM networks. Customers could access their bank's ATM for free and other bank's ATMs for a fee or sometimes for two fees—one by the owner of the ATM and one by the customer's bank for processing the out-of-network transaction. Originally ATMs had been considered cost centers, but due to the ability to generate fee income, ATMs were increasingly viewed as profit centers.

In addition, virtually every bank had a call center open 24 hours a day, 7 days a week, as well as a voice response unit (VRU) whereby customers could execute an increasing number of transactions via the telephone without having to talk to a live agent. By 2002, Internet banking was commonplace, providing customers the ability to view balances, move money between accounts, and pay bills electronically, which often incurred a $5 monthly fee.

As a result of the lower marginal cost associated with the electronic channels, most banks actively encouraged customers to move their transactions from full-service channels to self-service channels. Banks strongly advertised the availability and convenience of the electronic channels, offered monetary incentives for using the channels, and occasionally monetary penalties for using the more expensive channels (e.g., charging $3 to visit the teller).

Employees

Front-line employees in retail banks were often selected for their ability to perform repeated tasks, interact with customers, and their willingness to accept relatively low wages. Training primarily consisted of learning about bank-specific policies and procedures as well as the various features amongst the dozens of deposit and loan products available at any point in time. The latter became especially important after mergers, when customers from one institution where often forced into new products with unfamiliar attributes. Compliance with processes and understanding of specific product attributes was paramount in the industry. Key measures of performance were volume of calls handled and number of transactions processed.

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[2] David Dove and Chuck Robinson, "Mind the Back Door While you Greet New Customers," *American Banker*, August 22, 2002.

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The Commerce Story

When Hill founded Commerce Bank in 1973, he was determined to be different. "The world," he reasoned, "did not need another 'me-too' bank. I had no capital, no brand name, and I had to search for a way to differentiate from the other players." With $1.5 million he started a community bank in southern New Jersey and since had grown it, without acquisitions, into Pennsylvania, Delaware, and New York.

Hill created a retail franchise with branches typically open from 7:30AM-8:00PM during the week and modified hours on Saturday and Sunday. If the branch was in a busy location, its drive-through window might be open as late as midnight. Or, more precisely, ten minutes after midnight, as stated in the company's 10-minute rule, which asserted that branches should open 10 minutes early and stay open 10 minutes late.

When customers came into branches to open a checking account, they were treated with outgoing, friendly service. After the customer selected from the four different checking accounts (**Exhibit 6**), Commerce routinely gave a free gift for opening the account.

Deposit growth had averaged over 30% per year since 1996. In 2001 alone Commerce deposits grew by almost 40% (**Exhibit 2**) while its households grew by 20%. By comparison, cumulative deposit growth in the United States was 5% in 2001 (**Exhibit 4**). Hill reflected on the Commerce approach:

> Other banks decided to push consumers out of the branch because it is the high-cost delivery channel. They wanted to push them online. We totally reject that. You can't name me one retailer in this country that has pushed people where they don't want to go and succeeded. But the banks decided to push to electronic delivery, and they have totally failed. Our model is, we are going to give you the best of every channel knowing you are going to use all of them. The result is not only do we have the highest deposit-rate growth in this country by a long factor, but our online usage is 34%, which is higher than Wells Fargo.
>
> I don't have to make a sale to you every day. Once you open your account I am making money on your balances. The big-bank attitude sees a customer as a cost, not a revenue generator. I don't see it that way.
>
> You cannot find me any retailer who has driven store count down and has survived, and yet banks think they can drive customers out of their branches and still keep their business. I find that very hard to understand. We have some branches that get 100,000 customer visits a month; the average branch gets 40,000. As a comparison, an average McDonald's gets 25,000 per month.

Growth

To Commerce, New York City represented an enormous opportunity. "Everyone will tell you that New York is the most over-banked market in the country," Hill said. "I think it is the most under-banked market in the country. There are $500 billion in deposits in New York." Commerce did not enter its newest market quietly. Commerce spent $500,000 per branch on promotion, five times its usual spend, which included direct mailings, ads on subway and phone kiosks, and with the

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help of street vendors, 10,000 hot dogs given away wrapped in Commerce napkins.[3] Success was immediate. Commerce broke even in half the time it usually did, even with four times higher costs than any other region.

Hill maintained that the business should continue to grow organically. "No one has built a power retailer in this country through mergers and acquisitions," he emphasized. "You can only build a delivery model like this from scratch. Mergers and acquisitions are cost-cutting devices at their heart, and the merger of cultures and the dilution of brand is a formula for failure. Every big bank merger in this country has failed." In Hill's view, "it's easier to build a bank than to fix one."

It had taken 18 years for Commerce to grow to $1 billion in deposits, but it now surpassed this amount in individual quarters. Commerce expected to ultimately reach $100 billion in deposits and total 1,000 locations, from Washington, D.C. to Boston. Commerce's success was not limited to deposit growth. The bank's net income doubled from 1998-2001, compared with 20% for the industry as a whole. Doug Pauls, Commerce's chief financial officer, recalled the projections he saw when he came on board: "I am an accountant by trade and therefore a little conservative by nature, so when I looked at the projections in 1994 after I arrived here I thought they were pretty aggressive. But I wish I had that original plan, because we have completely blown that away."

Debits and Credits

Deposits

"We believe the value of a bank is not its loan base," Hill explained, "but rather the deposit base, what we call core deposits. Those are deposits that come to you for non-rate reasons. We are generally the lowest ratepayers in every market." Commerce's deposit rates were often half a percent lower than those of competitors.

Commerce's focus on its consumer business was unusual for the banking industry. Commerce generated more than half its deposits from its consumer business, compared with most banks whose consumer business was closer to a third of overall business. Hill observed:

> Banks had given up on growing altogether because they thought you had to pay the highest deposit rate to get growth. The big players decided in the late '80s, early '90s that it was too much trouble gathering and growing deposits on the consumer side. On the one hand, they began to fund themselves in the wholesale market; on the other hand, they began to cut costs in the retail network.

Pauls added: "When people ask Vernon if he is concerned about competition, he says not really, because they are fighting an air war while we are winning the ground war at the store level. We can't lose sight of that. Deposit growth at the store level is the basis of everything we do."

A branch network with longer hours inevitably has higher costs, which readily showed up in the expense ratio of a bank.[4] "A low expense ratio is a minus, not a plus," Hill emphasized. "The guys with a low expense ratio are every day disinvesting in their business." Hill had committed to investing in providing service in his branches after asking customers what they wanted. "We asked

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[3] Chuck Salter, "Lessons from the Best Bank in America," *Fast Company*, May 2002, p. 91.

[4] Expense ratio is the percentage of income spent on operating expenses; it is a common measure of a bank's cost structure.

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people, 'Why do you open a new account?'" Hill recalled. "Three percent of people said they wanted the highest rate; 62% said they picked a bank for service, convenience, and those kinds of things. Well, the competition is competing on the 3%; we decided to compete on the 62%."

Commerce looked for ways to save money, but not by counting savings on the income statement; instead it gave back to customers. Hill described this strategy:

> Every time Wal-Mart beats a supplier down to get a better deal they don't take that extra and add it to the bottom line; they improve the value proposition to the customer. This year we saved millions in expenses by switching ATM contracts, which we invested back to our customers. We could have taken that right to the bottom line, but what we decided to do is eliminate our fees to our ATM and check cards for the entire company. We don't charge for our cards, we don't charge for transactions, and in New York City if you use someone else's machine and they charge you a dollar and a half, we give you that dollar and a half back.[5] That is what a power retailer does. You use your competitive advantage to get stronger, not to make more money.

Loans

Loans made by Commerce were assigned to the branches that serviced the customers. The branches also received credit for the deposits. This was not the case across the industry. Falese described the more typical structure:

> At Fleet if the health-care lending group produces deposits they keep the credit in their group, and yet the branch has to service the account. The Fleet branch manager hates the health-care manager because the branch has to service the account and gets no credit. At Commerce the branch managers love the health-care bankers because the branch gets the account credit. That little adjustment entirely changes the dynamics.

Commerce's loan-to-deposit ratio was significantly below the industry average, and loans were considered carefully. "We don't make enough money in terms of the spread to justify taking credit risk," Falese explained. "The customer's ability to repay is the most important thing. Some of our best loans are the ones we did not make." Added Pauls: "The way we look at credit and credit quality is a lot tougher [than our competition]. Deals that would get approved elsewhere might not get approved here." Commerce focused most of its lending on commercial real estate projects, home mortgages, and consumer loans.[6]

Loan customers were encouraged to open deposit accounts with Commerce. For Falese, it was policy. He explained:

> Most other banks are driven by loans. My attitude is no deposit, no loan. We decentralize the delivery of the loan so that at some point you have to come in to the branch and sign the papers. The loan officer is also the branch manager. And that is when we encourage you to let us manage your deposits as well. My job is to make sure we make sound loans that get repaid and at the same time that we generate core deposits.

[5] Reimbursement of ATM charges up to $5 per month.

[6] Jay Palmer, "Service Master," *Barron's,* January 28, 2002.

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Not Customers, Fans

"We're not here to satisfy customers, we're here to blow them away," remarked John Manning, one of Commerce's most well-known employee trainers. "If you talk to our customers, they don't like us, they love us." Hill corroborated: "People buy our products because they trust our brand." Added Pauls:

> I'll go out to lunch around here and be in line at a Wendy's and someone in front of me will see my Commerce pin and start talking about how great Commerce Bank is. They love the fact that people know them when they walk in, that they are treated well; they are so happy with us they can't believe it. For one of our advertisements we used real customers, and the people who were directing the commercials marveled at how much these customers wanted to tell our story and how they felt about the institution.

Commerce branches were built to be inviting, with floor to ceiling windows and ample parking. (See **Exhibit 7**.) Commerce branches were replicated with remarkable consistency. "We know every screw in the model," Hill said. Most branches were built from scratch for about $1 million. With few exceptions, they had the same white-brick exterior capped with a black metal roof, the same black-and-white marble, the same no-frills checking and savings accounts, and the same lollipops and dog biscuits. "It makes life easier for customers," says chief marketing officer John Cunningham. "They know what the deal is wherever they visit one of our banks."[7]

For Commerce, deciding where to put a branch was just as important as what the building looked like. Hill sought a corner that was busy, but not too busy, with a good residential and commercial mix. Ultimately, Hill, who was also part owner of 45 Burger Kings in the Philadelphia suburbs, made the call himself, a decision that he insisted has more to do with gut feel than with demographic research. Usually, though, it's in the competition's backyard. If a competitor closed, the staff at the nearby Commerce branch was awarded $5,000.[8] Commerce's branches broke even within a year to 18 months. The average bank took three years.

Commerce had several customer-centric programs instilled in its branch culture. "I think extended hours started down the [Jersey] Shore, to be able to service people who were down there for the weekend," Pauls recalled. "Then we realized that it would make sense at all our branches." Hill explained. "My competitors think we did it so that people could bank with us on Sunday. If no one ever banked with us on Sunday the initiative would still be successful, because it sent a message to the customer: I am always there for you." When it rained, bank employees often escorted customers to their cars under Commerce umbrellas. The company gave out 300,000 pens a month as well as dog biscuits and red Commerce lollipops at drive-through banking windows. Hill made no apologies for spending money on these sorts of things:

> If you think like a retailer, then you're constantly coming up with ways to enhance the customer experience. Like the phones we added to Commerce ATM machines in case customers need to reach the call center. Or the 'check view' feature on the bank's Web site that allows customers to see an image of the front and back of a check a day after it has been deposited. Or the bright-red Penny Arcades in the lobby.

When Hill learned that other banks had started refusing to accept large numbers of coins or were charging customers to do so, he saw an opportunity.

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[7] Salter, "Lessons from the Best Bank in America," *Fast Company*, May 2002.

[8] Salter, "Lessons from the Best Bank in America," *Fast Company*, May 2002.

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> We said, 'We're going to spend $10 million to take your coins.' The Penny Arcade is more than a mere convenience. The real appeal—and the payoff—is that it's fun. Kids want to use it. Pack rats need to use it. People waiting in line at the teller counter can't help but watch when someone steps up to the machine lugging a coffee can filled with coins. In its own small way, the Penny Arcade transforms the bank into a more interesting and appealing place. And that is how you create traffic.

In 2001, Commerce's Penny Arcades handled 750,000 transactions, which totaled $71.7 million. The machines accepted coins and returned a receipt that could be handed to any teller in exchange for bills. There was no charge for the program, for customers or non-customers. Falese called it "Marketing 101": "If customers come, keep doing it."

Up until 2001, Carole Robbins, a new Commerce customer and a conference planner in Manhattan, was perfectly happy with her bank, but that was before it was acquired by Citibank. "Why am I switching from the meanies over there?" asks Robbins, as she glances over at the Citibank across the street from the new Commerce branch at 55th Street and Sixth Avenue. It was 8:15AM and Robbins had already taken care of her banking for the day. "If I treated my customers the way they treated me, I'd be out of business." In fact, mergers have been an enormous source of deposit growth for Commerce—when other bank's merge, Commerce's deposits tend to increase dramatically (**Exhibit 8**.)[9]

"[Commerce] is a blast from the past: a bank with an old-fashioned approach to service," continued Robbins. "There's a different attitude here, like we're all in this together. But time will tell. All restaurants are good in the beginning too."[10]

WOW!

We're asking you to forget the way you delivered your skills at other banks.

—Vernon Hill, chief executive officer[11]

Good service had a name at Commerce Bank; it was "*WOW!*" Nine people had gotten together in 1994 and developed the program. Jacovelli explained:

> We needed a framework for teaching folks service, so we came up with the SMART principles [**Exhibit 9**]. Then we decided we needed to be able to measure the impact of that service on both external and internal customers. Now the program is called "managing for *WOW!*"—our terminology for process improvement. All offices have quality-assurance results that they have to live by. As people meet their goals or exceed them there are celebrations.

WOW! stickers, little red Cs that were awarded to employees who *WOW!*ed customers either internally or externally, could be redeemed for merchandise such as Commerce sweatshirts, T-shirts, mugs, and radios. Every year since 1997 Commerce held its *WOW!* Awards to honor outstanding service performers for the year in a variety of categories (**Exhibit 10**). The first year the ceremony had taken the form of a small luncheon at a local country club. In 2003, the bank's 30th anniversary, all Commerce employees were scheduled to gather at Radio City Music Hall in Manhattan. Commerce employees were actors, the *WOW!* Awards their Academy Awards; employees peppered the

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9 Salter, "Lessons from the Best Bank in America," *Fast Company,* May 2002.

10 Salter, "Lessons from the Best Bank in America," *Fast Company,* May 2002.

11 Salter, "Lessons from the Best Bank in America," *Fast Company,* May 2002.

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ceremony with musical performances. The most glamorous prize, for retailer of the year, was the use of a Porsche Boxster for one year and was awarded to a branch manager.

More than parties and awards, *WOW!* was an integral part of the training process at Commerce University, a full-time education and training facility staffed by 41 employees. All new employees underwent an intense introduction to Commerce culture during a class called "Traditions," characterized as "part game show, part training session, part common sense." Employees were taught how to smile, shake hands, and greet customers. "Smiles have teeth," insisted Manning, adding, "voice mail is not *WOW!*" Employees were told by executive vice president of retail banking Dennis DiFlorio: "Don't come here for a job, come to be a leader, be passionate." Hill added his vision to the employees: "In many ways, you have joined a service cult. Nordstrom's has its Nordies, Commerce has its WOW! team. "We can't call ours Commies," DiFlorio explained.[12]

Commerce wanted raving enthusiasts, people who would get a kick out of providing great service. It did not hurt to be a little crazy. "We hire wack jobs," Manning explained to a room full of bank officers. "You're all wack jobs. And it is your responsibility to go out there and find more wack jobs." Recruiting was emphasized repeatedly to new employees, who were given stacks of cards to hand out to people who provided excellent service, whether in another bank, a restaurant, a retail store, or a gas station.

Weekly events like Red Fridays kept the bank playful. That's when the *WOW!* Patrol would visit branches and take photographs of staffers who were wearing red. Even customers would get in on the act. "It sounds juvenile," says Manning, "but people like getting their picture taken with Mr. C [the Commerce mascot]."

Commerce had two mascots. Mr. C, was a jolly, oversized red letter with white gloves. He was a walking logo, Commerce's version of the Golden Arches. Buzz, Commerce's second mascot, was an overjoyed, human-sized bee who ensured that the staff was creating buzz within the branches. In addition, internally, Dr. Wow, the ultra-mysterious character that no employee had ever met, responded to letters and gives out awards.[13]

Commerce University was the in-house training *WOW!* program generator. In addition to indoctrinating new employees, the university offered courses for existing employees, from part-time tellers to senior executives. An award of stock options often accompanied course completion. The university also acted as a training ground for future employees. In cooperation with Drexel University, high school students were invited to attend Camp Business, a free 10-day program that covered general business topics as well as the Commerce strategy.

Mystery shopping, also referred to as *WOW!* shops, was a significant component of performance measurement.[14] A staff of five Commerce University employees managed a team of 100 mystery shoppers, who collectively performed over 14,000 mystery shops annually. Each shopper was given a card with questions and considerations to rate during a visit to a branch. In addition to evaluating the overall condition of the branch, shoppers looked for a handshake followed by the standard Commerce greeting: "Hi! My name is _____. How may I help you today?" If the employee said "can" instead of "may," if the customer-service rep did not walk the shopper to a desk or give her the

[12] Salter, "Lessons from the Best Bank in America," *Fast Company*, May 2002.

[13] Salter, "Lessons from the Best Bank in America," *Fast Company*, May 2002.

[14] Mystery shopping involved anonymous visits by evaluators hired part time solely for the purpose of rating service.

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appropriate brochure, if the attitude wasn't perceived as genuine, the branch received a lower rating.[15]

Because salary increases were based on shopping results, the information from the shops was posted on an internal database for all branch managers to see. Leagues were organized whereby branches in different regions might compete against one another for the most impeccable service report. Mystery shopping also went beyond Commerce, with shoppers being sent to competitors' branches to open new accounts and test service.

WOW! was interwoven with the organization in many ways. One infamous aspect was the "kill the stupid rule" program, whereby employees who suggested an alternative to a stupid rule were paid $50.

Commerce made it easy for customers who wanted to talk to a person on the phone to opt out of the automated voice-response unit. Moreover, the live agents with whom they were connected adhered to a dress code far stricter than was typical of a call center setting. "We expect *WOW!* service to extend into everything we do," explained vice president of training and development Thomas DiSabatina. "You never know who will walk through our call center—stockholders, the press, Mr. Hill—and we want our reps to represent the *WOW!* It also reinforces their role of responsibility and accountability to bring the best to our fans."

Commerce vans, each painted blue and red and emblazoned with a logo, were considered free advertising by the bank. "If you ask the competition," Hill explained, "they will tell you that they do not paint their vans because they are afraid of getting robbed. Well, it is just ridiculous because the vans drive around with checks, not money, and besides, there hasn't been a robbery since 1945." In New York some vans drove around empty. *WOW!* was everywhere.

Staffing

With rapid growth, staffing was a perennial challenge. Continued success relied on getting the right people, integrating them into the Commerce culture, and training them. In Manhattan, for example, Commerce conducted 2,000 interviews for 40 positions. "This is not the job for someone who's interested in being cool or indifferent," Manning said.[16]

Falese characterized his hiring philosophy as emphasizing engagement both internally among employees and externally among employees and customers:

> We're pretty good at getting people in here and getting them to stay. I've had only one senior manager in the last 10 years who did not fit, and we knew it four months into it. I check in at three months, six months, and a year and ask what is working, what isn't, how is volume, what do you like? Many bankers outside of Commerce delegate so much of their work they lose touch with their customers, their skills, and their contacts. They rarely visit customers and think that business development is playing golf. They are not engaged.

Falese actively monitored the labor market, sniffing around for talent. He considered experienced people who might be available only part time. "It's okay to hire someone part time, someone who has retired and has 30 years of experience," he insisted. "There is no substitute for experience in a

[15] Salter, "Lessons from the Best Bank in America," *Fast Company,* May 2002.

[16] Salter, "Lessons from the Best Bank in America," *Fast Company,* May 2002.

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local market. Experience lets you know who the local entrepreneurs are, those who have been able to manage their business through the cycles." Falese used prospective employee interviews to learn about competitors' organizations and kept tabs on who worked where. He observed: "Mergers have created a pool of talent. We are engaged in markets, and we know who the better performers are in each market. I have organizational charts of all of my competitors. I know who their lending officers are; I know who their secretaries are, administrative assistants, clerking officers, operations people, and branch managers."

Retailtainment

Proposed in 2002 to improve the service experience for customers waiting in branches, Retailtainment encouraged branch managers to suggest ideas, even wacky ones, for entertaining branch customers on Friday afternoons. "We wanted customers to expect the unexpected and leave with a smile," explained Jacovelli. New ideas were needed to keep Commerce ahead of the competition. "We need the next penny arcade," remarked Pauls.

Competitors were beginning to adopt some of Commerce's basic service offerings and to emphasize the human side of service with advertising and marketing campaigns. Seattle-based Washington Mutual, a recent entrant in the New York market, had launched its own retail-experience bank, termed an "un-bank," which included roaming tellers, a children's play area, and no desks. ING, a Dutch bank with little branch presence in the United States, opened a café-style location in mid-town Manhattan that served espresso and savings accounts to customers seated at tables provided with free Internet terminals. Even Bank of America was experimenting with televisions to entertain customers waiting in lines.[17]

With some of its competitors offering better rates, Commerce, if it was to stay ahead, had to ensure that its value proposition was clear in customers' minds. Commerce deliberately competed on service, not price. It paid lower rates on deposits in order to pay for enhanced service. The question was, how far should it take differentiating on service? Jacovelli recalled a phone conversation she had with a friend who complained that although it was nice to be greeted by an employee and given a promotional pen, she would prefer that employee get behind the counter and help speed the line through a busy branch. Complained another customer: "There are too many greeters standing around not doing anything."[18] Jacovelli wondered if people really wanted entertainment while they banked.

Some branches had other problems with Retailtainment. Jacovelli related a call she received while away on a business trip about a recent mishap: "The branch manager had arranged for a hot dog cart and a juggler in the branch, all approved by marketing. The hot dog vendor had to use the restroom, and while he was gone his cart caught on fire. When the juggler tried to help, he also caught on fire. That evening it was all over the local news. It was a disaster."

As with any program implemented in a decentralized context, Jacovelli was concerned about branding implications. The bank had worked hard to ensure that its branches all had the same look and feel, embracing the philosophy of building from scratch wherever possible to control the branch environment. Retailtainment encouraged branch managers to be creative. Described Jacovelli:

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[17] Wasserman, "Welcome to the Un-Bank," *Brandweek,* November 4, 2002.

[18] Salter, "Lessons from the Best Bank in America," *Fast Company,* May 2002, p. 88.

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The branch managers know their customers better than anyone and should be encouraged to do whatever's necessary to satisfy their needs. However, as we've seen from experience, it is dangerous to leave people completely to their own devices. Some in the organization feel that with proper training and guidelines we can make Retailtainment a success. Others think that it is not the best use of our attention or resources and that we should stick to executing our existing service model. This is important for us because it centers on service and our entire success is dependent upon service. At the end of the day Commerce is one bank, one brand, and our success will be on delivering better service than the competition. The question is what role Retailtainment will have in our delivering on our mission.

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Exhibit 1a Commerce Bank Income Statement (year ending December 31; $ in thousands)

	12/31/2001	12/31/2000	12/31/1999	12/31/1998
Total interest income	624,986	522,941	392,980	296,765
Total interest expense	218,754	219,976	141,855	116,711
Net interest income	406,232	302,965	251,125	180,054
Provision for loan and lease losses	26,384	13,931	9,175	5,865
Total non-interest income	197,894	155,527	96,831	73,837
Salaries and employee benefits	*197,658*	*145,557*	*110,136*	*80,592*
Premises and equipment	*89,747*	*71,313*	*52,433*	*39,110*
Additional non-interest expense	*137,069*	*107,600*	*74,582*	*51,718*
Total non-interest expense	424,474	324,470	237,151	171,420
Pre-tax net operating income	153,268	120,091	101,630	76,606
Securities gains (losses)	1,439	3,213	1,943	2,934
Applicable income taxes	49,695	40,064	34,127	27,308
Income before extraordinary items	105,012	83,240	69,446	52,232
Extraordinary gains - net	0	0	0	0
Net income	**105,012**	**83,240**	**69,446**	**52,232**

Source: FDIC Web site, <http://www.fdic.gov/>, accessed February 23, 2003.

Exhibit 1b Commerce Bank Employees and Branches

	2001	2000	1999	1998
Employees	5,329	4,228	3,407	2,424
Branches	185	150	120	88

Source: FDIC Web site, <http://www.fdic.gov/>, accessed February 23, 2003.

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Exhibit 2a Commerce Bank Balance Sheet (year ending December 31; $ in thousands)

	2001	2000	1999	1998
Cash and due from depository institutions	584,850	486,994	431,173	313,919
Securities	5,212,214	3,497,522	2,828,777	2,394,476
Net loans & leases	4,652,015	3,712,051	2,978,017	1,943,052
Bank premises and fixed assets	410,451	321,261	229,917	151,877
All other assets	1,411,636	843,176	263,444	175,826
Total assets	12,271,166	8,861,004	6,731,328	4,979,150
Total deposits	10,228,610	7,437,270	5,674,937	4,501,544
Other borrowed funds	90	9,638	205,453	26,004
Equity capital	700,747	537,343	385,404	321,434
All other liabilities	1,341,719	876,753	465,534	130,168
Total liabilities and capital	12,271,166	8,861,004	6,731,328	4,979,150

Source: FDIC Web site, <http://www.fdic.gov/>, accessed February 23, 2003.

Exhibit 2b Commerce Bank Deposit and Loan Information (year ending December 31; $ in thousands)

	2001	2000	1999	1998
Interest-bearing deposits	9,221,383	6,753,279	4,652,945	3,578,041
Loan loss allowance	66,981	48,680	38,381	26,409
Non-current loans and leases	17,616	14,749	9,921	7,749

Source: FDIC Web site, <http://www.fdic.gov/>, accessed February 23, 2003.

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Exhibit 3a Consolidated Commercial Banking Industry Income Statement (year ending December 31; $ in millions)

	12/31/2001	12/31/2000	12/31/1999	12/31/1998
Total interest income	402,853	428,448	367,291	362,016
Total interest expense	187,696	224,488	175,149	179,265
Net interest income	215,157	203,960	192,141	182,752
Provision for loan and lease losses	43,420	30,013	21,817	22,215
Total non-interest income	157,049	153,370	144,373	123,642
Salaries and employee benefits	*92,630*	*88,567*	*85,451*	*79,101*
Premises and equipment	*27,570*	*26,781*	*25,795*	*24,155*
Additional non-interest expense	*102,097*	*100,763*	*92,967*	*90,877*
Total non-interest expense	222,297	216,111	204,213	194,133
Pre-tax net operating income	106,488	111,206	110,485	90,046
Securities gains (losses)	4,478	(2,283)	180	3,131
Applicable income taxes	36,741	37,946	39,343	31,931
Income before extraordinary items	74,226	70,977	71,322	61,245
Extraordinary gains - net	(248)	(32)	169	507
Net income	73,978	70,945	71,491	61,752

Source: FDIC Web site, <http://www.fdic.gov/>, accessed February 23, 2003.

Exhibit 3b Employees and Branches

	2001	**2000**	**1999**	**1998**
Number of employees (full-time equivalent)	1,701,721	1,670,861	1,657,602	1,626,978
Branches	65,654	64,079	63,684	61,957
Number of institutions	8,080	8,315	8,579	8,773

Source: FDIC Web site, <http://www.fdic.gov/>, accessed February 23, 2003.

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Exhibit 4a Industry Statistics: Consolidated Commercial Banking Industry Balance Sheet (year ending December 31; $ in millions)

	2001	2000	1999	1998
Cash and due from depository institutions	390,965	369,919	366,456	356,704
Securities	1,179,694	1,078,983	1,046,530	979,855
Net loans & leases	3,823,167	3,755,371	3,432,892	3,181,025
Bank premises and fixed assets	76,757	75,795	73,743	71,308
All other assets	1,098,491	964,543	815,539	853,640
Total assets	**6,569,074**	**6,244,610**	**5,735,160**	**5,442,531**
Total deposits	4,391,610	4,179,634	3,831,104	3,681,428
Other borrowed funds	567,743	570,657	555,318	416,696
Equity capital	597,137	530,721	479,731	462,142
All other liabilities	1,012,584	963,598	869,006	882,264
Total liabilities and capital	**6,569,074**	**6,244,610**	**5,735,160**	**5,442,531**

Source: FDIC Web site, <http://www.fdic.gov/>, accessed February 23, 2003.

Exhibit 4b Industry Statistics: Consolidated Commercial Banking Industry Deposit and Loan Information (year ending December 31; $ in millions)

	2001	2000	1999	1998
Interest-bearing deposits	3,505,277	3,423,073	3,127,704	2,961,347
Loan loss allowance	72,314	64,145	58,767	57,261
Non-current loans and leases	54,905	42,942	33,002	31,253

Source: FDIC Web site, <http://www.fdic.gov/>, accessed February 23, 2003.

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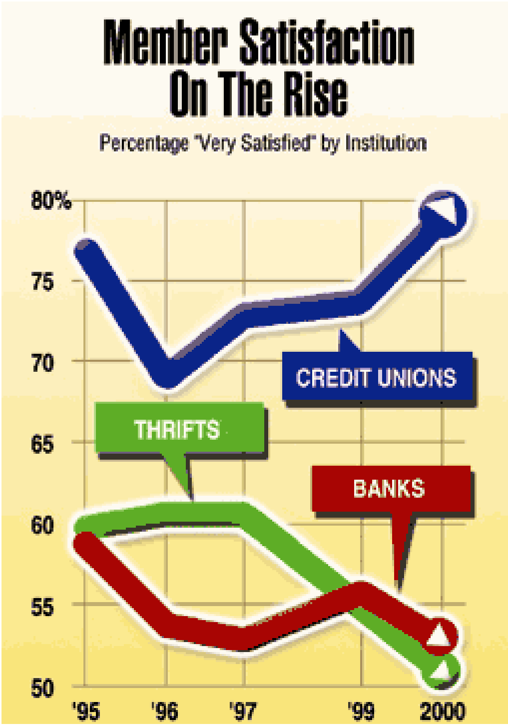
Exhibit 5 Customer Satisfaction Comparisons



Source: Adapted from American Banker / 2000 Gallup Consumer Survey.

Nearly 79% of consumers surveyed who used a credit union as their primary financial institution in 2000 said they were "very satisfied," with their financial institution as compared with 53% of consumers who use a retail bank. Savings and loans and other thrifts scored 51% in this area.[19]

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[19] Questions were asked on a 5-point scale, with "very satisfied," "satisfied," "neither satisfied nor dissatisfied," "dissatisfied," and "very dissatisfied" as the alternatives.

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Exhibit 6 Commerce Checking Product Descriptions

Commerce offered checking accounts with the first year free of monthly service fees regardless of balance.[20] This included free first order of checks.

ATM withdrawals were available at any ATM and purchases anywhere Visa® was accepted. Transactions were immediately deducted from checking account and detailed in monthly statements.

Any Commerce Bank checking account could be combined with a cash reserve line for protection from overdrafts. Commerce had four types of checking accounts:

Standard Checking

- A $100 minimum balance resulted in no monthly service fees.

Interest Checking

- No monthly service fees with a $1,000 balance. Unlimited check writing and interest.

50 Plus Club

- Customers over 50 who maintained a $100 minimum balance incurred no account maintenance charge for a checking account with interest, free checks, money orders, notary service, and travelers' checks.

Consumer Checking

- No minimum balance requirement and no per check charge for the first eight checks each month for a $3 monthly fee.

Source: Company Web site.

[20] Online banking—checking balances and account details—was free. A $5 fee was charged per month for electronic bill paying in which customers could pay their bills through the Commerce Web site.

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Exhibit 7a Typical Branch

Source: Company Web site.

Exhibit 7b Branch opening

Source: Company documents.

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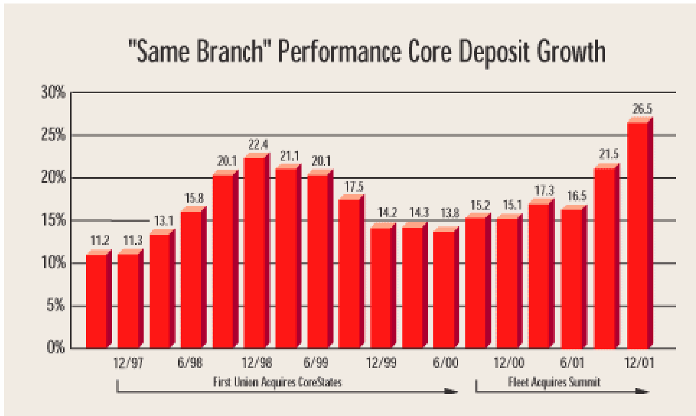
Exhibit 8 Effect of Mergers on Deposit Growth



Source: Company documents.

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Exhibit 9 SMART Principles

Say "Yes" to Customers!

- Don't hide behind bank policy. Refer situations which conflict with policy to your supervisor.
- Void forbidden phrases:

  "No . . . "

  "We can't do that."

  "I don't know."

  "Sorry you'll have to . . . "

Make each customer feel special!

- Be personable, pleasant, and positive!
- Politely address customers by their surname.
- <u>SMILE!</u>

Always keep customer promises!

- Take ownership of a customer's problem – solve it for them. Don't play corporate "Ping-Pong."
- If you can't correct the basic problem, take care of the mess it caused.

Recover

- To err is human! To recover, divine!

Think like the customer!

- Always **<u>exceed</u>** the customer's expectations!

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Exhibit 10 *WOW*! Awards 2001

Award	Nominee Criteria
Retailer of the Year	Core Deposit Growth, Total Deposit Growth, Consumer Loan Growth, WOW Shops, Total Losses, Employee Turnover
Rookie of the Year	Core Deposit Growth, Total Deposit Growth, Consumer Loan Growth, WOW Shops, Total Losses, Employee Turnover
Best Assistant Manager of the Year	Cash Items, Employee Turnover, WOW Shops
Best Head Teller of the Year	Cash Average vs. Cash Master, Teller Differences, WOW Shops/ Drive-thru Competition, Check Cashing Violations, ATM Up Time
Best Full-time Teller of the Year	Teller Differences, WOW Shops
Best Part-time Teller of the Year	Teller Differences, WOW Shops
Best Customer Service Rep of the Year	Procedure Violations, WOW Shops

Other awards included: Best Supporting Role By An Officer, Best Supporting Role By A Non-Officer, Best Regional Lender, Best Middle-Market Lender, Best Consumer Lender, Best Specialized Lender, Best Sales Representative, Best Customer Service Representative, Best Supporting Role, Outstanding Institutional Performance, Outstanding Retail Sales Performance, and the Instructor of the Year

Source: Company documents

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