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CASE STUDY

Chase Global Markets: Defining New Business Models in the Investment Bank Industry

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Title: Chase Global Markets: Defining New Business Models in the Investment Bank Industry

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Abstract: Like most financial institutions, Chase Global Markets (now part of J.P. Morgan Chase) found that e-business opportunities challenged its core business model. The Global Markets business serves large institutional investors (as opposed to individual investors) and thus handles very large transactions. The nature of the business creates unique challenges in an e-business environment, where investors want more competitor comparisons online but prefer to complete their transactions with a personal salesperson. This case study examines the efforts of Chase's e-Capital Markets group to revamp its approach to serving customers and developing IT solutions.

Key words: business models, e-business strategy, IT architecture



**Massachusetts Institute of Technology
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CHASE GLOBAL MARKETS

Defining New Business Models in the Investment Bank Industry

In October 2000, Simon Lack, Managing Director and head of e-Capital Markets, the e-commerce unit of Chase Manhattan Bank's Global Markets division,¹ reflected on how e-commerce was redefining investment banking. Traditionally, investment banks had not charged for services such as research, sales advice, and clearing trades. Instead they had recovered the costs of these services through high margins on their transaction prices. Lack noted that this revenue model was threatened:

What will start to happen as price transparency takes effect is that the transaction margin will get forced down. We will need to look at each piece of the value proposition to say, well, are we getting paid for the sale of that? Are we getting paid for the research? And maybe one day we will actually have to charge for settlement and clearing transactions and say, well, you have to pay separately for that as opposed to that being part of what you get when dealing with Chase.

—Simon Lack, Managing Director and Head of e-Capital Markets

¹ On December 31, 2000, Chase Manhattan Bank and J.P. Morgan merged to form J.P. Morgan Chase & Co. Chase Global Markets became part of J.P. Morgan Investment Bank.

Lack's e-Capital Markets team was charged with helping Global Markets address e-commerce opportunities and threats. In its first year, e-Capital Markets, in partnership with Global Markets' business leaders, had pursued a variety of initiatives that had cut costs and provided new web-based products and services. It was not yet clear, however, what new business model would emerge:

Today's marketplace isn't where clients are at all ready to pay explicitly for anything. But, in time, it is possible our clients will pick and choose. They might get their sales advice from one place and their research from another and they might trade in a third place and clear through a fourth entity—really unbundling the value proposition. So the challenge for us is to try to rebundle things back together in intelligent ways that continue to add value to clients.

—Simon Lack

Background

Chase Manhattan Bank, a global financial services firm, had 1999 revenues of \$22.9 billion (see Exhibit 1, Summary Financial Statements). With 75,000 people, Chase operated out of 46 different countries. Chase was organized around three

This case was prepared by Research Assistant Richard Woodham and Dr. Jeanne W. Ross of the Center for Information Systems Research at the MIT Sloan School of Management. This case is for the purpose of management education, rather than illustrating or endorsing any particular management practice. The case is part of a research project on e-business migration conducted jointly by Melbourne Business School and the MIT Sloan School. Support for the project from PricewaterhouseCoopers LLP is gratefully acknowledged. This case may be reproduced free of charge for educational purposes provided the copyright statement appears on the copy.

business lines: National Consumer Services, which dealt with retail, deposit taking, and mortgage origination; the Global Bank, which was responsible for investment banking activities; and a Global Services business that was dedicated to cash management and finance.

Chase Manhattan Bank was created in 1955, the result of a merger between Chase National Bank and The Bank of the Manhattan Company. In 1996, Chase became the largest bank holding company in the United States when it merged with Chemical Bank, which had acquired Manufacturers Hanover Bank in 1991. In the fall of 2000, Chase announced a merger with J.P. Morgan, a \$35 billion firm with strengths in investment banking and private client services.²

Chase Global Markets was part of the Global Bank business and generated \$4 billion of the Global Bank's \$10.4 billion in 1999 revenues. Global Markets was a sales and trading organization that served institutional (as opposed to individual) investors from 30 trading rooms around the world. Global markets traded a wide range of financial instruments, and traditionally dominated the foreign exchange and derivatives markets. Chase was also highly competitive in the US high-grade corporate debt market.

Chase Manhattan's Consumer Bank had introduced Internet banking for retail customers in 1997, and was growing the list of services available via the web. Global Markets had not rushed to follow suit because they saw their business as quite different from retail banking. Wholesale banking was relationship-based and highly regulated, and customers were not demanding e-commerce services. On the other hand, retail banking was a volume business in which individual customers were already accustomed to doing business electronically as a result of ATMs and related technologies. Even the success of Schwab and e-Trade in providing web-based securities trading did not pose an immediate threat to Chase Global Markets, because they served individual rather than institutional traders. But by the summer of 1999, Global Markets' competitors, including Citibank and J.P. Morgan, had established heavily funded, largely independent e-commerce units, intended to aggressively attack e-commerce opportunities in

² Private client services are the provision of investment advice to high net worth individuals.

wholesale banking. Early impacts of e-commerce on wholesale banking were becoming apparent within Chase: lower margins on trading volumes, greater information transparency, and an ongoing redefinition of the focus of the sales force from selling to a more value-added client advisory role.

E-commerce Strategy

In response to its competitors' initiatives on the Internet, Chase Global Markets established e-Capital Markets in August 1999. Simon Lack, a veteran derivatives trader and leader of the bank's derivatives operation, was named to head the e-commerce unit. In contrast to the approach at some of its competitors, Chase adopted an integrated approach to e-commerce within Global Markets. Each line of business appointed an e-commerce functional lead responsible for identifying e-commerce opportunities. These e-commerce leaders reported to their business unit heads, and also reported on a dotted line to Lack. The e-Capital Markets team itself was comprised of mostly technologists, who developed applications and coordinated business unit initiatives. Most of these technologists reported on a dotted line to Global Markets' head of information technology. Through this integrated, matrixed approach, Global Markets management intended to leverage existing client and product knowledge in its e-commerce ventures.

Global Markets used a three-pronged attack in its e-commerce strategy: offensive, defensive, and efficiency initiatives. Offensive initiatives were intended to gain market share where Chase had not traditionally been a leader, and thus bring new revenues into the bank. Defensive initiatives attempted to preempt competitors' moves into markets where Chase had traditionally dominated. Efficiency initiatives delivered cost savings to the bank from customer self-service or from straight-through processing that squeezed costs out of back office processes.

Implementing Offensive Strategy— Market Axess

Market Axess, an example of an offensive strategy initiative, allowed Chase to meet the needs of small to medium sized money managers for fixed income products,³ a client segment in which Chase did not

³ Fixed Income products in this case are corporate high-grade bonds, corporate high yield bonds, emerging market debt, and municipal bonds.

have a very large presence. A joint venture between Chase, J.P. Morgan and Bear Stearns, Market Axess was a multi-dealer electronic trading portal for fixed income products that targeted asset managers with between a half billion dollars and four billion dollars under management. The middle market was a high volume, low margin business, and Chase could not cost-effectively play in that market with its highly paid sales force. Market Axess allowed Chase to generate sales using technology rather than salespeople. The implications of this new capability were not lost on the salespeople:

Market Axess is definitely changing Chase. It's making all of the salespeople stand up and think about what it is they actually do for a living and where they add value. We firmly believe in the concept of SVA, Shareholder Value Added.⁴ We measure SVA. We measure it down to a desk level. If you are doing a transaction, you can measure it down to a transaction level. Salespeople are standing up and taking note. The world is changing.

—Rick Schonberg, Vice President of Partnering, e-Capital Markets⁵

Implementing Defensive Strategy—ChaseFX

ChaseFX was a defensive initiative focused on ensuring that Chase maintained its leadership position in the foreign exchange market. ChaseFX offered clients execution of spot, forward, and foreign exchange swap transactions:

By offering our clients the efficiency, immediacy, and reach of the Internet, Chase further increases its competitive edge in a market where it is already a top provider. We now bring the full range of FX services to our clients' desktops.

—Simon Lack, Managing Director and Head of e-Capital Markets⁵

⁴ SVA considers the incremental impact of a management initiative on shareholder wealth. In some cases, this can be assessed on the basis of cost reduction or profitability. In other cases, a decision may not have a direct impact on financial performance so the impact on SVA would be assessed in terms of intermediate outcomes, such as reduced cycle times or contribution to shared infrastructure.

⁵ ChaseWorld, June 26, 2000.

ChaseFX brought the potential to 'lock in' existing and future customers. *EuroMoney's* discussion of FX trading sites suggested this was possible:

In addition to competitive pricing, superior client service, and high quality research, new factors are separating winners from losers in the battle for market share: ease of access, efficiency of execution, and straight-through processing.⁶

Like Market Axess, ChaseFX changed the relationship between the salesperson and customers. As Chase provided information to customers via the Internet, the role of the salesperson changed from being someone who executed a trade on the customer's behalf to someone who provided advice and pointed the customer to helpful information and analytic tools on Chase websites.

ChaseFX met the demands of Chase customers who wanted to bundle a foreign exchange transaction with other Chase transactions and services, but it did not address the needs of those customers who were most interested in low-cost execution. Accordingly, Chase had entered into an alliance with the other two FX market leaders, Citibank and Deutsche Bank, to create a multi-dealer platform called Atriaux.⁷ Atriaux, which would be released in the third quarter of 2001, would allow an investor to specify five dealers when entering a request for a foreign exchange trade. The investor could then choose from among the five prices. Lack noted that by improving price transparency, Atriaux, like other multi-dealer systems, would reduce profit margins. Banks would try to compensate with greater volume and more efficient distribution.

Implementing Efficiency Strategy—Chase Bond

Many efficiency-oriented e-commerce initiatives were targeted at cost savings, such as those that put market data on the web to minimize the cost of fax and mail. Others, however, had strategic impacts beyond those of cost savings alone. Chase Bond was an example of the latter type of efficiency initiative.

⁶ *EuroMoney* e-finance special issue, June 2000. "FX: replacing the old way with the e-way."

⁷ Atriaux would compete against FXall, a multi-dealer system scheduled to go live in Q1, 2001. J.P. Morgan was one of the founders of FXall.

Chase Bond was the firm's online origination platform for fixed income products. Typically, companies entered debt instruments into the market by working closely with an underwriter at a firm like Chase. Together, the underwriter and the issuer's representative would decide how much debt to issue at what yield, making judgments as to what would sell. During the auction process, the underwriter would control how much information to provide to investors and interpret investor behavior for the issuer. This permitted the issuer to change direction in response to market interest.

The Internet offered the opportunity to make the whole process more transparent, and Chase teamed with several competitors to develop a platform to hook up buyers and sellers and let everyone see the outstanding bids. Issuers were excited about this new product because they no longer had to rely on qualitative feedback from underwriters. They could gauge demand more accurately and have more control over the process. Investors, however, were generally nonplused:

Once the initial novelty wore off, investors sort of felt like, well, it is great that you have a web site for me to enter orders into; but, basically, if you want my business, I am going to call you up and tell you what I want to do and you can put it in your own silly web site. And so, it wasn't the outcome we expected, but it was an interesting learning experience.

—Simon Lack, Managing Director and Head of e-Capital Markets

Global Markets management learned that the majority of its investors felt that for new issues they received preferential treatment from their salesperson. As a result, online trading was meeting with greater success in secondary trading than in issuance.

E-commerce Governance

Global Markets' integrated approach to e-commerce meant that ideas for e-commerce initiatives would be generated within five different business units as well as within e-Capital Markets. But because e-Capital Markets had limited resources for implementing new applications and because senior management wanted to focus those resources on the most strategically important initiatives, Global Markets developed a governance structure that assigned responsibility for both

strategy and execution throughout Global Markets(see Exhibit 2).

High-level Internet strategy was the responsibility of the Internet Policy Board (IPB). Donald Layton, Vice Chairman of Global Markets, chaired the IPB, which included Simon Lack, the leaders of each of the Global Markets businesses, the Head of Research, and the Head of Technology and Operations. In its monthly meetings the IPB reviewed the competitive landscape to identify new developments that might affect Global Markets' Internet strategy. In addition, each month one business unit would describe its e-commerce projects and products so that the IPB could assess the fit between the division's strategy and that specific business unit's products. Most importantly, the IPB determined Global Markets' priorities for Internet capabilities.

E-commerce heads in each trading unit were responsible for leading the execution of IPB strategies. But Global Markets attempted to infuse e-commerce thinking throughout the organization. For example, the Sales Council, a body comprised of the bank's North American sales heads, discussed e-commerce initiatives as part of its regular sales meetings.

The Project Management Office (PMO) was responsible for allocating IT resources and coordinating the multiple e-commerce strategies across Global Markets' business units. When e-Capital Markets was formed, project tracking consisted of a spreadsheet and a small team that would contact project owners to ensure they were on track. But when some early projects missed their deadlines, the Project Management Office was established to clarify accountability.

One of the things we found was that deadlines were constantly being missed, and it was nobody's fault. It was just that issues would come up at the last minute, and everybody couldn't believe that we didn't think about them, but not all the stakeholders were involved in the beginning.

—Lenore Albom, Vice President and Business Manager, e-Capital Markets

The PMO introduced several innovations to ensure effective implementation of e-commerce initiatives within Global Markets. First, the e-Project Life Cycle (EPLC) collapsed the traditional project life

cycle so that projects could be completed in 90-day modules (see Exhibit 3). The EPLC emphasized parallel processes, so that requirements generation, design, building, and testing were taking place simultaneously and iteratively:

The old project life cycle is really geared to a two-year type of technology project, and so each phase was done and everyone had to sign off on it and it was very, very methodical in its thinking but took a long time. So when we had these e-projects, we decided that we would make them into 90-day modules and develop the e-project life cycle to really address those modular projects.

—Lenore Albom, Vice President and Business Manager, e-Capital Markets

Second, the PMO required that all possible stakeholders read the project summary and sign an Impact Notification Form. Stakeholders might include risk management, legal, hardware support, customer care, audit, security, and other groups throughout the bank. In signing the Impact Notification Form, each group notified the PMO of potential issues related to their area so that the PMO could involve appropriate persons at the proper time and also ensure that key issues were identified at the outset of the project.

Third, weekly systems meetings became the tool by which project management issues could be identified and resolved in a timely manner. Although systems meetings had long been a practice at Chase, e-commerce systems meetings recognized the wide reach of e-commerce initiatives and brought in stakeholders from both business and technology, whether local or remote. When an issue was raised at one of the meetings, the stakeholders around that issue were required to report on how it was resolved at the next meeting. Simon Lack headed up these meetings, even if he had to call in from the road. E-Capital Markets managers felt that the meetings were valuable both for overcoming political barriers that might delay the launch of a product or service and for facilitating communication across Chase:

Because of the way e-commerce works—it touches on many parts of the business, many parts of technology, both infrastructure and applications development—these meetings are often attended by many people. Typically, 20 or 30 people are in the room. And what's

very impressive is that we can cover a half a dozen topics with that many stakeholders, hitting the key issues, and we can cover them in a half hour, forty-five minutes.

—John McFadden, Senior Vice President, GIST Management

IT Infrastructure

As a result of the Manufacturers Hanover and Chemical Bank mergers and a culture of addressing local, rather than corporate-wide needs, Chase Global Markets' IT infrastructure consisted of a proliferation of IT platforms, products, and tools. IT executives were concerned about the potential points of failure that had resulted from patching systems together. In the mid-1990s, IT management had started to build a common infrastructure, focusing first on the messaging and security architectures. Nonetheless, in 1999, Chase's infrastructure was not capable of the straight-through processing that Chase management felt was essential for effective e-commerce practices:

The readiness of the infrastructure when we first started was fairly poor in terms of being able to support global 24 x 7 Internet activity. We were very good at supporting local regional time zones. We were very poor at supporting a global presence.

—Marty Weinberg, Vice President, e-Capital Markets Technology Group

Exacerbating the problem, early e-commerce initiatives focused on fast delivery rather than industrial-strength infrastructure. Applications developers used development tools that supported rapid development, such as Microsoft NT and the Microsoft development suite. In late 2000, technologists were converting these systems to Unix platforms with high availability clusters and off-site disaster recovery:

We dug ourselves into a hole. We did it for a good reason because, if you want to get something out to the market quickly, that's the way to do it. So we now have to retrench; and ... it has taken a lot of time to migrate to a more stable, robust, scaleable platform.

—Marty Weinberg

Early standardization efforts had convinced both IT and business executives that a common, shared infrastructure not only provided a more reliable platform for e-commerce, but also a more cost-effective IT environment. Both IT and business

executives pushed for an increasingly standard and shared infrastructure. For example, business units found that clients were increasingly buying across business unit lines, but their multiple customer call tracking systems did not permit them to share customer data. As a result, the four main business lines started working together to build a common client tracking and sales management system using Siebel's customer relationship management product. In other cases, systems developers responded to a single business unit need by building individual systems in accordance with an IT architecture.

A multi-level governance process supported architecture standards. The technology governance board, which was chaired by the Global Markets CIO and included Global Markets' senior technology and operations heads, established technology strategy. This strategy was enacted by a senior architects' steering committee, which was comprised of approximately forty senior technology managers. This group met every six to eight weeks to identify opportunities to leverage shared infrastructure as well as shared applications capabilities. IT architects also performed architecture reviews of every new project to ensure that standard technologies were used whenever possible:

Historically, buy-in to architecture programs has always been difficult, but something has happened in the last year or two. I think it's a combination of, top down, management driving the need for architecture and seeing the value of it, and, bottom up, technology managers realizing that there's so much work to do that they can't do it all themselves without sharing.

—John McFadden, Senior Vice President,
GIST Management

To facilitate the sharing of infrastructure, Global Markets adopted a philosophy of “reuse before buy; buy before build.” Much of the success of the campaign to reuse rested with individual developers:

Our culture has evolved, over time, to ask the question of why didn't you use something that already exists? And I would say everybody typically goes through a thought process that would say, “How am I going to answer that question?” And the grilling that you can get means you really have to give it serious thought.

—John McFadden

The e-Capital Markets team attempted to leverage Global Markets' infrastructure in all e-commerce applications. Where immediate business needs dictated relaxing standards in order to bring a product quickly to market, IT managers got management buy-in for a two-step process in which successful e-commerce experiments were migrated to standard technologies.

Wherever possible e-Capital Markets also attempted to leverage capabilities from other parts of Chase. They noted, however, that retail bank needs were considerably different from those of the wholesale bank:

It is barely a positive that the consumer bank got there first... We have been saddled with systems, for example for authentication of clients, for web site metrics that have turned out to be not really appropriate to our needs. So we have had to go back and redo some of these choices.

—Simon Lack, Managing Director and
Head of e-Capital Markets

Organizational Change

Even as they tried to sort out emerging business models, Global Markets management faced the task of helping 5,000 employees deal with the rapid pace of change that e-commerce had already introduced. Management credited the 90-day delivery cycle with allowing the organization to adapt to ongoing, incremental change rather than face sudden, disruptive changes. Management noted that these smaller, constant changes were less risky than the larger systems projects that Global Markets had delivered in the past. This was because faster projects were necessarily simpler and therefore less risky technologically. Also because they put new capabilities in front of customers sooner, they received more immediate feedback from customers, thus reducing business risk. Another benefit of the constant deliverables was that they forced business managers to limit their systems requirements to those that were most essential:

I've seen the speed in getting decisions done, really evaluating what is a priority for us, where are our resources, what is a true risk to us versus a nice-to-have. It's so interesting to go to these meetings and have people say, “Okay, this is a real nice-to-

have but we don't need it. This is something we really need in order to make a launch," and to really put numbers around those and own those decisions. It makes things very competitive; it makes us really responsible for getting deadlines met and coming to market and being top of class, best of breed, to our customers.

—Lenore Albom, Vice President and Business Manager, e-Capital Markets

Ultimately, because most of e-Capital Markets' projects involved linkages to legacy systems, some projects would not be delivered in ninety days. However, the goal was helping to reinforce the changing mindset within the organization. Another mindset change involved heightened demands for process integration within Global Markets. In a large organization this meant having many touch points with other individuals in the bank. Long-term this involved fundamental shifts in how the firm operated which would continue to put pressure on the IT infrastructure:

E-commerce really forces us to focus on the customer. What we have to do is design our systems in a way that we have to turn our bank "on its end" in some respects and stop thinking about products and specific business silos and start thinking about what's important for the customer. And that has major implications for how we think about the infrastructure or the glue that holds all of our bank's customers' information together. It forces us to create a common customer perspective so that we can use a shared customer system across multiple products. It forces us to think through the security interfaces, as well as the customer interfaces as well as our client relationship management or sales force automation interfaces, so that they're all operating on a consistent basis.

—John McFadden, Senior Vice President, GIST Management,

To help the firm understand the need for ongoing change and to assess the costs and benefits of those changes, Lack was anxious to develop useful metrics that could demonstrate the value generated by e-Capital Markets in quantitative terms:

Today we measure things like percentage of business done electronically, percentage of transactions confirmed electronically,

number of web page hits, number of new clients coming on the web site, things like that. That doesn't quite get to be the sort of ROI analysis that can say, okay we know what we have invested in that system, so what has the actual payoff been? That is going to have to happen because everything else in the organization has to translate into shareholder value added and the Internet activities are going to be no different.

—Simon Lack, Managing Director and Head of e-Capital Markets

e-Capital Markets had been funded at a level that represented senior management's commitment to aggressively pursuing e-commerce opportunities, but as the unit matured, funding would depend, in part, on demonstrated value.

The ultimate test for e-Capital Markets—and more generally for Global Markets—would be its ability to distinguish itself from its competitors in the increasingly electronic investment banking industry. Many e-Capital Markets initiatives merely kept pace with competitors and customer demands. Consortia actually teamed Global Markets with its competitors.⁸ Long-term, Global Markets wanted to establish a distinctive presence on the Web:

We are conscious of the fact that the way we define what Chase really brings to the table for clients is going to need to shift. It will need to shift to giving really good advice and having very high quality problem solving skills. We will need to really advise clients on how they should manage their portfolio, how they should make decisions about risk. That means having very good, deep research that is insightful and that is unique, and that adds value to the client. It is those areas that are going to become more important as opposed to having a competitive price and taking down a large transaction at the right level.

—Simon Lack

⁸ Rick Schonberg, Vice President responsible for Partnering, noted that Chase insisted on partnerships with firms that would be viewed as "equals" in a particular market segment. Firms that had a noticeably lesser reputation would drag down the reputation of a consortium; partnering with much more visible firms could lead to power disparities.

Simon Lack entered e-Capital Markets' second year trying to identify feasible alternatives to Chase's existing pricing and bundling approaches. He was also trying to develop key metrics that would alert management early on about the potential SVA of new e-business initiatives.

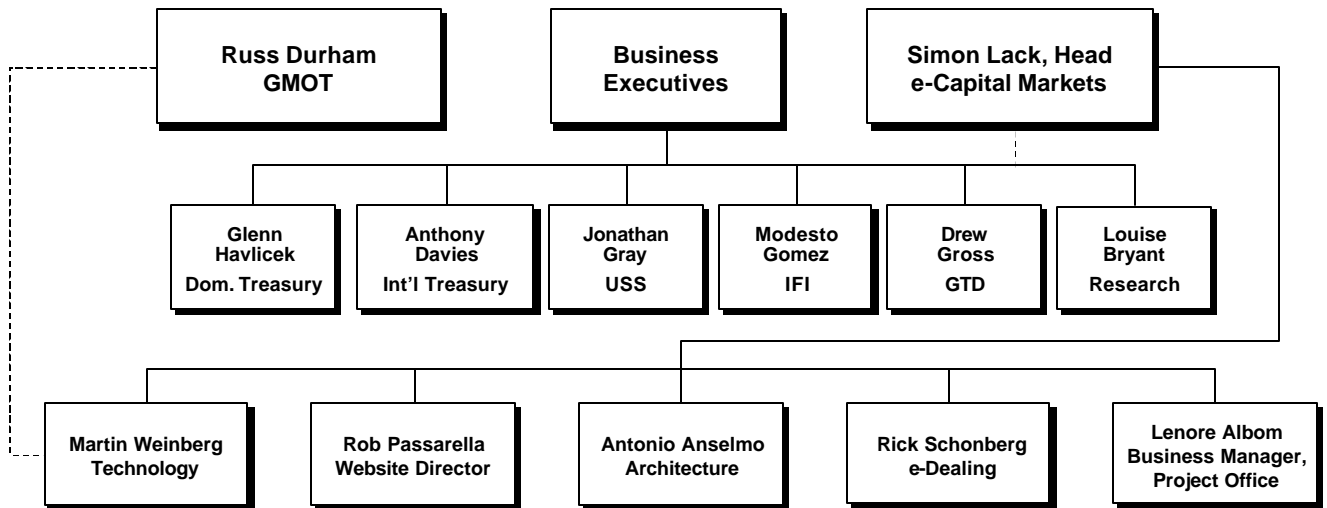
EXHIBIT ONE
Chase Manhattan Bank Summary Financial Statements

Year Ended December 31, (in millions, except per share data)	1999	1998	1997
INTEREST INCOME			
Total Interest Income	20,237	22,289	21,851
INTEREST EXPENSE			
Net Interest Income After Provision for Loan Losses	7,123	7,223	7,449
NON-INTEREST REVENUE			
Total Noninterest Revenue	13,473	10,090	8,555
NON-INTEREST EXPENSE			
Total Non-interest Expense	12,221	11,383	10,094
Income Before Income Tax Expense	8,375	5,930	5,910
Income Tax Expense	2,929	2,148	2,202
NET INCOME	\$5,446	\$3,782	\$3,708
Net Income Applicable to Common Stock	\$5,375	\$3,684	\$3,526
NET INCOME PER COMMON SHARE			
Basic	\$6.49	\$4.35	\$4.15
Diluted	6.27	4.24	4.01

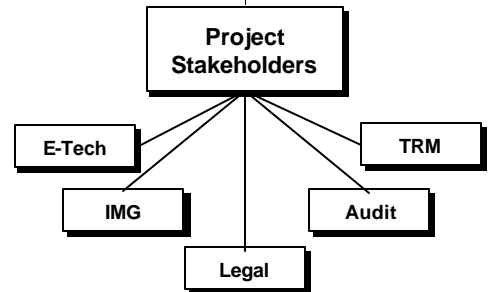
December 31, (in millions, except share data)	1999	1998
ASSETS		
Total Assets	\$406,105	\$365,875
LIABILITIES		
Total Liabilities	381,938	341,487
Commitments and Contingencies (See Note Twenty-Six)		
PREFERRED STOCK OF SUBSIDIARY STOCKHOLDERS' EQUITY		
Total Stockholders' Equity	23,617	23,838
Total Liabilities, Preferred Stock of Subsidiary and Stockholders' Equity	\$406,105	\$365,875

EXHIBIT TWO
Organization and Governance Structure

CAPITALMARKETS Organization



- ◆ Hybrid structure with matrix reporting
- ◆ Heavy reliance on partnership
- ◆ Centralized & decentralized systems development



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EXHIBIT THREE

Chase Global Markets E-Project Life Cycle

