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Sovran financial corporation competitive analysis

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SOVRAN FINANCIAL CORPORATION

COMPETITIVE ANALYSIS

An independent research project submitted in partial fulfillment of requirements for the MBA degree

by

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"Competition is the foundation of man's development. It has made the human race what it is. It is the spur that makes progress. Every nation that has eliminated it as the controlling force in its economy has disappeared, or will. We will do the same if we eliminate it by trying to give security, and for the same reason. Competition means that there will be losers as well as winners in the game. Competition will mean the disappearance of the lazy and incompetent, be they workers, industrialists, or distributors. Competition promotes progress. Competition determines who will be the leader. It is the only known way that leadership and progress can be developed if history means anything. It is a hard taskmaster. It is completely necessary for anyone, be he worker, user, distributor or boss, if he is to grow.

If some way could be found so that competition could be eliminated from life, the results would be disastrous. Any nation and any people disappear if life becomes too easy. There is no danger from a hard life as all history shows. Danger is from a life that is made soft by lack of competition."

- James F. Lincoln

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COMPETITIVE THEORIES

Competitive theories attempt to describe, analyze, rationalize and predict behaviors when two or more people want the same thing. Competition appears to come naturally to humans. We have evolved over vast numbers of generations in response to changes in our environment. Our early struggles for existence led to a highly developed tendency toward aggressive behavior. The process of natural selection depended on this trait to ensure that the strongest members of our species flourished. If unchecked, however, aggression would have eventually destroyed mankind. V. C. Wynne-Edwards[29] theorized that societies of higher animals have developed "conventional competitions" which encourage aggression while avoiding extinction. Businessmen in competition illustrate territoriality and ritualized tests of strength, two of the more prominent social conventions described by Wynne-Edwards. Rules of the game are formalized in other competitive theories.

Game Theory is a descriptive analysis of competition. According to the theory, players have some power to influence events and wish to maximize some goal. A zero-sum game is assumed. There is a winner and a loser, with no possibility of cooperation to allow both players to win. The outcome depends on the skill of the players, the quality of information which the players possess, and random events beyond the control of either player.

Economic theories of competition attempt to describe the interactions between economic entities. According to Adam Smith, the economic system is guided by an invisible hand - each individual acting in his own self-interests maximizes societal interests. This theory of perfect competition is refuted by most economists. They argue that perfect competition is unlikely to occur in the real world. Aggressive competitive behaviors lead to market imperfections including monopolies, oligopolies and governmental intervention. In our mixed economic system, competitive balance is maintained through free-market forces in combination with government regulations. Few competitors in the business world enjoy overwhelming strength in every product and market.

Overwhelming strength is the single greatest asset in warfare. "God is on the side of the big battalions", said Napoleon. Military theory also holds that defense is superior to offense and suggests that the stronger army adopt a defensive posture. In the absence of overwhelming strength, military strategists instruct us to commit all available resources at the decisive point in battle. Failure to join the battle is an unforgivable error. Von Clausewitz writes that, "Some statesmen and generals try to avoid the decisive battle. History has destroyed this illusion." Ries and Trout apply these military principles to contemporary marketing in their book, <u>Marketing Warfare</u>. They stratify businesses according to relative competitive position and suggest the strategy which is appropriate for each stratum.

A market leader may successfully adopt a defensive strategy, a strong second place competitor should go on the offensive and a third place competitor should develop flanking moves. Followers (95% of all competitors) must conduct guerrilla warfare. The greatest competitive challenge, according to Ries and Trout, is to identify the nature of the battleground and the kind of war to be waged. They suggest that, for service marketeers, the mind of the consumer is the battlefield. Our alternative actions are dictated by consumer perceptions of our competitive position. We can only act like a market leader if the market perceives that we are a leader.

From the humanities, game theory, economic theory, and military warfare, we can establish guidelines for developing competitive strategies at Sovran. We must engage in competition freely and fully. The desire to compete is an innate characteristic. There is no reason to hide the desire or apologize for it. We must be more skillful and better informed than our adversaries. In a May, 1986 conference sponsored by the Federal Reserve Bank of Chicago, Walter Wriston noted that banks are losing the information advantage we once had. Other competitors are rapidly learning as much about our customers as we know. More data is unnecessary; we are already awash in data. Interpreting that data to gain information is a vital skill which we must acquire. We must also learn to compete in a mixed economic system which includes government intervention in bank affairs. Constraints, even unfair ones, are no excuse for failure to join the battle with our competitors. We must study our competitors in order to establish an effective strategy for competing with them. We tend to focus on bank competitors and fail to grasp the intentions of other adversaries.

THE FINANCIAL SERVICES INDUSTRY

Roughly half of the banks in the United States failed after the stock market collapse of 1929. The failures were caused, in part, by intense competition among bankers which led to speculative investments in search of high returns. Legislation was enacted to safeguard the banking system by separating commercial and investment banking functions. Regulations resulting from this legislation prevented banks from operating across state lines, prohibited banks from selling insurance and securities, and established interest rate ceilings for deposit and loan products. In this highly regulated and competitively safe environment, the banking industry became increasingly conservative, risk-averse, and slow to adopt change. Bankers focused attention on profitable big businesses, reluctantly served the needs of smaller businesses, and virtually ignored the needs of consumers.

Other institutions served the needs of those neglected by banks. Savings Banks accepted the deposits of small depositors. Savings and Loans provided mortgage financing. Finance Companies and Credit Unions made personal loans. Bankers were committed to serving large accounts and were content with leaving undesirable business to others. Bankers made predictable profits by managing the spread between interest rates paid on deposits and the interest rates charged on loans. The net interest margin accounted for most of the profitability of commercial banks. To control costs and maintain a profitable margin, bankers began to automate back-office functions.

As the price/performance of computer technology improved, other functions were automated. Eventually, most bank services were provided by a computer. Increasing use of computers lowered the cost of providing financial services and increased the attractiveness of this business to other competitors. New techniques were developed for mobilizing cash, decreasing the need for reserve deposit balances and eliminating the need for banking intermediaries between major borrowers and lenders.

Bankers began losing their primary markets to new technologies and joined the battle with other financial institutions for small-business and consumer markets. Inter-industry conflict diverted attention from fundamental societal changes caused by the spread of computer technology into the general business arena. These changes were accelerated by the over-heated economies of the 60s and 70s. As interest rates and inflation grew, an increasingly sophisticated marketplace demanded higher rates on deposits, lower rates on loans and greater flexibility in borrowing and lending money.

In response to investor demands for higher interest rates, non-bank companies developed new liability products including mutual funds and money-market funds. Billions of dollars moved out of banks, savings and loans and other regulated businesses into the new instruments. Although deposit interest rates were deregulated between 1980 and 1987 and some inter-state banking is now permissible, product, service and geographic regulations still prevent banks from adjusting to market demands. Consumers have been voting with their feet and increasingly turn to non-bank companies for financial services and products.

Although bankers deserve much of the blame for current competitive disadvantages, it is clear that existing legislation is a severe problem. The Competitive Equality Banking Act of 1987 provided neither competitiveness nor equality. Lobbyists from securities, insurance and real estate associations gained new advantages through their efforts to include a moratorium in the act. The moratorium prohibited federal banking regulators from granting approval to banks who wished to offer new products and services. The restrictions stated in the moratorium applied only to banks. Other competitors were free to continue developing innovative and attractive financial products and services. Although the moratorium expired March 1, 1988, non-bank competitors lobbied hard for an extension. Banking lobbyists worked to assure that the moratorium ended as scheduled. Comprehensive legislation deregulating the financial services industry has been anticipated for nearly a decade, but has yet to be enacted.

Ten short years ago, the financial services industry did not exist. Discrete industries plied their trade within protected markets. The explosion of financial product and service providers has created a new and challenging competitive environment. Legislative actions have failed to keep pace with changes in the marketplace. When, and if, financial markets are fully deregulated, banks will face additional risks.

In its study of deregulation in five industries: securities brokerage, airlines, trucking, railroads and business terminal equipment, McKinsey & Company noted that, in the period beginning three years after deregulation of the securities brokerage industry, the top ten firms rapidly gained market share (increased from 45-53% between 1978 and 1980) at the expense of those in the second tier (firms in positions 11-15 decreased from 26-19 % in the same period). The increase resulted primarily from inter-industry mergers and acquisitions, e.g., Prudential's acquisition of Bache, Amex's acquisition of Shearson and Phibro's acquisition of Soloman. Following deregulation of the airline industry, variability in performance more than tripled, in terms of returns on sales or returns on assets, between the top three trunk carriers and the bottom three trunk carriers. The variability resulted primarily from the strong firms getting stronger and the weak firms getting weaker.

Sovran has made great strides in converting itself into a competitor in the new and chaotic financial services industry. Our biggest challenge, however, is to realize that we are not a big bank. We are a financial services company.

SOVRAN FINANCIAL CORPORATION

Sovran was created on December 31, 1983 through the merger of First & Merchants Corporation and Virginia National Bankshares. Each of the predecessor companies had grown through a strategy of acquiring other banks. Each of the predecessor companies had also established non-bank subsidiaries, where permissible, to conduct businesses denied to banks. The merger created a single-bank holding company with approximately $7 billion in assets. Since 1983, Sovran has grown to be a $20 billion, multi-bank holding company with 13 non-bank subsidiaries (Appendix 1). Sovran's announced goals include becoming the premier financial institution in the south-eastern United States and sustaining enough critical mass to remain an independent entity.

Sovran intends to accomplish its mission by building solid relationships with its customers, rather than selling services to them. In the early seventies, McKinsey & Company developed a segmentation strategy which many banks, including Sovran, have adapted for their own use. The strategy calls for stratification of customers into groups according to their value to the bank. Once the strata are developed, the bank applies different service criteria to them; for example, high-value customers are serviced in private financial centers, value oriented customers are serviced in the branches. In both cases, the cornerstone to the interaction between the bank and its customers is "relationship banking". Obviously, if many banks are competing with the same basic strategy then this will not provide the "sustainable competitive advantage" so eagerly sought. According to the strategic plan, we have competitive advantages which will allow us to successfully apply the relationship banking strategy:

- We have a sizable existing customer base.
- We are blessed with strong regional economies in our markets.
- We have substantially more branches than any of our competitors and a very large and growing number of automated teller machines providing convenience of delivery.
- We have a distinct advantage in name recognition.
- Our bank and financial services affiliates allow us to offer a broad product line.

Although not high-lighted in the plan, our management team is widely perceived as a strength. Cliff Cutchins, age 64, has engineered more than forty mergers and acquisitions since assuming management responsibility at Vaughan & Co. Bankers, a family-owned bank which became a part of Virginia National Bank in December, 1963. Cutchins became president of VNB in 1969 and was elected Chairman and Chief Executive Officer in 1980. With Coleman McGehee, he engineered the "merger of equals" which formed Sovran. In the four years since, Sovran has more than tripled in size while maintaining its history of strong earnings.

Cliff has announced his intention to retire in 1989. John Bernhardt, Vice-Chairman and President of Sovran Services, was expected to assume the Chairmanship. Unexpectedly, he resigned on February 19, 1988. Sovran's management succession plan has been altered and the new plan has been communicated (Appendix 2). The other members of our senior management team are:

C. Coleman McGehee, Chairman of the Executive Committee and Chairman of the Board of Sovran Bank, N. A. Coleman, age 63, joined First & Merchants in 1948 and became its Chairman and CEO in 1979. He presided over F&M's recovery from severe problems resulting from mid-1970s loans to Real Estate Investment Trusts. Coleman's decision to subsume his own interests to those of the company paved the way for the VNB/F&M merger. His position is now largely ceremonial.

Albert B. Gornto, President and Chairman-Elect of Sovran Financial Corporation. In addition to his new role as President, Bucky, age 58, maintains line responsibility for Information Management, Human Resources, Marketing and Operations. He has been with the company since 1957 and is highly regarded for his organizational skills.

Dennis C. Bottorff, Vice-Chairman and Chief Operating Officer of Sovran Financial Corporation, Chairman of the Board of Sovran/Central South. As former Chairman and CEO of Commerce Union, a $4 billion multi-bank holding company acquired by Sovran in 1987, Bottorff is the only member of the management team, save McGehee, with experience as CEO of a multi-bank holding company. Denny is credited with a dramatic turn-around at Commerce Union, which was suffering from problem loans booked during the 1970s.

Doyle E. Hull, Chief Financial Officer of Sovran Financial Corporation and President of Sovran Financial Services. Doyle, age 53, is responsible for Financial Products and Investments, Accounting, and financial services affiliates. He has been with the company since 1957, rising through the ranks of corporate banking and real estate.

Randolph W. McElroy, Vice-Chairman of Sovran Financial Corporation, President and CEO of Sovran Bank, N.A. Randy, age 53, joined F&M in 1960. He rose through the ranks in retail and commercial banking to assume the position of President of First & Merchants Corporation in 1976. Randy has strong business and social bonds to the city of Richmond and is assumed to be reluctant to move to Norfolk where Sovran Financial Corporation is headquartered.

L. Ralph Hicks, President and CEO of Sovran Bank/Maryland and Sovran Bank/Delaware. Ralph, age 50, joined Virginia National Bank in 1966 after a career as a Marine Corps officer. Pre-Sovran, he was, according to the grapevine, being groomed by VNB as a future CEO. Prior to assuming his current position, he managed Sovran's retail banking and credit card operations.

John B. Werner, Senior Executive Vice President. John, age 55, has been with the company since 1959 and is currently responsible for commercial lending, national accounts, Virginia accounts and international and real estate lending.

Ironically, certain of our strengths are our greatest weaknesses. Our sizable customer base requires massive operational support. Mergers and acquisitions have resulted in severe pressures on operating systems which were designed to serve far fewer customers in more compact markets. Non-interest expenses are high relative to many of our competitors and unresolved bureaucratic issues frequently cause bottlenecks in implementing important initiatives. Our branch network is expensive, both in terms of capital required to maintain and operate it and in terms of the people required to support it. Our financial services affiliates are operating outside the umbrella of operational support afforded our banks. We have not yet learned to integrate them.

For more than twenty years, Sovran's focus has been on asset growth through mergers and acquisitions. Cliff Cutchins has been the right man, in the right place, at the right time, to lead Sovran through this period. Our new leadership must establish its own vision in an incredibly dynamic environment. Although we have an able management team, they were trained as bankers in a regulated environment. They may lack the skills necessary to compete in a competitive marketplace.

Some of the larger marketing and management issues facing us include:

- Maintaining our independence.

- Differentiating the service we provide to our customers.

- Maintaining earnings and growth performances.

- Protecting and expanding our existing markets while entering new markets.

- Assimilating our financial services affiliates.

- Reducing operating costs substantially.

- Streamlining the organization to improve communications and clarify accountabilities.

- Lobbying in state and federal legislatures to attain and maintain regulatory equality.

DIRECT COMPETITION

Sovran's direct competition includes all banks operating in markets in which we have chosen to compete. Foreign banks operating in the United States are not subject to the same restrictions as domestic banks. They have lower capital requirements and broader product and service powers. Nationally, foreign banks now meet 23 percent of the need for domestic commercial loans. Twenty years ago, nine of the world's top ten banks were American. Today, twenty-three of the top twenty-five banks in the world are non-American.

In 1981, there were 750 unprofitable banks in the United States. In 1986, 2,750 were unprofitable. Industry return on assets has declined from approximately .8 percent in 1981 to an estimated .2 percent in 1987. In 1975, banks held 38 percent of the total financial assets held by financial institutions, in 1985 they held only 31 percent.

Banking's most profitable business, commercial loans to large domestic companies, has been lost to direct financing arrangements, notably commercial paper and corporate bonds. Domestic banks met 71 percent of the short-term credit needs of domestic corporations in 1975, only 25 percent in 1985. Commercial paper grew 140 percent between 1980 and 1985. During the same period, bank commercial loans grew only 51 percent. By May, 1986, the domestic commercial paper market exceeded the total combined commercial and industrial loans of all weekly reporting FRB member banks in the United States.

Bankers have replaced their commercial loan business with riskier and less profitable loans. Energy, agriculture and third world loans have been particularly troublesome and have contributed to declining performance at many banks. Although banks have taken some flesh wounds, they are still formidable competitors in the financial services industry. Sovran is currently outperforming large domestic banks (Reference Table 1) and is in the hunt with other southeast superregionals (Reference Table 2).

TABLE 1
COMPARISON OF SOVRAN TO DOMESTIC MULTI-NATIONAL COMPETITORS

	Five Year Average ROE	Five Year Average EPS Growth	5 Year Stock Price Change
SOVRAN	**17.8%**	**14.1%**	**39.6%**
Bankers Trust	17.3%	11.8%	65.7%
JP Morgan	17.1%	17.6%	110.4%
Citicorp	15.7%	10.1%	18.5%
Bank of Boston	15.6%	11.1%	96.7%
Chemical	15.2%	7.1%	1.4%
Manufacturers	13.0%	2.5%	-29.7%
Irving	12.9%	5.9%	140.7%
Chase	12.2%	5.9%	9.7%
First Chicago	9.5%	1.8%	24.1%
B of A	negative	n/a	-57.8%

Source: Forbes, January 11, 1988

TABLE 2
COMPARISON OF SOVRAN TO SOUTHEAST SUPER-REGIONAL COMPETITORS

	Five Year Average ROE	Five Year Average EPS Growth	5 Year Stock Price Change
First Union	22.7%	25.3%	105.3%
First Wachovia	19.1%	18.8%	n/a
Barnett	18.5%	17.6%	162.5%
SunTrust	18.3%	13.1%	n/a
SOVRAN	**17.8%**	**14.1%**	**39.6%**
C & S	17.2%	14.2%	118.8%
NCNB	17.1%	13.5%	105.3%

Source: Forbes, January 11, 1988

INDIRECT COMPETITION

Banking's role in the financial services marketplace has clearly been reduced. Indirect competition, including thrifts, credit unions, insurance companies and securities firms have grown by serving the customers banks ignored, or were barred from serving.

Thrift institutions began to consolidate after experiencing severe earnings problems resulting from fixed-rate lending and exceptionally high rates paid on deposits. After consolidation, the ten largest thrifts have exhibited very strong performance. However, the greatest threat from thrifts results from efforts to protect their depositors. The FSLIC (Federal Savings and Loan Insurance Corporation) is not sufficiently funded given the large number of ailing institutions. As a result, other competitors are rescuing troubled thrifts and using them as an entree to financial services markets.

Credit Unions are a significant and still growing competitive threat to banks. One in every three households is a credit union member. Customers cite low fees and quality service as features which attract them to the credit unions, but maintain services at other institutions because the credit unions are not convenient. Credit unions have lower overhead because they operate in company space. They also have the distinct advantage of offering payroll deduction for deposit and loan products.

Securities firms are attracting CD customers with Money Market Funds offering higher rates than bank certificates of deposit. Yields up to 20 percent are offered on Ginnie Mae funds backed by pools of mortgages. The federal government guarantees payment of principal and interest on the GNMA securities. Many customers apparently do not appreciate that the value or yield of the funds themselves are not guaranteed. Interest rate fluctuations negatively affect the funds; low rates cause a drop in fund assets and high rates depress the price of the funds. Money-market funds have increased $25 billion since 1978. The approximately 1300 domestic mutual funds have grown from $218.8 billion in October, 1985 to $402.5 billion in October, 1986.

Sovran's performance is compared to the top thrift institutions in Table 3, the top brokerage firms in Table 4, and the top diversified insurance firms in Table 5.

TABLE 3
COMPARISON OF SOVRAN TO THRIFT COMPETITORS

	Five Year ROE	Average EPS Growth	5 Year Stock Price Change
CenTrust Savings	200.0%	n/a	n/a
Columbia S&L	60.8%	29.2%	256.5%
Western S&L	45.1%	43.1%	283.2%
American Cont	37.7%	71.4%	312.7%
Homestead Fin	35.0%	75.5%	85.5%
Golden West Fin	32.3%	38.4%	142.4%
First Federal	24.4%	48.3%	18.8%
FCA	23.3%	n/a	-89.9%
City Fed Fin	21.2%	13.6%	-54.9%
SOVRAN	**17.8%**	**14.1%**	**39.6%**
Cal Fed	13.5%	106.8%	14.1%

Source: Forbes, January 11, 1988

TABLE 4
COMPARISON OF SOVRAN TO BROKERAGE COMPETITORS

	Five Year Average ROE	Five Year Average EPS Growth	5 Year Stock Price Change
First Boston	25.6%	13.6%	40.0%
Shearson Lehman	23.6%	22.3%	n/a
AG Edwards	21.8%	10.0%	-17.8%
Saloman	19.7%	8.6%	-26.7%
Paine Webber	19.3%	3.9%	-47.4%
SOVRAN	**17.8%**	**14.1%**	**39.6%**
Merrill Lynch	14.9%	.6%	-26.2%
EF Hutton	9.6%	n/a	-33.3%

TABLE 5
COMPARISON OF SOVRAN TO DIVERSIFIED INSURANCE COMPETITORS

	Five Year Average ROE	Five Year Average EPS Growth	5 Year Stock Price Change
Loews	22.6%	25.0%	284.8%
Reliance Group	21.9%	73.8%	n/a
Teledyne	21.4%	18.9%	112.6%
AON	18.8%	17.6%	74.7%
SOVRAN	**17.8%**	**14.1%**	**39.6%**
American Bankers	17.5%	9.8%	-19.1%
Cincinnati Fin	17.5%	14.9%	113.5%
Farmers Group	17.4%	12.3%	135.5%
Am Intl Group	16.7%	8.9%	104.1%
Old Republic Intl	16.4%	6.8%	45.2%
Harcourt Brace	16.0%	40.0%	n/a

Source: Forbes, January 11, 1988

GENERIC COMPETITION

Generic competitors include retailers, finance company subsidiaries of the automobile manufacturers and direct placement of debt by large borrowers through instruments like corporate bonds, commercial paper and interest rate swaps. The low rates offered by captive finance companies have diminished automobile loan portfolios at most banks. Bank market share of the auto loan business declined from 52.7 percent in December, 1980 to 40.6 percent in September, 1986. Finance companies share went from 30 percent to 40.8 percent in the same period.

Bankers who fail to see a strong competitor in the captive finance companies of the automobile manufacturers are whistling past the graveyard. Robert F. Murphy describes GMAC's diversification strategy, "We will go into areas where we think we can be very large. We would not go in and be a small player in any particular business. We hope to set the standard for the business itself." GMAC has already acquired two major mortgage firms and is the second largest mortgage lender in the United States. They plan to target new products to the eight million automobile loan customers they now service.

The threat posed by retailers is characterized by the entry of Sears into the financial services industry. Sears intends to provide one-stop shopping for financial services in much the same way that they serve the buying public at their department stores. By 1990, Sears intends to:

- issue 80 million credit cards nationwide.

- originate 7 to 10 % of all first mortgages.
- insure 20 million people through its Allstate subsidiary.
- initiate 1 in every 5 home sales through Coldwell Banker.
- operate 6,000 Sears financial centers nationwide.

Sears, owner of Dean-Witter with $57 billion in assets, is not the only new competitor. American Express has $68.5 billion in assets and intends to compete directly with banks on a nationwide scale. General Electric, parent company to Kidder-Peabody, is the only non-bank among the top ten business-to-business financing leaders in the United States. British Petroleum has opened an in-house bank. Volvo has an in-house bank with a billion dollar balance sheet. Kinder-Care has acquired the Centerbank Savings Association in St. Petersburg, Florida and is offering life insurance to children in its day-care centers.

The generic competitors have some common characteristics. They are service or information companies who offer a core service to an established, known base of existing customers. They are not geographically constrained and, in most cases, have a national constituency. They are looking for logical service line extensions to offer their customers. Financial services are an obvious choice. As competitors proliferate, the industry becomes ever more fragmented.

A SMALLER SLICE OF A LARGER PIE

Forty years ago the American market for magazines was served by a few large, high-quality, general-interest publications like Life and The Saturday Evening Post. The market for magazines in this country is now incredibly fragmented. Publishers target magazines to the specific interests of their readers. Although the total magazine marketplace is much larger, no one title dominates.

Like publishing, the financial services industry is in the process of splintering into hundreds of fragments. Each of those fragments represents a potential market for Sovran. If we hope to compete successfully in this new environment, we must make some conscious decisions about our competitive posture.

We are in a poor position to compete on price. We have built an organization designed to serve a large, homogeneous market. Our infrastructure is costly and those costs are reflected in our products and services. Even in a very narrowly defined niche, we are likely to be among the highest priced service providers. This is an obvious disadvantage against any competitor. We are particularly vulnerable to lower-cost providers who will target our most valuable customers. We must radically reduce management and staff positions. In addition to the obvious benefit of lower costs, I would expect productivity improvements from the reduced bureaucracy.

We are well positioned geographically. The SOVRAN CRESCENT (roughly following the Chesapeake Bay from Baltimore, Maryland to

Tidewater Virginia) contains a highly diversified and stable economic base in one of the fastest growing and affluent consumer markets in the country. The area supports a commercial banking deposit base of $63 billion, of which Sovran holds a 15% market share. Nearly 400 Sovran branches are augmented by thousands of automated teller machines available to our consumer customers 24 hours a day. Our distribution channels and market areas are a significant strength for us. Current legislation inhibits new entrants in our geographic markets. As soon as that barrier is removed, this advantage will begin to erode.

Although we offer a full line of banking services, they are not distinctive. Intensive services, like checking and savings accounts, are available to all customers with few, if any, restrictions. Selective services, like mortgage loans, Private Line loans or Visa Debit Cards, are offered only to those customers who qualify. Selective services are targeted to the middle to upper-middle income consumer. Exclusive services, like the Private Financial Center, are designed to meet the needs of the affluent customer. We are attempting to differentiate our services through "relationship banking". Other financial institutions, in abundant numbers, are doing the very same thing. Our product line offers no clearly discernable competitive advantage.

Given no long-term price, product, or distribution advantage, how should we compete ? Is image enough ? Sovran's image advertising has been effective. People know our name and they expect from us the warmth and care expressed in our advertising. For some people, those expectations are fulfilled. For others, Sovran delivers poor service in an uncaring way. Unless our customers experience excellent service consistently, the image is not the reality.

We must, in Tom Peter's words, "be obsessed with quality and customer service". I suggest that every officer, manager or supervisor spend one day each month in a customer contact position. Peak staffing demands would be addressed in a more cost-effective way and, at the same time, we will become more aware of our quality and service levels.

The desire to compete is innate. The ability to compete is learned. If we're going to compete, lets do it well. We must think small and focused rather than big and full-service. We must downsize our organization and our marketing in order to fulfill the needs of small niches. If we are skilled in responding to customer needs at reasonable prices, we can prevail in any competitive situation.

APPENDIX 1

SOVRAN FINANCIAL CORPORATION

BANK AND FINANCIAL SERVICES AFFILIATES

BANK SUBSIDIARIES

Sovran Financial Corporation/Central South

Sovran Bank, N.A.

Sovran Bank/DC National

Sovran Bank/Maryland

Sovran Bank/Delaware

FINANCIAL SERVICES AFFILIATES

Sovran Credit Corporation

Sovran Futures Corporation

Sovran Insurance, Inc.

Sovran Life Insurance Company

Sovran Mortgage Corporation

Sovran Capital Management Corporation

Sovran Equity Mortgage Corporation

Sovran Insurance Agency, Inc.

Sovran Investment Corporation

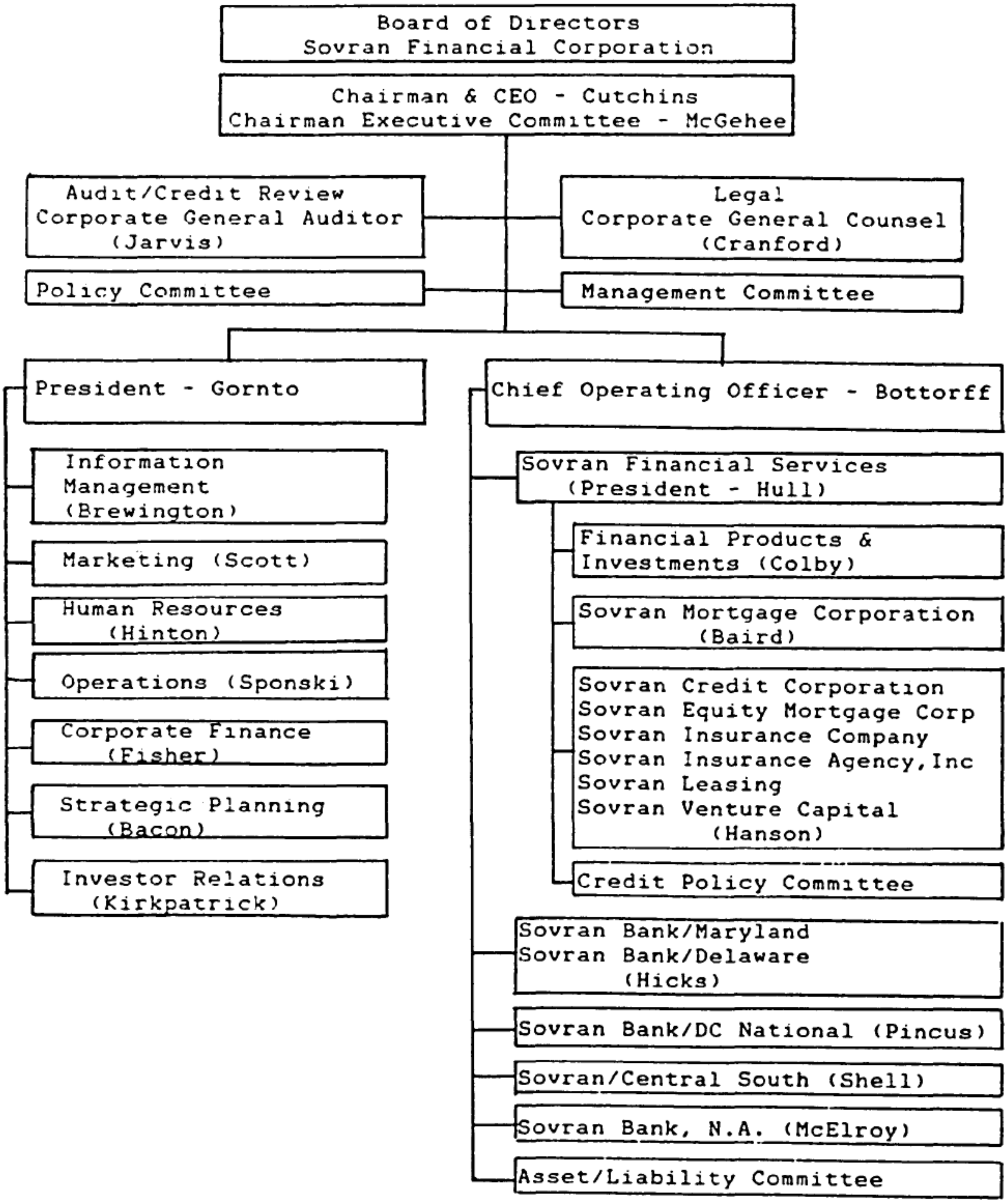
Sovran Leasing Corporation

Sovran Venture Capital

Cash Flow, Inc.

Financial Interstate Insurance Company

APPENDIX 2
ORGANIZATION CHART
SOVRAN FINANCIAL CORPORATION



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