

To grow fee revenues in a tight market, winning commercial banks will use a three-horizon “ONE” framework centered on optimization, new sales and expansion.

Commercial Fee Growth: Breaking the Revenue Drought

BY MICHAEL RICE, STEVE LEDFORD AND J.D. RICHARDS

Fee-based services are a major contributor to the commercial banking line of business, providing roughly a fourth to a half of revenues at larger banks. Yet banks have found it difficult to wring peak performance from their commercial fee-based services, with many opportunities lying hidden – and therefore dormant – among splintered operations.

Addressing the fee optimization challenge has moved to the front burner in a protracted era of slack loan demand. For the remainder of this year going into next, this is the number one revenue growth opportunity for many commercial banks.

The immediate opportunity centers on revising pricing practices with established customers and products. Often, for

example, negotiated pricing contracts and fee waiver concessions are left unattended following implementation. There are many possibilities to selectively revise arrangements, incorporating factors such as relationship tenure and profitability; product usage; customer segment and geography.

Then within the ongoing sales stream, there are many opportunities to analytically refine pricing on a segment basis, considering variations in price elasticity of customer demand. And the quickest payoff typically will come from a comprehensive audit to correct under-charges that result from data capture and billing mistakes.

These short-term avenues hold the potential for a 10% boost in overall commercial fee revenues within the first year. The medium-term growth horizon centers on winning share in current markets, and the long-term horizon centers on expansion into adjacent markets. But to unlock this growth, management will need to address two major challenges:

Over-delegation – By extensively delegating fee tactics to managers of various product lines, regions and customer groups, banks have limited their field of vision for opportunities that span across the organization. No one

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is looking across the product and operating silos to think comprehensively about customer needs and buying behaviors.

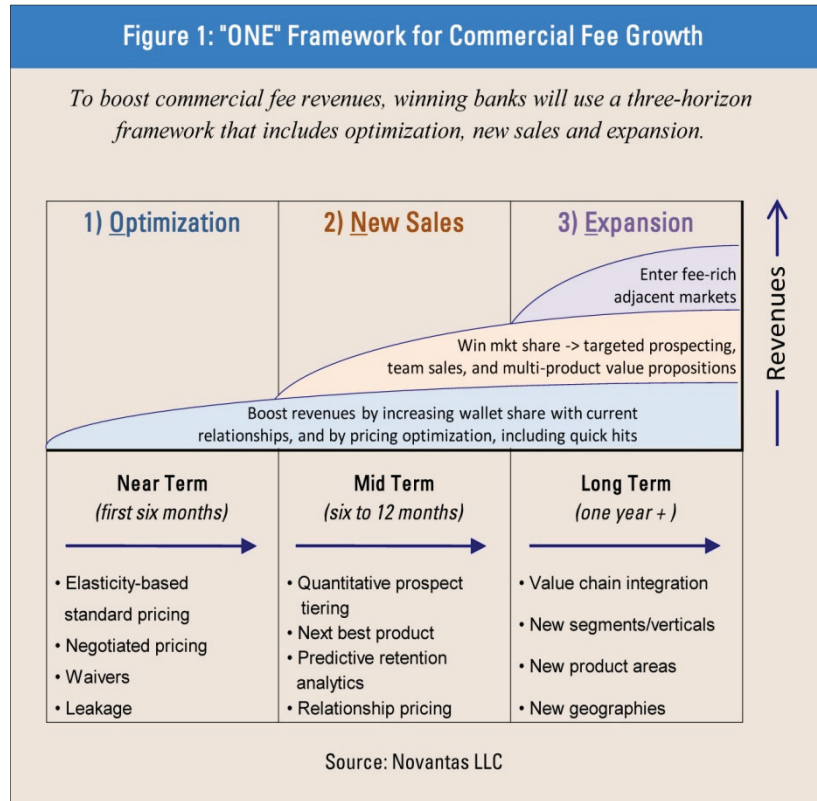
Under-investment – Along with a narrower focus, line managers have a shorter-term performance orientation. Possibilities beyond selling in the current quarter often are deferred or crowded out altogether, and this tendency has been further exaggerated in the current environment, where staffing and investment resources are tight. The irony is that while limited developmental resources have been further curtailed in a slack market, a failure to invest makes it all the harder to boost fee income.

To break out of this trap, commercial banks should look across the line of business to create a holistic view of fee-based activities and the various kinds of upside that can be captured with cohesive effort – short, medium and long-term. Once a developmental path is set, the focus turns to early successes that will lift current performance and also generate funding for advanced initiatives. Along with playing a more active role, executive management will need improved tools for performance management and measurement.

THREE HORIZONS

Although commercial banks have a pressing need for short-term fee revenue enhancement, there is a risk that isolated quick fixes will prove nothing more than that. Even the best ideas can get lost in the shuffle as business units pursue their varying agendas and bankers eventually turn more attention to lending in a recovering economy.

This would constitute a major lost opportunity, given the possibilities to achieve not only a solid immediate lift, but also sustained higher performance levels over the medium and long term. We believe it is feasible, for example, for progressive banks to target a 10% to 20% long-term improvement in commercial fee revenues over a one- to two-year time frame, with a significant portion realized in the near to medium term. The journey covers three horizons (Figure 1):



1) *Optimization* – Per above, initially the goal is to boost revenues from current relationships through pricing refinements.

2) *New sales* – Here the emphasis is on winning market share through targeted prospecting; team selling; and multi-product solutions.

3) *Expansion* – At this level the institution deploys resources to tap adjacent markets.

While commercial banks already are pursuing these three categories of opportunity, each in its own way, most are doing so in piecemeal fashion. Typically there is a loose assemblage of initiatives and project champions, with little systematic analysis of the overall opportunity set for the commercial bank. Inevitably some valuable avenues are overlooked and energy is dissipated on projects that had lower potential to begin with.

A better approach is to comprehensively assess the options for fee growth, then set a tight list of priorities for the organization as a whole. Considerations include the growth and regulatory dynamics of each current and potential market; sales headroom relative to emerging customer demand and the competition; incremental risk relative to capital outlays; and profit potential as measured by returns on economic capital.

Such assessments often yield up to a half-dozen solid possibilities. Even the most diligent teams miss some growth avenues, typically because they either did not fully consider ways to enter adjacent markets or did not quantify sales headroom.

HORIZON I EXAMPLE: NEGOTIATED PRICING

One factor that sets commercial banking apart from retail banking is that much of the pricing is negotiated. Customers are sophisticated and the services are complex, with a wide range of options and price points to negotiate. There is a high risk of sub-optimal outcomes, either leaving money on the table or pushing too hard and losing a deal.

The financial opportunity from closing such gaps is substantial. Yet many banks will have difficulty taking advantage. Few banks, for example, have established a structured negotiating process supported by the right management and technology framework. Relationship managers typically operate with an information disadvantage in negotiations, as system-wide deal information is rarely aggregated or readily accessible. Once booked, moreover, many deals are left unattended and not managed proactively. Finally, few banks have adopted advanced analytics to support negotiations (e.g., price elasticity of demand; logistic regression to help gauge the probability of winning a deal).

Effective negotiated pricing should address four essential questions, including: 1) How do we expect the customer to behave; 2) What have we learned from previous deals; 3) How will proposed pricing affect relationship profitability; and 4) What is the competitive context for fees and rates. Salient extracts from this assessment need to be disseminated in a way that is understandable and easy for relationship managers to use.

In support of these priorities, Novantas research has identified a number of best practices in negotiated pricing:

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Centralized support for negotiated pricing extends across products, markets and segments and should be implemented through a consistent process. By aggregating market intelligence, managing performance and leveraging analytical tools, the bank can systematically improve the negotiating position of relationship managers.

Demand-based pricing is based on the price elasticity of specific customer segments and buying behaviors, and is informed by competitive pricing in the relevant market.

A data driven process capitalizes on a variety of information, including account-level analysis; assessment of won and lost deals; competitive intelligence (gleaned largely through competitive bidding situations); and profitability projections.

A collaborative process balances centralized analytics and support with account officer autonomy. This arrangement provides leeway for officers to vary pricing within “guardrails,” supported by a centralized process for handling more substantial discount requests.

Finally, a *standardized and structured negotiating process* sets clear roles and responsibilities; provides automated analytics, an efficient workflow and continuous deal monitoring.

HORIZON II EXAMPLE: INTRA-MARKET EXPANSION

In a continuing flat market, there is high urgency to boost sales with established customers, and also within established markets. What distinguishes the best banks in this pursuit is their use of analytics to both identify and acquire fee-rich customers.

The goal is to concentrate marketing and sales resources in way that allows the institution to tap pockets of opportunity within the current portfolio of customers and markets. This requires an ability to concretely measure the attractiveness and accessibility (odds of success) of various opportunities at a client-prospect level. Few banks

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do this well today, creating an opportunity for first-movers to gain competitive advantage.

Perhaps the hottest example in today’s market is helping owner-operated businesses get back on track following the recession. Most of these businesses are Boomer-owned and have revenues of less than \$200 million annually.

For these owners, the recession (and its aftermath) has been a triple whammy – lower enterprise values, tougher credit conditions and delayed “liquidity events” (i.e. transactions that enable shareholders of privately-held companies to convert their illiquid ownership shares into cash, such as initial public offerings). The fee opportunity with these customers is tremendous. Examples include advisory services for recapitalizations and mergers and acquisitions, and investment and wealth management services.

Banks are beginning to target these customers, often through joint campaigns between commercial banking relationship managers and wealth management officers. This immediately introduces the question of analytics, given that half of sales leads typically founder on the twin shoals of prospect un-receptivity and low sales potential.

Leading banks use internal and external analytics to proactively consider two questions: 1) Which customer prospects are most attractive (e.g., fee wallet size; growth potential; risk profile) and 2) Which prospects are most accessible (e.g., type and level of competition; switching propensity). They leverage technology and sales force automation to make this information available for all relationship managers and product partners.

HORIZON III EXAMPLE: MOVING BEYOND BANKING

For decades banks have routinely provided back-office processing as an integral part of their cash management services for corporate clients. Lockbox

processing of receivables and account reconciliation are standard treasury management products, and are natural extensions of core depository and payment functions.

More recently, banks have begun pushing further along the value chain as a way to expand fee income through business services. The Bank of New York Mellon Corp., for example, offers a full accounts payable outsourcing service, SourceNet Solutions, incorporating capabilities such as online management of discounts and refunds; vendor cost analysis; and more traditional payment processing services as well.

Elsewhere, JPMorgan Chase & Co. provides enterprise document management for commercial clients through its DocManager Solutions service. Capabilities include archive, distribution and workflow routing of electronic and scanned image documents. Citibank has been processing U.S. Passport applications since 2005 under a contract with the U.S. Treasury Department.

Moving beyond processing services, there are opportunities to expand in innovative ways that leverage core banking expertise. For example, Silicon Valley Bank benchmarks the performance of clients against peers in areas such as cost management and cash flow, drawing on experience in serving industry segments such as high-tech, wineries and start-ups.

Banks could also provide full-scale credit management for clients, including credit analysis, terms negotiation and collections. Market trends are also creating new opportunities. Bank of New York Mellon, for example, has been clearing and settling carbon credits for companies that want to offset the impact of greenhouse gas emissions.

To be sure, non-traditional services are not a way to generate a quick-hit revenue boost. In the longer term, however, expanding the breadth of services will be the only way to build sustainable growth in fee income.

FIELD OF VISION

Commercial banking heavily relies on the initiative and judgment of various business line and relationship managers. There is a very good reason for this, given the need for flexible interaction with demanding clients having complex needs. In development and performance optimization, however, the collective best efforts of even the most talented individuals tend to fall short, also for very good reason, given their limited field of vision.

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The implication is that executive management will need to systematically identify and nurture key opportunities for fee revenue growth in commercial banking. The good news is that advances in information technology and analytics have opened a universe of information and insight that can be

distilled from across the organization and the markets it serves. This brings a new level of precision to decision-making.

By harnessing a systematic developmental approach now, in the pursuit of fee revenue enhancements that could begin to take effect yet this year, progressive banks are setting the stage for even more advances in the medium to long term. In this sense, leaders are repositioning for future growth even as they scour for every last penny of fee revenue enhancement in today’s tight market.

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