

The Relationship Approach To Retail Loan Growth

BY RICK SPITLER AND GAURAV GUPTA

Increasingly, it has become clear that the current economic recovery promises to be a drawn out affair. For the next few years, it is likely that most consumer loan categories will grow only modestly from current recession-battered levels.



The tepid recovery presents a critical challenge for retail banks, in that there may not be enough loan demand — particularly among customers with acceptable credit risk profiles — to support the overall industry distribution and sales capacity built up over the last decade. Winning banks will be the ones able to gain market share at the expense of competitors, primarily by doing more business with each customer.

The situation has introduced a turning point in consumer lending strategy. Instead of pushing individual products, as seen during peak market conditions, the competitive priority will be cultivating fuller customer relationships. This includes expanding and retaining established household and small business relationships; and anchoring and engaging new customers more thoroughly and effectively.

To succeed in the quest to build multi-faceted credit relationships, retail banks will need a far better understanding of household financial profiles and emerging needs. The splintered customer information residing in product silos will need to be pulled together in a way that supports specific initiatives, a challenge unto itself.

Improvement in targeted cross-sell will provide one of the most immediate payoffs on this effort. A precision outreach will be possible, based on a much clearer understanding of

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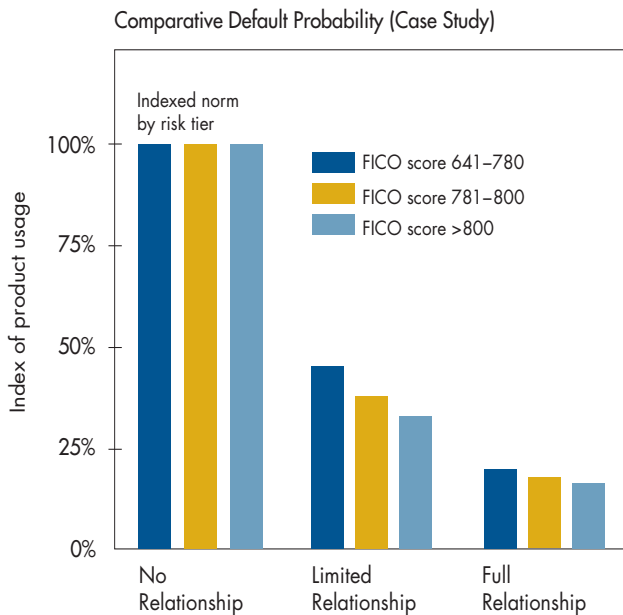
the receptivity for various products and combinations (which, along with revenue potential, can vary dramatically among different customer groups).

There also are near-term opportunities to leverage customer relationship insights in underwriting, risk exposure management, and collections. The larger knowledge of household financial profiles will enable banks to make better informed loan origination decisions, for example, and extend credit in situations where it otherwise would not. A unified approach is also more effective in working with households experiencing repayment difficulties with multiple accounts.

Longer term, progressive banks can make more fundamental revisions in areas such as product bundling, pricing and service that will bring new substance to relationship-based growth strategies. This will establish a more enduring relationship orientation that will serve the bank and its customers well beyond the current slow recovery.

Credit Risk Relationship Factor (Fig. 1)

Customers who have deeper, multi-account relationships with their banks exhibit lower credit risk.



Source: Novantas, LLC

THE CASE FOR RELATIONSHIP EXPANSION

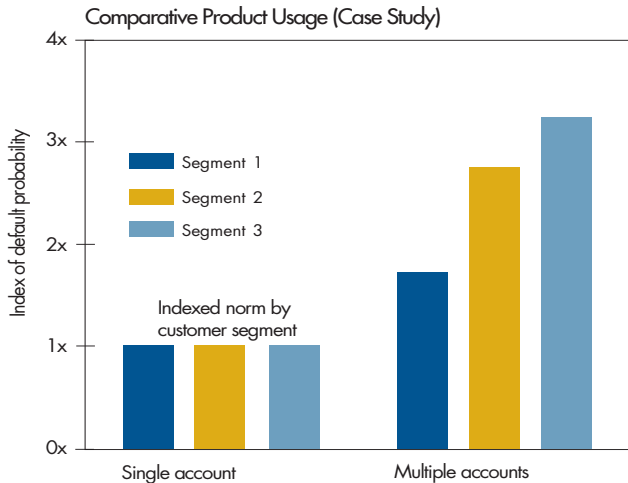
Looking ahead, we believe that U.S. households will generally continue to de-leverage, perhaps through 2012. This includes working down revolving and installment debt, rebuilding cash cushions, and for many, working through defaults. Employment remains a challenge; the housing market remains a challenge. In such circumstances, intense market share battles are a certainty for retail lenders.

But conventional product-centered strategies will be far less effective. In peak market conditions, there has been a pronounced tendency for banks to operate as cafeterias, with customers often taking the initiative in selecting individual products, typically from multiple providers. A single bank typically will capture no more than 10% to 15% of the average customer’s total wallet, meaning at least 85% to 90% of the relationship potential is usually lost to other providers.

Such fragmentation is far less of an issue in a rapidly expanding market, where there is plenty of business to go around. In the current soft market, however, splintered customer relationships can have a very real financial conse-

Product Usage Relationship Factor (Fig. 2)

Customers who have deeper, multi-account relationships with their banks exhibit higher product usage.



Source: Novantas, LLC

quence, both for winners and losers in the battle for wallet share. Every sales opportunity matters at a time when mortgage and home equity loan originations, for example, are running more than a third slower than the pace seen in the peak year of 2005.

The bottom line is that loan growth will be much more dependent on selling to established customers. There will be a major push to build multi-faceted credit relationships with households that are already doing business with the bank.

In building the specific business case for relationship expansion, it is important to look beyond the obvious fact that providing two profitable products to the customer is better than just one. There are powerful additional benefits (often ignored), including:

- **Lowered credit risk** (Figure 1), given that institutions with deeper ties to consumers are likely to be placed higher in the repayment hierarchy;
- **Longer life and higher usage** (Figure 2), given the extra stickiness that is observed when customers commit more of their finances and transaction stream to an institution; and
- **Higher pricing power**, essentially reflecting an attitudinal shift that occurs as in-depth customers place more emphasis on intangibles such as rewards, recognition and service.

To capture these advantages, however, banks will need to proceed in a systematic manner. Cross-sell activities must be

identified and prioritized within the context of customer needs and receptivity, along with variations in economic potential (including the three additional benefits of deeper relationships discussed above). Critical streams of information need to be pulled together and distilled, with an eye toward specific revenue-producing initiatives that will more than justify the effort that went into them.

INFORMATION ADVANTAGE

Not only do in-depth customers behave in ways that are more profitable to the institution, but they also provide access to a richer and more comprehensive picture of their finances. It is helpful to be able to spot important patterns in borrowing and saving, for example, as well as monthly transaction patterns and repayment behavior.

Such information helps the bank to proactively identify customer needs and meet them more fully. Banks can also detect impending household financial distress earlier. This improves chances of extending a helping hand in time, mitigating or even preventing further deterioration in a situation.

One aspect of this quest is unifying the slivers of customer and household information that often remain scattered among the various product silos within the bank. In an age of information overload, many major banks still are in a state of information scarcity when it comes to a composite view of retail customers and households.

Another aspect is making fuller use of information already on hand. The principal household checking account, for example, offers valuable insights into customer behaviors and needs, plus it provides more customer touch points. One clear priority is to capture the primary payments account and nurture the relationship-building opportunities that go with it, not only initially, but over the life of the relationship.

Some regional banks also may want to put more emphasis on the credit card. In conjunction with the checking account, it provides a fuller payment view, and by itself provides a window into customer behaviors and needs. Along with providing strong guidance in customer segmentation for use across all products, the credit card account can also provide a valuable vantage point in understanding and tracking the credit risk of individuals and households.

As a richer information stream comes into view, the focus then turns to analysis and the extraction of salient insights for specific initiatives. Some banks are beginning to analyze this information in sophisticated ways. Leaders, for example, are working to identify the key customer profiles, circumstances and product progressions that are the most hospitable to the cross-sale of high-value offerings such as home equity loans.

This is a distinctly different approach than what was seen

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15 to 20 years ago, when cross-sale first gained widespread industry attention. Early attempts were more of product-push exercise, with lots of time wasted on low-value or implausible offers, and less consideration given to underlying customer needs.

Under the new approach, the bank marries product profitability metrics with probabilistic estimates of customer receptivity, typically down to the segment level, and sometimes to a customer level. Then the cross-sell menu is narrowed to a short list of offers that will generate the greatest value for the bank and customers alike.

The early fruition of this effort lies in targeted initiatives that, through intelligent marketing, allow the bank to get a lot more mileage out of the current product set — without a lot of reinvention. For example, one major regional bank was able to lift its home equity cross-sell effectiveness by more than 15% by establishing a multi-faceted relationship filter that allowed it to focus on a prime subset of the most eligible and potentially receptive customers within the retail bank.

FOLLOWING THROUGH

Typically, relationship strategies don't go very far within the organization without executive management involvement. Individual product teams will need to collaborate among themselves and with the branch team if the bank is to succeed with centrally-designed cross-sell offers that branch representatives can sell within a relationship context. Also, individual product silos typically have their own performance incentive programs that discourage feature or pricing tradeoffs that, while successful with customers, might diminish the profitability of an individual product line.

There also will be a learning curve in re-fitting information systems and working through the complexity of the underlying analytics. One management implication is a probable need for greater centralization of key lending functions, linked to a much stronger analytical capability. This is in line with management progressions seen in the deposit business, where regional teams are placing greater emphasis on marketing and sales, and central teams are handling pricing strategies and tactics.

Then there is the question of how to become more proactive and responsive in the field. In many cases, for example, banks have opportunities to improve their anticipatory sales strategies, based on an understanding of customer stage of

life, major life events, and as we have mentioned, an analytical understanding of likely cross-sell progressions from one product family to another.

One clear implication is the need for greater consultative sales expertise within the branch, especially as it pertains to mortgage and home equity lending. Coming out of a wrenching U.S. housing market crisis, customers want to be assured that they are handling new borrowing in a way that won't come back to haunt them.

While relationship expansion does represent a more complicated growth strategy, the effort will be more than justified during the prolonged slack environment that apparently stretches ahead. This is the most constructive option at a time when fewer new customers are coming through the door.

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