NOVANTAS STRATEGY & MANAGEMENT

Monthly finances are out of control at many households. In turn, cash management must be the frame of reference in repositioning checking and household financial services.

Checking Evolution: Welcome to the Cash Management Account

BY SHERIEF MELEIS AND HANK ISRAEL

At a time of upheaval in the U.S. checking business, it is important for banking leaders to step back and clarify the problem they are trying to solve. Is it mostly about closing a serious fee revenue gap provoked by new regulation? Or is it about reformulating the overall consumer value proposition?

Quite understandably, crisis-mode course corrections are foremost on the minds of many industry strategists. Confronted with potentially dramatic reductions in checking fee revenues, banks are intensely studying new laws and regulations and searching for quick ways to correct broken product economics and re-engage with customers.

Often overlooked in the stampede to address the chaos in the checking business, however, is the fact that the industry challenge primarily stems from a fatigued business model and significant unmet customer needs – not from the changing rules of the road.

As early as 2005, some banks began experiencing double-digit annual defection rates in the overdraft customer base, suggesting that the revenue model built on exception fees was not sustainable. Remedial action would have been needed even without Reg E.

For a huge swath of customers, the most pressing issue is that monthly household finances are teetering out of control – as much a victim of the increasing speed and complexity of electronic payments as a beneficiary of new information and service channels. Amid all the hoopla about cards, online transactions and instant credit, many households have failed miserably in transitioning from the conservative cash-based practices of former times.

Basic household goals – paying bills on time; controlling expenses; and building balances to meet future goals and contingencies – have come under assault in an era of speed and complexity. It is a confusing time for the typical household, which has double the monthly transaction volume from a few decades ago; uses multiple accounts; and juggles a variety of payments vehicles, including checks, debit cards, credit cards, automated teller machines and automated clearinghouse transactions.

In this light, cash management has to be the frame of reference in repositioning checking and overall household financial services. The path to renewal lies with developing cash management solutions that link information, transaction execution, short-term savings and credit in a seamless and intuitive way. The job won't get done by adjusting individual products.

NOVANTAS VIEWPOINT SERIES

From a five-year strategic perspective, retail banks are facing major questions about the kinds of product and service combinations that will unlock a new era of healthy sustained revenue growth. This larger challenge won't be met through a tactical near-term emphasis on coping with new regulations and fee revenue disruptions.

Instead, now is a time when banks should be thoroughly investigating the various major household constituencies, not only to understand how they can better meet their savings, credit and payments requirements, but also to understand segment economics and growth potential, and the implications for how offerings should be packaged, priced and delivered. This exercise is especially important given that the primary checking account is the single most important relationship between the customer and the bank.

THE COMPLEXITY TRAP

One of the great ironies in U.S. financial services is that an expanding supermarket of offerings has largely failed to provide cleanly individualized services for households as they manage their monthly finances. It's a patchwork world where customers struggle through by making partial use of a variety of mass-market products.

The frequent result is financial confusion, which only exacerbates the hand-to-mouth circumstances of many American households. As highlighted by recent Novantas research, consumers are overflowing with stories about fractured household finances. Some issues are large and some are small, but taken together, they paint a near-riotous picture of monthly financial life:

❖ As multiple household members write checks and make debit purchases against the same account, it becomes difficult to coordinate and control spending, increasing the risk of account overdrafts. Managing the monthly finances of teens and college-age children is especially problematic.

❖ Automatic bill pay, designed to assure on-time monthly payments to specified parties such as utility companies and big-ticket lenders, is vulnerable to timing differences depending on when household paychecks are deposited, with the result that well-intended automatic bill pay arrangements lapse into "automatic overdraft."

❖ Cash at least can be tucked under the mattress and hidden from the monthly household spending dashboard, whereas it is difficult to sequester balances within the checking account. Especially in recent times, the consumer impulse has tended toward the view that that all money in sight is spendable, and the modern checking account does nothing to curb this tendency.

❖ In a similar vein, all households have financial goals large and small, yet many checking customers do not have any sort of goal-oriented dialogue or relationship with their banks. People generally respect the financial solidity that a bank represents and could use help in planning and saving, yet mostly get only product pitches from their banks. For many customers, the bank is not yet a partner in achieving household financial goals.

❖ Lots of people like rewards, but the typical household eligibility is fractured among multiple products and providers. Debit rewards typically come in last place, moreover, despite tremendous growth in transaction and balance volume.

❖ Many consumers feel like they have to sort through 95 account features to get to the five options that they really want to use. There is a hunger for a level of customization that allows customers to participate in the design of the product, in terms of selecting the features and options that they individually deem relevant (and increasingly, that also support the new sobriety around spending).

❖ So great is the concern about juggling monthly payments and avoiding overdrafts that many U.S. households now are trapped in a compulsive daily routine of electronically verifying their account balances. It should not be the case that people feel the need for 30 to 50 balance updates per month.

❖ While the multiplicity of banking touch points has expanded customer convenience, it also has contributed to household financial confusion as people try – and often fail – to monitor transactions conducted through the Internet, the cell phone, the cable connection, the debit card, the ATM, the call center, etc.

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There are many more examples that could be mentioned, but the point is crystal clear – households have a great need for assistance in managing their monthly finances, despite all of the ostensible advances permitted by electronic financial services. Long term, innovation in household cash management is the mother lode of opportunity for banks, not incremental improvements to various disconnected products.

ONE SIZE DOES NOT FIT ALL

As they awaken to this reality, leading banks are responding with a level of systematic research and innovation previously unseen in the industry. Advancing technology already has blurred product boundaries (for example, between debit and credit), providing a much better basis for blended offers, and progressive institutions are going a step further with needs-based innovations that offer custom blends of features for major customer groups.

A recent national survey of checking customers by Novantas and Informa Research Services makes a compelling case for segment-tailored approaches:

❖ *Rational Economists* tend to maintain higher monthly balances in their accounts and like to receive rewards and recognition for their patronage. They are heavy users of credit cards for monthly transactions yet are careful spenders. They have little appetite for debit or expanded account information and control.

❖ *Full Service Control Seekers* also tend to maintain higher balances, but by contrast, they make far less use of credit cards and do not care about rewards. They like debit; like to actively manage their accounts; and are willing to pay a fair price for fee-based account services.

❖ *Traditionalists* present yet another profile, maintaining lower balances but placing a high value on traditional banking access. They actively use debit; do not care about rewards; have little appetite for expanded account information and want to avoid fees.

❖ Elsewhere, *Runaway Spenders* maintain exceptionally low balances, knowingly overdraft on a frequent basis, are indifferent toward rewards, fees and debit.

While there are even more variations, these four examples are enough to vividly demonstrate how demand varies among major customer groups. Understanding these variations is the key to making the kinds of account innovations and revisions that will be needed to rebalance the post Reg E checking business and set the stage for future growth.

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RECIPE FOR INNOVATION

As they formulate distinctive responses for major customer groups, innovative competitors are fleshing out five different aspects of value, including: 1) information; 2) control/security; 3) liquidity and payment; 4) rewards; and 5) convenience and access.

Information. Innovations in this area include services that variously provide overdraft warnings at the point of sale and analyze household spending. At Mint.com, for example, customers can build a summary of balances and transactions across all accounts, and use the information to analyze spending, income, balances and net worth.

Control/Security. Control-related innovations include stored value accounts and services that help to manage spending. The "Virtual Wallet" offered by PNC Financial Services Group, for example, allows households to manage checking resources via an electronic wallet that can segregate balances for monthly spending and emergencies, and funds earmarked for long-term growth.

On the security side, there is a growing consumer demand for fraud protection services, and for services that combine planning and information protection. Online estate planning services, for example, can help to guide customers through critical decisions and documentation requirements, and then provide encrypted storage for materials.

Liquidity & Payment. Here, innovations include deferred debit, which provides some of the float characteristics of the credit card, and purchase installment plans at the point of sale. At BillMeLater.com, for example, customers can obtain installment plan financing for merchandise purchased online.

Rewards. This is a new battleground in debit competition, with innovations seen among merchant coalitions, individual merchants, and financial services providers.

Looking internationally, the "Axess" service offered by Akbank T.A.S, based in Turkey, provides real-time rewards at the point of sale, based on behavioral criteria set by banks and merchants. The arrangement builds brand awareness for both bank and merchant while rewarding the customer based on the pattern of purchase behavior.

Convenience & Access. Innovations in this area include mobile confirmations of transactions and remote deposit service. At USAA "Deposit@Home," for example, customers can deposit checks straight from their residences using a computer and scanner, and funds are immediately credited to accounts.

Ultimately, major institutions will need to deploy a suite of innovative offers to various key groups of checking customers. Novantas research, for example, suggests that segment receptivity ranged from 2% to 49% on rewards; 1% to 15% on overdraft text alerts; and from 2% to 20% on stored value payments.

SETTING PRIORITIES

Winning banks understand that product innovation in this space is a disciplined process. It starts with uncovering customers' unmet needs for cash management services and is followed by ideation on potential solutions; structured research-based testing of features and price points; and financial modeling of the expected impact.

In the wake of the Great Recession, millions of U.S. households are in financial disarray and a harsh light is being turned on bank service practices, particularly overdraft coverage on checking accounts. Amid a Washington-mandated rush to correct service and fee arrangements, there is widespread banking concern about how to rebuild the economics of the checking business.

It is within this context that a great turning point has been reached in retail banking. There's a potential for long-lasting competitive cleavage between institutions that mostly react to the crisis, versus those that look to the larger picture of customer needs and behaviors, particularly variations among major customer groups.

In the realm of financial services, the most pressing concern for the typical U.S. household is managing monthly finances. There is a deep and widespread need for checking-centered innovations that will help consumers to meet what in many cases is a daunting monthly household cash management challenge.

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Winning banks will keep sight of this overarching priority and anticipate their customers' household financial needs – not just react to regulatory changes.

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