NOVANTAS STRATEGY & MANAGEMENT

To win in a tight market for small business banking, institutions will need to serve the total customer relationship, including commercial and household financial needs.

Small Business Banking: Setting the Agenda for Relationship Growth

BY LES DINKIN

Even in the best of times, small business banking has not always been pursued with a cohesive focus at many institutions. In a recent survey of major U.S. banks, for example, fully half said they were not yet able to internally measure progress in serving the consumer financial needs of the small business owner's household.

Such instances were less of an issue during the boom years. Banks saw less need for a highly orchestrated small business strategy in an era when double-digit growth was the norm for loans, deposits and fee revenues.

But the picture certainly is different now. While the small business customer segment has held up better than many other banking books of business, the recession has taken its toll. There is a significantly smaller pool of credit-worthy enterprises with an appetite for borrowing. And the Fed's new Reg Q, deregulating the payment of interest on business deposits, could eventually impact margins in that business as well.

The upshot is that for the next few years, banks will be facing intense competition for a tightened pool of small business customers, especially high-value relationships that generate the lion's share of sector revenues. In-depth strategies that formerly may have been viewed as "nice to have" now will be essential in the relentless quest to gain profitable market share.

Small business bankers will need to look at the whole customer relationship, both business and household, and systematically identify profitable cross-sell opportunities in line with priority customer needs. Targeted marketing to the right clients and prospects will be essential, with less emphasis on mass-market product promotion. Then there is an entire chain of decisions in refining the array of sales resources, placing sales personnel in the right local markets, and providing sales expertise appropriate to the

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opportunity. Four concepts will be central in these growth initiatives:

❖ One is "sweet spot" capacity configuration, which concentrates sales resources in the local markets with the highest potential demand from both customers and prospects.

❖ Another is customer lifetime value, which analytically considers the full range of client opportunities, not just the current-year profitability of individual products.

❖ The third priority is refining the specialist equation, providing the right level and type of sales expertise in the branch and in the field.

❖ The fourth is branch sales optimization, a continuing challenge for many banks.

Recent Novantas research indicates that the small business banking relationship can potentially generate from five to 10 times the value of the average retail banking relationship. In many cases, banks have come nowhere close to realizing this potential, instead standing by as up to 80% of the client's business is divvied up among competitors. Winning banks will be the ones that make real progress in deepening the relationship with high-potential customers over the next few years.

CUSTOMER VIEWPOINT

In considering whether to expand the banking relationship, small businesses customers tend to rely on a simple but powerful set of experiential criteria. First, they usually act on the basis of a positive experience with the current banking arrangement, however simple it may be. Second, they often are persuaded on the basis of added convenience and the prospect of freeing up more time to focus on running the business. Third, they may want to gain more leverage in the banking relationship, such as improved pricing, higher levels of service, or various types of rewards and recognition.

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These requirements often present issues for banks, even before getting to the basic questions about products and services. Many small business customers feel they are not being served with the proper level of expertise. Convenience can be undermined as customers rotate between branch managers, branch counter representatives and field specialists, searching for responsive service. And rare is the bank that consciously puts together relationship value propositions that encourage multi-product purchases.

There is also a need for more proactive customer management. Representatives tend to focus on individual products, and only on an episodic basis, with little or no systematic intelligence from the parent bank as to which offers might elicit the highest likely customer receptivity while generating the highest value for the bank.

In such circumstances, it is easy to see why a lot of opportunity slips through the cracks. In a complex branch network that is largely preoccupied with serving retail consumers, only a small amount of staff effort is devoted to tailoring the small business customer experience. Bankers do the best they can and may even begin to assume that nothing better is even possible. Meanwhile, most platform sales representatives just do not feel competent or confident in conversations with small business customers.

Before embarking on new sales growth strategies, it is import to acknowledge a major organizational challenge that directly contributes to many of these performance shortcomings. That challenge is coordination between business units. At most banks, what we have today is a loose assemblage of customer-facing activities. Various branch bankers and specialists operate on different incentives; report to different managers and business units; and even use different market and customer information.

Such management fragmentation can work against performance improvement initiatives. That is why the organization that is serious about improving small business banking first needs to unify the leadership of the function.

In our experience, the small business unit performs more strongly when solidly parked within the retail line of business, with leadership that closely interacts with the retail team to coordinate initiatives through the branch system. Alternatively, it should operate as a standalone line of business, supported by strong partnerships with the retail and branch network groups and a mutually rewarding goal and incentive system.

THE PRINCIPLE OF PRIORITIZATION

In considering specific performance initiatives, it is important to avoid the trap of "across-the-board improvement." The opportunities in small business are decidedly unequal – by local market; by customer segment and receptivity; and in terms of value creation. In such circumstances, it is critical to deploy scarce developmental resources where they will do the most good. This is the context for the following four recommendations:

1) "Sweet spot" capacity configuration. Many banks still try for an even allocation of small business banking sales personnel and resources across the branch network. But this practice is routinely undermined by the realities of skewed local market opportunity. Our research in retail banking, for example, shows that up to two-thirds of the revenue potential can be concentrated in just one-third of the network geographic footprint.

Through systematic analysis, progressive banks are able to identify priority markets where they want to concentrate the small business effort. Typically they look for a "density factor" – high local concentrations of targeted, high-potential customers matched with a robust local branch network presence. Detailed examinations of market opportunity and sales headroom can be conducted all the way down to the level of "micro-markets" that encompass multiple neighborhoods.

Once priority local markets are identified, the bank has a roadmap for deploying marketing resources and field specialists – and for establishing local sales goals. Markets with above-average potential should have above-average targets.

2) Customer lifetime value. Most major banks still operate as a collection of product units, with each division tightly focused on its own current-year profit. This narrow orientation is especially detrimental in small business banking, where customers offer the double potential of business patronage and retail household patronage.

A better approach is to consider the full range of customer opportunities over the life of the relationship, and then establish cross-sell priorities in line with customer needs and potential value for the provider. This is the goal of customer lifetime value analysis.

Many banks are handicapped in CLV analysis because they have not yet combined business and household information for small business customers. This composite picture, assembled from information scattered across the bank, is critical in identifying high-value target customers and specific cross-sell opportunities.

3) Specialist equation. Many banks are forfeiting sales opportunities by relying primarily on branch managers – generalists, by definition – to handle small business sales. This is at odds with a growing customer desire for a more specialized level of banking expertise, and also at odds with the reality of platform staff capabilities.

In other cases, banks do assemble a respectable team of small business branch and field specialists, but then there is a struggle to gain full traction. Bankers are spread thinly when they should be concentrated in priority markets. They often operate without good customer information and lead generation lists. Efforts are often only loosely coordinated with the branch managers, who remain prominent in customer acquisition and service.

Often, local market representatives are left to their own devices in deciding "which customer or prospect to call on next." In some micro-markets, for example, the sales team should be largely focused on customer acquisition; in other markets the priority should be expanding share of wallet with established customers.

It is difficult to sort through these questions without accurate guidance on market potential and customer needs. This is why it is so important to analyze the network; the customer base; and local market opportunity. Once priorities come clear, then there is a much stronger basis for identifying the type and level of sales resources needed, where they should be deployed and how tightly they should be managed.

4) Branch sales optimization. Recent research indicates that small business customers and their households account for 40% to 50% of the annual revenue at many branches. Yet survey respondents said branch representatives rarely spend more than 10% to 15% of their time serving small business clients – consumer transactions get all of the attention. Additional challenges include high

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annual branch staff turnover, sales incentives that are skewed to widgets (without specific small business sales goals) and inadequate information on composite business/household needs.

Vague "process improvement" campaigns are not the answer. To sort through these important questions, the bank needs to clarify what it is trying to accomplish.

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We believe that the overarching priority should be serving the full range of small business owner needs, both for the enterprise and for the household. Through CLV analysis, it is possible to systematically identify the small business sales and service priorities across the franchise. This insight becomes the basis for effective revisions to all aspects of the small business sales model, ranging from overall design to everyday processes.

THE ROAD AHEAD

For perhaps several more years, banks will be facing a continuing revenue drought in small business banking, driven by a quadruple whammy of slack demand; a flat rate environment; a legislatively-induced fee revenue crunch; and Reg Q-driven margin compression. Most banks can no longer pump out an assortment of their very best products and rest assured that customers and profits will continue to come rolling in.

Instead, growth increasingly will hinge on gaining profitable market share at the expense of other institutions. Players will win by deepening the relationship with each individual customer, both established and new to the bank.

Small business banking offers the virtually the highest potential payoff from this effort compared with many other areas of the institution. But a systematic effort will be needed, centered on total customer needs as opposed to individual products.

As outlined in this article, some important groundwork will be required to set the stage for profitable small business relationship expansion. In our view it is unavoidable. Yet we see significant, tangible financial rewards for a priority-based transformation of small business banking, both in the near- and long term.

Alert banks will leverage their hard-won branch presence by using customer and market insights to claim profitable relationship wallet share currently lost to competitors. Banks at the losing end of that equation, however, will be even more disadvantaged in the continuing revenue drought.

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