

Winning retail banks will gain market share by consolidating household borrowings that often are splintered among multiple providers.

Sparking Consumer Lending

BY GAURAV GUPTA

Slack consumer loan growth is a major problem for retail banks. Along with tighter underwriting standards following the recent financial crisis, origination volume is being depressed by weak consumer demand as U.S. households shed debt. Yet significant opportunities remain for banks that can reorient their approach to consumer lending.

Instead of promoting products individually, the new emphasis is on serving established customers more fully and capturing more accounts at the onset of new customer relat-

ionships. Winning retail banks will gain market share by consolidating consumer and household borrowings that often remain splintered among multiple providers.

The vast potential of this approach is underscored by recent Novantas research indicating that roughly \$2 trillion of unconsolidated consumer loans are held by customers who might be willing to concentrate borrowings with their primary banks. This opportunity encompasses nearly a third of the retail customer base.

Most immediately, the emphasis is on focused campaigns that will concentrate marketing resources and sales efforts on select customer segments with high potential and high receptivity to account consolidation. Two major avenues that can provide early returns this year, for example, are home equity loans and credit cards.

Longer term, advanced retail banks will flesh out their knowledge of consumers and households to enable a comprehensive relationship lending strategy. Strengths will

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include: 1) nuanced pricing strategies that consider elasticity of demand, credit risk and the fuller context of customer needs; 2) innovations in product development, bundling and packaging; and 3) segment-tailored initiatives that effectively focus marketing and sales resources in areas of highest value to customers.

In following through, banks will need a much more unified view of the customer relationship. Transaction information from checking and credit card accounts, for example, can provide valuable guidance in formulating and underwriting consumer loan offers, yet many banks are not yet able to perform this type of comprehensive review. Both in early steps and over the long term, the advantage in relationship-based credit consolidation will go to analytically adept banks.

POSSIBILITIES WITH CURRENT CUSTOMERS

In making the business case for account consolidation with established customers, banks have advantages on both the demand side and the supply side of the equation. The key is nurturing primary relationships, typically centered on the household checking account, but also including savings and wealth management accounts.

On marketing offers such as credit cards and home equity lines of credit, for example, Novantas research shows that customers respond much more strongly to offers from their primary banks, compared with arms-length providers. And this advantage extends to situations where consumers proactively seek credit, with research showing a much higher likelihood of purchase from their primary banks.

Then from the internal banking perspective, there are three major advantages in marketing to established customers:

Lower cost to contact – Banks have multiple touch-points with current customers, including through the branch; the Internet; the call center; mobile banking; surface mail; and even via automated teller machines. In turn, these channels permit a low-cost frequency of contact that is far superior to cold-call campaigns. Combined with built-in levels of customer familiarity and receptivity, this translates into a lower cost of acquiring additional credit balances.

Better targeting – Through a careful review and analysis of established accounts, including balances, transaction patterns and demographic patterns, banks can identify and prioritize the target

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customers for new offers. This is invaluable in making effective use of marketing and sales resources to pursue high-value opportunities.

Better risk management – Based on customer information and observed behaviors with established household accounts, banks can be more discerning in their offers, either in safely extending additional credit on the basis of information that competitors do not have, or in avoiding lending opportunities that exceed established risk ceilings.

Multi-account relationships also provide a richer context for the detection of customer financial distress and proactive intervention with delinquent accounts. And our research shows that customers give higher repayment priority to their primary banks.

BEYOND PRODUCT PUSH

There are two main reasons why banks have not pursued a relationship credit consolidation strategy more aggressively in the past. First, eras of robust customer demand encouraged banks in “product push,” where strong profitable growth was achieved through a mixture of mass-market promotion, efficient production within the silos, and effective delivery over the branch network. Second, it has been difficult to build composite customer and household information, given the weak linkages between product silos and executive hesitancy over the effort, expense, and questionable incremental return relative to other uses of corporate resources.

One difference now is that product push is far less productive in consumer lending markets that have contracted dramatically. In 2010 the dollar volume of home equity originations was down roughly 80% from the peak year of 2006, and first

mortgage originations fell by nearly half, both for purchases and refinancing. Meanwhile, combined U.S. mortgage and consumer credit balances contracted by roughly 4.5% between yearend 2007 and yearend 2010. In protracted weak market conditions, the best growth opportunity is to gain market share, and winning banks will do this by serving customers more fully – in banking lingo, gaining household “share of wallet.”

Also there is a more enlightened understanding of integrated customer information, both in developing and monetizing composite data. Instead of exhaustively compiling information and then looking for revenue-generating applications, which often seemed to be the case with CRM, or customer relationship management, banks are using a project stair step that has revenue targets and a business case for each level of progress.

This year, for example, there are three major types of revenue opportunities with home equity products and established customers, including boosting activation and increased usage of outstanding home equity lines of credit; selling additional banking products to home equity borrowers; and providing home equity credit to customers who already are using other product lines.

To unlock these opportunities, banks will need to improve their analytical understanding of the current customer portfolio. Among active current users of home equity lines of credit, for example, what patterns and insights can be gleaned that will be of use in encouraging inactive account holders? What are the top cross-sell possibilities, based on knowledge of the total customer relationship? Such research-based explorations are crucial in an era when relationship expansion is the priority.

ADVANCED SKILLS

Beyond the launch point of winning more household business in key product lines, banks can develop a suite of capabilities that will enhance their abilities to establish and optimize fuller relationships with retail customers and households. Progressive institutions are laying additional groundwork for relationship-based performance improvement, including selling, pricing, risk management and product development.

Selling. Instead of processing orders for individual products, winning retail banks will work proactively with customers to meet their larger needs, often with multi-product solutions, in the branch, call center and online channels. Along with

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advanced analytics, this effort will be supported by new tools and training for front line staff.

Pricing. Much of today’s relationship pricing is centered on cross-product discounts, often proffered with little supporting analysis of the long-term profit impact (volume versus margin) or whether a discount is even needed. Along with more precise estimations of rate sensitivity and the business case for discounts, leading banks will consider the non-price drivers of customer purchase decisions, including rewards and recognition, service, convenience and control.

Risk management. Often today, retail banks still manage risk on the basis of individual product lines, with little composite knowledge of the total household relationship. Leaders will replace this fragmented exercise with a more holistic approach that looks at total borrowing, savings and monthly transaction patterns. Distillations of this information will be used to improve underwriting, risk monitoring and collections.

Product Development. There is a major opportunity for banks that can lift their sights from individual credit facilities to innovative combinations tied to major household needs and goals. Examples include customer needs such as household cash management, college funding and auto financing, each of which can be met in a variety of ways.

COORDINATED OUTREACH

Consumer lending has been a splintered exercise in banking, where individual products are championed by separate business units that seldom coordinate their efforts. This was far less of an issue in former eras of intense customer demand, but now a coordinated outreach is needed in the emerging battle for customer share of wallet.

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There are key management challenges and skill requirements in this journey:

- Individual product silos often lack both the motivation and the objectivity needed to unify household information and make savvy tradeoffs in pricing and features among multiple products.
- Today’s internal pricing and marketing teams, meanwhile, often are narrowly focused on using discounts to drive transactions, often without

analytical context on the major factors that influence customer decisions.

- Perhaps most importantly, retail banks need a much stronger grasp of total customer relationship value, a critical consideration in setting sales and marketing priorities that balance current-year goals with long-term value formation.

This year going into next, the advantage will go to banks that can comprehensively address these challenges, both for near-term performance improvement and the long-term transformation of consumer lending.

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