

Prioritizing for Growth in Commercial Banking

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To grow in a market that is only partially recovered, commercial bankers will need a set of focused initiatives that match strengths with select opportunities.



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Since the recent recession and financial crisis began, commercial banks have been appropriately focused on righting the ship by working out loan portfolios, improving capital ratios, cutting costs and responding to new regulations. The question now is how to achieve growth in a market that is only partially recovered.

As with other banking lines of business, much of the commercial opportunity for 2012 centers on gaining market share. While there will be pockets of reviving loan demand in various industries and areas of the country, many companies are either still recovering or remain averse to credit expansion. Companies also continue to consolidate banking relationships.

Commercial banks will need to establish a clear set of growth priorities to assure that resources are deployed where they will do the most good. To win business in a consolidating market for treasury management, for example, some banks will need to round out their product sets. Well-positioned regional banks could actually see respectable growth in treasury management next year.

Another opportunity lies with owner-operators of middle market companies and small businesses. Many proprietors delayed plans to sell or merge their enterprises during the recession and will be freshly considering their possibilities over the next few years. This presents a new wave of opportunity for advisory services and wealth management.

A third management priority is precision targeting. Commercial banks will need to enhance their analytical capabilities to find the most promising geographic regions and industry sectors for loan demand. This includes extrapolating observed patterns among current customers to guide prospecting and cross-sell activities.

Finally, there is major upside for banks that can elevate the general performance of relationship managers (RMs). Typically, RMs in the top quintile are more than twice as successful than average performers in sales, and four times as successful in generating risk-adjusted profits. Specific management actions are needed to close this gap.

While these four performance priorities are generally applicable in commercial banking, they need to be pursued within a strategic context. Each bank needs to refine its distinctive strengths and pursue performance improvement within that context. The bank with superior skills in credit origination, for example, will proceed differently than a competitor that might emphasize in-depth local relationships, or

another that emphasizes high sales effectiveness based on an analytically-driven understanding of customer needs.

DEMAND DRIVERS

Treasury management (TM) services will remain an important source of stable balances and reliable fee income, but overall market growth will remain sluggish for the next few years, likely no more than 3% annually. But some banks will thrive in an environment where more customers are consolidating their banking business. Indeed, providers that are successful in winning market share could exceed a 5% growth rate.

Unlike during the 2000s, however, the biggest banks won't necessarily dominate the competition this time around. We expect a number of regional banks with strong customer-focused offerings and high performance sales organizations to form their own "performance tier," outgrowing many of their larger competitors.

Commercial banking customers are still closely watching expenditures even two years after the Great Recession ended (at least statistically). Customers see multiple banking relationships as complex, costly and no longer necessary. Along with capturing pricing advantages, customers can also simplify financial management as they consolidate accounts and services with one or two banks.

In this environment, banks with broad, needs-targeted treasury management offers are more likely to win in the relationship consolidation game. As one of our banking clients put it, "If you don't have the product, you aren't going to get the cross sell." In turn, lagging regional and community banks will face immense pressure to close any visible gaps in their treasury management line of business in 2012.

Looking elsewhere, one of the most discussed — and least acted upon — opportunities is helping owner-operators of middle market businesses cope with a changed market and pursue transactions delayed by the recession. Most of these proprietors are Baby Boomers who saw their company valuations severely crippled by the recession, delaying so-called "liquidity events" such as sales and recapitalizations.

This presents opportunities for an integrated commercial banking/wealth management offer. According to a recent survey by Greenwich Associates, only a third of these businesses have viable succession plans in place. Now that valuations have partially rebounded, about 10% of owners are looking to sell, realizing that they face several more years of relatively slow growth. Other owners have postponed

retirement, hoping to hang on and recover lost equity, but they still represent a future stream of liquidity events.

All of these businesses need loans, corporate financing, estate planning services and tax advice. Most commercial banks have under-invested in this opportunity and have failed to develop joint sales and marketing efforts that are truly robust. In a revenue drought where fee income is at a premium, this is one of the biggest opportunities.

MARKET OUTREACH

Though demand for commercial loans has recently picked-up, variability across regions and industry segments remains high. The Federal Reserve's recently released Beige Book indicates significant volatility across districts, with parts of the South and upper Midwest outpacing the rest of the country.

The story is the same across industry sectors. While there are strengthening expansion possibilities in business, professional services, information technology and manufacturing, market sectors that rely on consumer spending (e.g., retail and hospitality) continue to lag. Even within business sectors we see divergence. Residential construction continues to show widespread weakness, while multi-family construction activity in the rental segment is strengthening.

To win in this "lumpy" environment, banks are going to have to manage at a finer level of market and customer detail, and significantly enhance precision targeting and supporting analytical capabilities. One priority is to profile current customers and identify success patterns within particular regional/industry segment combinations, including conversion rates, market share gains, credit performance and relationship profitability.

This analysis can be used as prospecting guidance for relationship managers. Banks can also mine their treasure troves of information in credit administration. Insights from customer financial statements can be used to develop performance benchmarks (e.g., growth, profitability and risk) for various company peer groups. Such proprietary performance summaries often are quite appealing to clients, and they are



useful to RMs as a business development tool to build rapport and credibility with prospects.

Another priority is achieving peak sales performance. In an environment where the majority of growth will come from taking market share, sales performance becomes a top strategic issue. Our research indicates that the top 20% of relationship managers dramatically outperform the field average. In our experience, this is driven by three underlying factors:

- Banks do not analytically assess the extent to which RM various behaviors drive purchase decisions.
- Sales processes are inconsistent and not grounded in purchase behaviors (most RMs view commercial sales as an "art" and eschew any hint of standardization).

- Training and coaching focus disproportionately on generic sales skills (e.g., presentation skills).

As a result, top sales performance is mostly limited to those relationship managers who intuitively crack the code on what customers really want and modify their sales behaviors accordingly. Most other RMs are not able to do this, however, and they would benefit greatly from a better defined sales process and more targeted training and coaching. In our experience, the “manageable middle” (i.e. middle 60% of RMs) can improve their sales performance by 30% to 50% with a more standardized, customer-driven sales process, supported by more systematic coaching.

EXECUTIVE AGENDA

As market share competition heats up in commercial banking, performance dispersion likely will widen as stronger players grow at the expense of others. Having the right strategy and developing a competitive advantage has never been more critical. As banks begin the 2012 planning and budgeting process, winners will address four priorities:

Refine the business model for competitive advantage: In our research on commercial banking performance, we have seen that top performers are the ones that have attained momentum with crisply-defined strategies centered on distinctive strengths. Many other competitors will need a sharper focus if they are to avoid getting lost in tactical priorities. Leading performers over the last decade, for example, have variously adopted four types of growth strategies:

- Credit leaders use superior underwriting skills to capture solid business that will carry them through all phases of the economic cycle.
- Multi-local players marry the sophistication of large-scale operations with in-depth community presence to build loyal, multi-faceted customer relationships.
- Sales leaders analytically identify key customer needs and buying behaviors, and follow through with a sophisticated sales and marketing process.
- Serial acquirers continuously expand by absorbing other companies, using technology efficiency and advanced integration skills to steady advantage.

Each commercial banking team needs to ask where their institution is advantaged, and if the answer is not clear, they need to revisit their strategies now.

Accurately deploy resources in high-potential markets: In an uneven recovery there will be a high dispersion of growth rates and earnings volatility among various regional markets, business sectors, asset categories and fee-based businesses. Banks must rigorously incorporate risk elements such as worst-case loss into their planning processes and decision

metrics. Segments with the best prospects for risk-adjusted growth need to be pursued very aggressively.

Close critical product and capability gaps: As we noted earlier, relationship consolidation is accelerating and product breadth is a key factor in the customer decision process. Many community and regional banks have critical gaps to plug in treasury management. Progressive offers include online spending controls; “virtual purchase” cards; robust capabilities for international payments; and tight integration of payables products. In other cases, banks looking to assist owner-operated businesses will need robust advisory capabilities in mergers, acquisitions and recapitalization, and wealth management and tax/estate planning.

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Strengthen execution capabilities: In our experience, only 60% of the intended value of a given strategy is typically realized. The most common causes of “leakage” are inadequate implementation resources; poor communications; unclear roles and accountabilities; and the inability of implementation teams to surmount coordination barriers among various product silos. Most companies are unaware of their execution soft spots and typically benefit from a diagnostic to identify gaps and needed changes.

Facing a slack recovery in loan demand, commercial banks are emphasizing cost reduction, either consciously or unconsciously locking down the current business model in the process. This sort of hunkering down will not prepare an institution for the splintered market conditions that are likely in 2012, however. There is a special urgency to re-focus on the few emerging opportunities with real growth potential. Winning commercial banks will seize the moment to gain market share.

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