



Threading the Needle for Consumer Loan Growth

BY GAURAV GUPTA

In a typical economic recovery, consumer lending is a bright spot in retail banking, with steadily reviving demand bringing balance growth from both new and already established customers. However, the demand outlook potential is more muted this year, presenting a different set of priorities for banks going forward. Several consumer loan strategies will provide opportunities next year; including elasticity-based pricing; cross-sell and account consolidation; and risk-adjusted returns.

The challenge banks face is that many U.S. households are still operating in defensive mode. People are paying down debt; they have lost considerable equity in their homes; and unemployment continues to be widespread. In turn, consumers are far less confident about new borrowing and spending, a situation that likely will persist for a good while to come.

The good news is that consumer lending still presents opportunity for players that can respond with new strategies and skills. Three major priorities for next year include pricing strategy; cross-sell and account consolidation; and improving risk-adjusted returns. These are critical factors in gaining market share and optimizing profitability.

Pricing strategy. In terms of more immediate and tangible results, consumer loan pricing is a high priority. Today, many lenders confine their pricing frame of reference to competitor actions, internal cost estimates and executive interpretations of recent results. This omits a universe of possibilities related to customer demand.

In home equity lending, for example, there is a large group of customers who don't have time for price-shopping and just want convenient access to credit. In some instances, small adjustments in rates can substantially improve profits — by more than 20% in one recent case study — without disturbing origination volume. In other cases, banks can generate substantial new business by adjusting offers to price-sensitive customers.

To identify such opportunities, banks need to study customers and understand why they are accessing credit in the first place. Uniform home equity pricing typically overlooks, for example, the extent to which account-holders actually will use their lines of credit; likely balance duration; shopping attitudes (price sensitive versus convenience-oriented); and the extent of consolidated business done with customers across all areas of the bank. A borrower getting ready to add a room to the house is different from someone who simply wants a backup line of credit to assure household liquidity.

Cross-sell and account consolidation. To grow in these tight conditions, winning banks will gain market share by serving customers more fully. This strategy particularly lends itself with established customers. Along with relationship knowledge, the bank already has affinity with current customers. Comparative ease of access lowers the cost of marketing. And there are underwriting advantages as well.

Nationally, we estimate that there is a potential \$2 trillion opportunity for consumer credit consolidation, based on recent Novantas research indicating that although many consumers have scattered borrowing wallets, they are attitudinally receptive to consolidating their business with their

primary bank. The best way to get started is with targeted cross-sell programs on key products, particularly credit card and home equity.

Over the medium to long-term, there are more extensive opportunities for banks such as: consolidate customer information drawn from various business lines; sharpen analytical skills in spotting key variations in customer segment demand; develop attractive multi-product solutions centered on household cash management; and begin to drive telling information into a branch setting where staff is better trained and equipped to act.

Risk-adjusted returns. In a wobbling market that may slip into a double-dip recession, banks need to keep a firm grip on underwriting and risk pricing. Yet caution must be balanced with a need for growth.

One response is to broaden the frame of reference for risk assessment. Many banks narrowly focus on historical payment behavior without considering other telling information, such as monthly household cash flows, asset strengths and overall debt load and customer attitudes and intentions. This expanded view is invaluable in origination, advanced detection of borrower distress, loan workouts and collections.

Another response is to orient credit decisions more strongly around value, as opposed to pure risk avoidance. There is a meaningful risk bandwidth that often gets dismissed today, yet still could present opportunity if properly priced. Risk management and lending teams will need better coordination to tap these additional possibilities.

In the areas of elasticity-based pricing, cross-sell, account consolidation and risk-adjusted returns, there are meaningful performance improvement opportunities that can be realized next year. Longer term, these initiatives also will help consumer lenders reposition for a market that no longer will thrive on high-volume origination.

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