As retail banks fight for growth through market share gains, executive management will need explicit strategies to cultivate fuller customer relationships.

New Strategies for Relationship Expansion

BY RICK SPITLER

Typically in banking, a single institution serves no more than 15% to 20% of the customer's total financial service needs, meaning that 80% to 85% of the relationship potential is lost to competitors. It is a longstanding issue that goes to sleep during market expansions and roars back to life when the revenue tide recedes during a downturn.

This system actually can work quite well in a strong market, where surging customer demand helps to satisfy the essential quest for sales volume. In turn, banks see less of a need for a coordinated marketing and sales outreach and in-depth composite knowledge of customers and households.

Instead of a temporary discomfort, however, relationship fragmentation now poses a sustained challenge for the banking industry. Revenues simply will not be rebounding to anything approaching pre-recession levels anytime soon. In the meantime, how can banks afford the massive duplication of expensive branch capacity that occurs when the typical customer goes to five different institutions for financial services?

We are entering an era when there will be towering pressure to take costs out of the branch network, not only because of recession aftershocks, but also because of an accelerating customer migration to alternative distribution channels. Currently, roughly 15 out of every 100 branches have a negative operating margin nationwide, according to our research. And that ratio will jump to roughly 18% once the impact of new restrictions on checking overdraft and debit card fees is fully realized.

But there is a very real risk in radical branch cost reduction. It disturbs the primary anchor for retail customer relationships and the potential for future growth. For critical transactions, such as opening accounts, making deposits and resolving problems, a majority of consumers still prefer the branch, according to a recent Novantas survey.

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The higher road will be to leverage the branch network through relationship expansion, garnering new revenues by winning a greater share of the customer's "financial wallet." Winners in this new contest will come out permanently stronger. Banks that lose even more wallet share, by contrast, ultimately could be at risk of losing their independence – cost-cutting will not tide them over.

The question is whether executive management can come up with specific strategies for relationship expansion. Blanket, high-intensity cross-sell tends to bombard customers with irrelevant offers – ineffective and also irritating. A moderately successful approach (often seen today) is selling additional products within categories, such as an additional savings account to a saving household. There is only one path to high-potential cross-sell, and that is selective selling across product categories, a strategy that can lead to an enormous boost in relationship profitability – multiples in many cases.

Thus the challenge is to set clear priorities for relationship expansion, in line with customer needs and opportunity for the provider. This roadmap is critical in marshalling the resources of the organization for tangible revenue results.

Through the lens of customer lifetime value, for example, the institution can consider the full range of opportunities over the life of the customer relationship. From this multi-dimensional analysis, the bank can identify the select types of offers having the highest potential with various major customer groups.

Importantly, this type of strategy will require a higher level of cooperation among the various product units within the bank. This is precisely why executive management must play a central role. Many larger customer opportunities get overlooked when business units narrowly focus on their own products and sales goals. Solid information and marketing bridges must be built to overcome this persistent tendency.

C-LEVEL CHALLENGE

The value of effective cross-sell extends well beyond numerical count and product margins. In-depth customers tend to stay with the bank longer and make higher use of their products. They give the bank a higher priority in the repayment of debt. In many cases, price sensitivity falls as the focus turns to rewards, recognition and service. Also, cross-sell can be far more cost-effective, compared with a product-by-product effort.

This is a case where the total value truly exceeds the sum of the parts. There is a definite "relationship premium" that is realized in effective cross-sell, In turn, this is one of the primary tools that successful banks will use in combating the ongoing revenue drought and shoring up the economics of the branch network.

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From an executive management perspective, however, a renewed emphasis on cross-sell reintroduces an age-old problem – lack of coordination among the product silos. There is a strong insular tendency among the business units, which tend to be slow in referring clients to each other, and in sharing customer information.

Internally, one place where the problem manifests itself is in annual planning and budgeting. Typically, this exercise is heavily centered on the individual business units within the bank, with each group focusing on its own revenue and profit goals, and the resources needed to achieve them. Then in customer-facing activities, the problem manifests itself in myriad individual product campaigns that focus primarily on unit sales, with little or no collective consideration of composite consumer and household needs.

To succeed in the new environment, executive management will need to ensure proactive collaboration among the product silos – a difficult and longstanding banking industry challenge that simply must be mastered. From time to time, each product area has valuable touch-points with the customer. In these fleeting moments of opportunity, an outreach is needed that (intelligently) extends beyond promoting an additional widget from within the same product family.

In considering how the business units should work together to achieve the full potential with each customer, an extreme answer is to "tear down the walls" between the business units. In addition to being complicated, such aggressive integration risks disturbing the management integrity of critical banking activities. A major product line, such as the credit card, has its own marketing, processing and risk management dynamics, which require continuous focused attention. Any linkages elsewhere within the bank need to be well-defined, and also well-justified from a revenue perspective.

In turn, executive management will be looking for selective multi-silo initiatives that amply justify the effort that goes into them. In our work with major banking companies, we have seen a tight list of projects gaining significant traction.

- Priority cross-sell to consumer households.
- Priority cross-sell to small businesses and their households.
- Improved credit origination decisions, risk management and collections.
- Improved financial management and customer segment targeting.

Sharp analytical guidance will be needed in these initiatives. Even with certain high-potential categories of cross-sell, the uptake can differ sharply among various customer groups. Currently, for example, many banks are targeting their "best customers" for home equity loans. That will be ineffective, however, for customers who currently are valuable on the basis of money market deposit balances – they are liquid already and probably don't additional interim credit.

To avoid such traps and take maximum advantage of proactive cross-sell, the bank will have to consider critical questions about required customer information; the level of analysis that will be needed; priority applications; and the various implementation factors that will be essential to success. Typically, for example, we find that the bank has some work to do in unifying scattered bits of customer information into a composite picture of individuals and households.

Multi-silo projects will need to be broken into their major components and then evaluated within the context of a business plan. Often, the head of retail banking will take the leadership in making this happen.

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IMPLICATIONS OF CUSTOMER LIFETIME VALUE

Quite extensively in banking today, revenue progress is measured in terms of product scorecards, typically centered on current-year sales volume and profitability. This nomenclature runs through a long chain of activities, including business unit planning and management; financial reporting; marketing and branch sales.

Rare, however, is the institution that understands the depth of relationship with each customer and household. Pattern recognition becomes a difficult exercise if the customer relationship can only be partially viewed through a series of product lenses.

Customer lifetime value seeks to close this gap by considering the full interaction with the customer over the life of the banking relationship. As an example of the difference this makes in decision-making, consider the current banking challenge with the demand deposit account. Given the successive crackdowns on overdraft and debit fees, there is a tendency to back away from checking. But this short-term view overlooks the fact that checking's potential CLV is still quite attractive – $3,000 to $4,000 – provided the bank can follow through with effective cross-sell of the right downstream products.

In these and other instances, the bank will be well-rewarded for the effort it expends on relationship diagnostics and priority cross-sell. Yet the benefits can only be realized through the direct involvement of executive management. It might be said that CLV is the ultimate interdisciplinary goal within the bank – potentially powerful yet critically dependent on coordination, cooperation, and disciplined applications.

One major executive consideration falls under the heading of composite customer information. As an example of the challenge, in a recent Novantas survey of best practices in small business banking, fully half of the respondents said they were not yet able to track the household consumer banking accounts of their small business customers. Major business lines seldom rally to close such informational gaps on their own.

A second major success factor with CLV is customer analytics. To identify priority cross-sell initiatives, the bank needs to be able to sort through a large set of possible product combinations and offer sequences, and arrive at a select list of offers that will provide the highest value to both the customer and the bank. In one

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instance, for example, the retail banking division of a major bank initially evaluated more than 200 cross-sell possibilities, eventually narrowing down the consideration set to somewhere between 12 and 15 possibilities that would capture the lion's share of the opportunity.

A third success factor falls under the heading of implementing targeted marketing campaigns – following through to match the right offers with the right groups of targeted customers in the field. In the post-crisis economy, mass-market product promotions will be far less effective in the face of slack demand. Fourth, within the branch network and call centers, there are interrelated staff considerations, including informational prompts, coaching and training, and sales incentives.

CLAIMING MARKET SHARE

As banks gear up for extended tight market conditions, the huge cost overhang of the branch network will provoke an inevitable battle for market share. The bank that best utilizes its branch sales capacity will have the best chance of retaining strengths during the revenue drought. The clear priority is doing more business with each customer.

For bank executive management, the challenge is to come up with a clear set of strategies that will capture cross-sell opportunities in a focused way, meaning maximum effectiveness with customers, and minimum waste and maximum return for the institution. Fortunately, this path has at least partially been paved by advances in information tools, permitting a much more effective approach to cross-sell than what was seen when the concept first attracted widespread attention 15 to 20 years ago.

Already in the industry, we are seeing instances where major regional banks have worked through some of the cross-silo information and coordination requirements and started to come to grips with some of the core issues in relationship expansion. Simply by establishing priority cross-sell marketing initiatives, they have been able to cost-justify initial efforts to build CLV, and they anticipate further momentum as the various product lines within the bank collaborate even more strongly to serve customers fully and proactively.

In this sense, the current revenue drought actually presents a defining moment for many institutions. A certain level of organizational transformation will be needed to make it through the next few years, yet the winners will come out permanently stronger. By contrast, there is very real possibility that banks with a "steady-as-she-goes" philosophy will lose further ground.

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