CLARIFYING THE CROSS-SELL AGENDA

Simplifying Relationship Banking: New Keys to Customer Engagement

Complexity Challenge in Commercial Lending

Building Core Balances with Segment Deposit Pricing
Cross-Sell Myths and Traps
At a time of frustration in relationship expansion, much of the blockage stems from flawed assumptions about customer needs categories and the stages of cross-sell.

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Relationship Banking Made Simple
An effective framework for developing relationships and growing cross-sell revenues sets clear objectives for each stage of customer engagement with the bank.

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Complexity Challenge in Commercial Lending
To improve market responsiveness and streamline complex operations, many commercial lenders need to establish a target operating model. One-off projects won’t suffice.

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Across the retail banking industry, there is a lot of urgent effort to improve revenue growth by serving customers more fully. A particular focus is consumer lending, where lagging post-recession demand has left banks hungry for earning assets.

The situation shines a fresh light on cross-sell and relationship expansion, a field that is laden with opportunity but elusive in its specifics. Onboarding has acknowledged value, for example, but has only partly delivered on its potential following the widespread industry embrace of formal programs to anchor and expand new customer relationships.

The challenge for senior management is that redoubled effort may not necessarily win the day, as detailed in our cover story, “Cross-Sell Myths and Traps.” Based on an extensive industry review, it turns out that a series of flawed assumptions have crept into cross-sell initiatives, limiting progress even as more resources are poured into the pursuit. For many players, it is time to reexamine the fundamentals of customer engagement.

Our companion article, “Relationship Banking Made Simple,” makes the case that in addition to understanding the progression of customer needs, it is necessary to understand the progression of the customer relationship with the bank. To set the proper stage for cross-sell, the first order of business is anchoring new customers in the active use of cash management services, including the primary checking account. Absent this foundation, the bank will have a much harder time purveying the full spectrum of offerings.

Elsewhere in this issue we take a look at segment-based customer responsiveness, both in the deposit business and in consumer lending. In a future environment of rising rates, new skills will be needed to attract and retain core deposits, as detailed in “Pricing for Deposit Customer Segments.” In home equity lending, the good news is that the market finally is stabilizing. But growth will be a selective exercise, as discussed in “Earning Your Profitable Share in Home Equity Lending.”

Finally, this issue explores two emerging issues in commercial and small business banking. “Complexity Challenge in Commercial Lending” presents a roadmap to improve origination efficiency and the customer experience, while “Inside Sales for Small Business Growth” advocates the expanded use of skilled bankers in telephone-based marketing, sales and relationship management.

Steve Klinkerman  
Editor-in-Chief
At a time of frustration in relationship expansion, much of the blockage stems from flawed assumptions about customer needs categories and the stages of cross-sell.
As customer acquisition rates have plummeted, cross-sell success has increasingly become a swing factor in retail bank performance. Banks simply need to capture as much share of their customers’ wallets as possible. However, the quest to build revenues by selling more to current customers often manifests itself in very customer-unfriendly campaigns, product-oriented and fragmented on a channel-by-channel basis.

All too often, the wrong things are presented at the wrong time, even the wrong place, representing a significant misdirection of effort and resources.
Along with being ineffective, such efforts can be off-putting to customers, appearing haphazard or worse, irrelevant. This gives rise to the complaint among executives that “We are pulling all these levers but cross-sell isn’t improving enough.” In many cases, much of the ineffectiveness traces back to a series of flawed assumptions about how customers buy products and how relationships evolve. For example, the purchase of a wealth-oriented product greatly depends upon the brand equity a bank has established with a customer. Trying to sell some form of wealth management to new customers before they have demonstrated any loyalty to their new checking account is not consistent with systematic relationship building.

Looking across the retail banking industry, there are six prevalent myths, or misunderstandings, that seriously degrade cross-sell performance (Figure 1: Myth vs. Reality in Retail Banking Cross-Sell). One misdirection is the use of narrow customer acquisition campaigns; another is overly-aggressive product push during the 90-day customer onboarding period. A third cross-sell trap lies with non-checking customers, both in over-estimating the potential to steer them into cash management products and in missing early-stage sales opportunities. Fourth, high-value offers for revolving credit are often over-supplied to the best deposit customers, who tend to be highly liquid and have far less need.

Performance metrics are a fifth problem area, exacerbated by the myth that the total count of products and services provides adequate guidance on cross-sell success. Sixth, cross-sell expectations have been overly tied to multi-channel sales fulfillment.

The urgency to improve cross-sell and gain profitable share of wallet is undeniable. A key challenge for bankers is how to advance the cross-sell agenda at a time of channel transition, data proliferation and a larger embrace of customer analytics. Cross-sell is not a new objective. However, with the slowdown in new customer acquisition, getting cross-sell right is now a major priority. Understanding how customers establish and expand relationships is fundamental to improvements.

**ACQUISITION AND ONBOARDING**

With targeted acquisition, the affluent and mass affluent segments are the most attractive deposit segments for branch banks and have the highest cross-sell potential. However, such customers only constitute about a third of the population.

In the quest for a sharper focus in the market, some bankers believe it might be best to narrow the appeal of general marketing messages so that a greater proportion of priority target customers will be attracted. In practice, however, a segment-tuned campaign typically does no better in eliciting responses from target customers than it does from the broader population as a whole.

Meanwhile, a focus on targeted acquisition ignores the importance of attracting the large volume of customers needed to help “pay for” the high fixed costs of the branch system. Even customer relationships that are unprofitable on a fully-loaded basis can at least contribute to covering fixed costs.

It is better to first get the basics right. Sweep a broad range of customers into basic cash management products that make sense for the customer, such as checking, and then later sort out and sell the most attractive follow-on options.

With onboarding, although it is possible to cross-sell additional products in the 90 days after a customer initiates a checking relationship, it is seldom highly productive. The truism that half of cross-sales happen in the first 90 days is driven by originations at the initial point of sale, right when the new customer relationship is beginning.

The more fruitful onboarding objective is to coax customers into fully using the products initially sold to them. Since the checking account is the product most customers buy first from an institution, the objective is to get customers to make their newly acquired accounts their primary “cash management” accounts.

The larger objective is establishing the bank as the primary cash management provider for a customer, not just checking but also savings, credit cards and sticky services such as online banking and bill pay. For an initial relationship, it is important to sell as many products within the cash management family as possible at the point of sale. One approach to accomplish this is to sell a cash management product bundle whose components can be selectively activated by the customer or, alternatively, promote relationship pricing benefits to drive additional sales at the POS.

The 90-day onboarding period then is the time for the bank to promote activation and usage of what ideally would be an initial family of cash management-related products and services, e.g. setting up direct deposits, online payments, automatic savings, debit and credit card usage, etc.
By building customer engagement in this way, the stage is set for a more informed offer of high-value products. The loyalty created by becoming a customer’s primary cash management bank opens up the best chance to deepen the cash management relationship, drive event-based lending and migrate customers to investment services (and insurance where relevant).

**SINGLE-SERVICE AND HIGH-VALUE PROSPECTS**
With single-service non-checking customers, in this era of reduced customer turnover and acquisition potential, banks are desperate to more fully serve customers whose first — and often only — product relationship began outside of checking. These are people who become associated with the bank via a standalone product such as a home mortgage, an auto loan, a CD or other items.

Novantas experience indicates that it is an extremely tough proposition to convert such customers into core checking relationships. Even with today’s expanded data sources, response rates are typically less than 2% for direct marketing campaigns to stand-alone customers.

Having said that, there still are opportunities for well-prepared banks to cross-sell checking and household cash management at the point of sale for standalone products, primarily through the use of product bundles and relationship pricing. One example is a linked checking account sold when a home equity line of credit is sold, perhaps with a relationship discount. A second is a high-yield savings account sold with relationship benefits for active usage of a credit card account.

Turning to product marketing campaigns, many banks use purchase propensity and next-logical-product models that seem to highlight opportunities with well-heeled customers. These models make the credit departments happy because the “best” customers are typically defined as those holding high-balance deposit products. Unfortunately, they often have little need for credit.

This leads to oft-seen situations where HELOC and card offers are rained down on high-value households with little

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**Figure 1: Myth vs. Reality in Retail Banking Cross-Sell**
To improve cross-sell performance, banks need to avoid flawed assumptions about how customers buy products and how relationships evolve.

<table>
<thead>
<tr>
<th>MYTH</th>
<th>REALITY</th>
</tr>
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<tbody>
<tr>
<td>Customer acquisition campaigns should be constricted to only reach the most attractive segments with the highest cross-sell potential.</td>
<td>Winning banks prepare themselves to sweep in a wide range of customers and then use their product strategies and cross-sell engines to profitably develop the new relationships.</td>
</tr>
<tr>
<td>The full range of products and services should be presented to new customers during the 90-day onboarding period.</td>
<td>Typically it is better to focus on activation of the cash management product(s) initially purchased, with the goal of becoming the customer’s primary cash management provider.</td>
</tr>
<tr>
<td>There is a lot of opportunity to cross-sell single-service relationships (card, mortgage, CD, etc.) into core checking and cash management relationships.</td>
<td>In practice, it continues to be difficult to convert single-service non-checking customers into primary cash management relationships</td>
</tr>
<tr>
<td>There is a lot of opportunity to cross-sell high-value credit products to the best customers.</td>
<td>A large portion of the best customers are poor candidates for revolving credit, not because of credit risk but because of utilization risk — they are highly liquid and the need is not there.</td>
</tr>
<tr>
<td>The total count of products and services sold to the customer provides a good measure of cross-sell success.</td>
<td>Count-based metrics fail to measure the customer lifetime value of different types and combinations of products and services, relative to the customer journey over time</td>
</tr>
<tr>
<td>It is important to be able to complete a sale in any channel, and to enable the customer to start an application in one channel and finish it in another.</td>
<td>This “universal capability” is nice but not necessary, based on Novantas research on how customers currently interact with channels to shop for accounts and complete applications.</td>
</tr>
</tbody>
</table>

Source: Novantas, Inc.
result. In this case, the trap lies in not making fuller use of the bank’s composite customer information to clarify household needs relative to cross-sell priorities. The tendency is still toward a series of product-focused, cross-sell campaigns, often with loose coordination at best, resulting in unproductive product push.

**METRICS AND SALES FULFILLMENT**

With cross-sell performance metrics, there is a continuing perception that a simple summation of products, balances and services provides an adequate measure of cross-sell realization for a given customer or household. This type of math had its place when first introduced a decade ago, but does not consider the progression of the customer relationship with the bank.

A perceived “low” cross-sell count may actually represent above-average penetration for an early-stage customer relationship that has not progressed much further than cash management. Elsewhere a perceived “high” cross-sell count may actually represent good penetration of products in the cash management domain, but zero penetration in other needs categories.

A more customer-centric set of measures is needed, in which the penetration of cash management needs is first quantified and then the penetration of other needs categories is also measured. Ideally this is done through a customer lifetime value lens that prioritizes the highest-value cross-sell possibilities.

Turning to sales fulfillment, while trends in multi-channel banking are indeed profound, a perception has arisen that the ability to fulfill a sale in any channel is a priority. The thought is that any channel that can promote an offer should also be able to fulfill an account origination (especially PC online and mobile).

In turn, banks are funding myriad projects to allow customers to both start and complete applications across all channels. While this is clearly nice, it does not reflect how new-to-the-bank customers behave. Novantas research confirms that about two-thirds of consumers prefer to shop for a new checking relationship online, but that in practice, 85% to 95% continue to open their new accounts in the branch.

To be sure, established customers are much more likely to shop for and open simple savings, card or secondary checking accounts online. But again, seldom is there a need for cross-channel account opening capabilities.

Given the scarce internal technology resources available in many banks today, the returns to these ultra-flexible sales fulfillment efforts are dubious. This is a time when banks should be carefully studying the customer progression from online research and shopping to in-branch fulfillment. This particularly applies to the high-value cross-sell of more complex products such as wealth and/or mortgage products.

**CUSTOMER JOURNEY**

The main point in presenting these myths is that a number of practices and initiatives in retail banking need stronger grounding in the end-to-end customer journey.

There is a simple formula for cross-sell. Banks generally need to start by selling “cash management” products at the point of sale, assisted by product bundles and relationship pricing, and use the onboarding period to cement the primary cash management relationship.

“With the benefit of familiarity and the study of account and channel behavioral patterns, the bank can begin to consciously manage the development of the customer relationship in ways that lead to higher cross-sell revenues, higher customer satisfaction and stickier relationships.”

The subsequent cross-sell of credit, investments, and insurance products needs to be based on triggers that predict customers’ likelihood to both buy and profitably use a product. Performance measurement should be structured around this journey.

With the benefit of familiarity and the study of account and channel behavioral patterns, the bank can begin to consciously manage the development of the customer relationship in ways that lead to higher cross-sell revenues, higher customer satisfaction and stickier relationships. To do this, the bank needs to determine: 1) which cross-sell outcomes are most desirable relative to customer needs; 2) the appropriate blend of channels, messages and offers for any customer; and 3) which customer interactions are critical in closing the business.

Along with vision, executives will need to bring a degree of skepticism as well, making sure that cross-sell goals do not fall victim to ingrained practices, conventional wisdom and popular perception. Management myths and traps can be very real enemies of success.

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An effective framework for developing relationships and growing cross-sell revenues sets clear objectives for each stage of customer engagement with the bank.

The vigorous pursuit of relationship banking strategies is not new to bankers. But in the current scramble for retail revenues, it often translates into a blizzard of cross-sell campaigns from various channel and product groups, many overlapping. This sales crush can be self-defeating, coming across to customers as repetitive if not somewhat random.

Compounding the cross-sell confusion is the ongoing shift in consumer channel preferences, especially with web and mobile banking. A coordinated outreach is required if the bank is to come across as relevant, informed and intentional to the customer.

These challenges make it ever more important to organize cross-sell efforts on the basis of how relationships develop. A relationship expansion strategy cannot be guided simply on the basis of product count. It needs to reflect how a customer engages with the bank, which in turn determines the bank’s brand permissions for cross-selling and deepening that relationship. For example, a wealth management “relationship” confers very different brand permissions than a primary checking account relationship.

Our research highlights four basic “needs domains,” each presenting a distinctive point of entry for relationship expansion (Figure 1: Major Domains of Retail Customer Needs). These include: 1) cash management for day-to-day living (checking, credit card, home equity line of credit, etc.); 2) investments for the future; 3) insurance for risk management; and 4) purpose-oriented credit for major purchases (auto, mortgage, etc.).

While consumers can begin a banking relationship within each of these categories, the most fruitful one for banks is the cash management relationship, centered on the actively-used primary checking account. A primary cash management relationship is grounded in the day-to-day banking needs of the consumer and is used far more frequently than one based on the other categories.

The benefit of owning the primary cash management relationship cannot be overestimated. It, more than any other category, gives the bank permission to talk with customers about all their other needs categories. It also provides myriad advantages in marketing and sales, given that it reveals the most about household financial condition and also is present in consumers’ day-to-day activity. First and foremost, bankers need an explicit plan to secure this foundational aspect of the retail customer relationship.

POWERFUL ECONOMIC LEVERAGE

When measured on the basis of customer lifetime value, or “CLV,” it is clear that activating or acquiring the primary cash management relationship provides enormous economic leverage.

An engaged customer is valuable not just in terms of current period profitability (up to 3.5 times an entry-level relationship), but also because of the potential for future profitability (as much as 10 times an entry-level relationship). Trying to sell “unengaged” customers seldom is successful, and even when such cross-sold offers are accepted, they often just add to the pile of underutilized products.

This gets to the point about looking beyond product
count. Going forward, banks will need to measure relationship value both in terms of breadth (number of categories a consumer holds) and depth (level of usage or engagement). The skews in customer relationship profitability are remarkable when viewed from this perspective, as illustrated by Novantas research (Figure 2: Drivers of Relationship Value).

A primary cash management relationship provides the most hospitable environment for cross-sell, given the brand permissions conferred to the bank. This dynamic is already strongly reflected in the relationship between active checking customers and the formation of total consumer balances (checking, savings and certificates of deposit).

Our research indicates that the lion’s share of retail funding comes from customers with active checking accounts, with only a trickle of balances associated with inactive accounts. In one multi-bank study, the funding contribution of active checking customers was roughly 10 times that of inactive accounts, as measured by total retail balances per checking relationship. This raises the question of how much more can be done to “activate” or engage the checking customer.

**ACTIVATING GROWTH**

In assessing various banking efforts to optimize cross-sell, Novantas research identified an overriding priority that seems so simple as to be obvious, yet is not receiving nearly enough...
attention — activation of the new checking account. In U.S. retail banking today, typically only about half of new checking accounts are in active use after the first 90 days (commonly viewed as the onboarding period for new relationships).

That leaves about half of new accounts idle in the early going. While such originations represent success for the reach of the network and equity of the brand, they also represent a failure to engage. These customers have clearly voted in favor of the bank for some element of their cash management relationship, just not their primary relationship. Ultimately most inactive checking accounts wind up being closed, representing the leading cause of account attrition.

Such outcomes can often be the byproduct of growth strategies and performance incentives that emphasize unit sales versus net growth in active cash management relationships. So how much lift is available from creating active cash management relationships?

In evaluating the potential returns from a hypothetical 10% performance improvement in three areas — checking activation vs. blanket cross-sell vs. customer retention — our research showed a three-fold payoff in CLV for activation, relative to the other options. This finding reflects the fact that the active primary account is strongly correlated with balance formation and retention; provides valuable information, rapport and access for cross-sell over the long term; and also has higher fee revenue potential.

The catch, however, is the need for swift engagement with new checking customers. Compared with the traditional notion of a 90-day onboarding period, the prime window for checking activation is more like 30 to 45 days. While tactics to encourage account activation can vary widely bank-to-bank, it is safe to say that the topic is deserving of much fuller attention at many retail institutions.

**STAGES OF RELATIONSHIP DEVELOPMENT**

Given that customers do not bring their total financial relationship to an institution from the outset, a framework is needed to develop relationships over time. While the four basic phases of acquire, engage, expand and retain are quite familiar, the retail bank needs to develop appropriate objectives for each phase (Figure 3: Relationship Development Stages). This preparation provides the best opportunity to organize the multi-faceted marketing efforts that strike many of today’s customers as random.

**Acquire.** While there are multiple channels and approaches to acquiring the customer, the objective should be the same across all. The bank needs to go after the primary cash management relationship. When customers open checking accounts they are implicitly raising their hands, willing to buy — but not anything and everything. The bank should recognize that the initial need usually is for “cash management” and offer as complete a set of cash management products as possible, even if not utilized initially.

**Engage.** The objective during onboarding should not be cross-sell per se, but utilization of cash management products. This includes any consolidation of payment activities, as well as consolidation of credit and debit balances (savings, HELOCs, credit card balances, etc.) that are in support of cash management.

**Expand.** In this stage the intent is to capture as much of the “situationally elastic” deposits and purpose-oriented loans as possible. This is the true monetization of the cash management relationship. Such efforts are often event-triggered and therefore benefit from the information generated by the cash management relationship. Targeting should extend across channels to reflect customer channel preferences for shopping and buying — as opposed to branch

**Figure 2: Drivers of Relationship Value**

A primary cash management relationship cross-sold into multiple needs categories can yield up to 10 times the value of an entry-level relationship.
campaigns vs. mobile campaigns vs. web campaigns, etc.

Retain. This last stage is for the retention of customers (even those who don’t have deep wallets), including rewarding those who bring the bulk of their relationship to the bank. Retaining single-product customers can be important as well (even those who may not be profitable on a fully loaded basis), since they contribute to the high fixed cost of distribution. Recognizing and rewarding the best customers has obvious benefits.

CUSTOMER-CENTRIC COORDINATION
This pragmatic, linear approach to relationship building seems obvious when observed from the customer’s perspective. The issue with delivering it is the need for customer-centric coordination across delivery channels and product lines.

Banks are too often fixated on “product units sold.” A bank-wide tagging and segmentation approach is needed to coordinate channel and product activities according to the right objective for the customer in the progression of the relationship. This is the key to winning in the emerging market. Bankers have to change to reflect the new realities. A simple, pragmatic notion of how accounts become relationships will become the new best-practice marketing approach.

Figure 3: Relationship Development Stages
A pragmatic, linear approach to relationship building needs to be supported with customer-centric coordination across channels and products.

Source: Novantas, Inc.
Complexity Challenge in Commercial Lending

By Michael Rice, Chevy Marchosky and David Zwickl

To improve market responsiveness and streamline complex operations, many commercial lenders need to establish a target operating model. One-off projects won’t suffice.

Complexity long has been a challenge in commercial lending. Success depends on quick responsiveness to a diverse set of clients, products and markets — complicated by the individual negotiations and deal creativity of relationship managers. Loan origination is rife with improvisation and ad hoc activity, defying efforts to streamline the business.

But even though the industry is attacking the complexity challenge with fresh determination, progress is slow. Refinements in particular areas end up not improving the overall workflow. Elaborate new software systems may require extensive customization, yet only succeed in a digital replication of inefficient processes. All too often, speed-to-market and the overall customer experience are not improved.

In many cases, the problem boils down to an essential management issue — patchwork versus framework. Although bright leaders and determined teams are tackling pieces of the puzzle, their efforts are not guided by a shared vision — what is the whole picture eventually supposed to look like as we strive for improvement?

To cut through this uncertainty and the lost opportunity it represents, many banks need to establish a target operating model for commercial lending. This entails an end-to-end review that defines required processes; where they will be performed; and how. Typically more attention is needed on the activities that support loan origination, but servicing must be folded in as well. At a large bank, the model helps to clarify the activities of thousands of people and dozens of essential steps in the overall work flow.

The payoffs are many. A key goal is to improve customer responsiveness and sales productivity by slashing the administrative burden on relationship managers, who often spend more than two-thirds of their time on internal processes and paperwork. Common operations can be consolidated. A roadmap can be developed to migrate the organization, and information technology can be better fitted to business requirements.

It may seem counter-intuitive that such a comprehensive effort is needed in commercial lending, given the voluminous balance growth seen in recent years. But behind the scenes, performance pressures are mounting. Spreads are eroding even as the commercial side is being called upon to do even more to offset the crawling consumer side, fueling a battle for market share that will require a sharpened customer outreach. Regulators are exerting more pressure for consistency. Meanwhile there is growing frustration with various performance initiatives that have not yielded desired traction.

For many banks, the development of a target operating model is essential in clarifying how the commercial lending organization can move ahead.

COMPLEXITY DRIVERS
The complexity in commercial lending reflects a variety of significant and oft-conflicting influences on the business. It starts with multi-faceted customer needs but also includes product design and management, underwriting and risk management, regulatory compliance, back office processes, staff
skills and technology applications (Figure 1: Complexity in Commercial Lending).

**Customer needs.** There are huge variations in customer profiles and needs (including the size of the credit facility), yet typically only a short window of time to respond. RM efforts at “instant customization” then must be threaded through an internal maze of processes and decision makers, chewing up time and resources.

**Product management.** Products must allow for significant variations in customer requirements while providing standardized outputs for booking, funding, servicing and credit management.

**Underwriting.** Credit and risk management processes are not always in sync (or well communicated) with sales processes and/or customer requirements.

**Regulation.** Following the financial crisis, regulators are paying closer attention to commercial lending. They are concerned about objective decision-making and the separation of duties between sales and credit management, as well as the clarity and consistency of underwriting and risk management processes. Much of this regulatory focus ultimately falls on the shoulders of the relationship managers.

**Loan services.** Operating processes (e.g., closing/book- ing) need to be aligned with sales and credit processes to ensure that customer expectations are met.

**Roles and skills.** The delivery of a commercial lending product requires a breadth and depth of skills. Some roles are inherently task-based, such as data entry. Others require a high level of expertise, such as the paralegals who review loan documents.

Yet many institutions have failed to separate skill- and task-based roles. This leads to process fragmentation, excessive hand-offs and a diffusion of accountability. As a result, the workflow is disorderly and the customer experience suffers.

**TRIAL AND ERROR**

Solutions have remained stubbornly elusive, despite considerable effort and expense on workflow redesign programs and new technology platforms.

**RM process redesign.** Acknowledging the pivotal role of relationship managers in winning new business, some lenders have focused their streamlining efforts on freeing up more RM time for prospecting and client development. This makes a lot of sense given that commercial bankers in the field typically are devoting only a third of their time to customers, with the rest spent tending to origination and servicing processes.

These programs tend to fail, however, by leaving larger questions unaddressed and even creating new problems.

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**Figure 1: Complexity in Commercial Lending**

Commercial lending depends on a complex set of interrelated factors. A target operating model helps to ensure that issues are addressed systematically and the needs of all stakeholders are met.

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**Source:** Novantas, Inc.
New servicing routines can become counterproductive by detracting from the customer experience. Critical tasks and activities may be left dangling, unmatched with the appropriate staff roles. Tangled interactions between the front office and the back office may not be clarified.

“Lean” programs. Lean programs strive for the double win of increasing value for customers with fewer resources. Based on a scrupulous study of workflows and the elimination of waste, such programs are intended to identify a series of highly specific steps that can be taken to enhance efficiency and effectiveness.

Many banks have invested heavily in this concept, some even creating dedicated Lean departments. But well-intentioned Lean programs often get off track. For one thing, organizations may recruit Lean professionals with little or no experience in financial services, who then attempt to apply the techniques and tools in a stringent manner more suitable for a manufacturing environment. Another problem is that Lean principles often are applied too narrowly, implemented in a focused area without considering the overall impact on the operating model. Although specific processes may be improved, holistic issues are typically left unresolved.

Such flaws have left banks trapped in a defeating cycle—applying Lean principles, failing to obtain results, stopping the program and starting over again. Program credibility is eroded as this continues, with disaffected staffers distancing themselves and becoming more dismissive of Lean as a “flavor of the day” project.

Technology platforms. On the servicing side of commercial lending, banks have made a lot of progress in migrating from a collection of separate software applications to more comprehensive systems that span multiple processes and teams. But the origination side has been problematic, with expensive initiatives seldom coming to full fruition. Ostensibly the origination side should be well-positioned for progress, given the robust, commercially-available applications in the market. These platforms are capable of supporting a great variety of commercial lending products, and they also integrate well with servicing applications and enterprise content management systems.

**Figure 2: Commercial Lending Process Model**

The target operating model is based on an explicit understanding of the commercial lending value chain, including human capital and technology enablers.

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<table>
<thead>
<tr>
<th>ORIGINATE</th>
<th>UNDERWRITE</th>
<th>CLOSE</th>
<th>MANAGE COLLATERAL</th>
<th>SERVICE</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Engage the client</td>
<td>• Gather documentation</td>
<td>• Create documents</td>
<td>• Pledge assessment</td>
<td>• Maintain client file</td>
</tr>
<tr>
<td>• Gather information</td>
<td>• Assess credit</td>
<td>• Satisfy conditions</td>
<td>• Store documents</td>
<td>• Process payments</td>
</tr>
<tr>
<td>• Price the deal</td>
<td>• Prepare loan package</td>
<td>• Appraisal review</td>
<td>• Retrieve documents</td>
<td>• Issue advances</td>
</tr>
<tr>
<td>• Structure the deal</td>
<td>• Obtain deal approval</td>
<td>• Close the deal</td>
<td>• Record collateral</td>
<td>• Issue advances</td>
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<tr>
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<td>• Secure collateral</td>
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<tr>
<td>• Issue term sheet</td>
<td></td>
<td>• Book the deal</td>
<td>• Release collateral</td>
<td>• Remove deal record</td>
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PEOPLE
(Organization, roles, responsibilities, performance measurement and compensation)

TECHNOLOGY
(Platforms, databases, tools and vendors)
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Source: Novantas, Inc.
However, the payoffs often are limited by various implementation and organizational problems. Technologies are rolled out without a careful understanding of the organization’s specific workflow requirements, and without developing management consensus on common objectives across the many business lines and departments. The all-too-common workaround is to recreate inefficient old processes on the new system, requiring extensive customization and sending implementation costs through the roof.

The effectiveness of these programs is further hampered by the seemingly unending stream of client-specific considerations in originating and servicing a commercial loan. Bankers believe that all commercial loans are unique, driven by the size and shape of the risk; the number of elements to consider in underwriting; and the differentiated structures of payments, covenants and conditions. Systems and teams need to accommodate such variations yet still converge on managing the common elements — principal, interest, repayment schedule, and maturity terms.

**TARGET OPERATING MODEL**
As we have seen, addressing the complexity challenge is as much about vision and cohesion as it is about technologies and techniques. Each element — client needs, origination and servicing processes, staff roles and skills, business units and technologies — needs to be understood in relation to the other and fitted into a vision of how a streamlined system is supposed to work (Figure 2: Commercial Lending Process Model).

To develop this model, the commercial bank will need an end-to-end review and redesign of its lending operations. This includes defining key processes, where they will they be performed, and how. Three particular issues are critical:

*Process transparency.* The origination pipeline is particularly in need of attention. Far less is formalized in a growth-intensive setting that emphasizes case-by-case responsiveness; the technology is newer; and market and regulatory changes are driving new approaches.

Four major groups are affected by origination process clarity, including customers, relationship managers, line of business management and production staff. Operational cohesion with loan originations in progress is an obvious focus, but the commercial lending group also needs a clear picture of business development.

In that spirit, the first step is to investigate the full cycle of key origination processes and set a vision for how they should work and link together. This includes the processes by which leads are developed into specific lending opportunities; how working concepts are vetted for fit with the bank’s criteria for new business; how a proposal is generated and turned into a term sheet; and activities required for negotiation.

**Figure 3: Credit Event Complexity**

The approval of a credit facility typically entails numerous “credit events,” including formal and informal staff interactions in meetings, reviews and conversations.

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* The chain of credit events often includes multiple iterations of the preview and pre-screen discussions with the business unit.

Source: Novantas, Inc.
Role clarification. Once the processes are defined, the question turns to work roles and organizational structure. Of course all banks have organizational charts, but in the throes of booking new business, formal structures often devolve into something resembling giant contingency teams, with lots of confusion and overlap between roles.

The target operating model seeks to tame this chaos by carefully matching defined processes with staff work roles. Such role definition is key in offloading processing burdens from relationship managers, and in reconsidering organizational structures.

In addition to the various loan origination roles, a target operating model defines the work roles for loan fulfillment. Depending on the bank, these roles can include processors, loan closing coordinators, documentation specialists and bookers. In addition to process efficiency, clear role definition is critical to a good customer experience.

Credit approval. High on the list of concerns is the complex (and often uncertain) routing of activities that lead up to the approval of a credit facility. The approval process entails a number of formal and informal staff interactions, including meetings, reviews and conversations. At some institutions, as many as 10 of these “credit events” precede the funding of a loan (Figure 3: Credit Event Complexity).

The struggle lies in the loose definition of these events, leaving key decision processes to become black boxes — undecipherable, unpredictable and certainly not efficient. One consequence is that relationship managers are forced to become internal lobbyists for credit approval. Rather than relying on a predictable process, they must work their network of connections to “pre-sell” their deals.

Poorly-defined credit events also squander staff resources, both in figuring out what needs to be done next and in dealing with the crush of required participants. Some events may include from three to seven staffers just to issue a term letter, regardless of risk level.

One of the most contentious issues centers on the final sign-off on deals, committee approval versus individual (or signature) approval. Generally, it helps to move deals along when higher levels of decision authority are closer to the transaction point with the client, which is the argument for signature approval. But that leaves regulators to question the purpose of credit committees, and whether sales urgency is having too much influence on critical underwriting processes. Most banks have a big knot to untangle.

Finally, the target operating model helps to clarify technology requirements. As the vision for processes and work roles is fleshed out, the organization gains a robust context for selecting and implementing technology components, based on an explicit understanding of the bank’s functional requirements. This can include determining the role of a customer relationship management application; or an enterprise content management technology such as imaging and electronic forms; or the right software bridges between origination and servicing processes.

ROAD MAP FOR CHANGE
Recent years have seen a vigorous loan expansion in commercial banking. Now the industry is turning the corner into a more challenging environment — not without promise to be sure, but presenting more difficulty in meeting high expectations.

Looking internally for upside potential, bankers have had high hopes that new technology applications would help them to finally deal with some of the longstanding complexity issues that have dogged the industry. But results have been mixed, with cumbersome processes still strongly detracting from RM client responsiveness and operating consistency and efficiency.

In many areas of the bank and not just commercial lending, the problem with incremental improvement is that it tends to take on a life of its own, to the point that it actually becomes an impediment. Though various executives and departments may show a lot of initiative in their specific domains, overall progress can remain muted, a victim of organizational disconnects.

For commercial lenders, a target operating model can provide a roadmap for change, one that has well-defined processes, work roles and appropriate technology utilization.”

“Though various executives and departments may show a lot of initiative, overall progress can remain muted, a victim of organizational disconnects. A target operating model can provide a roadmap for change, one that has well-defined processes, work roles and appropriate technology utilization.”

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Earning Your Profitable Share in Home Equity Lending

BY DARRYL DEMOS, RICH SOLOMON, GRACE LEE AND TED GIBSON

With high-volume product push a thing of the past, banks will need new strategies and skills to win in the crawling recovery projected for home equity lending.

After years of post-recession turmoil and contraction, the home equity lending business is finally leveling out, with the first sliver of growth projected for the second half of 2014 and visible expansion anticipated next year. That is good news for retail banks.

But while this is a time for hope, it is also a time for realism about the changed environment for home equity lending and what it will take to win in the new market. For a variety of reasons, growth and profitability trends likely will remain muted compared with prior expansion eras, even over the long term.

Lenders will face a continuing intense competitive environment, with each player jockeying to claim its fair share of profitable growth. The era of high-volume product push is over, raising questions about the new basis of competition — the strategies and skills that will be needed to win.

Essentially, many banks are facing a reformulation of home equity lending. In an emerging market characterized by modest growth, heavy competition and heavy regulation, winners will be the ones that learn how to tap pockets of opportunity, and also overcome loan origination complexities to expedite the customer purchase process.

The time to prepare is now, and several advancements will be required to win. The first is refined profitability modeling, going beyond portfolio averages to customer-level metrics that incorporate utilization characteristics and the cost of capital. A second priority is to improve pricing and market analytics, particularly elasticity-based pricing relative to competitors.

Third is more surgically precise targeting. Often today, targeted offers are based almost entirely on credit-worthiness, the higher the better, but overlook the potential for utilization. Both factors are important. Finally, the market now demands fast cycle times for underwriting and closing. This will be essential as volume picks up (yet can be at odds with regulatory pressures today).

These levers can help to drive profitable growth in home
equity lending. Ultimately they can be melded into an optimization framework that can be used across the franchise. As well, advanced players are establishing common technology platforms and inclusive governance structures to implement a more sophisticated customer outreach and manage the more complex processes that support it.

PARTLY SUNNY

The post-recession years have been devastating for home equity lending, formerly a mainstay of growth and profitability in retail banking. Over the five years ending December 31, 2013, total HE loan balances in the banking industry fell by 68%, or $177 billion, according to data published by the Federal Deposit Insurance Corp. Lines of credit fell by 24%, or $157 billion, over the same time period.

While it is still too early to declare a rebound, the rate of contraction has been slowing and there are some hopeful signs. Balance sheet runoff likely will end this year, at least for the industry overall. Meanwhile Novantas projections indicate that HE lines of credit, a barometer of borrower confidence, are poised for a modest upswing in 2014’s second half, fueling a roughly 3% lift for the full year. An 8% lift is projected for 2015 (Figure 1: HELOC Trends on the Mend).

These developments reflect recovery trends in select U.S. housing markets, a firming picture for U.S. employment, and banking industry progress in working down distressed assets and cleaning up the books to support fresh growth.

That is the sunny part of the outlook, but there are clouds as well. For one thing, the recovery in home values has been uneven across the country, with a number of markets still working to regain altitude. In places like Arizona, Florida and Nevada, many borrowers are still underwater on their mortgages — more than 20% of the total count in each of these three states, according to some estimates.

A further complication is new regulation, principally stemming from the Dodd-Frank Wall Street Reform and Consumer Financial Protection Act. Lenders now face additional scrutiny on key practices and details, including annual percentage rates, points and fees, and prepayment penalties. Then if such factors combine to produce a “high-cost mortgage,” borrower counseling is required. These and other regulatory requirements place a profit drain on origination and servicing.

Another braking factor is a general atmosphere of caution, both on the part of borrowers and lenders. Households have less appetite for mortgage-related credit and banks have tightened their standards for supplying it.

Figure 1: HELOC Trends on the Mend

Home equity lines of credit will grow by an estimated 3% for 2014 overall, with an 8% rise projected for 2015.

Source: Federal Housing Finance Agency, Federal Deposit Insurance Corp., macroeconomic and banking industry analysis by Novantas, Inc.
Combined, all these factors portend a “partly sunny” outlook for home equity lending. There will be growth, but not like before, and meanwhile new regulation has driven up the cost of doing business.

**PERFORMANCE IMPEDIMENTS**

Conventional practices are not up to dealing with the emerging market in home equity lending. Performance impediment has many faces:

- Origination profitability is often assessed on the basis of current margins, as opposed to probabilistic estimates of economic returns over the life of a credit facility. Often there is radical cross-subsidization of accounts. Furthermore, risk/return assessments overly depend on the FICO score and other traditional risk dimensions, omitting salient data from core customer relationships and perspectives on the extent of likely usage (and, therefore, profitability).
- Marketing still leans toward broad product push, with less pursuit of targeted opportunities with select customer segments.
- Uniform pricing often is extended broadly across the franchise, overlooking differences in customer rate sensitivity and variations in local market dynamics.
- Instead of being corrected, tedious loan origination processes have actually degraded with the advent of new regulation. Such practices may not have been perceived as front-burner issues in prior eras of peak growth, when all of the focus was on harvesting high origination volumes. Now, however, they detract from winning profitable share in a tight market.

Going forward, home equity lenders will need to understand their customers and markets at a much more granular level, and sophisticated analytics will be at the core of a winning response. Central to this effort is the concept of “de-averaging,” using a dynamic approach to segmentation along customer, product and local competitive attributes.

Among other things, this level of granularity will enable leading competitors to optimize rate offers to target customers without compromising the risk-adjusted profitability of their entire book. Effectively, banks will need to make a subtle-yet-powerful shift from risk- to profitability-based pricing, and explicitly understand profitability and behavioral variations across portfolio tiers and customer segments.

**NEW FUNDAMENTALS**

To reach this more analytically-driven level of performance, leaders are strengthening a series of specific capabilities. Even if a bank doesn’t have the resources to invest in all areas, each additional capability will yield significant improvements to the bottom line.

*Profitability modeling.* More than any other analytic capability, banks initially need insights into profitability differentiation across the portfolio. For one thing, portfolio-level metrics can mask huge skews within the book. Portfolio performance

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**Integrated Approach**

Ultimately the core analytic components in home equity lending need to be tied into an overall management and technological framework. This type of integration will support precise decision-making across the franchise, drawing on multiple performance perspectives. It will also help to unify the efforts of various business units and centers of influence within the bank.

*Optimization framework.* With pricing, banks need flexible optimization capabilities that will allow them to determine the best trade-offs between balance formation and margin enhancement, within defined limits. Pricing constraints can be set relative to the market and to floor hurdle rates. From another perspective, portfolio risk can be managed by balancing the concentration of assets attributable to each risk tier.

*Common platform.* It will be imperative for all of the management constituencies involved in home equity lending to work together to apply analytical findings throughout the product management and pricing processes. To orchestrate the changes needed to boost profitable growth, a number of parties need to be working off the same analytics.

For example: Finance needs to sign off on granular calculations of product costs; treasury needs to assess profit dynamics (e.g. net present value); and underwriting needs to assess potential results under different scenarios and provide feedback on segmentation and pricing decisions. Meanwhile, the product management team needs to coordinate segmentation changes and also integrate analyses to establish growth targets by segment. And the pricing team needs elasticity analytics to identify growth opportunities and segments where spread revenue can be increased with minimal volume impact.

This type of coordinated effort, supported by deep analytic skills, will be needed to earn profitable share in the emerging environment for home equity lending.

— Darryl Demos, Rich Solomon, Grace Lee and Ted Gibson
often depends on a small subset of extremely profitable customers, while myriad breakeven and subtractive accounts are left undiagnosed and untreated. Management needs to pinpoint this information in order to nurture strengths and address weaknesses.

Improved profitability modeling is also an important key to improved pricing. Once attrition and prepayment patterns are considered relative to term length, for example, short-term balances often prove less profitable than what commonly is perceived, providing insight on where higher pricing may be warranted.

Targeting also comes into play. By dwelling on risk factors and failing to model likely utilization, for example, banks often wind up over-directing generous HELOC offers to the financially strongest households, which typically have the least need for liquidity. Though these relatively larger lines go empty, they still incur charges for standby capital needed to support possible borrowing, and the compound effect is a series of wildly unprofitable accounts.

Meanwhile, material opportunities for more extensive usage of credit are being overlooked within the customer base. While it is certainly important to weigh risk within customer tiers exhibiting lower credit profiles, many banks underestimate projected profitability by failing to assess the likely extent of responsible usage, based on behavioral insights and the information advantage they have with their own customers.

**Market intelligence and pricing.** Beyond pricing to meet internal standards for profitability, it is important to evaluate pricing positions relative to local markets within the franchise, considering competitive stance (as reflected in market share) and total market opportunity as well. Marrying these two methodologies allows banks to price aggressively in segments where they can achieve hurdle profitability at below-market rates, while downplaying heavily-competed locales that inhibit profitable pricing at market levels.

**Surgical targeting.** Once a bank has incorporated insights from profitability and competitive data, the next step is to investigate differences in customer responses to rate (or price elasticity of demand). Banks need to identify and pursue elastic segments where an aggressive price will still achieve hurdle returns, while pricing more conservatively and achieving additional spread revenue in inelastic segments.

**“[R]egulatory tightening and a shrunken customer appetite likely will constrain volumes below pre-crisis levels, even in the long term. In this smaller home equity market, banks will need to sharpen their analytical toolkit to target the customers they can win at the right levels of profitability.”**

**Preparation cycle times.** The complexities of new regulation have led to increasingly long cycle times for the total sales process that spans application, offer, acceptance and closing. This creates the inevitable risk of demand drop-off — people can get frustrated and back out just short of the finish line. Meanwhile the anticipated increase in volume will require greater throughput capacity. Given these issues and the growing use of digital processes, it is clear that banks need to reconsider/redesign origination processes to improve cycle time and the customer experience.

Along with that, they need to re-examine how they are using (or not using) current systems capabilities, both for customer relationship management and loan origination. Finally there is a critical need for role clarity across the end-to-end origination process. Murky definitions can confuse both customers and staff; lead to excessive hand-offs of paperwork; and increase the potential for lost documentation. All detract from the customer experience.

**Preparing for growth**

While there are encouraging signs of stabilization and rising hopes for the beginnings of growth in home equity lending, regulatory tightening and a shrunken customer appetite likely will constrain volumes below pre-crisis levels, even in the long term. In this smaller home equity market, banks will need to sharpen their analytical toolkit to target the customers they can win at the right levels of profitability.

Leading banks are migrating away from traditional risk and propensity variables, instead using sophisticated analytical methods to discover high-potential customer segments and align appropriate offers. They are also working to develop a much more customer-friendly origination process at the point of sale. Such preparation will make all the difference as the market slowly improves.

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To nurture core deposit relationships in a tightening market, winning banks will leverage the customer information advantage for more targeted deposit pricing and marketing.

As retail banking executives prepare for the next cycle of rising interest rates, many are asking themselves what it will take to win. Competitors now value core deposits more highly because of regulation, and meanwhile depositors are likely to seek advantaged rates — particularly established customers who have been stuck with low-yielding accounts for years and have a pent-up hunger for attractive alternatives.

In the advent of a true market jump, many banks will be handicapped in their deposit pricing responses. Broad-brush pricing still is prevalent in the consumer deposit business. And even though fairly uniform pricing represents the bank’s best estimation of internal need for funding and general market requirements, it often collides with the realities of a diverse customer base.

The opportunity for growing deposits at an advantaged rate in an increasingly competitive environment lies in surgically targeting pools of attractive deposits. That implies segmenting the customer base and offering each segment what it wants (access, functionality, etc.), at prices the bank can afford to pay.

The demand for rates varies widely across a typical bank’s customer base, calling for tailored responses. Some customers primarily look for convenience and service, and price is not a primary factor in their banking decisions. Other customers constantly shop for the best return and will chase a better offer at a moment’s notice. To the extent these “hot” balances are needed, targeted rate offers should be fenced to prevent cannibalization. In the middle are customers who view rates as just one part of the value proposition and do not constantly shop. Often these are valuable relationships, deserving a balance of good rates and good functionality.

An ability to distinguish between these groups will be critical in managing the deposit portfolio going forward. Segment insights can be used to identify and nurture sticky balances,
or alternatively to tap the most rate-sensitive customers for short-term funding needs. This requires one set of strategies for steadily building cost-effective long-term balances, and another set for attracting rate-sensitive balances “as needed” through the selective use of aggressive pricing.

Much depends on the skillful use of one of banking’s great underutilized assets — information on customer product usage. The majority of new balances come from current customers, providing an advantage for banks that can derive relationship insights from the rich account and transaction data that is available internally. Success, however, will require a stronger analytics infrastructure and an ability to target customers in their preferred channels for shopping and transactions.

KEEPING UP WITH THE MARKET
Traditionally banks have used a priori segmentation schemes that consider factors such as product type; balance tier and term; and pricing variations seen in local markets within the branch network footprint. They heavily relied on the branch sales force to cross-sell products to established customers, augmenting marketing with direct mail campaigns to high-potential prospects. More granular customer-level strategies were minimal.

With the ongoing customer migration away from the branch to alternative channels, banks have suffered a blow to the traditional deposit marketing and sales model. Yet they have gained a potentially powerful new ability in direct marketing. No longer limited to paper- and counter-based interaction, institutions can conduct segment-targeted campaigns that reflect relationship dynamics and reach customers electronically.

The catch is that at many banks, deposit pricing capabilities have not kept up with changes in the market. To be sure, there have been meaningful advances, both in analytics that identify variations in customer price elasticity, and with the systems used to deploy more granular pricing schemes for use in the field. Yet for the vast majority of deposits, most banks still

Figure 1: Three Fundamentals of Deposit Growth Strategy

For cost-effective deposit growth, banks need to cultivate “everyday” household balances, prepare targeted rate offers where needed, and restrict high-rate offers.

HH CASH MANAGEMENT
Build a Strong Payments/Cash Management Franchise
- Cultivate balances held for payments and convenience
- Especially effective in markets with strong network brand
- Mine customer information to identify balances eligible for consolidation with the primary bank bankers have difficulty reaching

RATE TARGETING
Develop a “Surgical” Rate Strategy, Targeted to Situationally Elastic Customers
- Use behavioral modeling to create segment tags
- Develop targeted rate offers to attract “off-us” balances held by current customers
- Identify key “events” to market against

STANDBY OPTIONS
Develop a “Hot Money” Strategy
- Standby mass-marketed campaigns for use when and if other strategies fail to produce sufficient balances
- High prices relative to general offers, but with restrictive terms and conditions
- Could also pursue via an out-of-footprint direct bank, focused on national franchise lines of business

Source: Novantas, Inc.
“Higher rates may be well-justified for some customers; in other cases rates will not be on the customer radar screen. [In a future environment of rising rates], it will be critical to be able to tell the difference and determine when and how to pull various levers in marketing and pricing.”

use a fairly traditional rate grid to set prices.

A key emphasis (especially prior to the recession) has been pricing for balance acquisition. To selectively attract deposits while minimizing the distribution of aggressive offers where they are not needed, banks have honed their skills with introductory promotional rates, off-term specials for certificates of deposit, and protections embedded in the terms and conditions that go with promotional accounts. All of these tactics are product promotional approaches to growing deposits, and they completely ignore segment- and customer-level behaviors once the balances have been acquired.

Thus the more customer-centric issue is how to optimize pricing across the different needs and expected behaviors of established customers. Over the last five years, the depressed rate environment lowered expectations, and many customers essentially ignored the rate on their deposit accounts. When rates rise, there will likely be a leap in account turnover and balance migration as people search for higher returns.

Banks need to be prepared to refine pricing according to what the customers want and what the bank can afford, and also to recognize and nurture non-price drivers of customer loyalty. Higher rates may be well-justified for some customers; in other cases rates will not be on the customer radar screen. It will be critical to be able to tell the difference and determine when and how to pull various levers in marketing and pricing.

THE CASE FOR ADVANCED MODELING

To win in the new environment, banks will need to match an improved understanding of customer needs and attitudes with an ability to execute pricing strategies surgically. The pricing team must be able to make segment-informed tradeoffs in attracting long-term balances versus short-term funding.

Advanced deposit modeling will be a critical capability in many of these decisions. By analyzing customer profiles and behaviors, including individual transaction details, banks will find justification for using rates in many varied ways.

Primary checking account customers have favorable behaviors that speak to the value of targeted campaigns. Novantas analysis shows that customers with an active checking account are less demanding about rates, plus they are more likely to retain balances regardless of promotional campaigns. The top priority for such customers is building strong payments and cash management franchises to retain their convenience-oriented savings balances (Figure 1: Three Fundamentals of Deposit Growth Strategy). Additionally, established customers typically supply more than half of the balances garnered in mass market promotional campaigns. On average these balances are twice as likely to remain with the bank beyond the first year, compared with new-to-bank customers. Skillful banks can use targeted pricing to attract an even greater share of long-term balances from the current customer base by finding “situationally elastic” customers who will respond to a premium offer and then keep the money with the bank. These balances are more valuable from both an economic and a regulatory standpoint.

Most banks are just beginning to learn how to place these constructive core customer behaviors into a framework for targeted deposit marketing and pricing, leaving the retail banking industry in a general state of strong dependency on mass-marketed campaigns. It is time for a course correction.

In the future, targeted campaigns to build long-term balances should take priority, and aggressive mass-marketed pricing to attract hot money should be reserved for use only when needed to fill gaps in short-term funding. In situations where aggressive campaigns prove necessary, they should be conducted in controlled circumstances (e.g., tough restrictions, select markets) to minimize potential cannibalization.

TIPPING POINT

Although current market and portfolio dynamics remain quite manageable overall, the calm can be deceiving. Typically in a rising rate environment, a point is reached where many long-standing deposit customers become sensitive to account yields and begin to consider the possibilities of getting a better deal. Rate shopping can go from a trickle to a flood, leaving unprepared banks at risk of losing valuable core deposits.

To prepare for this eventuality, banks will need new levels of expertise in relationship pricing. Rich internal data on core customers will provide a valuable start, turning the question to segment-targeted analytic models, pricing strategies and marketing campaigns. Will competitors be ready in time?

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Profound changes in customer channel usage patterns now argue for a dedicated staff of telephone-based bankers who can strongly augment small business sales.

The telephone long has been a useful supplemental sales channel in small business banking, most visibly with cross-sales by phone-based service staff. By capitalizing on reactive opportunities with clients when they call, service reps have been able to generate a respectable stream of sales leads and referrals.

Yet within the typical organization, such activity has tended to fly on auto-pilot — not exactly starved for resources but also not seen as worthy of significant additional investment. The widespread assumption is that the phone channel has limited potential. But now there are compelling reasons to expand the role of phone-based sales.

With face time in the branch eroding as more day-to-day activity is redirected online, banks are searching for ways to maintain conversational rapport with small business customers, but without the considerable expense that goes with an expanded team of dedicated small business bankers in the field. They also need an effective way to handle a growing volume of purchase inquiries that originate via web-based customer research and need a personal touch for fulfillment.

The situation calls for a new type of “inside sales” team, centrally staffed by experienced small business bankers, that can play a much more proactive role over the phone. Along with expert responsiveness to inbound inquiries, this
includes cost-effective prospecting in designated territories; ongoing relationship management with assigned accounts; and even cross-sales with larger established accounts managed in the field.

This arrangement plugs a gap that, from an economic perspective, simply cannot be filled by local small business bankers. Commanding higher salaries and with client face time limited by local travel requirements, these field bankers typically need to focus their energies on a smaller number of larger, high-value opportunities and accounts.

To succeed, however, the inside sales model needs some important forms of support and coordination. The sales outreach is primarily data-driven, for one thing, requiring the skilled use of client and prospect information to prioritize efforts and guide calling activity. Also selling activities need to be coordinated so that the inside team avoids overlaps with the field teams while expanding total market coverage.

CASE FOR CHANGE
The inside sales model relies on dedicated team of trained, experienced small business bankers. Though purely dedicated to telephone-based sales, these bankers are distinctly different from service-oriented call center reps (Figure 1: The Role of Small Business Telesales).

Centrally-located, the inside teams do not rely on relationship-based referrals and sales, or on market-based networking. Instead they rely on advanced analytics to facilitate targeted sales activities.

But why is inside sales an important concept now? What has changed to elevate this capability from “nice to have” to “need to have”? The short answer is that small business customers increasingly are adopting the multi-channel behavioral patterns first seen on the consumer side, calling for creative responses to a changing market.

A challenging aspect of the digital migration is that it has progressed to the point of disrupting traditional marketing and sales practices. There is less customer interaction in the branch; product and provider selections are now strongly influenced by online research; and remote purchase fulfillment is on the rise.

Figure 1: The Role of Small Business Telesales

A robust phone-based team can provide cost-effective sales coverage, improve lead generation and the handling of referrals, and provide live support to online customers.

Source: Novantas, Inc.
Meanwhile the economics of the dedicated small business banker are coming into question. In an ideal world the ranks of roving field representatives could be expanded, offsetting the loss of face time in the branch by bringing personal contact directly to the small business client. But this resource is expensive and can only be used selectively.

Assuming a typical broad clientele drawn from all tiers of relationship profitability, Novantas research indicates that a single banker position typically needs to serve upwards of 250 small business clients just to achieve breakeven returns for the bank. This clearly is a stretch, especially given the time that needs to be spent getting to know customers and understanding their needs. How can banks profitably serve local small business customers with limited sales resources?

The answer lies in a tiered sales structure. Step one is to allocate the most expensive local banker resources to the customer segment with the highest revenue potential and profit margins. Step two is to establish a robust phone-based team that can provide cost-effective sales coverage for the broader clientele and prospect base.

This model requires a new approach that leverages technology and changing customer behavior to improve banker reach and efficiency. The good news is that many banks already possess some of the required infrastructure for inside sales. This includes robust telephone capabilities currently focused on service, which can be adapted to support a proactive sales function as well. Most banks will not be starting from scratch.

SUCCESS FACTORS

Small business telephone service centers are common and most banks have experimented with service-to-sales initiatives. Yet results have been mixed. Elsewhere banks have launched pilot projects with full-fledged bankers working over the phone, but again with varying results. But there is no reason to give up. The good news is that most of the early disappointments trace back to a set of common issues that can be readily addressed.

The first pitfall is not adequately integrating the new inside sales team with the established teams of local small business bankers. A murky delineation of roles and responsibilities between the two groups often sets the stage for future problems.

Direct, field-based sales professionals will need to focus on the larger and more profitable clients that justify the time required to cultivate and develop their business. To free up the direct sales teams so they can focus on larger clients, the inside team must be able to assume full sales responsibility for medium and smaller enterprises, typically those with less than $10 million of annual sales. This will require well-developed capabilities with phone-based prospecting, sales and onboarding.

To manage the end-to-end client relationship over the phone, inside sales bankers must become named resources, individually known to customers and easily reachable, facilitating customer rapport and relationship continuity. A trap to avoid is trying for blended assignments that have bankers visiting clients locally and also studiously working the phone. This sacrifices the efficiency of the inside sales model by leaving bankers saddled with the responsibility of travel and face-to-face meeting requirements.

A second impediment is a weak integration of supporting analytics with the inside sales team’s standard business practices. A centralized, telephone-based sales team works best when a qualified lead list is provided upfront.

There are four categories of analytics that must be considered in a sales environment: descriptive, prescriptive, predictive and inquisitive. Researching, refining and documenting analytic capabilities is an essential requirement for small business inside sales, and this groundwork can have broader organizational benefits as well.

A third mistake is over-pressuring skilled service representatives to assume the fuller banker roles and responsibilities needed for success with inside sales. Banker knowledge and credibility is critical, both in quickly establishing customer rapport and unlocking sales opportunities within the context of customer needs. This particularly applies to proactive outbound calling. This is a relatively new skill for many small business banking divisions and should not left to administrative and service staff.

In fact, the bankers who anchor the inside sales team often can prime the pump for local market sales by identifying and qualifying sales leads over the phone and scheduling sales appointments for the direct sales team. In addition to providing valuable phone channel experience for inside sales professionals, this type of field support helps with the integration of the function across the larger organization.

A fourth issue with inside sales is the risk of getting out of sync with the overall progress of the organization. In
some cases, more work is needed on centralized telephone service capabilities, an essential building block for robust telesales. Elsewhere the concern is optimizing the division of effort for client coverage and disciplined calling. Ultimately there will be questions about how to incorporate inside sales into a more complete multi-channel framework to win profitable share of wallet with every customer.

PROVEN CONCEPT

It is important to note that the inside sales model is being used successfully in other industries. Small business banking divisions will have their growing pains, but that is more about implementation: the concept itself is on sound footing.

Illustrating the possibilities, one information company has built the core of its sales effort around inside sales, thriving with a team that is 85% centralized and telephone-based. Notably, the inside sales team has proved itself quite capable of closing high-value transactions over the phone, with some contracts representing 500% of the revenues from the average small business sale.

The company in this case study has mastered many of the critical success factors for inside sales. Inside sales reps are individually assigned to the larger accounts and are able to develop in-depth relationships with customers in the phone environment (smaller accounts are pooled and supported by a separate inside sales staffing arrangement).

Customer analytics play a prominent role, used by the inside sales team to drive cross-sell initiatives with established clients. Digital tracking is used as well, both in prospecting and in monitoring the progress of interactions with potential new customers. Able to capture key information pertaining to website traffic, the inside sales team can rapidly contact prospects who have visited, requested information or asked for follow-up by a sales rep. Elsewhere this tracking capability is also used to support live chat.

In considering how to create this type of momentum in small business banking, there are three major issues:

Customer potential. Typically following a review of the client and prospect base, small business banking divisions find a smaller subset of larger clients that generate the lion’s share of revenues; a mid-size cohort that falls somewhat into a gray zone based on revenue potential and the cost to serve; and a numerically large group of grass-roots enterprises whose potential largely goes untapped.

The question is how changing channel usage patterns are affecting the approach to each group. Along with affirming the need for high-touch service for high-value accounts, a channel-informed review often reveals significant opportunities for alternative marketing and sales strategies, including inside sales.

Required capabilities. While some banks still have work to do in strengthening general phone-based capabilities, a major question lies with customer analytics, the backbone of inside sales. Inside sales activities are data-driven and employ customer and prospect information to help prioritize opportunities and direct sales calling activity.

Is the bank adequately prepared for an analytically-guided outreach that allows the inside sales reps to target their calling efforts and succeed largely without the benefit of local networking and referrals? Also the bank will be forming a new type of centralized banker team having its own cultural and skill dynamics.

Action plan. The inside sales function needs to fit within the bank’s strategy and overall division of labor for client coverage, making sure that efforts are coordinated with the activities of small business bankers active in local markets.

It is important to distinguish between the target customer segments for the two sales teams (often the field-based sales teams will take on larger customer accounts in more populated markets). It is also important to integrate the selling activities of the two teams by coordinating inside sales support for the cross-sale of current customers (including those initially acquired by the field sales teams), as well as new account acquisition for smaller accounts.

There is a significant opportunity for small business banking divisions to improve sales execution by building a set of leading multi-channel sales capabilities. One of the best near-term opportunities is to establish a dedicated inside sales team.

Many banks have made limited investments in this area and most underestimate the opportunity, instituting half-measures only. But increasingly profound changes in customer channel usage patterns now argue for an aggressive pursuit of the inside sales opportunity in small business banking.

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Harnessing Digital for Branch Sales

Online shopping and branch sales are now joined at the hip, yet most banks are not yet measuring the day-to-day effectiveness of digital in driving shoppers into the store.

BY CHRIS MUSTO AND KEVIN TRAVIS

What is the fastest-growing influence on household acquisition and deposit sales in the branch? Without a doubt it is the online experience for web-oriented shoppers. Yet few banks have formal programs to harness digital banking for branch sales.

Most players assume the online space is a separate sales domain. Online teams are measured by success in completing account originations online; meanwhile branches are left to struggle on their own as traditional local marketing and sales tactics erode.

Bridging these two worlds is imperative, as underscored by Novantas research showing that while two-thirds of consumers prefer to shop for a new checking relationship online, roughly 90% still open checking and other deposit accounts in the branch. Solving this problem begins with a recognition that in the important realm of new-to-bank household acquisition, online shopping and branch sales fulfillment are now joined at the hip — one cannot succeed without the other. From there, the race is on to investigate and optimize the digital-to-branch funnel.

Most banks are not yet measuring the day-to-day effectiveness of digital in driving shoppers into the store. This creates some serious management gaps, both in pinpointing issues and opportunities, and in determining the right level of investment in digital marketing, technology and analytics. The situation presents a clear call to action. Defending and growing market share will require formal metrics and programs that bridge the digital and branch channels, backed by a visible management.
commitment and strong collaboration among the retail silos.

**PARTIAL SOLUTIONS**

At most banks today, branches and digital channels have separate performance metrics and goals. At best, some banks can measure multi-channel results from one-off digital campaigns. But for the most part, branch sales productivity and the digital shopping funnel are managed as separate phenomena.

This has fostered partial solutions based on partial views of the situation. One example is a narrow focus on sales fulfillment online. Quite properly, banks are mindful of the customer online migration and want to make sure they can win their fair share of the growing online purchase stream.

Indeed, in one recent Novantas survey, 30% of surveyed checking shoppers reported that they preferred online migration and want to make sure they can win their fair share of the growing online purchase stream.

"...For the most part, branch sales productivity and the digital shopping funnel are managed as separate phenomena. This has fostered partial solutions based on partial views of the situation."

to both shop online and open accounts online. But in reality, even at national and large regional banks, rarely do more than 5% of customers actually shop then open online today, suggesting something is broken.

Online refinements can take on a life of their own. Lacking metrics that tie customer online shopping activity with account originations that later are completed in the branch, banks tend to measure their digital teams strictly by sales completed online. This actively discourages efforts to optimize cross-channel sales flowing to the branch.

Clickstream analytics can pose a further distraction. While this

**Figure 1: Mapping the Purchase Funnel**

With online shoppers, a range of impediments and solutions affect purchase pull-through, either online or more commonly in the branch. All of the key factors need to be analyzed and managed.

<table>
<thead>
<tr>
<th>AWARENESS</th>
<th>CONSIDERATION</th>
<th>PURCHASE</th>
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<td><strong>Typical Impediments</strong></td>
<td><strong>Potential Solutions</strong></td>
<td><strong>Potential Solutions</strong></td>
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<tr>
<td>• Online awareness strategy not attuned to market position</td>
<td>• Products perceived as uncompetitive</td>
<td>• Poor online account opening experience or expectation-setting</td>
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<tr>
<td>• Weak outreach to convey value proposition / benefits</td>
<td>• Mismatch of value proposition with the market</td>
<td>• Confusing or un-motivating handoff to the branch</td>
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<tr>
<td>• Lack of incentive to consider</td>
<td>• Overly complex product presentation</td>
<td>• Poor branch sales continuity when online shoppers arrive</td>
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**Source:** Novantas, Inc.
“The bank should be seeking to understand online customer intentions, particularly as they relate to potential offline actions. What is going on in the minds of online shoppers as they proactively navigate to the branch to fulfill transactions?”

The technique provides insights into the progress of online shoppers as they arrive at a web site and click their way through, taken alone it leaves out too many components that drive sales success, particularly cross-channel.

The bank should be seeking to understand online customer intentions, particularly as they relate to potential offline actions. For example, a shopper may query checking accounts online as a research exercise, trying to find out more about a product and what it takes to set things up. This shopper is likely then to abandon the online process, only to show up some time later at a branch, ready to open an account.

Ironically, clickstream analytics will tend to interpret this scenario as a defeat, seeing only that the application process may have started online but was never fulfilled online. And many bankers are tempted to buy into this type of interpretation, swayed by the impressive clickstream software statistics and ignoring the fact that most online-influenced deposit account sales are fulfilled in the branch.

KEY QUESTIONS

To methodically improve branch sales to digital shoppers, retail banks should start with completed sales in the branch and trace backward. The goal is to explicitly link branch sales with their online origins and influences. Banks also need to identify the hang-ups that cause some interested online shoppers to drop off prior to purchase (Figure 1: “Mapping the Purchase Funnel”).

Direct shopper research is critical to this investigation, not just descriptions of profiles and activity, but also the drivers of decisions and behaviors from the customer point of view. What is going on in the minds of online shoppers as they proactively navigate to the branch to fulfill transactions?

A further requirement of this research is that it should be market-based, given that the nature of the opportunities for digital-to-branch sales will vary by geographical market within the bank’s network footprint.

Finally, there is work to be done in understanding which elements of the digital experience make the most difference to the most desirable customers.

As it pertains to new-to-bank prospects, the digital sales and marketing landscape broadly divides into: 1) owned media (notably the bank’s public web site); 2) paid media (including display and search ads); and 3) earned media, such as positive mentions in social media and direct communication.

Alternatively, owned, earned or paid media may have shaken loose a customer who otherwise was not planning to switch; swayed a shopper already in motion; validated the bank; or simply served as a branch locator.

As these influences are better understood, the bank can more precisely identify the particular combinations of cross-media activities that will be most effective in each market.

In a dominant market, for instance, the web site may play a critical role in validating the bank. In an underpenetrated market, by contrast, a lack of brand awareness may increase the relevance of paid and earned media and the need for a compelling product offering.

Such investigations will help the bank understand the specific activities, influences and processes that drive completed sales transactions, leading to a gap analysis that identifies critical factors in need of improvement, and the likely upside. Ultimately, the bank needs to know what it stands to gain from improved digital effectiveness and how that will show up in improved sales productivity.

Banks that crack the code on understanding the value of digital to their overall sales funnel will begin to optimize their acquisition rates faster than their peers and likely reap outsized growth.

Getting this right will also inform the mix of channels that will be needed in the future to sell more, and will start the cultural shift banks are going to have to make to build multi-channel marketing and sales capabilities.

Banks already possess most of the needed data but have not yet assembled it correctly. As banks navigate their way through a digital world with a surprisingly strong and persistent interdependence with their physical networks, understanding digital effectiveness in driving branch sales is an important first step.

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In just over a year, U.S. banks have made great strides in selling wealth management products to their retail customers, both by overcoming organizational barriers and by tailoring the operating model to reach key customer groups. Can they keep it up?

Certainly the signs are encouraging. As measured by the portion of retail customers who have purchased at least one wealth product from the bank, “wealth penetration” rose from a general range of 3% to 5% in 2013 to a range of 6% to 8% in early 2014, according to a Novantas/BISA survey of 19 major institutions. Some of the best performing banks have reached penetration rates of 15% or more. This is welcome progress, but banks need even more. Since the Great Recession, banks have been under tremendous pressure to reach prior levels of profitability. But this has proved next to impossible in an era of low interest rates and margins, anemic overall loan growth and regulatory pressures on fees.

To offset the drag, banks have looked to other lines of businesses — elevating wealth management to a growth priority at many institutions. In fact, according to the Novantas/BISA research, three-fourths of the surveyed banks ranked wealth growth as either the number one or number two strategic priority. Importantly, this intensity is being translated into specific action.

Bank Wealth Management:
New Models Beginning to Bear Fruit

Bank wealth units have visibly boosted retail customer penetration rates in a short period of time, driven by improved internal collaboration and a sharper segment focus.

BY WAYNE CUTLER
along the two main fronts of business line integration and a targeted operating model for marketing and sales. In setting the wealth performance agenda for 2014–2015, banks need to continue this push, and there is good reason to believe that more progress is possible.

**WHAT’S CHANGED?**

Historically the wealth and retail banking businesses operated independently, each sourcing new customers through its own initiatives while rarely referring clients to each other or developing coordinated marketing strategies. Of the wealth management growth impediments cited by bankers in recent years, in fact, five of the top seven were related to organizational barriers such as senior management commitment, shelf space in branches, and standoffs between organizational silos.

Apparently bank management teams have taken notice, putting resources against these issues and using cross-organizational teams to ensure that the retail and wealth units work together to gain sales traction. As evidence, the most recent executive survey feedback traces only one out of the top seven perceived growth impediments to internal organizational issues.

A second, parallel round of change has centered on the operating model for marketing and sales, based on a realization that one approach will not be appropriate for all customer segments, either on the basis of needs or provider economics. Mass market customers, for example, are looking for more packaged solutions and tend to be more risk-averse to protect the smaller amount of investment dollars they have. By contrast, affluent and mass affluent customers tend to divide up their investment wallets and use a broader array of products and methods, both advised and self-directed.

Banks are tailoring offers to meet these differing segment requirements and refining product manufacturing and delivery economics accordingly. To engage customers in the branch and via the contact center and other channels, banks are finally moving beyond lip service with more structured and disciplined cross-selling programs.

There also is a sharper focus on targeted marketing programs with the established customer base, where there is a lot of untapped potential. While wealth management units will continue to seek new customer referrals from satisfied clients, the larger opportunity rests with current customers — both retail and small business — who already have developed a trusted relationship with the bank.

**“While wealth management units will continue to seek new customer referrals from satisfied clients, the larger opportunity rests with current customers — both retail and small business — who already have developed a trusted relationship with the bank.”**

In terms of positioning, the trend is to leverage the parent bank’s brand through cross-selling. Many bank wealth teams have realized that in a market crowded with powerful competitors, it is next to impossible to come with a truly unique wealth value proposition. And even then, it would be an uphill battle to win the necessary marketing support from the parent bank to build a distinct wealth brand.

**MID-TIER SURGE**

Though banks of all sizes have boosted revenues from the wealth business, mid-tier banks have seen the greatest improvement. Since 2008, banks with assets of $10 billion to $50 billion on average have exceeded a 12% annual growth rate. That compares with growth of less than 2% per year among larger banks with more than $50 billion of assets.

In our view, this demonstrates the continued relevance of regional brand strength, established branch distribution networks and core customer relationships. Regional wealth teams have a strong performance basis to win further organizational support and gain further ground with established customers.

Across institutions of all sizes, surveyed executives agreed on many themes for building the wealth management business among retail and small business customers. These include an emphasis on needs-based selling; a trend toward open architecture products; transitioning to more AUM-based fees; training and licensing field staff to sell investments; and using a hub-and-spoke distribution model.

Though challenges will continue in growing the wealth business among retail and small business customers, bank executives seem quite committed to making the necessary long-term changes, and many have already begun seeing their efforts pay off.

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ABOUT NOVANTAS

Novantas, Inc. is the leader in customer science and revenue management strategy for the financial industries. A FinTech 100 Company, its Management Consulting, Solutions, Data, and Research divisions specialize in investigating and interpreting customer needs, attitudes, and behaviors in ways that help banks refine marketing decisions, customer strategies, and sales and service activities, and to accelerate their immediate and ongoing economic performance.
Customer Analytics: Unlocking Growth
A new era is unfolding where in-depth customer analytics will have a direct impact on shareholder returns. The hunt is on for specific applications to drive performance.

Customer Analytics: Can Regional Banks Overcome Scale Disadvantages?
A North America multi-bank study by Novantas reveals an “arms race” to build systems, applications and talent in customer analytics.

Digital Drivers of Branch Sales Productivity
Rather than being divided, online shopping and branch sales fulfillment are joined at the hip for new household acquisition — one cannot succeed without the other.

Street Corner Presence vs. Perceived Convenience: Are Banks Ready for the Shift?
As the branch loses its all-encompassing role, retail banks must redefine how they provide and promote convenience.

Relationship-Based Deposit Pricing: A Technique for Building Lasting Balances
To win in the next era of rising rates, banks must learn to use relationship data in pricing to attract and retain lasting deposit balances, as opposed to chasing “hot money.”