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Winning with Online Shoppers: The New Sales Battleground

Keys to Revenue Growth in Digital Payments

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Revenue generation historically has been a fuzzy proposition with new technology in banking. Consumers have hugely benefited from the convenience of web and mobile banking, for example, but have tended to view these services as free add-ons to the checking account. Meanwhile banks have struggled to purvey their complex offerings in digital channels where ultra-simplicity is needed to engage impatient online shoppers.

These challenges were more financially tolerable in a pre-recession market where retail branch networks were throwing off huge profits. Now, however, the air has gone out of branch banking even as pressure redoubles to engage the digitally empowered consumer.

As discussed in our cover story, “Digital Banking: Building the Business Case,” a corner has been turned in retail marketing and revenue generation. It is time for corporate strategies and budgets to more fully reflect the importance of digital banking in growth and competitiveness (concurrently, there is much more to be done to rework distribution systems and local market strategy, both to economize and reposition branch networks).

As detailed in “Winning with Online Shoppers,” while banks have tended to economize their developmental outlays for digital, that is an increasingly risky proposition as online shopping proliferates. Even most branch purchases are now influenced by consumer online research and website product presentation. A comprehensive effort is needed to win online visibility; engage website visitors; and assure smooth handoffs to live sales representatives in the branch and contact center.

A companion challenge lies with digital payments, an arena where the pressures of technological innovation and nonbank competition are intense. As detailed in “Monetizing Digital Payments,” the good news is that there is a lot of financial upside with immediate capabilities, those either already in place or close at hand. But disjointed product menus must be supplanted with a much more coordinated outreach that is organized around the key goals and activities of target customers.

There is probably some truth to the sentiment that banks are being dragged into the future, given their decades-long investment in brick-and-mortar branch banking. But while the branch is certainly not going away, it is not the consummate delivery channel as before. With the revenue consequences coming into fuller view, there is a new level of urgency in strengthening the digital outreach in consumer banking.
Success in the online space has a growing revenue consequence. Amid technological transitions, customer strategy will require much stronger attention.
As U.S. retail banks consider their future, it is clear that the industry has been launched into an era of momentous change, driven ever more strongly by a firming digital marketplace. Depository institutions will again find opportunities for profitable growth, but success will come on very different terms from the past.

The good news is that: 1) because of regulation and its barriers to entry, banks’ particular position as depositories will remain safe in the future economy; 2) because banks are still unmatched in depth of customer relationships and information, they have powerful advantages in the transition to a multi-channel marketplace; and 3) let’s not forget the branches. Despite their waning role in service delivery, they are still hugely important in establishing the brand and providing customers with the reassurance of “access,” (more important than convenience going forward). But nothing can be left to chance at a time of rapid change in customer behaviors.

The old paradigm of branch-based delivery of paper-based products is giving way to a multi-channel marketplace for the digitally empowered customer, and there simply is no turning back from this trend. Mirroring trends in publishing, music, travel and a host of other industries, banking’s consumer online migration is forcing a major re-think of retail strategy amid seismic upheavals in distribution systems.

The exact contours of the future banking market are unclear. But there is plenty of evidence to suggest that online strategies and capabilities will eventually become dominant factors in growth and competitiveness. A whole new level of business line integration will be required to tap the full potential of the multi-channel customer.

One of the most important priorities is learning how to win with online shoppers. Our research shows that nearly
two-thirds of consumers now prefer to search online for banking products and providers, even though most still go to the branch to complete their transactions. A redoubled effort is needed to attract and engage online customers, with overall sales growth increasingly affected by the success of this effort.

Another priority is to preserve banking’s primacy in payments amid the ongoing shift from paper to digital transactions. This is critical in anchoring core customer relationships in a splintering market that is loaded with innovative, non-bank competitors. There is a growing revenue consequence as banks consider how best to merchandise their expanding array of digital payments services.

WINNING ONLINE

Customer online shopping and research already has a heavy influence on branch sales success (Figure 1), and the intensely competitive market for digital payments has become a battleground for control of core customer relationships and for fee revenue growth. These influences will only grow as the online channel facilitates and influences even more customer shopping activity and product and service innovations.

Most regional banks should be doing far more to beef up their online strategies and capabilities. But out of necessity to control costs, many institutions have rationed their online investments and developmental activities — often focusing on getting service delivery capabilities up to snuff. This investment orientation ignores the large and growing influence of online and mobile banking on branch and call center sales, as well as the role of digital payments in anchoring high-value customer relationships.

To move forward, banks will need a coordinated effort across multiple business lines, centered on winning with online shoppers and winning in digital payments.

Online Shoppers. Although it is already the case that roughly two-thirds of consumers first turn online to shop for banking providers and products, most people still prefer to go into the branch to complete transactions. This preference for online shopping and branch fulfillment likely will continue for quite some time. In turn, a coordinated channel strategy will be needed to nurture sales momentum.

One priority is to elevate online strategy and functionality to drive branch sales traffic. This includes winning customer attention in the online space; clarifying website design so that people can easily find and understand products of interest; simplifying promotional offers; and facilitating handoffs to the contact center and the branch.

Another priority is re-framing the branch sales process to accommodate and leverage any online-originated or -enhanced sales momentum. People may be attracted to the branch by simpler online offers, such as free checking, but then it will be up to the sales staff to detect and fulfill customer needs for more complex products.

Along with a changed management orientation, this transition will require sharper customer analytical skills and also a shift in resource allocation. Banks must realize that their websites perform “double duty,” attracting a rising volume of sales that are completed online and also playing a prominent role in driving sales traffic to the branch. As such, the online team cannot be left in isolation with a maintenance budget. A coordinated effort will be needed to adapt to consumers’ changing shopping behaviors.

Digital Payments. Banks held a long and profitable dominance over the paper-based payments system, but their primacy has been placed at risk by the

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**Figure 1: Shopping Preferences**

Checking customers make extensive use of online resources when shopping for a new account.

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<th>EXPECTED ACTIVITIES PRIOR TO ACCOUNT OPENING</th>
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* Multiple answers permitted. Source: Novarica Bank Shopper Insight Report; results from 2012 survey of consumers who say they intend to open a new checking account in the next 90 days
“Concurrent with further preparations for competition in digital banking and payments, executives will need to rework the distribution system and local market strategy.”

accelerating transition to digital payments (Figure 2). As customers become increasingly comfortable using nonbank alternatives such as PayPal, the traditional strength of the checking relationship is being eroded, weakening customer ties and also fee revenue potential.

Unfortunately, many banks are limiting their own progress in fighting this war. Overlapping products continue to proliferate among different business units, leading to splintered website presentations that create barriers to customer usage. And often there is a slow and uncoordinated pursuit of key opportunities in areas such as pricing strategy, high-value services and targeted customer outreach. Meanwhile established products, such as online bill pay, stutter along with low rates of customer adoption.

To turn the tide, banks need to lift their thinking beyond individual products and begin mapping a more comprehensive strategy for digital payments — one that recognizes that customers increasingly want a comprehensive day-to-day cash management solution, not just one-off products. One goal is to defend market position by channeling the maximum amount of customer payments activity (both transaction volume and balance flows) through the bank’s own conduits and products. Another goal is to optimize revenue growth by identifying opportunities to monetize payments, charging for value-added functionality. A third goal is to use digital payments as a proactive tool in driving down the cost to serve.

NETWORK TRANSITIONS

Though compelling, the pursuit of the digital opportunities cannot come at the expense of rightsizing the more traditional branch and sales approaches. Concurrent with further preparations for competition in digital banking and payments, executives will need to rework the distribution system and local market strategy, such that the bank can wring maximum performance from existing infrastructure and begin to reposition networks for a much leaner coverage model.

A Novantas analysis of the entire U.S. branch system indicates that fully one fourth of the collective network is eligible for near-term closure, given trends in customer online migration and the altered economics of retail banking. But our research indicates that swift action would carry a steep price tag, upwards of $30 billion to $50 billion. In other industries, companies that face similar needs for re-structuring might take a big one-time charge or even go through court-supervised bankruptcy reorganization, but these options are obviously unavailable to banks with strict capital requirements.

Even more frustrating for banks, many customers remain wedded to local branch presence even as their actual usage decreases. Particularly for high-value transactions, such as applying for mortgage credit or solving a problem, people still want lobby service. Thus, branch presence still influences the selection of a bank. Costs aside, branches are a

Figure 2: Changing Payments Landscape

Electronic payments already dominate the dollar volume of consumer payments, including purchases and bill pay, and will continue to grow.

<table>
<thead>
<tr>
<th>Annual Dollar Volume of Consumer Purchases and Payments</th>
</tr>
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<tbody>
<tr>
<td>$12 Tril</td>
</tr>
<tr>
<td>$6 Tril</td>
</tr>
<tr>
<td>'09</td>
</tr>
</tbody>
</table>

* Automated clearing house payments include all bill pay categories, as well as Web/Tel.

Source: Novantas proprietary payments model.
customer safety net that cannot be suddenly yanked.

The likely scenario is that the industry will close or reconfigure traditional branches at a slower pace over a period of years — probably 5% to 7% annually. This pay-as-you-go approach avoids a big financial hit and minimizes customer disruption, but it extends the pain of carrying excess infrastructure.

Getting down to specifics, how can banks cope with the interim challenges of managing the legacy network while taking the right steps toward a new distribution model? One important answer is to focus and differentiate by market to reflect the new reality of lower margins and increasing local competition.

Market Playbooks. In the not-too-distant past, banks could count on branch dominance to drive marketing and sales. Local customers were aware of the bank because it had branches nearby; they considered the bank on that basis; and they opened accounts at the bank on that basis. Today, by contrast, there is strong evidence that awareness, consideration, and purchase pull-through can be created in many ways, using marketing, product and distribution in new, market-specific combinations.

Thus the new goal is to drive higher customer awareness, consideration and purchase results based on strengths as they occur by market. This reflects the reality that the costs of operating in one market differ from the costs of operating in another; the bank’s branch network and ATM density differ; marketing spend and ROI differ; and the competitive set (and structure) will vary, as well as growth and cross-sell potential.

ATM strategy. The ATM has reached an inflection point. New technology has made ATMs more viable for deposit-taking, both within and away from the branch. Meanwhile consumers are more open to the use of ATMs for more complex transactions. In turn, the ATM will likely emerge as a significant physical distribution and branding point of presence, creating new possibilities for local market coverage. This will require further progress with ATMs to broaden service capabilities; enhance the customer experience; and provide greater convenience.

The larger picture is about recasting the role of the ATM in local networks. These units can now work harder in reinforcing local market presence and absorbing a higher transaction workload to permit branch capacity reduction. But careful planning is needed to unlock these advantages. The count and placement of ATMs must be considered within an overall market coverage model that includes full-service branches, small footprint offices, special purpose offices, and roving representatives.

**EXECUTIVE PRIORITIES**

Although retail banking has at least stabilized following the recession, a further challenging journey lies ahead as the industry more fully transitions to a multi-channel marketplace. In the quest to optimize interim performance while preparing for the future, there are three priorities for executive management:

The first is managing a discipline migration to a new business system that ultimately will become the core of the franchise. A sharply higher level of coordination between business silos will be required. Innovation and experimentation must be fostered in a way that supports a staged progression, making sure that new capabilities are appropriately framed for a multi-channel market and also integrated systematically.

“Big Bang” transformations carry far too much risk of customer and operational disruption. Winners will be savvy about pilot-testing new business systems and learning from early experiments before placing bigger bets. Executive vision will be needed to plot a multi-year development timeline.

The second is the careful measurement and management of the traditional branch-based business model. Various kinds of leakage that have been overlooked in prior economic expansions now must be methodically identified and firmly plugged. The good news here is that there still are substantial opportunities for smart cost reduction, as well as revenue and productivity enhancement.

Finally, extreme attention must be paid to managing the pace of change. The main thing is to carefully track and anticipate customers in their multi-channel transitions, striving to avoid the extremes of over- or under-investing in new capabilities. Now more than ever, winning banks will rely on customer-driven strategy and decision-making.

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Winning with Online Shoppers

BY ROB RUBIN AND ETHAN TEAS, WITH CHRIS MUSTO

At a time when many customers prefer online shopping and on-site fulfillment in the branch, a channel-coordinated strategy will be needed to nurture sales momentum.

As U.S. consumers shift more product research and purchase activity online, many retail banks are experiencing a growing disconnect in sales strategy. Rather than bridging the two worlds of branch and remote sales, institutions are tending to isolate the two worlds, forfeiting significant opportunities in multi-channel customer acquisition and cross-sell.

While the branch still plays a dominant role in sales fulfillment, our research indicates that most customers who go to the branch to purchase banking products and services have done some online research before ever entering a lobby. Among customers who have opened checking accounts over the last three years, for example, 61% prefer to shop online and 82% are willing to do so — yet 68% still went to the branch to complete their transactions. Most regional banks have not yet recognized this reality, much less adapted to it.

Instead, the value of online marketing and product presentation is strictly judged by the volume of business closed online, contributing to starvation budgets in that channel. Meanwhile branch networks cling to the outdated notion that sales primarily stem from local presence and spontaneous foot traffic.

Worse, multi-channel consumers are needlessly confused as they pick through tedious web pages to clarify their banking selections. Most products that replaced free checking are inherently more complex — and complexity does not shop well online. Then when shoppers clear online hurdles and go to the branch to buy, they encounter branch personnel who are generally weakly prepared to engage the online-informed customer.

Such imbalances must be quickly addressed if banks are to successfully navigate the transition to a multi-channel marketplace. Although it is already the case that over two-thirds of consumers first turn online to shop for banking providers and products, most people still prefer to go into the branch to complete transactions. And this preference for online shopping and branch fulfillment likely will continue for quite some time. In turn, a coordinated channel strategy will be needed to nurture sales momentum.

One priority is to elevate online strategy and functionality to drive branch sales traffic. This includes winning customer attention in the online space; clarifying website design so that people can easily find and understand products of interest; simplifying promotional offers; and facilitating handoffs to the contact center and the branch.
Another priority is re-framing the branch sales process to accommodate and leverage any online-originated or enhanced sales momentum. People may be attracted to the branch by simpler online offers, such as free checking, but then it will be up to the sales staff to detect and fulfill customer needs for more complex products.

Along with a changed management orientation, this transition will require sharper customer analytical skills and also a shift in resource allocation. As part of efficiency crusades in an era of branch network overcapacity, banks have slashed developmental budgets for online marketing and sales, unwittingly crimping what has become a pivotal channel in driving branch sales traffic. This imbalance must be corrected.

**HAVING IT BOTH WAYS**

Online shopping is now prevalent in retail banking (Figure 1). When respondents to the Novantas 2013 Multi-Channel Sales Survey were asked to identify their preferred channels for product research, online was cited as the top avenue by 58% of recent mortgage customers and 68% of recent checking customers. Among this group overall, 44% prefer to shop online for investments as well.

The picture is quite different, however, when customers finish their product research and are ready to open accounts. No matter which channel(s) customers use to research bank offerings, our research shows that most people still wind up going to a branch office to finalize their purchases of banking products and services (Figure 2).

While the customer tendency to “have it both ways” has a variety of implications, the point here is that the online channel is now a significant front end for branch sales. This critical linkage is not fully appreciated at many retail banks, which are unknowingly crimping the branch sales conduit by under-investing in the dot com (or public-facing) component of their websites.

Starting first with management orientation, banks must realize that their websites perform “double duty,” attracting a rising volume of sales that are completed online and also playing a prominent role in driving sales traffic to the branch. As such, the online team cannot be left in isolation with a maintenance budget. A coordinated effort will be needed to adapt to consumers’ changing shopping behaviors.

A key question is how to gain visibility online. In our experience, bank shoppers go straight to search engines (e.g., Google) when they start searching online for a new provider and/or additional products. As these shoppers refine their search phrases and begin to consider specific web pages they would like to read, the bank needs to be visible on the first page of search results to have a chance at marketing itself.

There are two types of links displayed on a typical search results page: “organic” results that the search engine algorithms deem the most relevant to the search phrase or keyword(s); and “paid” results that generate advertising revenues as users click on them. Most consumers (roughly 80%) only click on organic search results, usually selecting from among the top five organic listings.

To consistently rank in the top five organic results, the bank must optimize its website so that: 1) the site has greater relevance to keywords commonly used in local customer searches; and 2) the site is hospitable to the indexing activity of search engines. The bank also needs an on-going tactical program to establish inbound links with other websites to further stimulate site traffic.

Banks are certainly participating in so-called search engine optimization (SEO),

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* Multiple answers permitted. Source: Novarica Bank Shopper Insight Report; results from 2012 survey of consumers who say they intend to open a new checking account in the next 90 days.
but it is far from a mature practice today. Consumers continue
to care about branches even if they use them only rarely, so
search phrases for banking services often pertain to local
geographic markets. Yet our competitive reviews repeatedly
show a weak representation of local banks in search engine
responses. Banks need to develop a thorough understanding
of customer online research behaviors and then respond with
regionally-tailored SEO programs that will help them to win
market by market.

An alternative to SEO is so-called search engine mar-
keting (SEM), which focuses on the priority placement of
web links in exchange for an advertising fee. Google, for
example, displays paid links based on the keywords used.
Advertisers “bid” on placement within the paid links pre-
sented in search results. SEM tactics also extend to online
directories, forums and blog reviews.

Although only roughly 20% of online shoppers click on
paid links, the links still provide visual cues and reinforce-
ment of brand presence, which may help to spur additional
customer online research relative to a particular bank. The
key in evaluating SEM and SEO programs is to develop a
market-by-market understanding of customer needs and the
bank’s relative position. For example, appearing in organic
search results is more important in a market where a bank
has lower brand recognition.

Beyond arriving directly at the bank site via search, con-
sumers look to third party sites and social networking for
context and referrals. Banks can seek to influence third party
communities with direct outreach programs. And they can
consider how to engage bloggers and other online commen-
tators, following the lead of retailers and businesses involved
in consumer packaged goods. Banks also can apply tradi-
tional public relations tactics in the online world.

Influencing online media and social networks is probably
not a priority for many banks at this stage, however. This
activity represents a higher degree of difficulty and could
distract banks from the important work of establishing basic
online visibility and engaging third party influencers, where
there is plenty of room to improve.

LAGGING POSITION
The initial reward for investing in online visibility is higher
traffic, with more consumers attracted to the bank’s website
to shop. But there are critical factors to be managed in the
journey from an initial customer inquiry to a completed trans-
action, including ease of use for shoppers; product design,
presentation and information disclosure; and processes for
online fulfillment or handoff to a live representative.

Relative to other retail
industries, banks are in a lag-
ning position. Online shoppers
quickly turn elsewhere if they
become frustrated or disinter-
ested, so it is up to the bank
to prepare an easy customer
experience. There is a definite
revenue consequence in this
effort, with consumer research
by Novarica showing a high
correlation between the qual-
ity of the online experience
and purchase likelihood.

Consumers are prod-
uct-centric in their online shop-
ing behavior — “I need a
new checking account,” or

“Online presentation can make a big differ-
ence in winning or losing the business. In one
instance, the simple relocation of an ‘apply
now’ button on a web page sparked a more
than three-fold increase in the click-through
ratio for an online offer.”

Figure 2: Buying Preferences

Despite widespread use of alternative channels for shopping, most banking cus-
tomers still go to the branch to open accounts.

<table>
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<tr>
<th>TYPE OF SHOPPER</th>
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<td></td>
<td>Buys at branch</td>
</tr>
<tr>
<td>Prefers to shop online (68%)</td>
<td>50%</td>
</tr>
<tr>
<td>Prefers to shop by phone (3%)</td>
<td>54%</td>
</tr>
<tr>
<td>Prefers to shop by networking (14%)</td>
<td>76%</td>
</tr>
<tr>
<td>Prefers to shop at the branch (13%)</td>
<td>82%</td>
</tr>
</tbody>
</table>

* Source: Novantas 2013 Multi-Channel Sales Survey
“I want to refinance my mortgage.” Once online shoppers arrive at the bank’s website, their primary objective is to find answers to their specific questions, and most spend as little time and effort as possible. This is why utility and functionality trump high-concept designs.

Complex offers throw up an immediate wall for the many consumers who don’t want to read detailed information or dense blocks of text; simplicity generally works much better. Also, simple low-cost or “free” checking still attracts consumer attention; some flavor of this product is useful in piquing initial interest and paving the way for an eventual larger conversation that covers more offers and details.

Online presentation can make a big difference in winning or losing the business. In one instance, the simple relocation of an “apply now” button on a web page sparked a more than three-fold increase in the click-through ratio for an online offer.

Once a shopper is engaged, the best strategy is to provide plenty of channel options for fulfillment. Is the branch and ATM location finder accessible? Can customers connect with the contact center? Does the online application process provide answers to product-related questions or access to live help? It is essential that the bank has a multi-channel strategy for shoppers who are ready to buy.

Onboarding and cross-sell also require special attention for online customers. Particularly upon account-opening in the branch, the bank has a valuable opportunity to learn more about online-acquired customers and meet their larger needs.

A conversational setting really helps in the presentation of more complex offerings, but branch sales staff and contact center representatives need to be prepared. They need to be familiar with the bank’s online presentation (what products the website currently leads with; which qualities are emphasized) and understand the opportunities to convert simple product inquiries into deeper customer relationships.

**SHIFTING GEARS**

To be sure, senior banking executives are putting more emphasis on digital channels, recognizing that we now live in a multi-channel world. However, many organizations are structured in a way that isolates the online channel, creating conflicts with branch sales and even with other marketing functions.

Performance measurement is a major challenge. Under the current framework, only the value of online-completed sales is considered in justifying investments in online marketing and sales capabilities. But this denies the reality that most of the actual sales that result from online customer interaction accumulate in other channels.

This creates two distortions for management. At the top of the house, the perception of muted returns prevents a more aggressive shift to the online channel. Many of the online business cases that seem not to meet hurdle rates of return are actually accretive for the overall bank, considering sales that are completed in other channels. In turn, management often has cause to expand current online initiatives, as well as take on additional opportunities.

The second distortion is potentially more dangerous, in that the online team has a narrow incentive to maximize online sales transactions, even at the expense of potentially more productive handoffs to the branch and the contact center. This silo orientation manifests itself in website presentations that tightly steer customers into online fulfillment rather than allowing them to connect with their channel of choice.

A shift in executive mindset is required to overcome these distortions. The leaders of retail banking now must look across the various distribution channels to arrive at a silo-coordinated strategy, recognizing that investments made in one area may have their greatest payoffs elsewhere. Otherwise revenues will fall victim to channel friction.

In turn the bank will need some means to measure the impact of online investments on sales results in other channels. Measuring the buying experience across channels is a major challenge, though there are tools. Online-originated coupons can offer some insight, but can be undermined if they are dispensed by branch staff as well. Online appointment setting is another option in tracking the progression of customer inquiries to completed transactions. Safe to say, more work is needed in this area.

Finally, banks will need to rethink products and product suites to ensure that they perform in the online shopping process. New regulations have changed the economics of the checking business and forced a first round of product redesign.

But the issue is that many products replacing free checking are inherently more complex — and complexity does not shop well online. Products need to be optimized for the online shopping experience, recognizing that conversational explanations may either not be possible or will only come later in the process after customers are redirected following initial online interaction.

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Monetizing Digital Payments

BY CHRIS MUSTO AND HANK ISRAEL

To preserve their central role in consumer payments, retail banks must re-conceive digital banking as a payments hub. Specific revenue propositions will pave the way.

Banks enjoyed a long and profitable dominance over the paper-based payments system, but now their primacy is being placed at risk by the accelerating transition to digital payments made by consumers via web or mobile banking. Customers are becoming increasingly comfortable using non-bank alternatives such as PayPal, and as they do so, the traditional strength of the checking relationship is being eroded, weakening customer ties and also fee revenue potential.

But many banks are getting lost in the details of cutting-edge product innovation. In the relentless march of digital payments, there is a powerful instinct to slug it out product-by-product and feature-by-feature, for example with mobile wallets and advanced person-to-person payments. This tendency has fueled a disjointed series of “bolt-on” product launches, confusing customers and leading to disappointing returns.

To be sure, the pressure to maintain competitive parity is intense, and some banks still have work to do in fleshing out basic product sets. Many others, however, are reasonably abreast of the pack and should set the highest priority on making the most of immediate capabilities, those either already in place or close at hand. There are many tangible financial benefits in doing so, including fee revenue growth; enhanced cross-sell of ancillary services; improved retention of core customer relationships; and cost reduction through further electronification of transactions.

Looking at customer activation and usage, Novantas research indicates that the average regional bank has less than a tenth of the typical customer usage rate for person-to-person payments, compared with the U.S. household average across all forms of P2P providers. Meanwhile the median rate of bill pay usage among checking members languishes at 11%, despite a 55% median online banking product penetration.

Many banks are limiting their own progress in fighting this war. The central teams responsible for digital channels have less regard for customer-friendly integration and the top-level business case and revenue plan. As overlapping products continue to proliferate among different business units, website presentations are splintered, creating barriers to customer usage. Along with this is a typically slow and uncoordinated pursuit of key opportunities in areas such as pricing strategy, high-value services and targeted customer outreach.

To turn the tide, banks need to lift their thinking beyond individual products and begin mapping a more comprehensive strategy for digital payments. This includes much tighter coordination of business cases, performance measurement, developmental activities and customer information among various business silos. Today, progress is often delayed by splintered management structures that depend on a loose assemblage of semi-autonomous product and functional teams and external partners.

RELATIONSHIP FOCUS
Certainly banks have reason to be concerned about new players in digital payments. PayPal moved about $70 billion in U.S. domestic payments last year, roughly three-fourths consumer-to-business (C2B) and the remainder consumer-to-consumer (C2C). Then there is the competing biller direct model, which lets billers’ sites define the customer experience and has attained a dominant position in consumer payments. A more recent market entrant is Google, which launched Google Wallet in 2011 to little effect so far but which is now making a more direct assault on digital banking with its rollout of C2C payments capabilities within Gmail.

The goal for banks, however, is not to out-gun the niche players. For one thing, banks have their own successful track record in digital payments innovations, spanning bill presentation, invoicing and payment; interbank transfers; P2P; online wire transfers; and mobile applications. Much more can be made of these capabilities. Equally important, banks still own the center of gravity in customer relationships and
remain uniquely positioned to detect and serve the full range of customer needs. Innovation is still important, but the big picture is about defending and monetizing customer relationships amid the continuing transition from paper-based to digital transactions (Figure 1).

So how do banks hold themselves back? We believe there are three primary mistakes banks are making:

1. Splintering each new payments offering as a separate initiative, leading to a maze of features, limits, payment speeds and customer experiences;
2. Failing to integrate progressive payments capabilities into digital banking in a way that encourages adoption and use; and
3. Sub-optimizing numerous financial aspects of digital payments, including pricing, fee revenue strategy, and cross-functional metrics and business case development.

These mistakes have left banks going to market with a disjointed, overlapping, product-centric set of digital payments experiences with sub-optimal economics. Each method of moving money has its own product name. Website navigation schemes change from one product to the next. Website landing pages for online banking bury everything but bill pay behind a “transfers” tab, which typically has not been updated since online banking was first launched. Meanwhile pricing schemes are disconnected, with some consumers able to make free funds transfers to their external accounts via P2P at the same time that banks are charging for outbound bank-to-bank transfers.

Moreover, by creating a set of unconnected products instead of a cohesive digital hub, banks are encouraging customers to shop around for each of their payment needs. By neglecting the promise that the customer can use the bank to take care of any payment quickly and easily, banks are left to battle competing payments providers on a product-by-product basis, while making it easy for their own customers to pick and choose among competing providers for specific services. This encourages the very kind of fragmentation of the payments wallet that is already undermining the primary banking relationship.

To understand the impact of a disconnected payments strategy, consider a consumer using digital banking to pay a small business. To facilitate this payment, most national and regional banks offer two inadequate methods in two distinct silos: 1) paper-settled bill pays that take an indeterminate amount of time; and 2) P2P, which banks typically do not position as a way to pay small businesses; the website pages for bill pay do not even refer to P2P, and the P2P website pages do not refer to bill pay.

No wonder consumer adoption of bill pay remains stalled and adoption of bank-provided P2P services is minuscule. Meanwhile banks are missing an important opportunity to drive down the costly one in five bill pays still settled by paper.

**REVENUE PROPOSITIONS**

For hard-pressed retail bankers, revenue growth is a major call to action in digital payments. Hit by shrinking margins and restrictive fee regulations, the traditional checking business is only limping along, and now bankers are trying to compete in a digital payments marketplace where they are initially finding even less profit potential.

Further payments initiatives must be firmly guided by specific revenue propositions and

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**Figure 1: Changing Payments Landscape**

Electronic payments already dominate the dollar volume of consumer payments, including purchases and bill pay, and will continue to grow.

![Annual Dollar Volume of Consumer Purchases and Payments Graph](image-url)

*Automated clearing house payments include all bill pay categories, as well as Web/Tel. Source: Novantas proprietary payments model.*
the overall business case (Figure 2). Initially we see at least three types of opportunities to better monetize digital payments, including pricing strategy, contextual cross-sell and customer engagement.

**Pricing Strategy.** Our research confirms that many consumers are happy to pay for conveniences and special services, such as foreign ATMs and same-day bill pay. Conversely, there is a weak case for fees on day-to-day transactions, given competitive pressures and the strategic imperative of boosting customer adoption and usage. The tradeoffs between free basic access and charges for value-added services deserve more attention, and there is material upside in striking the right balance.

The so-called “Freemium” model has already seen some application in P2P, where banks may offer basic payment delivery for free and an expedited delivery for a fee. The same approach can be taken to facilitate same-day bill payments, or even next-day completion for bill payments that normally would settle with a paper check. Younger customers in particular are more likely to accept fees for value-added services, and our research indicates receptivity for a variety of additional services that banks could offer.

By contrast, “everyday value pricing” is more appropriate for the small business segment, where firms see a clear benefit in payments services and are far more willing to pay for basic services they depend on in the normal course of managing their finances. Overall, consumer-to-business payments offer significant untapped potential.

**Contextual Cross-Sell.** As banks consolidate the flow of customer payments into a smaller number of internally-provided digital interfaces accessible online and through mobile, they create an effective platform for making relevant offers at the time of customer need, both their own products and potentially those of partners as well.

With credit cross-sell, transaction-based financing is a prime example of untapped revenue potential, and it also

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**Figure 2: Near-term Revenue Priorities for Digital Payments**

In many cases, banks can take far greater advantage of digital payments capabilities already in place, permitting substantial progress without the need for large immediate investments.
Monetizing Digital Payments

“The winning proposition is that whichever way customers need to move money, and for whatever reason, they will be able to do so through their bank — and do so easily.”

brings unique banking value to digital payments. Today’s liquidity products are predominately focused on the point of sale, but consumers also need various kinds of bridge financing, both to cover contingencies and to assure funds adequacy for timely payments and transfers.

This remains a significant opportunity for banks, given their central role in handling transaction accounts and payments. Much more could be done to install credit functionality within the online and mobile software applications that consumers use to make payments and account transfers. Digital money movement provides a perfect banking venue for meeting consumer credit needs.

This segues into the larger topic of value-added services. A primary banking relationship may include a credit product and generally includes numerous online and offline interactions. Other assets that banks can leverage may include strong brand affinity and convenient branch and ATM access. Banks can build upon these assets to move large amounts of money, insure timely payment, provide early payee access to funds and the ability to choose a variety of funding and delivery options on the fly.

With merchant offers, as mobile and online payments become central to consumer bill payments (and eventually POS payment initiation), banks can promote competitive (lower-cost offers) at the point of sale, as well as offers from the current merchants in the form of electronic coupons to its customers. This is but one example of the benefits that centralized digital payments will have for consumer engagement.

Customer Engagement. Customer usage of digital payments produces a lift in balances, retention and cross-sell. Such usage also provides ongoing opportunities for cost reduction as digital service becomes more of a true substitute for teller-provided branch service and paper-based transactions. This circles back to the point that more progress is needed in promoting customer adoption and active usage.

The customer orientation to digital banking and payments should start during the on-boarding process, with the branch or phone representative treating digital payments as integral to the checking account. As a supporting management tactic, some banks have provided effective staff motivation by offering incentive compensation when customers make their first bill pay. Marketing efforts should focus on use cases, such as the convenience of sending funds to a friend or family member via the smart phone.

It is also important to measure the indirect financial benefits of digital payments. The dimensions of the contribution include customer behavior changes that lower costs; impact on credit and deposit balances; attrition rates; discounts and commissions generated; and float on in-process transactions. Both shadow accounting and a system of internal charges and credits can help to measure these indirect effects, which ultimately represent the lion’s share of digital payments’ economic benefit to the bank.

BRINGING CONCEPTS TO LIFE

The digital banking customer experience itself is where the battle for adoption and usage will ultimately be won or lost. To re-affirm their central role in handling the customer’s transactions, retail banks must re-conceive digital banking as a payments hub. The winning proposition is that whichever way customers need to move money, and for whatever reason, they will be able to do so through their bank — and do so easily.

Ultimately digital banking and payments can be transformed from a loose collection of capabilities into a robust relationship-building strategy. To do so in a way that assures profitable growth, banks must:

1. Assess market opportunity and revenue pools available to the organization;
2. Design and position products around customer needs;
3. Price services to drive adoption while capturing direct revenue from value-added services; and
4. Measure and manage to the economic benefits of digital banking money movement for the bank overall, not just direct fee revenue.

To be sure, a substantial effort is required to realign digital payments, most immediately conducting the research and analysis necessary to find the best pricing strategy for the bank. But the endeavor is more than worthwhile, given the potential to transform digital banking into an engine for recovering retail banking profitability.

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Client Development Model for Small Business Banking

By Michael Rice and Steve Ledford

To guide a more effective outreach to small business customers, progressive banks start with an analytical understanding of customer relationships and behaviors.

As banks continue to scour for revenue growth in a tight market, renewed attention is being paid to the small business market segment, particularly in the area of fee-based services. But while the growth potential is significant, the complexities of marketing, sales and distribution threaten to limit the opportunity for many banks.

One issue is that company size is not always a good predictor of sales potential, posing the risk of over-emphasizing the largest prospects while missing stronger pockets of demand among smaller outfits. Another issue is coping with the diversity of a vast client base that ranges from manufacturing to retailing to service industries.

In threading this maze, banks variously consider the overlapping domains of sales management, relationship management and distribution management. But the trouble lies in doing so cohesively. Too often, incremental improvements still result in a cumulative failure to lift sales productivity and revenue growth in small business banking.

The client development model overcomes this limitation by unifying efforts via an analytical understanding of customer relationships and behaviors. A clear view of the untapped potential with established clients and prospects helps the bank to do a much better job of setting sales priorities. An understanding of which clients want high-touch service and which do not helps to refine strategies for “relationship” versus “transactional” buyers. And a firm grasp of channel usage patterns and preferences helps the bank to take fuller advantage of remote channels to boost revenues and lower costs.

The foundation is a behavioral segmentation based on a profile of each customer, including usage of bank products, services and channels; profit potential; relationship orientation; and value orientation (e.g. price sensitive or utility driven). Translating these customer profiles into actionable segments is the heart of the client development model.
The science of “letting customer information drive strategy” is prevalent in retail banking. The concept is ripe for application in small business banking as well, given the high count of the customer base and the need for precision outreach to optimize sales productivity, customer relationship profitability and channel strategy. This is a much more effective way to market the more sophisticated capabilities of commercial banking within the tiers of smaller companies.

CASTING THE NET

Although the U.S. economy is showing more of a pulse, retail banking is still battling the constraints of low demand, low margins and lowered fee revenues. To help offset the revenue gap, banks are expanding their outreach to small businesses, particularly fee-based services.

While the collective opportunity is large, it is fractionated over a large and diverse customer base. Nationally, there are nearly 160,000 small businesses with annual sales of $10 million to $50 million, plus another roughly 1.25 million companies with sales of less than $10 million down to $1 million. This introduces some significant challenges.

The first is balancing profit potential against the cost to serve. Facing higher coverage requirements and lower sales potential per customer, small business bankers have to manage their time quite carefully and can only justify in-depth relationship management with the highest priority clients.

Small businesses also represent a broad array of industry sectors and have diverse profiles and needs. The needs of a $1 million sole proprietorship are different from those of a $10 million corporation. And even companies of the same size in the same industry may operate at far different levels of financial sophistication. Any model that tries to treat all small businesses the same will achieve inconsistent results (Figure 1).

Novantas research also underscores the rising importance of alternative channels in marketing and sales. Survey respondents express high receptivity to sales offers coming from sources other than relationship managers and product specialists. These include telephone and e-mail contact and even suggestions from customer service personnel. These emerging preferences spell opportunity but also vary by segment.

**Figure 1: Evolution of the Small Business Client Outreach**

The client development model improves on prior approaches with an analytical understanding of multi-channel client behaviors and a focus on growing share of wallet.

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**SALES AND SERVICE MODEL**

- A primary focus on prospecting and the initial sale
- Once a new client is acquired the emphasis shifts to service
- Cross-sell efforts are opportunistic
- Lack of active client management can lead to attrition as customer needs change

**RELATIONSHIP MANAGEMENT MODEL**

- A primary focus on client coverage and disciplined calling
- Effectiveness is highly dependent on the skill and knowledge of the relationship manager, and on the RM’s ability to learn about each client’s needs
- High-touch model is difficult to sustain at the client coverage ratios typical in business banking, leading RMs to narrow the focus to the best customers

**CLIENT DEVELOPMENT MODEL**

- A primary focus on increasing share of wallet for every customer
- Utilizes behavioral segmentation to target the sales approach
- Embraces all channels to meet client preferences at a reasonable cost
- Model adapts as more client information unfolds and/or client behaviors change over time

Source: Novantas, Inc.
To illustrate the range of needs across small businesses, consider three typical companies drawn from our market research:

- “Acme Electrical Switches” manufactures specialty electrical components for aviation, marine, and automotive applications. Its clients are makers of high-performance aircraft, speedboats, and race cars in the U.S. and Europe, and suppliers are in Korea, Taiwan, and Singapore. Acme has 40 employees in a high-tech factory and offers a full range of employee benefits including a 401(k) plan. Annual sales are $8 million, growing 20% per year. Their new chief financial officer has experience working at larger companies and is making fuller use of financial products such as letters of credit, foreign exchange, multi-currency accounts, liquidity management tools, and a full range of payment and collection services. Acme traditionally financed growth through a combination of revolving lines, equipment finance, and commercial mortgages, but is looking for outside investors and has asked its bank for capital markets advice.

- “Redbrick Enterprises” manages suburban office buildings in a major metro market for local investors. It also has revenues of $8 million per year, but there has been little growth since the last development was completed in 2007. Redbrick is family-owned. Finances are handled by a family member with no formal financial training, advised by the company accountant who likes to keep things simple. Redbrick does not own any of the properties that it manages, is debt free, and has only basic needs for financial services.

- “Flexible U” is a small chain of fitness facilities employing 100 full- and part-time staff, with revenues of $8 million per year. A full-time controller manages day-to-day financial activities with the assistance of a full-time bookkeeper, but the owner is the final decision maker for all things financial and signs every check. The chain has very little debt — occasionally borrowing to purchase exercise equipment or to refurbish rented space — and modest growth ambitions. It uses a variety of basic financial services, including third-party merchant and payroll services.

Of these companies, only Flexible U has the characteristics of a “typical” $8 million company served by a small business banker. Acme has the needs of a much larger company, and would be better served by a relationship manager who can coordinate the delivery of an array of bank services. And although Redbrick’s revenues would typically qualify it for a dedicated business banker, its primary banking interaction is to deposit rent checks at the beginning of the month and write checks for expenses. A bank trying to serve all three

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**Three-Tiered Market Coverage**

The practicalities of running a business require some level of segmentation based on size, especially when dealing with prospects or as a way of aligning business banking with the retail network. This calls for a three-tiered organizational construct.

Branch managers typically form the front line of small business banking, and they are usually the primary bankers for the smallest companies, generally those under $1 million in sales. Because they must handle the needs of consumers as well as businesses, branch managers rarely have the time, or the requisite skills, for in-depth relationship management. They are, however, often the first contact that clients have with the bank, and they open many business accounts. Without support, they are unlikely to be effective at client development.

Small business bankers are dedicated business specialists charged with developing client potential. Although some banks assign SBB’s to companies as small as $250,000 in sales, it is difficult for the specialists to justify much time with clients having less than $1 million to $2 million in sales. Even when focusing on larger customers, they usually are spread thin and can usually provide only basic relationship management support. Effective prioritization and targeting are essential for their success. Many banks are finding that remote small business bankers — working with clients by phone — can be a cost effective alternative to in-market SBB’s.

Business banking relationship managers can provide a more intensive level of engagement with larger clients having the needs and revenue potential that justify the effort. Typically this would be companies with at least $10 million in annual sales. Business banking relationship managers serving this segment can be expected to engage in true relationship management, including account planning and coordination of specialist sales teams from treasury management, merchant services, specialty lending, and capital markets.

Within each organizational tier, behavioral segmentation drives the client development model. In some cases, clients may be reassigned to a different tier that is better aligned with their behavioral characteristics.
companies with the same model would miss opportunities with Acme and devote too many resources to Redbrick.

**BEHAVIORAL SEGMENTATION**

To be sure, experienced small business bankers are aware of the diversity of the customer base, and some organizations and calling officers have honed their marketing and sales techniques to outdistance competitors. There is still a lot of leakage, however, even among top competitors in this space, with myriad opportunities lost as organizations expend their energies in the wrong directions.

A major reason for such disappointments is that many banks have not yet learned to capture the distilled guidance that comes from a more scientific analysis of the full small business customer base. While a side-by-side behavioral analysis of hundreds or thousands of clients may have been less feasible in prior eras of banking, that level of sophistication is now a reality — and rapidly becoming a competitive requirement.

Behavioral segmentation provides an analytical foundation for a targeted client development model. It begins by profiling the customer portfolio to quantify the value and potential of customer relationships and determine key success levers. It builds on these profiles by creating discrete behavioral segments within the portfolio. And it uses segmentation to drive resource allocation and client development approaches to achieve desired results, such as increased share of wallet or retention of profitable customers.

Customer profiles are based on a variety of factors, including current usage of bank services, profit potential, relationship orientation (e.g. transactional vs. relational) and value orientation (e.g. price sensitive or utility driven). Many factors, such as usage trends and price sensitivity, can be assessed based on balance and transactional history. Share of wallet analytics can provide an estimate of untapped potential. Insights into relationship orientation and price vs. utility trade-offs can be gleaned from bankers’ calling notes and histories stored in customer relationship management databases.

In most cases, this information should be used to derive a forced segmentation based on a hierarchical series of factors used to categorize the portfolio into discrete customer groups. Each behavioral segment should be aligned with a concrete development objective. In one approach, for example:

1. **The first factor is profit potential.** Clients that promise the most overall potential, as measured by annual margin, lifetime relationship value, or some other appropriate metric, should command the greatest share of resources. Note that the clients with the greatest potential may not be those that are currently the best, most profitable customers. Banks should focus on developing the untapped potential of customers if they want to achieve growth in a tough competitive environment.

2. **Relationship orientation is another factor.** Although banks may aspire to nurture deep client relationships, not all clients are interested. Clients who view banks as purveyors of financial commodities demand different treatment from those who are relationship oriented. To serve these “transactional” buyers, the bank needs an adaptable client development model. One size does not fit all.

3. **Third, an analysis of current usage helps to define the objectives of client development.** For example, retention should be the objective for profitable customers with whom the bank already has a high share of wallet. For single-product clients, the goal is cross-sell. In other instances, re-pricing may be an effective approach for clients that use a full-range of services but produce mediocre margins. Of course, for high-potential prospects in attractive markets, the goal is acquisition.

Once all clients are aligned with an actionable segment, the key to success is execution. This includes sales strategy; targeting the right offers to fully develop the potential for clients in each segment. It also includes channel strategy; reaching customers through all touch points including the direct sales force, inside sales, online channels, the external website, service-to-sales and advertising. Then with sales force design, the bank refines organizational structure (specialization, roles, reporting, responsibilities), deployment (coverage, resource levels) and performance management (metrics, compensation, incentives, training).

**THREE FACTORS**

There are three factors that will boost the organization’s effectiveness as it puts these concepts to work in small business banking. These include using customer analytics to generate targeted leads based on client needs; improving the follow-up on leads with inside sales; and refining online fulfillment to streamline onboarding.”
generate targeted leads based on client needs; improving the follow-up on leads with inside sales; and refining online fulfillment to streamline onboarding.

Targeted Leads. This is essentially an extension of the same behavioral analysis that is used to segment the client base. Here the analysis is used to identify opportunities to introduce clients to new products and services, consistent with their financial needs and financial management capabilities. Novantas finds that a behaviorally targeted approach can generate from three to six times the number of leads that typically can be identified by an over-extended business banker or branch manager.

Inside Sales. A dedicated team of sales professionals, interacting with clients by phone, can be highly productive in handling the large number of leads generated by behavioral analytics. The inside sales force will complement the efforts of branch managers and local business bankers, or even act as primary bankers for some client segments. Novantas research has shown that an inside sales unit can contact clients and close deals at one-half to one-third the cost per sale of a field sales force. This not only reduces the cost of sales coverage, but also makes it feasible to manage and cross-sell clients that would otherwise be unprofitable or simply neglected.

Online Fulfillment. Many sales are lost because of errors, delays or miscommunications in implementation. With large commercial clients, support staff can manage the process of underwriting and booking loans, or implementing cash management services. But this model is simply too costly for small business clients, so most banks rely on branch managers and business bankers to “get the paperwork right” and manage the onboarding process — a recipe for miscommunication and human error.

A more effective approach uses online tools to make the onboarding process highly automated and much more transparent. Simple services can be activated by simply clicking a button in the online banking system. More complicated processes, such as loan underwriting, can be tracked online, by the primary banker and the client. Meanwhile so-called “e-sign enrollment” eliminates the need for most paper documents.

Not only will the client development model help banks achieve growth in a challenging market, but it will also lead to more satisfied small business customers. According to a 2012 survey of small businesses by Novantas and Greenwich Associates, the most important attribute buyers look for in their banker is someone who “understands the needs of my business.” What better way to make clients and prospects happy than to arm their bankers with behavioral insights so they can do just that.

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Vertical Segmentation

So called “vertical segmentation” has logical appeal, and the idea is to provide market coverage arrangements that are customized for companies in various industry sectors (healthcare, retailing, construction, etc.) However, cost constraints limit the feasibility of this approach in small business banking.

For one thing, the comparatively lower revenue potential per client makes it difficult to justify the development of industry-specific products. Also the client base tends to be widely dispersed geographically, making it expensive to deploy an industry-specialized sales force.

Yet a vertical segment strategy is warranted in certain cases. For example, high sector concentrations in key markets (e.g. non-for-profits in Washington, D.C.; high-tech companies in Silicon Valley; entertainment companies in Los Angeles) can mitigate the typical challenges of serving a dispersed clientele. A bank may be in a position to build on an already strong competitive position to “own” an important segment.

Cost effective vertical segmentation requires efficient use of resources. Some customer segments have a higher propensity to use specific banking products, which can be bundled into targeted offerings. Examples include:

- **Retailers** — merchant services; inventory finance; sales tax payments, coin & currency.
- **Healthcare Practices** — equipment finance; liquidity management; merchant services.
- **Law Firms** — Interest on lawyer and trust accounts; liquidity management; partner loans, remote deposit capture.
- **Manufacturers** — cash flow lending; equipment finance; international wires/foreign exchange.

Finally, centrally located industry specialists can support in-market bankers via remote channels (phone, video), making it feasible to maintain sector-specific expertise.
Rethinking the Home Equity Line of Credit

It is time for banks to reconsider home equity growth strategies. There are substantial opportunities in targeting and offer design, including the use of precision pricing.

BY KENNETH ALVERSON AND GRACE LEE

Home equity lenders refocused their marketing and underwriting approach in the wake of the 2008 credit meltdown, but have they now fenced themselves in?

In walling off risk exposure, most banks have raised thresholds on FICO scores; lowered combined loan-to-value ceilings; and tightly focused on cross-sell to established deposit customers. While understandable as a crisis response, such tightening is now inadvertently compromising balance growth and profitability in a recovering market.

The irony of focusing on the most credit-worthy borrowers is that by virtue of their overall solid finances, these customers are the least likely to use their home equity lines of credit. Meanwhile, substantial opportunities are being overlooked among broader categories of potential home equity borrowers, both in terms of targeted customer acquisition and needs-aligned offers, including the use of precision pricing to encourage profitable usage.

To unlock expanded opportunities and uphold risk-adjusted returns, banks will need a stronger collaboration among the functional support teams involved in developing the offer and eligibility criteria, namely: credit risk, product, and distribution management. The goal is to identify credit-worthy pockets of opportunity in the overall market and current customer base; design offers to enhance marketability and encourage profitable usage; and effectively deploy offers, not only through the branch, but also via mail, online and through the contact center.

One strong advantage that banks have in this quest is access to extensive customer information, including transaction flows and comprehensive financial and household profiles. Distilled in the right way, this information provides far more insight than a simple FICO score, permitting a more nuanced and effective customer sales and activation strategy.

CRISIS RESPONSE

For many bank-owned lenders today, home equity credit risk management still centers on avoiding delinquencies and losses. The situation traces back to the explosion (and misuse) of the home equity line of credit.

In the years leading up to the housing meltdown, HELOCs were often used as a concurrent “piggy-back” to a first mortgage, permitting borrowers to avoid requirements for private mortgage insurance on loans exceeding 80% of property value. These piggy-backs also helped borrowers to avoid a jumbo loan designation, thus escaping a 25 to 75 basis-point rate hike applied to loan balances that exceed GSE loan size limits.
Combined with looser first mortgage underwriting qualifications, aggressive appraisal valuations and copious third-party originations, these practices ballooned originated HEL commitments to nearly half a trillion dollars in 2008. Following the credit melt-down that decimated U.S. employment, home equity loan portfolios generated massive losses and collateral protection evaporated for most high loan-to-value, second lien HELOCs.

With portfolio performance in such bad repair following the recession, virtually every bank lender revamped its approach to HELOC lending. Credit eligibility criteria were dramatically tightened (through higher FICOs, lower LTVs, and increasingly through tenured deposit relationships). Meanwhile plummeting home values and rising unemployment greatly narrowed the eligible customer base. Outstanding balances were further constrained as banks almost exclusively focused on top-tier customers, most of whom had long tenured relationships, stable deposits and excellent credit scores — but often the least need for credit.

Today, significant opportunities are being overlooked with a broader category of eligible borrowers in under-targeted customer segments.

“Today, significant opportunities are being overlooked with a broader category of eligible borrowers in under-targeted customer segments.”

To make perfectly clear, this situation by no means constitutes a call for renewed exposure at the shaky end of the home equity lending market. However, it does make a case for reexamination of current lending strategies, capabilities and management practices. At many banks, home equity originations continue to be held back by conflicting organization objectives and skill handicaps. For example:

Credit risk. These teams have been through a lot, but the goal of managing risk-adjusted returns has morphed into avoiding virtually all losses, which inadvertently misses large pockets of profitable lending opportunities. The typical bank is no longer incurring loan losses in home equity, but not really growing outstanding balances and profits either.

Product management. Home equity growth and profitability appeared to take care of themselves in the high-volume atmosphere prior to the...
“For many organizations, there are three areas for immediate focus in reenergizing home equity lending: targeting, offer design and pricing. With core customers, banks can harness deep, transactional customer information to develop a nuanced understanding of potential profitability and preferences, valuable for both targeting and offer management.”

recession, but it seems abundantly clear that sustainable and profitable growth will require a more refined approach. Yet at many banks, the product management teams still lack the advanced analytics needed to properly align offers with a customer’s most salient borrowing needs. Pricing is perhaps the most visible offer feature and needs to be precisely developed and deployed at a more discrete level, balancing the dual goals of fostering both growth and risk-adjusted returns.

Distribution management. Success in targeted customer acquisition and segment-based product development and pricing ultimately hinges on the distribution system. But at many banks, distribution teams have a limited ability to deliver segment-tuned offers quickly and dynamically through the branches. More work is also needed to effectively coordinate and leverage alternative channels — especially important given that a growing number of customers are not visiting the branches.

LEVERAGING CUSTOMER KNOWLEDGE

For many organizations, there are three areas for immediate focus in reenergizing home equity lending: targeting, offer design and pricing. With core customers, banks can harness deep, transactional customer information to develop a nuanced understanding of potential profitability and preferences, valuable for both targeting and offer management. Banks are also well positioned to calibrate pricing tradeoffs based on their superior knowledge of established customers and how they behave.

Across these three areas, the product management, credit risk, and distribution groups should be working in concert to deliver the right offer to the right customer, through the channel each prospect prefers. The results manifest themselves across three tangible areas of home equity origination:

1) Improved targeting helps the bank to identify prospects who are more likely to both respond and use the HELOC. As an example, this might include prospects with slightly-lower FICO ranges and more volatility in their primary deposit account balances, yet with deep, tenured bank relationships that often translate into lower delinquency rates.

2) Needs alignment — households have important credit needs for specific purposes such as remodeling, financing college tuition and handling major contingencies, and HELOC products are best designed and marketed within this context.

Customer needs can be clarified in several ways: during live assessment of borrowing needs, or by deploying advanced analytics based on a customer’s transactional data (both credit and deposits), or through ongoing customer and market research. A more comprehensive approach to customer relationship management has greatly enriched banks’ understanding of the customer base, allowing for more intelligent offer design and dissemination.

3) Precision pricing can also accelerate growth while preserving (or even enhancing) margins. Often today we find a significant portion of originated accounts inadvertently priced “underwater” from a risk-adjusted return perspective.

By contrast, advanced pricing approaches integrate a customer’s prospective profitability; competitive market considerations; and the customer’s behavioral profile, including relative sensitivity to rates (vs. other offer features such as fees, minimum payment and rewards). Such analytics provide nuanced segment insights into customer behaviors and provide a sound basis for testing new offer strategies.

Banking executives have no time to waste in coordinating efforts to accelerate profitable home equity growth. With home prices stabilizing, most refinances completed at historically low rates, and consumer credit profiles on the mend, many institutions will need to quickly morph their current strategies to take advantage of this opportunity.
Talking Up Sales in the Contact Center

The contact center has become the first line of defense in ensuring that a sale lost to the branch does not become a sale lost to the bank altogether.

BY ALAN MATTEI AND DARRYL DEMOS

Banking contact centers primarily have functioned as service hubs for customers who call for information or help with a problem. Now an expanded sales role is unfolding as people downplay the branch and shift more purchase-related activity to remote channels.

Even though shopping for financial services providers and products is shifting online, many customers still want a live conversation with a representative when they get ready to open accounts. To the growing extent that they do not want to visit a branch, the next best option is conversing with a contact center representative.

In this situation, the contact center is the first line of defense in ensuring that a sale lost to the branch does not become a sale lost to the bank altogether. It is a pivotal role that will only grow in importance as remote banking matures from a transaction service to a full shopping and banking experience in a multi-channel marketplace.

To succeed in this important transition, banks will need to strengthen their sales strategies for the contact center and back up the commitment with the appropriate investments in people, processes and technology. The progressive contact center will essentially become the largest and fastest-growing branch, a leadership role with increasingly large consequences for customer acquisition and cross-sell.

CUSTOMER RAPPORT

It will be increasingly difficult for banks to meet their sales goals as more high-value transactions occur outside of the branch. A face-to-face conversation often provides the best chance for the banker to establish a rapport with the customer, probe for needs and offer advice, and assist with all of the details so that transactions are completed smoothly and relationship ties are strengthened.

While banks can reasonably expect to boost web sales of simple products and service add-ons, more complicated advice-driven sales — often the highest value — still work best within a conversational context.

This is why the contact center is such an important fallback as customers conduct more high-value business outside of the branch. In the emerging remote banking marketplace, the contact center provides the best alternative to build sales rapport and assure customer responsiveness.

The complication is that contact centers generally are not prepared for this expanded role. Usually they are managed as high-volume service centers, with emphasis on cost control and hyper-efficient call handling.

To turn the tide in the contact center, the unit’s strategic role must shift from cost center to sales center. Leaders in contact center sales productivity recognize that each conversation offers a chance to strengthen and expand a customer relationship. This requires careful management and measurement of the sales process, tracking the yield from each step and also investing in the capabilities needed for further progress.

The potential payoffs exceed what many bankers realize. In mature
branches, the typical sales conversion rate (sales units divided by walk-in traffic) is only about 1.5% on average; the very best is usually no greater than 2.8%, but only in a fraction of locations. In contact centers, by contrast, we see higher average conversion ratios of about 2%, with best-in-class centers delivering double or triple the average in select areas with the right investments. Despite years of investments in branch selling, the best sales conversion ratios have only a fraction of the potential of the contact center.

One selling advantage in the contact center is dedicated customer attention. Our research shows that customers will usually set aside a minimum amount of time when they call to ask for help from a contact center, typically 15 minutes, providing a window of opportunity for an expanded conversation. If service consumes only five of the 15 minutes available, for example, callers are more likely to be pleased and more likely to spare time for a conversation about larger needs that go beyond the service event.

**CALL SUPPORT**

Sales performance in the contact center critically depends on analytically-driven call support. Two factors are call strategy tagging (CST), which helps to set priorities, and call guidance, which helps to facilitate customer conversations as they progress.

Tagging — The goal of call strategy tagging is to define the objective for each conversation. Many banks already tag customers for the “next best product,” but this implies that the right strategy is always a product sale — not so. Often there are more fruitful objectives such as reducing attrition; stimulating product usage; encouraging self-service; or evolving a secondary checking account into the primary account.

For this reason, CST goes beyond products to address all phases of the customer lifecycle. The goal is to provide immediate insight for agents in the course of customer conversations, considering a variety of outcomes and not just product sales only. Because customer strategies will necessarily change over time, a solid analytical process is needed to continually adapt to changing customer circumstances and possibilities.

**Call Guidance** — An expert call guidance system provides key conversational cues that have proven their worth in boosting sales, helping average agents to behave more like the best. It is much more efficient to improve the sales efficiency of the majority of agents than to constantly try to recruit and retain a handful of elite performers.

Many bankers believe that they already understand this point and hold out their customer relationship management (CRM) systems as proof. But while CRM does try to facilitate conversations by aggregating relationship data and coming up with sales suggestions, it stumbles when agents try to incorporate real-time information acquired in the conversation and then attempt to modify the approach to suit the situation.

By contrast, leaders in contact center sales productivity provide agents with real-time intelligent guidance systems. This new breed of technology mimics the decision tree that the best agents follow intuitively, and provides that intelligence to every agent on the floor. This approach also allows for rapid, continual testing for ongoing improvement.

While call guidance systems will not eliminate the need for agent training and product knowledge, they significantly reduce the burden placed on agents for rote memorization. Agents are brought up the performance curve much more rapidly.

Another benefit is enhanced compliance in today’s stringent regulatory environment. Agents need help in making sense of a complex set of national and state regulations that may come into play on any given call. Call guidance can help agents to remain compliant without having to memorize every possible regulation.

**DEVELOPMENT PRIORITY**

As U.S. retail banks continue to struggle with sales productivity, it is important to keep sight of opportunities in the multi-channel banking marketplace. A highly capable contact center will be a lifeline in preserving sales rapport with remote customers.

Yet often today the contact center remains an after-thought in the consideration set for investments that will help to boost retail sales productivity. Meanwhile contact center managers have little leeway or motivation to take the plunge on their own, remaining firmly planted in the role of hyper-efficient service providers.

Banks that can make the most of every phone conversation will be well-positioned to serve multi-channel customers who have left the branch and need high-quality remote services through the contact center. With their controlled environments and advanced technologies, contact centers can make a clear difference in sales performance, with the advantage going to players that make the needed investments now.

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More Coach Seats Needed for Retail Sales

BY DARRYL DEMOS AND DALE JOHNSON

Since the recession there has been a pronounced flight to quality in consumer banking, particularly in the checking business. But has the trend gone too far?

Many retail players have consciously deemphasized mass market consumer banking, further intensifying a trend of significant decline in new customer relationships and account origination. The average regional bank branch booked only 70 new accounts per month in 2012, down from 100 per month in 2008, and the deterioration is continuing.

Certainly retail bankers have reason to be discouraged about the mass market. By far the largest portion of their customer base, the profitability of this segment has stagnated with the introduction of new fee regulations; reduced margins on an already modest slice of deposit balances coming from the mass market; and an overall low demand for consumer credit, an important enhancer of mass market profitability.

In reaction, players are crowding to the other side of the boat. Fees have been hiked on basic products, discouraging mass market account formation, and meanwhile banks have focused their energies on customer acquisition and cross-sell within the mass affluent and affluent market segments. Such concerted pursuit of top-tier customers is a natural tendency seen across a variety of industries in times of duress.

But banks will face an even larger problem if they give up on the mass market. Drawing on a lesson from the airline industry, coach class passengers cover the cost to fly the plane, allowing the carrier to earn profits on business and first class service. But if coach seats are empty, the costs of idle capacity depress profits across all segments.

Retail branch banking is no different. While incremental returns (revenues in excess of variable costs) from mass market consumer banking have declined, they have not been eradicated. And they are critically needed to support overgrown branch systems while networks are winnowed out and repositioned for a multi-channel marketplace. Even today, following the travails of the recession and all of its aftershocks, incremental revenues from the mass market customer portfolio still pay for roughly two-thirds of branch network overhead at many banks.

Sales productivity is a burning issue in boosting this contribution. In the peak years prior to the recession, banks were generating roughly four dollars of sales value for every one dollar of expense incurred for full time equivalent sales staff. But the former 4x “return on sales force investment” now languishes at roughly 1.5x, a victim of declining sales volume, falling revenues per sale and rising labor costs.

But why does an up-market sales strategy worsen this problem? First, there simply is not enough untapped potential in this market tier to make up the gap in sales productivity. Second, many staffers lack the higher level of consultative sales expertise that is required. Third, an up-market focus overlooks an achievable and meaningful revenue stream from high-volume sales of everyday consumer banking products, including checking accounts.

In our research across multiple U.S. banking companies and thousands of branches, we carefully examined the tradeoffs in high-value versus high-volume sales and determined conclusively that both revenue streams must be nurtured to lift sales productivity. Otherwise, branch sales reps would need to generate massive double-digit sales increases with high-end customers, either in volume or value per sale, to offset the lack of a mass market customer base; either scenario is highly unrealistic.

Our multi-bank surveys and research show significant skews in account acquisition among regional banks, with some players lagging by 20% to 30% or more in the overall trend of deposit account origination among mass market customers. This is not a healthy development at a time when cost-burdened retail banks need to nurture incremental revenues to the greatest extent possible.

Our analysis of the entire U.S. branch system shows that one of every four branches is a candidate for near-term closure, both because of a slack market and because of dwindling lobby traffic as people more fully embrace remote banking. But quick action is near impossible given the enormous cost — an estimated $30 billion representing one full year’s worth of collective earnings in retail banking.

Thus, banks will have to cope with a substantial overhead burden for some time to come. To handle this transition successfully, banks will need to firmly reinstate unit sales volume as a goal for retail sales staff. A reenergized outreach to mass market customers will surely be a central factor in meeting that goal.

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Why Banks Must Embrace the Mass Market

Banks must renew their commitment to mass market customers, whose business is essential to support the fixed cost of the branch network.

BY RICK SPITLER

As banking leaders work to fully restore industry profitability following the prolonged recession, a key question is what to do about mass market consumer banking. Formerly a pillar of retail profitability, this market segment has been buffeted by new fee regulations, slack margins, weak loan demand and extensive credit aftershocks from the debt crisis. What remains of bank profitability in the mass market has further suffered since most consumer households do not carry high deposit balances and balances in general are not worth as much as they used to be.

While many banks have retreated from the mass market as a tactical reaction to the trying circumstances, some are now going a step further by altering retail strategy as well. Along with formalizing a redoubled commitment to high-end consumers, they are consciously downplaying mass market account acquisition and retention. As justification, they cite a lack of customer relationship profitability — why carry a boatload of underwater accounts that can’t fully justify the costly overhead? Though perhaps understandable given the circumstances, this up-market movement now threatens to create its own set of problems, primarily in covering the high fixed cost of branch networks. Even though branches are steadily losing customer traffic in the overall trend toward online and remote banking, networks are stubbornly resistant to quick and widespread closures, given the enormous attendant costs.

A Novantas analysis of the entire U.S. branch system estimates that fully one fourth of the collective network is eligible for near-term closure, given trends in customer online migration and the altered economics of retail banking. But our research indicates that swift action would carry a steep price tag of $30 billion to $50 billion, essentially a full year’s worth of earnings for the depressed retail banking line of business.

Even more frustrating for banks, many customers remain wedded to local branch presence even as their actual usage decreases. Particularly for high-value transactions, such as applying for mortgage credit or solving a problem, people still want lobby service, and branch presence still influences the selection of a bank. Costs aside, branches are a customer safety net that cannot be suddenly yanked.

Thus the more likely scenario is that
the industry will close branches at a slower pace over a period of years. This pay-as-you-go approach avoids a big financial hit and minimizes customer disruption, but extends the pain of carrying excess capacity. In the meantime, mass market patronage will be essential in keeping networks afloat.

Rather than scaling back with mass market consumers, retail banks must actively seek constructive ways to grow this book of business. Along with more actively promoting traditional credit and deposit products, winning banks will focus on product innovation as well, particularly in consumer credit and household cash management.

The executive hang-up in embracing this point of view is the powerful allure of top-tier customers. In the search for revenues, corporations naturally focus on the highest paying opportunities. For banks, the sweet spot lies with mass affluent and affluent customers, roughly the top 20% in customer relationship profitability, who typically are five to 10 times more valuable than the average.

But there simply are not enough rich people to pay for the massive branch infrastructure that banks have built. Today, retail banking’s so-called unprofitable customers still pay for roughly 70% of the fixed costs of branch networks.

Attempts to impose new fees and/or restrict the use of bank channels have sowed substantial dissatisfaction among mass market customers. For banks, the risks include outright defection (if prices are raised or branch service is disrupted) and a weakened ability to acquire new accounts and relationships.

It is a delicate situation to be sure, yet there are real opportunities to improve the mass market outreach with a changed orientation. One of the top opportunities is consumer credit, a field that is still being picked apart by national monoline and non-bank players even though local banks have deeper customer ties and customer knowledge.

Despite the travails of the housing collapse and recessionary impacts on employment and household finances, mass market customers still have a spectrum of credit needs, including consumer installment and revolving credit — and even a select growing demand for mortgages. For the analytically adept bank there are substantial pockets of opportunity, both in particular markets and with particular customer profiles.

This includes new product permutations, such as the unsecured line of credit, which plugs a financing gap for responsible households that lost home equity as housing prices fell. Other opportunities include money transfer services, person-to-person payments, and alternative forms of checking overdraft coverage.

Eventually the industry will likely evolve to a much more efficient “thin network,” with a select remainder of iconic branches supported by a lattice of reconfigured outlets offering limited service or standalone self-service. Such a network will be able to support the relatively simple service needs of the mass market as well as the more in-depth service requirements of mass affluent and affluent customers.

But the banking industry must tread a careful path to this destination. Essentially banks will need to earn their way out of the fixed cost overhang. In this multi-year quest, the now-less-profitable mass market consumers must not be abandoned, but rather embraced as necessary for covering the lion’s share of fixed bank branch costs.

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Evolving the Role of the Branch in a Multi-Channel World
A successful multi-channel performance agenda places the customer at the center of a cohesive effort to boost revenues, reduce costs and adapt to a changing marketplace.

Canadian Banks: Ready for a Multi-Channel Market?
A new Novantas survey makes it clear that many Canadian banking customers have moved solidly beyond the branch, raising the question of multi-channel strategy.

CFPB: Growing Pains of a New Agency
To restart growth in consumer credit, retail banks need to look at nontraditional products; the key is to organize offers around essential customer needs.

Growing the Wealth Business in Retail Banking
The new Consumer Financial Protection Bureau has made significant progress in its early days, but some issues may linger for quite some time.

The Contact Center: Retail Banking’s Revenue Bright Spot
The contact center is becoming the go-to resource for remote customers who want a real conversation with a banker, but sales capabilities need to be improved.

Sales Staffing: Managing the Extremes to Boost Productivity
The best places to start with sales productivity enhancements are at the market extremes, both low- and high-traffic, where capacity misalignment is the greatest.

Banking’s E-Crisis: Is the Branch Finally Obsolete?
As customers shift more purchase-related activities online, retail banks must overhaul former store-centric practices to meet the challenges of a digital marketplace.