ROLE CONFUSION
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Lee Kyriacou and Michael Rice

SPECIAL REPORT

Recipients of the Review print edition are also receiving a copy of our 2015 HELOC Consumer Survey, as published by Novantas Research. Representing a wide spectrum of age groups, household income and home values, survey respondents confirmed banking’s prominence in HELOC sales but also highlighted a new sales/usage paradigm centered on digital shopping and household cash management. This 20-page report can also be accessed online at novantas.com/2015-heloc-consumer-survey.
LETTER FROM THE EDITOR

Letter from the Editor

Reflective of industry growth priorities, this issue shines a spotlight on commercial banking and the outreach for small to medium-sized enterprises. Sales productivity is a concern in both areas. While the big commercial units are straining to sustain needed growth, the SME tier is looking to re-ignite sales after a protracted post-recession slump.

As detailed in our cover story on “Role Confusion in Commercial Lending,” coordination challenges are taking a toll as lenders field expanded sales and origination teams. With up to two-thirds of relationship manager time still typically spent on internal processes and paperwork, it remains difficult to truly place “all hands on deck” — a call to action at a time when rising expenses and loan loss provisions are undercutting profitable growth.

Meanwhile in small business banking, the market is finally on the upswing but banks are still stuck with the question of how to advance branch sales. As discussed in “Leveraging Regional Networks for SME Sales Growth,” Novantas research reveals stark differences between acquisition-intensive markets and locales where cross-sell is dominant. Sales staffing can be enhanced by carefully mapping such differences across the franchise.

Turning to retail banking, this issue offers a double helping of coverage on home equity lending. First within the pages of the Review itself, we probe the widespread problem with idle and under-utilized lines. As discussed in “Triage for Dormant HELOC Accounts,” our research indicates that roughly one of every five accounts poses a profit drag across the industry, with implications for product design, pricing and fee structures, and sales processes and incentives.

Second, the recipients of the Review print edition also are receiving a copy of our 2015 HELOC Consumer Survey, as published by Novantas Research. Representing a wide spectrum of age groups, household income and home values, survey respondents confirmed banking’s prominence in HELOC sales but also highlighted a new sales/usage paradigm centered on digital shopping and household cash management. This 20-page report can also be accessed online at novantas.com/2015-heloc-consumer-survey.

Finally, “Strategically Realigning Digital and Branches” continues our ongoing coverage of banking’s historic digital transition. The authors discuss digital’s growing role in shopping and the branch’s corresponding redefinition for sales and service.

Steve Klinkerman
Editor-in-Chief
To meet rising performance pressures, roles, responsibilities and activities need to be better matched with frameworks for origination productivity and underwriting cohesion.
Role Confusion in Commercial Lending: What Can Be Done?

BY MICHAEL RICE, CHEVY MARCHOSKY AND DAVID ZWICKL

In an era of intensifying competition, some commercial banks are reviewing their organizations with an eye to improve the client experience, boost productivity and strengthen underwriting and regulatory compliance.

One key initiative is establishing a target operating model, based on an end-to-end review that defines required processes; where they will be performed; and how. Another is adopting a credit event-driven management approach that introduces standards and streamlining techniques for major aspects of the underwriting decision-making process.

But while the possibilities are encouraging, attempts at fresh thinking are bumping up against some longstanding challenges in leveraging staff talent. Both by virtue of embedded organizational practices and the intricacies of dealing with knowledge workers, particularly relationship managers, precious time and talent is routinely dissipated because roles, responsibilities and activities are only loosely matched with overall frameworks for productivity and underwriting cohesion. For example:

- Up to two-thirds of relationship manager time is spent on internal processes and paperwork, a good chunk of which could be freed up for business development.
- Bankers skilled at client relationship expansion go underleveraged and -rewarded because they are lumped into programs that emphasize acquisition.
- Client and deal information is restricted over territorial disputes about who owns the client relationship.
- Skill gaps are created as subjective management perceptions of individual merit overshadow job requirements in hiring, promotion and transfer decisions.

Extending these and other related issues across a large commercial banking organization, it is clear that questions surrounding role clarity will need to be addressed if improved management frameworks are to fully succeed.

A central task is clarifying and leveraging the varying roles of knowledge and service workers relative to the target
operating model, or envisioned future state of the organizational management framework. Considerations include not only job activities but also implications for ongoing staffing decisions, performance incentives and career development, and the optimal span of control in various management layers.

CRISP DISTINCTION?
On paper, there is a crisp distinction between the objectives and needs of the knowledge worker versus the service worker:
• Generally, knowledge workers design and develop solutions for clients, innovate products and processes, and have higher levels of education and expertise. Examples in commercial lending include managers, relationship managers, portfolio managers, credit managers/underwriters, and loan coordinators.
• Service workers are more task-driven, handling specific functions for both internal and external clients, often following set procedures. Examples include customer banking specialists, closers, loan servicing specialists and bookers.

These two categories seem clear, yet in practice they are blurred in a commercial banking environment where executives long have carried blended responsibilities. In myriad ways, both subtle and obvious, organizational performance could be improved if the bank could better align roles, responsibilities and skill profiles with key activities.

Relationship managers are a compelling example. Though pivotal in revenue generation (and also among the highest paid employees in commercial organizations), RMs across the industry are typically over-involved in task-oriented activities such as data collection, routine client service and documentation. At best they are able to spend from 40% to 50% of their time on business development; most can only devote 20% to 25% — or scarcely more than a day’s worth of effort each week (Figure 1: Imbalance in RM Time Allocation).

Similarly, loan coordinators are often diverted to tasks such as gathering client documentation, tracking exceptions and overseeing boarding. Instead they should be focused on their primary responsibility, which is acting as the first line of defense in the fulfillment process, including the detailed review of loan documents for compliance with credit policy and coordinating modifications with external counsel and internal documentation specialists. As a consequence of distractions with task activities, critical skills are underutilized and the potential for risk exposure is increased.

Issues with role confusion extend well beyond knowledge-versus-service conflicts, as reflected in struggles with overlapping objectives within a skill tier. In a typical origination scenario, for example, the relationship manager’s role in customer acquisition is lumped in with the lesser-recognized role of the portfolio manager in client relationship expansion, even though few individuals excel at both (Figure 2: Relationship Focus in Business Development).

Credit approval is another area of role confusion. Large organizations typically limp along with a diffused and under-nourished commercial credit approval process. Highly-paid staffers are dragged from the sidelines to review detailed loan documentation. Intrusive managers lose sight of facilitation and become roadblocks.

A further challenge lies with management layers and spans of control. Often the organizational chart is cluttered with mid-management micro-teams where managers have only a few direct reports, reflecting a tendency to create positions less out of need and more as a reward for past sales success.

Figure 1: Imbalance in RM Time Allocation
While patterns vary by bank, commercial banking relationship managers typically spend too little time on sales.

![Figure 1: Imbalance in RM Time Allocation](chart.png)

Source: Novantas commercial banking research
WALLS AND BRIDGES
Whatever the impetus, role confusion has many repercussions: for the customer experience; cost and cohesion of origination; and the morale of knowledge and service staff. But as industry veterans know, the predicament is stubbornly resistant to change.

For one thing, efficient divisions of labor are simply less important to bankers who have strived over a period of years to acquire and expand valuable client relationships. Both for territorial and quality control reasons, many want to personally manage every aspect of client interaction and the business it produces, even if it means spending serious amounts of time swimming in task details.

Indeed, a known risk of RM process redesign programs is that clients may be displeased by “efficient” new servicing routines. Banker-client ties that originally cemented the relationship may be eroded, and the possibility of omissions and errors increases as responsibilities are distributed across loosely coordinated teams.

Elsewhere comprehensive technology platforms have proved difficult to implement on the origination side. Often in commercial banking we see fragmented information domains — relationship managers; lines of business; chunks of the origination process — providing patchwork support for current operations and perpetuating disconnects in roles and responsibilities. Coveted deal and client information is not shared in the manner that system designers envision, and endless customizations for various individual stakeholders perpetuate old processes on the new system.

There are, however, principles that can be used to capture more of the potential benefits from improved role clarity without upsetting the apple cart:

Target operating model. The organization cannot move ahead without a roadmap; a roadmap cannot be developed without a vision of the optimal future state. The development of a target operating model addresses this situation via an end-to-end review that defines required process; where they will be performed; and how. At a large bank, the model helps to clarify the activities of thousands of people and dozens of essential steps in the overall work flow.

Role alignment. Pattern recognition of knowledge worker versus service worker roles becomes much clearer with a target operating model in place, plus the model provides a comprehensive basis to identify constructive, feasible role revisions. Typically we find that commercial banks benefit from new and/

Figure 2: Relationship Focus in Business Development
Within the relationship manager role, the varying priorities of customer acquisition vs. relationship development need more conscious recognition and specific support.

Source: Novantas, Inc.
or redefined roles along three dimensions, including line of business, credit origination and fulfillment (Figure 3: Case Study on Realigning Roles and Responsibilities).

Customer considerations should be front and center in operating model design and role alignment. Opinion-driven attempts at competitive differentiation can diverge from actual customer preferences. Unchecked, such disconnects can become further embedded in the course of a reorganization, limiting its payoff. There is no industry standard operating model and competitors will still want to hone their individual approaches. But the acid test is customer resonance, a question deserving of more attention at many banks.

Spans and layers. In chiseling the organizational chart, management layers and spans of control should be informed by gearing levels for knowledge and service staff, geographical considerations, concentrations of skill sets and training needs, and the need to avoid “single points of failure” in critical tasks. Often is it possible to streamline the management structure by creating larger teams (five to eight knowledge workers or 12 to 15 service workers), led by people who are more carefully screened for relevant management ability and better supported by performance information for staff-related decision making.

**CHANGE MANAGEMENT LEVERS**

Even when hard-won clarity is achieved on a realignment of roles and responsibilities, successful implementation ultimately depends on change management — following through in a way that guides staff into new or revised work lives with minimum fallout.

One lever is performance management and compensation. Clarified roles permit clarified performance metrics. Portfolio managers, for example, should be measured on their ability to strengthen product penetration and service ties with current clients, while relationship managers should

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**Figure 3: Case Study on Realigning Roles and Responsibilities**

Organizational models will continue to vary across the commercial banking industry, but many are in need of refinement for staff performance improvement (illustrative case study).

Source: Novantas, Inc.
be measured on business development.

Organizations must be able to provide effective feedback and identify specific opportunities for individual growth and productivity improvement, cemented by pay and recognition frameworks that help to attract and retain high performers and encourage results-driven behavior.

Another lever is communication and leadership style. In any kind of reorganization, concerns can run high and (mis)information travels fast. The management team needs to hash out internal differences and present a unified front when rolling out widespread changes in roles and responsibilities.

A third lever is organizational structure. Thrust into new arrangements, staffers can become paralyzed or revert to old patterns. A clearly-designed and communicated organizational structure reduces transition uncertainty and promotes the utilization of current skillsets. Likewise, it creates channels for effective internal and external communication, so that staffers know where to turn to resolve workplace issues and address the inevitable client contingencies that attend the commercial lending process.

A final lever is career development, education and training. With the benefit of a formal role progression map for major functional areas (e.g., origination, underwriting, fulfillment, portfolio management), the organization has a context to assess staffers, including current fit and skillset and preparation for future roles. Executives cannot expect staffers to learn new skills all on their own, or solely from job experience. Instead, they must promote internal knowledge transfer and other avenues for proactive skill development, not only for individual growth but also for cross-functional productivity.

**COMPLEX CHALLENGE**

Commercial banking has had a strong run following the recession, becoming the primary profit engine that carried many organizations as retail banking operations continued to limp along. The commercial space lately has become somewhat over-hunted, however, curbing trends in both balance growth and profitability. Novantas research indicates that a divided field has already emerged, with only a handful of players sustaining full momentum while most others have either leveled out or actually retreated to varying degrees.

The situation presents a complex management challenge that includes strengthening and differentiating the customer experience, improving sales effectiveness and pull-through, and simultaneously improving efficiency via cost reduction. Importantly, all three objectives can be advanced via an optimal re-allocation of knowledge and service skills to the right roles and responsibilities.

As planning for 2016 begins, management teams should ask:

- Do we have the right role definitions for our operating model and desired customer experience?
- Are we assigning the proper resources to the right roles?
- What are the major points of process friction and revenue leakage?

In the spirit of gaining immediate traction, the near-term priority is clearing up major disconnects in roles and responsibilities relative to the operating model as it stands. Goals include freeing up more time for relationship managers to pursue customer acquisition and relationship expansion, and improving overall efficiency.

Building on this momentum, the medium-term emphasis is aligning technology enablers with roles. This stage introduces new levels of data integration and sharing, critical in a more extensive reallocation and leveraging of knowledge and service roles. Longer term, there are opportunities to review and refine the entire operating model and its supporting role design, with special emphasis on market differentiation and delivery of the desired customer experience.
A recent Novantas national survey indicates that roughly one of every five HELOC accounts may be sitting idle. What are the options?

After years of recession-driven contraction, home equity lenders are finally enjoying robust line origination growth. But progress is being compromised by an ongoing accumulation of dormant accounts, with utilization ranging from low to none.

While lender specifics vary, a recent Novantas national survey indicates that roughly one of every five HELOC accounts may be sitting idle, either mothballed for “emergency only” backup or crawling along after former large balances were paid down. It is a nagging problem that has gained fresh urgency as lenders shake off soured recession-era credits and search more earnestly for profitable balance growth.

The larger concern is with emergency only accounts, as illustrated by a behavioral analysis of results from the Novantas 2015 HELOC Consumer Survey. Segmenting customers by reported HELOC usage (both frequency of borrowing and line utilization), 14% of surveyed accountholders were clinging to the sidelines, either never drawing or confining themselves to smaller, infrequent draws, often quickly repaid.

The financial consequences of issuing emergency only lines are quite real, especially considering unfruitful outlays for origination and closing expenses. In a competitive climate that still emphasizes “no fee” origination, lenders are incurring roughly $600 to $1,000 in hard-dollar mortgage closing expenses for each new account — and the all-in cost is easily double that amount, including internal origination expenses and sales incentives.

These large up-front expenses are effectively draining profits from active accounts to subsidize closing costs for dormant ones. Plus there are ongoing capital charges for carrying open lines. Novantas estimates that for HELOC programs at most banks, each percentage point of lost utilization reduces the portfolio return on equity by 10 basis points.

An additional 8% of survey respondents fell into the category of “pay-downs,” or people who have either worked down previous large HELOC balances or have taken only modest draws over the life of the account relationship. These lines represent lost opportunity, especially given the degree to which customers often narrow their HELOC frame of reference to home improvement while overlooking its financing advantages for other needs (appliances, autos, tuition, etc.).

In addressing dormant accounts, the first order of business is to limit and restructure the origination of unused emergency credit. Along with avoidance via improved screening and revised sales incentives, there are opportunities to improve account economics via fee structure revisions. Also there are innovative possibilities with product design, for example, with a prequalified account backed by the promise of expedited processing when customers are really ready to borrow, deferring closing costs until it is clearer that such outlays are warranted.

Another priority is encouraging line utilization. Although established patterns with emergency only and pay-down accountholders may appear unshakeable, our research shows that many people do in fact change their HELOC borrowing patterns over time, reflecting evolving needs — this in spite of the fact that borrower awareness of the full range of HELOC financing possibilities is generally weak. Banks have a lot of work to do in this area, and the good news is that initiatives to boost utilization via improved borrower education and awareness are applicable across the customer base.

**DRAG FACTORS**

Dormant accounts stand in distinct contrast with major, active sectors of the HELOC portfolio. Traditional “periodic borrowers,” for example, make infrequent draws (mostly for home renovation) and carry high balances. This profitable core customer group comprises half of the typical portfolio, based on our behavioral analysis. Another group of “revolvers” encompasses more than a fourth of the portfolio and also carries high balances, but tends to draw more frequently for cash management purposes (Figure 1: HELOC Behavioral Segmentation).
While the origination pipeline is intended to amplify these two groups, it often falls short, either by generating initially profitable accounts that then become wasting assets, or by booking emergency only credit with extremely low draw potential. These drag factors long have gone unaddressed, both in the boom years when the overriding emphasis was on origination volume, and in the protracted post-recession years when credit stabilization had all hands on deck.

While no-fee, high-volume origination practices were the norm during the real estate boom of a decade ago, that is a flawed formula in the post-crisis environment. The pool of eligible borrowers is smaller, for one thing, and overall line utilization is trending down, whether because consumers are more cautious or because HELOCs have been oversold to customers with little more than contingency credit needs (Who would turn down a no-cost line of credit?). Clearly, banks will need to improve the success ratio in generating utilized lines in order to meet their growth targets.

Many factors revolve around the branch, cited as the most-used shopping channel by surveyed accountholders and also the dominant channel for HELOC origination. One issue is customer dialogue and the identification of customer borrowing needs. Among survey respondents who said they had not been considering a HELOC but opened one at the suggestion of the bank, 30% said they never use their lines, raising questions as to whether representatives are doing enough to detect borrower intentions (or merely responding to sales incentives linked to account origination volume, as opposed to HELOC balance formation). Even among people who proactively acquire HELOCs with the intent of contingency usage, the incidence of dormancy is high, raising questions on the adequacy of preparation to profitably engage this customer group.

Once booked, these emergency only accounts run afoul of product design and pricing schemes that suit the core customer base but do not work well beyond it. The assumption behind no-fee origination is that the cost will be more than offset by interest income on substantial carrying balances, often generated at the onset — not true for contingency accountholders. Lengthy draw and repayment periods are typically provided on the assumption that there is high potential for an actively-used long-term borrowing relationship — also not true for contingency borrowers.

Another assumption is that accountholders intuitively grasp HELOC’s advantages over other household financing tools for a variety of borrowing purposes, making it a veritable self-selling product in terms of line utilization — again not true for contingency and pay-down borrowers. The futility is further compounded when the bank resorts to the raw lever of price, for example, offering teaser rates to resuscitate dormant accounts. In fact, our research shows that these customers are the least sensitive to price.

Figure 1: HELOC Behavioral Segmentation

Segmenting customers by HELOC usage (both frequency of borrowing and line utilization) reveals distinctly different profitability dynamics within the overall portfolio.

![Figure 1: HELOC Behavioral Segmentation](chart)

Source: Novantas 2015 Home Equity Survey
RETHINKING RAINY DAY CREDIT
Banks do not want to turn away qualified HELOC applicants but do want to assure that account relationships can be maintained on profitable terms. To strike a better balance with emergency only accountholders going forward, management teams have a number of factors to consider, including sales, product design and pricing.

Sales. Typically the sales process is only loosely set up to detect situations where no-closing-cost origination offers are not warranted. Given the potential that one of every seven approved HELOC applications may wind up shelved for rainy usage only, many management teams will want to review sales incentives, the sales dialogue and performance metrics. Account dormancy should be a formal component of the sales management radar screen.

Product design. With an improved customer dialogue, banks will have more options to present HELOC product variations that will still be helpful to customers but do not over-commit bank resources. With a “prequalified” HELOC, for example, the customer goes through a streamlined application process and, with favorable internal review, then receives a notice of preliminary approval, as with a prequalified first mortgage. With this groundwork in place, the lender can assure applicants of a quick turnaround when they really are ready to borrow, deferring formal line commitments and the incursion of closing costs until better-justified circumstances.

It also may be helpful to selectively introduce shorter or conditional draw periods, both for cost containment and risk management purposes. By halving the typical draw period to five years, for example, the lender still provides an extended borrowing window while limiting the burdens of account maintenance and standby capital. A shorter draw period also helps to limit instances where years have passed since underwriting and approval, the accountholder’s credit profile may have degraded, and suddenly there is an overly large draw relative to the financial carrying capacity of the household.

To go a step further, lenders could even consider an expressly-designed and packaged “Rainy Day” HELOC product, with flexible characteristics of value to both lender and borrower, backed by a rate and fee structure appropriate for likely usage patterns. Our research shows that most people place their HELOC account with the institution that provides the primary checking account, underscoring the importance of a relationship-friendly context for product innovation.

Finally, product designs should include more lender options to close accounts. Reflecting traditional contractual terms, most of HELOC accounts on the books today cannot be closed for reasons other than delinquency. Left untended, this inflexibility virtually guarantees the ongoing accumulation of dormant accounts.

Figure 2: Current Fee Structures Among Top HELOC Lender

Annual fees and pre-payment penalties are widely used; however origination fees are rarely implemented (Figures for the top 13 HELOC originators).

<table>
<thead>
<tr>
<th>Fee Type</th>
<th>Prevalence</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Origination Fee</strong></td>
<td></td>
</tr>
<tr>
<td>Seldom include (avg $75)</td>
<td>15%</td>
</tr>
<tr>
<td><strong>Annual Fee</strong></td>
<td></td>
</tr>
<tr>
<td>Often include (avg $54)</td>
<td>69%</td>
</tr>
<tr>
<td>If annual fee, waivable 1st yr? (various criteria)</td>
<td>78%</td>
</tr>
<tr>
<td><strong>Pre-payment Penalty</strong></td>
<td></td>
</tr>
<tr>
<td>Fixed $ penalty if close 1st yr (avg $414)</td>
<td>23%</td>
</tr>
<tr>
<td>Lower of $ or % penalty (avg $417 or 1.33%)</td>
<td>31%</td>
</tr>
<tr>
<td>Penalty recovers original cost</td>
<td>31%</td>
</tr>
<tr>
<td>No pre-pay penalty</td>
<td>15%</td>
</tr>
</tbody>
</table>

Source: Informa; Novantas Analysis
Recipients of the Novantas Review print edition are also receiving a copy of our 2015 HELOC Consumer Survey, as published by Novantas Research.

This report can also be accessed online at novantas.com/2015-heloc-consumer-survey.

2015 HELOC Consumer Survey

In the next expansion phase for the home equity line of credit, winners will succeed on the strength of segment-, channel- and market-informed strategies.
Fees. Already in the industry, some lenders have introduced annual fees for HELOC accounts, with waivers for a specified balance threshold (Figure 2: Current Fee Structures Among Top HELOC Lenders). A further possibility is to set an origination fee for lines that are booked without an initial draw. Passing along closing costs should not be considered off-limits, especially with rainy-day lines.

As banks revise HELOC product positioning (term structure, fees, differentiated offers for rainy day borrowers), representatives must be prepared for new conversations with customers. Loan officers must be ready to discuss the advantages of waiting to apply or close until the need is more imminent. To align sales and product goals, banks should consider tying at least a portion of sales incentives to line usage, as opposed to a pure focus on new account volume.

LINE UTILIZATION

Many customers acquire a HELOC with a single borrowing purpose in mind, usually home renovation, and then simply want to retire the debt. Pay-downs represent the tail end of this progression. But the story does not end there.

As part of the HELOC consumer survey, we were able to ask respondents about their original intention for borrowing and actual subsequent usage. Results revealed that HELOC accountholders do a lot of crossing among categories of borrowing purpose, frequently using their lines in ways that differ from their primary stated intention going in. As an example, while 50% of respondents reported line usage for home-related purposes (multiple answers permitted), roughly a third of that usage came from households that acquired a HELOC for a different original purpose. A more dramatic example is big-ticket financing, where more than half of the reported usage came from households that had a different original HELOC borrowing purpose in mind (Figure 3: Borrowing Purposes — Original Intent vs. Actual).

This degree of spontaneous crossover among purpose categories makes a strong case for ongoing product education and promotion within the established customer base. But if feedback from prospective applicants is any indication, a stronger bank effort is needed to educate customers about the full range of HELOC usage possibilities. Among surveyed prospective applicants, 49% said they were unaware that they could use HELOC draws for non-home purposes, and 66% said they were unaware that draws could be used to refinance debt (Figure 4: Awareness of Product Possibilities).

One way to attack the problem is with targeted campaigns to capture “off-us” customer balances held with other lenders. These include revolving and amortized balances parked in alternative vehicles such as student loans, autos and credit cards.

To make clear, such pursuit should not limited to campaigns for dormant accounts only. It has been difficult to focus on marketing during the protracted post-recession years, but the situation is different in the emerging environment of

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**Figure 3: Borrowing Purposes — Original Intent vs. Actual**

While HELOC is viewed as closely related to home renovation, borrowers often make significant use for other purposes, migrating among needs categories as they go along.*

<table>
<thead>
<tr>
<th></th>
<th>Actual Usage by Borrowing Purpose (Multiple answers permitted)</th>
<th>Follow-Through on Original Intention</th>
<th>Crossover from Other Starting Intentions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Home-Related</td>
<td>50%</td>
<td>34%</td>
<td>16%</td>
</tr>
<tr>
<td>Big-Ticket Financing</td>
<td>45%</td>
<td>20%</td>
<td>25%</td>
</tr>
<tr>
<td>Cash Management</td>
<td>29%</td>
<td>12%</td>
<td>17%</td>
</tr>
<tr>
<td>Emergency</td>
<td>12%</td>
<td>4%</td>
<td>8%</td>
</tr>
</tbody>
</table>

* Survey respondents were asked to specify their primary intended purpose in acquiring a HELOC and then list all the actual purposes for subsequent usage.

Source: Novantas 2015 Home Equity Survey
rising home values, rising employment and improving credit quality. As a tax-advantaged household financing tool, HELOC has wide applicability outside of home renovation, with significant untapped potential for off-us balance acquisition and line utilization.

**MANAGEMENT AGENDA**

Now several years into the new cycle of line origination growth, banks are hopeful that the stage is being set for sustained balance growth as well. But as underscored by the Novantas 2015 HELOC Consumer Survey, portfolio drag from dormant accounts is an issue to be reckoned with, not only with respect to the current portfolio, but also given the risk of further accumulation under current account design and origination practices.

In diagnosing and addressing this pain point, three major questions come up:

**What are the dimensions of the issue?** Beyond the fundamentals of account behavior and implications for profitability, it is important to understand the associated customer characteristics. Factors include household demographics, price sensitivity, depth of overall relationship with the bank, estimations of current share of wallet and the potential to capture off-us balances.

**What are the options with product design, pricing and fees?** For most lenders the immediate priority is to revise the circumstances under which new accounts are being booked, particularly rainy day credit. Current standard offerings are not designed in contemplation of potential widespread dormancy. New alternatives are needed to patch vulnerabilities and promote a healthier origination stream going forward.

**What about marketing and sales?** Supported by the right analytics — portfolio, customers, and markets — the marketing team can play a lead role in the targeted acquisition and augmentation of HELOC balances, including initiatives to encourage expanded usage for non-home-related purposes. To bring marketing-driven opportunities to full fruition, the sales system needs to be revised so that borrower needs and intentions are proactively detected earlier in the sales dialogue, before application submission.

Of themselves, issues with dormancy-related portfolio drag provide a strong call to action on these three management questions, but most of the trench work is applicable across the customer base and origination stream. As with other retail banking lines of business post-recession, analytically-guided responsiveness will be a requisite to gain profitable HELOC market share in a setting of restrained growth.

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**Figure 4: Awareness of Product Possibilities**

Prospective applicants often have limited awareness of the full range of HELOC usage possibilities, pointing to a broader need for product education.

![Figure 4: Awareness of Product Possibilities](source: Novantas 2015 Home Equity Survey)
Strategically Realigning Digital and Branches

Bankers are challenged to a strategic reorientation as digital becomes a stronger driver of core banking relationships and the branch is recast in a more specialized role.

BY CHRIS MUSTO AND PAUL KADIN

Digital shopping now influences roughly 80% of the origination stream for new consumer checking relationships, yet 90% of new-to-bank checking accounts are still opened in the branch. This awkward juxtaposition has left many banks at a competitive disadvantage in the unfamiliar territory of digital marketing while also feeling hopelessly tied to expensive branch networks, where most new business is ultimately booked.

But banks need not resign themselves to this Catch-22. Rather than running on separate tracks, the branch and digital channels can increasingly be integrated by focusing on a growing category of “thin branch-ready” customers, so named because they have embraced functional ties to digital channels (shopping, transactions) to the point that they are ready to accept a narrowed role for the traditional branch (reassuring presence, high value sales, complex servicing).

Reflecting a growing familiarity and comfort level with digital and mobile banking, thin branch-ready customers not only transact the bulk of their banking activities online but also embrace online shopping when searching for banking products and providers. They remain emotionally attached to the branch, yet are sufficiently anchored in the digital space so as not to require an outlet on every corner.

Rising from 25% to 39% of the retail base in just the last two years, thin branch-ready customers now constitute the largest segment of primary checking customers, as revealed by the Novantas Bank Shopper Scorecard, based on a national consumer survey. They are not extremists who are ready to let go of branches completely, nor do they roam among channels indifferently; instead, they embrace...
“Importantly, the branch’s refined core role in sales and service does not require massive network density. Locations will need to be selected or preserved more specifically on the basis of sales relevance. With transaction convenience and new marketing influence shifting online, old-school street corner presence does not guarantee market share.”

digital as a growing “first instinct.”

The good news is that the interplay between digital functional attachment and branch relationship attachment presents new marketing and sales possibilities on the digital side and new long-term cost reduction opportunities on the branch side. However, to guard against competitive poaching in the digital space and sustain any possible momentum with former branch-centric customers, banks need to reorient their outreach to support the growing consumer preference for a digitally-anchored experience.

For starters, this includes solidifying and better promoting online and mobile banking capabilities, but the big picture is about organizational realignment. Leaders, business silos and staff across the bank need to get on board. Scattered efforts of the branch, digital, product, sales and marketing teams will not enable the bank to speak with one voice, which is critical in an era of accelerating digital migration.

BRAND PERCEPTIONS

As highlighted by our research, thin branch-ready customers are more likely to cite online shopping as the most valuable shopping method, visit the branch infrequently, and yet remain emotionally attached to the network. In this setting, brand perceptions are less influenced by local branch presence and more a function of multi-channel marketing. In turn, the advantage for marketing-intensive banks surfaces when consumers decide to shop for a new checking relationship.

Increasingly, digitally-influenced shoppers focus on a small cluster of brands that have already caught their attention, or even go straight to the website of the favored candidate provider and delve right into product options. These patterns stand in sharp contrast with the traditional approach of going to the most convenient nearby branch and sitting at the desk of a platform banker to see what is available on the spot.

The very largest U.S. banks have natural appeal to thin branch-ready customers, both because of brand strength and because of the outsized investments these players are able to make in digital channels and capabilities. This appeal already is conferring competitive advantage to the mega-banks, both in winning consideration among online shoppers and in winning/maintaining local market share with a reduced branch count.

The situation does not foretell the end of the branch. But it does suggest a narrowing to a more defined role in selling complex products and non-routine servicing. In our consumer preference study, people were asked about their ideal channels for various types of bank interactions. Forty-five percent of respondents said they would still prefer to go to the branch when opening an additional deposit account with their current bank, compared with a 35% preference for digital channels (Figure 1: Branch Relevance in High-Value Transactions).

When applying for a home equity loan or line of credit, 55% of respondents specified the branch, versus 33% for digital. The branch also remains the preferred channel for financial advice, eliciting a 44% response rate versus 18% for digital.

While service likewise remains a continuing branch strength, banks still should be working to shift more of the load to online channels. For problem resolution, 36% of survey respondents expressed a preference to go to a branch, with only 23% preferring digital channels. Tactics such as web-enabled interactive video with call center reps will help to shift that ratio, enhancing convenience for the growing ranks of thin branch-ready customers and helping with long-term initiatives for branch-related cost reduction.

SALES RELEVANCE

Importantly, the branch’s refined core role in sales and service does not require massive network density. Locations will need to be selected or preserved more specifically on the basis of sales relevance. With transaction convenience and new marketing influence shifting online, old-school street corner presence does not guarantee market share.

This is not an abstract argument. One major bank has already been able to scale back its expensive branch presence in certain markets while preserving customer rapport and service through a combination of web and mobile banking and imaging-enabled ATMs. Elsewhere, this same bank is using its brand power and digital capabilities to penetrate expansion markets at low cost, using a small number of highly visible branches.
Nimble small players are resonating with thin branch-ready customers as well. Our research confirms that in some high-density markets, one new entrant has been able to gain meaningful traction through a blend of marketing, online appeal and a sprinkling of high-visibility banking centers that do not even have teller windows.

This new type of outreach requires a commitment both to digital marketing and to digital as a touchstone of the marketing message. New levels of sophistication and resource commitment are needed to catch the online shopper’s attention and reinforce brand imagery and perceptions of convenience. Current strengths in online and mobile banking applications typically need stronger promotion, product presentations need further simplification, and screen navigation and channel handoffs need to be improved to increase the odds that online shoppers will stay on the path to a purchase decision and account application.

From a larger perspective, the retail bank is committing itself to a new type of digital-led customer experience, raising the bar on the level of responsiveness and customer satisfaction required of non-branch channels. Unless the bank consistently emphasizes a new formula for the customer experience, digital-oriented customers will find themselves at odds with a branch-centric provider mentality. Internal stakeholders across the organization need to understand the strategy and their role in delivering it.

Our research clearly indicates that a tipping point has been reached in checking competition. Digital is becoming a swing factor in customer awareness and purchase consideration, and the branch is being recast in a more specialized role. The situation calls for a strategic reorientation around banking’s new core customer.

**Figure 1: Branch Relevance in High-Value Transactions**

Digital channels have absorbed huge chunks of banking activity. But for things that matter most — issue resolution, advice, deposit account opening, loan applications — many people still prefer the branch.

<table>
<thead>
<tr>
<th>TRANSACTION TYPE</th>
<th>DIGITAL¹</th>
<th>BRANCH/IN-PERSON</th>
<th>PHONE</th>
<th>ATM</th>
<th>NO PREFERENCE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Information</td>
<td>76%</td>
<td>7%</td>
<td>7%</td>
<td>4%</td>
<td>3%</td>
</tr>
<tr>
<td>New credit card</td>
<td>64%</td>
<td>19%</td>
<td>8%</td>
<td>2%</td>
<td>9%</td>
</tr>
<tr>
<td>Transactions</td>
<td>41%</td>
<td>23%</td>
<td>3%</td>
<td>25%</td>
<td>8%</td>
</tr>
<tr>
<td>Service Issues</td>
<td>24%</td>
<td>38%</td>
<td>23%</td>
<td>2%</td>
<td>13%</td>
</tr>
<tr>
<td>Financial advice</td>
<td>18%</td>
<td>44%</td>
<td>13%</td>
<td>2%</td>
<td>23%</td>
</tr>
<tr>
<td>New deposit account</td>
<td>35%</td>
<td>45%</td>
<td>6%</td>
<td>2%</td>
<td>12%</td>
</tr>
<tr>
<td>New home equity credit</td>
<td>33%</td>
<td>55%</td>
<td>8%</td>
<td>2%</td>
<td>4%</td>
</tr>
</tbody>
</table>

¹Includes desktop, laptop, smart phone and tablet. Source: Novantas 2014 Multi-Channel Preference Study.
Leveraging Regional Networks for SME Sales Growth

BY DALE JOHNSON

The typical SME branch sales function dissipates resources and squanders opportunities for customer acquisition and cross-sell — a clear call to action on local sales strategy.

As regional banking companies consider their priorities for performance improvement going into next year, one area in pressing need of attention is branch-based sales with small and medium-sized enterprises. Often misaligned with local markets, the typical SME branch sales function dissipates resources and overlooks important opportunities for customer acquisition and cross-sell, exacerbating competitive vulnerability.

At the top end of the market, the mega-banks have gained share on the strength of market and brand presence, product depth and a superior SME sales management processes. Meanwhile at the grass roots level, community banks have upped their game in leveraging customer intimacy and local market knowledge for SME sales growth.

The damage being done to regional banks by this competitive squeeze is clearly reflected in industry metrics compiled under Novantas SalesScape Benchmarking. At a current average run rate of 1.9 new business relationships per branch per month, regional banks distantly lag large banks at 3.2 acquisitions per branch, and community banks at 2.9. Similarly, regionals have been stagnant in sales of small business deposits since yearend 2012 while large banks have accelerated by 17%.

To begin closing the gap, regional banks need to pay more attention to SME sales dynamics in the individual markets they serve, particularly the pronounced variations in acquisition potential vs. cross-sell potential seen in the typical network footprint. Based on our benchmarking analysis of branch sales in roughly 1,300 U.S. banking markets, for example, 10.7% of the branches account for 28% of all cross-sell system-wide, and a separate 12.5% of the branches account for 27% of all customer acquisition system-wide.

A detailed franchise footprint analysis is needed to recognize and fully leverage these specialized sales opportunities, including segment-specific SME customer potential and competitive intensity. By mapping the market and competitive landscape, the bank can begin to systematically address sales capability gaps. Typical revisions include reallocations of branch staff time, select additions of dedicated SME sales reps, reorientation of marketing and sales campaigns, and a recalibration of sales goals.

Precision deployment of SME branch sales staff is a foundational component of a comprehensive SME growth strategy but receives insufficient attention at regional banks today. Addressing this issue is essential to stem further competitive erosion.
**REGIONAL HANDICAPS**

Despite the encroachment of digital banking, branches remain the dominant channel for sales fulfillment and likely will remain so for some time to come. The need for a strong on-the-ground sales function is further magnified by the service and profitability dynamics of the small business owner, who tends to visit the branch more frequently and whose composite banking relationship (enterprise + household) is potentially three times as valuable as the average consumer banking relationship.

It is a recognized situation with significant revenue implications, yet few regional banks have adequately responded. The typical regional SME customer portfolio is overflowing with one-dimensional checking relationships, and our research shows widespread deficits in local SME market share relative to local branch presence. These disappointments trace back to a series of regional handicaps:

- One issue is that from a competitive perspective, regional banks tend to be “tweeners,” lacking both the customer intimacy and local market knowledge of community banks and the brand recognition and cachet of national banks.
- Second, many regionals have a weak center of gravity in the small business outreach, often relying on an un-compelling force-fit of products and sales processes originally developed for larger middle-market companies.
- Meanwhile regionals continue to rely on patchwork decision-making in the structure and deployment of the sales force. Instead of a systematic study of market differences, challenges and opportunities across the franchise, critical SME-related staffing decisions are driven by the scattered preferences of local management and projections based on past results.
- Finally, the branch sales posture is typically passive, with SME clients treated as a walk-in stream of “retail plus” customers. Often the outreach is confined to in-

**Figure 1: SME Branch Sales Archetypes**

“Acquisition branches” need sales staffing to support a high volume of new business, while “cross-sell branches” need a staffing emphasis on skilled relationship expansion.

<table>
<thead>
<tr>
<th></th>
<th>Acquisition Emphasis</th>
<th>Cross-Sell Emphasis</th>
<th>Mixed</th>
</tr>
</thead>
<tbody>
<tr>
<td>% of total branches (all banks, all markets)</td>
<td>12.5%</td>
<td>10.7%</td>
<td>76.8%</td>
</tr>
<tr>
<td>Average SME sales per branch per month</td>
<td>3.4</td>
<td>8.0</td>
<td>4.7</td>
</tr>
<tr>
<td>% of SME sales derived from new customers</td>
<td>78.0%</td>
<td>8.0%</td>
<td>47.0%</td>
</tr>
<tr>
<td>% of acquisition system-wide</td>
<td>27.0%</td>
<td>4.0%</td>
<td>69.0%</td>
</tr>
<tr>
<td>% of SME sales derived from cross-sell</td>
<td>22.0%</td>
<td>92.0%</td>
<td>53.0%</td>
</tr>
<tr>
<td>% of cross-sell systemwide</td>
<td>3.0%</td>
<td>28.0%</td>
<td>60.0%</td>
</tr>
<tr>
<td>Market share of business deposits</td>
<td>3.6%</td>
<td>9.2%</td>
<td>5.9%</td>
</tr>
<tr>
<td>Market share of business relationships</td>
<td>4.4%</td>
<td>9.2%</td>
<td>8.6%</td>
</tr>
</tbody>
</table>

* SME sales archetypes are based on a review of more than 10,000 branches and 1,300 markets nationally. Source: Novantas SalesScape Benchmarking
branch interactions (with no reps in the field), anchored by time-starved branch managers who may not have sufficient business banking skills, sales experience, training or coaching.

These issues come home to roost in the critical metric of SME sales per branch per month, which has risen by a paltry 2% among regional banks since yearend 2012. By contrast, sales throughput has risen by 5% at community banks over the same time period, and the mega-banks have racked up a hefty 12% increase.

**MARKET DRIVERS**

When regional banks get it right, they not only succeed at business customer acquisition but also dominate the SME checking/deposit relationship and expand from there via cross-sell of loans and other services. Among the elite 5% of larger SME relationships (annual revenues of $2.5 million to $5 million) identified in our benchmarking database, for example, regionals succeed in capturing 70% of the deposit wallet, 40% of the credit wallet, and 50% of the wallet for treasury management and merchant services.

These are inspiring results. But outside of the top 5%, the everyday reality is quite different. Along with difficulties/ inconsistencies in acquiring new clients, there is a monumental accumulation of static relationships, with wallet penetration that can only be described as dismal. Averaging for the bottom 70% of relationships in the $2.5 million to $5 million SME tier (as ranked by wallet share), deposit wallet penetration is 5%, loan penetration is 1%, andtreasury/merchant services penetration is 3%.

The good news is that, when spread across a large network and customer base, even incremental improvements in these ratios can have significant revenue potential. But what is the best angle of attack? This is the point at which all of the well-known tactics are typically reintroduced for discussion, things like training, coaching and incentives, improved usage of customer relationship management systems, targeting and lead generation, etc. — each having a place but all typically compromised by a lack of proper grounding in the varying dynamics of local markets.

Mapping unique market drivers is a crucial first step in determining how to address underperformance. For example, although many locales do have comparable traits and warrant consistent approaches, Novantas research indicates that within the typical regional franchise, up to a fourth of the footprint may be deserving of specialized treatment, either: 1) acquisition emphasis, or 2) cross-sell emphasis (Figure 1: SME Branch Sales Archetypes).

**Acquisition markets with opportunistic cross-sell.**

Representing 12.5% of outlets and 27% of all acquisition, branches in acquisition markets derive the majority of their sales from new clients, accounting for just 4% of cross-sell system-wide. Often situated in high-density markets where there is more churn (company formation, mergers, acquisitions, liquidation), these branches have a higher proportion of single-product (deposit) customers driven by checking acquisition. The focus is more on winning new customers than on deepening relationships, and while the pace of client acquisition is higher, penetration of the deposit wallet is lower.

**Cross-sell markets with opportunistic acquisition.** Representing 10.7% of outlets and 28% of all cross-sell, branches in cross-sell markets are leaders in cultivating in-depth SME client relationships, including deposits, lending and services. They account for just 3% of customer acquisition system-wide. Situated where the small business population is generally more stable and SME banking relationships are longer-tenured, these branches have a higher pace of account origination, capture a higher share of wallet, and enjoy higher economic returns on sales-related outlays.

Clearly, branches in concentrated acquisition and cross-sell markets are destined to struggle under “mixed” SME sales arrangements designed for the mainstream. Yet many regional banks are not even aware of the issue, much less taking action on it, because they have not yet done their market homework.

**THREE LEVERS**

Archetypal market analysis takes on added significance when overlaid with deeper analyses of the micro-markets served by clusters of local branches. Our research shows large variations in SME opportunity based on factors such as concentrations in industry and service sectors, average size and age of target companies, and marketing presence. These variables will influence the specific set of tactics appropriate for each market.

To cut through the complexity, three unifying principles can be used to organize the market-driven SME sales outreach, including: 1) sales force structure and deployment; 2) sales process; and 3) performance management.

**Structure and deployment.** In acquisition markets, the SME sales outreach should be organized around true hunter/gatherers who spend the bulk of their time calling on prospects to drive further acquisition (while opportunistically identifying cross-sell opportunities). Responsibilities for outbound prospecting are shifted from over-taxed branch managers to small business specialists/relationship bankers.

Often there are opportunities to deploy specialized small business banking officers who can rove in the field...
and provide sales coverage for multiple branch trade areas. Each acquisition specialist typically can support between two and five branches, depending on market and network density. In settings where the sales potential does not justify that level of resource commitment, current relationship bankers can be leveraged via targeted activity goals for small business acquisition.

In cross-sell markets, by contrast, in-branch sales teams are at the center of the SME outreach. The emphasis is on relationship expansion with established customers (where possible, leveraging the call center for client contact and appointment-setting).

Here the bank has more options to deploy higher-skilled in-branch sales staff — experienced professionals who have a good understanding of the small business segment and can quickly assess business needs. An in-branch SME rep typically can support between 150 to 300 small business customers. Deployment should be guided by local opportunity and supported by a customer portfolio approach that emphasizes relationship management and expansion.

Sales process. In acquisition markets, the outreach should include direct-response campaigns to drive sales traffic to the branch, using alternative channels including direct mail, e-mail, digital, phone and social media. These activities can be supplemented with branded advertising collateral and in-branch signage. Sales force efforts should be supported by advertising and outbound direct marketing, with targeted, ranked, and scored lead lists (supplied via CRM), focused primarily on switchers and new business formations in target segments and geographies.

For cross-sell, the focus is on driving activation, usage, and cross-sell through in-branch engagement. Customer analytics help to identify sales priorities and appropriate channel communications all along the customer journey — from acquisition through onboarding, activation, relationship-deepening and retention.

Performance management. In acquisition markets, SME sales goals and incentives should emphasize client acquisition, new balances and accounts, but constructed in a way that does not encourage growth the expense of account quality. Plans should set forth the specific activities (outbound phone calls, business visits, appointments, memberships, events, etc.) needed to generate “at-bats” with prospects.

For cross-sell, SME sales goals and incentives should emphasize progress with established customers, including wallet penetration and account retention. A special consideration is proactive engagement with newer clients, both to assure activation and usage of current products and to tap early cross-sell possibilities.

UPSIDE POTENTIAL

While acquisition and cross-sell markets represent more extreme cases of differentiation, even markets with generally mixed SME sales characteristics can exhibit a lot of variation, influenced by factors such as brand awareness, the strength of the distribution network, competitive intensity, the mix of industry and service sectors, client size and needs as reflected in annual sales, etc. For this reason, each regional bank needs a side-by-side analysis of the local markets served within its network footprint, including opportunities, issues, and strategic emphasis (i.e., acquisition, cross-sell, mixed).

In our experience, the banks that reach this level of comprehension quickly discover untapped market potential, opportunities to redeploy resources, and previously hidden drag factors in need of immediate attention.

Along with defensive concerns about encroachment by mega-banks and community banks, regionals have a strong motivation to address sales-related issues given the revenue upside potential with small and medium-sized enterprises. Our research indicates that a fully-developed (deposits, loans, services) proprietor/household SME relationship carries a potential net present value of roughly $6,000. And on average, each of the 1,300 markets served by SalesScape participants contains roughly 2,600 small businesses with annual revenues up to $5 million. The situation presents a clear call to action on market-driven SME branch sales strategy.

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Inflection Point in Commercial Banking?

As headwinds rise, breakout performance increasingly will hinge on key management initiatives needed to protect margins, control costs and improve productivity.

BY LEE KYRIACOU AND MICHAEL RICE

Commercial banking units continue to be a source of strength for their parent companies, but recent results paint a picture of tightening profit dynamics. While evocative of other recovery-era waves that quickly subsided, the current trend still points to the inevitable — a new performance climate in which raw balance growth will no longer carry the day.

The challenge is that operating expenses and loan loss provisions are currently growing faster than revenues, limiting the ability to translate continuing balance sheet expansion into earnings. So while commercial players can look forward to further growth, breakout performance increasingly will hinge on key management initiatives needed to protect margins, control costs and improve productivity.

The good news is that commercial loan and deposit balances continue to expand at a brisk pace. Among top commercial lenders for which publicly-traded information is available, year-to-year loan growth topped 10% in the second quarter of 2015, with deposit growth not far behind. This is consistent with an expanding U.S. economic recovery that now is rejuvenating the battered commercial realty sector while sustaining already-robust trends in other sectors of commercial lending.

But while second quarter revenues grew by 2.2% from the prior-year period, expenses grew at more than double the pace (4.7%) and loan loss provisions more than doubled, both on an absolute basis and as a percentage of revenues (Figure 1: Commercial Banking Headwinds). As a result, net income fell by 3.1% from the prior year (unadjusted for mergers, acquisitions or line-of-business reporting changes), and the estimated return on assets fell by 13 basis points, to 1.45%.

Quarterly loss provisions have temporarily spiked before and could modulate in future periods. But on a trend basis, the outlook is for higher provisions — not reflecting any sort of new credit deterioration, but rather a return to a more normalized run rate.

Following a flood of provisioning in the recession, banks built up huge pools of loss reserves that subsequently proved well in excess of what was needed to absorb charge-offs. The incremental recapture of those reserves has helped to prop up reported earnings for a period of years, but now the trend has largely run its course.

Based on industry averages over the past three decades, provisions likely will rise still further from elevated second quarter levels, reaching a new plateau possibly toward the end of 2016. The degree of headwind varied sharply among individual commercial units in the second quarter and likely will continue to do so, but the general provision/reserve outlook is less forgiving than in recent years.

Meanwhile margin compression — a painful side effect of intensifying competition — has been a primary concern for commercial bankers. While it is too early to call a turn, the collective net interest margin for the study group did at least stabilize.
in the second quarter, providing a brief respite from a five-year slide of roughly 100 basis points.

Going into the fall, at least some relief may come in the form of rising rates, with market-indexed loan yields rising a bit faster than funding costs. What cannot be escaped, however, is the ongoing intense competitive rivalry for credit-worthy clients and projects. It continues to be a borrowers’ market, with an oversupply of lending capacity relative to bookable loan demand, slowing the pace of potential spread expansion.

Elsewhere the commercial banking expense base is on the rise. Partly this is driven by the requirements of managing a much larger book of business. Industry-wide, commercial and industrial loans ballooned by 50% (i.e., almost $600 billion) since the last trough seen in mid-2010.

Commercial banks are also beefing up their sales teams to win further business while spending heavily to meet tougher risk management and reporting requirements in a tightened regulatory environment. Moving forward there are needed investments for items such as marketing analytics; development of fee-based products; refinement of the digital outreach; and modernizing loan origination processes.

**PRECISION MANAGEMENT**

Given the total situation, breakout performance in commercial banking increasingly will hinge on precision management, or an ability to analytically calibrate the outreach to capture nuanced opportunities in areas such as pricing, product customization and staff deployment in line with market opportunity and/or industry segments.

Also there is work to be done with sales models and the clarification of roles and responsibilities across the loan origination chain.

**Pricing.** Commercial loan pricing is heavily subject to negotiation. To strengthen the hand of relationship managers, promote consistency and provide more managerial context for transactions in the field, leading banks are deploying new analytic tools that provide key distillations of deal pricing information from internal and external sources.

A companion effort centers on relationship pricing discipline, specifically the use of rate concessions to win additional business from the client. Feeling the ongoing pressure of spread compression, commercial banking executives are improving the measurement, tracking and discipline of relationship pricing, wanting

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**Figure 1: Commercial Banking Headwinds**

While commercial balances and revenues continue to grow, progress is being offset by rising expenses and a normalization of the loan loss provision.

![Quarterly Results for Top Publicly-Traded Commercial Lenders](chart)

*Source: Novantas analysis of earnings releases from publicly-traded companies.*
“Breakout performance in commercial banking increasingly will hinge on precision management, or an ability to analytically calibrate the outreach to capture nuanced opportunities in areas such as pricing, product customization and staff deployment in line with market opportunity and/or industry segments.”

to better assure that instances of rate-shaving are productively linked to winning incremental business.

Banks are also rethinking commercial deposit pricing, bundling and relationship offers. With the prospect of rising rates becoming more tangible, banks need to come to terms with the pricing of “non-core” commercial deposits, whose value and usefulness have eroded under the terms of the regulator-imposed Liquidity Coverage Ratio.

From an organizational standpoint, an improved pricing framework starts with a firm foundation of data and analytics, brought to life by technology platforms and tools to facilitate information-sharing, client negotiation and management analysis and decision-making. One key performance application is a suite of enhanced pricing methodologies, considering factors such as variations in price elasticity of demand, competitive and regional influences and system-wide patterns. Then to foster consistent implementation, supporting processes and routines need to be clarified and rolled out in the field. A conscious change management program typically is needed to reorient bankers to the new program and assure its consistent and successful usage.

Staffing. As balance-hungry commercial banks continue to expand field staff in the quest for growth, savvy players are sharpening their skills in market-responsive RM deployment. With so much sales variation — both in opportunity relative to client size and industry sector, and in staff performance — there is a pressing need for smarter internal and market analytics, both to deploy resources and to identify and replicate best-in-bank sales behaviors.

Productivity. Staffing questions overlap with expense control and productivity issues as well. Given the trend of expense growing faster than revenue, now is the time to get serious about cost control. Commercial sales models traditionally have been sacrosanct but now need to be reexamined. Beyond sales force design (where and how many RMs and sales specialists to deploy; how best to segment the customer base for effective coverage), there are priorities related to digital capabilities, targeting analytics and leveraging bankers for phone-based sales.

Structure and process. There are also questions about roles and responsibilities across the loan origination value chain. A lack of role clarity is the root cause of productivity challenges, but few banks have been willing/able to address the situation in a comprehensive manner. Teams from credit administration, lines of business and operations must work together on an integrated solution.

Meanwhile the traditional loan origination process remains slow and expensive at most banks, and this is the right time to invest in streamlining and take costs out of that system. A faster and more responsive origination process can provide competitive differentiation and will be essential in combating small business poaching by non-bank lenders with analytic lending algorithms and same-day loan commitments.

Targeting. Finally, small business is now a clear opportunity, as growth has finally returned to the segment, and small business deposits remain of significant value in terms of funds transfer pricing credits. In terms of size, we are talking about a tier of companies that typically are too large to be served via the retail branch network yet can escape the attention of commercial banks focused on middle market and larger clients.

**DRAG FACTORS**

While commercial balance sheet growth remains strong, profitability is sagging and likely will come under further pressure. Drag factors include spread compression, the normalization of the loan-loss provision, and necessary investments in areas such as field coverage, market and customer analytics, and process improvement.

These issues argue for a number of performance improvement initiatives going into next year. Earning reports already show performance divergence among commercial units at publicly-traded banking companies, with significant variations in growth and profitability. Stragglers will especially want to review their management priorities.

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For more on these topics, view our multimedia at: www.novantas.com

How Healthy is Your Brand?
The new synthesis of branch and digital channels is forcing a redefinition of brand strength, especially now that online shopping has become prominent.

Rise of the Thin-Branch Ready
Consumers have a stronger digital center of gravity, but most do not want to completely sever branch ties. The situation calls for a new type of “Digital First” strategy.

HELOC Growth Drivers: The Case for Segment-Tailored Customer Strategy
Finally there are signs of life in the home equity line of credit, but a Novantas survey shows that a multi-faceted effort will be needed to revive the business.

Digging Deeper for Commercial Growth
In an era of margin pressure and intensifying competition, commercial bankers will need to step up to maintain profitable growth and differentiate themselves in the marketplace.

Branch Staffing: Reflective of Local Sales Dynamics?
Branch staffing decisions should be based on markets, customers and local sales dynamics, not spreadsheet averages driven by operating results.

Managing Credit Events for Commercial Performance Improvement
For better coordination between the origination and credit risk management teams, banks need to adopt an event-driven management approach for underwriting.

Analytic Keys to SME Cross-Sell
By improving data, analytics and multi-channel targeting, banks can digitally identify and pursue opportunities that otherwise could not be spotted or profitably served.
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Think FinTech...Think Novantas

The Best Technology is Built by Banking Experts

You most likely think of Novantas as a consulting firm with some of the best banking experts in the industry…and you would be half right. Over the past 10 years, we have also been building and deploying some of the most widely used technology solutions in the industry. Our secret sauce? An unrelenting passion for expertise and innovation. The same passion that drives our expert advisors drives our data scientists and technologists to build our award-winning software across pricing, distribution, sales, and marketing.

Find out what 30% of the top 50 banks already know...experts really do build the best technology!

NOVANTAS SOLUTIONS

Visit us at www.novantas.com/analytic-solutions-overview

Join us this Fall to see how our technologies are used in the market:

2015 SalesScape Symposium
Novantas Executive Series | September 17, 2015 | New York, NY

The speed and extent of change in branch activity are unprecedented and are driving a dramatic shift in strategy, resource allocation and sales planning. Join us for a 2-day interactive executive forum to discuss shared challenges, best practices and evolving needs as you navigate critical branch transformation programs.

Unlocking “Big Data” — How to Jumpstart Big Data Experiments That Drive Real Business Results
Banking Analytics Symposium | October 6, 2015 | Boston, MA

There is a lot of anxiety around “big data” in banking. And with the growing accessibility of big data resources, platforms in the cloud, and experienced programmers, banks are increasingly seeing viable opportunities to begin the experiment. Join us and learn how you can be successful with big data projects.

Solving Mid-Tier Bank Resource Challenges – “Building the Business Case for Investments in Deposit Pricing and Analytics”
GFMI 3rd Annual Retail Deposit Optimization and Strategic Management | November 2, 2015 | New York, NY

While mid-tier banks enjoy an inherent qualitative advantage with an understanding of their deposit bases thanks to their intimate knowledge of local markets, it can be difficult for this group to build the business case for investments in deposit pricing and analytics. Join us for an exchange of lessons learned, successes and aspirational goals of bankers looking to reduce the cost of analytics, while they dramatically improve their quality.

Contact Katie Davis to enquire about attendance — kdavis@novantas.com or +1-212-419-2562