

## Commercial deposits are key (April 30, 2009)

Here's how to get them

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Banks are currently enjoying a bit of a respite from their recent battle for deposits. The preceding economic boom drove significant loan growth within the banking industry, and many institutions struggled to keep pace with funding. Loan-to-deposit ratios expanded, competition for core deposits increased, and reliance on alternative funding sources, such as brokered deposits, grew. The pendulum has swung, however. Core deposits for FDIC-insured institutions increased by over \$238 billion in the fourth quarter of 2008, over two times the growth of the previous six quarters combined. Fourth quarter total deposits swelled by \$308 billion or 3.5%, marking the largest quarterly percentage increase in the last ten years.

Prior to last year, core deposit growth at larger banks far outstripped that of community and regional competitors; yet, the recent plights of these bigger banks have driven disaffected customers to more stable, smaller institutions and have helped to close the gap.

As the situation and markets stabilize, however, core deposit growth challenges will return, competition will intensify once again across the industry, and costs of funds will increase and further erode net interest margins. This thought is troubling for larger banks that can no longer expect to support earnings off of securitizations, capital markets, or NSF/OD charges. Smaller, more margin-dependent banks should be even more concerned.

### Lenders first and foremost

Traditionally, banks have looked to their retail arms to generate funding to enable their commercial and private banking divisions to lend. That paradigm has shifted some over the last decade, and banks have come to recognize that businesses and other organizations represent a significant source of non-interest bearing deposits. Spurred by the need for deposits and the fee potential of treasury management services (TMS), most banks' commercial units have evolved from opportunistic deposit gathering and cross-selling to devoting a portion of their budgets and attention specifically to these activities. Still, at most institutions commercial "relationship managers" (RMs) remain lenders first and foremost, and the commercial deposit opportunity continues to be underwhelmed.

On the surface, the situation at many banks may seem sound. In our experience, about 80% of commercial customers at most banks have a deposit relationship, and about half of those have both a deposit and credit relationship. Unfortunately, many of these deposit relationships represent mere fractions of the customer's total wallet and amount to either the minimum balance required to secure a loan or the cash associated with the one or two treasury or payment services they received from the bank. Retailers and other multi-location businesses that decentralize decisions

related to selecting cash management services providers further fragment the commercial deposit market. The implications of maintaining a lot of small relationships are costly, as banks would almost certainly provide better service with fewer resources and enjoy more customer stability by keeping half the number of relationships and doubling the sizes of those relationships.

Furthermore, alternative financial assets and non-banks are encroaching on bank deposits. According to the Federal Reserve's quarterly Flow of Funds Report, the percentage of financial assets held in deposits by nonfarm, nonfinancial corporations has declined from 5.9% in 2005 to just 4.5% at the end of 2008. Interest rates and economic conditions strongly influence business asset trends; as interest rates fall, businesses must maintain higher deposit balances to earn account analysis credit, but as the economy worsens, these same businesses may have less cash on hand. Many businesses have turned to money market funds as an alternative to bank deposits. Corporations increased their position in money market funds over the 2005-08 period from 3.1% to 4.8%.

### Product push still prevalent

Banks also face increasing competition from non-banks like American Express, First Data, and other recognized providers of payment and information services. Businesses looking for a place to park cash will continue to seek security, stability, and pricing concessions, and, recent turmoil aside, banks compare favorably on these attributes. Increased FDIC limits, access to even more deposit insurance through programs like CDARs, the potential of earning higher income on deposited balances via sweeps, and other facilities make banks even more attractive and enable businesses to ensure their money is working for them. Increasingly, however, businesses seek easier access to cash, information related to their cashflows, and facilitated exchanges with suppliers and customers. Though banks provide a wide range of cash and treasury management services, most banks still maintain a product-push mentality versus one aimed at resolving customer needs and helping customers to distinguish between overlapping service capabilities. For example, remote deposit capture is enjoying rapid adoption, though many companies might be better served by encouraging customers to replace checks with other forms of payments.

This disconnect between banks and their business customers is further evidenced by what banks monitor—often loan and credit balances, rates, and, if possible, fee income and relationship profitability. Few banks, in our experience, are able to measure comprehensive customer utilization of TMS or have a management customer information file (MCIF) that indicates customer TMS penetration. These weaknesses are exacerbated by banks' struggle to aggregate commercial relationships. TMS managers may diligently watch payment and transaction volumes, but that information does not always make it back to the relationship manager. As a result, those responsible for acquiring, cross-selling, retaining, and altogether developing customer relationships have a critically myopic view of customer behaviors and profitability drivers.

The results can be significant. One bank we know assumed all was well with a fast food franchiser client that maintained steady deposit balances and line utilization. However, the customer's profitability nosedived, and upon investigation, the bank determined that the franchiser had switched merchant providers and was now accepting point-of-sale credit card payments. The bank missed out on an opportunity to upgrade the client's service, and worse, lost its grip on the relationship and potential long-term retention of the customer's deposit balances.

Consequently, banks need to take a more proactive and customer-oriented approach to enhancing commercial deposit generation, and ultimately, TMS. Specifically, banks should look to:

1. Improve cross-sales and management of credit relationships,

2. Acquire and better manage deposit-only customers and customers whose credit needs are dwarfed by their deposit and payment requirements,
3. Adopt a segment-focused, "trusted advisor" sales and relationship management model, and
4. Develop a treasury management function that enables the above strategies.

You have to "engineer" deposit cross-sales

The primary focus of banks should be on cross-selling, deepening, and retaining existing relationships, as these efforts tend to be easier and cheaper than acquiring new deposit customers. Emphasizing cross-sales also addresses the notion mentioned earlier that 50 big relationships are better than 100 small relationships. Most banks have rudimentary commercial deposit cross-sales programs that rely on treasury management officers (TMOs) to work with RMs to identify and address opportunities. The results of these efforts may be suboptimal, however, depending upon how the process is managed.

Because RMs are not generally inclined to look for deposit and TMS opportunities—or "risk" a prized credit relationship by introducing a TMO—banks must engineer client review and calling processes and provide appropriate incentives and support for cross-sales success and cultivation of cross-line-of-business trust. We typically find that banks shy away from structure and process definition, perhaps in an attempt to empower employees. While the intent is admirable, insufficient direction applied across a decentralized sales force will usually lead to disparate results and inconsistencies. Thus, to ensure adequate attention and efficient use of valuable salesperson time, we encourage banks to provide guidance for RM-TMO portfolio reviews.

This guidance might suggest bringing a rotating list of portfolio relationships—plus those recently acquired, coming up for renewal, or in the sales pipeline—to the review. Banks should specify a minimum frequency for when RMs and TMOs should meet and consider activity tracking as part of performance evaluations. These reviews should not be confined to C&I relationships, as real estate and construction borrowers can have significant needs for services such as operating accounts, escrow, sweeps, funds transfers, purchasing cards, payroll, and account reconciliation, among others. Helpful tools include checklists for assessing opportunity, reviewing customer relationship status—including payment, ecommerce, and other TMS activity, and collecting contact information; outlines for determining follow up and joint calling responsibilities; and pitchbook templates that talk to TMS capabilities. Look to Marketing or Sales Management to develop new prospect lead lists and help mine existing customer data to ensure fruitful discussions.

Ideally, RMs and TMOs (and other sales specialists) have access to a joint sales and relationship management platform that enables tracking of customer communications and coordination of all activities. In lieu of such an information system, RMs and TMOs must be extra diligent about defining calling responsibilities and providing timely reports of results and interactions. Including Assistant Relationship Managers (ARMs) in the review sessions helps to groom the ARMs to become more client-centric and position them to help coordinate communications between the RM, TMO, and other sales specialists.

Maintaining a reasonable RM:TMO staffing ratio—probably between 5:1 and 10:1—enables relationship managers and treasury management officers to get sufficient time to work together and build rapport. RMs and TMOs should also receive regular training to ensure adequate appreciation and understanding of each other's product lines and capabilities.

Have you adjusted incentive comp?

Properly aligned incentive plans are also key to fostering commercial deposit cross-sales, as a lot of banks have recognized. A great number of the banks we have talked with this year have gone as far as to remove the loan growth component from the RM incentive plan—as loan generation is such a fundamental performance requirement—and moved completely to measuring and paying on portfolio income and deposit growth objectives. TMOs should be incented on cross-sales and deposit spread revenue. These measures might overlap those of the RMs but such double or shadow accounting can be extremely useful in encouraging teamwork. RMs and TMOs might also share some relationship development goals, such as number of new customers cross-sold or portfolio income growth.

### Case for a deposit sales specialist

Reliance upon an RM-only acquisition model will lead banks to miss some significant opportunities with customers for whom borrowing is not the primary concern. Most RMs' credit-focus and elementary appreciation of treasury services lead them to overlook not-for-profits, property managers, professional service providers, emerging technology companies, utilities, and other organizations with typically low loan demand and relatively more complex deposit and transactional requirements. To address this issue, a number of banks have carved out a role for outwardly focused sales people to help identify and generate new commercial deposit relationships. The concept of a deposit-focused sales specialist makes sense, but there are many issues to resolve.

For example, does this position carry relationship management responsibilities? Conventional wisdom would suggest "yes" because if not, the relationships would have to be assigned to an RM portfolio where they might be overlooked in lieu of credit relationships with which the RM is more familiar. Also, ideally, the commercial deposit sales specialists will have deep TMS knowledge as these capabilities are critical hooks in attracting deposit relationships. The combination of these two expectations—portfolio relationship management experience and TMS product knowledge—creates a conundrum, as few individuals will meet all skill requirements.

Thus, to get the program started, we suggest looking at existing resources within the organization and letting their interest, strengths, and weaknesses help to guide designation, role definition, and reporting structure. This may mean converting TMOs, RMs, ARMs, or all three to the new role and providing the appropriate training and support mechanisms to enable necessary growth and development. The best available resource approach implies beginning with a pilot implementation and initially housing the new positions in either Commercial Lending or Treasury Management and expanding those units' charters to accommodate the added responsibilities. Over time, as the position and the people in them mature, the bank may create a separate unit and enable the commercial deposit specialist role to become a career development option for new hires as well as others within the Commercial Banking division. Importantly, banks should avoid making the commercial deposit salesperson position part-time.

### Adjust the metrics

Regardless of how the job is defined and to which line of business it reports, clear internal business rules are required to avoid customer ownership issues and sales focus conflicts. These rules should reinforce job responsibilities and set expectations for what will happen when a deposit customer begins to have substantial credit needs or vice versa. In most organizations, the size and complexity of the credit relationship remain the litmus test for determining whether the relationship goes to/remains with an RM or not. This is suitable, but the procedure should ensure ongoing contact and coordination with the deposit specialist or TMO. Defining the commercial deposit specialist's target market in terms of sales size, industry, and other characteristics helps to provide both substance and guidance to the role and mitigate responsibility overlaps with branch managers focused on small business deposit generation. Also, Marketing can use these same target market definitions to generate lead lists.

Banks must create an incentive plan to motivate and measure the performance of the commercial deposit specialist. Depending upon responsibilities, metrics should include deposit balance production, deposit portfolio growth, TMS sales, and portfolio income. Goals should be structured to focus attention on DDA balances. Details like average versus point-to-point balances, 12-month rolling averages, and quarterly evaluations help to ensure sales people are encouraged to

accept deals in the best interest of the bank, such as balances funded by grants or seed money that will draw down over time but can be substantial and quite profitable in the short term.

### Focus on segments

Both cross-selling and new customer acquisition efforts are greatly enhanced through segment focus and implementation of a trusted advisor sales and service model. Banks that can demonstrate a keen understanding of customer needs and put forth a unique set of capabilities that align with those needs can differentiate themselves from competitors, command higher pricing, and become the provider of choice for deposit-rich market segments. Most models are industry driven and significantly more robust than a simple NAICS lead list. Banks like Stillwater National Bank (medical professionals), SmartStreet (homeowners associations), and Bremer Bank (not-for-profits) have developed programs that demonstrate industry understanding, offer critical product capabilities, and communicate commitment.

Segment focus also helps to spur the innovation of new products and ancillary services that are critical to creating competitive advantage. This innovation results from adopting the customer perspective and thinking in terms of needs versus products and current technology. Consider what the client is trying to accomplish—perhaps transact with cross-border suppliers, leverage cash dispersed across a wide footprint, or accelerate acceptance of customer payments—and create the combination of products, TMS, and ancillary services that addresses those needs. Equally important, the communication of these capabilities needs to be wrapped in a compelling value proposition that demonstrates industry knowledge and dedication and spells out the competitive advantages the bank provides to customers. RM, TMO, and sales specialist training should include segment/industry specific components.

As one might expect, segment specializations take time to develop, let alone become the basis for positioning. However, the potentially long learning curve should not dissuade banks from this powerful strategy. Rather, banks should begin by identifying the most prominent industries within their existing customer base and document, institutionalize, and communicate the capabilities that enabled this success. Banks with geographic sales organizations can create a matrix/industry structure with team leaders that support proposals and specialized client needs across the entire footprint. Additionally, for banks just beginning to focus on commercial deposit opportunities, marketing materials may initially be industry agnostic yet customer centric and talk to key cash management, operational, and other needs common across all targeted segments.

### Support from Treasury

Finally, banks need to ensure that their TMS unit supports and facilitates these initiatives. The TMS product manager needs to stay abreast of rapidly evolving technologies and educate frontline salespeople in terms of how these products address customer needs, the complexities and issues related to implementation, and alternative solutions. TMS must also manage activity monitoring and reporting and help relationship managers anticipate and be able to respond to emerging client needs, like international payments. In turn, successful TMS units require a credit risk management function that understands current technologies and how to protect the bank while ensuring timely transacting and competitive development of product suites. BJ

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