



### *Sales and Marketing*

#### **Better Business Banking Segmentation: Understanding Lifecycle Needs, Part. 2**

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In last month's article on small business banking segmentation, we posed the question: What is the optimal way to segment small business customers to best meet their financial services needs while also optimizing the returns to the banks that pursue them?

Historically, banks of all sizes have used metrics related to size to determine how best to sell to and support the banking needs of business banking customers. Typically, this has meant looking at company revenues and setting cut-offs to segment prospects and customers, e.g., \$1 million to \$5 million for "small businesses," greater than \$5 million to \$25 million for "small, mid-sized businesses," and revenues of \$25 million or more for "middle market" businesses.

Unfortunately, using revenue-based segmentation has sometimes resulted in frustrated and unhappy business customers and significant missed opportunities for the banks that serve them.

Another common size-based segmentation scheme used by banks for small businesses is focused on the number of employees. In the United States, there are nearly 27 million small businesses with fewer than 500 employees:

- 25.7 million U.S. businesses with between one employee (the owner) and 19 employees
- About 600,000 businesses in the U.S. with between 20 and 499 employees
- Roughly 200,000 businesses in the U.S. with between 50 and 500 employees
- Fewer than 100,000 businesses in the U.S. with between 100 and 500 employees

The needs of businesses within each of these employee tiers can differ dramatically. As a result, the number of employees may or may not be indicative of the best approach for banking them.

- Last month's column pointed out that segmenting businesses using size-based criteria like sales volume or number of employees has several potential shortcomings; an assumption that the size of the company drives their banking needs and preferences
- The potential assignment of less skilled resources to smaller companies
- Channel, product, and/or service offerings not aligned with the needs of the entity

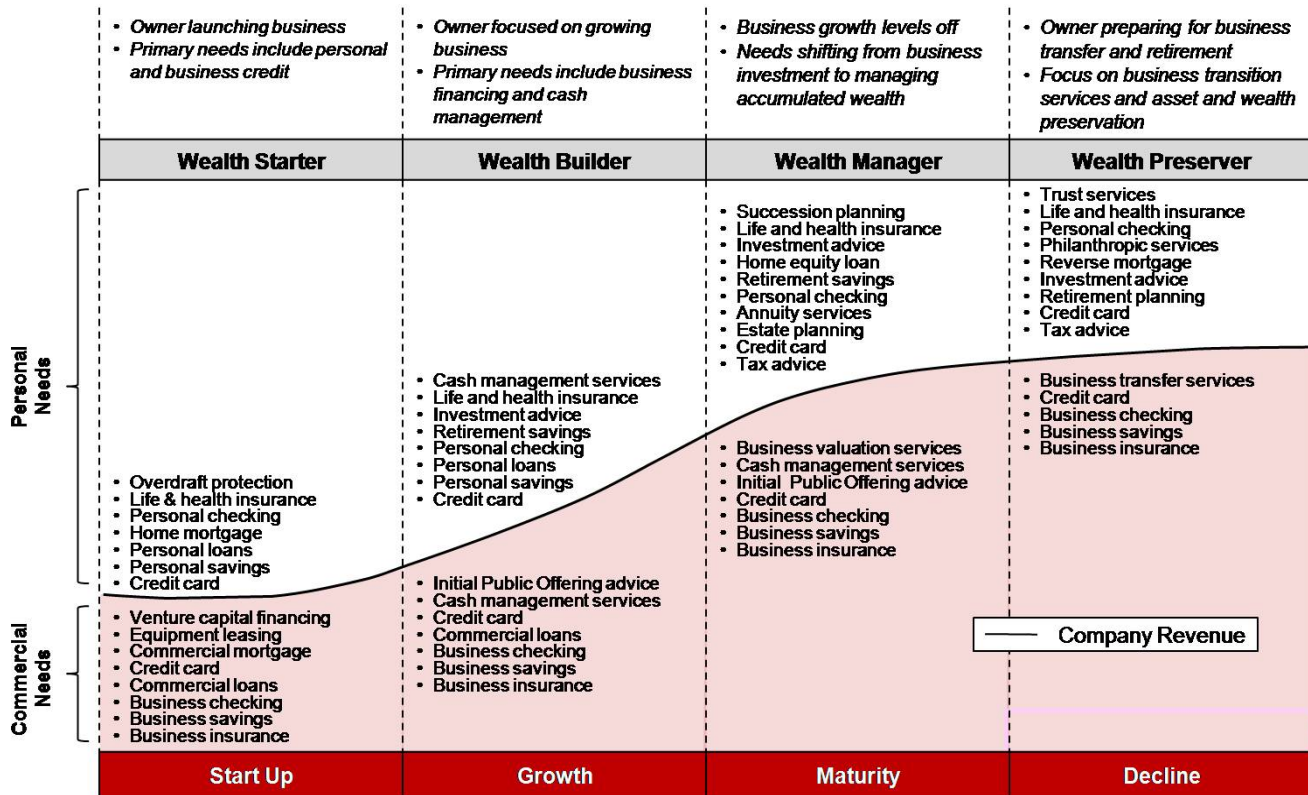
Given the shortcomings of these commonly used size-based schemes, what alternative(s) should banks consider to enhance their ability to reach and successfully serve these businesses? There are at least three ways that banks can improve their segmentation approach:

1. Understand the lifecycle of the business' and the business owner's needs
2. Create a scheme that focuses on the sophistication of these businesses and their needs
3. Develop a dynamic needs assessment feedback loop that enhances awareness of items 1 and 2, above

Last month's article focused on the first way banks can improve their approach to small business segmentation. This month's article focuses on the second key factor: creating a scheme that focuses on the sophistication of these businesses and their needs.

As depicted in the chart below, businesses have different needs for banking services. Those needs may be based on where the business is in its lifecycle while other needs may be based on the nature of the business and its banking requirements. The key point is the size of the business (measured in terms of revenues) may not necessarily be the primary factor in assessing the attractiveness of the business as a potential client. Despite this fact, most banks tend to segment and pursue businesses based on their annual revenues or the number of employees employed by the business.

### Lifecycle of Customer Needs



Source: Trump Bank; Spectrum Group; Business Banking Board research.

### Understanding the Needs of the Business

If not revenues or employee counts, what should banks focus on to better understand and segment customers and potential customers? Bankers can pursue the following approach to designing more insightful segmentation schemes:

1. Determine the banking needs of their small business customers by building profiles of their businesses. For example, services businesses need to manage their cash flow carefully as they often experience delays between when services are performed and payment is received.. Seasonal businesses, including agricultural businesses, have investment and borrowing needs that vary during the year. Retail businesses often need to purchase inventory to get ready for the holiday season when they make the majority of their sales. While there is an element of revenue generation in consideration of these businesses, a significant amount of their banking needs are tied to the nature and key characteristics of the business as well as the industry in which they operate. Use of a needs-assessment guide that recognizes the lifecycle of customer needs is imperative. (e.g., where is the customer or potential customer with respect to their lifecycle needs? Do they need assistance in developing a roadmap to meet these needs?)

2. Assess the areas of greatest need for your business customers. A business with significant and ongoing cash flow activity is likely to benefit from well-developed cash management products to ensure idle balances are invested, invoices are paid on a timely basis, and discounts for early payment of supplier invoices can be assessed or evaluated. Smaller business (in terms of revenues) may in fact see this as a key need and therefore a key “buyer value” when either choosing a new bank or staying with a bank. Unfortunately, most banks often only provide minimal cash management capabilities to these “smaller businesses” or platforms with minimal functionality. As a result, a business with \$2 million in revenues might, on the surface, not look that attractive and may not have significant credit needs, but may have significant average monthly DDA balances. For many banks, a new or potential customer with this profile might be missed entirely or turned over to a retail branch if the initial contact was initiated by the business. For many regional and community banks, a customer with this profile would likely be attractive, but may not be actively pursued given its annual revenues and therefore viewed as less attractive in that type of segmentation scheme.
3. Identify growth businesses in current markets or markets that the bank would like to pursue. All businesses go through cycles. Some follow the general overall business cycle, others are interest-sensitive, and still others may be leaders or tied to industries that are in an expansion or contraction mode. Again, focusing only on revenues may miss attractive targets given industry growth and markets factors. Technology-related companies are a good example of this phenomenon because many can have (and have had) explosive growth in a short period of time. Other industries that create innovation can also have rapid growth. The ability to understand these companies and their banking needs early in their growth cycle and relative to other market and industry prospects can provide great opportunities for community and regional banks.

### **Getting Started on a Better Business Banking Segmentation Scheme**

To start the process of establishing a better approach to segmenting the small business market or enhancing the traditional revenue model, bankers should seek answers to the following questions:

- In each of the bank’s markets, what is the total market for small businesses today and the potential for growth in the near future?
- What industry segments within a small business represent the best opportunities for profitable growth, particularly in consideration of our bank’s core competencies?
- What are the most important values, requirements, and buying behaviors of the small businesses in these growth segments?
- How can the bank achieve competitive differentiation with respect to the small businesses it has identified as most attractive?
- What products, services, and capabilities (from the process, technology, and organizational perspectives) are required to profitably and effectively capitalize on the best market opportunities?

The answers to these questions will provide some additional insights into segmentation approaches that may be more effective than the commonly used measure of revenues. Among the possible alternative segmentation schemes are:

- Industry
- Business type
- Business mix
- Ethnicity

The basis for alternative segmentation schemes cited above includes:

- Demographical bases (age, family size, lifecycle, occupation)
- Geographical bases (states, regions, countries)
- Behavior bases (product knowledge, usage, attitudes, responses)
- Psychographic bases (lifestyle, values, personality)

To be effective, market segmentation must keep the following issues in mind: segments or target markets should be accessible to the bank, each segmented group must be large enough to provide a solid customer base, and each segmented group requires a separate marketing plan.

The best scheme for a given bank will vary, but the steps to determining which is the right one and implementing the right one to pursue are the same.

1. Conduct extensive primary (focus groups and interviews) and secondary (internal and external data sources) research to develop valuable insights into customer characteristics and behaviors.
2. Identify, analyze, and prioritize small business segments (existing and potential customers) based on customer behaviors, attractiveness, attainability, strategic fit, and alignment with portfolio targets/tolerances.
3. Translate insights into strategically significant goals and metrics and align incentives/rewards to the achievement of these goals.
4. Leverage value-based segmentation to isolate at-risk customers and develop creative solutions to aggressively compete.
5. Develop new processes/workflows specific to the challenges of managing and decisioning small business applications (loan and deposit).
6. Create new products, operating models, and identify enabling tools/technology.

### **Conclusion**

Traditionally, banks have used revenues (or employee counts) as a primary focus for their pursuit and servicing of small business customers. As the ability of banks to collect more data from both internal and external sources continues to evolve, alternative segmentation schemes are possible. A key factor to success in today's ever-competitive small banking marketplace is finding subtle differences to gain a competitive edge. Banks that understand this reality will be able take advantage of sometimes significant and measurable differences in their customers and markets to implement more effective and profitable segmentation.

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