



Commercial Insights



Commercial Spotlight

Better Business Banking Segmentation: Understanding Lifecycle Needs

Jim Neckopulos, Managing Vice President, Financial Services Industry Team, Hitachi Consulting

Small business banking continues to offer attractive opportunities for banks of all sizes, be they national giants like Bank of America, JP Morgan Chase and Wells Fargo, or local community institutions. Moreover, because small businesses have been traditional sources of job creation in the U.S. economy and are likely to lead us out of recession, business banking opportunities should become even more pronounced in the coming months and years.

Being able to capitalize on business banking opportunities requires careful thought and analysis. The question that we explore here is, “what is the optimal way to segment these businesses 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. The results of this business customer segmentation then are used to make decisions on:

- The channel(s) used to sell and service these companies
- The skill set and experience level of the resources dedicated to them
- The set of banking product and services offered to them

Unfortunately, using revenue-based segmentation has sometimes resulted in frustrated and unhappy business customers and significant missed opportunities for the banks that serve them. As one example, many small business owners are often good candidates to become wealth management clients. However, many banks, including many national and regional banks, tend to sell and service their small-business customers through consumer banking channels. Some of these channels (e.g., retail branches or call centers) are not sufficiently focused on or skilled enough to meet the needs of these customers. Other channels (e.g., consumer online banking) may not provide the bank with sufficient visibility to, or functionality for, meeting the business or wealth management needs of these customers. Whatever the cause, the result is that the small business customer does not believe its preferences or needs are fully understood or are being met.

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 employees¹

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. On the one hand, employee numbers may be helpful in offering a company payroll services or direct deposits for their employees. On the other hand, the number of employees may provide little insight into understanding other needs (such as cash management) or customer comfort levels around newer, more sophisticated products and services like certain on-line banking products or remote

¹ Tiburon Strategic Advisors (May 2005)

deposit capture. The end result may well be an unnecessary misalignment between the bank and its customer when one need not exist, spelling missed opportunities for both the customer and the bank.

Clearly, segmenting businesses using size-based criteria 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:

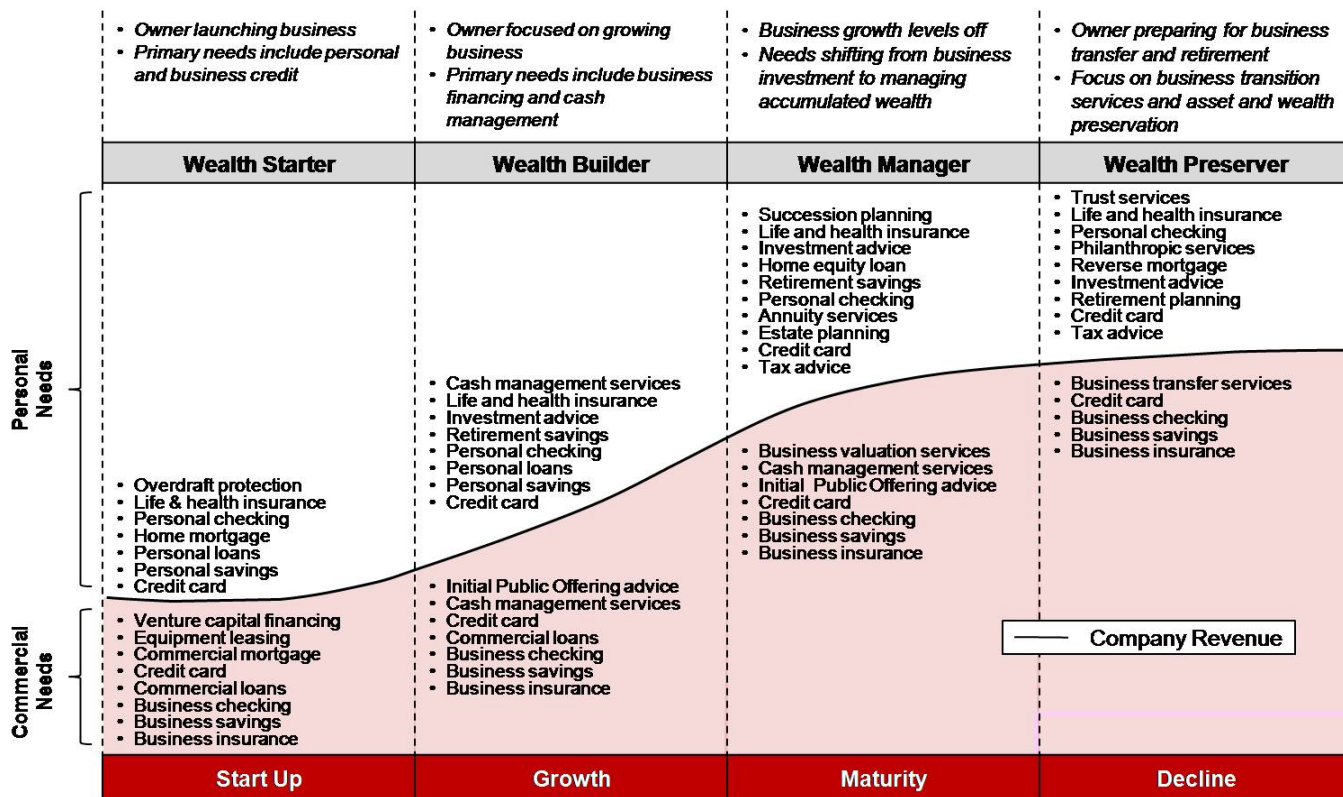
1. Understand the lifecycle of needs the business owner and the business
2. Create a scheme that focuses on the sophistication of these businesses and their needs
3. Develop a dynamic needs assessment feedback loop that enhances awareness of items 1 and 2, above

This article focuses on the first key factor: understanding the lifecycle of needs of the business owner and the business. Future articles will focus on using the second and third key factors to improve your bank's small business segmentation approach.

Understanding Lifecycle Needs

As depicted in the chart below, owners — much like their businesses — go through changes in their financial needs, both personally and for the business.

LIFECYCLE OF CUSTOMER NEEDS



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

How well bankers capture and understand these needs is critically important and starts with their training and go-to-market approach. Bankers, particularly community bankers, need to take a holistic approach to their selling and relationship management efforts. However, this is often in conflict with their desire — and sometimes in conflict with their compensation incentives — to “sell products” to customers. In many cases, bankers believe the key to starting a relationship with a new customer, especially a business customer, is to sign them up for a loan or line of credit. However, as the lifecycle model clearly shows, most potential new customers have many financial services product needs, which can be personal, business-related or a combination of both (e.g., using a home equity line to finance business needs).

To ensure that bankers best identify, understand and meet the needs of both potential and existing customers, they need to develop a methodology that prepares them for success. While many different approaches exist, including using automated support tools such as customer relationship management (CRM) systems, the best approaches share several common characteristics:

1. Use of a needs-assessment guide that recognizes the lifecycle of customer needs (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. Development of questions that determine key buyer values — related to factors such as convenience, price, service, access to expert advice, etc., — as well as the trade-offs between these factors (e.g., what drives their key decisions? Do they have a “trusted advisor” on whom they rely for advice? If so, how should the banker approach working with or ultimately replacing this advisor?)
3. Understanding the current economic environment and its impact on personal and business decisions (e.g., should certain steps in the customer’s or potential customer’s roadmap be accelerated or deferred due to unforeseen or unexpected personal changes in circumstances, the current business cycle, upcoming tax law changes or other industry specific considerations?)
4. Projection of future needs and requirements of the customer and potential customer — on both a personal and business level — even if they are not a business owner (e.g., what does their company’s retirement plan provide for? When will money be available? What will or should be done with any of the proceeds?)
5. Previewing the key factors and considerations related to the next phase of the lifecycle to identify critical needs and possible constraints, and to confirm desired outcomes
6. Monitoring of the above factors and information by holding periodic meetings with the customer or prospect to update any changes and assess the impact of those changes

Challenges and Opportunities for Smaller Banks to Meet Lifecycle Needs

The considerations above are critical to banks of all sizes to successfully meet the lifecycle needs of existing customers and to market to potential small business customers; they also demonstrate the strong link between business banking decisions and personal financial needs and considerations. However, these considerations present an even more difficult challenge for smaller banks, which struggle with the fact that their customers’ needs are becoming more sophisticated. Addressing increasingly complex customer needs across the lifecycle requires ongoing investment in technology. The challenge is in funding these technology investments.

In a smaller bank’s favor, however, is agility. In many cases, smaller banks can manage technology projects much more efficiently than larger institutions. Smaller banks also tend to rely more on partnerships with technology companies to address client needs. Similarly, smaller banks also use application service provider (ASP) versions of key applications to compete with bigger banks.

That same agility can be applied to smaller banks’ interactions with their business banking customers. Local — and, as a result, more flexible and faster — decision-making provides a critical and valued differentiator in small banks’ pursuit of business banking customers.

Another leveler of the playing field for smaller banks is payments. The 2009 Community Bank Payments Survey (Payments Survey) found that 52 percent of community banks increased payments-related spending, while only 11 percent decreased spending. Smaller banks can use electronic payments as another way to compete, since they do not need the infrastructure that larger banks need to process the high payment volumes of their corporate customers. Remote check processing (remote deposit capture) provides a great example of how technology is leveling the playing field between smaller and larger institutions. The Payments Survey revealed that 62 percent of community banks offer remote deposit capture (RDC), up 41 percent since 2007.²

² 2009 ICBA Community Banks Payments Survey press release (Sept. 17, 2009), as cited on www.remotedepositcapture.com

As financial services products become increasingly commoditized, smaller banks are focusing on service quality as a way to differentiate themselves from the largest banks. Some are focusing on niche markets — such as providing lockbox services for health care providers — that allow them to offer deep industry expertise to their customers. This approach and philosophy reflects a trend toward more sophisticated and targeted customer segmentation, where banks market “specialized” offerings such as cash management to veterinary clinics or apartment rental companies.

Smaller institutions also focus on the weaknesses of the larger institutions — such as “nickel-and-diming” customers for every little service — and use those weaknesses to their advantage. Good service makes good business sense and customers will pay for it if it is truly differentiating.³

Smaller banks also provide other value-added services — such as offering free seminars on business topics where the bank gets a chance to showcase their services not only to businesses themselves, but also to the customers of those businesses — to apply the lifecycle model to their benefit.

One regional community bank, Bremer Bank in Minnesota, uses servicing as a key differentiator in its cash management offering. The bank competes with banks such as US Bank and Wells Fargo as well as small community banks that are becoming more aggressive about going after the business banking market. “We really focus on the servicing of these cash management products — the bread and butter of business banking relationships. We don’t want to compete always on price — that’s not our niche and not our market,” says Steve Downhour, Vice President at Bremer Bank. “Part of our strength is that we offer a full line of services.”⁴

Increasingly important to smaller banks’ full line of services for business banking customers is full investment management. A 2008 Korn Ferry study, “Opportunities and Challenges Facing Community Banks,” cites “full investment management” as a key opportunity area for community banks. This opportunity is especially well-aligned with understanding both the personal and business-related lifecycle needs of a customer. The Korn Ferry study notes:

“The potential is incredible. The U.S. Small Business Administration estimates that 3.6 million small business owners are at least 45 years old, making the relationship and expertise of community banks more valuable. As retirement nears, business owners will seek advice on transitioning and selling their businesses. Banks offering investment management will realize an excellent cross-selling opportunity to established business customers.”⁵

Providing a full range of cost-effective, targeted solutions that meet both the personal and business needs across a business banking customer’s lifecycle can round out the service model for, and provide a competitive edge to, smaller banks that pursue business banking customers.

Conclusion

Banks of all sizes can improve their ability to compete for, and win at, banking businesses. The key is to understand *personal motivations* and the *buyer values* of customers and potential customers within the Lifecycle of Customer Needs. Bankers must understand the considerations discussed in this article to position themselves to deliver better business banking. For smaller banks, addressing these considerations presents additional challenges with respect to cost and scale. However, creative approaches to address these issues have been successfully applied; these include using ASPs to extend the bank’s technology capabilities, offering targeted and cost-effective electronic products and services, and offering better overall service models that address both the personal and business needs of business banking clients.

Jim Neckopulos is the Managing Vice President of the Financial Services Industry Team at Hitachi Consulting. He can be reached at 415-740-1320 or jneckopulos@hitachiconsulting.com

³ Small Business Banking, July 2007

⁴ Small Business Banking, July 2007

⁵ The Korn Ferry Institute, “Opportunities and Challenges Facing Community Banks,” 2008