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Enhancing deposit profitability

Beat the marketplace squeeze by applying advanced analytics to your deposit business

Deposits form the foundation of most financial institutions' operations. Not only are they the lead product for most consumer and many small business relationships, but they can also deliver significant profits in themselves — given the appropriate focus and management.

Realizing those profits can often be a challenge, though. The scale of the largest competitors has grown, especially with recent industry consolidation. Additionally, new entrants have and likely will continue to enter the market. The proliferation of deposit-taking institutions and the increasing commoditization of products is eroding customer loyalty. And the emergence of online business models has created a challenging operating environment in which controlling costs and extracting value are more important than ever. These factors mean that growing and retaining deposits organically and improving profitability are ever increasing challenges.

Fortunately, you don't have to fight the battle blind. Advanced analytics — powerful probabilistic and statistical techniques that extract business insights from complex customer, operational, and marketplace data — can help you better understand what drives margins and customer satisfaction in your deposit business and develop an integrated strategy for improving profitability.

The power of advanced analytics

Advanced analytics can leverage business scale to uncover subtle patterns in customer behavior, product performance, and other areas that pass undetected by the unaided eye, examining literally millions or even tens of millions of historical transactions along with information about factors such as cost to serve, certain customer demographics, channel, micro market economies, and others. Financial institutions can then use this information to develop profit boosting strategies such as modifying or discontinuing unprofitable products or customers, changing pricing or sales policies, or adjusting marketing and branch management strategies.

A financial institution's deposit business offers a fertile ground for the use of advanced analytics because it typically involves a large number of customers, products, and distribution points — online channels, branches, relationship managers — whose complexity is difficult to untangle without the use of powerful analytical tools and techniques. Often, basic analytics can reveal significant performance differences among different groups of customers, products, locations, or sales channels that can suggest specific profitability improvement strategies. With solid advanced analytics, institutions can also model the potential outcomes of changes to prices, locations, product features, and other factors, allowing financial institutions to "test drive" such decisions before implementing them more broadly.

A comprehensive approach to improving deposit profitability

In our experience, a comprehensive, analytics-driven approach to improving deposit profitability and growth that includes six profitability "levers" illustrated in Table 1 can help a financial institution realize and sustain substantial margin improvements, while also improving deposit growth and customer retention.

Table 1: Six levers for improving deposit profitability

Levers	Components	Potential Impact*
Profitability Analytics	• Product profitability analysis • Customer profitability analysis • Branch profitability analysis	6–8 bps
Market Assessment and Goal-Setting	• Prospecting and market opportunity assessment • Competitive market assessment • Deposit goal-setting for branches	9–12 bps
Pricing	• Price optimization • Competitive price benchmarking • Price concession management	8–12 bps
Customer and Prospect Predictive Modeling	• Account acquisition • Cross-sell propensity analysis • Attrition or churn analysis	12–15 bps
Relationship Manager Effectiveness	• Relationship manager performance • Relationship manager incentives	6–9 bps
Product Design	• New product development • New product pricing	7–10 bps

* Estimate based on the experience of a range of depository institutions

Profitability analytics

Using profitability analytics to better understand which products, customers, and branches are more and less profitable and *why* is a crucial first step in any deposit profitability improvement program.

Product profitability analysis

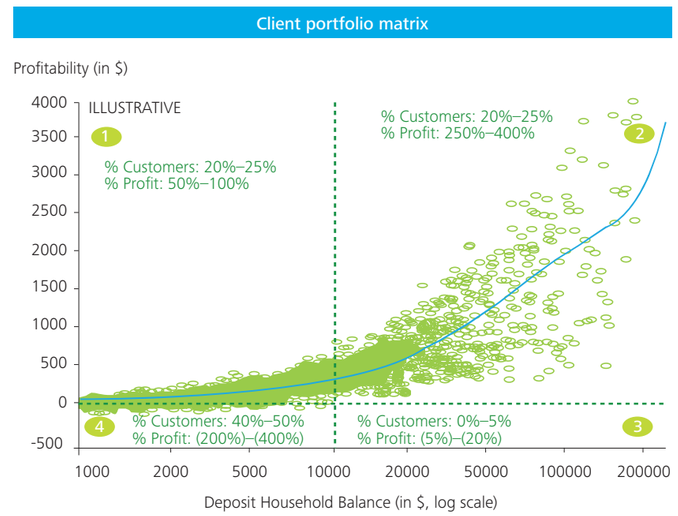
Greater visibility into product profitability both in aggregate and by balance range can form the foundation for product-specific strategies such as refining product designs, repricing existing products, and creating product bundles. Used on an ongoing basis, product profitability analytics can also support automation of business rules, such as alerts to key developments (e.g., declining profitability, excessive discounting) in specific products, so that product managers can quickly identify trends or exceptions and take appropriate action.

Customer profitability analysis

Customer profitability analysis can help financial institutions develop customer-specific sales approaches and support automated business rules such as alerts to identify underperforming customers or even opportunities to improve profitability. Understanding profitability on an individual-customer basis can help relationship managers respond appropriately if and when a customer asks for a special deal, such as a price concession or fee waiver. At the aggregate level, customers can be segmented by profitability and/or various demographic characteristics that influence profitability, and tailored strategies can be created to increase the profitability of each segment.

Figure 1 illustrates how customer profitability can be plotted against deposit household balance to help identify four segments to be managed with different sales and service approaches.

Figure 1: Example of an analysis of profitability by deposit household balance



1. Grow

- Launch sales initiatives to increase share of wallet
- Set up relationship-enhancing programs
- Identify opportunities to increase volume in current products
- Identify opportunities to increase balances
- Offer new products

2. Protect

- Provide adequate high-quality service and relationship management
- Provide value-added services
- Identify opportunities to increase balances

4. Fix or Flush

- Identify reasons for poor performance
- Determine importance of client
- Reduce cost to serve
- Recover higher cost to serve through price increases
- Push client to move to more appropriate service channel
- Consider terminating relationship

3. Re-evaluate

- Determine growth potential for higher-margin products and higher investment activity
- Monitor price concessions closely
- Identify opportunities to raise price or change price model

Branch profitability analysis

A branch profitability analysis rank-orders the individual branches within a financial institution's retail network by the performance of its consumer deposit, consumer loan, small business deposit, and small business loan products. Used in conjunction with information about local competitive performance and micro-market conditions, a branch profitability analysis can help financial institutions design and execute micro-market level strategies for individual branches that consider each location's specific customer and competitive characteristics. A similar analysis can be applied at the network level to better understand key network effects in individual markets and inform branch growth strategies in each micro-market.

Market assessment and goal-setting

Revenue and profitability opportunities for individual branches can vary greatly depending on a number of location-related factors, including the proximity of competitors, local population certain demographics, and even the building's accessibility to car and foot traffic. To take this expected variation into account, a financial institution should set customized goals for each branch based on an assessment of its total market potential, competitive environment, micro-market growth, and historical performance.

Prospecting and market opportunity assessment

A prospecting and market opportunity assessment can help determine each branch's total market potential by using zoning methodology to determine the size and scope of its trade area based on information about each branch's clients and the geographic presence of deposits and loans. The analysis then quantifies the business and consumer potential for each product based on the number of small business and consumers in each branch's trade area. This analysis can be further used to identify the top competitors in the trade area, as well as the key trends and "hot spots " for each product line where significant unexploited pockets of opportunity may exist.

Competitive market assessment

A competitive market assessment, which calculates the market share of each competitor within a branch's trade area, can help financial institutions understand which competitors within each branch's immediate vicinity are most relevant to clients and prospects. This information can he used to compare product offerings to competitive offerings, aid negotiations with clients, compute the competitive trend for deposit and loans, and develop competitive pricing for each micro-market.

Deposit goal-setting for branches

Boosting a branch network's profitability means investing just enough in each branch to support its revenue and profitability goals. But because each branch's total market potentials unique, setting across-the-board goals for all branches can result in targets for some locations that are unnecessarily low or unrealistically high.

The results of prospecting, market opportunity, and competitive market assessments, together with branch profitability analysis, can help a financial institution set appropriate branch-level goals that reflect branch specific competitive and market dynamics. Specific goals for particular customer groups, especially with respect to small business customers, can also he developed. With better information on goals and specific prospects, branch personnel can take steps to raise the average dollar amount of deposits per branch — or, if needed, reduce staff and services to a level appropriate to the branch's targeted performance.

Pricing

Pricing refers to both price setting — the development of list prices that support business goals — and price execution — the delivery of those prices to the marketplace in a way that induces customers to pay the amounts required to drive the expected margins.

Competitive price benchmarking and price optimization can help a financial institution improve price setting, while price concession management can help improve price execution.

Competitive price benchmarking

Competitive price benchmarking collects information on competitors' prices, both by product and by market area, and uses advanced forecasting techniques to predict future competitive price movements up to six months in advance, as well as the effective market price. An ongoing competitive price benchmarking effort can allow a financial institution to create customized alerts for its top competitors' price movements by market area and product line, helping management quickly decide how, if at all, to respond. Competitive price benchmarking can also be used to rank-order product prices with respect to top competitors by market area to inform growth strategies for individual products.

Price optimization

The traditional approach to setting rate sheets through a combination of cost-plus pricing and a qualitative assessment of relative competitiveness-fails to take client price sensitivity into account and, therefore, may leave potential profits and/or balances on the table. Price optimization addresses this shortcoming by developing theoretical performance maximizing, or "optimized," rates for each product. This statistical process uses historical transaction data to estimate price elasticity based on product, term (for time deposits), balance, geography, channel, and client characteristics. These estimates are then used to model thousands of potential pricing scenarios to determine which ones best meet management's objectives typically a combination of profitability and balances.

Price concession management

It is extremely important to monitor performance metrics associated with price concessions, as concessions affect the delivery of prices to the marketplace and thus a financial institution's overall pricing strategies. To keep price concessions from eroding profits, relationship managers should base price concession decisions on an analytics-driven understanding of a variety of factors: competitor rates, prices set on recent similar deals, client profitability, and more. By giving relationship managers such information and training them on its use, a financial institution can help its relationship managers use price concessions more judiciously and improve overall profitability.

Customer and prospect predictive modeling

Predictive models provide significant insight into the likelihood of a given outcome. With respect to deposits, predictive modeling draws on historical transaction and available demographic data to identify and quantify correlations between client characteristics and behaviors (e.g., tenure, product usage, transaction history, channel usage, credit scores) to predict the probability of a particular action, such as account closure, by a particular client.

Account acquisition

Predictive modeling can improve a financial institution's account acquisition efforts by helping management identify promising prospects for specific products and develop tailored marketing campaigns based on customer location, household income and size, and other customer characteristics. By helping financial institutions zero in on promising targets and purchase drivers, predictive modeling can help sales forces increase new business development productivity as well as design more effective loyalty programs for both new and existing customers.

Cross-sell propensity analysis

A cross-sell propensity analysis examines customers' historical purchasing patterns, customer lifecycle stage, and the historical success of previous cross-selling campaigns to determine which products and cross selling approaches are most likely to drive additional purchases by various groups of customers. This analysis can help financial institutions create, target, and manage products to address specific customer needs, identify effective sales and delivery channels for cross-selling, evaluate the prospective profitability of cross-selling efforts, and help relationship managers better understand when, how,and with what offers to approach customers for cross-selling opportunities. For instance, a cross-sell propensity analysis can identify customers at various life stages or experiencing life events (such as getting married,having a child, graduating college, or retiring) and identifying high value products that are likely to match their specific needs.

Attrition or churn analysis

An attrition or churn analysis can help identify customers or customer segments that are likely to reduce or end their relationship with the business, quantifying the probability of attrition and identifying probable drivers of behavior. This information can help financial institutions develop customer-specific strategies and tactics to encourage retention, prioritize the customers or segments to approach based on attrition probability and customer/segment profitability, identify the most appropriate channels through which to contact a customer, and evaluate the effectiveness of retention tactics using "test-and-control" methodologies.

Relationship manager effectiveness

Analytics can help financial institutions identify patterns in their relationship managers' behavior and deal outcomes, allowing management to identify effective internal practices that can be replicated across the institution, identify and address problematic relationship manager behavior (such as excessive discounting), and develop incentives to encourage desirable behavior.

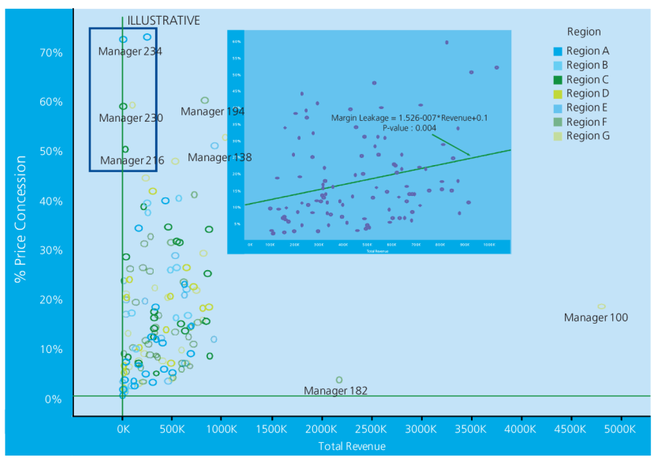
Relationship manager performance

Relationship manager margin leakage analyses can be used to compare relationship managers to each other or to internal or external benchmarks on key metrics, such as profitability, the amount and frequency of price concessions, product mix, and productivity, among others. Once a financial institution thoroughly understands how its relationship managers are performing, it can create automated business rules, such as alerts, to identify underperforming relationship managers for possible intervention. Management can then pinpoint the specific behaviors that need to be changed and prioritize their efforts to address underperforming managers.

Figure 2 illustrates how an analysis of relationship managers' price concessions relative to revenue can help identify managers that are a high priority for intervention.

Figure 2: Example of a relationship manager margin leakage analysis

- It is not uncommon to discover that degree of price concessions varies greatly by manager, and a greater degree of price concessions correlates with lower revenues
- Focusing improvement efforts on managers with historically high price concession levels is likely to yield greatest improvement



Relationship manager incentives

By examining correlations between relationship managers' behavior and performance and the amounts and structure of their incentives, a financial institution can better understand what actions its current incentive program tends to encourage and how well those actions align with broader business objectives. These analyses can bring valuable insights to the task of designing an effective relationship manager incentive program. The financial institution can then draw on further analyses, such as an investigation of how specific incentives and the resulting behaviors are likely to affect profitability, to refine its incentive program. Such a structured approach to developing an incentive program can also help attract and retain talented relationship managers.

Product design

To design and price new products, most financial institutions rely on market research techniques that simply ask respondents for their opinions about product features and prices. A more effective approach, however, is to ask respondents to choose among a variety of alternative sets of product/service attributes — including functionality, service levels, and price — and then apply an analytic technique called "conjoint analysis" to the results. This approach allows financial institutions to systematically evaluate specific prospective offerings for their potential attractiveness to the market based on respondents' actual behavior rather than opinions that may or may not reflect real life buying choices.

New product development

Applying conjoint analysis to data from properly designed market research can help financial institutions segment their existing and potential customer base to better understand variations in customer needs, determine the relative importance of product/service attributes to different customer segments, and quantify the relative attractiveness of alternate approaches for specific product/service attributes and the overall offering. Institutions can then determine the value of specific features of existing products to specific customer segments, allowing them to construct "derivative" products that target various customer segments with these desirable features.

New product pricing

Conjoint analysis can also help financial institutions determine the economic viability of a new product or service and set appropriate prices for new products and services by clarifying the relative value of product/service attributes to different customer segments. Multiple scenario analyses can also help financial institutions anticipate competitors' reactions to the introduction of a new product. These analyses can help financial institutions determine whether the expected revenues generated by a new product would exceed the associated costs to provide an adequate return on the required investment and capital outlay.

Key steps to improving deposit profitability

It's important to view a deposit profitability improvement program as an ongoing journey, not a one-time fix that can be realized through any single change such as a model implementation. Taking this broader view can help financial institutions realize the full potential of such programs by engaging a broad base of management and addressing the related data, process, technology, organization, and human capital changes necessary to support the effort. Here are some key steps to consider in implementing an effective deposit profitability improvement program:

- **Secure strong executive sponsorship.** Establish top-down support to help sustain an adequate resource commitment to the program and to help overcome resistance to any changes required to achieve the desired impact.
- **Involve key stakeholders.** Create a cross-functional effort that identifies concerns early on and communicates the potential benefits of the program broadly and consistently.
- **Prioritize initial areas of focus.** Conduct initial analyses to identify key areas of opportunity. Then lay out a broad blueprint, but focus initially on "quick wins" that will bolster senior management support for the effort and that may allow the bank to self-fund further investments.
- **Set up a comprehensive data warehouse and deploy robust analytics software.** Effective analytics depends on having vast amounts of high-quality data. Collect and store data on a transaction level; calculate profitability for products, customers, branches (and other distribution points), and salespeople; and use appropriate software to put enhanced information in the hands of decision makers.
- **Integrate analytics efforts with other corporate functions.** The organization's deposit analytics specialists, commonly a small, dedicated analytics team within retail bank marketing, should coordinate their efforts with corporate, treasury, and marketing for other products.
- **Enhance market assessment capabilities.** Design and develop tools and capabilities to monitor the market performance of top competitors at a micro-market level.
- **Align organization and performance incentives.** Incorporating performance incentives into the goals of personnel with direct customer relationships helps align the financial institution to focus on profitability.
- **Enhance skills and competencies.** Identify required analytical capabilities and fill gaps through training, recruitment, and the use of third parties.
- **Benchmark, monitor, and communicate results**. Set clear objectives for the program, report on progress regularly, and hold staff accountable for results. Demonstrate the value of the program throughout the organization.

The bottom line

An integrated, analytics-based approach to managing the deposit business can help financial institutions substantially improve performance and establish a basis for continued profitable growth. The required investments can be made over time; early investments that drive value can provide a foundation for, and even help fund, later improvements. Our experience shows that an effective profitability improvement program can be implemented for a relatively small investment and can result in substantial profit increases as well as provide greater insight to better manage the business.

How Deloitte can help

Deloitte's Financial Services Advanced Analytics service line includes a network of dedicated professionals with access to a worldwide wealth of experience in profitability analysis, pricing, statistical modeling, and market analysis in the financial services industry. Working hand in hand with industry specialists in wealth management and deposit management, our Advanced Analytics professionals can help your organization in its efforts to develop and implement a deposit profitability improvement program tailored to your unique business needs. Our integrated service delivery approach, using a unique combination of in-depth analysis, innovative thinking, and disciplined follow-through, can help your business in its efforts to achieve tangible bottom-line benefits quickly.

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