5 ESSENTIAL STEPS TO ACCELERATE CORE-DEPOSIT GROWTH

AT YOUR FINANCIAL INSTITUTION

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haberfeld
accelerating growth

What is this white paper about?

Your financial institution (FI) can effectively accelerate core-deposit growth, despite the challenges of an extremely competitive environment. While there are no shortcuts or promotions, there is a disciplined strategy that's proven to work.

In this white paper, we'll focus on the **5 Essential Steps to Accelerate Core-Deposit Growth**—and how this growth can be significant and sustainable for your financial institution.

The 5 Steps:

1. Change your **core-deposit growth mindset** from "campaign" to "constant."
2. Stop charging **nuisance fees**.
3. **Market smarter** using convenience-based dynamic modeling.
4. Invest in your **retail leaders**.
5. Leverage the **power of the referral**.

Before we examine these steps, let's take a look at the ever-changing banking environment and the challenges inherent for virtually all FIs.

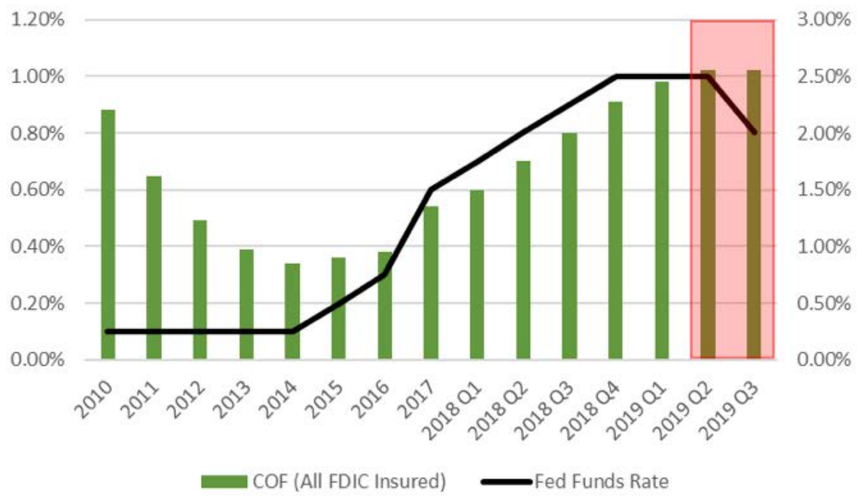
What are FIs experiencing right now?

In the last few years, the rising cost of funds has captured the attention of officers at most financial institutions, and with good reason: The average cost of funds has more than doubled over the last seven quarters, leaping from 48 basis points to more than 100.

In 2018 and early 2019, this trend was tempered by a nice increase in yield (3.85% to 4.40%) on earning assets. Overall, this has meant an average net interest margin increase of 15 basis points.

Then, there was Q3 of 2019. While the target fed funds rate dropped from 2.5% to 1.75%, our industry's cost of funds hasn't followed suit. Instead, our cost of funds has continued to rise due to the fierce competition for deposits. It's likely that we will see this trend continue, and a prolonged low interest rate probably won't help.

If a low-interest environment causes your yields to decline without impacting your cost of funds, there is only one way to strategically position your FI and improve your net interest margins. You must reduce your reliance on high-cost funding and focus instead on low-cost core deposits.



Across the country, FIs are competing aggressively for a finite supply of low-cost core deposits within their markets. In fact, low-cost core-deposit growth is the #1 concern for many FIs, and we agree wholeheartedly. You must confront the challenge head on, attracting more core relationships and thus affordable deposits. This is especially critical in our low-interest rate environment.

Simply put, the competition for core funding is fierce. So, how can you earn a larger share?

Step #1: Growth Mindset — Think "Constant" Not "Campaign"

Our marketing practices, data, and analysis show that earning core deposits results from a long-term lifestyle change not a temporary campaign. This is true for the same reason lifelong dietary changes are more successful than crash diets in making us healthier; we're committing to a sustainable shift in attitude and priorities.

Consider these questions:

1. Are your core checking relationships more valuable overall than your other one-off products and services? In other words, is core checking in your top three priorities?
2. Do you give these relationships proportional time, effort, and resources? Or is core checking just another product?
3. Are you in the business of convincing people to switch to your FI for their primary checking?

It will not surprise you to learn that core checking relationships need to be valued, prioritized, and supported by your time and talent.

Regarding the third question of whether your job is to convince people to switch to your FI, the answer to that *should* be "no." The data tells us that it's incredibly difficult to get people to want to switch banks—let alone switch to you, even if you have superior products and services. It's a lot of work to switch, so unless their current FI is a nightmare, they'll avoid the hassle at all cost.

And while so many FIs take this approach, few of them actually commit to a strategy robust enough to bring in results. For example, they'll run monthly promotions that only confuse the message and scatter resources: January is new customers, February is mortgages and refinancing, March is business checking, and so on.

Unfortunately, that's not how true growth works. You might get a short-term increase, but if you don't commit—really commit—you won't have sustainable growth.

While it's almost impossible to *convince* people to switch, we have good news—there's a substantial market of people each year who already *want* to switch! Our data shows that 8% to 12% of all consumers and small businesses move their primary checking account every single year. In other words, your opportunity is there!

The real question is: Of those who decide to switch FIs in any given year, how many will choose you?

As we pointed out, short-term campaigns make for short-term growth. Once the campaign ends, your numbers will stagnate and eventually drop off. However, if you commit long-term to ensuring that people have you in mind for when they do ultimately decide to switch, you'll begin to grow each month. Soon you'll be making a real impact.

This change can't happen overnight; it requires sincere investment. Along with monetary expenses, this approach requires human capital. It means asking your staff to change their priorities and entire way of conducting business. Even banks who have both the commitment and resources may not have the data or marketing to create a long-term strategy. That's why Haberfeld was created in the first place—to drive and implement this culture shift for FIs.

On average, people who want to switch primary FIs only consider one or two options. You want to become one of those options, ideally their top choice. This is the only way you'll experience real growth.

Step #2: Forget Nuisance Fees

Another vital component of growing core deposits: Stop charging nuisance fees. These fees (plus bait-and-switch marketing) are muddying up your strategy and are unnecessary for growth in revenue. It's simple: Offer undeniably attractive checking accounts without service charges or hidden fees, and promote them with an intelligent and transparent strategy.

So what to do? Contrary to conventional wisdom, there are easier, more customer-friendly ways to increase your revenue without employing nuisance fees or cutting costs.

The fact is, most FIs operate a number of expensive factories they call "branches" which are often running at half (or even less) of their capacity. An average community bank with the capacity for 3,000 customers has fewer than 1,500, largely for these two reasons:

1. Their rules and fees turn people and businesses away;
2. Their desire to avoid unprofitable customers make a healthy sales culture impossible.

What actually works to increase revenue is filling that extra capacity with more core customers and deposits, and never mind holding out for "perfect" customers. To earn these customers, you must know why people switch when they do, and what they're looking for in their new FI.

About 30% of the time, it's a major life event; they've moved to a new state, gotten married, etc. About 70% of the time, it's because they're sick of their current FI. They're burned out on hidden fees and unanticipated charges. The customer service is lacking, and the messaging is anything but honest. Perhaps their local branch closed abruptly, or they're angry at being denied a loan or losing an overdraft appeal.

As they look for a new bank, these jaded prospects are thinking, "What's the least bad option?" They don't have a lot of confidence in FIs, and that's why customer-service training is so important for your institution. Providing positive interactions from the very beginning of the relationship means the world to prospects and new customers alike. In particular, your prospects want the very opposite of their current institution: an FI that won't charge nuisance fees or make banking difficult through poor customer service.

Here, the role of nuisance fees is HUGE. When surveyed, 98% of customers indicated that fees were critical in their decision to switch. Even if you consider your institution's checking to be "free," these prospects likely view it as banker talk. They know that in reality, it's only free if they meet a myriad of nuanced conditions. They are well aware that we create these policies in closed boardrooms where we ignore the needs of real people.

If your "free" checking actually charges most customers $12 a month, they'll quickly learn that you're doing everything you can to get that extra $12 out of them. This means they'll leave, so we really have to get it right and *really* make it free.

Maybe your argument for nuisance fees is that most customers don't have to pay the monthly charge because they meet these requirements. If that's so, why charge it in the first place? The revenue stream here is very small, but it poses a large hurdle for new and prospective customers.

Just as importantly, it creates a hurdle for your employees! All banks talk about creating a positive sales culture conducive to sales, but most of them implement rules and requirements that make it all but impossible for staff to sell them with any enthusiasm.

Let's talk online banking, something all customers want. Most FIs let you do most everything online, and you should too—at no cost to your customer. Meanwhile, most customers want convenient local branches, especially when they open their account: 95% of new customers visit a branch to open theirs!

If this data resonates with you—and it should—your top priority should be adding value. In addition to offering nearby branches, convenient and free online banking, and requiring no minimum balance or monthly service fees, there are still more boxes your prospects are looking to check off before they consider you seriously. Chief among these is a checking account that's easy to sell, easy to buy, and easy (and free) to use. You may have other valuable products, but they won't add core deposits like transparent checking will.

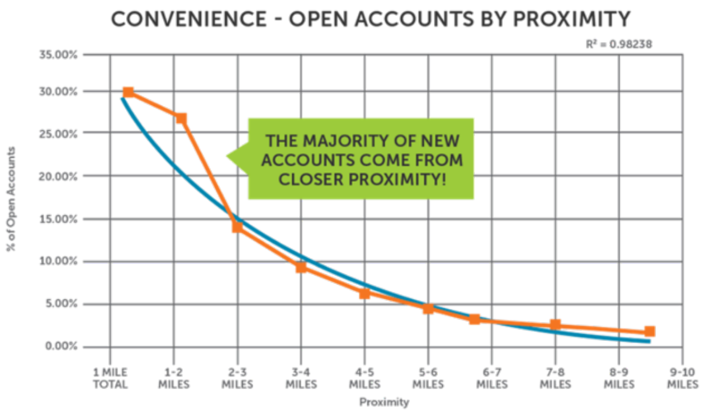
The wonderful thing about offering a truly great checking product is that, when combined with smarter marketing, it will truly create a more motivated staff and a more successful sales and service culture in each branch. The kind of non-interest income you'll generate this way is unequivocally better and infinitely more sustainable than growing revenue through nuisance fees.

Step #3: Market Smarter

The magic word here is **DATA**. As an FI, you have a lot of it. Why not use it? Your customers' actions are perfect for determining a road map for your marketing effort. If we use a few new data sets and the right mix of marketing channels, we'll create sustainable long-term growth.

As in most areas, simpler is better when it comes to marketing. Start with the most obvious factor: physical proximity. The closer someone is to one of your branches, the higher the likelihood is that they'll choose you. It's not everything, but it absolutely matters.

That said, using proximity to your advantage is a bit more sophisticated than drawing circles around your branches. Perhaps one or more branches are located in densely populated markets, and there's no way you can reach every household nearby. Perhaps one or more branches are located in a suburban or rural market, and it's difficult to decide how large to make your target marketing area.



That's why we must also factor in convenience and proximity. But what does "convenience" mean as we identify our audience? We've identified two key types of convenience.

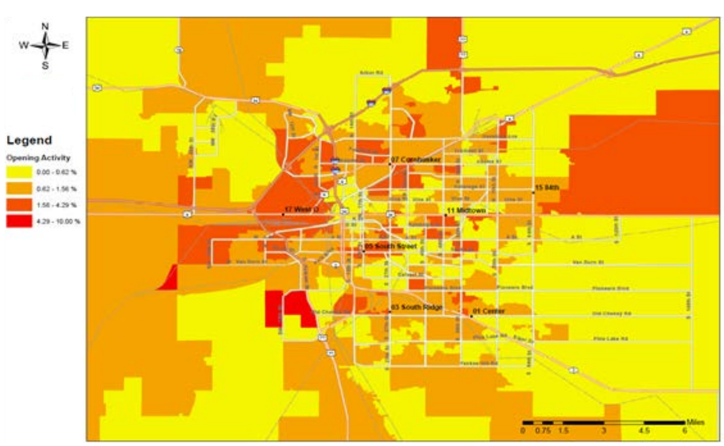
The first is **Demonstrated Convenience**. Within your market, how many people bank with you? Of these, how many have checking accounts? How many checking customers opened their account recently? And how do they interact with you?

All of this is powerful data to act on. The more positive responses you're getting in any given demographic, the greater the likelihood that others in that demographic will find you convenient and respond positively to your marketing.

Let the analysis of your own data tell you where your marketing dollars are best invested. For instance, if we send a party invitation out to our neighbors, we'll likely get a substantial response. To visualize the response we'll receive, look at the heat map below. The darker the color, the better the opportunity.

Having a model that allows you to identify markets with potential for growth is a great start, but don't stop there. It's just as critical to test at the edges while continuing to develop the way you use your data. We've done this for more than 30 years, and our data-analysis models continue to change and evolve as new data sets are available.

The second is **Predictive Convenience** which relates to your prospects' daily routines. Instead of looking at where prospects live, look at where they dine out, shop, go to school, get their hair cut, and work. This type of convenience plays a huge role in how people choose their primary FI. Consider: Have you ever chosen where to do business based on how close it is to your work, and/or because it's on your way?



The best way to judge predictive convenience is through GPS-enabled devices and phones. While we can't analyze GPS-based habits on an individual basis, it can be aggregated for certain neighborhoods. We can have a big picture of where your prospects go, which correlates strongly to where they spend their time and money.

GPS-based data can help you make really, really smart marketing decisions. It's also a prime example of how we continually enhance our data models. We may not know the next important piece of data in creating our target audience, but we're always testing on the edges to see which factors make a difference!

Finding your target audience is the most critical aspect of intelligent marketing, and it's followed closely by using the right channels for your messaging.

It's important to note that not all marketing is created equally, especially across various industries.

Earlier, we said that it's almost impossible to create primary demand through marketing—we can't make people want to switch. This is different for retailers. When Apple releases their new iPhone 12, for example, they create an immediate demand within many who already own prior models. For our industry, it's different, and we build our strategy based on different intended results.

For core-customer growth and its corresponding deposit growth, our marketing must have two primary purposes:

1) **Proactive Marketing**: Ignoring those experiencing major life changes, people only begin researching alternative FIs when they're burned out on their current one. Our goal here is to become one of their top two choices for when they decide to switch.
2) **Reactive Marketing**: This marketing is intended for those who are going through a major life change and who know they'll need a new institution. In particular, those moving to a new state will likely research their options online and/or solicit recommendations from friends and coworkers. Our objective is to be the most attractive and most recommended FI for these people.

For the purposes outlined here, proactive marketing requires identifying your best possible prospects using the data models mentioned earlier, and consistently reaching out to them with a mix of both direct and digital marketing. This will reach them in several different ways, each time with a very focused message.

For our purposes, reactive marketing should mostly focus on Google Search ads and building a culture of online and word-of-mouth referrals.

No matter which channel(s) you use, smart marketing must be measurable. To measure effectively, keep your goals in mind: growing core customers and low-cost core deposits. When we measure growth, it's in these areas. It seems intuitive, but it's easy for marketing strategies to lose sight of the real goals and instead focus on other less critical tactics, metrics, or best practices. These may be important, but only insofar as they measure and boost your core customer growth.

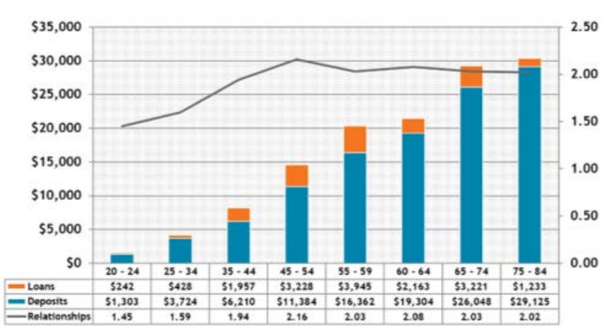
The last component of smart marketing is the message. What are you saying about your product offerings? About your pricing? About your services and features? If you develop these things according to the advice in this paper, you'll likely beat out most competitors in each of these categories.

Of these factors, the ones that REALLY count are your customer service and overall culture. As a community FI, you'll almost certainly win out over the big banks who share your market. That's a good thing, because big banks have a lot of prospects for you, many of whom are close to being burned out or already are.

To combat this threat, big banks often claim superiority to community banks in the area of convenience; "We have more branches and it's easier to find us!" But if you're targeting people who show great demonstrated and predictive convenience for your branch, it won't matter to those people if a big bank has 5,000+ locations. For your target audience, you're more convenient. With better products, zero nuisance fees, smarter marketing, and stronger support for your community, it'll be a no-brainer for people looking to switch.

There's one more caveat of marketing that's worth addressing: age demographic. Chances are good that you've spent time and money trying to figure out which age brackets contain your best prospects. It also seems like everyone and their dog is trying to convert both millennials and Gen Z customers, right?

It may be worth pursuing, but before you invest in marketing to specific age brackets, make sure to look at the data first. We'll illustrate our point more fully with the chart below, which represents age demographic information for the average community-based financial institution.



	20 - 24	25 - 34	35 - 44	45 - 54	55 - 59	60 - 64	65 - 74	75 - 84
Loans	$242	$428	$1,957	$3,228	$3,945	$2,163	$3,221	$1,233
Deposits	$1,303	$3,724	$6,210	$11,384	$16,362	$19,304	$26,048	$29,125
Relationships	1.45	1.59	1.94	2.16	2.03	2.08	2.03	2.02

Specifically, this graph offers data for relationships, deposits, and loan balances for customers by age.

Note that, while the products being used aren't too different across age brackets (save for debit cards and online services), average balances vary greatly.

More to the point, millennials and Gen Z customers maintain smaller household balances than the average customer. If you predominantly focus on selling to millennials, you'd likely have to open a lot more accounts than if you didn't specifically focus on them. That doesn't mean you shouldn't cater to them, or that they aren't meaningful. After all, they're the foundation for your core deposit future, and their balances will grow!

Our point is only that focusing on specific age groups may confuse your messaging and diminish your returns, and smart marketing focuses dollars on what will give you the best return. Worry less about age groups and think more about reaching the people most likely to switch to your FI.

Step #4: Invest in Your Retail Leaders

You have to spend your human capital just as wisely as you spend your marketing dollars. Each time we visit a community institution, we look closely at their customer growth-related performance by branch.

In many cases, they have branches in similar markets with identical products and marketing. So why would one branch perform markedly better than another? It will not surprise you to learn that it boils down to branch leaders. Hiring the right people and providing them with the right tools and skills is everything; you have to do everything you can to empower them to successfully manage your teams!

We have the distinct honor of working with 2,500+ branches and branch managers every single day. This allows us to compare the best performers and their habits to determine which factors make a difference when it comes to customer and deposit growth.

(Interestingly, in surveying both top and bottom performers, each group attributes their success rate to their team. Top performers give credit; bottom performers place blame.)

Evaluating the top and bottom performers has aided us in developing meaningful activities for branch managers that add real quantifiable value. Not all of these activities will fit your organization, but they will certainly give you a place to start. If you currently have certain activities in place for your team, ask yourself, "Do they tie back to our #1 priority of core-deposit and core-customer growth?"

5 High-value activities for high-performing branch managers:

1. **Weekly team meetings.** Once a week, take just 15 minutes to gather your team. It will create camaraderie and a common purpose, and practically, it will help your team sell your products and set specific goals for improvement. We're so committed to these weekly meetings that we provide our clients with everything necessary to hold them.

2. **Personal check-ins with each staff-member.** Once a month, talk to each staff member, one on one, and find out how they're doing. They may talk about work, but we encourage using this time to connect with them as people and learn about their skills, struggles, and motivations. And, if you build rapport, they'll feel *much* more comfortable asking for feedback—and you'll be better equipped to give it.
3. **Have a certification process.** Implementing service standards and establishing something to strive toward will give your team members a clear path to success. As long as they are improving, you're more likely to achieve excellence in customer service and true staff accountability.
4. **Observational coaching.** Managers should watch their team in action and offer immediate constructive feedback on what worked and what didn't.
5. **One-on-one career coaching.** Even the best leaders were once green, and only became the leaders they are from a mentor's coaching and guidance. We also provide our clients with the materials to carry out this mentorship.

How many of the above activities happen in your branches? How do you hold your team (including yourself and your managers) accountable? The lesson here is that you must not leave excellence and execution to chance. It must be deliberate, which requires a concrete strategy, the right resources, and a way to track performance.

Step #5: Leverage the Power of Referrals

Our clients have all made a referral culture part of their strategic objective. As a result, an impressive 15% of their new personal and business relationships stem partially or wholly from an existing customer referral.

That's a big number.

The key to growth from referrals is twofold:

1) **You must create a brand and culture worthy of strong referrals.** Products and customer service are key to this, and the strategy outlined above will get you there.
2) **You must channel referrals effectively.** Part of this is asking your current customers for referrals and tracking referral impact. You will likely find that top-performing branch managers also outperform others when it comes to referrals.

A referral is the biggest compliment a customer can pay you. To cultivate a culture of positive referrals, you must be aware of and acknowledge both the customers and staff members who successfully facilitate referrals.

Final thoughts

There are many ways to succeed in banking, and we are absolutely certain that growing core customers and core deposits is one of the best strategies available. The five steps discussed in this paper come from decades of working with and analyzing institutions that have successfully earned new core customers and deposits—substantially and sustainably so.

It also bears repeating that following these steps is a strategic commitment. Our FIs invest in this strategy financially, but more importantly, they invest time and resources into their people. While the results are often astounding, it's not magic; it simply means thinking about banking in a new way that's proven to attract new customers of all ages and walks of life.

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