The loyalty factor: Translating relationships into non-interest income

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Haberfeld's Dr. Sean Payant will speak at TBA's *Leadership Convention*, held June 27-29 at the Renaissance Hotel in Nashville. Register now at *TNBankers.org/leadership*.

2020 challenged our industry in ways previously unknown. We began the year expecting our biggest challenge would be continued growth of deposits at reasonable rates. Today, we are faced with three challenges: a prolonged low-rate environment with continued margin compression, keeping branches open and serving our communities, and an increasing number of customer transactions moving to the digital arena.

Much has been written lately regarding the validity of the branch in the current environment. Has community banking been changed forever based on consumers' digital behaviors? Possibly. Is some of this for the best? Definitely. Does the branch still have value? Absolutely! Unless your strategic plan is to shutter your branches and vacate your communities, we encourage you to keep reading.

Margin compression is real. So, what can you do? You can offset a portion of it by shifting your deposit mix toward low- or non-interest-bearing deposits. Adding long-term, low-rate deposit relationships should always be the foundation of any strategy, and community bank data shows your branches are the key to shifting your deposit mix.

While new core relationships are strategic in managing and maintaining your margins, they are also a key driver of additional non-interest-income (NII); this is a critical component in the shorter term. Financial institutions must increase their NII to offset some of the challenges on the interest income/margin side. To accomplish growing those new relationship you must do three things.

1. Add new customer relationships into your organization
2. Serve all of your customers better than any other financial institution
3. Make them loyal customers by increasing relational intensity

The Loyalty Factor

FIRST PRODUCT IN HH - ALL HOUSEHOLDS

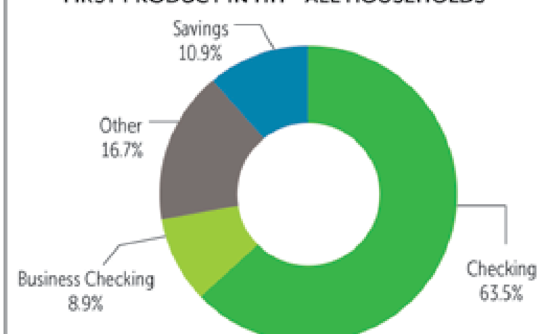

Chart: First product in household at community financial institutions

Years household has been with institution	Annual NII per household	Lifetime NII per household
<1 year	$166	$81
1-3 years	$206	$480
3-7 years	$233	$1,362
7+ years	$218	$4,241

Adding more relationships should be data driven, and the data shows the checking account and the branches are key. Looking at data from over 100 community-based financial institution, and over 2.5 million households/businesses illustrate this point.

The vast majority, or 72%, of consumer and business relationships at community financial institutions begin with a checking account. In other words, the checking account provides the best opportunity to create customer loyalty; it is the gateway to primary financial institution (PFI) status, allowing your bank first right of refusal on other products and services 68% of the time.

Even during the pandemic, and with limited access to branch networks, client data shows over 90% of new PFI relationships have come through branch channels (in-person, appointments, drive-thru, telephone). The value of your branches cannot be ignored.

The more customer loyalty you build, the more interest income and NII they generate. With consumer and business customers having almost six products and services with their PFI—the math works. Most importantly, the more loyal customers you have, the better your bank will perform now and in the future.

Segmenting data from several million customers based on their tenure with the community financial institution shows that loyal customers, over their lifetime, generate dramatically more NII.

In addition, annual NII contribution peaks once customers have been with their PFI for a few years. Further analysis of the data explains why the checking account revenue stream does not continue to grow. It is driven by customer age demographics. In general, more mature customers tend to drive more checking deposits than checking NII.

Creating Loyalty

In order to create loyalty, it is imperative your organization be positioned to capture new customers when they are ready to switch. Up to 12% of current retail and business customers are consistently switching financial institutions. A recent study published by The Financial Brand indicated this number could be as high as 22% post-COVID, driven by big banks failure to adequately serve customers during the pandemic.

So how do you position your organization for growth?

Checking Product: Simplify your checking

product offerings. Confusing products do not create value, and in turn, develop customer loyalty.

Processes: Remove barriers. Your account opening polices and customer identification program (CIP) practices often inhibit growth rather than encouraging it. Read them for yourself.

Promotion: If your bank isn't using targeted, data-driven print and digital marketing to grow PFI customers, you are missing opportunities.

People: Your team members must be equipped with the skills and the product knowledge to develop relationships with customers–customer loyalty is created through customer connections.

The Bottom Line

To create loyalty, you have to get the new customer first and the checking account is the key to the PFI relationship. Once you have them, products, processes, promotion and people move then up the loyalty ladder. As with any strategy, there is no silver bullet, but rather, your bank should be looking for a long-term, loyalty payoff.