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VIEWPOINT

Foster Customer Loyalty to Offset Lost Fees

BY GERARD DU TOIT and ANDREW SCHWEDEL

The turbulence of the financial crisis has receded, only to reveal the dimensions of a new problem for America's big retail banks.

New regulations make it more difficult for banks to expand profits by levying nuisance fees, which until recently accounted for up to 40% of many banks' checking account profits and a significant portion of their gross margins. Make no mistake: these were "bad profits" that accumulated at the expense of customers. But their disappearance has produced an emperor-has-no-clothes moment in the banking industry, revealing that only banks with a solid base of loyal customers will be able to grow without mergers.

Not surprisingly, every major bank has declared that their strategy now revolves around a strong customer focus. The problem is that most banks have a long way to go. Along with cable TV, telecom providers and health insurers, big retail banks rank near the bottom of all industries in measures of consumer loyalty. On the other hand, the loyalty leaders in the banking industry experience organic growth rates that are, on average, 10% higher and benefit from a cost of funds that is 80 basis points lower than their competitors, boosting their profit margins, according to a Bain & Company study of U.S. banks.

There's no question that loyalty is good for businesses. Loyal customers give their bank a larger share of their business, they refer friends and colleagues and they cost less to serve, because they're less likely to call with complaints

But the connections between loyalty and financial performance run even deeper. The potential gains are especially large for banks that earn the loyalty of affluent account holders — people with household incomes of $100,000 or more. This attractive segment shows up in surveys as the least satisfied with their principal bank. Yet our analysis shows that a loyal affluent customer is worth nearly three and a half times more than an average one and that a disgruntled customer is downright unprofitable once you factor in the effect of negative word of mouth.

What all of this means is that competition will ratchet up across the industry, raising the bar for success. So far, the major regionals and the national branch network banks are lagging badly. Our survey of 75,000 bank customers found that none of the national banks and only a handful of the regional banks rank among the loyalty leaders.

Most of the leaders fall into two groups, both of which seem to have customer focus hardwired into their business models. One group consists of direct or branchless banks, such as **USAA** Federal Savings and **ING** Direct, whose loyalty scores were nearly 70 percentage points higher, on average, than those of the national branch network banks. The other includes community banks and credit unions. Smaller and nimbler than the national giants, they have lifted their customer loyalty scores over the past two years, resulting in faster organic growth rates.

Still, it isn't simply a matter of size. Although it is more difficult for larger banks than for their more focused smaller rivals to rally around customers, it can be done. We uncovered a handful of relatively large regional banks that also score high on customer loyalty, among them TD Bank in the Middle Atlantic region, **SunTrust** in the South, Harris Bank in the Midwest and Bank of the West in California.

A major reason why more banks haven't joined them at the top of the rankings is that, for most, the pursuit of customer loyalty too often remains a project rather than a systematic way of doing business. Successful banks drive loyalty from the top, through a long-term commitment that is actively championed by the CEO. That sustained effort requires the organization to undertake not only the relatively easy task of measuring the cost of a specific customer initiative. It also compels the bank to do the much harder spadework of understanding the full lifetime value of customer relationships.

One thing that sets the loyalty leaders apart is their ability to align their entire organization around their customers. How? They begin by measuring how much more a loyal customer is worth and make the multiyear value of loyalty — not simply short-term profits — a key input to business decisions. Loyalty leaders also develop practical ways to ask their customers, one at a time, how they're doing, and immediately respond when their expectations are not being met. Not only does this repair the customer relationship; it provides a rich stream of learning to both front-line employees and managers on how to serve customers better, giving a large organization the quicker reflexes of a small one.

Gerard du Toit is the leader of Bain & Company's banking practice of the Americas. Andrew Schwedel is the leader of the financial services in the Americas.

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Contact info:
Gerard du Toit: gerard.dutoit@bain.com. • Andrew Schwedel: andrew.schwedel@baincom.