New England Financial Marketing Association

Learning to Speak CEO & CFO

A Companion White Paper

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The Strategic Role of Marketing

This white paper was written to accompany the session of the same title delivered at the 2017 New England Financial Marketing Association's ("NEFMA") Fall Conference on October 19th. The underlying premise is the need for financial marketers to rise above tactical execution and be a key contributor to their instutition's strategy. If you believe this should be true, read on.

In his 2004 book, Marketing as Strategy, Nirmalya Kumar, Professor of Marketing at the International Institute for Management Development in Lausanne, Switzerland, opined that CEOs lost faith in Marketing for two primary reasons:

1. The C-Suite is under pressure to deliver short-term returns by company stakeholders, and Marketing is perceived as a cost center that has difficulty connecting initiatives to returns. "Marketing initiatives must have a substantial, demonstrated, top- or bottom-line effect to excite the CEO."
2. Marketers are more often seen as specialists or tacticians that contribute to certain aspects of strategy development and execution, but do not lead cross-functional efforts to strategically position the bank for long-term success.

While teaching Profitability at the ABA Bank Marketing School, and yes such a class exists, I asked students how many participated in their bank's strategic planning. Forty six percent claimed they did. So, it appears evident that what was true in 2004 when Mr. Kumar wrote his book, remains true today. Financial marketers are frequently on the sideline or on "special teams" when the institution develops strategy, and only play a bit role in its execution.

Much of my class at the school, and articles I have written on behalf of ababankmarketing.com, are dedicated to improving Marketing's organizational status to be significant contributors to strategy. In my opinion and that of my colleagues, A Chief Marketing Officer ("CMO") cannot relegate themselves to a support role. They must be in a true "leadership" role to gain respect and influence as an executive. This white paper and the education session at the 2017 NEFMA Fall Conference were designed with this purpose in mind.

There are two roles executive management play at your bank: 1) functional leaders of their line(s) of business, and 2) strategic leaders of the bank.

In the second role, financial instutitution executives should create the strategy for the entire bank, not just their business line. The retail executive should play a role in the strategic direction of all lines of business, and the acceptable risks associated with pursuing those strategies. The same with other functional leaders. In meeting with executives I occasionally speak of the strategic role of the executive, because it is far easier to fall into the familiar role of the line of business manager. Without elevating the discussion to whole-bank strategy, those that manage support functions such as Human Resources, Compliance, and Marketing get marginalized in strategy development, and are often relegated to the tactical portion of plan execution based on each line of business needs.

This is a mistake.

To better understand Marketing's strategic role at your institution, ask the following questions:

- Did Marketing contribute vital information to the strategy team prior to strategy development (i.e. customer data and trends, market data and trends, etc.)?
- Was Marketing present to contribute at the strategic planning retreat?
- Does Marketing possess the institution's strategic plan?
- Is there a marketing plan that was built from the strategic plan?
- Does Marketing play an integral role in working with other executives in achieving their respective strategic objectives?

At the very top of the Marketing strategy continuum is the bank's brand. How *is* the institution perceived by constituencies? And how *should* the institution be perceived by its constituencies?

Brand, however, is the first sign of the gulf between Marketing and the C-Suite. What does brand get you? According to David Reibstein, a professor of marketing and branding expert at the University of Pennsylvania's Wharton School, "What makes it [brand] valuable from a company perspective is that customers are willing to pay a higher price or are more likely to buy."

Your business line managers would have a keen interest in how you can make prospects more likely to buy. Your CFO will take you to dinner if your brand could garner a greater yield on loans or a lower cost of funds. Does your brand accomplish this?

According to Forbes annual listing of *The World's Most Valuable Brands*, Wells Fargo ranks as the best in terms of traditional banking. The survey was clearly performed prior to their fake account scandal. Sure there are a few other financial services firms ahead of them such as HSBC (a foreign bank), and American Express (not a traditional bank). But in terms of traditional banking, Wells Fargo is the most valuable US-based bank (ranked #43 for overall corporate brands). Given Professor Reibstein's statement above, customers should be willing to pay a higher price to do business with that brand.

	2Q16	
	Yield on Loans	**Cost of Funds**
Wells Fargo	4.20%	0.36%
German American Bancorp	4.69%	0.31%

Source: SNL Securities LP

Not according to the accompanying table. German American Bancorp, a $2.9 billion asset community bank based in Jasper, Indiana had a higher Yield on Loans, and a lower Cost of Funds for the quarter ended June 30, 2016. German American also had a higher Return on Average Assets, Return on Average Equity, and a lower Efficiency Ratio than Wells. I couldn't find German American on the Forbes list. Is financial performance impacted by brand? Does German American enjoy a superior brand and pricing power in its local markets?

I chose a specific example, and the discerning reader would rightly challenge that I may have cherry-picked to prove a point. And there are other factors such as loan and deposit mix that impact those numbers. But there are a not-so-insignificant amount of examples in banking where the "best" brands, based on one definition or another, don't achieve the best pricing or results.

I recall a bank executive meeting, discussing line of business profitability results, where the commercial banking unit had lower growth than its peers. The senior commercial lender blamed loan pricing as the reason why they weren't getting the deals. The COO responded that if the bank had to be the best price to get deals, they didn't need high-priced lenders. This bank, in my opinion, had a brand problem.

But in terms of convincing the C-suite that this is the case. Good luck. There are too many German American-Wells Fargo instances, and too many times the C-suite hear that the institution needs to lower its loan prices, or raise its deposit prices to grow market share.

Brand tends to be one of those "Marketing speak" words that, when spoken, gets greeted with a collective sigh around the executive table. Add Return on Investment ("ROI"), click-through rates, followers, and so on to the list of terms routinely used by Marketing that generally have yet to earn respect in the C-suite. I am not saying these terms shouldn't get respect. I'm saying that those that occupy the C-suite today think in terms of paradigms they know. They don't see increasing page views as a problem to be solved. They have other things on their mind.

Rosetta Stone: CEO & CFO Speak

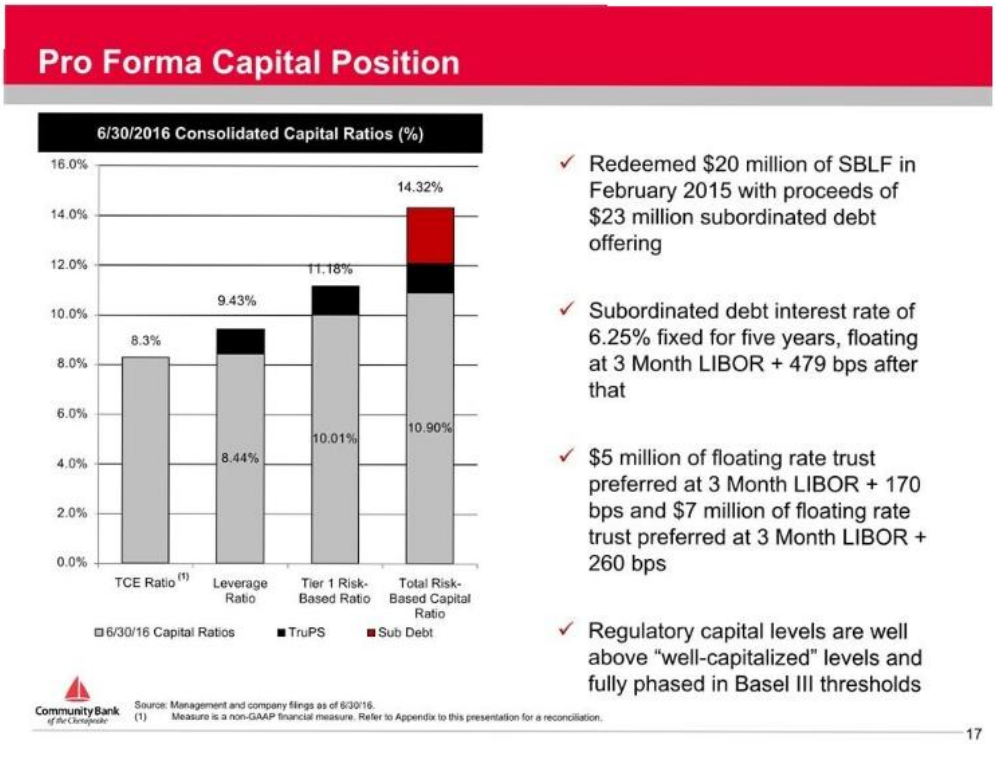
What other things? Net Interest Margin | Liquidity | Interest Rate Risk | Expense Ratio | Shareholder Expectations | Regulatory Exam…

I have written on speaking in a language understood by the CEO and CFO in an article titled [Connect ROI/ROE with the C-Suite] on ababankmarketing.com. In that article, I compared and contrasted a typical ROI analysis to a Return on Equity ("ROE") analysis.

Although ROI is an important tool to determine an undertaking, it does not usually balance the risk-reward tradeoff made by financial institutions. In fact, when comparing making an investment to grow credit card or home equity balances, ROI returned one answer, and ROE returned another. Which one would be better received by your CEO?

A Strategic Challenge

Let's look at a real world example of a publicly traded bank, Community Bank of the Chesapeake ("CBC") in Waldorf, Maryland. In 2015, Community Financial Corporation, the holding company for CBC, issued $23 million of subordinated debt to redeem its SBLF Preferred's that were soon to increase to a 9% dividend.



What does this have to do with Marketing? If we assume Marketing is a strategic partner to executive management, or *in* executive management, let me explain. According to CBC's shareholder presentation (see above), the subordinated debt was issued with a 6.25% fixed coupon for five years, after which it would become a floating rate at 479 basis points above the three-month LIBOR. What is your CEO and CFO thinking? We need to be prepared to redeem these notes in five years in case the coupon sky rockets at the floating rate.

Still not thinking what this has to do with Marketing. To further review the situation, CBC's stock trades very near book value when its peers have been trading above book value. If CBC is to redeem the $23 million in subordinated notes in five years, and will need to raise common equity to make the redemption, part of its strategy should be to improve their stock price through financial performance and greater demand so the bank doesn't significantly dilute existing shareholders. We can discuss financial performance later. But demand for the stock requires an active investor relations program to highlight the successes of the bank, the strength of its management team, and the attractiveness of the bank's markets.

In comes Marketing to solve a very strategic challenge. How to increase demand for CBC stock to elevate its valuation to at or above peer financial institutions so the bank is in a position to issue stock in five years to pay off its subordinated debt. Imagine being part of that executive roundtable discussing the multi-pronged approach of investor relations website development, digital advertising targeted at the 20-30 traditional community bank institutional funds, collateral materials, quarterly retail shareholder breakfasts, etc.

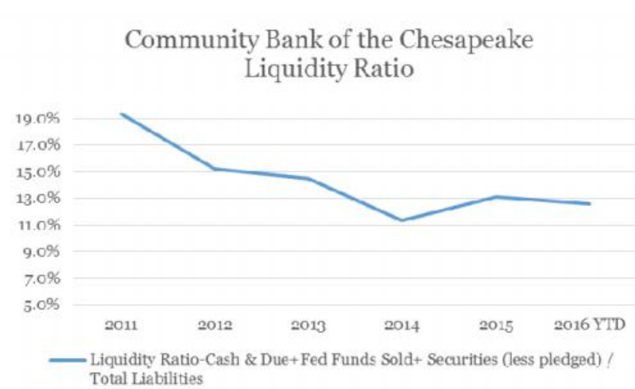
Although some may disagree, and at least one of my colleagues is among them, this is clearly a strategic challenge that Marketing could play a key role in solving. Would it at your institution? Or would you receive the tactical request to put together a glossy investor relations folder?

Financial Condition

What other things are on the mind of the C-Suite that takes a greater priority over the growth in online interactions, or the ROI of the local home show booth the bank sponsored? Let's turn back to our protagonist bank, Community Bank of the Chesapeake.

CBC has done a very good job growing its loan portfolio since 2011. At that time, the bank's loan to deposit ratio was 86.9%, meaning it had plenty of money to continue to lend. And it did so. Loan growth exceeded deposit growth since that time, and the loan to deposit ratio grew to over 101% by year end 2015, where it remains. This helped boost its net interest margin ("NIM") from 3.27% in 2011, to 3.63% today… because the bank is "loaned up", i.e. it lent out its deposits.

The challenge is that this decreased the bank's liquidity ratio, which is the amount of cash and unpledged securities as a percent of its total liabilities. In other words, how much liquid assets does the bank have to meet its liabilities.



Again, you ask as you read, what does this have to do with Marketing? Read on.

Although liquidity is stable, the bank's CFO is responsible for managing liquidity risk. In fact, liquidity is the "L" in your institutions's CAMELS ratings given by your regulators. This is a very important and strategic issue for the bank.

How can Marketing be a strategic partner in improving the liquidity position of the institution? The CMO reviews bank liabilities and sees opportunities. For example, the institution has 42% of deposits in CDs, far more than peers. CDs are more rate sensitive and therefore volatile than core deposits. In addition, 24% of deposits are in money market accounts ("MMAs"), a common parking lot for future CD customers in today's rate environment.

Knowing the trend in liquidity, Marketing proposes a plan to increase the stickiness, or duration in the CFO's vernacular, of CD and MMA deposits to reduce the risk of deposits running off in a rising rate environment, which will put pressure on CBC to raise rates faster than more liquid banks to maintain funding.

That puts Marketing front and center at the executive table identifying strategic priorities and being a key factor in improving the bank's financial condition. Imagine that conversation with your CFO!

I should point out that I used CBC as an example based on their publicly available information and do not have inside insights regarding their strategic priorities.

Can Marketing Improve Bank Profitability?

I would not be writing this, or speaking at the conference if I did not believe the answer to be yes. In fact, the several instances that I personally witness financial institutions set strategy and execute without Marketing input and critical support frustrates me.

This is particularly true in commercial banks that relegate Marketing to the retail line of business. It is true that the Marketing function is critical to a mass market customer acquisition strategy so common in retail banking. For example, the average balance of a retail non-interest bearing checking account is $5,200 according to my firm's profitability peer database. For a business checking account, the average balance was approximately $30,000. So a bank would have to acquire six retail checking accounts to achieve the same balance growth as acquiring one business account. In other words, more customers, more outreach, more marketing!

For a commercial bank, however, Marketing can play an equally important role, as the sales cycle is generally longer to win a business deposit account than a retail account.

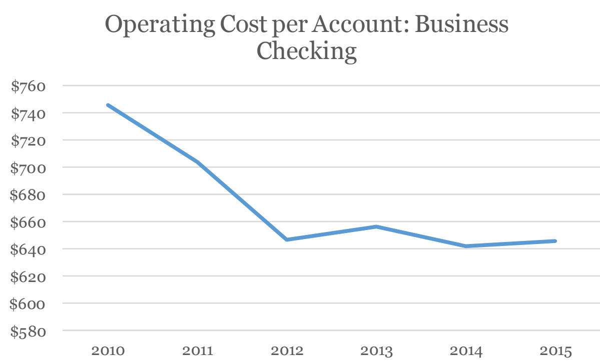
Strategic Objective: Cost Control

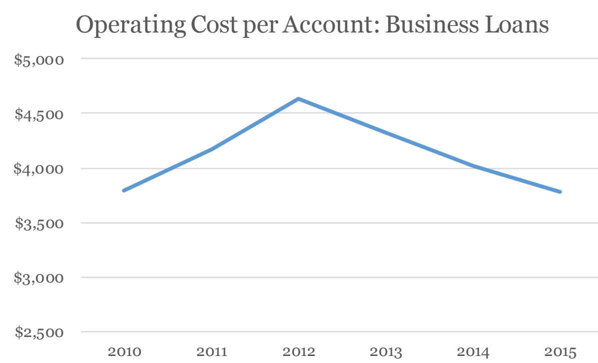
Let's say a hypothetical bank's C-Suite, as part of their strategy development, identifies cost control as a strategic objective as the insitution grows. The basis for this strategic objective is that the balance sheet has grown 8%, on average, each year for the past five years.

However, the expense ratio, defined as non-interest expense divided by average assets, has barely budged as the institution grew. This means it has not achieved economies of scale as it grew. A common scenario, by the way, even if this is a hypothetical institution.

Does Marketing, as part of the executive strategy session, propose a home equity campaign to grow even more if it can do so with an acceptable ROI? Could be true, but does it get to the heart of the matter?

If the institution measures product profitability, it should know operating cost per account for the products measured. The Marketing executive reviews operating cost per account for all product groups, and notes that although business checking balances grew 8% per year over the past five years, the cost per account decreased less than three percent. And the cost per business loan has barely budged over that period, even though that portfolio had similar growth.





I should note that although our bank is hypothetical, the cost per account in the charts above were actual averages from my firm's profitability peer database.

Using profitability information, and therefore armed with the knowledge that 84% of the cost per business checking account is from origination, Marketing proposes the following to reduce the cost per account, better leverage the commercial banking function, and reduce the overall expense ratio as the institution grows.

Proposed solutions to reduce commercial account acquisition costs:

1. Include deposit balances in commercial lender incentive compensation;
2. Streamline commercial onboarding process that includes resources from commercial and the retail branch staff to enhance cross-sale;

3. Build a micro-business (<$2 million in revenue) direct mail marketing campaign, including a compelling offer, with retail branch follow-up to grow new account acquisitions;
4. Implement small ticket loan automated underwriting; and
5. Automate business online banking enrollment.

The common response that I hear when bank executives are not pleased by the trend in the expense or efficiency ratios is to reduce costs. Marketing is one of the first budgets to take the hit. So Marketing's role in realizing better economies of scale, in my experience, has been to reduce its budget.

Imagine if Marketing played a critical role in zeroing in on the driver of the cost challenge. In this case, commercial banking account acquisition. Once the core issue comes to the surface, solutions can result. The CMO steps forward, saying: "here are ideas to reduce the cost per commercial account acquisition, better leverage the commercial banking function, and reducing its expense ratio." This is the language understood by your CEO and CFO.

This is not to say phrases like response rates, pull through rates, and Service Level Agreements ("SLAs") aren't critical to executing on the five ideas identified above. But they are sub-text to accurately identifying the driver of the profitability problem, and the strategies to successfully execute on the cost control strategic objective.

Summary

Banking is changing faster than any time since the Great Depression. What once took over a decade to adopt (i.e. the ATM), now takes one or two years (i.e. mobile banking). The playbook to acquire and keep customers through their lifetime is being rewritten. On the decline are physical locations, one-on-one interactions, and customer acquisition through traditional advertising and relationship building. Gaining importance is digital advertising to target customer segments for brand awareness, content marketing and online relationship building to reduce sales cycles, and data mining for targeted sales calls. All call for marketing leadership. Marketing's ability to communicate new methods to succeed in the future financial services landscape with the C-Suite will be critical to an enduring future.

To lead, speak the language of other leaders.

About the Author

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