

Consumer and SMB Deposits

Outlook and Top Priorities for 2024

The Bankers' Perspective



Banking Industry Research by

strategycorps 

Introduction

Earlier this year, StrategyCorps published the results of two surveys we did of hundreds of bank and credit union leaders.

From the first, we learned how banking leaders were preparing for what was fast becoming a very challenging and dynamic year. The second focused on small business owners and leaders to see what their unfulfilled banking needs were and what opportunities that presented community financial institutions (CFIs) with differentiated SMB deposit products to better serve SMBs and win market share back from megabanks and big regionals.

There's no doubt that the year is ending much differently than it started. Where last year at this time one of the biggest concerns was when the Federal Reserve was going to stop raising rates, now the question is have the increases stopped. There was no concern for the limits of FDIC deposit insurance coverage, with high profile bank failures, now it's about making customers (especially businesses) feel safe. Before there wasn't much attention on credit quality, now there are troublesome signs, especially for commercial real estate.

Add to that the quick pivot on surplus deposits to now intense competition for

deposits and the significant cost to attract them short-term and the implications of more deposit competitors beyond the traditional ones of past decades.

To address this as 2024 gets underway, it was time again to get direct input from bankers on what their plans are to address common revenue challenges. Like before, we surveyed hundreds of community bankers (at CFIs under \$30 billion in assets). Useful insights were revealed to reference as you formulate and implement your own plans to address the revenue challenges of the coming year.

We complemented these survey results with commentary from our perspective, using more than two decades experience working with more than 350 financial institutions on deposit and fee revenue strategies. Then we compared these survey results to trendlines we are seeing from our proprietary database of over a billion retail banking performance data points.

We believe this information provides insights from your banking peers to better understand the broader trends affecting CFIs and the formulation of your FI's plans.

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01 What is your 12-month outlook on traditional sources of deposit related revenue compared to today?

Our View: Over half of respondents’ bullishness on new customer/member deposit growth (and almost 40% for existing customer/member deposit growth) is shocking. As megabanks play the “your deposits are safer here” card and digital banks crank up the interest paid on deposits, not sure where all this bullishness is coming from.

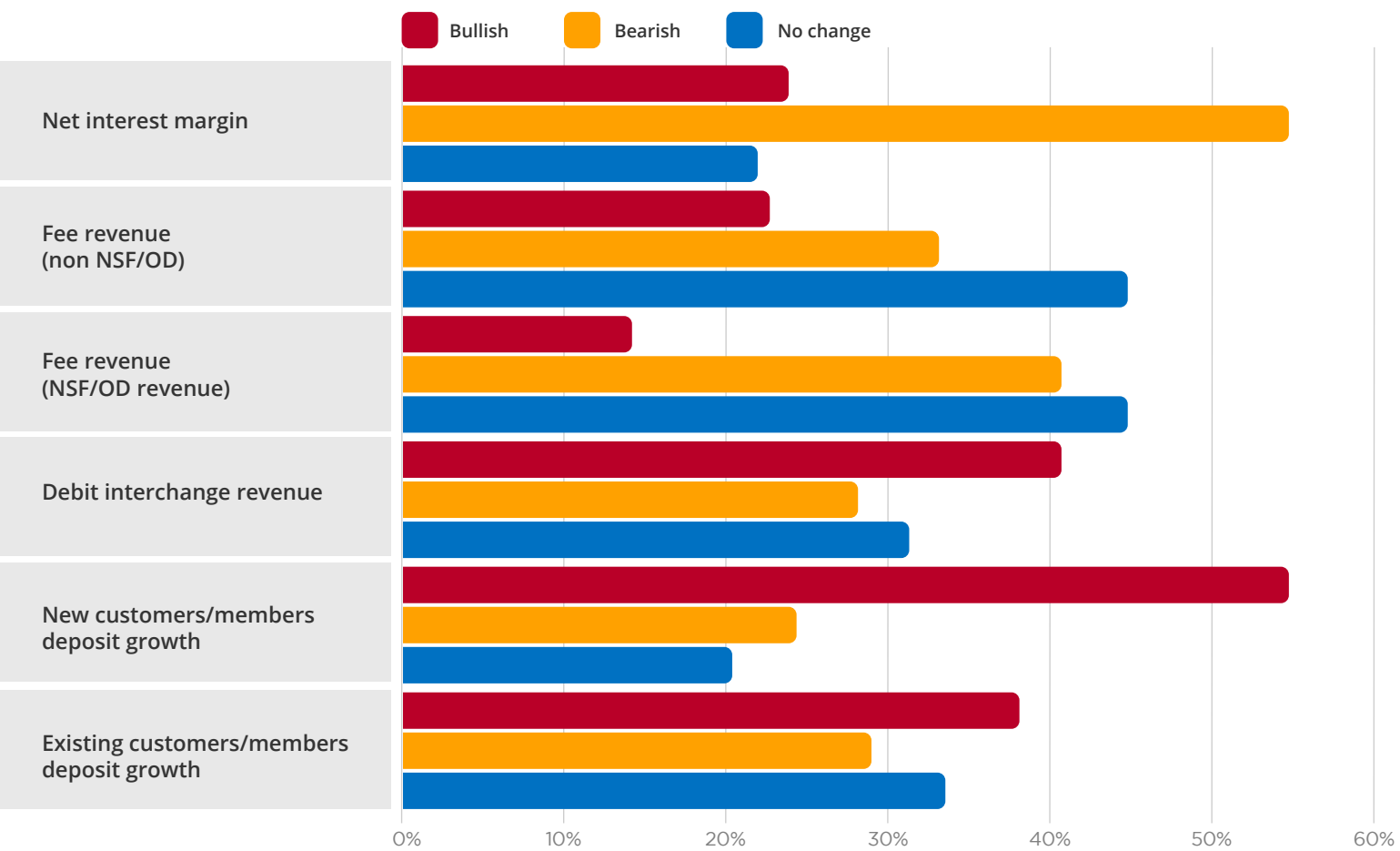
This bullish sentiment regarding new deposit growth may be a necessity to grow fast enough to offset deposit outflow and the stubbornness of a still narrow NIM. It’s also a surprising theme that FIs are more bullish on acquiring new

customers (which are more expensive to get) than growing the existing deposits.

Maybe we’re just missing something here (but we don’t think so).

The bearish view on ODs/NSFs isn’t surprising. Reducing or eliminating these fees are necessary as rising consumer and political sentiment will continue put this fee revenue in a negative light.

Not sure where the bullishness is about debit interchange, especially if consumer spending slows. Plus, credit cards are a formidable competitor in many aspects to debit cards.



02 What are your top priorities when dealing with consumer deposits? (rank in order)

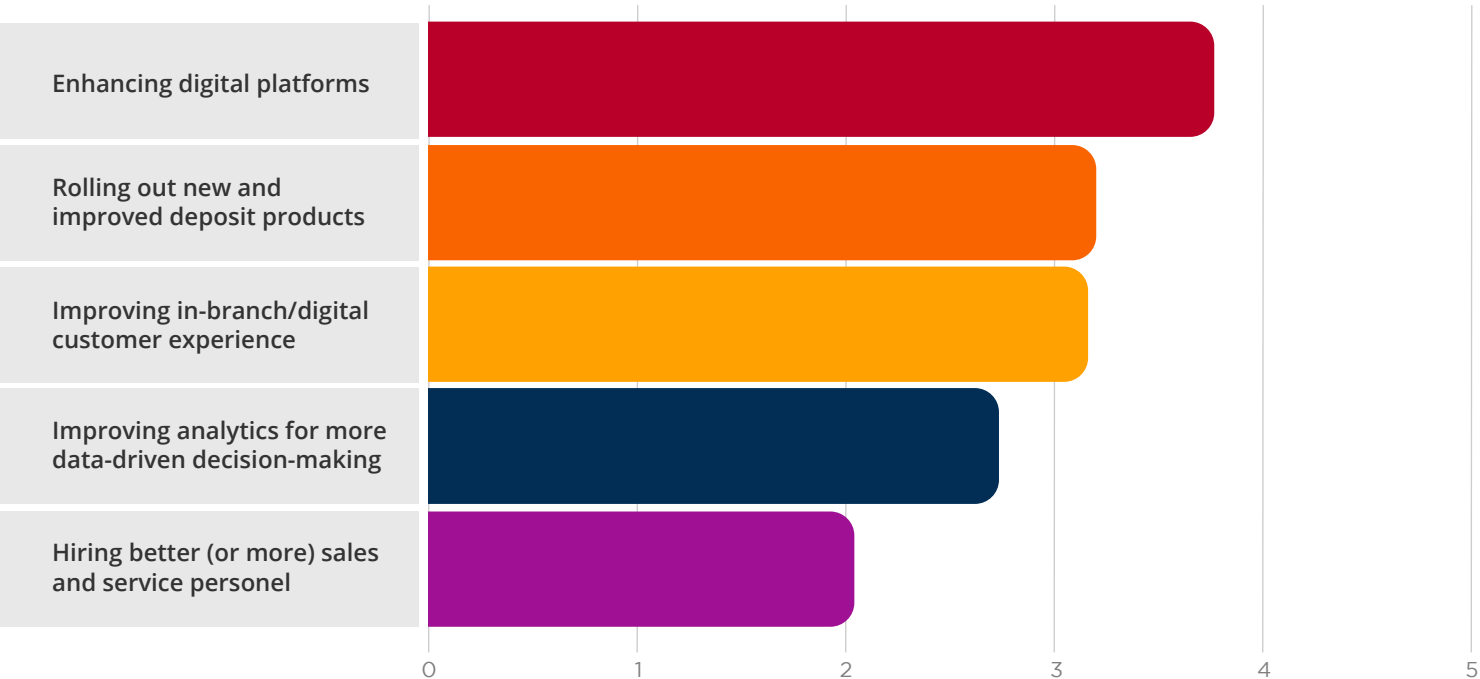
Our View: It's good to be in the digital banking platform business, given the top priority. Upgrading digital account platforms to make banking quicker and more efficient is often more complex (and expensive) than expected but isn't the only priority to win more consumer deposits.

Given this and the bullishness of growing deposits (from inquiry 01), new and improved deposit products have to also be a top priority. "Vanilla" products abound with a few CFIs adding some "sprinkles" such as being

aggressive with interest rates and copying the successful product featurization of digital banks (like early pay).

Good to see customer experience being a close third priority as it can get lost in the promise of technology.

Making decisions on platforms, products and experience without info to make data-driven decisions seems odd but most CFIs are so behind on analytics, relying on intuition is necessary to make progress on the higher priorities.



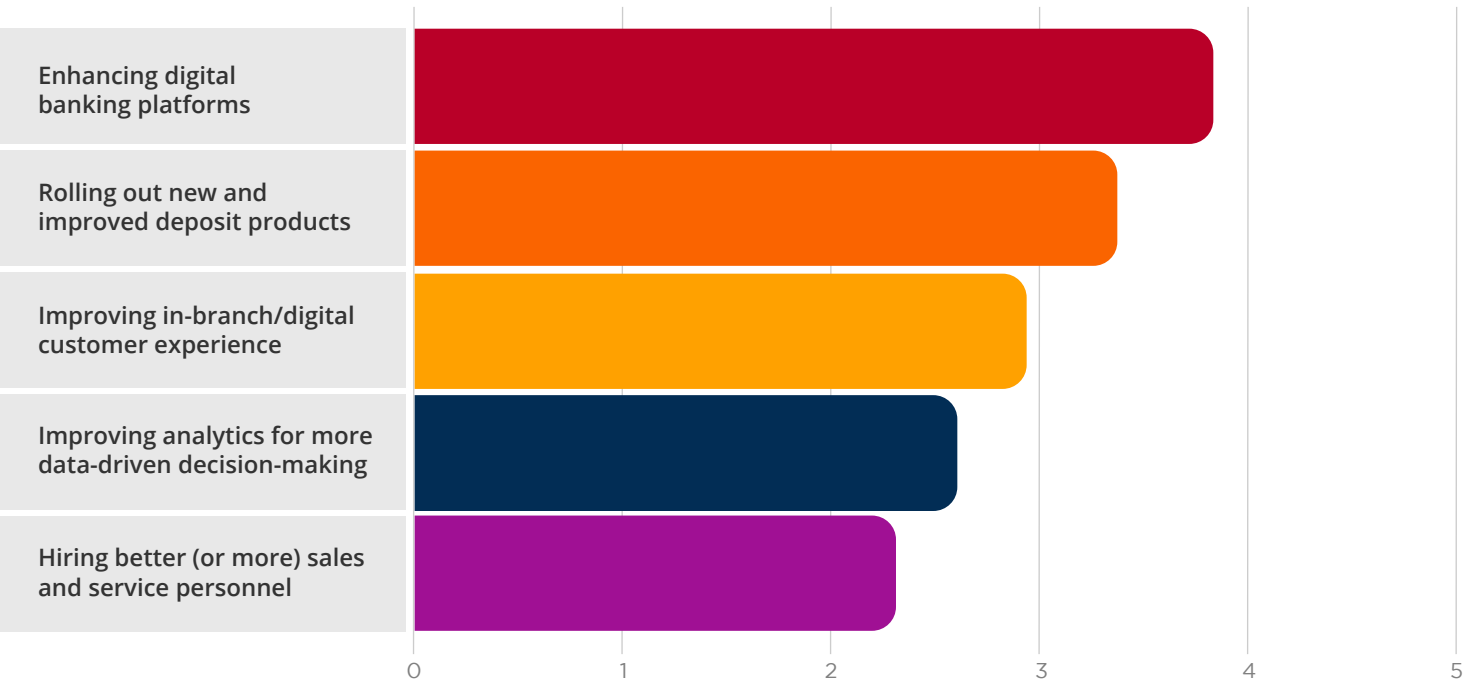
03 What are your top priorities dealing with SMB deposits? (rank in order)

Our View: Top priorities for SMB deposits are the same as consumer deposits with small differences in the comparative score rankings.

Our previous survey of SMB owners confirms the deliverables of these top three priorities will better fulfill their top banking needs, so there's nice alignment here.

However, the quiet truth is that many CFIs haven't made a true commitment to enhance their SMB products for years. This, plus the uninsured deposit exposure, has led to losing some of the SMB advantage gained with PPP.

SMBs are the lifeblood of many community FIs. Placing better products in the hands of better sales and service bankers will yield an improved digital and in-branch experience SMBs are yearning for and help offset the straying eye of SMB owners to megabanks, digital banks and non-banks focusing on payments.



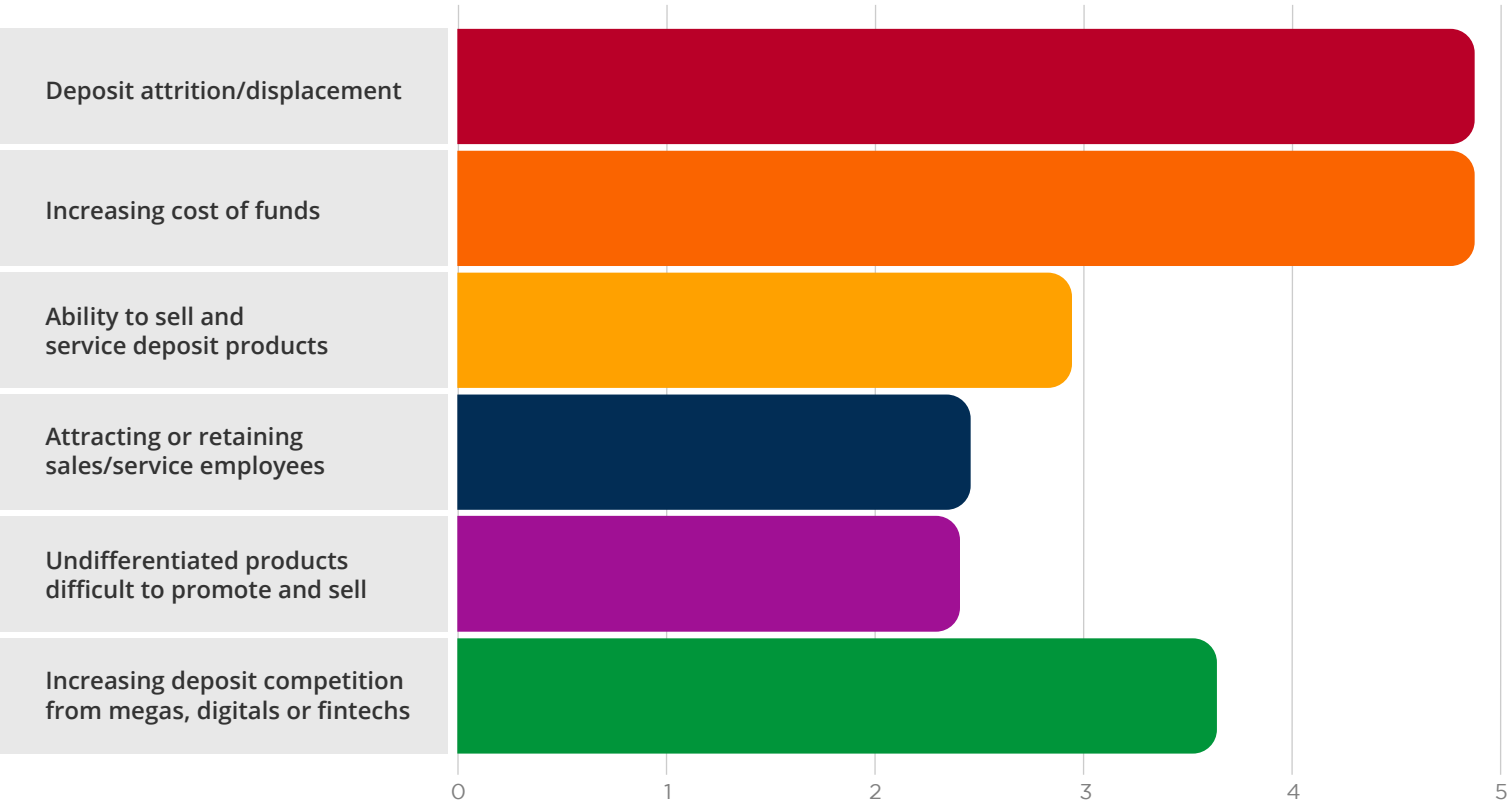
04 What are your top concerns related to consumer deposits? (rank in order)

Our View: The top two concerns here, by a large margin, are contrarian to the bullishness of deposit growth. Or maybe that bullishness is really disguised as the motivation caused by the fear of these top two concerns.

Nevertheless, in today’s market FIs have to “thread the needle” on managing the risk of increased cost of funds with minimizing deposit attrition. Gone are the days of parked money costing FIs just a few basis points of interest. The popularity of high interest rate savings accounts and CDs to attract new deposits from expanding

competitors, especially digital banks, means CFIs need better products supported by robust data-driven marketing and more productive sales and service people.

Deposits are the foundational key to building healthy primary consumer banking relationships. The challenge of “threading the needle” acquiring enough deposits without increasing cost of funds too much, with otherwise undifferentiated product won’t make it easy to allay these top two concerns.

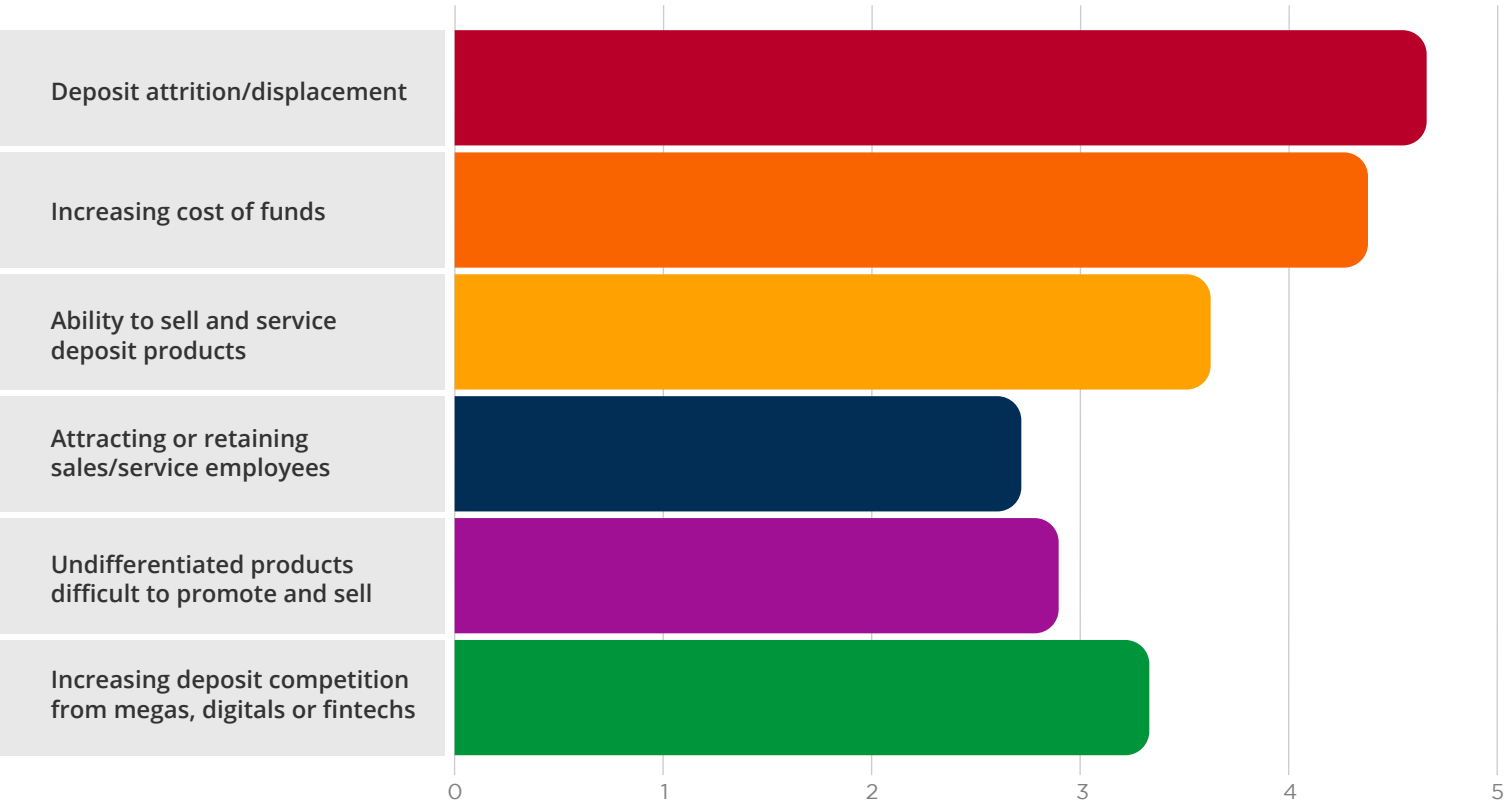


05 What are your top concerns related to SMB deposits? (rank in order)

Our View: Our market research white paper, Reinventing Business Checking, asked SMBs why they would consider changing their current banking provider. Number one, as always, was better rates and fees for the relationship value. But tied for a close second was “get better checking account product features” and “get better account/relationship management”.

Comparing why SMBs might be attracted to another FI with the FIs’ need to grow SMB deposits with the top two priorities is well aligned.

Like consumer deposits, putting better products in the hands of better sales and services personnel is a fundamental strategy to hedge against SMB deposit concerns and one many CFIs miss while being distracted with the prioritization of digital over this necessary strategy.



06 Do you expect your deposits in 2024 to:

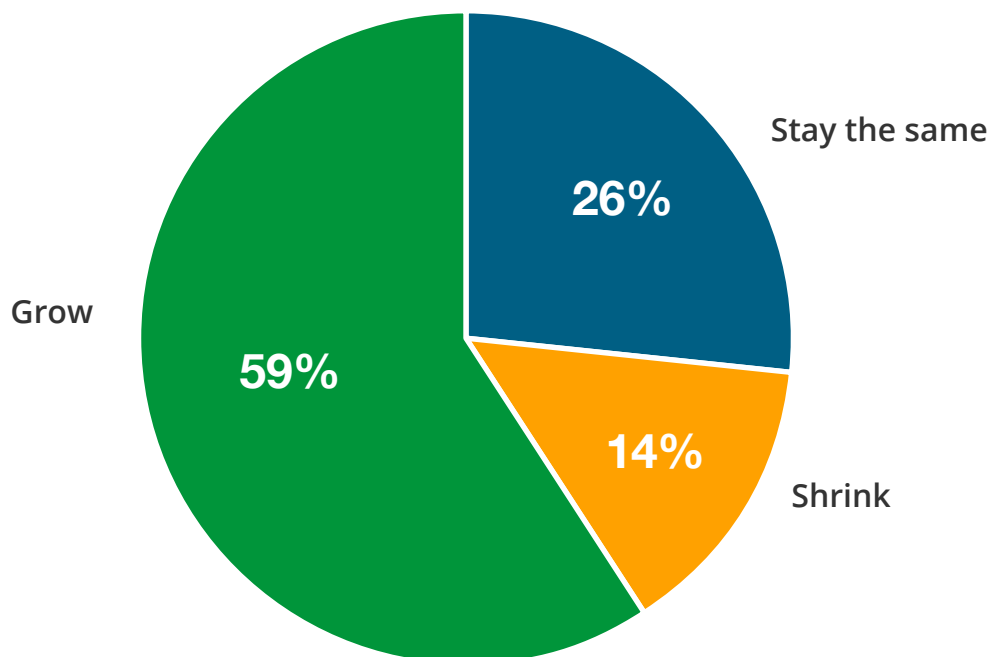
Our View: The response to this question is broken down further into three associated questions depending upon the response.

This base question gives a clear picture that a large majority of the responding banker audience is bullish on deposit growth next year. This was hinted at with the bullishness identified in inquiry 01 but further clarified and quantified here.

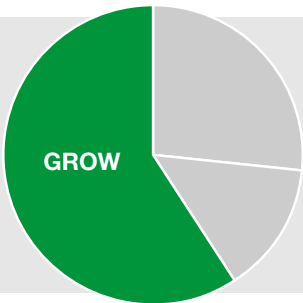
We can't say whether this popular growth expectation is based on the expectancy that the Federal Reserve will lower rates and the economy will have a soft landing or simply

whistling past the graveyard. It's a fact there are a growing number of FI competitors chasing a shrinking deposit universe. So growing deposits, or even staying the same, will call for different strategies than in the past few years, namely paying up for the deposits.

Acquiring new customers/members is expensive and risky. And if the economy dips further, relying on just new growth may be even riskier. Finding a more diversified approach, like growing existing deposits and boosting non-interest income is hopefully part of this growth expectation.



06A If you expect your deposits to grow, what are your target goals in the next 12-15 months?

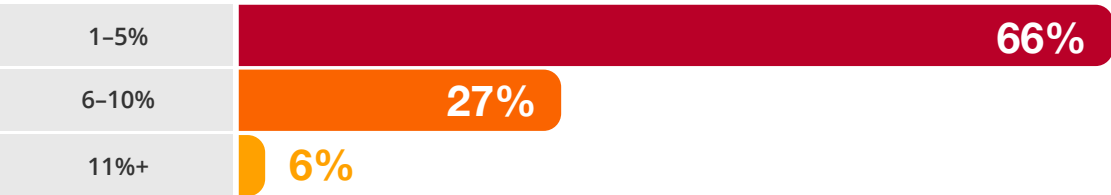


Our View: Net deposit growth of 1-5% doesn't sound very exciting. However, this top growth forecast may be a stretch for some CFIs given the current deposit dynamics in the marketplace.

To achieve any level of growth will mean a commitment to invest in acquisition marketing and sales- and product-related costs many CFIs will find difficult to fund given earnings pressures that will mandate expense control.

For those willing to make this funding commitment, higher acquisition costs will be a reality to get deposit growth at any level and will require a longer than expected financial return on those deposits as additional investment will be needed to evolve the depositor into a primary relationship.

It's hard to believe that 33% of CFIs are truly willing to invest what it will take to get 6+% deposit growth unless they have a stout cross-selling program to organically grow deposits from existing customers/members.



06B Which deposit growth is more important?

Our View: This small preference of consumer versus SMB accounts isn't too surprising, despite more potential opportunity with SMBs than consumers.

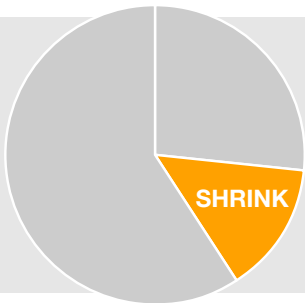
For an FI to get more than their fair share of both consumer and SMB customers, innovative products with new and relevant features are a

necessity. Product featurization is being led by the digital banks, so CFIs should at least mimic that.

Our SMB market research earlier this year revealed what SMB owners want in product features they consider important. Being successful here will put the FI in a better preferred incumbent position when the SMB has lending needs.



06C If your deposits are **shrinking**, does this have more impact on your consumer or small business deposits?



Our View: The velocity with which the nearly \$3 trillion deposit surplus shrank since April 2022 has been unprecedented. Seems like one day FIs had too many low-cost deposits and the next week they were scrambling for more deposits that cost much more and squeezed net interest margins again.

Inflation, consumer spending, the resumption of payments on deferred loans, and previously dormant deposits now seeking higher yield whip-sawed the deposit trendline, especially for consumer deposits as the results show.

Also, a contributing factor is SMB clients are a bit more sticky because frankly it's easier for consumers to move deposits around these days than SMBs, but both deposit types can still move deposits out of an FI faster than ever before as evidenced by Silicon Valley Bank's meltdown. It's the unforeseen liability of the speed of digital banking when things start to go south.



07 What's your main focus for expanding deposit growth?

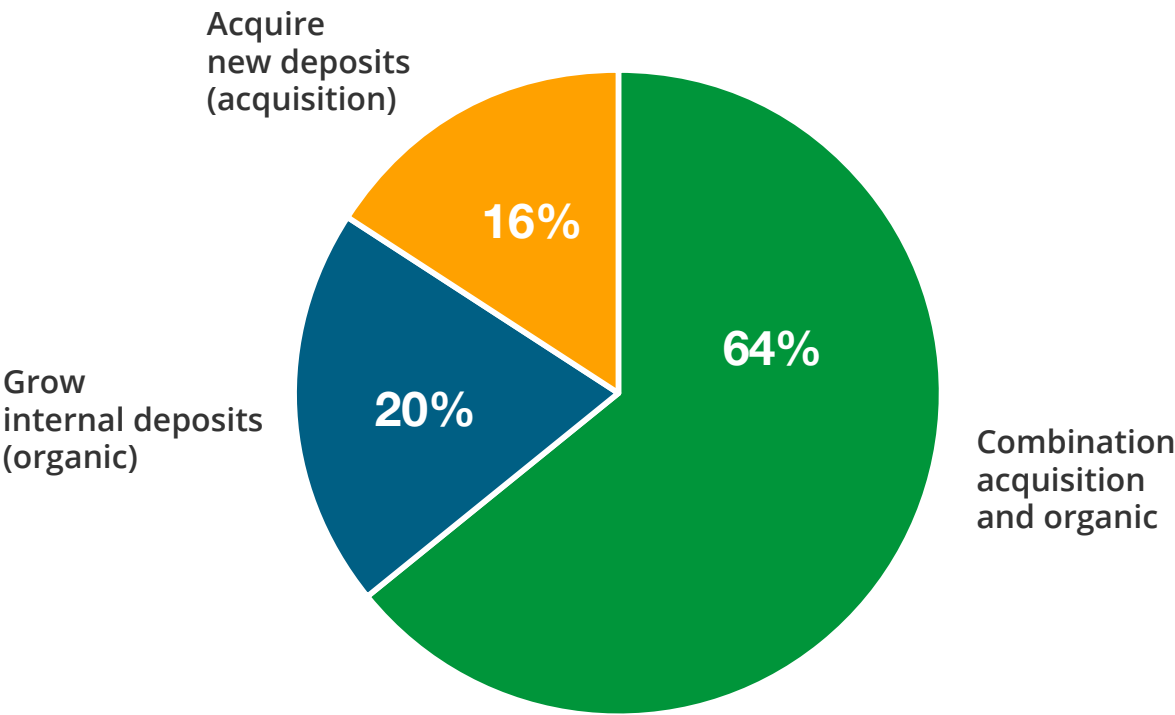
Our View: There are three follow-up questions from this broader question.

The combo strategy – acquisition and organic – planned by two-thirds of respondents is a balanced and reasonable approach. The percentage of each in the combo wasn't asked, but anecdotally our discussions with bankers is it is skewed materially towards acquisition.

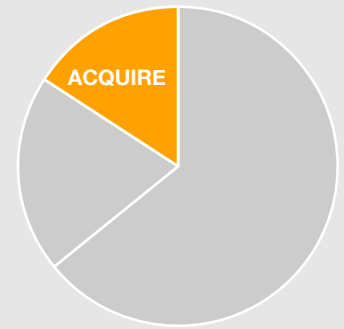
Given those FIs relying on acquisition as a material part of the combo plan and the 16% of respondents having a main focus on acquisition, let's revisit the deposit landscape: the top 15 largest banks have 74% of deposits,

the 4 megas alone have nearly 50%; and, only about 11% of consumers switch primary banking relationships per year. On the retail checking front, the major digitals together open more accounts than any other FI type (albeit very shallow and non-productive ones, despite a majority of consumers stating that a digital bank is their Primary FI).

This makes for quite a challenge for CFIs to acquire deposits at an acceptable level of investment and cost of funds. The 20% of respondents who are focusing mainly on organic, internal deposit growth acknowledge this reality.



07A If your main focus is **acquisition**, are your target growth goals focused on consumer deposit growth or small business deposit growth?



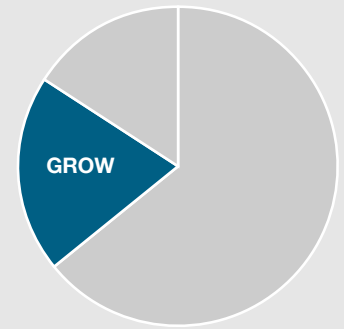
Our View: Given the deposit realities stated in the previous viewpoint, it's encouraging to see those FIs primarily focused on acquisition are targeting primarily SMB deposits.

This customer type has much more potential in terms of acquiring their deposit business. The megas don't primarily target them, the digital and fintechs have been more focused on consumers, and the undifferentiation of SMB deposit products creates a great opportunity for those FIs that do differentiate with product features SMBs want (and are likely buying from another third-party).

This market opening won't last long as the megabanks and big regional banks have been advancing their digital features and offering very attractive, customer-focused checking products for SMBs to reacquire the market share they lost from the PPP loan funding process. They are also investing in business development, namely sales efforts, to call on these SMBs and sell them banking products because SMBs acquisition is more about selling than marketing, unlike acquiring consumer deposits.



07B If your main focus is **organic growth**, are you more focused on consumer deposit growth, or small business deposit growth?



Our View: It's encouraging to see that the main focus of organic growth focus is balanced on both consumers and SMBs. These CFI leaders understand that they need to diversify their acquisition efforts on both of these market segments.

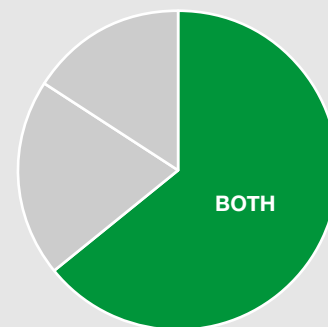
While competition is keen for both customer types, relatively speaking it's less so for SMBs. Ironically, SMBs, on average, drive more deposits and fee revenue relative to consumer

accounts. Having the right product and a sales culture will outcompete most other FIs for SMB banking business.

And while SMB owners are intensely focused on other aspects of their business than changing their FI relationship, setting up a new banking relationship and moving deposits isn't as hard as it used to be given digital platforms. Plus, smart FIs are taking on more of the administrative load for an SMB to change accounts than in the past.



07C If your main focus is **both acquisition and organic growth**, which of these is more important?



Our View: This prudent strategy versus mainly focusing on acquisition or organic growth is a bit offset by the mix of which types of customers are more important to achieving deposit growth goals.

Two-thirds of respondents that prioritize consumer versus SMBs seem to be focusing on the smaller opportunity of consumers versus

SMBs. As stated earlier, it will be more work to focus on SMBs - requiring product innovation beyond a “CD special” to buy deposit growth and necessitating a commitment to invest in a robust business development program to be successful. This is something a lot of CFIs aren’t openly willing to readily commit to.

Consumer

67%

Small Business

33%

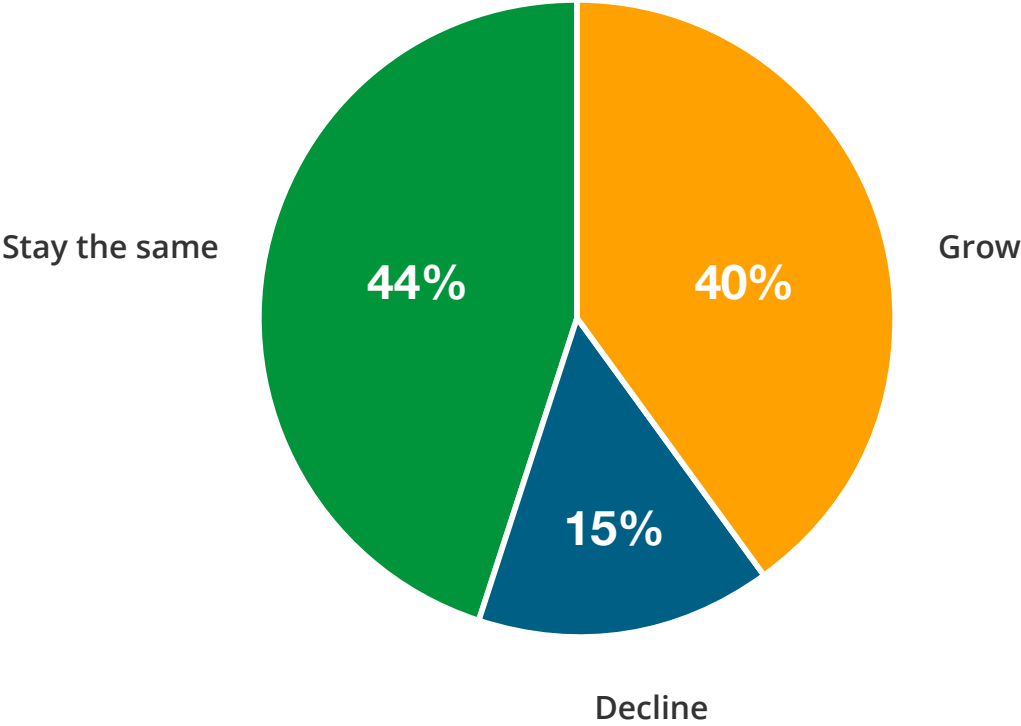
08 Do you expect your deposit-related non-interest income in 2024 to:

Our View: There are two follow-up questions from this broader question.

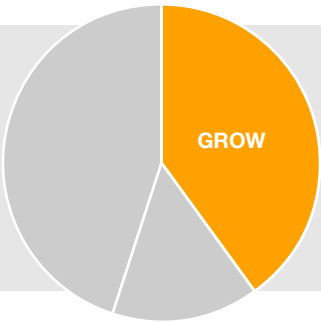
Nearly 60% of respondents expect their deposit-related fee income to remain the same or decline. This makes sense as NSF/OD policies and fees continue to change under competitive, political and regulatory pressures. This puts this fee source (that many CFIs are over-reliant on) at risk. However, 14% are bullish on growing NSF/OD fees (from inquiry 01).

On the non NSF/OD side, again from inquiry 01, the bears outpace the bulls on growing this fee source (33% versus 23% with 45% at no change). To grow non NSF/OD deposit fees will require a total rethinking of penalty-based pricing that’s dominated for decades.

Also from inquiry 01, there was more bullishness than bearishness (40% versus 28% with 13% at no change) on debit interchange fee growth.



08A If you expect your deposit-related non-interest income to **grow**, what is driving that growth?



Our View: 58% expect debit interchange fees to drive deposit-related fee revenue. They must be overly bullish given the regulatory proposal by the Federal Reserve to reduce maximum debit card interchange fees per transaction charged by debit card issuers over \$10 billion in assets. If enacted, like the previous cap, it will likely put downward pressure on debit swipe fees for issuers under \$10 billion in assets as well. Industry groups and associations are

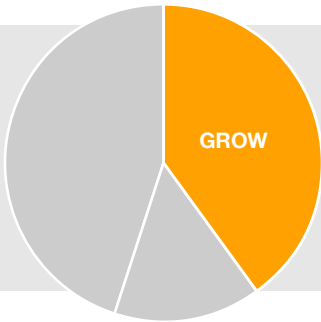
lobbying hard to oppose this proposal, so who knows when and if it will actually happen.

For the 37% of those expecting non-NSF/OD fee income growth as a driver, they must be planning on repositioning their penalty fee structure with some sort of value-added, subscription fee.

And for the 5% expecting NSF/OD fees to drive growth, they're truly contrarians thinking these DC labeled "junk fees" are making a comeback.



08B Which do you expect to contribute more to your deposit-related non-interest growth?



Our View: The hangover of totally free checking continues to negatively impact non-interest income growth from both of these customer/member types. It's proved a false economy once the NSF/OD gravy train left town. And it's left a lot of shallow, non-primary, unprofitable accounts on the deposit bases of CFIs.

It's also made consumers super-sensitive to any deposit fees, no matter what value is gained from the product. SMBs are fee sensitive as well but not as much as consumers.

Despite this, there is the opportunity for more debit card usage. Consumer accounts may well create more debit transactions,; however, SMB accounts with fewer transactions at larger transaction size generate more revenue (for FIs below \$10 billion in assets).

For SMBs there is also a huge opportunity to deliver in-demand, value-added product features for a modest commensurate banking requirement that will make those shallow SMB accounts more immediately productive.



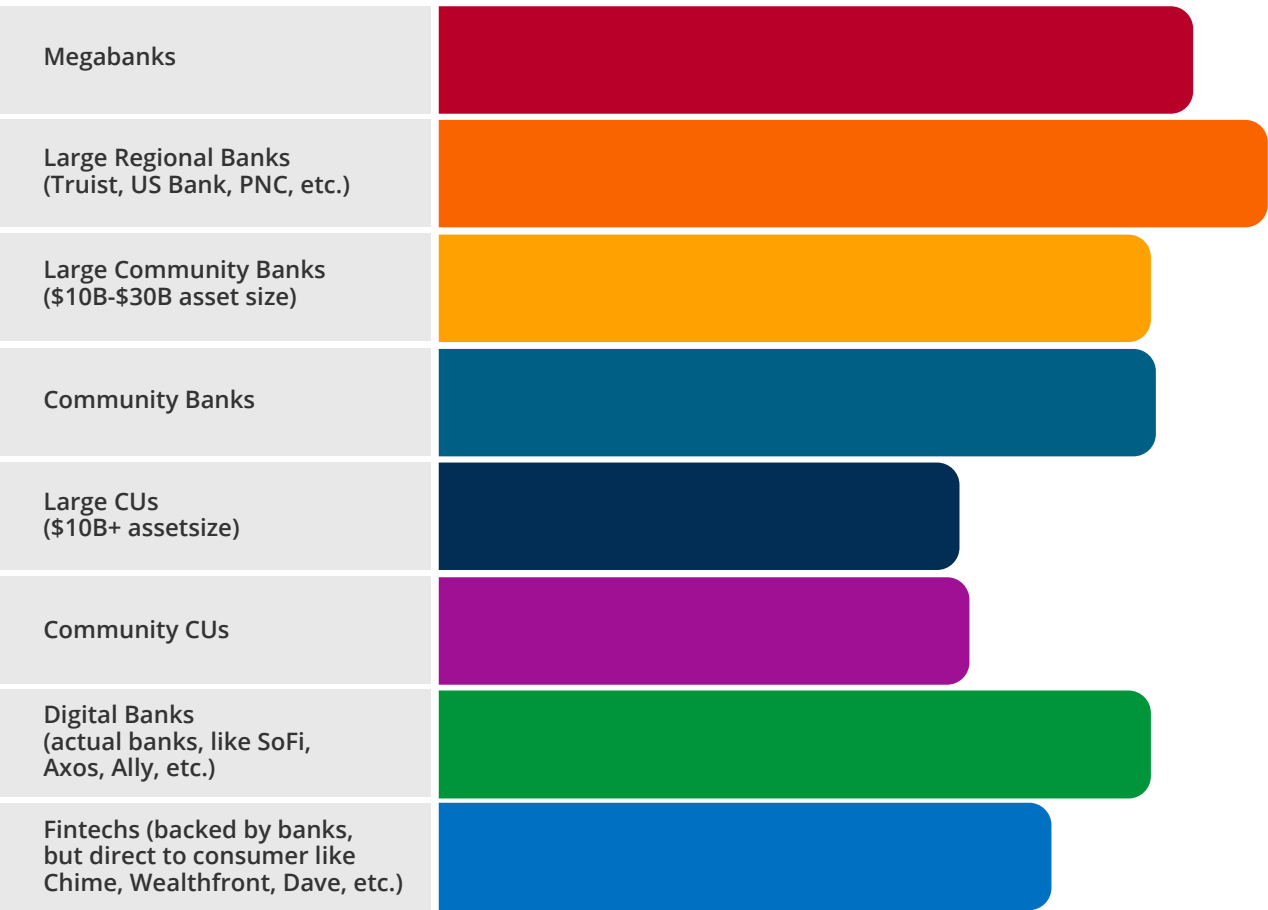
09 Rank in terms of these FIs successfully competing against your FI in growing deposit-based consumer customers/members.

Our View: It’s no surprise that the large regional banks and the megabanks are considered the top two competitors respondents of all size FIs (primarily CFIs under \$30 billion in assets).

The hangover of totally free checking continues to negatively impact non-interest income growth from both of these customer/member types.

One anecdotal reason for the lack of competitive concern of digitals and fintechs is consumers

aren’t closing their accounts at CFIs, so the number of accounts isn’t declining, Consumers are opening additional accounts at the digitals and fintechs and then gradually moving their business over. In that process, for the first time ever last year, per Cornerstone Advisors, more consumers consider digital banks and fintechs their primary FI than any other FI type.



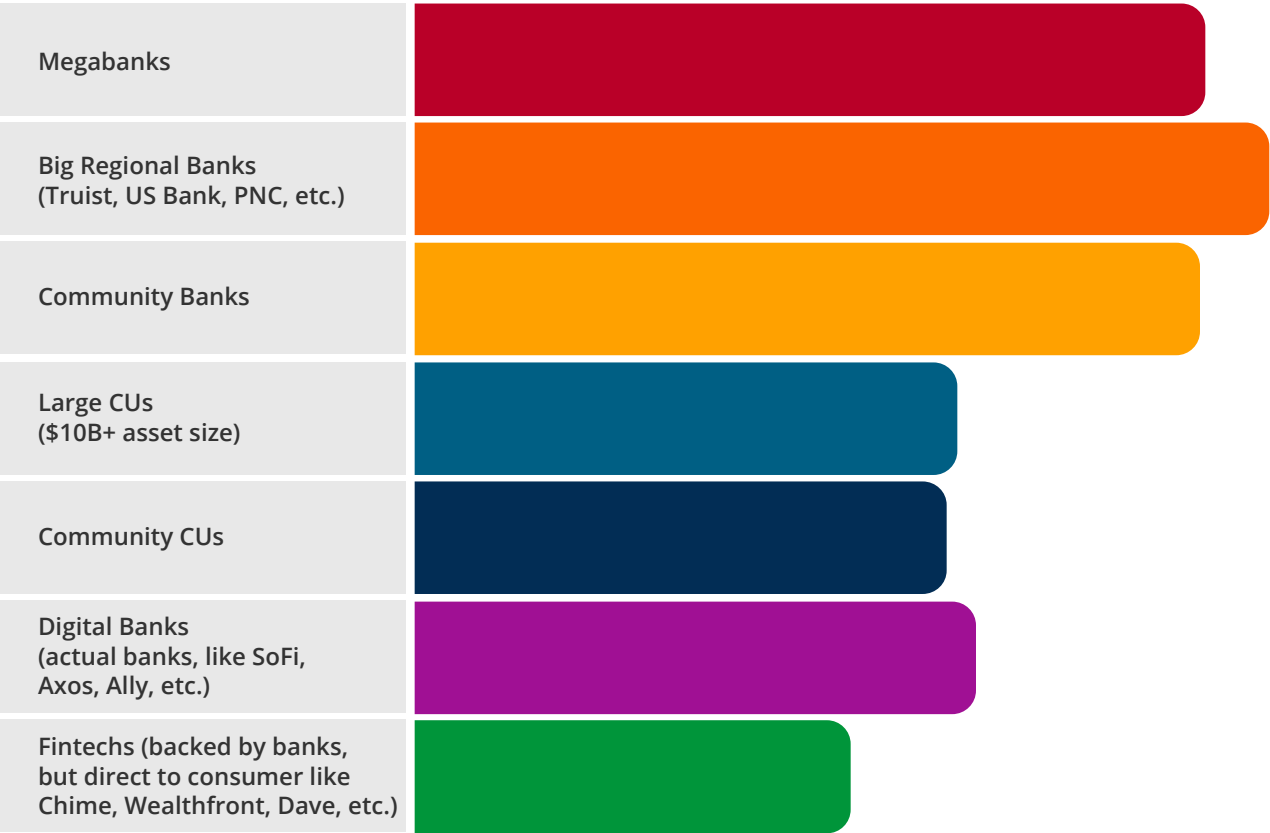
10 Rank in terms of these FIs successfully competing against your FI in growing deposit-based SMB customers/members.

Our View: The big regional banks are unabashedly uber-aggressive in trying to regain any lost market share that happened with PPP. And the megabanks aren't far behind as they extend their physical branch reach to truly be national in coverage to SMBs (especially Chase).

Community banks are fighting these intrusive forces (and each other) to maintain the advantage they got with PPP funding. They are at a disadvantage due to the inherent safety net of "being too big to fail" reality of the largest of the large regionals and the megas. This uninsured deposit safety factor is a big deal to

SMBs when things get iffy on uninsured deposits (like with SVB meltdown).

As stated before, this market is crowded with competition. FIs that make their deposit products different and more relevant to the needs of the SMB, and dedicate resources to a sustainable and accountable business development effort will capitalize on the inefficiencies of competing FIs - which are arming their business development officers with only a me-too product, effectively competing on being the low cost provider.




Ready to have your checking products perform better?

As checking experts, StrategyCorps delivers top performing analytical and product solutions for retail and SMB checking that:

- Identify precisely which customers/members consider your FI their Primary FI and which ones don't
- Compare your checking performance to your peers and best in class performers using our database of over a billion data points
- Determine specific revenue opportunities that exist with evolutionary product and pricing strategies
- Provide differentiated checking products that will modernize and simplify your retail and SMB checking line-ups that appeal to consumers and meet SMB owners needs, and fire up bankers to successfully capitalize on those revenue opportunities

Bottom line: on average, \$500,000 of new, recurring revenue per \$1B of assets for financial institutions of all sizes is delivered by data-driven strategic decisions and more engaging checking products.

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