WHITE PAPER

THE RISING NEED TO UNDERSTAND, MEASURE & DEPLOY RELATIONSHIP PROFITABLITY

ADVANCED ANALYTICS INSIGHTS FOR MANAGING AND GROWING RELATIONSHIP PROFITABILITY

As financial leaders pivot to grow revenues amidst rising rates and recessionary pressures, industry research suggests a gap exists for understanding customer relationship profitability to guide decision making on products, fee income, channel usage and relationship building. And the need for more intelligent consumer data analytics and actionable insights to reduce churn is ramping up.

For all the financial industry talk about improving digital experiences, increasing engagement, and the need to retain high-value consumer relationships, recent financial industry studies indicate that very few financial institutions can actually calculate profitability at the account, customer, or household relationship level with any degree of reliability or usability.

That lack of understanding which relationships drive margins and value, and which factors, or tactics may in fact negate profit, can impact agile scenario planning to improve product and revenue strategies that will be vital for sustainable growth and reducing the attrition of key member relationships ahead.

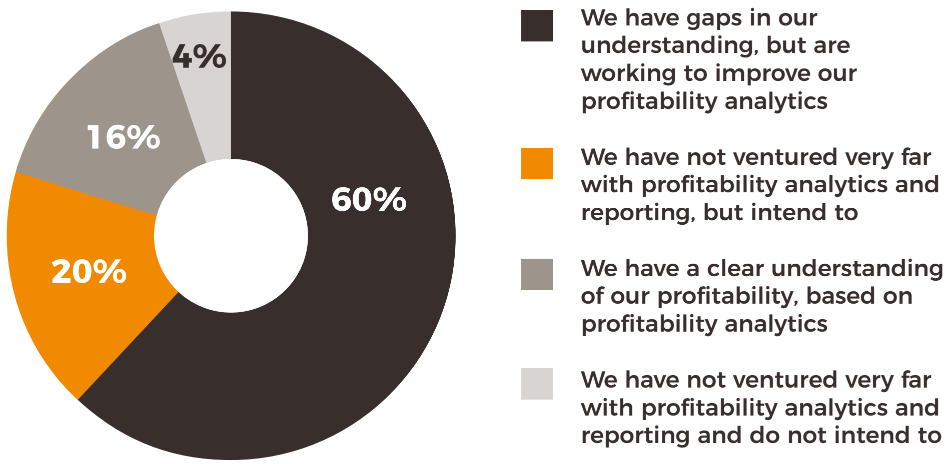
Why your data analytics should measure household relationship profitability

While profit modeling has long been the purview of finance and accounting, successful marketing strategies, new member acquisition, and personalized customer journeys today can all benefit from capturing and leveraging data analytics insights to improve the value of different relationships and retention.

Too often though, the lack of timely, data-driven marketing intelligence and slow, legacy communications and onboarding focused on generic cross-selling, frustrate consumers and unintentionally generate substandard results, unnecessary churn and resulting negative profits to the institution. And reducing churn and lost relationships can have a huge impact on your profitability: according to Bain & Company, a 5% increase in customer retention can increase profits by 25%-95%.

By calculating and tracking accurate product and member relationship profitability data, combined with smart

Which statement best describes your profitability analytics reporting?



AS COMPETITION FOR IDENTIFYING, RETAINING AND GROWING MORE OF THE "IDEAL" CONSUMER SEGMENTS INTENSIFIES, IT IS NO LONGER ENOUGH TO SETTLE FOR A ROUGH IDEA OF RELATIVE ORGANIZATIONAL PROFITABILITY, WITHOUT KNOWING WHICH SEGMENTS ARE THE LARGEST DRIVERS OF GROWTH AND PROFITABILITY.

segmentation data and targeting strategies, marketers, branch and lending leaders can mine and pinpoint where enhanced loan, deposit and profit opportunities exist. Armed with rich analytics insights and ideal target profiles, omni-channel communications can be personalized to help customers bank smarter, and generate higher engagement and increased financial results for the organization. Learn More.

A study by Kaufman Hall of financial executives, found only 16% of financial institutions identified having a clear understanding of their profitability based on their current data analytics.

The study also suggests there will be rising demand among leaders to prioritize, understand and track expanded profitability analytics across a wider range of important and actionable variables including customers, relationships, products and branches.

As the pandemic and resulting crisis led consumers to shift to more mobile and online options, and away from branches, tracking and measuring the impact of those channel shifts on relationship and branch profitability became even more complex.

Many digital strategies have left financial leaders searching for cloud-based, data-driven analytics insights and trends, to enhance their understanding of the drivers of product profitability, customer relationship value and the right mix and type of products, payments and channel usage that generate improved performance.

According to Strum Platform's Director of Strategy & Innovation Bill Hasapidis, "profitability analysis is one of the key building blocks of any successful data analytics program. But implementing it properly to drive insights and value requires careful planning and an understanding of the key drivers behind organizational, account level, product and customer profitability. Well-designed customer relationship profitability models provide a powerful means for linking marketing, onboarding and growth strategies to "bottom-line," repeatable performance results and enhanced future prospect targeting and market share growth."

According to the Kaufman study, more than two-thirds of all FI's (68%) plan to improve their profitability analytics in the future. This vital data to understand, measure and manage customer relationship profitability is fast becoming a key to increasing bottom-line performance.

A looming recession could drive the number of FI's working to improve their profitability analytics capabilities even higher ahead, as leaders adapt to the challenge of increasing earnings and capital with enhanced data, improved products and pricing, advanced transactional and payments data, and well-focused, tailored marketing.

The Time for Intelligent Relationship Profitability Modeling is Here

Financial and accounting executives have worked for years in broadly-focused, complex general ledger (G/L) measures of organizational profit and. As many finance leaders discover, navigating the vast technical and siloed data system issues related to derive accurate and usable profitability has been complex enough to slow, or even stop many from ever completing and implementing their profit models. While vital to understand organizational, portfolio, branch and channel level profit, they are rarely able to crack the code of account or customer level profit metrics.

The financial industry's lack of focus on the value of pinpointing highly engaged and profitable households, their changing relationship journey, channel preferences and behaviors only increase the chance of future marketing taking wild "shots in the dark" to increase performance. But the resulting attrition losses of key high-value profitable relationships, is becoming a material weakness that financial institutions must remedy—with knowledge, data insights and business intelligence they can act on.

Strum Platform President and COO Ben Stangland added this note, "as competition for identifying, retaining and growing more of the "ideal" consumer segments intensifies, it is no longer enough to settle for a rough idea of relative organizational profitability, without knowing which segments are the largest drivers of growth and profitability."

Too often organizational profit models are unable to pinpoint the crucial link of measuring decreased profitability resulting from poor retention, low engagement, and costly high industry churn rates. With a financial industry churn rate of lost customers averaging 8%—20% each year, and an average cost per new customer of $200-$1,200, the cost of losing valuable relationships at such a high rate can be staggeringly costly to profits as clients walk out the door each month in droves. And not knowing when—and why—you are losing your most profitable customers can hit bottom-line profits hard and fast.

Strum Platform's 20+ years of national data analytics and financial institution relationship profitability modeling has identified that the old financial industry truism of the 80/20 rule: that 20% of your customers drive 80% of profits is grossly underestimating reality. In fact, it's even worse. For most financial institutions, 90%+ of their consumer net profits come from 9-12% of their customers. Imagine the impact of losing 5% of those vital relationships in one year—from inattention and ignorance.

Without these crucial member relationship profitability insights, financial leaders are left guessing which demographic, or lifestyle segments, and even what percent of their total customer base are profitable, or unprofitable. That unprofitable client number is often well above 50-65% of the entire customer base; and often linked to single service, low balance unengaged relationships.

Identifying your most profitable relationships with intelligent data analytics, and models that can then predict ideal "look-alike profiles," using savvy machine learning models, allows marketers to engage customers with greater precision. They can also pinpoint vulnerable high profit "at risk" relationships early enough to take proactive action.

Those prediction models can have a profound impact not only on reducing churn, but on increasing retention and ultimately driving wallet share increases that boost in financial performance. It's profoundly more cost effective—and profitable, to bar the back door before losing relationships, than to spend it widening the front door to acquire new customers.

Unfortunately for many FI's, closing that analytics gap has been stymied by the burden of countless unlinked core and disparate data sources, coupled with archaic data analytics tools and flawed, or basic models.

Even FI's with savvy Data Warehouse, CRM and Business Intelligence systems often lack capabilities for linking data sources to member householding, geo-coding and appending vital lifestyle segmentation data models to individual members, accounts and integrating intelligent relationship-level profitability metrics. Linking this vital data analytics and triggers can then be used to improve and personalize onboarding journeys and user experience satisfaction and retention.

An Actionable Relationship Profitability Platform solution

In our data-driven consulting with US financial institutions in customer relationship profitability, our analysts built and sharpened a sophisticated and flexible best practice Funds Transfer Pricing (FTP) profitability model.

The model allows leaders to uncover deep analytics insights into true customer engagement, account and product usage and behaviors to derive a holistic view of relationship profitability value. This helps leaders fully understand the opportunities and insights gained from a comprehensive relationship with a customer and their entire household, not just a single product focus.

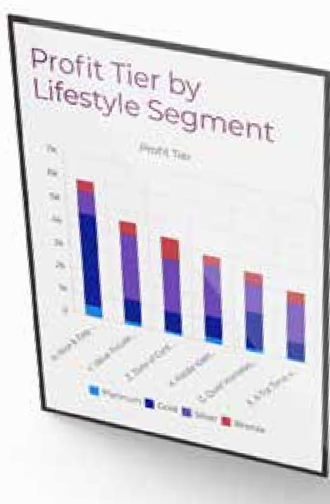
Best practice approaches for deriving account-level profitability and then aggregating to the member level will contain the following key components: 1) historical funds transfer pricing; 2) non-interest income and non-interest expense calculations based on member-specific transaction activity and 3) loan loss provision that reflects the inherent risk of each member. While the level of precision will vary depending on the availability of the data sources—including capturing account-level transaction detail, the main objective should be to reflect specific member behaviors and transactions in the calculation of relative member relationship value.

ProfiTrac™ is a customizable **Funds Transfer Pricing model**, that derives balanced net profit calculations, using a range of US funding rates to reflect costs, and allowing capital to be allocated on a risk adjusted **Return on Capital**. Each individual account, product and customer can then be evaluated from a wide range of core and disparate data sources for profitability. It gives each FI a wide range of user-driven rule-set algorithms, that can be customized to give them flexibility to tailor their own products, revenue and expense components, including unique loan loss risk and provisions.

The insights derived from the ProfitTrac™ model give financial leaders a highly accurate way to measure, track and improve client relationship and account profitability, while enhancing and visualizing net profit calculations among lifestyle segments.

In the ProfitTrac™ model, individual members (as well as their entire household) are ranked by their profit contribution, assigned a profit percentile and segmented into **Profit Tiers** based on their ranking of total profit contribution. This gives leaders deep granular insights into their retail client relationship profitability, and the factors that drive migration in profitable households.

Using business intelligence and data modeling, Strum Platform™ then links data to lifestyle segments, channels and product usage patterns to help leaders **view and manage profitability across mission critical growth and performance areas** like enhanced onboarding, branch revenue generation, segment migration patterns, and smarter product propensity models. Those insights can be implemented immediately via omni-channel marketing automation into smarter onboarding and reboarding journeys.



The behavioral insights derived from building net profit calculations of each individual account and customer relationship, gives financial leaders highly actionable analytics insights. With it they can track relationships profitability changes and identify proactive trends they can act on to increase bottom line performance, while improving user journeys.

Leveraging this financial, transactional and relationship data in next generation machine learning tools in the "data lake," allows FI's to use their anonymized data to crack the code of true "member relationship profitability" and even Lifetime Member Value, with machine learning to drive more focused retention strategies to nurture valued relationships.

Legacy MCIF Profitability Models Failed to Deliver Value or Actionable Insights

For years, traditional MCIF software was used by many FI's to calculate customer profitability, however few calculated it with any degree of accuracy or user customization. Absent critical expense and revenue items like transactional costs, margin and fee income, few finance leaders embraced the accuracy of the models. These legacy relationship profit models used a "one size fits all" generic approach, which although easier to implement, failed to capture critical differences in value among member segments that can improve relationship growth and performance results.

While the level of precision will vary depending on the availability of the data sources—including account-level transaction detail—the main objective should be to reflect specific member behavior in the calculation of relative member relationship value.

Relationship Profitability can be Applied to Branch Insights to Increase Market Growth & Performance

Armed with a tailored and defensible relationship pricing model, and customer data geo-coded to market location and branch transactional usage, organizations gain tremendous insights into

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the differences between each branch's most profitable relationships. Branch managers, sales leaders and call centers can begin to test assumptions about actionable steps they can take to deepen relationships, increase contact with their most valuable relationships to increase personalized service, identify opportunities to improve engagement and ensure higher retention and loyalty to identifying "at risk" customers.

With business intelligence applied against that same data, ML models can be built and the migration of valuable segments in their use of other channels. Ultimately the goal is to move more member relationships from lower profit tiers more rapidly towards profitability in their journeys, whether new onboarding journeys, or long-term relationships that have not been nurtured in years.

The Value of Relationship Profitability is a game changer

Once organizations finally have a grasp of the relative differences in their customer relationship engagement levels, they can design more personalized product journeys that lead to enhanced profitability, allowing positive outcomes to occur.

1. Analytics insights can be used to enhance growth and key segment penetration strategies with clarity around which relationships are driving bottom line profit and performance, and which can be guided up that ladder of engagement.
2. FI leaders can focus resources on retaining their most valued relationships pro-actively, rather than pretending losing those vital relationships of high profit are not critical to sustained financial performance. To be clear, your most profitable segments are the same one's other banks are fighting to steal away.
3. Onboarding journeys can be intelligently modeled to help each consumer relationship uncover the right products and journey that helps them improve their financial health, and build resulting organizational performance, a win-win.
4. Growth strategies from analytics insights, new product design, bundling, branch strategies and market growth can be enhanced with smarter insights from which relationships and products are most likely to drive increased net income.
5. Look-alike models can be built using ML to identify your ideal engaged, and high profit relationships by channel and preferences, to better target new customer acquisition and improve product journeys and personalization.

By knowing your members lives, behaviors, preferences, payments and channel transactions better, the door to tailor their journeys toward higher engagement, deepening relationships and profitability is within reach. Much of that first party data exists and can be augmented with rich third-party data. Harnessing the insights from that data with intelligent algorithms, machine learning predictive triggers, proven relationships profitability models, and actionable strategies to leverage it, will require deep expertise that most organizations don't have internally. It can be advanced with value-added partnerships, and a well-focused financial cloud data platform.

Applying those customer insights, analyst knowledge and data pattern insights with advanced Business Intelligence tools and a cloud-based Customer Data Platform is one key to accelerating your move to actionable profit data implementation.

Creating smarter, data-led automated marketing campaigns, more intelligent onboarding, and greater personalization become even more crucial to growing profitability and retaining valuable relationships. Managing relationship profitability and driving financial performance will continue to be one of the differences between those who struggle to sustain higher financial performance, and those that thrive.

Mark Weber is the CEO of Strum Platform™ a next generation financial Customer Data Platform. He is a national thought leader advising financial institution executives in harnessing their customer data to build agile growth strategies and advanced digital marketing, branding experiences and journeys that increase relationships and performance.

ABOUT STRUM PLATFORM™

Strum Platform™ is a next-generation financial Customer Data Platform that builds rich consumer insights to enhance experiences, spark engagement and enrich people's lives. We help financial leaders deepen relationship journeys with cloud business intelligence, hyper-personalized targeting and marketing automation that speeds onboarding relationship profitability, and automates marketing ROI, sales tracking dashboards and performance.

Learn more at strumplatform.com.

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