Why You’re Not Making Money on Cash Management Services and What To Do About It

Results from Abound Resources 2009 Survey: Cash Management in Community Banks
EXECUTIVE SUMMARY

The backlash against the largest financial institutions creates an outstanding opportunity for community banks to attract commercial deposits, increase fee income and lower cost of funds with commercial cash management products. In fact, 54% of recently surveyed CEOs have experienced an increase in fee income from commercial depository services in the last six months and 87% believe they can increase commercial fee income.

Many community banks are unaware that they already offer the cash management products to launch or expand their commercial cash management business because their current products are offered as a knee-jerk reaction to customer demand. For example, a bank that has half a dozen customers on sweep accounts, a few dozen customers using remote deposit capture, and a hundred or more customers using online cash management may say that it doesn’t have commercial products even though effective bundling of the products would result in a fairly robust commercial cash management line-up.

Far too often in community banks, commercial cash management products are handled as one-offs. To be successful, a disciplined product management approach is needed. By extending retail product management disciplines already in place to commercial cash management products, community banks can leverage their existing investment in cash management products; improve the pricing, delivery, infrastructure and sales/marketing of these products; and increase deposits and fee income by luring small and mid-sized businesses to the bank.

ABOUT THE SURVEY

In April, 2009, Abound Resources surveyed CEOs at community banks throughout the U.S. about the cash management products they currently offer and whether they believe there is untapped potential in commercial cash management. Fifty-five CEOs from banks ranging in size from $100 million to $3 billion in assets responded to the survey.

Respondents reflected the varied deposit base that is typical in community banks with almost half (47%) reporting that between 21% and 40% of their deposit base consists of
commercial deposits. The majority of respondents’ commercial deposit base comes from businesses with less than $5 million in annual revenues.

CASH MANAGEMENT DISCONNECT

In our Business Banking and Cash Management consulting practice, we see four factors driving the growing interest in cash management programs.

- **Flight to safety** – many commercial customers are giving community banks a new look but expect products comparable to what they had at their previous big bank.
- **Cost of funds** – in a tight margin environment, cost of funds becomes more important and commercial deposits and public funds tend to be cheaper than consumer deposits.
- **Portfolio diversification** – many community banks are seeking to lessen their dependence on commercial real estate by increasing commercial and industrial (C&I) lending. Cash management products are central to C & I lending.
- **Fee income diversification** – many community banks have seen sharp declines in overdraft fees and are looking for fee income opportunities from commercial customers.

Our survey confirms that community banks place a high priority on fee income earned from their current commercial cash management offerings, with 61% of respondents saying fee income is important or very important. Respondents are also bullish on the future importance of cash management: 80% say it will be important or very important within 2 years.
However, only slightly more than half (53%) of community bank have succeeded in increasing fee income from commercial cash management products within the last six months.

When asked if they believe that they could increase commercial fee income by offering additional cash management services and/or more aggressively promoting existing offerings, 86% of respondents replied “yes.”

Clearly there is a disconnect between respondents’ belief that they can earn more fee income and their ability to actually do so. Why are community banks having a difficult time generating revenue from cash management?

**“One-Off” Challenges**

We believe that community banks’ ability to increase cash management penetration is crippled by “one-off” solutions developed to appease a corporate customer demanding cash management as a condition to move business to the bank.

For example, of the respondents offering ACH origination services, almost one-third have fewer than 10 customers using the product. Of the respondents offering remote or merchant capture to customers, almost half (49%) have fewer than 10 customers it.
Not only are these “one-off” solutions inefficient, they also tend to result in poor product quality and under-pricing. In some cases, we’ve seen community banks not even recoup their costs when offering cash management products. Our previous research shows that sales and marketing best practices drive product penetration, not price, so we would like to dispel the myth that community banks have to “give their cash management products away.”

Here’s a typical scenario at a community bank that illustrates the “launch” of a commercial cash management product:

A mid-sized local business, disenfranchised with the poor service and concerned about the financial health and viability of the large financial institution it does business with, approaches its local community bank about transferring deposit accounts. The stickler is that the customer has become accustomed to an investment sweep product and the lockbox service offered by its current bank. In order to close the deal, the community bank must offer these products as well.

The bank rushes to implement these products, hastily calling a contact at another bank to find an investment sweep product. No vendor research or negotiating is done. The bank overpays for the product. There is no formal launch.

The bank assigns an employee in the accounting department to support the sweep application “as they have time.” Quality issues are not tracked and each problem is resolved in a vacuum. Support is inconsistent.

On the lockbox side, the bank decides it can process the items internally at a branch with excess capacity when the lobby is relatively quiet. Timely processing and reporting is not important. Again, the bank does not track quality issues.

Product development discipline is nonexistent, but features are added to these products as the customer demands. The bank lacks a process for creating and managing new products or performing a risk assessment or ROI calculation.

The new customer soon encounters errors with his lockbox processing and the sweep product, and contacts his relationship officer. The branch corrects the error, but more occur despite the good intentions of the employees involved. The bank eventually loses the customer, his account balances, and the profitable loan.

Another probable outcome of this situation is the bank assigns additional people to the lockbox and the sweep product. Still not addressing the product management issues, the customer continues to have issues but he gets lots of attention every time he calls in. Bank management has no idea what it is costing them to retain this customer and the true profitability of these products.
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STRATEGIES FOR SUCCESS: LEVERAGING WHAT YOU HAVE

Although the term “commercial cash management” (also known as “treasury management” or “business banking”) can encompass a wide range of products and services, most small and mid-sized businesses do not require overly sophisticated, complex, or expensive products. In fact, many community banks already have most, if not all, of the products they need to formally begin offering cash management services.

The community banks responding to our survey overwhelmingly already offer ACH origination (86%), remote deposit or merchant capture (84%) and online cash management (79%). Less common are investment sweep accounts (58%), positive pay for checks (58%), and wholesale lockbox service (40%).

<table>
<thead>
<tr>
<th>Services Banks Offer to Commercial Customers</th>
<th>My bank offers this service</th>
</tr>
</thead>
<tbody>
<tr>
<td>ACH origination</td>
<td>86%</td>
</tr>
<tr>
<td>Remote deposit/merchant capture</td>
<td>84%</td>
</tr>
<tr>
<td>Online cash management</td>
<td>79%</td>
</tr>
<tr>
<td>Investment sweep production</td>
<td>58%</td>
</tr>
<tr>
<td>Positive pay for checks</td>
<td>58%</td>
</tr>
<tr>
<td>Wholesale lockbox service</td>
<td>40%</td>
</tr>
<tr>
<td>Purchasing cards</td>
<td>23%</td>
</tr>
<tr>
<td>Payroll cards</td>
<td>12%</td>
</tr>
</tbody>
</table>

Source: Abound Resources, 2009

Successfully offering commercial cash management services requires a solid product management discipline with a focus on the commercial customer’s needs. Abound Resources believes that product development, packaging and pricing, sales and marketing, delivery and support all are part of a product management discipline. Often, community banks may lack expertise in one or more of these areas and rely on their vendors for help. For example, a bank may look to a vendor for marketing assistance only to wind up with a separate brochure (and customer logins) for each product offering. This silo approach nullifies the community bank’s advantage of truly understanding their customers. Instead, the bank should excel by positioning these products as a holistic approach to meeting customers’ overall cash management needs.

Brad Tidwell, President and CEO of $800 million Citizens National Bank sums it up this way: “For a bank like us, the upside of commercial cash management is significant. For too long, community banks have not put a premium on small business relationships. As
an industry, we’re still struggling with evolving from being small business friendly to small business focused. There’s a difference. To truly focus on small-business requires an investment not only in products and technology but an investment in people to make business banking and cash management work.”

Technology is also an important component of cash management success and some community banks may need to upgrade its technology if the current cash management or Internet banking platform is outdated or doesn’t provide appropriate risk management controls. First Financial Bankshare, a bank holding company with $3 billion in assets headquartered in Abilene, TX, recently recognized the need to upgrade its technology. While many banks have hunkered down to wait out the storm, First Financial instead has focused on creating the technology infrastructure to support their growing cash management business. Gary Webb, EVP of Operations, explains that the bank understood that its business customers wanted an online banking system with fully integrated ACH and wire transfer features. They also acknowledged that companies wanted to be able to delegate functions yet retain control of their bank accounts. Over the last six months the bank has converted their online banking platform to a new system built on a flexible .NET environment.

Says Webb, “In light of the economic climate, it was a bold move to revamp our infrastructure, but I’m very glad we did. Our new environment allows us to bring products to market quickly, control risk, and continue to be responsive to our customers. We now have the right tools to move our cash management business forward.”

Most community banks will also need to invest in processes and training in order to deliver quality and consistent products. Strong leadership is required, and we typically recommend that community banks name a manager to lead the effort. Oftentimes the bank already employs a perfect candidate; however, it’s important to relieve that employee of his or her other responsibilities to focus on quality and growth of the cash management product suite.

**Ready to Launch**

To launch a commercial cash management business, Abound Resources recommends that community financial institutions offer four main products:

1. **Online Cash Management**: the keystone of commercial cash management, this includes the ability to view transactions, transfer funds, and initiate transactions.
2. **ACH Origination**: enables a company to create electronic debits and/or credits for many purposes such as vendor payments or employee payroll. ACH origination is ideally offered as a feature within the online cash management product.
3. **Investment Sweeps**: especially important for small businesses lacking the time or expertise to make investment decisions.
4. **Remote Deposit/Merchant Capture**: enables community banks to expand their geographic footprint and compete against the big banks with multiple brick and mortar branches.
CONCLUSION

Many community banks view cash management offerings as a way to increase deposits and fee income, but our survey shows that few are successful in doing so. Instead, many community banks offer cash management as “one-off” products to meet the needs of only a few customers. However, by applying product management and sound marketing and sales disciplines to cash management, community banks have an incredible opportunity to grab market-share from their larger competitors and increase their profitability in a difficult economic environment.

ABOUT ABOUND RESOURCES

Abound Resources helps community banks and credit unions grow, become more efficient and make the right technology decisions – Guaranteed. Whether evaluating a core processor, improving a cash management program, negotiating technology contracts, streamlining processes, or starting a de novo bank, Abound Resources offers both advisory services and web-based solutions that can meet most any need and budget.

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About Abound Resources’ Business Banking and Cash Management Practice

Abound’s Certified Treasury Professionals (CTPs) provide complete cash management and treasury management consulting services to help you compete with the big banks and increase commercial deposits, improve fee income and lower your cost of funds. Abound’s services include:

- Assessments of your current cash management products and programs including mystery shopping.
- Cash management improvement recommendations and business line marketing plans.
- Selecting vendors and negotiating contracts for Internet cash management systems, merchant capture systems, wire systems, lockbox systems and services, merchant services, etc.
- System implementation assistance including customer communication strategies and materials
- Product development, packaging, pricing, marketing and sales training
- Account analysis and product training for lenders and other bank personnel
- Ongoing product management strategy and research including product and pricing trends.