Crossing the Balance Sheet

Meeting the Challenge of Designing and Implementing a Cross-Selling Initiative between Capital Market and Credit Market Teams.

A UNC Kenan-Flagler Business School White Paper

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Executive Summary:

Competition in the financial services marketplace has created a customer that is more expensive to acquire, much harder to keep, and less profitable when they stay, forcing banks and financial services institutions to rapidly invest in their vision of a future that is built on the effective collaboration among internal divisions and their external partnerships. This vision, when fulfilled, should lead to the development of product solutions that meet both the anticipated and unanticipated needs of the customer, expanding the customer's relationship with the institution while simultaneously improving customer retention rates and increasing the institution's overall profitability.

In this paper, we'll take a look at the conditions that have led to the current environment. We'll explore the reasons that cross-selling efforts often fail to live up to expectations, examine the past and present ways institutions have defined 'cross-selling' initiatives, and compare those to some of the more highly integrated solutions being envisioned today – in what we call 'cross-balance-sheet' selling. These 'cross-balance-sheet' relationships are binding and productive referral partnerships between such unlikely candidates as insurance agents and Realtors, or mortgage brokers and financial advisors. In addition, we'll discuss the core actions an institution must take to ensure cross-selling success; including specific ways to motivate financial advisors to increase their level of cross-selling when helping their clients meet financial goals.

The Changing Landscape

Banks and financial services institutions have long sought to shed the shackles of the Glass-Steagall Act, which inhibited cross-selling opportunities and limited the institutions' long-term profitability potential. As regulatory restrictions were slowly being lifted during the 1990's the United States experienced an unprecedented long-term rally in both the equity and debt markets, delivering record profits to the banking and financial services industry. During this boom, financial planning topics became increasingly popular in the United States as the news media repeatedly reminded baby boomers that they weren't adequately prepared for retirement. The financial services industry responded with a host of new services and competitors chasing this demand, from deep-discount Internet brokerages and day-traders to high-end wealth management boutiques.

As the bull market peaked, investors came to expect 20% yearly returns on their investments and projected out a bold new retirement expectation based on the impact this compounding would have on the growth of their savings. Seeing no benefit to a long-term advisor relationship and heeding the call for “diversification” among service providers, customers spread their investments across a dozen no-load mutual funds and/or a handful of brokerage accounts: a recent study conducted by Cerulli Associates found that 96% of high-net-worth clients employ the services of three or more advisors.[1] As the assets spread thin, investment institutions struggled to manage the cost of maintaining accounts. While individual planners, advisors, and wholesalers were making headlines with their mid-six-figure incomes, behind the scenes their institutions were finding it difficult to contain costs while managing high account turnover and increased trading activity with tighter market spreads. With the passing of the Gramm Leach Bliley Act in 1999, Congress tore down the walls separating bankers from insurers and Wall Street institutions, adding fuel to the competitive fire. This action, combined with pressure for greater disclosure requirements, has resulted in fierce downward margin pressure among financial services players. All these factors combined to create an environment where customers were more expensive to acquire, harder to keep, and less profitable when they stayed.

The new century brought a bear market that left many investors sitting on the sidelines while others headed for the exits. As a result, banks and other financial services companies’ aspirations for double-digit revenue growth has been supplanted by cost cutting and risk management initiatives designed to stem double-digit losses: profits at publicly traded NYSE institutions have fallen from $16.2 Billion in 2000 to $5.2 Billion in 2002.[2] While most expect the equity markets will inevitably rebound, individual investors today seek greater personalization and value from their financial services providers than they did in the past. The cost of acquiring customers continues to rise, and margins continue to be squeezed as differentiation becomes more elusive. To compete effectively, institutions must become more aware of the changing landscape of the consumer market and offer the integrated advice that customers most highly value in their relationships with financial services providers.

Throughout bull and bear markets alike, banks, wire houses, discounters, and other financial services institutions that formerly relied on unique product lineups to attract customers have found it more difficult to differentiate their offerings from those of their competitors. Looking for ways to make customers more profitable and loyal, financial services companies have continued their efforts to acquire a diversified product line and cross-sell it to their customers. As financial advisors solicit investors to swap their bank CDs for mutual funds or annuities, banks promote low cost term insurance in their customer statement stuffers to attract potential investors.

The customer has now become accustomed to getting services at a discount, and this expectation is putting price pressure on the institutions’ core products that are important to long-term institutional profitability. Furthermore, the initial ‘cross-selling’ potential of most relationships seems to fall short of the institutions’ expectations for

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[1] Wealth Management Letter, “Talking the Talk, but not Walking the Walk”, 5/28/2003, Vol 2, No. 23
[2] Bloomberg Markets, “Wall Street’s New Rules”, May 2003

customer profitability and long-term customer retention. For example, a source at GE Capital told us that in the late 90's First Union purchased mortgage servicing based on an expected cross selling ratio of 6 new products for each mortgage they serviced, but the actual number ended up closer to 1.2. As a result, the servicing rights ultimately carried a far lower value than that which First Union had initially calculated.

A big reason that First Union's expectations were missed is that the bulk of cross-selling efforts have remained within the various operational silos of many institutions. For example, consider a scenario where a State Farm agent sells life insurance to one of their auto insurance customers. Is this *really* a "cross" sale, or is it simply an extension of the same product line? When a Wells Fargo loan officer sells a home equity line to a new homebuyer at closing, or if a Wachovia Private Customer Services rep converts a CD to a mutual fund, is this a "cross" sale or simply product proliferation? The answer, as you may have guessed, depends on the context of the sale, on the advice that was delivered in conjunction with the product sale, and the value that was added to the customer relationship through the new product.

The fact is that the simple *offering* of these products isn't enough to keep customers from shopping: in many cases it stimulates the customer to shop further as they view each product as a specific commodity available at all institutions. Although these institutions may present a comprehensive product line to their customers, most are not integrating the products at the point of need, in a compelling manner that truly highlights a specific solution to the needs of the customer. In the end, the resulting intra-silo cross-selling fails to tap into the full profit potential of a customer, fails to deliver compelling value to the customer, and most importantly accomplishes little in the way of transforming the traditional, functionally-oriented customer relationship into something substantially more meaningful or beneficial.

Cross-Selling - The Elusive Holy Grail

Despite the time, effort, and money that the industry has dedicated to improving its cross-selling performance, most institutions continue to struggle at developing their non-traditional product lines. Cross-selling was recently dubbed "the Holy Grail" by Wachovia CEO Ken Thompson[3] – and it has proven to be just as elusive. With the exception of Merrill Lynch, which originated over $20 Billion in mortgages in 2002 (roughly $1.6 million per advisor), traditional financial services companies have struggled to gain critical mass in residential mortgage lending, which is arguably the single-most lucrative cross-selling opportunity from a long-term customer relationship perspective. "We feel the mortgage loan is a core consumer product…it's a high-trust product [and] it gives you an opportunity to provide a lot of counseling", says Mark Oman, chairman of the residential mortgage division at Wells Fargo.[4]

[3] G. Kennedy Thompson, speech at UNC Kenan-Flagler Business School, April 1, 2003
[4] "Why Wells Likes Mortgages", Mortgage Banking, p.23, June 2002

For example, Wachovia Securities - a *bank-owned* brokerage firm - originated just $1 Billion of residential mortgages in 2002, or roughly $125,000 per advisor. Even more noteworthy is the fact that Wachovia Securities' modest results are far superior to most of their brokerage peers. This sluggish performance applies equally well in reverse, as banks have had a similarly difficult time trying to cross-sell asset management products to their mortgage and credit customers. A recent study by the Gartner Group found that, while 74 percent of companies say they are cross-selling to customers, 70 to 90 percent of all cross-sale efforts fail.[5] Why is this the case when companies are dedicating so many resources to improving their cross-selling competencies?

Why Cross-Selling Fails

The reason many institutions fail to cross-sell effectively can be boiled down into three main weaknesses. First, institutions find it difficult to implement cross-selling across traditional business silos. Second, the flow of information is fragmented between the customer, the institution, and the institution's agent, so these parties are not thoroughly communicating the information that is necessary to enable the institution to optimally help customers reach their financial goals. Third, core corporate policies and support services are not sufficiently developed in a cohesive, integrated manner to best facilitate cross-selling efforts. Each of these issues is discussed in detail below.

Isolated Operational Silos

Despite efforts to encourage collaboration, the operational silos of the past are stubbornly holding their ground. While macro-level cross-selling statistics may have improved, individual bankers, agents, and brokers are still sticking to what they know best. Many transactions that are categorized as cross-selling activities are in reality nothing more than intra-silo product proliferation. A report by the American Banker's Association recently noted that, "Banks traditionally have not done as much cross-selling with their mortgage customers…because mortgages have come from a different part of the retail bank."[6] Selling more products to a single customer clearly *can* be good for the customer and the institution offering the products, but when a product comes from within the same silo of operation, is it simply a translative offering – moving one product to another place within the bank – or a transformative customer experience - one where the offering dramatically changes the context and character of the relationship?

Before developing specific cross-selling initiatives, institutions must first clearly articulate the goal of these initiatives and carefully define how the results will be measured so that the metrics used truly reflect the results of the cross-selling *in terms of the institution's end goals*. For example, many institutions measure cross-

[5] "Cross-Selling Software Boosts Bank Marketing", Bank Marketing International, January 22, 2003
[6] "Cross-Selling to Your Mortgage Customers", Bank Marketing, January/February 2001

selling in terms of the number of products they cross-sell to the customer (frequently referred to as the cross-sell ratio), establish quotas for their employees and managers, and set bonus targets based on this quantitative measurement.
By closely monitoring employee activities and pushing for cross-sell productivity, these institutions have inadvertently discouraged employees from engaging in customer service activities that don't directly produce a sale. By doing so, institutions create an environment where employees are reluctant to spend time resolving a customer problem that arises after the sale, leading to a decrease in customer satisfaction and loyalty.

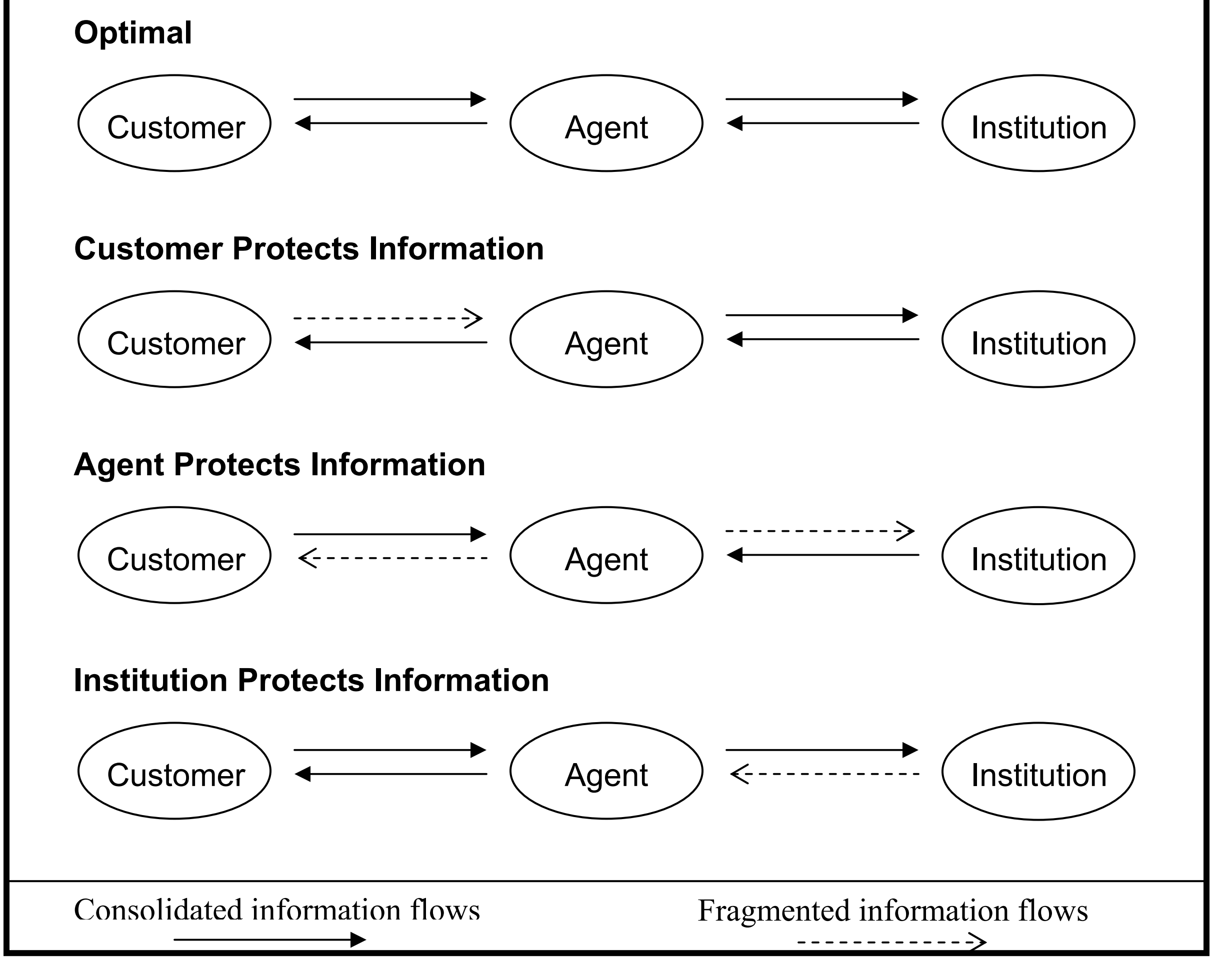
Each institution will evaluate the goals of its cross-selling uniquely, and therefore must recognize that one homogenous cross-selling strategy does not apply to all firms. Using the example above, if the institution's end goal is to increase customer loyalty and long-term profitability, and cross-selling is the means to this end, both quantitative *and* qualitative measurements must be introduced to ensure that the customer's needs are not only being met, but at the level of service quality they expect as well. Additionally, cross-selling effectiveness should not be measured solely in terms of products per customer, but in terms of providing the "right" additional products that specifically address the customer's most timely and critical needs. They must integrate each product offering into a comprehensive plan that assures the customer that they are making an educated decision relevant to their long term financial and life goals.

Making a translative sale, such as selling a CD to a mutual fund customer, might increase the institution's cross-sell ratio, but it has little impact on the customer relationship if the customer owns a high-rate mortgage and the institution misses the opportunity to save the customer money through refinancing. A proactive recommendation such as this would represent a transformative sale where the institution provides timely and critical financial advice that the customer highly values, transforming the customer-vendor relationship into a deeper "financial partnership".

Fragmented Information Chains

In recent years manufacturing organizations have dedicated a substantial amount of labor and capital towards improving their supply chains. The financial services industry has also worked to improve its supply chain, but here the supply chain consists of funds, services, and information rather than physical goods. Inventory sits not in warehouses (traditional supply chain) but in a file cabinet or computer (information chain), in the form of customer information that may or may not be efficiently distributed to the business silos where it can become productive. In financial services, information typically flows between three entities: the customer, the institution, and the agent who represents the institution while interacting with the customer (stockbroker, loan officer, teller, customer service representative, etc). This three-way information chain introduces the opportunity for information to be lost, underutilized, or concealed by any one of the entities, resulting in fragmentation of the information chain. This fragmentation results in inefficiencies that cause a decrease in customer service levels, unmet customer demand (i.e. lost business opportunities), and lost revenues to the institution. Figure 1 depicts the fragmentation that occurs when one of the members of the information chain protects, loses, or underutilizes information from the other members.

Figure 1: Fragmented Information Supply Chains



As the figure illustrates, fragmentation in the information chain results in the obstruction of information flows to the other members of the chain. When the customer withholds information, the agent and the institution are unable to adequately deliver the advice and optimal financial solutions to meet the customer's needs. When the agent protects, loses, or underutilizes information, the institution fails to acquire information about the customer and as a result fails to deliver optimal solutions in return. For example, the agent might not list the customer's mortgage rate in the institutional database, thus prohibiting the institution from monitoring rates on the customer's behalf and identifying a refinancing opportunity on a timely basis. Alternatively, the institution might offer special relationship pricing to customers who have their mortgage with the institution, but if the agent fails to inform the customer of this savings opportunity the customer is unable to take advantage of this benefit.

Finally, when the institution protects or underutilizes information (for example, the mortgage division does not provide client-authorized financial information to the investment division), it constrains the agent's ability to present optimal advice and integrated product solutions to the client. In all of these situations, the client ends up with sub-optimal financial advice and products, and the agent and institution directly or indirectly lose revenue. Note that this model depicts only one of many service delivery models that exist in the industry. Firms with different models (internet-based, call center based, etc.) will have unique and varying information chains.

There are several reasons why such fragmentation in the information chain occurs. First, geographic barriers may separate the customer, the agent, and the many independent business silos of the institution. Whereas a mortgage loan officer in a bank branch can walk over to an account manager to obtain a CD rate or open a checking account for the customer, he or she may not be able to meet with an investment advisor who sits in a different office.

Second, the institution's agent might protect or hoard information for one of the many reasons that are described below under "the challenge for institutions". The agent (such as a financial advisor) might feel the need to preserve the independence of his customer relationships and therefore hoard client information in order to increase the likelihood a customer would follow him if he should ever decide to switch employers. Alternatively, the advisor might fail to present products to the client because of his own personal aversion to the product or negative compensation ramifications. In both cases, this attempt by an advisor to hoard customer or institutional information can backfire on him, resulting in an unsatisfied customer who then begins the search for a new financial services provider who can better meet their needs. Again, the damage caused by fragmentation of the information chain impacts all parties negatively.

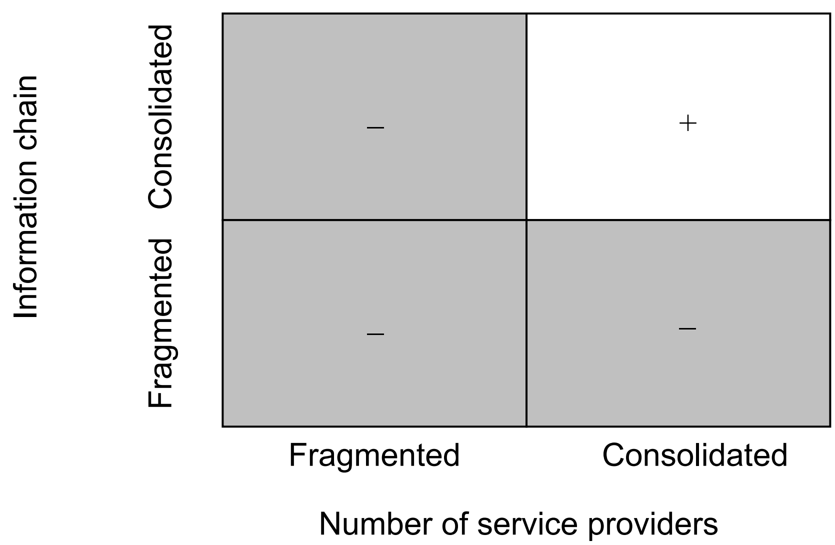
A fourth cause of chain fragmentation occurs when business silos within the institution hoard client information. Again, there are many reasons why this could happen. One might be an incompatibility of legacy systems in various silos that prohibit the transfer of this data. A second possible reason is that a dominant silo in the institution might feel the need to protect lucrative customer relationships from risks that could arise by introducing the customer to other silos. For example, the investment banking arm of an institution might be reluctant to refer a corporate client to another division because the banking unit fears that its control of the relationship could be diminished through the introduction of new services to the customer. Third, the transfer of information between silos could be fragmented because of "language" barriers – differences in terminology between the silos. In our interview with Randolph J. Cary, President and CEO of Mid-Carolina Bank in Burlington, NC, he noted that his lending officers "speak their own language" compared to other professionals in the bank.[7] Although Mid-Carolina's silos have been able to overcome this language barrier to deliver client-focused results, this is frequently not the case among larger institutions. The convergence of the credit and capital

[7] Interview with Randolph J. Cary, President and CEO of Mid-Carolina bank, 5/15/2003

markets has necessitated that terms such as “rate” and “qualified” be redefined to encompass a broader range of meaning when loan officers and investment advisors collaborate to address customer needs.

Figure 2 shows the adverse effects of information chain fragmentation. When a financial services institution fails to consolidate information chains internally, the value added to customer relationships diminishes. As a result, the customer finds little, if any, benefit from consolidating services with one provider and may find their needs better served by turning to multiple service providers. In this fragmented scenario, all parties are adversely affected.

Figure 2 – Effect of fragmented information chains



Firms must consolidate information chains in order to provide value to customers who consolidate services.

Fortunately for institutions, research has shown that customers prefer to consolidate their services with one provider as long as the services provided are competitive with outside offerings. As a result, institutions remain motivated to improve their information chains, and both parties stand to gain substantial benefit as these information chains consolidate and improve over time. The institutions that can implement improvements fastest will accrue substantial competitive advantages over those that lag.

Misaligned Policies and Support Services

To deliver maximum value to customers through cross-selling, and to reap the rewards of stronger customer satisfaction and increased loyalty that follow, institutions must provide knowledge, tools, and systems to their agents (such as a financial advisors) to enable them to effectively present products in a manner that is relevant to the customer's specific needs. In order to achieve success through cross-selling, institutions must redefine 10 core policies and services to ensure consistency with the institutions' cross-selling end goals:

1. **Organizational focus** – Executive management must clearly define the institution's objectives and communicate these objectives to their management teams and their subordinates. Organizational mission, values, and goals must align with the institution's cross-selling end goals, crossing silos to permeate the organization as a whole.
2. **Organizational and individual performance measurement** – The institution must establish performance measurements that reflect the end goals, not simply means to these goals.
3. **Compensation Policy** – Management and employees should be compensated based on both quantitative and qualitative performance in congruence with the cross-selling end goals.
4. **Motivation** – Recognition programs and incentives should reward cross-selling in a manner that supports the end goals.
5. **Procedures** – Institutional procedures should facilitate cross-selling activities and information flows between business groups, or "silos".
6. **Information technology** – Systems must be established and/or integrated to facilitate the flow of information, products, and capital between the customer, agent, and the institution, *across business silos*. They must also be structured to accurately measure operating performance comprehensively, and in terms relevant to the institution's end cross-selling goals.
7. **Service Delivery** – Products and services must be delivered to the customer in a manner that reinforces the type of relationship the institution desires to achieve with the client. For example, if a product is designed to be sold through an advisor, that advisor must be empowered and encouraged to address any issues that might arise as a result of that product sale. Additionally, information channels should be constructed to facilitate the identification and satisfaction of customer needs. As Mr. Cary noted in our interview, the agent is often faced with the task of resolving differences between the products that the institution is promoting through marketing channels and the products that best address the customer's unique needs.[8]
8. **Support services** – Support mechanisms and financial resources must be allocated in a manner that enhances cross-selling efforts, and must support the agents or systems that execute the cross-selling strategy across silos within a consolidated information chain.
9. **Product offerings** – Products and services should be designed to deliver integrated financial solutions to customers that address their needs in a comprehensive manner. Customer information should be shared across silos to ensure that product solutions provided by various silos are compatible with each other and are consistent with the client's overall financial goals.
10. **Pricing policy** – Product and service pricing should reward clients for loyalty across their balance sheet and between silos. A customer who has a large

[8] Interview with Randolph J. Cary, President and CEO of Mid-Carolina bank, 5/15/2003

relationship within one silo of the institution is valuable to the institution as a whole, and therefore should receive preferred pricing across all services throughout the institution, regardless of whether or not the silo providing a specific service is also the silo that ultimately benefits from the client's enhanced satisfaction and loyalty. Secondary silos should not be penalized for losses or lack of profits that arise from customer discounts designed to reward the important customers from other silos.

Crossing the Balance Sheet

Once an institution has built a strong platform to support its cross-selling initiatives, it must look for ways to sophisticate its cross-selling program in order to forge stronger customer relationships through transformative cross-selling. In this paper, "Crossing the Balance Sheet" describes a sales approach that entails offering combinations of products on both the asset and liability sides of the customer's balance sheet as an integrated solution. This integrated solution meets both the anticipated (translative) and unanticipated (transformative) needs of the customer. This cross-balance-sheet selling across divisional silos might involve collaborative selling between two divisions within a single institution or two separate institutions working in partnership: the challenges are the same through either method. To be successful, true cross-selling must:

- **Add wallet share to the financial institution** – increasing the institution's share of a customer's total spending and increasing the institution's income to a greater extent than expenses are increased, thereby improving customer profitability.

- **De-commoditize the offering** – adding value to the customer relationship beyond a simple product sale, thus reducing the likelihood that the customer will view the service as a commodity. When a similar product is offered for less by a competitor and the firm has not provided added value, the cross-sale can potentially weaken the relationship by inducing a customer to shop rather than strengthening it by inducing the customer not to shop because additional value is perceived ('gas station effect').

- **Increase loyalty** – reducing the likelihood that a customer would risk leaving the relationship to pursue product or service alternatives provided by a competitor because there is much more at stake for the customer than simply a product or service in isolation. By "bundling" a product with advice the institution creates a higher-value customer solution for the same price as the product alone. Such bundling transforms a product sale (expected by the customer) into a comprehensive financial solution (not expected by the customer), offering a better value than a product independently obtained from an alternate provider. Therefore, the client has little incentive to shop.

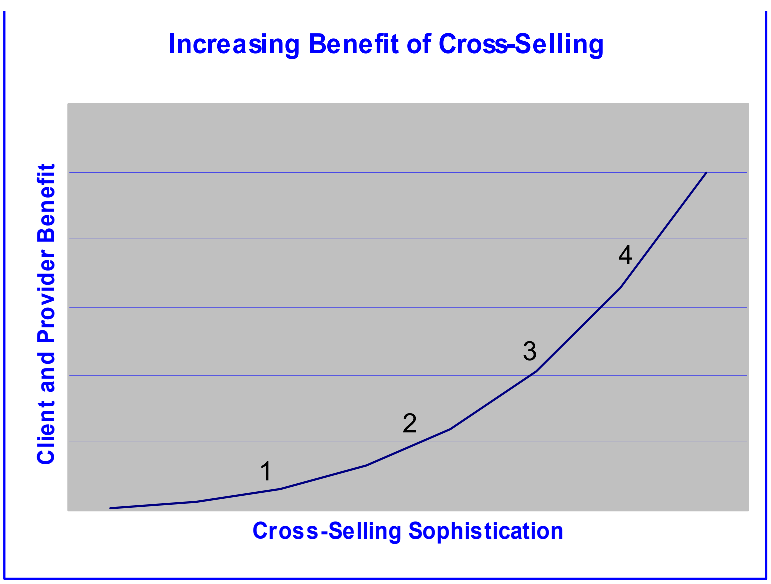
- **Perceptional transformation** – the customer no longer views the institution as a vendor, but a financial partner who can meet their financial needs in their entirety. Due to the consolidated flow of information and the institution's ability to deliver an integrated financial-life solution to the customer, the customer no longer perceives the institution as a "lending" expert or "investment" expert but as a "financial solutions" expert who can meet all the customer's financial needs regardless of product category or business silo.

To accomplish these goals, aspects of the transaction for the customer must move outside operational silos and *cross the balance sheet* to clearly address both the customer's asset management and credit management needs in relation to their overall financial life goals.

Four Levels of Cross-Selling

The return a financial institution receives on its cross-selling efforts increases exponentially as each of the above goals is met. Each goal represents a deeper and more meaningful level of impact on the customer – and is a direct result of effort placed on the integration of the product cross-over between the operational divisions. Additional long term cultural changes within the institution will ultimately result as divisional silos find a way to work together in this process and the organizational structure moves from a pure product orientation to *product solution* or *relationship* orientation.

Figure 3 - the customer and provider benefit at various levels of cross-selling.



Level 1: Add Wallet Share: Increase the profitability of a customer
Level 2: 'De-commoditize': Provide value that is highly visible and unique
Level 3: Increase Loyalty: Improve customer satisfaction and retention
Level 4: Transform Customer Perception: from product vendor to 'financial partner'

Figure 3 on the previous page illustrates the exponential growth of institutional and customer benefit at four increasingly more sophisticated levels of cross-selling, represented by the goals we have discussed. As we look at figure 3, let's consider an example to illustrate these 4 levels of cross-selling. The example begins with a customer who is obtaining a mortgage refinance.

Level 1: Wallet Share

At level 1, the institution introduces a new product into the customer relationship, increasing the profitability of the customer to the extent of incremental revenue minus incremental cost. In this example, we'll use a typical 'intra-silo' cross-sale where a customer is being sold a home equity line of credit with their mortgage. The customer's initial motivation for doing business with the institution might encompass convenience (due to the existing mortgage relationship) and transaction cost savings (due to the operational efficiencies of selling two products simultaneously). No new specific customer needs are identified or met, but the institution has positioned itself to benefit from future customer needs as they arise and/or as customer identifies them independently. To move this customer beyond Level 1 we must answer the following questions:

- *How does the customer know they chose the best mortgage for their needs? Was this clear to them at the close of the transaction?*
- *Was the product choice part of something larger than an individual product decision? Is there an emotional benefit being provided? Does the product choice enable the satisfaction of other needs?*
- *Were the savings and benefits highly visible?*
- *Was the ultimate product sale a commodity that could decrease customer satisfaction if they found the same product offering from a competing lender at a lower price the following day?*
- *Did the integration of the cross-sell initiative lead to a relationship that would be difficult to recreate by a competitor (thus de-commoditizing the offering)?*

Level 2: De-commoditize

At level 2, the institution creates value by combining the product sale with advice to create a financial *solution* for the client. In our example, the loan officer now recommends the consolidation of credit card balances or other consumer loans using the new equity line. Here, the institution begins to address customer needs that were previously unknown by explaining how the equity line can be used to address specific needs that have been identified through interaction with the customer. In doing so, the institution exceeds the customer's initial expectation and provides incentive for the client to consolidate their financial services rather than shop each transaction independently among various providers.

If we were to stop here, the institution would realize increased profit and the customer would realize financial benefits beyond pricing to include savings related to improvements in their personal financial strategy as a result of the institution's advice. Essentially, the institution has bundled two services – the product and the added advice – to create a bundled solution that provides greater value to the customer at no extra cost. Both parties are now marginally better off than at level one, and in many cases today the cross-selling ends here. However, with further nurturing and if reinforced through strong customer service, effective crisis resolution (when applicable), and consultative follow-through by the institution's agent, this relationship can evolve to level 3.

Level 3: Improved Customer Loyalty and Retention

At level 3, the customer has now received an integrated product and advice solution coupled with quality personal service. As a result, the customer experiences enhanced financial and emotional benefits. The complexity of the relationship and the information that the company and customer have exchanged during the process now makes it more difficult for a competitor to offer a comparable solution in the open market, moving us through Level 3 by increasing the loyalty of the customer and the likelihood that the institution will retain the customer's business going forward. The customer is invested now in an outcome rather than a stand-alone product, and both the customer and the institution have begun to realize the long-term benefits of their relationship (the customer can obtain customized products and advice that meet *unknown* needs while the institution can increase revenues with very little incremental cost). At this point, the relationship is ready to move to level 4.

Level 4: Perceptual Transformation

Level 4 is what we consider to be Ken Thompson's "holy grail" of cross-selling: or what we have referred to as 'Cross-Balance-Sheet' selling. When the institution is able to offer integrated financial solutions that cross silos and incorporate both the customer's assets and liabilities into one consolidated solution, the customer's perception of the institution evolves from that of a product provider to that of a financial partner. The ABA has noted that, "When the mortgage is closed…your new mortgage customer has built a relationship with your mortgage loan officer and trusts him as a representative of your bank. Training your mortgage officers about your deposit accounts allows them to sell products appropriate to the customer's life stage."[9] Consider our original example, with the following solution that changes the scenario from a level 1 product cross-sell to a level 4 cross-balance-sheet sale:

> *After the equity line application is secured, the customer is referred to a financial advisor who illustrates strategies for employing the equity line for the customer to accomplish goals they discuss in their meeting. In addition, a specific mortgage product is selected based on the optimal allocation of the customer's total free cash flow to achieve both prudent debt reduction and asset accumulation based on the customers spending, savings, education, and retirement goals.*
>
> *In the interview, the advisor demonstrates how the customer might pay off their consumer debt, which is not providing a tax savings to customer and is currently at a much higher interest rate. This increased payment savings and the tax benefits from the payoff of the consumer debt could be used to save for retirement, and would allow the customer to increase their 401-K contributions at work (adding more tax*

[9] "Cross-Selling to Your Mortgage Customers", Bank Marketing, January/February 2001

benefit and allocating cash flow to where is has the greatest long-term benefit). Remaining funds remain available on the equity line as a cash emergency reserve, thereby freeing funds that the customer had previously set aside in a checking account as an emergency reserve to be invested in a mutual fund account towards the customer's goal of buying a beach house when they retire at age 65.

This outcome is dramatically different than merely providing a check to the customer at the closing, and the providing institution thus evolves from a 'vendor' who sells products (an equity line) to a 'partner' that provides something far more beneficial (the outcome of using an equity line to reduce debt, increase tax savings, fund retirement, and create savings plan for future second home). The customer realizes 'highly visible' value from what was initially a simple equity line transaction, moving the customer to Level 4 in the relationship.

The customer benefits through the resolution of three problems: a need to reduce their interest rate (expected), a need to increase their insurance protection (unexpected), and a need to begin savings for their children's college (also unexpected). The customer's perception of the institution is altered through this resolution of identified needs and is transformed from the initial customer perception of the institution as a mortgage lender to the ultimate perception of the institution as a provider of financial solutions for all needs.

In the prior example, the institution created a transformative experience for the customer and provided a more complete cross-sell relationship by integrating not only products, but differing levels of expertise provided by the loan officer and the financial advisor as a team. This highlights the need for institutions to consider whether cross-selling is an end goal in itself, or whether the cross-selling is the means to reach a greater goal of increased customer benefit and value.

The increased benefit from the integrated solution provided by an institution who cross-sells *across the balance sheet*, as opposed to an institution who sells an intra-silo credit product, releases the ultimate value that a financial institution can unveil when business silos cooperate to consolidate information flows and improve inter-silo communications to deliver integrated customer solutions. Within this approach to cross-selling lies the key value for customers and their respective financial service institutions willing to invest in taking their cross-selling to this next level. The institutional benefits of "level 4" cross-selling include:

- *Increased income from the sale of multiple new products.*
- *Increase likelihood that customer will remain with institution long term.*
- *Increased likelihood that customer will tell others about their experience, leading to additional referrals for a variety of products (It is conceivable that a referral generated as a result of this experience could lead to a new relationship that begins directly at level 4, versus a traditional referral that begins at the less profitable level 1).*
- *Increased likelihood that additional new products will be purchased in the future.*
- *Increased likelihood that the loan officer will contact the financial advisor in the future to partner in customer transactions.*
- *Increased likelihood that the financial advisor will look for future cross-selling opportunities that they can refer to the loan officer.*

Improving Cross-Selling Competencies

While most full-service financial institutions seek to achieve this level of cross-selling success, many are still measuring their success by the cross-sell ratio.[10] Does this measurement fully assess the institutions cross-selling effectiveness? As we have shown, the impact on institutional and customer benefit is dramatically different for a relationship that involves a mortgage, investment account, and retirement plan than one that involves a checking account, CD, and safe-deposit box.

As an institution's cross-sell ratio of products per customer grows, it becomes increasingly more difficult to maintain the rate of that growth. For example, a checking account customer might be easily convinced to obtain a credit card or buy a CD at the same bank, but once these easy initial sales have been made, additional and more complex sales become increasingly difficult to achieve without a more thoroughly integrated cross-selling strategy. Furthermore, it may be easy to compensate a mortgage loan officer to sell a home equity line of credit to a customer refinancing their home mortgage, but it's an entirely different issue to motivate and train a financial advisor to effectively sell a mortgage solution to his investment clients. The point here is that a firm with a cross-sell ratio of 3, achieved by giving every client a credit card, could be at a substantial evolutionary and strategic disadvantage from another firm that also has a cross-sell ratio of 3 but is more profitable and is rapidly on its way to a ratio of 4 or 5 due to a sophisticated cross-balance-sheet sales platform.

Since our focus here has addressed the challenges of capitalizing on the convergence of the capital markets and credit markets, we'll further refine our focus to study the issues related to stimulating individual financial advisors (capital market team) to refer or cross-sell to a loan officer (credit market team). We'll base this work on both our own research and the practical experiences of KendallTodd, Inc., a company that has been focusing on this particular area since 1991. KendallTodd has worked to identify barriers and obstacles that must be overcome for these divisional silos at both an institutional and a grass roots level to eliminate these obstacles and establish a 'common dialogue' through which silos can refer their respective customers.

The Challenge for Institutions

When Wachovia announced their planned merger of Wachovia Securities with Prudential Securities in February 2003, some industry experts questioned the acquisition because, "Prudential brokers are known for being independent-minded, and they might object to Wachovia's efforts to cross-sell bank products."[11] Prudential's advisors are not unique in this respect. Below, we have outlined eight reasons why a typical financial advisor might be reluctant to refer their customer to a

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[10] "And they said it couldn't be done", ABA Banking Journal, April 2000
[11] "Wachovia brokerage to merge", Raleigh News and Observer, February 20, 2003

loan officer providing mortgage services, and how the financial institution can work to help them view the referral as an opportunity rather than a threat:

1) **Challenge**: Financial advisors are worried that a credit decision (which they have no control over) will impact their customer relationships. This perceived risk is not worth the perceived return. According to the ABA's *Bank Marketing*, "[brokers] are fearful of putting at-risk their advisory stature with clients for the sake of proprietary product-pushing."[12]
   Actions: The institution must help the advisor:
   - Manage client expectations effectively
   - Perceive the risk differently, as something that they can manage through active involvement in the transaction (rather than acting as an innocent bystander, or "victim", when an adverse decision occurs).
   - Alter their view on the potential rewards of the transaction, identifying the specific benefits of a "level 4" cross-selling relationship.

2) **Challenge**: Financial Advisors don't feel the compensation for a mortgage referral is enough to justify the risk or the work involved, and would rather refer the customer to a mortgage lender capable of referring customers back to them in the future.
   Actions: The institution must help the advisor:
   - View their compensation in terms of the long term relationship, not solely the immediate transaction value.
   - Illustrate how the immediate compensation value might be meaningful if they learn how to incorporate other product sales to this transaction through the implementation of an integrated cross-balance-sheet sales approach.
   - Consider the risk of giving a customer's financial information to another institution that will cross sell other services, despite any assurances to the contrary made by a lending officer.
   - Consider the value of the increased flow of customer referrals that will follow from a successful mortgage closing.
   - Consider the potential additional sales that will be uncovered through the relationship building that comes with helping the customer capitalize on credit-based needs to fulfill capital-based needs, and vice-versa.

3) **Challenge**: Advisors are accustomed to assessing a week's productivity by reviewing the following Monday's commission report. Or, as the ABA puts it, "Brokers are used to being paid in the same month they present a product to their client."[13] As a result, advisors frequently have difficulty associating the commission for a mortgage with the work involved to generate the sale, and would rather spend their time on an activity that will impact tomorrow's commission report.

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[12] "Is the Cross-Selling Real After a Bank-Brokerage Merger?" ABA Bank Marketing, October 2001
[13] "Is the Cross-Selling Real After a Bank-Brokerage Merger?" ABA Bank Marketing, October 2001

Actions: The institution must help the advisor:

- Think longer-term and view compensation on a relationship basis.
- Understand that consistent cross-selling will create an annuitization of commission revenues.
- Understand that broader customer relationships will lead to bigger overall commissions, less client turnover, new customers, etc.
- Realize that mortgage commissions can help stabilize choppy trading commissions and smooth the impact of economic and market cycles.

4) **Challenge**: Advisors don't feel that it's their responsibility to advise their customers about a mortgage.
   Actions: The institution must help the advisor:
   - Understand that customer satisfaction and loyalty are grounded in how well the advisor is meeting all their financial needs.
   - Realize that a customer relationship on investment performance is a roller-coaster proposition tied to the market. When the market goes down, so do rates, providing an opportunity for the advisor to provide significant value to the customer.
   - Understand that providing advice on non-investment products helps diversify the relationship and de-commoditizes the services being offered, differentiating the advisor from investment-only service providers and further increasing chances of customer retention.

5) **Challenge**: The advisor may not have integrated a comprehensive range of products into his customer communication.
   Actions: The institution must:
   - Help the advisor develop a way to communicate the value of the new products the advisor can offer.
   - Provide approved marketing and education tools the advisor can use to increase their confidence.

6) **Challenge**: The advisor may not possess the product knowledge to effectively present mortgage solutions.
   Actions: "Firms have recognized that in order to keep and grow assets they must invest more money in the financial consultant who will need better technology to do the advisory work well."[14] The institution must help the advisor:
   - Understand the similarities and differences between the capital and credit markets.
   - Take advantage of institutional analysis and presentation tools to help present lending recommendations.
   - Set basic expectations on how the advisor will be involved in the lending process as an advisor and advocate, as opposed to a lender.

[14] "The Future of the Industry" ,Registered Rep., January 1, 2003

7) **Challenge**: Advisors find it difficult to discuss loan products that often are packaged to their customer with rates and fees that fluctuate differently than their typical product sales.
   Actions: The institution must help the advisor by:
   - Providing an effective tool to illustrate the factors that the customer might consider related to rates and fees, or provide a simple 'best deal' guarantee.
   - Providing tools to help the advisor profile customer needs and present unique solutions without necessitating a great deal of training or using industry-specific jargon.

8) **Challenge**: Advisors typically avoid the lending business because they're afraid of having to dedicate a large amount of time to the sales, application and approval processes involved with a mortgage or other loan. In the words of James Gorman, Chairman of Merrill Lynch Private Client Group, the, "DNA of the industry has been sales, and service has been an afterthought."[15]
   Actions: The institution must help the advisor:
   - Understand their role as a referral source to an internal third party, and become comfortable with entrusting their clients to other capable professionals.
   - Stay focused in their capacity as a *financial advisor* and not simply an *investment advisor*.

9) **Challenge**: Advisors who have a bad lending experience will be reluctant to pursue cross-selling efforts for an extended period of time.
   Actions: The institution must help the advisor:
   - Recover from a bad lending experience through education, communication, and motivational resuscitation.
   - Define the lengths it is willing to go to make this a positive experience for them and their customers.
   - Believe that they understand the importance of those customer relationships and are willing to stand behind advisors when they embark on this process.

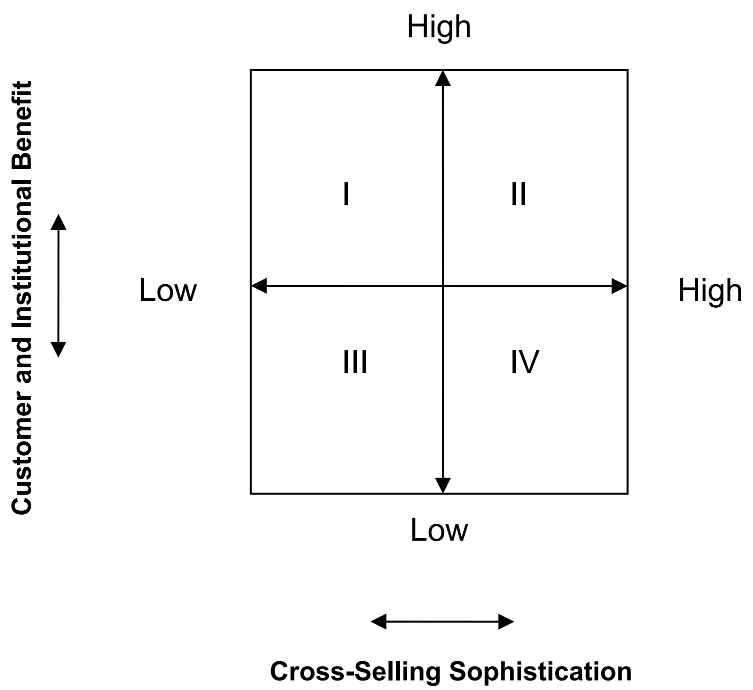
A Future of Collaboration?

At the outset of this paper, we discussed how the financial services industry has been investing in a future based on the effective collaboration of their internal divisions and their external partnerships. What will be the outcome of this scenario? Figure 4 on the following page shows four outcomes based on varying levels of 1) the sophistication of an individual institution's cross-selling initiatives, and 2) the individual provider and customer benefit that is ultimately gained from these initiatives. The outcomes are designed to reflect the experience of a specific institution rather than the industry as a whole. Below, we have discussed a

[15] "The Future of the Industry", Registered Rep., January 1, 2003

description of these four outcomes, the likelihood of each outcome becoming reality, and the implications for the institution and customer in each.

Figure 4 – potential future cross-selling outcomes



Outcome I – Low cross-selling sophistication,
High customer and institutional benefit

In outcome I, institutions fail to develop more advanced cross-selling strategies but nevertheless both the institution and its customers gain greater benefit. Under this outcome, clients would become increasingly loyal and more profitable despite the fact that institutions are not offering better integrated cross-selling solutions. In this situation, the benefits would derive from sources other than cross-selling sophistication, such as privacy concerns that lead customers to prefer dealing with only one provider. Although this scenario would be a pleasant outcome for all parties, it is *highly unlikely*. Without more sophisticated cross-selling strategies and the accompanying value-added advice, products will continue to become further commoditized and institution-customer relationships cannot realistically evolve beyond the simple product cross-selling found in “level 1” discussed earlier.

Outcome II – High cross-selling sophistication,
High customer and provider benefit

Outcome II could be considered the ultimate institutional goal, where cross-selling is occurring culturally within the organization, information flows are consolidated, and everyone from upper management to line personnel see the integration as part of their service to the customer. Systems, tools, and training continue to provide a foundation that reinforces the development of products and services between all divisional silos within the organization, improving pricing power, customer loyalty, and profitability while the benefits of a fully-integrated financial strategy dramatically benefits customers. In this outcome the majority of customers eventually move to Level 4 in our Cross-Selling sophistication scale. The tremendous benefits that the institution and its customers would reap as a result of this level of sophistication will compel institutions to work towards this outcome: however, only time will tell how well institutions can execute their cross-selling strategy. It is likely that those who fail to stay "ahead of the curve" will eventually no longer be legitimate competitors in the financial services marketplace of the future.

Outcome III – Low cross-selling sophistication,
Low customer and provider benefit

Outcome III may be the default starting point for most institutions due to either the limited time that cross-selling has been a priority or the limited resources the institution has made available for this endeavor. In addition, those companies who are not able to achieve the cross-selling competencies necessary to realize outcome II may find themselves in outcome III as a result. In this scenario, institutions either do not attempt to improve cross-selling strategies, are unable to create a viable cross-sell strategy, or find themselves unable to successfully implement a cross-selling strategy once it has been developed. This outcome represents the historical status of the industry, but as stronger companies evolve in their cross-selling strategy, competitive pressures will make cross-selling improvements a strategic imperative for all institutions, and they will no longer be able to survive if they do not evolve. It also represents those institutions that pursue a low-cost, no-frills business model that will find a niche of customers who do not want advice.

As we have described, there are numerous opportunities to improve cross-selling sophistication at many levels, so at minimum institutions should be able to achieve marginal improvements in their cross-selling strategy over time by mimicking the initiatives of successful institutions. Full-service institutions that fail to invest in their cross-selling strategy will ultimately lose substantial market share to those who do, and if these firms cannot control costs to compete with discounters they will prove unviable.

Outcome IV – High cross-selling sophistication,
Low customer and provider benefit

Outcome IV might result from an institution investing heavily in technology, but not in training for employees who must bridge the products and services. Substantial improvements to their cross-selling strategies are made, but customers do not see and feel the visible benefit from these strategies and in their eyes the products and services remain commodities. The machine works, but it has no soul. The institution would see moderately improved profitability as some customers benefit on an isolated basis, but overall would be unlikely to retain customer at the same level as a competitor. In this outcome, institutional profitability would suffer as they fail to gain advantages from their investments.

The Final Outcome

We would hope this paper highlights the urgency with which institutions must invest their attention and resources towards the implementation of a clear cross-selling strategy to meet their customer's financial needs. As a result, those institutions should clearly see a payoff through increased wallet share, a de-commoditization of their product offerings, increased customer loyalty leading to greater client retention, and an evolution of customers' perception of the institution from that of vendor to that of financial partner. Ultimately, the institutions that fail to pursue more sophisticated cross-selling strategies may find themselves in a weak competitive position long-term and relegated to a small consumer niche or market segment where revenue and market share are inherently limited.

It is inevitable that some institutions will achieve Outcome II above, so institutions that desire a share of the full-service market must be diligent in their efforts to align support systems and implement an effective cross-selling strategy. The ultimate payoff for the elite group of institutions who achieve Outcome II will be rich product and service sets that meet their customers' needs in such a way that few customers would risk migration to a competitor. This customer stability and frequency of income-producing transactions could establish for the institution a typical customer that is *less* expensive to acquire, *much* easier to keep, and a great deal *more* profitable when they stay.

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Ian Patrick spent 10 years in Merrill Lynch's consumer lending division, Merrill Lynch Credit Corporation. Over the first three years, he rotated among several functions within the firm including sales, marketing, processing, and secondary marketing while participating in a management training program. During the subsequent 7 years, Ian left the home office to work in Merrill's brokerage offices in the New England and Chicago markets as a Mortgage and Credit Specialist where he specialized in training and motivating Financial Advisors to cross-sell lending products such as residential mortgages, home equity loans, commercial real estate loans, and securities-based lines of credit to the firm's investment and asset management clients by providing integrated, planning-based solutions that enabled clients to reach their overall financial goals. Ian is currently pursuing his MBA degree at the University of North Carolina's Kenan-Flagler Business School.

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