



# RELATIONSHIP VALUE and THE ART OF LENDING

## HOW COMMERCIAL BANKS CAN PUT AN END TO MINDLESS DISCOUNTING AND CAPTURE THE TRUE VALUE OF THEIR PRODUCTS AND SERVICES

By *Kevin McCabe*

STRATEGIC PRICING GROUP  
A MEMBER OF MONITOR GROUP

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### **Commodity or Not?**

Is commercial credit a commodity? For many in the financial services world, it is. This view has led to some remarkable behaviors in the market by both bankers and their customers, and this behavior is destroying value.

Why is this happening with commercial credit?

*First*, credit deal structures rarely have competitive staying power. Today's credit terms can be easily shopped around to competitors before a deal is closed – a practice called “closing the file.”

*Second*, banks reinforce a commodity view in the market through widespread ad-hoc discounting practices and marketing and sales incentives. This drives behavior that is viewed by customers as product pushing.

*Third*, there are gaps between what customers most value from banks (e.g. access to working capital) and the banking industry's relentless focus on cross-selling more products to their customer base.

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The net effect has been that the most valued part of the offer (the credit) has become the most commoditized and discounted. Customers have been taught to negotiate credit terms because they'll usually get a better deal. As a result, banks are looking at a significant portion of their assets tied up in underperforming loan portfolios and a commodity mindset shared by both bankers and customers that prevents the breaking of the cycle.

A different approach is now required. By developing a deeper understanding of the

key elements of relationship value, and aligning offerings to match this value, banks can take the necessary steps to reverse the commodity view of credit and capture higher profits.

### **Relationship Value – What Is It?**

Most commercial banks (and banking executives) believe that strong customer relationships are central to their long-term success. But while banks talk about the tremendous value of relationship banking, most have not been able to measure its value or capture it in their prices.

Relationships only exist when customers say so. Relationships are complex interactions that form the intangible glue of your value proposition.

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While complex and multidimensional, banking relationships (at their core) can be boiled down into three critical elements:

- Knowledge
- Trust
- Flawless Delivery

### **Knowledge**

All too often, bankers interpret knowledge to mean deep product knowledge or strong credit skills. While surely important for a successful career in banking, these skills are focused on the product and, taken alone, are of limited value to a customer (especially to one who considers credit a commodity!).

Building strong relationships means developing an understanding of your customer’s business and his most pressing issues, such as:

- How does your customer really make money?

- Where are dollars best invested to drive revenues or reduce costs?
- How will competition and industry events impact overall profitability?

In short, customers value what their bankers know about their business and not what products and services are on sale. To build relationships that customers value, you need to go beyond the basics and become trusted advisors. This means demonstrating superior business knowledge of your customer’s situation and then using that knowledge to offer banking solutions that drive revenue and profit.

### **Trust**

Customers care about intent and want to know that you’re working in their best interest. For most banking customers, access to working capital (to fund operations, expansions, or unplanned hurdles) is their primary concern. Customers need access to capital at critical points in the life of their business. They want to know that you’re there when times are bad as well as when they’re good. If they believe this to be the case, they will pay a premium to keep the relationship intact. This trust is earned over time and needs to be re-earned every day.

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### **Flawless Delivery**

Knowledge and trust need to manifest themselves into actions. In building a banking relationship, it is not about the terms of the deal, but how you deal with the terms. Customers value accessibility, reliability and speed. Providing flawless delivery not only reduces uncertainty, but it’s often the critical element in the ultimate success or failure of a customer’s business.

### **Bringing it all together**

By focusing on relationship value (and not discounting policies, cross-selling schemes, and marketing gimmicks), you can drive both revenue and profitability. Our research indicates that the application of a value-based approach can add from *25 basis points* to as much as *100 basis points* in customer profitability. Importantly, this approach drives customer loyalty and separates you from the pack.

#### **Case Study:**

A US-based service company recently closed \$120 million in financing for an international acquisition. Bank A, a large international bank, presented an offer that just satisfied the customer's immediate request. Bank B, a bank of equal size, added a second term facility to their value-based offer, which clearly indicated the Bank's commitment to the long-term vision of the customer, as well as a deep understanding of the possible challenges of the acquisition. By focusing on relationship value, Bank B won the deal without providing price incentives. The customer made it very clear that Bank B had invested the time to understand the economics of its business model, and that this relationship value had been the deciding factor.

#### **Translate Relationships into Profits**

To lay the groundwork for a value-based approach, banks should:

1. Identify and measure the drivers behind how your customers make money and their underlying costs.
2. Pinpoint strategic opportunities by quantifying the value delivered to different customer segments and mapping it to buying behavior.
3. Arm your sales force with a value story that is tied to how your customers make money and develop communication and negotiation skills that reinforce relationship value.

4. Adjust sales and incentive programs to motivate sales people to address credit product profitability.
5. Institute strict discount policies and processes that are centrally managed, not centrally controlled.

By understanding what customers value in their banking relationship, you have the opportunity to add millions to their bottom line through profitable, organic growth. Properly framed, credit may not be a commodity after all.

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Strategic Pricing Group, a member of Monitor Group, is located in Monitor's Cambridge and Chicago offices. For more information, visit [www.strategicpricinggroup.com](http://www.strategicpricinggroup.com).

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