COMMENTARY

SALES FORCE EFFECTIVENESS

How to Balance Customer Centricity and Shareholder Value

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June 2017

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For years banks have been using sales performance measures that overweight economic transparency and short-term shareholder return. Ironically, most of these measures were not aligned to shareholder value. This applies not only to how a bank pays its sales force, but also to how they set goals and measures for the overall institution.

The perceived tension between customer centricity and shareholder return (i.e., bank economics) stems from the belief that they are mutually exclusive, as opposed to reinforcing. It is possible to strike a balance between customer centricity and shareholder return. In fact, maximizing shareholder value requires keeping them both in equilibrium.

Current regulatory scrutiny on bank sales practices, as well as challenging economics within the industry, call for a shift in management mindset and sales performance management practices across all business lines, not just retail. In our experience, refining sales practices to be customer-centric and value-focused has led to 20-35% growth in the economic profit in a relatively short period of time, as well as deeper client relationships.

In this paper, we identify five common organizational tendencies that can reduce sales force effectiveness and upset the balance between customer and shareholder value. We also provide observations on what makes an effective, customer-centric sales performance system as well as its benefits, challenges, and avoidable pitfalls.

INTRODUCTION

“Number of products sold per account,” “cross-sell ratios,” and “revenues and/or sales credits per client” are common metrics to evaluate the performance of a bank’s sales force. Unfortunately these metrics are vulnerable to five common “organizational tendencies” which, individually and collectively, can reduce the effectiveness of the sales force, and create potential blind spots when it comes to balancing customer centricity and shareholder value.

Focusing on what is easy to measure versus measures that better align with value.

What is behind it: Practicality. For most institutions, developing relevant measures that align with value (e.g. reflect risk adjusted returns, the cost of liquidity, and client behaviors, amongst others) is a gargantuan task. Data quality and accessibility can be poor, and resources to drive this may be lacking. In addition, some institutions focus on accounting and tax as opposed to economics and risk. Worse, many believe it is not worth the effort to think through what drives value. Hence, they opt for the easier path.

The blind spot: Measuring how your customers contribute to bank value is a critical part of any sales force performance system. Otherwise, you may be catering to a client base that erodes shareholder value or is not a good institutional fit. You may also lose sight of which customers are most valuable, as well as what levers improve the customer value, such as channel management, pricing, amongst others.

Example: “Number of products sold” does not offer insight into the value of a client, nor important behaviors that differentiate economically. Measuring how client relationships contribute to the overall value picture requires a break from the traditional product-led profitability measures.

Placing too much emphasis on company value and not enough on customer value.

What is behind it: The value a bank perceives from a client may be seen as a direct trade-off with the value a bank provides a customer, as if both customer and bank were in a zero sum game. This is a myth.

The blind spot: Banks need to focus not only on extracting value from a customer (e.g., pricing, channel management, cost initiatives), but also on increasing the value they provide to customers. By focusing on this value, banks create satisfaction, loyalty, and build deeper relationships. All of these elements directly contribute to better bank economics and shareholder value in the medium and long term.

Example: Many institutions place limited to no weight on "value to customers" in their sales metrics and omit critical client measures such as satisfaction, and instead focus on "number of products per household" or "profitability per client."

Distinguishing between good growth and bad growth.

What is behind it: With an organizational bias to grow, the sales force role is only about sales and does not distinguish bad growth (uneconomic, wrong fit of product to customer) from good growth (economic, customer values the services). By focusing on any growth, both in the short and long term, banks run the risk of destroying shareholder value through suboptimal economics or customer dissatisfaction. This is especially true in today's environment where industry returns are structurally challenged.

The blind spot: Not all customers are created equal, and in our experience, a good chunk of them are not economically profitable. Understanding what drives value at the customer level can help address growth through product and service offerings, pricing, and channel/service management.

Example: When all sales and growth are rewarded, including unprofitable sales, a much higher percentage of growth is not value creating. When Warren Buffett buys a company, his changes inevitably involve creating value through the elimination of unprofitable sales by changing pricing and/or decision rules for selling.

The long-term is a series of short-terms strung together.

What is behind it: Many banks place too much emphasis on short-term performance and not enough on long-term performance. This is evident when observing strategic planning practices, which are yearly reset exercises for banks.

The blind spot: This approach will ultimately constrain aspirations, investment, and results as an incremental bias that undermines long-term performance.

Example: Many sales performance systems are biased toward being new sales focused vs. retention and long-term, client relationship focused. Rarely, if ever, do sales force performance systems capture growth of balances over time, or lifetime value of client.

Too much top-down (across-the-board) orientation vs. bottom-up (tailored) orientation

What is behind it: It is much easier for banks to set top level, aspirational goals and cascade them down to the sales force than it is to calculate from the bottom-up.

The blind spot: The top-down approach can undermine the strength of incentives and create a distortion between the economic reality of different micro markets, client bases, employee quality and targets. This distortion is most evident when targets used to cascade down represent an across the board increase vs. last year's sales, or any other "pro rata" method. A bottom-up approach can be difficult to calculate and implement, but necessary to match top level targets to market realities.

Example: Reverse engineering the bonus pool from earnings targets does not reflect actual performance and can introduce fragmentation into the system. Allocating a bonus pool to teams also creates a similar fragmented result. When "stretch goals" are not appropriately tailored to the market, customers or employees, this leads to inefficient risk allocation, where the employee shoulders too much risk they have no control over (e.g. from market movements, rate movements, local GDP).

OUR APPROACH TO SALES PERFORMANCE MANAGEMENT SYSTEMS

Common sense rationale

A balanced, value-based, customer-centric performance management system stands on its own because it's the right thing to do, makes business sense, and should be transparent to all.

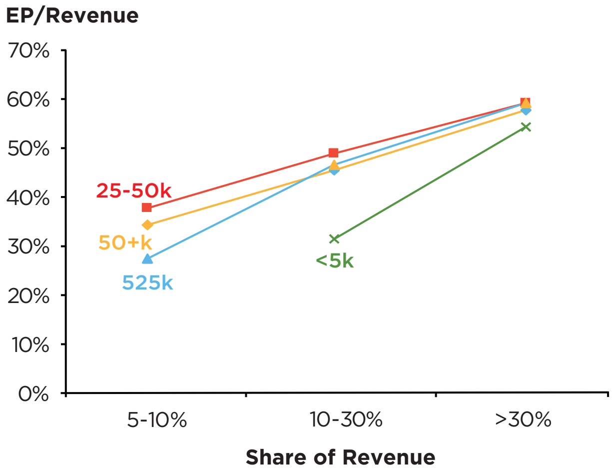
Do the right thing. First and foremost, banks need to keep the best interests of customers at the forefront of any of their decisions and actions—it's a fiduciary responsibility. Increasing customer benefit, not just the value of the customer to the bank, begins with understanding customer behaviors, attitudes, propensities to switch, and willingness to pay. Companies that focus on customer benefit tend to measure and reward the sales force based on the customer's experience by conducting research about customers' behavior and choices. With a better understanding of how to improve the value they deliver to customers and remove costs not valued by customers, the institution can extend customer relationships to areas of distinctive customer benefit. These firms also tend to view organic growth and productivity improvement as highly related.

It's good business. If you keep your customer's best interests at heart and focus on understanding what customers need and value, they reward you with their business and loyalty. Customers that have high degrees of satisfaction with their offerings tend to buy more from the same institution and have longer lasting relationships. For many businesses, the value of a customer relationship is greater than the sum of its individual parts (see Figure 1) as:

- Revenue increases as share of wallet increases, and the ratio of economic profit to revenue increases. (Economic profit is net income minus the dollar cost of liquidity, leverage and capital.)
- Key drivers are customer relationship costs that are fixed, and changes in product mix (that often improve) as relationships expand.
- Customer relationship duration typically increases as share of wallet increases.

What sets an institution apart economically is the ability to understand that the value realized from stronger, longer-lasting relationships is critical to making a range of customer offer, pricing, and investment choices. We have found up to 40 bps differential in deposit-specific funding costs that stem from offering better products to the right customers and aligning the sales force performance management system with the value proposition.

Figure 1: Retail Bank EP Margin and Share of Wallet



Average Performance	5-10%	10-30%	>30%
Revenue/Customer	94	194	606
Cost/Customer	76	105	252
EP/Customer	19	90	354
EP Margin	20%	46%	58%

Source: Marakon analysis

Transparency of what drives value in a client relationship is critical to producing results. In addition to understanding client behaviors and needs, the key ingredients to driving shareholder value are risk, profitability, and growth. If you can't measure how customers contribute to these factors, you are driving blind. While the bank has an obligation to do what is right for the customer, it must not lose sight of the best interests of the shareholder. Hence, moving to a system that does not contain any economic reflection of activity (such as those adopted in the UK) loses sight of this principle.

The balancing act: customer centricity and shareholder value

Our approach to sales performance management systems is deeply rooted in the concepts of "customer centricity" and "value." Customer centricity is not just simply avoiding incentives that may lead to bad behavior. Customer centricity means that the performance management system captures the level of satisfaction and/or the degree to which customer needs and wants have been met by the institution. On the other hand, the concept of "value" ensures that an appropriate economic lens is used to measure and understand client relationships, so as to not lose sight of the return requirements of shareholders.

Bringing the customer and shareholder perspectives together is difficult but essential to building a sustainable, fiduciarily responsible sales performance system. We believe that both concepts positively reinforce each other, as explained earlier in this paper.

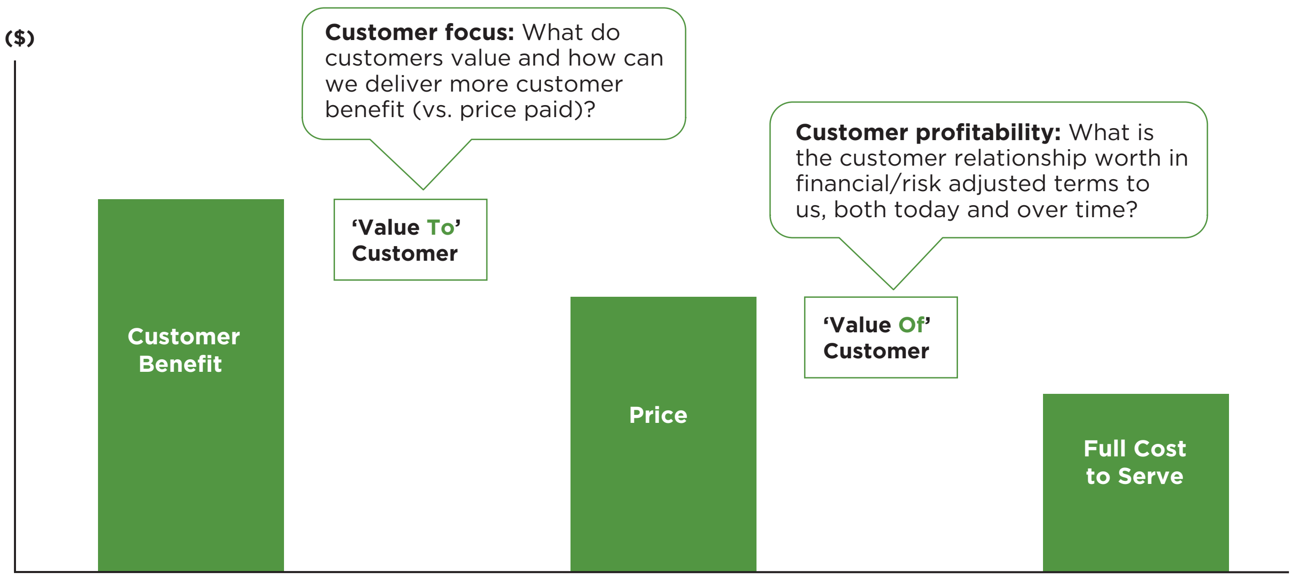
The **customer value equation** provides an easy and effective method to bring both perspectives together by locating the intersection of where a bank's offering meets a customer's "needs" and "wants." As illustrated in Figure 2, the right side represents the value of the customer to the bank. This is conceptually straightforward, given that it is bound by the price the customer is willing to pay for what is offered, and netted out by the "costs" of doing business. These costs include operating expenses, as well as the cost of the financial resources used by the customer—liquidity, balance sheet, and capital. On the left side is the more forgotten side of the equation: the value perceived by the customer from the bank offering or net customer benefit minus the price paid to the bank.

Using this lens is a better way to measure and incent the sales force, as it takes into account both the value the bank and its shareholders perceive from client activity, as well as the value a customer perceives from interacting with the bank. By using a customer value equation, a bank can measure how well its sales force is doing in creating value for its customers and quantify the value of those customers to the bank.

Embedding "value"

Both the "value of" as well as the "value to" the customer are dimensions that can, and must, be quantified to embed them within a sales performance system.

Figure 2: The Customer Value Equation



Source: Marakon analysis

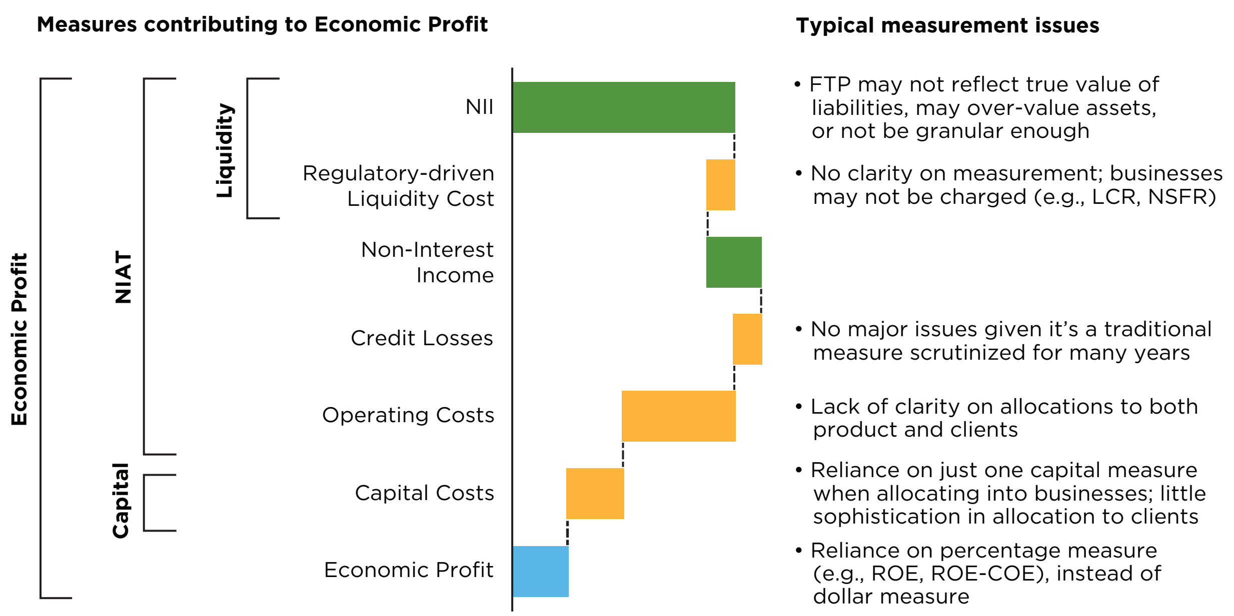
"Value of the customer:" Measuring and paying the sales force on a customer's economic contribution, while anathema of late, is a critical aspect of a performance measurement system. However, this cannot be the **only** sales incentive, as we have clearly stated. The customer's economic contribution should consider the following:

- A value-based measure that aligns sales performance with shareholder returns by capturing differing levels of risk, operating, and regulatory costs by customer (see Figure 3). It is critical that banks use value-oriented measures, such as economic profit, to measure the value of client relationships, as they best explain market value or Total Shareholder Return (TSR). This allows the bank to measure how the value of your client franchise aligns with shareholder returns over time.
- Sales force performance cannot be measured differently than the metrics applied to a bank's total operations, individual business lines, or products. Customer value must include revenues and all forms of costs—operating, capital, liquidity and balance sheet—and be consistent with metrics used throughout the bank.
- The economic impact of differences in customer behaviors should be factored into the value equation. Not all customers have the same risk profile, use a bank's resources equally, or buy products in the same manner.

Despite all the data challenges, organizations should strive to understand the economic profit contribution of customers. The ability to distinguish how a customer uses your capital, balance sheet, and funding are important aspects of the relationship that drive overall bank economics. We will elaborate on how these concepts can be more readily integrated into a sales performance measurement system in the next section of this paper.

"Value to the customer:" When interacting with a bank, customers receive a series of benefits for which they are willing to pay a given amount. The conceptual differential between the benefits and the price paid is "value to the customer." More concretely, this represents the levels of satisfaction the customer perceives from the product features, the quality of service received, as well as the price paid.

Figure 3: Economic Profit Measures



Source: Marakon analysis

To quantify this metric, a bank typically surveys the customer base in some form. Tools such as Net Promoter Score®[1] provide a methodology to quantify this variable. However, individual tailored approaches are also commonly used. The missing step for most institutions is linking sales performance measurement systems to these metrics.

These concepts need to be embedded within a sales performance measurement system in a way that is practical, scalable, and simple enough that a large sales force can understand them and embrace them. In the next section, we elaborate on how to approach what can seem a difficult task.

Key characteristics of an effective sales force performance management system

When building performance management systems, we find six key elements that drive success, as measured by sales contribution to economic profit, happier customers, and employees. Those elements include: simple metrics, economic profit as an expression of client value, customer centricity, rewards linked to outcomes, differentiated awards, and platform enablers.

1. **Keep the metrics simple.** Many institutions overcomplicate the way they measure sales performance. This frequently manifests itself in a multitude of metrics that the sales force is responsible for and paid on. Too many metrics make it hard for a sales person to discern what is important and dilute the desired impact. Some metrics may even conflict with each other, or jointly create a perverse incentive. In this case “less is more.” We recommend three to four metrics as the optimal balance of simplicity, ease of use, and effectiveness. The metrics should also balance the need to capture both the value “to” and “of” a customer. This can be achieved by using:
    a. **Customer value:** the economics of a customer relationship
    b. **Client experience:** the value a client receives from the bank
    c. **Teamwork:** tasks that cannot only be done by an individual
    d. **Compliance:** to avoid the rise of the “suboptimal behaviors”

    Even a small number of metrics need to be carefully weighted. These weights can vary based on the nature of the role (more service oriented vs. sales), the managerial level (branch manager vs. sales associate for retail, or relationship manager vs. regional manager for commercial), and the channel.

2. **Use economic profit as an expression of client value.** This captures the impact of the main value drivers (risk, balance sheet, liquidity, growth), and ties to the metric that most financial institutions and institutional investors use: dollar returns above cost of equity (ROE-COE). To follow are a few things to consider when using economic profit to express client value.
    a. **Include the most significant costs of the bank:** risk in the form of capital; balance sheet in the form of leverage; liquidity and funding, where applicable, in the form of appropriately calibrated FTP and B3 charges (LCR, NSFR, TLAC); as well as operating expenses.
    b. **Link economics with value to the customer:** i.e., measure sales economics by client segment or client type, based on behaviors. This should align with how the bank formulates its value proposition to clients, for example distinguishing primary clients from non-primary clients. Primary clients use a bank as its key financial relationship, which can manifest itself through type of products held (transactional accounts with payroll, mortgages and in the case of corporates, operating accounts with payments products) and behaviors (number of transactions, weighted average maturity of balances). The economic difference between these two segments is substantial and distinctive enough to measure. Table 1 illustrates different economic drivers of a client relationship and shows the difference for the metrics between primary and non-primary customers.

[1] Metric created by Bain & Company.

Table 1: Value Driver for Customer Relationships

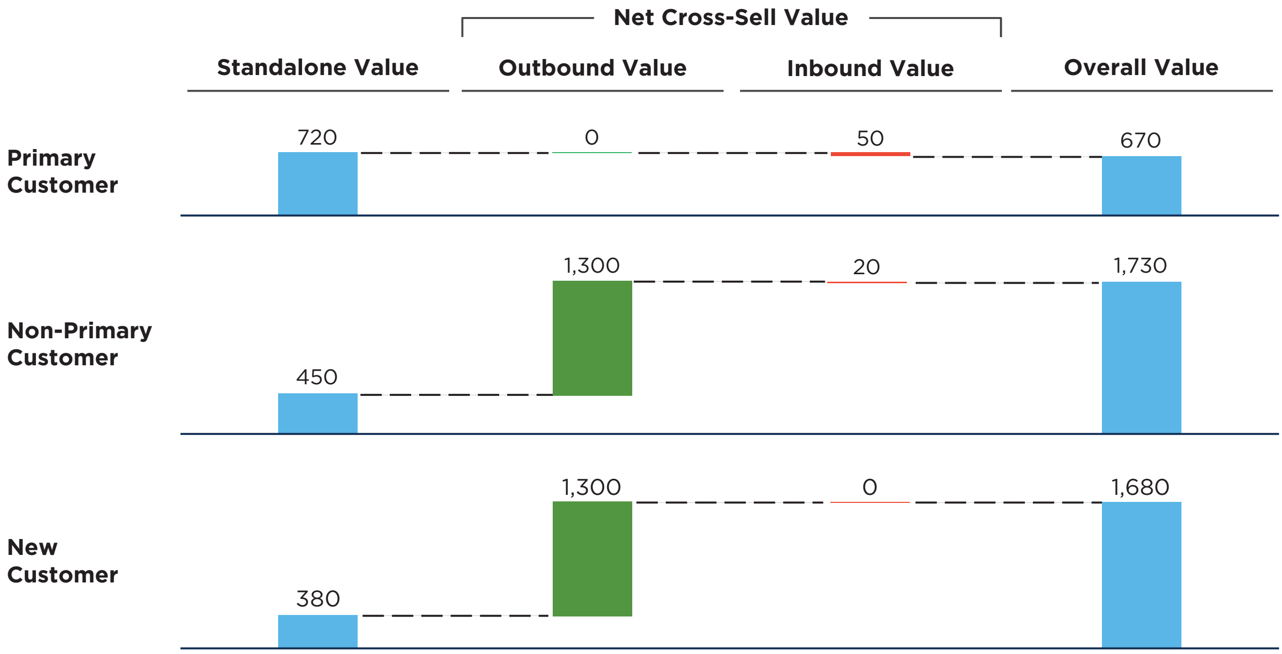
	Value of Primary/ Value of Non-Primary
Average # of Products	1.89
Average Duration (yrs.)	1.86
Average Balance ($)	1.39
Average Sale Size ($)	0.63
Average Growth (%)	2.16
Average Spread (%)	1.03
Lifetime Value of Customer (EP NPV) ($)	**2.48**
Lifetime Value per $10k of New Business (EP NPV) ($)	2.20

Source: Marakon analysis

In devising a sales performance system, we strive to understand how a customer's buying behaviors impact economics. One key behavior we believe is important to include in a sales metric is "propensity." Based on customers' historical and present portfolio of products, you can detect patterns as to which products drive cross-sell, and which products benefit from the sale of other products. In essence, we are looking for the "gateway" product in a bank relationship that brings more benefits to the relationship and institution than others. The flipside is that products with a high reliance on other products receive economic benefit but their value in a client relationship may be overstated. Hence, we calculated a "propensity" matrix to understand these relationships. Not surprisingly, we found that transactional demand deposit accounts (DDAs) are traditional gateway products and lead to the highest amount of cross-sell. Mortgages are relatively neutral, while mutual funds are the greatest beneficiaries of other product sales, and on their own did not lead to cross-sell.

This buying behavior is an important factor in the economics of products and client relationships, and should be considered when designing a sales metric to track the economics of sales activities. Table 2 illustrates an approach that embeds a net "cross-sell value" based on propensity analysis into a sales performance metric.

Table 2: Customer Need and Product Solution



Source: Marakon analysis

c. Given that client relationships can have different time horizons and glide paths, and the economics can vary based on the customer's lifecycle stage, it is important to factor in a lifetime value perspective. Simply put, you discount expected future economic profit flows to the present. It does create a mismatch between current P/L and sales results. However, it errs on the side of promoting long-term relationship building.

d. Many banks tend to only look at new originations or sales and neglect balances. We have found that balances typically constitute 50% of all economics in retail and commercial/corporate banking. Hence, it is important to capture changes to balances, both increases and decreases. This allows a bank to see the impact of relationship growth and deepening, as well as retention (or lack thereof).

3. **Stress customer centricity.** As we have emphasized repeatedly, any sales performance system must keep the customers' best interests as a guiding principle. We identify four ways to anchor a performance management system to make it client-centric and avoid conflicts of interest, primarily by understanding and linking back to the value a customer perceives from the bank.

   a. **Segmentation.** Segmenting customers based on their needs, wants, willingness to pay, and switching behaviors is bread and butter to many banks. However, tying these into the performance management system is rare but very effective. Segmentation offers a view into what type of customer is more/most satisfied, and/or highest economic profit contributors.

   b. **Product neutrality.** As important as measuring value using economic profit, however, is the level of granularity of product measures. Too much granularity can create a conflict of interest between clients and the sales force. The economics of products sold should be grouped based on client needs (e.g., secured lending, unsecured lending, payments and transactions, wealth) so that the sales force is incented to fulfill a client need with the best possible product, as opposed to selling the highest returning product.

Table 3 depicts various customer needs. For example, if a client needs unsecured credit, the sales force can assess what is best for the client given the situation – a line of credit or a credit card? If a credit card, which is the best option? If each product had a different economic profit associated with them, the sales force would be incented to sell the one most valuable to them, and not necessarily the one that is most valuable to the client. If you design product groupings so that every product within the grouping is of equal value (banks can use the weighted average value of all products within the category), you remove the temptation to serve the bank first, as opposed to the client.

Table 3: Customer Need and Product Solution

Customer Need	Product Solution
Payments and Cash Mangement	Retail Checking Business Operating Account
	Cash Management
Savings and Investment	Savings, CDs, Mutual Funds, Other Investing
Unsecured Lending	CC (No fee) CC (Fee) Line of Credit
Secured Lending	Mortgages, Term Loans, Secured Lending
Other Products & Activities	Partner Referrals

Source: Marakon analysis

c. **Measure customer experience.** It is imperative that institutions measure the customer's experience of the bank, particularly as they interact with the sales force. Some institutions use the popular Net Promoter Score® as a proxy for satisfaction, based on the likelihood of a client recommending an institution to someone else. While this is a simple and useful approach, it does not get at the drivers of experience or satisfaction, and may impede the view of what impact sales/channel has on the customer. It can also "hide" extreme results. Other measures, such as Net Value Score[2] are based on a similar concept but separate benefits and price. Regardless of the measure used, being systematic and granular enough about this metric is vital to maintain customer centricity, and the sales force should be rewarded accordingly.

d. **Avoid "bad behaviors."** No performance management system is perfect. Sales and sales management must meet all regulatory requirements, especially those designed to ensure the safety of the customer, as well as work as teams. We recommend inclusion of a metric on behaviors, which can be quantitative or more subjective, e.g. audit results, how a salesperson follows the rules and embodies that spirit of "doing the right thing" by the customer, bank, and his/her peers.

4. **Link rewards to outcomes.** Linking rewards to outcomes (e.g., sales expressed as economic profit, customer experience) is more effective than "drivers" or key performance indicators (KPIs) such as number of calls or visits. Many of these KPIs are critical to a performance management system to enable the sales force to achieve results; however, they may not necessarily lead to results. These types of "input" indicators are enablers. (see "Provide platform enablers" below).

5. **Differentiate rewards.** The rewards of a high performer and an average to poor performer need to be differentiated enough to motivate behavior. Managers often "peanut butter" their rewards, spreading them across the entire sales force in a shallow and somewhat even fashion. Steepening the rewards curve is a natural motivator, and will ultimately play an important role in employee satisfaction and retention.

6. **Provide platform enablers.** A sales performance management system that incorporates all five points above is not enough. Banks must empower and enable their employees with the right tools, training, and coaching to support the delivery of "value to the customer." The first tool is a set of KPIs that factor into coaching and training. A handful of behaviors and actions (e.g., calls, visits, lead follow-ups, sales training, product knowledge) are well-known drivers of sales and customer satisfaction and should be quantified in the form of KPIs to be used as a training and coaching tool for managers. This approach effectively measures the inputs and ties them directly to outputs, which is ultimately how a sales force should be rewarded.

   In addition to KPIs, tools should be developed to provide enough information to the sales force. Lead generation algorithms can become more meaningful by recommending actions based on identifying and distinguishing customer segment and/or behavior (e.g., who is a non-primary client and what are their needs given their segmentation). This allows for more focused, effective, and customer-centric sales discussions and can even help stem attrition (e.g., identifying corporates where balances are on the decline). Performance reports for the sales force should be frequent, cut across all channels, and provide enough granularity along the three to four key metrics to empower the sales force. Customer information, with product data and attributes (e.g., segmentation), should be readily available. Finally, team huddles and core training programs should continuously incorporate and emphasize customer experience and product neutrality.

[2] Developed by B2B International as a measure of customer satisfaction that allows for a better understanding of what drives perceived value between price and benefits.

THE BENEFITS AND PITFALLS OF A CUSTOMER-CENTRIC SALES PERFORMANCE MANAGEMENT SYSTEM

There are many benefits of shifting to a sales performance management system that balances client centricity and economic transparency. In our experience, changes similar to the metrics described above have driven increases of anywhere from 20-35% in economic profit over a span of six to twelve months, and resulted in higher retention rates of top performers. However, other equally relevant benefits are gained.

Customer centricity improves client retention and strengthens relationships. With regard to economic impact, we see longer deposit duration and better overall client margins, which should translate into a more productive balance sheet. In addition, strong sales people are incentivized to enhance business via a “morally astute” system, which in addition to more differentiated pay, facilitates retention and employee satisfaction, as it puts them behind a cause other than just selling.

However, moving to a balanced, customer-centric sales performance management system is a difficult task and requires a culture change. We have observed some common pitfalls and offer ideas on how to avoid them.

Lack of testing. Include the people who will use the system in its design so they can identify loopholes that could be exploited. Conduct limited focus groups at the branch/sales person level, relationship manager level, and at management levels, to help offset “unintended consequences.” Given the size of most financial institutions, a pilot in a region, or with smaller groups across regions, is a safe way to test the system and begin identifying “culture bearers” who can act as sponsors or leaders in successive rollouts.

Governance. It is difficult for some banks to place the customer dimension before products when making decisions because most banks are product aligned. To maximize the success of changing to a customer-centric approach, products should not lead the effort. A neutral agent, such as distribution (non-product aligned) or change management group should lead and support the effort. Once the system is in place, leadership should be a shared responsibility across functions and products so that everyone has a voice at the table.

One change at a time. Most institutions have major transformation programs in place across branches, distribution, etc. It is important to be able to conduct this exercise in a way that the institution has clarity on the key drivers of successful change. If many programs are run at once, signals can get crossed. In addition, there is typically a limit to the bandwidth for change at most institutions.

Inaccurate reporting. Your sales force will quickly disavow any management system that does not provide an accurate view of their sales. To preserve the integrity of the program, we advise investing time to get the reporting right before the pilot/rollout.

CONCLUSION

The current business environment for banks is challenging from a regulatory and economic perspective. Balancing customer centricity and economics can only help drive value for institutions, appease the regulators, and harness the power of the client to deliver results. Placing the customer at the center of what a banks does, especially for something as delicate and important as the sales performance management system, is just good business.

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We help clients achieve their ambitions for sustainable profitable growth through:

- Stronger strategies and advantaged execution based on:
    a. A better understanding of what drives client economics and value
    b. Insight into changing industry dynamics and the context in which clients need to succeed
- A stronger management framework to generate better ideas and link decisions and actions to value
- A stronger organization with a more focused top management agenda and well-aligned resources
- A more confident and effective leadership team that's focused, decisive, and strategic

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