WHITE PAPER

Building a Pricing and Profitability Management Ecosystem

How to implement the tools that matter in your financial institution

Q2

Some financial institutions spend the majority of their total technology budget on maintaining their core systems, but that is not where value is created.

How do FIs really add value? How do they make money? Those questions should not only have easy answers, but they should also be the driving force behind the FI's most important strategy decisions. So why aren't more banks and credit unions pointing resources to the systems that help them get better at those two things?

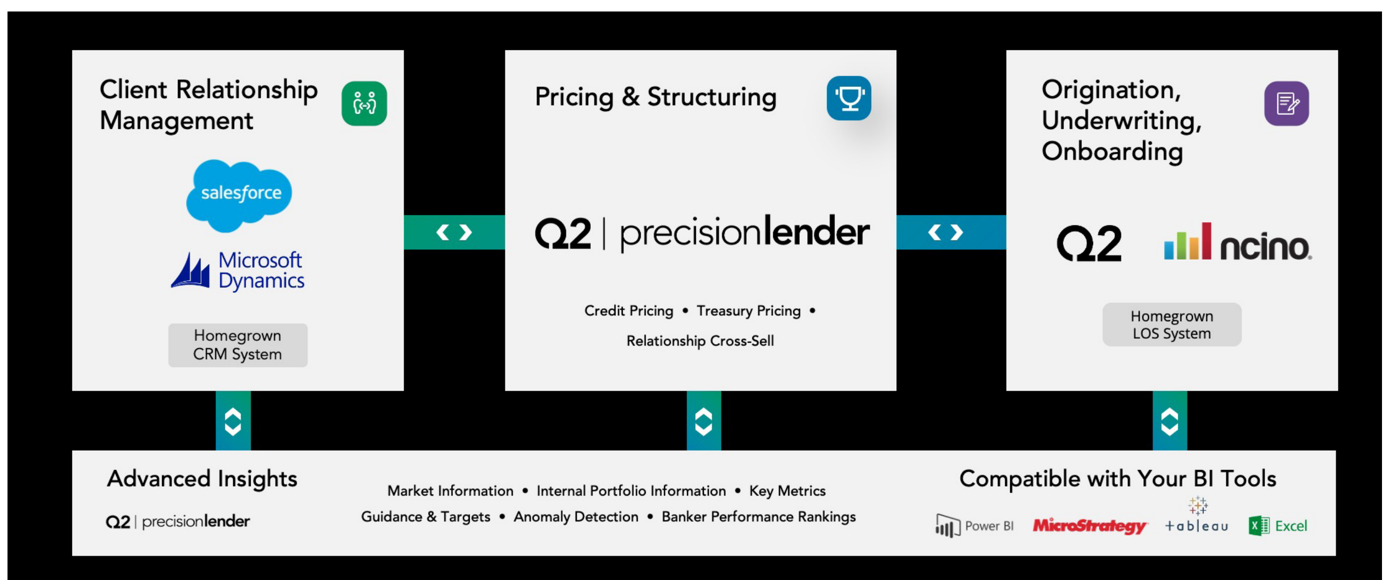
The Heart Versus the Brain

The answer might just lie with the marketing genius who decided to name the FI's accounting software the "core system." Every FI we've ever talked to has a love/hate relationship with their "core" and the vendor that supports it.

The issue is that we are asking these systems to do things they were never designed to do. Core systems were built for debits and credits, making sure that everything balances and that we don't lose any pennies. They are the epitome of a commodity in the banking business in that there is really no way to differentiate based on them. Keeping track of transactions and balances is the absolute minimum requirement, and everyone ends up delivering the same product to the customer (an accurate accounting of transactions).

So, yes, the core is vital, which is why we call it the "heart" of the FI. You must have it, and its job is to circulate basic but essential elements to the other parts of the institution. But it was not designed to be a central data warehouse from which we can manage the organization.

The brain is the collection of systems and processes where FIs make decisions that generate real value and returns. Here's what happens when those tools are put to work closing a valuable deal.



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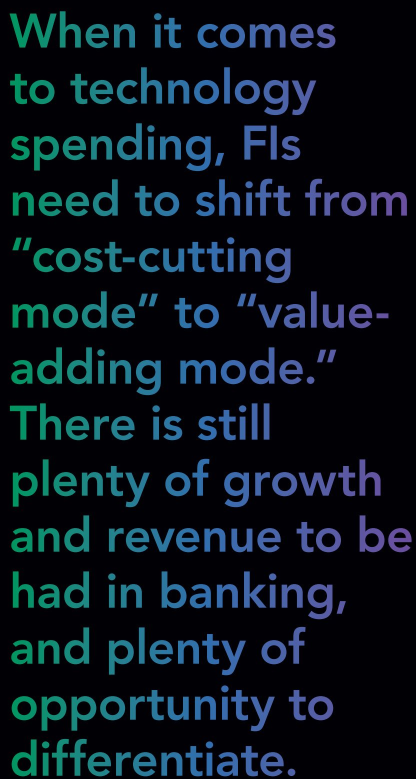

Generally, the sales process is tracked in some sort of CRM system. You negotiate through a pricing and profitability tool, and then the deal runs through various workflow systems (underwriting, doc prep, etc.) to get to closing. After it is on the books, the same CRM and underwriting tools will be used to service and manage the loan, and you will use other portfolio-level resources to measure the profits and risk so that the FI can adjust strategy where necessary.

The brain is where FIs build relationships with prospects and account holders. It's where they analyze and price the risks they are taking, and it's how FIs can service and support their customers or members once they are on the books. **Those three functions are the only ways that FIs truly differentiate themselves and generate value for all stakeholders.**

When we walk through this "heart versus brain" layout with FIs, they almost universally agree with the principals, including the argument that the brain is where they add value. And yet, if you compare the resources allocated to each, including vendors and dedicated personnel, spending on the heart systems still dwarfs the spending on the brain systems. This disconnect between cost and value is one of the chief reasons for the industry's vulnerability to new competition and customer apathy.

So, how can FIs solve this problem? The answer is twofold.

First, they need to continue pushing back on their core vendors. The basic strategy employed by the vendors has been to make it so painful to switch that you will put up with the continued price increases, the forced bundling, the slow updates, and the inferior service. There are plenty of consulting groups that can help you renegotiate, and it is generally worth the time and effort to do so. Pushing may not always result in lower costs, but it should result in better products to justify the price.

Second, when it comes to technology spending, FIs need to shift from "cost-cutting mode" to "value-adding mode." There is still plenty of growth and revenue to be had in banking, and plenty of opportunity to differentiate. To do that, though, FIs will need to start investing heavily in brain systems and in personnel with the expertise to integrate those systems into the FI's practices and culture. Doing so will build a better customer or member experience, and FIs know that this has always had a lucrative ROI that far outweighs the impact of simply cutting costs. Banking used to be a cutting-edge industry, and it can be again with a slight shift in focus—from the heart to the brain.

The Big Four

To get a better understanding of just how powerful and effective a banking ecosystem can be, let's take a closer look at the most important systems—"The Big Four." We'll explain what each system does and how it fits into the overall ecosystem.

Note that, although we are talking about technology here, the bigger picture is the FI ecosystem itself. When systems flow smoothly from one to the next, so do processes between lines of business within the FI. And when everyone within your FI is on the same page, you can develop a deeper, more meaningful relationship with the customer or member.

Customer Relationship Management

For a time, Customer Relationship Management (CRM) systems seemed to have a nasty reputation in the banking industry. Blame it on the fact that FIs are the ideal candidate for CRM, and therefore many tried to adopt those systems when they first became available. Unfortunately, early CRM tools were big, bulky, and expensive, and they didn't really integrate with anything the FIs already had in place.

On top of that, early CRMs were incredibly tedious to use. Management teams wrote big checks and then spent the next several years trying to threaten and bludgeon their employees into actually using them. Management wanted access to data and insights on their sales process, but getting that data required consistent manual input from the staff. The hill simply proved to be too steep in most cases, and often the projects were abandoned. CRM projects started to be viewed as career killers, and many FI executives still carry those battle scars.

However, the tide seems to have turned. The CRM technology of today has transformed to be nearly unrecognizable from the earliest versions. These are not your father's CRM tools, and the allure of a more efficient and transparent sales process is finally coaxing FIs back to take another look. They know that to succeed in today's competitive market, the stack of yellow legal pads in the cabinet can no longer serve as the method for tracking and measuring sales.

Modern CRM systems are usually cloud-based and have become much more than just a way to track sales calls. Many organizations are using them as the foundation for their entire sales, approval, and origination process. Unlike the core, they have been built from the ground up to handle data coming and going in multiple directions. Lots of data. A CRM should serve as your central repository for all institutional knowledge about each of your account holders. It will tell you who that customer or member is, what business you do with them, how profitable they are, and what opportunities there are for earning future business.

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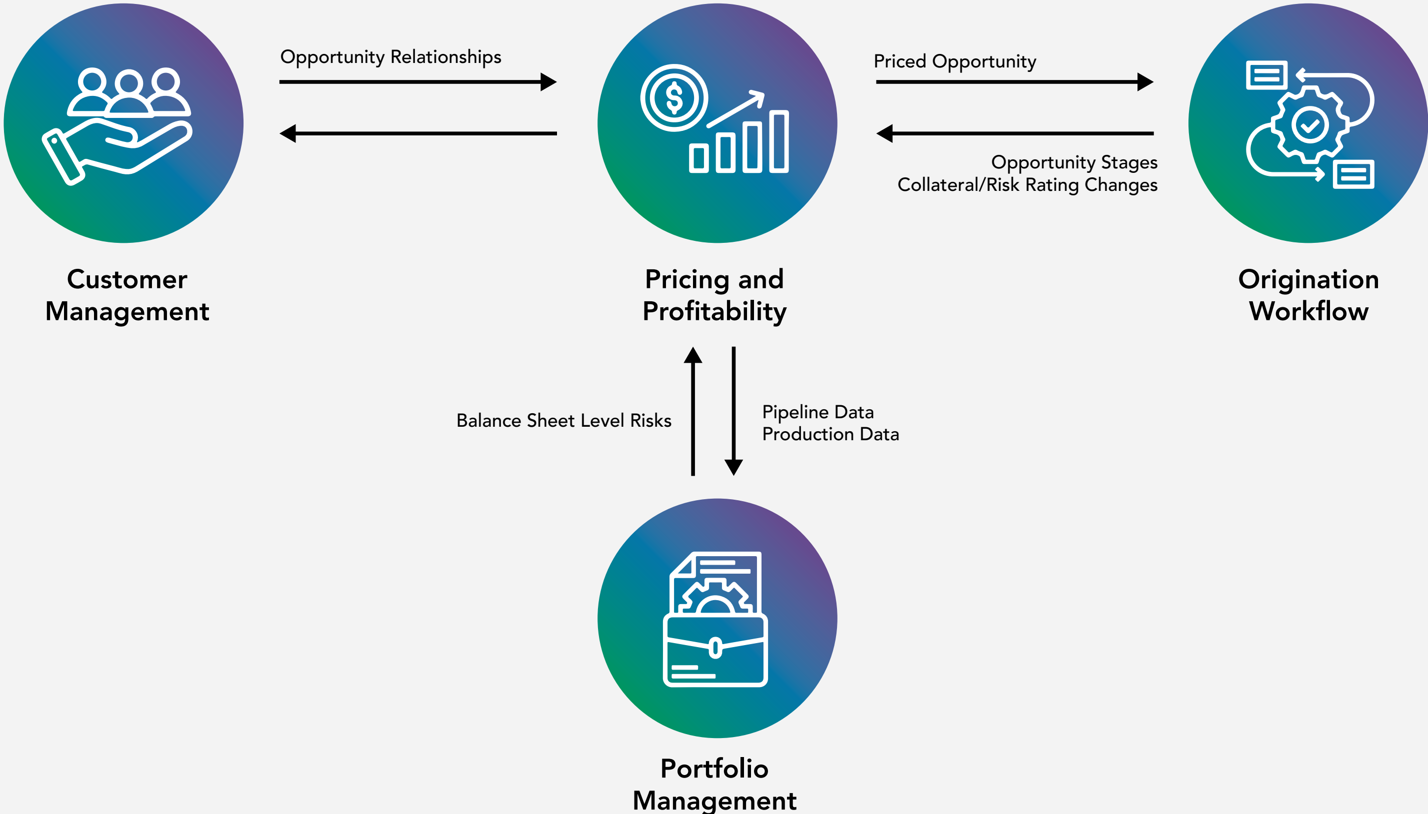
In addition, CRMs are excellent stage tracking and task management tools. They can track the history of all activity with each account holder, and they can be used to schedule future tasks and activities. Think of the CRM as the conveyor belt in your loan assembly line. Once a loan is created on the system (as what is usually called an "object") the status can be moved from one process to the next, with an employee completing the necessary work and then handing it off to the next person in line.

Once this is in place, you can see the production process in motion. We know FIs that have dashboards to measure sales velocity, how many calls it takes to generate a deal, and how many days it takes at each step in the process. Bottlenecks are found and fixed, and the entire organization gets smarter about selling and servicing their customers or members.

All that functionality is why the CRM is not only listed as one of our "Big 4" systems in the brain of the FI, but it's at the beginning of the loan origination process. It is where your conversations with customers or members start, and where you should start your work. Then it can act to keep moving the deal forward until you have met your account holder's needs as quickly (and profitably) as possible.

Pricing and Profitability Management

Pricing and Profitability Management is the easiest one for us; it's the box we fill with Q2 PrecisionLender. Pricing is the FI's most powerful performance lever, yet many treat it as an afterthought. We see the full spectrum of solutions in this space, ranging from no solution at all ("The market dictates pricing, so why bother?") to elaborate homemade models. The issue with nearly all of them is that they are entirely disconnected from the rest of the sales process.



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The reality in many FIs is that pricing is a seat-of-the-pants decision by a relationship manager (RM) based on competitive offers that are determined in a similar fashion. Then, when it's already too late, that deal is plugged into a cumbersome pricing model that is nothing more than a glorified calculator. Even worse, it's a calculator with a binary outcome; the deal either passes or fails the hurdle rate. With this setup, it is impossible for a pricing system to create value. At best, it will cause you to say no to some bad deals that are already well into your process.

Instead, you need to move the pricing decision as close to the customer or member as you can possibly get it. In terms of systems, that means it should be directly connected to your CRM. This strikes some FIs as an odd pairing. Why would we attach a pricing model to our CRM? Isn't pairing the warm and fuzzy relationship stuff with the cold hard reality of the math a little like mixing oil and water? That might be true in a traditional business, where you are attaching a price to a separate, tangible product. The price for an iPhone, for example, doesn't need much CRM interaction.

But in banking, pricing is the product. The structure and terms attached to the funds you lend are the solution for your customer or member, and to get the right fit, you absolutely need all the context provided by the CRM.

It's also the next logical step in the process. Once all your business development efforts managed in the CRM result in a live opportunity, you will move into formal discussions about the right structure and price for that funding need. For maximum efficiency, RMs should be able to jump directly from their opportunity to a pricing discussion and have the full benefit of knowing the history, relationship status, and profitability of that customer or member.

All that context should be combined with a pricing tool that is designed to **enable** RMs, not block them. Most pricing systems are designed with one goal in mind: Keep RMs from doing bad deals. A successful system, though, should approach it in the exact opposite way: Help RMs do great deals.

This may seem like a subtle difference, but to the RM, it changes everything. Instead of a pricing model being one more thing that can trip up a deal and keep them from serving their customer or member, it becomes a sales and negotiation tool that helps them find ways to help. What does this really look like? Most pricing tools communicate red lights and warning labels to the RM with terms like:

The maximum fixed term is
7 years

Non-recourse loans are
strictly prohibited

No loans with
LTV >75%
will be approved

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We have seen huge improvements in performance by altering this approach to using green lights that highlight suggestions. Instead of a list of things to avoid, use a list of options that work. It becomes a menu of solutions thatwill benefit both the FI and the borrower, and it helps the RM work through these options with the customer or member.

- Increase the Spread by 12 bps
- Add $32,472 to the Initial Fees
- Add 0.325% to Initial Fees
- Adding $2,191K of Commercial DDA reaches opportunity target
- Reduce LTV to 67%
- Reduce Maturity to 47 months

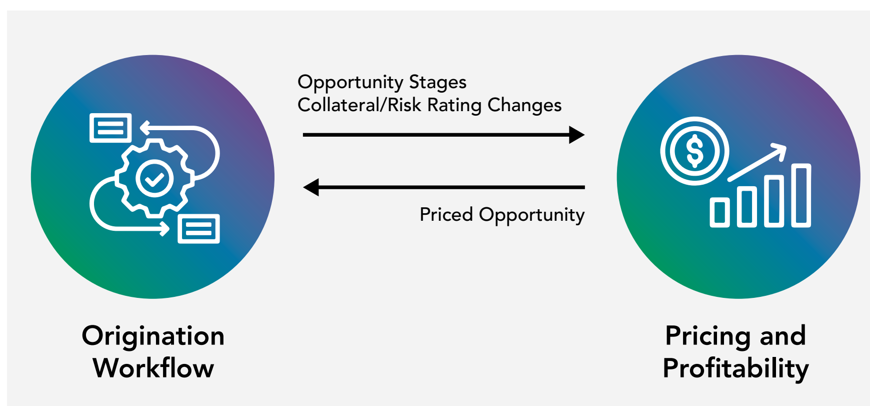
Changing the perspective of the tool, in turn, changes the perspective of the users (which should be the RMs, since they're the ones negotiating the deal), enabling them to influence outcomes in a big way. RMs using this approach win more deals, win better deals, and earn loyalty from their customers or members.

The real magic of integrating pricing and CRM, though, happens after the deal is priced. The pricing of a deal creates a wealth of usable data, as we now have deal terms, scenario details, and profitability results. Those profitability results cover not just the new opportunity, but also the profitability of all the existing business you have with that customer or member. You now have profitability metrics on individual accounts, bundles of business, and relationships that can be rolled up to measure products, RMs, markets, risk grades, collateral types, and dozens of other categories. All of this can be pushed back into the CRM, where it creates invaluable context for all future discussions with that customer or member. And you get it without having to manually enter more data into the CRM.

FIs that have figured this out are the ones that are taking market share from their competition. They often come into deals with unique offers that cause other FIs to scratch their heads and wonder: "How can they possibly offer a deal like that?" The answer isn't that they are simply more aggressive. Their advantage is that they have an insight the competition doesn't, because they have a complete picture of that relationship and how winning this next deal impacts their portfolio.

After the deal is priced, it then moves on to the next systems in the value chain—origination workflow management and portfolio management.

Origination Workflow



Origination Workflow Management (we'll call it workflow for short) covers several functions, but the big picture of this phase is that it's where we underwrite and document the transaction. While that sounds simple, the reality is that many of these processes get complicated and messy. This is the first place FIs focus on when working on efficiency, as there are sometimes dozens of disparate systems involved that don't communicate with each other. and none of them link back to the core.

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Employees end up keying in the same information multiple times, leading not only to slow turnaround times, but also rampant errors and discrepancies. FIs also end up with data spread across these siloed systems, making it nearly impossible to report on and evaluate risk. Risk grades, collateral, and guarantor data may all be stored in different systems, and none of them link back to the core.

We see FIs taking a couple of approaches to solve this problem. There are a few vendors that offer a comprehensive "origination system" or "operating system" for commercial loans, and they have gotten significant traction. The upside is that everything comes in one package, is seamlessly integrated from day one, and the origination process is significantly streamlined. The downside is that implementation can be a beast. The system touches everything in the organization and requires an overhaul of just about every process in the loan function.

The second option we see FIs taking is to use the CRM as a tracking tool to coordinate all these systems. Remember, these platforms do a great job of tracking stages (originally designed for sales stages) and task management. With that functionality, FIs can create stages, with approval authority, that encompass not only the sale, but also the origination.

For example, a stage can be created called "underwriting," and only certain employees can move it from underwriting to the next stage. When it is marked for underwriting, a series of tasks can be triggered and then assigned, like having an analyst evaluate financial statements and order appraisals. All the progress is tracked in the CRM, even if other tools are used to actually complete the work. Then, the results can be stored in a document repository, with links in the CRM. The CRM simply acts as a central hub so that anyone involved can see where a deal is in the process, who owns which tasks, and find the documents and data they need.

The key, of course, is the system must be used consistently across the organization. This only works if the next steps get kicked off by moving the stages in the CRM. In other words, it must be properly documented within the CRM before the next steps begin. Analysts can complete their tasks and then move it to the next stage for official approvals, and then it must be marked as approved to start preparing closing documents.

Whatever the mechanism, though, the workflow systems need to receive the deal terms from the pricing solution so they can be underwritten ("Is this deal really a grade 3?") and documented (loan agreement matches the economics of the pricing and structure) accurately. This can either be handled as a direct connection to the pricing system, or those deal terms can be pulled from where they are stored in the CRM. Once all the workflow processes are completed and the deal closes, it gets uploaded to the core system, and from there it will show up in the data feeds to the pricing system to measure its profitability going forward.

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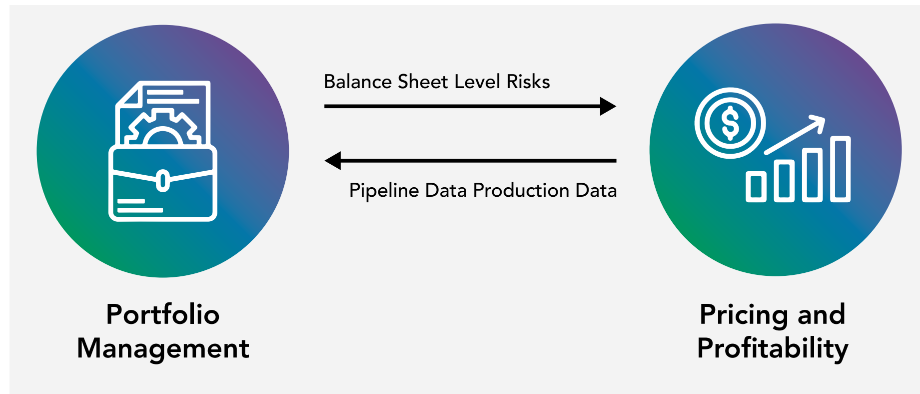
Portfolio Management

Last but not least are the systems we refer to as Portfolio Management. In this section, the FI is evaluating all the business that has been booked at an aggregate level. Here, the management team can monitor levels of interest rate and liquidity risk, analyze profit trends, allocate capital, and determine if the trade-offs for credit risk and return are appropriate. The hard—but critical—part of this step is linking it back to the tactical business decisions made every day instead of just creating stacks of reports and vanity metrics that don't ever lead to action. That struggle is the reason portfolio management should be closely connected with pricing. The FI's portfolio metrics should determine the appetite for specific types of deals and risk going forward, and deals can be priced accordingly. Pricing then becomes the steering mechanism by which management can allocate the balance sheet according to high-level strategy.



Of course, all of this requires data to serve as a feedback mechanism. How is the pricing translating to production? What types of deals are you winning, and at what profit levels? Where do you have opportunities to achieve growth without relaxing risk standards?

This is data that is available in your pricing system. Once you have a grip on how current pricing targets are driving production, you can close the loop by tweaking those targets in the pricing system to get production to align with the goals for the balance sheet.

For example, if you are nearing concentration limits in commercial real estate, you can increase the targets for those and use that limited shelf space for only the best, most profitable deals. Now more than ever, FIs are asking about deposit rates, and this capability makes it very easy to see what the impact of a deposit reprice will have on the relationship.

Putting it Into Place

A pricing and profitability management ecosystem is an impressive concept, but it's also daunting. Here are a few proven key philosophies that will help guide you along the way.

1. Don't try to do a complete overhaul all at once. Break the project into manageable pieces, focusing earlier efforts on where you will see the biggest impact. Create a master plan but execute it in bite-size chunks. Start with a pricing solution. It will have the biggest revenue impact and will help pay for the rest of the overhaul. Then, tackle the CRM, as it will act as the "conveyor belt" for the entire process.

2. Choose solutions that will "play nice" wit h all the surrounding systems. Look at options outside the list of typical FI vendors who tend to build closed systems and charge dearly for clunky integrations. Choose vendors that embrace APIs, software that makes connecting all the systems much simpler and more efficient.

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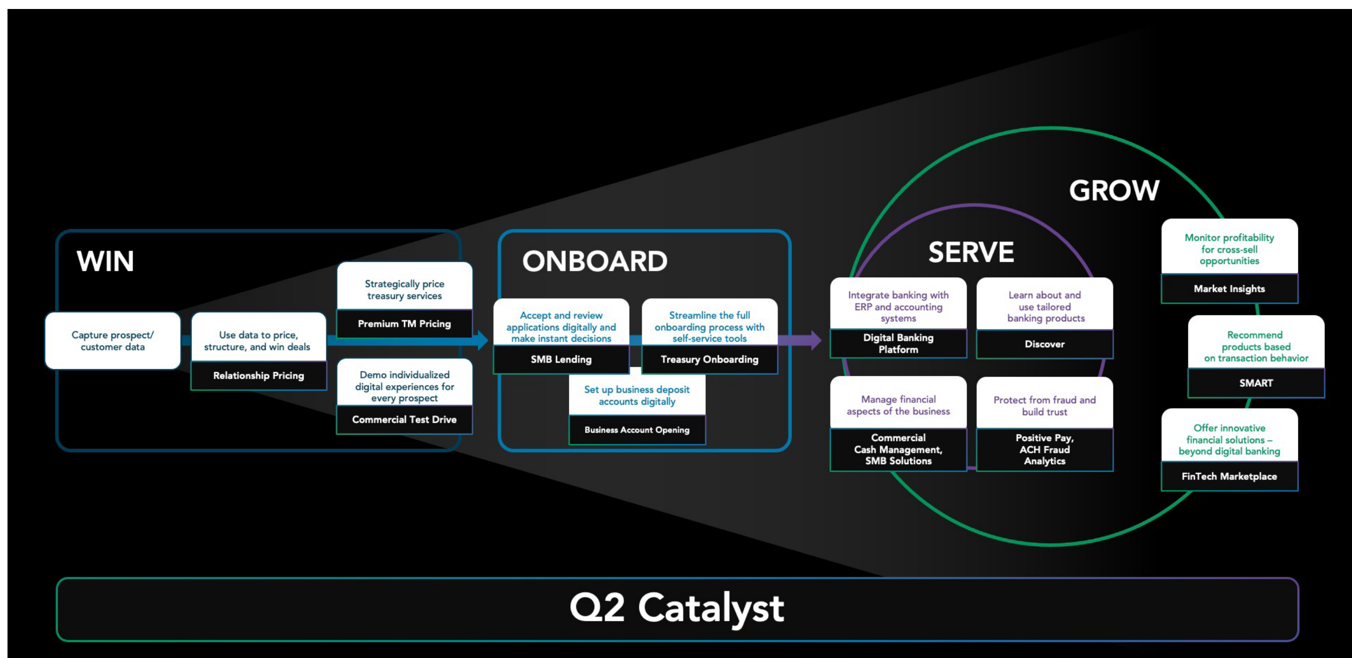
3. Add resources and capabilities so that if something isn't available out of the box, you can build it in-house. Yes, that does mean writing some code. But it isn't code to build complex and hard-to-maintain proprietary systems; it's code to connect and automate various parts of the ecosystem. Having already selected the right vendors and systems, coders will often just connect already available end points or request that new end points be surfaced by the vendors.

Yes, it will take time and resources, but in the end, you will have an infrastructure in place that is tangibly different from the competition. Not just in terms of efficiency—though it certainly is that—but in terms of customer or member experiences.

Commercial relationships get fast, personal, and customized responses from the FI, and employees don't have to spend their time and energy focused on internal procedures and policies. Instead, they have very focused conversations that help them best match the FI's products to the customer's or member's needs.

Q2 PrecisionLender is an important piece of Q2 Catalyst, our set of digital banking solutions aligned with the end-to-end journey for commercial businesses that helps banks and credit unions win more commercial accounts, onboard them faster, serve them better, and grow stronger relationships.



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Ready to begin?

Learn more about the critical first element in your ecosystem.

Start with pricing

Q2 PrecisionLender is a part of Q2 Catalyst, a suite of best-in-class commercial banking solutions. Q2 PrecisionLender is a sales and negotiation solution used by more than 26,000 bankers at financial institutions of all sizes, including some of the largest banks in the U.S. Its intelligent virtual analyst, Andi®, empowers client relationship managers with actionable, real-time insights and coaching to structure, price, and negotiate better deals while also building stronger and more profitable relationships. By augmenting bankers' strengths with the latest technology and data, Andi delivers recommendations on different structures and tactics while the deal is being priced and negotiated. To learn more about how Q2 PrecisionLender can help you modernize your commercial banking, visit precisionlender.com.

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