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Replace Fee Income with Free Checking. Really

By John Rountree and Scott Kluge
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The traditional banking profit model is going through a period of upheaval. As a result, banks now have the need and motivation to finally break down internal barriers necessary to truly deliver a financial supermarket for consumers.

Yes, we said it: Financial supermarket. And no, you're haven't traveled back in time to 1998. It's 2012, and we're going to argue that realizing the dream of the supermarket is the answer to the industry's current woes.

Let's back up a bit. As many bankers are painfully aware, the Dodd-Frank Wall Street Reform and Consumer Protection Act dramatically reduced banks' ability to generate fee income. Simultaneously, increased capital requirements from the Basel Committee on Banking Supervision have reduced the ability to leverage deposits, in turn reducing interest income. Add current low interest rates on loans and massive consumer deleveraging occurring and it's a perfect storm attacking the traditional banking profit model, necessitating a new growth strategy.

In 2010, banks collected more than $60 billion in banking and debit card fees alone, and it's estimated that $15 billion, or one quarter of the revenue stream has since been "legislated away" in the wave of consumer-protecting financial reforms, according to data from Moebs Services and Card Hub. Many of these fees were historically hidden from consumers, in the form of transaction fees paid by merchants, or affected only a small proportion of consumers. The majority of consumers enjoyed free checking, free ATM usage, and rewards programs. The problem was these benefits weren't actually free. They were subsidized by the underlying fees.

Banks are now frantically looking for new ways to replace this lost fee revenue. No one likes the airline fees but travelers pay them as there are few comparable alternatives to air travel and there are only a handful of providers. However, in banking neither condition holds true.

As a result, banks are having a difficult time charging for things historically free to consumers. There was uproar when banks announced $5 to $15 monthly fees on checking accounts and they were forced into retreat on monthly debit card usage fees. Clearly, the use of the "stick" – more visible fees – doesn't work. Unless a new strategy is developed, it's anticipated that consumers will vote with their wallets and transfer their accounts to free alternatives at smaller banks and credit unions.

Is there a winning strategy that will create more revenue and drive greater lifetime value? Indeed, it starts with a "carrot," incentives for consumers to consolidate more business with one bank thus simplifying their financial lives. But this is only a starting point as banks need to focus on consumer benefits that go beyond the convenience of a single statement.

It's common knowledge that consumers with multiple accounts with one bank are typically more profitable than consumers with only a single checking account. They have multiple revenue streams, lower acquisition costs and greater longevity. This drives greater lifetime value. Historically, this logic drove banks to become financial supermarkets to serve their customers' mortgage, brokerage and retirement needs in addition to typical bank services. The challenge has been convincing consumers to consolidate their accounts with one bank.

Here is where we throw out the carrot. Instead of raising revenue by adding new fees, why not focus on raising revenue by creating real, tangible incentives for customers to do more of their financial business with one institution? We are not suggesting a return to the days of free toasters, but rather a shift in focus from punitive charges to consumer incentives. How about free checking as the carrot?

Free checking has proven to be a compelling and necessary offer to attract and retain customers. The challenge has always been in how to offer free checking profitably.

And here's where the also supposedly outdated concept of the financial supermarket comes into play.

Now that fee revenues can no longer subsidize free checking, the cross-selling of additional products and services is the last hope for its survival. This strategy requires financial institutions to finally get serious about cross-selling, the holy grail of the banking industry. Banks have been working on cross-selling for the past 20 or more years with mixed results. But during those years, they could rely on fat margins from the old profit model of hidden fees and low capital requirements to make ends meet when the cross-selling failed. Those days are gone.

Now, banks must figure out how to cross-sell, break down their own product silos and convince consumers of the benefits of the financial supermarket to restore long-term profitable growth.

With checking being the anchor product for most consumers, why not leverage this sticky account differently? Offer the carrot – give the consumer free checking, make them a lifelong partner and build that long-term incremental relationship revenue. We would rather have a carrot. Wouldn't you?

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