The Problem with Historical Performance:

What Really Matters In Setting Fair Sales Goals

WHITE PAPER:

FINANCIAL SERVICES

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ABSTRACT

THE ANNUAL RITUAL OF SALES GOAL SETTING FOR BRANCH OFFICES HAS PRESENTED CHALLENGES FOR RETAIL BANK SALES MANAGERS FOR YEARS. THE ULTIMATE OBJECTIVE OF THE PROCESS IS TO MAXIMIZE SALES VOLUME BY SETTING AGGRESSIVE, YET ACHIEVABLE, GOALS FOR EACH BUSINESS UNIT. SET A GOAL TOO HIGH AND THERE IS RISK THAT THE SALES FORCE WILL STOP SELLING UPON REALIZING THE TARGET CANNOT BE REACHED. SETTING A GOAL TOO LOW MAY LEAD TO THE BUSINESS UNIT PUTTING FORTH LESS EFFORT ONCE THE GOAL IS REACHED. SINCE NEITHER OUTCOME IS PARTICULARLY DESIRABLE, SETTING A PROPER GOAL BECOMES A VITAL COMPONENT OF A SUCCESSFUL SALES MANAGEMENT PROCESS FOR RETAIL BANKING ORGANIZATIONS.

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Variations in Historic Branch Based Product Level Sales

Research conducted by Pitney Bowes MapInfo reveals that there is significant variability in historic product sales at individual branches. Our analysis of sales data from 750 branch offices across five regional banks indicates that even among high sales volume products, the year-over-year variation is significant.

The chart below illustrates the variation. Among the 750 branch offices in the analysis, only 29% had unit sales of non-interest checking accounts within 10% of the number sold in the previous year, while 45% differed by more than 20% (x < 0.8 or x > 1.2, where x = previous year's sales).

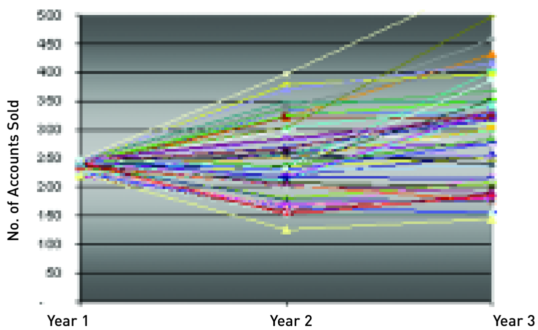
CONSUMER NON-INTEREST CHECKING

ABSOLUTE PERCENTAGE DIFFERENCE FROM PREVIOUS YEARS SALES	PERCENTAGE OF BRANCHES
<10%	29%
10%-20%	26%
20%-30%	17%
30%-40%	12%
>40%	16%

Removing young branches and considering only branches that had sales within a few units of the average number of unit sales for a branch (229) reveals similar results. Limiting the analysis to those branches that sold between 220 and 250 non-interest checking accounts in year-one, subsequent year unit sales were within 10% (0.9 < x < 1.1) of the previous year only 25% of the time.

The graph below displays the annual unit sales of non-interest checking accounts for 50 mature branches that sold between 220 and 250 non-interest checking accounts in year-one.

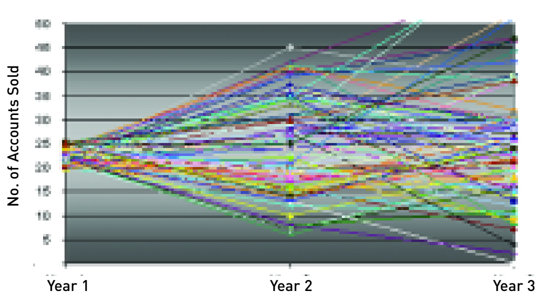
ANNUAL NON-INTEREST CHECKING ACCOUNT SALES



Each line represents three years of branch sales, and while many branches have similar unit sales volumes in years two and three, many others do not. Imagine using last year's sales as a basis for subsequent year goals. The reasons for such variation are many, as we'll discuss, and considering a previous year's performance is not a good measure of what can be expected in subsequent years.

Other products which produce less volume than checking accounts show even greater variation, such as home equity loans as shown below.

ANNUAL HOME EQUITY LOAN SALES



Here we see that a typical mature branch sold between 20 and 25 home equity loans in year one. In this sample of 84 branches 35% had sales in year 2 that were more than 40% different from the sales in year-one.

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The Goal Setting Process

The process of branch goal setting begins with the finance department of the bank setting top-of-house goals for broad portfolios. Typical examples might be to grow term savings balances by 5%, or increase the short-term loan portfolio by 8%. These broad portfolio goals will then be subdivided into finer detail so that the term savings balance goals might be split into IRAs and CDs, for example, or liquid deposits into checking, savings, and money market products.

Once product level goals for the retail bank have been set, the next challenge is to establish goals for the bank's various sales channels. A certain amount of the loan growth may be allocated to direct mail channels that typically have success in selling credit cards and home equity loans. Outbound telemarketing and web-based channels, while representing a small piece of the overall volume of core retail product sales, may also be given targets.

The vast majority of new product sales are expected to come from the financial institution's branch network and its sales force. The challenge is to properly allocate the goals in an equitable manner giving each unit a similar opportunity to reach, and hopefully exceed, its specified target. Goals are typically allocated to a high level in the network hierarchy (a state, region, or market) then further allocated to the branch units within the higher levels of the hierarchy.

A good allocation system will set goals in a way that allows each sales point to have an equal opportunity to reach its goal. Any other approach will create a suboptimal result, as some branch offices will be given a goal that is too high for the opportunity afforded them, while others will be given a goal that is easier to achieve given their opportunity.

Approaches to Goal Setting

HISTORIC SALES

Most banks use one of the following approaches or elements of them to set branch goals. The most common approach is to allocate goals based on historic performance, based on what the branch achieved last year. For example, branches will be asked to increase sales by 20% over what they sold in the previous year, so a branch that increased sales by 5% the previous year will be asked to do 6% (5% X 1.20). Likewise, the branch that increased sales by 10% in the previous year will be asked to increase by 12% (10% X 1.20).

There is a certain comfort level that comes along with setting goals that look similar to either the previous year's goal or actual production. Setting a goal that is much higher than what was actually produced in the previous year could bring into question the reasonableness of the goal. Therefore, basing the goal on what was asked in the previous year, or what was actually sold, intuitively "feels right." Data availability is not an issue; the goal is based on a number that is known. Nor are there likely to be issues in conveying how the goal was determined.

The problem with this approach, as discussed earlier, is that there is wide variation in year-over-year product sales for individual branches. One reason for this variation is that branches are at different places on their maturity curve. Young branches tend to have very high percentage increases over previous years as they build their base of business. Another reason is a changing competitive environment. The addition of a competitor's new branch down the street will have an effect on your branch's ability to generate sales. Yet another reason for variation is bank-induced sales campaigns, which will generate peaks and valleys in a branch's sales history. Further, this method does not address the question "How high is up?" Because a branch may have consistently increased sales by 10% for each of the past 3 years, it is not an indication that the branch can continue

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at that pace. The market changes, competition changes, and any number of other factors will affect a branch's ability to generate increasing sales. Finally, this approach tends to punish high performing branches as management expects the same level of performance as has been displayed in the past. The same holds for poor performers who are rewarded for performance that is lower than what it can be.

UNIFORM ALLOCATION

A second common method is uniform allocation whereby all branches are given the same increase. If the bank's goal is to sell 7% more checking accounts than it did last year, then everyone is expected to sell 7% more checking accounts. This approach is certainly easy to communicate, but difficult to defend. Many of the same issues facing the historic performance approach exist here. Foremost is the notion that opportunity is not uniform. Uniform allocation will reward branches in high growth markets where new account openings are commonplace, and punish branches that are in mature markets. Further, some branches do not have the same opportunity to sell CDs or home equity lines of credit for example, because their markets are different, the competition they face is different, and even facilities are different. Each has an effect on what you can sell effectively.

SHARE OF WALLET

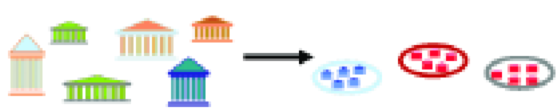
Another approach is one based on total wallet where branches with the most demand in their trade area get the largest goal. This is a slightly more refined approach in that it uses some measure of market opportunity. Like the others, it is relatively easy to communicate: There are 20,000 households in the market, and an estimated $25 million in checking account balances, which is more than any other branch trade area, therefore the largest goal will be allocated to this branch. However, this does not consider competitive intensity, nor does it consider that younger branches will not compete as effectively as mature branches. As a result, it rewards branches in weak competitive markets and punishes branches in highly competitive markets

OPPORTUNITY BASED GOAL SETTING

A better approach to goal setting is one based on a branch's true opportunity, which considers market realities, product potential, competitive environment, branch age and facility characteristics. Such an approach will provide an answer to the question, "How much is reasonable?" given the opportunity that exists for the branch. While an opportunity-based approach is complex to build and challenging to communicate, it will provide an equitable and defensible method for allocating product-level goals to branch offices that maximizes true potential to the branch.

One approach to opportunity-based goal setting is to account for all of those factors, which affect branch performance that are not controllable by the branch or its sales force. Those factors fall into three primary categories: market or trade area characteristics, competitive environment, and facility characteristics. By accounting for factors that affect sales but are not controllable by the branch, it is possible to analytically measure the opportunity that exists for a particular branch to sell a specific product.

One way to account for those uncontrollable factors is to create peer groups for all branches based on the similarities in each of the three categories: Market characteristics as defined by the demographic composition of a branch's trade area; competitive environment defined by the number and type of competitors in the trade area; and facility characteristics, such as type of facility, sales and service capacity, environment around the branch, age of branch, and other measurable attributes.



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By placing branches of similar opportunity together in these peer groups, it is possible to compare, or benchmark, one branch's performance against others (for example, by similar trade area demographics, competition, and facility types.)

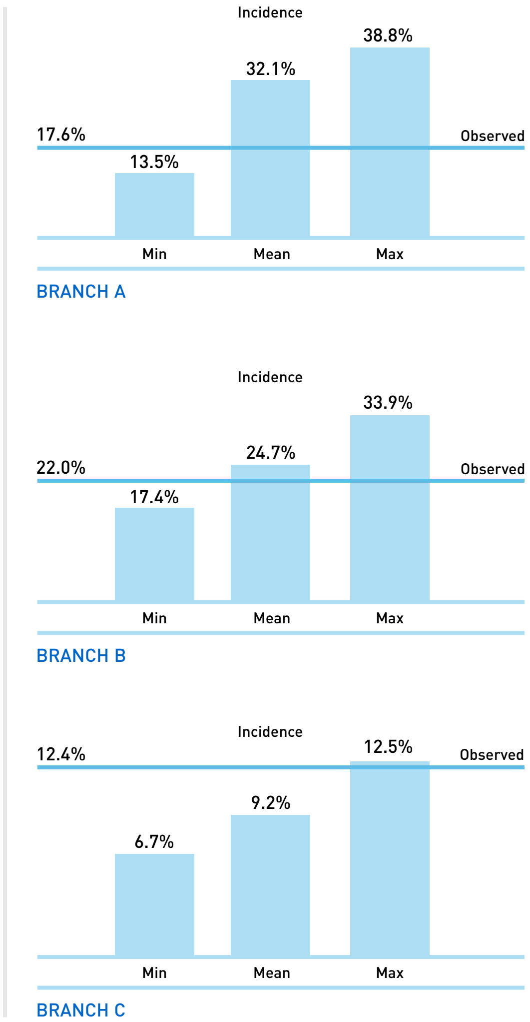
Benchmarking metrics that can be used to measure the upside opportunity for branches include market share or household penetration, untapped cross-sell potential, attrition, and average balances. When viewed across products, each branch will be placed along a series of performance continua indicating whether it is performing poorly compared to branches in similar situations, or whether it is closer to being "best in class."

Take household penetration as an example. A branch's facility type and the level of competition it faces are two key factors that, all else being equal, will go a long way in predicting its trade area penetration. However, by comparing a branch's household penetration against others that have similar branch attributes and face similar competitive forces, it may be concluded that the branch that has low household penetration relative to its peers has more upside potential to sell to new households. The branch in this peer group that has a high penetration rate has less upside potential since it has demonstrated that it is more deserving of the "best in class" label compared to others in the peer group.

Similar processes can be followed for other benchmarking metrics. Incidence rate, the percent of a branch's household that has a particular product, is a metric that can be used to measure cross-sell opportunity.

In the example below, three branches have varying incidence rates for home equity loans: branch A =17.6%, B = 22.0%, C = 12.4%. By all appearances, branch C is the poor performer among the three, at least as it relates to cross-selling home equity loans to its customer households. But a closer look reveals that when compared to similar branches, branches whose trade areas may be dominated by a high proportion of residential apartments, or a more mature population with fewer credit needs, it actually is doing very well. It's 12.4% home equity incidence rate is just below the maximum 12.5% among its peer branches.

HOME EQUITY LOAN INCIDENCE RATES



Knowing how much upside opportunity exists for a branch to sell products, whether the potential is from a trade area penetration metric, incidence rate, average balance, or attrition, can help determine where a branch is along a set of performance continua. Therefore, when it comes time to allocate sales goals across a network of branches,

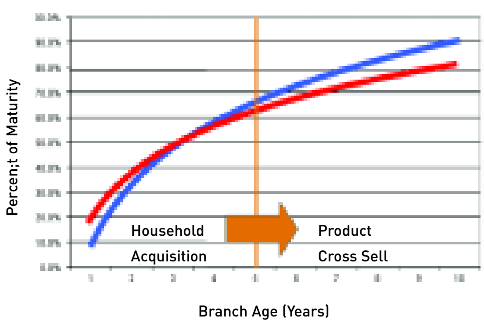
IT IS IMPORTANT TO RECOGNIZE WHERE AN INDIVIDUAL BRANCH'S OPPORTUNITY WILL COME FROM.

a methodology can be employed where branches with more upside opportunity are allocated a larger goal on a relative basis than a branch that has less opportunity available. In the home equity loan example for instance, if all three branches had the same number of households, branch A would be given the highest goal among the three since there is more opportunity to sell to existing households than at either of the other two branches.

Other Considerations

Once an equitable goal allocation process has been followed and those goals have been communicated to the branch sales force, it is important to recognize where an individual branch's opportunity will come from. For example, young branches will tend to find more opportunity acquiring new customer households than long established branches that rely more heavily on cross-sell efforts.

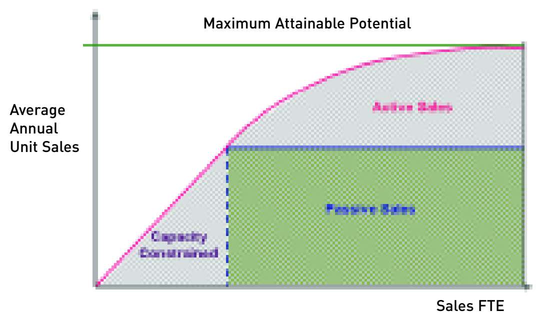
CONSUMER DEPOSIT AND LOAN BALANCE MATURITY



A good goal allocation system will recognize this relationship and allocate a proper mix of goals from acquisition and cross-sell, thus placing focus where the true opportunity lies.

Staffing levels should also be considered as part of this process. Sales of some products are much more passive than other products. For example, active selling is typically not required for opening checking accounts for most retail consumers. A home equity line of credit on the other hand, will involve much more active selling, and as a result will require different skills and different resources than if checking accounts alone were being sold.

SALES VS. FULL-TIME EQUIVALENT



As displayed on the above graph, as Sales Full-Time Equivalent increase at low levels, capacity is constrained in making passive sales. But as the number of Sales FTE increases and reaches a minimum to meet all of the demand from a fixed quantity of passive sales, opportunity for active sales increases until it reaches a level of diminishing returns.

Summary

To maximize branch based sales a method which equitably allocates goals will ensure an efficient use of resources. As we have seen, use of historic performance is fraught with problems since significant variation exists for a variety of uncontrollable reasons. Time and again financial institutions experience a sense of loss when too many branches fall short of stated goals, while other branches inexplicably reach their number well before the end of the year. Such experiences suggest an inequitable allocation method where some branches are given unachievable goals, and others are benefiting from other factors that are not being considered in the goal setting process. Only by measuring the true opportunity can such inequities be avoided.

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