YOUR MOST PROFITABLE CUSTOMER TYPES

by Steve Brown

At a recent dinner party, we observed the difference between boys and girls when it comes to cooking s'mores. Girls, placed the chocolate on the graham cracker, toasted the marshmallow and placed the hot marshmallow carefully between the Hershey's/graham cracker platform. Boys, on the other hand, ate the chocolate, fast-balled the marshmallows at the backs of other boys, flung the graham cracker like a Chinese fighting shuirken over the fence and prepared to sword fight with the coat hangers. Bankers, like boys having dessert, often don't appreciate the component parts of relationship profitability. Banks tend to treat all customer segments the same, when in reality they have completely different compositions. While some understand customer profitability or product profitability, we have only met a handful of banks that have gone down to the next level to ascertain customer-type profitability. Having a working knowledge about what type of customer contributes the most to the bottom line is important as you design product bundles and marketing campaigns. In order to determine profitability, we analyzed banks on a fully loaded basis (looking at both direct and indirect costs), adjusted for credit risk and aggregated profitability across all product lines including loans, deposits and services used. After looking at more than 40 different customer segments, the clear winners are: 1) Funeral homes (low probabilities of default, high deposit balances); 2) Municipalities (very low probabilities of default, high MMDA balances, low interest rate sensitivity); and, 3)Professional medical services (strong loan activity, above average fee income generation, utilization of a high number of deposit products). Worth mentioning, in 4th place, are religious organizations. While their activity is lower than the before mentioned segments, religious non-profits have low probabilities of default and higher than normal balances in 2 key areas Â– checking and savings. The combination boosts profitability to near-3rd place levels. In the middle of the pack are title companies (low loan usage, but high deposit balances), real estate firms (strong product usage, but higher default risk) and a host of other entities such as non-religious non-profits, lawyers, accountants, insurance companies and schools that just don't utilize enough products or have below normal balances. Who are your least profitable customer segments you are salivating to know? They tend to be entities that are non-seasonal commercial entities (such as restaurants), because they don't have a great borrowing need or have periods of high cash balances. In addition, very cyclical or speculative companies are low on the profitability spectrum, as they tend to have higher-than-average default rates, such as mining, textile manufacturers and early stage technology companies. In addition, retailers of all types tend to be at the low end of profitability spectrum due to usage and balances. If you are interested in how you generate profitability, take some time to slice and dice customer type data (or give us a call to outsource). While not as much fun as slinging marshmallows at your fellow banker, carefully constructing profitability from customer segment types can result in a harmonious dessert of higher ROE.

LOAN PRICING MODEL

We will update our online loan pricing model over the weekend with the latest loan performance, risk and cost statistics. If you are not using a loan pricing model, how can you possibly compare loan alternatives to best allocate your capital and resources? For more information, contact us for more information.

BANK NEWS

Acquisition

Alabama National BanCorp. ($6.7B, AL) will buy The Peachtree Bank ($530mm, GA) for an undisclosed sum.

MBA Index

Mortgage applications jumped 11.9% to its highest level in January. While new purchases were up 7.6%, refis were up 17.5%.

Branching

The OCC reports 38% of all depository institutions have increased their branch presence by 5% or more over the past few years, putting pressure on profitability as they ramp up. The OCC also indicated about 60% of the growth had occurred in urban areas.

Manhattan Pricing

Co-op prices in NY City fell 16% for 3Q, to an average of $1.3mm.

Top Analyst

If you followed the top banking analyst's "buy" recommendations, your annualized return for the quarter would have been 20.8%, or 4.8% above the 16% industry return.