MULTI-LAYERED PRODUCTS

by Steve Brown

When we work with banks on product development, one thing we emphasize is to envision your product and service offerings in 3 layers. The first layer is composed of the building blocks of individual core products and services. This "Product Layer" is really the heart and substance of an independent bank and includes products like term loans, revolving facilities, ACH, checking and platinum money market accounts. The next layer takes these core products and packages them according to "solutions," which is really a code word for "price elasticity." In other words, the goal for the 2nd or "Functional Layer" is to create packages that are targeted at either price sensitive or non-price sensitive customers. For example, our research shows that the average price sensitive customer is reactive to deposit pricing (since there are many more deposit customers than loan customers) and fees, but not to credit pricing (at least not to the same extent of price sensitivity). Therefore, banks designing bundled product offerings that combine a high rate money market account (that waives fees for balances over $25k), with a term loan, will see increased profitability. What bankers lose in profitability and interest rate sensitivity on the deposits is more than made up for on the loan. The end result is a more profitable product bundle than an MMDA account combined with other depository accounts (since those would be equally price elastic) or with an investment account. Better yet, banks that combine an MMDA account with a loan and investment account are even more profitable and price inelastic. The Functional Product Layer can be constructed so that up to 5 different packages are available for the spectrum of price sensitive customers. This layer gives banks a way to channel their customers based on general needs and characteristics in the marketplace. Another way to look at this is that by having the Functional bundles, banks can now recognize and categorize their customers into those that are more service oriented and those that are price oriented. Profit margin is protected on customers that are service sensitive, while increased on those customers that are largely price sensitive. The 3rd and final layer or "Segment Layer" should be designed to basically take the same product bundles and target them at specific customer groups. By taking the previously mentioned MMDA/Loan bundle, calling it "The Real Estate Management Package" and making that available to condo associations, banks can increase profitability and decrease price sensitivity. Wrapping the Functional product bundle with customer-specific marketing (and increased training for staff), banks can better target various customer segments. This allows the bank to further differentiate itself by playing up its expertise in a particular field. In so doing, the bank has created a value point, allowing it to attract a higher premium on loans and extract more value from deposits. Management can now leverage each functional package into a customer competency to enhance profitability. By using this three layered product offering approach, banks get their product and service line working double duty, while targeting the specific characteristics of its customer set. Without getting too complicated, banks can effectively match both the exhibited propensities of its customers (price shoppers vs. value shoppers vs. service shoppers) with the implied needs of a particular customer segment (be it condo associations, doctor groups, women owned business, etc.). This gives banks not only a wide range of flexibility, but is yet another tool to help diversify away from just competing on price.

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BANK NEWS

M&A

Sterling Bancshares ($4.3B, TX) will acquire Partners Bank of Texas ($184mm, TX) for an undisclosed amount.

NIM Alert

Bank earnings have been trickling in and we have been monitoring net interest margins. Note that out of a group of 9 national and large regional banks, all saw their 4Q NIM contract. Here are the actual NIMs for this group (average is 3.33%): Bank of America 2.75% (lowest in this group); BB&T 3.70%; Fifth Third 3.16%; KeyCorp 3.66%; National City 3.73%; PNC 2.88%; Regions 4.1%; SunTrust 2.94% and Wachovia 3.09%.

Competition

Wells Fargo has launched a new program that will allow customers to anonymously donate up to $250 to 6 different charities through their ATM network.

Business

A global study has found the number of American adults starting or running a new business has fallen to 10%, compared to 12.4% one year ago. Other findings: individuals aged 25 to 34 are the most likely to start a new business, while those aged 55 to 64 are the least likely.

Payment Risk

The Fed asked that large payment systems, such as automated clearing house, credit and debit card operations conduct a self-assessment as to risk, approve it and have it available for the public by year-end.

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