LOYALTY

by Steve Brown

Dogs have a loyalty instinct that runs deep and is also very well known. Sayings, poems, stories and even art have all been devoted to the subject of dog loyalty as it relates to their owners. Let's face it, when it comes to dogs, loyalty and devotion are part of their natural instincts. That is probably one main reason why so many people who have dogs also view them as a member of the family. When it comes to banking, however, customer loyalty can be another matter entirely. Studies show that it costs 5x more to win a new customer than it does to retain an existing one. Yet, despite the fact that independent banks provide excellent service and should therefore have strong customer loyalty, studies show something different. In fact, a recent study found that customers most often stay with their bank because of its location. Given the number of branches that have been built (up nearly 15% in total since 2000), bankers have more work to do. The same study found that the 2nd most often cited reason people stayed with their bank was that they perceived a high cost to switch. Given a compelling offer from another institution, these customers are also at risk. Further, banks in general have a 26% average employee attrition rate in the branch (overall attrition rates are running at 18% for the industry). Given that 1 in every 4 tellers walks out the door every year, consistency of message, training and customer knowledge are very difficult for any bank to maintain. Compounding the problem, consider that in many banks, 60% of experienced managers will retire in the next 4Y. Finally, while we are big fans of technology and remote deposit capture, consider that banks initiate only 5% of all contacts with customers and that as much as 90% of customers have only limited contact with their bank. Given all of this cheery news, what can an independent bank do to increase its customer loyalty? To get some ideas, we combed through research from Wharton and USC that examined the effectiveness of customer loyalty programs. Here are some tips and other information worthy of passing along for those banks endeavoring to enhance customer loyalty. More than 75% of people utilize at least 1 loyalty program and companies spend nearly $1.5B on such programs each year. Loyalty programs in one form or another have been around for more than 100 years. Banks should consider offering a combination package of a rebate plus points on promotions. Findings indicate such an approach is more effective than offering either one in isolation (even if the single offer is more than 2x higher). It is believed that such pricing raises the perceived value of the offer and indicates people do not value each unit of "currency" equally. The point value also matters. For instance, researchers found that people see more value in a free round trip ticket than an equivalent amount of money. Because people use money to pay bills, they perceived it to have a lower value than the ticket, which provided memories. Finally, banks considering a loyalty program will have more success if it is "seeded" first. By offering a program that requires 10 points, but seeding it with the first 2 on the first visit, banks tap into the psyche of customers. People mentally see this as a task that has already begun and is incomplete, rather than an unseeded one which hasn't begun (and so has less emotional value). By trying some of these techniques and including personalized service, support, technology and simply listening more, banks stand a better chance of increasing customer loyalty. Only 36% of customers say their bank listens to them, so throw them a bone now and again and you will increase loyalty.

BANK NEWS

Loan Spreads

While most independent banks wouldn't be caught dead lending to companies that make subprime loans, it is interesting to note that the average borrowing spread for such companies is about Libor+190bp, according to recent Wall Street research. At that level, such companies are borrowing at approximately Prime minus 100bp. Just goes to show you how competitive things have become and how banks will have to live on lower spreads going forward.

Competition

Fifth Third Bank has launched a new unit targeting small businesses and staffed it with 500 people. The unit includes salespeople (focus on loans, cash management products and setting up retirement programs for business owners) and portfolio managers (responsible for underwriting). The bank said it is rolling the program nationwide.

Competition

Bank of America indicates that in 2005 it kept no single family residential loans on its balance sheet, while last year it held 15% and this year it is projecting the percentage will be closer to 35%.

Branch Sale

Provident Bankshares Corp ($6.0B, MD) will sell 6 branches in VA to Union Bankshares Corp ($2.1B, VA) for an undisclosed sum. The bank said it was doing so as a strategy to optimize the branch network and focus on core markets.