# WATCHING THE WATCHMAKERS

by Steve Brown

What can bankers learn from the watch industry? Perception can be as potent as execution. As the largest watchmaker in the world, Seiko has held an advantage over its Swiss watch industry rivals. Seiko invested heavily in research and development and unveiled several timepieces featuring technological innovations: the first quartz watch with day and date; the first LCD watch with an hour, minute and second display; the first quartz chronograph; the first calculator watch; the first TV watch; and the world's first automatic quartz watch.

Seiko was manufacturing hundreds of millions of low cost watches a year in the 1970s, while the Swiss industry was still steeped in watch-making tradition. Other than Seiko, Swiss watchmakers were slow to adapt to quartz watch production on a mass scale. The result was that many Swiss watchmakers have consolidated or closed. Over the years, the number of companies has decreased from about 1,600 in 1970 to about 600 now.

How does this apply to banks? The "Seiko banks" of today with a large operation, low-cost structure and an international footprint are Citi, Bank of America, JPMorgan and others. These large banks regularly compete against community banks that have less access to resources, capital markets and have a smaller geographic reach. To find out how community banks can compete against such industry giants, we take a look at what the Swiss watch industry did to Seiko.

By the early 1990's the Swiss watch industry had made a comeback, achieving tremendous growth and stealing market share from Seiko. Today more than half the value of the watches sold worldwide is generated by the Swiss industry. The Swiss watch companies identified a meaningful area of differentiation for consumers: perception of value. While mechanical watches constituted only 14% of Switzerland's finished watch exports, it accounted for 62% of the total value. Eight Swiss watchmakers (Swatch, Rolex, Richemont, LVMH, Patek Philippe, Bulgari, Chopard and Gucci) account for 90% of the luxury watch market.

Swiss watchmakers realized that select, desirable consumers did not want low-cost watches because they associated low-cost with low quality. By specializing and keeping their timepieces exclusive, higher priced and less "high tech;" Swiss watchmakers captured and converted consumers looking for higher perceived value. In so doing, they created a new market for their products.

Community banks likewise cannot compete with "Seiko banks," unless customers perceive community bank offerings as qualitatively different. Community banks must differentiate in service, local knowledge, product offerings or customer identity. For example, community banks have the ability to spend time with their good customers, working on financial planning and deepening the relationship. This drives loan and deposit growth. By targeting everyone, community banks risk alienating the very clientele they must target, in order to differentiate themselves. Further, community banks should create a brand identity that will determine their product offerings, rather than allowing undifferentiated products to create their identities.

Community banks that focus unwaveringly on their unique customer niche are better positioned to capture new clients - whether or not they decide to deliver a quartz, mechanical, diamond-set, stainless steel, wood, plastic, ceramic, sporty or trendy watch that is either hand wound or automatic. Banks that focus on their niche, lock down their brand, and don't launch another line of new watches simply to counter their own "Seiko" competitors will remain well positioned into the future.

## BANK NEWS

**M&A**

Prosperity Bancshares, Inc ($6B, TX) has agreed to acquire 1st Choice Bancorp ($305mm, TX) in a deal valued at $68mm, or 2.5x book.

**No Deal**

First Horizon's ($37B, TN) sale of 9 branches to Fifth Third Bank ($57B, OH), which was scheduled to close on Friday, will not take place because First Horizon abandoned the deal. In response, Fifth Third filed a lawsuit against the bank, asking the US District Court to force First Horizon to complete the transaction.

**Econ Growth**

The 5Y Treasury yield as increased 20+bp relative to the 2Y and 10Y Note. This intermediate yield rise is significant, as the last 2 times it has occurred (in 1990 and 2001), the economy began to expand within 9 months.

**Housing Barometer**

The nation's largest homebuilder, D.R. Horton, took a $246mm write-down in its fiscal 1Q, as it charged off land and inventory. For the quarter, revenue fell 39% (vs. same period in 2007), the cancellation rate was 44% and the builder sold 36% fewer homes.

**Muni Bonds**

Spreads on bank qualified bonds with insurance have increased by an average of 1.30% due to the lack of confidence in the monoline bond insurers. This makes muni bonds attractive, as their probabilities of default are still around 0.2% (with a lower future tax base projected).

**Foreclosures**

A new study finds the total number of homes that went into some stage of foreclosure jumped 79% in 2007 compared to 2006. The top 10 highest by state in order were: NV, FL, MI, CA, CO, OH, GA, AZ, IL and IN.