BETTING ON THE RIGHT CUSTOMERS

by Steve Brown

At the ABA CFO Exchange in Kansas City last night it was helpful to have a casino night. We were comforted by the fact that bank CFOs are so disciplined, that they treated even fake money as their own. The night also helped underscore our speech today at the conference, where we will highlight the future of bank performance. After all, the predicting the future is just an exercise in probabilities. Our point is that many banks are making current decisions that, in all likelihood, will determine future profitability. Some of these decisions are going to result in above average profitability and some will not.

Take for example, customer acquisition. In the past, community banks heavily courted real estate developers, because these customers generated loans. That is a good thing, but it is not the whole story. In our recently updated study, we found that developers do tend to generate an above average amount of loans. We also found they leave a below average amount of deposits, have greater leverage, exhibit higher default rates and have an overall financial position more correlated to the general economy than many other customer segments. Just like no craps player should be surprised when they roll a "7;" no bank should be surprised that after banking their share of developers, the bank finds itself with higher than historic loan losses, tight funding and lower profitability.

There is nothing wrong with banking developers but bankers that do so must make sure they offset the risk with a client sector that mitigates this risk. For that matter, if your bank will open an account for any customer in the community, then don't be surprised if you end up with the average profitability of the community. While there is nothing wrong with banking any customer that walks in the door, banks would be better served by focusing on customers that have desirable characteristics.

Let's say you wanted to increase deposits. Our data finds certain types of customers tend to bring in larger deposits. These include condominium associations, unions, trade groups, law firms, funeral homes and start-up technology companies, to name a few. These and about 120 other customer sets are highly valuable to banks and tend to produce customer profitability that is 3 to 5x greater than average.

Despite that type of profitability, few banks actually commit marketing and other resources to specifically target these deposit-rich customer segments. To really see results, banks should consider understanding their cash management needs, cyclicality, current trends and services required for a each customer type. Sometimes lines of credit are important, other times it may be letters of credit; while at other times it may be business sweep or foreign exchange.

Once a product suite is designed, it also pays to create specific marketing materials that highlight this expertise. Putting a couple of sentences onto a website no longer counts as a marketing specialty. Spending money on brochures sends a message that the bank is committed to the sector and understands the industry. For that matter, hiring a consultant that not only has expertise in a chosen field, but can also introduce the bank should also be considered. Retired doctors, pharmaceutical reps or office managers are the perfect people to support this effort. These people can also be invaluable when putting together marketing and sales programs.

Having more profitable customer types does not guarantee success, but it does shift the odds in your favor. Before you gamble on an average customer, conduct a test. Take a profitable customer group, develop a specific action plan to bring them in the door and we will bet it will pay off in spades.

BANK NEWS

States Doing Well

Bankers worried about bond insurers may want to consider buying bank qualified municipal bonds issued by MT, NM, TX, W VA or WY. These states are all doing well, as a result of strong agriculture and commodities prices.

RDC Risk

Fraudsters are using remotely created checks and other payment technology to steal money. As of July 15, the FRB said it would hold the bank of first deposit liable for deposits of fraudulent remotely-created checks.

Painful Situation

There are currently 700k bank owned homes on the market and another 1mm in some state of foreclosure. Experts say it will take 2Y to 3Y until the mess is finally cleaned up.

CU Expansion

A credit union bill will be voted on by the House this week. The bill doubles commercial loan thrift to 20% of assets and eliminates the 20% ceiling on lending to small-business. Also included is the option for financial institutions to opt out on yearly privacy disclosers if practices remain unchanged.

Sharing

The FRB and SEC are finalizing an information sharing agreement on investment banks. The agreement includes sharing data on transaction settlements, short-term financing, cash and trading positions and leverage and capital requirements.