CROSS-SELL VALUE AND GETTING OUT OF JAIL

by Steve Brown

In the game of "Monopoly," one item that had the greatest volatility in value was the iconic Get Out of Jail Free card. Since players couldn't collect rent if they were in jail, managing jail time could be important. For example, those playing a 6 person game that owned Boardwalk and Park Place with hotels on them might be willing to pay $2,187 for the privilege of getting out of jail in order to collect your $2,000 in rent from the approaching players. The price one is willing to pay is dependent on where other players were positioned on the board and the probability of them landing on the properties. The cost of acquiring a Get Out of Jail Free card (assuming one is for sale) was deducted from the expected value of rents. On the other hand, players who weren't land barons might find that card worthless to them and they might have been willing to go to jail in order to avoid paying rent.

The math of calculating the value of return against the probability of use is an important one when setting discounts on business products to help increase cross-sell, boost profitability and aid in retention. Banks need to weigh potential lost revenue against the value derived from the gain of a new product sale, in order to determine whether such tactics make sense. Since this is one of the topics at our upcoming High Performance Workshop coming up next month, we won't go into too much depth here, but we wanted to give readers a general overview of some of our findings and methodology.

For starters, banks interested in building deposits should consider one of the best cross-promotion tactics and offer a rate reduction for a given loan in exchange for opening a primary checking account with auto pay. At present, only about 10% of community banks we know do this, but we expect more will do so soon, in order to build deposit balances. The tactic is particularly effective for small business loans, where balances are relatively large compared to loan size. If conducted effectively, the hit rate can be in excess of 15%, which is fairly good, considering that a bank landing $15mm in loans would capture approximately $1mm in new deposits. This all comes at a cost of roughly $7k per annum, which includes marketing, but not account maintenance. On a fully-loaded cost allocated basis, the net profitability of this promotion works out to be somewhere north of $18k per annum, which is nothing to sneeze at (considering banks can also increase their retention by a rate of 4x and also probably increase customer satisfaction). Working with the same promotion and offering discounted loan fees also works, but our analysis shows it is not as effective and garners only about a 3rd of the profitability.

Another effective cross-sell plan is the promotion of credit cards to business deposit customers, by offering fee waivers and low introductory rates. This is still one of the most tried and true promotions and works much better if it offers a platinum-type, premium card to small businesses. The problem is that almost 62% of community banks already offer this type of promotion, so it is also difficult to differentiate from competitors. However, if other banks in the area aren't utilizing this cross-sell tactic, it can garner an estimated $255 per year per customer on a net basis, which is obviously much better than passing "Go."

Banks can attempt multiple cross-sell tactics with varying degrees of success. Waiving fees for additional checking accounts, offering an extra 25bp in rate for additional money market accounts and other special promotions on insurance, brokerage and wealth management products all work to one extent or another.

Like trying to figure out what you are willing to pay to purchase another player's Get Out of Jail Free card, it is helpful that before offering a given promotion, banks take the time to calculate their probability of success multiplied by their net profitability in additional business (including the cost of such promotion). Once modeled, banks can make better decisions on which promotions to run, for what products and when. Now, if only we had a Get Deposits Free card.

BANK NEWS

FN/FH Preferred Stock

In a trend likely to surface at many other banks in coming quarters, JPMorgan said it will take a 50% writedown on FNMA and FHLMC preferred stock. Banks hold an unknown but reportedly fairly large piece of the estimated $36B in preferred shares of these GSEs.

Financial Sector

S&P has issued a negative outlook on nearly half of the 50 highest-rated financial institutions in the country, the highest proportion in 15Ys.

Fraud

A new report finds incidents of mortgage fraud jumped 42% nationwide on loans originated in the 1Q that have since been found to be fraudulent. In order, states with the highest number of reported cases were FL, CA and IL/MD/MI (3 way tie). The most common fraud was reported to be misrepresenting income, employment history and debt/income.

Summer Lull

Though M&A deals typically slow in Aug, this month's merger volume looks to be the slowest Aug in 15Ys.