NOT ALL CUSTOMERS ARE THE SAME

by Steve Brown

At a recent dinner party, we observed the difference between boys and girls when it comes to cooking s'mores. Girls, placed the chocolate on the graham cracker, toasted the marshmallow and placed the hot marshmallow carefully between the Hershey's/graham cracker platform. Boys, on the other hand, ate the chocolate, fast-balled the marshmallows at the backs of other boys, flung the graham cracker like a Chinese fighting shuirken over the fence and prepared to sword fight with the coat hangers.

Some bankers, like boys having dessert, often don't appreciate the component parts of relationship profitability. These banks tend to treat all customer segments the same, when in reality, they have completely different profitability profiles. While many understand customer profitability or product profitability, we have only met a handful of banks that have gone down to the next level to ascertain customer-type profitability. Since a bank is the composition of its customers that makes a key difference in profitability. In fact, a targeted customer strategy can add approximately 3 percentage points to a bank's ROE.

Having a working knowledge about what type of customer contributes the most to the bottom line is important as you design product bundles and marketing campaigns. In order to determine profitability, we analyzed banks on a fully loaded basis (looking at both direct and indirect costs), adjusted for credit risk and aggregated profitability across all product lines (including loans, deposits and services used). After looking at more than 60 different customer segments, there are differences. Trade associations, labor unions, insurance companies, venture capital firms/asset funds and broker-dealers all hold large cash balances, tend not to be interest rate sensitive, use a variety of banking services that generate fees and tend to have lower relative credit risk. Municipalities, professional services, mid-stage technology companies, title companies and non-profits also produce above average profits. Note that most of these segments derive their profitability from cash management services and deposit balances versus loan growth.

Developers and certain manufacturers can be profitable for banks, but are such because of loan generation. If your bank is trying to curtail its use of capital, then there is little need to go after these customer categories.

Along with highly profitable customer segments, it is also important to note the least profitable groups. In general, customer types that are non-seasonal commercial entities (such as restaurants and c-stores) have some of the lowest profitability (yet often make up a bulk of the customer base for banks), because they don't have a great borrowing need or have periods of high cash balances. In addition, very cyclical or speculative companies are low on the profitability spectrum, as they tend to have higher-than-average default rates (such as mining, textile manufacturers and wineries). In addition, retailers tend to be at the low end of profitability due to usage and balances.

If you are interested in generating increased profitability, take some time to slice and dice customer data. If you don't have the data, contact us and we will provide an outsourced profitability system for you (called "Relationship Profitability") and work with you on strategies to increase earnings. While not as much fun as slinging marshmallows at your fellow bankers, carefully constructing profitability from customer segment types can result in a harmonious dessert of higher ROE.

BANK NEWS

Gone Guarantee

As the Federal guarantee on money-market mutual funds expires today, investors pulled more than $55B out from funds this week. Currently there is $3.5T held in money market funds in the US.

Student Loans

The House passed a bill that would end federally-subsidized student loans and replace them with direct federal loans. The change is expected to save $87B over 10Ys for the government.

TARP Bill

In the House, a new bill has been proposed to form a trust to oversee TARP investments where the Gov't has more than a 15% stake. The trust will be managed by 3 trustees with orders to sell off assets by the end of 2011.

CMBS Restructuring

In an attempt to stave off a CRE problem, Treasury issued more lenient tax rules on restructuring loans bundled into CMBS. Currently, only owners already delinquent can begin restructuring talks. Under the new rules, borrowers who are current can begin talks at any time. From now through 2012, over $150B CRE loans packaged into CMBS will mature.

TARP Repayment

The Treasury projects banks and other financial institutions will repay an additional $50B on top of the $70B already repaid over the next 12 to 18 months.

Mobile Banking

USAA reported that in the first 3 days after its launch, some 70k customers had installed an iPhone application for remote capture and deposited $1.5mm into their deposit accounts..

Bank Execs

A KPMG survey of banking executives finds the top business challenges in order are managing risk, finding new sources of revenue growth, regulatory compliance, raising capital and restoring investor confidence.

Copyright 2018 PCBB. Information contained herein is based on sources we believe to be reliable, but its accuracy is not guaranteed. Customers should rely on their own outside counsel or accounting firm to address specific circumstances. This document cannot be reproduced or redistributed outside of your institution without the written consent of PCBB.