# BEING THANKFUL FOR LOWER CHURN

by Steve Brown

If you are hosting Thanksgiving this year, we have a question - what were you thinking? If you are going to be thankful for something, you might as well throw in a good dinner to the list and be a guest. However, if you do have to cook, do not worry, because we bring our quantitative mindset to determining how much turkey you need to cook. According to the Federal Reserve, you need to divide bad loans by gravy...No sorry, that was the wrong calculation. According to Martha Stewart, the average 155 pound person can eat 1.5 pounds of turkey. Thus, if you are having 20 family members over for dinner, aside from a bigger bonus, you are going to need 30 pounds of turkey. This is a turkey the size of a small NY borough, so plan accordingly. At 18min per pound, that's 9 hours of cooking time, which means you better stop reading and start cooking now. On the other hand, if you don't like waking up at 3am to start cooking, there is another way - call your relatives and have them drop some weight before they come over. This gives you an extra hour and a half of sleep, as you should be able to get by with a 25lb turkey.

Our point, aside from being fixated on stuffing, is that there is more than one way to approach a problem. Take profitability and customers - you could spend approximately $13,150 acquiring a new customer or you can spend about $531 and keep the customer you already have.

If you don't know your "customer churn" you should. Most of the banking industry uses a "defection rate" which takes both voluntary and non-voluntary (such as moving) defecting customers for a given year and divides it by the total customer base at the start of the year. Rates below 12% for a community bank are good, while anything above 20% is destructive.

While interesting, in our opinion, this doesn't tell the whole story, since the customer base changes over the course of the year and new customers are coming in. To get a better handle on this dynamic, we use a "Net Customer Formation Ratio" that takes new accounts opened for any given period and divides it by new accounts closed for that period. Unfortunately, the average for most community banks is in the 1.15 range which means for every account closed, banks opened just a little more than one account. In other words, banks are largely running in place. If you apply the cost of customer acquisition and defection, the math comes out that banks should be spending more resources in keeping current accounts happy.

Of course, a certain amount of churn is good, as banks want to move out their unprofitable customers, while bringing in profitable ones. If you have a profitability system, great, if not, add one to your holiday wish list because next to credit quality and deposit pricing; customer profitability is the next most important thing to tackle if you want to affect net income the fastest.

At BIG, we have developed a predictive model that helps banks identify which customers could leave and why. We will present some of our findings today on a free webinar at 11am PT / 2pm ET. Retaining customers is vital for banks that wish to improve profitability and we will look at some best practices in improving retention and implementing a successful program: To Register:

https://bigevents.webex.com/bigevents/onstage/g.php?t=a&d=855716156

If you can't make it because you have some cooking to do, not to worry, because we will run the online seminar again in December. If you can make it, the session will start you thinking down the path of improving your Net Customer Formation Ratio which will add nothing but gravy to your bottom line.

## BANK NEWS

**M&A**

United Community Bank ($774mm, IL) has agreed to purchase Brown County State Bank ($82mm, IL) and Marine Bank & Trust ($196mm, IL) from Mercantile Bancorp ($1.7B, IL) for an estimated $25.6mm, with an additional $2.3mm provided certain provisions are met.

**Ugly Situation**

FHLMC said it may lose $500mm due to the bankruptcy protection filing of Taylor Bean & Whitaker Mortgage and the FDIC closure of Colonial Bank. Taylor Bean processed borrower money that included loan payoff funds, borrower payments of P&I, taxes and insurance through Colonial Bank. Taylor Bean used accounts at Colonial to deposit money from mortgage borrowers that was on its way to Freddie Mac. Taylor Bean managed a mortgage servicing portfolio of about $80B.

**Housing Weakness**

In a sign the worst may not yet be over for the housing sector, research firm First American CoreLogic reported 23% of people with mortgages owe more than their home is worth and another 4% are within 5% of negative territory. Combined, the figures equal about 27% of all home mortgages.

**TARP Talk**

Of the 19 banks involved in this year's stress tests, 9 have yet to repay TARP funds, of which approximately $142B was injected. The FRB has requested these 9 to turn in plans for repayment.