THE SECRET SAUCE IN PRODUCT DEVELOPMENT

by Steve Brown

In most businesses, it used to be that if you wanted to find out what your customers wanted, you convened a focus group and asked them. The problem is that this method has limited power. The issue is two fold, one is that perfection is plural - there are many ways to obtain high satisfaction. The other issue is that oftentimes, customers really don't know what they want.

For a good 30Ys, up until the mid-80's spaghetti sauce sold in stores came with the same consistency in really only 2 varieties - with meat and without. Why, because that is what focus groups told testers that they wanted. By 1986, the Campbell's Soup Company, with its Prego brand, was trying to compete with Ragu. Unlike the standard industry practice at the time, Campbell's took a different approach to testing in that they cooked up some 25 different sauces in every variety and then asked groups to test and rate each. After combing through the data, market researchers found that consumers like sauces that come in basically 3 varieties - plain, spicy and extra chunky. The amazing part was, that until they showed focus groups what could be, no one knew that consumers desired spicy or extra chunky spaghetti sauce. The findings helped Prego launch "Zesty" and "extra-chunky" lines of Prego, both of which went on to be successful.

While we convene about 3 to 4 focus groups per year, to help banks with product development, we have learned to innovate and then test (as opposed to the other way around). This methodology was just recently employed by US Bank. US Bank, for instance, wanted a counter to BofA's Keep the Change program and to capture a product for the economic times. The result was its Savings Today and Rewards Tomorrow (START) that was developed and then immediately tested in focus groups and live markets. This goal-oriented savings account incents customers to move money in a dedicated fashion (for example on a specific day each month) from their checking to their savings, in order to reach a stated goal. If they do, the Bank rewards them with a $50 Visa gift card if they reach $1k in savings.

What US Bank found was that the product was a hit and captured higher than expected usage. More importantly, the Bank found that instead of cannibalizing checking balances, START actually helped customers save, by providing a method and incentive to shift funds from discretionary spending to balance building. By not providing a set interest rate, US Bank brilliantly shifted the consumer's focus away from rate and into one of service - a tactic that we wholeheartedly endorse. In addition, the Bank locked consumers in during a period of low interest rate sensitivity - another tactic we support. Because consumer targets are usually in excess of $1k and the time to save covers several years, the average interest cost is estimated to be sub-2%. While that may not sound that cheap, consider that the interest rate sensitivity of a START account exhibits a duration of approximately 4 and just a little under 3 in a +200bp rate environment (a good profile given upward rate risk).

US Bank is now in process of rolling the START account out nationwide and it all began with coming up with an innovative product and testing it out in a live, controlled market. Had, US Bank stopped to ask consumers what they wanted; they may have said higher rates and lower fees. However, if you put a group of savings products in front consumers, what they really coalesce around is the notion of wanting banks to help them achieve financial goals. By putting innovation in front of customers and then testing, your bank's product development process may find its secret sauce in a more efficient manner.

Related Links:
BIG METRICS

BANK NEWS

Banks Closed (22 YTD)

On Friday, the FDIC closed: 1) Carson River Community Bank ($51mm, NV) and sold it to Heritage Bank of Nevada (NV). Heritage acquired 1 branch, all deposits (no premium) and 74% of assets. 2) Rainier Pacific Bank ($718mm, WA) and sold it to Umpqua Bank. Umpqua acquired 14 branches, all deposits (for 1.04% premium) and 93% of assets. For more information on the banks, see under "Failed Banks" at BIG METRICS (link below)

FDIC Risk Weight Clarification

The FFIEC has clarified risk weights for purposes of risk-based capital requirements for claims on or guaranteed by the FDIC. In short, direct claims on and claims unconditionally guaranteed by the FDIC (such as FDIC-insured deposits and debt guaranteed under TLGP) are 0%; guarantees under loss-sharing agreements of assets from failed institutions are considered conditional and should be 20% risk weighted.

Thrifts 4Q

The industry pulled out a $505mm gain for the 4Q and cutting even at $29mm for all of 2009, marking the first annual profit in 3Y. Troubled assets dropped from 3.65% to 3.25% in the 4Q. Noncurrents in single family dropped from 5.76% to 4.99% and commercial loans from 3.22% to 2.71%, while construction and land loans hit a high at 13.8%.

FNMA & FHLMC

Fannie Mae posted a $16.3B loss in the 4Q, marking the 10th quarterly loss in a row. The company asked the Treasury for an additional $15.3B in funds. Meanwhile, Freddie Mac reported a $21.6B loss for 2009 and said it will no longer buy and securitize IO mortgages effective Sept. 1st.