

## 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 have to cook, do not worry, because we bring our quantitative mindset to determining how much turkey you will need. 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 Newt Gingrich, so plan accordingly. At 18min per pound, that's about 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 will give you an extra hour of sleep.

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 \$13,415 acquiring a new customer or you can spend about \$540 and keep the customer you already have.

If you don't know your "customer churn" we present a couple of ways to look at it. One way is to use an industry standard metric of 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, 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 open 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, such as our BIGProfit. Next to credit quality and loan/deposit pricing; customer profitability is the next most important item to tackle if you want to affect net income the fastest. We take the concept a step further and put a predictive model in place to highlight customers most likely to leave your bank. Most banks tackle a departing customer at a point where they have already decided to exit. A better approach is to tackle the problem at the first sign of an issue, such as canceling a service, stopping direct deposit or materially reducing balances.

Many banks have cross-sell initiatives for 2012, which is an excellent place to lower the defection rate. Products such as payroll, remote deposit capture or even an extra savings account can improve a bank's churn ratio over the course of a year. Another great lever is a formal customer complaint process, complete with follow up and immediate resolution. Making sure an upset customer is heard and their problem is resolved is another effective way to improve churn. Finally, instituting a quality

assurance and/or customer follow up program makes sense. Call new clients (or old clients in new products) and ask how they are being treated and how they like the new product or service to make a difference.

Soft loan growth and low yields mean improving customer churn is an excellent area of focus to improve earnings per share for 2012. Give it a try and we assure you that you will add nothing but gravy to your bottom line.

## **BANK NEWS**

### **Bank of America**

The WSJ is reporting that BofA's board has been told it could get a formal written enforcement order if regulators aren't satisfied with steps taken to strengthen the bank. Meanwhile, SNL Financial indicates there are 1,042 banks and thrifts currently operating under formal enforcement actions. BofA shares are down 58% this year and are now trading at the same low level reached in March 2009.

### **Stress Round 3**

The Fed will require US banks to conduct another stress test, starting as soon as next Tue. The test will stress bank income statements and balance sheets under a variety of scenarios and the results are required to be submitted to the regulators in early Jan.

### **Shut Down**

Following action last week working with Google, the TARP Inspector General (SIGTARP) has shut down internet advertisement scams through Yahoo! and Bing. In the past week, SIGTARP has shut down 125 of these alleged scams and together, Microsoft and Google have suspended relationships with close to 1,000 advertisers and agents tied to alleged fraud schemes.

### **New Limits**

Congress has voted to increase the maximum size of loans guaranteed by the FHA to \$729,750 which had fallen to \$625,500 on Oct. 1. The bill now goes to President Obama to be signed into law.

### **3Q Release**

The FDIC will release 3Q financial results for the banking industry today followed by a briefing by acting FDIC Chairman Martin Gruenberg at 10:00AM ET.

### **GDP for 2012**

Economists warn they will reduce 2012 GDP predictions if payroll tax cuts and unemployment benefits aren't extended. Both expire at the end of this year.

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