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## SCIENCE & LEARNING IN BANKING

by [Steve Brown](#)

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You should never stop learning in life. Just when you get comfortable with something, it is our experience that a new nugget of information or wisdom will find you that changes your perspective. For example, the scientific method for experimentation that we all learned in school can be applied to new products and services, process improvement and bank performance. You see, scientists are innately curious about the world around them and are always seeking to understand how things work. They look at a given problem and mentally begin to break it into smaller problems to solve. They focus on a problem with an open mind, formulate a possible solution, perform controlled experiments, record the data, analyze the data and then use that data to develop a conclusion. That process not only delivers results, but it creates a structure that can be leveraged. The next time you run into a problem at the bank, try following this scientific process and see what happens. Late last year, researchers from Pepperdine University and Northwestern completed a series of studies that produced information directly applicable to banking. In its most basic form, the results of these studies fundamentally challenge many long-held beliefs around product bundling. Specifically, researchers studied how consumers respond to product bundling when two products with very different prices are put together. Prior to this effort, many had surmised that consumers would perceive such a combination to be at least as valuable as the most expensive item, or would add the two together and sort of average the prices to determine value. Instead, researchers found consumers put together more informal groupings of items they come across during a given shopping event. This can produce unexpected results, such as producing "sub-additive" (rather than additive) judgments, where the consumer is interested in paying less for the combination or bundle, than for the most expensive item by itself. The researchers surmised this may be a result of human reasoning processes, whereby numerical values are simplified by the person by placing items into groupings or categories that are easier to handle or think about. Decisioning, satisfaction and other factors ultimately depend on how the person sorts various products into "buckets" and the values assigned. For example, sorting products you come across in a store into mental buckets of good/bad; expensive/cheap; healthy/unhealthy; large/small and others occur continually as you shop - even though you may not be consciously aware you are doing this. As such, they also influence behavior, the price people are willing to pay, the perceived value received and how satisfied your customers ultimately are with any product. Just knowing that bundling an expensive item with an inexpensive one does not always increase the overall perceived value from the customer (and may decrease it) is good to know. To be sure, product bundling is a complex and curious business with many different twists and turns. Understanding this, soliciting input from customers, trying different combinations and constantly checking and re-checking are fundamentally critical to achieve the best results over time. As you review your product offerings in this new light today, keep in mind the viewpoint of the scientist the next time you look at a problem to solve. Start with an open mind, think about a potential solution, perform experiments and develop a conclusion. Then test that conclusion over and over until you produce the magic elixir in your beaker that can be poured over the bank's suite of products to enhance earnings.

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# BANK NEWS

## **M&A**

Independent Bank (\$5B, MA) has agreed to acquire Central Bancorp, parent of Central Co-operative Bank (\$521mm, MA) for \$54.8mm in cash and stock or about 1.15x tangible book.

## **M&A**

Bar Harbor B&T (\$1.2B, ME) will purchase Border Trust Company (\$47mm, ME) for 97% of tangible book (3.9% premium on its loans). The story is getting press as it's the first acquisition in Bar Harbor's 125 year history.

## **M&A**

The parent of Encore Nat'l (\$1.6B, FL), has agreed to purchase a substantial amount of Royal Palm Bank (\$89mm, FL) from Mercantile Bancorp (\$839mm, IL) to include branches, loans and deposits. The terms of the deal were not disclosed.

## **Durbin**

According to Fed data, the average interchange fees for large banks fell 45%, from 43 cents in 2009 to 24 cents at the end of 2011. For banks under \$10B, interchange fees remained at an average of 43 cents.

## **Dodd Frank**

Banks met with Fed officials to discuss specifics of Dodd-Frank. In particular, banks sought to blunt the impact of a rule that would limit how much exposure can be had to one borrower. As proposed, no two large US banks would be able to have net credit exposure to one another totaling more than 10% of regulatory capital - banks are pushing for something closer to 25%). Also, banks discussed getting more transparency around stress testing.

## **Clarification**

To clarify yesterday's story, while 3 branches were sold by Bank of Hampton Roads, only 1 was sold to First Bancorp (parent of First Bank, NC) while 2 were sold to BNC Bancorp (parent of Bank of North Carolina, NC). Prices of all were undisclosed.

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