

## CUSTOMER DEGREES OF SEPARATION

by [Steve Brown](#)

When you think of six degrees of separation, you probably think about the idea that everyone is on average approximately six people away from another person. Put another way, someone you know (1), knows someone else (2), who knows someone else (3), who knows someone else (4), who knows someone else (5), who ultimately knows anyone else in the world you are trying to meet (6). To test this hypothesis, Stanley Milgram conducted an experiment in 1967 using the postal service and found that the number was indeed six. Roll forward to today and update the analysis using Facebook and you find it takes an average of only 4.7 hops to link together any two people using mutual friends. So, six degrees of separation is now only 4.7. It looks like Walt Disney was right - it is indeed a small world after all. Estimates vary, but it would appear about 80% to 90% of banks are reevaluating their business model. Increased competition, changing customer behaviors, low interest rates and a weak economy have driven this issue to the top of the list for many bank strategic planning sessions this year. Given this, some bankers are asking what would a buyer like to see them do and does that make longer term sense for their bank. Right now, credit quality is a nagging issue (albeit better than before), so buyers remain cautious and tend to reduce the value of anything that is or could spell trouble in the loan portfolio down the road. That will blow over in the next year to 12 to 24 months, however and in our opinion valuations will then shift toward core earnings, core funding and a bank's ability to organically grow. To build a better mousetrap, these are key areas for bank management teams and directors to focus on during their planning session. The landscape here provides some clues, as projections run from 500 banks less in the next few years to as many as 1,000. If that happens, pricing power should begin to return, however that also assumes the online and mobile world don't overwhelm everything else (which seems possible as well). To find out more, we examine a report from Ernst & Young on the banking industry to uncover additional clues worthy of consideration. For instance, the report found that bank loyalty is down sharply. Customers in the U.S. who switched their main bank increased from 38% in 2011 to 45% in 2012. Additionally, if you wondered why competition was so high, beyond weak loan demand overall, customers with only 1 bank have declined from 51% to 42%, while those with 3 or more have risen from 16% to 23%. These statistics show more customers are shopping around and more are willing to switch if the right offer is made or need is met. This is just the new reality, so one approach we heartily endorse is to identify your best customers, set up a team to work with those customers and then focus on extending both their deposit and loan relationships for longer maturities. Then, have an ongoing program to cross sell customers into other products and services over time to add stickiness to the relationship and reduce the odds customers will switch to a competitor. Another area that surfaced from the study was that when it comes to seeking advice on banking products and services, people turn to families, friends and colleagues first. This happens some 63% of the time in the U.S. and is one reason why larger banks are focusing energy on social networks, easier to use web sites, online banking communities and other areas. To capture the hearts and minds of customers and potential customers, maybe it really is all about the degrees of separation. All you have to do now is to identify those 4.7 people to capture that customer you have always been seeking. Our advice would be to start with Kevin Bacon to get a leg up on the competition.

### BANK NEWS

#### M&A



Bank of Henderson (\$78mm, KY) will buy Harrison Bancorp (\$50mm, KY) for an undisclosed sum. Harrison is the holding company of The Harrison Deposit Bank and Trust Company, KY.

#### **M&A**

Bank of the Ozarks (\$3.8B, AR) will buy Genala Banc (\$170mm, AL) for \$27.3mm (\$13.9mm in stock and \$13.4mm in cash). Genala is the holding company of The Citizens Bank of Geneva, AL.

#### **M&A**

NBT Bancorp (\$5.9B, NY) will buy Alliance Financial (\$1.4B, NY) for about \$233mm in stock, roughly a 22% premium to its closing price from Friday. Alliance is the parent company of Alliance Bank, NY.

#### **Layoffs**

First Horizon National (\$25.5B, TN) is offering 400 employees (about 9% of its staff) up to one year's pay and benefits to voluntarily leave. The company is seeking to cut overhead and improve efficiencies as it consolidates business lines and locations. First Horizon is the parent company of First Tennessee Bank.

#### **Competition**

Wal-Mart has teamed up with American Express to offer a reloadable prepaid card called Bluebird. The card will have no minimum balance and no overdraft fees and say all fees associated with the card will be obvious to the user and within their own control. The card is an alternative to debit cards and checking accounts and customers can deposit funds onto the card using direct deposit, a mobile app, cash at a Wal-Mart register or linking a bank account to the card.

#### **ATM Fees**

Bankrate.com reports its annual analysis finds the average ATM surcharge for noncustomers has risen 4% to \$2.50. Meanwhile, the fee banks charge their own customers for using a competitor's ATM also climbed 11% to \$1.57.

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