



Unconventional Wisdom to Grow Core Deposits

Sean C. Payant, Ph.D.
Chief Consulting Officer



A Bold Statement

"I believe 7 out of 10 participants at this Iowa Bankers Association Conference today can double the rate of core retail and business customers acquired, and it can be done very profitably."



Wits of Wisdom

"Whether you think you can or you think you can't...You're right."

Henry Ford



Thinking about Market Share

- FDIC data does it based on deposit dollars
- Instead, do some research and see how many rooftops and how many businesses are around your branches
- Compare to the number of unique addresses you have in your portfolio
- EVERY YEAR: 10% - 15% of those are "changing financial institutions"
- You can get a bigger piece of the pie!





A Similar Business Model . . . Mortuary Sciences

- A nice, big, expensive facility is required
- The facility is frequently empty (underutilized)
- Customers make an emotional decision
- Generally gets one shot to close the deal
- The service offered is a commodity that is difficult to differentiate
- Thinks it differentiates on service, but no one can tell from the outside - they all look the same until you experience it



A Funeral Home Business Plan

- “People remembering people”
- Average cost of a funeral: \$5,884
- 75% of deaths result in a funeral
- 1st year projected: 29 funerals
 - About 1 every other week

Source: Funeral Home Business Plan, Evergreen Life Memorial Center



Banker Think

- ROA, ROE, NIM, NII, NIE, efficiency ratio - global, macro measures
- We don't tend to think about "same store sales," "factory utilization," etc.
- How much revenue do you get per widget?
- How much revenue will you get from selling one more widget?
- What does it cost you to process one more widget?
- How utilized are your factories?



Let's Dive Into That....

- Revenues per widget - what is an average core customer worth at your bank?
- Costs per marginal widget - differentiate marginal costs from fixed costs.
- Do we have excess capacity in the factory?



What are Customers “Worth?”



Computing “Value”

- We monetize core customers in two key ways:
 - Balances (deposits and loans)
 - Non-interest income

So...what is an average current customer “worth” at your bank?



Retail Portfolio - Household Level

Account Group	Client Ratios	Client Balances
Checking	1.565	\$ 4,888
Savings	0.481	7,265
Money Market	0.030	66,092
CD	0.073	27,337
IRA	0.025	19,175
HSA	0.023	2,692
Consumer Loan	0.085	10,978
Line of Credit	0.018	9,166
HELOC	0.036	36,722
Mortgage	0.054	124,776
Business Checking	0.109	17,478

Total Relationships:	2.499
-----------------------------	--------------

Total Deposits:	\$ 17,570
Total Loan Volume:	\$ 9,158



Business Portfolio - Address Level

Account Group	Client Ratios	Client Balances
Business Checking	1.528	\$ 27,060
Business Savings	0.081	\$ 16,538
Business Money Market	0.049	\$ 118,509
Business CD	0.025	\$ 50,257
Business Loan	0.183	\$ 142,537
Business Line of Credit	0.032	\$ 85,156
Business Real Estate	0.116	\$ 406,382
Retail Checking	0.866	\$ 9,718
Retail Savings	0.429	\$ 8,827
Retail Money Market	0.053	\$ 92,863
Retail CD	0.075	\$ 40,912
Retail IRA	0.026	\$ 18,070
Retail HSA	0.032	\$ 3,057
Retail Consumer Loan	0.088	\$ 16,016
Retail Line of Credit	0.037	\$ 4,598
Retail HELOC	0.050	\$ 43,456
Retail Mortgage	0.091	\$ 170,280
	Business Only	Business & Retail
Total Relationships:	2.01	3.76
Total Deposits:	\$ 49,751	\$ 70,511



An Example



One Recent Example

- 8 office bank in the Midwest
- Were at “net zero” (openings = closings) - the portfolio of accounts was not growing
- Implemented a strategic core customer acquisition strategy
- Openings of new consumer and business accounts more than doubled
- First year: portfolio grew by over 3,600 net new consumer accounts and 500 net new business accounts
- Added from the new “households”
 - \$22MM in new checking deposits
 - \$21MM in new loans
 - \$5MM in “other” deposits (Savings, CD’s, etc.)



Computing "Value"

- Their yield on loans was 5.15%, the checking deposits cost an average of 5 basis points
- $\$21\text{MM} \times 5.1\% / 4,100 \text{ new accounts} = \$261/\text{year}$
- What are the "other" deposits worth?
 - \$5MM in Savings, CD's, etc.
- What about over an 8 year average life?



Non-Interest Income

- Their average account yields about \$100/year in net NSF fee income
- Their average account yields about \$60/year in interchange income
- Net NSF income + interchange income = \$160/account/year



Let's Recap

Yield:	\$261/customer/year
Value of "other" deposits:	\$????
Fee Income:	<u>\$160/customer/year</u>
Total:	\$421/customer/year



Danger in using Averages?

- Realize when this bank doubled acquisition rates, something HORRIBLE happened. . .
- They doubled in all strata of accounts
- Meaning the percentage of customers that are truly unprofitable doubled, too
- Which pulled the averages down to "only" \$421/customer
- Question: *Is that really such a bad thing?*



And, They Stay a Long Time!

- Haberfeld client average retail attrition: 11.55%
- Meaning average life is > 8 years!!!



And, They Stay a Long Time!

- Haberfeld client average business attrition: 10.43%
- Meaning average life is > 9 years!!!



But We Haven't Talked About Staffing

- How many new hires if we get one more marginal customer?
- How many new hires if we double the size of the portfolio?
- Let's put this in context, though:
 - The typical community bank is opening about 3/branch/week



What does the next customer cost?

- So you add one more PFI customer:
 - Issue a debit card (\$5?)
 - Send a statement (\$12?)
 - A little more data processing (\$???)
 - Bill pay (\$???)
 - Write off a little principal from overdrafts on some (\$5?)
 - What else?
- Clients report average direct marginal costs are about \$30-\$50/customer/year



Marginal Profitability is Key

If we get one more core customer...

- \$300 - \$500/year in revenue
- \$50/year in costs
- They stay > 8 years

That looks VERY profitable!



Net Present Value of the Relationship



Retail: \$2,939

Business: \$11,369



A Foundational Belief

Growing and serving more core customers is a good thing over time
- do you believe that?



Capacity

- Your branches and the big bank branches look the same.
- They have up to 5,000 customers per branch and the typical community bank has about 1,200.
- Question: *Do you have excess capacity? Could you handle more customers?*



But Wait!
If you actively market for new customers, you will get unprofitable customers!



Actually...

- The new customers you get will look pretty much like the current customers you are getting.
- You can't make them look much different.
- If you want a different looking customer... move your branch!



Unprofitable Customers Will Clog Our Lobbies!!!

- First, your lobbies aren't clogged - most of the time we could fire a cannon off and not hit a customer!
 - And it's getting worse - transaction volume in branches is declining.
- There is no perfect filter...just get twice as many who look like (on average) the ones you're getting today.
- You will get a LOT more unprofitable customers...
- In about the same ratio you are getting them today.



Conventional Wisdom

- Fully allocated cost model: Estimates in the \$200-\$300 per year range
- With that analysis firmly implanted, we start to make decisions without questioning the premise or the business model:
 - Marketing and Targeting: We have to get the perfect customer in order for them to be profitable.
 - Products: We have to structure our products so that we can't have an unprofitable customer.
 - Fees: We have to raise them in order to cover all these huge costs.





What Happens if the Funeral Director Doubles?

- Moves from 29 funerals/yr. to 58?
- What happens to fixed costs?
- What happens to marginal revenues?



Fundamental Structure in Banking

- Banking is a business of high fixed costs, low marginal costs (for the next core customer) and high marginal revenues relative to the cost, on average.
- You have TREMENDOUS excess capacity.
- Getting more core customers is a very strategic, profitable undertaking.



Wits of Wisdom

If you want something you've never had,
you have to do something you've never done.

Unknown



Business Models: Marginal Revenues vs. Marginal Costs

There are many businesses like ours with high fixed costs and low marginal costs that monetize customers well at the margin

- Movie Theaters
- Convenience Stores
- Even funeral homes!



Doubling? Really?

- Understand the emotional dynamics of switching
- You can't get anybody to switch...but you can get twice as many to pick you when they are ready to switch
- Must do effective marketing
- Have good product: good product is easier to sell than bad product
- Close the business when it comes in

More to come on this...



Customers Make an Emotional Decision

- When do you become the primary financial institution (PFI)?
- When customers give your name in response to this question: *"Where do you bank?"*
- They are telling you where they have their primary operating retail or business checking account.
- The checking account is the foundation of "PFI-dom."
- How do prospective customers choose?



Getting New Customers in a Fixed Marketplace

The Emotional Dynamic



In Every Market...

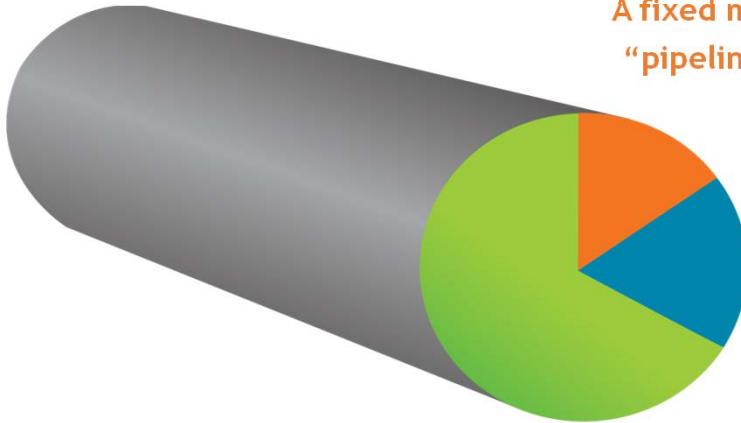
- In a given year, about 10% - 15% of the households “change financial institutions.”
- When you start getting new customers, by definition, your competition is getting fewer.
- We call this system net zero—when financial institutions are trading households back and forth.



The Good News!

Believe it or not...but it's counter-intuitive

A fixed market is an infinite
"pipeline" of opportunity!



Approach and Message

- You can't get anyone to switch, but you can do something profoundly different...
- You can get a lot more of them to pick you after they have already decided to switch!



“Changing Financial Institutions (FIs)”

- Perception is switching is really, really hard
- People only do it if they feel they have no choice
- Certain events beyond our control create the opportunity, you rarely get people to switch, it's just too difficult
- Be there when they decide to switch
- Set the right conditions for them to notice and pick you!



Why Do People Change FIs?

- Mad at the old FI (70%)
- Moved
- Changed jobs
- Life event (e.g., married, divorced, etc.)
- New bookkeeper
- Switching is largely event driven



When Do People Change FIs?

- When they have money
- When do they have money?
 - When they get paid
- When do people get paid?
 - Weekly or bi-monthly
- About every six weeks you get a double-whammy payday



Marketing

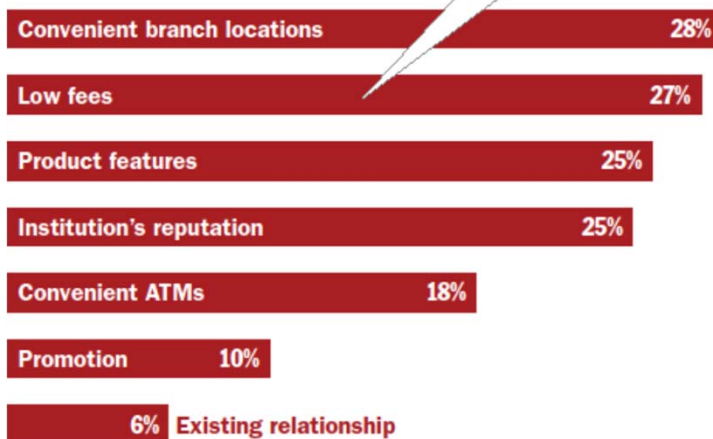


An Observation

- Bankers will spend money for acquisitions and to build new branches in order to grow...
- But they severely under-invest in marketing to fill up the branches they already have.

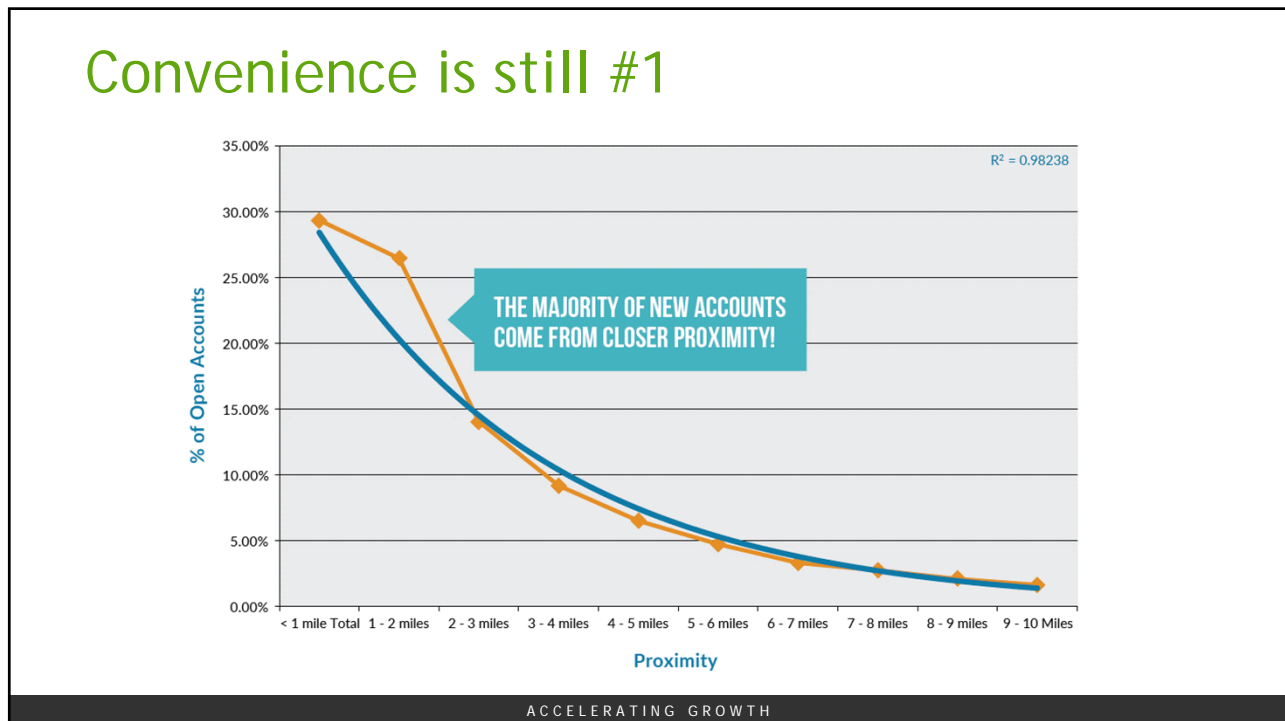
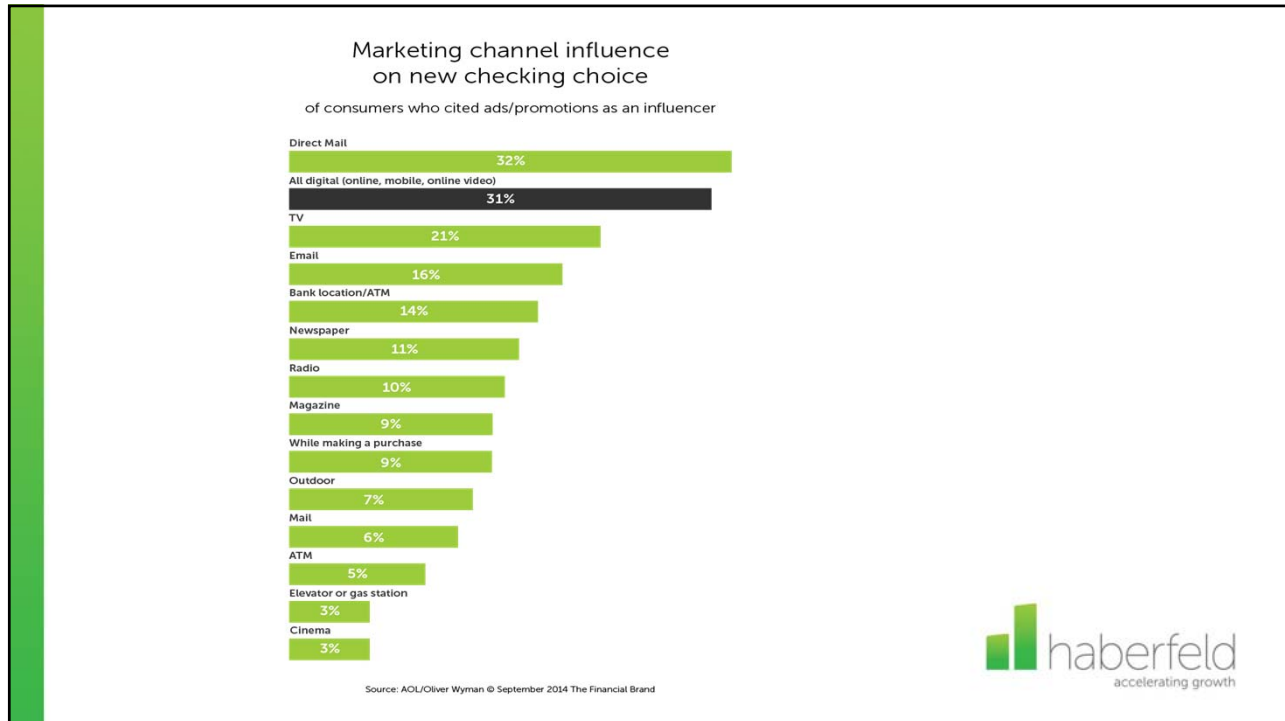


Reasons consumers cited as factors when choosing a new checking account



Source: Novantas © April 2015 The Financial Brand

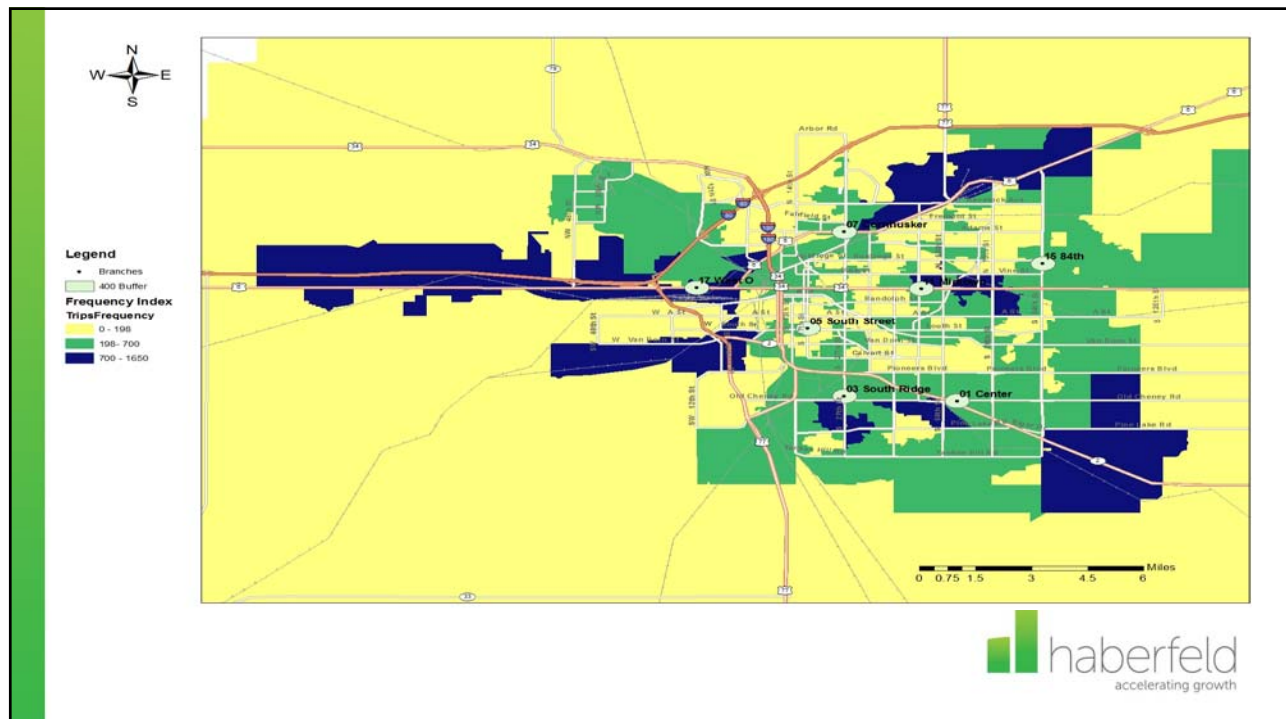




Electronic Marketing

It's changing!!!!

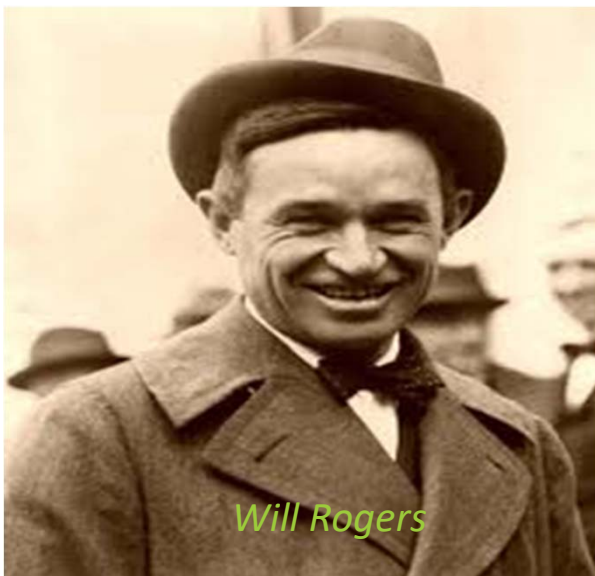
- >68% of ad requests online include location-based data...
...but few banks use that!
- Do you do any PPC? Map where you are already getting customers and do PPC there, not everywhere...



Getting A Lot More People in the Door

- What do people want when they are changing banks?
- Simple, easy to understand products
- No cost
- Low hurdles (if any)

Question: *Can we make money delivering this?*



It isn't what we don't know that gives us trouble...

it's what we think we know that just ain't so.





One Shot to Close the Deal

- Do your policies recognize that?
 - “Does my spouse need to be here?”
 - “What forms of ID do I need?”
- Do you pre-screen customers in order to qualify for an account?



Account Screening - Client Data

Category	Account Screening	No Account Screening
NSF Frequency	2.76	3.50
Principle Losses	\$4.85	\$8.36
Net Fee Revenue (after losses)		+\$9.78
Account Openings per Branch per year		+78

ACCELERATING GROWTH

Account Screening - Recent Case Study

Flagged as "Would not have been opened with account screening."		
Accounts Opened	202	
Accounts still active	157	78%
Accounts with charge-off	21	10%
Fee Income Analysis - 7 Months		
Gross OD Income		\$15,600
Debit Card Interchange		\$4,100
Charge off		\$4,612
Net Impact*		\$15,088
*Does not include savings from cessation of account screening inquiries.		

ACCELERATING GROWTH

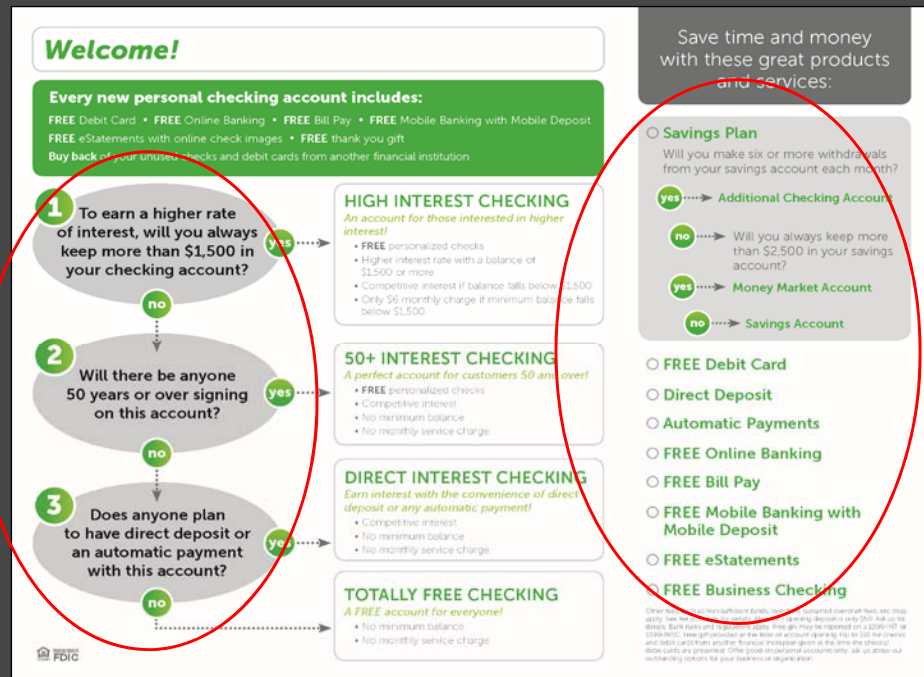


One Shot to Close the Deal

- Do your policies recognize that?
 - "Does my spouse need to be here?"
 - "What forms of ID do I need?"
- Do you pre-screen customers in order to qualify for an account?
- Do you have consistently applied questions that get the customer into the account that is right for them?



Take the emotion out when they actually come in.



One Shot to Close the Deal

- Do your policies recognize that?
 - “Does my spouse need to be here?”
 - “What forms of ID do I need?”
- Do you pre-screen customers in order to qualify for an account?
- Do you have consistently applied questions that get the customer into the account that is right for them?
- Does your frontline team ask for the business every time?





The Service Offered is a Commodity

- You think you differentiate by giving better service, but...
- If they aren't a customer, they haven't experienced your service!
- You can make service a competitive advantage.

How?

- Leverage your existing customers for referrals.
 - Well run banks can get up to 30% of new openings from customer referrals



Conclusion

- There are at least a few similarities between the funeral director's business and ours. I hope you have enjoyed this whimsical comparison.
- We think community banking is alive and well.
- The "death" that needs to occur is that of "conventional wisdom."
- With good marketing and effective execution, you can double your current results (well, most of you can)!



Contact Me Anytime

Sean C. Payant, Ph.D. | Chief Consulting Officer

402-323-3614 (Office)

402-440-0947 (Cell)

sean@haberfeld.com

www.haberfeld.com

