Driving Customer Profitability while Lowering Attrition Risk

BY SCOTT MCCLYMONDS

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Scott McClymonds

My previous article in the last issue of this magazine introduced customer portfolio management (CPM) as a vital strategy to help you understand customer profitability, strengthen your brand and increase your profitability.

In contrast to traditional analytics, CPM offers a holistic approach to your customers, markets and individual performers that can be used for budgeting, asset-liability management and branding.

We discussed using four customer profit groups as the foundation for CPM because profitability measures the value customers bring to your bank, and four groups provides sufficient definition without overcomplicating the analysis.

In this second article we'll use a case study to take a deeper dive into CPM by showing how community banks can cost effectively use the same tools and analytics as bigger banks to improve their financial performance and market presence.

Creating Value and Closing the Gap

Let's begin our case study by examining new accounts and balances over the last year. Figure 1 shows the number of new accounts opened during that time. It is broken into four distinct profit groups, which we call End Zone, Red Zone, Mass Market and Lower Tier. Orange bars represent new accounts opened by pre-existing customers and green represents activity from new ones. Similarly, Figure 2 shows balances associated with the new accounts.

The charts show that End Zone customers opened 13 percent of new accounts and those accounts provided 89 percent of new balances. Reading it another way, 87 percent of our new account efforts brought in 11 percent of the new balances.

If you knew 13 percent of your new core deposit accounts created 89 percent of your new money, what would you do about it? I advise clients to more closely examine who those customers are and what is attracting them to your bank, then develop ways to find more like them. Many of the same types of customers are in your bank but have not seen or been shown the value of bringing the rest of their relationship to you. Other equally profitable prospects live in your markets and can be persuaded to bank with you through referrals from your high profit customers.

Your executives need to know these numbers well because they are the drivers of your CAMEL rating, ROA, net income and efficiency ratio. End Zone customers are driving your bank's growth of capital, assets and income, while the other three profit groups are creating most of the expense.

The End Zone customer will need to drive your budgeting in terms of asset, liquidity and profit growth; while the other groups will drive your budgeting in terms of personnel and operations expenses. Your ALM will be closely associated with the behaviors of the End Zone group as well, so your financial team will need to closely inspect the maturities of their loans and deposits and use those to help project ALM needs into the future.

Trouble in the End Zone

Your most profitable customers, those in the End Zone group, are not equal in their profitability or behavior within your bank. The next few figures draw out those differences and show serious issues needing attention.

Figure 3 shows the most profitable sub-group of End Zone customers earn the bank about $36,000 per year, while the less profitable sub-group earns about $21,000 annually. Those are healthy numbers in any case, but certainly distinct. In most banks these customer groups are largely unknown, invisible, with no plan in place to address their needs.

Figure 4 show the most profitable sub-group, End Zone 1, has an average of seven services, which is fairly good. In contrast, End Zone 2 and 3 only average about three services. I often

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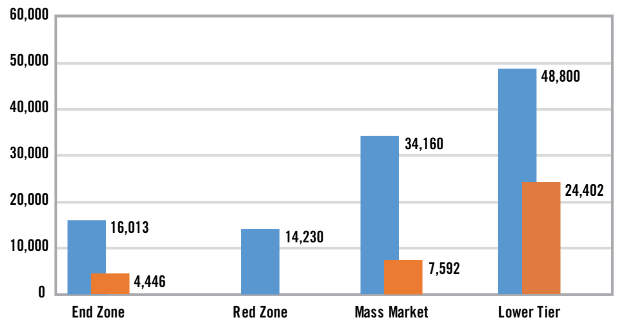
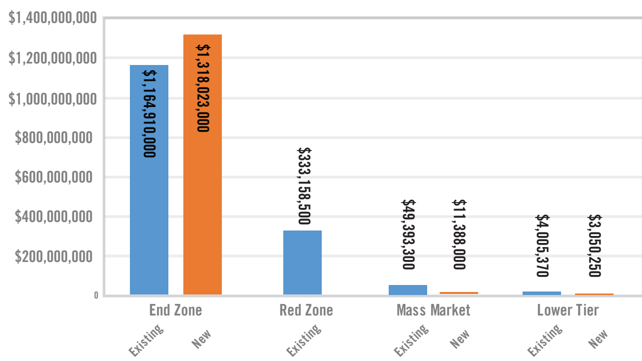
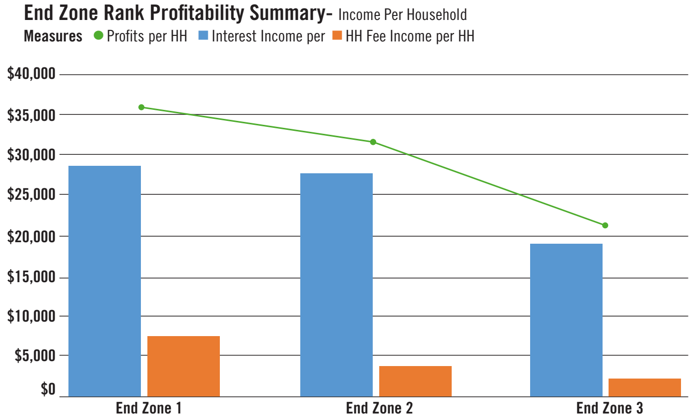
Number of Accounts



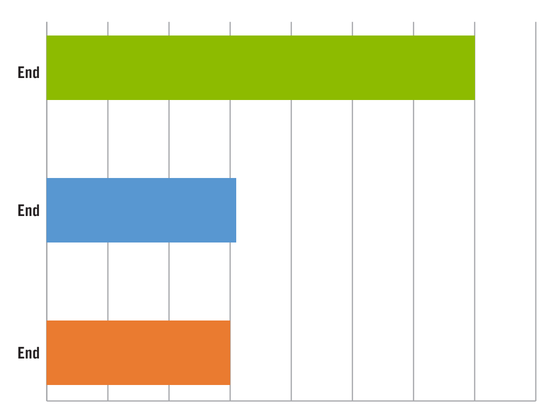
Account Balance



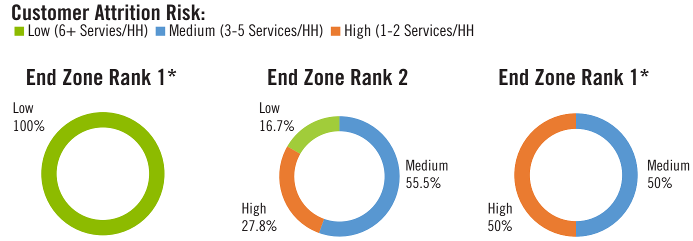
End Zone Rank Profitability Summary- Income Per Household



Services/HH by End Zone Rank



Customer Attrition Risk:



call this hidden risk, or the risk no one is aware of. That's because customers with fewer services are more likely to attrite, and three services is a low number for any household, let alone an End Zone 1. Putting $30,000 in annual profits at risk is a large risk, and compounding it by the almost 3,600 households in this example creates a staggering profit risk.

Your executive team should be having a meeting at this moment to determine how to mitigate this risk.

Fortunately we're able to dive more deeply into this risk of attrition to pinpoint these trouble spots. Figure 5 shows a little over half of End Zone 2 and 3 customers have between three and five service with us, with a little less than that holding one or two services.

Since we know customer profitability in each sub-group we can quantify the financial impact of attrition, and contrast that with the associated risk.

Customers holding higher numbers of services are more likely to purchase additional ones than those with less services, so a relationship strategy geared toward End Zone 2 and 3 customers with three to five services should yield greater results.

However, customers with one or two services are more likely to attrite, and are also harder to build relationships with. Since they are both highly profitable and at high risk, we cannot ignore them and need to put our best minds to work to understand how we can create more value for them.

Fixing the End Zone Trouble

Now that we're aware of our End Zone trouble spots, we need to fix them. Our starting point is to understand who the End Zone 2 and 3 customers are. From there we can use our insights to put together a corrective action plan. With the approval of the executive team and board, we will operationalize the best ideas through a strategy, defined goals and metrics, and empowering our employees assigned to these customers.

Congratulations. You now know more about CPM than almost all of your peers. This brief case study has shown the benefits of utilizing CPM, and the ramifications of ignoring it. Although we focused on End Zone customers, we could have just as easily created the same exercise for Lower Tier customers.

Far from the typical analytics or MCIF system sitting in a corner or operated by a junior person, CPM is a strategic function that spreads customer knowledge throughout your bank and lets you focus on key areas of performance.

As we have seen, CPM goes beyond marketing into finance, training, sales, operations and deep into the values of your customers. Integrating it with your bank's core values, strategy and operations will strengthen the benefits you can provide your customers and community. BNE