FINANCIAL PERFORMANCE

ProfitStars®

Customer Profitability

How Much Do You Really Know About Your Clients?

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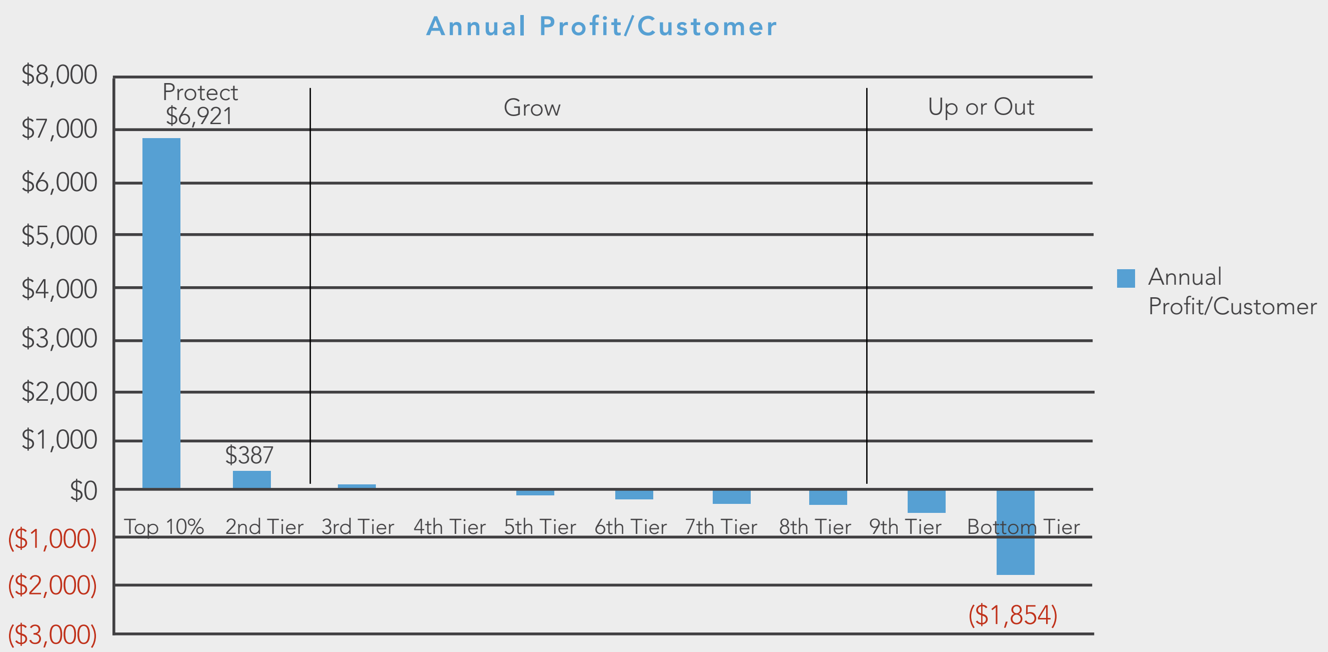
The financial service industry is currently undergoing several significant challenges, including the mortgage meltdown and economic downturn, but there is also a much more subtle challenge on the horizon. That challenge is a concentration of balances and profit among very few clients. As the industry discovers this trend, there is an increased pressure to better understand your customers (especially their profitability) so you can develop strategies to "protect" your best customers!

This is best illustrated by cross sectioning the client base based on their profitability and then analyzing the results, as illustrated in the graph below. In looking at the numbers of one $2 billion bank, the results are a bit disturbing. Over 180 percent of their profitability is coming from the top 20 percent of their clients. Conversely the bottom 20 percent of their portfolio delivers a negative 60 percent of the organization's profit. The middle 60 percent of the organization is basically a "break-even" group with a significant number of clients delivering a small negative profitability.

What Does This Mean and What Do We Do About It?

This concentration of profit suggests we can classify the clients into three major categories: Protect, Grow, and Up or Out. The top 20 percent are clients we want to protect, the middle tier represents ones that we hope to grow, and the bottom tier represents those clients that we aggressively need to work to improve or find a way to exit them from the bank. Active account management of both the top and bottom groups are essential for an organization's success and delivers the early fruits from this information.



Protect – These clients represent the organization's best clients and need to be treated in a special way. The goal with this group is to ensure that they understand that we appreciate their business and will work hard to continue to provide them exceptional service. Some of the most successful strategies to accomplish this may include: a dedicated banker to handle all of their account needs; special pricing and service fee structure; inclusion in the banks VIP program – with all its benefits; regular outbound/proactive calling; specific marketing plans and fee waivers on certain transactions – no questions asked. These clients are the lifeblood of your organization and you need to find ways to make them feel special to avoid losing these accounts. If you are successful in making them feel special, could you target a 100 percent account retention strategy for this group? Bank presidents typically want to know when and why we lose one of these clients!

Up or Out – These clients represent the least profitable client in your organization and like the "Protect" clients need active account management. These customers are often unprofitable for two primary reasons. The first groups have adversely rated loans. For these clients, the cost to carry these loans greatly exceeds the margin associated with the account. These clients need close monitoring and strategies to shore up their credit. Are there additional collateral, guarantors, ways to restructure the debt, or other lenders that might be better suited to handle the risk of this credit? Can you help the client find alternative financing?

The second group of clients has been as a result of bank pricing decisions. There are often large CD clients in this group that were offered premium rates. Rates are often found to be significantly (50-75 basis points) over the rate to borrow funds from an external source. While these clients do have significant balances, why are financial institutions paying rates significantly above the market to keep the business, especially given the fact that the overall relationship is not profitable? For these clients, FIs need to develop a more disciplined pricing approach and ensure exception pricing is thoroughly reviewed.

Grow – These clients represent the vast majority of your clients, yet deliver very little to your bottom line. For these clients, it's best to practice a passive account management strategy, where you aren't spending significant resources reaching out to them. It's a good strategy to analyze these clients' needs and build targeted marketing campaigns to see if you can move some of them into a more profitable status. The key tools to use for this approach would be a strong profitability system coupled with a CRM/MCIF system, so you can understand both profitability and product usage. Then target clients in certain groups – with profitable product/service offerings. These offerings could be targeted at increasing revenues (debit card usage, remote deposit capture, overdraft protection, etc.) or decreasing expenses (internet banking, consolidated statements, electronic statements, and promoting lower cost delivery channels). Making a modest increase in profitability for this large group could yield significant improvement in your organization's profit.

Summary – The key in these challenging times is good information about customer profitability and strategies to deal with each of your clients in a way that is appropriate given their situation. Armed with this information, you can develop strategies to improve the profitability of each segment of your client base. If you are interested in learning more about the RPM solution and strategies for success, please contact a ProfitStars® Account Manager or RPM Sales Executive at (800) 356-9099.

AS RPM PRODUCT MANAGER & CONSULTANT FOR PROFITSTARS, BRAD DAHLMAN is responsible for product management, implementation, consulting, and support of the RPM solution. In these roles, he is responsible for helping define the product direction and also responsible for roll-out and support of the product. He has provided banker insights into the product design dating back to prior to Jack Henry's purchase of the RPM product, which occurred in January of 2005. Brad has 20 years of experience in the bank and data processing industries. During his banking career he has held positions in finance, audit, operation, and technology areas with several banks. His most recent role prior to joining Jack Henry & Associates/ProfitStars was Senior Vice President of Operation and Technology, which he held at three mid-sized community banks in the Minneapolis-St Paul area.