

METAVANTE WHITE PAPER

# Deposit Growth and Branch Network Effectiveness

Practical Approaches to Mitigate the Rising Cost of Funding Assets

**Tom McGrath**

Senior Banking Strategist

Metavante Consulting & Professional Services



1-800-822-6758

## Executive Take-Aways

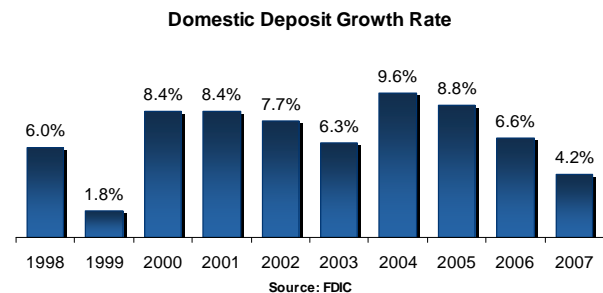
- The industry’s ability to grow deposits is constrained, with deposits currently providing only 64.5% of funding requirements. The availability of interest-free deposits is the same as it was 15 years ago.
- Though efficient mechanisms have evolved to facilitate the collection and allocation of available funding to match credit demand, they are a more costly way of funding assets than core deposits.
- All markets are not equal in terms of deposit and loan potential, making the identification of viable market opportunities for growing core deposits critical for mid-tier, regional, and community banks.
- Given the challenges of the current market – including competition from large banks who grow deposits by acquiring their competition – mid-tier, regional, and community banks should consider the following tactics for growing their deposit bases:
  - Aggressive marketing and promotion of deposit products and services.
  - Achieving critical mass and avoiding a minimal presence.
  - Allocating staff and establishing sales goals based on market potential.
  - Identifying and focusing on the volume of business that should be developed given market potential.
  - Redeploying from low potential markets to fund more productive expansion.
- De novo banks provide a valuable, real-life example of how rapid deposit growth can be achieved for mid-tier, regional, and community banks.
- Deploy short-term actions to build deposits:
  - Determine where the bank stands in terms of market share across all products, focusing on deposits.
  - Ascertain the causes of gaps found in the market share analysis.
  - Use the insights gained from primary and secondary research efforts to form the basis

for a series of concrete actions to address deposit shortfalls.

- Refuse to reward account-churning sales tactics.
- Use insights about market potential to rethink branching strategies and tactics with a clear eye toward existing markets where the bank is not currently successful.

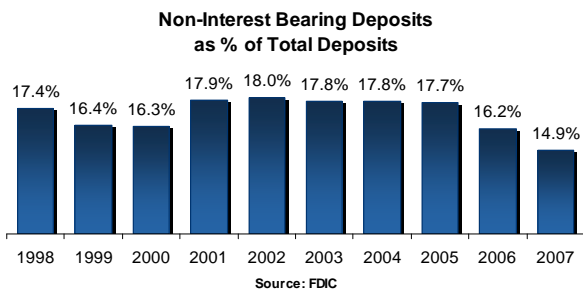
## The Decline of Deposit Balances

Today’s banking mantra is, “we need to grow deposits.” Little wonder, as the inexorable decline in net interest margin is negatively affecting the potential for profitable growth. It is not surprising, then, that banks are focused on attracting additional free deposits – or at least comparatively lower-interest cost deposits – as a means of containing the expense of funding loans and other assets.



To provide a contextual starting point for a discussion of acquisition strategies, it is useful to understand just how constrained the industry has become in terms of “growing deposits.” A quick look at the last 10 years suggests that banks’ total capacity to fund loans and other assets with deposit balances has declined. Deposits now only provide about 64.5% of funding requirements according to year-end 2007 data produced by the FDIC. The domestic deposit growth rate slowed to 4.2% in 2007 as depicted in the above graphic. In addition, as shown in the following chart, despite two recessions and two periods of robust economic expansion, the availability of interest-free deposits has fallen to the lowest level in 10 years.





## The Challenge for Mid-Tier, Regional, and Community Banks

The challenge most banks face in regard to deposit growth is partially borne out by the following statistics:

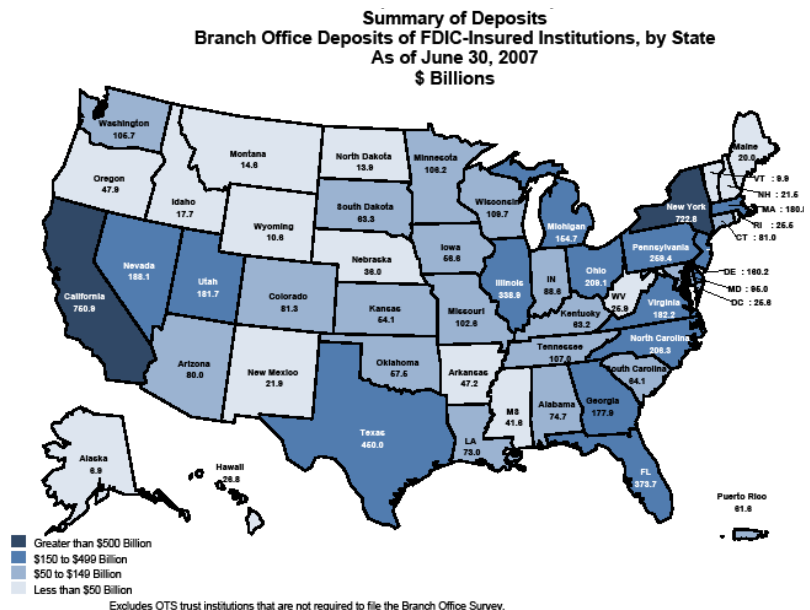
- In 1994, the top 50 banks and thrifts in the U.S. operated 18% of the industry’s branch offices and domiciled 27% of the deposits held in domestic offices<sup>1</sup>.
- By year-end 2006, the top 50 banks and thrifts operated 40% of the branch offices and domiciled 55% of the deposits in domestic offices<sup>2</sup>.

There is no doubt that major banks determine the direction of deposit products and services and are controlling increasing shares of the deposit market as a result of well-documented industry consolidation. The situation is only becoming more challenging as you read this.

The issue is complicated by the fact that not all markets have equal deposit potential. The accompanying graphic illustrates the variances between markets across the country (states have been used for ease of presentation)<sup>3</sup>.

Ninety-two percent of all deposits held in domestic offices are found in 370 Metropolitan Statistical Areas (MSAs) across the country, yet 23% of all branch offices, servicing just 8% of total deposits, are located outside these MSAs<sup>4</sup>.

To place a finer point on the observation, 16% of total branches, or about 14,700 branch offices, have total deposits less than \$10 million each and contribute little more than 1% of all deposits held in domestic offices<sup>5</sup>. While there are countless explanations for small offices, taken in the aggregate, it is reasonable to question the value of these offices as low-cost funding vehicles.



Since all markets are obviously not equal in terms of deposit and loan potential, the first set of challenges for mid-tier, regional and community banks looking to grow deposits is determining where to operate a bank, where to branch, or how to acquire depositors with low cost deposits. It must be understood that because of their scarce business potential, some markets cannot support multiple banks. Others simply do not justify any allocation of resources. As there is a time and a place for market expansion, there are instances when one should cut losses and withdraw. Community Reinvestment Act requirements notwithstanding, there is little reason to continue operating ineffective branches when resources can be deployed more productively elsewhere.

## Keys to Deposit Acquisition

In this context, it's best to think of deposit growth as essentially a zero-sum game: an individual bank is only going to rapidly add lower cost deposits by beating the other banker to the potential depositor, capturing that business and retaining it.

One method of increasing deposits is to acquire the competition. This certainly simplifies thinking about the problem, but may prove practical only for banks in the top 50 with their substantial branch and loan production office systems, national reach, and conceivable alternative delivery channels.

What, then, about the 8,716 banks and thrifts operating in the United States that have significantly fewer options? Fortunately significant deposit growth potential exists for these banks, if they employ the right methodologies. The balance of this paper discusses practical steps that smaller financial institutions can take to organically grow their deposits.

## Strategies and tactics for growing deposits

In our view, the keys to successful, cost-effective deposit acquisition include:

- **Aggressive marketing and promotion of deposit products and services.** Merely opening a new office, offering Internet account openings, or operating a 24-hour call center in an attractive market will not generate new business that maximizes deposit market share.

In our judgment, the single largest impediment to deposit acquisition is a lack of name recognition, including insufficient market awareness of the banks' products and services. Waiting for "word of mouth" to spread and bring business leaves bankers standing around with little to do.

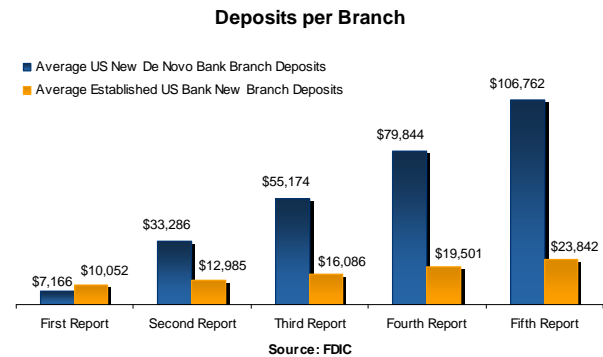
If customers are to buy a bank's offerings, the bank has to be seen and heard. The array of cost-effective media for disseminating a bank's message has never been greater. It is time to move beyond that ever-present rate ad to vehicles more in tune with today's target customers. A bank should talk to its ad agency, get some creative help, and start thinking and acting outside of the box.

- **Achieving critical mass and avoiding a minimal presence.** Scale economies and utilization efficiencies matter in capturing new business and operating a profitable bank.

Achieving a reasonable semblance of size in any market is critical. More offices in a smaller geographic footprint are almost always preferable to single office outposts spread across a larger region.

While there may be some psychological reward derived from being the number-seven bank in a five-bank market and trying harder, this mindset usually ends up being the prescription for an eventual sale in order that shareholders may recapture their investments.

- **Allocating staff and establishing sales goals based on market potential.** It is understandable that bankers strive for control of personnel expense by managing branch staffing, but it is likewise clear to us that the issue facing banks is not so much the quantity of bank staff as much as the disposition of that staff and the tasking of bankers to capture available business.
- **Identifying and focusing on the volume of business that should be developed given market potential.** Less reliance should be placed on merely adding a percentage of last year’s results to set the goal for this year. This leads to the undesirable effect of embedded underperformance and rewarding the wrong sales force members for nothing more than having the good fortune to be in a good market.
- **Redeploying from low potential markets to fund more productive expansion.** The resources to pay for marketing and greater market density can be made available by exiting underachieving locations and markets that are absorbing a disproportionate level of spending.



Most de novo institutions share a common set of characteristics:

- They are generally located among existing banks in markets with significant potential, not in declining or remote locales. Willie Sutton would be pleased. These bankers are doing business where the money is.
- All resources are explicitly deployed to capture the potential in the market based, for the most part, on an intimate understanding of the market segments being targeted by the bank. A significant emphasis is placed on generating free public relations coverage and personal marketing to reach prospects with skilled bankers focused on acquiring new business.
- Since they are not burdened with legacy delivery systems, resources are not absorbed in maintaining underperforming locations or committed to marginal initiatives not directly linked to attracting and servicing new customers.

## Banks that Do It Right

One set of bankers seems to understand the keys to building deposits: those launching de novo institutions.

A comparison of de novo growth rates to growth rates of new offices opened by established banks shows a marked difference in strategy toward adding deposits. In each and every case, de novos acquire deposits from other banks. The successful results are shown below with five consecutive annual reporting periods worth of data from the FDIC Summary of Deposit survey for a constant set of offices opened between July 1, 1999 and June 30, 2004.

## Short-Term Actions to Build Deposits

1. Determine where the bank stands in terms of market share across all products by focusing on deposits. It is a straightforward proposition to understand the bank’s current customer segments, and it does not take significant work to identify the segments that populate the bank’s trade area and their propensity to acquire bank services. Comparing the profiles of the bank’s segments to the other segments populating the market is an easy way to understand how effective the bank can be in attracting available and potential new

business. Third-party market research firms possess a wealth of information to help identify the gaps and value the potential of growth.

2. Ascertain the causes of gaps found in the market share analysis. The obvious sources of problems are:
  - A lack of adequate advertising, promotion, and direct marketing initiatives.
  - The absence of scale (and visibility) in some markets.
  - Primary customer and prospect research may be necessary to understand why the bank is not top-of-mind when a prospect is making a buying decision or – if it was considered – why it did not capture the customer’s business.
3. The insights from primary and secondary research efforts should form the basis for a series of concrete actions to address deposit shortfalls. The most common outcome is a series of decisions to:
  - Increase spending on new products.
  - Add quality sales personnel.
  - Utilize a fuller array of advertising and promotion to achieve new sales targets for new business. These should be based on market potential rather than the mere act of adding a percentage to last year’s actual results.
4. Do not reward account-churning sales tactics. Set targets and remuneration based on net new business only. If the bank is not setting sales targets and rewarding the acquisition of net new business, the source of deposit growth shortfalls has been discovered.
5. Use insights about market potential to rethink branching strategies and tactics with a clear eye toward existing markets where the bank cannot be successful given its current position and capacity for further investment. Redeploy scarce resources to higher potential opportunities. A schematic describing a systematic evaluation process for an existing branch franchise is included in Appendix B. There is a substantial opportunity to reallocate branch expenditures across the industry.

## For More Information

Metavante Corporation’s team of specialists comprises practitioners in financial services, operations, technology, risk management, and retail and commercial banking. Our operational expertise covers the many facets of deposit growth and branch network effectiveness. We deliver measurable results that aim to increase efficiency, grow revenue, and improve profitability.

To learn more, call 800-822-6758 and talk to one of our consulting professionals, or visit us at [metavante.com](http://metavante.com).



**Tom McGrath**  
Senior Banking Strategist  
Metavante Consulting &  
Professional Services

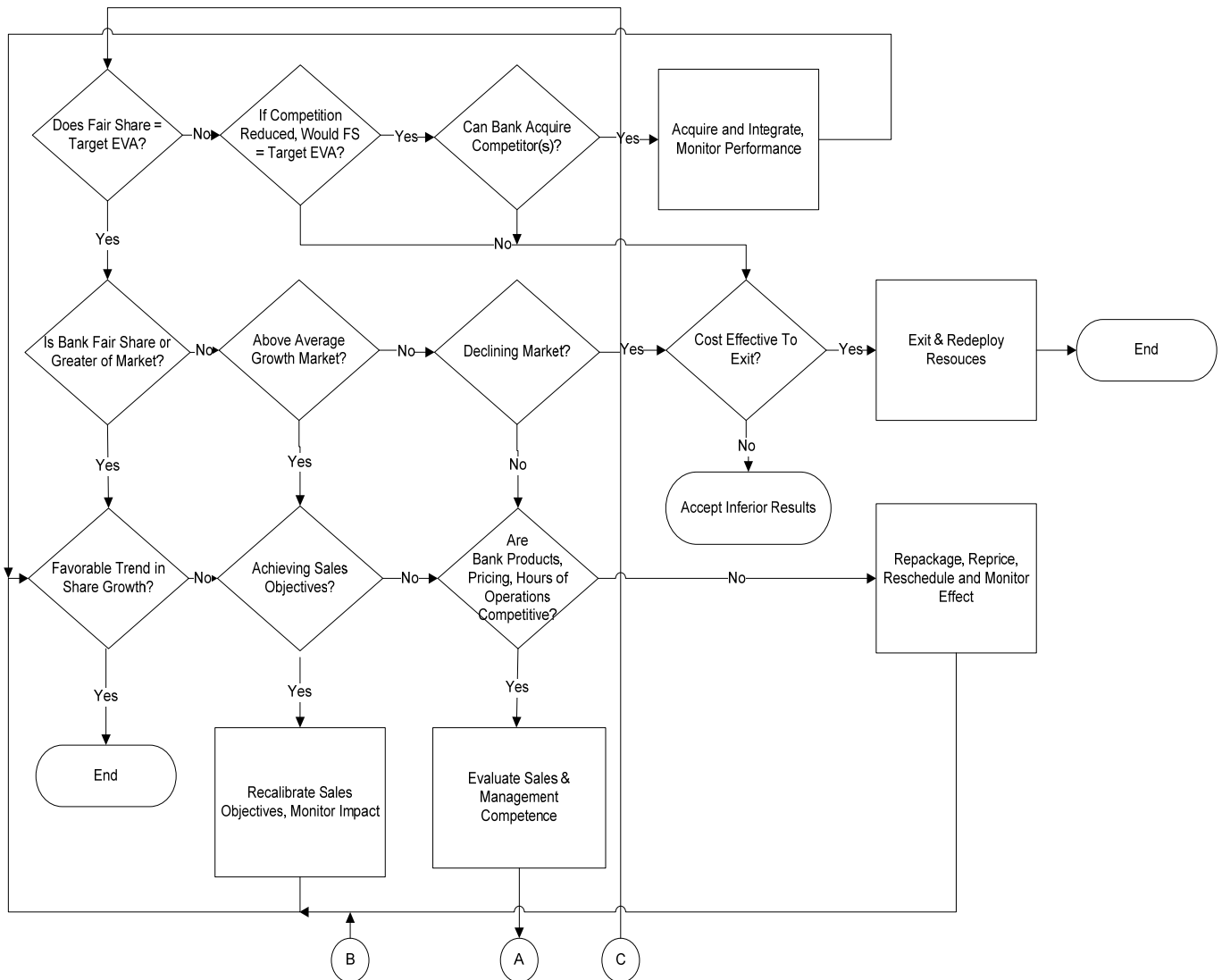
## Appendix A: Branch Stratification by Deposit Size

Nearly one-quarter of all branches – roughly 22,700 offices – contribute less than 3% of total deposits, as shown in the FDIC Summary of Deposits data below. Metavante’s costing and profitability studies have concluded that the operating cost of acquiring and servicing deposits in these small offices run upwards of 200% of the expense level of large scale, efficient branches and can add as much as 100 basis points to the cost of these funds:

Deposit Balances		Branches		Deposits in Domestic Offices	Branches		Deposits		Average Size
>Than	<Than	Number	Cummulative Number		Percent	Cummulative Percent	Percent	Cummulative Percent	
\$0	\$5,000	7,067	7,067	\$17,546,613	7.75%	7.75%	0.27%	0.27%	\$2,483
\$4,999	\$10,000	7,670	14,737	\$57,820,295	8.41%	16.16%	0.90%	1.17%	\$7,539
\$9,999	\$15,000	8,009	22,746	\$100,055,262	8.78%	24.94%	1.55%	2.72%	\$12,493
\$14,999	\$20,000	7,534	30,280	\$131,663,649	8.26%	33.21%	2.04%	4.76%	\$17,476
\$19,999	\$25,000	7,005	37,285	\$157,438,314	7.68%	40.89%	2.44%	7.20%	\$22,475
\$24,999	\$30,000	6,266	43,551	\$172,137,253	6.87%	47.76%	2.67%	9.87%	\$27,472
\$29,999	\$35,000	5,505	49,056	\$178,846,839	6.04%	53.79%	2.77%	12.64%	\$32,488
\$34,999	\$40,000	4,960	54,016	\$185,847,434	5.44%	59.23%	2.88%	15.53%	\$37,469
\$39,999	\$45,000	4,249	58,265	\$180,437,067	4.66%	63.89%	2.80%	18.32%	\$42,466
\$44,999	\$50,000	3,750	62,015	\$177,919,563	4.11%	68.01%	2.76%	21.08%	\$47,445
\$49,999	\$55,000	3,200	65,215	\$167,906,872	3.51%	71.51%	2.60%	23.69%	\$52,471
\$54,999	\$60,000	2,827	68,042	\$162,234,098	3.10%	74.61%	2.52%	26.20%	\$57,387
\$59,999	\$65,000	2,443	70,485	\$152,435,385	2.68%	77.29%	2.36%	28.56%	\$62,397
\$64,999	\$70,000	2,024	72,509	\$136,446,063	2.22%	79.51%	2.12%	30.68%	\$67,414
\$69,999	\$75,000	1,783	74,292	\$129,109,908	1.96%	81.47%	2.00%	32.68%	\$72,412
\$74,999	\$80,000	1,572	75,864	\$121,693,327	1.72%	83.19%	1.89%	34.57%	\$77,413
\$79,999	\$85,000	1,426	77,290	\$117,490,820	1.56%	84.76%	1.82%	36.39%	\$82,392
\$84,999	\$90,000	1,215	78,505	\$106,284,047	1.33%	86.09%	1.65%	38.04%	\$87,477
\$89,999	\$95,000	1,062	79,567	\$98,266,836	1.16%	87.25%	1.52%	39.56%	\$92,530
\$94,999	\$100,000	958	80,525	\$93,324,330	1.05%	88.30%	1.45%	41.01%	\$97,416
\$99,999	\$105,000	868	81,393	\$88,913,667	0.95%	89.26%	1.38%	42.39%	\$102,435
\$104,999	\$110,000	737	82,130	\$79,183,013	0.81%	90.06%	1.23%	43.62%	\$107,440
\$109,999	\$115,000	709	82,839	\$79,688,900	0.78%	90.84%	1.24%	44.85%	\$112,396
\$114,999	\$120,000	616	83,455	\$72,302,725	0.68%	91.52%	1.12%	45.97%	\$117,375
\$119,999	\$125,000	578	84,033	\$70,740,810	0.63%	92.15%	1.10%	47.07%	\$122,389
\$124,999	\$130,000	504	84,537	\$64,253,933	0.55%	92.70%	1.00%	48.07%	\$127,488
\$129,999	\$135,000	475	85,012	\$63,053,181	0.52%	93.22%	0.98%	49.04%	\$132,744
\$134,999	\$140,000	402	85,414	\$55,285,268	0.44%	93.66%	0.86%	49.90%	\$137,526
\$139,999	\$145,000	363	85,777	\$51,739,031	0.40%	94.06%	0.80%	50.70%	\$142,532
\$144,999	\$150,000	330	86,107	\$48,681,315	0.36%	94.42%	0.75%	51.46%	\$147,519
\$149,999	\$155,000	269	86,376	\$41,002,838	0.29%	94.72%	0.64%	52.09%	\$152,427
\$154,999	\$160,000	274	86,650	\$43,180,845	0.30%	95.02%	0.67%	52.76%	\$157,594
\$159,999	\$165,000	263	86,913	\$42,754,349	0.29%	95.31%	0.66%	53.43%	\$162,564
\$164,999	\$170,000	251	87,164	\$41,991,783	0.28%	95.58%	0.65%	54.08%	\$167,298
\$169,999	\$175,000	199	87,363	\$34,317,948	0.22%	95.80%	0.53%	54.61%	\$172,452
\$174,999	\$200,000	876	88,239	\$163,516,780	0.96%	96.76%	2.54%	57.14%	\$186,663
\$199,999	\$500,000	2,259	90,498	\$640,700,428	2.48%	99.24%	9.93%	67.08%	\$283,621
\$499,999	\$1,000,000	378	90,876	\$260,250,081	0.41%	99.65%	4.04%	71.11%	\$688,492
\$999,999	Largest	315	91,191	\$1,863,071,186	0.35%	100.00%	28.89%	100.00%	\$5,914,512
Totals		91,191		\$6,449,532,056	100.00%	100.00%	100.00%	100.00%	

# Appendix B: Branch Network Optimization Framework

Any office can be subjected to this analytical process to determine an appropriate set of actions ranging from product and pricing changes, to alternative staffing configurations, to sale or consolidation of offices that cannot be brought to a reasonable standard of contribution.



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