What a customer cross-section can tell you

Before you can protect your best customers, you have to know who they are

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Many of the current challenges to the financial service industry are obvious enough—the fallout from the recession and the legislative reaction to the financial crisis being two obvious examples. But there is also a much more subtle challenge on the horizon. It is the concentration of balances and profit among very few clients. As banks discover this trend, there will be an increased pressure to better understand their customers (especially their profitability) so they can develop strategies to “protect” those customers.

This is best illustrated by cross sectioning the client base based on their profitability and then analyzing the results. In looking at the numbers of one $2 billion bank, the results are a bit disturbing. More than 180% of its profitability is coming from the top 20% of clients. Conversely, the bottom 20% of its portfolio delivers a negative 60% of the organization’s profit. The middle 60% 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 can be done about it?

This concentration of profit suggests banks can classify the clients into three major categories: “Protect,” “Grow,” and “Up or Out.” The top 20% are clients you want to protect, the middle tier represents ones that you hope to grow, and the bottom tier represents those clients that you 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 is essential for an organization’s success and can deliver the early fruits from this information. Let’s examine these groups a little further:

1) 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 you 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 bank’s 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% account retention strategy for this group? Let’s put it this way: bank presidents typically want to know when and why they lose one of these clients!

2) 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 group has 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. Is there additional collateral? Are there additional 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 is the result of bank pricing decisions. There frequently are 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 may have large 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, banks need to develop a more disciplined pricing approach and ensure exception pricing is thoroughly reviewed.

3) Grow — These clients represent the vast majority of your accounts, yet deliver very little to your bottom line. For them, 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 idea, however, 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 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 other low-cost delivery channels). Making a modest increase in profitability for this large group could yield significant improvement in your organization’s profit.

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.