O'LEARY'S ESSENTIALS: ACCOUNT ANALYSIS IS THE CORNERSTONE OF BANK PROFITABILITY

Many bankers and lenders still don't get it

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It's an article of faith among many bank marketing experts that 80% of a bank's profits comes from 20% (or less) of a bank's customers. Would you be surprised to know in this day and age that many community banks cannot specifically tell whether individual accounts are profitable?

Many can, of course, and have been measuring account profitability at the individual and household level for many years.

But what about those who can't or don't? Can they survive?

This is not a casual question.

Winner, loser, in-betweener: Know the differences

About ten years ago veteran banking consultant Alex Sheshunoff published an article on the subject of Customer Relationship Management that's become a bank marketing classic. It's as relevant today as the day it was written.

His methodology in the conceptual sense is simple enough to be equally applicable to big banks and small:

1. Know who your best customers are and make sure you value them in specific, tangible ways.

2. Know who the losers are.

3. Know who is in the middle--and develop strategies to improve their profitability.

4. Eliminate those who cannot become profitable (or service charge them to eliminate the deficit).

Easily said--getting at the facts

Larger banks employ an array of tools and technology to understand their customer bases and to solicit and maintain their business base. They also have developed approaches to their customers with differentiated levels of service depending on relative profitability of the accounts.

Remember that the ways customers interact with banks are changing. Not all customers want "high touch," preferring convenience and efficiency to cookies in the lobby. But smaller banks can take individualized and less-automated approaches and accomplish much of the same result as larger banks, though in less formal or structured ways.

The basic starting point for any bank from the largest to the smallest is a tool with which to analyze account profitability.

Simply assuming that a bank's staff knows the customer base well enough to make effective and consistent judgments on who is a "good" customer is simply dangerous to a bank's long-term strategic viability.

Matching will to act with tools to act by

Many community banks fail to address basic account profitability for one of several reasons.

First, they may assume they already know enough to effectively assess individual account profitability.

Or they may feel that any formal system requiring the application of technology is too expensive for them at their current size.

But often the most significant obstacle of all is the lack of institutional will to follow through completely on the logic of a CRM system.

At some point, if you know who isn't profitable and is unlikely to ever be, the sensible thing is to help them out of the bank, or at least to require a much lower subsidy by the bank for them to remain. Not all community banks act with the discipline of their larger competitors in eliminating unprofitable business.

The standard tool for determining account profitability is generically referred to as "account analysis." This is a formal process where all account activity is analyzed in terms of either cost or revenue. Aggregate cost is subtracted from aggregate revenue and the equivalent of a gross margin on an account-by-account basis is the result.

This is not necessarily a precise process, especially the part requiring a costing out of a bank's internal services. Nonetheless, it yields reasonably accurate information over time and produces a relative hierarchy of account profitability. Large banks have taken account analysis to very sophisticated levels but sophistication need not be an overriding concern for a community bank.

Turning analysis into action

What's often a difficult part of implementing a CRM program, especially as the bank grows in total asset size, is calibrating the level of individual customer service commensurate with individual account profitability.

One way to do this is through the assessment of fees. The most profitable customers are those whose "natural" activity is most profitable for the bank or who pay their own way through explicit service charges.

Frequently in community banks the level of service between the top and bottom tiers is essentially undistinguishable. To those who say, "All customers deserve equal service" I say, "Get over it. Your owners can't afford that."

Note that I'm not saying that customers don't deserve individual respect and good service. But they should pay their own way. If they are not contributing in a positive way to the bank's bottom line, whose fault is that?

Some community banks approach customer service as if they were a public utility: Everyone is entitled to the same service. While it's true that banks have a franchise to conduct business by virtue of their charters, they are not required to subsidize a losing customer base.

The lender's eye: Why this matters to the credit folk

Understanding account profitability is essential to survival for community banks. Many banks think they understand who is profitable, but often these conclusions are based on assumptions rather than hard data.

Seat of the pants assumptions are a dangerous bet for strategic survivability today.

But the lack of institutional discipline to build account profitability systematically and the inability or unwillingness to force the incorrigibly unprofitable account out of the bank (or to pay its own way by service charging) are probably a greater threat to strategic viability.

Lenders often take the view that bigger is better.

A larger loan, they reason is more profitable for the bank than a smaller one. That makes sense on its face, but what about the mix of an individual's business--balances, activity, fees, and other business relationships?

Nor are all product lines equally profitable or have the same cross-selling opportunities. Long-term financial health and viability, especially among community bankers today, requires an appreciation and comprehension of each customer's individual worth to the bank.

That starts with actionable information followed by the deliberate and persistent implementation of a long term strategy of customer account profitability.

You need a plan. If you don't have one for your bank, you can bet that your competition will.

And that you won't like it.

Talk back! Is Ed on the money? How has your bank addressed these challenges?

About Ed O'Leary:

Veteran lender and workout expert O'Leary spent more than 40 years in bank commercial credit and related functions, working with both major banks as well as community banking institutions. He earned his workout spurs in the dark days of the 1980s and early 1990s in both oil patch and commercial real estate lending.

O'Leary began his banking career at The Bank of New York in 1964, and worked at banks in Florida, Texas, Oklahoma, and New Mexico. He served as a faculty member and thesis advisor at ABA's Stonier Graduate School of Banking for more than two decades, and served as long as a faculty member for ABA's undergraduate and graduate commercial lending schools.

Today he works as a consultant and expert witness, and serves as instructor for ABA e-learning courses and has been a frequent speaker in ABA's Bank Director Telephone Briefing series. You can hear free audio interviews with Ed about workouts here. You can e-mail him at etoleary@att.net. O'Leary's website can be found at www.etoleary.com.

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