



WEST MONROE PARTNERS

Know Your Customers: The Evolution of Customer Knowledge

August 4, 2009

Business in the Right Direction. Go West.



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- ❖ Why is it important to know your customers?
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Definition: Knowing your customer – Being able to answer three key questions

I. Who are my customers and what are their financial/banking needs?

II. What are the profitability of my products and customers?

III. What actions can I take to improve my profitability?



Where does your organization stand with respect to customer analytics?

- | | Yes | No |
|---|--------------------------|--------------------------|
| 1. Can your institution identify profitability by customer? | <input type="checkbox"/> | <input type="checkbox"/> |
| 2. Can your institution identify profitability by product? | <input type="checkbox"/> | <input type="checkbox"/> |
| 3. Do you believe your marketing dollars are targeting the potential customers you want to reach? | <input type="checkbox"/> | <input type="checkbox"/> |
| 4. Is improving your institution's customer analytics a priority? | <input type="checkbox"/> | <input type="checkbox"/> |



Often smaller institutions face challenges investing in customer analytics

Reasons for not using analytics

“We Know Our Customers”

- We are a small institution with low employee turnover and know our customers well
- Our customers’ needs haven’t changed
- Customer analytics seems like an academic exercise

People Resource Constraints

- We don’t have the analytical resources
- We have a full set of priorities already
- We don’t have enough analytical work to justify an FTE

Technology Investment Constraints

- We don’t have the appetite or budget to invest in customer analytics
- We already have a CRM / CIF system



Use of analytics is correlated to strong financial performance

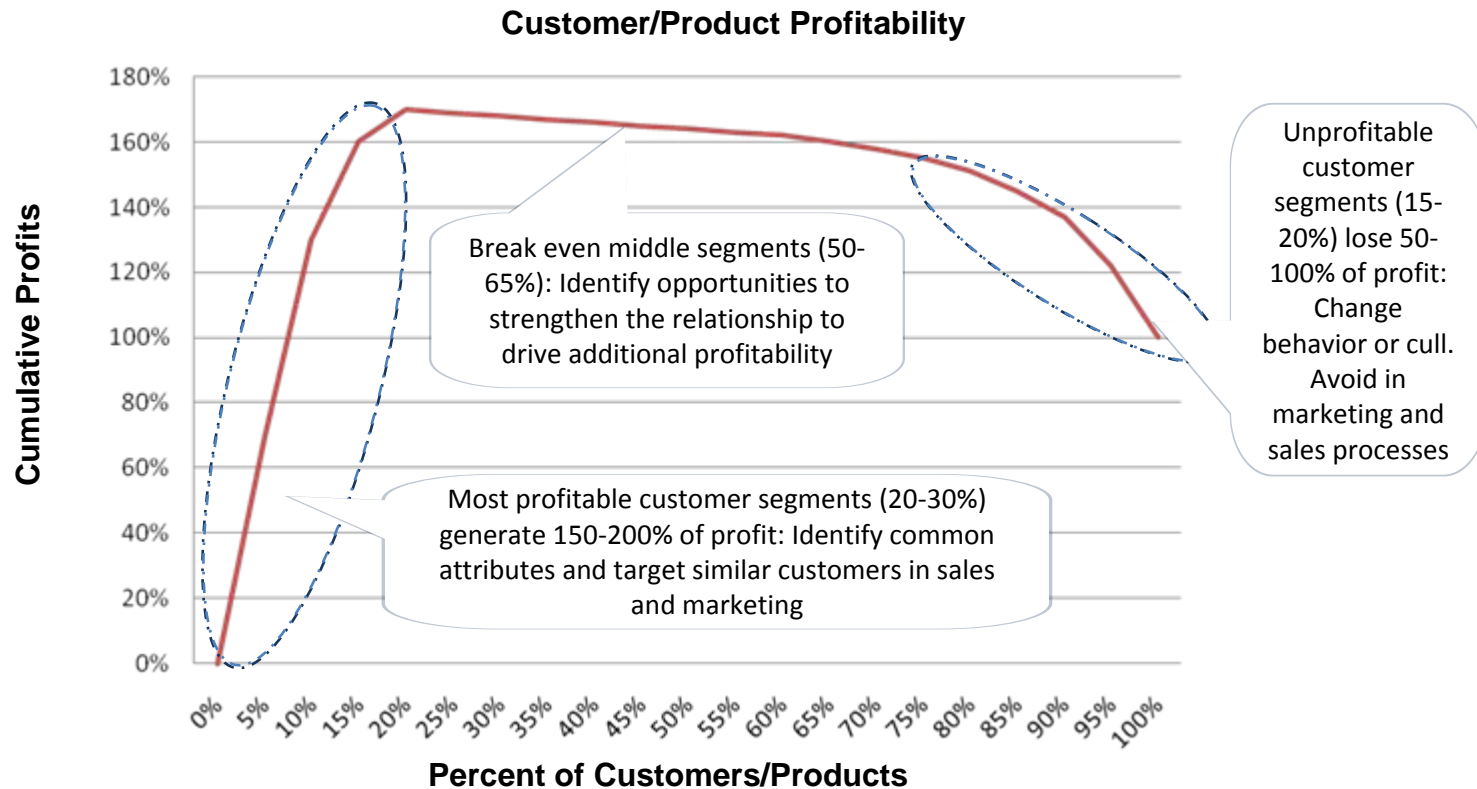
- ❖ A recent study found “a significant correlation between higher levels of analytical maturity and robust five-year compound annual growth rates”
- ❖ “High performers” – (Outperformed their industry in terms of profit, shareholder return, and revenue growth) – were five times as likely to use analytics strategically as “low performers”

Low Performers		High Performers
23%	Have significant decision-support / analytical capabilities	65%
8%	Value analytical insights to a very large extent	36%
33%	Have above average analytical capabilities within industry	77%
23%	Use analytics across their entire organization	40%

Source: “Analytics and Business Performance: Transforming the Ability to Compete on Analytics into a Lasting Competitive Advantage,”
Harvard Business Review



Analytics can help identify the customers/products that generate value and those that destroy value



Source: *Customer Profitability Measurement and Management* Robert S. Kaplan, V.G. Narayanan, Harvard Business School



The case of the safe deposit box: Profitable or not?

Opinion suggested safety deposit boxes should be eliminated.

Safe deposit boxes:

- Aren't profitable
- Distract tellers
- Should be eliminated

However, analysis suggested this might be a mistake.

- Product was profitable
- Product households tend to be over 45 and have combined balances over \$30,000
- Product owners were most profitable and owned the most products
- Owners were price insensitive
- Prices were too low
- Discontinuation would prompt current customers to move entire relationship

Specific actions were taken to improve the product.

- Increased pricing
- Replaced smaller sizes with larger
- Launched targeted marketing campaign

Impressive results were attained

- Revenue increased by 17%
- Average utilization rate increased by 12%



Banking/CU industry dynamics have increased competition for customers

Government/Regulators

- Increasing level of regulation
- Increasing scrutiny of loan portfolios
- Demanding higher levels of capital and liquidity



Customers

- Loyalty has been shaken
- Credit quality decreasing
- Low switching costs



Banking/CU Industry Impact

- Customer retention is key priority
- Fierce competition for deposits
- High level of service is not a differentiator
- High cost of funding/reduced spreads



Investors

- Demanding higher returns given perceived risks
- Demanding higher capital levels
- Focus on fundamentals (e.g. deposit growth, lending quality)



Winning institutions will rely on improved customer analytics to attract and retain customers

Objectives	Improve customer profitability; acquire and retain deposits; generate capital-free income	
Strategy	Focus on understanding and enhancing customers relationships	
Understand	Understand the composition of your customer base	Identify your "best" customers
Plan	Proactively identify unmet customer needs	Offer products and services that uniquely address customer needs
Execute	Migrate customers into "better" segments or relationships	Attract new customers that share important characteristics with your "best" customers

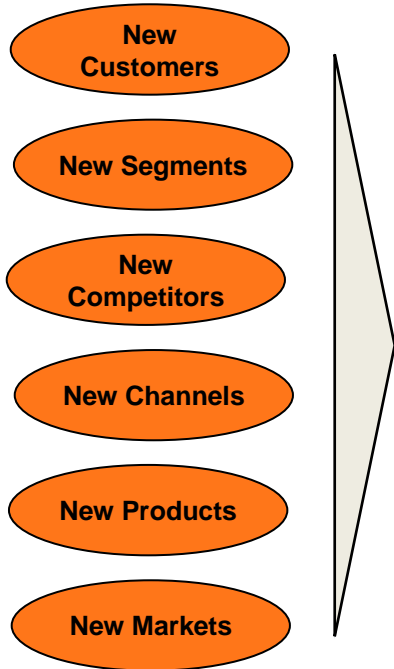


More information – better decisions

Improvement Option	Example Improvement Initiatives
Retain and Grow Current Customers	<ul style="list-style-type: none">▶ Rationalize customers, products, segments, and markets based on profitability▶ Re-prioritize and align marketing efforts▶ Improve retention policies and develop cross-sell plan
Strengthen Pricing and Increase Fee Income	<ul style="list-style-type: none">▶ Grow more stable fee income▶ Re-price unprofitable products and unbundle others and price separately▶ Encourage and incent customers to use less costly channels
Improve Customer Service	<ul style="list-style-type: none">▶ Develop differentiated service models and improve focus on high value customers▶ Increase use of lower cost delivery and service channels
Improve Product Development	<ul style="list-style-type: none">▶ Prioritize development efforts on high profitability products and customers▶ Rationalize product portfolio▶ Identify and target unmet customer needs with new or modified products



Embedding analytics capabilities into policies and processes is vital

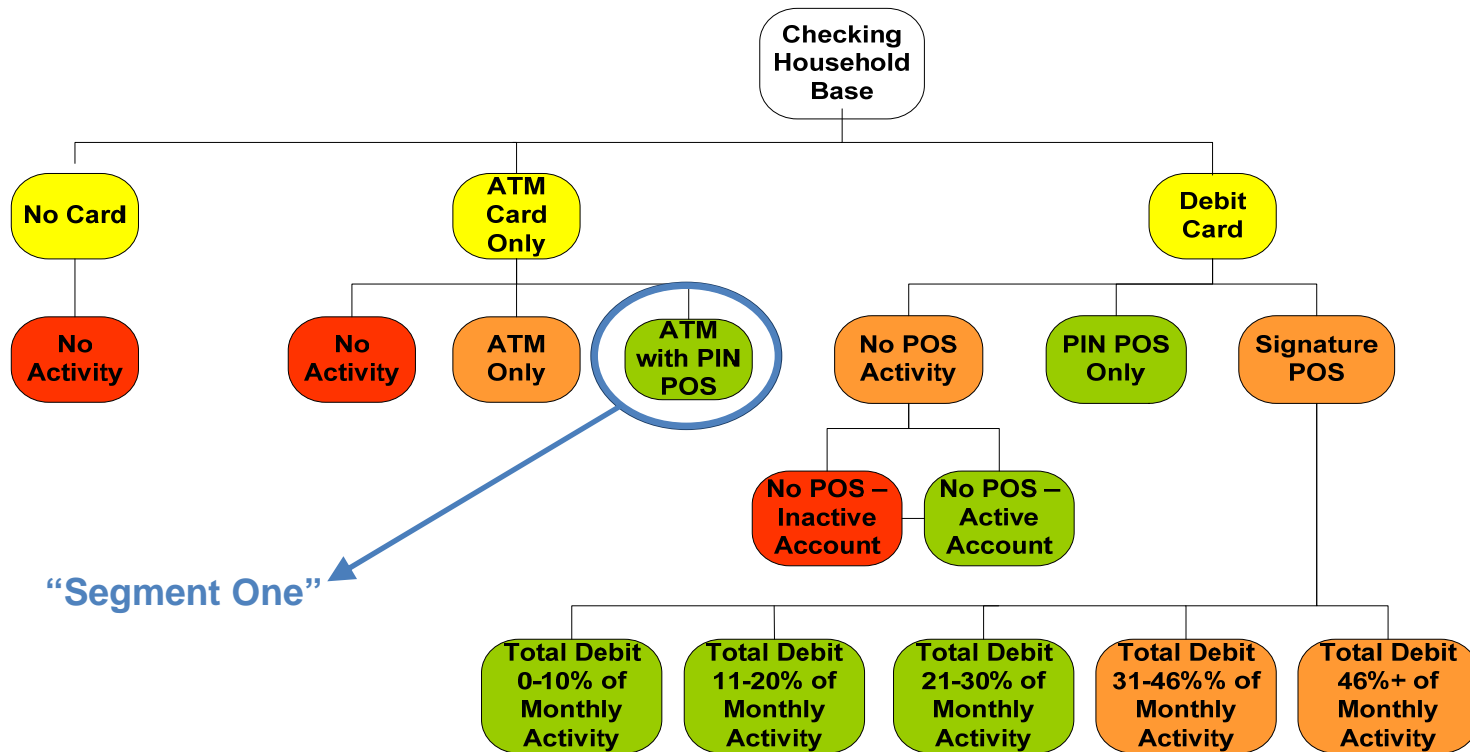


Required Changes	Ongoing Benefits
<p>HR Policies and procedures</p> <ul style="list-style-type: none"> • Incentives aligned with profitability not revenue • Profitability metrics and reports • Profitability training for all employees 	<ul style="list-style-type: none"> ▸ Organizational behavior that is aligned with profitability
<p>Data Analytics Access</p> <ul style="list-style-type: none"> • Real-time profit data access • Real-time customer data access • Archives of profitability data 	<ul style="list-style-type: none"> ▸ Capability to analyze customer and product profitability over time: ▸ Identify trends and make adjustments as needed ▸ Identify best branches, bankers, and loan officers, and why ▸ Determine what makes a customer profitable and why ▸ Better target and track marketing campaigns
<p>Processes</p> <ul style="list-style-type: none"> • Periodic profitability reviews • Profitability goal setting • Customer service process • Product development process 	<ul style="list-style-type: none"> ▸ Focused product development ▸ Constant analysis, improvement, and forecasting of profitability ▸ Profitability goals that are tangible and easily monitored ▸ Customer service and customer decisions based on customer profitability and anticipation of customer needs



Debit Card Case Study: Segmentation Analysis

- ❖ Problem: Financial institution sought to grow fee income by increasing debit card usage among checking customers but didn't know what messages to target to which segments
- ❖ Solution: Analyze segments of existing checking customers based on their level and type of card usage



“Segment One”



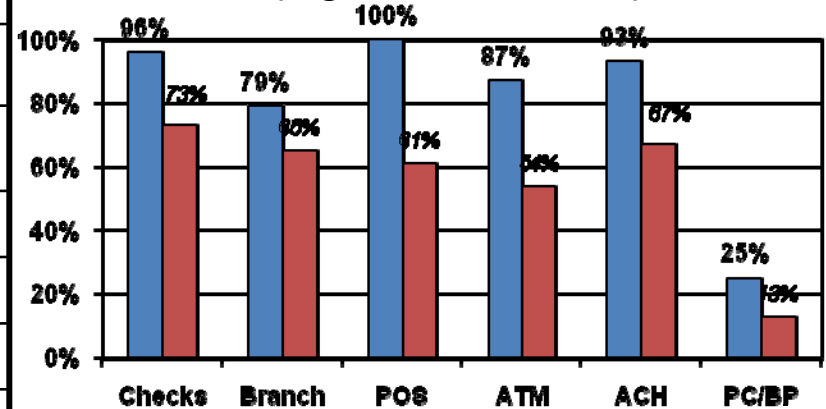
Debit Card Case Study: Segmentation Analysis

- Analyzed attributes of each segment (age, products, tenure, etc.) to determine marketing messages

Segment Attributes

	Segment One	Total	Diff or % of
# of Households	467,134	6,326,805	7.4%
KS Cross-Sell (HH w/Tenure >=2YR)	7.95	6.84	+1.111
KS Cross-Sell (HH w/ANY Tenure)	7.91	6.67	+1.24
Lending Product	18%	17%	+1%
Investment Product	3%	2%	+1%
Liquid Deposits Bal	\$7,066	\$15,851	(\$8,785)
Retail Checking Bal	\$4,937	\$10,326	(\$5,389)
Average Age	39	45	-6
Average Tenure	6.89	7.76	-.87
Average # of Accounts per HH	2.62	2.72	-.1

Segment Channel Engagement (Segment One vs. Total)



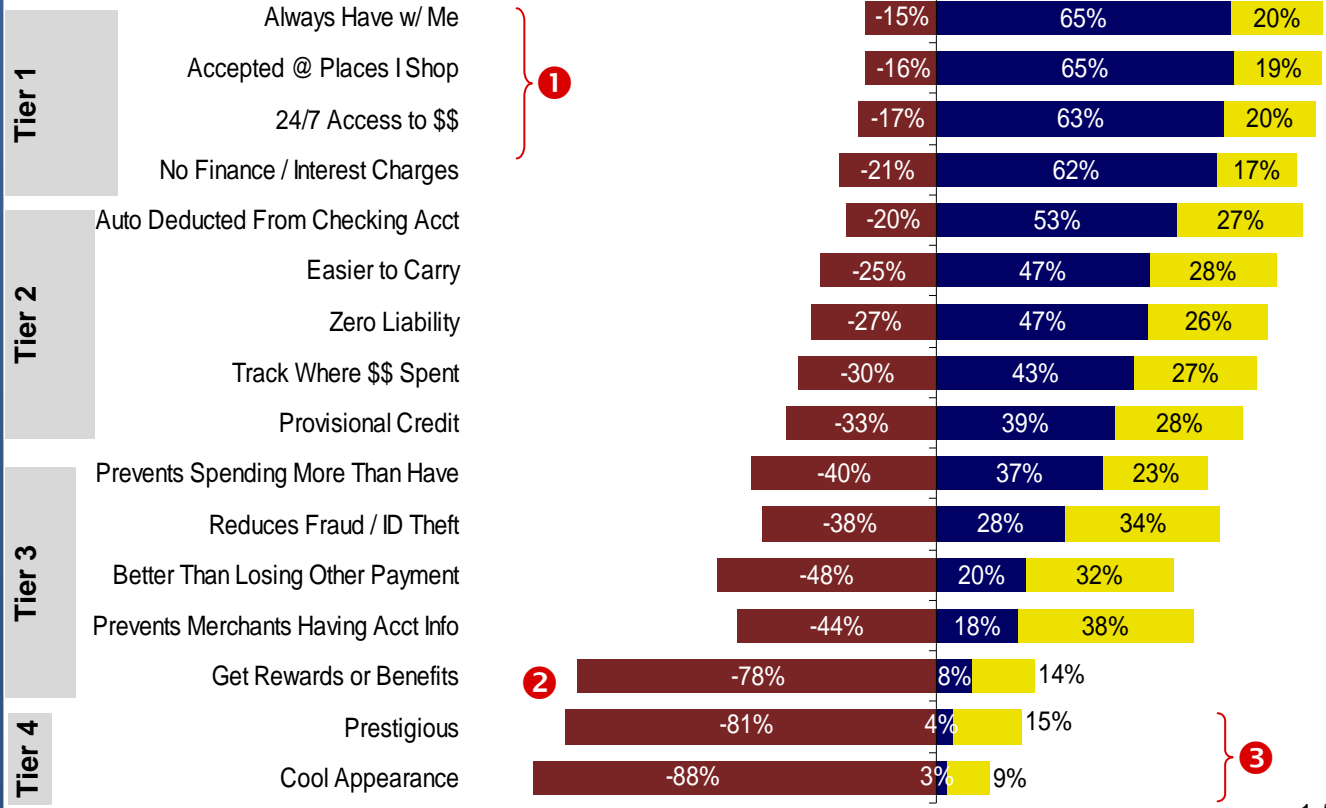


Specific reasons why consumers use their debit card follow a similar pattern; convenience/ease of use (1) are main reasons while rewards (2) is “not a reason.”

Detailed Reasons Why Use Debit Card

(GP shown)

■ Not a reason ■ Major Reason ■ Minor Reason



- Customers and non-customers do not differ greatly on why they use their debit card.

Notable differences:

- Non-customers significantly more apt to say controlling spending is a *major* reason they use their debit card (30% vs. 20%).
- The ease of tracking money is more of a reason (major or minor) why our customers use their debit card (63% vs. 55%).
- Rewards is a “major” reason consumers of big banks use their debit card vs. our bank (13% vs. 5%)
- Security may be more of a barrier among those who do NOT use their debit card vs. primary users (21% vs. 2%).
 - Caution: base sizes are extremely small among this sub-population.

1. “Big banks” = BofA/Fleet, Chase/Bank One, Citibank, Key Bank, Sun Trust, US Bank, Wachovia, Wells Fargo



Debit Card Case Study: Segmentation Analysis

- ❖ Launched a debit usage campaign customized by segment
- ❖ Unique, targeted messages on the benefits of debit card usage were created and distributed to each segment via direct mail
- ❖ All segments saw an increase in debit usage
- ❖ The greatest increase in debit usage was among the customers who used their debit cards relatively infrequently

Segment One Overview

- ❖ Younger than average with low levels of deposit
- ❖ Household actively engaged in POS, upgrade ATM cards
- ❖ Heavy Check and Cash usage
 - ◆ Promote usage in everyday spend
 - ◆ Key against cash: Chargeback rights, zero liability, safer
 - ◆ Key against check: Faster, more convenient, better POS acceptance



Product Analytics Case Study: Revealing an Unprofitable Product

- ❖ Problem: A small commercial Bank realized that its anecdotal customer knowledge wasn't sufficient to answer fundamental questions about its customer base including:
 - ❖ Who are the Bank's customers? What are their needs?
 - ❖ Which products do they use today? What other products could the Bank offer them? Are any of those profitable products for the Bank?
 - ❖ And what if the products aren't profitable? Then what? Does the Bank know exactly why they're losing money and what to do about it?
 - ❖ How can the Bank deliver those products and services more profitably?

- ❖ Solution: Bank implemented an analytics program to inform its go-to-market retail strategy



Product Analytics Case Study: Revealing an Unprofitable Product

- ❖ Discovered that the Passbook Savings Accounts, one of the Bank's most widely used products, was actually costing the Bank money
- ❖ Prior to this effort, Bank had not been breaking non-interest income down by product
- ❖ On average, each Passbook Savings Account was costing the Bank \$850 per account per year!
- ❖ Bank had been unaware that its Passbook Savings Account was not profitable

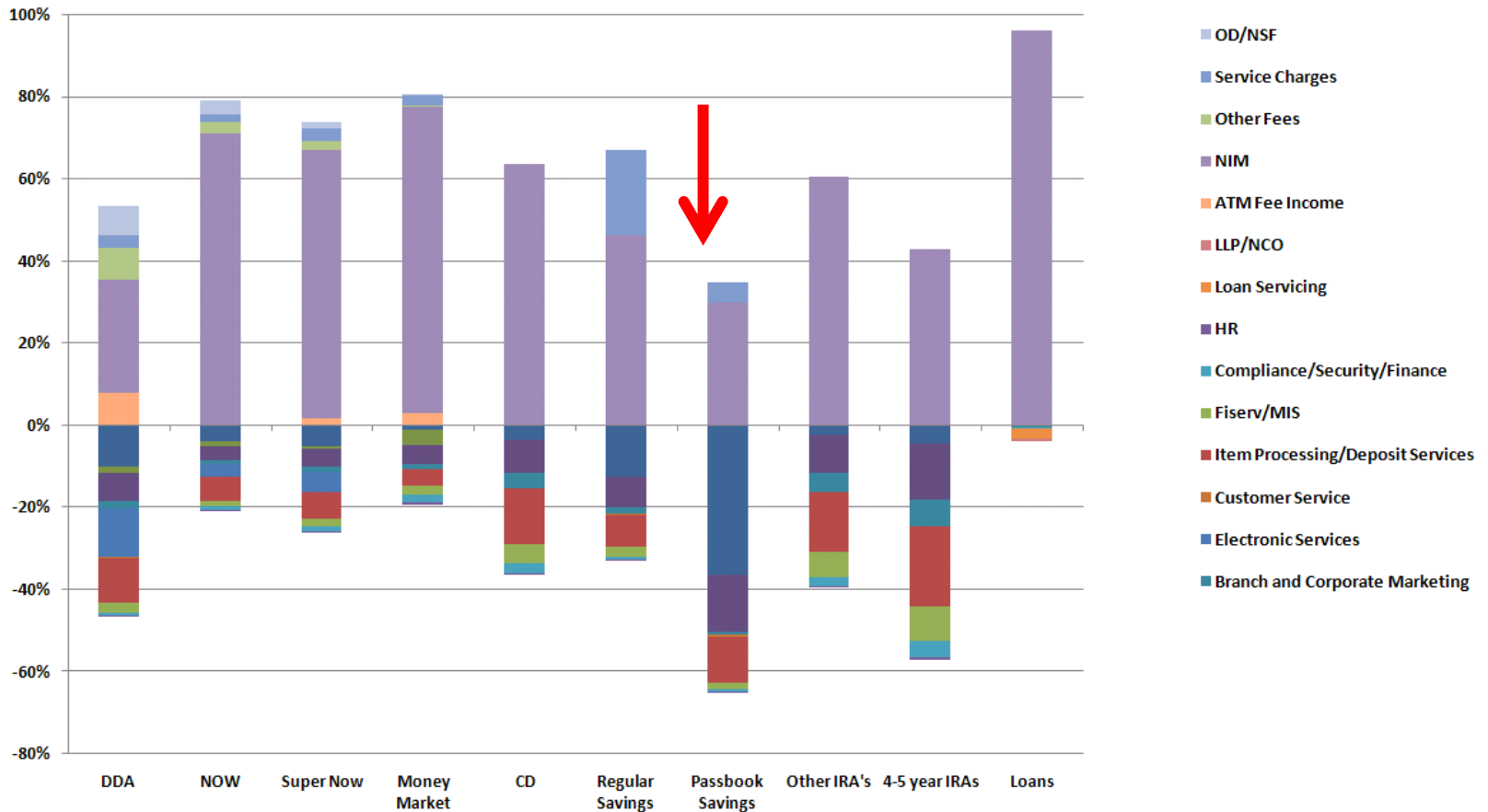
Direct Contribution by Product

	Total	Per Acct
Consumer Mortgage Product	\$296,837	\$109
DDA	\$691,081	\$57
NOW	\$557,462	\$1,030
Super NOW	\$58,044	\$150
Money Market	\$291,954	\$779
Regular Savings	(\$22,678)	(\$2)
Passbooks	(\$1,343,989)	(\$850)
Other IRA	\$8,975	\$15
4-5 Year IRA	(\$15,871)	(\$32)
CD	(\$221,365)	(\$60)
<i>NII from other Borrowings and Liabilities</i>	\$51,226	



Product Analytics Case Study: Revealing an Unprofitable Product

Further analysis revealed the biggest factor contributing to Passbook Savings Accounts' lack of profitability was its unusually high branch servicing, many times higher than for any other product

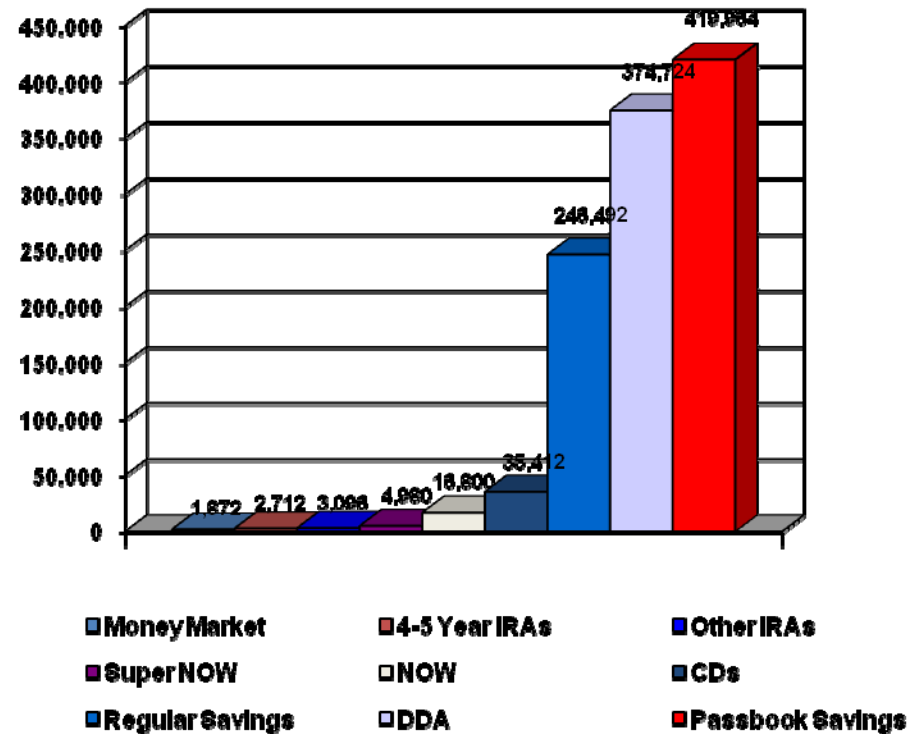




Product Analytics Case Study: Revealing an Unprofitable Product

- ❖ Passbook customers were different in a number of ways from customers using other accounts
 - ◆ Passbook users were, on average, older than other customers at the Bank
 - ◆ They were less likely to trust online banking and they favored “old fashioned banking” – i.e. face-to-face banking inside a branch
 - ◆ They did not utilize any electronic payment options which could generate fee income for the bank

Branch Transaction Volumes Per Product





Product Analytics Case Study: Revealing an Unprofitable Product

- ❖ The Passbook Savings Accounts were losing about \$1.4 MM per year, primarily due to extremely high branch usage. This is a primary example of product 'misuse'
- ❖ In order to improve overall profitability, the Bank gradually phase out the Passbook product by not opening new Passbook accounts and trying to drive current Passbook customers to other savings products
- ❖ To make other products attractive to customers that would prefer a Passbook, the Bank improved its technology, such as online banking features. Technology could be enhanced with relatively little investment and yield a high expected ROI
- ❖ The Bank encouraged customers to increase their use of electronic services such as ATMs and online banking through education and incentives