

THE ART OF POSITIONING

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BRANCH PRODUCT RESEARCH BRAND

Targeting the Wealth Market: Securities Demand Across the U.S.

An old and obvious adage in banking holds that the best way to insulate a bank from margin pressure is to sell products not affected by the margin. While the pursuit of non-margin based revenue has driven many institutions to evaluate a raft of mass market deposit product fees, the wealth management line of business also holds substantial fee income potential through management and activity fees. However, whereas checking account ownership approaches ubiquity, wealth management demand remains considerably more concentrated in the hands of affluent retirees and top-earning professionals, leaving broad variance in opportunity across markets.

Considering the wealth management product set as trust accounts, directly owned securities and packaged or managed securities such as mutual funds and annuities, demand is highly skewed toward the most urbanized areas. Households residing within defined metropolitan areas carry average securities holdings of \$128,000 per household (where securities is used as an umbrella term impounding each of the aforementioned products); compared to \$95,000 per household for those residing in non-metropolitan areas. The New York MSA alone accounts for nearly 8% of all U.S. securities, even though the market holds only 6% of the nation's household base; while adding four other markets – the Los Angeles, Chicago, Washington and Philadelphia metros – impounds 20% of all U.S. securities demand. In aggregate, the 30 largest MSAs hold about half of the nation's total securities demand.

Within that top 30 group, though, there is wide variance in per-household demand, spanning from the Washington, D.C. metro, which boasts average securities demand of \$193,000 per household, to bottom-ranking Orlando, which offers demand of only \$110,000 per household. In terms of per-household demand, the top eight MSAs are located in either the Northeast corridor or California, with Seattle and Chicago rounding out the top 10.

Although the absolute population size of the largest metros gives those markets an advantage in aggregate demand, many of the top-demand

markets in terms of per-household demand represent smaller communities, either edge cities built around affluent suburban cores (Bridgeport, CT; Easton, MD; Oxnard, CA) or retirement havens (Naples, FL; Honolulu, HI; Napa, CA; Cape Cod, MA; Hilton Head, SC). However, the highest per-household demand of any U.S. metro resides in a small enclave of just 7,500 households. The town of Los Alamos, New Mexico, built around the national research laboratory of the same name, shows average securities demand of more than \$250,000 per household, as the 'company town' community is comprised near exclusively of affluent professionals working at the laboratory. Still, because of the limited size of its household base, Los Alamos' aggregate securities demand ranks just 56th among U.S. metros, underscoring the importance of considering both per household and aggregate demand when *(continued on page 4)*

Securities Holdings per Household, 30 Largest U.S. MSAs

| MSA | Securities holdings per household |
|----------------|-----------------------------------|
| Washington, DC | 192,945 |
| San Francisco | 177,147 |
| Boston | 163,596 |
| New York | 158,807 |
| Baltimore | 158,796 |
| Los Angeles | 147,912 |
| Philadelphia | 147,702 |
| San Diego | 146,441 |
| Seattle | 143,765 |
| Chicago | 138,491 |
| Sacramento | 136,086 |
| Minneapolis | 135,454 |
| Denver | 132,585 |
| Houston | 129,595 |
| Miami | 128,625 |
| St. Louis | 128,470 |
| Portland | 126,865 |
| Dallas | 126,529 |
| Atlanta | 125,698 |
| Detroit | 125,395 |
| Kansas City | 125,095 |
| Riverside | 124,300 |
| Phoenix | 122,768 |
| Cincinnati | 122,588 |
| Cleveland | 121,449 |
| Pittsburgh | 119,884 |
| San Antonio | 115,988 |
| Charlotte | 114,040 |
| Tampa | 113,207 |
| Orlando | 110,770 |

Top 20 U.S. Metros Ranked by Securities Holdings Per Household

| MSA | Securities holdings per household | Households |
|---------------------------|-----------------------------------|------------|
| Los Alamos, NM | 265,031 | 7,568 |
| Naples, FL | 211,823 | 145,798 |
| Bridgeport, CT | 201,413 | 345,921 |
| Washington, DC | 192,945 | 2,245,786 |
| Easton, MD | 187,241 | 16,130 |
| Honolulu, HI | 185,836 | 323,037 |
| Napa, CA | 184,674 | 50,726 |
| San Jose, CA | 182,564 | 662,248 |
| Oxnard, CA | 181,144 | 274,810 |
| Barnstable, MA (Cape Cod) | 179,468 | 95,846 |
| Hilton Head Island, SC | 179,213 | 80,907 |
| San Francisco, CA | 177,147 | 1,730,131 |
| Trenton, NJ | 176,115 | 135,114 |
| Torrington, CT | 173,883 | 74,853 |
| Summit Park, UT | 172,826 | 14,126 |
| Gardnerville Ranchos, NV | 172,704 | 20,005 |
| California, MD | 169,427 | 39,704 |
| Vero Beach, FL | 169,308 | 63,565 |
| Santa Barbara, CA | 166,974 | 146,864 |
| Boston, MA | 163,596 | 1,834,114 |

Mobile Banking and Mobile Bankers: Where Does the Value Lie?

As consumer preferences for electronic channels have grown, branch transaction levels have declined, with in-branch transaction counts down by more than 35% at many branches over the past five years. The ability to conduct many purchase transactions without cash; the increased use of direct deposit by employers; and the proliferation of ATMs and point-of-sale cash back terminals have all combined to replace a significant proportion of branch visits. However, the decline in transaction counts in no way eliminates the need for the branch; rather, it allows bankers to redefine what constitutes a branch while boosting the value of what occurs in that redefined branch.

The oft-repeated maxim of the branch-is-dead crowd typically proceeds as follows: "If you can pay your bills from your cell phone and deposit a check from your cell phone and purchase items with a debit card and address those few cash needs from an ATM, why would you possibly need a branch?" That presumably rhetorical question carries two major flaws. First, keep in mind, no one can use your bank's online bill payment function, or its direct deposit capability, or its remote deposit application... or any of the other electronic channels, without first opening an account. And where do consumers – and small business, too – open accounts? Overwhelmingly, at a branch. So irrespective of how customers transact once they have an account, they still need a means of initially establishing that account, or they never become customers in the first place. Second, the maxim presumes that personal interaction with a banker carries no value. It presumes that new technology should replace bankers, when in fact it creates greater opportunity for bankers to support their customers.

As bankers, we should not perceive declining transaction counts as a threat. The financial reality shows that declining transaction counts give more reason for branches to remain, not less. Transactions cost money, sales earn money; so the less of the former we need to perform and the more of the latter we're able to generate, the more profitable our branches become. The fewer dollars we need to expend on transaction processing, the lower the breakeven balances required for profitable operation. The smaller the space required for branch operations, cash storage and customer queuing, the lower the breakeven balances required for profitable operation.

Declining transaction counts render branches more profitable, allowing more locations to potentially serve as viable branching opportunities.

Consider if transactions at a branch at your institution fell to zero. No one walked in all month to deposit a check or obtain cash. Would the branch cease to exist, or would it still have purpose in your network? At first thought, you might claim the former. But before submitting your final response, consider the possibilities: freed from the burden of cash handling and transaction processing, you wouldn't need a vault. Or under counter steel equipment. Or dye packs, or teller cash recyclers, or even tellers, or many of the other elements that keep branches so expensive to operate. Rather, you'd have a venue reserved only for sales and customer service; for holding meaningful conversations with customers about their financial needs and how your institution can facilitate attainment of their financial objectives. Against that reduced cost structure, breakeven account volumes plummet, and profitable branches can exist in a multitude of previously inhospitable environments: a kiosk in a mall; the corner of the neighborhood coffee shop; a college dormitory for a few weeks a year; a converted RV in a hospital parking lot on pay day.

Such alternative sales venues return to the second flaw of the argument that declining transaction counts dictate branch closures. Technology does not obviate bankers, it enables them; and it allows complete redefinition of what constitutes a branch. The cashless branch can exist anywhere a banker with a laptop or tablet can travel - the mobile banker bringing the branch to the customer in a way that the mobile banking platform never can. To suppose otherwise is to believe that the banker plays no role in the consumer's banking decisions, comparable to a belief that a visit to the online site WebMD is somehow tantamount to a direct consultation with a physician. The value we provide lies in the knowledge of our banking officers, not in our ability to cash your check – though if you still need that service, we're happy to help there, too. But the reduction in such transactional needs in no way eliminates the need for our branches; rather, it allows those branches – whether stationary or mobile, permanent or temporal – to focus on the product sales that deliver value to both the customer and to our institutions.

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Understanding Household Profitability

Every bank and credit union has a general ledger system that reports on corporate and branch level profitability. Some institutions also maintain sophisticated cost accounting systems that can calculate product-level profitability. Branch and product profitability reports both provide useful information in managing an institution, but a third dimension, household profitability, can deliver at least equal value as the other two measurements.

The ability to measure household profitability delivers the obvious primary benefits of helping an institution discern which customers contribute the greatest value, and the concentration levels of its key profit-driving households (i.e., an 80/20 type rule of x% of our customers supply y% of total profits). However, when combined with external demographic data, household profitability measurements provide the secondary benefit of an estimate of wallet share, or performance against a household's potential. There is certainly benefit in understanding that the Hamilton household supplies our institution with \$300 per year in profits. But there is even greater benefit in learning that the Hamilton's entire relationship could yield \$1,000 in annual profit, yet our institution has captured only 30% of that total opportunity, while competing institutions capture the remainder.

Not surprisingly, the first requirement for calculating household profitability is to define what constitutes a household; but that warrants an explanation as to why the household supersedes the customer as the preferred unit of measurement. While many accounts are opened at the individual level – for example, IRAs by definition are opened individually rather than jointly – most major financial decisions such as mortgages and retirement planning are reached at the household level. Thus, it is beneficial to view profitability in that context; for multi-person households such as a wife, husband and child, the most relevant view is of their individual, joint and custodial/minor accounts in aggregate.

Institutions that license MCIF (Marketing Customer Information File) systems already have a means of aggregating individual accounts to the household level; but for those lacking such a tool, a simple grouping of relationships with the same address will provide sufficient, if not irrefutable accuracy. That noted, keep in mind that household profit is simply the sum of the profit of the accounts within each household. Building the profitability of each account involves the following data points:

- > Margin, calculated as the difference between the product's actual rate and an institution-wide pooled rate (see *Branch Profitability: How to Calculate Margin Using Spreads in Bancology, March 2007*)
- > Monthly account service charges, based on a 12-month history, if possible (this applies to each of the fee and cost items noted below, too)
- > NSF fees, net of waivers
- > Returned item fees
- > Electronic interchange fees, such as debit card and own foreign ATM fees
- > Miscellaneous fees, though the above listed items impound the vast majority of consumer account fees
- > Origination costs, amortized over the first 12 or 24 months of the product's life
- > Transaction costs, using your institution's per-item costs or industry norms for teller transactions, ATM deposits, ATM withdrawals (foreign and on-us), checks written, POS withdrawals and EFT debits and credits (such as direct deposits and online bill payments or transfers)
- > Processing costs, such as statement rendering; use a standard amount for each product group (checking, savings, etc.)

Tallying those revenues and expenses, first at the account level and then at the household level, yields an overall household profit contribution that allows ranking of households by value or classification by value tier, as well as "80/20" type calculations. Profit-based calculations can support differential service offerings, such as recognition programs, fee refunds, rate premiums or top-of-queue call center routing for the institution's most profitable households. Many institutions prioritize such offerings through a simple stratification, for example, "A" households contribute profit of more than \$1,000 per year; "B" households contribute profit of more than \$500 - \$1,000 per year; and so on.

The shortcoming of such an approach is that it neglects to consider that our "D" household, someone in the bottom profit tier,

may be someone else's "A" household. Before prescribing a service protocol based on a household's \$50 annual contribution, it remains critical to understand if that contribution represents the household's full potential or just some smaller share. A segment-based model can help in that determination. First, assign age and income values to each household record, the former from the customer's date of birth and the latter derived either from an MCIF append or block group level append of Census data. Next, classify the households into age-by-income segments; a simple three-by-three grid such as that illustrated below will suffice.

| Household Income | Age, Head of Household | | |
|---------------------|------------------------|-------|-----|
| | < 35 | 35-64 | 65+ |
| < \$35,000 | | | |
| \$35,000 - \$75,000 | | | |
| > \$75,000 | | | |

Then, for each cell, parse the most broadly cross-sold households as a proxy for those who maintain their full relationship at the institution. Now compute the average profit contribution of that top cross-sell group as an estimate of the full potential of a household in each segment. You can then compare the actual contribution of each household at your institution to its full potential; the measure often referred to as wallet share that addresses the critical question: is that a "D" customer because they carry limited financial needs; or because they're my competition's "A" customer?

By defining the value of a full relationship in each market segment, the segment-based model combines with the household profitability model to show each household's current and potential contribution. And while the former still offers an effective means of prioritizing service offerings, the latter will provide a most efficient means of prioritizing cross-sell efforts.

Need assistance building a branch, product or household profitability model? Contact Bancography at info@bancography.com or review our Profitability Monitor tool at bancography.com/profitability_monitor.html.

NEWS

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- **ABA Marketing Conference**
October 4 - 6 in Denver
Booth 307
- **BAI Retail Delivery Conference & Expo**
October 13 - 15 in Las Vegas
Booth 2130

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selecting markets to target for wealth management initiatives. Even Cape Cod and Hilton Head, which rank 10th and 11th in per-household demand, still rank outside of the top 100 in terms of aggregate demand despite hosting bases of more than 80,000 households each.

The rankings notwithstanding, even markets with low overall demand may hold pockets of affluence. For example, recall that Orlando shows the lowest average securities demand among the top 30 metros; yet within that market, Seminole County carries average holdings of \$130,000, near the median of the large metro group. Thus, if

planning a wealth management strategy, consider markets not just at the MSA level, but also at the county and even submarket level. However, in performing such comparisons, be sure to consider per-household demand as an indicator of whether the market overall carries significant wealth management needs; as well as aggregate demand to determine whether the market holds sufficient revenue potential to justify the staffing and operational expense of delivering wealth management services.

If you wish to learn more about wealth management demand in your markets, contact us at info@bancography.com.

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