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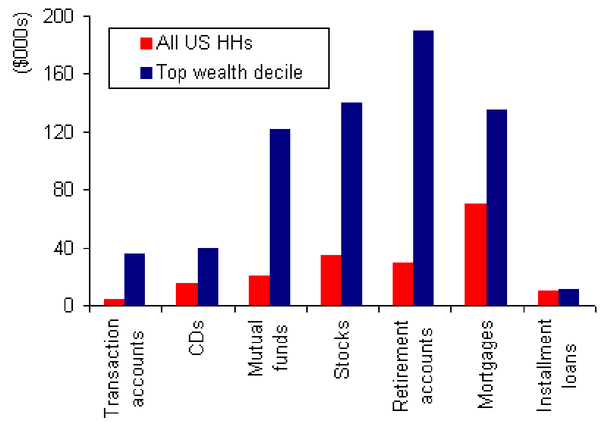
Findings from the Survey of Consumer Finances

In March, the Federal Reserve Board released its 2001 Survey of Consumer Finances, a comprehensive survey of consumer financial behavior. The SCF is conducted triennially, with the latest edition conducted in late 2001. It addresses banking habits, savings, investments, borrowing, and wealth accumulation. In providing information on financial holdings cross-tabbed by demographic segment, the SCF forms the basis for many models we employ at Bancography, including those underlying the product-demand model in our BranchPlanner software tool.

The SCF shows how disparate financial product use remains. The graph to the right shows median product holdings for US households, and the divergence from the holdings of those products by the wealthiest 10% of US households.

Median holdings of households owning this product type



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Branch Network Optimization: The Clean Slate Approach

Network Optimization involves more than where to open or close branches and ATMs. Rather, it measures a market's potential for retail, commercial, and investment/securities offerings. Network growth should not be viewed solely by the number of branch openings, but rather as the potential garnered from optimizing all submarkets through expansion, infill, closure, and consolidation.

Bancography approaches network optimization using the Clean Slate Approach. In this technique, we first examine a market irrespective of the location of current branches. Instead, we design the optimal branch network from the perspective of a new entrant whose strategic mission mirrors that of the client bank. Only after this optimal network is defined do we then examine the current branches, and project how to rationalize the current franchise into the optimal network.

A Clean Slate optimization project includes the following steps:

- An initial meeting to define guiding principles such as the bank's target-market segments, market share goals, and distribution philosophy.
- Submarket definition, in which all potential branch locations in a market are determined based on concentrations of competing branches; retail development; and population density. Each submarket is defined in terms of specific census blocks and profiled demographically. On-site visits follow in selected markets to verify the boundaries of the submarkets.
- Using internal bank data and secondary sources, we build demand estimates for each submarket for all consumer and business deposit and loan products. This step may also include wealth products.
- Based on the market's competitive composition and demographics, we forecast the bank's likely penetration in each submarket. This yields demand estimates for each product, which then dictate the appropriate service model: branch, drive-in, in-line…and corresponding staff levels.
- Since every bank measures branch profitability differently, we integrate the demand projections with your bank's own financial model to yield financial projections for each submarket. Further, we develop an automated application that will run financial projections, in Excel spreadsheet format, for all submarkets. You can change assumptions in the financial model, and the model will recalculate for all submarkets and re-rank all markets. The application allows you to select any submarket from a drop-down menu and instantly view full financial projections. It also quickly maps the target franchise, i.e. all submarkets that exceed the bank's profit thresholds.

...continued on page 2

THE ART OF BANK PLANNING

Findings from the Survey of Consumer Finances

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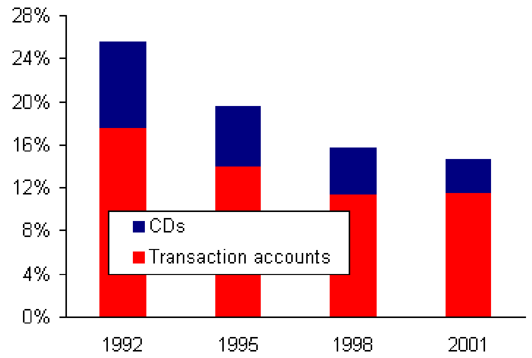
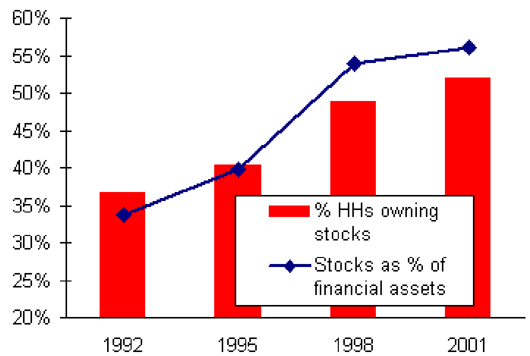
The 2001 SCF shows continuing erosion of traditional bank products' share of consumer financial assets.

Bank-product holdings as a share of total financial assets, all US households



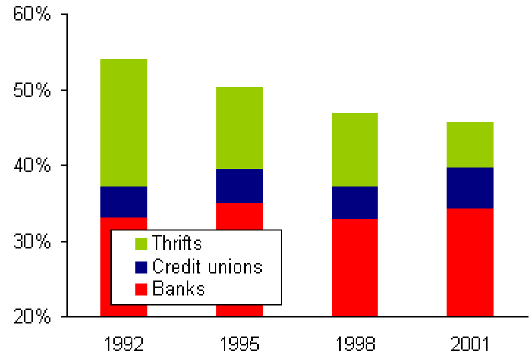
The data further illustrate that stock holdings increased as bank holdings decreased. Over 50% of households now own stocks, compared to 37% in 1992, and stocks now represent 56% of all financial assets, compared to 33% in 1992.

Stock ownership in US households



Banks are maintaining share in lending. Banks supply 40% of all primary mortgages and 45% of all second mortgages (including home equity lines and loans). In aggregate, banks, credit unions, and thrifts supply 46% of all consumer credit, with only the lattermost type of institution losing share in the past 9 years.

Share of credit supplied by institution type



The SCF provides extensive data with which to examine product holdings and banking preferences across demographic segments. It also contains data about transaction behavior, institution selection criteria, and even the distance consumers travel to conduct their banking. This article presents a few high level statistics. We will present additional findings in future issues of *Bancology*.

Sources for the statistics above: *2001 Federal Reserve Board Survey of Consumer Finances, Full Public Data Set; and Recent Changes in U.S. Family Finances: Evidence from the 1998 and 2001 Survey of Consumer Finances, Federal Reserve Bulletin, volume 89.*

...continued from page 1

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➠ Finally, we overlay the existing network. Each submarket will fit one of these criteria—action groups:

Clean Slate recommendation	Current network	Action
Branch	Branch - performing at market potential	None
Branch	Branch-underperforming	Relocate / Monitor
Branch	No branch	Build
No branch	Branch	Close / Consolidate
No branch	No branch	None

A Clean Slate optimization project will leave a bank with a blueprint for its branch franchise for the next 2 – 4 years. And, it will leave the bank's project team well prepared to update the findings with software and modeling tools left behind once the project is complete.

To learn more about our Clean Slate Approach, please call 205.251.6227.

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How to Calculate Wallet Share

Banks often measure performance in terms of market share, a measure of how an institution fares relative to its competitors. However, as bank cross-sell programs have matured, wallet share has also become a frequently measured statistic. First, a definition: wallet share measures the proportion of a consumer's total holdings that the bank captures. As such, it gauges the bank's penetration of its own customer base. The term asset share is often used synonymously with wallet share.

Mathematically, wallet share equals the consumer's holdings with the bank divided by the consumer's total holdings. Thus, calculating wallet share requires the readily attainable statistic of holdings at the bank and the less accessible statistic of the client's total financial portfolio. Exact total client holdings can be obtained through primary interviews, but it would be costly and time-consuming to interview enough clients to yield a statistically valid sample. Alternately, a client's total holdings, "the wallet", can be inferred through models.

To model the wallet for a given client, start with an assumption that total holdings for any client can be predicted based on known demographic information about that client. Research proves that financial holdings correlate strongly with age, income, and other demographic variables. The following process outlines a simple, segment-based approach to calculating wallet share.

1. Devise a segmentation scheme. A simple age-by-income grid with at least four groupings in each category will work adequately. For this example, assume a 16-segment grid, derived from 4 groupings of each variable.

2. Using an export file from your MCIF, calculate the average or median holdings by product-type for each segment. Do they differ across segments? If so, this indicates a sound basis for modeling product-use by segment. If two adjacent cells in the grid show similar holdings, it indicates that the households in those cells behave similarly; combine those segments.

3. The prior step shows average holdings by segment, but we are seeking the client's total holdings. One way to approximate total holdings is to assume that broadly cross-sold clients carry nearly all of their holdings at your institution. As these clients own so much at your bank, they likely own very little elsewhere. Repeat step 2, but this time only with clients that own at least 4 distinct services, including both deposit and loan products. The "full-household" results define the wallet for each segment. Or, rank all households in each segment, in turn by total assets and liabilities. Assume the top 20% are outliers and consider the 80th percentile – the top quintile – as indicative of the most a client in that segment could own; that is the "full-wallet" for clients in that segment.

4. Next, validate your model against external sources. Using data from the Census Bureau or a demographic provider, obtain the total number of households in each segment for a known geography such as the MSA in which your bank is headquartered. Multiply the full-wallet holdings for each segment by the number of house holds in the segment and sum the results across all segments. Compare this to a known total for the geography, such as deposit totals reported by the FDIC. A variance of +/- 10% indicates a model sufficiently precise to estimate wallet share.

5. Now, for each client on your MCIF, calculate the total wallet based on which of the 16 segments the client falls into. By dividing current holdings by the modeled full-wallet for each client's segment, you can now calculate wallet share for one client, for all clients in a segment, or across all segments for any geography.

This method allows you to estimate wallet share for deposit or loan products. Because securities as consumer assets and mortgages as consumer liabilities represent such a significant portion of holdings, additional calculations will be needed to project the complete consumer-wallet unless your bank operates an especially large securities or mortgage business. There are several data sources that will facilitate adding these products to the wallet by segment grid, including the Federal Reserve Board's Survey of Consumer Finances and demand estimates from various demographic providers.

Note that you may find wallet share exceeding 100% for individual clients, as there will always be outliers whose holdings exceed what their demographics indicate. However, the impact of these will dissipate if you examine wallet share across a large sample in order to estimate your bank's performance within a specific segment or geography.

This article outlines an approach to estimating consumer wallet share; more rigorous calculations in each step will improve precision. The business-wallet can be similarly projected with a sales by SIC code grid and wealth holdings with an age by investable assets grid.

Contact us at 205.251.2262 or info@bancography.com to discuss more detailed calculations or to share your bank's approach to wallet share calculations.

Bancography's Steven Reider will teach a course in "Delivery Channel Management" at the American Bankers Association's Stonier Graduate School of Banking, June 8 – 14 in Washington, D.C. Stonier is the only national graduate school for bank executives. Its curriculum includes an intense three-year program, structured around the business of banking, business management, strategic planning, and organizational leadership. We encourage all bankers to consider this valuable program.

Our Delivery Channel class will address tactics for identifying branching opportunities; the role of acquisitions in a branching strategy; defining branch trade areas and determining the reach of current branches; methods of obtaining demographic, competitive, and product demand information; and how to identify and evaluate the impact of branch consolidation opportunities.

For more information about Stonier, visit the American Bankers Association at www.aba.com.

CONTACT

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