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THE ART OF BANK PLANNING
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Too Many Branches? Opportunity in the Southwest, Saturation in the Northeast

Scan any banking magazine and you'll likely see front page evidence of US banks' renewed interest in branch banking. Most of the top twenty US banks have announced significant branching initiatives. Bank of America, Washington Mutual, JPMorgan Chase, and Bank One represent just a few of the banks planning major branch rollouts across the nation's largest markets. Most US banks plan to increase their branch networks by 10% - 15% in the next year (see Bancology, August 2003 for more about planned branch additions and costs). The volume of planned expansions raises questions as to whether the industry will overbuild, especially in markets such as Chicago where numerous competitors all plan large branch rollouts.

The chart on page two examines branch concentration in the twenty largest US metropolitan areas (as measured by number of households).

...continued on page 2

Introducing Bancography Store

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Market & Branch Information Databank

A lite version of our ***Library*** application that we deliver with branch optimization projects, ***Bancography Store***, provides an easily accessible profile of each branch in your institution. Designed to reside on a computer network, ***Bancography Store*** houses demographics, maps, photographs, floor plans, and general commentary about your branches and those of your competitors.

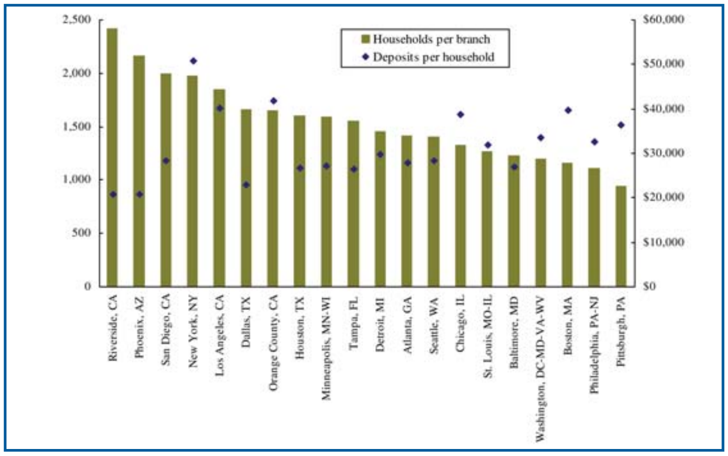
For every branch in your network, users can perform the following tasks:

- **Branch information**: Record hours of operation, current manager, lease details, configuration, and other information.
- **Market profile**: Note retail anchors, primary employers, pending developments, and residential composition.
- **Demographics**: Review summary consumer and business demographics such as population, growth, density, income, age, and number of businesses.
- **Competition**: Examine a list of competing branches, and add information such as number of drive-ins, presence of ATMs, and other comments.
- **Map**: View a map of the submarket, with all competing branches plotted.
- **Photographs**: Store an unlimited number of photographs of the interior and exterior of your branch, competing branches, or nearby retail developments. This feature also supports display of branch floor plan drawings.

Bancography Store allows departments, such as Marketing, Properties, Branch Administration, Delivery Systems, and even call centers to share current information about each branch and its surrounding areas. A security feature allows you to restrict user access to selected information. ***Bancography Store*** provides invaluable guidance, as users can quickly summon photographs and descriptions of any branch, and all interested departments can view branch information from a common source.

Annual licenses for unlimited users within an institution begin at $1,600 per year for institutions with fewer than 50 branches. Current ***Bancography Plan*** clients will receive a 25% discount. Call 205.251.2262 for additional information or visit www.bancography.com.

...Too Many Branches continued from page 1



Among these metros, concentration ranges from Pittsburgh, which already offers one branch for every 950 households, to Riverside – San Bernardino, which offers one branch for only every 2,500 households. Notably, the Sun Belt areas from Texas to Southern California boast seven of the eight least concentrated metros. Contrastingly, the northeast houses the five most concentrated metros, including four cities along the northeast corridor - a continuous urban span running from Boston to Washington.

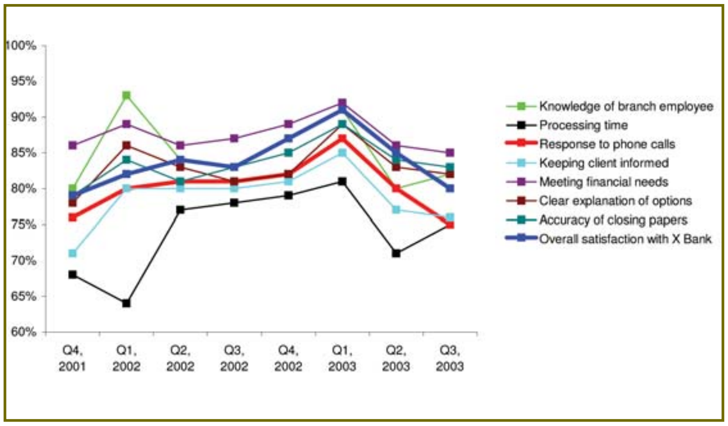
The low branch concentration in some metros may reflect the low affluence of those communities. The blue diamonds on the graph represent estimated retail and small business deposits per household. This statistic was estimated by removing the main offices and their corresponding large commercial and public funds concentrations from FDIC/NCUA reported totals. Main offices are defined as any branch housing over $250 million in deposits. Markets such as Orange County, with low branch concentration but high deposits per household, offer high opportunity when compared to markets such as Baltimore, which show high branch concentration but low deposits per household.

Other useful benchmarks in comparing market opportunity include deposits per branch, four firm concentration ratio, and deposit growth per competitor. Contact Bancography to see any of these measures for your bank's markets.

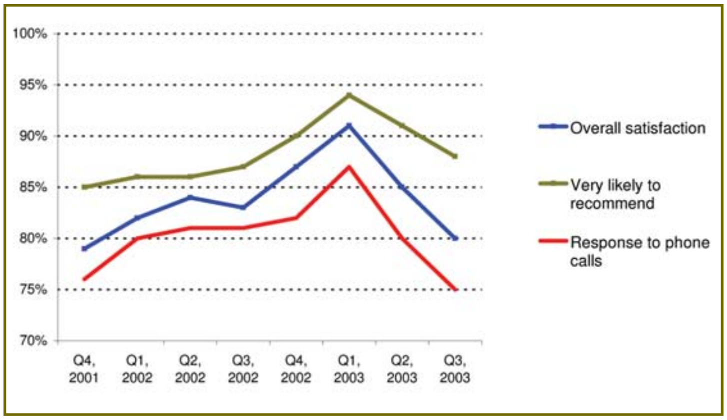
Marketing Research Case Study: Correlation between Satisfaction and Loyalty

All industries understand the importance of measuring loyalty in addition to satisfaction. Although a client may be extremely satisfied with your institution, that does not necessarily mean that he will use your bank for his next product purchase or recommend your bank to his business associates. This phenomenon is the primary reason institutions strive to build relationships rather than purely taking orders for products and services.

This marketing research case study illustrates the relationship between satisfaction and loyalty of consumer loan applicants. The client bank measures customer satisfaction and loyalty at the institution level and across many lines of business. The bank included a survey and business reply envelope in every consumer loan closing packet over the past two years.



The preceding graph depicts the proportion of respondents rating X Bank excellent (5 on a 5 point scale). Of all the attributes measured, *Response to phone calls* has the greatest impact on *Overall satisfaction of X Bank*. Now the bank realizes where to focus its efforts to positively affect customer satisfaction of those applying for consumer loans.



The second graph plots likelihood to recommend along with the two attributes discussed above. The correlation between the three measures is readily apparent. Note the lockstep correlation between satisfaction and loyalty.

If you have any questions about this tracking project or would like more information on how to plan your own marketing research study, call 205.251.6227.

How to Measure ATM Profitability

Banks deploy ATMs to provide customer convenience, generate fee income from non-customers, offload teller transactions, and build brand perception. Regardless of the underlying mission of their ATMs, banks must quantify the machines' financial return to the institution. In calculating ATM contribution, banks must impound numerous factors in their profitability models.

Revenue

Interchange income includes only those fees derived from networks such as Pulse, Cirrus, and Honor. When your bank processes a transaction for a client of another bank, the network collects a fee from the cardholder's bank and remits a portion of that fee to the machine owner, retaining the remainder to cover its own expenses. These fees are set by agreement between your bank and the network. The fees may vary depending upon which network passes the transaction to your machine, but your ATM department can supply an appropriate blended rate to apply to each acquired foreign transaction.

Surcharge income represents the fees that your institution, as terminal owner, imposes directly upon cardholders of other banks. Unlike interchange fees, surcharge fees remain in your direct control and can vary for each machine.

Although cash withdrawals are almost always free to your bank's customers, your bank may charge certain other **customer fees** for balance inquiries, mini-statements, or sale of items such as postage stamps and movie tickets. Each of these fees warrants a distinct line item in your profitability model.

Some banks realize rent payments from selling **advertising** on ATM screens, surrounds, or receipts.

Expenses

Depending upon the type of ATM, **depreciation** can prove a significant expense. ATMs depreciate as bank equipment - typically over five years.

Off-premise ATMs commonly incur **rent** in the form of a fixed monthly fee. ATMs deployed in partnership with a retailer may also include a **transaction rent**, where the landlord receives a share of the machine's revenues.

Maintenance costs include both ongoing repair contracts (fees paid to a third party for repairing a disabled ATM) and cash maintenance (fees paid for cash re-supply and deposit collection). For off-site depository machines, daily collection fees may add significant expense.

If your bank outsources ATM **processing**, you will pay a per transaction fee to a third party provider. Alternately, you may incur overhead for internal processing which you should attempt to allocate on a per transaction basis. This can be a difficult cost to obtain and may be omitted.

Adding all revenues and subtracting all expenses yields an initial profit estimate, but one final calculation will improve your model's fidelity in comparing ATMs primarily servicing clients with ATMs primarily serving non-clients.

Banks realize an **opportunity savings** from customer transactions removed from the more expensive branch channel. Any transaction performed at an ATM represents an activity that was not performed by a teller. Thus, the ATM profit model should credit the ATM for the teller cost not incurred. This is not a one to one substitution; on average consumers perform four ATM withdrawals to replace each teller withdrawal. Thus, your model should credit the ATM with one-fourth the cost of a teller transaction for each customer withdrawal. You may choose a different ratio, and the teller withdrawal cost will vary by bank; contact your accounting department for the appropriate cost statistic. The opportunity savings represents an estimate, so you should always state profit before and after applying this value.

Your ATM offerings may dictate inclusion of additional factors, but this example categorizes the most significant items affecting ATM profitability and provides a useful template from which to build a model specific to your institution.

Defining Branch Trade Areas

When forecasting the performance of a new branch, bankers must estimate the likely drawing area from which the branch will capture new relationships. Trade areas vary significantly, depending on the type of branch, the line of business served, and the density of the surrounding market. The more frequent the transaction, the greater premium consumers award to convenience, thus the smaller the trade area. Guidelines for branch trade areas across various business lines are as follows:

- Retail banking
  - ✓ Population density (population per square mile) > 10,000, 1 mile
  - ✓ Density 5,000 – 10,000, 2 miles
  - ✓ Density 1,000 – 5,000, 3 miles
  - ✓ Density < 1,000, 5 miles

...CONTINUED ON BACK PANEL

...Defining Branch Trade Areas continued from page 3

- Small business banking (annual sales of up to $10 million) trade areas typically mirror retail trade areas
- Commercial banking (annual sales > $10 million), 4 – 6 miles
- Mortgage banking, 6 – 10 miles
- Trust and private banking, 10 – 15 miles

The size and visibility of the branch, the bank's brand strength and market position, and numerous other factors also affect branch trade areas, but the above represent reasonable guidelines on which to build projections. For more precise definitions, use mapping software to plot your bank's households and calculate the minimum distance from which each branch draws at least two-thirds of its clients. A future issue of Bancology will explain this process for calculating custom branch trade areas in depth.

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