

SYNDICATED RELEASE: MARKETING RESEARCH BENCHMARKS AND TOOLKIT

The challenge for bank marketers and strategists lies in how to distinguish their institution in the marketplace. There are three market differentiators: products and services, convenience, and service quality. Competing on products and services is a necessary imperative. Competing on convenience is also crucial, but very expensive, with the average new branch costing \$1.3 million. The most neglected area where financial institutions can make a significant difference and positively affect the bottom line with minimal investment is service quality.

“...the more touch points an institution has, the less personal touch there actually is.”

Marketing Research Benchmarks and Toolkit examines the current state of the industry by presenting trends, benchmarks and commentary on the following:

- Reasons consumers choose their primary institution
- Reasons customers leave their primary institution
- Customer satisfaction and loyalty
- Impact of experiencing a problem
- Problem descriptions and remedies

The first part of the toolkit outlines how to implement a marketing research project by offering guidelines on methodology, results, frequency, sample size, outsourcing versus in-house and preliminary research.

The toolkit also includes 9 surveys ready for immediate implementation. These instruments measure the most commonly studied areas in banking:

- Customer Satisfaction Surveys (3 types)
- Market Awareness & Competitor Research
- Attrition
- Consumer Loan
- Mortgage Customer Service
- New Account
- Branch Manager - Internal Service Quality

The final section of the toolkit provides a quick reference chart portraying statistical accuracy and sample size and a list of more than 60 web sites offering free industry research.

For more information or to purchase **Marketing Research Benchmarks and Toolkit**, contact us at (205) 251-6227 or research@bancography.com. The cost for this research guide is \$950 for non-clients and \$760 for clients. Purchaser will also receive 20% off of all Syndicated Research for one year.

THE BRANCHING IMPERATIVE: IMPLICATIONS FOR PROFITABILITY

In the second quarter 2004 issue of Bancology, we presented evidence showing that banks operating large branch networks gain a disproportionate share of deposits in their markets. Our study examined the 50 largest metropolitan areas in the United States and demonstrated that the largest competitors in a market capture not only the largest share of deposits, but they also show the highest deposits per branch, as consumers disproportionately reward the largest competitors with their balances. That is, large networks outperform smaller networks even on a per-branch basis, as each successive branch captures its own deposit base and, by improving the bank's perceived convenience, also renders consumers in other submarkets more likely to select the institution. *In this article we will discuss the implications of these findings on branch design and formats. These findings are excerpted from an article co-written with our colleague, Timothy Ryan, president of Ryan Bank Concepts.*

The primary implication of these findings is that a bank will benefit from building a broad, marketwide delivery network. But if additional branches yield incremental deposit growth, then every bank faces an incentive to add branches. Yet if all banks add branches at the same rate, the relative outlet rankings of the competitors will remain unchanged. For example, if each bank responds to the knowledge that large networks outperform small networks by doubling its network, then presumably market share positions will not change, yet per-branch deposits will decline. Consumers will benefit from more convenient access to branches, but banks will simply raise delivery costs without increasing deposits. Faced with this 'prisoner's dilemma', a bank can pursue one of three responses:

- The bank can maintain its current network size, losing market share as competitors expand their networks.

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- ➔ The bank can build conventional branches at the same pace as its competitors, but sacrifice profitability, as balances per branch are diluted.
- ➔ The rational solution, and the only option which maintains both market share and profitability, is to build a network that maintains or increases outlet share, yet employs a branch format that reduces expenses to offset the projected dilution of average balances.

As the number of branches continues to rise, the composition of branch networks will change. Insights into the future shape of branch networks should inform current decisions about branch network infrastructure. At a minimum, bankers must avoid investments that will be proved imprudent by foreseeable outcomes of established trends.

In contemplating the evolution of branch networks, it is critical to understand the process that will govern their development. As markets are scoured for potential sites, pockets of untapped potential will progressively decrease. Established clusters of successful branches will attract new entrants, as will emerging growth areas. As a result, average deposits per branch will decline, jeopardizing the profitability of existing and new branches.

Branch skeptics expect the threat of runaway expenses to restrain branch expansion. However, a “rational” decision by one bank to reject competing for location supremacy will not dissuade aggressive action by competitors. Nor will it insulate this bank from revenue erosion as competing branches open. Only when every bank foresees equally dim prospects for de novo branch profitability will equilibrium emerge.

Under these circumstances the competitors who can achieve acceptable profitability at lower revenue levels per site will enjoy the greatest freedom of action. They will find opportunities in markets that appear “over branched” to others and will thrive in locations that would produce crippling drag-on-earnings for less adept players.

There are two dimensions to achieving profit in areas of lower revenue potential. The first is outperforming competitors in attracting customers, thereby generating a disproportionate share of available revenue. The second is reducing expenses so that profitability remains intact even with lower revenue. These are not mutually exclusive options, but rather a continuum along which banks must position their branch programs.

Typically, branch design discussions emphasize revenue enhancements from improved sales environments. To the extent that these design notions add capital cost and operating expense, they shift the balance from the low-expense operating model toward a dependence on higher revenue. However, only anecdotal evidence supports most projections for improved sales. Thus, banks that pursue this approach will struggle to justify new branches as markets continue to tighten.

The competitive environment will be shaped by banks that can continue to act as average revenue per branch declines. When one accepts the challenge of operating more branches while keeping expenses in check, it becomes mathematically obvious that costs per branch must decrease. Unless customer behavior patterns undergo a dramatic shift, branch networks will come to consist of many smaller branches, each costing less to operate than today’s conventional branches. Bankers must reconsider their current delivery strategies in light of this trend.

Branch design must support location strategy—not the reverse. Just as architectural design cannot overcome a deficient location, no prototype branch program will succeed unless it enables the execution of an effective location strategy. Institutions that develop successful small branch formats will realize a significant advantage over those who cling to a conventional, expensive branch model. In a market share contest that favors providers of copious branch access, small branches will form the backbone of successful delivery networks. Banks should begin today to learn how to design, operate—and excel at—small-scale branching.

REQUEST SAMPLE BANCOGRAPHY PLAN REPORTS FOR YOUR NEXT PROPOSED BRANCH LOCATION



CUT OUT AND SEND IN.

Bancography will send you trade area maps, a demographic profile of the trade area and competitive profiles of the trade area and the county. You may request the reports by completing this form and faxing it to us at (205) 251-2269 or by visiting the Bancography Plan section of our web site at www.bancography.com.

Contact Information:

Name: _____
 Institution Name: _____
 Phone Number: _____
 E-mail: _____

Branch Location Information:

Street Address or Intersection: _____

 City, State, ZIP: _____

Contact us at (205) 252-6671 or info@bancography.com for more information.

HOW TO INTERPRET FDIC DEPOSIT STATISTICS

The FDIC recently released its annual branch deposits statistics for all FDIC insured institutions. Once a year, all FDIC insured banks and thrifts must report the deposit totals for all open branches. The FDIC publishes this information and a variety of market share reports, on its web site under the heading Summary of Deposits, at www2.fdic.gov/sod.

Although bankers eagerly chart the performance of their branches against those of competing institutions, the FDIC data sometimes provide a distorted portrait of the actual competitive environment. The following tips can help you get the most out of the FDIC Summary of Deposits information.

- ▶ Always remember that the data are self-reported, with no formal verification process. Therefore, do not treat the reports as uniformly accurate. Be careful to scan the data for apparent anomalies, and where possible send reports to your local personnel to verify that the reported branches actually exist. Although the dataset appears largely accurate, we have observed incorrect addresses, ZIP codes, county codes, and even the presence of closed branches in the FDIC branch lists.
- ▶ Large area data are always more accurate than small area data. Thus, a market share report for an entire MSA may omit a branch, but a single branch omission would have only a small effect on market share at that level. But a missing branch on a market share report for a single town could greatly skew the interpretation of the report.
- ▶ Take advantage of the download capability. The FDIC site provides a wealth of valuable reports. But each

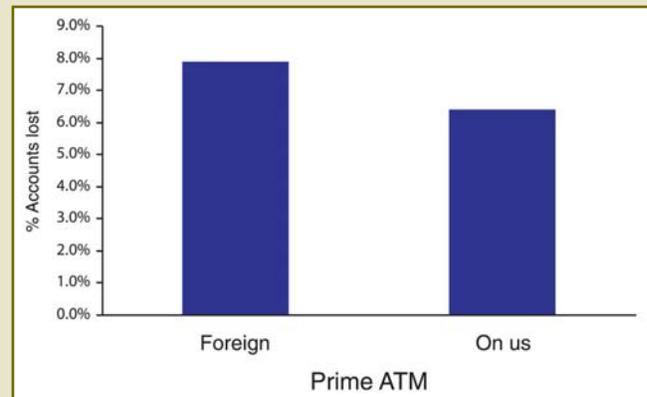
report also gives the ability to download the report data into an Excel spreadsheet for further analysis. You can download branch level data or aggregate county and MSA totals.

- ▶ Be careful of the impact of main offices. If a major bank's headquarters falls within the county you're examining, that bank may appear to control a dominant share of the market. But much of its deposit base may arise from large commercial deposits, public funds, trust accounts, or other non-retail sources. Further, main offices often include balances from customers that live well beyond the county in which the main office is located. To offset the effect of main offices, it can be useful to omit each competitor's main office from your market share reports. To do this, first retrieve a list of all branches in the county. Then, delete the largest branch of each competitor, if that branch exceeds \$250 million in deposits. (The exact cutoff you select may vary, but the principle is to define a decision rule that discriminates between main offices and branch offices.) Now sum the deposits of the remaining institutions by branch to calculate market share for the county or MSA.
- ▶ Consider branch service model type when evaluating market share. The FDIC branch level reports include a 'service type' code for each branch. This code classifies the branch as a traditional free-standing, in-store, drive-in only, trust office...or other type, from a list of sixteen categories. Although useful for distinguishing in-store branches from free-standing offices, ground-level research often reveals in-store branches coded as traditional brick and mortar offices. Still, even a limited ability to identify in-stores can help clarify your market evaluations.

RESEARCH FINDING: ADDING ATMs IMPROVES RETENTION

In two recent projects, Bancography uncovered evidence that strong ATM networks have a positive impact on customer retention. Bancography assessed the transaction behavior of ATM users over a one year period. For each customer, the ATM that the customer used most frequently during the preceding 12 months was designated as the prime ATM. Then, the customers were grouped depending on whether the prime ATM was an 'on us' machine or a 'foreign' machine. We tracked the retention rates of both groups. Over a six-month period, the attrition rate of customers whose most frequent ATM was a foreign machine exceeded the rate for the on us group by a wide margin, 7.9% for the foreign group vs. 6.4% for the on us group. The likely cause of the disparity is that the group for whom the most frequently used (and presumably most convenient) ATM was foreign tired of paying transaction fees and switched to banks with nearby fee-free ATMs.

This finding implies that banks can reduce attrition by offering broad, convenient ATM networks. We will explore the relationship between ATM distribution and retention in greater detail in a future issue of Bancology.



Bancography is pleased to announce its affiliation with the **Kentucky Bankers Association** and the **Community Bankers Association of Illinois**. For more information, visit www.kybanks.com and www.cbai.com. If your bank association is interested in partnering with Bancography to offer branch planning services to your members, contact Laura Levie at (205) 252-6671 or laura@bancography.com.

Bancography has partnered with the ABA to offer **discount pricing to ABA members** on select delivery system and marketing research products and services. Visit www.aba.com and click on *special offers* for more information.

Bancography's Steven Reider will speak at the 21st annual **Savings Association Trade Executives (SATE)** meeting, which will be held in Naples, Florida from January 15 - 18. SATE is a group of banking trade association executives (each representing their state banking associations) who meet to

share information and ideas on how to better serve the banking industry.

Bancography has released a new version of its **Bancography Plan** software, which includes the updated 2004 FDIC data. For more information or to request a demonstration disk, contact Laura Levie at (205) 252-6671 or laura@bancography.com.

If you enjoy reading Bancology, you'll also appreciate **GonzoBanker**, a weekly newsletter from our colleagues at Cornerstone Advisors. **GonzoBanker** contains provocative research, analysis, and commentary on major issues facing the banking industry. Read the newsletter online or register for e-mail distribution at www.gonzobanker.com.

Thank you to everyone who visited Bancography at the **ABA Marketing Conference** and the **BAI Retail Delivery Conference and Expo**.

BANCOLOGY, a quarterly journal

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