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At the Margin

Battle Tactics for Deposits 101: Gauge Your Performance.

The Doctor Is In!

The battle for retail deposits is on... big time!

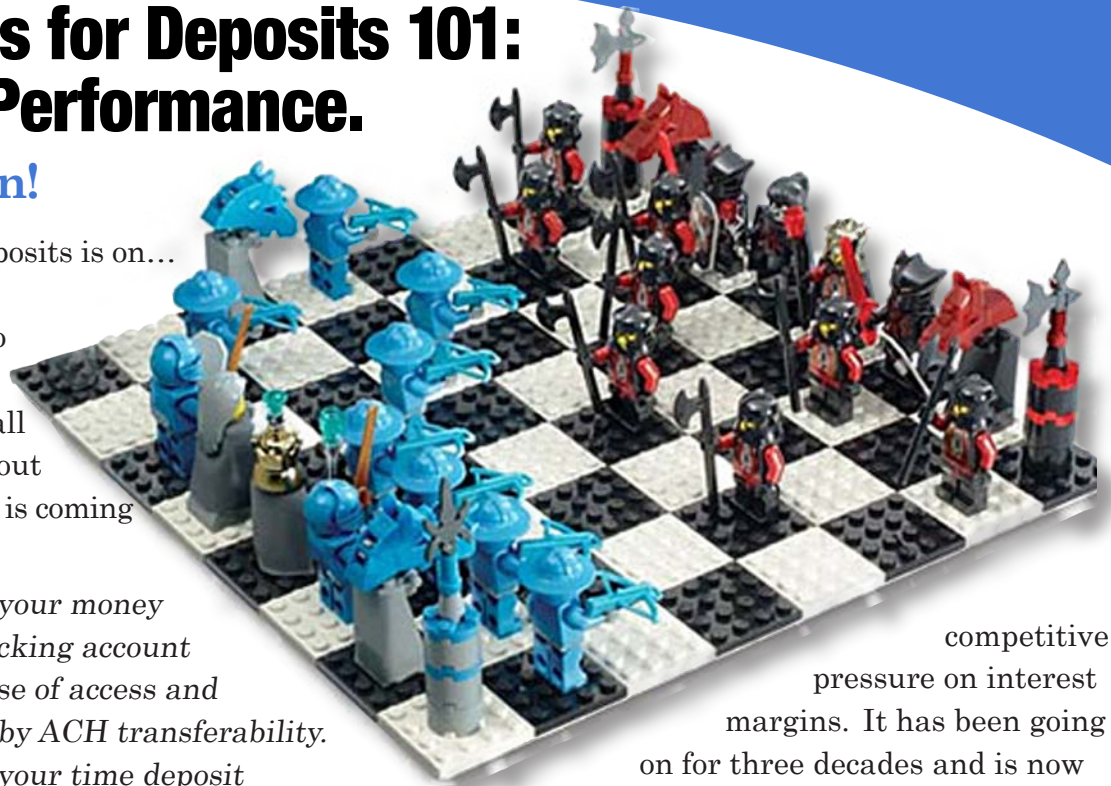
In what is no surprise to community financial institutions nationwide, Wall Street, flush with its bailout money and bank charters, is coming after your deposits:

- They are coming after your money market, savings, and checking account customers with online ease of access and balance mobility created by ACH transferability.
- They are coming after your time deposit customers with a version of CD rate wars on steroids. They are using sophisticated tools of relationship pricing through market segmentation and product differentiation.

Now is **not** the time to back off, retreat, and to allow the mega financial conglomerates to control the battle field!

Impact on Interest Margins Can Be Managed

We can all lament the impact that this deposit battle is having on interest margins... but then again, haven't we been saying that interest margins are under downward pressure... FOREVER! The increased commoditization of financial service products has driven this



competitive pressure on interest margins. It has been going on for three decades and is now being accelerated by the current financial crisis. Sure, the sources of non-interest income (revenues from maximizing point of sale contact with consumers) of mega banks help them to offset the costs of their deposit warfare. But these impacts on interest margin can be mitigated with savvy, efficient retail pricing tactics and product innovation strategies. [Parliment Consulting Services](#) is actively involved in helping financial institutions develop such tactics and strategies.

Plan Your Competitive Response

You need to put the speed and pace of your competitive response to these deposit wars into the

context of an overall strategic financial plan. A plan which focuses on incremental increases of net income: “growth for income sake.”

A previous [“At the Margin”](#) article specified how institutions could use a loan production matrix to manage the implementation of such an income focused strategic financial plan.

Now we are going to drive the same accountability for managing deposit growth down to your branch level.

You know I am always saying to my fellow directors that the way to get management accountability without “invasive micro-management tactics” is to simply ask the following: “When management presents new ideas for products, strategies, or tactics, just ask them to simultaneously present a way for the board to measure and monitor progress with respect to the ideas.”

Develop a *Branch Performance Gauge*

Well, this is what we’re going to do with the effectiveness of your branch network... measure the success of your branch through a gauge of deposit growth and market penetration with respect to a specific list of competitors. Sounds simple and straight forward, but believe me, some pretty sophisticated geo-coding analysis lies behind the development of our ***Branch Performance Gauge***.

Ultimately, the success of growing deposits must come from one of three sources:



But you need to measure your success at growing deposits for each of your branch markets. Measurement lays the ground work for successful retail strategies and management accountability.

We do not address the growth of deposits through the Internet delivery system for this particular analysis. It is important! But our focus is on the growth of deposits specifically through a branch network. The success of Internet tools can complement the effectiveness of the branch network.

While this [“At the Margin”](#) will focus on measuring branch ***performance***, we will devote the next “At the Margin” to measuring branch ***potential***. It will be important for community financial institutions to gauge the total capacity of deposit sources including all those funds *not currently in bank branches*. A whole host of economic and demographic variables affect the growth of deposits from both consumer and business markets. With our alliance partner, [Verde International](#), we have developed an index of these factors which allows a community financial institution to gauge the deposit potential within each market.

Ultimately, the success of growing deposits must come from one of three sources:

- 1. Intrinsic growth within each branch taking into account the changing economic and demographic characteristics of the area.**
- 2. Pirating your competitors' deposit base.**
- 3. Breaking into the treasure trove of balances on deposit at money market mutual funds held at brokers.**



-Tom Parliment

Prescriptions for Success

As we work with clients around the country and speak to financial institution management at conferences, we always hear the frustrations of how to grow deposit balances. It is very often noted that “there is no deposit growth in my community.” REALLY?

It becomes challenging to develop deposit budgets by branch when anecdotal remarks lead management to actually believe there is no deposit growth in their communities. Yes it is true that you’re all pirating deposits from each other, but why wouldn’t you want to be on the winning side of that battle?

Dr. Tom and I realized that there had to be a simple, but realistic, way to measure deposit growth by branch. Working with [Verde International](#), we developed a sophisticated analytical tool, **Branch Performance Gauge**, which provides a simplified measurement gauge to project deposit growth and measure performance with respect to your direct competitors. It is an empirical measurement tool that takes the emotion out of accounting for branch performance.

Dr. Tom’s Bank (presented on page 6) shows the analysis for State Street Branch, actual data from one of our clients.

Who Are Our Competitors for Deposits?

For State Street Branch’s geographical area, we determined the number of closest competitors appropriate for the individual branch analysis. We typically start with the closest 20 because it is a manageable number of branches to evaluate deposit performance. This can change, however, based on whether or not your branches are in very rural areas or based on geographic impediments such as mountains, lakes, rivers, etc. which impact the actual drive time.

The competitors are listed by the approximate distance from State Street Branch. For this branch, the closest 20 competitors are within 10.2 miles. For branches that are located in metropolitan and more congested areas, the closest 20 competitors may be within a few miles. For very rural areas, the distance of the closest 20 competitors may extend farther.

Therefore, the list of competitors may need to be tweaked based on distance or other factors. Branch managers may find that some competitor

branches don’t belong due to market overlaps or other factors. A few examples are specialty banks or “in-store” branches. In fact, we deleted a small “in-store” branch from the closest 20 competitors to State Street Branch.

Very often we find that geographic markets of branches overlap. The **Branch Performance Gauge** allows us to account for these branch overlaps and therefore assign accountability to a specific branch.



Working with Verde International, we developed a sophisticated analytical tool, **Branch Performance Gauge**...

What Was the Historical Growth of Deposits?

The Table on page 6 shows State Street Branch's historical June 30th deposit balances: \$36 million in 2005, \$46 million in 2006, \$51 million in 2007, and \$50 million in 2008. You can see that although there was growth during the first 2 years, the branch actually shrank during the last year. Why? Was it a function of the markets, deposit strategies, missed opportunities?

The Table also shows the list of outstanding deposits per competitor branch. Note that many of the competitor branches did not grow (at least consistently) during that time. However, many competitors did grow consistently during that same time frame as highlighted by the red arrows. What were their deposit strategies? Was the growth based on CD promotions? Was it based on business strategies and commercial demand deposits? Were there acquisitions or branch consolidations?

What Are the Specifics of the Defined Deposit Market?

The competitive total of deposits was calculated for each year: \$637 million for 2005; \$711 million for 2006; \$774 million for 2007, and \$798 million for 2008.

State Street Branch deposits (\$36 million for 2005, \$46 million for 2006, \$51 million for 2007, and \$50 million for 2008) were then added to the competitive totals, which gave us the total market for deposits (\$674 million for 2005, \$757 million for 2006, \$824 million for 2007, and \$847 million for 2008). Is the market growing? Yes, it grew \$173 million, or 25.7%. Where did the growth come from? Did population or demographics change? Did an acquisition or bank closing impact our market?

State Street Branch market share was calculated by dividing its deposits by the total market deposits for each year. Specifically, for 2005, market share was 5.4%; in 2006, it grew to 6.1%; in 2007, market share remained at 6.1%; and in 2008, it lost market share at 5.9%. Why has market share not grown? Do we not have the strategies to effectively compete for deposits?



Oops! The branch has to grow another \$25 million to meet the second target.

It is worth noting that as market share increases, it is critically important that effective product differentiation and market segmentation strategies be developed to minimize the cannibalization of deposits. You cannot afford to price up old money to raise new money. High cannibalization will raise the marginal cost of raising deposits!

Rules for Branch Deposit Growth Targets:

In working with clients regarding branch growth, Dr. Tom and I developed two Rules for branch deposit targets:

1. Target your branch deposits to be at least the average size of the branches in your market area within a reasonable time frame.
2. If your branch is above average, target the growth to be at least the average size of the branches in the top quartile within a reasonable time frame.

The competitive average branch was calculated for State Street Branch market. The branch, currently at \$50 million, is 124% of the average size branch of \$40 million. Good! It exceeded our first target.

The branch was then evaluated against the average of the top quartile. The \$50 million branch is 67% of the top quartile branch of \$75 million. Oops! The branch has to grow another \$25 million to meet the second target. What strategies will we need to meet the growth? What deposit products will be required?

What Were the Historical Growth Rates?

The competitive average growth rate was calculated for the market, which revealed a slowing of branch growth (11.6% in 2006; 8.9% in 2007; and, 3.0% in 2008). Is that due to the geographic area, the demographics of the region, or maybe a specific entry into the market?

State Street Branch growth rate also slowed, from 25.7% in 2006 to 10.4% in 2007. However, in 2008 the branch did not grow and in fact shrank by 1.9%. Why? The market grew during that same period. The branch manager may have concrete reasons for this exception.

What is the Projected Growth for the Market and for State Street Branch?

What can be projected for growth in the market and for State Street Branch over the next 18 months (to December 31, 2009)?

The model evaluated the 3-year growth (from 2005 to 2008) of the total market. It projected, based on the historical growth, an additional total market growth of \$109 million over the next 18 months.

Based on this market growth, what additional growth can we project from State Street Branch?

If it simply maintains its market share of 5.9%, we can expect to grow deposits by \$6.4 million over the next 18 months.

But what about the \$75 million top quartile target? How fast should the branch close that gap? This is the substance of real incentive building!

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Now, let's go back to my original quote by community bankers: "There is no deposit growth in my community." REALLY?

To quote Pat Reily, CEO of Verde: "Sales people will always have a reason why their goals are tougher this year, and they will always find a way to lower expectations so they can be rewarded for exceeding them."

The *Bank Performance Gauge* has been designed to cost-effectively guide you and your management team to ask the right questions and catalyze discovery. While not a perfect analysis, it's a great start, and a quick way to gain tactical advantage while developing your long-term deposit strategy.

-Janet Frankl-Lockwood

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[Parliament Consulting Services, Inc.](#) focuses on Strategic Financial Planning to help community financial institutions gain and maintain sustainable superior earnings growth.

[Verde International](#) provides ongoing strategic planning resources and guidance across the business enterprise at product and local-market resolution via in-depth data analysis and deployment of state-of-the-art decision science solutions.

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Bank
Performance
Gauge



Branch Performance Gauge



| Bank Name | 6/30 Deps. (\$K) | | | | # | Approx. Dist. Mi. | 6/30 Comp. Deps. (\$K) | | | | Comp Bank Name |
|--|------------------|--------|--------|--------|----|-------------------|------------------------|----------------|----------------|----------------|------------------------|
| | 2008 | 2007 | 2006 | 2005 | | | 2008 | 2007 | 2006 | 2005 | |
| Dr. Tom's Bank | 49,620 | 50,586 | 45,811 | 36,449 | 1 | 0.8 → | 40,137 | 38,094 | 21,441 | 7,892 | FARMERS BANK |
| State Street Branch | | | | | 2 | 1.2 | 22,880 | 24,214 | 27,298 | 27,228 | FIRST FSB |
| 283 State Street, Somewhere, USA | | | | | 3 | 1.3 | 83,597 | 81,218 | 93,773 | 81,309 | FIRST NATIONAL BANK |
| Full Svc Offc | | | | | 4 | 1.8 → | 42,976 | 36,317 | 34,268 | 25,617 | INVESTORS BANK |
| | | | | | 5 | 3.0 | 15,408 | 15,192 | 13,664 | 19,212 | TWIN CITY FEDERAL |
| | | | | | 6 | 3.0 | 53,019 | 51,514 | 51,747 | 48,360 | BANK OF NEWTOWN |
| | | | | | 7 | 3.0 | 46,887 | 50,551 | 52,860 | 52,109 | BANK OF AMERICA NA |
| | | | | | 8 | 3.0 | 69,822 | 71,511 | 56,400 | 52,887 | CENTRAL BANK |
| | | | | | 9 | 3.0 → | 36,650 | 34,825 | 32,012 | 31,632 | FARMERS BANK |
| | | | | | 10 | 3.0 | 40,116 | 42,950 | 38,778 | 37,440 | SUNTRUST BANK |
| | | | | | 11 | 3.1 | 34,182 | 39,744 | 33,582 | 32,759 | FIRST NATIONAL BANK |
| | | | | | 12 | 4.5 → | 34,668 | 33,290 | 32,730 | 25,045 | CITY BANK |
| | | | | | 13 | 8.2 | 36,270 | 38,071 | 30,011 | 23,761 | CITIZENS NATIONAL BANK |
| | | | | | 14 | 8.3 → | 42,466 | 39,426 | 37,657 | 31,181 | SECOND FEDERAL |
| | | | | | 15 | 8.8 → | 119,959 | 118,152 | 104,058 | 97,533 | MILLENNIUM BANK |
| | | | | | 16 | 8.9 | 10,832 | N/A | N/A | N/A | SUMMIT BANK |
| | | | | | 17 | 10.0 | 10,240 | 7,757 | 4,270 | N/A | COMMUNITY BANK |
| | | | | | 18 | 10.2 → | 21,750 | 17,075 | 15,697 | 14,780 | TWIN CITY FEDERAL |
| | | | | | 19 | 10.2 | 4,404 | 3,608 | 703 | N/A | ATLANTIC BANK |
| | | | | | 20 | 10.2 | 31,437 | 30,819 | 30,223 | 28,423 | SUNSTATE BANK |
| Competitive Total | | | | | | | 797,700 | 774,328 | 711,172 | 637,168 | |
| Total Including Branch "283 Bank View Blvd" | | | | | | | 847,320 | 824,914 | 756,983 | 673,617 | |
| Branch % Share | | | | | | | 5.9% | 6.1% | 6.1% | 5.4% | |
| Comp Average Deposit Balance | | | | | | | 39,885 | 40,754 | 37,430 | 37,480 | |
| Branch Dep. Bals. As % of Comp Average | | | | | | | 124.4% | 124.1% | 122.4% | 97.2% | |
| Comp Top Quartile Deposit Balance | | | | | | | 74,657 | 74,589 | 71,768 | 66,440 | |
| Branch Dep. Bals. As % of Comp Top Quartile | | | | | | | 66.5% | 67.8% | 63.8% | 54.9% | |
| Comp Average Growth Rate | | | | | | | 3.0% | 8.9% | 11.6% | | |
| Branch Growth Rate | | | | | | | -1.9% | 10.4% | 25.7% | | |

| | |
|---|----------------|
| Projected '09 Addl Market Growth | 109,248 |
| Proj '09 Addl Br Growth@Same MktSh | 6,398 |