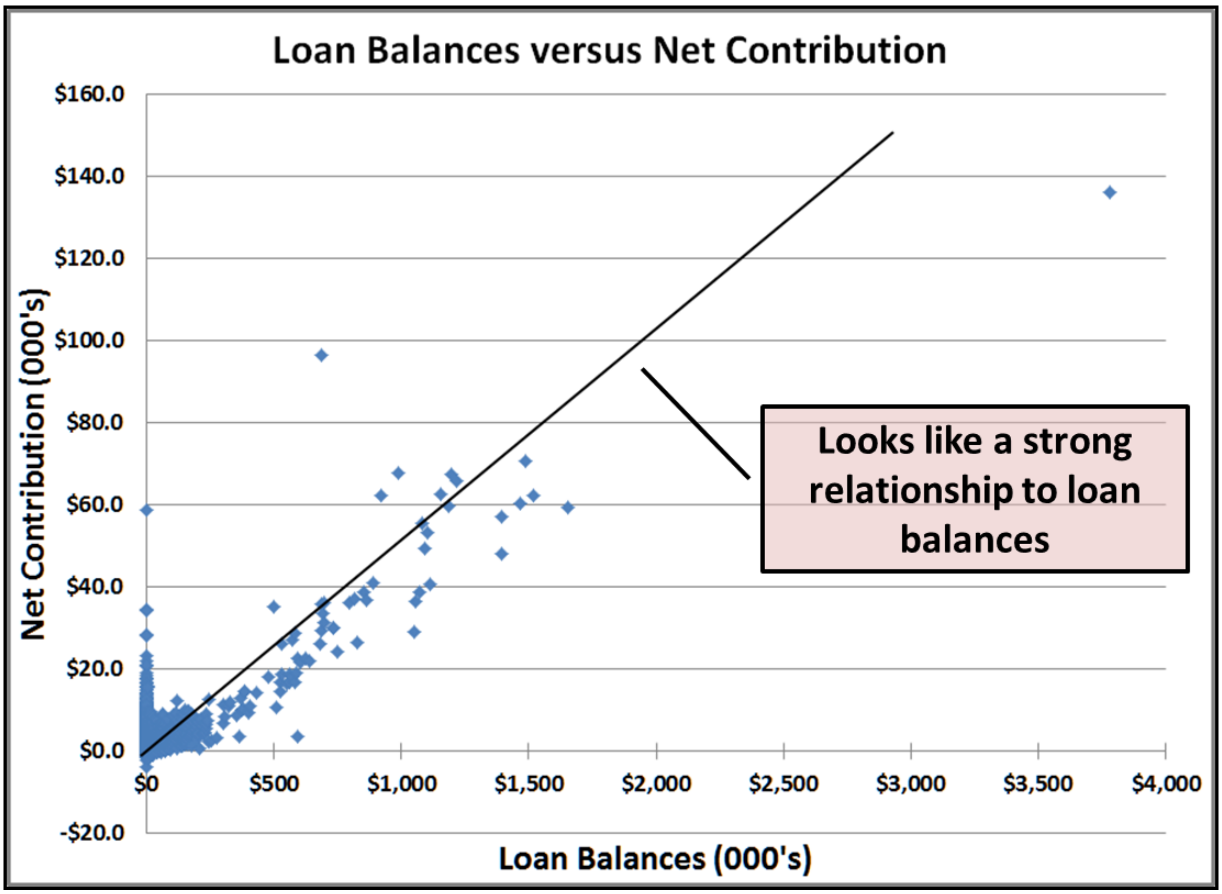
Banking Industry Myths, Part 3 (altavia.com, 2016)

In Parts 1 and 2 of this blog we disproved the banker's old Rule of Thumb that the more financial products (accounts) owned by a customer the more profitable is that customer. One take-away from rejecting this Rule of Thumb is that sales campaigns focused on cross-selling to existing customers are counterproductive. No, cross-sell efforts should focus on existing *profitable* customers, not unprofitable customers. We noted that selling an additional account to an unprofitable customer is likely to increase his or her unprofitability.

Another banker's Rule of Thumb used to guide policy is that loan balances drive profitability. That is, the larger the loan balances carried by a customer the more profitable is that customer. This Rule of Thumb has the ring of truth to it since the higher the loan balances the more interest income earned (this assumes a positive spread on the loan). Unfortunately, this Rule of Thumb, like the other, is a myth.

Let's use the customer profitability management information from a mid-sized Credit Union to examine the idea that higher loan balances mean higher customer profitability. If you look at this concept from 50,000 feet, it seems to make sense.



The chart of Loan Balances versus Net Contribution by customer shows a fairly strong linear relationship between loan balances and net contribution, particularly for customers with loan balances over $300k. There are, however, only a few hundred customers with loan balances over $300k out of the Credit Union's 56,000 customer base. What about all those customers with loan balances less than $300k, the bulk of the Credit Union's customer base? Is their profitability also driven by loan balances? We will examine that question in our next blog post.