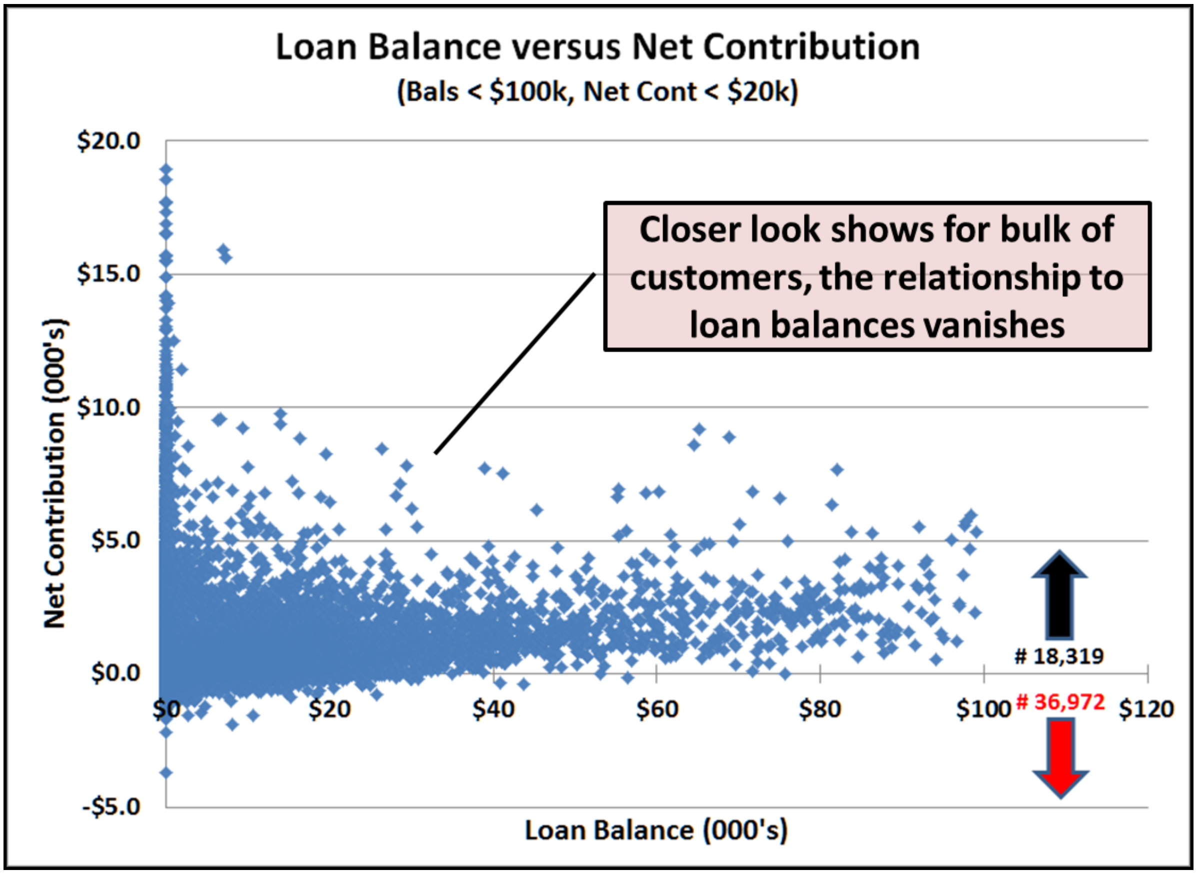
Banking Industry Myths, Part 4 (altavia.com, 2016)

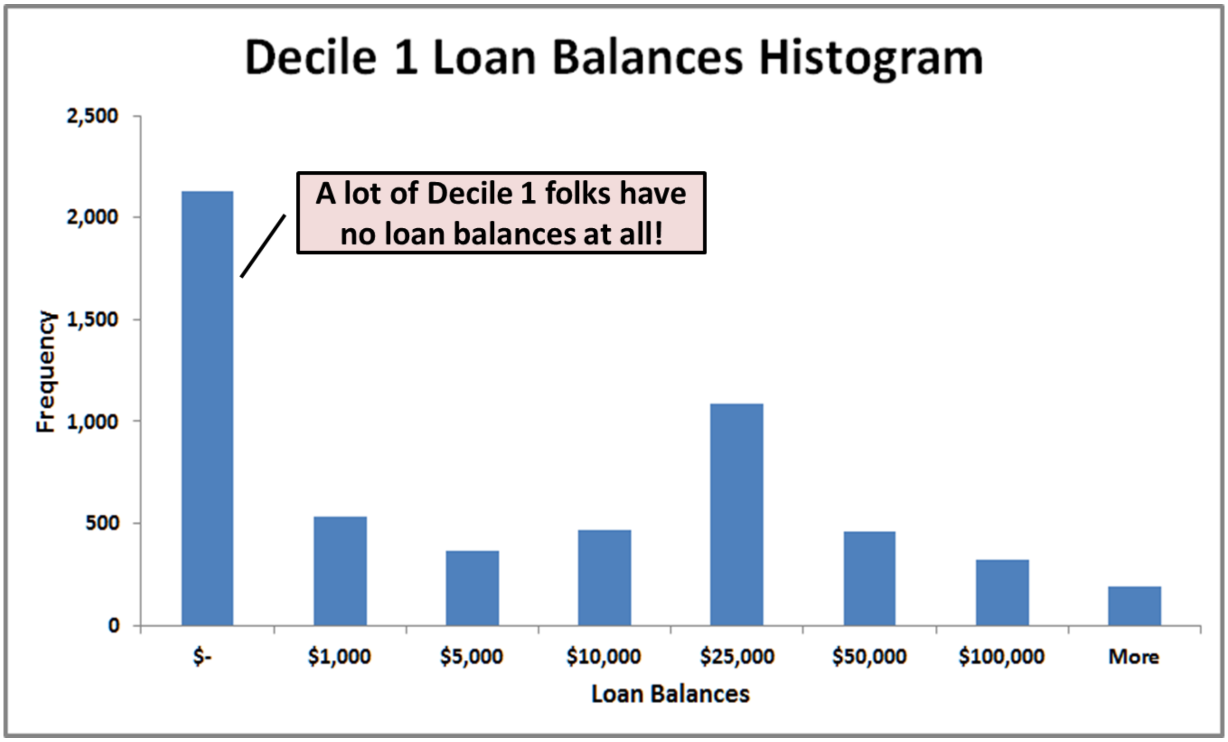
In our last post we started looking at the banker's Rule of Thumb that the larger the loan balances carried by a customer the more profitable is that customer. The chart displayed in that last post, based on customer profitability management information from a mid-sized Credit Union, tended to bear this out, particularly for customers with loan balances exceeding $300k. However, there are only a few hundred customers with loan balances exceeding $300k out of the Credit Union's 56,000 customers.

What about the bulk of the Credit Union's customer base, those customers whose total loan balances are less than $300k? Is their profitability also driven by loan balances? A chart that looks at customers with loan balances less than $100k shows that the relationship between loan balances and profitability vanishes.



It is not that loan balances aren't important to a bank's bottom line. Of course they are. The point is that loan balances are not a good predictor of a particular customer's profitability, and sales campaigns aimed at increasing loan balances may or may not impact a customer's profitability in a positive way.

The above chart includes both profitable and unprofitable customers. What about the Credit Union's most profitable customers. Surely their high profitability is driven by loan balances, right? Again, the Rule of Thumb misleads:



Decile 1 consists of the Credit Union's most profitable customers (customer profitability deciles were introduced in Part 1 of this blog series; where each decile represents 5,562 customers). As the chart makes clear, almost 40% of the Credit Union's most profitable customers carry no loan balances at all! Although loan balances drive the profitability of many of the Decile 1 customers, it is once again not a good predictor of these customers' profitability.

Sales campaigns aimed at increasing loan balances without a better understanding of the customer being marketed will prove disappointing. Loan balances are important to a banks bottom line, but factors other than loan balances can dramatically impact a customer's profitability. The Rule of Thumb that the more loan balances a customer has the more profitable is that customer is false for the bulk of the credit union's customer base. For all practical purposes this banker's Rule of Thumb is a myth!