CPG WIRE
BI-MONTHLY NEWSLETTER

CAPITAL PERFORMANCE GROUP

VOLUME 14/ISSUE 1
JANUARY/FEBRUARY 2015

Facing the Social Media Challenge

Over the last few years, many banks have struggled with improving the financial performance of the retail banking business. The reasons are well known. Shrinking loan demand, the negligible value of deposits, and regulatory pressures on fee income have forced many banks to focus on expense reduction to achieve targeted returns. However, within this environment, pressures on marketing have increased to build positive, differentiated brands, acquire new profitable customers, deepen customer relationships, and support multi-channel distribution systems. While these demands have increased, resources have not. At the same time, the cost of traditional media has accelerated while its effectiveness has declined. Consequently, this need to do more with less has caused many banks to start to examine alternative media as a way to create more impactful messages at a lower cost.

Social media is fast becoming one of the alternatives banks of all sizes are looking to in order to address this dilemma. After all, that is where the customers are – 72% of all internet users are active on social media, 89% of internet users ages 18 to 29 are active on social media, and 93% of all marketers are now using social media to convey their messages. However, because of the variety of options and the uncontrollable nature of social media, banks are faced with a number of challenges in developing and executing a social media strategy. These include understanding the options, focusing on those with the highest potential, determining what each medium can and can't do, establishing realistic success criteria, and creating an integrated mix across all marketing channels.

Social Media Dos and Don'ts	
DO	**DON'T**
Create Many Individual Networks	Expect a Large Institutional Following
Tailor Messages to Individual Situations	Create Generic Institutional Messages
Use Social Media to Listen to Customers	Use Social Media to Preach
Establish Credibility and Promote Capabilites	Try to Promote or Sell Individual Products
Identify Opportunities to Engage Interactivity - Be Prepared for Negative Feedback	Eliminate Negative Feedback or Discourage Input
Have Some Fun	Be Boring
Take Some Risks	Let Everyone Take Risks
Monitor and Control Content	Allow Widespread Content Creation

These challenges can seem daunting; however, in our view, the need to develop an effective social media approach is becoming a necessity for banks of all sizes, not just the largest institutions.

M&A Activity Acceleration

Whole institution deals excluding terminated and government-assisted acquisitions				
	2011	**2012**	**2013**	**2014**
Number of Deals	147	217	226	291
Total Deal Value ($MM)	17,007	12,811	14,226	18,586
Median Assests of Target ($000)	139,749	125,762	167,672	158,267
Median Assets of Buyer ($000)	762,631	792,690	1,095,753	1,137,828
Median Prices/ Tangible Book (%)	110.10	119.04	124.84	134.79
Median Price/EPS (x)	28.51	20.69	19.44	23.88

Source: SNL Financial, LC, 2015. Data are as of January 22, 2015.

The long-predicted consolidation wave among banks is underway. The table above shows that the number of deals has increased every year since 2011. In 2014, the number of bank and thrift acquisition transactions reached its highest level since 2006. Greater compliance burdens coupled with challenges to grow revenue have prompted many smaller institutions to find merger partners. Acquirers view acquisitions as a means to grow earning assets and achieve greater operating efficiency.

As the pace of consolidation has increased, so have valuations. The median ratio of the acquisition price paid to seller's tangible book values has increased steadily since 2011. While valuations are significantly lower than pre-crisis levels, the large number of potential buyers coupled with improved asset quality have enabled institutions to command higher premiums.

Momentum in M&A activity should continue in 2015. The factors which drove the most recent increase in consolidation will likely remain in place in the new year. A survey by KPMG of banks with less than $20 billion in assets found that 49% of respondents were "somewhat" or "very likely" to be involved in M&A activity during the year.

Today's Definition of Top Performance in Banking

In CPG's strategy engagements, achieving high levels of performance relative to peer banks is the typical goal for management. While the definition of what constitutes high performance can vary based on a bank's business model, for traditional banks that derive the majority of their earnings from intermediation activities, high performance typically means the ability to consistently deliver double-digit ROE while growing the balance sheet. Banks that do this, more often than not, have high levels of efficiency in their

continued on back

Today's Definition of Top Performance in Banking (continued)

operations and high levels of productivity from their frontline staffs.

In today's crowded marketplace, banks that deliver high performance relative to peers may find that this, alone, is not enough to attract the capital needed to acquire other companies and continue to invest in digital transformation, new products, and lines of business that enhance the value proposition. To do this, management must not only deliver strong financial performance but also demonstrate that it has or is building scalability, has a unique story in terms of how it competes, allocates resources toward growth opportunities, and has a strong performance-based culture.

Top Performing Traditional Banks – Financial Targets
10%+ ROE
60% or Lower Efficiency Ratio
Top Quartile Asset Quality (Relative to Peers)
8% or Higher Tangible Common Equity Ratio
Fees Income as a % of Revenue 25%+
Generating Positive Operating Leverage

Industry Insights for 2015: Out-Takes from Thought-Leaders

Strategy

Does Strategy Drive Execution? Or Does Execution Define Strategy? At the end of the day, a company's strategy is determined by the sum total of the decisions management makes on a daily basis. It is not what management says, but what it does that defines strategy. *Mary Beth Sullivan and Rolland Johannsen, St. Meyer and Hubbard's Coaching the Conversation Newslettter, January 8, 2015.*

Consider Operating Expenses as Strategic Investment: A hypothetical $1 billion-asset bank has $30 million in operating expenses. If you could blink, in I Dream of Jeannie fashion, and have a clean slate to spend the $30 million, how would you do it? Banks tend to take last year's budget and add 3%. *Jeff Marsico, BAI Banking Strategies, January 16, 2015.*

Marketing

Loyalty in Limbo: For the second consecutive year, the survey found that the industry's biggest challenge was satisfying the demands of better-informed and less-loyal customers. This challenge is felt most acutely by retail bankers, with 34% citing waning customer loyalty as their biggest challenge. *Jim Marous, The Financial Brand, September 29*.

Payments

Smart POS: Progress has been seen in next-generation "smart POS" for small and midsize retailers. Cloud-based table POS solutions have continued to mature and scale (i.e., Square's $6 billion valuation). Expect some players to break out this year as leading contenders to be the "merchant operating system" of the future. *First Annapolis Consulting, Themes On Our Radar 2015, January 2015.*

Regulatory

Consumer Protection: The Consumer Financial Protection Bureau (CFPB) continues its supervision of large banks as it advances into nonbanks - such as nonbank auto lenders, student loan services, mortgage servicing firms, private education, payday markets and debt collectors. *Deloitte, Top Regulatory Trends for 2015 in Banking.*

Regulators Target Excessive Reliance on Overdraft: The heat is back on overdraft. Now that the CFPB and other regulatory agencies have finalized a number of enforcement actions against large credit card businesses, they are re-focusing attention on banks' overdraft programs and practices, following similar investigations several years ago. *Rolland Johannsen, BAI Banking Strategies, December 2014.*

Personalizing Your Customer Interactions with Analytics – Banks Playing Catch-Up to a Flower Shop

Many of the articles highlighting the top trends in banking for 2015 include the importance of customer analytics. The ability to understand your customers' needs and communicate with them in a personal way, will provide you with a competitive advantage. In order for interactions to feel individualized and human, they must be well informed. Banks have more information about their customers than many retailers but have failed to fully leverage this information when engaging with customers at the branch, call center, or online. Gallup research has shown that fully engaged customers have higher balances, hold more accounts and stay with their primary bank longer – in fact "nearly three-quarters (71%) of fully engaged customers believe that they will use their primary bank for the rest of their life."

Many retailers have already found ways to individualize and personalize their customer interactions. Retailers are forming customer relationships that earn loyalty in the face of increasing competition, and personal data is the surest way there. Brands like Zappos, Netflix, and Amazon are already showing the power of personalization.

This month, ProFlowers will leverage its own customer insights to launch a multi-channel campaign to capture a disproportionate share of the Valentine's holiday consumer spend. Like Zappos, ProFlowers parent Provide Commerce has expanded its offering to include more than just cut flowers. By expanding the products offered to include plants and other gifts, they have enhanced the value they bring to their customers. By asking their customers what dates are important in their lives, ProFlowers can now reach out to their customers with a personalized offer throughout the year – holidays, birthdays, anniversaries and other special occasions.

Banks need to earn their customers loyalty in the face of increasing competition. In 2015, banks will need to better leverage the personal information that their customers have already provided to them and anticipate their future needs by mining additional data such as transaction behaviors and spending. Customers expect their banks to know what they need – just like other brands are doing.