Deposits: Measure What You Manage

Measuring customer or deposit acquisition growth requires analyzing the total flow of funds into a bank by discrete categories.

BY DAVID McNAB

What is "deposit acquisition?"

At first blush, the answer seems easy: new customers. But when we look at this more closely in a retail banking context, the picture becomes cloudier. Are we talking only about new customers and their balances? Or new products sold and their associated balances? Or growth in account balances overall, which includes growth from existing customers?

This lack of precision can cause confusion when bankers try to get a handle on measuring their deposit growth to identify the true sources of growth. If they simply focus on new accounts and related balances, the lion's share of their growth opportunity will actually go un-measured because 80% of account balance growth in a quarter typically comes from existing customers (see chart, "Old Customers, New Money"). Institutions that fail to focus on that 80% are going to miss a lot of potential growth opportunities.

To alleviate this confusion, we believe deposit acquisition should be defined as all the new money flowing into the deposit portfolio – including capitalized interest added to balances – because that is what constitutes your total portfolio growth. The problem then becomes designing a measurement system that captures and analyzes this growth of new money.

Here's how our firm worked through that issue:

Product Sales

Taking new product sales as the basis for measuring deposit acquisition overcomes some of the problem by including both new and ongoing customers in the basis of measurement. It also, however, introduces a new problem: product cannibalization.

When a new customer (20% of growth) opens any account, you can count that as a new product sale because it brings in new money. When an existing customer (80% of growth) does the same thing, however, it isn't always easy to tell what has really happened. The new product may result from a cross-sale, a product substitution or both. A cross-sale occurs when an existing customer places new money into a new product. But, if that customer is simply transferring money from one product to another, we categorize it as product substitution. And, of course, a customer can be doing both at the same time, which really makes things complicated.

Product acquisition, in fact, often does have different funding components associated with it. These include:

- Funds from outside the bank. This is clearly something that should be called sales (cross-sales if from an existing customer) and included in our acquisition definition.
- Product substitution. This is a substitution within one side of the balance sheet that results in no change to the customer portfolio balances overall as, for example, converting a term deposit to savings or vice versa. Product substitution is something different and should not be included in our definition of acquisition.
- Loan proceeds. This differs from product substitution in that the customer's portfolio balances will grow as a result of increases in both loans and deposits. This kind of growth should be included in the definition.

To better understand the impact of these complexities, we conducted research to see just how descriptive product-based acquisition metrics really are. After analyzing the flow of funds for a million households over three months during 2005, we found that 46% of deposit growth occurs in new products and the rest derives from accounts of products that already existed in customer portfolios. Looking at just new product balances, we learned that nearly a quarter (22%) of the funds flowed in as product substitutions or loan-to-deposit transfers (see chart, "New Deposit Product Funding").

Based on this analysis, we concluded that product acquisition metrics are not sufficient for managing deposit acquisition because they include things they shouldn't (product substitution) and omit things they should (growth in ongoing product holdings).

New Accounts

So what about measuring new accounts? Every bank has likely used account-based acquisition metrics simply because they are easy to obtain from internal systems. Unfortunately, these metrics are fraught with the following deficiencies.

- New accounts account for only 53% of deposit portfolio growth, omitting growth from augmentation of ongoing accounts by ongoing customers;
- New accounts can be funded by new money, product substitutions or loan to deposit transfers;
- New accounts can also be funded by account substitutions, i.e., renewals and account transfers.

We extended our research to include analysis of the flows of funds at the account level. Using the same sample populations, we saw that only two-thirds of the money added to new deposit accounts came from outside the banks. The remaining sources of funds were account switches (17%) product switches (15%) and loan-to-deposit transfers (see chart, "New Deposit Account Funding"). Augmentation of ongoing accounts, which accounted for 47% of total portfolio growth, was split between new money (85%) and internally-funded flows (15%).

This research demonstrated that using new accounts to measure acquisition excludes a huge amount of account augmentation growth and that the growth we do see at the account level is a blend of new and old money. Our conclusion: the traditional ways of looking at portfolio growth – by product sales or new accounts – lacks the level of integrity we'd expect for something as important as understanding and measuring a bank's deposit acquisition performance.

Putting it Together

When managing deposit acquisition, bankers are focused on customers, whether new, ongoing or lost, so that they can monitor the effectiveness of their relationship-management strategies. They also care about products and accounts, whether new, ongoing or lost, to measure their product management activities. And they care about the flows of funds that contribute to balance growth.

When we look at the changes in any customer's balances with a bank over time, we can classify those changes in terms of customer status. New customers, with their associated accounts and balances, represent one component, 20%. The remaining 80% of deposit growth is associated with ongoing customers.

We can also look at balance changes in terms of the status of accounts and products. As with customers, accounts and products may be classified as new, lost or ongoing. There is, of course, a logical relationship between new accounts and new products. A new product always involves a new account, but an account may also be opened as a new account within an ongoing product category. Introducing the account and product status dimension into the measurement framework enables us to define cross-sales and account acquisition as separate types of activity that can be explicitly managed.

We completed the acquisition measurement framework by adding a third perspective to the analysis: the source of funds flowing into accounts. This can be classified into four components: new money, lost money, product substitutions and loan-to-deposit transfers. Flow-of-funds identifies the actual funding sources of portfolio growth, which are independent of the status of the customer, product or account. Introducing funding flows enables us to distinguish new money growth from internally-funded growth.

By assembling all of these classifications into a single analytical framework, we can create unique cells corresponding to each combination of customer status, product status, account status and funding flow (see chart, "Deposit Categories Drive Analysis"). This framework can be used to classify, analyze and report on deposit portfolio acquisition metrics. It embraces all of the key dimensions of information required to measure acquisition, retention and cross-sale volume and provide banks with a transparent, verifiable and consistent view of portfolio dynamics.

Each cell in the framework has a specific meaning for analytical purposes. The cells can be combined to provide a vast array of specific-purpose metrics. For example, acquisition can be defined as new money brought into all accounts regardless of customer, product or account status. It is also possible to subdivide acquisition into sub-categories such as cross-sales and provide clearly defined metrics to support objective setting, performance measurement and incentives for each subcategory of acquisition activity.

Finally, the framework enables you to quantify and analyze product substitution flows to better understand customer reaction to value proposition differentials by observing actual flows between products, which is otherwise very difficult to do.

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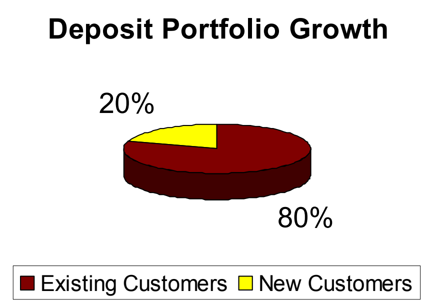
CHARTS

Source: FlowTracker Analytics Inc., Markham, Canada. Based on analysis of flow of funds for a million households over three months during 2005

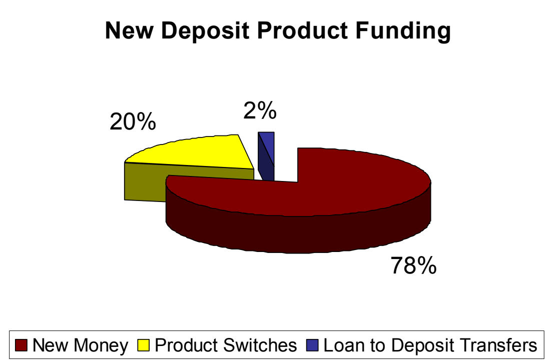
Old Customers, New Money

Most bank deposit portfolio growth in a typical quarter comes from existing customers



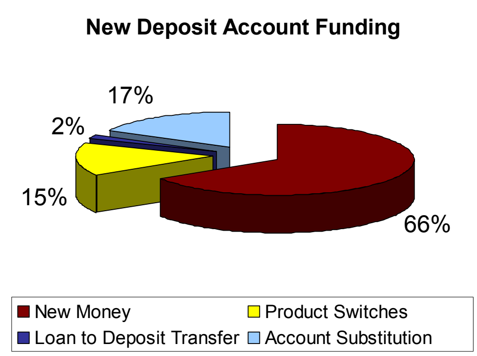
New Deposit Product Funding

Nearly one-fourth of new product balances in a deposit portfolio each month come from existing customers.



New Deposit Account Funding

One third of the funds used to fund new accounts come from inside the bank.



Deposit Categories Drive Analysis

A single analytical framework with unique cells corresponding to each combination of customer status, product status, account status and funding flow can be used to classify, analyze and report on deposit portfolio acquisition metrics.