Segmentation for Dummies…
Not That You Are
by Charles B. Wendel

Last time I wrote about the value of segmentation and that many banks, despite its benefits, fail to focus on segmentation as a distinguishing strategy. Among those *potential* benefits:

- Enhanced knowledge of specific lending risks
- Lower costs of business origination
- Higher per client returns from relationship-based selling

Over the years we've seen that a few basic principles should guide banks in deciding the segments to focus on.

Start with your current portfolio. Every time we've analyzed a bank's portfolio, we've seen that the bank already has some clear concentrations by industry and loan types. For example, on the business side, many banks, whether they want them or not, already serve many restaurants and similar entities with current accounts, if nothing else. Depending upon a bank's geography, banks may have significant business with schools, hospitals, or other medical groups.
Some groups may be candidates for a deposit generation focus rather than loans, but they still may provide an actionable segment.

Let opportunity knock. In many cases, we've seen banks enter a segment because an expert team in a particular area was looking for a new home. Obviously, loan cowboys are to be avoided, but the best industry focused teams highlight self-discipline and provide long-term customer service, factors that differentiate them.

Stick with the segments you choose. Banks often jump into and out of business lines. The value of segmentation increases over time as a bank develops a reputation in an area. Industry segmentation will fail if a bank develops a reputation as revolving door.

That said, cut when necessary. Segments need to be reviewed by management on a regular basis. Last time I mentioned how banks that had long lent to the taxi medallion industry suffered when the value of those licenses collapsed. Right now, for example, the trucking industry appears to be soft. Banks should not abandon trucking, but rather review exposures. While most clients may just be suffering a hiccup, others may be in more difficult and permanent decline.

Keep consumer segments simple. I'll never forget consulting recommendations from a firm that uncovered 15 or more psychographic profiles of consumers. It was a sophisticated piece of analysis that I am sure cost the bank a ton, but it was largely worthless. There was no way that any retail bank could execute such an approach, particularly with its level of turnover. Today's technology increases the possible success of multiple consumer segments, but the number of distinct segments may be three or four not 15.

Every bank business line should segment and communicate that segmentation internally. How basic is it that each line of business should have a clear understanding of what other businesses are doing? Yet, to this day too often bankers operate without that basic information or have the wrong idea about what another area of their own bank is doing. A bank can’t move in a unified direction with this approach.

The point of this and the last article centers on the need for banks to distinguish themselves from the bank or credit union or Fintech next door. Segmentation provides a key building block to do so.

FIC works with senior management and Boards on issues that are critical to a bank’s sustainability and growth. We emphasize practical solutions that we customize to a company’s capabilities and culture. Reach FIC at cwendel@ficinc.com.