

THE FREEDOM OF AMERICAN BANKING

by [Steve Brown](#)

As we celebrate this July 4th holiday, we should rejoice in the freedom of our industry. No other country on the face of this earth has a banking system as unique, as stable and as profitable as America's. Since we constantly analyze banks for performance, one question that has always perplexed us is what factor or factors, outside of the quality of management (which was a result of an earlier study of ours), are correlated to superior performance. To answer the question, we took a group of banks whose ROE exceed 17% for the last 4 quarters and looked at 15 economic factors. The research was interesting not in what we found, but what we did not find. Several variables in which we expected correlations, we found none. In looking at local household income levels, for example, we expected to find a relationship that the higher the income was for the area, the more banks could charge for their products and services, since these customers would be less price sensitive. Despite this theory, no connection could be derived. Likewise, in looking at regional unit labor cost, we found little correlation between the price of wage inputs and profit margins. Since labor is the largest single cost for a bank, this is somewhat counter-intuitive, however productivity (which was not measured) clearly is a mitigating factor. Those banks that face higher wage structures, tend to leverage technology more and tend to have either more skilled employees or provide better training. Some factors, such as market size, did not surprise us, as we found top producing banks in both large and small markets. What shocked us, was that the competitive environment had little bearing on profitability. Again, this is somewhat counterintuitive, since we expected that the greater the competition, the more pricing pressure that would be present. Despite looking at the number and size of banks divided by area output, no clear link emerged on profitability. While this factor came the closest to producing a meaningful correlation, there was nothing significant that we could materially account for past our margin of error. In many cases, banks that commanded a greater market share, against fewer competitors, were hamstrung with a higher cost base, as they offered a greater number of products across a dispersed geographical area. The conclusion to our findings is that higher operating margins cannot be attributed to a single macro or micro economic variable. Whether you're a mature bank, or a de novo, the only quality that we have found that matters so far, is the quality of the senior management team. While we are certain that external factors matter, we have not yet been able to point to any with quantifiable evidence. This lack of a conclusion, only underscores one of the beauties of American banking - there are such a wide array of banks producing superior performance in so many different ways, that no single external factor really matters.

BANK NEWS

Customer FHLB Dividends

FHLB's across the country said they were planning on increasing their 2Q dividend payouts. Many remain well below the FF rate, including Dallas at 4.91% and San Francisco at 5.08%. However, Atlanta said they would boost their dividend to 5.60%.

Salary Increase

The Conference Board expects salaries to increase by about 3.5% for 2007. Most banks use this number if they do not have regional data for 2007 planning purposes. Usually by September we have an industry number that may be more accurate.

Customers

In an effort to get new customers, more banks have begun offering virtual safe deposit boxes. Such boxes allow customers to store digital information (i.e. insurance policy, will, deed, etc.) for a fee and are expected to become a fast growing product line for banks in coming years.

Technology

A new report from Celent finds that by the end of this year, 18% of checks will be sent and received electronically, a number that will grow to 56% by the end of 2007. Banks considering remote capture services may find it interesting that another study indicates nearly 20% of all businesses in the country will be using remote image capture by 2010.

Small Business

A new study finds 37% of small businesses and 58% of mid-sized businesses regularly use online banking. Currently, only 40% of banks accept online applications for small business deposit accounts.

Housing

A study finds 67% of lenders believe there is a real estate bubble, while 50% feel it has already begun to burst or will do so soon. The same survey found 92% of lenders expect housing to correct.

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