PROFIT PER EMPLOYEE

by Steve Brown

It makes sense that in the industrial age, corporations used ROA as a measure of financial performance. At that time, a firm's value was largely derived from its ability to use factories, inventory and raw materials. These days, profit is more derived from ideas, software and service. This is no more evident than with banks. A bank's long-term value is derived not so much the loan it has on its balance sheet today, but its ability to keep generating loans in the future. As such, management's ability to lead the institution in the proper strategic direction and the ability of its line personnel to execute on that plan is of utmost importance for deriving franchise value. For banks, we are increasingly using profit per employee instead of ROA, as a measure of performance. For starters, it happens to be a cleaner measure than almost all other financial measures. There are no reserves, write-offs, goodwill, depreciation, splits, dividends or liquidity preferences to adjust for. Take profit before dividends, divide that by the number of full time employees and you get a number that is comparable across the board. Second, both assets and capital are easily obtained. Talent, as most CEOs would agree, is a much more valuable resource. From our profitability work with banks, we know that a top performing loan can produce a 25% risk-adjusted return. In similar fashion, a top performing branch produces a 35% risk-adjusted return. However, a top performing employee dwarfs all other resources in the bank (with the exception of maybe technology and marketing) producing in excess of a 180% return. Further, a loan that produces a 20% return today may run into problems tomorrow. A smart employee will adapt to changing markets, strategies and environments - thereby proving his or her value over time. Since banking is first and foremost a "people business," measuring it may give management a performance metric that is better correlated to the creation of value. It is no surprise that many of the top banks (and for that matter, top U.S. corporations, such as Microsoft, Exxon and AIG) not only measure profit per employee, but also have some of the highest return on equity and market value. The average independent bank earnings per employee is currently $170k, up 7% from last year. Top performing banks usually are over $300k, with $1mm+ not uncommon. Once a bank reaches 5Ys of age and $300mm in assets, profit per employee is fairly stable and uncorrelated to asset size. This stability further adds to this measure's credibility as comparable metric. If you want to accomplish greater sales penetration in a given area these days, it is more relevant to ask what people and what technology do I need to meet the goal than it is to ask what fixed assets are needed. In our opinion, devoting resources to making employees more productive is a better use of time than worrying about how to make existing assets pay a higher return. Employees tend to be a more sensitive input to an organization. As we look at bank earnings releases for 1Q, we see a tremendous amount of information on assets (loan mix, branches, new direction, etc.), but very little on human capital. However, it is this idea-generating and hard working talent that now drives the creation of shareholder value for 2007 and beyond.

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BANK NEWS

Regulatory

The FDIC has dropped the hammer on banks involved in subprime lending, by warning them to work with borrowers that are unable to make their payments. The FDIC statement included wording that "prudent workout arrangements are generally in the long-term best interest of both the financial institution and the borrower" and indicated said it would not seek regulatory penalties for institutions that make reasonable arrangements to help borrowers.

Supreme Court

Due to the ruling of Watters vs. Wachovia, subsidiaries of national banks are not under regulations mandated by the states in which they reside. National banks can only be controlled by federal regulations.

Foreclosure Rise

Foreclosures increased 47% in March from the same time last year. CA, FL, TX, MI, and OH made up over 50% of total foreclosures.

PIN Fees

A recent survey by Pulse EFT, revealed that 28% of banks still charge a PIN debit fee (but down from 32%). For banks that do still charge, in a majority of the cases, by dropping the fee, revenues will increase due to greater usage.

Online Accounts

If you want to see the benchmark of what your online account opening process should look like, check out the new BB&T site at http://www.bbt.com/ and pull down the desired "Open an Account" on the left hand side. It is one of the best in the industry. Clear, concise, quick, logical and with instant approval.