THE PROFITABILITY OF REMOTE DEPOSIT CAPTURE

by Steve Brown

As we pick up from where we left off yesterday, we were discussing profitability and the latest trends in remote deposit capture ("RDC") from our ultra-hip, but dimly lit hotel room. Like our hallways, the view of RDC profitability is murky. According to the recent ABA Community Bank Competitiveness Survey, only 24% of banks report profitability in RDC on a standalone basis. This number, in our opinion, is slightly misleading, because it does not take into account the 20% to 40% reduction in future branches (when combined with online banking) that we estimate will occur once this product is fully rolled out. In addition, this number doesn't take into account reduced usage of ATMs, branch item transportation costs and other similar savings. Finally, RDC allows for a radically altered strategy (such as expanding out of your current geographic footprint), an option that is worth millions of dollars itself, outside the cost of bricks and mortar savings. Let us give you some other numbers and then let us come back to the profitability question:

2007 saw RDC go from a defensive product against large banks to one of offense. This is a good thing, as evidence seems to suggest that a 25% average price reduction is one of the few ways to move customers from one bank to another on an RDC platform. Low profitability is partly a function of banks not rolling RDC out aggressively enough. Because fixed costs (scanners, training, support, etc.) compose 43% of the average community banks expense structure for this product line, the more customers a bank adds, the more profitable RDC will become. This should be easy to do, as only 5% of the nation's community bank customers are currently utilizing the product.

Banks charge on average a $40 monthly fee for the product, with many rolling such charges into analysis. More than 33% of community banks also charge a fee of around 6 cents per item. The average community bank only has 25 customers on RDC, sending 72 items on average through a month. If we assume a 90% loan-to-deposit ratio; a 3.5% margin; a current cost of funds around 3% (as well as standard merchant, set-up, maintenance and transaction fees); we arrive at the calculation that the average community bank does in fact make money on RDC - to the tune of $15k per month. That is not amazing, but when you consider banks only have a limited number of customers on the product and the platform gives banks other cross sell opportunities and customer "stickiness," it is a clear winner. If you assume the economics stay unchanged for the next year and a bank adds another 25 clients, profitability goes up to $39k/mo., a 150% increase as economies of scale begin to kick in.

Let's look at the current economics another way. As we alluded to yesterday, fees are not the largest driver of profitability, but rather it is the type of customer using RDC. In past articles we have discussed our findings that RDC is a major client retention device, almost as good as online banking. Given that 25% of community banks don't charge anything for RDC, the question arises, "Can you make money on a standalone basis, without charging fees?" The answer is yes - if you target the right customers. If you assume all of the above, but charge the customer nothing, it turns out that the average community bank needs about $35k per month in deposit flows to break even. This can happen a variety of ways, but the larger the median check value, the easier it is to achieve profitability. To that point, studies show the average wholesale user of RDC brings in $71k. For this segment of customer, profitability is clearly attained, with or without fees. For comparison, profitability for the average small retail business (liquor store, dry cleaner, etc.) is closer to $9k, so banks should apply fees to this customer group.

Profitability for RDC is just coming to light, so we have a little way to go before we can nail down the numbers further. As you can tell, we are more bullish on the product than many and wholeheartedly believe the product can be wildly profitable. If you can indulge us for one more day, tomorrow we would like to showcase some cutting edge strategies that banks are starting to utilize when it comes to RDC.

BANK NEWS

Wamu Advertising

While we are not fans of the bank, we are of their retail advertising. The Bank launched its new "simplify banking" campaign to solid audience approval. The series of ads tout easier banking and pushes its core checking accounts with extras such as free ID theft protection, free ATM withdrawals and high-level customer service.

More Losses

BNP Paribas, France's largest bank and the owner of Bank of the West and First Hawaiian Bank in the U.S., reported a 42% drop in 4Q profit. The bank wrote down loans on leveraged buyouts and debt backed by bond insurers, as it also set aside more reserves.

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