

## STRATEGIC PLANNING AND THE POWER CURVE

by [Steve Brown](#)

When it comes to statistical analysis to help drive banking decisions, it helps to know the "shape" of your challenge. As we have said, ROE among different sized banks largely follows a bell shaped curve, implying a normal distribution. The strategic implication of this is that there are many ways to produce superior ROE in a downturn - specializing in a lending class, being in a certain geographical area, becoming larger, shedding assets, etc.

Another distributive shape is an asymmetric distribution. The return on loans is like that. Banks can either gain money (interest) or can lose it all (principal default). Here, the strategy is to find ways to increase profits, while decreasing risk. Instituting warrants, prepayment penalties and additional fees for superior performance, allows bankers to capture more upside (thereby "normalizing" the return on loans).

Yet another distribution is the "power curve." A power curve, like the example on the right in our graphic, is characterized by a concentration of outcomes. The classic power curve in banking is deposit market share. Here, the large national banks control 90% of all deposits and 80% of deposits below \$100k. The disparity between large and small has grown over the years, due to less regulation and more competition - an interesting concept if you think about it.

You see, power curves are often the result of free market dynamics in situations where scale is important. The removal of interstate banking laws back in 1994, for example, resulted in an accelerated shift from a near-normal distribution of deposit market share to a power shape. Industry openness and profitability, such as those found in software or biotech, often lead to power distributions. The ironic part is that many of the regulations or anti-regulatory positions that the ABA or ICBA support are often counterproductive when it comes to certain competitive parts of the business (like deposit gathering). The current financial crisis will surely result in additional regulations (such as executive compensation limits), that while painful to see enacted, will result in community banks being more competitive.

Power curves aren't bad things and aren't immutable. However, instead of fighting industry dynamics, it helps to embrace it. Strategically, banks that fight for market share for the sake of market share are fighting an uphill battle. The far better strategy is to segment the market and go after deposits with profitable characteristics. By executing a niche attack, community banks can turn the power curve to their advantage.

We will be discussing power curves and how to better compete against national banks at our upcoming Executive Management Conference in San Francisco during May 3rd to 6th. Our analysis, based on hundreds of top and bottom performing banks, is a graduate-level education that you can't afford to miss. By spending 4 days with us, you will gain insight to help you compete. Register at: [http://www.pcbb.com/2009Conf\\_Summary.asp](http://www.pcbb.com/2009Conf_Summary.asp)

# BANK NEWS

## **M&A**

Northwest Bancorp Inc. (\$7B, PA) will purchase Keystone State Savings Bank (\$26mm, PA). Both institutions are held by mutual holding companies and no cash will be exchanged in the deal.

## **Greater Deposit Insurance**

The House Financial Services Committee approved a bill that would make permanent the \$250k deposit insurance coverage.

## **OTS Reporting**

New reporting requirements including how thrifts handle fair value, reporting the number of interest bearing accounts over \$250k in balances, reporting non-consolidated or non-controlled subsidiary interest and other items will all be phased in 2009 starting in 1Q.

## **Unemployment**

A recent survey of 52 economists predicts unemployment will peak at 8.8% by the 1Q of 2010. As of the end of December, states with rate of 9% or more included MI (10.6%), RI (10.0%), SC (9.5%), CA (9.3%), NV (9.1%) and OR (9.0%).

## **Regulatory Changes**

The House Financial Services Committee approved a bill that would permanently increase FDIC deposit insurance to \$250k and raise the FDIC's Treasury borrowing authority to \$100B. The FDIC had been seeking the borrowing expansion after projecting losses of \$40B from bank failures through 2013.

## **Always Working**

Banks may be interested to know 98% of small business owners' work during their time off (which includes nights, weekends and vacations).

## **Empty**

A record 19mm homes (or about 6.7%) were vacant in 2008, as ownership dipped to an 8Y low (of 67.5%). Meanwhile, the proportion of vacant homes for sale saw its largest increase in over 50Y.

## **TARP**

As of yesterday, 359 institutions have taken TARP CPP money for a total of \$195B.

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