DOES GROWTH BITE?

by Steve Brown

One of the reasons for Apple's fast growth is their simplicity of products. When it comes to computers, iPods, iPhones and iTouches, Apple no longer includes an instruction manual with each product. While it is somewhat scary to open up a MacPro that contains the same amount of processing power as NORAD in 1980, it is also refreshing not to have 7 discs, 4 instruction manuals and 3 miles of product liability disclaimers fall out. All that stuff in the box is usually worthless, because many consumers either, A) have an IQ of a gerbil and won't deal with things like instructions or disclaimers, or B) are men and won't deal with instructions or disclaimers. Either reason, we are happy not to have our lives cluttered.

More useful than instruction manuals and disclaimers is some recent data we uncovered on bank performance. We looked at 3,600 banks from 2004 to 2008 in order to see whether growth rates contributed to bank problems. For years, we have been a proponent of slow and steady growth. We can point to many examples of banks that have grown at a 25% clip, only to see their cost of funds skyrocket, loan losses ratchet upward and net income tank. This is a nice cause and effect story that is easily understood and is a favorite of regulators. However, the problem after looking at our data - there is no evidence that growth kills.

Not being gerbil-brained, we like to test our commonly-held beliefs and found in this case, the rate of growth has little bearing on bank risk or performance. For the record, we did find that in approximately 15% of the cases, the indirect problems associated with high total asset growth (defined as growth over 10% per annum for 3 consecutive years), did lead to a reduction of relative net income. However, in another 15% of the cases, total asset growth over 10% lead to an increase in net income margin. In fact, if you graph all 3,600 banks, you find pretty much a straight line with a slope of 0.029. In other words, there is no correlation between high growth and net income margin. For every bank, that lowers underwriting standards and puts high cost deposits on the balance sheet to achieve a 20% growth rate, there is another bank that is building quality infrastructure, not increasing risk, driving core deposits and successfully managing credit. In other words, a bank can be successful at all rates of growth.

At our upcoming 2009 Executive Management Conference in San Francisco May 3rd through 6th, bankers will learn more details about the characteristics of successful high growth banks. For example, here are some of the questions we will be answering: What new products are capturing customers? Are rural branches or urban branches more profitable? Do you care about competition in banking? If you were going to invest in a bank (or start a bank), what states are the best? What loan mix will help or hurt profitability given the risk? The answers to these and other questions might surprise you because we doubt it is what you will expect. We are down to 15 remaining spots at the Conference, so we urge you to sign up quickly. For more information on the Conference and to register, go to: http://www.pcbb.com/2009Conf_Summary.asp

Unfortunately, when it comes to banks they don't come with instruction manuals. Let's face it even if they did, we would never read them anyway.

SURVEY AND ANSWERS

We would like to get your opinion on the current state of the banking industry. Please take 5 minutes to complete this short survey. In exchange for your time, we will not only provide you with the aggregate survey results after May 9th to help with strategic planning, but will also provide our EMC presentation on "Maximizing Profitability in Today's Banking Environment." Go to: http://www.zoomerang.com/Survey/?p=WEB2293EPJCNJ9

BANK NEWS

CRE and Housing

Billionaire investor Sam Zell said in an interview this morning that he felt commercial real estate values were down nationwide by 30% and that the housing market was "bottoming out."

More Sight

In an effort to increase transparency, officials within the FRB are reportedly considering having more regular news conferences to discuss monetary policy (and open up to Q&A) and adding new sections to its web site.

Fees

Following heightened scrutiny from the Congressional Oversight Panel, BofA is reducing its overdraft fee hike to $35 opposed to the planned $39. However, checking fees and account maintenance costs will be increased. By the numbers, up to 75% of banks' consumer fee income results from overdraft charges and insufficient fund fees. The median overdraft fee will likely rise to $27.50 this year, up from the $25 median for the previous 5Ys.