COST CUTTING

by Steve Brown

A $4B community bank looking to reduce expenses decided to cut back-office support and protect the front-line branch/sales staff. Executives reasoned that utilizing this tactic, revenues could be maintained, as the bank needed salespeople to interact with customers. Unfortunately, while costs fell, deposit production fell even more. Salespeople had to do new account processing, account set up, follow-up and even marketing. Instead of selling 60% of the time (which is the average for most banks), sales staff were reduced to less than 30%. In similar fashion, another bank ($2B) slashed marketing to the bone and found out that it missed several opportunities to enhance the bank's brand and support deposit growth.

Cost management is important in banking, particularly these days given significant strains and it explains at least 10% of ROE. This makes managing expenses one of the 10 most important jobs a CEO does (behind managing asset quality, loan mix, deposit mix and others). However, cost cutting can backfire as much as it can help. While most banks have excesses that can be cut, the risk is in cutting costs that could hamper sales, customer service, risk management, product development or core marketing. Is it a good idea to cut $400k in expenses this year, only to miss out on a $3mm opportunity to bring in cheaper core deposits next year? Assuming the timeline to results is reasonable and the opportunity can be verified, we would argue cutting in that instance may not make sense.

When cutting sales expenses, the key is to have a profitability system in place in order to determine what areas of the bank are important and what are not. Since the bulk of a bank's earnings are driven by only about 10% of the accounts and only about 50% of a bank's customers are truly profitable, making sure these relationships are maintained is extremely important.

One key question to ask when considering cost cuts is whether you would invest in a given business within the bank right now. If the answer is no, then this is a candidate to be cut. At our last industry-wide review in 2008, for example, we found that 20% of branches were not profitable. Reducing unprofitable branches is clearly a consideration. In the same vein, now is the time to streamline products and services to make things simpler and more efficient. If you have multiple types of deposit accounts that do virtually the same thing, a low rate environment is perfect to consolidate them and free up operational resources.

Finally, there is the issue of people. A bank's personnel remain their most valuable asset and middle to top performers should be maintained. We strongly believe that 80% of a bank's sales time in this environment should be devoted to selling cash management services and retaining the most profitable customers. When it comes to staffing, oftentimes the answer lies in retraining line positions to help with relationship management, deposit growth or loan workouts.

When cutting costs, the primary goal is to think carefully about productivity and try to maximize the salesperson's time in selling the right products to the right customers. In the case of the $4B bank above, the proper mix was to let go of 3 production officers for every 1 support person to maintain efficiency. For other banks, it is a question of culling unprofitable lines of businesses and branches.

Cost cutting is never fun, but it is one of those tough jobs that management has to do. Cost cutting done carefully and properly can decrease costs AND boost revenue.

BANK NEWS

Green Pastures

Forget all the talk of "green shoots" in the economic recovery. We just read the first positive article in at least 18 months on homebuilders looking to buy land. It surfaced this morning in the WSJ, so go out, buy the issue and frame it on your wall - great news for community banks holding land loans.

CRE Weaker

A new report on commercial real estate finds delinquencies, foreclosures, and lender-owned properties have climbed to $97.4B nationwide in Jun. That pace has doubled every quarter since Dec.

Still In The Woods

The national mortgage delinquency rate climbed to a seasonally-adjusted 9.12% in 1Q, the largest increase in history. Meanwhile, the percentage of loans entering foreclosure also soared to its highest level on record.

Economic Projection

Moody's is projecting GDP will grow 1.4% in 2010, 4.7% in 2011 and 5.8% in 2012. Meanwhile, the IMF predicts GDP will only grow 0.75% in 2010.

Less Debt + More Saving

A new Gallup Poll finds 33% of Americans have reduced debt over the past 6 months and the average savings rate has jumped to 4.2% from 0.0% last year.

Muni Pressure

A survey of states finds income tax revenue is down 26% in the first 4 months of 2009 compared to the same period last year.

More Work

A survey by HR firm Robert Half, finds 31% of financial company CFOs are postponing or reducing the amount of vacation they plan to take this year due to economic weakness.