DON'T WORRY ABOUT THE COMPETITION

by Steve Brown

It was football great Vince Lombardi that used to dismiss questions about an upcoming opponent by saying that it doesn't matter what the other team does, it only matters how our team executes. In one famous exchange during a practice when members of the team were worried about how they were going to stop a Dallas Cowboys running attack, Lombardi gathered the press and told them what his first five running plays were going to be. He went back to his team and said, look, now the Cowboys are worried about our running attack. When a player raised his hand and said coach, "but now they know our plays," Lombardi said that is right, so let's get back to what I wanted to focus on in the first place and that is making sure we run those plays perfectly. Sure enough, despite knowing the plays ahead of time, the Cowboys had difficulty stopping the attack. When it comes to banking, don't pay too much attention to the competition because in the big scheme of things what really matters is how your bank executes. We looked at the performance of more than 3,000 banks from 2004 to 2010 and found that statistically, competition in banking doesn't matter. That is, the number and type of competitors in the market is not a predictor, nor is correlated to, net income performance. Banks in heavily competitive markets tend to do just as well as banks that have few other banks in their market. While rural banks tend to have slightly better margins, they have slightly worse loan growth. Further, while we agree the bank across the street might drive up deposit rates, chances are that a competitive marketplace is adding performance in other areas. The causes of this are severalfold. For starters, competition increases as opportunity increases. Large, growing and lucrative markets usually attract other banks and bank branches. As such, the market, as a function of expected profit per branch, stays relatively constant. For every time you lose a loan deal to the bank across the street, you most likely gain another piece of business from another competitor. Similar to the above, banking centers tend to attract more business. The presence of other banks in the marketplace actually serves to boost the economy by making credit cheaper which thereby spawns other business development. As a result, the cities and towns with multiple banks usually have faster and longer economic development than areas with fewer banks. In addition, competitive areas attract quality talent and other resources more inexpensively, thus making banks in fast growing markets more efficient (while costs may actually be higher, productivity is greater). Finally, competition in banking serves to provide better information to participants, thereby allowing banks in competitive markets a more efficient allocation of resources. This is counterintuitive, but some of the most profitable loans made are the low margin, low risk ones (since credit quality overwhelms all other loan performance factors). As such, the presence of competition serves to better highlight those high quality borrowers and provides more transparent pricing to the marketplace, which aids in overall efficiency. Furthermore,competition drives banks to obtain lower cost structures and product innovation. While everyone loves a monopoly, monopolistic companies are inefficient. In any given month, while competition may hurt, in the long run, competition serves to produce a better bank. If competition doesn't have any strategic statistical significance, then it follows that bankers should limit spending strategic resources on worrying about the competition and devote more time making sure your goals are clear and execution is as crisp as it can be. As Lombardi said, more important than competition is determining what you are willing to give to achieve your goals - "Once you agree upon the price you and your family must pay for success, it enables you to ignore the minor hurts, the opponent's pressure, and the temporary failures." Amen.

BANK NEWS

HSAs

A Bill was introduced to Congress that has some legs, as it seeks to make health savings accounts more popular. At present these accounts aren't too profitable at banks because of their limited usage. Should the Bill pass, catch up contributions could be made, more Medicare patients could be eligible and insurance costs could be paid from an HSA.

Foreclosure Statement

The attorneys general will most likely let banks choose from a menu of options in order to provide aid to borrowers in order to settle the foreclosure suit.

Correction On Our Correction on ERISA

We had it right the first time. Our story last week about the 6th Court of Appeals supporting a lower court's ruling that a bank acting in the capacity of trustee cannot be held liable under the ERISA for the investment performance of 401(k) plans stands. We are sorry we ever ran this one.