BUSINESS MODEL OPTIONS TO MAKE YOU BLUSH

by Steve Brown

Blushing happens when you are embarrassed in some way and your body releases adrenaline. When that happens, your blood vessels dilate, breathing and heart rate accelerate and energy is directed to your muscles. That process causes the veins in your face to dilate, creating a reddish color. Voila - blushing and embarrassment explained. Now that we have that out of the way, we shift our discussion to areas around your bank that may boost profitability, as we highlight practices other banks are successfully doing to improve their bottom line and restructure the business model.

First, the major Wall Street firms and the Fed have all reduced expectations for GDP. The rough range is about 1.5 to 2.0% at this point. We bring this up because as we have repeated often, this is the natural level of loan production that is occurring across the country. While regions may see more or less growth, the key is that even at double that rate loan demand remains tepid at best. Bankers will be faced with this issue through at least year-end, as the political environment won't likely support any new stimulus or other programs designed to boost small business demand. Our suggestion here is to seriously consider recasting your budget and seeing where this lower demand will take your performance so you can make adjustments.

Gear up for a fight. Yes, we know you have been busy, but with yields low and a paucity of loan opportunities, expect competition to remain fierce for customers. Stay on top of clients; know who left; why they left; then track and actively report this stuff to protect your franchise from slowly eroding. Low interest rates will mean higher coupon loans and securities will prepay faster. That reinvestment risk, plus heavy competition for existing and new loans also means margins will continue to grind down. Analyze the impact to your bank of a 20% drop in margin over the next 12 months and have a plan in place, so you can execute with your eyes closed before that happens. In addition, Europe isnÃ¢Â€Â™t going away, so things will remain choppy.

When it comes to generating income, analysis of banks with assets between $100mm and $1B finds the 80/20 rule still applies. For this group, about 83% of total income comes from interest sources, while 17% comes from non-interest sources.

Drilling into the biggest piece of this two-piece pie, we find that on the asset side, about 71% of interest income comes from loans, while 12% comes from securities. Everything else pretty much rounds to a bunch of nothing.

Therefore, in order to hang onto this biggest piece of the pie just like your older brothers and sisters used to do when you were a kid, you have to grab it quickly by either boosting loan origination (not too likely) or finding higher-yielding securities (have to go longer, take more structure or take credit risk, which are all more risk and ill-advised at this juncture). In short, not much is going to come from these sources until the economy finds more footing. Tread warily; fight the urge to chase yield and work like crazy to keep your best loan customers from shopping around. Keeping customers will require more personal visits (about 3x to 5x your normal we would say because competition is so strong right now), solutions-based selling (know their business before you visit) and finding new opportunities with existing customers (to expand the pie).

Shifting to the smaller 17% portion of the pie that is non-interest income, consider the sources that generate the most lift. The data shows these are service charges on deposits (the biggest driver), followed by gains on sales of loans (nearly all SBA) and fiduciary activities. Dragging things down (and essentially canceling out the fiduciary piece entirely), are losses on sales of OREO (so write-downs still continue).

To improve this piece, bankers will have to increase deposit service charges wherever possible, sell more SBA loans and increase fiduciary activities. These are tough to do, so plan thoroughly and execute continually to avoid feeling flushed.

We have just begun this discussion, so look for more tomorrow, as we go deeper into the expense side and business model. We will try to surface other areas you may want to consider, as you continue forward during this tumultuous period.

BANK NEWS

M&A

Westfield Bancorp ($595mm, OH) will acquire Western Reserve Bancorp ($190mm, OH) for $18mm and pay off about $4.950mm in Western's TARP.

More New Rules

A new accounting standard proposal by FASB will require banks to broaden disclosures around liquidity and interest-rate risks. Standardized tables would include expected maturities of all financial assets and liabilities, plus expected repricing gaps and interest-rate sensitivity.

Competition

Wells Fargo said it has begun rolling out mobile check deposit to its customers nationwide. Wells indicated the ability to make deposits through a smartphone is the service mobile customers "request most often."

Competition

In an effort to capture more of the small business market, Bank of America continues efforts to hire 1,000 small business bankers in multiple states. In the past few months, BofA said it has hired bankers in WA (30); Northern CA (70); AZ (29); NV (13); NC & SC (45); and GA (35).

Competition

PNC Bank will reportedly pay $90mm to settle a class action lawsuit on overdraft fees.

Competition

The insurance subsidiary of BB&T has begun offering flood insurance online to customers.

Fined

Barclays Bank will pay a record $453mm fine to settle allegations by U.S. and British authorities that it manipulated Libor, which is used in about $360T of financial contracts. Many other large foreign banks remain under investigation.