THE BANK BUSINESS MODEL

by Steve Brown

When it comes to strategic planning, one thing to ask your management team is whether you have the right business model. To have a substantive conversation about this, it helps to have the right language and terms. A business model describes how an organization creates, delivers and retains value for the long term against the competition. It is the platform upon which a bank executes its strategic vision. It is composed of essentially 4 main areas that include customer focus, product/service offerings, infrastructure and financial characteristics. While most banks do well planning around customers and products, some banks could benefit by putting more effort into dealing with infrastructure and financial characteristics (as those items matter equally when it comes to setting a strategic plan). Infrastructure describes the structure of the bank in which it delivers its value proposition. This includes delivery channels such as branches, ATMs and online banking; as well as partnerships. Infrastructure also includes how to best utilize resources (talent, credit, etc.), what important activities drive value and organization cost structure. In short, infrastructure is the fiber or processes that hold the bank together. Financial characteristics describe the quality and method of cash flow being generated. Some great business models have been undermined because management failed to recognize the risk inherent in cyclical revenue streams. A bank makes its money off interest, one-time fees, subscription fees, transaction fees, asset sales and a host of other areas. How these revenue streams fluctuate with regard to demand, competition, interest rates and volatility, merits a discussion (in order to design a model that best suits the needs the shareholders). By the same token, pricing strategy, capital at risk and margins are important to acknowledge and proactively manage. Here, most banks take their financial characteristics as a fait accompli, but like products and infrastructure; good management teams recognize they can exhibit some control over this aspect of the business model. If all this sounds too academic, consider a recent practical application. A bank asked if they should expand further into private banking. Private banking is a great example, as years ago; banks that focused in this sector needed a tight, vertically integrated business model to service customers. In other words, any bank wishing to go into private banking had to offer high-end banking products, as well as insurance, trust services and wealth management. In essence, they had to run 4 separate businesses in one - all with very different models. After reviewing the business model, it turns out that wealth management has financial characteristics that are counter to the goals of the bank. To solve the problem, a new business model needed to be designed. It had the bank partnering and outsourcing its wealth management divisions, so it could focus more resources on core banking products. The end result was margin and market share improvement, as the customer was offered a wider array of products and a higher level of expertise. The bank was also able to devote more management attention and resources into building out cash management, which ultimately helped gather more profitable customers. While the success of outsourcing a division like wealth management largely depends on cultural fit and business model goals, for some, this is the right answer to designing a more profitable institution. This year, with so much radically changing in our industry, take a look at all aspects of your business model to see what changes need to take place to achieve your goals. Start with a common language to discuss the business model and then build from there until the major aspects of the bank are questioned. Pay particular attention to infrastructure and financial characteristics. While it seems obvious, getting your business model right is core to banking success.

BANK NEWS

Closed (33)

Glasgow Savings Bank ($25mm, MO) was closed and sold it to Regional Missouri Bank ($136mm, MO). Regional gets 1 branch, all deposits and essentially all of the assets.

2Q Earnings

Citibank reported that 2Q profit declined 12% vs. the same period last year (beat profit estimates but missed on revenue), as revenue fell and the bank released fewer loan loss reserves. The bank grew loans 1% vs. 2Q 2011, expenses declined and CEO Pandit said the company remains focused on reducing operating costs.

Massize Settlement

Visa, Mastercard and large banks that issue their credit cards have agreed to pay retailers $6.05B plus a 10bp reduction in credit card interchange rates for eight months (estimated at $1.2B) to settle lawsuits going back to 2005. The lawsuits accused the companies of fixing fees for processing debit and credit card payments and prohibiting stores from steering customers to cheaper ways to pay.

New Regulation

Beginning Sep. 30, the CFPB will begin oversight of credit reporting agencies under its nonbank supervision program. This group accounts for about 94% of the ratings industry and will be the first special group the CFPB will supervise under powers granted by Dodd Frank.

Banking Fraud

The former CEO of Virginia's Bank of the Commonwealth was among six executives indicted for an alleged fraud involving a cover-up of the bank's financial condition from 2008 to 2011. The executives reportedly concealed loan delinquencies by overdrafting deposit accounts to make loan payments, extending or modifying problem loans to make them appear current and falsifying financial records.