AN UPLIFTING INDUSTRY BANKS SHOULD KNOW ABOUT

by Steve Brown

The elevator business doesn't sound like a particularly dynamic line of work at first blush. After all, it depends on tall buildings and sedentary lifestyles. However, it also seems to have figured out how to earn superior margins despite the fact that selling elevators is actually not that profitable. Certain oddities of the elevator business also seem to keep the number of competitors low as four major elevator companies control 67% of the global market. Sure, China is building tall buildings

that need elevators, but most other countries are not. The profit on new equipment is also relatively low. The key for this industry comes because people don't like to get stuck in elevators, so office managers pay hefty fees for maintenance contracts. Elevator companies make more than 50% of their profits from service contracts, most of which are put in place at the time of installation. Competition is kept out of the marketplace because any new operator would need a vast network of technicians to even begin. Wouldn't it be nice if the banking industry could find something similar?

As community bankers seek creative ways to generate earnings, we ponder whether there is a persistent business opportunity with relatively low up-front costs that generates an ongoing revenue stream. Customer profitability has a number of drivers, but the longevity of the customer matters a great deal. The cost of acquiring a new customer is expensive and if the relationship is driven by NIM in a low interest rate environment, things can get even dicier. In this environment, it just takes a very long time to generate enough NIM to overcome initial expenses.

By deepening the customer relationship with your bank, things begin to change. For the customer, it becomes inconvenient to change the banking relationship because they are doing other things with you. Customer sensitivity is also reduced and they tend to stick around or at least give you a shot to keep their business. But what if a customer is rate-sensitive?

Right now, many banks are seeking to grow their C&I portfolios to diversify away from CRE, reduce regulatory pressures and avoid lending concentrations. That sounds good on paper, but many banks are finding that the rate on C&I loans skinnier than they had hoped. In addition, C&I customers can be rate sensitive.

This is one area where relationship banking can help and a focused effort it required. If a customer relationship generates income from other areas of business, the bank can afford to accept a lower coupon rate on the loan. That we all know, but one way to address this is to offer a bundled business package to cement the relationship. Services like lock-box, payroll and international, backed by qualified staff to take care of special business customers, can go a long way here. Layer in an appropriate monthly fee, offer the program to select business customers already doing business with you and then ask them for referrals to really get things rolling. To get a lower rate on a loan, customers only need to select the bundled package.

Taking such a holistic approach hits all the buttons for a more profitable customer base, selling more products, increasing customer longevity, reducing acquisition costs and reducing the sensitivity to the ups and downs of the banking business.

BANK NEWS

New Brand

ING Financial has announced it will rebrand itself in the US and switch to the name "Voya Financial," which is short for "voyage." ING will roll out the new brand over the next few years.

Settlement

Bank of America said it would pay $500mm to settle a lawsuit by pension funds and other investors who said they were misled about $350B of mortgage securities they bought from Countrywide.

Painful

Bank of America reported a 56% increase in mortgage lending, but 91% of those were loans it already had on the books that simply refinanced to lower rates.

Growth

A recent survey by Grant Thornton finds about 60% of banks expect to grow this year through organic loan origination, followed by 28% through merger and 6% by entering new lines of business.

Economic Growth

Wells Fargo projects Q1 GDP will come in at 2.8% (driven by higher consumer spending on homes, autos and replenishment of business inventories), but then drop to 1.8% in Q2 (due to limited personal income growth, higher taxes and market uncertainty).

FHLB Advances

Despite the fact that deposit inflows continue to outstrip loan outflows, community bankers in OH, PA and NY worried about extension risk were the primary driver behind the first increase in FHLB advances since 2008 (increased by 1.8%). It is still much less expensive to use hedging tools, so we urge community bankers to call us to get help in this area if you are considering borrowing longer-term to match long-term customer loan demand.

Housing

The latest Zillow survey shows home prices are expected to rise 4.6% in 2013 and 4.2% in 2014.

Stock Market

Goldman Sachs is projecting the S&P 500 will rise 20% in the next 2Ys.