Beware the Splash of Sugar in Your Coffee

by Steve Brown

We work on this publication quite early in the morning and it is our habit to do so while clutching a mug of good coffee. It's a preference, a habit and not an addiction. After doing research for this piece, however, it actually seems mankind has been addicted to caffeine for millennia, until pretty recently almost exclusively through the consumption of coffee and tea. In 1903, for instance, the first version of instant coffee appeared in Japan. That same year Coca Cola replaced cocaine in its popular soft drink with caffeine and sugar. Shortly thereafter in 1912, the FDA asked that caffeine be removed from Coca Cola, as it was clearly addictive and dangerous. Coke reduced the amount of caffeine in response and increased sugar even more. These years later, we find coffee is a staple in the US. Per capita coffee consumption hit a peak right after WWII at 47 gallons per person per year although it is only about half that now. That said, while coffee consumption has declined, caffeine consumption has increased, through energy drinks like Red Bull.

Addictions come in many forms and bankers are certainly not immune. For the most part, bankers are traditional and like to do business the way it has always been done. Things are assumed to stay mostly as they always have and everything else is just a cycle that will eventually end. This time of year is all about budgets and forecasting, so when bankers peer into their crystal balls they are seeking to determine what interest rates are likely to do, build estimates on expenses and projections of income for the coming year, funding costs and finally loan growth. While management makes every attempt to be realistic with projections, there is strong pressure from bank boards to grow so numbers often reflect that. Board members want to see improvement in share price and one way to historically accomplish this is through loan/asset growth.

We did some quick analysis and pulled asset growth numbers from 2006 to see what a reasonable expectation may look like when it comes to budgeting. It is probably no surprise that asset growth was very strong into the end of 2008 and then dropped like a used coffee filter shortly thereafter. There has been recovery with the median annual asset growth rate in 2010 at 2.55%, then 3.44% in 2011 and 3.77% in 2012. So far in 2013 though, we have seen a shockingly meager increase of 0.29% through Q3.

To add further evidence of a slowdown of growth in 2013, we looked at the number of banks that saw an increase in assets and compared it to those that shrank. In the years 2009 through 2012, there were more than twice as many banks that grew as those that contracted. Yet in 2013, things changed and the numbers are basically even with 3,500 banks that have grown and 3,300 that have contracted.

Realistically, the data points to a reflection of the economy as a whole. It is primarily driven by consumption, but consumers remain tight on money. Given only slow improvement in most economic sectors, loan growth too will remain slow. Perhaps your bank can dig up some loans in order to grow, but be careful. Taking on credits others don't want can be far more dangerous than stagnation, so don't let growth pressures to push your bank to act irrationally.

We know that bank boards and management in general are tired. After all, it has been a long haul since the crisis began and we aren't out of it just yet. So for now, go get another cup of coffee and take the time to have a serious conversation with your board about what your bank stands for. Every bank has a reason to exist and a purpose in its community. Reinforcing those ideas at this time of year as you strategize about 2014 will help your team avoid the temptation of overestimating what may be realistically possible.

BANK NEWS

Closed (24 YTD)

Regulators closed Texas Community Bank ($160mm, TX) and sold it to Spirit of Texas Bank ($542mm, TX) under a purchase an assumption agreement. Spirit acquires 2 branches, all deposits and $148mm of assets.

Big Change

The CFO of Fifth Third Bank (OH) said the bank plans to shift about 33% of its branches to a self service format as it seeks to cut costs and respond to changing customer behaviors. He also reported 86% of all deposit transactions took place in branches 1Y ago, but now that was only 75% (mobile increased to 6% and ATMs reached 19%). The bank says 70% of all transactions performed by a teller can now be done through self service channels.

Mobile Competition

latest data from Bank of America shows branch activity has declined 11% this year; ATM, online and mobile has increased 5%; the bank has 14mm active mobile customers; the bank adds about 7,000 new mobile users per day and 8% of its checks are deposited by RDC.

Divestiture

Pacific Mercantile Bank ($917mm, CA) will stop originating mortgages and exit the mortgage business in order to focus more efforts on commercial banking.

Regulation

Regulators have issued guidance indicating consumer protection laws and regulations apply to social media activities the same way they do when banks use other customer communications channels. Regulators said they expect banks to manage potential risks to themselves and consumers through appropriate oversight and control.