Chasing The Bear Of Profitability

by Steve Brown

We came across a story of a MA police department that offered some very specific advice to its constituents: "chasing bears through the woods while drunk with a dull hatchet is strongly not advised". We could examine the grammar in the warning (was the bear drunk and carrying a hatchet or was the pursuer?), but instead we will focus on the somewhat obvious nature of the advice. Chasing large animals when impaired or at any other time is likely to not end well. Generally people with a problem bear around their homes call the police. But the most logical path is not always obvious or the easiest to follow.

Banks can find this same difficulty when trying to maintain and improve the profitability of their institutions too. There is an old adage that 80% of any business's profitability comes from 20% of its customers. The number of customers that add to the bottom line in community banks is generally fewer than that - more like 10% of a bank's customers generate over 100% of profitability.

Most bank customers rest in the middle, more or less a break-even proposition for the bank between what it costs to provide their services and what they pay. Then there are those customers who actually cost the bank money. You know them because they probably frequent your lobby and probably spend a lot of time with your customer service personnel. They will always ask that fees be waived and they will require the highest interest rates on CDs and savings accounts. They frequently tell your personnel what good customers they are, but this is unlikely. Identifying customers who cost the bank money and either charging them more or allowing them to leave is an important step for any bank trying to improve its margins.

What can a bank do about those customers who are mostly just a break-even proposition? Moving up the profitability of the middle group of customers can be accomplished by a number of means. For banks that want to go on the offensive, cross selling other products that generate fees and deepen the relationship is a good tactic. A defensive strategy to move the profitability needle of this group could include product restricting or pricing. For example, a bank could adjust minimum balance requirements required to avoid deposit service charges. Of course, when making any product change, banks want to be certain not to alienate the "A" customers.

How can a bank protect its most profitable customers? First you have to know who they are. Then, make sure these customers are routinely touched with periodic in-person visits and dialog about their needs. Protecting these customers may even mean lowering their profitability through granting special pricing on new services or a proactive repricing on an existing loan. To bring in profitable new business, banks should understand the most profitable industries in their market footprints and direct new product development, marketing efforts and incentive compensation around those industries.

In the end, a bank has to know which customers, relationships and products are the most profitable and focus efforts there. Banks generally have an idea, but the use of a relationship profitability model to know both the details and the overall picture is crucial to success when margins overall are so thin. PCBB has a relationship profitability model - ProfitIntel - that can help your bank understand its opportunities and how better to protect its most important customers.

This knowledge is like having the understanding ahead of time that chasing a bear, particularly with a dull hatchet, is a poor idea. Give us a call to learn more about how ProfitIntel can sharpen your banks efforts.

BANK NEWS

Competition

Wells Fargo is reportedly undergoing a new companywide effort to streamline five major departments, as it seeks to uncover savings it could then reallocate into cybersecurity, risk, compliance and new customer technologies.

Top Risks

A survey of bank executives by Accenture finds 65% say cyber security is the risk most like to become more severe in the next 2Ys, followed by credit risk (62%) and fraud/financial crime (61%).

Ag Lending

The Fed St. Louis has released a survey that finds farm income and land values are continuing to head lower (down 2.5% YOY in Q1).

Community Banking

A speech by NY Fed Governor Powell highlighted the following: "community banks face significant challenges today"; "historically thin net interest margins have constrained profitability"; he believes "for smaller institutions (related to the Volcker rule and incentive compensation) would be helpful"; "community banks generally do not face the adverse incentives of compensation agreements that may encourage executives and loan officers to maximize lending volume at the expense of safety and soundness"; and "supports raising the asset threshold for both the Volcker rule and incentive compensation rules (to $10B)".

Unemployment

New research by the Chicago Fed finds the natural unemployment rate for the US may be 5.0% today and is projected to decline to 4.4% to 4.8% in the next 5Ys.

Retirement Worries

A poll by Harris finds 74% of Americans worry about not having enough income when they retire.