A Winning Discussion Around Ideal Bank Size

by Steve Brown

We have attended many community bank conferences this year all over the country. Invariably, some speaker steps to the podium espousing the virtue of reaching an "ideal" bank size. Such speakers seem to take every opportunity to tell attendees they must get bigger to survive. They point to the heavy cost of regulation, the difficulty of staying on top of technology and push hard to convince banks that it will be tough to survive and thrive unless they reach at least $1B in size. Since it is now nearing year-end and boards are closing off strategic planning sessions, we thought it would be interesting to discuss this very issue.

To begin, we have to choose a couple of metrics that are common to banks and in some circles approximate performance. Given FDIC data is readily available, we chose ROA and ROE as the two comparative metrics we will use for our analysis today.

To set the table, we first create a control group of banks that is about $1B in size (+/- 25%) to capture our universe of so-called ideal banks. This results in 370 institutions ($751mm to $1.249B in assets). For this group of banks the median ROA is 0.91% and ROE is 8.48% YTD through Q2.

Now that we know what the ideal goal is, we next check to see how other banks are doing in general. To do this, we capture the same comparative metrics using standard FDIC commercial bank asset buckets of <$100mm (ROA 0.91%, ROE 7.64%), $100mm to $300mm (1.01%, 9.04%), $300mm to $500mm (1.06%, 9.88%), $500mm to $1B (0.94%, 8.57%), $1B to $10B (1.24%, 10.52%) and finally, $10B or larger (1.03%, 9.31%).

Comparing ROA first, we see that out of the 7 groupings available the ideal bank at 0.91% would rank dead last and be in line with the very smallest asset-sized banks of $100mm or smaller. Further, the ideal bank would produce an ROA 11% worse than the median of all groupings. To truly get into the rare air of the best ROA banks, it looks like you may need to grow to be $5B to $10B in size perhaps.

Next we move to ROE. Here we see that the ideal bank is at 8.48%. Again, while not at the very bottom of the stack, these ideal banks are more than half a point below the median and are only one notch above the lowest performing group (again banks <$100mm).

Now, every region is different and every bank is different so size isn't a great measurement stick obviously but that is exactly the point of our discussion today. Consider as well that to beat the ideal bank, you can be anywhere in size from $100mm to $300mm; $300mm to $500mm; $500mm to $1B; $1B to $10B or $10B or larger. You just can't be less than $100mm in size based on these metrics alone.

One other data point you might find interesting. If you were to reach the so-called ideal size bank, this group of 370 banks would still only control 2.3% of total bank assets ($355,417,941) of which you would control 0.006% if you were the median-sized bank ($932,693) in this group.

Now we know some banks are chasing growth and some have legitimate reasons to do so, while others think that doesn't make sense. Our discussion today is only to open the door to further thought and analysis as you set strategic plans in motion over the coming years so you know where you are going.

In the meantime, enjoy the journey wherever you go, as you seek to operate a clean, profitable and focused bank of almost any size. As can be seen here, there just isn't any real "magic" in being some randomly selected asset size and there are many different ways to win!

BANK NEWS

M&A Imbalance

In yet another example of the imbalance that exists when it comes to mergers and acquisitions expectations over the next 2Ys, a recent RMA survey of community bank members finds 56% plan to participate in M&A and 44% do not. Of those who plan to get involved, 86% expected to acquire another bank while 14% expected to sell.

Mobile Millennials

Bank of America reports it finds millennials check their phones 45x per day on average.

Jobs Picture

CNN reports the labor force participation rate for men ages 25 to 54 was about 97% in 1965, but now sits at a record low of 88%. Experts say men have dropped out of the labor force in record numbers because they can't find jobs that pay enough or don't have the education and skills to get employment.

Retirement

The EBRI reports only 22% of people say they are very confident they have sufficient savings for a comfortable retirement.

Board Count

A Bank Director compensation survey finds banks have a median total number of board members as follows: holding company (10) and lead bank (10). Of note, banks >$5B in assets have a median 8 lead bank directors compared to 11 ($1.1B to $5B), 10 ($501mm to $1B), 9 ($251mm to $500mm), and 8 (banks <$250mm).

Director Focus

A PwC survey of corporate directors finds the primary areas identified as those that need "much more time and focus" are: strategic planning (20%), succession planning (17%), IT risks (13%), talent management (10%), industry competitors (9%) and risk management (7%).

Regulatory Focus

The RMA reports recent conversations with regulatory agencies finds current hot buttons include: cybersecurity, operations risk, the impact of CECL, interest rate risk, strategic risk, oil and gas concentrations.

Economic Projection

JPMorgan has updated its Q3 GDP projection, slashing it from 1.5% to 1.0% given weaker economic conditions.

Employees

A survey by technology staffing firm Modis finds 50% of workers pick having flexible work hours as their top perk today.