C-suite

Connect ROI/ROE with the C-Suite

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By Jeff Marsico

I don't understand how you measure the ROI of your Facebook page.

Sound familiar? Many CEOs and CFOs will respond with glazed eyes as you explain the hypothetical return on investment (ROI) of any given marketing initiative. That's because the ROI of something even as simple as a billboard ad can seem very convoluted. Yes, you could calculate the delta between your new account acquisition run rate versus prior to the billboard. But there are many other variables at work besides your billboard, right?

When you speak only in terms of ROI, you may be creating a major disconnect with your C-suite. And that can lead to risky decisions.

This is important. More and more, I see banks elevating the marketing function to the executive level. To that I say amen! Face to face interactions between banker and customer are on the decline. And growth now requires the sales cycle to begin well before the first handshake. As a result, marketers need to learn to speak the language of the C-suite.

Both technology and marketing executives commonly use ROI, and that's fine. But I must admit that when I began teaching profitability at the ABA School of Bank Marketing, I had to ask my marketing friends about how ROI is typically calculated.

Before scoffing at my ignorance, know that in all of the executive profitability meetings, board meetings, and strategy sessions I attend, I cannot recall one instance discussing ROI. I'm not saying it is never discussed. Just not typically discussed. Return on equity (ROE), on the other hand, is discussed often. As it should be.

Because banking is a risk-reward business, ROE is the most relevant measure.

Risk is measured in many ways. The Office of the Comptroller of the Currency (OCC) identifies nine risks to banks.

	OCC Risk Categories
1	Credit
2	Interest Rate
3	Liquidity
4	Price
5	Foreign Currency
6	Transaction
7	Compliance
8	Strategic
9	Reputation

How many of these risk categories do ROI calculations consider? Perhaps you increase ROI thresholds to account for risk. So why not move to ROE? It's the language spoken by your bank executives and board. Why not by you too?

Calculating ROE by balance sheet category requires that capital be allocated to the projected increase in balances resulting from your marketing initiative. Your bank should already identify capital allocations by balance sheet category based on perceived risk. Regulators do the same thing in a reverse engineered way, by increasing or decreasing an asset based on perceived risk. Cash gets a 0% risk-weight, qualified mortgage loans 50%, commercial loans 100%. These calculations are used to determine your bank's total risk-based capital ratio. You must be 10% or better to be considered well-capitalized.

No need to get caught up in the regulatory nonsense. The point is that each balance sheet item requires different levels of capital. Credit card balances likely require more capital than home equity line of credit (HELOC) balances because there is greater risk.

Here's an example: Assume your bank wants to increase its loan balances and the executive team is wondering whether it can increase credit cards or HELOCs. It asks the marketing department to do an analysis of what is feasible and the attractiveness of doing one over the other. Schooled in ROI, the marketer brings the following table to the next executive meeting.

ROI

(dollars in thousands)		Credit Card	HELOC
1	New Balances	$10,000	$10,000
2	Interest Income	$1,000	$400
3	Cost of Funds (FTP)	150	150
4	Spread	850	250
5	Fee Income	200	50
6	Total Revenue	$1,050	$300
7	Estimated net charge-offs	400	25
8	Incremental Operating Expenses	200	15
9	Net Revenue	$450	$260
10	Campaign Cost	$50	$50
11	**Return on Investment (ROI)**	**900%**	**520%**

Given the resources, the marketer feels confident that a $50,000, well-run initiative can yield $10 million in new balances. And the ROI calculation heavily favors the credit card initiative. With no consideration to risk, one would expect the bank to move forward with the greatest ROI.

Hold on, says the Chief Risk Officer! Our executive incentive plan makes no mention of ROI. But ROE is front and center. So the marketer turns to the CFO, who turns to the bank's capital plan. Just how much equity should be allocated to credit cards versus HELOCs?

The marketer did not participate in the capital plan. So the CFO gives background on how the bank determined risk per balance sheet item. It took the OCC list of nine risks, and looked at history within the bank's markets to estimate what was lost and what could be lost if the bank was to befall hard times. This led to a capital allocation of 10% for credit card balances, and 5% for HELOCs. I could go into greater detail on the mechanics of allocating capital to balance sheet and off-balance sheet items and activities, but I'm not sure you would want to keep with our story. The story is that ROI clearly favored embarking on the credit card campaign. The ROE scenario tells something entirely different.

ROE

(dollars in thousands)		Credit Card	HELOC
1	New Balances	$10,000	$10,000
2	Net Revenue	$450	$260
3	Campaign Cost	$50	$50
4	**Return on Investment (ROI)**	**900%**	**520%**
5	Capital Allocation	$1,000	$500
6	**Return on Equity (ROE)**	**45%**	**52%**

Most banks have recovered from the 2007-08 financial crisis. The banks that were built for good times and bad suffered minor setbacks, and got back to normal quicker than banks that were less disciplined in risk management or were in difficult geographies. The U.S. economy has recovered, albeit slowly. The institutional memory of what happened to our industry is moving farther into the past. Are we making decisions designed to stoke growth and profits in good times, only to risk giving it back during the next recession?

Using ROI alone to guide the bank in making tactical or strategic decisions supports profit growth with less consideration to risk. That approach ignores what might happen to newly added balance sheet items during the next recession.

By partnering with executives to allocate capital based on risk, you balance risk and reward, leading to better strategic decisions. This will lead your bank to a more sustainable future.

So go ahead and continue to calculate ROI. But when helping your management team make informed decisions on the future of the bank, balance your analysis with ROE. Your CEO and CFO will appreciate it, as will your board and shareholders.

Jeff Marsico, is executive vice president and a founding shareholder at The Kafafian Group, Inc., a strategy, profitability, and advisory firm specializing in community financial institutions. Email: jmarsico@kafafiangroup.com

Jeff is currently a faculty member for the ABA Bank Marketing School.

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