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Knowing Costs Is Half the Job; Banks Must Also Take Action

One day in the 1960s I cashed a $200 check at a bank and asked the CEO, "How much did it cost you to cash that check for me?"

by Paul Nadler

His answer: "Someday we hope we'll know."

It is obvious that "someday" has been slow to arrive. A recent two-part series in these pages said that profitability software is just now telling bankers which accounts make them money. But though bankers are beginning to learn which accounts they should coddle and which they should bounce, the real question is: Do they have the guts to take the actions that these cost figures call for?

When customers threaten, "You give me what I want at my price or I'll move my account," bankers who know their costs should respond, "Can you find the bank across the street by yourself or do you want one of our tellers to assist you?"

I remember a CEO in York, Pa., who bragged that his bank had beat out the Philadelphia banks for the state's working account. But then we discussed the revenue his bank had lost because it had to hold low-yield state bonds to retain these deposits. "No wonder the Philly banks let us have the account," he said.

I recently attended a panel for community bankers at the national convention of the Association for Management Information in Financial Services.

AMI, based in Scottsdale, Ariz., is trying to build community banker membership, and from what I learned by sitting in on this panel, I can endorse this effort.

The moderator, Robert Kafafian, executive vice president with investment banker Hopper, Soliday & Co., got my attention right from the start when he revealed that community banks get only 10% of their revenues from fees!

In today's banking world this is a red flag. Banks have been badly burned by borrowing short and lending long, and equally burned by borrowing long and lending short. So smart bankers use gap management — matching maturities of assets and liabilities. If the gap cannot be widened, banks must depend on fees to augment profitability.

Some banks' most profitable product is the overdraft.

One weakness many community bankers have is a willingness to waive late fees, overdraft fees, and even account fees for people they know, simply because they know them. Mr. Kafafian pointed out that at many banks the most profitable accounts are the ones that break the rules — and pay for it through penalty fees.

"With the overdraft being the most profitable product they have, I have seen banks send fruit baskets of appreciation that arrive at the same time as foreclosure notices," he said.

This reminded me of the bank that imposed a huge late fee on credit card delinquents. The president explained, "People who are late feel guilty and they somehow like to be punished for this."

Another point from the AMI panel was that before a bank backs away from imposing high fees or rates because it fears losing an account, it should examine whether the larger bank across the street really wants this account.

One complaint against superregionals is that when they take over a bank, they impose a minimum on the size of loans they will make. This represents an opportunity for organizations that remain independent, to pick up loans under that size.

Of course, any discussion of profitability must include evaluation of cost — should a loan opportunity be evaluated relative to the marginal cost of funds to finance it, or should it be judged against the average cost of balances in the bank?

The AMI meeting panel spent a good hour on that. The results were predictable: Virtually no two bankers agreed on which loans and accounts are profitable, relative to funds transfer capital.

Equally valuable was the discussion of what to do when you decide that a product is not profitable, especially if you have to offer it for public relations reasons or because good customers want it.

Maybe you have to offer a loser, especially if good customers want it, the panel concluded, but you don't have to promote it. For example, if you lose money on student loans, then don't hand out applications. If another type of loan or account is profitable, let the lending officers know, and tell them they will be appreciated for making these loans.

To conclude: As the recent two-part series in these pages noted, you have to know what is profitable and what is not. But as the AMI meeting brought out, a second step is necessary — to do something about it. ◇

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