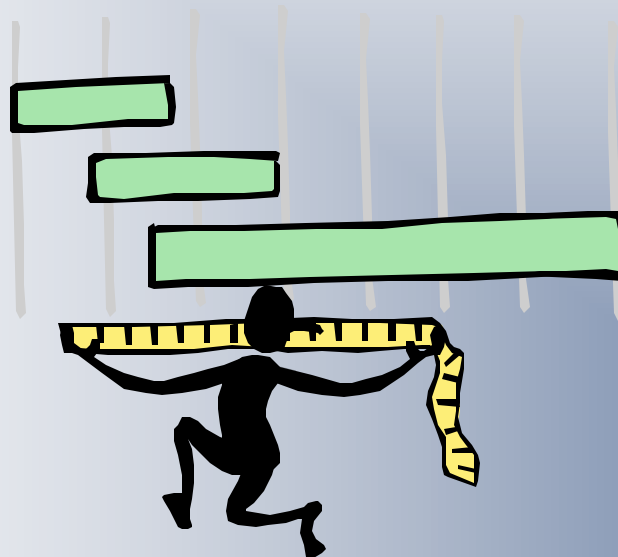


# Improving Your Channel And Customer Profitability



Presented By:  
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# Improving Profitability

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- ➔ Understanding Bank Profitability.
  - ◆ Opportunities for Growth.
- ➔ Understanding Components of Profitability.
  - ◆ Channel Profitability.
  - ◆ Account Profitability.
  - ◆ Customer Profitability.



# Average Bank Income Statement - \$000s

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Interest Income	\$	17,513
Interest Expense		<u>7,835</u>
Net Interest Income	\$	9,678
Provision		763
Fee Income		<u>3,668</u>
Net Revenue	\$	12,583
Expense		<u>8,246</u>
Net Income	\$	4,337
Income Taxes		<u>1,376</u>
Net Income	\$	2,961

Source: FDIC; Average \$100 million - \$1 billion commercial bank

# Key Metrics - \$000s

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Assets	\$244,452
Deposits	\$202,051
Equity Capital	\$23,280
ROA	1.21%
ROE	12.7%
Efficiency Ratio	61.8%

Source: FDIC; Average \$100 million - \$1 billion commercial bank

# Where Do You Find Growth?

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- ➔ Increase Balances?
- ➔ Change Pricing?
- ➔ Decrease Expenses?

Current level of  
efficiency determines  
operating leverage!



# Use The Income Statement To Identify Opportunities

	Before
Assets	\$244,452
Deposits	\$202,051
Equity Capital	\$23,280
Interest Income	\$ 17,513
Interest Expense	<u>7,835</u>
Net Interest Income	\$ 9,678
Provision	763
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Net Income	\$ 2,961
ROA	1.21%
ROE	12.7%
Efficiency Ratio	61.8%

<i>What-if</i>	
Increase Balances	0%
Increase Fees	0%
Decrease Expense	0%



# Increasing Balances 10% - *Increases Income 21%*

	Before	After	Change	% Change
Assets	\$244,452	\$268,897	\$24,445	10%
Deposits	\$202,051	\$222,256	\$20,205	10%
Equity Capital	\$23,280	\$23,280	\$0	0%
Interest Income	\$ 17,513	\$ 19,264	\$ 1,751	10%
Interest Expense	7,835	8,619	784	10%
Net Interest Income	\$ 9,678	\$ 10,646	\$ 968	10%
Provision	763	840	76	10%
Fee Income	3,668	3,668	-	0%
Net Revenue	\$ 12,583	\$ 13,474	\$ 891	7%
Expense	8,246	8,246	-	0%
Net Income	\$ 4,337	\$ 5,228	\$ 891	21%
Income Taxes	1,376	1,659	283	21%
Net Income	\$ 2,961	\$ 3,569	\$ 609	21%
ROA	1.21%	1.33%	0.12%	
ROE	12.7%	15.3%	2.6%	
Efficiency Ratio	61.8%	57.6%	-4.2%	

# Increasing Fees 10% - *Increases Income 8%*

	Before	After	Change	% Change
Assets	\$244,452	\$244,452	\$0	0%
Deposits	\$202,051	\$202,051	\$0	0%
Equity Capital	\$23,280	\$23,280	\$0	0%
Interest Income	\$ 17,513	\$ 17,513	\$ -	0%
Interest Expense	7,835	7,835	-	0%
Net Interest Income	\$ 9,678	\$ 9,678	\$ -	0%
Provision	763	763	-	0%
Fee Income	3,668	4,035	367	10%
Net Revenue	\$ 12,583	\$ 12,949	\$ 367	3%
Expense	8,246	8,246	-	0%
Net Income	\$ 4,337	\$ 4,703	\$ 367	8%
Income Taxes	1,376	1,492	116	8%
Net Income	\$ 2,961	\$ 3,211	\$ 250	8%
ROA	1.21%	1.31%	0.10%	
ROE	12.7%	13.8%	1.1%	
Efficiency Ratio	61.8%	60.1%	-1.7%	

# Decrease Expenses 10% - *Increases Income 19%*

	Before	After	Change	% Change
Assets	\$244,452	\$244,452	\$0	0%
Deposits	\$202,051	\$202,051	\$0	0%
Equity Capital	\$23,280	\$23,280	\$0	0%
Interest Income	\$ 17,513	\$ 17,513	\$ -	0%
Interest Expense	7,835	7,835	-	0%
Net Interest Income	\$ 9,678	\$ 9,678	\$ -	0%
Provision	763	763	-	0%
Fee Income	3,668	3,668	-	0%
Net Revenue	\$ 12,583	\$ 12,583	\$ -	0%
Expense	8,246	7,421	(825)	-10%
Net Income	\$ 4,337	\$ 5,161	\$ 825	19%
Income Taxes	1,376	1,638	262	19%
Net Income	\$ 2,961	\$ 3,524	\$ 563	19%
ROA	1.21%	1.44%	0.23%	
ROE	12.7%	15.1%	2.4%	
Efficiency Ratio	61.8%	55.6%	-6.2%	

# Current Efficiency Ratio Determines Operating Leverage

	Before	After	Change	% Change
Assets	\$244,452			
Deposits	\$202,051			
Equity Capital	\$23,280			
Interest Income	\$ 17,513			
Interest Expense	<u>7,835</u>			
Net Interest Income	\$ 9,678			
Provision	763			
Fee Income	<u>3,668</u>			
Net Revenue	\$ 12,583			
Expense	<u>9,342</u>			
Net Income	\$ 3,240			
Income Taxes	<u>1,028</u>			
Net Income	\$ 2,212			
ROA	0.91%			
ROE	9.5%			
<b>Efficiency Ratio</b>	<b>70.0%</b>			



# Decrease Expenses 10% With Less Efficient Store *Increases Income 29%*

	Before	After	Change	% Change
Assets	\$244,452	\$244,452	\$0	0%
Deposits	\$202,051	\$202,051	\$0	0%
Equity Capital	\$23,280	\$23,280	\$0	0%
Interest Income	\$ 17,513	\$ 17,513	\$ -	0%
Interest Expense	<u>7,835</u>	<u>7,835</u>	-	0%
Net Interest Income	\$ 9,678	\$ 9,678	\$ -	0%
Provision	763	763	-	0%
Fee Income	<u>3,668</u>	<u>3,668</u>	-	0%
Net Revenue	\$ 12,583	\$ 12,583	\$ -	0%
Expense	<u>9,342</u>	<u>8,408</u>	(934)	-10%
Net Income	\$ 3,240	\$ 4,175	\$ 934	29%
Income Taxes	<u>1,028</u>	<u>1,325</u>	<u>296</u>	29%
Net Income	\$ 2,212	\$ 2,850	\$ 638	29%
ROA	0.91%	1.17%	0.26%	
ROE	9.5%	12.2%	2.7%	
Efficiency Ratio	70.0%	63.0%	-7.0%	

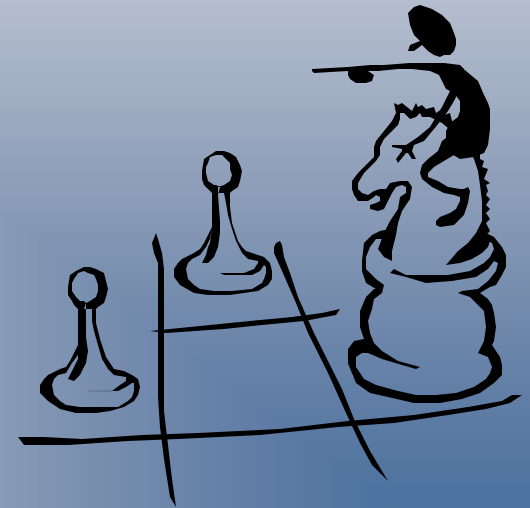
# Increase Balances 10% - *Increases Income 28%*

	Before	After	Change	% Change
Assets	\$244,452	\$268,897	\$24,445	10%
Deposits	\$202,051	\$222,256	\$20,205	10%
Equity Capital	\$23,280	\$23,280	\$0	0%
Interest Income	\$ 17,513	\$ 19,264	\$ 1,751	10%
Interest Expense	7,835	8,619	784	10%
Net Interest Income	\$ 9,678	\$ 10,646	\$ 968	10%
Provision	763	840	76	10%
Fee Income	3,668	3,668	-	0%
Net Revenue	\$ 12,583	\$ 13,474	\$ 891	7%
Expense	9,342	9,342	-	0%
Net Income	\$ 3,240	\$ 4,132	\$ 891	28%
Income Taxes	1,028	1,311	283	28%
Net Income	\$ 2,212	\$ 2,821	\$ 609	28%
ROA	0.91%	1.05%	0.14%	
ROE	9.5%	12.1%	2.6%	
Efficiency Ratio	70.0%	65.3%	-4.7%	

# Turning Goals Into Strategy

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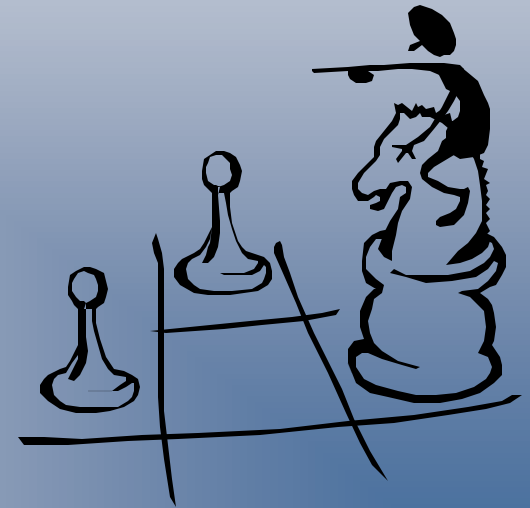
- ➔ It's not enough to set goals for revenue growth or expense reductions.
- ➔ Fine tune each bank's strategies by looking at:
  - ◆ Customer Potential;
  - ◆ Channel Mix;
  - ◆ Efficiency Ratio;
  - ◆ Market Opportunities;
  - ◆ Types of Customers.



# Turning Strategy Into Activities

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- ➔ Income statement will point to potential strategies.
- ➔ In order to realize strategic objectives, it's necessary to break the income statement into smaller components:
  - ◆ Customer Profitability;
  - ◆ Channel Expenses;
  - ◆ Activity Costs.



# Start With A Simple View

## TRADITIONAL BRANCH PROFITABILITY

Assets	\$30,556	
Deposits	\$25,256	←
Equity Capital	\$2,910	
Interest Income	\$ 2,189	
Interest Expense	<u>979</u>	
Net Interest Income	\$ 1,210	
Provision	95	
Fee Income	<u>458</u>	←
Net Revenue	\$ 1,573	
Expense	<u>1,031</u>	←
Net Income	\$ 542	
Income Taxes	<u>172</u>	
Net Income	\$ 370	

3,886	Customers
\$6,500	Average Deposits
\$7,864	Average Loans
\$118	Average Fees

\$507	Personnel
\$100	Premise
\$40	ATM Machines
\$50	Teller Equipment
<u>\$334</u>	Other Expense
\$1,031	

# Move To A More Complex Customer View

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<b>CUSTOMER PROFITABILITY BEFORE CHANNEL COSTS</b>			
	Mass Market	Premier	Small Business
Households	3,386	300	200
Deposits	\$1,849	\$50,000	\$20,000
Loans	\$1,051	\$50,000	\$60,000
Fees	\$115	\$100	\$200
Account Costs	\$50	\$80	\$100
Profitability before Channel	\$211	\$5,058	\$4,130

# ..And A More Complex Channel View

<b>CHANNEL EXPENSE</b>			
	Traditional Branch	In Store Branch	Offsite ATM
Personnel	\$507	\$254	\$0
Premise	\$100	\$50	\$10
ATM Machines	\$40	\$40	\$40
Teller Equipment	\$50	\$25	\$0
Other Expense	<u>\$334</u>	<u>\$167</u>	<u>\$10</u>
	\$1,031	\$536	\$60

# Defining Profitability

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- ➔ Understanding channel cost and customer revenue is just a starting point.
  - ◆ As with looking at the bank's income statement, it helps determine where you should focus.
- ➔ Channel costs need to be assigned to customers to determine appropriate action.
  - ◆ Cross Sales;
  - ◆ Channel Development/Promotion;
  - ◆ Acquisition.



# Activity Costs - Different From Bank To Bank

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- ➔ Using industry averages is misleading because of the many different factors that enter into channel costs.
  - ◆ Fixed Costs;
  - ◆ Channel Mix;
  - ◆ Transactions Per Location.
- ➔ But there are some simple things you can do to determine your activity costs.



# Size Total Bank Channel Costs

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## *Hypothetical Bank*

	Locations		Annual Expense (\$000s)
Traditional Branches	6	\$	6,186
In Store Branches	2		1,071
Offsite ATMs	4		240
Phone Bank	1		354
			<hr/>
		\$	7,851

# Allocate Total Channel Costs To Activity Drivers

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*Hypothetical Bank*

	Annual Expense (\$000s)			
	Teller	ATM	Fixed	Total
Traditional Branches	\$ 2,734	\$ 240	\$ 3,212	\$ 6,186
In Store Branches	456	80	535	1,071
Offsite ATMs	-	240	-	240
Phone Bank	-	-	354	354
	<u>\$ 3,189</u>	<u>\$ 560</u>	<u>\$ 4,101</u>	<u>\$ 7,851</u>

# Apply Costs To Total Bank Activity

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## *Hypothetical Bank*

Annual Transaction Volume	Teller	ATM	Phone
Traditional Branch	983,376	509,184	-
In Store Branch	196,675	118,810	-
Offsite ATM	-	32,000	-
Phone Bank	-	-	373,056

# Determine Costs Per Transaction

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## *Hypothetical Bank*

	Teller	ATM	Phone
Traditional Branch	\$4.93	\$2.62	
In Store Branch	\$4.01	\$2.37	
Offsite ATM		\$5.00	
Phone Bank			\$0.95

# Measure Activities By Customer/Segment

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	<u>Monthly Transactions</u>		
	Teller	ATM	Phone
Traditional Mass Market	3.0	2.0	1.0
Traditional High Value	5.0	1.0	1.0
In Store Mass Market	2.3	2.7	1.0
In Store High Value	3.8	1.3	1.0

# Apply Activity Costs To Arrive At Channel Cost Per Customer /Segment

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	Annual Transactions Cost			
	ATM	Teller	Phone	Total
Traditional Mass Market	\$178	\$63	\$11	\$252
Traditional High Value	\$296	\$31	\$11	\$339
In Store Mass Market	\$108	\$76	\$11	\$196
In Store High Value	\$181	\$38	\$11	\$230

# Determine True Customer Profitability

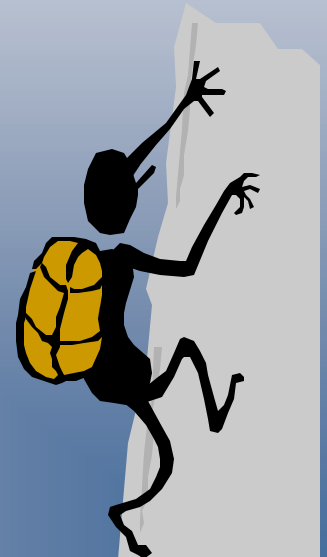
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	Annual Profitability		
	Account Profit	Channel Cost	Net Profit
Traditional Mass Market	\$211	\$252	(\$41)
Traditional High Value	\$5,058	\$339	\$4,719
In Store Mass Market	\$211	\$196	\$16
In Store High Value	\$5,058	\$230	\$4,828

# Next Steps With Profitability

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- ➔ Understand profitability by channel or for specific branches.
- ➔ Allocate costs of specialized sales forces to acquired customers.
- ➔ Determine next steps with specific customers/segments.
  - ◆ Cross Sales;
  - ◆ Channel promotion;
  - ◆ Retention.
- ➔ Create a database for each customer.
  - ◆ Apply 1:1 decision rules based on each situation.



# Identify Leverage And Develop An Action Plan With Each Customer Segment

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## Source of Net Profit

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	Account Profit	Transactions Cost	Efficiency Ratio Strategy
Mass Market	296%	196%	73% - Decrease Transactions Cost
High Value	104%	4%	5% - Retain/Increase Balances
Business	109%	9%	10% - Retain/Decrease some transactions Cost

# Pulling It All Together

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- ➔ Using this spreadsheet tool can help you define your areas of greatest leverage.
- ➔ Overall profitability can be understood by channel and customer type.
- ➔ Action plans can be developed once you understand:
  - ◆ Channel Costs;
  - ◆ Activity Costs;
  - ◆ Customer profitability.

