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California Independent Bankers

Lessons in Efficiency

Learned from the Best Banks on Main Street

By Kevin Tweddle, Chief Operating Officer - Bank Intelligence Solutions, Fiserv

The prudent and practical bankers on Main Street can teach other bankers a thing or two about riding out these times of hard-hitting change. Although interest rates remain low, loan volumes have diminished and regulatory developments are making it hard to increase non-interest income, community bankers have found a way to protect profitability.

The efficiency ratio is the amount it costs a bank to earn $1 in revenue. If the efficiency ratio is 68 percent, that means it costs $0.68 on average to earn a dollar. So, when it comes to efficiency ratios, lower is always better.

Except for the spikes caused by mortgage losses after the subprime meltdown and increases in F.D.I.C. premium expenses, efficiency ratios for all banks and thrifts have remained relatively flat since 2007. But, due to the new normal of squeezed margins, intense competition and ongoing regulatory change, the expectation is that efficiency ratios will climb.

2010

To prosper in this type of environment takes the best possible efficiency ratio. The efficiency ratio can be reduced by shaving costs and increasing revenue. This is what the best performing banks on Main Street are doing: they're turning wins of small basis points into collective gains.

This January, Fiserv studied all U.S. financial institutions to identify the Highly Efficient Community Banks and learn what they do best.

In order to identify the Highly Efficient Community Banks, Fiserv established certain parameters and minimum criteria for the banks to meet. In addition to eliminating special purpose banks and banks with more than $20 billion in assets, the field was narrowed to include only banks with:

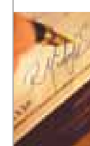
- An efficiency ratio of 45 percent or lower in each of the last two years
- A loan portfolio with no more than 5 percent non-performing loans
- Minimum core funding of 30 percent

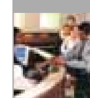
After evaluating the banks and thrifts against the selection criteria, only 13 institutions emerged as Highly Efficient Community Banks.

Stark differences surface when the average performance of the 13 Highly Efficient Community Banks is compared to industry averages/medians. It takes Highly Efficient Community Banks 40 cents less to earn every dollar than the average institution.

The most efficient community banks generally hire fewer people, pay them more and provide them with incentives to generate profitable asset growth. Revenues per employee average a whopping $458,000 for the Highly Efficient Community Banks versus $168,000 per full-time employee (FTE) for the rest of the field. Similarly, these high performers have fewer branches but produce more revenue on a per branch basis.

To keep branches profitable into the future requires assessing how branches will be impacted by new delivery channels, including online and mobile banking. This will help banks determine what the profitability model should look like now and five years down the road. Part of the profitability model may require deployment of technology to enable paper-free processes, image capture of teller line activities and remote deposit capture.





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For all banks with less than $20 billion in assets, deposit service charge fees make up the largest percentage of non-interest income. That percentage has fallen from almost 55 percent in 2006 to just 48 percent in 2010. What will help recover that revenue? As in any industry, the answer involves how goods and services are priced and differentiated.

Most banks and thrifts are reviewing all fees and charges to make up for lost revenue.

Options to consider include:

- Increasing late charges, processing fees and renewal fees on loans
- Introducing fees for unused product lines and linked accounts
- Increasing foreign ATM fees
- Increasing safe deposit box fees
- Deploying alternatives to free checking products

What the market will bear is certainly a concern in implementing revised pricing. But, in the case of raising ATM fees, even with a 50 cent or $1.00 increase the service could still be priced below the fees that the big banks charge. The same may hold true for price adjustments on other products.

Historically, customer acquisition is an area where community banks have been relatively weak. However, many high efficiency banks are using new technology and channels, like social media, to help identify and target viable groups of potential customers.

Institutions are also growing clientele by catering to niche segments, including medical practices, non-profits and homeowners associations. High efficiency banks pursue new business with orchestrated plans. Additionally, high efficiency performers are not confined to one isolated operating strategy. These banks often have a strong base of small business customers and are likely to have diversified loan portfolios.

Large numbers of potentially profitable customers may be left unreached if only the *tried and tired* acquisition techniques are used. Instead, a fresh acquisition approach should be formulated, based on a comprehensive understanding of the bank's footprint. This requires identifying the types of businesses and consumers that reside in the area and knowing the strengths and weaknesses for all financial institutions competing in the market. To assess ongoing threats and opportunities, it is critically important to keep abreast of regional consumer and commercial developments taking place.

Banks don't know —what they don't know —about their markets. In order to uncover hidden prospects, banks can use technology to identify *all* the types of businesses and consumers present in the market. Technology can also identify prospect matches in terms of characteristics and demographics to support acquisition goals.

Armed with knowledge of the market, banks can put plans in place to gain an advantage over competitor's products lines, go after specific segments and niches, and better serve the needs of changing demographics.

The 13 Highly Efficient Community Banks know their markets, have a diverse customer base and product set, and treat their people well. So, which bank on Main Street is the most efficient? Pocahontas State Bank, an Iowa institution with an impressive 2010 efficiency ratio of just over 20 percent. Statistics aside, it's clear that Pocahontas Bank and the other Highly Efficient Community Banks are very effective at not just working harder, but working on the right things.

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As a trusted advisor to bank executives across the country, Kevin Tweddle facilitates executive strategy sessions and shares best practices gleaned from the industry's top performers. Kevin's 23 years of financial services experience include five years as CFO of the Bankers Bank in Atlanta, where he helped to grow assets from $700 million in 1999 to $1.5 billion in 2004. Successes which he personally piloted, coupled with Kevin's exposure to initiatives of banks nationwide, give him unique insights into achieving high levels of efficiency in challenging times.

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