

# Back to Profitability

**Making Profitability Systems Work for the Bank**

**May 27, 2015**  
**Webinar**



# AUSTIN ASSOCIATES, LLC

## Financial Management Consultants for Community Bankers

- Community bank advisors for more than 40 years
- Specialized consulting and advisory services
  - Asset / Liability Management
  - **Profitability Measurement & Improvement**
  - Loan & Relationship Pricing Systems
  - Balance Sheet Structuring
  - Regulatory Compliance
- Current owners are consultants/managers
- Over 200 bank/thrift clients in 2014 in 26 states

# Austin Associates Webinar Series

## Upcoming Webinars

- July 28, 2015 – Strategic Planning
- Sept 29, 2015 – Commercial Loan Pricing

# PRESENTER

**Jeff Morris**- joined Austin Associates' Financial Management Division in 1998. He is responsible for profitability analysis services and works with clients who utilize the firm's innovative software products, including its proprietary organization/product/customer profitability software and its loan and deposit pricing software, with over 35 years experience in various financial management roles.



## Jeff Morris

**Managing Director & Principal  
Financial Management & Consulting**

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419-517-1775

# AGENDA

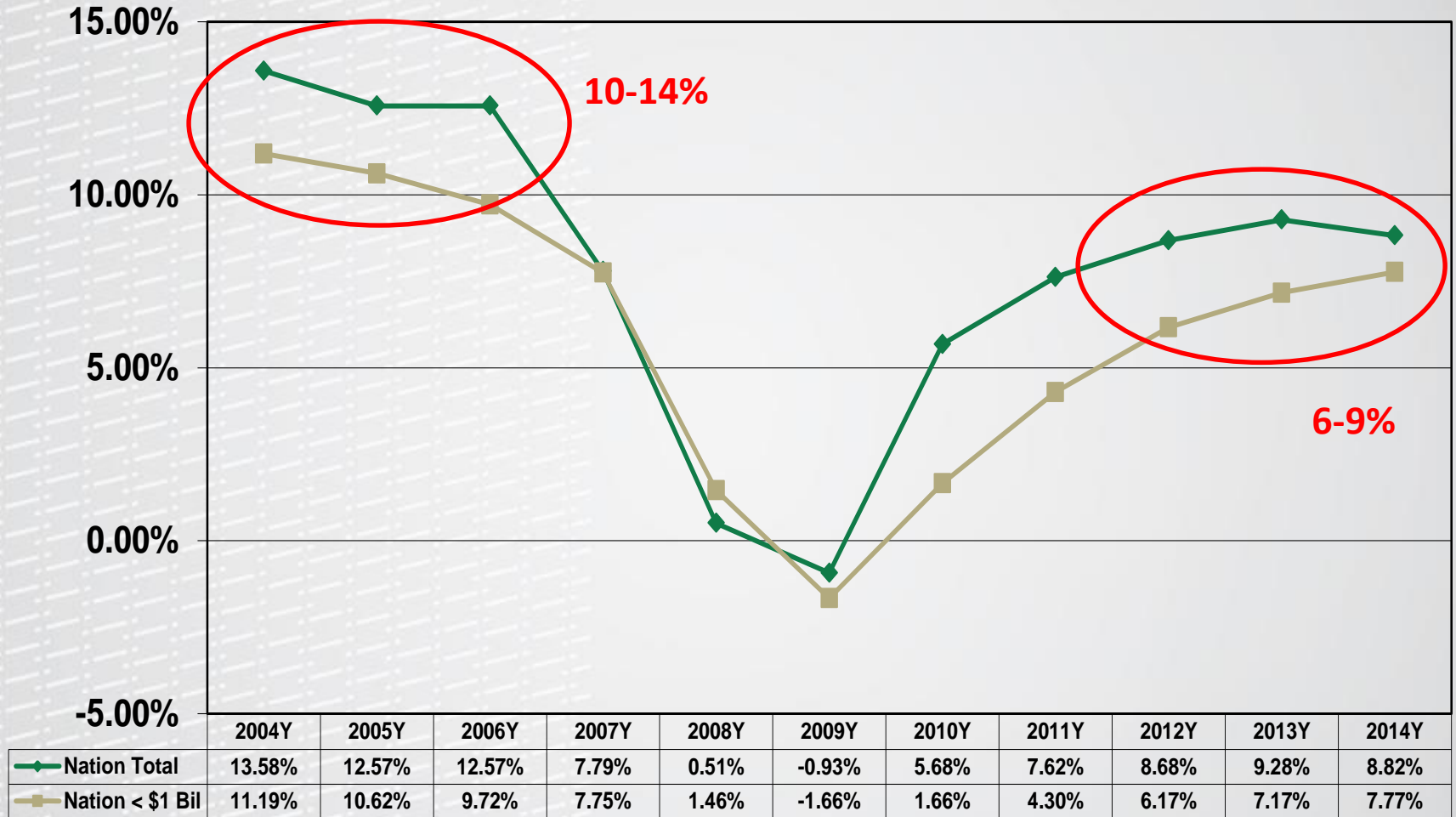
## Profitability Webinar

May 27, 2015

- Industry Trends
- Profitability Concepts, Dimensions, Best Practices
- Using Profitability Measurement Results
  - Product
  - Branch
  - Officer
  - Customer



# INDUSTRY TRENDS



Source: SNL Financial

# BARRIERS TO PROFITABILITY IMPROVEMENT

- Low interest rate environment
- Stringent price competition
- Slow growth economy / weak demand
- Pressure on fees
- Increased regulatory costs



# PROBLEMS WITH PROFITABILITY SYSTEMS

- Cumbersome
- Expensive
- Fluctuating results
- Lack of buy-in, confidence in methodology
- Domain of larger banks
- Inconsistent with community banking philosophy



# APPROACHES TO PROFITABILITY

- In-house managed systems:
  - Supported by vendor software, or
  - Spreadsheet driven (one off)
- Outsourced
  - Ongoing
  - Single purpose analysis

# PROMISE OF GOOD PROFITABILITY SYSTEMS

- Customer centric
- Provides understanding of profit drivers
- Measurement enables management
- Management enables improvement
- Tracking improvement period-to-period
- Ability to reward performance

# PROFITABILITY SYSTEM – BEST PRACTICES

- Single system – multiple views
- Every area of the bank is involved
- Continuously reconciling
- Highly visible rules and assumptions
- Comprehensive reporting
- Two way integration
  - Everything ties back to core
  - Results carried forward to operations

# CRITICAL MEASURES TO GET RIGHT (1 of 2)

## Funds Transfer Pricing

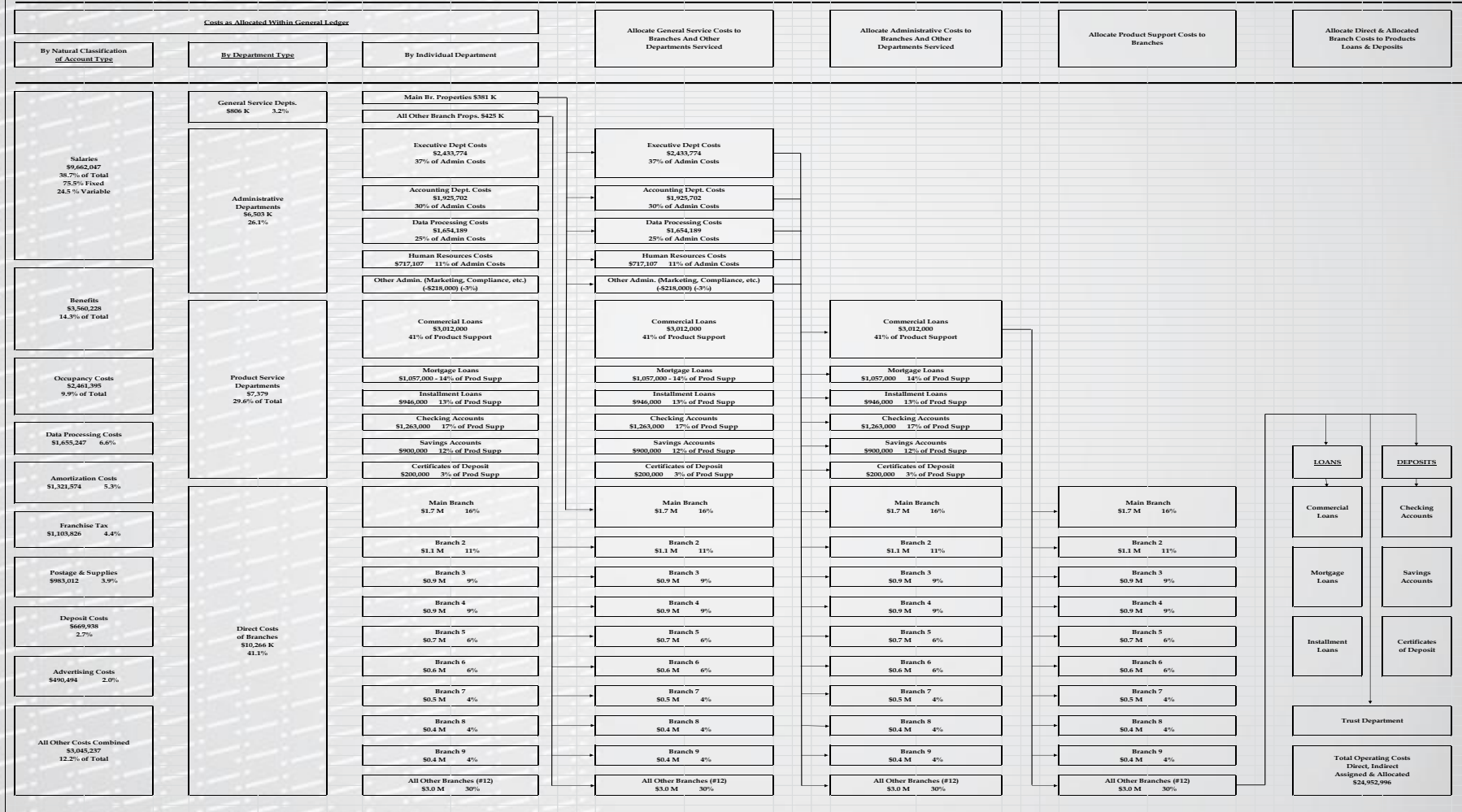
- Maturity Matching FTP for:
  - Loans
  - Investments
  - Certificates
  - Other Borrowings
- Blended Rates for:
  - Checking
  - Savings
- A fully-balanced system  
(i.e. Credit for Funding  
Equals Costs of Funding)

## Operating Cost Allocation

- Identify variable costs and assign directly to products
- Allocate staff time directly to the products and services they provide
- Base overhead allocations on most reasonable available statistics
- Use a cost flow diagram to make costing system visible
- Show cost components by product in graphic form

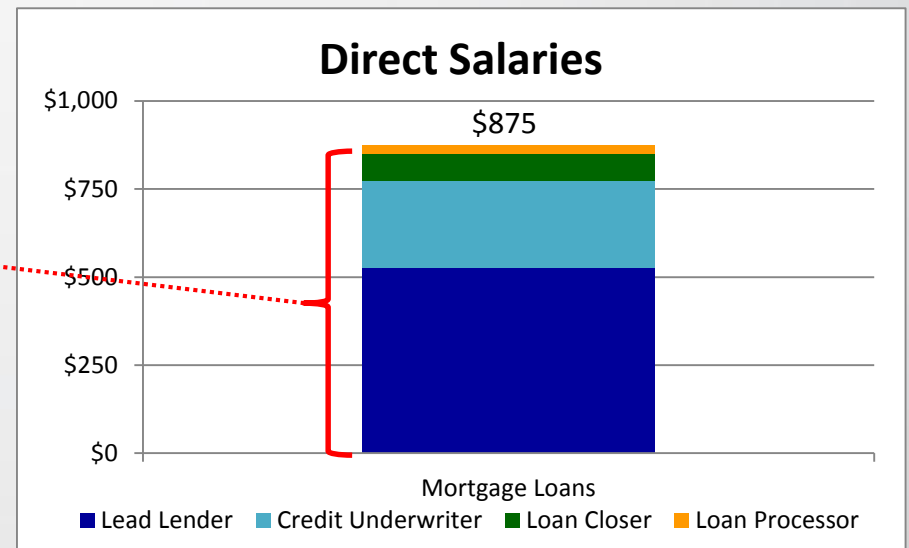
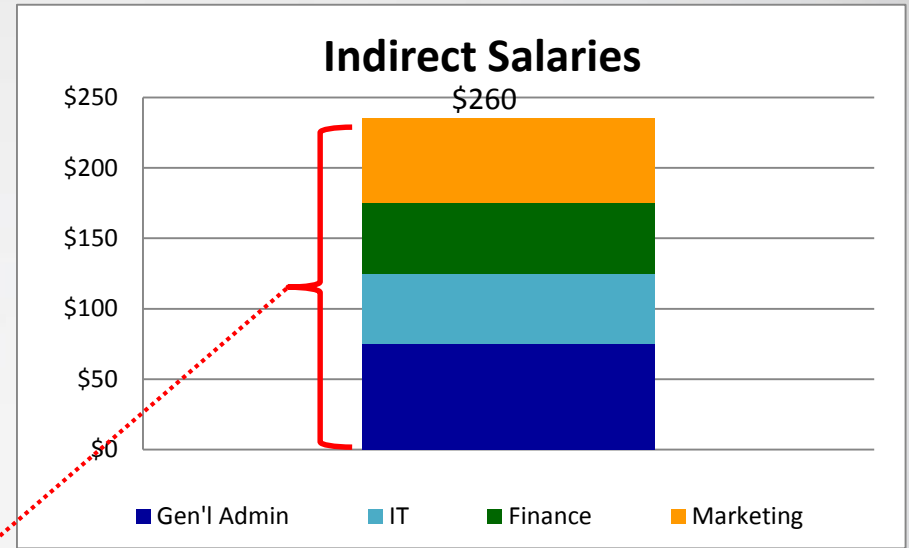
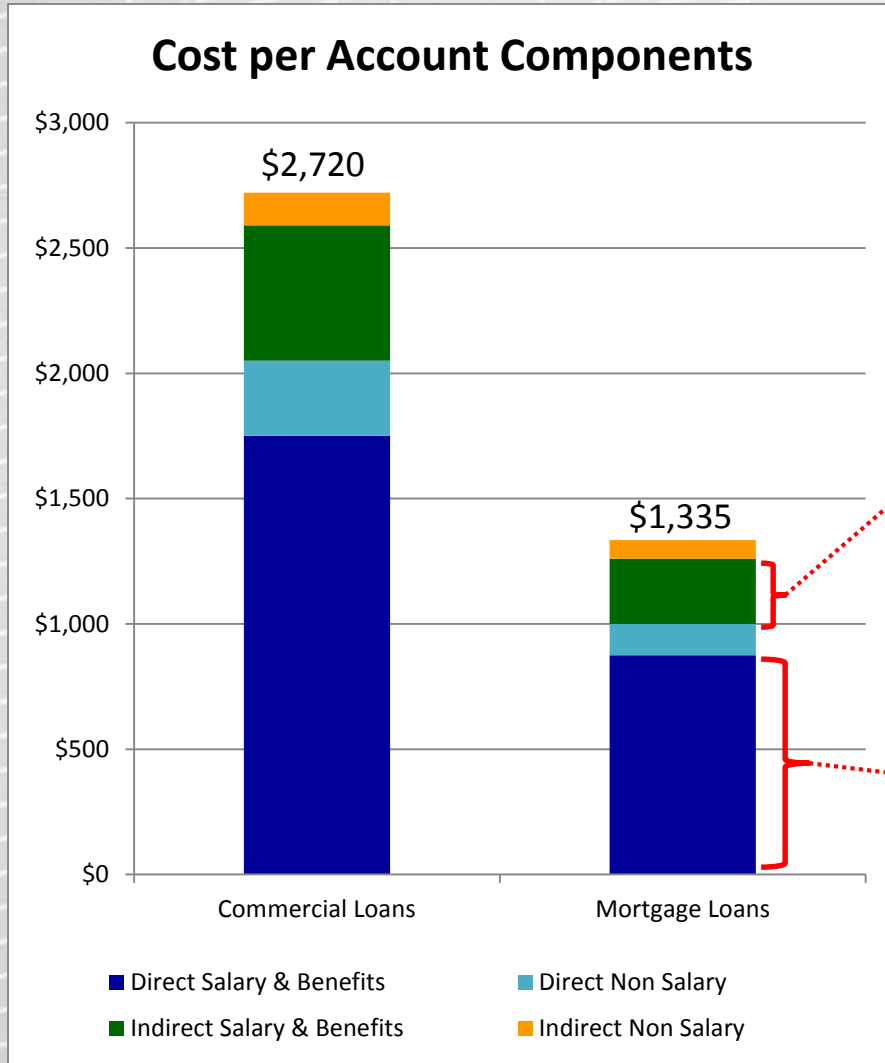
# Example Cost Flow Diagram

## Cost Allocation Process - Conceptual Diagram Austin Example Institution





# Example Cost by Account Type Summary



# CRITICAL MEASURES TO GET RIGHT (2 of 2)

## Fee Income Allocations

- Assign at account level
- Directly to account that paid
- Track interchange income
- NSF & ODP

## Provision for Loan Losses

- To get to the customer account level of detail you must track:
  - ✓ Changes to the Reserve (RFLL)
  - ✓ Charge-offs by customer
  - ✓ Recoveries
  - ✓ Upgrades
  - ✓ Downgrades
  - ✓ Relief of Provision for seasoned loans

# USING PROFITABILITY RESULTS TO GENERATE IMPROVEMENTS

- Involve end users in system development
- Tie expectations to elements under their control
- Make all assumptions visible

# PRODUCT PROFITABILITY

## USING RESULTS TO GENERATE IMPROVEMENTS

### Audience / Users

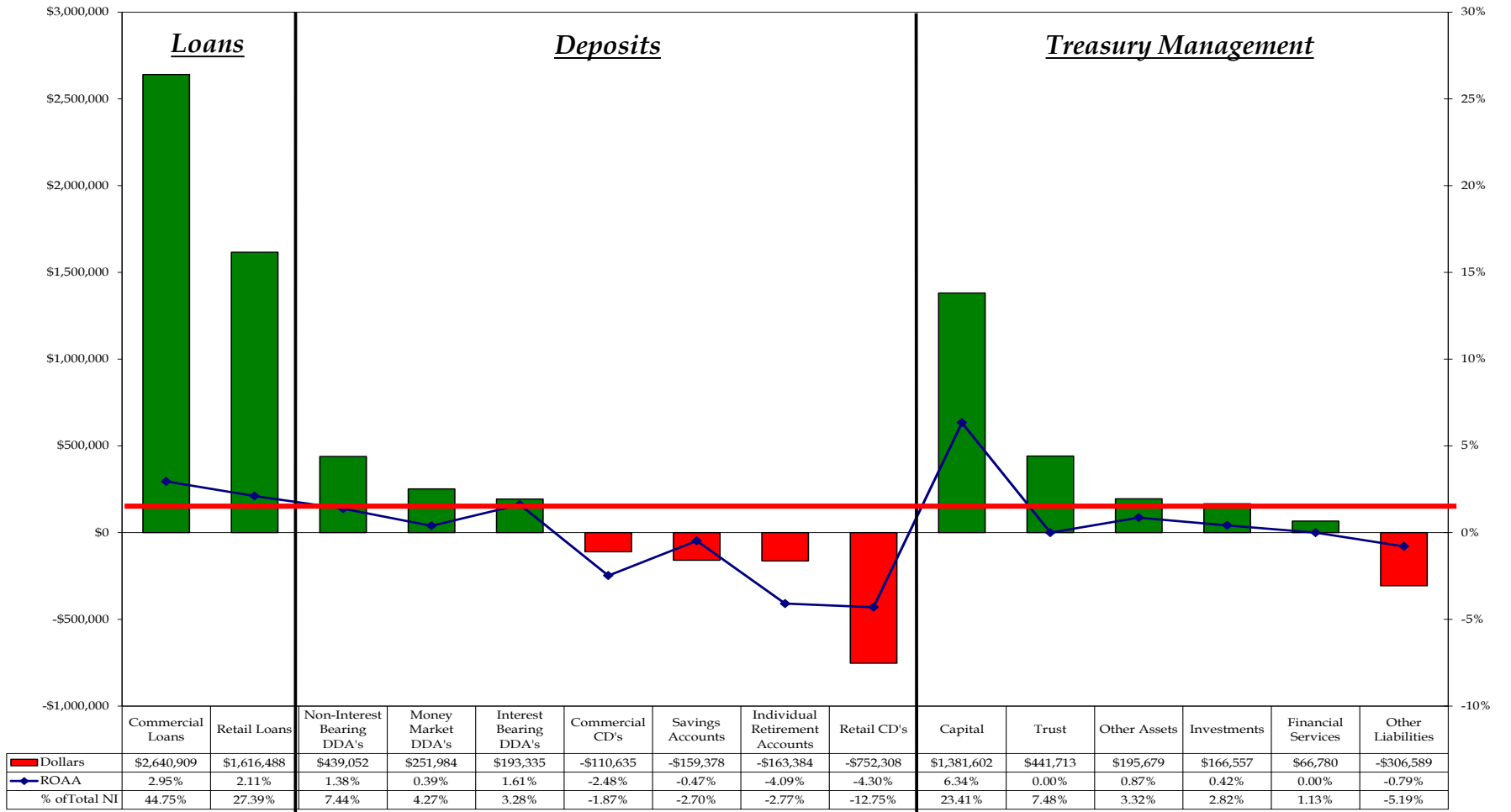
- **Senior Management**
- ALCO
- Marketing
- Operatons

### Deliverables

- Profit contribution of each product (\$'s, ROAA, ROAE)
- Product mix strategy
- Product growth

# PRODUCT PROFITABILITY

## USING RESULTS TO GENERATE IMPROVEMENTS



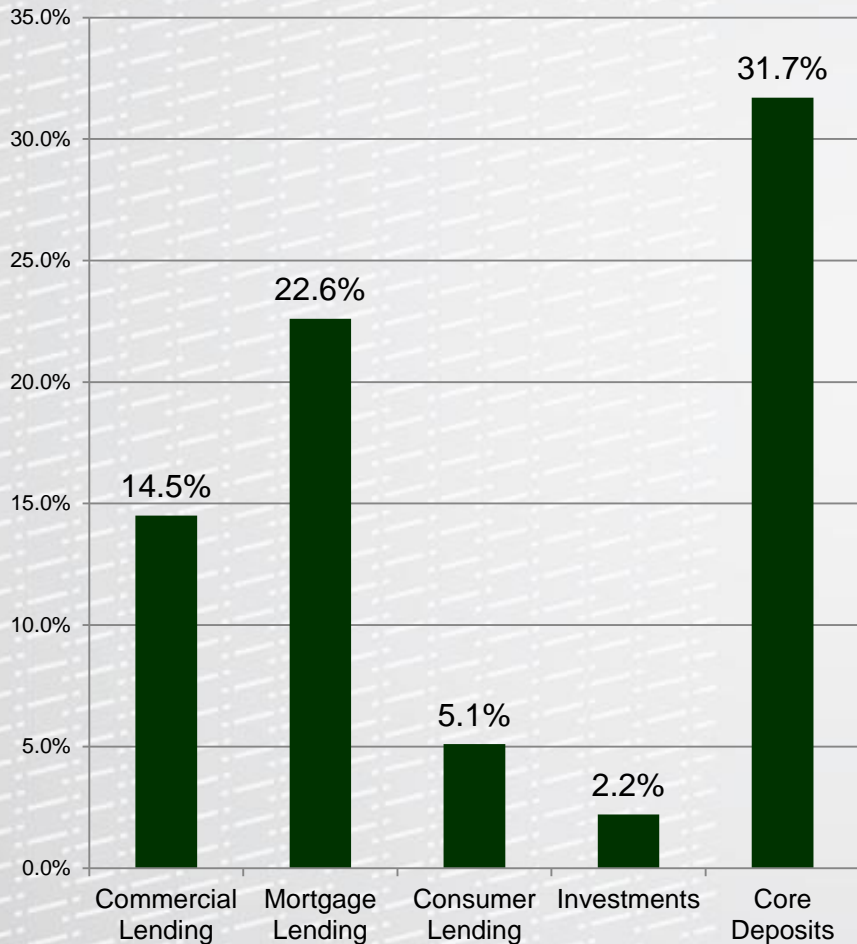
Return on Average Balance



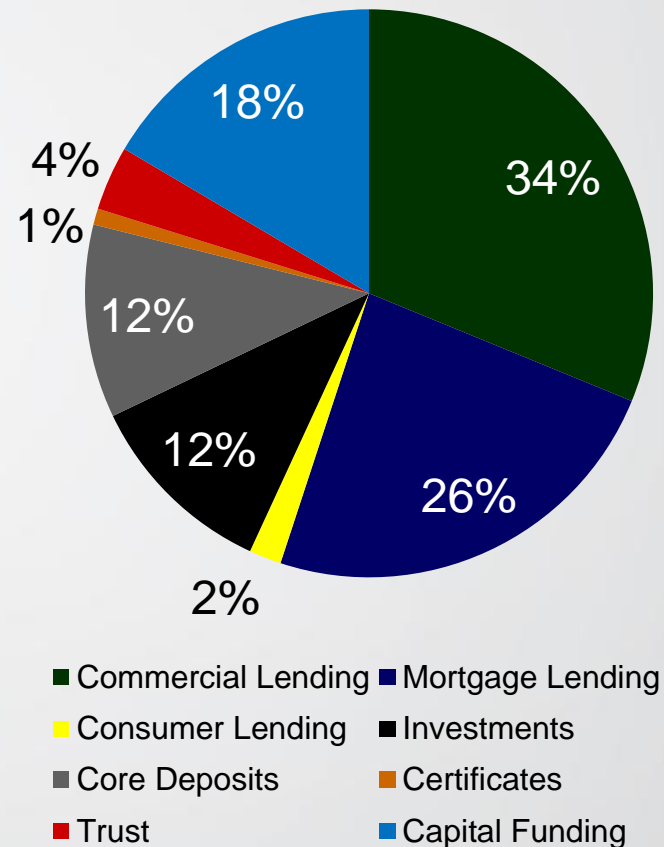
# PRODUCT PROFITABILITY

USING RESULTS TO GENERATE IMPROVEMENTS

## ROE by Product



## Dollars of Profit



# BRANCH PROFITABILITY

## USING RESULTS TO GENERATE IMPROVEMENTS

### Audience / Users

- **Branch Managers**
- Marketing
- Operations
- HR / Training

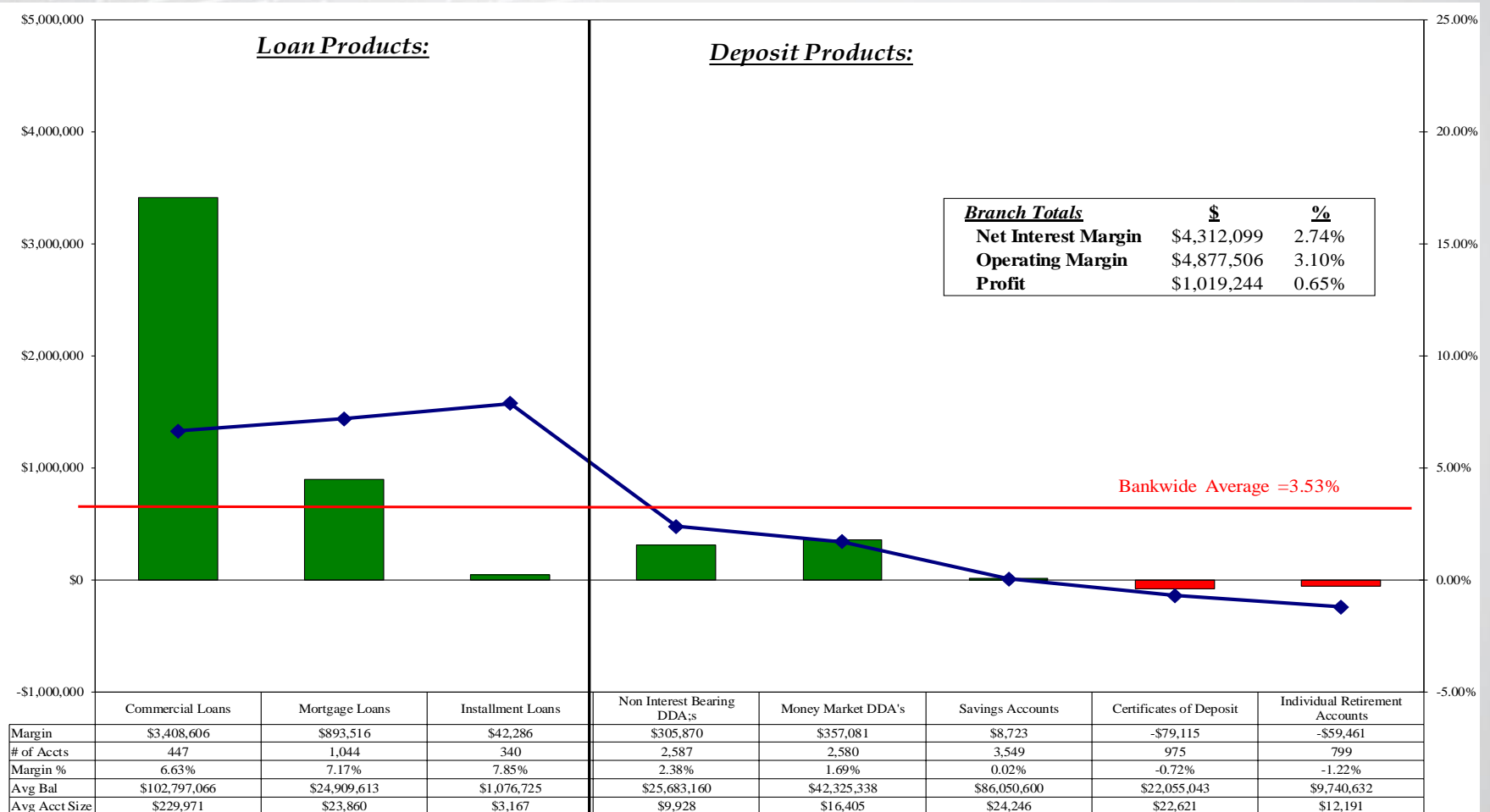
### Deliverables

- Most profitable products
- Top 100 most profitable customers
- Product mix of profitable customers
- Cross sales success
- Product growth

# BRANCH PROFITABILITY

## USING RESULTS TO GENERATE IMPROVEMENTS

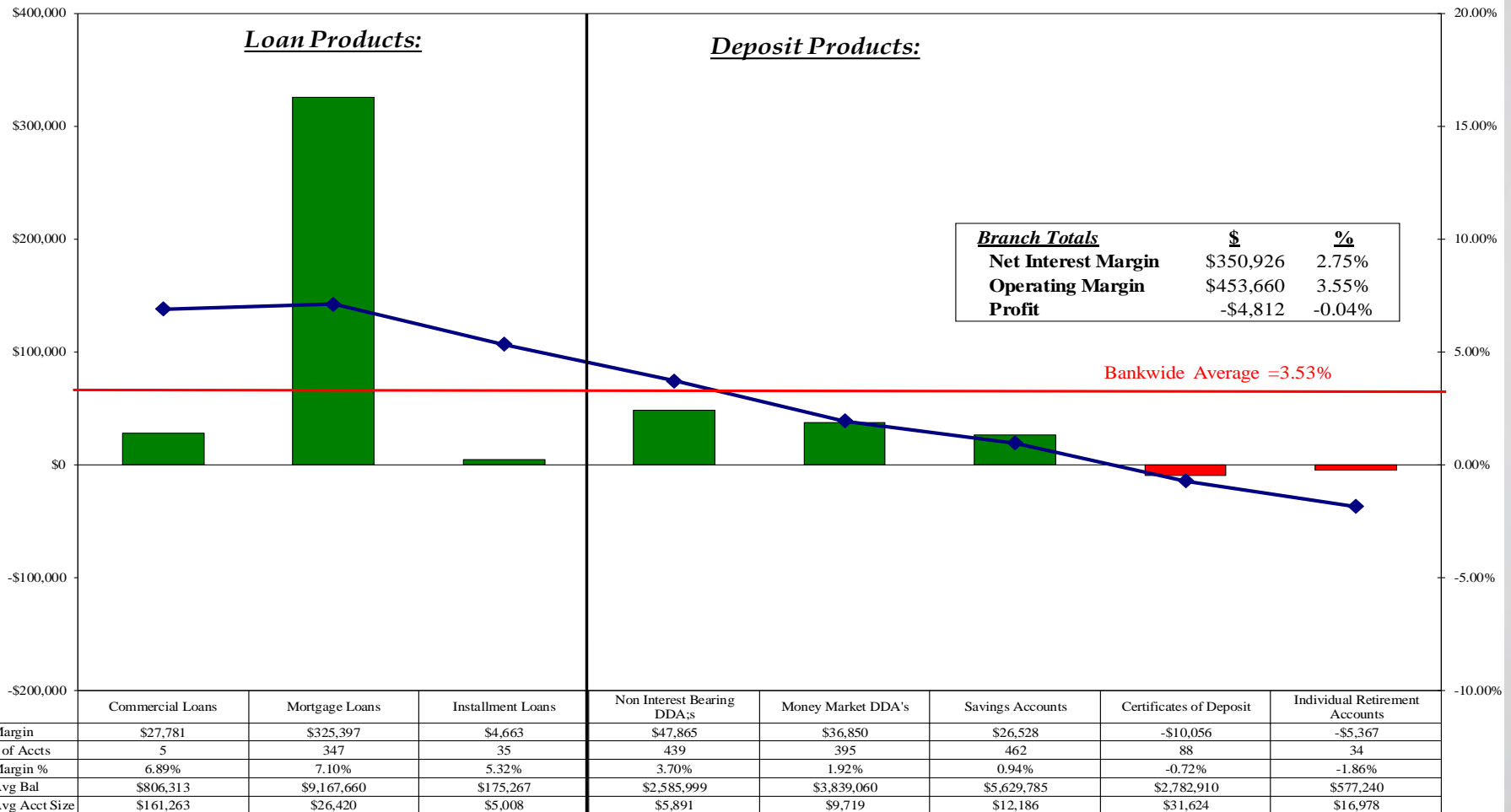
### Product-Line Profitability - Operating Margin



# BRANCH PROFITABILITY

## USING RESULTS TO GENERATE IMPROVEMENTS

### Product-Line Profitability - Operating Margin



# BRANCH PROFITABILITY

## USING RESULTS TO GENERATE IMPROVEMENTS

### Other Deliverables

- Branch network evaluation
- Sales strategies
- Selling effectiveness
- Funding strategies
- Pricing adjustments
- Value as a source of loan referrals
- Incentives / rewards





# CUSTOMER PROFITABILITY

## USING RESULTS TO GENERATE IMPROVEMENTS

### Audience / Users

- **Marketing**
- Lenders
- Operations
- HR / Training

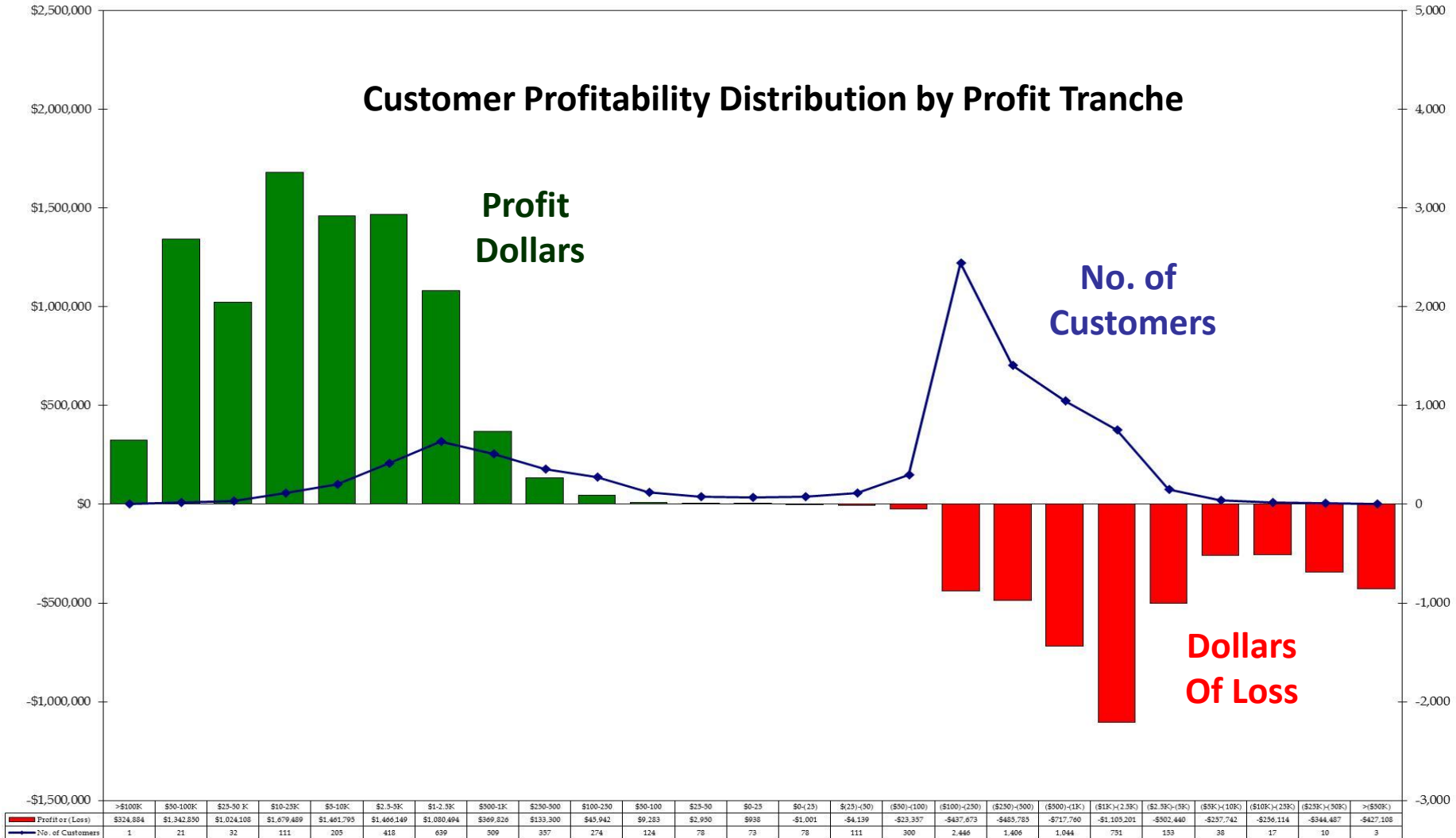
### Deliverables

- Top 100 most profitable customers
- Customer retention
- Profile of profitable customers
- Prospecting
- Marketing Strategies

# CUSTOMER PROFITABILITY

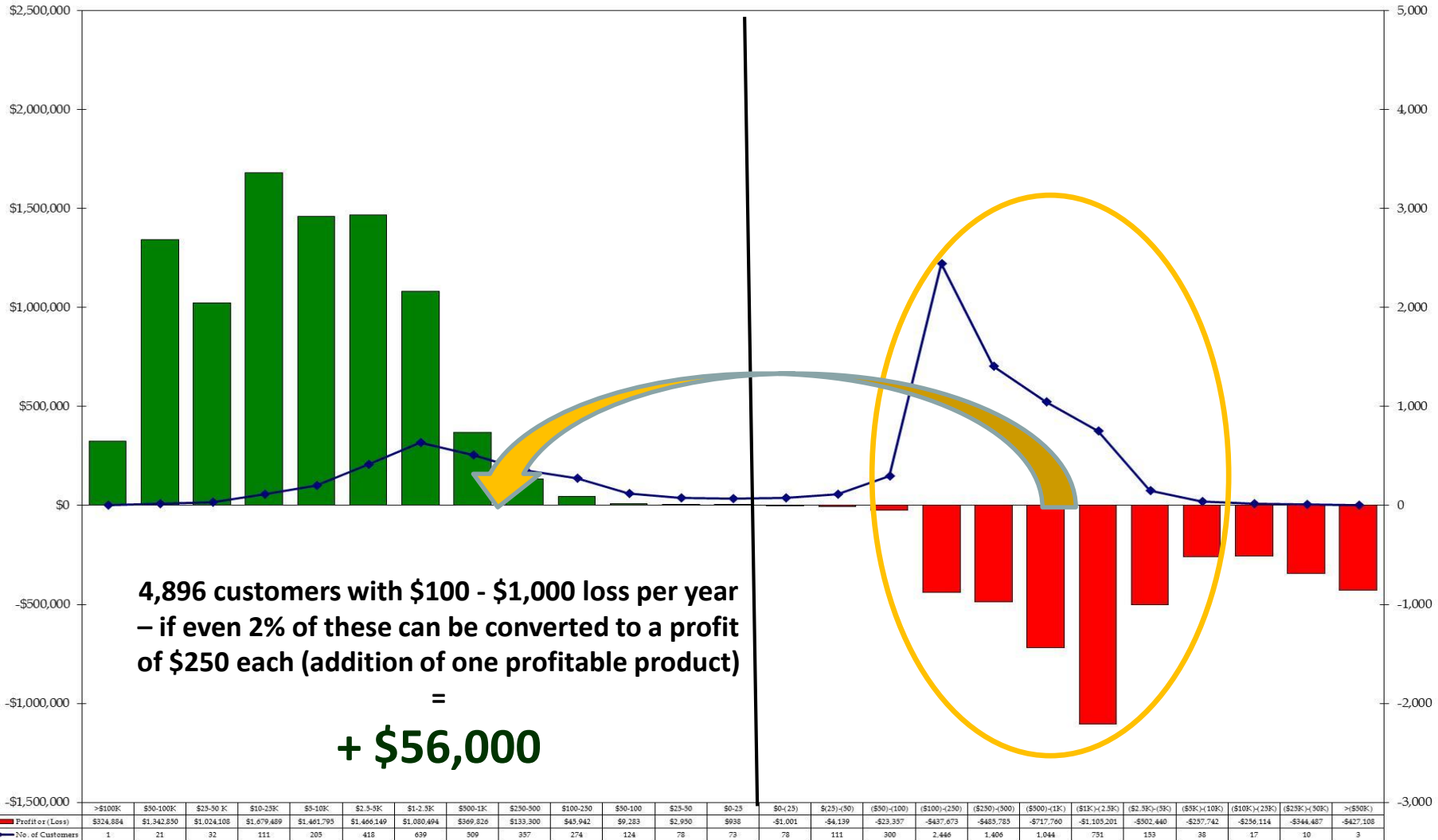
## USING RESULTS TO GENERATE IMPROVEMENTS

### Customer Profitability Distribution by Profit Tranche



# CUSTOMER PROFITABILITY

## USING RESULTS TO GENERATE IMPROVEMENTS



# OFFICER PROFITABILITY

## USING RESULTS TO GENERATE IMPROVEMENTS

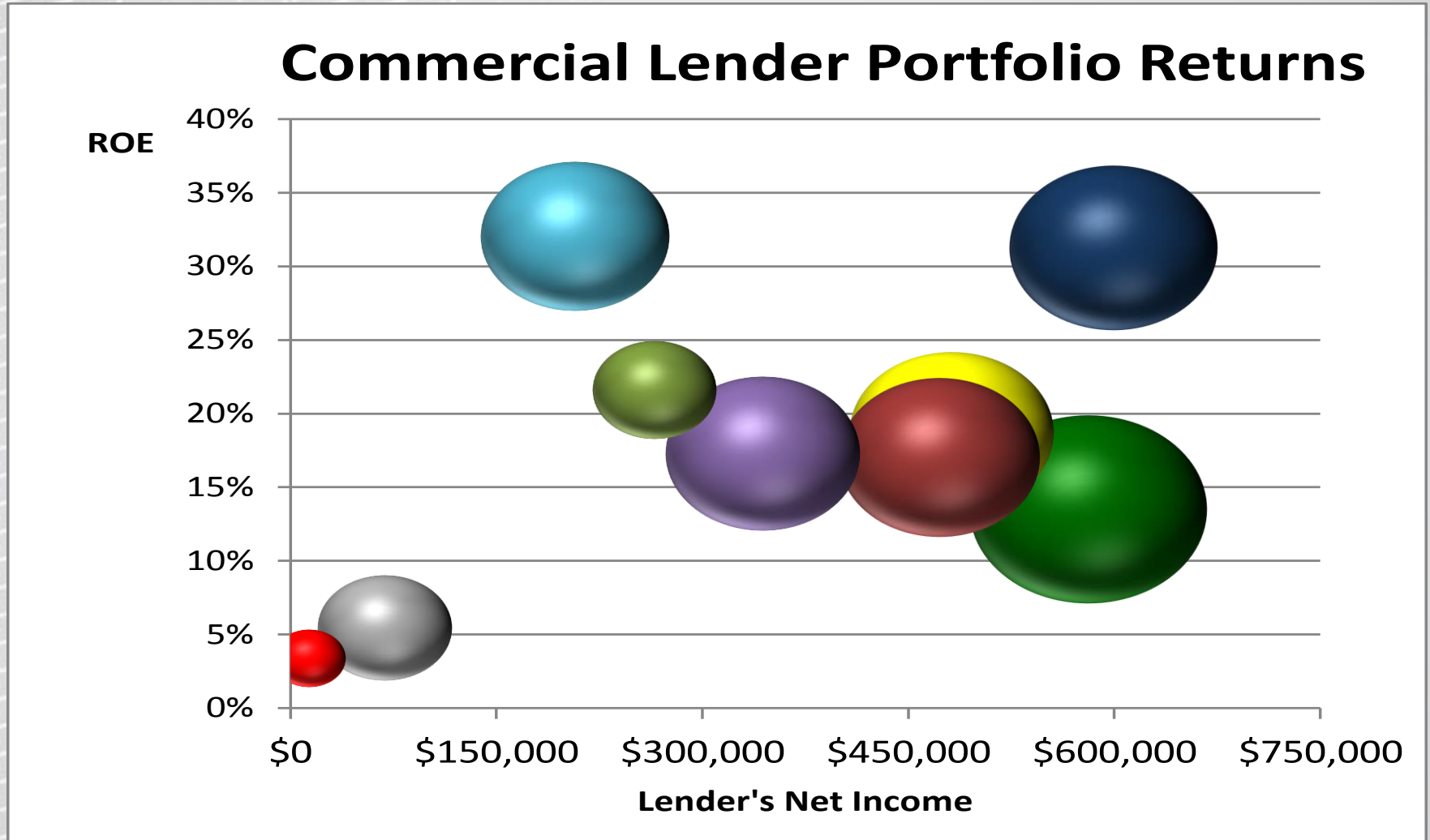
### Audience / Users

- **Commercial Lenders**
- Mortgage Lenders
- Branch Managers
- Senior Management

### Deliverables

- Top 10 most profitable customers
- All customers ranked in descending order by ROE
- Portfolio average ROE
- Improvement trending
- Best prospects for profitability improvement

# OFFICER PROFITABILITY





**Time for a few questions ?**

**THANK YOU FOR ATTENDING TODAY'S WEBINAR!**

# CUSTOMER PROFITABILITY PROFILE

## Commercial and Retail Customers

### COMMERCIAL CUSTOMERS

HIGHLY PROFITABLE	MODERATELY PROFITABLE	MINIMALLY PROFITABLE	MINIMALLY UNPROFITABLE	MODERATELY UNPROFITABLE	HIGHLY UNPROFITABLE
Heavy Commercial Borrowers with Large Checking Account Balances	Larger Sized Borrowers with Very Large MMDA Account Balances	Average Commercial Loans with Large MMDA Account Balances	Smaller Commercial Loans with Average Account Balances	Smaller Commercial Loans with Large MMDA Account Balances	Larger Sized Loans with Average Deposit Account Balances
Avg. Loan - \$1,073,000 Avg. Checking Balances - \$120,000 - \$394,000	Avg. Loan - \$209,000 Avg. Checking Balances - \$83,000 - \$376,000	Avg. Loan - \$100,000 Avg. Checking Balances - \$16,000 - \$177,000	Avg. Loan - \$78,000 Avg. Checking Balances - \$3,000 - \$57,000	Avg. Loan - \$51,000 Avg. Checking Balances - \$11,000 - \$254,000	Avg. Loan - \$392,000 Avg. Checking Balances - \$9,000 - \$71,000
N = 100	N = 410	N = 331	N = 534	N = 545	N = 31

### RETAIL CUSTOMERS

HIGHLY PROFITABLE	MODERATELY PROFITABLE	MINIMALLY PROFITABLE	MINIMALLY UNPROFITABLE	MODERATELY UNPROFITABLE	HIGHLY UNPROFITABLE
Large Retail Loan Balances with Large Deposit Balances	Large Retail Loan Balances with Solid Deposit Balances	Modest Retail Loan Balances with Solid Deposit Balances	Smaller Retail Loan Balances with Average Deposit Balances	Smaller Retail Loan Balances with Average Deposit Balances	Moderate Retail Loan Balances with Average Deposit Balances
Avg. Loan - \$308,000 Avg. Checking Balances - \$165,000 - \$359,000	Avg. Loan - \$114,000 Avg. Checking Balances - \$29,000 - \$272,000	Avg. Loan - \$46,000 Avg. Checking Balances - \$13,000 - \$98,000	Avg. Loan - \$23,000 Avg. Checking Balances - \$2,000 - \$40,000	Avg. Loan - \$23,000 Avg. Checking Balances - \$2,000 - \$34,000	Avg. Loan - \$68,000 Avg. Checking Balances - \$4,000 - \$39,000
N = 97	N = 1,083	N = 609	N = 1,785	N = 2,986	N = 37

# CONTACTS

We appreciate hearing from you.

If you have questions or comments, regarding today's Webinar, or if you would like to see any of your bank's current customer relationships modeled, please feel free to contact us at any time.

We would also be pleased to provide your management team with a personalized demonstration of the Austin Profitability System - simply contact Jeff to arrange a date and time for your demo.

## Jeff Morris

Managing Director & Principal  
Financial Management & Consulting

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