Facilities: Branching for profit

The old 80/20 rule can be applied to branch offices: 80% of the problems are caused by 20% of the branches.

That's a guideline that too many savings institutions deliberately overlook, according to Kenneth H. Thomas, a branch planning bank consultant for K.H. Thomas Associates of Miami and Philadelphia.

Branch profitability should be reexamined continuously, he advises. And, this process may require outside assistance.

"It's been our experience that bank management and staff can get maybe 10% of the problem branches — the obvious 10% — but the other 10% may need some outside expertise to get agreement on."

According to a recent study by the American Bankers Association, a commercial bank branch has to be $20 million to $25 million in deposit size to be profitable, but Thomas strongly disagrees.

"If you took the ABA study at face value, you would end up closing half the branches in the country," he says. "We don't believe that that many are unprofitable."

BREAK-EVEN SIZES

Thomas says that a truer break-even point is between $10 million and $12.5 million, while even a branch with as little as $6 million in deposits can be profitable if it generates a lot of loans, for example.

Thomas offers two performance tests for branches: a basic ratio test, comparing expenses and deposits to other branches within the system, and a break-even branch core-deposit level test.

Even when the evidence is obvious, Thomas finds institutions that will keep unprofitable branches.

"That's something that has always bothered me," he says. "Sometimes, it's looked on as a sign of past management problems, and they don't want to admit they've made a mistake or embarrass a board member."

All too often, however, he finds managers who are holding onto the branch for a rainy day.

"We call it the 'ace in the hole,'" he says. "The savings institution may be profitable, so they wait until they are unprofitable. When things get bad, it is a quick fix to close the branch. We are totally in disagreement with that strategy, and any shareholder would be, too."

Other times, however, a branch closing could be found to violate the institution's Community Reinvestment Act responsibilities, he points out. Branches in the inner city and declining areas are especially vulnerable.

"Savings institutions must be able to document their decisions to close branches," he says. "If the question is brought up later, they can say, 'we have been tracking profitability on an annual basis, and here is the A, B and C of why we did it.' Don't just say, 'we closed it because we didn't think it was profitable."

To evaluate the branch closing, Thomas also recommends tracking the depositors and personally contacting the largest customers.

"We shoot for a 50% retention rate if the nearest branch is a reasonable distance away," he says. "We have had clients who have retained over 90%. You would be surprised how many will stay with you if you ask them to."

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