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Revenue Growth Must Top Priority List

By WYN LEWIS

Over the last two years, the U.S. banking industry has significantly shifted its approach to creating shareholder value, from an exclusive focus on reducing expenses to a more balanced approach that stresses revenue growth as well as expense minimization.

This change follows 10 years during which the efficiency ratio was ascendant as the primary indicator of managerial competence. It caused our industry to focus almost myopically on acquisition and then on employee reductions as the primary drivers of net income growth.

But as a result, the "easy opportunities" to execute expense reductions in an acquired bank by pursuing more aggressive expense controls are no longer so easy. As many recent acquirers are finding out, the balance between the benefits of immediate reductions in personnel costs and the cost of maintaining operational quality and revenue has shifted. The typical internal consolidation strategy, stressing speed at any cost, has been replaced by a far more customer-focused strategy of maintaining operational quality and revenue.

COMMENT

Lewis

The problem facing so many banks in 2000 and beyond is how to continue to achieve double-digit increases in net income when the traditional source of this growth – single-digit reductions in expenses – is no longer available.

The answer is ultimately the same for every industry, and banking is no exception: Over the long term, shareholder value is achieved through revenue growth, and what we witnessed over the last 10 years was an aberration that is quickly coming to an end.

However, it has been around for so long that it is very difficult for many of us to see it in that light, let alone adapt to a new environment.

In the future, our achievements will be measured in terms of increases in assets such as knowledge and expertise, rather than reductions in force, and we will generate value through the creation of new resources, not through the elimination of excess capacity.

Yet for many in banking, aggressively pursuing a revenue-growth strategy is hard to accept. We have never looked at banking as a high-growth industry. It has no Microsofts, Yahoos, or Dells. On the contrary, it appears to have a collective assumption that there is some cap on revenue, and that the only way individual banks can grow is by buying market share from others.

It is time we dispel this myth.

Our industry is in need of a cultural shift that rewards innovation, revenue growth, and the creation of value for customers, while placing less emphasis on the minimization strategy of the past. We need to look at technology primarily as a driver of new revenue opportunities, not just as a way to reduce costs by eliminating full-time jobs.

There are several banks that have begun to prioritize revenue growth above expense minimization, and they have seen modest success by creating new and better products, value-pricing these products, increasing the cross-sell ratio, and attracting new customers. These banks have clearly and unambiguously shifted managerial focus and its intellectual

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and innovative capacity toward revenue growth and away from expense minimization.

This shift in emphasis has accelerated dramatically in the past two years, especially among the very largest banks that have successfully increased net income year after year by pursuing intense expense-reduction policies. The approach that has worked best has been to look for specific, easily implemented opportunities that trigger targeted changes in cultural and philosophical attitudes.

What may come as a surprise, however, is the magnitude of these initiatives. An analysis of the results of 20 projects completed over the last five years for very large banks shows that these revenue-only programs generated new annual-revenue streams of about \$2 million per \$1 billion of domestic transaction deposits. This is very significant. For a bank with \$10 billion in assets, netting \$150 million after taxes, and with an annual net-income-growth target of 10%, such a program might generate \$15 million after-tax, or an entire year's targeted growth.

The point, then, is that even in the largest and arguably most sophisticated banks, opportunities for new revenue growth are everywhere. They exist both because these banks have been focused elsewhere (on expense minimization) and because realizing these opportunities requires a change in mindset that is not easy.

In order for a bank to remain successful and profitable in this period of incredible upheaval, this change must occur, and my observation has been that it must begin at the top. It is the prestige and visibility of the executive office providing the direction and will to change that makes the difference, and will move the institution from an internally focused minimization strategy to a customer-focused revenue growth strategy.