

NORTHWESTERN Banker Newsletter

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November 15, 1971

Advises Profitability Analysis

Bank profits are a major concern of every banker. The key, according to John F. Falkenberg, vice president, The First National Bank of Denver, lies in determining customer profitability. Here is a summary of Mr. Falkenberg's remarks before the 47th National Convention of Bank Administration Institute at Miami Beach, November 8, 1971:

Q. When is a bank in a position to take positive action to improve bank profits?

A. When it has identified its key accounts.

Q. What are key accounts?

A. The 20% of customers who produce 80% of the profits.

Q. How is the 80%/20% rule arrived at?

A. The rule of thumb for many businesses that 80% of sales and profit comes from 20% of the customers also holds true for banks. In fact it is nearly 90%/20% for deposits.

Q. Can this be verified?

A. The FDIC reports that on June 30, 1971, 89% of the demand deposits from individuals, partnerships and corporations in 13,600 insured banks were in only 20% of the demand deposit accounts. These were accounts with balances over \$1,000. Fifty-seven per cent of the deposits were in just 1% of the accounts, those with balances over \$20,000.

Q. What does this mean?

A. If your bank is anything like the national average, you can put the 80%/20% rule to work for you. If



John F. Falkenberg

your key accounts are profitable, your bank will be profitable.

Q. How is this done?

A. Make each major customer a profit center. First, identify your major customer relationships — the sum of all that the customer does for your bank and all that your bank does for the customer. Then decide on the value of your money in your bank by selecting the transfer price or the internal price of funds that seems to best represent the management philosophy of your bank and which is consistent with other cost of funds calculations in your bank.

Q. How is the profitability analysis of a non-borrowing depositor determined?

A. It is relatively easy. Deduct float and reserves from the total deposits. Then apply the transfer price to determine total income. Deduct account activity costs, interest paid on time deposits, and any other costs

that can be allocated to this relationship. The result is profit, and the larger the profit, the more important the customer.

Q. What about borrowing customers?

A. Determining their profitability is more complicated since lending funds are limited and a bank must choose between alternate loan opportunities, but five basic approaches are used to measure the profitability of borrowing customers.

Q. Where may the five basic approaches be found?

A. Bank Administration Institute is conducting a study on loan profitability analysis in cooperation with Robert Morris Associates. A report should be ready early in 1972.

Q. Are all five approaches used together?

A. No. Once the customer's profitability has been determined, a yield or margin can be calculated by any one of the five methods. Net funds loaned are calculated by subtracting the borrower's available deposit from the gross loan. The profitability of borrowing customers can then be compared by comparing their yields or margins.

Q. How about setting a profit goal and how does one measure how well the loan meets the profit goal?

A. The profit goal must be stated in the same terms of yield or margin that are used for measuring the loan. It

PROFITABILITY ANALYSIS...

(Continued on back page)

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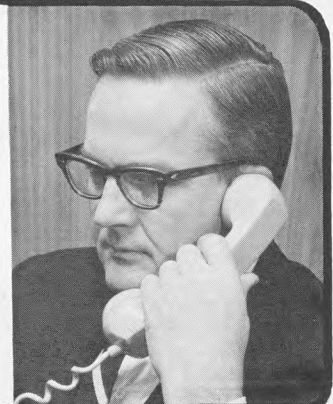


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IOWA NEWS

ALDEN: Leo Jorgensen, president of the Alden State Bank, announced that Merrill Nerem has joined the bank as assistant cashier. Mr. Nerem has been with the Livermore State Bank, Livermore, as assistant cashier since 1968 and prior to that with the Renwick State Bank.

CROMWELL: Mrs. J. R. Moore was elected as a member to the board of directors of the Cromwell State Savings Bank. She will fill the vacancy on the board caused by the sudden death of her husband. Robert Gordon, who has been on the board since 1965, was named chairman.

DUBUQUE: Hawkeye Bancorporation has filed a \$2 million "breach of contract" lawsuit in Dubuque County District Court against the Key City Bank and Trust and its parent company, Iowa National Investment Company. In December of last year, stockholders of Iowa National Investment voted against Hawkeye's offer to take control of Key City.

DES MOINES: The Iowa Bankers Association has announced that the 24th Annual Tax School will be held November 22 & 23 at the Hotel Fort Des Moines in the State Ballroom at 9:00 A.M. Instruction at the school covers the field of federal and state income taxation. This year, the Iowa Trust Association will hold an all day workshop on November 23.

It was also announced that Arthur E. Lindquist, Jr., executive vice president and secretary of the IBA has accepted the chairmanship of the 1971 Iowa Farm-City Week Committee. Governor Robert D. Ray will proclaim November 19-25 as "Iowa Farm-City Week".

GRINNELL: Max A. Smith, president of The Poweshiek County National Bank has announced the promotion of Gary J. McKibbin to assistant cashier. He joined the staff in September, 1970 after graduating from Iowa State University in August, 1970.

IOWA CITY: The University of Iowa



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announced the largest individual gift recorded thus far in 1971 for any American college or university: 85,000 shares of Bandag, Inc. stock valued at approximately \$3.5 million from Roy J. Carver, chairman of the board of the Muscatine company. Mr. Carver is also a director of the First National Bank of Rock Island, Illinois.

OTTUMWA: Union Bank & Trust Co. stockholders voted unanimously to accept the stock exchange offer tendered by Banks of Iowa, Inc., Cedar Rapids holding firm, and 195,000 shares of Banks of Iowa now has been issued for 100% of Union Bank. Max von Schrader, Sr., chairman, and Jay C. Blackford, president, of Union Bank, will be elected to the Banks of Iowa board this month.

NEBRASKA NEWS

GRAND ISLAND: Richard E. Spelts, Jr., chairman of the board and chief administrative officer of the First National Bank of Grand Island, and general manager of Spelts of Nebraska, Inc., was recently elected to the board of directors of Northwestern Public Service Company.

OMAHA: First National Bank opens for business today, November 15, in its new building located at 16th and Dodge Streets. Official address is One First National Center. The bank occupies the first 10 floors of the 22-story building. Complete story and pictures appear in the November **NORTHWESTERN BANKER** magazine.

ILLINOIS NEWS

CHICAGO: Illinois Bankers Association president, Lewis H. Clausen, president, Champaign National Bank, recently announced several IBA administrative personnel changes. Norman C. Peterson, formerly administrative assistant, was promoted to the post of assistant secretary; Helen M. Kresich, director of communications and editor, **ILLINOIS BANKER** magazine, and Thomas W. Dardis, director of education, both of whom will retain their present titles, were elevated to official officer status.

CHICAGO: Edward C. Ragland was named sales representative for Trains & Boats & Planes, Inc., a travel agency Seaway National Bank, according to Harold R. Algar, president.

CHICAGO: Joel Shiffrin has been elec-

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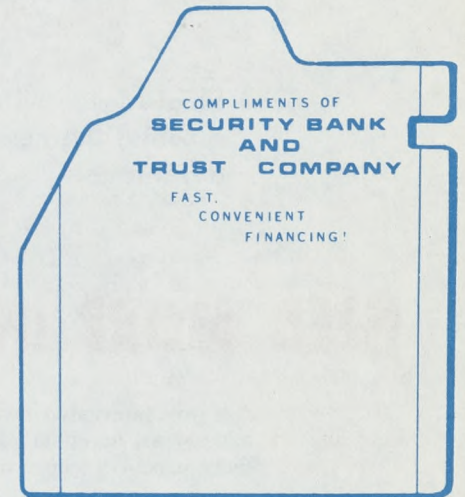
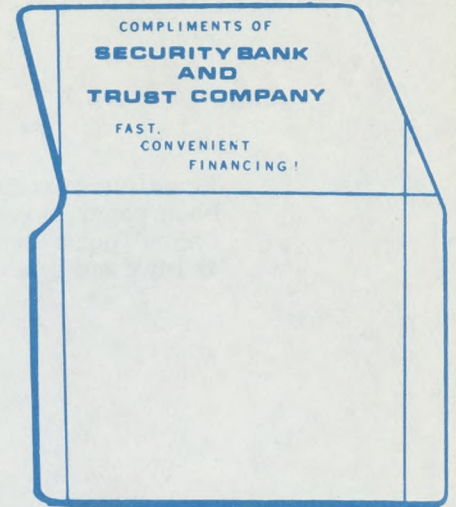
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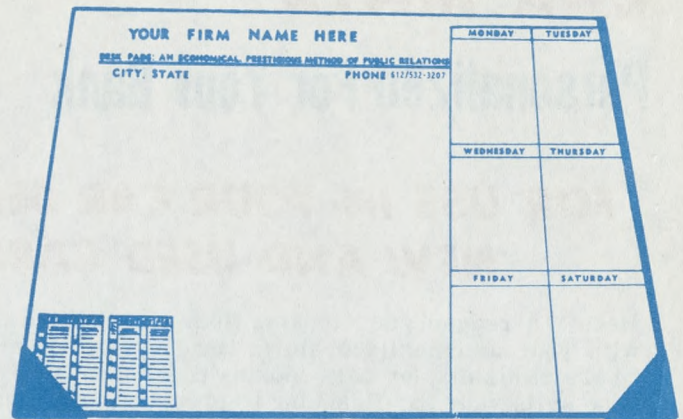
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ted executive vice president of the United of America Bank.

CHICAGO: Caleb J. Penniman has been elected executive vice president of the Interbank Card Association.

OAK PARK: Clarence R. Preiss, vice president and trust officer, Oak Park Trust & Savings Bank, will be retiring on November 30 after 47 years of service. He was named vice president in 1958.

MINNESOTA NEWS

EDINA: Edina State Bank is moving into its new quarters at 5050 France St. today. Open house will be held in December. The bank's Mosler Pneu-Vista drive-in will be open 24 hours a day from 7:00 a.m. Monday through 3:00 p.m. Saturday each week. The bank's phone number will be 920-0120.

MINNEAPOLIS: Mrs. Robert Henry, 96, of Volga, S. D., died last week. She was the mother of George Henry, vice president, First National Bank of Minneapolis.

MINNEAPOLIS: The Minnesota Bankers Association is sponsoring a series of Regional Staff Training-Public Relations meetings which began last week, according to MBA president, William G. Kirchner. Eight meetings have been planned, each of which will begin at 5 P.M. at the following locations: November 16 -

Mankato High School, Mankato; November 17 - Kahler Hotel, Rochester; November 22 - Park Rapids Area School, Park Rapids; November 23 - Androy Hotel, Hibbing; December 7 - Hotel Hunt, Montevideo; and December 8 - Marshall High School, Marshall. A dinner and speaker will conclude the program.

MINNEAPOLIS: The Federal Reserve Bank building, located at Fifth and Marquette, has been sold to a group headed by Peter Tishman, president of the Peter Tishman Real Estate Company and Jay Marc Schwamm, president, Goal Realty Development, both of New York. The Reserve Bank will continue to occupy the structure until moving to its new offices at Marquette and Third Street in about a year.

MINNEAPOLIS: First National Bank of Minneapolis is planning to relocate its North Side Office from the current location near West Broadway and Washington Avenue North to a new south side site at 53rd and Lyndale. Relocation is required because of the construction of I-94, which will have an interchange at the present North Side location.

ROSEVILLE: G. Reed Macomber, president, Roseville State Bank, and treasurer of the Minnesota Bankers Association, is recuperating in Abbott Hospital in Minneapolis from a heart attack.

ST. PAUL: The First National Bank has culminated a five and one-half year building project and will move into its new quarters December 4. The executive offices and correspondent bank department will again be on the second floor.

SPRAGUEVILLE: A hearing will be held November 18 in connection with the application to the state banking department to move Farmers Savings Bank to Preston (pop. 960), where the bank now has an office. Spragueville (pop. 100), then would become the office. Spragueville residents are protesting the move.



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NORTH DAKOTA NEWS

DEVILS LAKE: Construction has begun on the new Western State Bank. The building is scheduled for completion August 1 of next year.

OAKES: Carl Roy Bowman, president of the First National Bank, died recently at the age of 65. He joined the bank in 1925 and was elected president of the bank in 1969.

COLORADO NEWS

DENVER: Four staff members of the United Bank of Denver - Gary B. Ashley, Thomas W. Swanson, Robert A. Esperti and Richard T. Vancil were promoted to vice president, according to John D. Hershner, president. Ashley and Swanson will continue in the commercial banking division, while Esperti and Vancil will continue in the trust banking division.

WYOMING NEWS

TORRINGTON: H. D. Shellenberger, Jr., executive vice president of The Citizens National Bank, Boone, Iowa, has accepted the presidency of Citizens National Bank, Torrington. He will also be one of the principals in the ownership of the Torrington bank.



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PROFITABILITY ANALYSIS...

(Continued from front page)

can be set by analyzing a hypothetical high-quality prime-rate loan to determine its yield. Or the profit goal can be the planned profit of the bank or of the lending function translated into a desired yield. The actual yield divided by the profit goal yield will give an index number which will indicate whether or not a loan has achieved its profit goal.

Q. What are the possibilities of profitability analysis?

A. They are tremendous. Some examples:

- Existing loans can be analyzed to see which are profitable.
- Profitability of proposed loans can be predicted and the loan officer guided in negotiating rate and terms.
- The trade-off between compensating balances and interest rates can be quantified.
- The larger the compensating balance, the lower the interest rate can be and still yield a desired profit.
- At management level, it can be used to improve the profitability mix of a bank's loan portfolio.
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credit would "not only stimulate greater investment and employment, but also spur productivity and enhance the competitiveness of the U.S. economy," the Chase Manhattan Bank said recently. One of the econometric forecasts analyzed in the report assumed the enactment of the entire tax bill including the 7% investment tax credit as passed by the House, and other assessed the absence of any investment credit/depreciation package. Comparison of these forecasts showed that, with the incentives by the end of 1973: Business investment would be \$5½ billion, or 4% greater, and the GNP would be raised \$13 billion and personal income by \$11 million. Employment would increase by 380,000 jobs — almost all of them in manufacturing, the Chase said.

MONTANA NEWS

BILLINGS: First National Bank has opened a new drive-in facility according to Al F. Winegardner, Jr., president.

GREAT FALLS: The Glacier Chapter of the Bank Administration Institute will be holding its winter meeting on December 4 at the Rainbow Hotel in Great Falls. The meeting will be on "Bank Security". Lynn S. Meredith, U.S. Secret Service agent, and John M. Reed of the Federal Bureau of Investigation will be the featured speakers.

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