Increasing Fee Income Without Raising Fees

By Sean Payant, Chief Consulting Officer, Haberfeld

Over the last 10 years the banking industry has seen a steady decline in fee income associated with checking accounts – community banks under $10B have seen a 32% decline and banks over $10B have seen a 45% decline in fee income when compared to a 2008 baseline. Many institutions are raising fees. Should you?

One option: start adding minimum balances in order to get additional income from your current customers. Following the lead of big institutions, some community banks have tried to make up fee income by instituting additional account fees with disappointing results.

This is not isolated to the banking industry; other retailers and business have tried this approach.

Case in point, several years ago, Starbucks ran a test where they required a minimum purchase in the drive-thru to encourage those wanting a $1.85 cup of coffee to come into the store. As you can imagine, the pilot-test ended abruptly – less than a month later. What Starbucks really knows is when customers come into the store they will spend more; however, creating a minimum purchase requirement was not the solution, it upset customers and hurt their image in those markets.

As community bankers, we need to look through the lens of the prospective customer. One of the primary reasons consumers switch banking providers is to eliminate monthly checking account service charges. The majority of consumers still do not want to pay for a checking account. Price matters.

In 2010 prior to the implementation of the Dodd-Frank changes related to retail debit cards and overdrafts services, an extremely profitable-midsize bank in the northwest decided to implement a $9 per month service fee on checking accounts. Their fee income dropped dramatically and attrition went up substantially. In a public statement, the CEO ultimately stated the bank made a mistake; however, much of the damage was already done. If monthly service charges aren't the answer, then what is?

UNDERSTAND CAPACITY

Understanding capacity is one of the biggest challenges in the banking industry. Banks have very high fixed costs and very low marginal costs. Each branch is an expensive "factory" that is running at 15%-40% capacity, 50% if you're lucky. The typical community institution averages 1,000-1,200 core relationships per branch. The big banks average 3,000-5,000 per branch. If you have factories running at 30% capacity, your primary objective should be to fill the excess capacity by serving more customers.

Client data shows marginal expenses (core processor, account servicing, etc.) for the next core customer are approximately $30-$50 per year; however, each new core customer generates approximately $300-$500 in revenue each year. Excess capacity allows us to look at the each new customer as a marginal investment who can spin off multiples in revenue.

While not all customers drive the same level of fee income, it is important to create and grow primary financial institute (PFI) relationships. After analyzing millions of core banking relationships, over many years – the data shows for 73% of customers the checking account is the foundation of the relationship, creating opportunities to provide additional products and services.

UNDERSTAND RISK - REMOVE INEFFECTIVE FILTERS

Most financial institutions use some type of screening service during the account opening process. Banks need to understand these services only report negative information, which is rarely updated. Client data consistently shows these systems are not doing what banks think they are doing – reducing fraud. They are, in fact, reducing opportunities to grow fee income by turning away customers who value overdraft services.

What other filters are you using? Do you require a spouse to be present to open a checking account? If your organization does, you need a better process for adding joint signers after account opening. Credit scoring? Stop it. There is no viable reason to evaluate a credit score prior to opening a checking account. How many forms of ID do you require to establish a relationship? One government issued, unexpired ID should be sufficient as long as consumers can provide their Social Security number (not their Social Security card), physical address (does not need to match the address on the ID) and date of birth. Are you in compliance or well beyond? Think through why your bank is saying no today and develop strategies to say yes more frequently.

REVIEW OD/NSF SERVICES POLICIES

Provide everyone with up to $100 of overdraft credit at account opening. People who value this service will not wait 30- or 60-days to utilize it. Be there when your new customer needs you.

We analyzed the subsection of new customers who had an overdraft in the first 30 days. We found over a seven-month period banks were seeing a 51% closure of accounts where the bank required a 30-day waiting period. We then looked at banks that paid overdrafts early within the first 30 days. There was only a 36% attrition rate, meaning 64% of the new customers were still active and 79% of them continued to utilize overdraft services.

Banking is a business of high fixed costs with low marginal costs for the next customer and high additional revenues. Nearly every bank has tremendous capacity. In addition, client data continues to show more accounts equals more profitability and opportunity. The focus should be on growing core customers and making sound decisions in the process. ◆

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