

# forward

A PUBLICATION OF THE FINANCIAL MANAGERS SOCIETY



PROFITABILITY

## MARGINAL IMPROVEMENTS

Reading through the various topics that comprise this issue of things for community institutions to be aware of heading into 2018, it's both remarkable and not at all surprising how many of them can be tied back in one way or another to the concept of profitability. The quest for income stands as the dominant challenge facing FMS members heading into the year according to the results of a recent Quick Poll. Deposit strategies will be made with profitability firmly in mind. Digital banking, branch and lending decisions all stand to benefit from good, solid profitability data.

Yet despite the many foundational ways in which it touches the business, not every institution has firm grasp on how best to measure and analyze its profitability.

"We've conducted surveys with regard to this, and 83% of institutions feel they are not doing enough in terms of profitability measurement," says Ken Levey, a vice president in the Financial Institutions division of Kaufman Hall. "We've been in such a tight margin environment over the past ten years and institutions are fighting for every basis point. So we need to understand for example, which customers, products and departments are bringing the most value to the organization and how we can improve low performers to become, if possible, more profitable."

Levey says that there are several key elements that make up a good profitability system, one of the most important of which is the ability to understand all the components of profitability, including net interest margin allocation (through

**“ Without management developing and communicating the importance of profitability analysis, it is very difficult to be successful in its implementation. ”**

*Ken Levey, Vice President – Financial Institutions, Kaufman Hall*

Funds Transfer Pricing), allocations on non-interest items and the allocation of loan loss.

"Measuring these in a consistent framework with metrics that are easy to reconcile and understand will ensure that the entire team will understand and be able to act on the analysis," he says.

To this last point, Levey notes that any profitability system, however well constructed, is only as good as the extent to which it is utilized throughout the organization. He recommends that every institution establish a cross-functional profitability steering committee that can help determine the goals, metrics and strategy that will guide the use of profitability data and ensure that it's being used in the right ways.

"We find that less than 12% of institutions have such a committee, and those that do are typically more successful in their deployment and usage of profitability analysis," Levey explains. "Without management

developing and communicating the importance of profitability analysis, it is very difficult to be successful in its implementation. A profitability steering committee that is comprised of representatives from across the institution not only helps ensure that all factors are considered as the institution develops the framework of the profitability process, it also helps achieve buy-in once the results are rolled out."

Given the importance of such data to so many different areas, it's probably fair to say that building a better profitability system – or fine-tuning the one already in place – is a worthwhile 2018 resolution for every community institution to consider. The key is to not put it off any longer. ■