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A retail branch profitability measurement model for the thrift industry

Rex L. Smith III

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A RETAIL BRANCH PROFITABILITY MEASUREMENT MODEL FOR THE THRIFT INDUSTRY

A research project submitted in partial fulfillment of the requirements for the MBA degree

by

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SECTION I

BACKGROUND AND PROBLEM

Deregulation of the financial services industry has created a need for management to adapt a different approach to operations. Drastic regulatory and environmental changes have forced thrifts and banks to concentrate on increasing efficiency and core profitability from the retail branch network. Once considered to be highly bureaucratic, financial institutions are trimming back office review and focusing on a more decentralized leaner operation. (Middaugh, 1988) Expensive mergers and large conglomerate financial powerhouses have created a need for increased management controls and reasonable methods of measuring the true profitability of the individual business units within a financial services company.

HISTORY OF THRIFT REGULATION

To fully understand the structural and organizational changes that have been forced upon the industry requires an examination of the regulatory changes that have taken place and the accompanying competitive environment that has evolved. The
first of these changes took place in 1980 when Congress passed The Depository Institutions Deregulation and Monetary Control Act. This law repealed Regulation Q which set the interest rate banks and thrifts could pay on deposits. It also eliminated the set rate differential of 25 basis points between thrifts and banks. The differential gave thrifts a regulated competitive edge over banks.

The 1980 regulation lifted rate limits on the right side of the balance sheet while holding mortgage rates (a major asset category for thrifts) at a set non-competitive price. This allowed rapid repricing of liabilities (cost side) while holding the asset (earnings side) at a regulated low rate. The prime rate at this time soared to new record highs, and many thrifts were caught with mismatched portfolios. While deposit products were very rate competitive and short term in nature, mortgage loan rates remained fixed at low rates with long maturities. This lead to negative spreads and erosion of net worth.

The second major regulatory change took place in 1982 with the passage of The Depository Institutions Act. This law began to eliminate the barriers to interstate banking and permitted banks to set up their own brokerage operations. Later that same year, interest rate restrictions on residential mortgages were lifted and entry barriers into the home mortgage market were
eliminated. By the time full deregulation was phased in, most thrifts had been ravaged by the pricing mismatch and the competition from the deregulated deposit side of the balance sheet. This problem lead most thrifts to search for new methods to rapidly increase earnings. New products and services on both the deposit and loan side were created to emphasize collection of fee income.

High dollar real estate development loans became extremely popular because of the large fees collected up front and the ability of a large variable rate credit to have an almost immediate effect on the ROA of the loan portfolio. However, these credits also have a substantial risk of default that can have an immediate negative effect on ROA and net worth. By the mid-1980's, many thrifts had suffered losses from bad real estate holdings. Others managed to use real estate development to help restructure old fixed rate asset portfolios into profitable variable rate ones that better matched the liability side.

Adoption of Financial Accounting Standards Board statement number 91 eliminated immediate credit of fee income and the desirability of large real estate loans (Financial Accounting Series, 1988). It required that any fees collected in advance on
a loan transaction be amortized to income over the life of the loan instead of going immediately to income. This reduced the potential income stream thrifts had prior to FASB number 91.

The most recent regulation has also created the most change within the thrift industry. The Financial Institutions Reform Recovery and Enforcement Act of 1989 (FIRREA) will eliminate all differences between banks and thrift institutions. This will put extreme pressure on most thrifts to make the balance sheet and core earnings resemble those of a bank. New capital requirements, along with asset mix and risk ranking requirements, are forcing thrifts into a tough and newly competitive arena.

THrift OPERATIONS AFTER DEREGULATION

FIRREA has eliminated direct investment in real estate and has severely restricted the amount of loans that can be made for commercial real estate projects. Seventy percent of assets are required to be in residential mortgage notes, an asset that has carried a very thin margin since the deregulation of 1982. Thrifts must, therefore, look for highly profitable loans to fill the remaining thirty percent of the earning asset category.

There will be a lot of new competition for loans that have traditionally been made by banks. Thrifts must decide what type of new loan products to market and what channel of
distribution to use. The choices for thrifts are: asset based business loans, trust services, and, consumer loans and services including upscale professional and executive lending.

Large banks have dominated the first two categories for some time, and thrifts do not have the manpower nor the expertise to compete against them. The third, consumer services, is something thrifts have had experience with, but mostly from a collection of funds standpoint. Resources must be redirected to place emphasis on the total consumer relationship. A good consumer service base has been the foundation for most banks in establishing long run profitable growth plans (Gopalan, 1988). A solid retail branch network is the key to building that base.

In addition, efficiency of operation of the branch network is imperative. In the midst of all the regulatory changes, technological changes and increased consumer awareness have also added to the competitive pressure. This combination has brought about significant changes in business practices that increased competition between financial institutions. The increased competition is the reason operating efficiency is so important. Of course, achieving operating efficiency assumes an accurate and timely measurement of that efficiency. Most financial institutions have had the luxury in the past of judging efficiency through very broad methods of measurement.
HISTORICAL MEASUREMENTS OF PROFIT

Generally, the focus for profitability is at the macro level and consists of many varied micro returns within the institution. Historically, return on assets (ROA) and return on equity (ROE) have been the primary measurements that financial institutions have relied upon to indicate economic health and critical trends. The traditional assumption holds that if these key ratios are maximized, then shareholder wealth is also maximized. ROA defined is, "The ratio of net profit to total assets, measuring the return on total assets after interest and taxes." (Rao, 1987). Since asset utilization is simply increasing the rate of return on loans or increasing the volume of loans, ROA as defined seems to be a good measure for bank performance. Increased competition and growth has lead banks to emphasize hurdle spread rates on loan assets to ensure a certain level of profitability.

These simple ROA "spread pricing" models are made applicable to both individual credits as well as complete loan portfolios. The purpose is to motivate staff at all levels to continually think in terms of total return to the company. However, banks realize that growth in assets does not necessarily translate to enhancement of stockholder wealth. This is true when new assets generated do not meet planned rates of return. If this occurs, leverage increases because bank assets increase at a rate
faster than the rate at which the bank can create equity capital through earnings. The difference must be funded by additional debt.

Return on equity is considered by some to be a better measurement of performance "because it measures how well the company is employing capital provided by stockholders" (Bedwell, 1986). Improving ROE has become increasingly popular as the result of the increasing number of mergers and acquisitions in the industry. Banks with a high ROE are more difficult to acquire, and if acquired, the price paid per share is at a premium.

While many analysts still use ROA and ROE as the predominant measures of bank performance, as an internal measure of a business unit performance they are weak. First, both are merely snapshot measures pulled from the book entries of the company. Book values fail to account for changes in the value of assets, liabilities, and equity occurring between their placement on the books and their removal by sale, repayment, maturity, or charge-off. The failure of book values to reflect such changes in net worth is a serious problem when a bank is attempting to measure the performance of individual units on a momentum basis. Second, ROA and ROE are subject to a number of variables that may or may not be controlled at the business unit level and,
therefore, may not be translatable to that level. Many times totals and reports of a more macro nature obscure the fact that an outstanding performance of one component, such as a product or branch, can be offset by substandard results in another component. Prospective growth in earnings and potential profitability of each business unit may be much more important as a measure of bank performance (ABA Journal, 1985).

Many institutions use the budget as the sole means of control and performance measurement at the micro level. Budgets can be helpful to evaluate performance, motivate personnel, or to plan for future changes. Unfortunately, many institutions try to accomplish all three purposes using one budgetary device. This does not work. Use of budgets for motivation requires that targets be difficult but attainable, as well as relatively rigid. Use of budgets for planning implies the "most likely" scenario be used. Use of budgets for performance evaluation requires that adjustments be made after the fact to account for unforeseen events. Clearly, these budget characteristics are in conflict with one another (Middaugh, 1988).

PROBLEMS OF PAST MEASUREMENT METHODS

Given the shortcomings of these measurement tools, how does a thrift or any other financial institution go about measuring performance on a micro or subunit level? The answer
requires a look at the organizational structure. First, most institutions have recently gone through a complete structural change. Some change has been in response to the regulatory environment, while other change has come from the need to service newly developed financial products and services designed to help the institution compete in the environment of the future. The additions in products and services have meant whole new departments, adding to the already complex and mammoth structure of financial institutions.

To be competitive, to comply to regulation, and to be profitable are becoming tasks of measuring and controlling the efficiency and effectiveness of each business unit. Organizational structure is the first step to achieve these three goals. There are obviously many variations in corporate structure, each with a particular emphasis and purpose. There are; centralized management and decentralized management, top down and bottom up, and matrix management. In some cases, one division of the institution may be completely different from another in respect to its management structure. At this crucial first step, the question then becomes "what type of structure do we need for our company?".

For the thrift industry the answer has been dictated to the institution through regulation. The structure needed is the one
that best motivates efficient retail banking production through the established branch network. It becomes imperative that each institution consistently and accurately measure the performance of each branch as a decentralized independent unit (Faletti and Harty, 1989).

In the past, such measurement has typically consisted of three generic branch goals: 1) performance of expense control as it relates to a predetermined and focused budget, 2) performance of deposit intake ability and, 3) performance as it relates to the quality and quantity of loan business generated. On the surface, this seems to be an adequate form of measurement for a retail branch or a unit of branches. These three items seem to summarize the role of the retail branch within the organization.

The problem with all three measurements is that their contribution to profitability is usually not specifically or correctly defined. For example, most branch expense budgets contain such items as "equipment depreciation" or "equipment repair and service". To be effective, expense control must involve more than a budget. A system for costing and cost allocation must be used in measuring expense (Dallas-Feeney, 1989).
Production goals can be effective but are usually reduced to "more is better." Different products vary significantly in service costs, fee income, and interest rate risk.

Some institutions use spread pricing models to measure production. Spread pricing models attempt to measure the average asset cost against the average loan yield and give the branch its true margin on those funds. Most branches, however, directly lend out less than twenty percent of their total deposits. What credit, if any, does the branch receive for its excess deposits?

This question as well as the expense and budget questions raised earlier point to the main issue of analyzing branch profitability. It is a question of transfer pricing, i.e. the role of the branch within the organization and how profits and costs are allocated on a regular basis. It can be seen that the previous methodology merely raises more questions than it answers. Given that an efficient and profitable branch system is imperative to the long run survival of the organization, the first step is to define in detail all of the components that could possibly be considered in evaluating branch performance.
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ORGANIZATIONAL STRUCTURE OF A THRIFT

A typical thrift is divided into three or four very distinct divisions. These include: (1) a real estate investment division, (2) a subsidiary group of related entities, and (3) a retail banking division. Some thrifts will also run a separate mortgage banking division.

(1) The real estate division is usually responsible for joint venture development of all types of real estate, from single family residential neighborhoods to large commercial retail and office centers. This division may also include income property lending as well as construction and permanent mortgage lending. Under the new legislation (FIRREA), all joint venture activity must be divested and the amount of lending done on nonresidential property has been severely restricted. No more than four hundred percent of capital can be loaned out in commercial real estate. This equates to approximately ten percent of assets for a typical thrift.

(2) The subsidiary group includes all sorts of small,
vertically integrated companies such as leasing corporations and title insurance companies. These subsidiaries are usually not a drain on the capital of the parent institution and are typically managed independently. Subsidiary companies have also been eliminated under FIRREA unless the subsidiary is separately capitalized and conducts business at "arms length".

(3) The retail banking division consists of a branch network responsible for the majority of funds inflow and all consumer lending. In addition, there also may be a wholesale funds group to facilitate balance sheet management. Most of the back office functions at a thrift revolve around supporting the retail branch network and residential mortgage lending.

RETAIL BANKING PERFORMANCE

Under the new regulatory environment, a majority of the income must be made by and through the retail branch network. The responsibility of the branch must change within the corporate structure if the institution wants to survive in the new environment. The purpose of this paper is to develop a means of accurately assessing the profitability of each branch within a retail network. It is imperative for management to communicate the expectation of profit for each branch in the system. Losers must be identified early and eliminated.
But when is a branch considered a loser? The performance of a branch can vary drastically depending upon the methods used for costing funds or allocating overhead. In a thrift, the size of the infrastructure and the number of ancillary products and services that cross divisional lines make the method of determining profit a very difficult problem.

To overcome this problem, management must determine several key assumptions before developing a branch profit model. First, the purpose of the profit model must be well defined. Purpose will help determine the degree of accuracy needed, as well as, the basic guidelines for associating costs and revenues with the branches. The purposes are: 1) to create a usable scheme that accurately reflects the true contribution of each branch and 2) to create a motivational tool for production and efficiency of operation.

The second assumption is that the simplest model is the best model. It is important for the model to be easily understood by the branch staff. Understanding will speed acceptance.

The third decision involves the cost of information. For many industries, cost and revenue information can be easily traced to finite sources. Unit contribution margins for each product are usually straightforward with respect to revenues and
direct, variable costs. This is not the case for most financial service companies. Information on individual product margins can be difficult and costly to specifically define. Management must decide upon an acceptable level of information and accuracy given the cost of information restraint.

The last assumption is that the measurement of branch performance must have a consistent theoretical base. No measurement model will be useful unless it is based upon accepted standards that correctly and consistently shows accurate results.

RESPONSIBILITY ACCOUNTING AS THE SYSTEM OF MEASUREMENT

To follow these assumptions, the profit measurement should utilize responsibility accounting. Responsibility accounting is a system that measures the plans and actions of each responsibility center in the organization (Horngren and Foster, 1987). Typically there are four major types of responsibility centers. They are: (1) cost center; accountable for costs only, (2) revenue center; accountable for revenues only, (3) profit center; accountable for costs and revenues, and (4) investment center; accountable for costs, revenues, and investments. Ideally this system traces costs and revenues generated to the individual at the lowest level of the organization which handles the primary day-to-day decision responsibility for the items.
Under the responsibility method, each branch within the retail network would be identified as a profit center. This is appropriate since under the new regulations, the role of a typical thrift branch has been drastically changed. The old role was simply to be a majority provider of funds for the institution. The new role is to be not only the provider of funds, but also the provider of assets. A typical description of branch responsibility submitted to the Office of Thrift Regulation would mention, "delivery of many varied financial products and services to a described market area". It would also contain phrases such as, "meeting established profitability goals", or "productivity goals of deposit and loan products". In other words, the role of the branch is to take in as many deposits as possible and to lend out as much money as possible in an efficient manner.

This can best be accomplished by building a measurement model based upon the responsibility accounting concept of the profit center. In a profit center, the manager is responsible for both costs and revenues. Since branches will be under added pressure to generate loan volume (revenue), the accountability of both cost and revenue is crucial. In addition, the profit center concept can be employed in a simple and straightforward manner. This makes it cost efficient, and easy to understand.
ESTABLISHING THE PROFIT CENTER CONCEPT

To establish the profit center concept, it is necessary to identify all sources of income and expense that could possibly be attributed to a branch and, then, logically define a method for determining which are appropriate. A branch profit model must define: 1) the sources and uses of funds, 2) the costs and yields and, 3) a method of "fairly" pricing excess funds. Some additional issues that need to be contended with are: (1) reserve requirements, (2) regulatory allocations of funds, (3) amount of credit given for excess funds, (4) method of expense allocation, (5) credit for "foreign transactions", and 6) federal insurance premiums. These issues can and should be addressed one at a time as the profitability model is built.

There are other functions that are a crucial part of branch activity that are not production oriented. These include: audit reporting, control requirements, and security and safety requirements. However, these are secondary responsibilities, since they are merely offshoots of the production function.

Deciding which activities to include in a branch profitability model requires a consistent and theoretically correct approach to the defining costs and revenues. The contribution approach will be used to define the profitability of each branch because, "The contribution approach to cost
allocation...attempts to respond simultaneously to the purposes of economic decisions and motivation" (Horngren and Foster, 1987). This method matches the original purposes of the model. Under this method, costs are not allocated unless they are clearly traceable to the branch network.

The problem occurs when making the distinction between controllable and uncontrollable costs. Controllability is the degree of influence that a specific manager has over the costs or revenues in question (Horngren and Foster, 1987).

Ideally, the system will omit uncontrollable costs from the determination of contribution. Unfortunately, controllability is difficult to pinpoint because few costs and revenues are clearly under the sole influence of one manager. As each category of expense and revenue is reviewed, the distinction must be made based upon the contribution of that category to the overall responsibility of the branch.

DEFINING EXPENSES

Thrifts are formed under either a state or a federal charter. Bank charters are created under a National Charter termed "Association" (hence N.A. follows the bank name). In any case, the governing body of the charter requires that the institution submit an application for approval for each new
branch location that it desires to open. The premise of the application is to prove that there is both sufficient demographics to support another branch bank in the proposed trade area and that the branch can show profitability in a "reasonable" length of time.

The income statement section of the application lists a series of expenses that can be categorized as: (1) interest expense (or cost of funds), (2) personnel expenses, (3) occupancy expenses (4) equipment expense (5) marketing expense, and (6) miscellaneous expenses. Most institutions use similar categories. Each expenses must be reviewed using the contribution approach to see if it should be incorporated into the branch profit model.

Once expenses and revenues are defined, a "spread pricing" model can be established to measure the potential profitability of each branch. A spread pricing model is a method of establishing income for each branch. It determines the amount of credit a branch will receive for loans generated and for deposits not lent. In effect it prices the "spread" between loans and deposits for the institution.

EXPENSE RECOGNITION

Interest expense is probably the easiest classification
because it involves only one item. It is the interest paid on the deposits a branch takes in over a period of time. This obviously meets the first criterion of responsibility accounting. It is directly associated with the production of deposits.

But, is interest expense controlled by the manager? Different demographics produce different types of deposits which vary in cost. For example, a branch located in an affluent neighborhood with a mean household age greater than fifty will usually have a heavy concentration of certificates of deposits. Interest expense on certificates is higher than any other deposit account. The location of the branch can make a difference in the deposit expense for that branch.

Since the manager does not make the decision of where to build a branch (or even its physical characteristics and capacity), there is an argument that the interest expense of each branch should not be allocated as it occurs but pooled together and averaged so each branch is assigned the same cost for deposits. The only variation between branches would be from the total dollar amount of deposits. The manager is not penalized by a potentially bad location decision made somewhere else in the company.
The trouble with that argument is that it hides a real expense that is necessary to judge performance. If a branch only attracts expensive deposits, the management of the institution should know this in evaluating the strategic position of that branch in the corporate system. Also, it is important to track changing trends as the deposit mix of branches change. A blended rate does not accomplish this. Thirdly, an argument can be made that managers do have the ability to control the deposit mix of a branch. Product knowledge, better service techniques, and cross product selling have proven to be successful in promoting products that previously have not been sold in certain demographic areas. Therefore, the cost of funds expense should be accounted for as actually incurred.

While the argument for a pooled rate may seem a bit unusual, it does illustrate the point that the issues of responsibility and controllability can be difficult. When building a profitability model it is necessary to keep the big picture in mind as the distinction between controllable and uncontrollable items is made. It is important to remember the overall goals of the model as decisions of cost and revenue assignments are made.

The next category of expense is personnel costs. These expenses typically involve all costs associated with labor in the
branch. They include benefits and perquisites, such as, providing food services and education benefits. Most of the individual expense accounts in this category are easily tracked to a particular branch of origin. They are definitely controlled by the manager of the branch because the term "manager" refers to the responsibility of managing the people of the branch. In almost all cases, the responsibility is matched by the authority. Therefore, all cost associated with the personnel of a branch should be included in the expense of that branch.

The remainder of the expense categories cannot be traced to the branch in such a direct manner. Occupancy expense is a broad category that usually includes both real and intangible expenses associated with the physical location. It includes such items as rents, maintenance, taxes, utilities, and depreciation. While it may be obvious that such expenses are necessary for the production effort, the question of control of these expenses is a bit more difficult. However, these expenses are necessary to the daily operation of the branch and should be included as expenses for the branch. It is important for managers to be aware of the wide range of costs incurred in operating a branch.

The same logic should also apply to the category of equipment expense. All items listed are used in the daily production effort which is the responsibility of the branch to
the corporation. Therefore, these items should be expensed against the branch.

The last two categories of expenses are discretionary in nature rather than committed. Discretionary costs are costs arising from periodic or budget appropriation decisions that directly reflect executive management decisions (Horngren and Foster, 1987).

Marketing costs can be specific or general in nature depending upon the purpose. Image advertising for the company as a whole may or may not have a specific benefit to branch production. The contribution approach says that if the costs are not clearly traceable to a particular segment, they should not be generally allocated. Because of the difficulty in tracing them, and because the decision for marketing expense is made by executive management, these costs should not be allocated to the branch network.

Miscellaneous expenses should be reviewed to determine which ones are directly associated with production in the branch. Any expenses previously allocated from other divisions should be eliminated. Any expenses that cannot be directly traced should
Some costs are associated with a particular branch product, but are not generated by a branch. This creates a problem. The Automatic Teller Machine (ATM) cards are a prime example. The cards are sold at the branch level as an added benefit for checking accounts. The cards, however, generate an expense each time they are used. This expense is not traced by the origin of the card. Typically, all card expenses are grouped by machine and summed together. The total is then allocated back to the branches on a percentage of machine use basis. Those branches without a machine are not responsible for any expense even though they give cards to their customers. The costs are tracked this way because the expense of tracing each transaction cost to a particular card would be prohibitive.

This is a prime case where management must follow the contribution assumption and not allocate any of the cost. It is not clearly traceable to a finite source. This assumption may seem to distort the accuracy of the profit model, but in reality, any significant costs are usually traceable. Any costs that are not traceable are usually that way because they are so insignificant it is not cost efficient to attempt to track them. If top management finds a significant cost that is not traceable, they should take a hard look at whether or not it is allocated to the branch network. If it is, a fair method of allocation should
be used so managers "buy in" to the expense as part of their operation.

Deciding which expenses to include in the branch model may appear difficult, but it is not impossible. It should be done with two basic thoughts in mind; the ultimate goal of the model, and the cost benefit analysis of information. With these assumptions, and the contribution approach in mind, the task can be accomplished.

REVENUE RECOGNITION

The same contribution approach should be used to review sources of branch revenue. While the income of a branch seems to be direct and straight forward, the allocation of "excess funds" is the major determining factor of branch profitability. Excess funds are deposits attributed to a branch that are not lent back out directly by that branch. In other words, excess funds are net deposits minus net loans on a branch by branch basis.

These funds are given to other lending groups in the company. The profit made between the cost of those funds and the return on the different loan portfolio is called the "corporate margin." There are many ways to handle the margin allocation and each one has a different effect on the branch profit.
Most institutions use a "pooled" rate of return and credit this against the cost of the excess deposits. The pooled rate is the composite rate of all the other lending areas. In most cases, the earnings rate applied to excess deposits is between one and two and a half percent above the cost.

Under the contribution method, interest income and interest expense should be recorded on an all inclusive basis. Total interest margin must be allocated to those segments where interest income is generated. Since the branch network is usually responsible for less than 30% of the total loan portfolio, the net margin is split among several different lending groups. The question is how to assign the margin between these divisions.

Because other loan departments do not generate their own funds, they must "buy" their money from the branch network. The "price" of these funds can be determined in several ways. It is simply an issue of transfer pricing between two divisions of the organization. The branch network is the seller and the other loan divisions are the buyers. Management has the choice of several basic methods: 1) cost based pricing, 2) arbitrated pricing, 3) dual pricing, and 4) competitive pricing. Standard
cost accounting states that the best potential method should be based upon the ability of the buyer and the seller to market their "product" outside of the company.

Unfortunately, the decision is not this simple. In the financial services industry, it is difficult to say whether a buyer or seller of money could do their business outside of the company. The user of funds in a financial institution really has only two choices for sources of funds. The first is, obviously, the branch network. The second is from borrowed funds or wholesale operations.

Borrowed and wholesale funds are usually short term in nature and more expensive than branch deposits. Typically they would only be used to match against a short term loan portfolio such as single family construction lending. Because of their high interest rate and short term maturity, these funds are used only when the resource of branch funds has been exhausted or when funds are needed for a very short period of time. Therefore, these funds cannot be considered a viable alternate source for the loan departments. This leaves the retail branch network as the one true source of funds.

The branch network, on the other hand, has several buyers of funds including themselves. The branches are open to a
marketplace while the lending groups are not. The solution to the pricing of funds should be **dual pricing**. Dual pricing uses two separate transfer pricing methods to price each interdepartmental transaction (Hermanson et al, 1980). It is obviously an arbitrary number set by management. Management should, however, remember the purposes of the model and utilize the contribution approach to decide what the price paid for funds.

The purpose of the model is to motivate the branch to peak production. Selling excess funds is not as efficient as lending them out at the branch level. It is certainly not peak production. The transfer pricing method should encourage more loan production at the branch level. This produces economies of scale and expands consumer relationships.

Since the method of pricing is somewhat arbitrary to begin with, it should be used to encourage compliance with the strategic plan of the company. This can be done without a drastic affect on the accuracy of the model. One general rule should be observed in establishing the selling price. Funds should never be sold below their costs. This might discourage a manager from aggressively seeking new deposit business.
for loans generated in the branch than for funds sold to other divisions. This can be accomplished by establishing a price for sold funds that is between the costs of those funds and the average rate of return for loans in the branch. If the credit for excess funds is barely above their cost, then the more incentive a manager has to produce branch loans.

The typical gross ROA on a corporate loan portfolio is four percent. This translates to a four hundred basis point spread above the average cost of funds. Zero percent is the point where loan yield equals the cost of the deposits. Because branch loan production is so important and competition for consumer loans is fierce, the rate paid on excess funds should be tiered based upon the percentage of deposits lent out.

The more deposits a manager lends back out in loans, the more credit is given for excess funds. This structure encourages managers to lend aggressively up to the point where it becomes less prudent to continue to lend. That point is defined by the federal reserve requirements. Each branch must keep part of the deposit base liquid. The law requires twenty percent reserve for all liquid deposits and six percent for all others.

Each branch has its own distinct reserve requirement based upon its deposit mix. The contribution method defines reserve
requirements as a traceable item and, therefore, one to account for in the profit structure. The tiered credit system should encourage aggressive lending up to the needed reserve amount. At that point, the credit for excess funds should begin to exceed the potential yield on any branch loan. This still encourages deposit intake but discourages lending beyond required reserves. This creates a reasonable and feasible method of income recognition for the major revenue category, credit for excess funds. In reality, most branches would never have a loan portfolio large enough to achieve that point.

All other sources of income are fee related and should be easily traced to the branch of origin. These include both deposit account fees and loan fees. In addition, some ancillary product fees may be shown as branch revenue. This would include for example: credit card fees, safety deposit box fees, and travelers check fees.

The last issue that needs to be addressed with regard to the model is the cost of "foreign" transactions. A branch transaction is considered foreign if the branch that originated the account does not service transactions on that account. The branch that services the account spends their labor hours while the originating branch gets credit for the deposit balance.
There are really only two feasible ways to handle this dilemma. The first way would involve tracking transactions by branch to see which ones are foreign. Then, a method of charging-back the service costs to the originating branch would be developed. The second way is to assume that a lot of foreign transactions occur within the system every day and that they probably come close to equating over time. This should be the preference, since the costs and time of tracking the transactions would be large.

REFERENCES

Section II


Once the appropriate income and expense categories have been defined, the actual branch profit model can be set up on computer spreadsheet software. The format of the spreadsheet should be based upon the same assumptions as the model. Therefore, the inputs of the model should be well defined categories of revenues and expenses, and the output should be easily understood by branch managers.

Because managers are accustomed to analyzing income statements for loan requests, the model should be designed in income statement form. The model output should show actual revenue, expense, and profit data on a month by month basis. It is also possible to design the model to compare actual monthly results against predicted goals on a monthly basis.

The model utilizes established spreadsheet format. The spreadsheet is divided into two distinct sections for data input.
and results output. The data input section lists the major
determinants of branch income and expense in column form in the
top left corner. The calendar months are labeled across the top
for each category. This allows easier input of data, as well as,
a year to date approach to the measurement of profit.

The second section of the model performs the actual
calculations for income and expense and lists the resulting
output by category. The model is extremely flexible, since the
major category calculations are done using cell references and
not absolute numbers. Less significant determinants, such
as direct expenses and fee income, are manual inputs since these
categories are independent of any other references. Total
expenses are subtracted from total revenue to form the monthly
branch profit (or loss). The monthly profit output is then
summed for a year to date figure. All figures are as of the
current month end. An example of the model and an explanation of
the cell labels and references follows.
### BRANCH PROFIT MODEL

**INPUT SECTION**

<table>
<thead>
<tr>
<th>Jan</th>
<th>Feb</th>
<th>Mar</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>TOTAL BRANCH DEPOSITS</strong></td>
<td>$7,000,000.00</td>
<td>$7,500,000.00</td>
</tr>
<tr>
<td><strong>TOTAL BRANCH LOANS</strong></td>
<td>$700,000.00</td>
<td>$750,000.00</td>
</tr>
<tr>
<td><strong>BRANCH COST OF FUNDS</strong></td>
<td>8.00%</td>
<td>8.00%</td>
</tr>
<tr>
<td><strong>BRANCH AVG. LOAN YIELD</strong></td>
<td>11.875%</td>
<td>11.875%</td>
</tr>
<tr>
<td><strong>CHARGE-OFFS AND RESERVES</strong></td>
<td>$0.00</td>
<td>$0.00</td>
</tr>
<tr>
<td><strong>TOTAL EXCESS FUNDS</strong></td>
<td>$6,300,000.00</td>
<td>$6,750,000.00</td>
</tr>
<tr>
<td><strong>YIELD ON EXCESS FUNDS</strong></td>
<td>9.00%</td>
<td>9.00%</td>
</tr>
</tbody>
</table>
# PROFIT CALCULATION

## REVENUE:

<table>
<thead>
<tr>
<th></th>
<th>JANUARY</th>
<th>FEBRUARY</th>
<th>MARCH</th>
</tr>
</thead>
<tbody>
<tr>
<td>Branch loan income</td>
<td>$6,927.08</td>
<td>$7,421.88</td>
<td>$7,916.67</td>
</tr>
<tr>
<td>Charge-offs</td>
<td>$0.00</td>
<td>$0.00</td>
<td>$0.00</td>
</tr>
<tr>
<td>Net branch loan income</td>
<td>$6,927.08</td>
<td>$7,421.88</td>
<td>$7,916.67</td>
</tr>
<tr>
<td>Deposit earnings credit</td>
<td>$47,250.00</td>
<td>$50,625.00</td>
<td>$54,000.00</td>
</tr>
<tr>
<td>Safety deposit box rent</td>
<td>$300.00</td>
<td>$300.00</td>
<td>$350.00</td>
</tr>
<tr>
<td>Service charge fees</td>
<td>$1,500.00</td>
<td>$1,500.00</td>
<td>$1,800.00</td>
</tr>
<tr>
<td>NSF and overdraft fees</td>
<td>$2,000.00</td>
<td>$2,100.00</td>
<td>$2,200.00</td>
</tr>
<tr>
<td>Travelers check fees</td>
<td>$140.00</td>
<td>$140.00</td>
<td>$140.00</td>
</tr>
<tr>
<td>Loan fees</td>
<td>$1,000.00</td>
<td>$1,500.00</td>
<td>$2,000.00</td>
</tr>
<tr>
<td>Other income</td>
<td>$0.00</td>
<td>$0.00</td>
<td>$0.00</td>
</tr>
<tr>
<td><strong>TOTAL REVENUE</strong></td>
<td><strong>$59,117.08</strong></td>
<td><strong>$63,586.88</strong></td>
<td><strong>$68,406.67</strong></td>
</tr>
</tbody>
</table>

## EXPENSE:

<table>
<thead>
<tr>
<th></th>
<th>JANUARY</th>
<th>FEBRUARY</th>
<th>MARCH</th>
</tr>
</thead>
<tbody>
<tr>
<td>Branch cost of funds</td>
<td>$46,666.67</td>
<td>$50,000.00</td>
<td>$53,333.33</td>
</tr>
<tr>
<td>Personnel expense</td>
<td>$8,500.00</td>
<td>$8,500.00</td>
<td>$8,000.00</td>
</tr>
<tr>
<td>Occupancy expense</td>
<td>$4,000.00</td>
<td>$4,000.00</td>
<td>$4,000.00</td>
</tr>
<tr>
<td>Equipment expense</td>
<td>$3,000.00</td>
<td>$3,000.00</td>
<td>$3,000.00</td>
</tr>
<tr>
<td>Miscellaneous expense</td>
<td>$100.00</td>
<td>$100.00</td>
<td>$100.00</td>
</tr>
<tr>
<td><strong>TOTAL EXPENSE</strong></td>
<td><strong>$62,266.67</strong></td>
<td><strong>$65,600.00</strong></td>
<td><strong>$68,433.33</strong></td>
</tr>
</tbody>
</table>

## BRANCH NET PROFIT

<table>
<thead>
<tr>
<th></th>
<th>JANUARY</th>
<th>FEBRUARY</th>
<th>MARCH</th>
</tr>
</thead>
</table>

## YEAR TO DATE PROFIT

<table>
<thead>
<tr>
<th></th>
<th>JANUARY</th>
<th>FEBRUARY</th>
<th>MARCH</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>($3,149.58)</strong></td>
<td><strong>($5,162.71)</strong></td>
<td><strong>($5,189.38)</strong></td>
<td></td>
</tr>
</tbody>
</table>
**TOTAL BRANCH DEPOSITS**

This cell contains the actual total dollar deposit amount of the branch at the current month end.

**TOTAL BRANCH LOANS**

Total branch loans is the actual dollar loan amount outstanding for the branch as of the current month end.

**BRANCH COST OF FUNDS**

Branch cost of funds is calculated by taking the weighted average interest rate of all the deposit products of the individual branch.

**BRANCH AVERAGE LOAN YIELD**

Branch average loan yield is the weighted average yield of each loan category in the individual branch portfolio.

**CHARGE-OFFS AND RESERVES**

This category refers to any branch loan amount that has been classified as a non-performing asset. A loan is non-performing when the normal payment is delinquent by more than 90 days and it is doubtful that the principal balance of the loan will be
recovered. This balance is entered into the cell to be subtracted from branch loan income. In addition, some loans require that a specific reserve be set aside because they have been assessed as a potential loss. Any specific reserve amount must also be input in this field to be subtracted from the branch loan income.

A negative entry in this cell refers to a loan recovery. Periodically a loan that was previously charged-off can be will be repaid in part or in full through collection efforts. Any dollar amount that is recovered should be credited back to the branch as loan income. A negative charge-off accomplishes this.

**TOTAL EXCESS FUNDS**

Total excess funds is simply total branch deposit dollars minus the total branch loan amount. This is the amount that can be "sold" to other loan divisions within the thrift.

**YIELD ON EXCESS FUNDS**

The interest rate yield assigned to the branch for "selling" its excess funds to other lending areas is the yield on excess funds. Based upon the assumptions used to develop the model this yield will be 100 basis points above the branch deposit cost.
PROFIT CALCULATION

In this section, the cell references from the input section are used to calculate the following: branch loan income, charge-offs, net branch loan income, deposit earnings credit, and branch cost of funds. Input cells for other fee and expense categories are also contained in this section. Finally, totals for the revenue, expense, and profit figures are calculated. This section is designed as a simple income statement so that the flow of the information is easy to follow.

The model is designed to allow additions to the revenue and expense categories. Management can decide how simple or complicated the final output should be. However, if too many changes are incorporated the model may lose validity.

SAMPLE MODEL RESULTS

The sample numbers used in the model came from a typical thrift branch open for a one year period (Sheshunoff, 1989). The results show a distinct logical relationship between the input factors and the output totals. Since branch profit measurement is relatively new, there is not a lot of historical data to verify the findings of the model. There are however, several facts that indicate the relationships within the model and the final outputs are accurate and useful.
The validity of the model is substantiated by several industry statistics. Statistics from the Federal Deposit Insurance Corporation show the breakeven point for a typical thrift branch should occur where total deposits are approximately eight million dollars. The results of the model at that level concur with the F.D.I.C. findings.

The sample branch numbers also substantiate the validity of the relationship between loan volume and total profit, using the responsibility approach. The model shows the importance of having a good loan to deposit ratio and a good loan yield to cost of funds ratio. The larger the ratios, the more total profit increases. This will encourage managers to be sensitive to pricing issues on both sides of the balance sheet. In addition, the model shows the results of added fee income and the effect of expense control to the total profit figure.

The model gives branch managers the opportunity to understand how even the smallest branch decisions (like waiving overdraft fees) affect the total monthly profit of the branch. This information should give focus and direction to the managers regarding total profitability and efficiency of operation.
Executive management can use the output generated by the model to judge the performance of each branch to decide if the capital expended is achieving the appropriate return. This is very important in an industry where capital is desperately needed for survival. An accurate assessment of contribution from each branch in the retail network is the key to enforcing the correct use and return on capital. If the model guidelines for the contribution approach and responsibility accounting are followed, then the resulting branch profit numbers should represent an appropriate measure of the branch contribution to corporate profitability. "When branches are set up as a profit center, profitability reports must be used to meet overall organizational goals" (Mickle, 1985).

REFERENCES


Sheshunoff, Alex. The Branches of Virginia. Sheshunoff Information Services, Inc., 1990
SECTION IV

SUMMARY

THE NECESSITY OF A BRANCH PERFORMANCE MODEL.

For years thrifts have operated on the premise that the branch network was simply the source of funds for other key lending divisions. The passage of FIRREA has put pressure on thrifts to "go back to basics" and to become profitable from core operations. A sound and reasonable estimate of branch profitability has become the key to survival for thrifts in today's competitive, deregulated environment.

Developing a branch profit model takes time, but the result is a favorable impact on the strategic position of the institution. Thrifts must be concerned with overall branch performance and the ability to set attainable goals. A good estimate of revenues and expenses at the micro level helps provide better information, and focus, to improve daily decisions that have long term effects on corporate profitability.
Unfortunately, historical measurements of thrift performance do not translate to the branch level. ROA and ROE fail in the attempt to create an accurate and timely measurement of branch profitability. Budgets can be useful under some circumstances, but again fail to communicate true branch profitability. The key to measuring branch performance is the development of a system to track individual branch revenues and expenses.

Numerous software packages exist in the market that claim to provide profitability analysis. However, a majority of these packages are more concerned with the macro level. The profit measurement systems at the business unit level contain standardized numbers for allocating direct transaction fees. They also recommend the allocation of corporate overhead to each branch or business unit.

This type of profit measurement ignores the true importance of the branch focus. The first objective of a branch profitability model is to build branch efficiency by having an accurate assessment of regular performance. Standardized costs and overhead allocation distort the true performance measurement of the branch. Corporate overhead should be judged as a separate cost issue. Strategically sound decisions require that executive management know the contribution of each branch as an independent profit center.
The second objective is to motivate the branch staff to perform at the highest level. Accountability is the key to motivation. If managers are not held accountable for the decisions they make, then the system lacks incentive. Accountability can not happen without a reliable measure of performance. Only when performance is measured with a well defined and accurate system is there a basis for a goal oriented culture. A branch profitability model provides this measurement.

WHY THE RESPONSIBILITY MODEL WORKS

The model developed in this paper provides the information necessary to accurately measure individual branch profitability. The profit center concept developed under the responsibility accounting method matches the new role of the thrift branch as a provider of revenue, and not simply cost. The model addresses the cost accounting issues that other models have ignored in the past. Using the contribution approach to define revenues and costs, the model develops a standard for branch profit that is theoretically sound.

In addition, the format of the model makes it simple to use and easy to interpret. The model combines normal budget cost measurements with goal performance issues to create a more inclusive measurement of performance than other models have.
accomplished. A thrift that uses this model will have a strategic competitive advantage over other financial institutions that do not have an accurate picture of retail branch performance.

The responsibility model encourages branch managers to exert control over the factors that influence branch performance. The model is also a superior training mechanism for managers because it gives them a clear understanding of the thrift’s financial criteria, how they affect profitability, and how more efficiency can be generated.

The future for the thrift industry lies in the ability to create sound income from basic branch operations. A system to measure individual branch performance is the first step towards this goal. Once a system is in place to measure branch performance, then management can move towards more accurate product performance measurements. This added direction to the strategic planning process will help management establish priorities for resource allocation. Perhaps then thrifts will begin to recognize the importance of knowing product and transaction cost when making strategic corporate decisions. The model developed in this paper is the base for such a system of information. Responsibility accounting reinforces the profit center concept and promotes greater efficiencies throughout.
This increased efficiency will enable thrifts to create a profit from core branch operations which will sustain the capital needed for long term viability.
APPENDIX A

Formulas for the spreadsheet model calculations
(Enable 2.0 Integrated Software Program)
APPENDIX A

B8:  +B3-B4  
B13:  +B4*B6/12  
B14:  +B7  
B15:  +B13-B14  
B17:  +B8*B9/12  
B24:  @sum(B15..B23)  
B27:  +B3*B5/12  
B32:  @sum(B27..B31)  
B34:  +B24-B32  
B36:  +B34  
C8:  +C3-C4  
C13:  +C4*C6/12  
C14:  +C7  
C15:  +C13-C14  
C17:  +C8*C9/12  
C24:  @sum(C15..C23)  
C27:  +C3*C5/12  
C32:  @sum(C27..C31)  
C34:  +C24-C32  
C36:  +B36+C34  
D8:  +D3-D4  
D13:  +D4*D6/12  
D14:  +D7  
D15:  +D13-D14  
D17:  +D8*D9/12  
D24:  @sum(D15..D23)  
D27:  +D3*D5/12  
D32:  @sum(D27..D31)  
D34:  +D24-D32  
D36:  +C36+D34  
E8:  +E3-E4  
E13:  +E4*E6/12  
E14:  +E7  
E15:  +E13-E14  
E17:  +E8*E9/12  
E24:  @sum(E15..E23)  
E27:  +E3*E5/12  
E32:  @sum(E27..E31)  
E34:  +E24-E32  
E36:  +D36+E34  
F8:  +F3-F4  
F13:  +F4*F6/12  

APPENDIX A

F14: +F7
F15: +F13-F14
F17: +F8*F9/12
F24: @sum(F15..F23)
F27: +F3*F5/12
F32: @sum(F27..F31)
F34: +F24-F32
F36: +E36+F34
G8: +G3-G4
G13: +G4*G6/12
G14: +G7
G15: +G13-G14
G17: +G8*G9/12
G24: @sum(G15..G23)
G27: +G3*G5/12
G32: @sum(G27..G31)
G34: +G24-G32
G36: +F36+G34
H8: +H3-H4
H13: +H4*H6/12
H14: +H7
H15: +H13-H14
H17: +H8*H9/12
H24: @sum(H15..H23)
H27: +H3*H5/12
H32: @sum(H27..H31)
H34: +H24-H32
H36: +G36+H34
I8: +I3-I4
I13: +I4*I6/12
I14: +I7
I15: +I13-I14
I17: +I8*I9/12
I24: @sum(I15..I23)
I27: +I3*I5/12
I32: @sum(I27..I31)
I34: +I24-I32
I36: +H36+I34
J8: +J3-J4
J13: +J4*J6/12
J14: +J7
J15: +J13-J14
APPENDIX A

J17: +J8*J9/12
J24: @sum(J15..J23)
J27: +J3*J5/12
J32: @sum(J27..J31)
J34: +J24-J32
J36: +I36+J34
K8: +K3-K4
K13: +K4*K6/12
K14: +K7
K15: +K13-K14
K17: +K8*K9/12
K24: @sum(K15..K23)
K27: +K3*K5/12
K32: @sum(K27..K31)
K34: +K24-K32
K36: +J36+K34
L8: +L3-L4
L13: +L4*L6/12
L14: +L7
L15: +L13-L14
L17: +L8*L9/12
L24: @sum(L15..L23)
L27: +L3*L5/12
L32: @sum(L27..L31)
L34: +L24-L32
L36: +K36+L34
M8: +M3-M4
M13: +M4*M6/12
M14: +M7
M15: +M13-M14
M17: +M8*M9/12
M24: @sum(M15..M23)
M27: +M3*M5/12
M32: @sum(M27..M31)
M34: +M24-M32
M36: +L36+M34
APPENDIX B

State of Virginia Application to Establish a Thrift Branch
APPLICATION TO ESTABLISH A BRANCH

APPENDIX B

INFORMATION AND INSTRUCTIONS

This application form has been designed to elicit the minimum information required by the Bureau of Financial Institutions for the purpose of determining whether a particular applicant ought to be granted a certificate of authority to establish a branch office. However, it is the applicant's responsibility to furnish additional information to demonstrate that such authorization will be in the public interest as defined in §6.1-13 of the Code of Virginia. If the space allotted is insufficient, a separate page should be used. Additional information and documents must be submitted on 8½" X 11" paper.

A check for $1,500, payable to the Treasurer of Virginia, must accompany the application. Copies of the following documents, as well as the application, must be filed in duplicate.

1. An executed lease or letter of intent from owner(s) of property to be leased, or executed purchase agreement.

2. A scaled map showing the proposed trade area and the locations of financial institutions having trade areas which overlap the applicant's proposed trade area.

3. A detailed current balance sheet, itemizing investments in land, buildings, leasehold improvements, furniture, fixtures, and equipment, and other fixed assets.

Once the application and accompanying documents are received by the Bureau, they will be reviewed. Only when it is determined that they have been completed satisfactorily, will the Bureau conduct its investigation. Therefore full and complete answers are required.

All documents filed will become a part of the public record unless the applicant makes a written request for confidential treatment of some particular document or information. Final determination as to the confidentiality of such information will rest with the Commissioner of Financial Institutions.

Inquiries concerning the preparation and filing of this application should be directed to the Division of Research and Structure, Bureau of Financial Institutions, Post Office Box 2AE, Richmond, Virginia, 23205. [Telephone: (804) 786-3657]

The undersigned certifies that he believes the facts contained in this application and all accompanying schedules and statements are true and that he has been duly authorized to file this application.

Name

Signature

Address

Title

Date
APPLICATION FOR A CERTIFICATE OF AUTHORITY
TO ESTABLISH AND OPERATE A BRANCH

Bureau of Financial Institutions
State Corporation Commission
Post Office Box 2AE
Richmond, Virginia 23205

FILE IN DUPLICATE

1. GENERAL INFORMATION

<table>
<thead>
<tr>
<th>NAME OF APPLICANT INSTITUTION</th>
<th>DATE IT COMMENCED BUSINESS</th>
</tr>
</thead>
<tbody>
<tr>
<td>MAILING ADDRESS</td>
<td>NAME THE COUNTY OR CITY WHERE THE MAIN OFFICE IS LOCATED</td>
</tr>
<tr>
<td>NAME OF AFFILIATED COMPANY, IF ANY</td>
<td></td>
</tr>
</tbody>
</table>

PROPOSED BRANCH LOCATION (street, city, or town and county or other identification)

<table>
<thead>
<tr>
<th>NAME OF PROPOSED BRANCH</th>
<th>DISTANCE FROM MAIN OFFICE</th>
<th>EXPECTED OPENING DATE</th>
</tr>
</thead>
</table>

WILL THE CAPITAL OF THE APPLICANT BE INCREASED PRIOR TO THE ESTABLISHMENT OF THE PROPOSED BRANCH?

- Yes (if yes explain)
- No

NUMBER OF BRANCHES THE APPLICANT OPERATES:

1. Opened
2. Authorized, unopened

OFFICIAL FOR RESPONDING TO QUESTIONS RELATING TO THIS APPLICATION (name, address, telephone number)
II. QUARTERS

Provide information with respect to the quarters in which the proposed branch will be located. Indicate whether the land and/or building will be leased or purchased. Indicate the size and cost of land and building and the cost of site improvements to be borne by the applicant. Specify all transactions and associated costs to be borne by the applicant. Indicate any plans to open in temporary quarters, describe such quarters and give associated costs.

---

NAME AND ADDRESS OF SELLER OR LESSOR

EXPIRATION DATE OF LEASE

IS SELLER OR LESSOR RELATED OR CONNECTED IN ANY WAY WITH THE APPLICANT?

Yes (if yes, explain)

No

---

III. INVESTMENT IN FURNITURE, FIXTURES, AND EQUIPMENT

(Show estimates by an asterisk *)

<table>
<thead>
<tr>
<th>ITEM</th>
<th>NO. OF UNITS</th>
<th>TOTAL COST</th>
<th>ANNUAL RENTAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>Vault door(s)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Safe(s)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Safe deposit boxes</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Counter and cage fixtures</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Drive-in windows and remote kiosk(s)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Night depository</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Security equipment</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Furniture</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>TOTAL</td>
<td></td>
<td></td>
<td></td>
</tr>
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</table>
IV. FUTURE EARNINGS PROSPECTS

A. ESTIMATED DEPOSITS

<table>
<thead>
<tr>
<th>DESCRIPTION</th>
<th>FIRST YEAR</th>
<th>SECOND YEAR</th>
<th>THIRD YEAR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Year-end Demand (non-interest bearing)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Year-end Interest Bearing Deposits</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Year-end Total Deposits</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Average Demand (non-interest bearing)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Average Interest Bearing Deposits</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total Average Deposits</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

B. ESTIMATED INCOME AND EXPENSES

<table>
<thead>
<tr>
<th>DESCRIPTION</th>
<th>ESTIMATED AMOUNT</th>
</tr>
</thead>
<tbody>
<tr>
<td>First Year</td>
<td>Second Year</td>
</tr>
</tbody>
</table>

Gross Income (0 % of estimated average deposits)

EXPENSES:

1. Interest on deposits
2. Salaries and benefits
3. Net occupancy expense (details below)
4. Furniture & equipment (deprec., rental, etc.)
5. Advertising
6. Telephone
7. Legal
8. Postage
9. Computer services
10. Miscellaneous
11. Net preopening expenses (First year only)

Total estimated expenses

ESTIMATED NET PROFIT (OR LOSS)

OCCUPANCY:

Rent
Depreciation
Maintenance (include building staff salaries)
Insurance
Taxes on real estate
Utilities (heat, light, power, etc.)
Other occupancy expenses

Total occupancy expense

Less: Rental Income
V. PUBLIC INTEREST

A. DEFINE THE TRADE AREA AND DESCRIBE ITS ECONOMIC BASE AND DEVELOPMENT, ITS ECONOMIC AND DEMOGRAPHIC GROWTH AND POTENTIAL, AND THE LEVEL OF FINANCIAL COMPETITION.
V. PUBLIC INTEREST (CONTINUED)

B. DISCUSS THE CHARACTERISTICS OF SERVICES OFFERED BY FINANCIAL INSTITUTIONS IN THE TRADE AREA AND SPECIFY HOW THE PROPOSED BRANCH WILL DIFFER OR COMPARE IN THE QUANTITY AND QUALITY OF SERVICES TO BE OFFERED.
V. PUBLIC INTEREST

List all the offices of banks and savings institutions whose primary trade area overlaps with the primary trade area (the minimum area where more than 75.0 percent of the deposits will originate) of the proposed office. Show the deposits of each office in the last three years, specifying the date.

<table>
<thead>
<tr>
<th>NAME AND LOCATION</th>
<th>DISTANCE &amp; DIRECTION</th>
<th>/_/19</th>
<th>/_/19</th>
<th>/_/19</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Banking Offices</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2. Savings Institution Offices</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
APPENDIX C

The Cole Survey Branch Manager Job Description
POSITION TITLE: BRANCH MANAGER II (LENDING)  

Function: With broad responsibility manages a small branch office and extends credit to businesses and individuals. Oversees the operation of a branch office with total loans and deposits between $10 million and $20 million.

Has responsibilities such as:

1. Exercising executive and administrative control over the functions of the office, including implementation of local policy and explanation of company programs, policies, and objectives.
2. Extending credit to businesses and/or individuals through a variety of commercial, instalment, and/or real estate loans.
3. Representing the company in the community and developing and promoting additional business.
4. Attending to the needs of existing and prospective customers, including opening new accounts, certifying checks, and handling customer complaints.
5. Maintaining prescribed security controls to protect the facility against criminal and fraudulent operations and unnecessary risk or exposure.
6. Exercising the usual authority of a manager concerning staffing, performance appraisals, promotions, salary recommendations, and terminations.

Note: This is a single-incumbent position per branch. Incumbents extend credit to businesses and/or individuals, and may also have some business development responsibilities. The branch size parameters noted above are general guidelines. Other factors such as branch location, amount of unsecured lending authority, and type and complexity of loans approved should be considered when matching incumbents to this position.

Branch Managers primarily responsible for expanding existing business relationships and developing new business, should be reported as a Branch Manager (Business Development); incumbents who do not extend credit to businesses or individuals, and are not primarily responsible for business development, should be reported as a Branch Manager (Non-Lending).

Commonly reported Cole Levels: 2-3
**Position Title:** BRANCH MANAGER IV (LENDING)

**Function:** With broad responsibility, manages a large branch office and extends credit to businesses and individuals. Oversees the operation of a branch office with total loans and deposits between $40 million and $75 million, with a full complement of exempt and non-exempt employees.

*Has responsibilities such as:*

1. Exercising executive and administrative control over the functions of the office, including implementation of local policy and explanation of company programs, policies, and objectives.

2. Extending credit to businesses and/or individuals through a wide variety of commercial, instalment, and/or real estate loans.

3. Representing the company in the community and developing and promoting additional business.

4. Providing platform services for special existing or prospective customers and assisting at times of heavy business.

5. Maintaining prescribed security controls to protect the facility against criminal and fraudulent operations and unnecessary risk or exposure.

6. Exercising the usual authority of a manager concerning staffing, performance appraisals, promotions, salary recommendations, and terminations.

**Note:** This is a single-incumbent position per branch. Incumbents extend credit to businesses and/or individuals, and may also have business development responsibilities. The branch size parameters noted above are general guidelines. Other factors such as branch location, amount of unsecured lending authority, and type and complexity of loans approved should be considered when matching incumbents to this position.

Branch Managers primarily responsible for expanding existing business relationships and developing new business, should be reported as a Branch Manager (Business Development); incumbents who do not extend credit to businesses or individuals, and are not primarily responsible for business development, should be reported as a Branch Manager (Non-Lending).

**Commonly reported Cole Levels:** 3-4
Function: With complete responsibility, manages an extremely large branch office and extends credit to businesses and individuals. Oversees the operation of a branch office with total loans and deposits of over $150 million, with a full complement of exempt and non-exempt employees.

Has responsibilities such as:

1. Exercising executive and administrative control over the functions of the office, including implementation of local policy and explanation of company programs, policies, and objectives.

2. Extending credit to businesses and/or individuals through a wide variety of commercial, instalment, and/or real estate loans.

3. Representing the company in the community and developing and promoting additional business.

4. Providing platform services for special existing or prospective customers and assisting at times of heavy business.

5. Maintaining prescribed security controls to protect the facility against criminal and fraudulent operations and unnecessary risk or exposure.

6. Exercising the usual authority of a manager concerning staffing, performance appraisals, promotions, salary recommendations, and terminations.

Note: This is a single-incumbent position per branch. Incumbents extend credit to businesses and/or individuals, and may also have substantial business development responsibilities. The branch size parameters noted above are general guidelines. Other factors such as branch location, amount of unsecured lending authority, and type and complexity of loans approved should be considered when matching incumbents to this position.

A number of smaller branches may be under the incumbent's administrative authority, but their primary responsibility is to manage a branch. Incumbents whose primary responsibility is to manage a group of branches should be reported as a Branch Group Manager.

Branch Managers primarily responsible for expanding existing business relationships and developing new business, should be reported as a Branch Manager (Business Development); incumbents who do not extend credit to businesses or individuals, and are not primarily responsible for business development, should be reported as a Branch Manager (Non-Lending).

Commonly reported Cole Levels: 3-4
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