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MEASURING THE SOCIAL DIVIDEND IN WSBI MEMBERS' ACTIVITIES: REVEALING THE HIDDEN ELEMENTS

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MEASURING THE SOCIAL DIVIDEND IN WSBI MEMBERS' ACTIVITIES: REVEALING THE HIDDEN ELEMENTS

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A study commissioned to OPM by WSBI

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Preface / Acknowledgments

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Oxford, November 2008

EXECUTIVE SUMMARY

Building upon the findings from a previous study undertaken by OPM for WSBI – which showed that the reach of the accounts maintained at postal and savings banks worldwide is much greater than previously thought and greater also than that of any other form of accessible financial institution – this present study seeks to look at some of the ways through which savings banks are able to achieve greater outreach and play a significant role in the communities where they provide services, while still operating profitably. While savings banks may be competitive for-profit institutions, their corporate values and business approach give these institutions a certain competitive advantage in that they are closely identified with or linked to local communities. Such an approach is founded on achieving a social return (sometimes also called a social dividend), as well as a financial return that will enable the sustainability of their operations.

This present study seeks to highlight the value that is implicitly created in the operations of savings banks by providing services at a common tariff in more marginal markets as well as more favoured ones. It is not meant to quantify and capture all the aspects of the value that is created or that accrues as a result of savings banks' activities. Rather, the methodology used seeks to identify the cost that can be assigned to the provision of financial services to a market that would otherwise be beyond the range of what is typically considered bankable by other financial institutions. In particular, the study assesses the value of the deployment of resources that support the retail distribution network in marginal areas. We have taken this particular approach to defining and measuring the social dividend because we think it gives the greatest insights into how savings banks deliver access to retail financial services to all segments of society at a common tariff across all regions of the economies they serve.

This study looks at six cases of WSBI member savings banks, namely: (1) PostBank Uganda; (2) Hatton National Bank in Sri Lanka; (3) Banco Caja Social in Colombia; (4) Caisse d'Epargne Nord France Europe in France; (5) Caixanova in Spain; and (6) Red River Bank in the U.S.A.

Our analyses show a number of very clear results and issues cutting across the different cases studied:

- There is no evidence of massive financial transfer from stronger savings bank branches operating under more favourable market conditions to weaker branches in more marginal market catchment areas – i.e. all of the branches in the less favoured locations all covered (or very nearly covered) the marginal costs of keeping their presence in those areas;
- To the limited extent that branches in more favourable market catchment areas do shelter those in less favourable ones, it generally seems to involve the creation of extra operating profit to cover central overheads and required earnings on capital that they would have to cover in any case were the more marginal branches to be closed; and
- The manner in which savings bank capital is generally managed – with less of the overriding commercial imperative to create and distribute surplus capital back to shareholders – makes it easier to sustain marginal branches that only need relatively small amounts of capital;
- But to achieve this, it is crucial that operating resources – particularly staff and premises – are deployed in a way that fits the business potential of the less favoured areas so productivity of human and physical capital is kept as high as or even higher than in more favoured markets.

These savings banks remain accessible across a wider range of market catchment areas because they choose to do so and actively adjust their business model to achieve this. The targeted retail banking model that fits itself to local market conditions as described above, can actually earn very high returns on equity. Properly segmented, these operations can fit well within a fully developed shareholder value framework, but that framework must itself be nuanced to allow this to happen – clearly many other types of banks are not able or willing to do this.

The results of this study are significant because they provide greater insight than before about the various mechanisms that allow some financial institutions, such as savings banks, to maintain a strong commitment to local community development. The study has looked in particular at these banks' provision of financial services to a broad spectrum of clients including low-income individuals, and their support of socially-relevant projects and programmes that promote the socio-economic development of local communities. Specifically, the analysis of the different cases covered in this study shows that these institutions have the ability and flexibility to be able to scale direct local branch costs to broadly fit the income generating potential of quite disparate catchment areas. This in turn allows these banks to maintain their strong target-market orientation while at the same time operate profitably and sustainably.

FOREWORD

Following on the publication in this 'Perspectives' series of the results of research on Access to finance, the World Savings Banks Institute (WSBI) is proud to present you with a new pioneering study: *"Measuring the Social Dividend in WSBI Members' Activities – Revealing the hidden elements"*. This study is aimed at identifying and characterising the social dividend generated by savings and socially committed retail banks.

The social dividend of WSBI member banks materialises in their long-standing corporate social responsibility (CSR) policies and in their direct support to programmes and projects in their regions with a view to foster economic, social and cultural development.

But a substantial part of the social dividend of savings banks remains invisible still and is especially linked to their provision of extensive access to financial services including to underserved customer groups and geographical areas, which would otherwise be deprived of proximity banking services.

A sample of six WSBI members, in developed and developing countries (Spain, Sri Lanka, Uganda, Colombia, France and the USA), has been studied. The results show that the savings banks' business model is ideally suited to achieve broad outreach because of its flexibility in accomodating the demand of each local community, by deploying only the services which are really needed, without questioning the overall profitability.

The present study does not only identify this "hidden" social dividend, it also measures the value it creates as well as the investments needed for the provision of financial services to markets beyond the range of what is typically considered bankable.

The overall conclusion which one can draw from this study is that savings banks are sustainable financial partners and growth engines for their communities and regions. Our member banks, wherever their location, play a crucial role as they are able to support local economic activities and responsibly supply credit, especially to small businesses and micro entrepreneurs, in good as well as in bad economic cycles.

Chris De Noose
WSBI Managing Director

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Abbreviations

BCSC	Banco Caja Social – Colombia
CENFE	Caisse d'Epargne Nord-France Europe
CSR	Corporate social responsibility
FS	Fundación Social (Colombia)
MFIs	Microfinance Institutions
OPM	Oxford Policy Management
PBU	PostBank Uganda
PEDN	Private Education Development Network (Uganda)
RRB	Red River Bank (USA)
WSBI	World Savings Banks Institute

1 INTRODUCTION

A recent study undertaken by Oxford Policy Management (OPM) for the World Savings Banks Institute (WSBI) has shown that previous estimates of the total number of accounts maintained at institutions providing financial services for customers that are outside the reach of mainstream commercial banks are significantly under-stated.[1] Using data from member-banks of WSBI, the number of accounts at postal and savings banks worldwide was estimated to be well in excess of one billion worldwide. The reach of these accounts into the mass market is much greater than previously thought and greater also than that of any other form of accessible financial institution.

Significantly, research has also shown that savings banks are institutions that can achieve greater outreach without compromising profitability. This therefore justifies their being considered among 'double bottom-line institutions' – i.e. institutions that balance the twin objectives of providing financial access while still operating profitably. Savings banks tend to provide financial services that are affordable to low-income groups and in markets that do not guarantee regular or high volumes of usage of these services by clients (e.g. in thinly populated areas), and at the same time remain profitable institutions. This may be explained by the savings banks' generally high level of staff productivity, in terms of accounts managed per employee, and their much lower cost to asset ratios than in other 'access' institutions such as microfinance institutions (MFIs).

1 Peachey, S.; Oxford Policy Management (2006): Savings Banks and the Double Bottom-Line: A profitable and accessible model of finance; sponsored by World Savings Banks Institute for the World Bank and Brookings Institute Global Conference on Access to Finance – May 2006; Perspective no. 52 http://www.wsbi.org/uploadedFiles/Publications_and_Research_(ESBG _only)/Perspectives%2052.pdf

The analysis of available income and expense data on a number of savings banks, however, shows that the evidence on the relationships between cost efficiency, productivity and outreach is mixed: (i) savings banks with the broadest outreach had cost-asset ratios that were similar to several of those with narrow outreach, and (ii) there were as many savings banks with broad outreach with strong staff productivity (up to 1,000 accounts per employee) as there were narrow banks with the same level of productivity.

Building upon these initial findings, this present study seeks to look at some of the ways through which savings banks are able to achieve greater outreach and play a significant role in the communities where they provide services, while still operating profitably. While savings banks may be competitive for-profit institutions, their corporate values and business approach give these institutions a certain competitive advantage in that they are closely identified with or linked to local communities. Such an approach is founded on achieving a *social return* (sometimes also called a social dividend), as well as a financial return that will enable the sustainability of their operations.

This study looks at six cases of WSBI member savings banks, namely: (1) PostBank Uganda; (2) Hatton National Bank in Sri Lanka; (3) Banco Caja Social (BCSC) in Colombia; (4) Caisse d'Epargne Nord France Europe in France; (5) Caixanova in Spain; and (6) Red River Bank in the U.S.A.

This paper is organized as follows. In the following section (section 2), the concept of the social dividend in the activities of savings banks is further elaborated. This is followed in section 3 by a description of the methodology of the study, including a brief overview of each of the six cases. Section 4 provides a summary of the results and cross-cutting issues following the analyses of the six cases covered in this study, followed in section 5 with the presentation of results for each case study. Lastly, section 6 discusses some initial ideas on taking these results forward.

2 CHARACTERIZING THE SOCIAL DIVIDEND

The challenge in any study of the social dividend – especially that which covers a diverse set of institutions – is that there is a tendency to create some artificial segmentation of the social return. For example, what is the status of the retained financial profit that allows a socially responsible but nevertheless shareholder-owned bank to keep growing? Is this more or less a form of or a part of a social dividend? And what about the profit that a publicly or socially-owned bank forgoes in order to maintain branches that allow it to reach customers or locations not served by other types of banks? Equally, is the dividend that is implicit in forgoing profit more or less a social return, compared to the financial dividend that is returned to the owners of a socially-oriented bank?

We address these questions by considering the return made by socially responsible banks to fall within a spectrum – starting from the purely financial return through the implicit and onto explicit social returns, and even going further to the positive social externalities that those various returns can help create.

As already noted, earlier work by OPM identified that broad outreach is compatible with making adequate financial returns. Thus, this element is not revisited in this study. Moreover, the element of the wider external return (i.e. broader externalities) that can be leveraged off the other forms of social return are also outside the scope of this present study. This is not to say that wider externalities are unimportant; we recognize that they underpin all the other forms of social return that savings banks deliver because these have no intrinsic value unless they help improve the social and economic fabric within which savings banks operate.[2]

2 The importance of broader externalities can be more adequately captured within the scope of a full socio-economic impact analysis. A study on the social and economic impact of the social activities of Spanish Savings Banks was commissioned by the Confederation of Spanish Savings Banks (CECA) and published in 2005: See http://www.obrasocialcajas.org/105/obrasocial. nsf/0/82D50FD5269B7191C1257228004526DD/$file/impacto_28marzo.pdf.

Figure 2.1: Potential returns created by socially responsible banks

Creating / retaining enough profit to keep bank capital growing sufficiently to support the growing business of meeting clients' growing needs.

Tailoring the business model so well that the needs of more marginal clients can be serviced without forgoing profit.

Forgoing profit to keep more marginal branches open and to keep providing affordable services to low-income / small-scale clients.

Explicitly returning profit either through dividends paid to founding social entities or social expenditure under an explicit CSR programme.

Leverage gained in terms of improved prospects for local growth, employment and social solidarity as a result of the bank's activities.

No study of social returns can ignore the explicit return represented by either a dividend flow to communal owners of the bank concerned or an expenditure flow via an active corporate social responsibility (CSR) programme, but this is well documented in the case of savings banks.[3] An overview of the key issues is, however, provided in the following section, along with descriptions of the CSR activities undertaken by the banks covered in this study.

This present study seeks to highlight the value that is implicitly created in the operations of savings banks by providing services at a common tariff in more marginal markets as well as more favoured ones. It is not meant to quantify and capture all the aspects of the value that is created or that accrues as a result of savings banks' activities. Rather, as will be discussed in more detail in the following section, the methodology used is an attempt to identify the cost that can be assigned to the provision of financial services to a market that would otherwise be beyond the range of what is typically considered bankable by other financial institutions.

3 World Savings Banks Institute / European Savings Banks Group:
European Savings Banks: From Social Commitment to Corporate Social Responsibility: 9th European Symposium on Savings Banks History; Madrid, 4 - 5 May 2006; Perspectives no. 55. http://www.wsbi.org/uploadedFiles/Publications_and_Research_(ESBG_only)/Perspectives%2055.pdf
WSBI Savings Banks Socially Responsible Activities, a Wealth of Experiences – Insights from WSBI Members in Africa, Asia and the Americas, Sept. 07 http://www.esbg.eu/uploadedFiles/Publications_and_Research_(WSBI_only)/WSBICSRreport%20%202007%20screen%20view.pdf; ESBG Savings Banks Socially Responsible activities, a wealth of experiences, Oct. 07 http://www.esbg.eu/uploadedFiles/ESBG/CSR_Activities/study%20esbg%20november%202007screenview.pdf

In particular, the study assesses the value of the deployment of resources that support the retail distribution network in marginal areas. We recognize that there are other important aspects in the equation – such as the range of products and services offered, the overall pricing of these services, and the proportion of low-income or vulnerable customers actually reached by the branch network wherever it is located, etc. These are important issues to consider and other studies approached the problem by exploring these aspects. We have, however, taken this particular approach to defining and measuring the social dividend because we think it gives the greatest insights into how savings banks deliver access to retail financial services to all segments of society at a common tariff across all regions of the economies they serve.

This study therefore focuses on the two relatively less recognised, implicit forms of the social dividend – the incalculable part that comes from tailoring the business model to deliver both outreach and profitability, and the calculable but still implicit element that comes from forgoing profit to keep marginal branches open and marginal customers served. This has been done by studying six specific cases of savings banks operating in different parts of the world. This study is guided by the following key questions:

- Because savings banks also pursue values other than the maximisation of shareholder returns, what is the 'opportunity cost' of such a social commitment?
- How does this approach and its underlying business model support the realization of wider social returns (e.g. reaching out to the poor, improving access to finance)?
- How might the technique be rolled out to other WSBI members who presently have a less broad outreach?

3 THE EXPLICIT SOCIAL DIVIDEND RETURNED BY SAVINGS BANKS

A gradual transfusion of some elements of commercial practice into the non-profit sector and vice versa, as well as a need for new capital sources for philanthropy, has created an environment within which capital for the social sector is increasingly drawn from the mainstream business activities that underpin the economy. In some cases, this is facilitated by governments allowing companies to treat revenue streams as a source of capital for work done in the broader public good. As a result, the investment is no longer viewed as just producing a pure financial return to shareholders but also a social return to the communities towards which these investments are directed. This constitutes what is often referred to as activities falling under corporate social responsibility (CSR).

Savings banks have an established track record in operating in a socially responsible way; but the approach is now slowly spreading to other commercial entities across the financial sector. The exact form of these activities among savings banks and the organising framework within which they occur varies across the numerous members of WSBI and ESBG, but common strands do emerge.

Most of the activities are explicitly directed towards marginal groups and aimed at strengthening their capacity to participate in society generally and in its economic and financial activities in particular. There is also often an educational dimension, with savings banks often promulgating material that explains how microenterprises and individuals can manage basic budgeting of income and expenditure and use different financial services to help with this.

Some savings banks operate as part of the public sector and as such often act as the channel for public financial support to marginal communities. They often also run their own explicit initiatives to improve access to financial services for those groups. Other savings banks have a more social form of ownership, often community based, to which all customers are automatically enrolled. These community associations are then a channel for the bank's explicit social return either through financial dividends paid to the associations for use locally or CSR expenditures linked to them. A variation of this is to have distributed profits from the banking business funding a social foundation that then returns those profits as explicit CSR expenditures in the communities from which the bank has made its profit. Finally, there are purely shareholder-owned savings banks that nevertheless directly forego some profit by incurring extra expenditure on CSR activities.

All these variations are covered by the six participating banks in this study.

PostBank Uganda (PBU) is a publicly owned institution and has partnered up with a local NGO called Private Education Development Network (PEDN), involved in the Aflatoun programme. Through this partnership, PEDN reaches out to children in schools and teaches them the value of savings; savings clubs are then formed in schools and these are then linked to PBU. Apart from collecting these savings, PBU engages these savings clubs in its other social activities and also offers piggy-banks to all students and children who open up accounts with the bank.

Caisse d'Epargne Nord-France Europe (CENFE) is 80% owned by some 300,000 co-operative shareholders organised in 24 associations. It pays these associations a dividend of 3¾% on accumulated equity and then puts aside half as much again to fund explicit local social and economic projects. This is done within the scope of the *Projets d'Economie Sociale et Locale* (PELS) framework established nationally for all French savings banks. This framework focuses on support for microenterprises (both loans to individual entrepreneurs and grants provided to mentoring organisations) and strengthening social and financial inclusion for vulnerable groups.

Both **Caixanova** of Spain and **Banca Caja Social** (BCSC) of Colombia channel profits back to social foundations that undertake wider CSR activities. For Caixanova, this is no small sideline: in 2006 it devoted over 40% of its earnings after taxes to supporting socially-relevant activities, which is impressive even when compared to the other Spanish *cajas*.

Its contribution amounted to more than €41 million in 2006, supporting a total of 4,282 activities / projects, with an estimated 2 million number of direct beneficiaries. For BCSC, the foundation (*Fundacion Social*) is the owner of the bank and all profit that is not retained in the bank is available for explicit CSR activities.

BCSC in Colombia does not carry out social projects itself. It considers its role as being focused on the provision of financial services that are strongly oriented towards lower-income individuals. Other (non-financial) activities aimed at promoting greater economic inclusion and social participation – such as in education and the training provided to small entrepreneurs, promotion of human rights and supporting community-based institutions – are all undertaken by BCSC's owner and founding organization, *Fundación Social* (FS). Although BCSC does not directly invest in or get involved with these non-financial activities, its image in the market is that of a financial service provider that is strongly linked to FS and the social activities it supports.

Both purely shareholder-owned banks in the study also undertake significant explicit CSR activities. At **Red River Bank** (RRB) in the USA, its ownership by 250 local investors gives it strong roots in its local community. As well as having an explicit CSR expenditure line, a separate business development expenditure line funds many activities that would be treated as CSR in other more purely shareholder-value driven commercial banks. In total, these expenditures amount to around $1 million and reduce gross profit at Red River Bank by more than 10%.

Hatton National Bank (HNB) of Sri Lanka also runs an explicit CSR programme to which it contributed Rs 25 million (around $ 250,000) in 2006. This fund is managed by a unit within its own organization. (Projects funded include building of public libraries, for example.) HNB considers this as a testimony of its commitment to being a socially-relevant institution. It also recognizes that this kind of involvement creates a strong sense of good will for the bank as it relates to current and prospective users of financial services.

CSR activities are increasingly expanding beyond companies' activities (as described above) that contribute to the realization of various social and community goals. They are also becoming more integrated with the day-to-day business activities of companies – e.g. with the development of environmentally-friendly products and policies, improved relations with suppliers, employer's involvement policy, etc.

Although savings banks' CSR activities are still strongly focused on social activities, they progressively tend to embrace other aspects of the evolving landscape of activities under CSR.

The six banks covered by this study demonstrate all the various approaches to supporting socially-relevant activities. The socially-relevant activities and projects these institutions support cover a broad range of issues and concerns. Some of these activities are not that strongly related to the banks' financial activities (e.g. in sports), while others are very much linked to the development of local markets and therefore have their long term implications on the business of the bank.

The latter kind is demonstrated by such activities as CENFE's provision of grants to support enterprise mentoring networks and activities that help generate employment. These also include support given to the creation of new businesses. Another interesting example of this would be RRB's setting up of a Red River Bank University – which administers financial literacy campaigns and programmes to especially help low-income families understand financial products and services. Moreover, RRB also participates in the Small Dollar Loan Pilot Programme of the FDIC, which studies affordable and responsible small-dollar loan programmes in participating financial institutions.

The banks' involvement in this kind of social activities is especially justified given that it has the capacity and resources to help develop the quality of local financial markets (e.g. employees and managers who are able to provide financially literacy training and support). Moreover, these activities also serve as fertile ground for these institutions to understand the demands of the market and how they could offer services that will allow improved levels of financial access. For example, PBU's involvement with children's savings clubs helped to facilitate the redesign of one of its savings products. Specifically, smaller balances in children's savings accounts have been accommodated, starting with 100 Ugandan Shillings (approximately US$ 0.06). The partnership between PEDN and PBU is proving to be beneficial to both PBU and the markets it seeks to serve. Already plans for expansion of the programme on a national scale are under way. Similarly, for RRB, its participation in the Small Dollar Loan Pilot Programme offers the opportunity to tap into even new markets by expanding relationships with individuals who may not be fully utilizing the mainstream financial system at present.

On the other hand, it is important to point out that in certain markets, there can be a strong case for initiatives that effect greater social and political inclusion, which serves as the bases for developing markets. This is, for example the case in Colombia, where FS invests in civil society strengthening and public campaigns that favour the peaceful resolution of armed conflicts in the country, among many other initiatives. To BCSC and FS, the establishment of peace and order is an important prerequisite to the economic development of the local communities where the bank operates.

4 DESCRIPTION OF PARTICIPATING BANKS AND METHODOLOGY USED

The six cases chosen for this study offer a mix of institutions operating in both developed and developing country environments. The cases may also be distinguished in terms of their ownership patterns, branch coverage, and operational size. Some of the banks covered in this study are national in scope, while others concentrate their operations in certain regions or geographic locations.

The methodology used in this study is designed to build up the cost of providing different services, starting with the direct costs involved and layering on other support and central control costs before eventually adding on the costs of a bank's central executive and any strategic initiatives it may implement. In this way, a judgement can be made as to whether a particular service needs:

(a) direct financial support at the semi-variable operating cost level; or
(b) some sheltering from the allocation of any semi-variable control costs; or
(c) just sheltering from central executive and business development overheads.

Clearly, the last of these tiers in the taxonomy is financially much more sustainable than the first. In our experience, the results emerging from such an analysis are usually quite surprising, with the provision of small value money transmission and savings services in marginal areas often proving more financially sustainable at direct operating cost level than generally expected. These services, however, are very vulnerable to overloading with regional / central management overheads that more properly relate to the business of larger money centre branches.

Table 4.1: Profile of case studies

	BCSC Colombia (as of Dec 2007)	HNB Sri Lanka (as of Dec 2007)	PBU Uganda (as of June 2007)	Caixanova Spain (as of Dec 2007)	CENFE France (as of Dec 2007)	RRB USA (as of Dec 2007)
Assets (million USD)	3172*	2,187	50	75,000	42,600	589
Deposits (million USD)	2,783	1,604	30,6**	26,640	30,960	488
Branches #	260	171	22	540 (529 in Spain)	277	14
ATMs / ATM locations #	463	167	6**	483	477	18
Staff #	5, 836	2,890	183	4,153	2,378	211

(*) Asset figures are for the entire BCSC group.
(**) Figures, as of 30 June 2008.

The modelling approach used in this study has been developed by one of the authors with *Sparkassenstiftung für Internationale Kooperation* (SBFIC) and is designed specifically for application in savings and other retail banks. They allow an easy implementation of a form of activity-based costing and involve the following six key elements of the final cost.

- Grouping staff by whether they (a) serve customers directly, (b) support / control either people or systems involved in customer service or (c) form part of some central, non-allocated, executive and strategic overhead (such as the CEO, business development projects, brand building, etc);
- Layering the direct cost of these staff with the cost of the facilities they use (premises, transport, security, and some elements of IT);
- Allocating customer service staff to products in proportion to the volume of work created by each product;
- Adding in IT systems and accounting costs also in proportion to the transactions processed at the various product levels;
- Calculating the unit costs per transaction processed for each product group, split into those related to the customer interface and those related to the underpinning processing systems; and
- Grossing-up these unit costs for the different layers of local, regional and central executive / strategic costs.

These models are then developed for two contrasting branches in each savings bank – one major money centre and one in a less advantaged, possibly rural region – for each institution. In some of the cases we've covered in this study, a total of three branches were studied (i.e. Uganda and United States). The decision to cover more than two branches was primarily driven by the close links between the operations of a certain branch (typically rural-based) and another one that is possibly operating as some sort of satellite branch or extension of the rural-based branch. For example, this was manifested in the way some of the branches shared certain functions between them (e.g. loan officers) or even served markets that were highly complementary. The choices made of the branches to be analyzed for each case study were made in consultation with the respective institutions.

In the next section, we provide a brief outline of the findings on the six cases completed, which summarizes the cross-cutting issues among the cases studied.

5 SUMMARY OF FINDINGS AND CROSS-CUTTING ISSUES

All of the case study analyses completed so far can lend themselves to more in-depth analysis to fully extract all the richness of information that this sort of modelling exercise can deliver. Our analyses show a number of very clear results and issues cutting across the different cases studied:

- There is no evidence of massive financial transfer from stronger savings bank branches operating under more favourable market conditions to weaker branches in more marginal market catchment areas – i.e. all of the branches in the less favoured locations all covered (or very nearly covered) the marginal costs of keeping a presence in those areas;
- to the limited extent that branches in more favourable market catchment areas do shelter those in less favourable ones, it generally seems to involve the creation of extra operating profit to cover central overheads and required earnings on capital that they would have to cover in any case were the more marginal branches to be closed;
- and the manner in which savings bank capital is generally managed – with less of the overriding commercial imperative to create and distribute surplus capital back to shareholders – makes it easier to sustain marginal branches that only need relatively small amounts of capital;
- but to achieve this, it is crucial that operating resources – particularly staff and premises – are deployed in a way that fits the business potential of the less favoured areas so productivity of human and physical capital is kept as high as or even higher than in more favoured markets.

The last two points above are absolutely fundamental to understanding why it is that savings banks can deliver on a social responsibility to run retail banking operations throughout all regions without hopelessly compromising their financial soundness.[4] For a shareholder-value driven bank the priority is generally to deploy standardised operating units with a strong lending dimension, where they will make the maximum possible return on capital. This implies an immediate need for capital and high levels of central oversight. As a result, each branch needs to make a certain minimum contribution to central overheads and a minimum required profit to justify the deployment of capital that its existence requires. For commercial banks this way of targeting the deployment of branch networks unambiguously maximises risk adjusted returns on capital. Many savings banks, however, accumulate their capital over time rather than raise it from shareholders and for them securing the required returns on capital involves a different but still economically rational and efficient strategy. If there is no imperative to earn and distribute surplus returns on capital, the imperative is to earn a sufficient return overall to keep overall capital growing in line with expanding overall business needs. Because underemployed capital need not (and often cannot) be returned to shareholders, withdrawing it from branches in more marginal market catchment areas could actually reduce overall returns on capital because it cuts an activity that does usually make at least some contribution to central overheads and maybe even a small profit. Clearly a savings bank does not want too much of its capital tied up in marginal branches that barely break even but provided operating costs at these branches are commensurate with the income-yielding potential of their market catchment areas then it is profit maximising and an effective deployment of capital to keep them open.

4 Despite the perception among many policy makers that publicly or socially-owned banks have a tendency to be loss-making very few savings banks actually are. For the bulk of WSBI membership for which a separately identifiable profit and loss account is available (some 70+ in total), just over 90% made a profit in 2003. Of the rest (just under 30) these were almost all postal savings banks for which isolating the genuine profit and loss of the banking operation is not easy and lack of accounting evidence should not be seen as an attempt to hide losses. See WSBI Perspective 52 of 2006 for more detail.

This strategy becomes even more realistic and rational when branches in more marginal areas have a relatively more savings-focused balance sheet than their counterparts in more favoured areas. In these circumstances the risk-weighted deployment of capital in these branches is relatively small because deposits need only be backed with low risk interbank placements and liquid government securities. There is, therefore, very little risk that keeping marginal branches open in these circumstances will drain away much capital from branches that can deploy it at greater returns. Here, savings banks at least in developed banking systems are actually helped by their regional focus – if a local community needs a predominantly savings service, then a savings bank has none of the driving brand values that force it to maintain a substantial lending presence as well. This approach of fitting the business model to each local community can be nuanced further – if a community needs access to payments, savings and retail lending services then savings banks can deploy a range of standardised products to match those needs. The standardisation means that control is intrinsic within the product design (through say credit scoring) and not by heavy central oversight. In this way the additional lending activity only has to earn enough extra return to justify the marginal extra deployment of risk-weighted capital and this is usually amply priced into the product. Thus, *the savings bank business model is ideally suited to easing its way into as many local markets as it can possibly reach*.

A caveat should, however, be registered here that sometimes *regulatory requirements – especially across the developing world and acutely so in Africa – can hinder the ability of savings banks to fit the resources they deploy to local market potential*. These constraints take the form of minimum security requirements irrespective of branch size and sometimes also de facto minimum staffing requirements that are implied in mandatory control structures. This has the effect of raising the breakeven threshold relative to a market catchment area's realistic carrying capacity. The effect is either to force the marginal branch to become loss-making or force the savings bank to withdraw from that area. That said, savings banks are remarkably resilient in the face of such pressures and often sustain a much broader geographical accessibility than do purely commercial banks and do this by having smaller average branch sizes with higher levels of staff productivity in terms of numbers of accounts per employee.

Therefore, *the overriding inference drawn from the case studies described below is that these savings banks remain accessible across a wider range of market catchment areas because they choose to do so and actively adjust their business model to achieve this*. The targeted retail banking model that fits itself to local market conditions as described above, can actually earn very high returns on equity. Properly segmented these operations can fit well within a fully developed shareholder value framework but that framework must itself be nuanced to allow this to happen – clearly many other commercial banks are not able or willing to do this.

All this has shaped the way this study has been structured. Rather than just looking for social dividends as crude transfers from branches in better off areas to make good operating losses in less favoured areas, the focus has been on how well the resources deployed in the marginal branches can be scaled back to fit the lower revenue generating potential of that branch's market catchment area. Then, to the degree that costs cannot be exactly matched to revenue, the study goes on to look at where breakeven occurs and what this implies for overall profitability:

- is it, for example, before even the point at which all local costs can be covered (very rarely);
- or, is after local costs have been covered but before semi-variable central control and support costs have been allocated out to the branch concerned (again rare);
- or does it only come somewhere after all variable and semi-variable costs have been covered, by which point the marginal branch is helping raise the overall return on capital?

Because each of the banks that have generously co-operated in this study has a different accounting system, the exact methodology followed in each case is described in each case study section rather than here. Interestingly all the cases have lessons for each other and the results of this analysis can be developed further so as to have a more uniform approach that could be recommended for other savings banks to try for themselves.

6 CASE STUDY FINDINGS

6.1 Caixanova (Spain)

Caixanova consolidated its position as one of the leading financial institutions in the region of Galicia through the merger of three savings banks (Caixavigo, Caixa Ourense and Caixa de Pontevedra) between 1999 and 2000. It now has a total balance sheet of some 23 billion Euros and has evolved from being a purely regional financial institution to one with branches in all of Spain's regions as well as in other countries (Portugal, France, Germany, Switzerland, UK, USA, Mexico, Venezuela and Brazil). By the end of 2007, Caixanova had a commercial network with a total of 541 branches, of which 410 were in Galicia, 119 in other Spanish regions and 12 abroad. Nevertheless, it remains commercially and socially very committed to the region of Galicia.

The two contrasting branches modelled were taken from a major coastal town and an inland rural town. The contrast is best seen in the income profile of the two branches, with half the income per employee in the rural branch compared to the urban one. The bulk of this difference comes from much lower lending activity at the rural branch (some 75% lower on a per employee basis). But deposits mobilised per employee in the rural branch are half the level achieved in the urban branch. These balance sheet differences of course strongly influence the level of capital employed at the two branches, not just in per-employee terms but even more so in absolute terms – the estimated total deployment of capital at the rural branch is less than one twentieth of the amount deployed at the urban one.[5]

5 The crude estimates of capital deployed at each branch are OPM's own calculations of the approximate amount of regulatory capital required to support branch lending and investments (fully weighted and requiring an 8% capital allocation) plus the deployment of any deposits not on-lent at branch level in low risk liquid assets (assumed 10% risk-weighting and therefore only requiring a 0.8% capital allocation).

Caixanova has a very sophisticated system for allocating costs to products and branches, which starts with transactions and links most of these through to account contracts and then on to products and branches. In this way costs for transactions processed outside the branch where the governing account contracts are held can be transferred across to their home branch and set against the income that contract delivers. This allows operating costs at the branches to be decomposed into four key elements:

1. the cost of central support for and processing of transactions related to a branch;
2. a standardised direct cost allocation for the branch's own cost of serving its customers including a net adjustment for out of branch transactions (i.e. transferring in a cost allowance for branch customers' use of other branches and transferring out a cost allowance for serving customers of other branches);
3. an adjustment to the allocation of direct branch costs for difference between the calculated cost allocation under 2 above and the typical cost of staff and office facilities for a branch of the same size (using median salaries and median costs per square metre of office space); and
4. a final adjustment for the difference between typical and actual staff and office costs.

The reason the cost allocation layers up in this way reflects a couple of a fundamental commercial issues of relevance to other savings banks and one factor specific to Caixanova as a Spanish savings institution. The first factor is that any sophisticated system of cost allocation cannot be recast continuously so inflation and small changes in processing times always opens up a gap between the calculated and typical average actual cost of servicing customers. Second, activity based costing systems of this sort calculate the cost of processing specific transactions for customers not the cost of keeping branches open to service customers so another element of the gap between calculated and typical average actual costs comes from having to pay for idle time in even the best run branches. These are both factors that have to be addressed in allocating costs at any savings bank.

Table 6.1 Key business parameters for the two sampled Caixanova branches

2007 – in 000s Euros, unless otherwise stated		Larger urban	Small rural
Total income		**2,699**	**246**
of which	– net interest on credits	534	32
	net interest on deposits	1,541	189
	net fees and commissions	454	26
	other	170	-1
Total expenses	1,681	267	
Average lending / investments[6] (Euro millions)		50.4	2.4
Average deposits (Euro millions)		77.1	8.7
Crude estimate of capital deployed per branch (Euro millions)		4.3	0.2
Number of branch staff		10	2
➜ *Reminder*	– income per employee	270	123
	costs per employee	168	134
	lending per employee (Euro millions)	5.0	1.2
	deposits per employee (Euro millions)	7.7	4.4
	crude estimate of capital per employee	425	120

The third factor is, however, more specific to Caixanova. Because of the labour contracts it has inherited from its pre-cursor savings banks there is a large service-related element to individual staff remuneration. This can mean that less of the actual difference in cost of service comes from different levels of resources being deployed than comes from differences in individual wage rates. There are also sometimes locally specific differences in the unit costs of the facilities within which those staff operate. This is why the Caixanova system separates out the third and fourth stages of adjustment from typical to actual costs.

6 Excluding internal fund transfers.

As it happens, the fourth stage adjustment is not very significant for the two branches modelled for this exercise. Far more significant is the third stage adjustment between calculated costs of processing transactions and the cost allocation of keeping each branch open with its staff complement at typical wage rates and unit costs for facilities. For the large urban branch the shortfall between calculated and typical cost is 60% but for the small rural branch it is 80%. This fits with the rural branch director's perception that the lack of sophistication raised the processing time per transaction significantly (not least because there can be some element of home delivery of services to older clients).

The very final stage of the cost allocation, as with the other banks in the study, relates to allocating out central overheads. The Caixanova model handles this as well, with a sophisticated formula that allocates some costs in line with transaction or balance sheet volumes and others as a flat rate allocation per branch. From the table overleaf it can be seen that the small rural branch ultimately makes a loss because its direct costs at local level per employee are the same as those of the larger urban branch but the rural income per employee is less than half the urban level. Another way of looking at this is to say that the second employee in the small rural branch – who needs to be there to keep the branch open when the other staff member is away form the branch (Caixanova has no single-person branches) – cannot be supported by the volume of available business. This gives the small rural branch twice the cost-income ratio of the larger urban one even at the level of direct local costs and the percentage point gap ultimately widens at the total cost level suggesting that the formula for distributing central costs does not quite adjust for differences in business volumes.

Despite all this the small rural branch does manage to cover its own variable operating costs (direct and indirect) and it almost certainly covers all semi-variable network control costs and still makes a positive contribution to fixed head-office overheads. Therefore, the social dividend implicit in keeping the small rural branch open is, probably best characterised as the cost of keeping one more extra employee in post than can strictly be justified by business volumes provided that these costs can be covered out of local revenue. Closing the small rural branch because it cannot cover its allocated share of fixed head-office overheads would actually be profit-reducing because the portion of fixed overheads that it can cover would then have to be borne by more profitable larger urban branches. One further factor needs to be taken into account – the small rural branch requires much less capital per employee and given its small staff complement very little capital in total to keep the branch open.

Table 6.2 Key profitability indicators for the sampled Caixanova branches

2007 – Euro 000s / percentages	Larger urban	Small rural
Average allocated income per employee	270	123
Average allocated cost per employee at median rates	**170**	**132**
of which – at direct, local level	77	71
indirect cash / transaction level	28	8
HO overheads and network control	66	53
Overall cost-income ratio at median rates	63%	107%
of which – at local level	28%	57%
local + cash / transaction control	39%	64%
Average allocated cost per employee at actual rates	168	134
of which – at direct, local level	74	72
indirect cash / transaction level	28	8
HO overheads and network control	66	53
Overall actual cost-income ratio	62%	108%
of which – at local level	28%	59%
local + cash / transaction control	38%	65%
Average overall actual profit / loss per employee	+102	-11

To summarise, it can be claimed quite reasonably that the small rural branch requires no operating subsidy to keep it open despite its much lower income-earning potential. However, it does require sheltering from some fixed central overhead that would in any case have to be borne by other branches were the small rural branch to be closed. Moreover, while the small branch does tie up some capital at barely breakeven levels the amount involved is smaller even than the difference in the branch staff complement would suggest and is unlikely to materially constrain the faster growing parts of Caixanova's business.

6.2 Banco Caja Social - BCSC (Colombia)

Banco Caja Social BCSC is the socially-owned banking arm of Fundación Social of Colombia. Banco Caja Social BCSC operates through 264 branches but also through a number of agents. It has been a pioneer in providing savings and lending services to the urban low-income segment in Colombia. Banco Caja Social BCSC serves over one million clients with saving products, and 200,000 clients with active loans totalling more than $414 million. More than 70 percent of these loans have a maximum credit limit of $2,070, and are mostly in the personal banking and entrepreneurial sectors, with an average monthly income of $274 per family. Key to *Banco Caja Social*'s success has been its ability to offer a portfolio of products and services specifically tailored to meet the needs of low-income customers, paying particular attention to minimum amount requirements when opening accounts as well as product simplicity. For example, there are no minimum balance requirements when opening personal current accounts and savings accounts at Banco Caja Social BCSC. One of Banco Caja Social-BCSC's products is a savings account called "*Alcance su Casa" (Get your dream home)*, which is targeted towards individuals and families of a certain income range, and who are provided savings facilities in order to access governmental housing subsidies.

The two contrasting branches modelled were taken from the Cundinamarca Department. One of the branches studied (Kennedy) is located in Ciudad Kennedy, one of the most populous districts of Bogota, the national capital, whereas the other branch is located in Facatativa, a municipality located 28 miles northwest of Bogota. Situated in a more rural environment, the main economic activity in Facatativa is the growing of flowers for export.

Table 6.3 Key business parameters for the two sampled Banco Caja Social BCSC branches

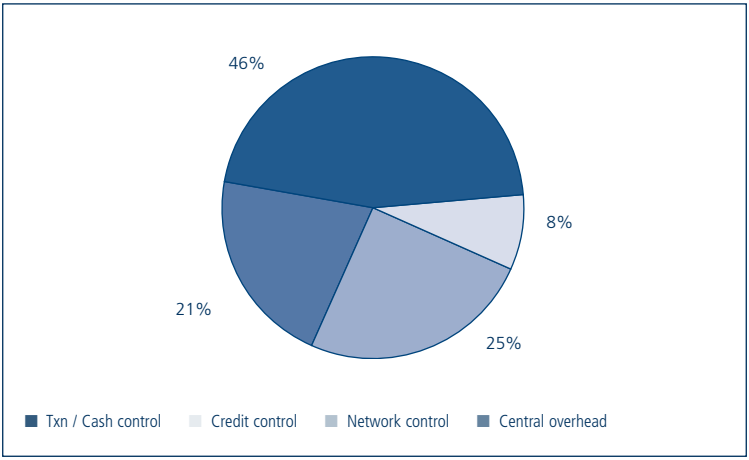
Data based on Jan-Sep 2007 – Peso millions	Ciudad Kennedy branch	Facatativa branch
Total number of staff	13	8
of which – front-office staff	4	2
credit officers	6	4
Total median assets	20,778	11,275
per front-line employee	2,079	1,959

Apart from the obvious contrast in size, the main difference appears to be the volume of deposits mobilised. This is not obvious from the table above but can be imputed from the income and expense statements of the two branches. Ciudad Kennedy has almost twice the asset base of Facatativa and this is reflected in the different levels of interest income generated by the two branches. The Facatativa branch relies much more heavily on more costly funds provided by head-office treasury such that its funding costs are almost the same as those of the much larger Ciudad Kennedy branch. Looking just at deposit interest paid and adjusting for the different size in the balance sheet of the two branches, the Facatativa branch probably has only just over half the self-funding capacity of Ciudad Kennedy branch.

Ideally, given such a difference in the business mix, the modelling exercise would look separately at the breakeven points for the credit and non-credit (payments / deposit) business. This has, however, only proved possible on the cost side. This was done for local costs pro-rata to front-line head count. Head-office costs were available by department and these could be allocated to the four functions shown in the chart.

BCSC already has a methodology for allocating head-office costs to branches so the proportions in the chart were used to split these allocations by their source.

Figure 6.1 Banco Caja Social BCSC head-office cost mix



The resulting estimate of the cost charged out for head-office cash and transaction processing was allocated to each branch's non-credit business. On the other hand, the cost charged out for head-office credit control is obviously allocated to the branch credit business. The cost charged out for network control was allocated pro-rata to front-line staff numbers and the head-office central overhead costs are spread pro-rata to all other allocated costs. Following these steps, we then calculated the cost per front-line employee for the two main product clusters and then combined these for all front-line employees. This allows the overall cost-income ratio to be broken down by source. This is done in the table below and then followed through with a comparison of income yields as well as overall costs and profit as a percentage of average assets.

These calculations suggest that the main impact of the difference in market conditions is to reduce the net income yield Banco Caja Social BCSC can earn. Costs, however, seem to be broadly adjustable in line with the balance sheet size of each branch, although it is likely that costs for processing deposit and payments per front-office employee is slightly higher in the Facatativa branch than at the Ciudad Kennedy branch (the former having a third of the deposits generated by the latter, but half of the staff processing the business).

Table 6.4 Key profitability indicators for the sampled Banco Caja Social BCSC branches

Data based on Jan-Sep 2007 – Peso millions.	Ciudad Kennedy branch		Facatativa branch	
	credit	non-credit	credit	Non-credit
Total allocated staffing	6	4	4	2
Total allocated costs per employee	**125,867**	**268,114**	**119,601**	**295,845**
of which – local costs	62,732	62,732	57,150	57,150
HO cash / transaction control	15,831	138,119	13,821	160,779
HO network control	29,643	29,643	28,755	28,755
HO overheads	17,660	37,619	19,874	49,160
Average allocated cost per front-line employee	**182,766**		**173,589**	
of which – at local level	62,732		57,150	
HO cash / transaction control	64,747		62,807	
HO network control	29,643		28,755	
HO overheads	25,644		24,876	
Average allocated income per front-line employee	**219,560**		**168,248**	
Overall cost-income ratio	**83%**		**103%**	
of which – at local level	29%		34%	
local + cash / transaction control	58%		71%	
local + cash / transaction + network control	72%		88%	
Average overall profit / loss per front-line employee	**36,795**		**-5,340**	
Overall profit / loss as a % of median balances	**+ 1.8%**		**- 0.3%**	
comprising – income as a % of median balances	+ 10.6%		+ 8.6%	
costs as a % of median balances	- 8.8%		- 8.9%	

The net result of all these calculations shows that the Facatativa branch is making a small loss on a fully-costed basis. However, it does cover all local and allocated transaction processing and head-office control costs. Therefore, closing the branch would actually deprive Banco Caja Social BCSC of profit because its contribution to central control and overhead costs would be lost. The reason for the loss is that, while costs can be scaled in line with branch assets it does not seem possible to scale them back sufficiently to cover the shortfall in income yield.

The social dividend for the Facatativa branch is therefore roughly equivalent to almost 2% of its risk-weighted balance sheet – 0.3 percentage points for the shortfall between branch income and fully allocated costs, and one to two percentage points to create a reasonable target return on equity of around 15%. Because Banco Caja Social BCSC appears to be a bank that fully lends across its network, then the social dividend as a percentage of the whole balance sheet will not be much different from the 2% suggested here on a risk weighted basis.

6.3 Postbank Uganda (Uganda)

Postbank Uganda is an example where minimum deployment of operating resources required to open a branch limits its capacity to exactly fit local market conditions in more marginal areas but even here the marginal branches just about cover the variable costs associated with keeping them open.

PBU was spun off as a standalone bank during the wider break-up of the old post, telecommunications and national savings model inherited across East Africa from the colonial era. It was set up as a properly capitalised (indeed well capitalised) bank that operated under a special law that placed it on the edge of the regulated banking sector but limited its product range and restricted options for investing mobilised deposits. It still provides access to its basic passbook account through post offices but has also established a parallel network of its own branches to support a wider range of newer products. This branch network is steadily being extended nationwide and currently totals some twenty full branches, three small sub-branches and a small number of mobile banking units. Some of this network is beginning to extend into areas previously ravaged by rebel insurgency.

Gulu branch chosen for this exercise as one of those in a more challenging market environment is one of the main towns in this area of the former insurgency. It opened within the last three years and its Lacor sub-branch is even newer having opened in June 2007. The contrast was provided by PBU's main City Central branch, which is co-located in the national capital (Kampala) with the bank's headquarters.

The contrast between City Branch, Gulu Branch and Lacor Sub-branch is shown in the table above and the sheer difference in scale is immediately apparent. Equally apparent is how difficult it is to scale resources to the different size of business – Gulu has just under a third as many front-office staff as City Central but one sixth of number of deposit clients.

Table 6.5 Key business parameters for the sampled PBU branches

Data based on Apr~Sep 2007 – U.sh	City Central branch	Gulu Town branch	Lacor sub-branch
Total number of staff	29	6	3
of which – front-office staff	10	3	3
credit officers	17	2	0
Total number of deposits	58,400	9,500	750
per member of front-office staff	5,840	3,133	250
Total deposit balances	13.12 bn	0.83 bn	0.23 bn
average per deposit account	217,000	87,600	312,000
Total number of loans	3,150	150	n.a.
per credit officer	185	75	n.a.
Total loans outstanding	7.42 bn	0.29 bn	n.a.
average per loan	2,355,000	1,891,000	n.a.
Estimated capital deployed*	0.80 bn	0.03	n.a.

* 1% of deposit balances and a further 9% of any lending out of deposits

The contrast in credit business is just as extreme – Gulu has just under a tenth of the credit officers that City Central has but not even one twentieth of the number of borrowers). Clearly some of this is to do with a problem of having to deploy a certain minimum number of staff at each site – witness Lacor sub-branch carrying the same complement of front-office staff as in Gulu Town but to service the payments and savings business of less than a tenth of the number of clients. Equally, however, there are clearly market factors at play – average deposit balances at Gulu are less than half the level seen at City Central branch in Kampala (although interestingly, average deposits at the new Lacor sub-branch, which has been opened specifically to handle the business of a local hospital, are 50% higher). Moreover, the percentage of deposits that is lent out as loans is much lower at Gulu (35%) than at City Central (57%). This all works through to a very much smaller deployment of capital at Gulu Town than City Central.

Given such a difference in business mix it quickly became clear that the modelling exercise for this study would have to look separately at the breakeven points for the credit and non-credit (payments / deposit) business. This was built up in a number of steps, starting with local branch costs:

- first, full staff costs from branch financial accounts were split between the front-office, crediting and shared overheads according to the split of branch payrolls;
- then branch non-staff costs were allocated to the same three functions pro-rata to head count;
- branch overhead costs were then spread over the three functions pro-rata to allocated staff and non-staff costs for those functions.

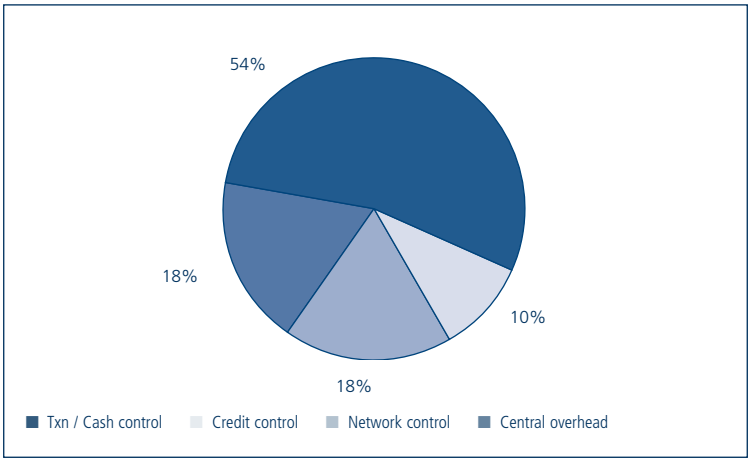
A similar approach was then followed with head office costs, which were allocated to one of four possible functional clusters and then allocated out as follows:

- head office central overheads – split evenly across the three network regions (central, south / west and north / east) and then spread pro-rata to branch overheads;
- branch network control – handled in the same way as head-office central overheads;
- central cash handling and vault services – spread pro-rata to front-office staff numbers;
- other central transaction processing costs – also spread pro-rata to front-office staff numbers but with City Central branch weighted up to reflect centralised processing of client payroll services.

On the basis of this, all of PBU's costs could be allocated to either its front-office or its credit officers. A further slight adjustment was made to staffing to move a small fraction of the front-office staff (and therefore allocated cost) from non-credit to credit business to reflect the administrative work involved in disbursing new loans and processing repayments. By this stage it was possible to allocate costs between each branch's credit and non-credit (payments / services) business.

As regards allocating income, fees were relatively easy because these were already split between credit and other fees in the branch accounts. Net interest income was more problematic because PBU does not have an internal funds transfer pricing mechanism. It was, however, possible to isolate income on government securities and create a proxy for the average risk-free yield (roughly 8%). Credit business was then allocated net interest income equivalent to the difference between this proxy risk-free rate and the average yield on loans all times the total loan portfolio and then less bad debt charges. Non-credit business was allocated net interest income equivalent to total deposits times the difference between average deposit rate paid and the proxy risk free rate.

Figure 6.2 PBU head-office cost mix



The net effect of all this was to create the income and expense indicators shown in the table on the next page. This shows clearly the consequences for financial performance of operating the two very different branch configurations in the two very different areas. In City Central both businesses have overall cost income ratios of just under 60% and therefore the branch there makes a profit even after allocation out of all head-office costs. Indeed, it makes a very strong return on estimated capital deployed (165% on a full year basis – a typical target for foreign investment in a developing country commercial bank would be 30%). By contrast, Gulu Town makes a loss on its credit business at all levels of local and central cost allocation and only just breaks even on its non-credit business once centralised cash and transaction processing costs are allocated out. It cannot, therefore, cover its allocation of central network control costs or make any contribution to central overheads and on a fully costed basis it loses the equivalent of nearly 90% on a full year basis of its very much smaller capital allocation.

Table 6.6 Key profitability indicators for the sampled PBU full branches

Data based on Apr~Sep 2007 – U.sh.	City Central branch		Gulu Town branch	
	credit	non-credit	credit	Non-credit
Total allocated staffing (full-time equivalent employees)	17.2	9.8	2.1	2.9
Total allocated costs per employee	**21,597**	**59,604**	**11,559**	**25,434**
of which – local costs	21,160	16,614	10,996	10,226
HO cash / transaction control	427	* 42,068	401	6,737
HO network control	5	464	81	2,279
HO overheads	5	457	80	2,246
Total allocated income per front-line employee	36,425	101,138	10,123	21,326
Overall cost–income ratio	59%	59%	114%	119%
of which – at local level	58%	16%	109%	45%
local + cash / transaction control	59%	58%	113%	98%
local + cash / transaction + network control	59%	58%	113%	109%
Overall profit / loss by product type per front-line employee	14,829	41,534	-1,436	-4,108
Average overall profit / loss per front-line employee	24,547		-3,000	
6-month profit / loss as a % of estimated capital deployed	83%		-44%	

* the allocated central transaction processing cost for City Central's non-credit business is very large because it handles all automated salary payments for clients and this is offset by very much higher fees earned per front-office employee.

Looked at this way, the social dividend implicit in maintaining the branch in Gulu Town seems very high but this overstates the burden of costs involved in this. Gulu Town only makes a loss when it gets allocated a share of costs that could be reduced only very slightly were the branch to be closed (i.e. the only partially variable network control costs and fixed central overheads). Almost all of these costs that push Gulu Town into a loss would still have to be carried by more profitable branches even if that marginal branch was closed. Without the allocation of these costs Gulu Town would do slightly better than break even. Therefore, provided that the Gulu branch is typical of the more marginal branches within the PBU network, the best estimate of the social dividend achieved by keeping such branches open is that the PBU forgoes any certain return on the very small amounts of capital thereby tied up.

6.4 Caisse d'Epargne Nord France Europe (France)

Caisse d'Epargne Nord France Europe (CENFE) has also consolidated its position through merger of three regional savings banks in the north west of France (Flandres, Hainault and Pas de Calais). This was completed in 2008 and the new merged entity will be in a position to expand outside its region but most probably northward into Belgium to exploit the integration of markets around the European transport corridor for which Lille is a major hub. It now has a total balance sheet of in excess of 20 billion euros and a total of 277 branches.

CENFE has just invested in a sophisticated GIS market mapping system that links its client records to local market survey data down to branch catchment area. A geographical unit within the overall region is allocated to the branch that hosts the accounts of the majority of CENFE customers living in that unit. The survey data allows population in each branch catchment area to be estimated and various measures of customer penetration can be calculated – total penetration, core customer base (for which CENFE has meaningful contact details) and priority customers (eligible for active personal contact). The survey data also allows an index of relative average income to be calculated for each catchment area. These are the variables used for this study but they are not the limit of the system.

The market potential data plus branch data for 2006 for a total of 23 branches have been used at this stage in the study. CENFE are currently collating branch data for 2007 for the whole merged entity. The sample used so far comprises all the branches in Lille and all the branches in one of the other more mixed sub-divisions running along the border with Belgium. This latter group includes a couple of rural branches but nothing systematic can be said about them compared to urban branches, although a fuller data set would allow such a comparison to be made. At this stage, it is, however, possible to compare the financial performance of larger versus smaller branches and branches in catchment areas with above average income versus those with catchment areas with below average income. The cut-off between larger versus smaller branches was set at those with six or more full-time equivalent staff versus those with five or less, which splits staff evenly between the two groups. The above average income versus below average income distinction splits total staffing roughly two to one.

This data suggests that staffing is allocated largely in line with client numbers and does not yet take account of differential client profiles. This is not surprising given that the GIS market mapping system is very new and has not yet had time to influence the deployment of staff resources. It also suggests that smaller branches tend to be in slightly better off catchment areas than larger ones and have slightly better customer profiles in terms of how many clients can be contacted and how active they are.[7] Similarly, as a group, the branches in catchment areas with above average client income have more core clients per employee and a slightly better profile of clients than those in catchment areas with below average client income.

7 Even though the proportion of the contactable core client base that is eligible for active contact is lower than in the larger branches the contactable core base is so much higher as a proportion of total client numbers that the proportion of total clients eligible for active contact is higher than in the larger branches. Hence the assertion that the overall profile is better. This also applies to the penetration measure. In fact both types of branches have broadly the same penetration in terms of total clients but the higher share of core clients among total clients of smaller branches gives a better quality of penetration and hence the higher effective penetration ratio shown.

Table 6.7 Key business parameters for the sampled CENFE branches

GIS Data based on June 2007	Branch staffing		Client income	
Branch financial data based on 2006 – Euro 000s	Larger (6+)	Smaller (2~5)	Above average	Below average
Number of branches in sample	7	16	15	8
Total staffing in the sample branches	**54**	**57**	**73**	**38**
Average core client base per employee	990	985	1030	900
– as a percentage of total client base	55%	69%	66%	54%
– proportion active	80%	84%	82%	81%
– proportion eligible for active contact	42%	39%	42%	37%
Estimated penetration of population (core clients)	25%	34%	33%	32%
Client income index (average = 100)	98	103	109	87
Deposits mobilised per employee	9,738	8,732	9,621	8,453
Percentage of deposits mobilised on-lent by branch	69%	59%	61%	73%
Estimated capital deployed				
– per branch[8]	3,433	1,283	1,942	1,929
– per employee	445	360	399	406
Branch income earned per employee	271	260	266	266

8 The crude estimates of capital deployed at each branch are OPM's own calculations of the approximate amount of regulatory capital required to support branch lending and investments (fully weighted and requiring an 8% capital allocation) plus the deployment of any deposits not on-lent at branch level in low risk liquid assets (assumed 10% risk-weighting and therefore only requiring a 0.8% capital allocation). Money raised through the special *livret-A* programme which is passed on to public housing agencies is not treated as requiring capital.

Interestingly, however, this does not translate into higher levels of branch income earned per employee as shown in the table above. This is partly because smaller branches and, counter-intuitively, branches in catchment areas with above average client income, have lower on-lending ratios. This issue needs further investigation and a larger sample because the large / small and better-off / worse-off groupings overlap in the current sample in ways that allow just one or two branches to distort the group averages. Nevertheless the scatter charts below the table, which use the current sample, suggest that (a) branch staffing is determined much more by catchment area customer numbers than relative client income; and (b) there is no systematic link (that is yet apparent) between income per employee and relative client income.

Figure 6.3 (A) Staffing by core client numbers / income

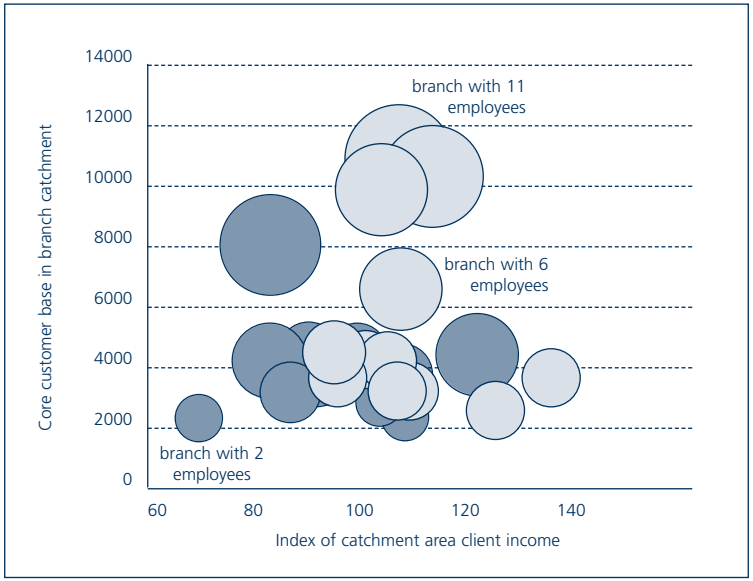
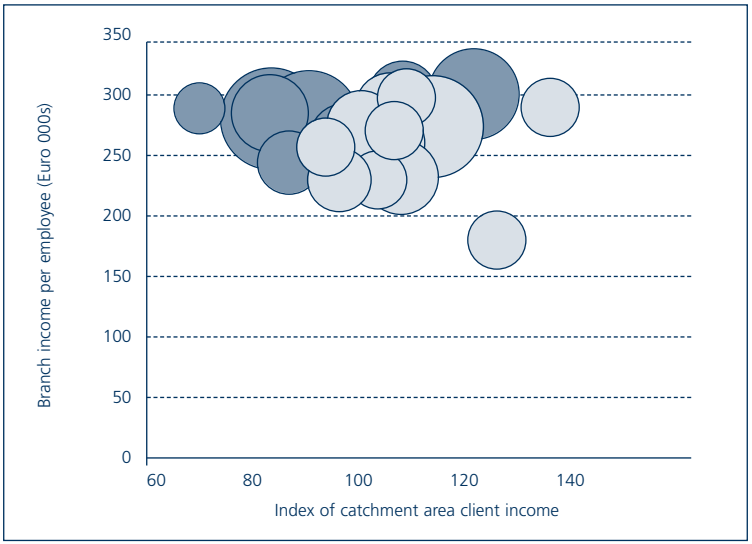


Figure 6.3 (B) Branch income per employee / staffing by client income



Better resolution should be possible when the full data set for the whole merged entity is available. Given that the market planning system and related customer profiling has yet to shape the income yield from different catchment areas, it is particularly interesting to see how closely resources have been fitted just to core customer numbers.

The following tables take something of the Caixanova costing methodology and recreate it for the CENFE branches in the current sample. It has not yet been possible to create the adjustment for out of branch client activity, but it has been possible to calculate tiered cost income ratios at common average rates for each key element of cost. These are shown in the first table below and the cost income ratios arrived at just using these average rates are virtually identical at all levels for both splits of the sample branches modelled.

By contrast, the second table below calculates the same cost ratios but using actual costs, not standardised averages. Interestingly, it appears from this table that in the less advantaged catchment areas CENFE not only scales the number of staff to fit the available number of customers but it also manages to keep actual costs per employee below average costs across the whole sample. Ultimately this makes less advantaged branches more not less profitable than branches in the better off catchment areas.

Table 6.8 Cost ratios for the sampled CENFE branches using standardised costs

Branch financial data based on 2006 – Euro 000s	Branch staffing		Client income	
	Larger (6+)	Smaller (2~5)	Above average	Below average
Average staffing per branch (full-time equivalent)	7.7	3.6	4.9	4.8
Branch income per employee	**271**	**260**	**266**	**266**
Total allocated costs per employee	**219**	**216**	**219**	**216**
of which – local costs	145	145	146	143
HO cash/transaction/network control	28	25	27	27
HO overheads	46	46	46	46
Overall cost–income ratio at average unit costs	**81%**	**83%**	**82%**	**81%**
of which – at local level	54%	56%	55%	54%
local + cash/transaction/network control	64%	65%	65%	64%
Overall profit / loss by product type per front-line employee	52	44	47	50
➜ *Reminder* – estimated risk-weighted return on capital	12%	12%	12%	12%

Table 6.9 Cost ratios for the sampled CENFE branches using actual costs

Branch financial data based on 2006 – Euro 000s	Branch staffing		Client income	
	Larger (6+)	Smaller (2~5)	Above average	Below average
Average staffing per branch (full-time equivalent)	7.7	3.6	4.9	4.8
Branch income per employee	**271**	**260**	**266**	**266**
Total allocated costs per employee	**224**	**212**	**223**	**207**
of which – local costs	149	142	149	137
HO cash / transaction / network control	27	25	27	26
HO overheads	48	45	47	44
Overall cost–income ratio at actual unit costs	**83%**	**81%**	**84%**	**78%**
of which – at local level	55%	54%	56%	51%
local + cash / transaction / network control	65%	64%	66%	61%
Overall ratio between actual and average unit costs	**102%**	**98%**	**102%**	**96%**
of which – at local level	102%	98%	102%	95%
local + cash / transaction / network control	102%	98%	102%	96%
Overall profit / loss by product type per front-line employee	47	49	42	59
➜ *Reminder* – estimated risk-weighted return on capital	11%	14%	11%	15%

Overall, therefore, CENFE gives the clearest example (amongst the banks examined in this study) of a savings bank that scales its costs to fit the varying available customer base across different branch catchment areas. Equally, the higher returns on capital at smaller and less advantaged branches are unlikely to remain unchanged as the new GIS market planning and customer profiling systems start to influence the deployment of resources and the income generated per employee from better off catchment areas rises. But, and this is the crucial difference with savings banks, the branches in the less advantaged catchment areas should still be able to deliver a sufficient return on the equity tied up in them while the branches in the better-off catchment areas should help lift the overall return on CENFE's total equity.

6.5 Red River Bank (United States of America)

Red River Bank is an example of a privately-owned community bank that is common across much of the United States and a contrasting model to the large national savings banks (mostly publicly owned) that have been covered in the previous case studies. It is very much a local bank, rooted in the community that it serves through clusters of branches and a variety of electronic service delivery channels (cards, ATMs, telephone, internet, etc).[9] Despite it being privately owned, Red River Bank also demonstrates the core values of a savings bank being very retail-focused, strongly rooted in the region it serves and having a strong ethic of social responsibility.

Three branches have been modelled for Red River Bank that together account for one fifth of its total deposit base. The first of these – Pineville – is an urban branch and the second largest in the whole branch network. The second – Lecompte – could be described as a rural branch that mostly services larger accounts of local agricultural and horticultural businesses and their owners. The third – Forest Hill – is located close to Lecompte but serves a completely different market segment, namely the individuals who work for those agri-horticultural businesses, among them many migrant workers. Basic comparative statistics are shown for the three branches in the table below.

9 Red River Banks also operates mobile banking units. However, these are not operated in the areas covered by the branches in the study's sample.

Clearly, based on this data, just being a large urban branch does not guarantee Pineville a stronger balance sheet than the rural branches; it does generate more deposits per employee and can support more staff servicing depositors. But it has a smaller loan business despite its bigger deposit base. The advantages coming from the more up-market customer base at Lecompte are also clear. Its deposit base is 60% of that of Pineville but it can support more loan officers and the loan business it puts on its own loan books generates almost twice as much income than that generated at Pineville. It also has to process less over-the-counter and ATM transactions per dollar of deposit (0.003) than does Pineville (0.004), which helps keep staff costs down. In contrast, Forest Hill has a much smaller deposit base (barely a third of the size of Pineville) but must process more over-the-counter and ATM transactions per dollar of deposit (0.005) than either of the other two branches. It therefore has a much lower deposit mobilisation per employee servicing depositors than do Pineville and Lecompte. Forest Hill also supports a smaller loan business with the sort of relative income-generating potential seen in Pineville and not Lecompte.

These differences needed adjusting for and also needed to be drawn out carefully in the modelling done for Red River Bank. Unlike BCSC in Colombia, Caixanova in Spain and CENFE in France, Red River Bank's accounting regime does not include any internal transfer pricing to create a notional interest income to offset the interest cost of deposit-taking. Nor is there any notional cost of funding to offset some of the actual interest earned on loans. This hits a branch like Pineville particularly hard because it raises a lot of deposits but earns relatively little from branch lending, so much so that its accounts record it as having negative net income. The situation is exacerbated by a relatively high degree of centralisation of bank lending: almost all loans over $50,000 and therefore almost all mortgage lending are booked centrally and not at the branch that sustains the wider banking relationship with these customers. Because of this, a branch like Pineville can incur the interest expense on deposits that fund a loan to one of its own customers but not receive income from that loan because it is booked centrally. This is not just an issue for Pineville; indeed only Lecompte Branch across the whole Red River Bank network books enough income to cover its operating costs and make a profit even though the bank as a whole is profitable.

Table 6.10 Key business parameters for the sampled RRB branches

Staffing data all shown as full time equivalents Branch data based on 2007	Pineville URBAN	Lecompte RURAL	Forest Hill RURAL
Total branch staff	**10.50**	**8.50**	**7.50**
of which – management overhead and support staff	0.95	0.60	1.50
supporting loan business	1.71	2.20	1.00
servicing depositors	7.84	5.70	5.00
Deposits mobilised (US $ 000s – average in year)	49,823	28,675	17,969
– per employee involved in deposit-taking	6,354	5,031	3,594
Teller transactions in branch (000s)	163	74	83
Transactions using branch ATMs (000s)	39	13	12
Income from branch loan portfolio (US $ 000s during year)	716	1,202	396
– per employee involved in branch lending	419	546	396

Creating a full internal transfer pricing system and rebooking the loan income back to the branches (that generate the lending opportunity) is well beyond the scope of this project. It has, however, been possible to create a crude proxy for internal transfer pricing that is sufficient to separate net interest earned by Red River Bank into a margin on deposit-taking and a margin from lending (plus a net yield on investment of capital).[10] On this basis, it is possible to compare the profitability across the three branches based solely on its deposit-taking activity. This is what is shown in the table that follows. Once this has been done, the actual income from lending at the three branches could be deducted from total branch income – leaving just fee and commission income on deposits, plus a few other minor items. Then the notional interest income on deposits at the three branches was added in to create a net income just related to the deposit-taking business of those three branches. This could then be compared with the fully-loaded direct costs of servicing depositors at those three branches in the same way as has been done for the other case studies.[11]

10 The approach taken was to assume that the whole deposit base of just under $500 million could have been invested in risk-free instruments yielding 5% on average through 2007. This fits with the trend of Federal Funds rates through the year before the so-called 'credit crunch' broke which would dominate the average yield earned through to the end of the year (the new much lower rates would have only had a major impact going through into 2008). Thus, the whole deposit book could have earned just short of $25 million and in the modelling for this study the three branches are credited with a fifth of this between them, pro-rata to their share of bank-wide deposit mobilisation. On the other side of the balance sheet, the loan book needs funding and because the yield curve through most of 2007 was relatively flat, the same 5% risk-free rate is used as a proxy for funding costs. Thus in the modelling, the whole bank-wide loan book of $450 million has a cost of funding of $22.5 million and this is deducted from actual interest received on lending. Any residual net interest not calculated in this way could then reasonably be ascribed to investment of capital.

11 Branch staff salaries were grossed-up for other related costs (taxes, insurance benefits, pensions, etc) and then the total cost of branch facilities and other operating expenses were spread pro-rata to full time equivalent staff numbers. Then, a proportion of the cost of the branch manager that reflected the share of his time not spent on cultivating lending opportunities, plus all of the cost of support staff (couriers, maintenance, etc) and all of the branch business development cost was spread across the front-line. The total general costs of all front-line staff were then allocated either to lending or deposits, based on the split of their workload. Finally, at this pure direct branch cost level, (a) certain costs specific to deposit taking were added to the total fully loaded costs of staff servicing depositors and (b) costs specific to branch lending were added to the total fully loaded costs of staff working on lending. This last step resulted in a total cost of servicing depositors that could be compared to the newly identified branch income from deposit-taking described in the previous footnote. It also provided a total cost of branch lending that could be rolled up with rough estimates of what it might be at other branches (a third of their total direct branch costs) and actual data for the cost of central lending units. This rolled up cost of lending could then be deducted from the newly identified net bank-wide income from lending as step on the way to calculating the overall profit derived by the bank from that lending.

The next step was to allocate central costs to the branch deposit business, again using broadly similar rules to those used in the other case studies. Ten percent (10%) of central costs (that relate to operational support costs) were allocated to the lending business and the rest out to the sampled branches (pro-rata to their share of total bank-wide teller transactions). Central accounting and finance costs were allocated out pro-rata to the share of the total bank-wide balances represented by deposit balances at the sampled branches (i.e. the share of their deposits in total bank-wide assets and total bank-wide liabilities / capital).[12] Network and personnel control costs were allocated pro-rata to branch numbers and personnel, as in the other models. That just left a small amount of fixed central overheads (the central executive, marketing expenditure and business development, etc) to be allocated out pro-rata to the newly calculated share of total bank-wide net income accounted for by deposit-taking at each of the sampled branches. The cumulative effect of all this is shown on a per-employee basis in the table on the next page.

What immediately becomes strikingly clear is how income per deposit-taking employee is spread rather evenly over the three branches and how direct local costs are just as evenly spread irrespective of a branch's overall characteristics. When deposit taking is accounted for on a like-for-like basis, Pineville comes out top in terms of income per employee, Lecompte in the middle and Forest Hill at the bottom. But the gap between the two extremes on deposit income or costs per employee involved is barely 10%. If, however, central operational support costs are allocated out, the picture changes dramatically. Lecompte is favoured by the relatively low use by its depositors of over-the-counter services compared to the value of money deposited. This means it attracts a lower allocation of central support for such branch operations. Pineville and Forest Hill, by contrast, have higher activity rates relative to amounts held on deposit and therefore attract higher proportionate allocations of central operational support costs. Central control costs also bear more heavily on Forest Hill because these are allocated per branch or per employee.

12 This approach was chosen because the bank outsources its basic data-processing to a common provider of such services (i.e. to a co-operative of community banks of which Red River Bank is a member). The bulk of accounting work done by bank staff relates to movements in total balances by account code not individual transactions. Therefore, the accounting effort has been spread pro-rata to the balance sheet rather than transactions. This in turn means a larger share of central accounting and finance costs is carried by the loan business than would be the case if bank staff had to account for all individual transactions.

Table 6.11 Cost ratios for deposit-taking at sampled RRB branches

2007 – US $ 000 per employee working on deposits unless otherwise indicated		Pineville	Lecompte	Forest Hill
Average allocated income on branch deposit business		**162**	**154**	**150**
Crude estimate of capital required to support deposit-taking		51	40	29
Total estimated expenses related to deposit taking		193	149	170
of which	– direct, local level (fully variable)	57	52	52
	indirect transaction level (fully variable)	119	75	95
	indirect control level (semi-variable)	12	16	18
	central overheads (fixed)	5	5	5
Overall cost-income ratio including central overheads		**119%**	**97%**	**113%**
of which	– at direct, local level only	35%	34%	34%
	direct plus fully variable indirect	109%	83%	98%
	direct plus all indirect transaction / control	116%	94%	110%
➜ *Reminder*	– overall cost-income at 1% higher risk free rate	86%	73%	91%
	overall cost-income at 1% lower risk free rate	197%	143%	149%

As a result, Lecompte just breaks even on deposit-taking and Pineville and Forest Hill make small losses (i.e. their cost-income ratios, as presented above, are beyond 100%). The table also makes clear how finely balanced deposit taking was for the three sampled branches even at the higher Federal Funds rates being applyed in 2007. Now that those risk free rates have been cut sharply after the so called 'Credit Crunch' broke in late 2007, all Red River Bank branches are likely to be making a loss on pure deposit-taking activity were the funds mobilised only to be invested at risk-free rates of return.

This is hardly surprising – savings banks in advanced market economies with the sort of low-interest environment seen since the disinflation of the 1990s would all have experienced the same problem. Profit for them comes from doing a full range of retail business with their depositors and in particular meeting not just their savings and transactional needs but also their housing, consumer and small business finance needs. Red River Bank is no exception in this respect, with 90% of its deposits deployed in retail lending. It is therefore important to allocate the profit from that lending to the branches that sustain the depositor base that both funds and generates that lending. This allocation is reported in the table on the next page.

The allocation of the profit on lending was estimated by calculating the total net profit on lending for the whole of Red River Bank, by combining lending at branch level and the lending done centrally and then by allocating this to branches pro-rata to deposits mobilised. Net income on lending was calculated on the basis of total loan interest and fee income for the bank, less provisioning and also less the estimate of funding costs calculated in the way already described. From this, all costs of central lending units were deducted as were the estimated costs of branch staff supporting the loan activity. Finally, 10% of the central operational support costs and about 40% of central finance and accounting costs were also deducted. The resulting total amounted to just about 40% of total profit before tax at the bank.

The allocation of a share of the total profit from bank lending down to branch level brings both Pineville and Forest Hill into break-even levels (i.e. at 97% and 99%, respectively). This is also in consideration of the margins of error for an exercise like this. Extra profit from lending brings with it a substantial extra capital requirement and returns on capital are low at all three branches.

Table 6.12 Cost ratios at sampled RRB branches including lending profit

2007 – US $ 000 per employee working on deposits unless otherwise indicated	Pineville	Lecompte	Forest Hill
Average allocated income on branch deposit business	162	154	150
Share of bank-wide loan profit (pro-rata to deposits)	**42**	**33**	**24**
Estimate of total net income due to branch	204	189	174
Total estimated expenses related to deposit taking	193	149	170
Overall cost-income ratio including central overheads	95%	79%	98%
Estimated capital required to support deposit-taking	51	40	29
Estimate of extra capital required to support lending	**423**	**334**	**240**
Estimate of overall return on capital at branch level	2%	10%	2%
➜ *Reminder* – overall cost-income at 1% higher risk free rate	93%	78%	96%
– overall cost-income at 1% lower risk free rate	97%	81%	99%

The real importance of adding in loan profit is that it insulates the branches from volatility in the risk-free rate – a 1% fall in that rate still reduces branch deposit income by a substantial amount. But 90% of this loss is recovered through a widening margin on its allocation of the bank-wide loan business.

In conclusion, Red River Bank also demonstrates the same capacity seen in other case study banks to scale its direct local branch costs to broadly fit the income generating potential of different branch catchment areas. As in the other cases studied, it can also run small branches in relatively more disadvantaged rural areas at breakeven. To do this, however, it needs a mixed deposit and lending business. The fact that the sampled rural branch in a less well off catchment area (Forrest Hill) only just breaks even is more a reflection of general profitability issues than anything to do with either its size or characteristics. Interestingly, the larger urban branch in the sample (Pineville) has virtually the same level of profitability.

6.6 Hatton National Bank (Sri Lanka)

Hatton National Bank (HNB) is an example of a privately-owned commercial bank that combines a strong retail presence throughout Sri Lanka with a demonstrable commitment to corporate social responsibility. A total of 114 branches are organised into three zones that are in turn split into regions to reflect local geography. The branch network is also graded from Premier and Super-Grade (the large city branches accounting for about 10% of all outlets) down through Grade A to Grade C (which capture the smaller urban and rural branches). The two branches chosen for this modelling exercise were Wellawatte (a Super-Grade branch in the capital city, Colombo) and Hambantota (a much smaller Grade C rural-based branch).[13] The table below illustrates the difference in scale of the two branches and the significant difference in income per employee between the two (in contrast to costs per employee, which are very close).

13 These classifications of the branches reflect the status as of December 2007, when field studies were conducted.

Table 6.13 Basic business parameters for the two sampled HNB branches

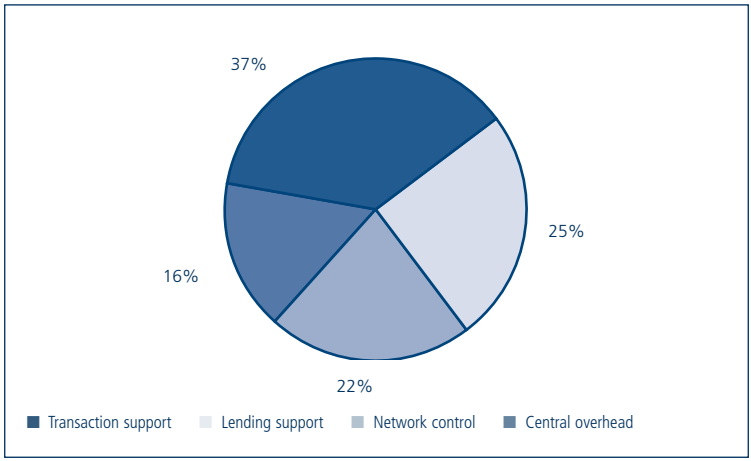
Data based on Jan-Sep 2007	Wellawatte branch (major urban)	Hambantota branch (smaller rural)
Total number of staff	55	15
of which – credit officers	15	6
other front-line staff	32	6
branch control / support	8	3
Total branch income (*Rupee millions*)	155.5	26.0
per front-line employee	3.3	2.2
Total branch expenses	56.5	15.5
per front-line employee	1.2	1.3
Overall local direct cost-income ratio	36%	60%

Fortunately, HNB operates an internal transfer pricing system for funds passed up to Head-Office Treasury, so the income figures shown for the branches are not distorted by surplus deposits that cannot be deployed locally. As a result, the local direct cost income ratios shown in the table above do not need adjusting at branch level for missing income.

This immediately raises the main issue addressed in this case study: Does the rural Hambantota branch earn enough of a local surplus to cover a reasonable allocation of central costs? We find that it clearly covers its local direct costs amply with its own income but not to the same very marked degree as the super-grade Wellawatte branch based in the capital city.

With the HNB case study, there is a good base of cost-centre data on head-office costs that need to be allocated out (to branches). But identifying exactly how much of variable central (transaction and loan related) support costs should go to each branch is more complicated. This is because of an ongoing systems upgrade that was being rolled out by the bank right through the period modelled and only completed for three quarters of the branch network by the end of the exercise. As a result, getting consistent transaction data for the whole branch network has not been easy and straightforward. However, despite this constraint, HNB has provided enough data to answer quite conclusively the question posed above.

Figure 6.4 HNB head-office cost mix



Central transaction processing support costs were allocated pro-rata to each branch's share of total front-line staffing (2% share for Wellawatte and half a percentage point for Hambantota). This allocation rule was used because of the difficulties mentioned above in getting comparable non-credit transaction numbers for the whole nine months across the whole network. Nevertheless, the relative allocation of these costs – a four times larger charge going to Wellawatte than Hambantota was confirmed by a comparison of non-credit transaction numbers for the branches. Lending support costs were allocated pro-rata to each branch's share of total new lending during the nine months (5% share for Wellawatte and a quarter of a percentage point for Hambantota). Semi-variable control costs were mostly allocated per branch except for those clearly related to personnel management, which were allocated pro-rata to front-line employment. Fixed overheads were allocated pro-rata to other central cost allocations.

Table 6.14 Key profitability indicators for the sampled HNB branches

Data based on Jan-Sep 2007 – SLK rupee thousands.	Wellawatte urban branch	Hambantota rural branch
Average allocated cost per front-line employee	**2,346**	**2,197**
of which – at local level	1,203	1,293
HO variable transaction / credit costs	818	395
HO semi-var network control costs	141	363
HO fixed overheads	184	146
Average allocated income per front-line employee	**3,309**	**2,167**
Overall cost-income ratio	**71%**	**101%**
of which – at local level	36%	60%
local + transaction / credit support	61%	78%
local + txn / credit + network control	65%	95%

On the basis of these calculations, the conclusion that can be drawn for HNB is that its marginal rural branches may very well reach just about break even, but earn very little or nothing on the capital tied up in them once all costs are allocated out. This is broadly the conclusion drawn for most of the banks in this study and, as with them, this does not compromise the overall health of HNB because branches in more favourable market catchment areas account for the bulk of its capital deployment. These branches in more favourable market catchment areas – such as the Wellawatte branch – almost certainly do make a significant positive return on that capital. Moreover, to close the marginal HNB branches just because they do not earn a targeted return on the small amounts of capital deployed in them could actually reduce overall profit for the bank. This is because they do almost certainly cover the vast bulk of any fixed central overheads and semi-variable control costs that could reasonably be allocated to them and which would unlikely be reduce were the branch network to be cut back.

7 TAKING THE STUDY'S RESULTS FORWARD

The results of this study are significant because they provide greater insight than before about the various mechanisms that allow some financial institutions, such as savings banks, to maintain a strong commitment to local community development. The study has looked in particular at these banks' provision of financial services to a broad spectrum of clients including low-income individuals, and their support of socially-relevant projects and programmes that promote the socio-economic development of local communities. Specifically, the analysis of the different cases covered in this study shows that these institutions have the ability and flexibility to be able to scale direct local branch costs to broadly fit the income generating potential of quite disparate catchment areas. This in turn allows these banks to maintain their strong target-market orientation while at the same time operating profitably and sustainably.

The study has covered only a sample comprising of two branches in each of the cases analyzed. It will therefore be interesting to consider rolling out the analysis to cover all other branches of the banks and identifying which of these would be classed as operating in marginal economic areas. The main requirement for such an undertaking would be to provide standard branch P&L data (for all branches) and then collect staff numbers in total and with a split between cashier / tellers and loan officers. The provision of a basic balance sheet for each branch would also help split income between the credit and non-credit businesses and would add to the richness of the data. This would then enable the calculation of a more robust estimate of the social dividend attributable to keeping branches in marginal areas open as well as indicating how easily this is covered by surpluses at the other branches. It would also allow the various forms of return made by savings banks to be compared to each other in terms of both relative scale and importance.

Moreover, it would be useful to consider the differences between branches in marginal areas and those in more affluent locations in a more dynamic setting by introducing the time dimension. For example, does the social dividend change as branches evolve and their markets develop? Does a marginal branch grow with its customers? We may find that on average, some marginal branches are growing more slowly than others, but it would be useful to see the role of these marginal bank branches in supporting overall bank growth.

Lastly, the present study is primarily focused on the social dividend which can be directly ascribed to the provision of financial services to customer groups and to geographical areas that other banks may not consider as part of their target market – i.e. we have looked at the differences between branches in more marginal market catchment areas and stronger ones operating in more favourable market conditions. One early outcome from the study has been as interest expressed by some of the case study banks in building upon the findings of this study to cover a broader measurement of the social and economic value created by savings banks.[14]

14 The measurement of this value or impact created is almost always made against an assessment of the market reach of financial institutions. This is premised on the understanding that reaching the poor and / or providing financial access to an otherwise unbanked or hard to reach clientele in itself constitutes an important development outcome. There is however much debate surrounding the definition of who the poor are, and which segments of the poor should financial services be oriented towards. Moreover, the debate also extends to how and where the impact can be measured. Should it be measured in terms of the direct impact among the poorest clients of the financial service provider? Or should it be measured to cover the employment-generating effects of the services accessed by those who are not-so-poor? Lastly, there is an entire discussion on the cost-effectiveness of providing financial services versus other initiatives – which covers how the impact of savings banks can be measured in terms of the financial access they provide and the other investments institutions make in the areas of socio, cultural and economic development. This can be challenging especially if this latter set of activities are sometimes classified as part of the banks' marketing activities and will therefore pose difficulties in isolating the effects or outcomes.

This possible broadening of the remit of the study, would of course, require a somewhat different set of tools that could allow impact measurements that, for some, banks would transcend the provision of financial access narrowly defined: some of the banks' have an involvement in other non-financial activities. We consider this response by these banks to be a positive sign of how socio-economic impact evaluation is valued within their systems and culture of institutional planning and management. The merits of undertaking such an extensive evaluation will enable these institutions to more strongly communicate their value to both internal and external stakeholders, especially in the context of how more and more commercial banks are increasingly adopting similar philanthropy-driven strategies and activities.

WSBI – ESBG – The Global Voice of Savings and Retail Banking

WSBI (World Savings Banks Institute) is one of the largest international banking associations and the only global representative of savings and retail banking. Founded in 1924, it represents savings and retail banks and associations thereof in 92 countries of the world (Asia-Pacific, the Americas, Africa and Europe – via ESBG, the European Savings Banks Group). It works closely with international financial institutions and donor agencies and promotes access to financial services worldwide – be it in developing or developed regions. At the start of 2006, assets of member banks amounted to more than €8,081 billion, with operations through more than 191,000 branches and outlets.

ESBG (European Savings Banks Group) is an international banking association that represents one of the largest European retail banking networks, comprising about one third of the retail banking market in Europe, with total assets of € 5,215 billion (1 January 2006). It represents the interests of its members vis-à-vis the EU Institutions and generates, facilitates and manages high quality cross-border banking projects.

WSBI and ESBG members are typically savings and *retail* banks or associations thereof. They are often organised in decentralised networks and offer their services throughout their *region*. WSBI and ESBG member banks have reinvested responsibly in their region for many decades and are one distinct benchmark for corporate social *responsibility* activities throughout Europe and the world.

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