Finding lost revenue deep "in the weeds"

Revenue analysis will help Chemung Financial dig out more than a million-and it won't be just a one-time find

By Steve Cocheo, *executive editor & digital content manager*

We call it 'tribal law,'" says Karen Makowski, explaining how practices, procedures, and even pricing become embedded in a bank for years without anyone questioning it, reviewing it, or revising it.

Every bank has its share of tribal law. If you don't agree, you either work at a de novo bank, or haven't looked hard enough. It's there.

Makowski, executive vice-president and chief administrative officer and risk officer at $1.2 billion-assets Chemung Financial Corp., Elmira, N.Y., gives an example that comes down to a wrinkled, yellowed piece of paper. This slip contained four rules for ACH processing that someone in deposit operations followed for resubmitted items that hadn't been honored the first time.

It was such a routine matter that no one had asked about the four rules on that slip for years. Who has the time to look at such minutiae? The employee's predecessor had passed the slip on long ago, with the instruction that it was "the way it is done." *Tribal law.*

The problem was that this bit of tribal law was costing the bank money. No, it wasn't a hemorrhage of green ink. And it wasn't a "loss," not in the sense of a loan gone bad or an investment being sold way below its purchase price. Instead, the slip caused a lost income opportunity.

Chemung Financial recently found, with the help of an outside consultant, nearly $1.5 million in annual *pre-tax*revenue opportunities that the company had been missing out on. Note, this is not a one-time windfall, not a one-time accounting adjustment, not a major new product line, not a layoff-and not something as simple as reviewing utility bills and finding mistakes or waste. It's an ongoing gain, subject to evolving market and customer behavior, of course, but improvement that's the result of a combination of correcting "tribal law," adjusting practices to fit alternative industry approaches, closing open loops that actually prevented revenue from being collected, and bringing daily bank practice in line with what the bank had already been disclosing as its policies, but wasn't always actually practicing.

Some of the gains resulted from the equivalent of financial archeology. Chemung's consultants found such buried items as special waivers where customers weren't paying posted fees. The reasoning for the waivers-and possibly even the personnel originally involved-was long forgotten. Another example: Markets where customers could access foreign ATMs without charge, to make up for lack of branch coverage. The company has been on an acquisition path in upper New York State as well as in nearby parts of Pennsylvania over the last two decades, and it has found that purchasing other banks also can mean acquiring their tribal law. In the course of that expansion, the original lack of proprietary ATMs and branches had been filled in, negating the need for the regional waivers. But the waivers had continued.

Chemung's path to improvement

When you are in the picture, it's hard, at times, to see such things. Yet, the income gains-"revenue enhancement" they call it-that Lodestone Banking Consultancy, Inc., found for Chemung might never have surfaced but for an unexpected shift in the company's corporate strategy in late 2011.

With the tight margin squeeze affecting Chemung and many other institutions, management felt the time had come to revisit many of the bank's fees and charges as well as product offerings.

Chemung had already explored and adopted many of the "usual suspects," which banks go to on the cost side, over the years. Like many other community banks, employees wear multiple hats-working a job and a half, or even two jobs, according to Makowski.

"We're a pretty lean company," explains Ronald Bentley, president and CEO. At the same time, doing business in slow-growth markets, the bank had pursued mergers to augment organic growth, while confining those to markets it understood. You wouldn't find Chemung looking into downstate markets, for instance, which are a different animal from upstate New York.

Management also insists on sticking to community banking practices, including service and an attitude of working with customers going through rough times. "We do a lot of things that the bigger banks do not do," explains Bentley.

An internal team had put together a combination of fee increases and other efforts to bolster income. But, with the bank on the verge of implementing a broad revamp of its schedules, a national event gave it pause.

In the wake of the implementation of the Durbin Amendment, Bank of America proposed a $5 per month fee for debit cards. Top management there defended the fee, which quickly became controversial, in part because it was possible to reduce charges by bringing more business to BofA. However, only the main thrust caught the eyes of media and consumers, and the megabank backed off. Other large banks had already done so, and BofA stepped back. But the well was poisoned.

Now, with any kind of fee increases suddenly looking like publicity toxins, Chemung's management saw that it was time for a rethink. More income, while essential, could not come at the price of bad publicity.

Digging in and asking questions

Lodestone's method is simple in concept and extraordinarily detailed in execution. "We believe that every bank in America is losing $1 million [in income opportunities] per $1 billion in assets," says Mark Clark, managing partner as well as half of a husband-and-wife team that specializes in what Lodestone calls "forensic revenue analysis."

"Forensic" calls to mind television shows like *CSI*, and while the firm doesn't literally use microscopes and the like, the approach requires going into such depth. Beyond this, the firm is adept at tracing flows of data-and lack of flows, in some cases-among a bank's diverse operations and silos, in ways busy insiders can't necessarily see. Shahin Clark, president, began her consulting career as an internal advisor at Marine Midland Bank (now HSBC), and went on to consult with other institutions through another firm before going out on her own in 1994.

The Lodestone technique combines intimate understanding of bank profitability drivers with in-depth knowledge of multiple core and general ledger systems, where much, but not all, of a bank's missed revenue opportunities lie.

Long hours spent in the guts of Chemung's systems went into this project, but finding tribal law also requires the sociologist's role of talking to the members of the tribe.

"Lodestone just keeps asking, 'Why?,'" explains Chemung's Makowski. Shahin Clark and her team spent many days on premises, talking to everyone from officers to staffers with their hands on current processes, to understand how the bank worked. "They are terrific at peeling things back, layer after layer," to see what's at the root of an issue, according to Makowski. "They solved a lot of leakage, and we found that nickels and dimes add up."

Often working side-by-side with the consultants, Michael Crimmins, senior vice-president, support services, found himself not only helping them gain access to essential data, but serving as a sounding board. "I was also the initial vetter of their ideas," he explains.

In essence, the firm's approach isn't one of adding a cookie-cutter template to an existing operation, but of finding what's missing in each client bank's systems and the reasoning behind everything the bank does. Extensive modeling must be done to see what will work. A factor that helped at Chemung was the "test bank" that the company pays its core provider extra for. This parallel simulated operation in the core system allows a unique depth of modeling that permits new ideas to be test-driven from end to end.

The engagement ventured beyond the bank itself, with Lodestone using its own money to open accounts at competitive institutions to test their offerings. This shopping of competitors was carried out in other ways, too. This was part of the firm's effort to show the bank not only what rivals did, but to enhance its explanation of industry practices that the bank could learn from.

Finding leaks, improving plumbing

Forensic analysis of a bank takes the investigator deep into core systems. They are full of switches and settings that may be missed when implementing one change or another, and sometimes simply re-setting something can connect dots that prevented revenue from being collected.

Cracking open a fat binder of project issues, Makowski goes over one change recommended by Lodestone that required worksheets from the system architecture to illustrate how something was being missed. Such issues could arise simply from a setting of "1" where the proper setting was "0," she explains. In commercial account analysis, this could prevent a legitimate, existing fee from even being collected.

While finding items like this is part of how the bank adopted recommendations with the payoff described at the beginning of this article, broader issues also surfaced.

One involved an issue that many banks grapple with: order of payment. Philosophies differ regarding whether to pay checks low-to-high or high-to-low. Makowski explains that Chemung had been a high-to-low bank, believing that large items like mortgage payments should be prioritized. Lodestone recommended going to a third alternative: sequential payment, that is, paying items in check number order, so that check No. 1 is paid, then check No. 2, and so on.

"We thought we only had two choices, but we had three," says Makowski. Now, the bank pays sequentially, after certain noncheck items are accounted for. (ATM debits count before checks, Makowski points out, since the customer has the cash in hand as soon as the ATM delivers it.)

Implementing recommendations

The end product of Lodestone's weeks of immersion consulting was a list of recommendations-action steps, rather than a loose list of brief ideas, with advice on how to go about putting them in place. Out of 25 recommendations, the bank decided to accept many, declining some, and putting others off for further down the road. The firm also advised the bank on the viability of the internal ideas previously assembled, suggesting which would work.

Makowski says that the firm's understanding of core systems enables it to say, "Here's the way to ask your core provider to set this or that up."

Some recommendations are invisible to bank customers, but Mark Clark says that a good third of Lodestone's recommendations typically require new or revised disclosures to customers.

"We eliminated a lot of grandfathering that we had accumulated over the years," says Makowski. A key element of the engagement had been to not recommend fee increases, but to uncover lost income, with a minimum of pain, according to Mark Severson, executive vice-president and CFO. Lodestone's job was to dig into the details, "and it was pretty thorough," he says. The firm brought time and manpower that the bank needed.

Compliance is critical when policy change meets customer. Part of the implementation process required minding notice periods required by law and regulation, which Judy Barton, vice-president, bank operations, coordinated, so notices of changes would reach customers within requirements. Messages were honed to make sure the bank made it clear what would change, and account openings during the transition period had to be managed carefully, so customers had current bank rules in hand while being apprised of what would be coming.

Individual product communications needed adjustment, and an overall communication vehicle was devised. Chemung issued a fat pamphlet covering disclosures to consumer, business, and other clients in advance of the April 1 transition, taking the opportunity to both clarify what would be changing and streamline some items that had needed improvement. The bank also used the transition to introduce a new suite of youth accounts.

Customer contact about upcoming changes was critical, according to Michael Wayne, senior vice-president and director of marketing.

"We wanted to give the branch folks an opportunity to engage with our customers," says Wayne. One purpose was to show them how product choices made years ago might need to be reevaluated as the bank implemented the recommendations. Some customers of the bank's popular free checking account-slated for revisions-would now benefit by switching to its global checking package, which enables them to avoid fees by making debit card transactions, for example.

Makowski especially appreciates the need to make things clear to customers, because, besides her title "hats," she also heads up the bank's customer care program. And she points out that employees had a horse in the race: "We're customers of the bank, too. Some of the changes affect us."

Set up a waiver stop

One takeaway every bank can use concerns that bane of profitability-the staff-level waiver. Sometimes, once input, these become set in stone, or so some would have it. But Shahin Clark says that every core system allows such waivers to be set up with a time element, so the advisability of continuing the waiver can be reassessed. "People don't always use all the features of their systems," she explains.

And one imperative for any new regime of profit improvement is the cooperation, and active participation, of senior management. Top officers help a bank's staff get past a reluctance to open up to outsiders.

At Chemung, Makowski found that it also helped to make it clear that Lodestone's engagement wouldn't reflect badly on anyone. The project was not a "witch hunt," the bank stressed; it was for the good of the company.

"Nobody was called on the carpet," Makowski says.

And another message helped. These days, when other banks in New York have been making cuts in staffing, discovering lost revenue also pays salaries.