My first professional meeting with a bank's CEO was fortunate because he told me, "Bank strategy is multibusiness strategy." His idea gave me a critical window into bank profitability. To understand the success of his bank, he said, I would have to understand the success of one of the bank's small business ventures and the positive impact it had on the bank's profits, stock price, and, in turn, on the bank's ability to determine its own future.

Since then, I have analyzed banks as diversified corporations and attempted to understand which of their businesses make money and drive their profits. In practical terms, this means viewing banks as multibusiness firms that encompass commercial banking, retain banking, and other businesses, not as single business firms. Usually, it means segmenting their income streams, direct costs, and indirect costs by line of business and allocating overhead in the light of the bank's strategic intent and strength. It also means allocating assets and capital to businesses (not to investments, which is a different matter).

Using this approach, I have been surprised by what can be learned about many high-performing banks from the public record: The multibusiness model and income segmentation give new understanding of profit drivers and of the losers that consume resources and reduce profitability.

In the 1990s, with more banks disclosing line-of-business information, some analysts question whether this segment information will be useful. They cite a lack of precision, reliance on subjective estimates, and a lack of comparability among banks' internal accounting practices as obstacles to meaningful disclosures. In this article, I will use informed assumptions based on public information--not presumably more precise internal data--to show that even rough estimates of lines-of-business revenues and expenses can open useful windows onto a bank's strategic direction, for management and analysts alike.

I'll demonstrate a method of line-of-business analysis with retrospective review of the well-known custodial house, State Street Boston Corporation. Since State Street has recently completed a three-year realignment of its businesses that reduced its commercial loans to a mere 12% of assets at December 31, 1994, and since State Street has reported line-of-business results since 1993, the results of our analysis are predictable. With lime reason to be surprised by the results, you will be better able to focus on applying the lines-of-business approach at your own bank.

FIVE STEPS TO LINE-OF-BUSINESS ANALYSIS

Let me outline the method of line-of-business analysis:

\* Identify the bank's principal businesses.

\* Tabulate the quickly identifiable revenues and expenses, by business, from the bank's records, for example, its interest earned and paid and its fee incomes by business.

\* Consider how the bank's businesses are funded, that is, what assets they have invested and how to account for their costs. (In this step, focus on the role each business plays in sourcing and investing the bank's funds.)

\* Allocate the bank's overhead to its various businesses in some reasonable way.

\* Estimate the profitability of each of the bank's businesses and consider what the pattern means.

Benchmarking, that is, comparing your businesses to those operated by other banks or nonbank financial service specialists will help you determine what are normal or exceptional costs and performance. Benchmarking can both improve your understanding of your own, or any bank's, businesses and help you estimate their profitability.

Great precision is unnecessary in this type of analysis, since its purpose is to raise significant questions quickly rather than to provide definitive answers. More research can follow, when needed, and when it can be focused on issues where a payoff is expected.

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