

Non-Core Values

The total of loan assets held by European banks that are judged to be 'non-core' to their business strategies is currently estimated to be heading on for 1.5 trillion euros. Of these assets, 900 billion are categorised as non-performing loans (NPL), i.e. to some degree toxic. However the remaining 600bn euros of non-core assets are producing some yield, albeit possibly below the aspirational levels of return on equity that could be achieved elsewhere. So is there a danger of throwing the baby out with the bathwater or, worse still, giving the baby away and getting stuck with cold murky bathwater that stagnates until it eventually dries up?

At the time when it looked like things were going to start getting tough, it probably seemed like a good idea to ring-fence the business that didn't feel like it fitted with your plans for the future and which you wouldn't go for if you had your time again. However to move these immediately out of their traditional reporting lines and into 'Non-Core Divisions' seems a less compelling course of action. The biggest danger was that management would take its eye off the ball – the asset books would be expected to under-perform by their very nature, increasingly high levels of bad debt and impairment would be accepted without challenge and the line and senior managers previously tasked with making the best of it would move onto more interesting things.

In many cases the management was effectively outsourced – with external experts in the running down and disposal of assets brought in. The risk here was that these managers, no matter how competent, were one step removed from the business and motivated and judged by completely different and potentially conflicting sets of measures and targets. The least convincing argument was that the non-core approach could result in the asset portfolios and their supporting businesses being improved to the point where they would become attractive to potential buyers. The inference here being that when something was declared non-core and moved into run-off and disposal structures it would somehow be managed better than when it was being run as a core business by managers expert in the specific field. The reality is that many of the assets will sit there leaching profit until they are disposed of in a fire sale, when the market will take them on at a price where a modest profit can be squeezed out.

RBS has led the pack in terms of disposal of non-core business – first by being more transparent about what it regarded as non-core and then by mounting aggressive disposal campaigns. The recently agreed sale of Aviation Capital means that RBS is well on target for ridding itself of most of its non-core business within the next two to three years. For most banks, though, there will be a need to manage the dwindling non-core assets for another decade or more. In some cases the portfolios and supporting businesses are simply too big or too toxic for anyone else to take on – it's all very well deciding that you don't want to pursue a particular business any more but you can't force someone to buy it.

There's also an issue around whether any organisation has absolute total control of what is core and non-core. In the past year Marks and Spencer's catastrophic drop in clothing sales was saved only by a dramatic increase in the sales of Brazilian Knickers, which any women under 60 or any renaissance or metrosexual man worth his salt will tell you is the latest weapon in the battle against the Visible Panty Line (VPL). However at the AGM a contingent of older women were up in arms about their perception that M&S has abandoned them, a probable cause of some of the overall drop in clothing sales. The message being that M&S can embrace sexy lingerie but it turns its back on sensible pants at its peril.

The same could be said of some of the less attractive and run-of-the-mill asset portfolios – vehicle leasing, smallish scale asset finance, slightly down-market high street personal finance. They may not be very sexy but they are likely to be in the €600bn of low-performing rather than non-performing loans and, in their usefulness to the small businesses and SMEs that all the banks claim to be supporting, the customer base and government could regard them as core, whether the banks like it or not. So, whether your main concern is NPLs or VPLs, you may need to stand back and take stock of what you regard as non-core and consider whether it's time to bring it back into the fold and start doing some serious portfolio and customer management.