THE KAFAFIAN GROUP INC.
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Performance Measurement | Strategic Management | Profit & Process Improvement | Board & Management Advisory Services | Financial Advisory

Fourth Quarter 2015 Volume 7 Issue 4

TKG Perspective

Teaching & Speaking Engagements

Community Bankers of New Jersey
The Somerset Hills Hotel
Warren, NJ **January 25**
Financial Industry Overview

Northern New Jersey Community Bankers
The Stony Hill Inn
Hackensack, NJ **January 28**
Financial Industry Overview

ABA
National Conference for Community Bankers
JW Marriot Desert Springs Resort & Spa
Palm Desert, CA **February 15**
CEO Exchange Panel Moderator

Oregon Bankers Association
Executive Development Program
Willamette University MBA Portland Center
Portland, OR **April 5**
Bank Profitability

Conferences, Conventions & Other Events

Southeastern Conference for Community Bankers
The Hyatt Key West
Key West, FL **January 27-29**

AMIfs
Annual Convention
Tempe Mission Palms Hotel
Tempe, AZ **April 27-29**

Pennsylvania Bankers Association
Annual Convention
Fairmont
Southampton, Bermuda **May 11-14**

New Jersey Bankers
112th Annual Conference
The Phoenician
Scottsdale, AZ **May 11-15**

Maryland Bankers Association
Annual Convention
Omni Amelia Island Plantation
Amelia Island, FL **June 5-8**

Jeff For Banks Top Three of 2015

By: Jeffrey P. Marsico, Executive Vice President

For those who may not know, I have been authoring a blog for the past five years. I do it separately from any writing or speaking I do for The Kafafian Group so I can be provocative and have it represent my own opinion, rather than the collective firm's point of view.

However, you can't separate the author from the consultant, and I've found it interesting to know and review my top read blog posts from 2015. I thought readers of TKG Perspectives would find them interesting as well. So here are the top three read posts from Jeff For Banks from 2015.

Breaking Branch Mediocrity (posted: February 21st)

How often do we observe banks band-aiding branch underperformance by adding "business development officers" or "cash management officers" to their ranks? Often. Bankers must recognize this inefficient organizational layering because they viewed this post more than any other last year.

If bankers were truthful with themselves, they would recognize that this layering, i.e. additional employees with fancy titles, is nothing more than covering up for the shortfall, real or perceived, in branch staff skills to execute bank strategy.

Instead of adding staff and layering cost onto a cost structure already burdened with non-revenue producing expenses, why don't banks get the most from their investment already made in their branches? I offered four suggestions:

1. **Hire to execute your strategy**. If your strategy is to be the number one business bank in the markets you serve, then hire branch employees that can speak intelligently to business owners about how your bank can serve them.

2. **Develop branch staff**. Assuming your strategy is mentioned above, do you have a branch training curriculum that leads to a "Small Business Qualified" designation? If you are not satisfied with branch staff abilities to execute your strategy, and have invested the time and energy into developing them without results, then perhaps you have the wrong staff. But don't complain about staff capabilities if you have done nothing to improve them.

3. **Provide meaningful incentives**. If you want branch managers to be the tip of the spear for small business relationship development but give those that succeed a 4% raise and a $500 holiday bonus, which isn't materially different than those that did not succeed, why be surprised that we have to build organizational layers to compensate for staff shortfalls. Instead of incentives on balances or number of accounts, how about branch profitability and profit trends? Imagine the behavior differences!

4. **Communicate your strategy**. Assuming you have a strategy that clearly identifies the bank you strive to become, then communicate it to your employees! Who else do you expect to execute on the strategy day to day?

There you have it. Four concrete steps you can take to make branches more effective at achieving your bank's strategy.

The next most-read post was different than the first. It was based on current events, mainly, Square 1 Financial's sale to PacWest.

Say It Ain't So Doug! Square 1 Bank Sells to PacWest (posted: March 7th)

Square 1 Financial of Durham, NC announced on March 1st that it would sell to LA-based Pac West Bancorp. Square 1 was led by Doug Bowers, hence the post name. It was one of the most successful bank startups in a generation. The deal left me scratching my head, because at first glance it made little sense that a bank with Square 1's earnings trajectory would sell.

If Square 1 could maintain their trajectory, shareholder value would surely outpace what PacWest would generate. Their three-year EPS compound annual growth rate was 86% at the time of the announcement, compared to PacWest's 12%. And Square 1 did not receive a share price premium in the deal, leading me to hypothesize that their earnings growth was unsustainable.

So why sell, Doug? I had three opinions…

1. **Institutional Ownership**. Square 1 was owned 70% institutionally. Many banks brag about their level of institutional ownership. But few of these owners care about issues not relating to growth in shareholder value. So if the growth engine was projected to sputter, the level of institutional ownership may have signaled time to get out.
2. **Law of Large Numbers**. This law means it becomes more difficult to generate the amount of business to replace loans running off the books and support robust growth. For Square 1 with a $1.2 billion mostly commercial business loan portfolio, it likely needed at least $400 million per year in loan production just to keep pace. Perhaps it was projecting much lower loan growth.
3. **Growth Trajectory**. Eighty six percent annual EPS growth was most likely unsustainable, meaning the 22x earnings multiple the market awarded Square 1 might shortly be in jeopardy. Slower balance sheet and earnings growth, combined with a falling earnings multiple, would equate to little stock price appreciation until things normalized. If this was the case, then it makes sense they would seek to lock in their robust gains.

Of course, this was all speculation as we did not represent either party in this transaction, and were not privy to the discussion that led to Square 1's decision to sell. What we can tell you is that Square 1 was an extraordinary financial institution that we are sorry to see leave the landscape, as we held them out as a premier example how a niche bank with focused effort can lead to superior results.

Banks Are Far From Amazon (posted: August 22nd)

This post was in response to a New York Times expose on the working conditions at Amazon. If you haven't read it, you should. It characterized the online retailer as a soulless, dystopian workplace. By trying to create a meritocracy, the unintended consequence included nothing more than petty zinging and flaming. The kind you see on social media. Except Amazonians do it to your face, in public. Founder Jeff Bezos, naturally, refutes the characterization.

Unlike Amazon, in our experience, banking is drifting far from being a meritocracy. Which is good given Amazon's cultural by-product. But not so good in moving our institutions forward in the face of rapidly changing customer preferences. In some institutions, the inertia reminds me more of a government agency than a shareholder owned company.

So how do we strike a balance between Amazon and the US Board on Geographic Names (an actual government agency)? Here are some ideas.

1. **Create incentive systems with meaningful and transparent awards for achievement**. See above for the idea of using profits versus widgets. And make incentives meaningful, such as 10%+ of total compensation. Include front line and support functions. Use them to lift achievers up, rather than break others down.
2. **Fire people**. There is nothing more motivating to eager employees than firing the laggards. If an employee is not putting forth the effort, has a bad attitude, or simply doesn't care or works against your strategy, FIRE THEM!
3. **Build a collaboration culture**. We are not suggesting death by meeting. But you must forge forward with the pre-eminent question being "how should this be"? Get the people needed to make and act on the decision into a room and don't leave until you work it out. Then take action!
4. **Promote learning from failure**. Mark Zmarzly, CEO of Hip Pocket, a FinTech startup, commented on this: "People in banking are too afraid of failure. We do not advocate risk taking and therefore we've developed a culture of people who avoid risk. Risk is at the heart of entrepreneurship. It's not about being risky but piloting new ideas and mitigating risk. We build moats in our industry… we need to build bridges." Well said Mark!

There you have it. My top read posts for 2015. I appreciate any and all that read my blog, and encourage your comments whether you agree with me or not! Discussion and debate leads to better decision making, strategic risk taking, and resilient banks!

Find Jeff For Banks at: www.jeff-for-banks.blogspot.com