


THE KAFAFIAN GROUP INC.
...helping banks perform better™

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TKG Perspective

Watch for Us

Teaching/Speaking Engagements

North Carolina Bankers Association
Management Team Conference
Pinehurst Resort
Pinehurst, PA **October 24-26**
Keeping Things in Perspective

New York Bankers Association
Financial Services Forum
Waldorf Astoria
New York, NY **November 8-10**
Risk Assessment from the Boards Perspective

Maryland Bankers Association
CFO & Financial Management Forum
Baltimore, MD **December 2**
How Will Dodd-Frank Affect M&A Activity?

Southeastern Conference of Community Banks
Hyatt
Key West, FL **January 26-28**
Keys to Bottom Line Profitability

Financial Managers Society
Philadelphia Chapter
Philadelphia, PA **February 9**
CEO Roundtable

American Bankers Association
School of Bank Marketing and Management
Southern Methodist University
Dallas, TX **May 17-24**
Product and Customer Profitability
Profitability and Strategic Issues

Pennsylvania Bankers Association
PBA School of Banking
Penn State University
State College, PA **June 5-10**
Strategic Decision Making & Organizational Structure

2010/2011 Conferences and Conventions

New York Bankers Association
Financial Services Forum
Waldorf Astoria
New York, NY **November 8-10**

New Jersey Bankers Association
Annual Convention
Fairmount
Adventura, FL **May 11-15**

Pennsylvania Bankers Association
Annual Convention
Boca Raton Resort
Boca Raton, FL **May 12-15**

Maryland Bankers Association
Annual Convention
The Greenbriar
White Sulphur Spring, WV **June 5-8**

North Carolina Bankers Association
Annual Convention
The Homestead
Hot Springs, VA **June 11-14**

Things That Confound Me!

By Robert E. Kafafian

On an annualized basis, TKG performs somewhere between 35 and 40 strategic plans. Most of these engagements are between the months of June and December. However, this year we completed almost a year's worth of plans by June 30th. You may ask, WHY? The answer is the result of regulatory actions and formal agreements which have required financial institutions to prepare, amongst other things, strategic plans, capital plans, profit plans, liquidity plans, management, board and organizational studies, along with a myriad of credit related improvements.

The top three critical issues in many of these plans are: 1) Address and Resolve Regulatory Issues, 2) Improve and Stabilize Credit Quality, and 3) Capital Adequacy. For those that are encountering these problems, resolving them in an expeditious manner will be critical to survival. For those banks that do not have these problems, there is tremendous opportunity to gain market share and achieve future profitability and success.

FINANCIAL REFORM

In addition, we now have Financial Reform to deal with and the government is still trying to figure out whether they want big banks or small banks to survive, or those in between. Phrases like "too big to fail" ("TBTF") or "too small to survive" ("TSTS") are being bandied about. Large banks are being required to prepare "living wills" designed to break troubled companies into pieces, while smaller banks are potentially being burdened out of business with increased regulation.

Regulators are fighting for their own control and survival and there are over 243 pending rules that still need to be finalized in this new legislation. Perhaps most disturbing, the federal government continues to urge banks to make more loans, while bank regulators are saying "why would you have ever made that loan," as well as reclassifying or down grading many loans currently in bank portfolios. The industry is certainly feeling the pain of this conundrum.

THINGS THAT CONFOUND ME!

Over the past few months as I reflected upon these challenges, I began to list things that confound me. I believe the future success of many financial institutions is predicated upon many of the following items.

Historic Lack of Strategic Planning
Unfortunately, many banks have operated without any strategic plan or direction. They continue to be satisfied being one of the gang of 8,000 banks with no clear cut vision or mission, and no attempt to differentiate themselves from the crowd. Additionally, many that do plan dust off the previous plan every three to five years only to put it back on the shelf, never utilizing the resulting product to manage the bank or monitor the execution of the plan.

Successful banks have moved to rolling three year plans that include executive summaries, vision and mission statements, a situation analysis, strategic objectives and critical issues, tactical goals and initiatives, and financial projections. Today, these financial projections must also be decision tree based, giving the board and management an understanding of what might happen or need to occur given various scenarios. Goals and initiatives must include deliverables, the individuals responsible for executing the task, start and completion dates, budget impacts, etc. The combination of strategic thinking and monitored execution must become an annual event of both the Board and Management.

Historic Lack of Risk Management

Historically, risk management primarily focused on loan credit quality. Today, however, risk factors have moved far beyond the loan portfolio. For example, the current crisis highlights that credit quality also includes the investment portfolio, while the 1980's savings and loan crisis highlighted the need to manage credit and interest rate risk.

Many banks are now separating the chief lending officer and chief credit officer functions. Many other banks are centralizing all risk components under a new position titled chief risk officer. However the structure, banks are now realizing that the following categories of risk must be measured and monitored on an ongoing basis; credit; interest rate, liquidity, price, reputation, strategic, operational/transactional/IT, compliance, and foreign exchange.

Lack of Profitability and Performance Measurement

Manufacturers, the service industry, and many other sectors have long used management accounting tools to price services, manage costs, and understand the profitability of line-of-businesses and product lines. The financial industry is late to this game. The average financial institution currently sells over 100 products and services. The days of understanding performance by "the seat of one's pants" are over. Banks must use funds transfer pricing to manage spreads, properly allocate capital to better measure ROEs, and manage fee income, direct, indirect, and allocated overhead expenses to understand organizational, line-of-business, branch, product, customer, relationship, and market segment profitability.

Too Much Focus on Selling While Customer Service is Deteriorating

Many banks have become so focused on selling products to new customers that they have forgotten that quality customer service is the biggest driver of sales. The result is we end up losing more customers out of the back door than we are capable of bringing in through the front door. Building quality relationships is key to success, and for community banks, necessary to remain relevant to your customers and market place. Front line staff must be developed to understand that just giving away products, services, and rate is not customer service. Remember, market hard, sell soft…make friends to make customers.

Lack of Succession Planning

A notorious trick of Investment Bankers is to build relationships with banks whose CEO is 58 years old, or older. This is often due to fact that many community banks do a poor job of planning for succession and the resulting exit strategy is a sale of the bank. While it is often difficult to keep good talent in community banks if there is no clear cut line or quick path to the top, a better job of executive development, cross training of potential top talent, and external searches for future replacements must become a strategic focus. This should include the board, executive management, senior management and middle management levels.

Lack of Preparation for the Future Use and Security of Technology

Statistics show that the 18-38 year old age group currently does more than 75% of their transactions via some form of technology, while the 60 and older age group still utilize a branch over 60% of the time. These demographics are aging rapidly, requiring banks to meet the technological needs of future customers. This will also require increasingly visiting customers on their turf, and branch networks migrating towards becoming more consultative centers. Internet banking, ATMs, remote capture, mobile banking, etc. are becoming the norm. Additionally, the expanding pace of a national and global economy require increased vigilance in data security and fraud prevention.

Expectation of Unrealistic M&A Multiples

Many expect that the financial industry is about to experience an escalation in merger and acquisition activity. Some expect that soon we will have half as many banks as there are today. Unfortunately, the bloom may be off the rose with regard to historic bank M&A multiples. This is partly the result of the number of troubled banks, the fact that there are fewer banks, and also the result of the gap in size between large and small banks. This may require smaller banks to consolidate amongst themselves, and what may appear to be more mergers of equals. Whatever the case, pricing expectations may need to be tempered. This is why it is important for banks to manage to maximize performance and success, and earn the right to remain independent, if they so choose.

Unwillingness to Face the Future Reality and Make Difficult Decisions

Some have said that banks under $250 million in assets are too small to survive. Others have said that banks over $500 billion in assets are too large to manage. Statistics can point to banks on both ends of the scale that are healthy, well run and profitable. Are there challenges for each? Absolutely. What it boils down to is a willingness to work hard, plan, execute and manage, hold people accountable, as well as the willingness to make the difficult choices with as much information as possible to make informed decisions. For those that succeed in these respects, opportunities will abound.

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