



TKG Perspective

Watch for Us

Teaching/Speaking Engagements

Maryland Bankers Association
116th Annual Convention
The Sanctuary at Kiawah Island
Kiawah Island, SC **June 4**
Directors Duties and Responsibilities

Pennsylvania Bankers Association
PBA School of Banking
Penn State University
State College, PA **June 4-8**
Strategic Decision Making & Organizational Structure

AMIFs
AMIFs Institute
Washington University
St Louis, MO **July 15-20**
Organizational, Branch, Product and Customer Profitability

Pennsylvania Bankers Association
PBA Advanced School of Banking
Penn State University
State College, PA **July 15-20**
How Do Banks Make Money?

Maryland Bankers Association
The Maryland Banking School
University of Maryland
College Park, MD **July 30 – August 3**
Bank Financial Principals

North Carolina Bankers Association
North Carolina School of Banking
University of North Carolina
Chapel Hill, NC **August 5-10**

2012 Conferences & Conventions

New Jersey Bankers Association
108th Annual Convention
Charleston Place Hotel
Charleston, SC **May 30-June 3**

Maryland Bankers Association
116th Annual Convention
The Sanctuary at Kiawah Island
Kiawah Island, SC **June 3-6**

Florida Bankers Association
Annual Convention
The Boca Raton Resort & Club
Boca Raton, FL **June 10-13**

North Carolina Bankers Association
116th Annual Convention
The Hilton Head Marriott Resort & Spa
Hilton Head, NC **June 16-20**

Virginia Bankers Association
119th Annual Convention
The Homestead
Hot Springs, VA **June 17-20**

Financial Managers Society
Finance and Accounting Forum
Red Rocks Casino Resort & Spa
Las Vegas, NV **June 24-26**

Strategic Management of the IT Function

By Todd R. Sassaman, Vice President

Most bankers would intuitively agree that information technology (IT) is a strategic function in the banking industry. It is increasingly important to interact with customers over the web and via mobile applications. The amount of technology needed to support even traditional banking functions like branching and lending is growing continuously. The chart to the right demonstrates that spending on data processing is a significant and rising component of the non-interest expense of Mid-Atlantic commercial banks. It's unfortunate, then, that in strategic planning retreats, we see many institutions tackle the growing complexity and urgency of technological demands with tactical or piecemeal approaches. It need not be so and many banks could use IT to enhance their value and relevancy in a changing world.

Ron Shevlin of the bank research firm Aite Group addressed this particular issue in his 2011 book, *Snarketing 2.0*. His research concluded that the specific technologies a firm uses are less important than the manner in which the bank manages the IT function. His research identified high performing financial institutions and attempted to discover, through surveys, how those institutions managed their IT operations.

According to the research, there were three dimensions of IT management that high performing institutions shared:

1. Tolerance of IT risk
2. Senior management support of IT; and,
3. Coordination between IT and business functions.

Ratio of Data Processing Expense to Tangible Operating Expense

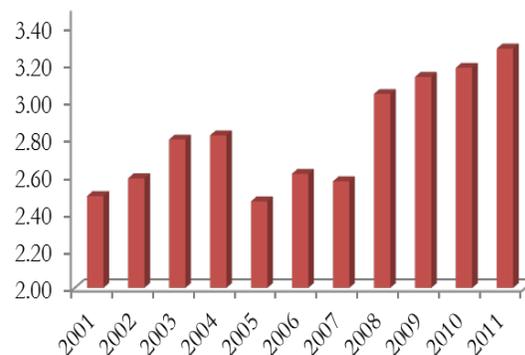


Chart Source: SNL Financial LC

Criteria:

Institutions making up the data are commercial banks in the Mid-Atlantic States with total assets between \$250 million and \$5 billion, excluding institutions with parent companies based outside of the region.

Data processing expense is defined as the amount filed on the call report Schedule RI-E ("Explanations") in field RIADC017.

Tangible operating expenses are defined as the sum of salaries and benefits, occupancy and equipment, and other non-interest expenses, which excludes goodwill impairment and amortization of intangibles.

These three dimensions underscore the importance of considering IT as a strategic function. Shevlin's research also reflects TKG's experience. During a recent strategic planning engagement, the bank's Chief Technology Officer indicated that he was less concerned with his current project list and more concerned with how he might build and support the Bank's branch of the future. This is a much more strategic concept than making ATM's conform to ADA requirements. Later, the CEO informed us that the CTO did not have an IT background prior to joining the bank.

Two observations can be made from the CEO's statement: One, the CEO approved of the CTO's performance and appreciated his foresightedness; Two, the CEO felt that a traditional IT background was a limitation for someone in the role of a Chief Technology Officer. The first observation is a positive example of someone managing IT in a strategic manner. The second observation displays an opinion of the CEO that, we feel, is common throughout the industry. IT managers are, speaking anecdotally, frequently preoccupied with their laundry list of projects and fail to integrate those items into a holistic plan that will ensure the long-term success of the institution. Focusing on tactical or defensive projects may indicate a fear of risk, as an IT manager may prefer to devote all available resources to projects that have been clearly sanctioned as critical by management or regulatory fiat.

TKG staff also has significant experience assisting banks in analyzing their usage of systems provided by vendors and outsourcers. A common result of our work in these types of engagements is the discovery that many banks pay for more services than they use or are paying for services using a contractually specified volume, either of accounts or transactions, significantly higher than the actual number.

While this seems like a basic observation, for even modestly sized community banks this has on multiple occasions added up to significant excess cost, draining resources from strategically important technology initiatives. It also indicates either that the bank is not regarding IT as a function worthy of high-level attention or that expertise for IT management rests solely in the hands of a limited number of managers.

Regarding IT as merely a source of substantial cost savings is also a false strategy. Many community banks mistakenly think they are unable to offer competitive technology when the reality is there are a number of vendors that can enable them to provide the majority of service offerings that large banks offer, from smartphone applications to web-based services. The important thing to realize is that carefully considering how and where IT expenditures are made will ensure the bank is both exercising prudent financial management and remaining strategically competitive.

The question then becomes, what is an institution to do? Shevlin offers the following advice:

1. Senior managers must develop a commitment to understanding how technology impacts the success of their institutions and create a culture that understands and accepts risks in pursuit of value creation.
2. IT managers must understand that the projects they support have a wider business purpose and reach out to business unit managers in order to ensure their joint success.
3. Business coordination projects involving IT and sponsoring business units can build early successes that make culture shifts more palatable and understandable to the entire institution.

Understanding these key points will permit banks to serve their customers better and remain relevant in a complex world.



TKG, as part of our consulting and advisory engagements, frequently evaluates our industry, its trends, successes, and challenges. We are pleased to share our thoughts with you, our valued clients and friends, in the form of this periodic newsletter. If you would like to discuss anything further, or learn more about our performance measurement, strategic planning, regulatory assistance, profit/process improvement or financial advisory services, please call us at (973) 299-0300 or visit us at www.kafafiangroup.com.