# Directions In Strategic Thinking For Community Banking

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I don't have time for this, I really don't. Or the patience, either. For the same reason I don't play golf.

"Touchy-feely" strategic planning issues really aren't my forte. It's just that I spend three weeks out of every month on location working with financial institutions that are struggling with day-to-day operational issues, and at the same time are trying to see the forest through the trees.

I watch some institutions trying to price loans as if they were individual assets while others price loans as one component of a financial relationship.

I watch some institutions underwrite loans based solely on the basis of collateral value while others underwrite loans based on the total cash flow and net-worth of the individuals doing the borrowing.

I watch some institutions struggle with the concept of charging fees to customers while others base their profitability on selling as wide a range of products as they can justify and charging fees for services.

I watch some institutions without a clue as to what to sell to whom while others use complex cross-referencing between customer information files and demographic profiles to know just what product to pitch and how to pitch it.

I watch some institutions struggle to sell a sales culture to their employees while others motivate and incent their employees and then let go the 20%-30% of their people who just can't or won't fit into it.

I watch some institutions wrestle with how humans and technology can work together while others quickly automate all of their production processes and save their people for real problem-solving, customer contact and selling.

I watch some institutions that still act as if the point of sale is the bank and that the hours of operation are defined by employee convenience while others recognize that the point of sale is wherever you can capture the customer's attention and the hours of operation are defined by customer convenience.

So here's what I want you to do. I want you to survive into the next decade. Please review your strategic plan and make sure that it is designed with a focus of purpose and that it is getting implemented with a sense of urgency, which is warranted by an increasingly competitive environment.

## WHY THE COMPETITIVE URGENCY?

Look around you. Bankers are busy eating each other and their children. The competition to provide continual increases in shareholder value pushes institutions to improve earnings per share. ROE equals ROA times LEVERAGE is the financial treadmill upon which all operating strategies are built. Even mutual institutions must pay attention to this financial imperative, for the forces driving their stock competitors defines the very pace and complexity of the competition for their customer franchise.

Maintaining a competitive ROE of 12-15% requires either an annual increase in ROA of 12-15%, an annual asset growth rate (LEVERAGE) of 12-15% or some combination of the two. Folks, you and I know that the increasing securitization in the asset markets is squeezing interest margins and putting downward pressure on ROA. It takes considerable improvements in operational efficiency and/or fee income just to keep ROAs from falling. Thus, most institutions use LEVERAGE to feed the ROE ðbeastó, hoping to keep the shareholders safely on their chains. The continual need for leverage is fueling the unrelenting frenzy of mergers and acquisitions in the banking business. In turn the M & frenzy is all about the competition for customersé for marketsé for people to sell stuff to!

## OUTLINING YOUR FOCUS

Let me give you my own outline of a strategic planning process. Itôs a process designed specifically to help an institution identify the resources that will have to be committed during a three to five-year planning period and to link this process to the annual business plan and budget. Itôs only one of many possible planning processes, Iôm sure, but itôs one that has worked for a number of my clients. It consists of five basic steps:

1. Commit to the type of banking franchise, which you desire to be. If you are a typical ñcommunity bankò providing a range of loan and deposit services, youôre really a ñretailerò. Youôll probably want to be defined as the ñcore bankò for a specifically designated customer group.
2. Define the primary customer group upon which youôre going to focus. Any other customer group being served by the institution must have its relationship to your primary customer group clearly designated. If youôre an institution thatôs focused on serving households, then stay focused on households. Your decision to serve small businesses should be viewed from the perspective of how it supports or augments your ability to serve households.
3. Prioritize the products and services required by customer groups as well as the delivery systems and processes necessary to make these products and services accessible to the customer.

4. Establish a "capital budget" of the resources required to accomplish your goals and laying-out a timeline for completion of specifically defined tasks.
5. Derive your annual business plans and budgets from this strategic plan.

## COMMITTING TO BECOME/REMAIN A "CORE" BANK

First off let's not get hung-up on semantics. The term "bank" is not meant to aggravate all the Thrifts and Credit Unions out there. Most of the depository institutions reading this article provide a range of savings, transaction and lending products and services. The real issue is what package of products and services is going to be required for your institution, whatever its charter, to remain or become the primary (core) financial institution for the particular customer group(s) upon which you've focused your business.

Basically you want to minimize the number of customers who tell you, "I'd like to do business with your institution, but you don't provide 'blankety-blank' product or service".

There is some built-in bias to our discussion. It's oriented toward the business of "community banking". If a specialized mortgage banking company or a commercial banker exclusively catering to businesses is doing strategic planning, then the steps of the process still remain relevant but the discussion would obviously pertain to their particular businesses. In fact, many institutions are part of a holding company or own service corporations which are engaged in different businesses, each of which should be involved with their own strategic planning exercises.

For a community banking franchise, however, most of the focus is going to be on providing products and services to households, that is, personal banking services. The question becomes, does your institution desire to provide most of a complete bundle of personal banking services, becoming a sort of 'one-stop' financial services store. Yes or no. It makes a difference. Because if you chose the full-service approach you'd be committed to a wide-based retail marketing model. You'd be attempting to continually increase the number of products and services purchased by target households as you build a multi-faceted customer relationship. Relationship management issues will pervade all areas of product design, pricing and service.

Developing and managing a sales culture within your organization takes on critical importance to your success.

## DEFINING KEY CUSTOMER RELATIONSHIPS

So, if you're a 'retailer', who are you going to concentrate selling stuff to? If you're going to concentrate on selling personal banking services to households then stay focused on that customer group. It's not often that products, services, delivery systems, marketing approaches or sales people designed for one customer group are equally successful when used for another customer group.  You can still serve other customer groups as long as you're trying to build tie-ins to the focus on households.

For instance, by providing financing for residential real estate builder/developers your ultimate goal is to capture end-loan or take-out financing.  Whether you keep the loan or sell it, you want the household's banking relationship.  Some households run small businesses that can be effectively serviced via personal banking product lines.  My bank provides a "business line of credit" for my small consulting practice that is really nothing more than a personal credit card issued in the name of my business with a $100,000 credit line attached.

Within the household sector there are sub-sectors with their own specific needs.  It's clearly possible to differentiate the needs of older "saver" households, real estate-based credit households and the younger consumer credit, transaction account-focused households.  Look, probably my household distinctions are already outmoded.  The point is that products and services can be customized to fit the demographic and economic profiles of certain household populations.

It is entirely possible that you will want to identify more than one "key" customer group for which to provide "core" banking services.  If this is so, then each customer group deserves the full treatment of the entire strategic planning exercise.  We are most familiar with this being the case with community banks which simultaneously service both commercial and consumer markets.  I urge financial institutions, which heretofore have concentrated on serving households not to underestimate the complexity of developing such a dual focus.

## PRIORITIZING PRODUCTS AND SERVICES

Identify the "bundle" of products and services that will permit your financial institution to be designated as a "core" bank by a specific customer group.  If you're serving households you obviously have to have a basic menu of savings, transactions account and lending products.  And, as long as you do offer a complete menu, you still may wish to specialize in certain types of products.  It makes a lot of sense for institutions that have developed strong niches in real estate mortgage lending, for example, to continue to develop marketing strategies which cross-sell off that strength.

However, while giving clear priority to maintaining your areas of strength, you must identify those products and services, which will give credence to your designation as a full-service financial institution.

First-lien mortgage lenders, especially portfolio lenders must absolutely offer the best equity line loans in their markets.  Do not let any other lender extend credit to the least risky households in your portfolio.  After all, given the tax advantage afforded mortgage interest, designing products that allow your first mortgagor to take full advantage of their equity will provide the means to provide "consumer lending" to these households.

Don't be so sure that being "full-service" always means developing new products, it may mean featuring an old one! For example, several of my clients serve customer groups, which place special importance on passbook savings accounts and using money orders to pay bills. For these clients to forsake passbooks and money orders in favor of truncated checking accounts would be sheer folly.

**PRIORITIZING DELIVERY SYSTEMS AND PROCESSES**

The best-designed product is worthless unless the customer can gain access to it. Each time you identify a critical product or service you must also examine how it is being delivered to the customer. Every institution must constantly reassess how the accessibility of its products and services can be improved via technology, location and process.

The best checking account is worthless without an ATM card. The best mortgage product is worthless unless the customer gains access to it at the point of sale of the real estate transaction. For crying out loud the battle for the customer franchise is increasingly being defined as the battle over the point of sale. If the institution can control the point of sale, not only can they improve the speed of service but also gain the ability to cross-sell other products as well.

Advances in technology must always be taken into consideration when accessibility is being planned. But while "home banking" via computer may eventually move the point of sale literally onto the laps of the customer, it's still too early to ignore convenience as defined by branch location. So most institutions will have to juggle considerations of technology and physical location as they define the accessibility of their products and services.

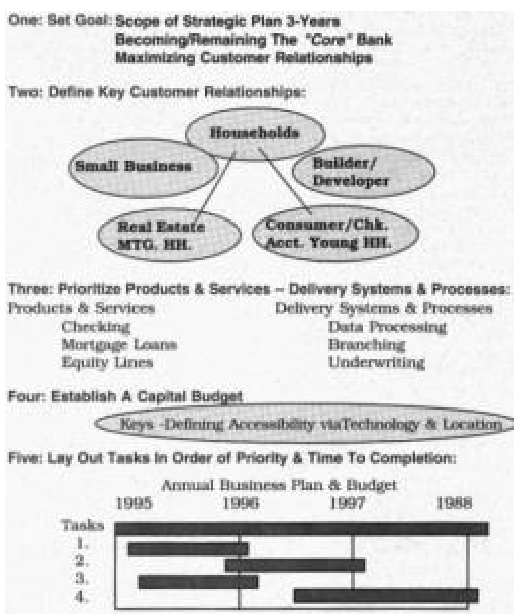
Ironically, for many institutions, accessibility may be sabotaged by the underwriting process. Some lenders, especially traditional mortgage lenders, have based their credit decision solely on the value of the collateral to secure the loan. Other lenders have traditionally looked to the strength of the income and net worth of the borrower to secure the loan, augmented but not limited by the value of collateral. In the no-holds-barred battle for the customer franchise it will be important for lenders to re-evaluate their underwriting policies and procedures to make sure that they aren't losing opportunities to make credit accessible to their best risks. (At least spend as much time doing this as you do fulfilling your CRA requirements. Oh dear, that wasn't very politically correct was it? )

## BUILDING THE CAPITAL BUDGET, LAYING-OUT A TIME LINE AND DERIVING THE ANNUAL PLAN

Thus far your strategic plan has identified and prioritized products and services, delivery systems and processes. Now it's time to add-up the costs it terms of time, money and human resources of making these necessary investments in your institution. By the way, mutual institutions, this is the very process that needs to be done BEFORE contemplating a conversion to stock charter.

Layout these "strategic tasks or action plans" according to some order of priority and synergy. Then impose the time lines that relate to annual business and budget planning periods. This way, the annual plans will have a sense of continuity. As importantly, you'll be able to tell the impact that the strategic investments will have on measures of annual operating performance. By doing this, you'll also be able to allow for the impact of unanticipated external events. This is absolutely critical when planning incentive bonuses, which are based on year-to-year or peer-relative performance. Directors, shareholders or employees don't like to be surprised.

There. That's Dr. Tom's strategic planning model. It's nothing really that special. But it does involve the institution in setting a lot of priorities and making a lot of choices. Because of the need to make all of these decisions, I've been searching for some better way of organizing this process. And, you know, I think that I just may have found it. It's called the Analytical Hierarchy Process or AHP for short.

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