ANOTHER LOOK AT YOUR STRATEGIC PORTFOLIO

by Steve Brown

When we were growing up, water was one of those things that was just there. Coming out of streams, lakes and faucets, water was free and clean. Imagine if you were a CEO back in the 70's and prosposed bottling water and selling it at a price higher, per fluid once, more than the price of gas - you would have been laughed out of the smoke filled board room.

These days, despite environmental concerns and evidence that bottled water may be even more harmful than tap water (it is tested a lot less), our kids scoff at water out of a faucet. This is a mistake as we tested a radom sample of bottled water and found hidous things with our microscope (see picture). Despite these problems, bottled water remains a multi-billion dollar industry all because some CEO in the 80's took a chance.

Back in September of 2007, many bank boards said they plan on doing what they have been doing for 2008. 2 months into the year, we can see clearly that strategy is not going to work. Many banks are convening an ad hoc strategic planning meeting to at least ask the question how can they better take advatage of the current market opportunities. Many more banks are taking another look at how they can re-adjust their lending, deposit and new customer acquisition focus.

Top performing banks ask and re-ask tough questions about how sustainable their high margin products and services will be and what are they can do to replace them, knowing that only 1 in 5 new ventures will exceed expectations. In order to help in strategic planning, some banks use a "Real Options" methodology. Unlike the traditional Net Present Value ("NPV") calculation that finance executives typically lean on, the Real Options model looks at various cash flows of a potential new venture, considers different outcomes, and assigns probabilities to each one. The key to Real Options is to identify the risks associated with a capital investment and the range of options or critical decisions that address those risks. Each option can then be assessed and factored into an overall value for the investment.

In this market, many banks are finding that by limiting risk, giving up short-term growth potential, accepting lower margins and reducing overhead expenses, would leave them the best chance to increase their probability of success in each new venture. By intuitively using the Real Options model for evaluating strategic objectives, banks sometimes find that by making a number of small investments in both new products and markets creates the best probability of success. Other banks will choose to focus their energy on a single area because that strategy, while the highest risk, presents the best long-run return.

Regardless of which path banks choose, it is helpful to think of strategic decisions as an investment. Banks know that while some investments will produce spectacular returns, most will produce average returns and many will fail. It is also interesting to note that the average top performing bank develops 3 to 10 projects every year, in the hopes of initiating 1 or 2 good ideas. This is the antithesis of many banks, that choose to do the same thing year in and year out. The crazy thing is that despite poor performance some banks are still planning to stay the course.

We highly recommend that banks call an additional offsite strategy meeting in the next couple of months and take another look at their portfolio of initiatives for the future. Portfolio planning works in loans and securities, so why not use the same theories in strategic planning? Like bottled water, an idea that seemed totally crazy last year, just may end up making you a lot of money in 2008.

BANK NEWS

TAF

The Fed announced that it would keep its Term Auction Facility going 2x per month "until no longer needed." The facility has successfully provided banks another outlet to garner liquidity.

Hedge Funds

Peloton joins Thornburg, Sailfish and other hedge funds that are being forced to liquidate billions in assets (particularly asset-backed and mortgage securities) due to tighter credit associated with margin calls. Look for this story to continue to play out as high net worth individuals and pension funds loose billions.

FDIC

Released the Interim Assessable Deposit Review Guide. The guide educates bankers on what they must do to report and document quarterly average of daily closing deposit balances. This is a new line on the Call and Thrift Financial Report for institutions that are larger than $1B in total assets.

Liquidity

The Fed proposed the loosening of intraday requirements to permit the voluntary pledging of collateral to cover daylight overdrafts, while raising the fee from 35bp to 50bp for uncollateralized drafts.

Top Trainers

BB&T Corp ($127B, NC) ranked #18 and Capital One Financial Corp ranked #15 in Training magazine's "Training Top 125" survey of organizations that excel at workforce training.

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