GETTING STRATEGY OFF TO THE RIGHT START

by Steve Brown

Sometimes people say, "You are your own worst enemy." When it comes to strategic planning, this is often true as most banks struggle not from competition, but from self-inflicted errors in corporate strategy. In other words, for many banks, the process is flawed from the start.

Problems in strategic planning start with confusion over the task of long-range planning. Sometimes, a bank comes up with tactics instead of strategy. Other times "strategy" is confused with a "goal." For instance, for a bank to say that it "wants to have the dominate market share in its community" or wants to acquire 2 banks before the end of the year has not described a strategy, but an aspiration. For that matter, mission or vision statements also are not strategies. Successful banks have developed a strategy that makes them unique by identifying a particular customer segment, exploiting a certain technology or capitalizing on a certain business model (and there are many banks out there with unique business models). A strategy is what sets a bank apart from its peers, not what makes them the same. To try to emulate another successful bank in your market can start the spiral towards "competitive destruction."

Often, we hear at retreats that a bank wants to be "the best" in its market. In our opinion, this is really a worthless statement as there is no definition around what "best" is. Further, it is difficult for a bank to be "the best" in the creation of loan value, deposit production, customer service, market share or profitability. Bank management may define its competition in its SWOT analysis (strengths, weaknesses, opportunities and threats) and then choose to take on each competitor against their greatest strength. The result is almost always a failed strategy, as a bank can't possibly employ enough resources to successfully compete on multiple fronts where a competitor has already demonstrated an expertise. Keeping longer branch hours to match one competitor (a customer service tactic), but then offering high deposit rates to match another (a high price tactic) will doom a bank from the start into failed performance.

The most successful banks strive to be unique. Banks that hope to develop an earnings-building strategy for 2009 need to start with a unique value proposition, a set of objectives, identification of resources, a set of priorities that will assist management in making future decisions and a timeframe to carry out the strategy. Only then can it say that it truly has a "strategy." Once identified, the hard work starts and many banks fail to follow-up and execute their developed strategic objectives. Many banks start with a solid strategy, but then evolve into failure, as other priorities or operational goals crop up. Every day, in every meeting and with every decision, management must answer the question - "Does this action support our strategy?"

The only real dominant goal for a bank to have in 2009 is - To earn X% (where X is an above average market return compared to investments) return on equity. A bank may have other goals, but its number one effort should be to align bank operations with the objective of creating greater economic value. From there, we challenge all community banks to develop a strategy that set you apart from the competition and exploits some defined advantage. Support the CEO, as the job of keeping everyone on track, communicating and making the tough decisions in order to stay on track can tax even the greatest leaders. Once developed, communicate your strategy to everyone inside and outside the organization. Not only will that endeavor help ensure success by holding management accountable, but it will keep everyone pulling in the same direction. Better yet, the openness and clarity will help with the competition. If your competitor knows what your strategy is (and they are rational), the probability is better that the competing bank will find something else to be unique at. It is this uniqueness that is at the heart of a successful bank strategy.

BANK NEWS

Poor Thrift Performance

A closer look at the 2Q data shows thrifts lost $5.4B, the 2nd largest quarterly loss ever behind the $8.8B posted in the 4Q of 2007. Thrifts set aside an average of 3.68% of average assets in reserves during the quarter.

MOU's

The OCC and FRB sent out more Memorandums of Understanding thus far in 2008 than all of 2007. Since last August, 11 banks and 8 credit unions have failed.

Rules

The Treasury department is considering a rule requiring banks to include tax-exempt subsidiary holdings when determining interest expense deductions overruling a tax court decision in 2007.

Investment Idea?

The Iraqi Reconstruction bonds have narrowed to a price of +484bp over Treasuries. For the record, this spread is narrower than the debt of both National City Bank and Key Corp (in the +700bp range).