LOOKING FARTHER AHEAD

by Steve Brown

10Ys from now, banking will be a different place: 23% percent of our readers will be retired, 20% will not be working in banking, and 7% will be running a new bank. There will be 17% fewer banks and 30% fewer branches. Those banks and branches that do exist will be smaller. Credit margins will be skinnier, driven down by greater competition from financial institutions and customers that are more transient and interest rate sensitive. Operating expenses will be reduced slightly, due to greater use of credit scoring, electronic loan processing, imaging and more efficient core banking. Net interest margins will be slimmer, however, fee income will be higher. While operating margins will be smaller, banks will have a better handle on risk and produce a greater return on risk-adjusted capital.

The important question is where will your bank be in 2019? One of the best management exercises is to develop a 10-year plan (not just a 3-year) and work backwards about what it means in terms of capital, employees, distribution channels, products, footprint, competitive position and key strategic priorities. Can your bank make it on its existing product set? In what areas should those new products and services be developed? How many branches do you need and where? Decisions on staffing, corporate organization (stay private or go public?) and new business lines can be implied by a bank's future goals.

One needn't be a futurist to come up with answers to the questions about how the bank will look in terms of assets, capital and earnings. In fact, if you think your bank will look the same, only bigger in 10-years, chances are you're missing something and not being innovative enough. The goal of this exercise is to not name exact products, but to identify areas of growth. The exercise of 10-year planning starts with crafting a set of goals (asset size, geography, branch network, etc.) and then rank their relative importance. Is market share more important than growth? What about the trade-off between growth and earnings? Once targets are identified, the team can then work backwards to identify 7, 5, 2 and 1-year goals. While 5-year plans are common, the time frame is too short for many managers, as it usually takes 3-5 years for a new product to be rolled out and accepted. Further, most managers can almost taste 5-year targets, whereas 10-year goals allow for greater vision and bigger dreams.

The current trend of producing a 10-year plan dovetails nicely to the latest trend in asset-liability management - producing "going concern value." Traditionally, banks have looked at the ALM position of their current balance sheet, without asking the question of what is the risk, once current assets and liabilities mature. In other words, going concern value treats a bank not as a portfolio of assets and liabilities, but rather one of a series of growing earnings and risk streams. Focusing 10-years into the future highlights what bank managers can do today (in terms of business direction, infrastructure and brand) to ensure adequate shareholder return in the future. Not only does a journey of 1,000 miles start with a single step, but you have to know where you are going in order to get there. In this age of uncertainty, many banks will tend to focus just on surviving the next year. However, this could be a mistake as they could miss chances for opportunities and overlook areas where managers can remake the bank from the ground up. Banks that go through the exercise of developing a 10-year plan, may find that taking a longer view may actually get the bank there faster.

BANK NEWS

Commercial Loan Risk

Moody's predicts the default rate on corporate loans could rise from 2.4% last year to 12.8% by the end of this year - the highest level on record. That isn't surprising when you consider companies need to roll over $1.4T in high yield bonds and loans in coming years, with more than half coming due in the next 5Ys.

Goldman Projection

Goldman Sachs warned investors that the chances for a "double dip" recession remain significant.

Memorandums

Year to date, regulators have sent out 285 memorandums of understanding (most of which have not been publicly disclosed), compared to 399 for all of last year.

Sales Hurdles

A study by the National Association of Realtors finds 82% of people don't have enough money for a down payment and 80% are waiting for the job market to stabilize before buying a home.

More Funds

After reporting 8 consecutive quarters of losses, Fannie Mae asked the Treasury dept for another $10.7B in capital. Over the past 2 years, the firm has lost $101.6B and taken $44.9B capital from the Treasury

Rising Rates

PIMCO, the largest money manager in the world, says the Fed won't raise rates until 2011 as they seek to boost the economic recovery.