

TESTING BANK STRATEGY (PART 1 OF 2)

by [Steve Brown](#)

In our line of work, we see many different bank strategies. Some we help formulate, some we just offer opinions on and some we just listen to. While some bank strategies are big, bold and game changing, others are nothing more than a retread of their 1985 strategy. When we analyze a bank strategy, we apply 10 tests (in order of importance below), to help determine if a bank is on the right track. In case you are coming to our EMC Conference or if you think about using one of our products or services, know that these questions drive what we do:

1) Will the strategy generate a risk-adjusted ROE above its cost of capital? A bank without a value-driven strategy will find its long run return at or below the cost of its capital. If this is the case, the bank will find it difficult to survive. A good strategy starts with the goal of earning a superior return. ROE is our favorite measure and is vastly superior to targeting growth or margins. Next to one overriding metric, we like to see banks develop a set of key business indicators to help monitor progress and serve as milestones along the way.

2) Does your strategy have a vision? While financial measures (like ROE) transcend vision in our book, having an articulated deeper meaning of helping customers or servicing the economic growth of the community will provide that emotional catalyst to employees, customers and stakeholders to help you succeed.

3) Is your customer in the middle of your strategy? We believe a bank's reason for being is not to make loans, but to provide financial value to its customer. While taking advantage of market dislocations such as looking for below book acquisitions or FDIC-assisted transactions may be the best use of capital, it is not sustainable. Any strategy that enhances long run customer value and returns an above average risk-adjusted ROE to your shareholders is a winner.

4) Does your strategy play to your competitive advantage? A bank must have or be able to obtain a positional (like marketshare) or execution advantage (like lending expertise or customer service) for a strategy to be sustained. Banks should be able to point to specific results (be it lower loan losses, higher margins, or superior customer satisfaction), processes or knowledge in order to validate this competitive advantage.

5) Is your strategy forward looking? Too many banks place too much weight on the existing in the status quo. Is your bank bucking trends or leveraging them? A strategy that goes against trends may doom a bank, while a strategy that embraces regulatory changes in the marketplace, deleveraging, more reliance on fee income, technology, social media, customer mobility and higher capital costs will find a boost to its bottom line.

Developing a superior strategy is an underutilized exercise in banking and in itself will give your bank a long run competitive advantage. While we covered 5 important tests today, tomorrow we will give you 5 more that you might not be thinking of.

BANK NEWS

Careful

The FDIC restated again that it encourages banks to give feedback on examinations. If your bank disagrees with exam findings, it is urged to work with their field examiner, FDIC office and then regional office to resolve issues. Division-level informal reviews of contested exam findings are now more common and if the informal effort fails to resolve disagreements, banks can file a formal supervisory appeal.

Credit Scores

The Fed proposed regulations to Reg V (Fair Credit Reporting) requiring creditors to disclose scores and related information to borrowers where the scores played a material part in credit decisions or pricing.

Disclosures

As we read through bank's financial statements we notice a rash of longer and more disclosures. In particular, legal liability, repurchase risk, loan grading, derivatives, fair value (and credit assumptions), and acquisitions.

Wells Fargo

The Bank is in beta test of their Visa microSD mobile payment platform in San Francisco. The technology is one of the first banks to use DeviceFidelity's In2Pay application which enables a Blackberry (users get a new microSD card) or iPhone (users get a new case with an microSD card) to handle secure contactless payments.

Treasury Yields

Pimco's Bill Gross said he thinks we will see Treasury Yields 1.50% higher by June as QE2 liquidity gets removed from the market.

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