

**The
Kafafian
Group**

Bank Strategic Management

**Maryland Bankers Association
School of Banking**

August 2024

DISCLOSURE STATEMENT

FORWARD LOOKING STATEMENTS

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Source: The Kafafian Group, Inc



STRATEGY

WHY WE NEED IT

“If one does not know to which port one is sailing, no wind is favorable.”

- Seneca, Roman philosopher

STRATEGY

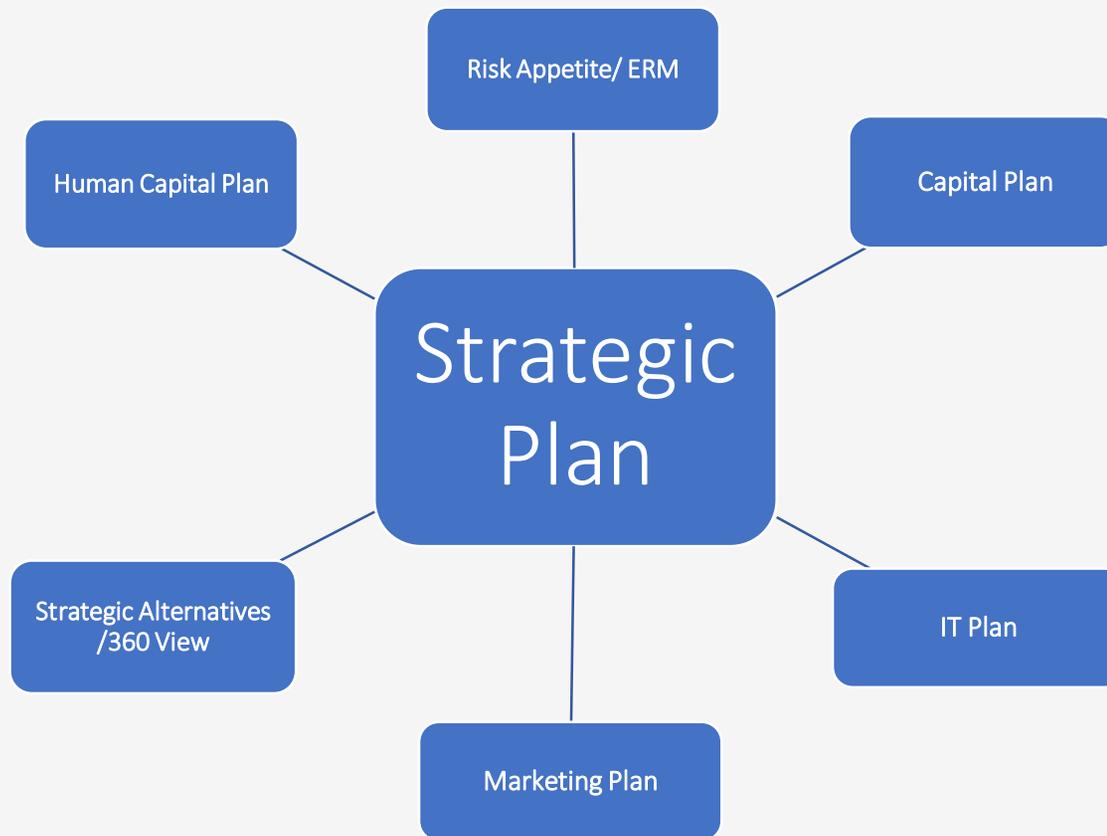
WHY WE NEED IT

“Plans are worthless, but planning is everything.”

- Dwight Eisenhower

STRATEGY DEFINED

STRATEGY COMPONENTS



STRATEGY DEFINED

STRATEGIC PLANNING PYRAMID



Source: The Kafafian Group Inc.

STRATEGY CONTEXT

SITUATION ANALYSIS

He who knows the enemy and himself will never in a hundred battles be at risk.

Sun Tzu in “The Art of War”

STRATEGY CONTEXT

SITUATION ANALYSIS

- Purpose...
- Concerted effort to identify “what is”. Rigorous and honest self assessment, analyzing industry direction, bank markets, competitors, and emerging customer preferences.
- Internal Analysis:
 - Strengths;
 - Weaknesses
- External Analysis:
 - Opportunities;
 - Threats

STRATEGY CONTEXT

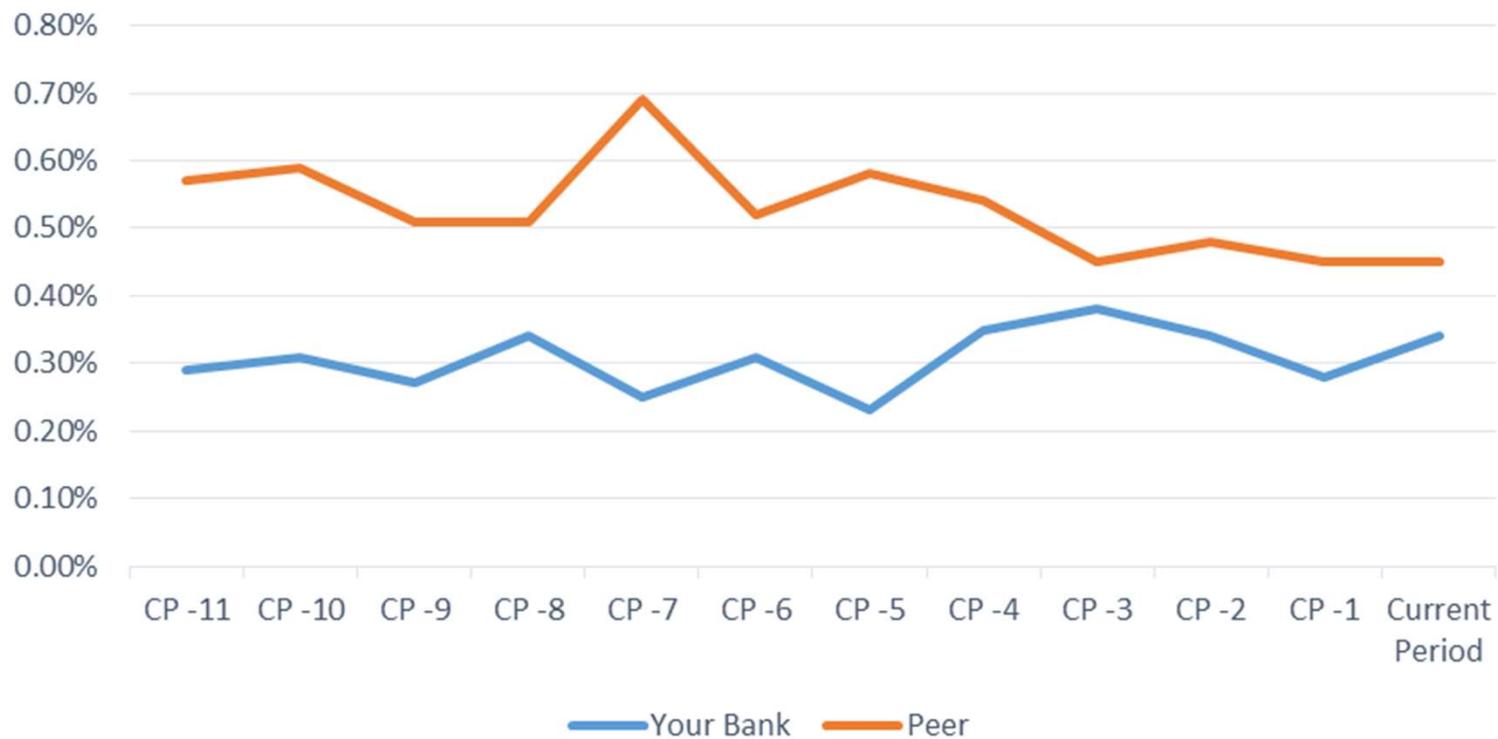
SITUATION ANALYSIS

- Strength - Unsubstantiated
 - Strength: Efficient lending operation that allows us to price aggressively in the markets we serve.
 - Basis: Corporate efficiency ratio of 55%, below that of our peer group. Also, lenders and staff always appear busy.
- Strength - Better
 - Strength: Efficient lending operation that allows us to price aggressively in the markets we serve.
 - Basis: Lending expense ratio has dropped five consecutive quarters and is better than peer group.

STRATEGY CONTEXT

SITUATION ANALYSIS

Lending: Direct Operating Expense as % of Loan Portfolio



STRATEGY CONTEXT

SITUATION ANALYSIS: WHERE ARE WE ON STRATEGY?

STRATEGIC BET: BUILD OUR OWN SMALL BUSINESS LOAN PLATFORM

The OnDeck logo features the word "OnDeck" in a bold, blue, sans-serif font, followed by a blue chevron symbol pointing to the right.

- Could be transformative, yet a company can walk away from them.
- Strategic bet that worked: Think Apple's entry into mobile phones, now 52% of their revenues.
- Strategic bets that didn't work: Think New Coke.

Source: StartEngine, OnDeck, SBA websites.

STRATEGY CONTEXT

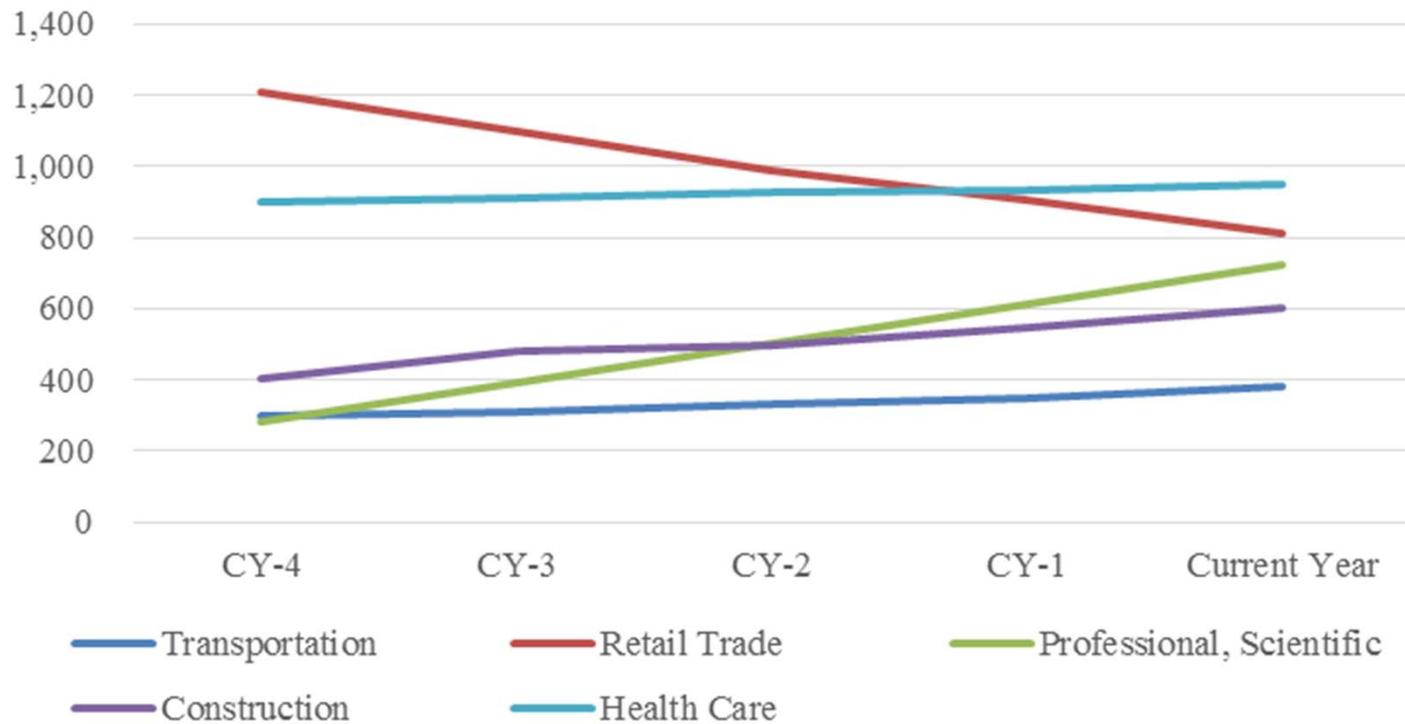
SITUATION ANALYSIS: DEMOGRAPHICS

	Base Period	Projected	% Change Base- Projected
1 Total Population (actual)	501,226	514,930	1.47
2 0-14 Age Group (%)	20.51	19.45	(1.14)
3 15-34 Age Group (%)	27.99	26.95	(0.52)
4 35-54 Age Group (%)	28.38	25.63	(3.78)
5 55-69 Age Group (%)	14.72	17.93	9.90
6 70+ Age Group (%)	8.40	10.05	13.73
7 Median Age (actual)	36.10	37.80	2.16
8 Total Households (actual)	166,785	171,050	1.45
9 < \$25K Households (%)	NA	20.69	(6.87)
10 \$25-49K Households (%)	NA	19.60	(2.28)
11 \$50-99K Households (%)	NA	26.51	(2.11)
12 \$100-\$199K Households (%)	NA	24.27	7.37
13 \$200K+ Households (%)	NA	8.93	35.02
14 Average Household Income (\$)	NA	91,357	9.42
15 Median Household Income (\$)	NA	66,194	7.97
16 Per Capita Income (\$)	NA	31,016	9.37

STRATEGY CONTEXT

SITUATION ANALYSIS: CUSTOMER ANALYTICS

Commercial Checking Account Trends



STRATEGY CONTEXT

SITUATION ANALYSIS: PROFIT PERFORMANCE

	Your Bank	Client Defined Peers	Relational Peers
1 Total Assets (\$000s)	\$693,551	\$801,451	\$771,815
2 Total Loans (\$000s)	477,301	648,107	528,399
3 Total Deposits (\$000s)	556,476	648,454	640,156
4 Loans / Deposits (%)	85.77	97.66	82.14
5 Borr. / Assets (%)	10.66	6.33	6.75
6 Tang. Equity / Tang. Assets (%)	8.50	7.95	8.83
7 Equity / Assets (%)	8.50	8.33	8.97
8 Tier 1 Leverage Ratio (%)	9.45	9.12	9.98
9 Tier 1 RBC Ratio (%)	13.04	11.39	13.47
10 Total RBC Ratio (%)	14.30	12.43	14.71
11 NPAs / Assets (%)	2.44	1.75	1.82
12 NPAs ex. TDRs / Assets (%)	0.71	1.18	1.15
13 Reserves / NPAs (%)	56.70	47.92	49.09
14 NCOs / Avg. Loans (%)	0.17	0.42	0.08

STRATEGY CONTEXT

EXERCISE: PROFITABILITY SPEAKS TO STRATEGY

Breakout Groups:

1. Your group will select a bank
2. Identify the bank's key financial strength, why, and how to take advantage of it
3. Identify the bank's key challenge, why, and how to fix or mitigate it
4. Select a speaker for your group to present to the class

STRATEGY PYRAMID

The best business leaders I knew distinguished themselves, in part, by a willingness to make choices that focused energy, resources, and effort. The wishy-washy tried to cover their bases by doing and pursuing a little bit of everything, clearly fearful of committing to the wrong path. In the end, they succeeded only in diluting already scarce resources and scattering their focus to the point of inefficiency. Great managers, on the other hand, made tough either-or choices that directed effort and talent toward a limited number of objectives.

Chris Lowney, former Jesuit and JP Morgan investment banker, and author of “Heroic Leadership”

STRATEGY PYRAMID

VISION

“All great companies have a visionary leader at the top who is always pointing to the kind of organization they are going to be.”

Ken Blanchard

STRATEGY PYRAMID

VISION

- Purpose...
- Mission is who we are
- Vision is who we would like to be

- Bad Vision:
 - Strive for excellence in delivering state of-the-art solutions to sophisticated worldwide markets.
- Good Vision:
 - Be number one or number two in every market we serve.

STRATEGY PYRAMID

VISION – THE UNIVERSAL VISION CRAFTER

Our vision is to be the *(fill in: superior, preeminent, cut above)* banking solution to *(fill in: small business, middle market, wealthy, working class, professional, not-for-profit, all of the above)* customers to help them achieve *(fill in: financial independence, their dreams, superior results)* and help our communities *(fill in: thrive, grow, succeed)* and our employees *(fill in: realize their potential, excel, be happy)* while *(fill in: enhancing, achieving, striving for)* shareholder value.

STRATEGY PYRAMID

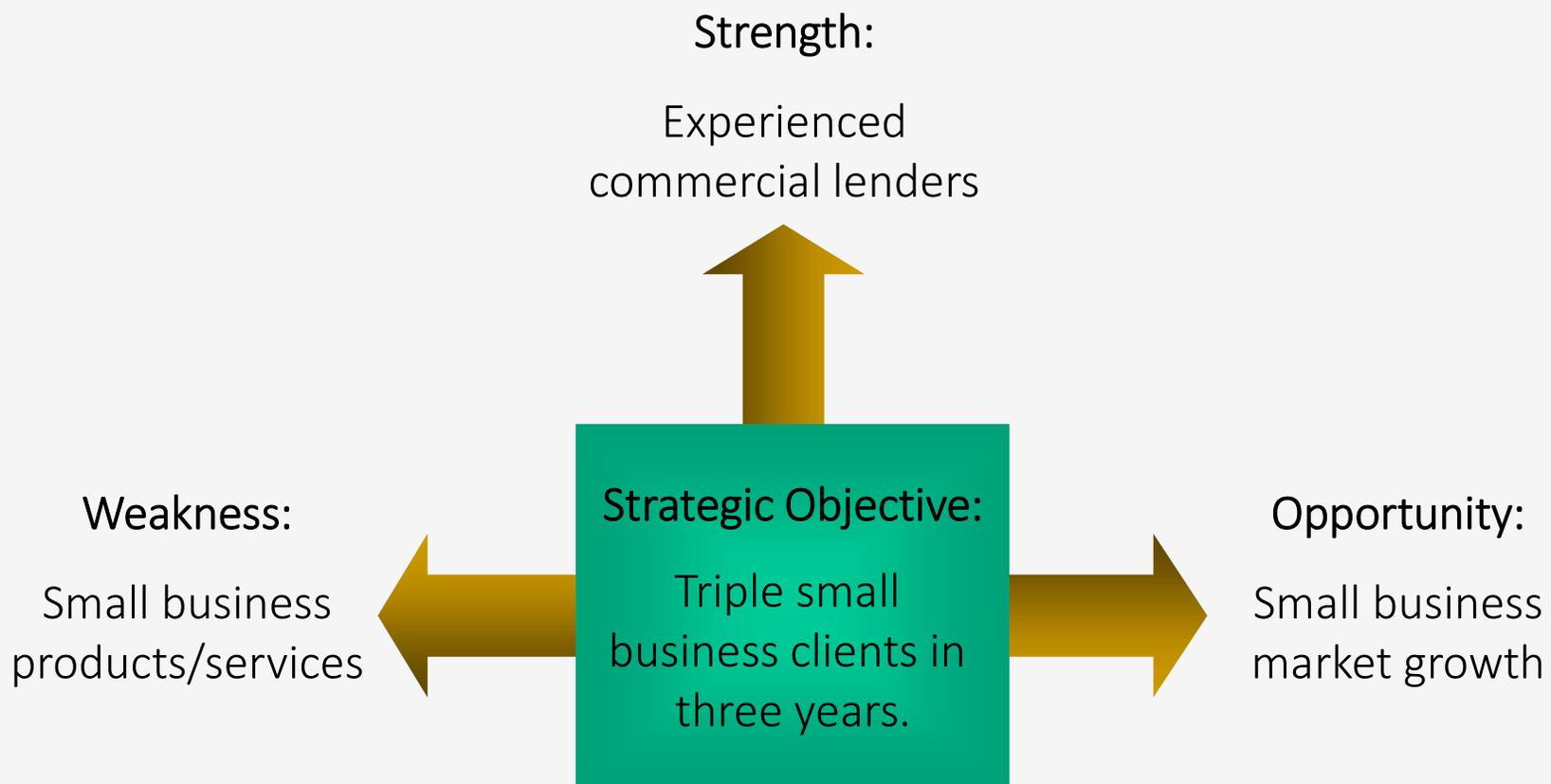
STRATEGIC OBJECTIVES

- Strategic objectives form the essence of the plan
- Move the organization closer to its vision while focusing on results that improve the organization's competitive position such as:
 - Increasing market share;
 - Building and supporting the brand;
 - Gaining a sustainable competitive advantage; and/or
 - Enhancing shareholder value
- Define what success looks like for each strategic objective
 - SMART Goals: Specific, Measurable, Aggressive yet Achievable (Marsico edit), Relevant, Time based

STRATEGY PYRAMID

STRATEGIC OBJECTIVES

VISION: BE THE #1 BUSINESS BANK IN THE MARKETS WE SERVE



STRATEGY PYRAMID

OPERATING PLAN

“At some point, planning must degenerate into work.”

Peter Drucker

STRATEGY PYRAMID

OPERATING PLAN

Strategic Objective	Goal	Task	Management Responsible	Completion Date
Triple small business clients in 3 years.	Achieve top quartile net interest margin in 3 years.	Redefine the role of loan officers as relationship driven loan originators.	Doe	[DATE]
Triple small business clients in 3 years.	Achieve top quartile net interest margin in 3 years.	Develop plan for small business product suite roll out including product development, training, and marketing.	Deer	[DATE]
Triple small business clients in 3 years.	Achieve top quartile net interest margin in 3 years.	Evaluate expansion of SBA platform and achieve preferred lender status.	Deer	[DATE]
Triple small business clients in 3 years.	Achieve top quartile net interest margin in 3 years.	Streamline approval and setup processes for small business lending while maintaining credit quality.	Buck	[DATE]
Triple small business clients in 3 years.	Achieve top quartile net interest margin in 3 years.	Develop ability to accept online small business deposits and line of credit applications.	Doe	[DATE]
Triple small business clients in 3 years.	Achieve top quartile net interest margin in 3 years.	Designate one or two existing lenders to focus on small business loans and deposits.	Buck	[DATE]

STRATEGY PYRAMID

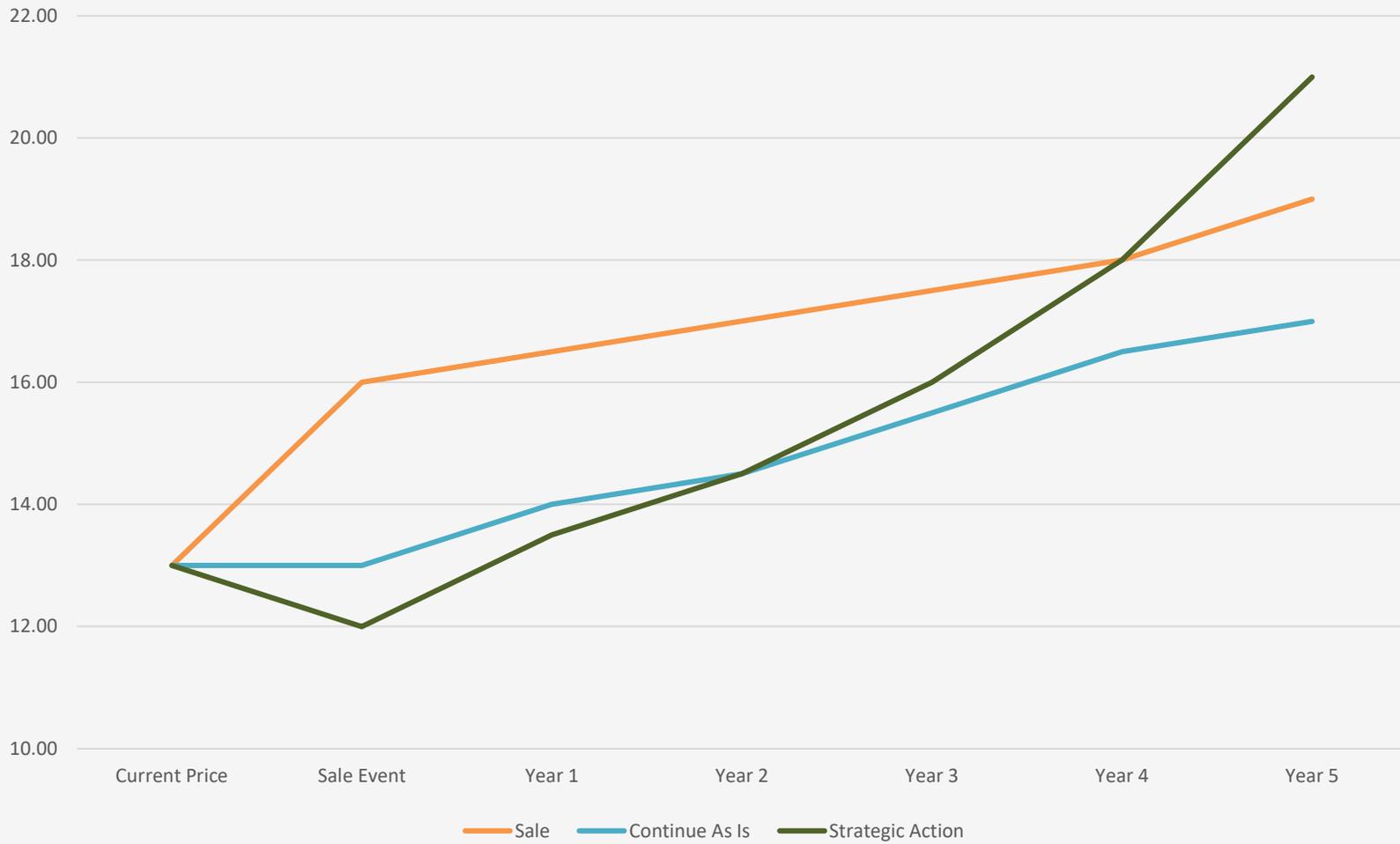
FINANCIAL PROJECTIONS – POLL

If you were CEO, would your strategic projections....

1. Be conservative to the point where success is likely
2. Be aggressive where there's a fair chance of not achieving them
3. Look to the current year's budget and forecast and add some achievable percent
4. Do multiple scenarios such as stretch, base, and stress
5. Other (please identify in chat function)

STRATEGY PYRAMID

FINANCIAL PROJECTIONS



STRATEGY PYRAMID

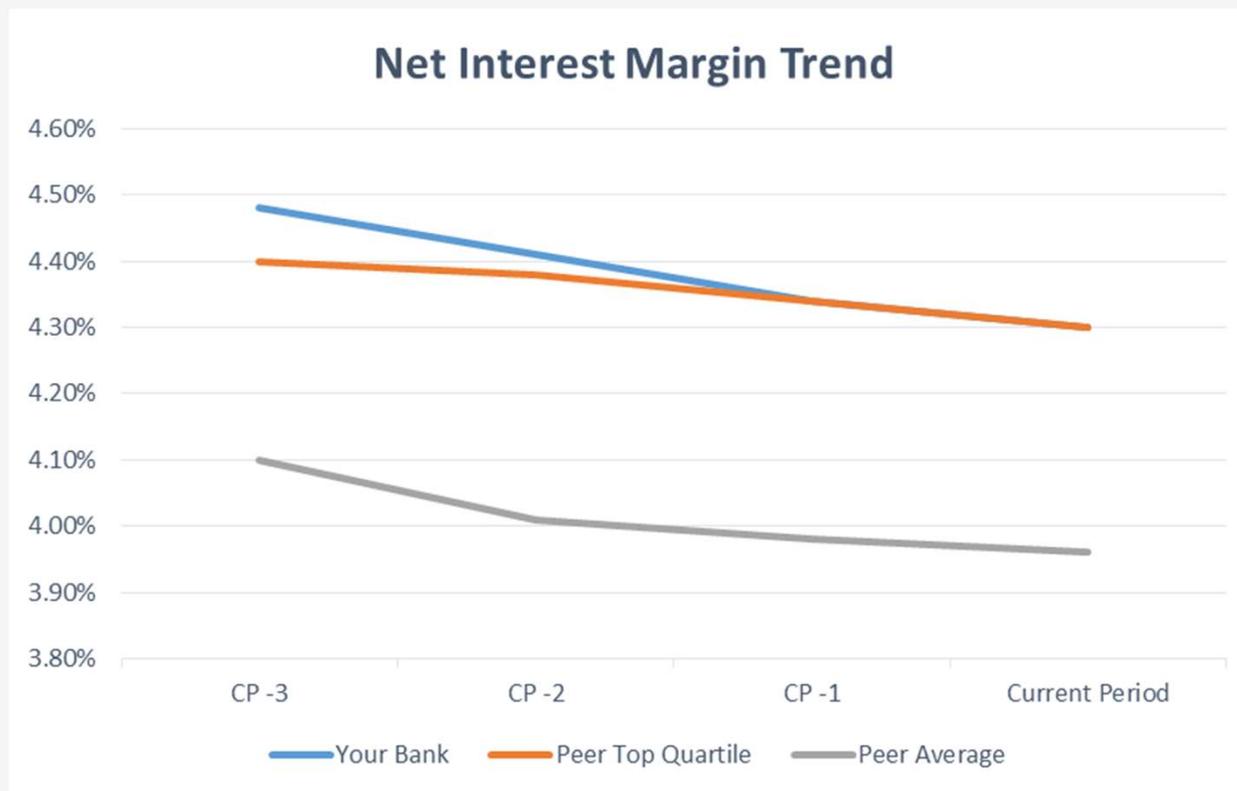
FINANCIAL PROJECTIONS

- Be careful about sandbagging.
- What would success look like, in financial terms, if the bank was successful executing its strategy?
- Can be developed first, and the operating plan is developed to “hit the targets”, or...
- Can be developed after operating plan, incorporating impact from initiatives
- Board sets higher level financial targets (ROE, EPS growth, etc.)
- Operating plan and financials developed to meet/exceed targets

PROFITABILITY AS A STRATEGY TOOL

GOAL: ACHIEVE TOP QUARTILE NET INTEREST MARGIN

- Bank maintained top quartile net interest margin through trend period.
- But the downward trend exceeds top quartile peers.

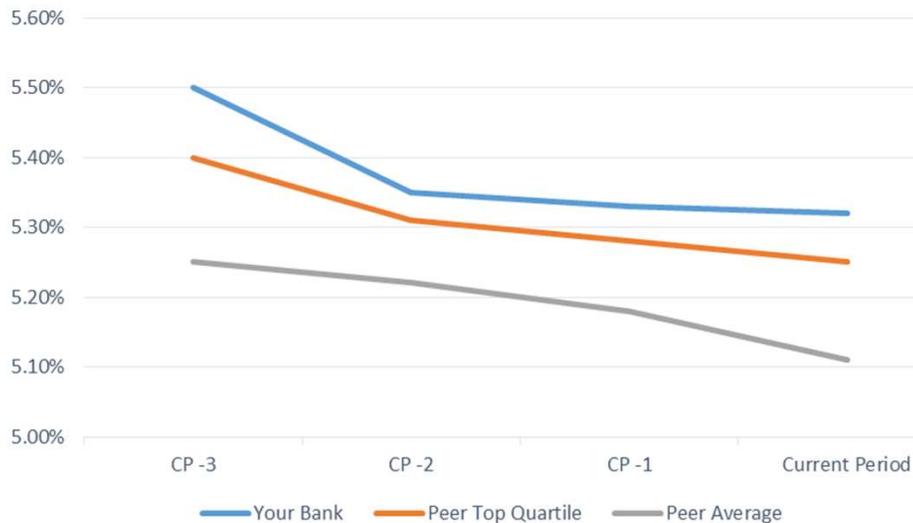


PROFITABILITY AS A STRATEGY TOOL

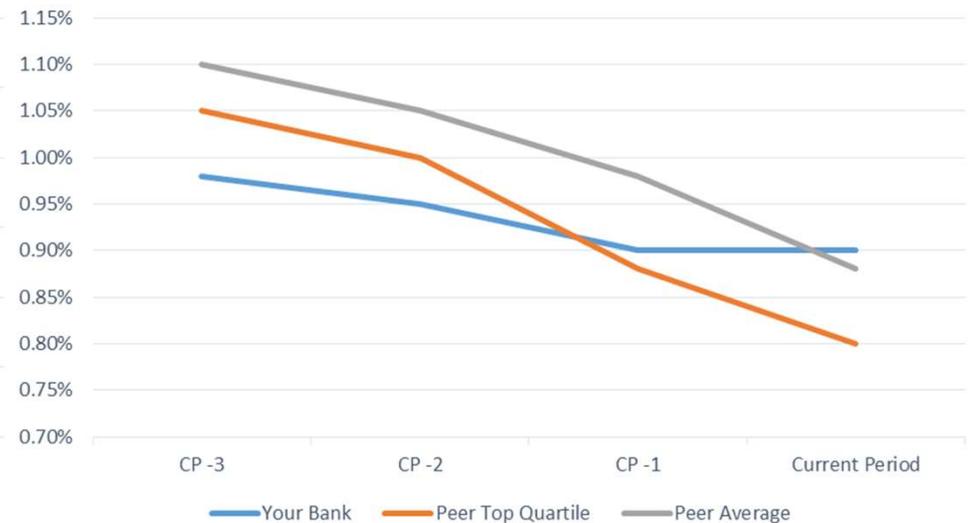
GOAL: ACHIEVE TOP QUARTILE NET INTEREST MARGIN

- Yield on earning assets trend is similar to top quartile peers.
- The reduction of cost of funds is not at the same pace as top quartile or average peer.

Yield on Earning Assets Trend



Cost of Funds Trend



PROFITABILITY AS A STRATEGY TOOL

GOAL: ACHIEVE TOP QUARTILE NET INTEREST MARGIN

- Using Funds Transfer Pricing, the Asset Product Spread appears to keep up its end of the bargain.
- The decline in the Liability Product Spread appears to be causing the relative decline in NIM.

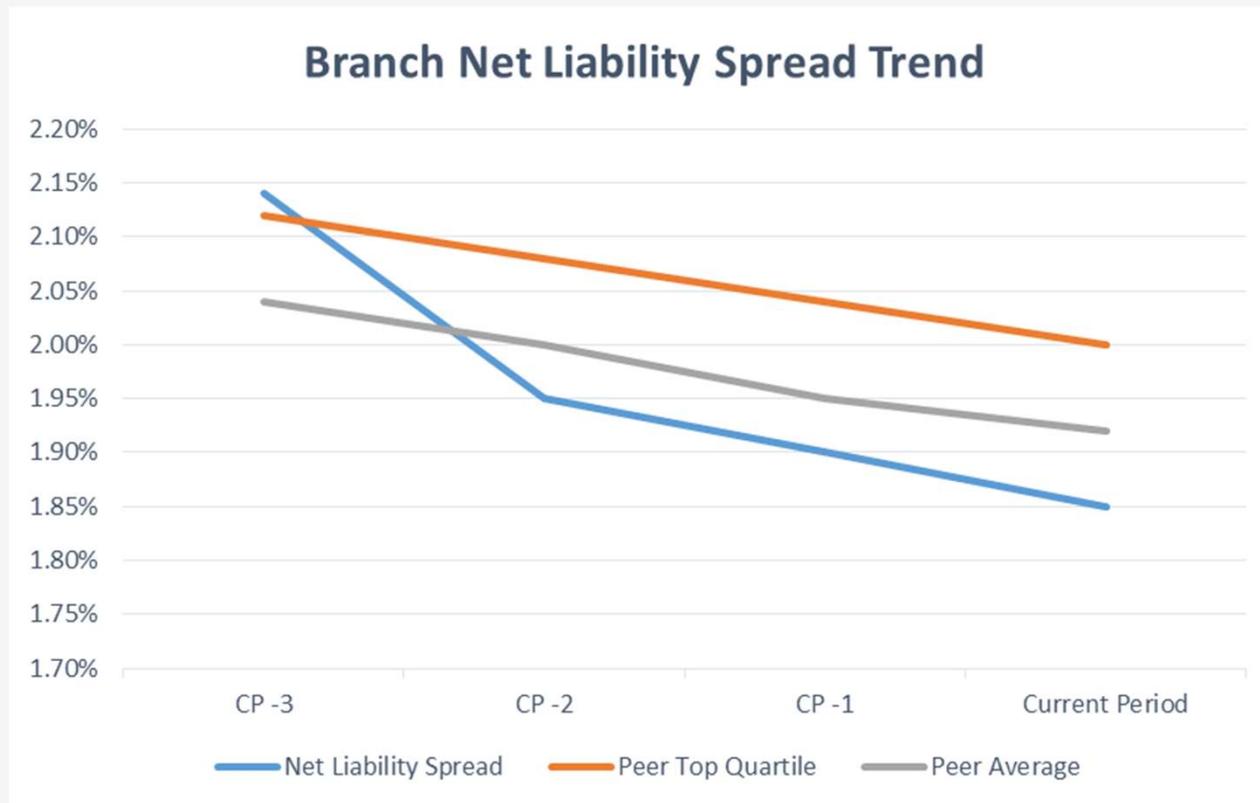
	CP -3	CP -2	CP -1	Current Period
Yield on Earning Assets	5.50%	5.35%	5.33%	5.32%
FTP	<u>3.00%</u>	<u>2.85%</u>	<u>2.84%</u>	<u>2.84%</u>
Asset Product Spread	2.50%	2.50%	2.49%	2.48%

	CP -3	CP -2	CP -1	Current Period
FTP	2.90%	2.80%	2.69%	2.58%
Cost of Funds	<u>0.98%</u>	<u>0.95%</u>	<u>0.90%</u>	<u>0.90%</u>
Liability Product Spread	1.92%	1.85%	1.79%	1.68%

PROFITABILITY AS A STRATEGY TOOL

GOAL: ACHIEVE TOP QUARTILE NET INTEREST MARGIN

- Branches enjoyed top quartile net liability spread, until something happened.



PROFITABILITY AS A STRATEGY TOOL

GOAL: ACHIEVE TOP QUARTILE NET INTEREST MARGIN

- The bank conducted a money market promotion since CP -3.
- The promotion was not executed well, as bankers were not successful in bringing in significant relationships with the new customers.

Money Market Spread Trends

	<u>CP -3</u>	<u>CP -2</u>	<u>CP -1</u>	<u>Current Period</u>
FTP	2.30%	2.25%	2.22%	2.20%
Cost of Funds	<u>1.30%</u>	<u>1.31%</u>	<u>1.35%</u>	<u>1.40%</u>
Money Market Spread	1.00%	0.94%	0.87%	0.80%
Peer Average MM Spread	0.98%	0.98%	0.95%	0.93%

PROFITABILITY AS A STRATEGY TOOL

USING PROFITABILITY IN PLAN EXECUTION

GOAL: ACHIEVE TOP QUARTILE NET INTEREST MARGIN

BANK BRAND VALUE (BBV)

1	Institution	Umpqua Bank
2	Parent	Umpqua Holdings Corp.
3	Ticker	UMPQ
4	Total Assets (\$000)	30,036,680
5	Market Capitalization (\$MM)	4,377.2
6	Yield on Loans - (NPLs/Loans)	3.76%
7	Yield on Loans - (NPLs/Loans) Over Median	0.48%
8	Tax Effectuated Percent of Net Income	20%
9	Cost of Funds	0.19%
10	Cost of Funds Under Median	0.00%
11	Tax Effectuated Percent of Net Income	0%
12	Brand Value as % of Market Cap (8+11)	20%
13	UMPQ Aggregate Bank Brand Value (\$MM)	868.2

- Brand should result in something. Cadillac doesn't have the same price points as Chevrolet. Both will get you there.
- Forbes measures brand value by EBIT/Capital >8%.

PROFITABILITY AS A STRATEGY TOOL

USING PROFITABILITY IN PLAN EXECUTION

<i>(dollars in thousands)</i>	CP -3	CP -2	CP -1	Current Period	Growth
Branch-originated Loans	\$12,225	\$13,874	\$14,002	\$15,145	\$2,920
<i>net asset spread</i>	3.01%	2.98%	2.95%	2.94%	
Branch Deposits	\$37,034	\$39,892	\$42,354	\$45,089	\$8,055
<i>net liability spread</i>	2.10%	2.06%	2.02%	1.99%	
Net Asset Spread	\$368	\$413	\$413	\$445	\$77
Net Liability Spread	<u>778</u>	<u>822</u>	<u>856</u>	<u>897</u>	<u>120</u>
Total Spread	1,146	1,235	1,269	1,343	197
Branch Fee Income	\$148	\$160	\$169	\$180	\$32
Total Branch Revenue	\$1,294	\$1,395	\$1,438	\$1,523	\$229

PROFITABILITY AS A STRATEGY TOOL

USING PROFITABILITY IN PLAN EXECUTION

- The bank implemented a product management culture.
- They assigned product managers that were closest to the product to search for and implement ways to continuously improve product profitability.

Personal Money Market Accounts

	3Q22	4Q22	1Q23	2Q23	3Q23	% Change		
						Prior Quarter	Year Ago Quarter	
1 Average Balance (000)	\$361,998	\$352,952	\$335,237	\$319,297	\$319,299	0.00%	11.80%	Driver 1: Spread
2 Credit for Deposits (FTP)	2.12%	2.18%	2.28%	2.36%	2.37%	0.01%	0.25%	Driver 2: Fees
3 Rate Paid on Balances	<u>0.21%</u>	<u>0.56%</u>	<u>1.12%</u>	<u>1.31%</u>	<u>1.32%</u>	0.01%	1.11%	
4 Net Product Spread	1.91%	1.62%	1.16%	1.05%	1.05%	0.00%	-0.86%	
5 Product Fee Income	0.02%	0.01%	0.01%	0.01%	0.00%	-0.01%	-0.02%	Driver 3: Expenses
6 Total Product Revenue	1.93%	1.63%	1.17%	1.06%	1.05%	-0.01%	-0.88%	
7 Operating Expense	<u>0.51%</u>	<u>0.52%</u>	<u>0.53%</u>	<u>0.58%</u>	<u>0.60%</u>	0.02%	0.09%	
8 Pre-Tax Profit (Pre-tax ROA)	<u>1.42%</u>	<u>1.11%</u>	<u>0.64%</u>	<u>0.48%</u>	<u>0.45%</u>	-0.03%	-0.97%	
9 Equity Allocation	2.00%	2.00%	2.00%	2.00%	2.00%	0.00%	0.00%	Driver 4: Volume
10 Pre-Tax ROE	71.00%	55.50%	32.00%	24.00%	22.50%	-1.50%	-48.50%	
11 Number of Accounts	2,841	2,983	3,013	2,953	2,894	(59)	53	
12 Average Balance Per Account	\$127,419	\$118,319	\$111,268	\$108,140	\$110,348	\$2,207	(\$17,072)	Driver 5: Balance
13 Annualized OpEx Per Account	\$650	\$615	\$590	\$627	\$662	\$35	\$12	

*All percentages are as percent of the portfolio's balance

Source: The Kafafian Group, Inc. Actual percentages and numbers are for demonstration purposes only.

PROFITABILITY AS A STRATEGY TOOL

QUESTIONS TO ASK

- What is my bank's strategic vision?
- What is the strategy to move us closer to our vision?
- Are their SMART goals so we know what success would look like?
- Do strategic projections show what success would look like?
- Do personnel development plan resources match their importance to our strategy?
- Is there alignment between our strategy and our culture?
- Do we use profitability to promote a positive accountability culture and measure success at the most granular level?