GREGORY A. NOONAN
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Business Management For Results

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Why Your Bank Must Avoid the Path of Least Resistance and Do 2010 Strategic and Financial Scenario Planning Now

By Greg Noonan, President, Gregory A. Noonan & Associates Inc.

August has concluded and usually by now many executive leadership teams in the financial institution industry are settling in on their high-level business targets and strategic guidance for 2010. However, 2009 has been such a daily challenge for industry executives that it may seem easier to just hunker down, freeze business plans, and focus on surviving. For those institutions that are leaning toward inaction, now **is** the key time to model your financial scenarios and integrate your strategy. Although the thought of doing this may seem stressful, with some structure, it will be easier than you think and the rewards will be worthwhile.

The preferred approach to business management is to create a strategic plan with three to five strategies that guide the development of sales and operational plans. This plan is typically accompanied by a five-year financial projection which is built from the strategic plan assumptions. Then the annual planning targets are used to guide each year's budget. For 2010, I would recommend starting with the financial scenarios and then selectively integrate strategic projects that can fit within the parameters of the financial picture.

Of course, in practice we see varying approaches to planning where a company may have a strategic plan but not a five-year projection, or maybe the reverse, a financial projection with no action items. Then for many, planning and financial forecasts are completed once a year, in the Fall, with no real long-term planning. Regardless of what category your bank falls into this year, I would highly recommend getting your financial scenarios modeled so that a couple of weeks from now you have a solid understanding of what balance sheet structures are necessary in various economic environments.

The financial institutions that revised their forecasts in March and April with multiple scenarios already have a solid understanding of the 2010 challenge and have selected targeted strategic initiatives to improve their position over the next few years. For most institutions, a significant strategic opportunity exists as customers and talented employees are up for grabs.

Financial Institution Assumptions

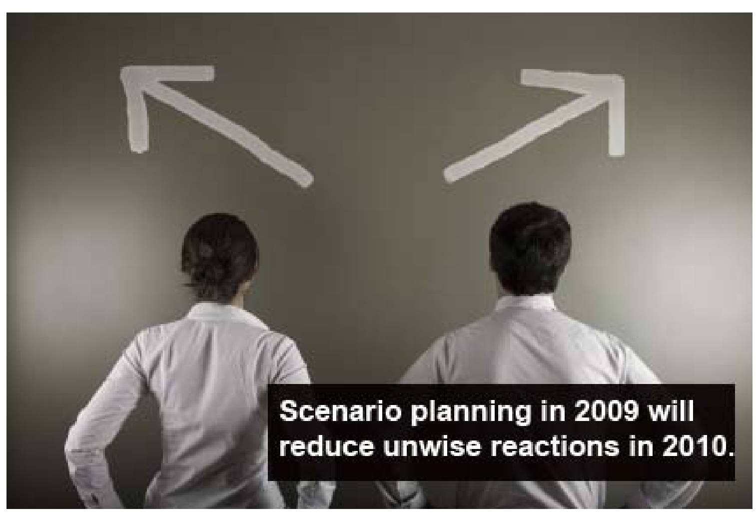
There are primarily five drivers to earnings:

1. Loan and deposit volumes
2. Loan and deposit yields
3. Asset quality
4. Service charge or specific business line income
5. Staffing level and personnel expense.

The financial staff can focus on these five drivers and get a good handle on pre-tax income. Today, all of these drivers can vary significantly as institutions control growth and cut expenses to maintain or improve capital positions. New loan volume is carefully managed while deposits have grown. Margins have compressed, but some organizations will see increasing margins as their deposits re-price lower. If interest rates increase slowly in 2010, margins will increase, but a quick increase in rates usually creates challenges with the margin. Where will your margin be in December 2009? Service charge income continues to decline and may level off for some institutions while the mortgage business simply will not compare to recent history. Every institution struggles with asset quality since no one has experience with the levels of non-performing assets that continue to increase every day. When will the CRE shoe drop? Finally, across the board staff cuts, hiring freezes, bonus elimination, and reduced benefits cannot continue over the long-term. Does your organization have critical needs or shallow depth in key staff areas that are beginning to surface? How much investment is needed to shore up sales and operations and what technology investments could take the pressure off of lower staff levels? Finally, in today's environment, fraud losses and increased FDIC assessments must be assumptions that are given attention.

The Forecast

Since the assumptions can vary widely, create two or three different targets for each driver. For the margin, some good data collection from your core systems and your ALCO process will allow the financial division to estimate a range of margin scenarios in a relatively short period of time.



One word of caution, do not overanalyze or spend weeks trying to get this exact. The financial division should create a high-level model and worry only about the drivers so that executive management can understand the various earnings and capital results based on changes in product mix, margin, asset quality, fee income, and personnel expense.

Once the model is set, and a base case is created, running scenarios goes quickly. We recently finished a base case where the organization realized that their margin would improve 30 to 50 basis points and then we modeled 16 scenarios in two hours. From these scenarios, management can settle on a five-year financial scenario that provides the desired earnings, capital, and reserves that will best align to the institution's strategic goals.

It is important that the model includes action-oriented metrics that go beyond earnings targets such as ROE, net margin, or net income. Proper metrics will be critical in communicating the business strategy and financial goals in terms that employees understand.

Once a five-year scenario is selected, the first year of that plan can serve as the target for the 2010 budget. But the key will be to keep the model fresh and conduct regular scenario-based forecasts, since all assumptions will or can change dramatically. With regular forecasting, the executive management team can then adjust business plans on the fly as warranted by the financial picture or economic conditions.

The Business Strategy

Some work on strategic planning can be conducted simultaneously as the financial scenarios are created. Executive management discussions on growth, profitability, capital, markets, lines of business, competitors and organizational strengths and weaknesses can yield a list of opportunities and challenges for the bank. The organization should also accumulate a listing of current projects and engage key managers and employees for an internal assessment of how the company is positioned regarding customers, products, and employees.

Through targeted meetings and discussions, key strategies and tactical projects can be identified that fit the current economic environment. At the executive level, a vision can be created that lays out priorities for 2010 and the next three to five years. The strategies or projects are likely to target manager and employee activities that can create momentum with customers, solve an operational issue, or automate workload for efficiency. These activities should align to the action-oriented metrics discussed previously.

The final step is to assess the strategic direction and prioritize the company's 2010 goals and projects in a manner that will best complement the five-year financial scenario. Then, company-wide communication and employee goals can reinforce the most important initiatives for 2010 and help keep everyone on the same page.

The one certainty each year is that things will change. Regardless of what 2010 brings, the companies that conduct regular updates to financial forecasts and strategic projects will be positioned to make planned adjustments during the year versus replicating the reactionary environment in most banks during the last two years.

GNA provides consulting and management services to financial institutions in the areas of strategic planning, merger & acquisition, financial management, profitability analysis, enterprise performance management, process improvement, retail branch productivity and project management. The company also conducts project management training and has a complete suite of services and products to assist companies in building a best practice financial division.

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