

Beyond 2008: Driving Long-Term Earnings Growth

With bank industry earnings in decline and the expectation for continued economic problems through 2009, many bank CEOs have assumed a defensive posture. Bank executives need also to position for long-term growth – and need to spend both time and money today to reap benefits tomorrow. Areas of opportunity include:

- 1. The mass affluent market.** BAI Research and Mercatus Partners, in their study, “Competing in the Retirement-Dominated Future,” indicate consumers in the United States hold retirement assets in excess of \$16 trillion, over four times the size of consumer deposits. Yet only about 20% of mass affluent consumers have ever sought advice about retirement from their bank. Fidelity is the market share leader today – but with only 13% of the market. Now the big banks are threatening a more aggressive approach. B of A's stated goal is to be in the top 5 nationally in terms of retirement assets, which means it needs to amass hundreds of *billions* in additional retirement assets in the next few years.
- 2. Generation Y.** As big as the Baby Boom Generation, Generation Y represents an enormous opportunity for financial services companies. Those who target these consumers while they are still young may have a tremendous head start on building share. Celent LLC, in a May 2007 online survey of 591 college students at 34 U.S. universities, found that 60% of respondents say they will keep their banking relationships after they've graduated, up from 48% just

four years before. Some banks are beginning to test new approaches and target these consumers at early ages. Some are teaming with Internet heavyweights, such as JPMorgan Chase teaming with Facebook on a credit card offer. Others, including US Bank, TCF, and Wachovia, are building significant inroads on college campuses by linking ATM and debit features to on-campus identity cards. Still, a banking model that appeals to large numbers of Gen Yers has yet to emerge.

- 3. Small business deposits.** With liquidity a pressing issue for most banks, we expect to see heightened competition for small business accounts. JD Powers' 2007 study of small business customer satisfaction with their overall banking experience shows the industry has a lot of room for improvement. Satisfaction is based on seven factors – with transaction methods (think online and payments capabilities) and relationship with representative topping the list. The study finds that the average satisfaction level of small businesses with their banks is 697 index points on a 1,000-point scale, which is relatively low. With average balance levels at 30 times those of consumer accounts, banks should be looking for new ways to bring value to small businesses.
- 4. Payments and the international marketplace.** The growing international payments and trade services businesses are providing an earnings boost to some banks across the country. “These businesses are growing, and many of them are in a sweet

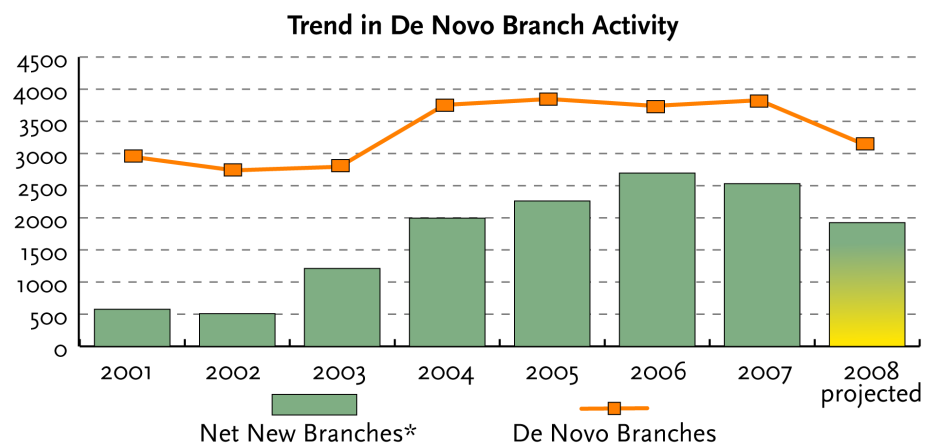
spot if we look at what is going on in the economy today,” Wachovia's then-CEO Ken Thompson told investors at a conference recently. Wells Fargo & Co. and Bank of America Corp. recently announced a plan to consolidate their ACH operations in a joint venture called Pariter Solutions LLC, a move that will enable the banks to clear their shared transactions “on us,” and provide the potential for substantial earnings as they build scale and move to compete in the growing global payments arena.

- 5. Commercial bankers as business advisors.** To better position themselves as advisors to their clients, more banks are building industry sector expertise and standardizing approaches to providing advisory-oriented services. Sectors of the business marketplace that are growing or undergoing changes that create opportunities include nonprofits, energy, agriculture, healthcare, and eldercare services. Arming traditional bankers with the knowledge and tools to extend their skills beyond those required to help businesses finance growth is a real challenge. Banks that can develop these types of skills and extend their value propositions to bring a range of services to sector-specific business clients will be well positioned for future growth.

If you are interested in strategic planning support, including meeting facilitation, please contact Mary Beth Sullivan at 202/337-7872 or msullivan@capitalperform.com.

Fewer New Branches

The total number of de novo branches is on pace to decline in 2008. An emphasis on efficiency and expense control at banks of all sizes has served to dampen activity. The rate of branch closures has also slowed, and the ratio of branch closures to branch openings is on pace to decline relative to 2007. It is too early to determine whether this trend will continue, but regardless, banks that cut back too far on branch expansion now may face greater difficulties meeting funding needs and driving revenue growth in the not-too-distant future.



*Projected based on activity reported from 7/1/2007 through 5/8/2008. Source: CPG analysis of FDIC and SNL Financial LC data, 2008.

Top Big Banks: TCF Case Study

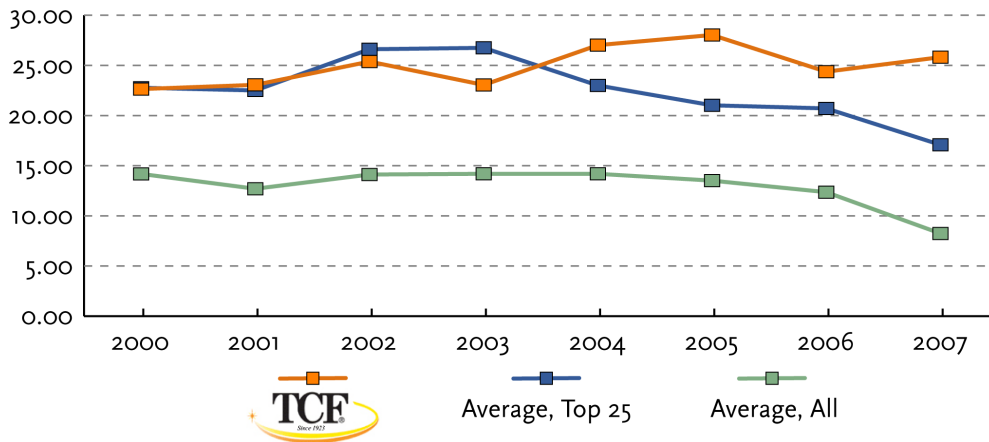
Every year, CPG partners with the *ABA Banking Journal* to produce a list of the year's top performing banks and thrifts, ranked based on year-end return on average equity (ROAE). Part One of these rankings examines the performance of institutions with assets of \$3 billion or more. TCF Financial Corporation of Wayzata, MN, was 2007's top performing public bank with an ROAE of 25.82%. TCF has displayed consistent high performance over the past few years, appearing in our top 5 since 2005 and in our top 25 since 2001.

For the past three years, noninterest income at TCF has represented roughly half of the total revenues of the bank. Though the bank has seen some margin compression, its net interest margin of 3.95% is still well above the industry average. Traditionally, TCF's noninterest income has come from deposit service charges; however, the bank is actively looking for other sources of revenues. Dur-

ing 2007, TCF made a "concentrated effort" to manage and diversify its noninterest income, increasing deposit service charges by 2.9%, raising card revenues by 7.4%, and growing balances in its leasing and equipment portfolio by 14.6%. TCF's leasing and equipment finance business generated both interest and noninterest income and has become an important source of revenue for the bank.

Many of this year's top performers used a similar strategy. Among the top 25 institutions, noninterest income represented on average 32.19% of total revenues, compared to an average ratio of 28.01% for all institutions. This helped to alleviate some of the margin compression and to counter some of 2007's other negative trends. This was not, however, the only strategy applied by this year's top 25. For more information, please see the May 2008 issue of the *ABA Banking Journal* or go to www.ababj.com.

Trend in ROAE at TCF Financial



Announcements

Banking's Top Performers

In the 16th annual *ABA Banking Journal* Top Performers ranking, CPG's Vanessa Mambrino reviews the performance of the nation's best banks. Look for the top 50 big banks in the May issue and the best community banks in the June issue.

Bank Executive Survey

The 15th annual Bank Executive Survey conducted by Grant Thornton was published in the most recent issue of *Bank Director Magazine*. When asked how banks would grow and compete profitably in the next three years, 91% said by increasing cross-selling efforts to

current customers. CPG's Gary Stein, along with Compass Bancshares' Shawn O'Brien and Ocean Bank's Candy Fitzek, are speaking to this at the 2008 *ABA Marketing Conference* in September. Their session "Leveraging Sales Opportunities Across Bank Lines of Business," will provide a step-by-step process for maximizing sales opportunities and increasing cross-sell results. Find out more about the conference at <http://www.aba.com/Events/mktg.htm>.

Feedback?

We want to hear from you! Contact us at wire@capitalperform.com.

Steps to Executing a Successful Efficiency Program

Corporate efficiency programs will become more widespread in the coming quarters as executives struggle to offset the effects of weak revenue growth and higher credit costs on performance. The following are a few of the steps to perform as part of a successful bank-wide efficiency program:

Technology expense is often the largest and most difficult category to bring into alignment. A first step is to calculate the amount of expense required to maintain in working condition the current technology infrastructure of the institution. This provides the baseline expense level. Any incremental funding should go strictly to projects that improve efficiency or generate revenue. To enforce this, incorporate performance metric into the performance scorecard of the IT unit that expresses technology expenses as a percentage of the bank's total revenue. It should decline over time.

Branch networks represent significant investment and ongoing expense. A key component of any efficiency program is the evaluation of branch performance versus market potential. A performance ranking analysis can be conducted and the outcome of the evaluation should be to identify branch performance improvement opportunities, opportunities to reallocate resources, and branches that are candidates for sale or consolidation.

Benchmarks exist for **discretionary spending** categories and, when coupled with an analysis of the rate of growth of each item, can provide for significant expense savings opportunities. Department heads should be required to reduce any nonessential expenses, especially where they are out of line with benchmarks.

When properly executed, efficiency programs are not just an effective means to align expenses with revenue – they are also a vital part of continuous process improvement in an industry marked by contracting margins and consolidation.

Contact Claude Hanley for efficiency support at 202/337-7875 or chanley@capitalperform.com.

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