

# “STAKEHOLDERS”

Creating value for owners, managers, other employees,  
and most importantly, your customers.

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## ALM is a Marketing Activity

by Dennis Guida

Don't be too alarmed by the title. I'm not suggesting the Marketing Department take over your organization's ALM reporting and investment functions. However, I am suggesting that the focus of ALM switch from "risk management" to "winning the business." All too often, the ALM function consists of an ALCO meeting each quarter to discuss some "really complicated stuff" that isn't truly necessary for everyone in the organization to understand. This really needs to change.

I want to encourage our clients to bring their ALM knowledge and insights "out of the closet" in order to assist your customers as well as preserve your organization's interest margins. By the way, we've been doing the same thing here at MHA. Over the years, we've quietly developed an ALM practice that now serves 47 institutions ranging in size from start-ups to \$3.8 billion in assets. (I've been providing ALM consulting services since 1993.)

You're probably a little skeptical, so let me offer a couple of examples. I'm guessing many of your customers are asking about fixed rate loans. I'm also guessing many of your loan officers are telling prospective borrowers they just can't do it given this low rate environment. The result is either a less-than-satisfied customer or the loss of potential business.

Now here's how an organization that integrates its ALM and marketing efforts approaches this same situation. The same loan officers would tell customers they can consider a fixed rate loan for any term desired. In fact, really good lenders would assist customers in determining the best solution given the loan's purpose and customer cash flow considerations. They might even go on to explain the cash flow consequences given various rates



and terms. In addition, rate reductions might be possible if core deposits are maintained and/or fee income services are utilized (e.g., merchant processing). Compared with the first example, this approach is far more likely to result in satisfied customers, maybe one so satisfied that they might refer someone else.

Here's the really great part. All of the options I described can be accomplished while reducing interest rate risk. From a marketing perspective, I'm suggesting a strategy of product bundling and customer consultation that results in loan products that are competitively priced and add value (which sure beats having the best "giveaways"). From an ALM perspective, I'm suggesting you engineer the terms and pricing of your loan products so your organization meets its duration and margin objectives while also meeting your customers' needs. You see, ALM and marketing strategies are interdependent and these interdependencies can be exploited to improve your organization's performance.

Oh, by the way, core deposit growth and better margins also will create bigger Stakeholder payouts. (You knew there would be a link.)

The first step in the process is getting your organization's ALM and marketing staff to begin communicating with each other. The goal is not to make ALM experts out of your marketing staff or vice versa. The goal is to ensure your ALM staff understands what's needed from a marketing perspective (and why), while also ensuring your marketing staff understands your organization's ALM goals (and why). Most importantly, this communication must be ongoing because spreads and yield curves change all the time as do customer needs and sales strategies. One more thing, don't hesitate to contact us if you need help bringing these two worlds together.

## Introducing Brian Côté Director, ALM Services

Please join us in welcoming Brian Côté to the MHA team as Director – ALM Services. Brian brings over 30 years of financial services experience, which includes his most recent experience as the CFO of a publicly held institution with over \$17 billion in assets. As a CFO, he specialized in building dynamic PC-based models to forecast interest rate risk, liquidity, profitability, financial performance, and credit losses. He has a successful track record of implementing these tools in a variety of domestic and international environments, including entrepreneurial start-ups as well as very large banks. Although Brian's specialty is in analytics and forecasting, his diverse background also includes raising capital, launching IPOs, managing



investment portfolios, and leading M&A activities.

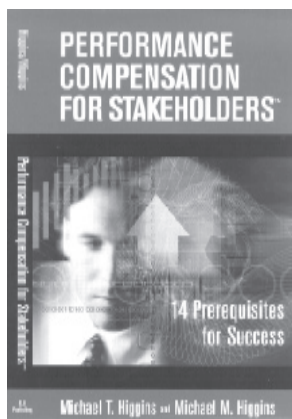
Paul Homan, former head of the OCC's bank examination staff, recently said this about Brian, "I know him to be highly competent and a natural leader with the technical and communication skills, the work ethic and good judgment to excel at his job. His character and integrity are of the highest order and beyond reproach."

Brian resides in Southern California with his wife Tammy and their six children. Both he and his wife are avid bicyclists and they both ride competitively on a local cycling team. We're excited to have Brian on our team and offer his expertise to our clients.

## PERFORMANCE COMPENSATION FOR *STAKEHOLDERS*<sup>™</sup>

### 14 Prerequisites for Success

by Michael T. Higgins and Michael M. Higgins



### Why Traditional Compensation Methods Fall Short

In the last century, the world has gone from being an industrial economy driven by manual labor to a global economy driven by information. Yet, little has changed in reward compensation methodologies since the Industrial Revolution.

In their book *PERFORMANCE COMPENSATION FOR STAKEHOLDERS*<sup>™</sup>, 14 Prerequisites for Success, the authors relate a state-of-the-art method for performance management. The "STAKEHOLDERS" premise is as simple as it is effective: Total employee compensation must be tied to performance if businesses are to maximize their potential.

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# Do you have a silver lining in 2009?

By Mike Higgins, Jr.

The year 2009 has not been favorable to the bottom line of many financial institutions. Regulatory demands for higher capital ratios, special assessments and credit losses have put many organizations into an operating loss for the year.

To those who only look at the “bottom line” (a huge mistake, by the way) it is easy to assume that management teams have done a poor job this year. Oh contraire. The most important number on your financial statement is not net income. In fact, the most important number does not even show up on your income statement. The most important number, which should be reported on your income statement, is net revenue. Net revenue is defined as follows:

Net Revenue = Interest Income minus Interest Expense plus Non-Interest Income

Net revenue is the only thing that will offset special assessments. Net revenue is the only thing that will replenish credit losses. Net revenue is the only thing that will add to capital. In short, miss your net revenue budget and you miss your net income budget (guaranteed ... see the analysis below).

*Peer group data shows that for every 1% shortfall in net revenue, a 3%-4% shortfall in pretax net income will result. Miss net revenue by 5% and pretax net income will be short by 15-20%. The relationship between net revenue and net income is very strong.*

Here is another perspective on why this number is so important:

- 100% of employees can influence net revenue (loans, deposits and non-interest income) in either a direct sales role and/or a sales support role.
- 15% (or less) of employees can influence non-interest expense in a material fashion. In financial services, about 90% of your costs are fixed, so that leaves only 10% that can really be influenced, and if you could do without 10% of your cost structure, you would not budget it to begin with.



- 3% (or less) of employees can influence provision expense (e.g., credit losses). Underwriting standards, credit policy and loan approval is managed by a small committee of individuals. The other 97% of employees follow the directives of the 3%.

- 0% of employees have anything to do with special assessments and regulatory demands for higher capital ratios.

So where is the silver lining? It is in your year-to-date results. Compare your budget net revenue to date versus your actual net revenue to date. If you are ahead of budget on this “gross profit” figure, then you have a silver lining. Your organization is producing net revenue that will ultimately offset demands for higher capital ratios, special assessments and credit losses. Furthermore, since 80% of net revenue comes from the balance sheet, and a significant amount of non-interest income is related to the balance sheet, most net revenue is recurring in nature (because you have an effective ALM strategy in place; call Dennis and Brian if you need help here). Recurring revenue is effectively a run-rate of earnings momentum to carry you into the next year. If you are exceeding budget on net revenue, your sales, marketing and support processes are working to their planned affect (and thereby should be rewarded).

So, the next time a board member or shareholder hammers you about net income, be sure to look at net revenue. It might be the silver lining that shows how effectively over 90% of your employees are really performing.

Lastly, in desperate times, organizations take desperate measures. If your employees are hitting their net revenue numbers, the best way to keep them from your competition is by compensating them in a manner that creates loyalty to the organization; not one that looks for greener grass on the other side of the fence. Feel free to contact me at [mhigginsjr@mhastakeholders.com](mailto:mhigginsjr@mhastakeholders.com) if you would like to discuss this topic further.



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## **Welcome New Clients since our last announcement!**

*San Antonio National Bank*  
San Antonio, TX

*Corporate America Family Credit Union*  
Elgin, IL