

KaufmanHall

AXIOM

Relationship Profitability:

Unlocking Value from the Institution's Relationships

April 12, 2019

Brad Brockman

Brad Brockman is a Senior Solutions Engineer in the Financial Institutions practice of Kaufman Hall. His responsibilities include assisting financial institutions of varying sizes and complexity in the development of solutions to analyze and improve their financial performance, utilizing the Kaufman Hall Axiom Software Suite.

Brad has more than 20 years of experience in performance management and analytical solutions for the banking industry. Prior to joining Kaufman Hall, he was the Solutions Leader at IBM, where he was responsible for leading financial solutions across North America, including the development of profitability, budgeting and planning, predictive, and business intelligence tools. Brad is a regular presenter and author in the industry on analytical solutions. He earned an M.B.A. from the University of Phoenix and a B.S. in Finance from Northern Kentucky University, and holds certifications in Analytics, Big Data, and Master Technical Sales.



Brad Brockman

Senior Solutions Engineer
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Bryan Ridgway

Bryan Ridgway is a Senior Solutions Engineer within Kaufman Hall's Axiom Software Financial Institutions practice. In this role he assists clients and prospects in understanding how the Axiom solutions can help analyze and improve their overall financial performance. In addition, he provides industry thought leadership through the creation and delivery of articles, webinars and conference speaking engagements.

Bryan has twenty-five (25) years of experience in the financial risk and performance management areas within the banking industry. Prior to joining the Axiom team, he was the Director of Product Management for the financial risk and performance management solutions at Fiserv, where he was responsible for leading overall business strategy in this area, including the development of funds transfer pricing, budgeting and planning, and asset liability management solutions.



Bryan Ridgway

Senior Solutions Engineer
Financial Institutions
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Bring Profitability Information from the Back Office to the Front Lines



Objectives

1

How to create a culture focused on increasing value?

2

Why you need to analyze profitability and pricing at the relationship level to help accomplish this?

Agenda

1

You need to understand the value of each relationship

2

You can't afford to price in a vacuum

3

Are your relationship managers really 'producing'?

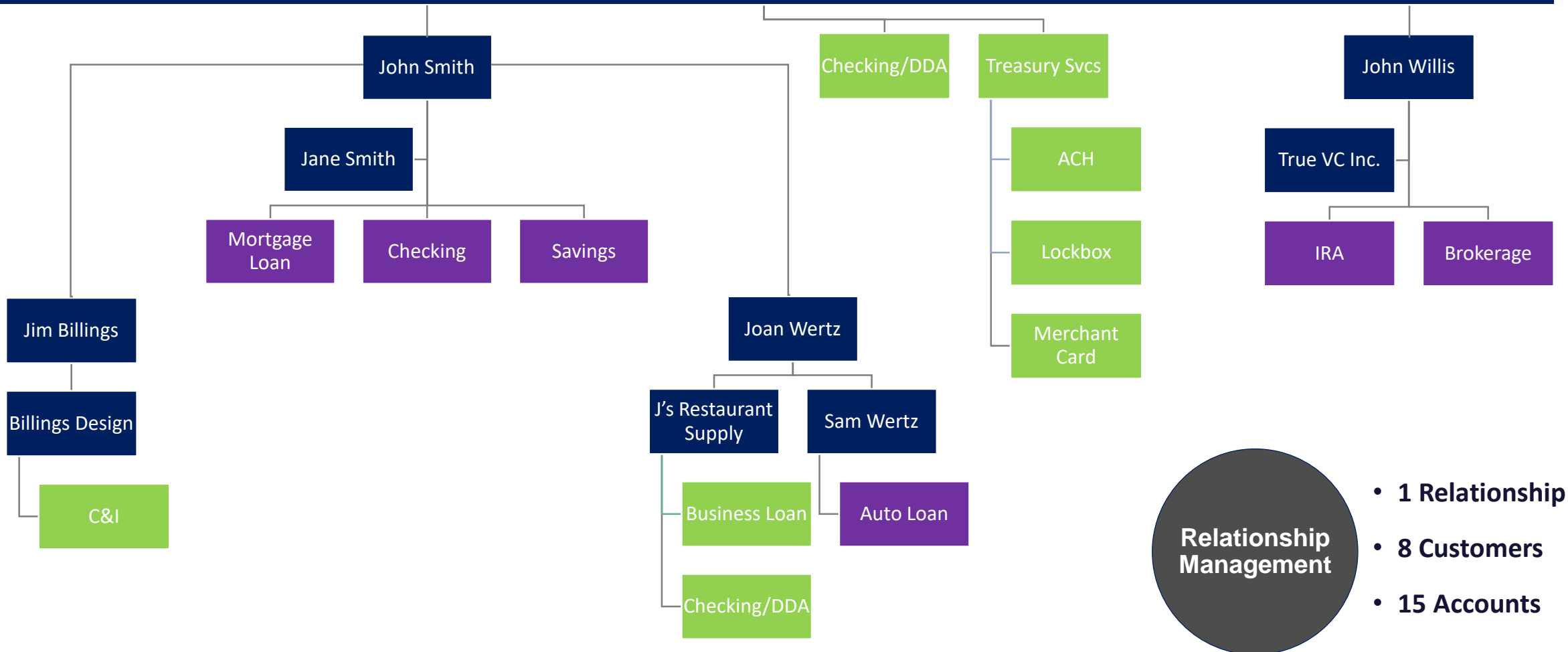
4

The criticality of consistency

You Need to Understand the Value of Each Relationship

Definition of a Complex Relationship

Triple J Restaurant Group, Inc.



Relationship Management

- 1 Relationship
- 8 Customers
- 15 Accounts



Do you know what percentage of relationships are driving your profitability?

20%

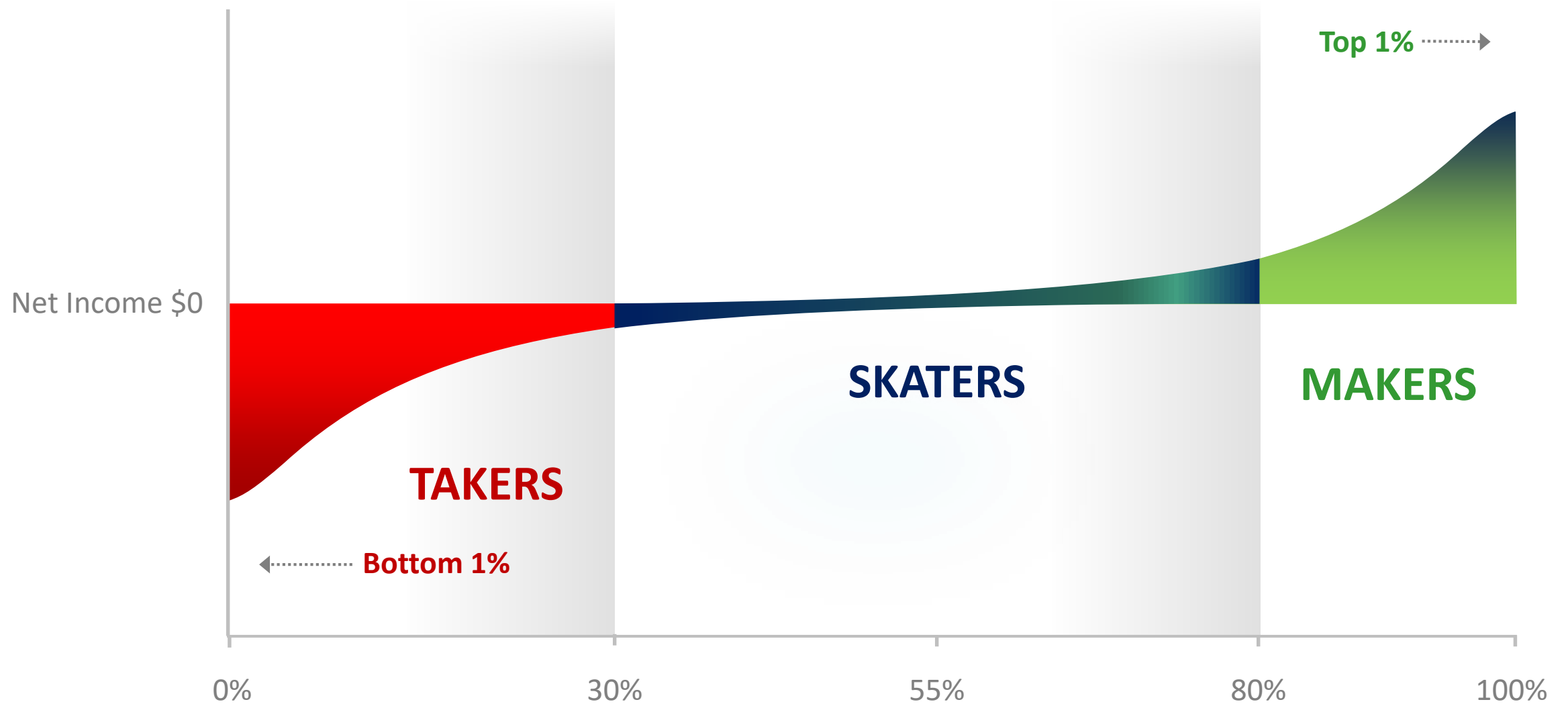
On average only 20% of relationships are creating economic profit

1%

The top 1% create most of that value

Where Does Profit Come From?

Industry research shows us that:



Relationship Ranking

Highest Monthly Contribution

BMOS Construction

\$37,328

Relationship Manager: Ken Levey

Highest 12 mo Contribution

BMOS Construction

\$460,238

Relationship Manager: Ken Levey

Highest 12 mo RAROC

Barrett, Rosalyn

200.60%

Relationship Manager: Roberta Hall

Lowest Monthly Contribution

William Co

\$(462)

Relationship Manager: Roberta Hall

Lowest 12 mo Contribution

William Co

\$(5,981)

Relationship Manager: Roberta Hall

Lowest 12 mo RAROC

Atkins Co

-60.06%

Relationship Manager: Ken Levey

Top 10 Relationships -12 month Contribution

Rank	Relationship	12 month Contribution	% of Total Relationships	Relationship Manager
1	BMOS Construction	\$460,238	35.92%	Ken Levey
2	Arch Technical Services	\$265,986	20.76%	Fitz Mack
3	CC Bath Industries	\$71,664	5.59%	Ken Levey
4	Sanders Co	\$40,435	3.16%	Ken Levey
5	AAA Design	\$39,619	3.09%	Bob Markus
6	Jacobs & Kim	\$31,787	2.48%	Roberta Hall
7	WinterHouse	\$31,379	2.45%	Ken Levey
8	Abbott and Snyder LLC	\$29,286	2.29%	Ken Levey
9	Marks Co	\$28,215	2.20%	Roberta Hall
10	Little and Jones Enterpris	\$24,413	1.91%	Ken Levey

Bottom 10 Relationships -12 month Contribution

Rank	Relationship	12 month Contribution	% of Total Relationships	Relationship Manager
177	William Co	\$(5,981)	-0.47%	Roberta Hall
176	Debbra William	\$(2,372)	-0.19%	Roberta Hall
175	Acevedo, Fred	\$(572)	-0.04%	Tom Mccarthy
174	Ball, Lizette	\$(348)	-0.03%	Roberta Hall
173	Adams, Grace	\$(323)	-0.03%	Angelique Collins
172	Conrad, Evangeline	\$(320)	-0.02%	Roberta Hall
171	Coleman Co	\$(288)	-0.02%	Roberta Hall
170	Sexton, Pauline	\$(251)	-0.02%	Roberta Hall
169	Travers, Serena	\$(135)	-0.01%	Roberta Hall
168	Girl Scout Troop #7500	\$(95)	-0.01%	Roberta Hall

What Do You Do with this Information?

Create Relationship Tiers

- Revenue
- RAROC (ROE)
- Current contribution
- 12 month contribution
- Relationship size
- Others

Develop Relationship Management Plans

- Keep your most valuable relationships
- Improve the profitability of low profit, high balance relationships
- Use profitability tiers to drive relationship plans, interactions and decisions

Profitability Centric Relationship Management

Profitability Centric Relationship Management

Onboarding

- To Onboard or not to Onboard?
- Based on potential profitability

Pricing

- Does the deal make sense?
- At a deal level?
- At a relationship level?
- At what price?

Account Planning

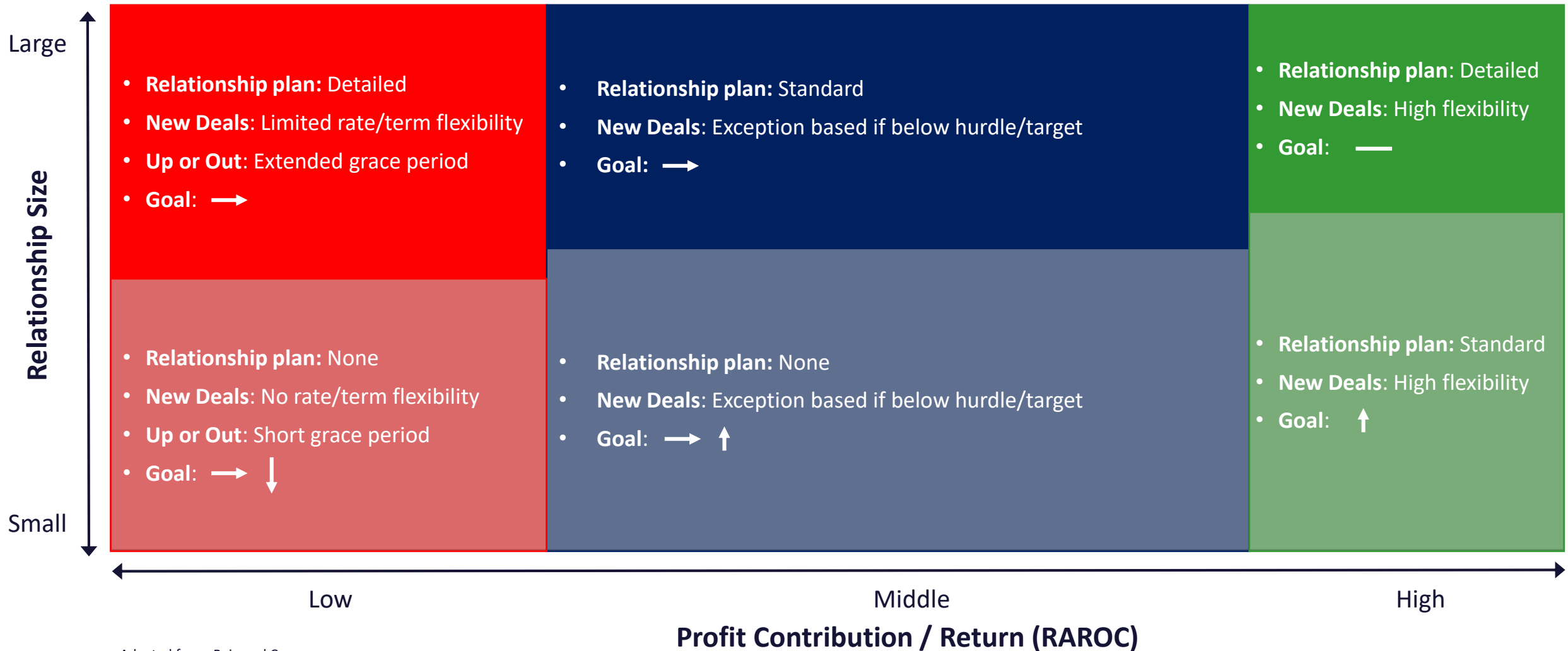
- What is the expected return/ profitability of the account?
- Will the relationship grow and how fast?
- How much is the bank willing to invest to grow the relationship?

Relationship Management

- What is the RM plan for high value clients?
- What is the RM plan for low value clients?
- Marketing plans?
- Special offers / events?
- Frequency of analysis / interactions
- If not, should the bank exit the relationship?

Adapted from: Bain and Company

Relationship Planning / Deal Strategy by Tier



Adapted from: Bain and Company

The Risks



Concentration
Risk



Credit
Risk



Reputation
Risk

← Measure & understand financial impact of each →

You Can't Price in a Vacuum

Product-Based



Risk-Based



Relationship-Based

John Smith

- Small Business Owner
- Looking for C&I Loan

- **Credit Rating:** 3
- **Financials:** Erratic financials and profit, but 18 months of steady growth
- **Industry:** Rapidly Expanding Restaurant Business

- **Existing Client:** Checking, Treasury
- **Family:** Mortgage, checking & savings
- **Individual Profit:** Positive, Top 30%
- **2 Business partners:** both have other business loans & deposits tied to other businesses and personal accounts
- **1 VC Partner:** large wealth mngt client
- **Relationship Profit:** Positive, Top 1%

Sally Jones

- Partner/Owner in Small Business
- Looking for C&I Loan

- **Credit Rating:** 2
- **Financials:** 3 years of steady financials & profit
- **Industry:** Local Health Care Provider

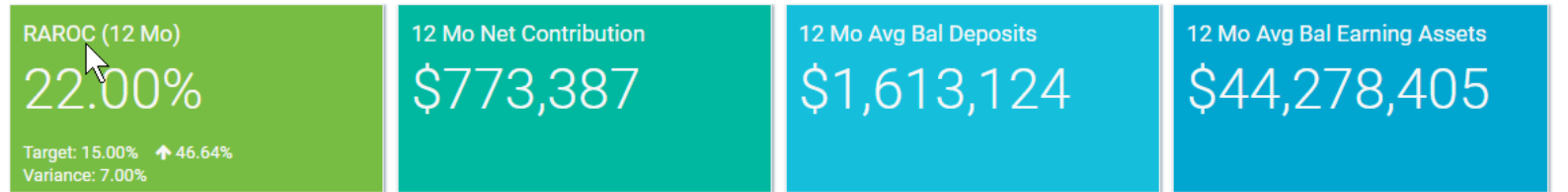
- **Existing Client:** Checking, Commercial CD, Treasury Services, Wealth Management
- **Family:** Mortgage & Auto Loan
- **Individual Profit:** Positive, Top 10%
- **No other connections**
- **Relationship Profit:** Positive, Top 20%

Price on Value



- Relationship-Abbott & Snyder LLC
- Price vs Value
- Pricing to competition
- Pricing Cost + basis
- Price to Value

My Portfolio



Relationship ↑	12M RAROC	RAROC Decile	RAROC Rank	12M Cap	12M Contrib	Contrib Decile	Contrib
▶ A MOVEABLE FEAST LTD	157.763%	1	3	\$184	\$291	7	
▶ A W Johnson Agency	12.805%	7	88	\$4,532	\$580	6	
▶ Abbott and Snyder LLC	50.420%	2	25	\$58,083	\$29,286	1	

Customer	12M RAROC	12M Cap	12M Contrib	12M Avg Bal EA																														
▶ Abbott & Snyder LLP	50.093%	\$57,362	\$28,734	\$712,061																														
≡ Prod Rpt Grp <table border="1"> <thead> <tr> <th>InstrumentID</th> <th>Prod</th> <th>Prod Desc</th> <th>12M RAROC</th> <th>12M Cap</th> <th>12M Contrib</th> </tr> </thead> <tbody> <tr> <td>KHA_SV_209202073</td> <td>KHA_SV_1133</td> <td>Savings Student</td> <td>-11.079%</td> <td>\$41</td> <td>(\$5)</td> </tr> <tr> <td>KHA_DD_208148321</td> <td>KHA_DD_1121</td> <td>MMDA 1</td> <td>-0.023%</td> <td>\$2,136</td> <td>(\$0)</td> </tr> <tr> <td>KHA_LN_400344403201710</td> <td>KHA_LN_1071</td> <td>Commercial Loans</td> <td>47.170%</td> <td>\$13,741</td> <td>\$6,482</td> </tr> <tr> <td>KHA_LN_400344403</td> <td>KHA_LN_1071</td> <td>Commercial Loans</td> <td>53.706%</td> <td>\$41,444</td> <td>\$22,258</td> </tr> </tbody> </table>	InstrumentID	Prod	Prod Desc	12M RAROC	12M Cap	12M Contrib	KHA_SV_209202073	KHA_SV_1133	Savings Student	-11.079%	\$41	(\$5)	KHA_DD_208148321	KHA_DD_1121	MMDA 1	-0.023%	\$2,136	(\$0)	KHA_LN_400344403201710	KHA_LN_1071	Commercial Loans	47.170%	\$13,741	\$6,482	KHA_LN_400344403	KHA_LN_1071	Commercial Loans	53.706%	\$41,444	\$22,258				
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How do we Accurately Make Pricing Decisions?

- Do we price based on the competition?
- Do price on transaction?
- Do we price knowing the full value of entire relationship?
- Do we price taking into account all product and service costs?
- Do we price knowing the value and sphere of influence?

Relationship Pricing:

Make pricing decisions based on the empirical profitability of the relationship

Relationship Profitability:

Retain and grow the relationships that drive profitability

Making Better Pricing Decisions

Structure Deals based on Profitability of the Relationship

Abbott & Snyder LLP

JT 2 09/06/2018



Compare

Relationship Manager: Ken Levey
Ken Levey

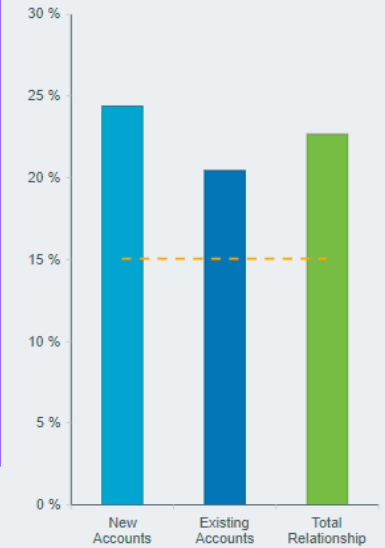
Product	Account ID	Origination/ Avg. Balance	Initial/Current Interest Rate	Original Term	Maturity Date	12 Mo Contribution	RAROC
CDs < 100k		20,000	0.50%	12		71	11.77%
Commercial Loans		750,000	4.50%	60		13,085	24.55%
+ Add New Account							
<input type="checkbox"/> DDA 3	KHA_DD_204142662	29	0.42%	-		(25)	-943.84%
<input type="checkbox"/> DDA 3	KHA_DD_206116210	2,484	0.42%	-		(36)	-15.51%
<input type="checkbox"/> DDA 8	KHA_DD_208148321	49,369	0.42%	-		(233)	-5.09%
<input type="checkbox"/> Commercial Loans	KHA_LN_400344403	416,682	6.44%	61	9/15/2017	8,867	23.99%
<input type="checkbox"/> Savings Student	KHA_SV_209202073	969	0.42%	-		(45)	-109.02%

Pricing Request RAROC

22.83%

Target RAROC: 15.0%

	New Accounts 24.41%		Existing Accounts 20.79%		Total Relationship 22.83%	
	Average Bal	Yield	Average Bal	Yield	Average Bal	Yield
Assets	687,773	4.50%	416,682	6.44%	1,104,454	3.22%
Liabilities	20,000	0.50%	52,851	0.42%	72,851	0.35%
Commitment	-		-		-	
Allocated Capital	53,902		41,796		95,698	
Income	Income	% of Balance	Income	% of Balance	Income	% of Balance
Total Margin FTP - Assets	23,660	3.44%	15,543	3.73%	39,203	3.55%
Total Margin FTP - Liabilities	134	0.67%	(0)	0.00%	134	0.18%
Total Margin FTP	23,794	44.14%	15,543	37.19%	39,336	41.10%
Non-Interest Income	-	0.00%	160	0.38%	160	0.17%
Total Income	23,794	44.14%	15,703	37.57%	39,496	41.27%
Allocated Costs						
Provision	825	1.53%	-	0.00%	825	0.86%
Origination and Maintenance Costs	4,175	7.75%	3,359	8.04%	7,534	7.87%
Transaction Processing Costs	-	0.00%	-	0.00%	-	0.00%
Total Costs	5,000	9.29%	3,359	8.04%	8,369	8.71%
Income Taxes	5,638	10.46%	3,655	8.74%	9,293	9.71%
Total Costs and Taxes	10,638	19.74%	7,014	16.78%	17,653	18.45%
First-Year Contribution	13,156	24.41%	8,688	20.79%	21,844	22.83%



Making Better Pricing Decisions

Scenario Comparison: Abbott and Snyder LLC

NEW PRICING REQUEST 04/10/2019

[← Back](#)

Target RAROC	Current Portfolio		Scenario 1		Scenario 2	
15.00%	RAROC 45.72%		RAROC 37.60%		RAROC 39.28%	
	Average Balance	Yield	Average Balance	Yield	Average Balance	Yield
Assets	691,366	7.34%	1,150,571	4.41%	691,366	7.34%
Liabilities	53,849	0.40%	153,849	0.14%	153,849	0.14%
Commitment	-		-		-	
Allocated Capital	56,103		100,941		65,353	
Income	Income	% of Balance	Income	% of Balance	Income	% of Balance
Total Margin FTP - Assets	40,706	5.89%	57,611	5.01%	40,706	5.89%
Total Margin FTP - Liabilities	145	0.27%	819	0.53%	819	0.53%
	Income/Expense	RAROC	Income/Expense	RAROC	Income/Expense	RAROC
Total Margin FTP	40,891	72.88%	58,430	57.89%	41,525	63.54%
Non-Interest Income	1,270	2.26%	1,270	1.26%	1,270	1.94%
Total Income	42,161	75.15%	59,700	59.14%	42,795	65.48%
Allocated Costs						
Provision	835	1.49%	1,386	1.37%	835	1.28%
Origination and Maintenance Costs	4,644	8.28%	6,674	6.61%	6,124	9.37%
Transaction Processing Costs	-	0.00%	-	0.00%	-	0.00%
Total Costs	4,644	8.28%	6,674	6.61%	6,124	9.37%
Income Taxes	10,993	19.59%	15,073	14.93%	11,002	16.83%
Total Costs and Taxes	15,637	27.87%	21,748	21.54%	17,125	26.20%
First-Year Contribution	25,650	45.72%	37,953	37.60%	25,670	39.28%
Change from Projected Existing Contribution			12,302		20	
Variance from Target RAROC		30.72%		22.60%		24.28%



Submit this Scenario

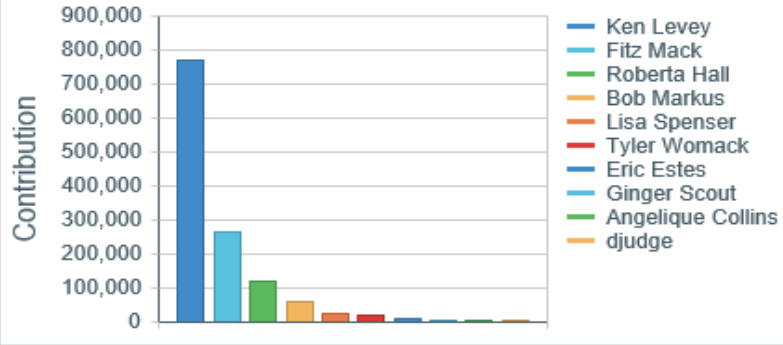


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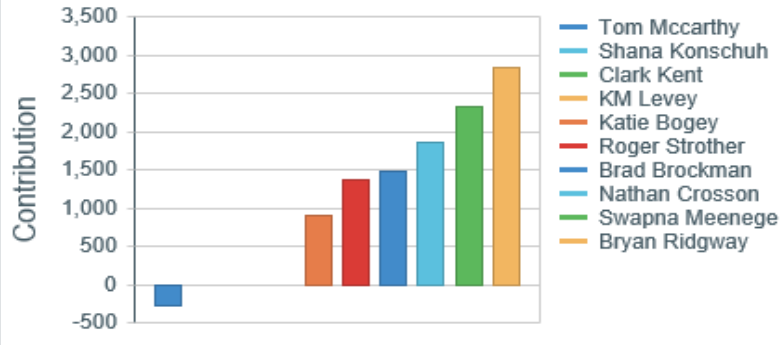
Making Better Pricing Decisions

- 12 mo Contribution
- 12 mo RAROC

Top Ten Relationship Managers



Bottom Ten Relationship Managers



Relationship Manager Ranking - 12 mo Contribution

Rank	Relationship Manager	12mo Contribution	% to Total Relationships
1	Ken Levey	\$768,290	59.36%
2	Fitz Mack	\$265,986	20.55%
3	Roberta Hall	\$118,288	9.14%
4	Bob Markus	\$60,283	4.66%
5	Lisa Spenser	\$22,635	1.75%
6	Tyler Womack	\$20,572	1.59%
7	Eric Estes	\$8,465	0.65%
8	Ginger Scout	\$6,018	0.46%
9	Angelique Collins	\$5,508	0.43%
10	djudge	\$4,142	0.32%

Rank	Relationship Manager	12mo Contribution	% to Total Relationships
21	Tom Mccarthy	\$(281)	-0.02%
20	Shana Konschuh	\$-	0.00%
19	Clark Kent	\$-	0.00%
18	KM Levey	\$-	0.00%
17	Katie Bogey	\$903	0.07%
16	Roger Strother	\$1,364	0.11%
15	Brad Brockman	\$1,486	0.11%
14	Nathan Crosson	\$1,853	0.14%
13	Swapna Meenege	\$2,322	0.18%
12	Bryan Ridgway	\$2,838	0.22%

Highest 12 mo Contribution

Ken Levey

\$768,290

of Relationships: 32

Highest 12 mo RAROC

Katie Bogey

58.71%

of Relationships: 3

Lowest 12 mo Contribution

Tom Mccarthy

\$(281)

of Relationships: 2

Lowest 12 mo RAROC

Tom Mccarthy

-1.14%

of Relationships: 2

Are your Relationship Managers
really 'Producing'?

2008 Financial Crisis

Lesson Learned

NOT ALL GROWTH IS GOOD!

How is your Institution's Performance Evaluated?

Growth

- Asset Size
- Balance Sheet Growth
- Customer / Member Growth
- Number of New Accounts



Performance

- Earnings
- Return
- Value
- Dividends



How are Most Relationship Managers Evaluated?

Growth

- Asset Size
- Balance Sheet Growth
- Customer / Member Growth
- Number of New Accounts



Performance

- Earnings
- Return
- Value
- Dividends



Does your institution include profitability as a metric in calculating the incentive compensation of employees?

36%

include profitability as a metric
for incentive compensation

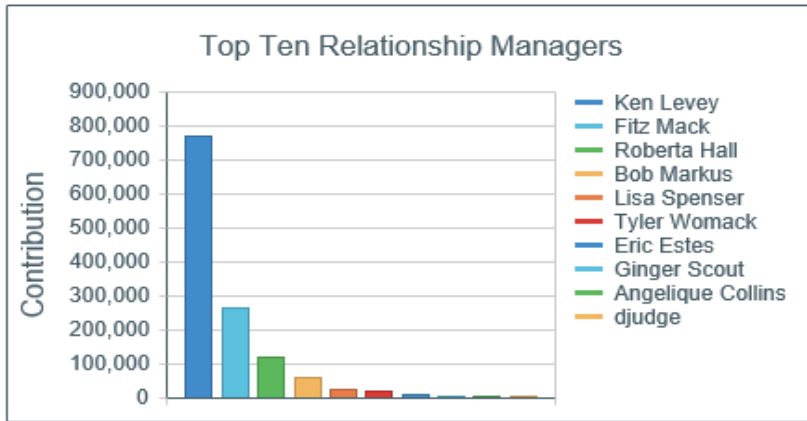
41%

say they would like to include
profitability as a metric at their
institution

Evaluate Relationship Managers by Performance

Relationship Manager Ranking - 12 mo Contribution

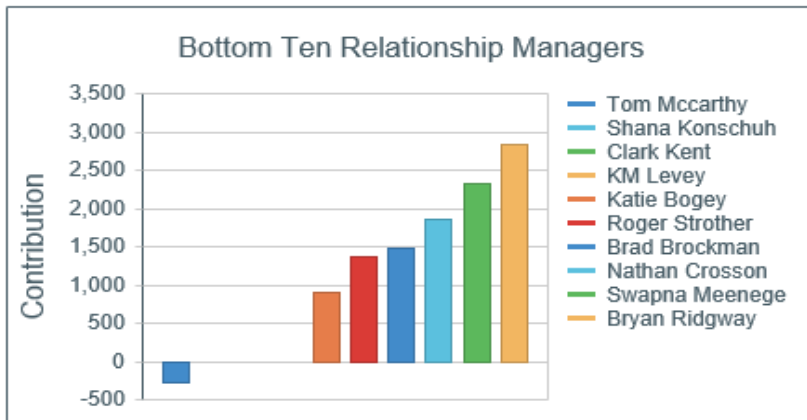
- 12 mo Contribution
- 12 mo RAROC



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Lowest 12 mo RAROC
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-1.14%
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Evaluate Relationship Managers by Performance

Relationship Manager Ranking - 12 mo RAROC

- 12 mo Contribution
- 12 mo RAROC



Rank	Relationship Manager	12mo RAROC
1	Katie Bogey	58.71%
2	Nathan Crosson	52.95%
3	Fitz Mack	39.31%
4	Angelique Collins	27.77%
5	Roberta Hall	22.18%
6	Tyler Womack	21.63%
7	Ken Levey	21.32%
8	Lisa Spenser	19.63%
9	Eric Estes	17.80%
10	Bob Markus	15.35%

Highest 12 mo Contribution

Ken Levey

\$768,290

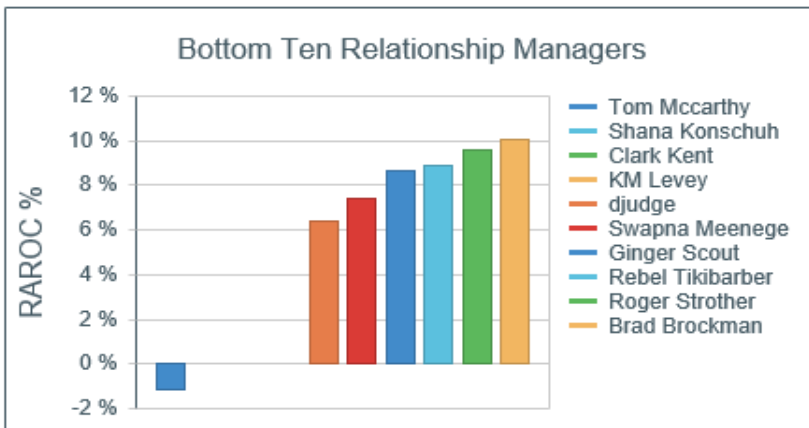
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15	Ginger Scout	8.65%
14	Rebel Tikibarber	8.88%
13	Roger Strother	9.57%
12	Brad Brockman	10.06%

Lowest 12 mo Contribution

Tom Mccarthy

\$(281)

of Relationships: 2

Lowest 12 mo RAROC

Tom Mccarthy

-1.14%

of Relationships: 2

Enable RMs to Evaluate Own Performance

RM Monthly Change Analysis - Ken Levey

December 2017



Evaluating Relationship Manager Performance

Best Practices

- ✓ Align Relationship Manager (RM) goals with institution goals
- ✓ Align RM goals with how you evaluate customers / members
- ✓ Evaluate RMs on combination of performance objectives
 - Profitability, Return, Growth
 - Rank RMs based on performance
- ✓ Make it count...tie RM profitability to incentive plans
- ✓ Enable the Organization...data, processes, tools

The Criticality of Consistency

Consistency

- Executive buy in and commitment
- Steering committee
- Consistent approach to profitability across dimensions
- Consistent between historical and projected
- Alignment with the budget/planning process



Consistency

RM Monthly Change Analysis - Ken Levey

December 2017



Consistency: Across Segments

Luna Co #AAA0234

Profitability Statement- November

Bank rank (NCM)

Bank rank (ROE)

	Total
Average Outstandings	
Interest Income/FTP Credit	7,031
Interest Expense/FTP Charge	1,258
Net interest income	5,773
Estimate for loss provision	1,139
Adjusted net interest income	4,635
Non-interest income	71
Operating income	4,705
FDIC Expense	1
Direct activity costs	79
Contribution margin before taxes	4,625
Taxes (28.3%)	1,309
Contribution margin after taxes	3,316
Allocated capital	166,726
ROE	24.2%

Product- Commercial Loans

Profitability Statement- November

Average Outstandings	717,754,528
Total Number of Loan Accounts	527
Average Loan Balance	1,361,963
Interest Income/FTP Credit	2,849,764
Interest Expense/FTP Charge	784,462
Net interest income	2,065,303
Estimate for loss provision	1,297,528
Adjusted net interest income	767,774
Non-interest income	4,476
Operating income	772,250
Estimate for FDIC / collateral	0
Direct activity costs	40,947
Contribution margin before taxes	749,341
Taxes (28.3%)	212,064
Contribution margin after taxes	537,278
Allocated capital	86,130,543
ROE	7.6%

Consistency: Historical and Projected Profitability

Historical/Actual Profitability

- Relationship Management
- Actual Profitability
- Reporting and Performance Analysis

Forecasted Profitability

- Forecasted Profitability and Pricing
- What-If Modeling
- Pricing Scenarios
- Reporting and Performance Analysis



Consistent Process

- Goals and Targets
- Account Plans
- New Marketing
- Budgets
- Product Initiatives

Recap

Key Takeaways

1. You need to understand the value of your relationships
2. You need a robust pricing process
3. You need to ensure your relationship managers are performing
4. You need consistency in your profitability approaches

Final Thought

CREATE A CULTURE OF PROFITABILITY...

by bringing profitability from the back office
to the front lines!

Q & A

THANK YOU!



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