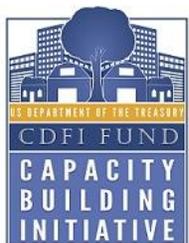


Training Module:

Reducing Costs through Operational Efficiencies



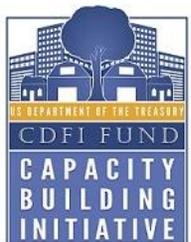
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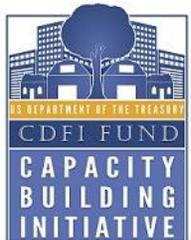
Why Reduce Costs through Operational Efficiencies?

- CDFI MDIs have challenges with optimizing operating efficiency due to their unique business models
- Key challenges face CDFI MDI Operating Efficiency:
 - Managing a high-touch business model with low profit margins
 - Keeping pace with new banking technology
 - Increasing cost of regulatory compliance



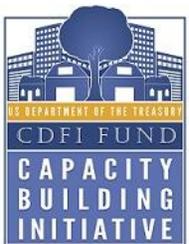
Structure of the Module

- I. Understanding the impact of your business model
- II. Measuring your efficiency and identifying areas for improvement
- III. Developing short and long term solutions
- IV. Breakout session



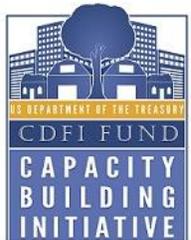
Goals of the Module

- To understand how to assess operational efficiency
- To provide examples of ways to improve operational efficiency
- To highlight examples of strategies that CDFI MDIs have utilized



Characteristics of Highly Efficient and Effective Banks

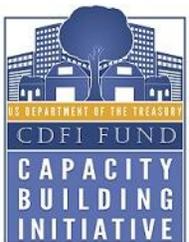
- How do high performing CDFI MDIs consistently accomplish impressive results?
- High performing banks are good at:
 - Focusing the entire organization on a highly visible and easy to understand strategy
 - Driving accountability throughout the organization
 - Simultaneously managing multiple challenges
 - Formulating timely reactions to changes in customers and competition
 - Introducing innovation in response to market demand
 - Managing operations that are flexible and able to respond to change quickly
 - Maintaining high levels of quality control with less variability in processes



Holistic Approach to Revenue and Cost

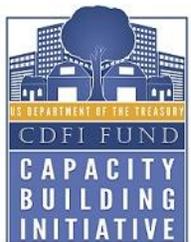
- Both important for managing profitability
- Evaluate impact of revenue and cost strategies on your mission
- Solutions may reduce costs or generate revenues, depending on your bank
 - Example: providing or using a shared service
- Sometimes it is hard to increase revenue but you can control the walls of your bank and associated costs
- Need to consider that cutting certain costs could decrease revenues

Everyone in the bank is responsible to create a culture of managing expenses that are in your control. What does this mean to your bank?



Core Questions to Consider when Reviewing Operations

- What portion of the bank's organizational costs are covered by service revenue?
- How can the bank provide its customers with quality banking services at the lowest cost?
- What are some of the financial implications of changing the mix and cost of services?
- How can the bank produce the greatest revenue relative to real cost?
- How can the bank determine the most cost efficient process for delivering banking services to customers?



Understanding the Impact of Your Business Model

*Defining strategic priorities and
understanding how they impact efficiency*

Impact of Your Business Model

Important to have a complete understanding of your business model before making major efficiency improvements

Strategy before action

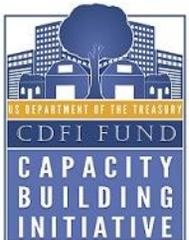
- Understand your business model prior to improving efficiency
- Prioritize decisions
- High-impact investments/processes

Mission-aligned tactical solutions

- Vehicles for enhancing efficiency
- Targeted use of resources
- Effective outcome

Top Costs for CDFI MDIs

- | | | | |
|----|---------------------------|---|----------------------------|
| 1. | Facilities | } | 70% of non-interest income |
| 2. | Payroll | | |
| 3. | IT | | |
| 4. | Contracts | | |
| 5. | Interest Expense | | |
| 6. | Other Costs of Collection | | |



Impact of Your Business Model

1. Bank Goals

- What are your priorities?
- What is your definition of success?
- Are you currently reaching your goals?

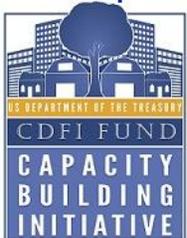
2. Peers and Competitors

- How do you compare to other CDFI MDIs and other similar institutions?
- What are the market opportunities and constraints?
- Who is your competition?



3. Customers

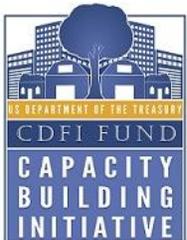
- What is unique about your customers?
- Do you focus on certain demographics?
- What are the opportunities and challenges in servicing your customers?
- Why do your customers choose to do business with you?
- What are your customers' preferences? Their adaptability to new technology? Their special needs that you fulfill?



1. Bank Goals: Formalizing your Strategy

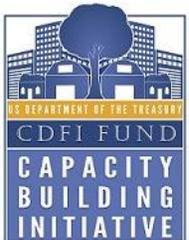
- **What are your priorities?**
 - Profitability
 - Market share
 - Serving community
 - Providing access to capital
 - Religious/cultural imperatives
- **What is your niche? How do you create one if not defined?**
 - What is your value to the community?
 - How would your customers describe your mission?
- **Impact on decision-making**
 - Products and services
 - Processes
 - Human capital
 - IT investments

Theme: Formulating your bank goals is a key part of the strategic planning process. This will be covered in detail during the Strategic Planning module

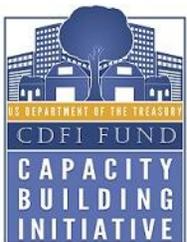


2. Competitors and Peers: Understanding Your Competition and Relative Performance

- **Who do you compare yourself to? now and in three years?**
 - Other MDIs
 - Community banks
 - Regional banks
- **Who do you compete against?**
 - Credit unions
 - Large banks
 - Community banks
 - Checking cashing
 - Retail
- **What are the benefits of understanding your competitors and peers?**
 - Understanding your competitors and your value proposition
 - What products are they offering?
 - How is their customer demographic the same or different than yours?
 - What value do you offer that they do not? How can you differentiate yourself?
 - Performing peer analysis
 - Understand your comparative performance
 - Identify additional potential revenue sources
 - Analyze costs and operating expenses compared to peers



3. Customers: Understanding their Impact on your Costs



Measuring your Efficiency and Identifying Areas for Improvement

*Looking at ways to analyze data to improve
your institution*

Steps to Measure Efficiency and Identify Improvements

Step 1

Track and Measure Financial and Operational Indicators

Step 2

Analyze and Benchmark Key Indicators and Metrics

Step 3

Identify Opportunities to Improve Efficiency

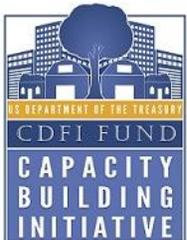
Step 4

Prioritize Areas of Improvement and Align with Mission and Business Model

Step 5

Implement a Plan for Short and Long Term Improvements

Tip: This does not have to be done for the entire bank operations. You can focus on specific departments to start.

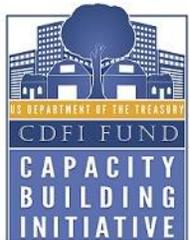


Step One: Track and Measure Indicators



What efficiency indicators are important?

- **Efficiency Ratio:** non-interest expense / net Interest income and non-interest income
- **Operating Expense/Loan Portfolio**
- **Personnel Expense/Loan Portfolio**
- **Cost Per Loan:** operation expense/average number of loans outstanding
- **Amount of Non-Staff Resources Being Used:** supplies, IT, facilities
- **Ratio of Banking Service Income to Cost**



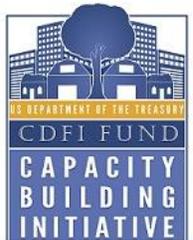
Tip: Metrics are a key part of how investors evaluate your institutions both for equity investments and M&A

Step One: Track and Measure Indicators

Based on the capacity assessment tool results*

Analyzing and Monitoring Efficiency:

- 29%: Monitor operating expenses on a regular schedule at least quarterly
- 64%: Monitor operating expenses at least quarterly, have key efficiency indicators, and perform benchmarking against a peer group
- Average Efficiency Ratio: 95.6%



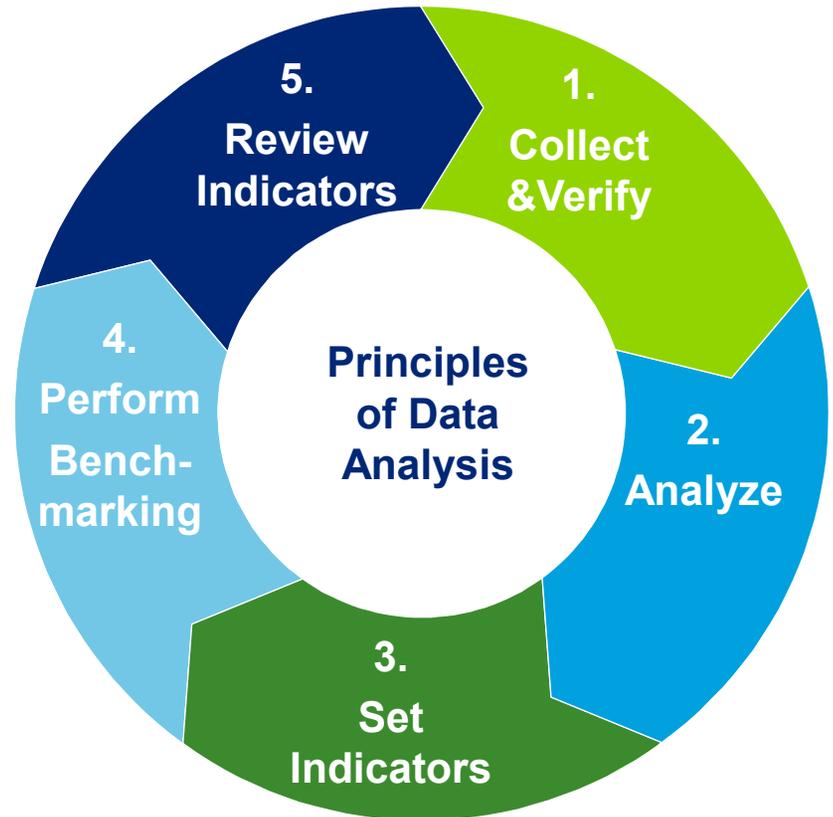
*based on those in attendance for Atlanta and New York that submitted a completed capacity assessment tool

Step Two: Analyze Data and Benchmark

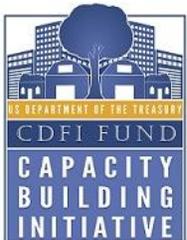


Financial and operational data

- 1) Collect and verify both internal and external data
- 2) Analyze data with software package
- 3) Set benchmark indicators
- 4) Perform benchmarking analysis monthly, quarterly, as part of budget cycle
- 5) Review indicators



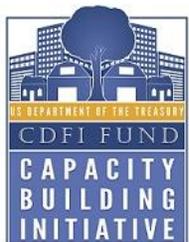
Tip: It is critical to understand how you compare to your peer group and competitors and to understand the trending of these indicators and the underlying reasons for changes



Step Two: Analyze Data and Benchmark

- **Benchmarking based on your business model**
 - What is your peer group?
 - Benchmarking against top quartile
 - Setting goals
 - Track progression
 - Metrics don't lie
- **Example peer group analysis resources:**
 - FDIC (Statistics on Depository Institutions, Uniform Bank Performance Report)
 - NCIF Bank Impact
 - American Bankers Association
 - Bank Trends
 - SNL Financial

Further information: You can find links to these resources together on the *Preserving and Expanding CDFI Minority Depository Institutions* Virtual Resource Bank



Step Two: Analyze Data and Benchmark

Make informed decisions by analyzing your costs including:

- Type of cost including non-interest expense
- Product
- Customer segment
- Branch or geography
- Department
- Time of day

Example: Bank Facilities Costs

- Cost per square foot
- Communication costs
- Utility costs
- Cleaning services
- Bank services
- Maintenance costs

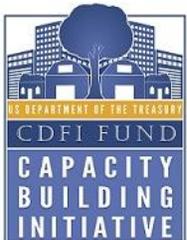
How much does it cost to operate?

How does this compare to the revenue brought in?

What is the break-even point?

How does this change based on day/hour?

What is the relation between costs to customer traffic patterns?



Step Two: Analyze Data and Benchmark

Utilize computer spreadsheet programs or commercial software packages to help with analysis of cost and revenue

- Can build simple excel tools to track operational efficiencies internally
- Check with your banking software provider for additional costing analysis packages

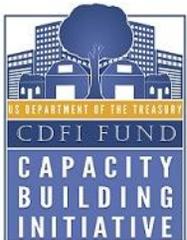
Sample vendors include:

- **Ncontracts**: web-based contract and vendor management solution
- **Temenos**: multiple bank solution product for expense control
- **Banker'sDashboard**: community bank management tool
- **vCom Solutions**: telecom solution for banks

Assessing Program Capabilities

Consider the ability of potential programs to analyze related cost and revenue factors, such as:

- Mix of services
- Staffing patterns
- Amount of time staff members spend delivering services or doing administrative tasks
- Amount of non-staff resources being used (supplies, IT, facilities)
- Percentage income of a banking services as measured against the cost
- Achievement of established strategic and performance objectives
- Revenue sharing among various departments or facilities



Step Three: Identify Opportunities to Improve Efficiency

Step 1

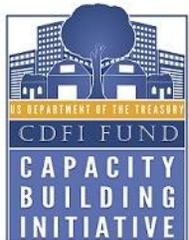
Step 2

Step 3

Step 4

Step 5

- **Target Areas with Higher Likelihood of Inefficiencies**
 - Data processing
 - Loan operations and loan services
 - Procurement/contracts
 - Staffing and productivity
 - Salary and compensation
 - Accounting and reporting
- **Analyze Contracts on a Dollar Basis**
- **Identify Potential Solutions**
 - Eliminating steps
 - Automating
 - Combining functions
 - Transferring costs
 - Entering into partnerships or joint ventures
 - Outsourcing or utilizing shared services provider
- **Conduct Process Assessments and Diagnostic**



Step Four: Prioritize Areas of Improvement and Align with Mission and Business Model

Step 1

Step 2

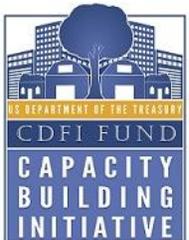
Step 3

Step 4

Step 5

Ensure action items align with your overall strategy and business model

- **80/20 (Pareto) principle and “Law of Vital Few”**
 - **Money:** Analyze product mix and customer segments to identify those in the lowest 20 percent for contribution margin. These are likely to be the ones that require the largest amount of resources
 - **Time:** Understand impact of human capital elements and investments in technology
 - **Cost Drivers:** Understand your cost drivers; you don’t need to look at everything
- **What is obvious? What low hanging fruit can you address first?**
- **Prioritize action items**
 - Is it in line with strategy? Critical or not?
 - Does it improve profitability?
 - How to get to the highest level of service at best cost?
 - Are there any potential consequences? (*reduction in revenues, reduces quality of product or service*)



Step Five: Create an Implementation Plan for Short and Long Term Improvements

Step 1

Step 2

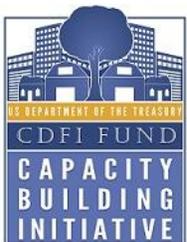
Step 3

Step 4

Step 5

- **Short-term/long-term perspective**
 - What can you do now?
 - Invest more to save more?
- **Expense strategies**
 - Preventing
 - Reducing
 - Maintaining
 - Cross-subsidy
 - Investing for the future
 - Learning from your own business
- **Important to gain management support**

Tip: Run a pilot! It's okay to take risks. "Just for this week, let's try this process..."

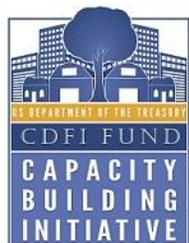


Developing Solutions

Examples from the CDFI Industry

Aligning Efficiency Challenges with Potential Solutions

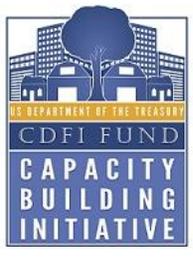
Efficiency Challenges	Potential Solutions
<p>1. Duplication of function <i>Example: Procurement performed by function</i></p>	<p>1. Centralize function <i>Example: Central procurement</i></p>
<p>2. High cost of interacting with customers <i>Example: Majority of interaction with customers is face to face via bank branches</i></p>	<p>2. Provide mobile and online banking services. Offer education to customers on how to and tips for usage. <i>Example: Shift to more virtual transactions, especially with younger customers</i></p>
<p>3. Long delays with manual processes <i>Example: Loan origination has manual components that take a long time</i></p>	<p>3. Automate all or parts of process <i>Example: Automate some of the underwriting or borrower data integration with systems to reduce time to originate</i></p>
<p>4. Staff with downtime <i>Example: Credit staff with available time during the day</i></p>	<p>4. Have staff help with strategic initiatives or new programs <i>Example: Credit staff could help with product cross-selling or marketing during downtime</i></p>
<p>5. Non-core function absorbing too much time or resources <i>Example: Loan servicing performed in house for non-key portfolio</i></p>	<p>5. Outsource non-core function <i>Example: Utilize third party to provide loan servicing</i></p>



Focus on Low Hanging Fruit First!

What can you do now to reduce costs?

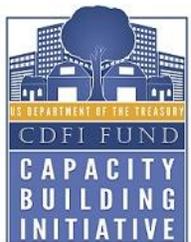
- **Internal Process Improvements:** Challenge your employees to identify improvements. What extra processes don't add value?
- **Recognize Customer Suggestions:** These can lead to potential cost reductions or new revenue products
 - Suggestion box in lobby
 - Example receive many similar suggestions "I wish you had a notary."
- **Contract Administration:** What are your current contracts? All of these could be open for negotiation!
 - What can you control? "We have always done business with..." These are areas to consider competing!



Operational Solution in Practice: Shared Services

Shared services is collaboration with other banks and vendors to leverage economies of scale and benefit from the sharing of ideas for improvement

- Individually, CDFI MDIs may not be able to compete with the resources of larger institutions, but shared services can provide a more level playing field
- Banks can cut costs by 25-30 percent by centralizing and consolidating IT through the use of shared services
- Keep informed of shared services and growing trends through American Bankers Association and other banking associations

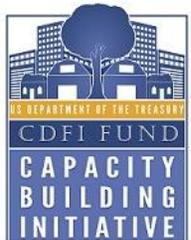


Shared Services: New Jersey Bankers Association Services Corporation

NJBA Services Corp: A for-profit subsidiary of the New Jersey Bankers Association formed in 2009

Service Provided: A vetted list of product and service providers to assist the NJ banking community with revenue generation and operational improvements. Services include:

- Risk Management: enterprise, operational, credit, compliance, etc.
- Pension Management Administration
- Security Management: education, compliance
- Foreign Exchange
- Audit
- Global Payment Services
- Voice and Data Communication
- Employment Screening

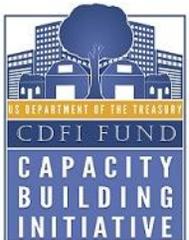


FY2011-2012 revenue increased by \$180,000 in referral fees

Operational Solution in Practice: Contract Administration and Procurement

Contract Administration and Procurement is one area where most depository institutions are still tackling to find operational efficiencies

- 5 percent reduction in indirect spend can translate to a 1-3 percent impact on the bottom line
- Data collection and analysis is paramount to the identification of opportunities to decrease expenses, i.e., spending that is above-average
- Sourcing Process: planning, replication, and evaluation/reward
- Always utilize competitive bidding – Goal: at least three bids!
- Compare ROI of performing services in-house or using contractor
- Not only for new contracts! Renegotiate and compete existing contracts with renewal!



Contract Administration: Learning from CDFI MDI Peer

Situation

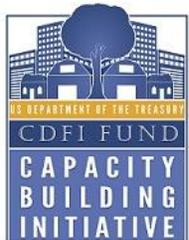
The CDFI MDI was undergoing a turnaround with new ownership. As part of the due diligence process and as a first step after buying the institution, the CDFI MDI leadership conducted a thorough review of all existing contracts.

Process

- Identified contracts that were expensive based on the value of what they were getting
- After initial review of all contracts, individual contracts are now reviewed during renewal process – this is a continual process in which all staff feel empowered
- Gained staff efficiencies by having tellers monitor various contracts during down time
 - Benefit: maximizing use of existing staff time, staff feels empowered and are learning something new

Outcomes

- Reduced IT costs by 50 percent by replacing the core processor
- Reduced Courier costs by 80 percent
 - This included historic shipping of checks to the Fed versus using electronic payment
 - Reduced frequency of cash ordering to decrease fees
- Reduced Telecomm costs by 40 percent, but still high due to limited competition
- Some things were not worth reducing cost, like basic facilities maintenance since it could lead to increased costs later if not properly maintained



IT Solutions and Considerations

Examples of Front Office IT Solutions

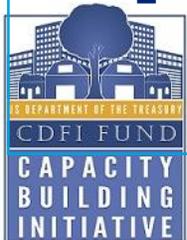
- Online applications
- Mobile banking
- Outsourced call center
- Personal financial management tool
- Remote deposit capture (RDC)
- Self-service kiosks
- CRM system

Examples of Back Office IT Solutions

- Cloud-based platform
- Loan processing
- Procurement
- CRM platform uses for back office

Key Considerations before Investing in IT Solution

- **Select Information Technology solutions to improve customer experience and realize efficiencies**
 - One-stop platform vs. diverse set of providers
- **Investments in technology will only reap results if they are utilized**
 - Procure only what you need
 - Are existing systems being utilized?
 - Train employees on IT
 - Provide customer education for front office IT
- **Track impact of IT investments**
 - Return on investment: costs saved, customer experience improvement, employee satisfaction



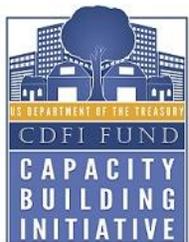
Technical Solution in Practice: Cloud-Based IT Platform

What does cloud mean?

- In this context the cloud means network-based services, which appear to be provided by physical server hardware, and are in fact hosted by virtual hardware
- Such virtual servers do not physically exist and can therefore be moved around and scaled up (or down) as needed without affecting the user
- Should not be confused with remote server access, which has used the word cloud for marketing purposes

What are the advantages of the cloud?

- Acts like shared services platform: can develop and share various applications developed between CDFI MDIs
- "Moving to cloud" also refers to an organization moving away from a traditional IT cost model of buying the dedicated hardware and depreciating it over a period of time to an IT cost model of using shared cloud infrastructure and paying as you use it, making it more feasible for CDFI MDIs



Cloud-based IT Platform: Learning from CDFI Industry

Situation

- Implemented by one of the largest CDFIs in the U.S. with a complex structure. CIO inherited a network of over 80 IT systems to manage. The goal was to move to one core system with applications and tools built off that core system

Solution

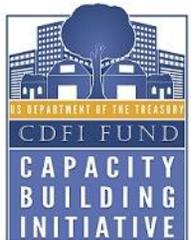
- Evaluated the options for an integrated platform. They decided to adopt a cloud based platform for its ease of use, flexibility, and purchase structure that did not involve high up front costs in buying a “system”
- This cloud platform acts as the central system, acts as a data warehouse with applications built off the system and integrated with three specialized systems

Outcomes

- Gained significant savings in IT costs in adopting cloud-based IT platform
- Real-time reporting and data-analytics
- Ease to build specific applications for “internal clients”
- Easy for investors to log in and view reports and real time data

Lessons Learned

- IT shop may be the most reluctant to adopt the new system (reduces the need for system developers and increases the need for business analysts)



Breakout Session

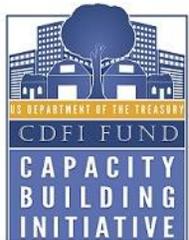
Addressing a challenging situation typical for all CDFI MDIs and discussing solutions

Breakout Session: Looking at Bank Facilities Costs

Bank facilities are typically the largest operating cost for a CDFI MDI, and therefore, it is important to analyze these costs, along with the corresponding revenue patterns, to identify ways to improve operating efficiencies and lower costs

At your table group, discuss the following points:

- What analysis does your bank currently perform related to bank facilities costs? How often and to what level of detail?
- How has your bank adopted different operating strategies based on the shifting needs and expectations of your customers and community?
- What alternative schedules for bank operating models and hours have you considered and/or implemented? If you haven't, what has held you up (bank culture, risks, board, etc.)?
- What have been the successes and challenges with these alternatives?



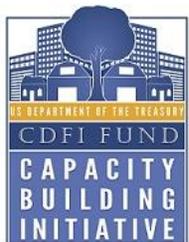
Breakout Session: Looking at Bank Facilities Costs

On a regular basis, your bank can perform data analytics related to the patterns of customer foot traffic, revenue, and costs for bank facilities. This helps to identify when your peak times are for highest revenue and your slow times where operating costs are high compared to the revenue gained

Options to consider to lower facilities costs:

- Open drive-thru window and keep bank lobby closed during non-peak times
- Consider alternative schedule based on customer needs (Example: longer hours on Saturday and close one week day, stay open on Sundays, etc.)
- Invest in human capital and train employees for multi-functions (Create a culture of service! Can tellers perform other tasks during their downtime?)

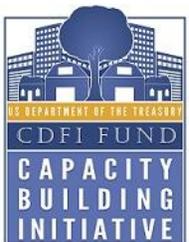
Key Takeaway: It is important to revisit this analysis on a regular basis, as customer demographics and lifestyle patterns change, facilities usage, and revenue in-take for your CDFI MDI will also change



Wrap-Up

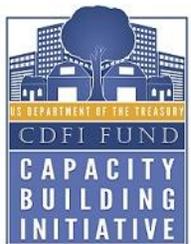
Key Takeaways

- Understand business you are in: be strategic
- Use data: collect, analyze, and track
- Develop operational and technical solutions to improve efficiency
- Align with strategy
- Keep abreast with leading practices: learn from your peers and other banks

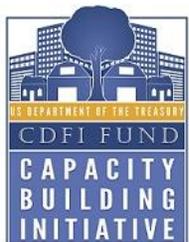


Examples of Potential Technical Assistance

- Support with defining strategic priorities and understanding their impact on efficiency
- Support with peer benchmarking analysis
- Performing cost and revenue data analytics
- Identifying opportunities to improve efficiencies
- Helping to prioritize areas of improvement and walking through alignment with business model
- Support with the conceptualizing a pilot project to implement an area of operational improvement



Questions?





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