This article, second of two, continues describing successful SuperCommunity banks that have effectively executed the SuperCommunity banking strategy with a flair of their own.

CAPITOL BANCORP – BUCKING THE TREND

Capitol Bancorp is a counter-intuitive company. It does many things that are associated with lesser performing companies: separate charters, non-contiguous facilities and banks, location strategy that is banker-driven (in other words, Capitol will not charter a new bank in an attractive location if the right banker isn't available), and perceived huge overhead due to a unique ownership structure and countless charters. Yet, Capitol is a super performer. What's the secret?

Unique de novo bank chartering strategy

Capitol is a $3.5 billion bank holding company specializing in chartering and building regional community banks. The Company has over thirty individually chartered affiliate banks in three widely ranging markets: the great lakes, the southwest and California. This regional expansion provided Capitol with unique diversification benefits that far outweighed the inability to leverage the brand in a densely networked geography.

In the past twenty years, Capitol acquired only one bank that it did not originally develop as a de novo bank. New bank charters started in the early 1990s and have continued through the 2000s, augmented by LPOs in Houston, Atlanta and Dallas as test markets.

The Company's de novo strategy is unique. It is driven by the identification of attractive markets and distinct communities, followed by the hiring of a local community banker to head the new bank, generally concentrating on collateralized CRE lending. Consumer and mortgage lending is less active, but Capitol also owns 51% of a mortgage company that offers mortgage originations to Capitol's affiliate banks.

The de novo process

The de novo strategy has worked exceptionally well for the Company. It starts with the identification of growth markets nationwide with no regard to geographic proximity to headquarters or other facilities,. The process then includes hiring local relationship bank executives and managers, providing them with centralized logistical resources including in-house investment banking and legal counsel to support the chartering process (this is an important core competency for the Company, since it has significantly reduced the costs if de novo charters due to this internally developed and housed expertise). Capitol also contributes part of the start-up capital, and structures a separate holding company with ownership by the executives as well as the Company. Capitol typically owns 51% of each de novo bank, often through a majority controlled subsidiary holding company. Other investors, primarily the de novo's management, contribute the remaining capital.

The expectation is for the new bank to reach 15% ROE within the first three years. After the third year, Capitol usually buys out the de novo's minority shareholders at a pre-negotiated price of 150% of book value. Note: This strategy is reminiscent of Sterling Bank's de novo branching program where each community's movers and shakers get convertible stock in Sterling, to be converted into Sterling shares at a higher rate with faster breakeven, (end of note).

The 15% hurdle rate has not been achieved in all de novo cases. When that occurs, management changes take place at the individual bank level to move underperformers back into the 15% ROE range.

<u>SuperCommunity Bank model</u>

Each of the twenty nine individually chartered banks is independently and locally managed. Product, pricing and most credit decisions are made at the local level. All but Capitol National Bank operate as main office banks without other branches. Their focus is on profitability first and growth second, another counter-vogue principal.

The Company's asset mix, primarily comprised of commercial and CRE loans, has minimal convexity embedded in it, which made Capitol less vulnerable to the margin compression that so many other commercial banks have experienced in the past three years. That margin has been the primary driver of revenues, with low fee income at 15% of total revenues. This is expected to continue given the banks' deposit and loan mix characteristics, as deposits are mostly commercial-driven.

This local management, decisioning and delivery is supported by central facilities for technology services, accounting and regulatory reporting. The holding company also sets credit policies, monitors asset quality trends, and provides asset liability management. Capitol anticipates further centralization of the management of liquidity and enterprise risk management as it grows.

The success of this de novo process can be an inspiration to many banks who are looking to strike their own path but are concerned about breaking the pattern of an entire industry. Capitol's success demonstrates yet again that effective execution is what success is all about. In Capitol's case, the combination of original thinking and buttoned-down execution is the winning combination.

<u>Unusual capital structure</u>

Capitol's capital structure is also unique and bears discussion. Tangible equity capital ratio is much lower than the leverage ratio (most unusual) because of the portion of capital at the affiliate banks that is owned by their management and other investors and trust preferred equity. Both elements have been used to lever the capital further. This helps absorb part of the start-up losses and mititages the risks of new bank development. The trust preferred equity minimizes common equity dilution by displacing a portion of the common equity that would have

otherwise been needed for investment in the banks (which contributes to the higher than average double leverage ratio).

This operating model perfectly executes the SuperCommunity bank philosophy of effective combination of local delivery and management with centralized customer-transparent facilities. What makes this business proposition unique is the individually chartered companies and the nationwide scope of the enterprise, as well as the unique financing and buyout provisions associated with the program. A key ingredient to its success is also the internally developed de novo chartering and regulatory expertise, which makes the prospect of chartering 2-4 banks a year more palatable and economically feasible.

Capitol has enjoyed very strong asset growth in the past six years as a result of many new bank formations. Such growth has been profitable enough to cover the start-up costs of the new banks while generating strong current income and building future franchise value. The Company will continue new bank development as it is its core strategy and the cornerstone of its success. It expects to form 2-4 new banks a year for the foreseeable future. The earnings drag of the new banks' losses continues to diminish since the franchise is generating enough income to better absorb these losses, with ever more banks producing larger volume of earnings.

Capitol has proved that resource deployment works when the resources are carefully selected and appropriately motivated. Its business model incorporates what many might consider unnecessary costs, yet this revenue-driven, innovative strategy has proven most effective. Earnings have been growing annually and the opportunities for continued growth are almost limitless, since the entire country is Capitol's oyster.

TCF: JOE LUNCHBUCKET LIKES CONVENIENCE, OR ANOTHER AMAZING DE NOVO STORY

TCF is an $13 billion company, yet its convenience outlets far exceed others of its size. The Company has OVER 400 branches, including 250 in-store branches, almost 1200 ATMs machines, 1.5 million debit cards and 1.4 million checking accounts. This is indeed an unusual profile, and a highly profitable one as well. The Company has built a fortress balance sheet with high quality loans and low cost deposits. It augments its strong basic banking business with a leasing and equipment finance operation and a mortgage servicing unit. The combined result is superior ROA and ROE consistently over time.

Selling convenience

TCF is a company that is all about convenience. Its banking products are simple and clear, and branches are open 7/364, both traditional and in store branches. The

Company offers ATMs, aggressively markets debit cards, phone banking and online banking, all as an integral part of a cohesive strategy to offer more convenience and a product suite that is appropriate to its target customer – the Average Joe.

TCF has accomplished this crystal-clear strategy by opening 229 new branches in the past 6 years. These new branches account for 2/3 of the entire network, and include 250 in-store branches. The Company's nimble management style enables it to shift tactics within its stated strategy, which means that it is now opening more traditional branches than supermarket facilities, reflecting new market opportunities (exhibit X: The TCF financial footprint).

Product suite design

TCF has carefully built its product line, using the free checking account as the anchor to building relationship. It has not emphasized wealth management, appropriately reflecting its target customer base, and has built deeper usage of such products that effectively serve its market, including the debit card, express coin service, insurance services and check cashing. Both internet banking (378,000 accounts, up from only 20,000 in 2000) and campus banking (another forgotten customer base, accounting for almost 80,000 checking accounts) are high growth additional products and customers the Company caters to.

Metro strategy

Many banks find that they cannot meet their profitability and growth hurdles in rural markets. Few, like Capitol (see above) and Sunflower, defy that convention, but most fail to maximize shareholder value in such markets. TCF has had the advantage of initially focusing on large, densely populated areas. It was never saddled with rural, no growth markets. Site selection is a science at TCF, and sites are picked using variables such as population, density, household income and growth. While this sounds familiar, TCF goes where others don't, considering its clearly targeted customer segment. The Company does not branch in the affluent suburbs, but rather covers downtown and in other densely populated areas.

Clear distribution strategy

One of the issues banks have been struggling with is the role that each distribution channel plays in the entire network. Banks often neglect the network effect altogether, both in planning new branch site and in closing them. Schwab was one of the first companies to have a specific idea in mind for the role of each channel in contacting customers. TCF is another example of such clarity. The in-store branches are typically used for customer acquisition and new account openings (in my days at Wells Fargo I found that channel to offer the highest checking account growth opportunities as well), while stand-alone facilities are utilized to solidify relationships and cross-sell additional products.

Disciplined approach

TCF is a highly disciplined company Which got this foundation from its courageous, outspoken and driven CEO, Bill Cooper, who retired last year. Bill was an excellent

communicator and who spoke his mind clearly and bluntly. His quantitative and disciplined thinking permeated the entire Company, which has undertaken some of these characteristics, like many companies with strong CEOs do. Consequently, TCF enjoyed excellent metrics and benchmarks, as well as clearly defined expectations. For example, a traditional branch breakeven point occurs in 32 months (based on deposit size only) at $15.3 million and 2.250 checking account (lower than the competition, due to TCF's outstanding efficiency and cost containment culture). An in-store branch breaks even at 27 months and $3 million in deposits with 2000 checking accounts, again below industry averages.

Understanding the profitability dynamics of the branch network helps TCF goal performance crisply. The target for new checking account growth at a new branch is a 200 accounts per month. It is simple, clear and doable.

<u>Strong sales and marketing culture</u>

TCF leads with the free checking product, but it also follows with cross-selling, something many banks claim and few execute. Over 40% of the checking account customers have a home equity loan or line with the bank, a good penetration ratio. Other cross-selling products include debit card and bill payment. TCF has developed innovative marketing approaches to encourage debit card usage among its hinterland customers, most notably its phone card, and the results have been impressive and highly profitable.

TCF continues its innovative marketing by offering $20 to all customers for referring others, and it knows with precision how many accounts have been opened as a result of this promotion. While this is nothing new, it is the crispness of execution that makes such a promotion a success at TCF. The team is goal oriented and effective, and the goals are simple, few and well rewarded.

<u>Incentives</u>

The Company's compensation is founded on its firm believer in pay for performance, and, therefore, has effective incentive programs in place. The example below shows management's sensitivity to ensuring that incentives achieve precisely what they are intended to do. For example, in 2003 the only criteria for manager incentives include Voluntary attrition (as opposed to customer moves outside TCF's footprint), mystery shops (since service, surprisingly, is a hallmark of the Company and is evidenced by almost no customer defections due to poor service), and voluntary turnover (since not all turnover is bad, but good people turnover is a major impediment to success).

TCF has structured its incentive programs to meet three important criteria:

- **The objective must be measurable. This is facilitated by profit center reporting which divides up the bank into measurable profit centers.**

- **The program is tightly managed such that management can focus on both the individual employee and the program performance as well as big picture objectives,**
- **Accountability rules. Once objectives are set and the process sis managed, the results are measured and employees are held accountable for their results.**

TCF also has long term employee incentives that encourages them all to be owners, believing that owners act differently than employees. I strongly share this conviction and find that such incentives truly motivate employees to "run it like you own it".

Given the Company's emphasis on service, it also provides incentives and recognition for quality service. Employees have simple, basic customer service standards and behaviors for which they are immediately and consistently recognized anytime, anywhere they are observed delivering these service elements. TCF measures its employee satisfaction and retention, and found that this program helped increase both.

In summary, TCF is a company that delivers consistently as a result of a highly focused, disciplined and well-articulated approach to the marketplace. Its corporate philosophy statement captures in one page what every employee should know about the company, and leads every team member in the same direction.

SYNOVUS: THE IMPORTANCE OF VALUES

Synovus is unique in its peer group. It is a $27 billion company with an equity ratio over 10% yet its ROE exceeds 17% in a bad year (it has not been below that level since 1996), and breaks 20% in good ones. ROA hovers between 1.8% and 2%+. These results are most unusual in any bank, and especially in banks of Synovus' asset size. What's the secret? Says Jimmy Blanchard, The Company's inspirational Chairman: "Our team members have maintained their focus on our company's core values of people, service and performance". The annual report says: " Understanding is what makes us strong…In a time when business pages are filled with complicated business models and buzzwords, this creed might seem rather simplistic. But our customer covenant is indeed the framework of our corporate strategy – the boundaries within which we work. True, we rely heavily on thorough knowledge and robust technology and proven business processes, but our strength is rooted in how we connect with people: The customers we serve, the communities

we support, and the team members we employ". This is what Synovus is about – people culture.

<u>The culture</u>

Synovus believes, like many do, that financial services is, to a large degree, a commodity business. So relationships have to be the cornerstone of the Company's success. Every decision made, from the decentralized banking approach to the needs-based sales strategy to the creation of cutting edge technology is made with the customer's best interest in mind. "What we do has a tremendous impact on people's loves, as we take our role very seriously". This sense of responsibility and customer focus permeates the entire company. It doesn't mean, however, lack of accountability. As Richard Anthony, Synovus CEO, sums it up, "taking 100% responsibility. Giving back. Embracing individuality. Doing the right thing. Pretty basic principles that might even sound a bit "square" …but it's the framework that makes our company great".

Not surprisingly, Synovus has been named one of the top 100 best places to work in the US by Fortune Magazine for six years running. Its people know how management feels about them, and their productivity and commitment show. They also know that Synovus' leadership has formal expectations that put them on the same playing field as the employees – everyone has to be accountable for their performance standards. In management's case, there are leadership expectations along four categories:

- **Live the values**
- **Share the vision**
- **Manage the business**
- **Make others successful**

These four dimensions are enough to draw a picture of the company: driven by integrity and shared vision, yet focused on performance and teamwork. Helping others succeed is a core value, which indeed helps make the whole greater than the sum of the parts.

<u>The roots</u>

Synovus has a strong capital foundation, a long history of top industry performance and a people-driven service culture. Founded over a century ago is Columbus, Georgia by a mill owner who realized, when one of his employees' skirt got caught in a machine, that her hem was the only place she could put her money it. He then apportioned a compartment in the mill's safe to keep the employees' cash in, and the rest is history.

Synovus started operating as a single bank in 1888. At that time, the company's founders made the commitment to deliver superior customer satisfaction, to practice conservative financial policies and to treat people with courtesy and respect – not only customers, but everyone they came in contact with. Over the years, this

simple but sound commitment has been carefully preserved at Synovus within the corporate culture – it's the way they do business. It may sound corny but it is very real and feels tangible to those who interact with the company and know its people.

Synovus reflects the philosophy and conviction of its management team, and Richard Anthony in particular. Richard is thoughtful about everything and is totally committed to people. Even the name "Synovus" has been carefully selected, created through the combination of Synergy (the interaction of separate components such that the total effect is greater than the sum of the parts" and novus (Latin for "new"), intending to imply superior quality and somehow different from peers. Blanchard has certainly been successful in achieving such distinction.

Service not in name only

Management is convinced that the philosophy described above is what made Synovus unique and successful. "The key to our success has been and will always be our service culture. Our people believe in honesty and treating folks right – keeping the customer first… Synovus is a people-oriented company. From customers to team members, shareholders to business associates, we never forget that people are vital to our success. People are the foundation of Synovus and the first link in our value chain."

Sounds corny, but it is oh so true at Synovus. Service is a daily unwavering commitment and it comes through in customer interactions consistently. The company's stellar financial results reflect the business soundness of this warm, fuzzy proposition. It may feel unfocused, but it is razor sharp within the company and it works!

There is evidence to support the claim that Synovus provides world-class service. Its customer covenant survey shows overall customer satisfaction rating of 9.1 out of ten. They say than 9.24 times out of ten they would recommend Synovus to others (ten means they would definitely recommend the Bank). This is enviable – and actionable - customer satisfaction.

We found independent corroboration to Synovus' claims in our SCBenchmarking study, which shows Synovus has the highest cross-sell ratio of the entire study population for both commercial and retail customers.

Extraordinary diversification

Synovus operates several distinct businesses within two main categories:

- **Financial services, including five key services:**
  - **Banking**
  - **Financial management**
  - **Mortgage**
  - **Insurance**
  - **Leasing (both consumer and business)**

- **Payment processing, including a wide range of products such as:**
  - **credit card portfolio management**
  - **e-business services**
  - **credit card payment processing**

Payment services are provided by TSYS, now the largest processor of international payments in the world.

This is yet one more of the elements that make the Company so unique. For its size, Synovus is extraordinarily well diversified, enjoying countercyclical, self-hedged income streams from various business lines. Its business mix is unique for a bank its size, and fee income exceeds 50% of total revenues, another unusual feature that helped the Company has a banner year in 2002 despite a 40 basis point decline in its net interest margin.

<u>Decentralization</u>

Synovus believes in the portfolio strategy and the concept of decentralization. It is not just a risk management tool – it's a lifetime philosophy. Each business, both within and outside the bank itself, as well as each bank affiliate, make their own decisions while being held accountable to their goals. This structure, reminiscent of the old BancOne uncommon partnership, is extremely powerful. It fosters entrepreneurial thinking and spirit, and it also harbors strong earnings power due to the relatively small size of each unit. It is easier to ask each affiliate bank for another $500,000 of income than to figure out across the company where to find $10 million. It is also wiser to do so, because each bank president, each LOB CEO, knows where the best opportunities lie, and can capitalize upon them quicker and more efficiently than a central unit.

Decentralization is supposed to be costly, yet we saw throughout this chapter how most successful banks maintain decentralized structures without huge penalties to their efficiency ratio. Synovus is no exception. It has what some might call unnecessary layers of management, not to mention nearly 40 bank charters, yet its efficiency ratio centers around 50%. Part of the reason is, again, the earning power of disciplined decentralization. Too much autonomy creates chaos. Successful community banks do not tolerate chaos nor lack of performance – but they do offer many people the opportunity to function as CEO and have enough rope to hang themselves – or fly. Synovus boasts very strong growth rates even through the most recent recession, and I believe the reason revolves around its structure. For example, even the Financial Management services unit, which has suffered from adverse markets since 2000, exhibited CAGR revenue growth of 19% since 2000. Those of you who own trust and wealth management businesses know how difficult this is and how rare.

Decentralization has its challenges, particularly for corporate staffs who can only influence the business owners, not dictate. Everyone knows what kind of reception

one gets when you show up and say, "I'm from Corporate and I'm here to help". At Synovus, the reception is more open, but decentralization still provides an on-going challenge to consistent execution.

<u>TSYS</u>
One cannot discuss Synovus without talking about TSYS, its payment processing unit. With compounded annual net income growth rate of 24.4% over the last 19 years, TSYS is a goldmine. Its success is due to the vision that started it in the first place: a laser-focus on card issuing business. TSYS has been using technology and service as a powerful combination to lead its value proposition, and the results have been spectacular.

In sum, Synovus is a very special company that started like so many other community banks. Its management team took it to the next level and beyond through a people-focused corporate philosophy, coupled with highly diversified and disciplined business model, augmented with an extremely attractive specialty business. The results have been extraordinary.

SUMMARY: BEST PRACTICES EMERGING THEMES

The list of successful SuperCommunity Banks is highly diverse. The banks above range from plain vanilla, basic banking to diversified financial services companies, from rural to metro banks, from small to quite large, from organic growers to acquirers. Yet they all have certain elements in common. The themes that emerge include:

STRATEGIC THEMES

- **<u>Strong corporate culture</u>. While the cultures of the banks above vary widely, they all have strong, tangible, living, well articulated, constantly communicated corporate culture.**
- **<u>Clear focus and strategy</u>. The successful companies are not meandering. Their success is the result of methodical planning and execution; their focus is clear and understood by most employees, and their strategies and execution fit within the stated corporate focus.**
- **<u>Simplicity</u>. The successful banks are not complicated. Their strategy and vision can be simply and quickly articulated. Their organization structures are simple, their purpose easily understood.**
- **<u>Specialty businesses</u>. This element does not appear in all successful community banks, but in some. They use the additional line of business focus to counterbalance adverse margin movements and generate non-**

capital-intensive fee income, as well as grow share in specific market niches.

- **<u>CEO involvement</u>. These companies' CEOs are involved with their people and their customers and intimately understand the business. They do not micromanage, but they are hands-on. Their vision is clear and they personally communicate that vision frequently and consistently to all constituents.**

MANAGING THE BASICS

- **<u>Excellent asset quality + high reserves</u>. All the banks mentioned above have superior asset quality coupled with high loan loss reserves, a very conservative posture.**
- **<u>Conservative financial management</u>. Conservative posture in financial and risk management across all major bank risks is a hallmark of successful companies. While they still may stub their toe occasionally, they never bet the bank, nor do they take interest rate or other bets.**
- **<u>Strong employee stock purchase plans</u>. Employees are encouraged to buy the bank's stock and feel and act like owners. The bank facilitates employee ownership in several different ways.**
- **<u>Tight cost management</u>. Cost consciousness is part of the culture in many of these banks, most of which enjoy efficiency ratios below 50%. This is not the result of a cost cutting event but rather a long term cultural imperative. The benefit of the cost focus is that the bank can achieve stellar results with less effort, since it does not have a huge cost "rock" to carry, and a larger percentage of revenue dollars drop directly to the bottom line.**
- **<u>Effective capital management, including stock buybacks</u>. Publicly traded community banks pay attention to their stock price and ensure that shareholder value is paramount through both stock buybacks and dividend management.**