

# Evaluation of current performance of arvest bank and planning for the future

[Literature](#), [Russian Literature](#)



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### Introduction

Despite the rapid changes in the business environment it has been the important function of the banks is to manage the risks associated with the flow of money. In fact this risk is inherent as has been observed over a period of time. The economic growth of a nation depends largely on the bank loans provided for financing various economic activities like construction, expansion of business and industries, purchase and trading in inventories, home, and other consumer loans. In order to fund the loans and to make a profit there from, the banks should have the sources for getting money as low a cost as possible. The depositors look for the security of their investments before placing their money with the banks as deposits. Although deposit insurance acts to protect the small depositors, the banks will not be able to manage its business solely on small deposits. They also need larger deposits in which case the large depositors look more into the safety of the money they would like to place with the bank and they also expect the banks to operate safely. Safety of a bank revolves around how well the bank is able to manage the risks associated with its business. In addition to the risk analysis, the depositors and other agencies who deal with the banks make an assessment of the overall performance of the operations of the bank and this assessment greatly influences the reputation of the bank in the market.

This paper makes a detailed report on the evaluation of the performance of Arvest Bank on the basis of UBPR data. The paper also presents a planning for the future strategic growth of the business of the bank.

## Situation Analysis

### Arvest Bank – An Overview

Serving the areas of Arkansas, Kansas, Missouri, and Oklahoma Arvest Bank can be considered as the popular of the bank of the residents in these areas. While the focus of most of the banks is on both the personal and business accounts, Arvest Bank is mainly concentrating on the accounts of the common people. Online banking is the core strength of Arvest Bank. The history of the bank reveals that the efforts of the visionary Sam Walton – the founder of Wal-Mart with the purchase of the Bank of Bentonville in 1961 has made the beginning of the successful growth of Arvest Bank[1]. With an intention to diversify from the retail activity and also to develop the concept of a community bank to serve the local population efficiently, Walton acquired this bank. Thus the main impetus to the development of the bank came from the desire of the founder to let the bank make the decisions in a decentralized way at the local level and to involve them actively in the development of the local community. This mission has now proved successful with Arvest bank being the largest in Arkansas with Arvest Bank Group controlling several banks in Arkansas, Missouri, and Oklahoma with an asset value of \$ 9.3 billion and 164,000 active online customers and 24,000 monthly bill-pay users[2].

“ Arvest Holdings owns Arvest Bank, which has some 200 locations in Arkansas, Oklahoma, Missouri, and Kansas. The bank provides traditional deposit and loan products, as well as trust, asset management, and brokerage services. It maintains a decentralized structure in which local managers and boards of directors have the final say on lending decisions and deposit rates in many of the communities that it serves. Arvest, which has grown to be the biggest bank in Arkansas largely via acquisitions, expanded into Kansas when it bought Caney Valley Bancshares in 2007. Descendants of Wal-Mart founder Sam Walton (including bank CEO Jim Walton, a son of Sam and one of the richest men in America) own Arvest Holdings” (Arvest Holdings Inc)[3].

### Competition

The competition in the banking industry has been found to be at all time high. The commercial banks meet the competition not only from other banks, but also from insurance companies, credit unions, auto-finance companies, real estate firms, stock broking firms, other financial institutions, start up and regional banks and also other national banks. There are several other institutions and organizations, the banks are expected to meet in competition during the conduct of their business[4].

The challenges that the bank faces take various forms like pricing pressures, introduction of new financial products, and the competition for the customers. The competition seems to be focus on the short term aspects in competing rather than on a long term basis. The bank faces the pressures not only relating to the competition from other players in grabbing of the

market share but also from the changing regulations and also mounting administrative expenses which have an adverse impact on the earnings of the banks. In addition the performance of the bank is always subjected to different kinds of risks the bank is expected to face in the conduct of its business.

But the competitive pressures have made the bank to acquire new organizational skills to make them stronger and tougher in meeting the challenges. There are lessons learnt by the bank from the actions of competitors. With the increase in competition the bank gets the tendency to face the challenges with the inherent and acquired strengths. Some of the competitive strengths that Arvest Bank has acquired in the process of conduct of its business are detailed in the following section.

#### Competitive Strengths of Arvest Bank

The major strength of the bank lies in the commitment of the management to follow honest, fair and ethical practices while dealing with the

##### 1. People in the Bank:

The major strength of the bank is the people who have identified and associated with the bank. These people contribute to an ocean of knowledge and experience and the culture of team work possessed by the people provides all the strength required by the bank to meet any challenging situation.

##### 2. Commendable Customer Service:

In the ever growing competition it becomes vitally important for the bank to provide exemplary service to the customers which goes to improve the market position of the bank. Once the bank is able to establish its credibility in the minds of the customers its success is automatically ensured. Thus the efficient customer service has always been the strength of Arvest bank.

### 3. Provision of Training:

The bank is operating in an economic environment which is changing from time. This necessitates the periodic upgrading of the skill sets of employees of the bank. Arvest bank provides the associates with the required levels of training to make them capable of doing their jobs with ease and expertise. The training covers not only the technical aspects of the jobs being handled by the employees but also offers career growth and professional development which adds to the personal strengths of the employees as well as the competitive strength of the bank

### 4. Structure of the Bank:

The unique structure of Arvest Bank allows the bank to offer to its customers a full range of products and services and at the same time acts as the potential strength of the bank. The uniqueness of the structure of the bank enables each bank in the group to focus on the individual communities they are serving by adopting the policy of having a local board capable of administering local management by taking decisions based on local business environment. Thus making each bank a member of the respective community the bank has gained enormous competitive strength

#### 5. Products of the Bank:

Having a range of financial products catering to various types of customers with the ability to deliver them on the required time is the unique strength possessed by Arvest Bank. The products and services developed by the bank are supported by various operational areas of the bank. Such products and services take into account the current and future needs and preferences of the customers.

#### 6. Support from the Stockholders:

The relentless support from the stockholders also provides the competitive strength for the bank.

“ All this is possible due to a committed and passionate stockholder group who is cognizant of internal and external customers, the need for proper support, a long-term outlook, a constant theme of doing the right thing, and stability”[5] .

#### Risk Management in Arvest Bank

It is observed that the core business of Arvest Bank is the provision of advice and transaction services for financial assets, the usual banking operations including the payment systems and loans. The Bank will be in a position to render advisory service only when it is trusted by the customers and the trust develops through the exceptional performance being demonstrated by the bank. The management of risk in the Arvest bank necessitates the knowledge of the bank as to the effectiveness in extending credit and service loans. It also requires the bank to monitor its interest rate risk in

such a way that the bank does not pay more in interest than its earnings. Maintaining adequate capital is a part of the risk management process of the bank and the risk management also involves creation and adoption of effective operational policies and procedures that ensure the delivery of exemplary customer service in an efficient manner which prevents the bank from losing the customer accounts unnecessarily. The attitude and approach of the bank in complying with the regulatory provisions is of utmost importance from the point of view of safety of operations and also building a strong reputation among the customers. It is said that managing risk is nothing but having knowledgeable and well trained people to do the right things at the appropriate point of time. While effective risk management revolves around the systems, policies and procedures established by the bank it also depends to a large extent on the caliber of the people who contribute to the success of the bank in all respects[6].

#### Economic Scenario

One of the important factors that had contributed to the development and success of Arvest bank is the development of the local economy in the Arkansas region. The rate of growth of the local economy is much higher than the national average in that the region offered a high potential for the development of various industries and that has naturally resulted in the development of banking industry to newer heights. Despite the increase in the overall interest rates the growth of loan demand in the region remained positive with marginal increase in the number of projects coming up. Changes in the oil prices have not impacted the local economy much, and



the inflation level has also been maintained at stable levels, despite the tightening monetary policy by the Federal Reserve. The continued support in the form of bringing in new vendors and employees from other parts of the country by Wal-Mart, Tyson Foods, and J. B. Hunt has helped the bank to grow at exceptional levels. In fact this has been one important aspect in the development of the local economy. Thus the continued development of the economy has offered enormous scope for the bank to grow.

### Competitive Environment

The growth of the bank in the Northwest Arkansas region was not an easy task to accomplish in terms of the competitive environment in which the bank had to function. The bank continued to be the foreign runner in the competition among other banks with the solid support of its customers. The personal banking being the core activity of the bank was supported by the customer segments like the high income professionals, professors, and lectures from the Universities in and around Arkansas and the physicians practicing in the locality. Although there was severe competition from the other banks in the region to lure away these customers from Arvest bank, the bank was able to retain the customers through an efficient and personalized service which could not be matched by the competitors. The customers valued the service they could get from the bank in the place of the lower charges and higher promises from the bank's competitors.

In an industry environment where all the players offer almost the same financial products and services one bank excels due to the level of service it provides to the customers. This is the precise reason that Arvest bank is able

to maintain its enviable position in the Northwest Arkansas region in successive years[7]. Arvest bank is able to offer a wide range of financial products and services with an affordable and competitive charges and fees that are offered with a quality service irresistible by the customers to accept. This has taken care of the impact of much of the competitive forces in the region.

### Resources of the Bank

One of the best resources Arvest bank is having is in the ownership of the bank by Wal-Mart. With its financial strength and managerial expertise in running large business undertakings, the Wal-Mart management is able to steer the bank into success. Arvest has been able to accumulate large reserves out of its earnings to finance all its acquisition activities without expecting any further injection of funds from the owners - the Waltonfamily. The functioning of the bank in terms of the earning capacity and financial performance had all along been exemplary that the bank is able to mobilize the resources needed by it for its expansion on its own strength.

Another important resource the bank is holding to its advantage is the quality of its executive staff. The bank would not have performed this well without the contribution of its executive staff. The teamwork is all pervasive at all levels of the organization which is further motivated by the bank's policy that every employee is considered as a valuable asset to the organization. The team spirit and the high potential capabilities of the executive and other staff of the bank have made the bank advance towards its success and domination in the Northwest Arkansas.

## Mergers of Banks - Potential Consequences

The merger of banks had been the result of the elimination of branching restrictions. One of the most popular reasons behind mergers is the desire of the banks to increase their market power.

But still the banking industry remains fragmented at the national level and is much less concentrated as compared to any other industries[8]. It is true that banking is still predominantly a local service and the banks have been trying to concentrate locally during the last two decades even though the industry has seen a lot of changes at the national level. This is evident from the efforts of Arvest Bank to consolidate itself in the region of Arkansas and the neighborhood. The main reason for the phenomenon is that the mergers have occurred generally across the local markets rather than within them. Another view point is that the extraordinary development of information and communication technology has contributed to the mergers of the banks which had helped the record keeping of the banks which is the core of the banking companies. Because of the cost savings resulted to the banking companies through the extensive usage of personal computers and automated teller machines (ATMs) the banks were equipped to manage the information data base more efficiently and cheaper. Thus it seems clear that the technology is the very fundamental factor that influenced merger of banks at least at the local levels. The important consequences of merger of banks may be summarized as:

### Diminished Service

The most important complaint that is received from the customers on the merger of two banks is that they are not able to receive the same level of service as they had been receiving from the earlier banks. This may be true due to the fact that there might be a change in the product mix and pricing of the products as well and this might not have satisfied the old customers, as they would like to go with the original products. Secondly because of the numbering effect, due to growth in the sizes of the banks, there may be a natural impact on the quality and initiative of the banks.

### High Fees and Charges

Another consequence that has been pointed out by the customers is the charging of higher transaction fees. It is certain that the banks have made a critical assessment of the schedule of their charges and have moved to increase the charges over the period especially the larger banks have started to charge high fees than smaller ones. The reason for this state is that the banks have started unbundling the services and started charging for individual services rather than offering a bundle of charges for one fee.

### Credit Availability

The mergers of banks were considered as a hindrance to the provision of financial assistance to small businesses as the larger banks may not be very keen in extending the credit facilities to smaller entities. However there is very little strength in this argument, as the larger banks with their technological backing are now able to offer more varieties of financial products to all their customers including the small industries.

The consequences of merger do not apply for the services rendered by Arvest Bank, as the larger banks may not be in a position to offer the same level of service as being offered by Arvest. This is more than proved by the results of Wilkerson-Flake Survey which show that Arvest bank enjoys a market share of 48 percent in the Northwest Arkansas region. It is a fact that there is several large banks do business in the same region but with a comparatively lower market share than Arvest. It would be difficult for the national banks which are larger to recognize the desire of the customers to be known by their first names simply because of their sizes, but this is made possible with Arvest which is the secret of the success of Arvest Bank. This is not practicable for larger national banks as they always tend to service customers with a smaller number of staff with a view to keep the overhead low. But Arvest places a complete contingent of staff at all locations all though the working hours for providing the best customer service possible.

### Conclusion

There are several other issues the bank has to face in growing against the completion like the reduced export trade out of the Arkansas region, fear of terrorism which affected the functioning of the bank to a large extent. Despite the severity of the issues the bank was able to prove its ability to overcome these and other economic issues, by a basic ingredient to success the ' value added customer service' which has made the bank grow leap and bound to reach the present level of activity against all odds.

### Strategic Analysis

### Analysis of Balance Sheet

## Loan Portfolio

The implementation of a strategic analysis requires a detailed study of the balance sheet of the bank to assess its relative financial strength in terms of assets and liabilities the bank is holding as on a particular date. An analysis of the Uniform Bank Performance Report (UBPR) of Arvest Bank for the year ended 31st December reveal a total loan portfolio of \$ 6160 billion<sup>[9]</sup> (for the year ended 31st December 2005: \$ 5768 billion) which is 6.80 percentage higher than last year. The total value of the assets of the company as of 31st December 2006 stood at \$ 8794 billion (for the year ended 31st December 2005: \$ 8159 billion) which works out to an increase of 7.78 percentage as compared to the previous year. The sector wise breakdown of the loan portfolio is presented below:

### Sector

Year ended 31st December 2006

Year ended 31st December 2005

\$ billion

Percentage

As per UBPR

\$ billion

Percentage

As per UBPR

Real Estate Loans

4, 613. 6

74.		24	
4,	285.		0
73.		39	
Commercial			Loans
619.		9	
11.		38	
700.		0	
11.		69	
Individual			Loans
746.		3	
12.		06	
709.		3	
12.		72	
Agricultural			Loans
68.		5	
1.		13	
69.		4	
1.		11	
Other			Portfolio
112.		4	
2.		26	
4.		3	
0.		96	
Total			
6, 160.	7		

5, 768. 0

Compared to the previous year there is no major changes in the loan portfolio of the bank. The commercial loans have been reduced by 2 percent and there is an increase in the other loans to the extent of 1. 75 percent.

An analysis of the percentages of the peer group indicates that Arvest Bank has extended real estate loans higher than the peer group exposure. The real estate loan sanctioned by the peer group constitute 63. 63 percent for the year ended 31st December 2006 (62. 91 percent for the year 2005) as against the corresponding exposure of 74. 24 percent (73. 39 percent for 2005)by Arvest Bank. The loans extended to other sectors by peer group account for 0. 31 percent for agricultural loans (1. 13 percent - Arvest), 18. 64 percent for commercial loans (11. 38 percent - Arvest)

7. 17 percent for individual loans (12. 06 percent - Arvest) for the year ended 31st December 2006.

#### Loan Mix

The real estate market has been one of the fastest growing sectors in the Arkansas region in the past five year period.[10]. This factor has contributed to the increase in the percentage of the real estate loan portfolio of the bank. Even though the construction sector has accounted for only 5 percent of the total employment of the state, the sector has experienced a strong growth during the year 2006. The activities in the sector rose by 6. 1 percent during the last quarter of the year 2005.



“ Construction and development lending also was strong at insured institutions headquartered in the state. Construction activity is expected to benefit in the near term from several large-scale commercial projects that are underway in downtown Little Rock. In addition, both commercial and residential projects abound throughout the Fayetteville-Springdale-Rogers area.” (Naomi. M, 2007)[11] A spectacular activity in the construction sector was expected to bring 17, 500 residential lots which were in progress. There were four commercial projects undertaken to bring into existence a total office or retail space of 2. 87 million square foot (Naomi. M, 2007). This goes to prove the tremendous improvement in the real estate sector loan by Arvest Bank. Another area where Arvest had outperformed the peer group is the individual consumer loans which are due to strong automobile sector that resulted in an enhanced exposure for Arvest.

#### Loan Yield

The performance by Arvest Bank is more than the peer group with respect to the yield from the loans. Arvest had achieved a loan yield of 8. 01 percent for the year ended 31st December 2006 as against the peer bank performance of 7. 15 percent. Arvest Bank has done exceptionally well in terms of yield in respect of agricultural loans. This is evident from the analysis of the UBPR for the year ended 31st December 2006. The yield from agricultural loan for Arvest Bank is 8. 96 percent as against 7. 77 percent of the peer banks. Whereas in the case of credit card loans the bank has underperformed than the peer group with a yield of 9. 69 percent as against the peer group performance of 11. 41 percent. This is due to the fact that Arvest Bank had

concentrated more on the real estate sector and the consumer loans of other forms.

The higher yield for Arvest Bank goes to prove the commitment and the superiority of the service being provided by the bank to its customers. Since the bank provides a comparatively higher level of service to the customers they do not mind in paying little more to enjoy the personalized service. The higher market share of Arvest Bank also goes to prove that the higher yield is due to the preference of the customers to bank with Arvest Group than the other local and national banks. With every increase in the interest rates the yield for the Arvest Bank is bound to increase.

#### Reserves, Loans Loss Provision and Charge - Offs

The loan loss provision for Arvest has been arrived at 1.36 percent as compared to 1.14 of the peer banks for the year 2006 as reported by the UBPR. This percentage stood at 1.40 for the bank for the year 2005 as against 1.17 for the peer group. In these two years the loss provision is more than the peer group. Perhaps this position is due to the high market share the extent of the loss provision has to be made more than that of the peer banks. Similarly the loss provision to average assets was fixed at 0.15 percent for the Arvest Bank as against 0.13 percent for the peer group. The percentages were 0.14 for Arvest and 0.13 for the peer banks for the year 2005. The bank's performance has been poor as compared to that of the peer group in respect of the recoveries of the past credit losses where the percentage for the year 2006 for the peer banks was 38.27 while it is only 24.71 percent. The bank's efforts in this direction were not sufficient to

recover the past losses. The charge offs have been maintained at 0.16 percent for both Arvest and the peer banks. For the year 2005 the charge offs were less for Arvest at 0.18 percent as compared to 0.20 for the peer group. An analysis of the past performance of Arvest Bank for the past years shows that the bank has been consistently adopting a conservative approach in its loan exposures. This is evident from the loan loss provisions which are either less than or slightly higher than the peer group provisions. With the stringent monetary and fiscal policies of the Federal Reserve and increasing fuel prices Arvest would continue to adopt a conservative approach in providing for the percentage of loan loss provisions.

#### Securities Portfolio and Mix

The Uniform Bank Performance Report for the year 2006 shows that Arvest Bank holds \$1062.3 million for the year 2006 (\$755.3 million for the year 2005) as Available-for-sale securities to be categorized under FASB 115. Out of the total available-for-sale securities held by Arvest Bank 76.15 percent constitute US Treasury and Government Agencies whereas the peer group holds only 19.34 percent in the US Treasury securities. This shows that Arvest Bank follows the policy of carefully selecting the security mix which will safeguard the money deposited with the Bank. This will additionally ensure the liquidity of the securities.

Arvest Bank is taking a conservative approach in respect of the selection of its security portfolio and mix of securities. This is quite clear from the percentages which constitute the total available-for-sale securities as compared to security mix of the peer group banks. Arvest Bank holds

Municipal Securities to the extent of 12.96 percent and the peer banks hold 5.27 percent. The other securities held by the peer group banks are mortgage backed securities with 24.23 percent of the holdings whereas Arvest Bank holds only 7.72 percent only in mortgage backed securities. It appears that Arvest Bank wants to maintain a totally conservative approach so that the funds of the depositors are invested with utmost care in safe and liquid securities. However the Bank retains the choice of changing the securities mix since most of the funds are invested in more liquid and safe securities.

#### Securities Yield

The yield on the total securities has shown an increasing trend at 5.06 percent for the year 2006 as against 4.82 percent for the peer group. For the year 2005 the percentage of yield was 4.19 percent against the peer percentage of 4.35 percent. With a portfolio of securities which was conservative Arvest Bank was able to get a higher yield on the investments in various securities which show the prudence of the bank in keeping the investments liquid as well as to earn more yield for the depositors. With this, the bank is able to maintain a balance of favorable yield along with the safety of investments through the conservative approach.

#### Funding Source Issues

Arvest Bank was holding a total deposit of \$ 7410.6 million for the year 2006 and the amount of deposits for the year 2005 stood at \$ 6924.9 million. The total deposits for the year 2006 constitute 84.88 percent of total liabilities of Arvest bank. The core deposits account for 78.10 percent of the liabilities as

against the peer group percentage of 53.82 percent. The policy of Arvest Bank is not to rely on non-core deposits like the peer banks. This is shown by the high percentage of the core deposits which makes the investments of Arvest Bank have been made with comparatively lower risks and are also found to be least expensive sources of funds. Since the Bank does not depend largely on non-core deposits the interest it pays are maintained at lower rates and this results in better yield for the bank.

The Demand deposits of Arvest Bank has been showing an increasing trend since the year 2000. The demand deposits for the year 2006 stood at \$ 728.6 million (\$ 711 million for the year 2005) which have registered an increase of 2.39 percent over the previous year. The reason for this increase could be traced to the development of the bank's business in Northwest Arkansas and also the subsequent acquisition of Superior Federal Corporation and the Mountain Bancshares by Arvest Bank in the year 2003. The acquisition of these financial institutions have proved to be a right move as they have contributed much to the financial performance of Arvest Bank. The acquisitions could be viewed as one of the strategic moves of Arvest Bank to increase its presence in those places in which the Bank did not have offices or branches. This also helped to increase the market share of Arvest Bank. The acquisitions have proved to bring some positive impact in enhancing the deposit and asset base of the Bank in locations like Little Rock and Fort Smith and also helped these banks to cover their net losses.

From the analysis of the performance of the Arvest and other banks on the basis of the UBPR it appears that Arvest had all along been trying to use

more of its core deposits as the main source of its funding purposes, whereas the peer banks had relied more on the non-core deposits. The core deposit figures for Arvest have registered a continuous growth over the period and stood at \$ 6868. 3 Million. This represents an increase of 22. 5 percent from the year 2004. While Arvest had continuously managed to increase the core deposit percentage to 78. 1 percent in the year 2006, the peer banks more or less maintained the percentage of core deposits around 54 percent during the years 2004 to 2006. From this it can be inferred that the peer banks are unable to mobilize enough core deposits with the result that they have to depend largely on expensive non-core deposits as their funding sources. This is reflected by the Net non-core fund dependence ratio of 33. 81 for the peer group for the year 2006 as against the ratio of 2. 39 for Arvest. This obviously allows the bank to price its loan portfolio competitively and at the same time more profitably.

### Capital Position

According to the prevalent regulatory capital rules, the banks are categorized into well-capitalized banks to critically under-capitalized banks on the basis of the certain criteria.

According to these criteria Arvest falls under the category of a well-capitalized bank. A well capitalized bank is defined to include one which has[12]:

- (1) A total risk-based capital ratio of 10 percent or greater and
- (2) A Tier 1 risk-based capital ratio of 6 percent or greater and

(3) A leverage ratio of 5 percent or greater

As against the total risk based capital percentage of 12.22 percent for the peer banks for the year 2006, the percentage for Arvest stood at 10.29 percent for the year. Similarly the Tier 1 risk based capital to risk based assets percentage for Arvest is found to be 9.01 as against 10.61 percent for the peer group. The leverage ratio for the year 2006 was at 8.16 percent for the peer groups and for Arvest the percent stood at 6.73 percent. The lower level of these capital ratios as compared to the peer group ratios need not be looked at an issue of concern as the Bank is backed by the financial standing of the Walton family who owns the bank With Jim Walton being the Chairman and CEO of the Bank there is no need to bother about these lower capital ratios as additional capital can be brought into the Bank within no time. Arvest was able to operate from its own generation of funds. Nevertheless there always exists the strength of financial support from the owners which increases the confidence of the customers of the Bank.

The internal accruals are used to make more acquisitions.

#### Analysis of Income Statement

##### Net Interest Margin

Arvest has recorded a total interest income of \$ 556.5 million (\$ 431.0 million for 2005) for the year 2006. Against the interest income the Bank had incurred an interest expense of \$ 207.7 million for the year 2006 (\$ 121.174 million for 2005). This signifies the growth in the core deposits in the

year 2006 as compared to the year 2005 on which the Bank had to pay interest.

The interest income represents 6.55 percent of the average assets of the Bank, whereas for the peer group this ratio stood at 5.95 percent. The interest expense is at 2.44 percent of the total assets for the year 2006 for Arvest as against the ratio of 1.59 percent for the year 2005. The interest expense for the peer banks stood at 2.72 percent for the year 2006 and 1.89 percent for the year 2005.

#### Non-Interest Income

The non-interest income of Arvest Bank for the year 2006 was \$ 226.1 million which is 4.11 percent of the average assets of the bank. The peer group had a non interest income representing 3.20 percent. The non-interest expenses for the year 2006 for Arvest amounted to \$ 398.9 million which is equivalent to 4.69 percent of the average assets of the bank and the peer banks had incurred a non-interest expense of 2.54 percent. The major portion of the non-interest expense relate to the personnel cost for the bank incurred due to the extended working hours of 7.00 am to 7.00 p. m. The bank's practice of working for 12 hours has paid off by the increased market share for the bank. Again, there is quality of service, and customers feel like the products Arvest offers are a good value for the money[13]

#### Net Income

The net operating income for Arvest Bank stood at \$ 101.4 million for the year 2006 which is equivalent to 1.19 percent of return on the average



assets of \$ 8499 million. The peer banks have recorded a net income of 1. 23 percent on the average asset value. The net operating income for the year 2005 was \$ 83. 65 million which is 1. 10 percent (peer group: 1. 28 percent) of the asset value of \$ 7613. 1 million. One of the major reason for the lower rate of return for the Bank than the peer group is the additional employee cost which is justified on the basis of the enhanced market share the bank is enjoying due to the additional working hours.

The net income as a percentage of total equity of \$ 775. 8 million for the year 2006 represents 13. 46 percent whereas the peer group reported a net income as a percent of average equity of 12. 89 percent. This percentage has showed a tremendous improvement over the percentage for the year 2004 when the percentage stood at 9. 73 as against the peer banks rate of 14. 50 percent.

### Analysis of the Overall Performance of the Bank

#### Asset - Liability Management (ALM)

In any banking institution the Asset Liability Management (ALM) takes a predominant role in determining the success or otherwise of the bank. However the process of ALM is complicated as it necessitates the bank to maintain the earnings as high as possible and at the same time without involving the depositor's funds in serious risks. It is always the endeavor of the banks to advance more loans at attractive interest rates, raise the interest rates on deposits, and open more branches to increase their market share and these can be accomplished by adopting good credit policies, finding cheaper sources for funding requirements and at the same time

maintaining adequate liquidity to meet any exigencies. This requires a completely tactical balancing act on the part of the bank. Arvest has excelled in the direction of ALM by keeping its investments on securities safe by taking a cautious and conservative approach while coming to the issue of selection of its security mix. This was evident from the analysis of the securities mix in the previous section. On the advances side 74.24 percent of the loans were made in the real estate sector which prima-facie may appear to be a risky loan portfolio. However Arvest has consciously made these advances taking advantage of the real estate and construction boom in Arkansas and has also secured these advances by underwriting each of these advances. Moreover the Bank follows a stricter evaluation of the borrowers before advancing the loans.

#### Risk Control

#### Credit Risk

The credit risk being faced by Arvest Bank is at the same level as other banks in respect of situations where an advance is classified as sticky or provisions have to be created again the recovery of some advances or some charge-offs have to be undertaken by them. The Bank however appears to be taking adequate precautions by resorting to underwriting measures wherever possible in the routine way depending upon the nature and extent of the loan amounts. The exposure of Arvest Bank to the real estate sector is higher than the peer group and to this extent the Bank has undertaken the risk in this respect. This was due to the continued growth in the real estate sector in the Arkansas State with more number of people migrating to

Northwest part of the state[14]. However with the decline in the housing market and due to the issues relating to sub-prime lending the real estate sector faced certain uncertainties which is a clear risk for the Bank, although a major portion of these advances have been underwritten.

### Interest Rate Risk

As far as the interest rates are concerned the position of Arvest may be said to be a sound one, as with every rise in the interest rates the Bank will maximize its interest income. The Bank's policy of keeping most of its investments in securities which are short-term in nature and also classified as high grade securities, the interest rate risk of the bank is held under check. This kind of investment policy also helps the Bank to narrow down the spread between the long-term and short term yields thus maintaining a flattened yield curve[15]. According to Brian Reynolds, chief market strategist at MS Howells, a Scottsdale, AZ. brokerage firm, " One surprising benefit for investors from a flattening curve is that banks are becoming more aggressive lenders to companies. When the yield curve is steep, banks make money by borrowing at cheaper short-term rates and lending at higher long-term rates. When the yield curve flattens, banks have to find another way to make money"[16]. In a rising interest rate environment the bank will continue to hold its policy of investments in high grade, short term, and liquid securities to maintain a consistent yield in such a way that the interest on the loan portfolio is offset without hurting the earnings of the bank.

### Liquidity Risk

The Bank appears to be well protected with the choice of its funding sources as core deposits and also by maintaining the loans to deposits ratio of about 84 percent. With a total securities portfolio of \$ 1062 million in available for sale securities the Bank may be said to be well covered in respect of the liquidity risk. The volume of securities combined with a liquid security portfolio will ensure that the liquidity of the bank is maintained at controllable levels.

### Capital Risk

The Bank is well placed as far as the capital risk is concerned, as the Bank is owned by Walton family with whom there may not be any difficulty to bring in additional capital as and when required. Moreover the Bank is classified to be one being a well-capitalized bank. Hence it may be stated that the Bank is well protected from any capital risk.

### Overall Income/Risk Performance

Out of the performance analysis of the Bank based on the UBPR for the year 2006, it is observed that the Bank has made extraordinary earnings and with its prudent policies the bank has been able to mitigate the issues risks associated with the loan and security portfolios by resorting to smart investments and also underwriting of advance wherever necessary.

The Bank has also been performing consistently well which is evident from the analysis of the historical financial figures for the past five years.

### Summary of Analysis

The overall performance of Arvest Bank can be assessed from the point of view of value added customer service and enhanced market share. Despite the increase in the employee costs as compared to the peer banks, Arvest was able to involve itself with an improved customer service with the extended hours of working, expanding to more locations, employing skilled and trained professionals and adopting customer focused banking which has bestowed the bank with an extraordinary market position. The Bank has also maintained its service to the customers at a level unmatched by any other national or regional banks. The greatest strength of the bank lies in its decision making process which is highly decentralized and also the ownership of the bank plays another important role with its mission of serving the community which is embedded in the culture of the Bank that has ensured its success over the periods.

#### Five Year Strategic Plan

#### Proposed Actions to Deal with Competitive Strengths and Weaknesses

Arvest Bank is primarily a relationship bank rather than a transactional bank and this policy has intertwined with the organizational culture of the Bank at all levels. The competitors being the people who are from former executive management cadre or corporate lenders have acquired the basic competitive strength of having the knowledge about the strengths and weaknesses of Arvest. The competitor will thus try to use this against the operations of Arvest which the Bank has to take guard against by updating its strategies according to the changing needs of the market. This can be accomplished by the continuous underwriting of the risks and also by following stringent credit

norms. The Bank will also do well to look for more strategic locations from where it can operate to serve a larger section of the community.

Ownership of the Bank will continue to provide an immense competitive strength to the Bank. The policy of the Bank to encourage decision making at the local level also enhances its competitive strength against the competitors where faster decisions about loans make the business easier to achieve. The employee stock options enable the Bank to retain the best talents in the market.

#### Actions against Economic Forecasts

With the ending of the housing boom there have been changes in the economic scenario with more supply of houses against lesser demand. This necessitates cautious moves by the Bank with respect to its exposure to real estate advances. With only one percent of Arvest's in-house or secondary market loans the Bank's position is very comfortable with respect to its real estate portfolio. The economy continued to do well despite the Federal Reserve's action to tighten the monetary policies. In a quarterly poll conducted by TEC International, a San Diego based organization of CEO's nationwide, rising interest rates were cited by 27% of the CEO's as the biggest concern for the country's economy, followed by higher fuel costs, 21%; the national deficit, 18%; inflation, 11%; and the cost of the war in Iraq coming in at 9%[17].

In an economic scenario where there are interest rate hikes the Bank has to maintain the balance between the pricing of the loans, and the interest rates on its deposits. With a changed economic scenario the Bank has to change

the product mix and also try to introduce new financial products and services in to the market to cater to the different segments of customers.

#### Actions to Deal with the Results of Ratio Analysis

The performance of the Bank in terms of the various ratios is comparatively better than the peer group banks. However there are certain areas where the Bank has to improve its working to be at par with the industry. One of such areas is the non-interest expense where the bank's ratio is much higher than that of the industry. However this area needs to be tackled with caution as it relates more to the employee cost which is a delicate one to deal with.

Arvest has the strength to offer better interest rates for its core deposits and the Bank will continue to use this strength to mobilize more resources.

#### Implementation of the Strategic Plan

The following are some of the action that has been taken or need to be taken to implement the strategic plan successfully in the Bank.

#### Information Systems

The Bank will continue to invest in cutting edge technologies for improved protection and security of customer related information and data. This includes the provision of ' fire wall' technology[18]

#### New or Improved Products

Based on the suggestions from the annual meetings with the employees the Bank had in the past brought out several new products and services and/or improvements to the existing products and services to enhance the value of

the customer service. In fact most of the products the Bank are comparable with the product offering from the competitors. The Bank will undertake a continuous evaluation of its products for any possible improvements.

#### New or Improved Delivery Systems

Coupled with the introduction of new products and services, the Bank will strive to make positive improvements in the delivery system to meet the customer preferences. One of the area that can be attended to immediately in this respect is the processing of the loan documents at the local level which are being processed at a central location currently. This will result in an immediate improvement in the delivery system of the Bank

Sending the bank statements to the handheld computers is another area where the Bank may show some effective improvement in the delivery system.

#### Five Year Financial Plan Analysis

##### Average Balance Sheet

The asset growth of the Bank is expected to be 11. 64 percent in the year 2007. A consistent growth rate of 11. 64 percent has been assumed for the Bank for the next 5 years. With the growth in the local economy in Arkansas the Bank is expected to perform consistently well during the next five year period as per the estimates. However with the elections due in the year 2008 there are bound to be some changes in the economic scenario that may affect the working and profitability of the Bank to some extent.



The net loans to total assets is showing a decreasing trend from 72.02 percent in the year 2005 to 69.54 percent in the year 2006 and there is no major change envisaged in this rate signifying that the Bank will be performing consistently during the next five year period. The real estate and construction boom that helped the bank to improve its performance over the last few years will taper off and this will have an impact on the overall loan portfolio of the Bank in the coming periods.

No major changes have been predicted in short term investments, and cash and due from banks which are expected to be maintained at 6.17 percent and 3.57 percent of the average assets over the next five years. The fixed assets have been estimated to be increase by 9.81 percent annually on a consistent basis. The increase is forecasted on the assumption that the Bank will acquire properties in new locations in the process of expansion of its business during the next five years.

On the liability side while the non-interest bearing deposits will continue to increase at the rate of 8.67 percent and the interest bearing assets to the average assets will be maintained at 76.21 percent during the next five year periods. Other borrowed funds will be maintained at 5.35 percent of the average assets. Other liabilities will continue to be maintained at 0.91 percent of the average assets and the equity capital to average assets will be maintained at 8.86 percent over the period of next five years.

#### Average Rate and Yield

The yield in terms of interest income to average earning assets will be maintained at 3.57. The non interest income will be maintained at a

constant level of 2.66 percent to the average assets during the strategic planning period of next five years. With the expected changes in the interest rates and the consequent changes in the loan portfolios the Bank needs to adjust its investments in different securities to maintain the average yield over the period.

#### Net Interest Income

The net interest income is assumed to be in the region of 4.10 percent for the year 2007 which is expected to go down to 4.08 percent in the year 2010 and 2011. The changes in the net interest income may be attributed to the fact that the bank will aggressively go in for more core deposits to fund its lending over the period and under such circumstances the Bank may have to pay additional interests on the deposits.

#### Provision for Loan Losses

The total provision against the loan losses has been estimated to be at 1.35 percent of the total loans. This percentage is assumed after taking into account the potential loss of loans on account of increase in the interest rates and the consequent inability of some of the borrowers to service the loans and the interest. However the provision has been reduced from 1.39 percent for the year 2006 to 1.35 in the subsequent years.

#### Other Income Statement Elements

The following table presents the expected increase/decrease in the other items of earnings and expenditure of the Bank for the next five planning years

\$ Million

Particulars

2007

2008

2009

2010

2011

Interest

Income

621.

365

693.

712

774.

482

864.

657

965.

331

Interest

Expense

232,

204

260,

143

291,

177

325,

663

364,

002

Non-Interest

Income

252,

432

281,

823

314,

637

351,

270

392,

169

Non-Interest		Expense	
445,		405	
497,		265	
555,		162	
619,		801	
691,		966	
Net	Income	before	Taxes
175,		548	
195,		086	
217,		055	
241,		743	
269,		468	
Net	Income	after	Taxes
108,		806	
120,		869	
134,		483	
149,		781	
166,		961	
Projected	Loan	Loss	Reserve
20,		639	
23,		042	
25,		725	
28,		720	
32,		064	
Projected		Dividend	

55,	134
55,	134
55,	134
55,	134
55,	134
Retained	Earnings
53,	672
65,	735
79,	349
94,	647
111, 827	

The following table shows the various percentages in respect of the items of the income and expenditure of Arvest Bank that will be maintained in the next five year period.

Earnings		and	Profitability	
2007				
2008				
2009				
2010				
2011				
Net	Interest		Income/Average	Assets
4.			10	
4.			09	
4.			09	

4. 08

4. 08

Non-Interest Income/Average Assets

2. 66

2. 66

2. 66

2. 66

2. 66

Non-Interest Expense/Average Assets

4. 69

4. 69

4. 69

4. 69

4. 69

Provision for Loan Loss/Average Assets

0. 22

0. 22

0. 22

0. 22

0. 22

Pre-Tax Net Operating Income/Av. Assets

1. 85

1. 84

1. 84

1. 83

1.	83
Net Operating Income /Average Assets	
1.	15
1.	14
1.	14
1.	13
1.	13
Return on Assets (ROA)	
1.	15
1.	14
1.	14
1.	13
1.	13
Net Income on Equity (ROE)	
13.	55
14.	02
14.	38
14.	66
14.	84

### Conclusion

Based on the projections for the next five years Arvest Group Bank is expected to undergo several changes. But still the Bank will remain in a good shape financially. The Bank will continue its expansion into different locations and also will try to acquire more new financial institutions so that it

can serve a larger community in the new territories. There will be increase in the average yield. However the Bank may have to pay enhanced interest rates to source more of core deposits to be used as the main source of funding its lending operations. Equity capital will show an increase due to the bank's profitability and ownership's willingness to leave money in the company for future acquisitions. Net Income will show a positive trend over the next five years, which will be a direct result of Arvest's continuing implementation of its core philosophy of relationship banking. ROA and ROE will continue to grow as the company structures it to grow internally and through acquisition, and increase profitability. As competition continues to make risky loans in an attempt to gain market share and show profits to their shareholders for the short-term, Arvest will remain focused on our internal strategies to underwrite credits solidly, and concentrate on long-term growth.

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Appendix 1 Statements of Projected Income and Balance Sheet Items

2007

2008

2009

2010

2011

ASSETS

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Securities

Portfolio

1,	035,	266
1,	155,	805
1,	290,	377
1,	440,	619
1,	608,	353

Short-Term

Investments

585,	481
653,	649
729,	755
814,	722
909,	582

Total

Loans

&

Leases

15,	803,	230
17,	643,	235
19,	697,	475

21,	990,	895		
24,	551,	342		
Total	Earning	Assets		
17,	423,	977		
19,	452,	689		
21,	717,	607		
24,	246,	236		
27,	069,	278		
Less:	Reserves			
9,	204,	475		
10,	276,	172		
11,	472,	650		
12,	808,	435		
14,	299,	749		
Net	Earning	Assets		
8,	219,	502		
9,	176,	516		
10,	244,	958		
11,	437,	801		
12,	769,	528		
Cash	and	Due	From	Banks
338,			763	
378,			206	
422,			241	
471,			403	

526,		290	
Fixed	and	Other	Assets
930,		886	
1,	039,		271
1,	160,		275
1,	295,		369
1,	446,		191
TOTAL	AVERAGE		ASSETS
9,	489,		150
10,	593,		992
11,	827,		474
13,	204,		572
14, 742, 009			

2007

2008

2009

2010

2011

LIABILITIES & CAPITAL

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NonInt Bearing Deposits

826, 328

925, 750

1, 036, 189

1, 158, 914

1, 295, 347

Interest Bearing Deposits

7, 263, 490

8, 137, 421

9, 108, 183

10, 186, 947

11, 386, 205

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Total Deposits

8, 089, 818

9, 063, 172

10, 144, 372

11, 345, 861

12, 681, 553

Borrowed Funds

509, 903

571, 253

639, 401

715, 131

799, 320

Subordinated Debt

-

-

-

-

-

Total Int Bearing Liab

7, 773, 393

8, 708, 674

9, 747, 584

10, 902, 079

12, 185, 526

Other Liabilities

86, 731

97, 166

108, 758

121, 639

135, 959

Equity Capital

802, 698

862, 401

934, 943

1, 021, 941

1, 125, 177

TOTAL LIAB. & CAPITAL

9, 489, 150

10, 593, 992

11, 827, 474

13, 204, 572

14, 742, 009

CAPITAL & RESERVES

Capital & Reserves (EOP)

922, 921