
A LENDER'S PERSPECTIVE ON BANK-SIZE DEBATE

Rethinking your career path? Life for a lender in a big bank or a small bank can be very different. Some points to ponder for lenders and leaders

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Not long ago I posed the question of whether one should want to work for the biggest bank in town or the most profitable. The choices are not mutually exclusive and one might do either quite successfully. There are some implications lurking behind the answers to these questions, though, and they are important for today's banker, no matter where they currently work.

Bank size can't be ignored

Today, banks are saddled with compliance and other regulatory requirements and it takes an operation of scale to be able to afford much of the required infrastructure.

"Several" years ago, as a Stonier student, my cohorts and I were taught that, on average, a branch had to be \$25 million in total deposits to be profitable, according to the Functional Cost Analysis of the Federal Reserve. By the same broad metric, the minimum size of a single bank's profitability was in the \$250 million range.

The economics have changed greatly in the intervening 30 years and the old rules of thumb are all but meaningless today except for one: size matters.

And, optimal size for profitability is increasing in both absolute and relative terms.

Many functions can be outsourced but none can be completely offloaded, in terms of responsibility for proper administration and governance.

Outsourcing is a credible and viable alternative for smaller banks, especially in the area of such things as loan review. The hallmark of an appropriate loan review, for example, is independence, with credit competency a very close second.

But not everything can be outsourced. Nor, if something is outsourced, can the bank escape responsibility for shortfalls in the process. This means that smaller is not necessarily better and the issue of scale needs to be carefully understood.

Apart from required functions to operate a safe, sound, and compliant bank, size confers certain advantages of scale of operation. Larger banks often offer a wider array of customer services and can perform certain functions with greater competency and lower levels of operational risk. This is largely due to the ability to spread or allocate the costs of operating systems over a bigger customer base.

In other words, done properly and carefully, a large bank can operate at lower unit costs of production.

Some words for the careerist

Career opportunities for functional specialties within the bank are often better in larger institutions. Credit training programs, continuing educational opportunities, management depth, career pathing, and benefit programs tend to favor the larger banks over the smaller ones.

Yet there are many career arguments in favor of smaller banks.

1. They are often more nimble and can react to customer problems and opportunities very quickly.
2. Contact with customers is often closer and more "tactile" than in larger banks.
3. Smaller banks often operate with a higher level of perceived customer knowledge and understanding, owing to structural and organizational factors that favor small institutions.
4. They often have deliberately limited product lines emphasizing simplicity and that in turn can favor customer service and enable quicker responses to customer needs and wants.

Bank size and understanding of the customer

Understanding customer and product-line profitability between larger and smaller institutions can be a two-edged sword.

Larger banks are likely to have more robust operating systems that generate useful and timely customer profitability information. Smaller institutions often rely on "seat of the pants" judgments on such matters. Such observations can often mislead or turn out to be just plain wrong.

Smaller banks have to work very hard at understanding customer profitability. Such calls are frequently subjective. As they are "closer" to the customer, that can often be accurate but as an assumption it relies on the simplistic idea that customer profitability is a relatively simple science.

Size and the bank's board

The responsibilities assumed by directors of large or small banks are not simple as they seemed to be a generation or two ago.

They are complex, systemic in nature, and require a level of sophistication that can seem (and in fact be) daunting to many of the participants.

Size here generally favors larger rather than smaller enterprises in terms of attracting worthy candidates from within the local community's talent pool.

Now, where does this come out?

One of the fundamental issues that all of us who earn our living in banking have to confront is the issue of survivability.

What does it take to survive for the long term? Is it simply a good ROE?

Minimum size levels for consistent profitability no longer necessarily equate to "size to survive."

There's little question in my mind that minimum size requirements to ultimately survive have increased appreciably through the wrenching experiences of the last business cycle. De novo banks may be fun places to work, and offer their organizers handsome potential returns. But they are very vulnerable businesses with little tolerance for judgment errors or flawed execution of strategy.

Longer term, community banks need to understand:

1. Customer and product profitability
2. Importance of a strong culture for nurturing both customers and staff through product- line specialization and complexity and the ability to afford those skills that are needed for compliance and conformance to law.

Competition is everywhere. Competition is no respecter of turf, tradition, or any other consideration-short of delivering what the customer wants and needs when he wants it and needs it.

In my work with ABA's e-learning courses, I deal with community bankers across the country and often internationally. Seldom do I conduct a class where the talent of today's community bankers is hidden under a basket.

Talent shows and today's community bank talent is abundant.

What's missing?

In many cases, what's lacking at the smaller community bank level is an institutional mindset that understands the complexity of today's workplace.

There are, I fear, many community bank business models that are obsolete in today's environments.

These need to be addressed with an urgency that I don't always see or feel today.

- About Ed O'Leary:

Veteran lender and workout expert O'Leary spent more than 40 years in bank commercial credit and related functions, working with both major banks as well as community banking institutions. He earned his workout spurs in the dark days of the 1980s and early 1990s in both oil patch and commercial real estate lending.

O'Leary began his banking career at The Bank of New York in 1964, and worked at banks in Florida, Texas, Oklahoma, and New Mexico. He served as a faculty member and thesis advisor at ABA's Stonier Graduate School of Banking for more than two decades, and served as long as a faculty member for ABA's undergraduate and graduate commercial lending schools.

Today he works as a consultant and expert witness, and serves as instructor for ABA e-learning courses and a frequent speaker in ABA's Bank Director Telephone Briefing series. You can hear free audio interviews with Ed about workouts here. You can e-mail him at etoleary@att.net. O'Leary's website can be found at www.etoleary.com.

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