CULTURE AND LONG-TERM SURVIVAL: A CONNECTION NO BANKER CAN IGNORE

Will your bank be among the survivors?

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For the last several years there has been an evolving consensus in our industry that our financial regulatory authorities are determined to reduce the number of insured banks to about 5,000 institutions. This would represent a decrease of more than a third from the current number and a startling decline of over two thirds since the mid-980s.

I'm not arguing here that this is either good or bad. We are an industry of scale and it takes large volumes of fee-based transactions and large volumes of assets on which to earn a return, together with an extensive infrastructure, to get the job done.

Congress has also piled myriad compliance responsibilities in the name of "public policy" on us, starting in earnest over 40 years ago.

Compliance and audit staff members are absolutely necessary in the compliance sense and to provide boards of directors assurances on a variety of matters such as asset quality. But they and other such functions don't contribute a nickel to revenue. They are cumulatively dead weight, in the profitability sense. But that started years ago.

The question I think that many community and smaller regional bank managements and ownership groups are beginning to ask is, "What will it take to survive the next cut?"

This is not a survival issue based on asset quality or liquidity or most of the other categories of risk that we deal with day in and day out. Instead, it comes down to essential skills.

The bank survival tool kit list is lengthy, including well-developed skills in credit, marketing, strategic competence, vision, human resource training and development, computer systems, capital access ... and first-class execution. If there's one overarching word or term to describe this confluence of survival characteristics it's this:

"Culture."

Culture, its adaptability, and its staying power

A wide-angle definition of culture is, "A broad pattern of human behavior." We can subdivide these patterns of behavior into functional areas such as a credit culture, a sales culture, a nurturing culture, and so on.

What I'm suggesting is the need to consider and analyze what sort of culture we have in our banks today, as measured by what we think we're going to need for the next generation.

• Are we conservative in credit risk?

• Are we sales driven?

• Are we customer centric?

The labels we place on our cultures are not nearly as important as that you and I understand what the culture really is and what it needs to be.

Then ask yourself the strategic question: "Can this culture sustain the bank into the new environment that's coming, an environment of increasing size, complexity, and competitive intensity?"

Does culture stretch to fit all sizes?

Here's the problem as I see it, and have lived it, the last 30 years or so. Community banks have grown by a combination of organic growth and acquisition. Note that acquisitions have the potential to dilute the culture of each merger participant whether the combination is one of approximate equals or an outright acquisition akin to a whale swallowing a guppy. (In the latter case, there's not much doubt about the surviving culture.)

But what happens in mergers of equals?

To get deals done, promises are often made to one side or the other. Five years later, a keen observer can often detect two cultures at work ... and not necessarily representative of the best of either of the original versions.

I've commented on earlier occasions on the weaknesses in community bank credit training that often results as a bank grows by merger. The resulting institution is now often a much larger one but without the benefit of training and the formal development of skill sets necessarily equal to the new competitive reality.

One of the biggest issues, and one that gets almost no real discussion that I'm aware of, is the quality of executive leadership of the surviving institution. One side or the other is often in an advocacy position for a competitive management group or particular individual.

Ultimately, there will be one CEO and one senior executive in each primary functional area.

Without years of observation and acquaintance, how does one side or the other really know what it's getting in the new management group or, for that matter, with the new culture?

Food for reflection: The Bank of New York Mellon news

Let me say that I don't have an answer for this. The news of the last week of the unexpected dismissal of Robert Kelly, CEO of Bank of NY Mellon, is possibly instructive of the hazards involved. Mr. Kelly was removed by the board for unspecified "differences"; but the subsequent chatter suggests that the board was concerned about Mr. Kelly's management style. These reports say that the board was reacting to an anxiety about executive-level morale and the possibility of additional turnover.

The Bank of New York Mellon is noted for its conservative culture. Each institution before the merger four years ago was an iconic sort of enterprise with a long tradition of quality and soundness.

Mr. Kelly was a relative newcomer at Mellon Bank at the time the merger was announced (having been recruited from Wachovia in the months before) and succeeded to the top job at Mellon due to the unexpected resignation of Mellon's former CEO. Mr. Kelly was then picked to head the combined institution.

It is perhaps important to note that, in a way, he was an outsider at the time of his selection. Neither board of directors had had the opportunity to observe him carefully over the years. One would think that behaviors injurious to his job tenure would have been visible to others if he'd enjoyed a reasonably long history with either bank.

Questions to ask

Now is the time to be thinking about the sort of culture your bank wants to have over the next generation. The long-term process of developing managerial and leadership skill sets and the day-to-day vetting of an individual's traits and behaviors is essential.

- • Does your culture have deep roots?

- • Does it develop and sustain leaders?

- • Does it assure that the requisite skill sets are in place for long-term competitive advantage?

- • Does the culture sustain and nurture itself through internal controls that are enforced?

- • Is it dependent on the personality of a single person?

- • Is it capable of weeding out those who don't "fit"?

These are not casual questions. And the answers have enormous long-term implications in our diminishing pool of insured banks.

Not everyone will survive, as there's not going to be enough room.

Can you--and will you--be among the winners?

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 has been 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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