
LET'S SAVE OUR WAY TO PROSPERITY—AGAIN

Some ways are better than others

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In the frothy atmosphere of the oil boom of the late 1970s and early 1980s I was in Midland, Texas. Money was easy and expense controls were lax, but the interesting thing that I remember about that period is that not all of us were comfortable with the excesses around us.

It seemed unreal.

And, of course, we learned soon enough that it was.

Cycle comes back around to chopping and cutting

Boom times are great to have a taste of, but cost control is a fact of business life, although it is a cyclical phenomenon in terms of its intensity and durability. There's much lately in the financial press and in the accumulation of anecdotal evidence to indicate that many, if not most, banks are heavily emphasizing cost containment. One more time, we as an industry seem to be trying to save our way to prosperity.

We owe strict cost containment to our shareholders. We are in a revenue trough thanks to the workings of the economic cycle as well as the recent legislative changes embodied in Dodd-Frank. So, in the short run, all we can do to preserve profitability and a reasonable return on equity is to watch our costs and pare back where and when we can.

I've endured regimes where the dominant theme was "more work for less rice." That's no fun and it's not sustainable either, in terms of the productivity of human capital.

Are there better ways, ways that are more sustainable, sensible, and systemic?

Looking back, I was twice involved in major efforts that paid off. In both cases we were able to do what's right by shareholders as well as make some real progress on efficiency.

What really drives efficiency?

There's a hospital consultant in Albuquerque with a national practice whom I know from our joint service on the Chamber board. He is a staunch believer that without process change, there can be no permanent productivity gains. He firmly believed that 80% or more of all productivity gains are directly traceable to changes in process, not to automation. Computing hardware and software alone are woefully insufficient and cannot produce systemic cost structure change.

We get glimpses of this view in looking at evolving branch productivity in the way our customers access us either directly, face to face, or through electronic means. Remote deposit capture is a relatively recent and high profile example of what's happening and the profound impact they are having on our customer interfaces.

So why does our default position seem to center on shrinking our staffs by some predetermined percentage? We are going about saving money the wrong way.

Time to spend on better ideas?

Admittedly this is not the time to recommend to most community bank managements large investments in new systems. It should be, though, if you believe the hospital consultant's premise that you've got to change process to make any real headway with the cost structure.

At Liberty Bank in Oklahoma City several years ago our chairman was determined to improve our productivity.

We were skirting the threshold of being adequately capitalized so any undertaking that would reduce short-term profitability even though the long-term benefits were enormous was out of the question. With the help of our outside auditors, the executive management of the bank was assigned the task of reviewing another area of the bank not managed by that person. We were to look for structural changes that could lead to enhancements in processes and thereby positively impact profitability.

My assignment was IT. We were an IBM mainframe shop but one of the topics on the table was outsourcing our entire IT systems capability.

A couple of years later we did that, though I can't say that it was due to anything I said or did. At the time, I was the bank's credit administrator and the head of loan review was assigned to do the review of my area. Fortunately he understood how credit administration worked and his input was constructive and useful.

At the end of this process that took about 90 days, we identified ideas that the auditors estimated contained savings of about \$10 million. We actually implemented many of them. What we went through gave a fresh look to possible cost savings and created a newfound empathy among the executive managers for the challenges of the day that each of us faced.

It was much more effective than "more work for less rice."

Reengineering: An idea whose time has come ... again?

About ten years later I was involved in First Security's corporate reengineering, a phenomenon that was quite common in the mid-90s.

Selected management members were temporarily detached from their day-to-day responsibilities and worked in functional teams at corporate headquarters under the direction of a cadre of outside banking consultants. The internal teams were tasked with a list of functions on which they had to develop detailed recommendations on how to eliminate a minimum of 40% of each function's cost. There was no ducking that number so some of the recommendations weren't feasible when committed to paper. A surprising number were, though, and made it to implementation.

During the life of this project,, which extended over about six months, we eliminated an impressive chunk of non-interest expense including over 20% of the company- wide headcount and improved our efficiency ratio about 400 basis points on an annualized basis. Revenue opportunities got attention too, although the gains there took longer to develop and

mature.

How was all of this possible? What we did was radical--we took an axe to processes and procedures and then rebuilt them from within into something better for the future.

Signs and symbols do matter

One final thought on cost containment is appropriate and that's the lasting value of "signs and symbols."

One enduring image I have many years later is how the president of Liberty Bank, my boss, would walk around the bank and turn off lights in vacant offices. I've never forgotten that and likely never will. These are accumulated habits that ultimately make cost containment efforts durable.

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.

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