WHEN ONE DOOR SLAMS, OPPORTUNITY KNOCKS

ROE worshippers must beware who will "exit" whom, in the long haul

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There was an article in Inc. magazine the other day describing how some very large banks are executing a deliberate strategy of "exiting" certain commercial lending markets. They select who exits through combinations of product line, customer profile, and geography.

Never mind that some of these borrowing customers had survived the Great Recession and clawed their way back to profitability.

Forget that they had been customers of the bank in some cases for decades, having started with a predecessor bank that became part of a much larger entity.

Ignore if you can that they have diminished opportunities for finding new lending relationships due to the slow and creeping paralysis of the last few months as we as an economic society approach the fiscal cliff.

What's behind this? And what are the implications?

Increasing focus on ROE versus the bigger picture

The imperative at work here is an optimum Return on Equity for the stockholders. The bigger the enterprise, the more important is this single financial metric. In fact, I've been surprised at how persistent this idea is among even community bankers. To many today, the ROE is the metric that trumps all others. ROE is the ultimate capitalistic ratio as it measures the financial return being earned by the owners.

This is not, however, the whole story.

Every business has its constituents or stakeholders, those parties or interests that are interrelated components of a business and whose needs and requirements are often in tension, one with the other. Sometimes the tension is severe--such as when a business is in financial difficulty and the ownership seeks to preserve the business while possibly inflicting (or permitting) hardship on employees and creditors. In recent years, the conflicts have occasionally been painful and occasionally severe between and among the various stakeholders.

The principal constituencies of a bank include (and are not limited to) employees, borrowers, depositors, owners, regulators, creditors, and the banking public. A complete listing would be considerably longer.

When the excessive risk taking and the resulting inadequate capital ratios of our industry became evident for all to see, many banks were forced to curtail their activities. They had to trim their business models, ration credit to a redefined customer profile, and make those painful adjustments to bring resources into alignment with appropriate risk tolerances.

This is "high sounding" language and often finds its way in very similar terms into communications with shareholders. Think of press releases or the "Chairman's Letter" in bank annual reports. These communications usually mask a series of transitions that are putting multiple constituents into painful conflict.

Shareholders versus stakeholders

When the shareholders' interests are being protected by the bank's management, is the customer enjoying similar protection and concern?

What of the business relationships unceremoniously dumped out for the sake of ROE?

What of impacts on whole segments of commercial lending business?

And the resultant reduced level of credit availability for a community and its small-to-medium-sized business base?

At times, such actions may be absolutely necessary--as a bank may be on the verge of collapse. But somehow, significant if temporary repercussions among a business segment of a community are often undertaken in the name of financial efficiency, not survival. In the long run, the business has to be healthy to survive. But are the willful policies of retrenchment in the name of financial efficiency an ethical and reasonable response to the situation considered as a whole? re the consequences to the other stakeholders of the business appropriate and justifiable?

Such management behaviors seem today as anticipatable as they are regrettable for the consequences they produce on others.

At some point, the sheer size of a bank multiplies the potential for constituent conflict. This raises the question of a bank's growth strategy. Is a bank growing to gain economies of scale without careful analysis of profitability and long-term sustainability? At what point does growth outstrip the ability to comfortably manage the community-employee-stockholder stakeholder tensions? If in the process of preserving stockholder value, is the bank at risk of destroying its reputation among its customers and communities?

If so, maybe the growth hasn't been worth it.

Or put another way, will too sharp a pencil rip the paper?

Is this an opportunity for smaller banks?

While we all have to acknowledge the imperative to preserve and grow our businesses in qualitative terms, do we ever find ourselves overlooking the legitimate expectations of the customers and the community and mindlessly compromising the latter for the sake of the former?

Need I remind anyone of the enormous opportunities that such circumstances open up for community and smaller regional banks? Some big banks' priorities are clearly displayed with their demonstrated lack of real concern for customers and communities. And what of the well being of their employees? How demeaned are they in the process?

They are where new policies meet the customers--or, perhaps, soon-to-be-exited customers...

If there was ever a time to tout the advantages of doing business with a local bank, it's now.

It's time to make the case for local ownership, local management, local decision-making, and a sense of common purpose and community of interest between local banks and local borrowers.

There are many things that big banks can do better than smaller banks. But fidelity to the values of customer and community loyalty doesn't necessarily seem to be among them.

As community bankers, perhaps our case has never been easier to make. Nor our value proposition so convincingly made by our competition.

We recently observed Small Business Saturday. Why not make 2013 "The Year of the Community Bank"?

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 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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