

Strategies you need for turbulent times (May 21, 2009)

Still uneasy about the economy? Here are suggestions to help your bank emerge even stronger

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Fear. It is an emotion being felt by many CEOs and boards of directors in financial institutions today. Fear of just how deep and long the current economic crisis will run. Fear of how much damage the recession will inflict on the asset quality, capital position, and long term competitiveness of their institution. And fear of their next regulatory exam, and possible actions and orders imposed upon them.

To effectively ameliorate these fears, three key questions need to be asked and answered:

1) How long before the economy stabilizes and markets normalize, thus providing sound institutions the opportunity to generate reasonable earnings?

No one can answer this question with certainty, of course, but the discussion of the possible scenarios will lead to several key strategic steps.

As part of the discussion, it might be useful to identify and think of those lines of business which have fallen out of balance and require further correction, much like the housing/mortgage market bubble. Other bubbles in various stages of correction or seizure include construction lending, commercial real estate, C & I, credit cards, auto lending/leasing, et al.

At risk of further prolonging these overheated LOB bubbles is a long list of causal market forces: over-leveraged and wary consumers, weakened businesses with slowing investments, global recession, fluctuating currency and energy markets, and unforeseen future failures (e.g., banks, insurance companies, hedge funds). Longer-term forces include inflation risks stemming from the bailout efforts, excessive budget deficits, and prolonged trade imbalances.

Despite recent market gains, with so many forces still at play, it is difficult to build a credible case for a dramatic and lasting recovery any time soon. In fact, this recession already rates among the deepest and longest in U.S. history, and given the aforementioned persistent risks, it could morph into a prolonged period of weakness. With little significant good news on the horizon, the economic environment for the foreseeable future will likely challenge even the most solid and conservative of institutions, and require continual diligence.

One method we have found to effectively address the ongoing uncertainty is the creation of economic scenarios during your planning efforts. By identifying several possible economic climates and formulating logical strategies for each scenario in advance, you will be better prepared and remove the risk of regressing into "crisis mode"; if conditions further deteriorate, by simply "pulling the trigger" on those previously identified steps appropriate for the conditions which actually evolve.

2) While waiting for stability and recovery, what steps should be considered to mitigate further damage and ensure institution viability?

Many institutions have already completed the traditional steps associated with coping in a recessionary environment. If you haven't done so already, take the necessary actions to reduce costs wherever possible, without cutting into core operations required to properly serve your customers. Take special care to avoid across-the-board cuts; instead, cut strategically, reducing a greater percentage of resources in less promising or unattractive areas. Also seek to increase efficiency and productivity within the organization; in essence, doing more with less.

It may also be useful to identify other defensive strategies by evaluating possible steps in each of the CAMELS components. Here, pay special attention towards strategies to maintain and preserve:

- Capital (e.g., shrink assets, suspend dividends, end stock repurchases, add direct investment by directors/others);

- Asset quality (evaluate lending standards, conduct independent credit quality review, enhance collections capabilities, etc.);

- Earnings (reduce non-interest expenses, adjust staffing to shifts in volume/traffic, eliminate excess capacity); and

- Liquidity (increase core deposits, reduce loan volume, sell investments, establish alternative funding sources, et al.).

Clearly, the integrity of the balance sheet will be paramount for survival.

One area often neglected in steps to ensure viability is the bank's lines of business offerings. While in actuality each LOBs doesn't offer the institution the same contribution to its earnings, growth, or safety, unfortunately we often treat them with equal emphasis in our marketing and sales efforts. This doesn't make sense, especially in times such as now where every positive contribution to the organization is critically important.

To optimize your lines of business, begin by evaluating recession-induced shifts to the profitability, demand, and safety of each line. Then prioritize each LOB by their revised profit-demand-safety contributions. The aim here is to emphasize those lines which offer us the greatest profits, growth, and safety, while greatly curtailing or exiting other businesses that contribute weakly to our goals.

3) What strategic opportunities to enhance long-term positioning are available now to institutions in reasonably sound condition?

Even in highly turbulent times, your focus shouldn't be exclusively defensive. For those institutions where your survivability is assured, you need to also look offensively, seeking to reposition the institution and improve your long term competitiveness once the economy turns positive. The most obvious opportunity is to gain new customers by communicating a clear message of safety and soundness to prospective customers seeking to flee weakened competitors. A less obvious but more highly valued message to business banking customers would be your role as a reliable partner in serving their financial needs (countering the reduced funding commitments recently experienced by many businesses from other banks).

Another area to consider would be an acquisition that makes true strategic sense. This might include an institution that enables you to achieve a meaningful gain in market presence. An additional opportunity would be an acquisition that adds or strengthens a line of business that is compatible with your core focus, and allows you to serve your customers better or more profitably. While valuations are at opportunistic lows, care must still be exercised not to enter into any deal that places the stability of your own organization at significant risk, should things go awry.

Conversely, it may be appropriate to take steps now to maximize your franchise value in the eyes of a buyer, for a possible sale once valuations return to reasonable levels. This would be especially appropriate for those institutions where your long-term competitive prospects are not readily clear. The immediacy of earnings over costly growth, for instance, should be a focal point of a value pursuit; whereas building market share and core skill development would be appropriate for those institutions looking at viability for the long haul.

To identify and take advantage of other opportunities, consider what your own future environment may look like, and position your bank to best succeed in those new conditions. In doing so, don't just stop at identifying the likely changes; also identify steps to implement, so you can take advantage of new opportunities and reduce the negative effects of new threats. For many institutions, this new environment will encompass moving back to banking fundamentals, conservative risk management, and an increased regulatory scope and burden. Under these conditions, possible action steps to consider include shoring up and optimizing lending and deposit LOBs, striving for low-cost production/delivery leadership, and increasing compliance capabilities.

In turbulent times, new strategies alone may not be enough. You may also need a new process for planning. We hear institutions express frustration that newly devised plans are quickly out of date in these fluid conditions. An alternative approach may be to form task forces, with separate groups for defensive/damage mitigation issues, and another for offensive/opportunistic situations. Each group would be relieved from the traditional calendar-based plan development and documentation; instead focusing on shorter and more frequent meetings, with flexible recording and tracking tools—all in an attempt to plan, effectively respond to, and monitor rapidly changing conditions. BJ

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