Another One Bites the Dust
by Charles Wendel

A few weeks ago, I wrote about a once prestigious bank that, tied at least in part to its acquisition by a much larger bank, suffered loan losses, organizational changes, and regulatory issues. This time the sad story involves a commercial finance company that for a while outperformed many peers and was a Wall Street darling.

Envy. I'm usually happy not to be a client's full-time employee, (probably the client is as well) but this time I felt guilty of the cardinal sin of envy as the Chairman passed out envelopes to his senior staff. I attended as their consultant to lead a planning session. No envelope would come my way.

"You're all millionaires," said the Chairman as his management opened the envelopes and examined the numbers. And he was right. Based upon the current and expected stock price and the stock grants highlighted in each individual's package, they were all going to be millionaires at this company once selected by *Fortune* as one of the best places to work in America.

But a few years later, the company filed for bankruptcy, its stock price tanked, and millionaires were no more.

When I first walked into this company, I could sense its energy, intensity, and pride. This non-bank financial services lender emphasized its industry knowledge and the excellence of its team, most of whom came to the company after having worked at leading competitors. Serving a dozen or so specialties, they lent where many banks would not and, in turn, received strong fees, good interest spreads, and warrants and upsides of various types. They could take on bigger players and win because of their culture of quick decision making, limited bureaucracy, and asset knowledge. And, unlike most companies, the Chairman was often the final decision maker and internal Supreme Court. He knew the business and knew its numbers in detail.

I'll never forget one late night in an upscale restaurant. A top salesperson hopped up and down on his seat in excitement while telling how he was breaking through his revenue goals to make bonus payouts that bank competitors could only dream of. In contrast, so many of the bankers I knew felt beaten down by the internal bank bureaucracy and operated with a sense of alienation from their employer.

This company quickly became my favorite client. They wanted new ideas and acted on advice that would help them to grow. They were also tough clients in a good way, demanding strong analysis, questioning assumptions, pushing against any half-baked ideas, and requiring thoughtfulness, energy, and realistic recommendations from an advisor. The Chairman read everything you gave him (that in itself is unusual) and made a point of critiquing not only the analysis but also any poor grammar or wrong spelling that he came across. Unfortunately, he did come across both and let me know when he did. This was a client who kept you on your toes and challenged you. And the staff was smart and committed. And fun.

So, what went wrong?

Public company. While being a public company affords more financing options for a company and more paths to wealth for employees, it also presents great danger to a specialized lender. Growth is not aways good in that business, yet the market responds to growth and punishes companies that fail to meet expectations. This company probably pushed too hard to meet those expectations.

Investment bankers. Companies that want to grow attract IBKers both for funding and deal making. And when organic growth became more difficult, management made the mistake of listening to those bankers and acquiring companies that did not fit it culturally nor share the same approach to risk assessment.

Concentration risk. Avoiding concentration risk is so basic it should not need to be mentioned. But the company's post-mortem showed that a few units had overlent, helping to destroy the portfolio approach that had been part of its success.

A charismatic, brilliant leader. I know, that doesn't seem bad, but in this case? While most of the investment bankers and private equity people I've met consider themselves the smartest person in the room, this Chairman was…until he was not. On reflection, he may had been some health issues that everyone ignored, partly because he could be an intimidating person and told them to. And those health issues might have resulted in some bad decisions, including those related to personnel and M&A deals. It also seems that succession planning was informal, and certainly inadequate. But who was going to demand that an intimidating, charismatic, brilliant leader focus on schooling a replacement?

A first-rate but ineffective Board. Many of the men (I think it was all men) on the Board were successful leaders in their fields. They did not want their own Boards to poke their noses into the details of how they ran their businesses. In turn they had neither another the time nor the inclination to dive deeply into this company. And, after all, it was a big success. I remember the Chairman telling me of the advice he had received from a mentor. He was told not to put a retired person on the Board because they would have too much time available to ask questions.

Failing to read the tea leaves. Were there signs that the company was slipping? Moving to a new company-named tower was likely unnecessary. And a corporate jet at least in part as a response to cigarette smoking being banned on commercial aircraft? Pushing for M&A deals in unknown financing areas was a big flashing red light. I've told the story before that we (and others) successfully advised against one acquisition that the Chairman had initially wanted to do. But I wasn't invited into the next due diligence, a deal that was completed but, arguably, harmed the company.

Disastrous communications. The Chairman was the face of the company to all outsiders, including rating agencies and the press. For whatever reason, at the same time the company announced a large credit charge, it also announced the Chairman's departure. He was likely the only person who had a shot at reclaiming Wall Street's confidence. Without him the vultures were able to swoop down. While even a strong successor may not have been able to stop the bleeding, in this case the open wound quickly became larger as funding options dried up.

The company's failure hurt many people, not only financially, but in other ways. For some it was the best place they ever worked. But others leveraged what they learned there to start their own company and/or to achieve success in banking, real estate, landscaping, and other areas.

One major lesson. It is very difficult to challenge how a company is operating while it is showing strong results. Little tolerance exists for doubters, for those asking questions that seem misaligned with the company's performance. But that may be the most appropriate time for some skepticism and inciteful questions.

FIC works with senior management and Boards on issues that are critical to a bank's sustainability and growth. We emphasize practical solutions that we customize to a company's capabilities and culture. Reach FIC at cwendel@ficinc.com.