Community Banks: Yes or No?
by Charles Wendel

The current *Economist* magazine features a brief article titled, "*The state of America's community banks"* with a subtitle *"Don't write off the admirable bantamweights of the industry.*"

The article notes that there are almost 5,000 community banks (banks with assets less than $10B) still operating, with an average ROE of 10.6%; that ROE is 200bps higher than in 2017. However, total assets of all community banks are about equal to Bank of America's total assets.

The article also mentions the reduced regulatory burden these smaller banks face and their ability to adapt to the digital age. One banker interviewed talked of "a difference in the tone at the top" of regulators as well as the positive impact of simplified lending and capital rules. The article also highlights a $1.4B bank that has customers in all 50 states and makes online loans for "fancy mobile homes." The article goes on to say that community banks make 40% of small business loans and have knowledge of the local area that no big bank can (or may even want to) provide. At the same time, community bank numbers "have been thinning by around five a week."

Basically, the article suggests that some number of community banks will survive, based upon their local knowledge, niche expertise, and ability to adapt. Well, of course.

On the same day a banking article written by a McKinsey & Co team popped up in my email. That article states, "The prime differentiator among firms is talent." Well, of course. It then proceeds to state that talent in combination with technology can reduce bank operating expenses. My initial snarky reaction was to ask whether Captain Obvious had taken over that (and other) consulting firm.

However, two comments in the article are worth highlighting: *"Firms may find that in a digital world just 10 percent of their managers create 50 percent or more of the value, and yet none of them sit with the senior team. On the other hand, as many as 20 percent of firms' managers may create little value."*

I agree with that assessment and believe that most senior bankers will recognize this as the truth. And, those percentages do not only apply to the digital world. There are too many people "phoning it in" in many banks, both big and small ones. Community banks, in particular, cannot afford deadwood, but their cultural paternalism often allows "value destroyers" to remain.

Here's a few example of personnel and organizational issues community banks and others should address:

- Years ago, one client told me of the positive impact of his exiting the bottom 10% of his sales staff; fewer bad deals were sent through the credit process and productivity improved. *Exit poor performers*.
- In another case a CEO acknowledged that the head of one of his units needed to be replaced, but he saw his retirement approaching and decided to let the next

man/woman deal with that personnel issue. Not exactly a profile in courage. *Make, do not punt, decisions.*

- At another bank no clarity exists about who is responsible for “X”. I have seen “X” be deposits, digital banking, and various other initiatives. The net result: mediocrity in decision-making and execution. *Appoint a leader*.
- On the same day, years ago, we had key meetings with a bank and nonbank clients. The nonbank had two decision makers in the room; the ban k meeting occurred in a large conference with maybe 15 attendees. *Limit meetings and attendance.*

Again focusing on the apparent, the McKinsey article pointed out the amount of time bankers spend in meeting with each other, meetings that often result in another meeting rather than decision-making. Meeting discipline is the exception rather than the norm at most banks. That article notes that “Banks can reduce the pain with a coherent set of meeting practices: for example, 45-minute time limits for standard meetings; mandatory advance agendas; discouraging attendance by multiple, similar senior managers (for example the CEO and COO of a business); and inviting only necessary attendees.” These are hardly breakthrough concepts and, while they are obvious steps, they are steps that most banks avoid taking. *Too many meetings; too many people at meetings; meetings that last too long.*

Community banks will continue to have an important and valued role for consumers and small businesses, but many have to manage themselves differently in the future. One item neither article mentioned is the importance of smaller banks leveraging third-party software, whether through their Core providers or others. Without that skill and a culture that emphasizes and exploits partnerships, community banks cannot survive.

One major issue that community banks and commercial banking overall also needs to address is, why should a top quality 20-30 year old join their bank? If banks cannot find a path to attract and retain the top quality minds that private equity and Fintechs are pursuing, banks may be relegated to becoming low profit transaction utilities; that’s not a happy fate.