Is Bigger Really Better?

by Charles Wendel

Short answer: no.

The stampede you heard after SunTrust and BB &T announced their "merger of equals" was investment banks running to the airport to pitch similar deals to other banks. Banks need to be bigger, right? Technology costs demand that, right? Banks that don't merge now risk being left behind, right?

The Winners. Who benefits from the type of big combinations like SunTrust and BB&T?

Investment banks: one word, fees.
Lawyers: see above.
IT consultants: IT chaos breed IT opportunity.
BIG consulting firms: Senior management will likely want McKinsey, BCG, or Bain to bless their reorg plans and lead the massive cost takeout process. Cost take-outs justify this deal and their impact can be quantified for investors and Wall Street.
Top management: Top management always does well in these deals even if they leave the bank shortly after the deal closes. Exit packages and retention payments ensure it.

Deal Justification. First, mergers of equal seldom, if ever, turn out to be that. The stated goal of "combining the best of both companies to create the premier financial institution of the future" often turns out to be an elusive or even delusional goal. This deal announcement also quotes one of the bank's leaders as saying the new bank "provides the scale needed to compete and win in the rapidly evolving world of financial services."

That still needs to be proven and, in fact, may be an incorrect concept. One highly successful regional bank head recently commented, "Big banks spend so much [on IT] that they think they will run small banks out of business." But, he noted that the core processors and many other IT firms were "equalizers" in the digital wars. And, a consulting firm assessing the recent Fiserv/First Data deal (which has its own integration issues) wrote these types of deals "are creating bigger, more diversified vendors that banks and credit unions use for payments services…pursuing strategies to gain scale and build the firepower to invest in new technologies and customer experience capabilities." In other words the Core processors and other vendors may allow a smaller bank to quickly match most of what a larger bank can offer its increasingly digitally oriented customers.

But for the rest of us?

What the investment bankers and others also don't explain is how banks with different cultures, different IT systems, and different strategies will combine successfully. They certainly do not point out the potential goldmine that these deals offer to smart competitor banks that can now move in to take concerned employees and disgruntled customers.

One stakeholder group that does not benefit from these deals are mid (SVP and below for sure and even some EVPs) and lower level employees, including the critical branch and operational staffs that allow the internal bank engine to run.

In areas in which branches have no overlap, employees may not lose their jobs but disruption will likely still be significant, as the new SunTrust and BB&T Bank launches a new name, new organization and new procedures. (I forgot to mention branding firms as another set of winners from this deal. Let me save the shareholders $1MM+. Sun is a happy and strong image; Trust is a good thing and increasingly hard for banks to demonstrate.) Reporting lines may be unclear for months or years as political dynamics play out and "equals" become less equal.

However, in areas like Miami, where FIC is based and where both banks have a significant branch presence, disruption will be fundamental. 20%+ cost reduction has to be achieved in order to justify this deal. SunTrust and BB&T have approximately 20 and 30 branches, respectively, in FIC's catchment area. No surprise, many locations overlap between the two banks. Some branches will close; branch employees and SME bankers will be fired.

Smart midlevel and branch bankers are already polishing up their resumes and making sure their LinkedIn info is up to date. Senior bank management has probably been reassuring their bankers about how good this merger is and that disruption will be minimal; unfortunately, they may be misleading both themselves and their employees.

The other stakeholder group not mentioned so far is the customer. While for years some banks have been stating they want to improve the customer experience, their actions communicate something else. How does getting bigger help the consumer or small business customer, or, for that matter, any other customer? In fact, it represents a serious threat to them: a threat to service quality as basic functions may no longer perform as before; a threat to their companies as banks may alter their risk parameters and pricing guidelines, a threat to their personal income statements, as banks look to increase fees in order to enhance the returns.

More consumers and business customers are wary of the "bigger is better" mentality. This merger gives the customers of these banks a wakeup call that inadvertently encourages them to look around at other bank and nonbank options.

Many years ago I consulted for the old Chemical Bank in NYC (now Chase). Even then, they were a leader in the middle market company space. Their then head of marketing set up a pre-Internet system that focused on calling the customers of banks that were being disrupted. Back then the disruption was likely more due to credit issues than mergers. Even in that era of paper-based systems, they tracked which prospects were using which banks; when problems arose, they called them and often found a warm response to the call.

The best advice I can give to those banks that overlap with SunTrust and BB&T is to lever the readily available data and create swat teams to identify and focus on the clients of those banks and their best line people.

The very smallest banks do need to scale up in order to pay for fixed costs, attract necessary talent, and meet regulatory costs and hurdles. But managers of larger banks ($2-10B+) should be considering how best to meet the IT and customer challenges ahead. Agility and working with third parties plays a key role, Acquisitions, maybe; mergers of equals, unlikely.