Merger Fever
by Charles B. Wendel

In 2000, 8,300 FDIC insured banks operated. By year end 2020, the number was down below 4,500, and since 2010 fewer than 15 new bank charters have been approved by the FDIC. The pressures on the banking industry will only increase in 2021, encouraging more banks to sell or seek the always illusive "merger of equals" with those deals always seem to wind up with one bank being more equal than the other.

Forces pushing toward faster consolidation and the disappearance of many smaller banks have been occurring for years but have been accelerated by the pandemic. The best bankers have been making a list of issues and checking it more than twice for the past year.

Digitalization. The tipping point that should have pushed banks to "think digital" occurred years ago, but many bankers only got the message in 2020. Bank execs, many of whom grew up in a different era, have to sift through often a myriad of digital options with vendors and big consulting firms all pounding them for dollars while fomenting a sense of impending doom, if the bank fails to sign up with them.

Further, within banks there are competing digital factions, among them: the digital savants with almost a cultlike belief in all things digital and a dismissive attitude toward "traditional" bankers; "analog" bankers who express skepticism about digital and concern about its impact on customer relationships while hoping they can survive until their retirement; and the rest of the bank, trying to assess options and maintain the bank's culture while adopting appropriate technology.

Big banks are struggling through these issues with staffs of hundreds. Smaller banks and many regionals may lack the expertise, the bandwidth, and the energy to deal with this topic effectively. Bigger banks may have a natural advantage here.

People and space management. Who knows when, if, or how employees will return to offices? Each passing month makes a return to 9-5 office life less likely, as banks learn to manage remotely and employees learn they like to work and can be effective there at least a few days a week. In recent days I spoke with a friend who several years ago had been offered a job at a top five bank. The exec wanted to hire her, but told her she would have to commute to the NYC office daily. She passed on the job. That type of requirement is gone now, allowing a bank to attract different employees than in the past. That's great, but why would a top candidate go to a bank that lacks a coherent strategy or does not appear to be a long-term player?

HQ and branch needs are also changing with low interest rates and customer needs making many branches unprofitable and unnecessary. We know bank managements that in the past have fought closing branches as if they were being asked to give up a child. Branch closure and redesign (smaller spaces with more technology) is essential. The idea of operating unprofitable branches as "billboards" advertising a bank's presence in a major city no longer makes sense if that major city is largely deserted for the foreseeable future.

The Election. No, Elizabeth Warren is not Secretary of the Treasury, but many of the new recruits for areas like the CFPB will push for more consumer and small business protection and

more lending to needy but credit-weak segments. Everyone I've spoken with expects more regulations, more focus on "corporate responsibility,." more constraints on how banks generate revenues and higher regulatory costs. Banks need scale to pay for those costs and banks below $500-1B will have ROE and ROA increasingly squeezed.

NIM and Cost reduction. Interest rates are low and expected to remain so. Margins are reduced, as are revenue opportunities. This all points to yet another cycle of cost reduction, an enervating and soul destroying process for banks. I was just looking at a balance sheet for a $500mm asset bank with an expense ratio about 60%. They need to reduce that percentage while investing in technology, regulatory compliance, and other initiatives that may not generate additional revenue. That bank's stock, along with others like it, has been down to flat. BODs better prepare themselves for sales at figures below their expectations of a few years ago. Some banks may have stayed around too long.

We haven't even mentioned other factors undercutting banks. They include possibly deteriorating loan quality, Fintech lending, encroachment into the payment space, likely more aggressive activities by Credit Unions, and Wal-Mart and others broadening their banking focus. The list goes on.

BODs should force themselves and senior management to address the challenges their bank faces and determine with as much objectivity as possible whether they are buyers, sellers, or for the short-term, survivors continuing to operate below the norm in the hope (never a good strategy) of better days ahead. Then, to paraphrase Senator Warren, they need a plan.

FIC works with clients on these and related issues. Continued uncertainty requires organizational flexibility as financial institutions focus on their future performance and growth while managing current portfolios and changing customer expectations.