Sell?

by Charles B. Wendel

Prior to the financial crisis of the last decade I had a client that timed his bank's sale as well as any company I had ever worked with. I commented to the Chairman that he sold his company on the right second of the right minute of the right hour of the right day. Shortly after he sold the bank one of its main business segments largely collapsed. Without its timely sale to a player with deeper pockets its future might have been in doubt.

Today, banks are operating in a very different environment. The economy has largely stabilized, and loan portfolios have improved. Nonetheless, the senior management of banks and its Boards (particularly but not exclusively publically traded banks) should be actively evaluating whether now is the time to sell. However, not surprisingly, every banker survey shows that there are a lot more banks that want to acquire than be acquired. To some degree this results in sellers being in demand, in many cases allowing for attractive premiums.

Why sell now? The reasons for at least considering a sale or merger seem to be increasing both in number and significance.

Growth will be difficult to achieve. One leader at an acquired bank commented that his commercial bankers expected to have a difficult time making their numbers and maintaining the growth that Wall Street demanded. We hear similar comments from other banks faced with constraints related to limited retail areas in which to pursue growth. In some cases banks even need to trade off growth to meet capital needs (for example, Citi's ales of several consumer and commercial businesses).

Regulatory requirements will continue to be demanding and likely grow. Bankers know the issues here better than any outsider every will, about the amount of time, energy, and dollars required to address regulatory concerns. As one banker whose bank had effectively dealt with BSA and AML issues commented: "Besides what is there to look forward to…Basel III cap requirements?"

Overall, costs are increasing. IT, privacy, compliance, regulatory, and other costs are increasing. Cost categories that hardly existed five years ago have grown in number and dollars required. Most of these costs bring with them no or minimal revenue benefits as the cost of doing business increases. These costs and others appear likely to continue to rise, putting smaller and less productive banks at a competitive disadvantage.

Returns will remain low. These and other factors result in returns on equity that will be difficult to exceed single digits, potentially making it difficult to attract and maintain investors. Few banks will be able to attain what used to be the twin goals of 1% ROA and 15% ROE

Aging workforce and leadership. The leaders of many banks are baby boomers. Some have reached their retirement years while others have simply hit a point at which the hassles of running a bank outweigh its benefits. The sense of achievement and accomplishment required to motivate bankers has been replaced by the daily grind of following internal and external rules. Not fun.

Shifting customer base. Just as management is aging, the majority of the customer base is shifting to Gen X and Gen Y and away from baby boomers. Banks grew in size with the boomer expansion. Understandably, many bankers remain unclear on how to address the still evolving requirements and potential of this group. Not only are they more difficult to manage but the economic potential they offer to banks may be more limited than that previously provided by boomers.

Valuations are rising. Recent deals suggest that interested buyers are willing to pay up to gain entrance into certain markets or types of clients and, in general, valuations have improved. Ay this point the old phrase about a rising tide lifting all boats seems relevant to bank valuations. Timing is everything.

Steps to take. Evaluating a bank's path provides an instance in which banks need outside independent help to consider their next steps. But, approaching an investment banker or business broker with this assignment approximates letting the fox into the hen house, since it is in their self-interest to do a deal.

Further, before considering a sale, management should take steps to make itself as attractive as possible to potential buyers. Obviously, buyers will pay more for what they view as a well-run machine rather than a turnaround. One bank that proactively pursued its own sale put together an overview book describing its focus as it worked internally to streamline processes and become more productive, all things that it should have been doing in any case.

Frankly, it is relatively easy to lay out a case for selling now. Next time, I will take on what may be a more difficult assignment, namely, focusing on why bankers should stay the course and not go down the sales path.