Sell?

by Charles B. Wendel

Over the years I've attended many conferences in which senior bankers meet over cocktails and informally discuss sale or merger opportunities. In past years there have been more buyers than willing sellers, since potential sellers saw their value with a different set of eyes than potential acquirers, eyes that viewed their franchises as being of great value. That may be changing.

It might be too extreme to suggest than consolidation will hit the banking industry like a tsunami over the next 12-24 months. Or, maybe not. While no one can predict the future the outlook for banks features so many clouds that many senior bankers should consider whether uncertainty and threats to profitability outweigh the positives.

Challenges include:

Net interest margin. The squeeze on margins will continue for the foreseeable future.

Credit losses. Both consumers and businesses are stretched. Strains may occur in the mortgage and credit card areas on the personal side. Small businesses will struggle to maintain their O/O CRE.

Capital. Seemingly sufficient form most banks now, but requirements may change.

The cost of Covid. Very unclear as to dollars and timing, but probably a greater cost than banks are projecting.

Branches and how to manage them. Branch downsizing or retrofitting will entail significant costs.

Elizabeth Warren. She could be the new Secretary of the Treasury. If you run a bank and believe that is likely, selling before November may seem appealing.

Community demands. Despite the billions that the industry has spent on CRA and related initiatives, banks should expect more demands. Two areas that will get increased scrutiny involve the exploitation of the poorest related to overdraft fees and credit card interest rates. Banks that depend on these two heroin-like sources of income may find themselves under attack more scrutiny.

Employee needs. It has been fascinating to see the different attitudes of friends and colleagues to the virus. Some people remain in a state close to panic, after months barely venturing out of their homes. It is fair to say that bankers tend to be more conservative and less "devil may care" in their attitude to life. They need care and tending as they reenter offices, if they ever do. The cost and time entailed in managing split shifts, office redesign, etc. will be significant.

CRE management, your own. Banks tend to own or operate out of many buildings. Here in Miami I have already seen banks close branches permanently. Banks will struggle to reduce fixed CRE costs. Struggle may be the operative word for 2020 and 2021.

Technology costs. There is no doubt that IT expenses will rise, tied to the digital transformation process. Staffing requirements to support this effort will also change.

Growth. Other than PPP and Main Street loans, new business lending will face multiple hurdles. Consumers also appear to be borrowing less, as they conserve their dollars.

Age and Motivation. What we are willing to manage through at 50 years of age is not what we are willing to manage through at 60 or 70, particularly if our personal investment portfolios will see us through until the end. Fact, not opinion. Why put up with the above challenges if you don't have to? If you option is…fishing, or golf, or reading?

Another ticking time bomb: strategy. Back in 1996, I wrote a book, *The New Financiers*. It included an interview with Dick Kovacevich, then Chairman and CEO of Norwest and later Wells Fargo. He pointed out that many banks lack a coherent strategy, one that differentiates them and provides a path for the future.

"The other ticking time bomb is, I guess, not really a ticking time bomb because it is not going to blow up on everybody at the same time. It involves the question – 'What business are you in? I think that the business industry is dead. There is not enough revenue in the thing we call banking to be viable over the future. Most banks should sell because they don't have the wherewithal to figure out what business(es) they are in, or it is not worth the cost to try to do so….the major reason to sell is that you are not in the right business and don't know how to get in the right business, or the cost of getting in the right business is too great relative to getting the power of someone whom you think might be there and riding that horse. Most people wait too long. When this crunch comes – and it is inevitable – you are going to have a tremendous differentiation that doesn't exist today between the stock price of the buyer and the stock price of the seller. Some banks are going to be at a tremendous competitive disadvantage. The question is when, not whether… There will be huge opportunistic losses between what managements could have sold …versus what is going to be there…when the banks don't have business, have high credit losses, and are to be forced to sell."

For many banks that time is now.

Using virtual meeting technology, we have been working on these and related issues. Because of continued uncertainty, banks and credit unions need to focus on the future as they manage current portfolios and changing customer expectations.