PEOPLE ARE OVERRATED

by Steve Brown

In our youth we invested in a martial arts studio. At the time, it was our passion and it was one of the hottest trends in the city. While the investment was a flop, the lesson we learned was invaluable. Never invest in any business that relies heavily on the quality of human labor. While classes were always packed at this studio, inevitably, good instructors would either demand higher pay (because they were responsible for bringing in a greater-than-average portion of students), or they would go out on their own and take students with them. Over time, variable costs would rise. Further, because competition made the business a commodity, the studio was limited by what it could ultimately charge. The situation was made worse due to a lack of investment in marketing. In banking, most management teams say the strength of their organization is in its people. While we don't disagree, we have a different take. The strength of an organization is in what its people can impart on the organization. Currently, banks are offering stratospheric compensation packages to loan officers in an attempt stimulate greater growth. The higher any employee's salary, the more they should contribute their expertise to the infrastructure of the bank. A loan officer that brings in business is good, but an officer that trains others on a new lending line or process is better. If it is just a book of business that management is seeking, loan officers will either bid up their compensation to the point of indifference (risk and cost equal to return), suffer a drop in production (for a variety of reasons including they never really had the stated book of business anyway), or move on after the contract period. The short supply of qualified loan officers in the current market gives this class of employee the power to negotiate. If these loan officers control the customer, chances are these relationships will be transitory. Our intent is to not pick on loan officers, as this paradigm is also true throughout banking (branch managers, etc.). However, before making that next high salary offer or grant that huge raise, executive management should ask themselves what other long-term value does this person add to the organization. Banks need to add quality people, but they need to do so within a high quality structure. A bank that strives to create a special culture, brand, technology, process, service or product that cannot be easily replicated adds permanent and long-term enterprise value. A bank that hires high-priced talent and then lets them operate as a fiefdom may create short-term value, but the long-term addition is questionable. Starbucks knew long ago that to counter its coffee revenue and its labor expense (both commodities), it had to build value by building its brand, locations and customer experience to transcend its employees. While a bank will always rely heavily on the quality of its personnel, strong management will embody the best traits of each employee into its very fabric. Banks that do not invest in differentiating infrastructure will find long-term profits punched down to size.

BANK NEWS

M&A

Independent Bank Corp. ($2.7B, MA), the HC for Rockland Trust Company, will acquire O'Connell Investment Services Inc., a Rhode Island-based investment management company, for an undisclosed amount.

M&A

Financial technology services provider Fiserv will acquire CheckFree for $4.4B. CheckFree does electronic billing and payment, online banking, ACH payments and fraud and risk management.

CheckFree's business serves 21 of the top 25 financial institutions in the U.S. and processes more than 1B transactions per year.

M&A

Belvedere Capital announced it will acquire 2 more banks as it works to build a southern CA banking platform. The company will acquire Spectrum Bank ($165mm, CA) for $37mm, or 3.05x book and said it will also acquire First Heritage Bank ($218mm, CA).

Consolidation

Park National ($6.4B, OH) announced it will merge its eight Ohio charters into one and place the banks on a single operating system.

Margin Issues

Q2 earnings reports showed that shrinking lending spreads have replaced rising deposit costs as the main drag on net interest margins for many banks.

Cutting Back

Wells Fargo, one of the largest mortgage lenders, said it is making "day-to-day decisions on the pricing and availability" of alt-A mortgages made through brokers. A cutback in the credit quality tier just above subprime will likely exacerbate the housing slowdown as it makes less money available for home purchases.