BANK DECISION MAKING

by Steve Brown

Imagine a courtroom where the trial consists of the prosecution presenting a couple of PowerPoint slides and a spreadsheet on why the defendant is guilty. The judge then challenges and clarifies some of the facts and, seeing no major issues, declares the accused man guilty. Few would consider this due process. If this would be shocking in the courtroom, why is it acceptable in banking?

As readers of this publication will tell you, we believe a bank's processes can be more important than its products or services. The above analogy highlights a flawed process that we have witnessed dozens of times in bank board rooms and executive management sessions. While admittedly an oversimplification, the process of having a group of managers arguing one side of a business case and then dumping everything in front of the CEO to be both challenger and final judge, can be improved. Building a good decision-making process begins by largely ensuring that these flaws don't happen. In order to prevent bias and apathy from creeping into the decision process, we offer a few best practice tips that we have found effective.

One requirement is to make sure not only risks are highlighted, but uncertainties and assumptions are known by the group. Someone should always be assigned to find out the major variables and assumptions that are implicit in any decision that could be wrong or could change in the future? For instance, many banks made the decision to increase their construction loan allocation because it was a profitable line of business. Few ever questioned the underlying risks and assumptions that might have shown profitability was unlikely to be sustained. Justification was usually - "that is what our market desires." Few questioned the assumption that if they added different lending talent to the team, the bank could expand into C&I or agricultural perhaps.

In similar fashion, when it comes to strategic decision-making, banks should make sure a contrary point is not only heard, but supported. We try to do this and it usually works quite well. Assign a team member to take the opposite side of the debate, regardless of their beliefs. Further, make sure that the due diligence team seeks information that could be contradictory to the main presented hypothesis.

M&A is our current classic example of flawed decision making, as many management teams have convinced themselves that they need to grow. The justification is usually that regulatory costs are now so huge that you need to be a $1B bank to survive. The funny part is that no one really knows what Dodd-Frank will cost, so how can anyone sanely reach that decision? So far, while the costs do appear to be increasing, it is not by a material amount and there are reasons to believe that it may even help in some areas of profitability. Further, while that last 4 quarters do show that size is positively correlated to profitability, we have the past 40 quarters that show the opposite. While a merger or acquisition may be the perfect idea, we are not sure you can get "independent 3rd party advice" from the very investment bank that stands to profit from doing a deal. If you don't want to assign a team to take the opposite side of a potential M&A decision, maybe bring in a 3rd party or have the same team that made the argument now take the opposite side.

While there are no magic techniques to remove biases from decision-making, an important consideration for any process is for an opposite point of view to be heard and supported. One bank

CEO we know always requires everyone on the team to write down, in secret, 3 reasons why they think the proposal will fail and he keeps them for accountability. Whatever the method, having a consistent way to make solid, economically driven decisions, will help banks better prosecute success.

BANK NEWS

Bloomberg Fed Action Survey

A Bloomberg survey of 44 major economists indicates they expect the Fed to change the "extended period of time" statement language later this year and allow the securities portfolio to shrink; before raising interest rates or actively reducing the balance sheet.

Economic Activity

CNNMoney reports GDP grew 3.1% in 4Q, but has since slowed to a projected 2.0% in the first 3 months of 2011, according to a survey of economists

Jail Time

A federal judge has sentenced a former EVP of the failed Omni National Bank of Atlanta to 5Ys in prison and $6.8mm in restitution for manipulating sales and accounting related to foreclosed properties. The officer cleared OREO off his books by making loans to unqualified buyers at inflated prices; forged credit information and never reporting some foreclosures at all.