Courtship And Engagement

by Steve Brown

There is quite a lot of noise around M&A activity in the banking world these days. Our regular readers have no doubt followed the activity shown in the right-hand column of this publication. We try our best to include announcements that will be of interest to our readers, and M&A always seems to be of interest-- whether it's between humans or companies. Acquisitions (like any process) require lots of steps and many things can go wrong along the way. There is the question of compatibility and whether a combination will be successful.

To give a bit of a different perspective, we pondered what human mergers have in common with bank mergers. For humans, there is a timeline for life-changing events, and the same applies to mergers. For people proceeding through the steps to marriage, studies find the highest percentage (40%) is engaged for 13 to 18 months prior to the big event. Further, some 44% meet their spouse's parent within 1 to 6 months, and 48% first said "I love you" in 1 to 6 months. On the other hand, 41% of first marriages end in divorce and about 10% end in the first 5Ys (another 10% in the subsequent 5Ys). In addition, about 60% of second marriages end in divorce, so it appears prior experience as a spouse doesn't help much.

For banks, most seek to merge to capture more customers, geography, or product lines. This boosts market share and usually adds assets. After the event, back office functions are consolidated, redundant staffing is eliminated, and efficiencies are squeezed out to get more value. It's believed that these steps will improve performance--but the reality is that sometimes it does, and sometimes, it doesn't improve performance.

Reasons vary, but for sure mergers in banking upset the apple cart for employees and customers alike. This can diminish a brand and cause the exodus of important employees and customers. Mergers can also bring about unexpected problems. There was a case of a bank which acquired another and while the acquiring bank had reviewed a legal issue and had counsel assess the risks before the acquisition, the bank found itself on the wrong end of an expensive legal outcome. An officer of the acquired bank was named as a defendant in a case of assault for pointing a shotgun at two employees of a restaurant in dispute with the bank over the disposition of assets. The bank officer was found guilty, the restaurant employees sued the bank and won $6mm in damages. The acquiring bank, having inherited the liabilities of the previous institution found it had also gained the old bank's future liabilities. The acquiring bank ended up having to pony up the cash.

As with some marriages, banks have seen their fair share of horror stories. Many of these were related to regulator arranged mergers at the height of the financial crisis. Look no further than the BofA acquisition of Countrywide and Wells Fargo's acquisition of Wachovia to follow the money to the large fines that ensued as a result of prior issues with those acquired companies.

Merger and acquisition activity can make sense for some community banks but it can also blow apart even the best laid plans, so care must be taken to conduct very deep due diligence on any targets. We recommend that banks proceed carefully when considering a merger or acquisition, to consider all aspects of what could go wrong, even beyond what legal counsel or other experts might find because the ramifications can be large and long-lasting.

As with human marriages, be sure to get to know the other party, don't kiss on the first date and have a long enough courtship to know your partner well. If all the reasons still seem right, then maybe you can go for it. While divorce is still possible in the future, at least you did your best up front to make things work and start out on the right foot.

BANK NEWS

Enjoy Vacation

A survey by Expedia finds only 8% of workers say their bosses don't want them to use all of their vacation days. Relax and enjoy this summer.

More Retirement

Vanguard reports the average 401(k) balance climbed 18% last year to $101,650. That is a 47% increase over the past 5Ys.

More Discussion

A BAI survey finds less than 20% of small business owners say their primary bank proactively recommends financial solutions to them.

Cash Buying

RealtyTrac reports 88% of single family residential home sales were all-cash in Q1 vs. 56% of condo sales. Both are pretty high levels if you ask us.

SBA Lending

Under the 7(a) program the SBA will guarantee up to $5mm or 75% of the loan amount, whichever is less. Under the SBAExpress program the amount is $350,000 or less and up to 50% of the loan amount. Under the 504 program the SBA through a Certified Development Company (CDC) will fund up to $5mm with 50% financed by a bank, 40% by the CDC and 10% by the business.

Small Biz

Pepperdine University researchers looked at the most common reasons small business loans are turned down and found it was due to the quality of earnings/cash flow (29%), insufficient collateral (23%), debt load (13%), size of the company (6%), customer concentrations (6%), insufficient credit (5%), size/availability of personal guarantee (4%), insufficient operating history (4%), economic concerns (4%), insufficient management team (3%) and a weakening industry (2%).

Economy

The latest Wall Street Journal survey finds economists expect GDP to grow just 1.6% this year, a 28% decline from the 2.2% they expected just one month ago.