WHICH ROAD TO TAKE WHEN AT A CROSSROADS

What a start to the year! In several conversations with bankers about their strategic future, the following comment, "at a crossroads" has come up. While it was good to hear that the bankers recognized that they were at a crossroads -- it is also something of a concern as to which road to take with a challenging future? Right now, I see so many banks standing at a crossroads where they are on one of three roads -- where do the others lead?

For most community banks there are three different roads from which to choose. Those three roads lead to:

1. Prosperity;
2. Underperformance Failure; or
3. Increasing Marginalization.

The first road leads to prosperity, but when we look at the community banking landscape in the United States, we recognize that a relatively small number of banks will find themselves on the narrow road to prosperity. Marketplace challenges prohibit many community banks from advancing on this road. While one can disagree with whether the marketplace is the sole culprit, we must all agree that the road to prosperity will be narrow. There are fewer banks, and the economy has not been much help. Maybe the real question here is the definition of "prosperity." Prosperity today looks much different than it did a few years ago. If boards and management cannot define what prosperity means to them and also to their shareholders, then how can prosperity ever be obtained? That probably should be one of the first questions at any strategic planning retreat -- what does success or prosperity look like now and in the future? In today's environment, a reasonably return on average equity, return on average assets, return on investment, and being a value-added entity are what need to be the focus of boards as they arrive at the true definition of prosperity. The emphasis should be on **reasonable** as well as **realistic**.

The second road leads to underperformance -- failure in the sense that banks significantly underperform or, worse, do not understand how to perform. They fail to perform for the benefit of their shareholders as well as their marketplace. While we saw a number of failures several years ago with the Great Recession, and a few last year through the hard exit, we also saw more failures by banks that did not understand their bank and what it could deliver or did not have the leadership to achieve an acceptable performance. We think that failures through the hard exit will be a likely path in the next few years for a small number of banks. However, we also believe that there are many banks that continue to underperform and are a failure to their shareholders and to their community. These banks are only being kept alive due to the interest of the management or board in prolonging their control and an inability to fully understand the performance of their banking institution. We have seen many that fit within this group look to sell recently, but there are still many more that are going nowhere. While there may be some form of a partial recovery in a sale -- it never meets the initial expectations related to the investment.

The third road leads to increasing marginalization, and we believe that it will continue to be a wide and well-traveled road for many banks. Jim Collins in *How the Mighty Fall and Why Some Companies Never Give In* (Collins Business Essentials 2009) offers an insight: "Organizations are more likely to fail because of what they do to themselves, rather than what the marketplace does to them." That raises an interesting question for boards and managements as to what the biggest threat to success is. For some, it is the board and management themselves.

For the last several years, we've looked at over twenty exceptional banks, and we continue to study what makes a community bank a success. Interestingly, the most successful banks (those that we have identified as exceptional banks) faced the same challenges as the less successful ones. What makes them successful is not their circumstances, but how they choose to respond to those circumstances.

The competitive environment for a banking institution in Santa Cruz, Hemet, Lodi, Eureka, San Diego or other areas in which successful banks are located, are no different from the competitive environment in the Central Valley, San Francisco, and Los Angeles. We see smaller community banks often going head-to-head with the major banks, or even the large regionals, and winning in most instances. The performance of others is not an excuse when it comes to an exceptional bank's own performance.

Many of these exceptional banks are winning primarily due to how they focus their energies and successfully adapt to environmental changes. They are boldly creative in aligning those changes with the mission, vision, and core values of their banks. Many of these banks motivate strategic change while preserving their bank's traditions.

This is a challenging undertaking, and we find that success comes only to the most adept leaders. We will have several of those exceptional bank leaders at the California Community Banking Network

(Continued on page 10)

WHICH ROAD TO TAKE WHEN AT A CROSSROADS

(Continued from page 9)

Directors Roundtable at Auberge Resort Del Mar, Caliofnria on June7, 2024. We encourage bankers and board members to attend.

When looking at exceptional banks, and also talking with their leaders (both CEOs and directors), we keep asking the question: what are the keys to a bank's prosperity in a very challenging and interesting time? We believe the keys are very simple:

A great leader;
A compelling vision;
An extraordinary senior team; and
Board support.

The First Key – A Great Leader

The single best determinant of a bank's success is the quality of leadership the Chief Executive Officer provides. Almost all of the literature on CEO leadership agrees on one key point. It is less about what the leader knows, and more about how the leader acts. For example, we have profiled over the last several years dozens of banking institutions and their CEO leadership. We have also written about leadership trends of Lincoln, Sun Tze, U.S. Grant, Geronimo, Attila the Hun, and even Vikings. Several of these deal with various different essential qualities for the successful leader. Whether they are 8 to 12 in number, what is revealing when we go back and take a look at these lists is that there is usually only one item that relates to technical competence. However, the list normally highlights, for strong Presidents and Chief Executive Officers the following:

Exemplify Integrity
Listen Well
Create Coalitions
Communicate Early and Often
Challenge Conventional Wisdom
Win People to a Point of View
Build Trust
Act Decisively

Great leadership appears to be first and foremost a people thing. It's about winning others over and leading them, in many cases, to a place they could not and perhaps would not go on their own. This is the foundation for building the mission, vision, and values that become the core of your bank. Every hire and every decision should have its base in this endeavor.

We have long believed that most CEOs do not hire other executives that are at or beyond their level. This is just part of human nature. So, if you have a CEO who does not possess many of the elements identified above -- then it is likely that will migrate through the C-Suite and also the staff. We know that there are many CEOs who are the exception to this rule, and we believe that their banks are those that are positioned to "win" going forward. For those banks who are the rule, we suggest the board take some time and think about whether there is the leadership necessary to make a difference.

For those banks that need to change, it is critical that they first achieve a universal embracing by all critical partners of the idea that meaningful change must occur. Also, they need to make a clear case on what will happen to them and the bank if change does not occur. Then they should involve those same partners collectively in brainstorming appropriate solutions which will ensure the bank's future viability and growth. Those are the critical aspects of planning the strategic direction for the bank and critical elements of Human Capital Banking.

The Second Key – Compelling Vision

We have written about vision on several occasions in this *Newsletter*. A vision needs to accomplish two basic things: (a) it needs to pull people out of their comfort orbits; and (b) it needs to attract resources. Many community banks are on the road to marginalization because at one level they cannot imagine themselves on any other road. They are reluctant to identify and agree upon the challenges they face and even more hesitant to commit to a course of action. They have at the outset a vision failure due to paralysis.

At this time in our country and the 2024 election, it is very difficult to see any of our candidates with a compelling vision. We should just remember the "I Have A Dream" speech of Dr. Martin Luther King, Jr. He stood before a crowd of 250,000 people at the Lincoln Memorial and inspired our hearts with four words, "I Have A Dream," and with those words a nation was galvanized. Dr. King's vision was so compelling that it pulled people out of their comfort orbit, their own visions of what they wanted to do, and who they wanted to be, and conveyed a greater possibility than they had ever imagined. Your community bank must do the same thing. It must galvanize; it must light up the room. Otherwise, the road will be marginalized.

When looking at the exceptional banks, they light up the room, they are different, they look forward, they don't evaluate their performance based upon what other banks are doing, and they are basically walking their own vision. What we find is that our partners, including shareholders and employees, respond to being emotionally moved to action. Vision is the fuel that ignites the engine of urgency.

(Continued on page 11)

WHICH ROAD TO TAKE WHEN AT A CROSSROADS

(Continued from page 10)

This is what we have long referred to as "motion orchestration." Vision gives direction and, most importantly, hope, and these are the times when people really want to feel that there is hope for their bank.

When it comes to tracking resources, a vision is the best way that the bank can secure recognition, customers, shareholder investments, talented employees, and great boards of directors. Resources follow banks that are going somewhere. No matter what else they might do, visions that fail at these essentials will ultimately fail the community bank.

The Third Key - Extraordinary Senior Team

Many of the CEOs whom we have talked with and profiled have emphasized that their job was not to run the bank, but it was simply too complex and the time demands were too great.

Instead, their job was to build the senior team, and it was the senior team's job to run the bank. Nothing is more important to a great vision than a team that is committed to carrying it out. The best teams are made up of a small number of people with complementary skills who are committed to a common purpose and performance goals and have an approach by which they hold themselves mutually accountable. Unfortunately, what we find is that many senior teams at community banks are out of sync with that definition. In too many cases, the team is actually a collection of competitors vying for scarce resources. To win, team members too often believe that someone else on their team must lose. In addition, the senior team seldom orbits the larger vision, and, rather, they orbit their individual visions and build coalitions that seldom share goals and resources. Finally, they do not consistently support the decisions that are made. If they agree with the decisions, they may support them. If they do not, then they may be passive resistors or, in extreme cases, saboteurs.

We have written on several occasions about Patrick Lencioni's *The Five Dysfunctions of the Team* and the necessity of consistency within the senior team members. That is all of the players being on the same page, sharing the vision, sharing the direction and, basically, drinking the Kool-Aid.

Great teams are not always shaped around titles, but instead a person's impact on the results that are needed. Sometimes that means violating hierarchy and boundaries to create a leadership team focused on achieving the bank's goals and sustaining the vision. Who are the best committed to action on the ground? Who can make a difference in achieving the mutual goals and visions? That person is on the team!

Several of the characteristics of important team members are as follows:

- Orbit the Vision;
- Be More Committed to the Members of the Team than the Groups They Lead or Manage;
- Be Highly Collaborative;
- Do Not Shy Away from Conflict;
- Decide and then Commit as a Team;
- Hold One Another Accountable; and
- Celebrate Each Other's Success

The Fourth Key -An Effective Board

Boards play a vital role in the overall process. The board must insist on the best CEO, It starts at the top. We've always stated that the board's number one job is having the right leader in place. Also, a board must insist on a vision that is, as noted earlier, compelling. Too many visions are happy talk, and they tend to be more of a balm than a catalyst. Board members must understand the value of a vision. They must embrace the vision.

Finally, a board must support and respect their senior management team, and that means giving them the resources that they need. In many cases, particularly when resources are tight, there can be political turmoil, but such support is vital. Boards and their CEOs must stand firm. If you have the wrong CEO, then it's time to make a change. If you have the right CEO, best to stand behind them and support.

An Additional Element

The final element on the narrow path to prosperity is a sense of "urgency." Over the last several years, boards and managements have been impacted by the regulatory environment as well as the competitive environment, and that has caused a lack of sense of urgency, primarily with regard to the strategic direction of their bank. Too often these boards have proceeded down a strategic direction that is mandated by the regulatory agencies as to what is best for their franchise. That cannot be the case, and it is important for many boards to **STOP COMPLAINING and START DOING!**

Recently, we had conversations with several boards and executive managements. During one conversation, a CEO stated that he was not contemplating any new addi-

(Continued on page 12)

WHICH ROAD TO TAKE WHEN AT A CROSSROADS

(Continued from page 11)

tions or changes for at least a year, because he did not want to increase expenses and wanted to preserve a mid-single digit ROAE. He wants to cut expenses as compared to moving their organization in another direction and was not open to exploring a combination with another entity since he did not think he could get the value he needed from another bank. Another CEO stated he was holding a planning meeting with hand-picked senior executives, board leaders, and a few key shareholders. The goals of the meeting were two-fold. The first was to identify a handful of non-core activities that could be eliminated and therefore free up resources, as well as staff time. The second was to operationalize three to five initiatives that could have immediate positive impact on the franchise.

When you look at those two answers, where do you think these banks are going? This is a time when boards and managements need to continue to look at the issues and challenges that face them and have an honest and in-depth conversation. There is a road to take, and for most boards and managements -- they are positioned to make the right choice at the crossroads. We believe boards and managements should pick a road for prosperity, because doing nothing is marginalization or, worse, underperformance failure.

Gary Steven Findley, Editor