LEARNING FROM BANK TURNAROUNDS

Here are 10 success factors underlying most turnarounds of operations and earnings.

by **J. MICHAEL FEEKS**

How do some community banks manage to go from near-failure to above-average ROAs and ROEs in a matter of a several years? How do mediocre performers achieve top-tier financial performance in similar timeframes? Generally speaking, there are at least 10 success factors underlying most turnarounds of operations and earnings.

1. Planning pragmatically

Turnaround plans are qualitatively different and more urgently implemented than typical business plans. Effective turnaround plans share a number of attributes:

A clear vision—If some members of the board and management envision a "full-service, high-performance community bank" and others have in mind an approach to "sell the bank," it is unlikely that either strategy will be implemented successfully. With the managerial workload and intense pressures involved in a turnaround, it is clear that all concerned need to be pulling in the same direction.

Detailed financial plans—In his bestseller *The 7 Habits of Highly Effective People,* Stephen Covey counsels us to "begin with the end in mind." He cites the example of building a house where details are blueprinted before the first nail is hammered.

At a community bank, beginning with the end in mind means developing pro forma, multiyear financial statements showing what the bank should look like when the turnaround is complete. Management then works backward to determine what is needed to make that vision a reality. For example, to achieve a target ROA of 1.50%, the bank may need to establish a number of supporting goals such as an efficiency ratio of 55% or a ratio of noninterest income to assets of 2%.

Once such goals have been established, alternative strategies for reaching them need to be considered, then translated and tested in financial terms. In so doing, management learns: What can we afford to do? How soon? What are the best opportunities? As strategies are finalized, the next steps involve the creation of detailed implementation plans.

Clear priorities—With so much to be accomplished in a turnaround, emphasis must be placed on doing the right things, as well as doing things right. For example, exceptionally high priorities may need to be established for fully complying with regulatory orders, reducing nonperforming assets, or improving management in key spots. A bank with serious problems can ill afford to squander precious resources on "nice-to-have" projects or activities.

Clear accountabilities—Since many turnaround tasks are complex, interdependent, and need to be accomplished with great urgency, managers throughout the bank need to know who is doing what with whom and when. For example, loan officers need to know the types and volumes of loans that are consistent with the plan; branch administrators need to know how much and how soon direct expenses must be reduced. Accountabilities need to be firmly fixed, in writing.

An inclusive process—Plans should not be developed or monitored entirely on a top-down basis. The best strategies and results are achieved when managers throughout the organization are involved in the planning process and buy into what needs to be done.

2. Assuring the needed commitment from directors

Especially in turnarounds, both management and regulators look for clear direction, active involvement and strong support from an undivided board. Where directors are not unanimously committed to a well-reasoned turnaround plan, management's focus and morale inevitably erode and regulators' surveillance and controls increase. Regardless, beyond the requirements of normal corporate governance, directors need to be prepared for regulators to mandate higher levels of involvement and responsibility, especially if the bank is required to enter into some form of supervisory agreement.

3. Building and empowering a team

There is no place on a turnaround team for marginally effective players, micromanagement or bureaucratic processes. At the outset, the board and top management need to assure that there are highly capable managers in each key position and that the team is empowered to move decisively.

4. Keeping good relationships with regulators

Far too many regulatory relationships turn adversarial when a bank encounters serious problems, thereby slowing the turnaround process and making it more stressful. Bank management needs to understand that examiners are charged with higher levels of surveillance in troubled situations and are required to develop more detailed knowledge of the bank's operations. Considering their stake in the bank's health as well as their expertise, regulators should be treated as partners in the turnaround process. Cooperative compliance is imperative.

5. Accelerating workouts

Savvy turnaround managers know the *real* cost of nonperforming assets (NPAs). In addition to creating net interest income shortfall, chargeoffs, and an expensive workout department, sizable NPAs consume management attention and detract from the bank's reputation. Banks need tailored workout plans for each sizable exposure, a capable workout staff, a sense of urgency, and the courage to take decisive action—including the possible sale of some portion of the portfolio at discounts beyond those already taken.

6. Maintaining policies, procedures, and controls

When fighting fires, it is easy to forget that failure to maintain sound policies, procedures, and controls can be devastating to a bank. We have all seen situations where failures in these disciplines have resulted in substantial writeoffs, assessments of monetary penalties, special regulatory agreements, and management shake-ups. For example, banks have been penalized in recent months for inadequate anti-money-laundering programs, accounting irregularities, and failure to maintain appropriate risk management practices. Such events tarnish a bank's reputation through adverse publicity that continues for months. Considering the severe penalties for failure in these disciplines, banks need to assure that their policies, procedures, and controls are thoroughly reviewed on a regular basis and are maintained at best-practice levels.

7. Monitoring relentlessly

Board and top management need to be committed to a thorough, ongoing process for tracking and reviewing results compared to the plan and assuring a disciplined execution of strategies. In addition to regularly making sure plan implementation is on track, the benefits of these reviews include raising the confidence levels of regulators, directors, and employees. This approach also is effective in managing their expectations and galvanizing day-to-day support.

8. Selling persistently

In addition to developing and implementing turnaround plans, the most effective management teams regularly "sell" the plan to the people involved in making it happen—directors, employees, shareholders, customers, and the community. These constituencies need to be reminded frequently of what the bank is determined to accomplish and how important their strong support is to the cause.

9. Communicating constantly

Typically, there is no shortage of rumors in an organization with problems. We recommend preempting the grapevine, acknowledging the problems, and communicating to the point of near overkill. Morale will be better; so will productivity. In addition to keeping employees informed on the turnaround progress through frequent meetings, e-mails, and newsletters, many banks have benefited from devoting similar attention to regulators, customers, and other members of the bank's community. At every opportunity, management needs to point out the milestones and celebrate the victories.

10. Assuring adequate resources

Most banks are staffed for normal operations. If management is dealing with regulatory orders and implementing a turnaround plan, it will need additional help. Directors and management tend to underestimate the resources needed to simultaneously run the bank, fix the bank, meet additional regulatory requirements, and communicate with all constituencies to address concerns about the bank's problems.

There is no *One-Minute Manager* for turnarounds. In our work with banks, we have seen that such efforts require vision, leadership, teamwork, and unremitting dedication to implementing a plan. We also have seen that the 10 success factors above are the common threads in management practice for nearly all the successful turnarounds. We strongly recommend them as a checklist for any board or management targeting dramatic improvement in bank performance. **|BD|**

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