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Community Banking: A Culture Shift

Professional Case Study

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Abstract

Community banking has long been a competitive and highly tumultuous industry. This paper examines the shift in cultural identity that a Southern California community bank attempted to undergo in response to the financial crisis of 2007. Special focus will be on the leadership of the change process by senior management, and the change process itself. Developing a strategy that would increase the employee's professional knowledge, reduce dependence on high-cost, single product deposit relationships, and expand business deposit relationships would prove to be a challenging and demanding task. Simultaneously transitioning from a reactive, customer service-focused environment to a proactive, sales-driven dynamic team would prove unattainable. The following is an examination of the collapse of Vineyard Bank.[1]

[1] The author was a manager at Vineyard Bank from early 2007 until July, 2008 (1 year before its collapse) and has no financial or material interest in the success or failure of the bank in its current or previous organizational forms.

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In early 2007, banks in affluent markets began experiencing a decline in real estate values and an increase in commercial loan defaults. By the end of the year, the crisis had spread across the nation and the country was in a financial crisis spurred on by the popping of the housing bubble. This narrative begins in early 2007 when senior management decided that action needed to be taken to remain competitive in the declining market.

History

The bank was founded in the 1980's as a community bank for residents of the Inland Empire, a primarily working class region east of Los Angeles, CA. The bank prided itself on hiring local talent, and allowing people of all educational and professional backgrounds to "work their way up" by starting as tellers and eventually becoming managers toward the end of their careers. The staff was generally less educated in business and formal education than other competitors, but made significant gains in market share by focusing on customer service and personalized banking for the residents of the area. Through the late 1990's, assets remained stable and the bank hovered around assets totaling 100 million. Then, in 2000, the bank hired on a new CEO to lead the bank into the new millennium. As a local business man with little banking experience, the new CEO stepped up to expand the bank's holdings through acquisitions and by offering exceptional interest rates on high-cost deposit products in the hopes that the bank would acquire the complete banking relationship of that customer lured in by the attractive interest rates. By the end of 2006, the bank had assets totaling 2.3 billion (Vineyard Bank, 2007), twenty-three times the amount just 6 years earlier, and approximately twenty branches scattered around the most affluent areas of California. Operations were heavily dependent on deposit relationships, brokered deposits, and construction lending. The bank essentially made money

acquiring high-cost certificates of deposit (CDs) by offering high rates of return to private individuals (rate shoppers) and brokers (who left upon maturity for higher rates elsewhere) and lending that money out at even higher interest rates on commercial loans, specifically residential construction lending. The potential for profit seemed infinite.

Challenges

The bank was forced with a choice – should they continue to operate as they had been with hopes of the explosive growth experienced in the recent past, or should they shift their business strategy and corporate culture to become more competitive and increase core relationships with their clients. The choice was easy and the bank set off to shift the culture from a localized community bank focused on customer service to a team of professional business bankers focused on large corporate relationships and efficient branch operations. The challenge was multifold – retrain a branch network of employees to shift their focus from service to sales, realign the policies of the bank to support the development of profitable relationships, absolve its self-imposed responsibilities to service low-income, residential clients, refocus its efforts in commercial lending and private banking, and recapture its non-performing assets.

Approach

The bank's senior management decided that it would be best to immediately de-incentivize the sales of personal products that diverted resources away from private banking and commercial sales activities. However, they were unable to immediately develop a plan to increase compensation for the sales of commercial and private banking products, which led to a dismal performance in the first half of 2007. With their sales slowing, their core competency of personal products floundering, and losses on construction loans continuing to mount, management decided that it would be best to re-educate the staff on business matters, such as

how the weighted average interest rate affects the profit margin, how the bank is able to loan money, and what is needed to maintain healthy financial operations with the organization. They instituted this practice from the top down and failed to make the connection that most of the employees were unable to link the types of products sold with levels of profitability. The losses continued.

During analysis conducted in the second half of 2007 (of which the author was a part), it was determined that the employees were confused about their role in the organization. They (generally) did not have the educational background to understand the secondary market, cost of funds, and the types of performance needed to sustain branch operations. In a profitability report, one branch manager (who had a 4-month average patronage of 14 clients per day on Saturdays) recommended that her office remain open on Saturdays "to service the clients" who needed to cash their checks. That attitude was a microcosm of the bank's employees and branch managers who were unable to visualize the types of changes needed to increase profitability. The change continued with the implementation of regular informational seminars conducted by various SVPs on their area of expertise, mentoring sessions with each branch manager on professional development, and the incentivizing of low-cost deposit relationships. The bank also reorganized its branch and sales team structures to be more conducive to developing business relationships.

Outcome

Beginning in late 2007, the bank experienced high turnover among the experienced and successful managers who were frustrated with the other employee's unwillingness (or inability) to recognize the need/cause for change and able to obtain positions at more stable banks. This left the bank with a group of employees who were unable to leave because their professional qualifications prevented them from doing so (uncommitted low performers) and those who were

simply unaware of the need to change at the organizational level (committed and professionally incompetent). After nearly two years of attempted cultural changes, the bank saw minimal shifts in culture and retained a core set of employees and low level managers who perpetuated the status quo. As a result of the inability to shift the culture and performance of the bank as a whole, the bank slowly sold off its assets and branches at a loss to cover its Non-Performing Assets (NPAs) and was eventually seized by the FDIC on July 17, 2009.

Analysis

Deciding to shift cultures within an organization can be a challenging and frustrating decision. The need to make a shift was clear in this case and the proponents of change made a strong argument. Unfortunately, there had been long-standing cultural attitudes that supported the status quo and were unable to mold to fit the changing times. Examining the series of choices that management made in chronological order will best assist in identifying a trend in culture-based performance. Beginning in 2007, assets holding strong and tangible business results led to the decision to remain focused on the core competencies of personal banking relationships. (These would later be determined to be inaccurate foci for the bank moving toward sustainability)

Lack of Organizational Commitment

Porter, Steers, & Mowday (2007, p. 178) describe the stages of organizational commitment and focus on how the commitment is perceived by the employees at each stage. The “anticipation stage refers to the pre-entry stage of employment with an organization” (Porter, et al, 2007) in which the employee decides if the value of the organization are commensurate with their own. For the employees currently employed at the bank, their values (as demonstrated, articulated, and documented) revolved around the desire to assist their community and to “not

have to sell their clients" on the products of the bank. In the beginning when they[2] first joined the bank, their values aligned perfectly with those of the community bank setting and they were allowed to perform in a manner that was for the betterment of the clients and not the bank. Little pressure was ever applied to these employees to meet performance standards and sales goals were not required. Moving to more recent years, these same employees had trouble understanding 1) the need to change and why the bank was unable to continue operations as it had done for years, and 2) that this shift in culture was a decidedly permanent decision made by management.

As a result of the lack of organizational commitment, there became two factions of the organization who grew in opposite directions as the culture shift began. The first faction, established branch managers who had a proven track record of high performance (but chose to remain with the organization as referenced above with those who left) effectively separated themselves from the organization by neglecting policy changes, running self-developed media campaigns, and opening the types of accounts that management specifically instructed them not to because it did not meet with the greater, organizational strategy. These managers were geographically separated from the cluster of core branches and headquarters and were located in the more affluent coastal areas or Northern California. This autonomy led to their history of "fending for themselves" in competitive environments and encouraged them to break from the corporate culture shift. This faction maintained profitability even in the harshest of times. The second faction consisted of those who were loyal to the organization's headquarters unit and did not know how to alter strategy to become profitable and competitive. These branches focused on adjusting strategy exactly as ordered and largely missed the concept of profitability in terms of

[2] "they" is used as a term for the majority of employees hired into the bank over the past 20 years who had worked their way up, not previously experienced change in the bank setting, and had strong cultural, ethic, or social connections to the communities they served.

banking relationships. The problem existed, as Lewicki and McAllister pointed out (1998), that management trusted and distrusted each faction oppositely. Management trusted the first faction to accurately acquire profitable relationships and low-cost deposits, but distrusted them to follow the directions given and adhere to the singular corporate strategy. Alternatively, management trusted the second faction to follow directions, but distrusted them to independantly make decisions on banking relationships[3] and loan applications. Lewicki and McAllister further point out ”that rational behavior (from the organization’s standpoint) can be enabled by creating work environments where... there is a match between individuals skills and job requirements.” (1998) In this case study, it is clear that there was a discrepancy between the skills of the employees and the job requirements as evidenced by the inability of new accounts representatives/personal bankers to sell and to only service, or by the inability of branch managers to recognize profitiblity among operating hours.

Poor Strategic Operations

For a team of employees who was uncomfortable with a change in culture and operating standards, reassurance is required. In order to develop trust, a demonstrated history of performance needs to be met at every stage of the change execution. Once the employees made the first step in the direction of change, poor strategic operational choices deflated the momentum that had built up surrounding the new education and training. Newly (re)trained employees hit the branches with first-time ever sales goals and made significant impacts on the asset level of the bank by acquiring new deposits. Unfortunately, simultaneously the management was entering negotiations to sell the most profitable branches to raise capital. These

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[3] “banking relationships” is used here to mean which relationships would be profitable, and thus, should be pursued as compared to those relationships that were not profitable and would end up costing the bank money indirectly as a result of service costs, personal service from the employees, and expansive processing of back-office negotiables, such as: checks, items, deposits, coins, wire transfers, etc.

branches (those referred to above as the first faction) were mainly on the coastal areas where there was little corporate presence and they traditionally catered to a more select and affluent community concerned with private banking services, reputation of the bank, and commercial loans. They were profitable. Because they were relatively isolated and operated product lines dissimilar from the core branches, management thought it to be a cost-saving idea to sell them to improve the balance sheets. Unfortunately, the overall impact to the total assets was a reduction in both loans and deposits – and sustainable profits. This is what Senge refers to when he states that "the same action has dramatically different effects in the short run and the long" and "conventional forecasting, planning, and analysis methods are not equipped to deal [with dynamic complexity]." (2005, p. 442) The newly (re)trained employees viewed this as a negative event because their incentives were tied to the overall asset/capital structure of the bank as a whole – a loss of net assets at the end of the monitoring period meant that all the branches would not meet their sales goals, and thus, not be compensated. This was a very different outcome than what the employees expected as a result of their hard work and by selling a bank asset for a profit. Incorporating a systems theory approach would be an opportunity to evaluate the complex interactions among processes that fall into play when determining compensation and would be an opportunity to examine the repercussions of a single action in the long and short runs. In this case, the complexity of the situation with its dynamic and detailed complex relationships, led to "Fear, Uncertainty, and Doubt", or the FUD Factor as Pietersen (2002) points out, among the employees who were already dealing with the affects of the change process.

Conclusion and Further Research

Labeling a single theory, theorist, or concept as a solution to a complex problem is traditionally superficial, but in this situation, a systems theory approach would have been very

useful. The inability to successfully mesh the external environment (in which the organization had little influence on) with the internal strategies resulted in significant losses to stakeholders, employees, and clients. The desired shift in culture was undertaken in a way that expected understanding in a concept (profitability) that was previously unknown to the employees and lower level managers of the organization. A narrow analysis of operations was undertaken to develop a strategy to overcome significant external obstacles without regard to their impact on current or future operations. This, coupled with the inability to promote a mutually beneficial and committed relationship between the employees and the change model, led to the failure of cultural transformation.

The research on systems theory is being widely researched and expanded, but the focus on how limited thinking led to the meltdown of the financial services industry would be beneficial. It is hard to definitively connect or disconnect external events within the universe of decisions made by the organization under study without additional research on how systems theory can be implemented into a chaotic, and unpredictable, external banking environment. It will be years before the relationships can be mapped and defined that led to the financial crisis in 2007.

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