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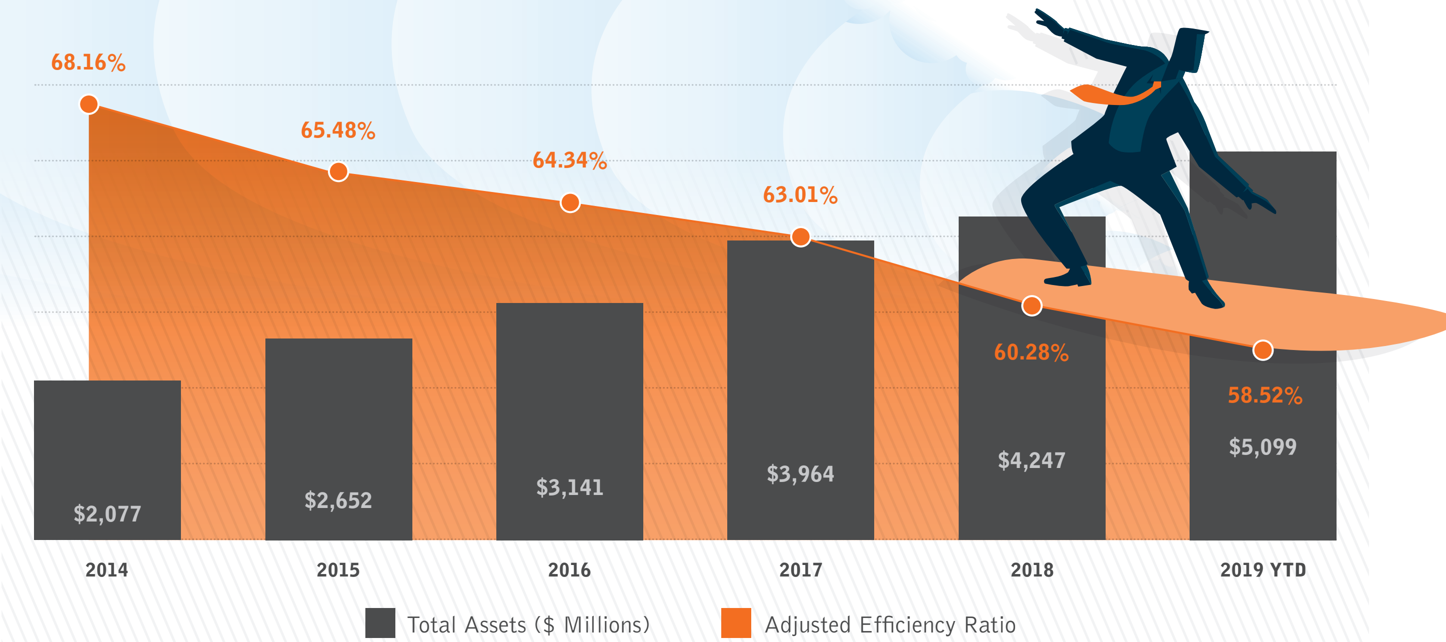
MARKET INTELLIGENCE

The Virtues of Growth

Horizon Bancorp's efficiency ratio has consistently improved as the bank has grown larger through a series of acquisitions.

Source: Horizon Bancorp



Bigger Is Better (Again)

Twenty years ago, the mantra in banking was that "bigger is better" – that size alone was a virtue. The rationale back then will sound familiar to bankers today.

"Two years ago I thought we could survive," said Gerry Cameron, chairman and CEO of U.S. Bancorp when it merged in 1997 with First Bank System. "Then I started to realize how many technology projects we had to delay because we didn't have enough resources."

No one revered scale more than Hugh McColl, the chairman and CEO of NationsBank at the time. It was McColl who, upon announcing NationsBank's merger with BankAmerica Corp. in 1998, proclaimed that "bigger is, indeed, better."

It was, that is, until it wasn't.

Size translated into scale, yes, but as time went on it became clear that it didn't translate into shareholder value.

"I'm at a loss to understand why reporters continue to view Hugh McColl as a banking-industry genius," Tom Brown, the founder and CEO of the hedge fund Second Curve Capital, wrote years later. "He's anything but: As a result of the enormous bank-buying binge he [embarked on] starting in the mid-1980s, McColl is arguably responsible for perhaps more value destruction than any executive in stock market history."

The problem of too-big-to-fail banks in the financial crisis only fueled arguments against scale in banking. Bigger was definitely not better.

But now it is again.

Last year's merger between BB&T Corp. and SunTrust Banks, creating the sixth biggest commercial bank in the country, was predicated on the argument that scale was needed to fuel technology investments.

"Individually, we are strong," said BB&T's Chairman and CEO Kelly King. "But together, we will be best-in-class. We will be able to leverage our scale to create capacity for incremental investments in technology to create a sustainable competitive advantage."

Big banks aren't the only institutions that think this way; smaller banks do too.

Bank Director's 2020 Bank M&A Survey, starting on page 36, highlights Midland States Bancorp, a $6.1 billion asset bank based in Effingham, Illinois, which has grown more than 10-fold over the past decade thanks largely to nearly a dozen acquisitions.

Another example is Horizon Bancorp, a $5.2 billion asset bank based in Michigan City, Indiana. It has used 14 acquisitions to grow to its current size from just $587 million in assets going into 2002. Its strategy is summed up in the chart on the previous page showing that, as Horizon has grown, it has also become more efficient.

Analysts have argued for years that scale works in banking until you get to a certain size and then the benefits begin to diminish. Banks like Midland States and Horizon are right in the sweet spot based on this logic, where size and shareholder value can grow in tandem.

But technology may be testing this theory now. Even big banks like BB&T with long histories of outstanding performance see scale as an urgent imperative.

Bigger is better, again.

Size Matters

The role that technology has played to spur consolidation in banking isn't new; it influenced banks' calculus to merge two decades ago just as much as it does today.

Yet, the potency of the influence has grown more acute. You can see this by looking at a collage of trends at the nation's biggest banks: Digital customers exceed 51 million at JPMorgan Chase & Co., more than three quarters of deposits at Bank of America Corp. are now completed without a teller, and teller and ATM transaction volumes at Wells Fargo & Co. have dropped by 16% since 2016.

New innovations from companies like MX, which offers a popular data platform for financial service companies, will only accelerate these trends. "Together with our banking and credit union partners, we're making it easier for consumers to better manage their finances and take control of their financial future," says Jane Barratt, chief advocacy officer at MX.

Technology also introduces new risks to the banking industry. It used to be that banks were principally concerned with interest rate and credit risk. If they nailed those two things and ran an efficient operation, they could consistently earn a comfortable profit.

This is no longer the case. "I think the biggest risk in the [financial] system today is a successful cyberattack," noted Sullivan & Cromwell Senior Chairman H. Rodgin Cohen last year. (Cohen is the subject of this issue's cover story.)

"That is a very serious risk, but I think the more likely [danger] is that a single bank — or a group of banks — are hit with a massive denial of service for a period of time, or a massive scrambling of records," Cohen continued. These are very real risks, as we learned with the cyberattack on Capital One Financial Corp. in 2019.

It's a digital world; banks are just living in it.

John J. Maxfield is executive editor of Bank Director.

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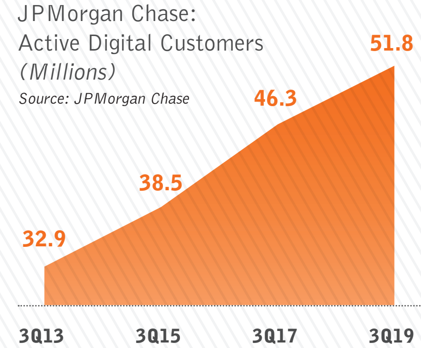
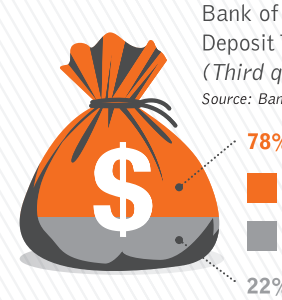
This column is sponsored by MX Technologies, provider of a data platform that's used by leading financial institutions to collect, enhance, analyze and present customer financial data.

The Digital Banking Revolution in Three Acts

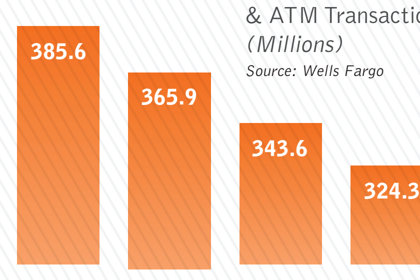
JPMorgan Chase:
Active Digital Customers
(Millions)
Source: JPMorgan Chase



Bank of America:
Deposit Transactions
(Third quarter 2019)
Source: Bank of America



Wells Fargo: Teller & ATM Transactions
(Millions)
Source: Wells Fargo



As seen in the 1st Quarter 2020 issue of *Bank Director*