



## The Bank Holding Company Concept: A Best Practice for Credit Unions?

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## Thoughts from 60 Years Ago (*Centralize, or Decentralize?*)

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"If we can agree that the economic problem of society is mainly one of rapid adaptation to changes in the particular circumstances of time and place, it would seem to follow that the ultimate decisions must be left to the people who are familiar with these circumstances, who know directly of the relevant changes and of the resources immediately available to meet them.

"We cannot expect that this problem will be solved by first communicating all this knowledge to a central board which, after integrating all knowledge, issues its orders. We must solve it by some form of decentralization. But this answers only part of our problem.

"The 'man on the spot' cannot decide solely on the basis of his limited but intimate knowledge of the facts of his immediate surroundings. There still remains the problem of communicating to him such further information as he needs to fit his decisions into the whole pattern of changes of the larger economic system."

**–F.A. Hayek, *The Use of Knowledge in Society* (1945)**



# Charles Handy and Federalist Concept

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- Federalism seeks to be big in some things and small in others, to be centralized in some respects and decentralized in others
  - It aims to be local in its appeal and in many of its decisions, but national or even global in scope
  - It endeavors to maximize independence provided that there is necessary interdependence
  - It should be lead from the center but managed by the parts
  - It is messy, untidy and always a little out of control. Its only justification is that there is no real alternative in a complicated world.
  - No one person or group is so all-wise to be able to balance the paradoxes on their own or run the place from the center
  - No one in a federal organization can have exactly what they want



Charles Handy - The Age of Paradox

# The Tenth Amendment of The Constitution

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“The powers not delegated to the United States by the Constitution, nor prohibited by it to the states, are reserved to the states respectively, or to the people.”





## Lessons from franchising

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- In franchising, the business format is the product
- Franchise fees typically range from 4% - 6% of revenues, depending on the product and services provided
- Franchisers typically give franchisees a menu of standard product offerings. Local franchisees typically choose which of these standard products to offer based upon local market demand and conditions.
- The franchise chains most successful utilize a combination of franchisees and company owned stores
  - Company owned stores are better at maintaining standards and piloting new corporate initiatives; however, the average company store manager lasts 18 – 24 months
  - Franchisees are more adaptive, often more profitable and more blunt about their feedback; franchisees typically sign 15 – 20 year contracts



# Lessons from Franchising

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- Maintaining uniformity and local responsiveness grows more difficult as a chain expands into new and more varied markets
- Managing franchisees is different than managing company stores. Company stores are managed by district supervisors who “tell” store managers what to do. Franchisees are interfaced with by franchise consultants who “sell” ideas, concepts and maintenance of franchise uniformity.
- The key way franchisers manage franchisees who do not follow standards is to restrict their growth of outlets
- Multi-unit franchising is the key to managing a franchiser's scope of growth. Existing franchisees add more units each year than are added by new franchisees.
- Chain operators acquired franchisees when they failed to develop a market to its fullest potential



# The Network Organization

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- Network organizations are generally divided into business areas, areas of expertise and support areas
- The corporate group must facilitate the creation of a more effective internal network. It is the broker of capabilities within the organization.
- The system operates independently of hierarchies and organizational charts
- Each piece of the network must add value, or it's dropped from the network. The network itself must add value or it ceases to exist.
- Best practices and knowledge flow freely, finding their most productive use
- The responsibility for managing and deploying capabilities lies with the Business Units. Corporate mission, corporate standards, corporate design are executed on a local basis.
- Each layer of the firm is exposed to the market and clear performance feedback



# What Drives a Network Organization?

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- Corporate standards that limit the need for continuous cross functional teams
- An emphasis on standard and very brief (limit 2 pages) written communication that:
  - Identifies an issue
  - Presents key information
  - Offers recommendations
- Meetings are only held for outstanding disagreements requiring negotiation; decisions are documented and shared
- Every area of the company operates with simple menus, checklists and milestone project plans to keep the interfaces very simple between functions
- Best practices and business tools are aligned across functions so that they integrate and reinforce each other (e.g. common referral management approach)
- Corporate intranets become the lifeblood of the company – a source of trusted, reliable information and support



# Examples of Network Type Organizations

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## ■ **General Electric** (and GE Financial)

- Decentralized business units bound by common planning and strategy discipline
- GE's central product is management
- Shared administrative/operations resources across business lines
- Common operational tools such as Six Sigma and WorkOut
- Large degree of management rotations and best practice sharing among groups

## ■ **Visa**

- Described as a “chaordic” organization – a non-stock, for-profit membership corporation; ownership is in non-transferable rights of participation
- Designed to blend cooperation with competition
- Cooperatively and equitably owned
- Multiple boards of directors with jurisdiction over certain areas or activities

## ■ **ABB**

- Highly decentralized European power conglomerate famous for “blowing up” its corporate headquarters staff in the late '80s
- In 2002, faced with mounting debt, complex organization and legal claims, the organization has to cut back, consolidate and refocus



# Who Are Best Practice Bank Holding Company Models?

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## ■ Synovus

- \$35 billion company headquartered in Columbus, Georgia
- 41 separate bank charters across five states
- Centralized back office and administration
- Also owns large credit card processor (TSYS)
- Regularly recognized as “Best Place to Work” in America



# Who Are Best Practice Bank Holding Company Models?

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## ■ Zions Bancorp – \$35 billion

- Operates with six different bank charters (Utah, Colorado/New Mexico, California, Arizona, Nevada, Washington)
- Only Utah has the Zions name in branding with no real attempts at dual branding
- Just purchased Amegy Bank as beachhead in Texas
- Recently standardized systems environment, but state-level franchises have high degree of autonomy
- Has developed some niche businesses in Check 21/ correspondent banking services (Net Deposit)



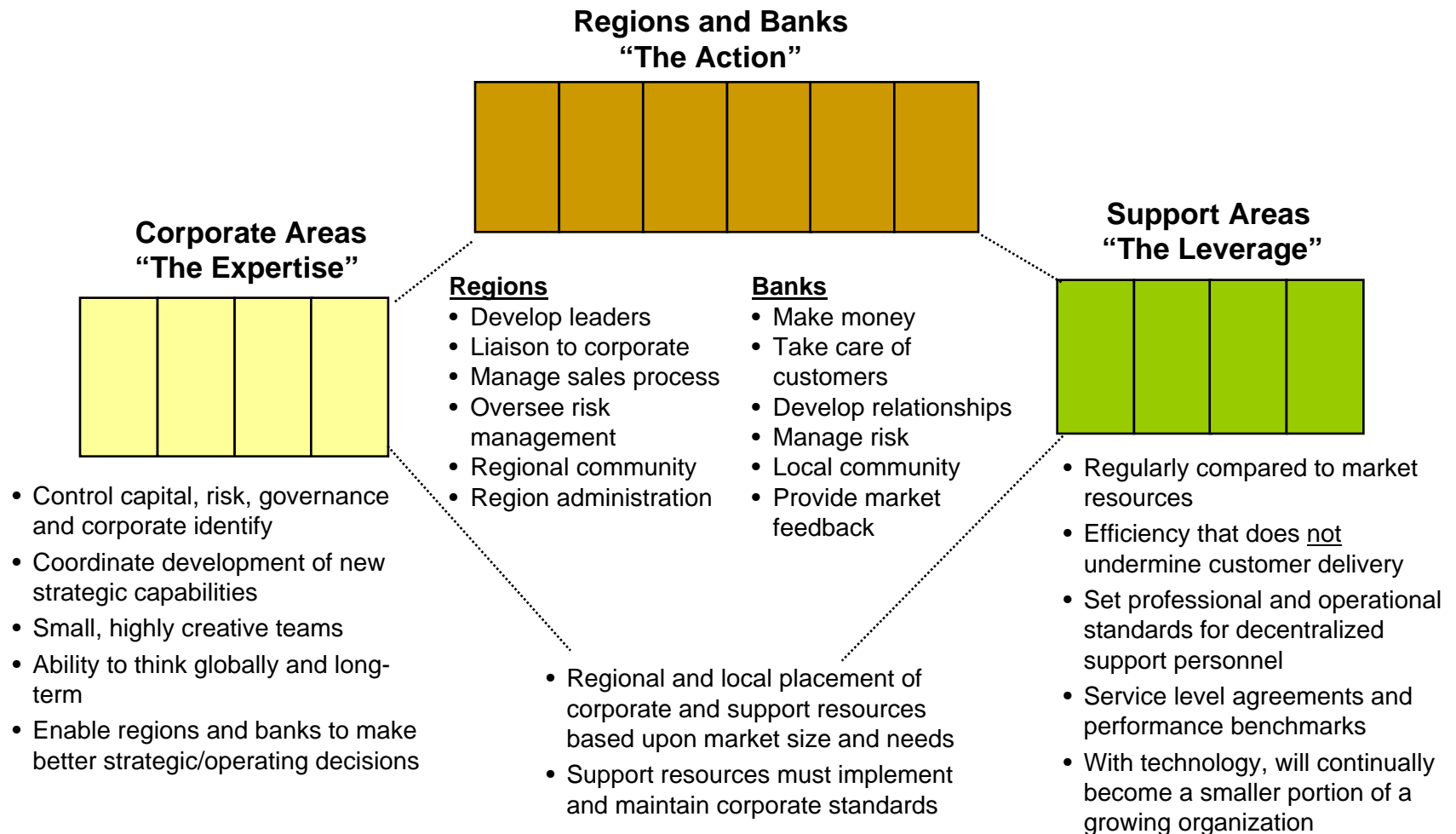
# Who Are Best Practice Bank Holding Company Models?

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## ■ Capital Bancorp

- Started by Michigan entrepreneur Joe Reid
- The company is a bank creation machine
- Takes a majority interest in each “*de novo*” bank started
- Raises local capital from board, management, investors
- Investors have option to sell their shares back to Capital after three years at a pre-set price
- Each bank has its own community bank brand and many compete in the same market
  - Phoenix has 5 – 6 Capital Bancorp subsidiaries
- Common back office functions, but still a large degree of local bank autonomy
- The model does provide entrepreneurship, but has trade-offs
  - Convenience is not provided with a common branded branch system
  - Participating larger loans due to legal lending limits can be cumbersome

# Architecture of a Successful Holding Company



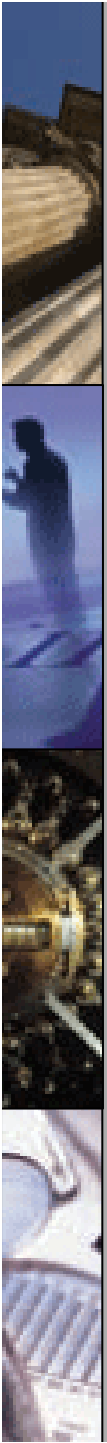
# Comparison of Integrated and Vertical Business

## ■ Integrated Business Area

- Value from integration is greater than autonomy
- Front-line employees work for the region
- Operational employees work for the operations group
- Dotted line coordination to the Corporate Business Area
- Integration efforts are delivered through a common front-line and back-office infrastructure
- Regional profitability drives performance measures
- Business area performance is viewed both financially and non-financially
- Corporate cost allocation systems are significant

## ■ Vertical Business Area

- Value from autonomy of the Business Area is greater than integration value
- Front-line and operational employees report directly through business line but may be placed physically in the region
- Integration efforts are coordinated on a “dotted line” basis
- Business area performance drives profitability
- Referral credits and shadow accounting become significant efforts
- Examples might be brokerage, trust, insurance, auto buying



## History Tells Us Holding Companies Often Consolidate the Model

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- Barnett Bank (FL) – Now part of Bank of America
- Banc One (OH) – Now part of JPM Chase
- First Interstate (CA) – Now part of Wells Fargo
- Bank IV (KS) – Now part of Bank of America
- Sun Trust (FL) – Still independent but more centralized

### ***Why Does Consolidation Occur?***

- Financial opportunity for efficiency becomes tempting
- Complexity becomes unwieldy
- Regulatory burden is higher
- Organic growth slows and shareholders become impatient



# Elements of Successful Holding Company Operations

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- Product standardization
- Centralization/standardization of back office functions
  - Reduce complexity as much as possible (e.g. bank routing # and credit card BIN numbers)
- Strong benchmark metrics and service level agreements to drive internal productivity and collaboration
- Common management and performance reporting
  - Promote competitive spirit among different divisions
- Common employee development and certification standards
- Active intranet, video conferencing and distance learning
- Effective dual branding approach
- High energy corporate events and internal branding to build the culture
- Entrepreneurial compensation models
- Collaborative bottom-up/top-down planning and governance processes