

# The remaking of America's banks

*In the next few years, the U.S. banking industry will undergo its most profound restructuring ever.*

BY SUZANNA ANDREWS



*BONY's Bacot: His hostile tender for Irving Bank Corp. dramatized the new realities in the industry and ushered in an era of predatory banking*

American commercial banks have a choice: They can change, or they can die.

Understand this, and you have a framework to order the riot of events in this industry — the hundreds of businesses sold and shuttered, the brawls over bad loans, the brutal hits to capital, the debt rated little better than junk, the thousands of people fired. Commerce, like biology, has an evolutionary theater, and bankers hold center stage right now in what will be one of the most remarkable transformations ever of a corporate species.

Richard Fredericks, a bank analyst at Montgomery Securities, calls it the age of Darwinian banking, in which powerful companies — well-capitalized, sharply managed — devour weaker ones or drive them out of business. He sees a world where proud old names fall prey to vigorous upstarts. Managing director and analyst Thomas Hanley of Salomon Brothers

believes the industry restructuring now in process is so fundamental that no issue — not even LDC debt — can be understood apart from it. The transformation, he says, “will frame any debate in banking well into the 1990s.”

Some bankers are thrilled, some are terrified; but all are aware of how much the world has changed in the two decades since they closed ranks to thwart Saul Steinberg's ungentlemanly assault on Chemical Bank Corp. They discuss the changes in remarkably candid terms, acknowledging the industry's many mistakes: too much leverage, ill-considered global expansion, bloated expenses and, at nearly every major bank, a complete absence of direction. “A very few years ago,” confirms First Interstate Bancorp chairman and CEO Joseph Pinola, “none of us had any strategy at all.” Security Pacific Corp. chairman and CEO Richard Flammson III is even blunter: “You can't be in

this business and be dead from the neck up anymore.”

## Elemental forces

The task confronting those who run banks is immense. It isn't enough for them merely to *react* to the elemental forces sweeping through the industry — to sell a division or two or adopt this scheme for bad loans and that one to meet new capital requirements. Rather, they need a far deeper understanding of their current businesses, a vision of the future and a strategy for turning the banks they have now into organizations that can thrive in a harsh new world. Although the restructuring so far appears limited to the nation's biggest banks, the forces of change could soon sweep the midsized superregionals into the vortex. Those who want to prevail “are worrying about staying healthy,” says SunTrust Corp. president Joel Wells. “We see the bodies scattered on the landscape

# "I told Robinson you're better off owning 60 percent of something properly financed than 100 percent of something you're strapped owning."

nine months or even a year of tough times for the industry, we'll still be much better off for having done it."

The increased capital from the Nippon deal and the behemoth operations facility gave Shearson a confidence, even cockiness, going into the bidding that no other aspirant had. Shearson saw itself as almost *destined* to win Hutton, if for no other reason than the sheer complementarity of the two firms. Explains Lane: "All of the things that were negative to Hutton" — such as its relatively weak investment banking and trading operations — "were unimportant to us, so we were only paying for that which we wanted to buy. The only part that was irreplaceable to us was the retail system; the money management operation was a wonderful add-on. And no other player could get the synergies and the economies we could get."

While a number of potential bidders — Dean Witter Reynolds, Weill's Commercial Credit, Equitable, Transamerica Corp. — circled around Hutton, the one that was most worrisome to Cohen was Merrill Lynch. "If Merrill had acquired Hutton," says capital markets chief Freiman, "they would have had 17,000 account executives. They would have been unchallenged for decades to come." But to Cohen's surprise, and relief, Merrill never made a serious run.

"I have to tell you," confides Cohen, "I thought they were the ones who were our toughest competition and should have been the ones to buy it. But I'm the only one around here who seems to think that. Everyone else here was worried about Dean Witter and Pru-Bache because of George Ball — maybe he'd get Prudential to write a big check. And I said forget it. It turns out I was wrong, but we were all wrong."

## The hard part

Shearson, in fact, emerged as the only serious bidder (see box, page 88). The negotiations, indeed, were the *easy* part. No sooner had the ink dried than Cohen and his colleagues had to scurry around the country to ensure that the franchise they had just spent \$961 million for — the 6,500-strong Hutton sales force — wasn't picked apart by vulturous competitors. They offered bonuses, but at the same time made it clear that the brokers would have to accept Shearson's lower payout schedules. The palmy days when the brokers ruled the roost at a foundering firm were over.

Retail chief Simmons says that 310 Hutton brokers have opted to jump ship, mainly for big bonus offers from other firms, "and considering that the normal attrition rate in this business is 14 to 15 percent, that's pretty good." Meanwhile,

in an effort to calm the waters, the firm is soft-pedaling branch consolidations; "there will be some consolidation in smaller offices, but our intention is to consolidate no major city branches," says Simmons.

## Ruthless Huns

The aspect of the Hutton deal that has attracted the most public attention, of course, has been the layoffs: Between 5,000 and 6,000 people — mostly in investment banking, capital markets and operations, and mostly from Hutton — lost their jobs in the merger. While the popular image of Shearson in all this is of a band of ruthless Huns sacking Rome and taking no prisoners, both Cohen and Lane insist they were acutely sensitive to the human toll. "It's a gut-wrenching experience," says Lane. "As long as you remember there are people involved, it's terrible. That's 6,000 people, and they have families, and they have children. The corollary, of course, is that if you don't do it, both firms are in trouble."

Once the Sturm und Drang of the takeover has passed, the challenge for Cohen and his aides will be one of making the most of the formidable machine they have built. To some observers, including some of Cohen's subordinates, this will mean, among other things, an inevitable drift to greater bureaucratization, à la Merrill Lynch, with all the dangers that implies. What has been impressive about Shearson's growth so far is how *little* the firm has been bureaucratized, at least on the upper levels.

Indeed, there are aspects of the place's management that harken back to CBWL days. Lane, for instance, personally signs off on every single raise; before the Hutton acquisition, that meant going through 27,000 raise requests. ("If you only sign the big ones, you lose touch with what the numbers really look like," he explains.) In job interviews, prospective high-level hires are likely to find themselves bystanders as Cohen and Lane argue with each other over the questions. In Robinson's words, "If they do have differences, they don't let it kind of build up; they'll get in the middle of the ring and have at it."

And Cohen, for one, doesn't see why this has to change. "We are not much different today than we were five years ago," he says. "The people are the same, we have a very good time, we enjoy each other, it's a very relaxed place. What do people tell you — that we *have* to become bureaucratized, that we *have* to become like Merrill Lynch? How do they know?"

Nevertheless, Cohen does seem to be making certain concessions to the vastness of his empire. One is to delegate more. Another is to acknowledge that

enough is enough, that Shearson's spree of Wall Street acquisitions may have finally run its course. Indeed, while his lieutenants don't rule anything out, Cohen pointedly *does*. "We're plenty big enough," he says. But what if, say, a Paine Webber were to become available? "It's highly unlikely that we would have any interest," he replies.

"We will make additional acquisitions, but not in the traditional securities business," Cohen says. "What we'll focus on is rounding out the asset management and banking activities, à la what we've done with the Boston Co. in the U.S. I think there are a couple of places in the world where we should have a similar capability. That's the direction we're going to go in: asset-intensive businesses as opposed to people-intensive businesses.

"The only one we're not in now that we'd like to be in is life insurance," adds Cohen. "We sell a lot of it on the retail side, and at some point it makes sense for us to own the manufacturing capability and have those assets on our books. So I can see us acquiring a life company."

This, in short, is the new, expansive Peter Cohen, a Cohen who can insist that "size is not what drives us" and can sound positively blasé about the real possibility that someday very soon he may be running the biggest, most powerful organization on Wall Street. Nevertheless, his friends say he cares a lot more about it than he lets on. "What did the Hutton deal represent to Peter?" asks one. "To be No. 1. Period."

Every once in a while, Cohen drops his guard, and a glimmer of that intensity shines through — such as when he muses that "only those people who have been here can appreciate what went into building this place to this point. The numbers of nights gone without sleep over the years to get things done, the anxiety of what looked like the end of the world for us more than once."

Those who have seen Cohen lately say he looks surprisingly unhappy for someone who has accomplished so much so quickly. Perhaps it is because the burden of swallowing a Hutton — once the initial glow of triumph has faded — is a wearisome thing. ("Well, that's two more years of my life ruined," he told someone recently.) Perhaps it is because, as Cohen argues, that's just the way he is: "I have trouble emptying my head and getting into a happy-go-lucky mood," he says.

Or perhaps it is because he has come to realize that the days of struggling and striving — for respectability, for leadership, for recognition by his peers — may finally be coming to an end. Peter Cohen has arrived. And for a tough person, that often is the worst news of all. ■



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#### Predatory banking

It took a dramatic event to burn the new realities into the consciousness of this staid community. That event occurred last September when Bank of New York Co. launched its hostile tender for Irving Bank Corp. The \$1.08 billion bid is small change in the takeover world, but its effect on bankers has been profound, especially since it got the Fed go-ahead late last month. This first hostile battle between two major banks "shocked a lot of bankers into thinking, 'That could be us,'" says David Beim, a managing director of Dillon, Read & Co.'s financial institutions group and a former Bankers Trust Co. executive.

It is precisely this vision of predatory banking that motivated Bank of New York chairman and CEO J. Carter Bacot to make his run at Irving. "You don't need 14,000 banks anymore," he says, explaining that Irving would give his bank the size and clout to avoid being taken over itself. After four years of polite discussions with Irving's management, Bacot decided the stakes were too high to wait

any longer: "We wanted to do it before someone else did."

The fear of an unwanted takeover runs like a dark thread through the restructuring plans of more than one banker. On January 14, battered all day by market rumors, Manufacturers Hanover Trust Co. made an extraordinary evening announcement: It was embarking on a massive restructuring and taking a big hit to earnings to pay for it. An executive described the moves, which included 2,500 layoffs and the sale of several businesses, in straightforward terms: "We did what we thought an outsider would do to us. We think we did enough, but maybe someone out there thinks we haven't and will take a run at us."

This harsh discipline — manage your company well, or someone else will — is familiar to other businesses, but it's still alien to many banks, which have been astonishingly inefficient organizations. According to McKinsey & Co. consultant Lowell Bryan, banks at the end of 1986 turned in a \$95 billion expense report. Of that, close to 25 percent was devoted to pure corporate overhead that brought in no revenues. Only a quarter of the total was directly related to products or clients.

On top of that, few bankers knew how they made — and wasted — their money.

For the past two decades, banks have generally expanded their total earnings by leveraging their equity more and more. The method made them look ever wealthier, but it masked the millions they squandered on low-return businesses. When bankers began to confront this problem three years ago, they were shocked. Assisted by consultants like the New York-based First Manhattan Consulting Group, they allocated capital to business lines, products and even clients in an effort to measure the returns each yielded. The average bank with more than \$5 billion in assets, says First Manhattan president James McCormick, has about a third of its money sunk in investments with returns on equity of less than 10 percent. "If you have a lousy mix of business like that," he says, "you're under pressure to restructure."

#### Redeploying resources

Having finally figured out how their capital is being used, bankers must choose the most profitable way to deploy this scarce resource. That means keeping some business lines and dumping others. "The big job at banks today is rationing the capital to the hundreds of businesses that demand it," says SecPac's Flamson. The realistic bankers can no longer be afraid to cut into total earnings to become more ef-



Nubar Alexanian

*Bank of Boston's Stepanian: Ending completely its reliance on LDC loans for earnings and boldly pumping up reserves, the bank has been among the most responsive to analyst and investor demands for better performance*

*Citi's Reed: Its vast resources notwithstanding, the bank is bearing down on costs and streamlining its operations, concentrating on earnings and ROE rather than new investments*



Michael Mella

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Not even the main players can predict what the industry will look like when the transformation is complete. But by examining the ways in which many banks are struggling to evolve and by measuring the magnitude of the pressures that leave them no choice, you can get a glimpse of the future of American banking.

Some of the forces buffeting banks are quite familiar: securitization, new competition, technological change. But more recently, three factors have converged to bring all the pressures to a head:

- **Deregulation.** During the next few years, the industry will undergo a massive consolidation. Virtual nationwide banking will be possible by 1992, and there is a growing likelihood that new legislation will allow nonbanking companies into the business. Every bank chairman worth his salary knows there will be casualties; and

everyone, says one bank president, "is feeling vulnerable."

- **Hostile markets.** Shareholders, investors, analysts and rating agencies are demanding that banks perform better. Debt ratings have been sliding steadily; stock multiples are an embarrassment. Until recently, bank managers felt protected by their regulatory structure from the unsentimental treatment the market meted out to the rest of corporate America. Now, says David Cates, president of Cates Consulting Analysts, "the market has gotten fed up with the apparent immunity of banks." Privately, analysts are doing bust-up analyses of banks, betting on which ones aren't likely to survive. Publicly, they are clamoring for even larger reserves against bad loans and ruthlessly calculating the damage that this would wreak on the country's weaker banks.

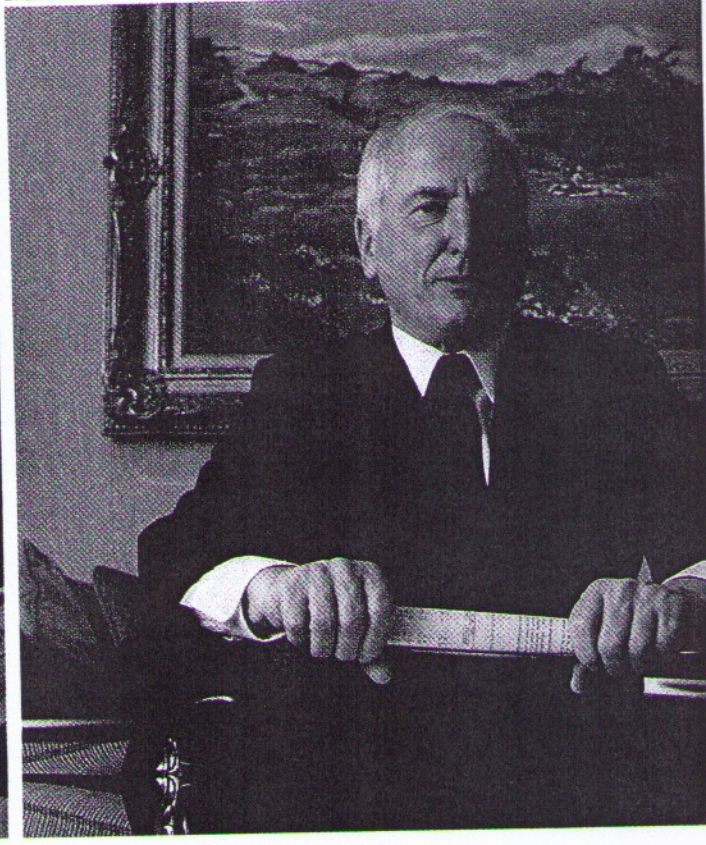
- **Capital inadequacy.** Even the most powerful banks were shocked last Decem-

ber when the Federal Reserve Board announced new capital standards. Set in conjunction with bank regulators of eleven other major industrialized countries, the standards redefine and increase the capital banks must have. By 1992, U.S. banks will have to show common equity equivalent to 4 percent of risk-adjusted assets. They will, moreover, be forced to subtract all their goodwill — some \$4 billion at the nation's top ten banks — and most of their loan-loss reserves from capital. The new standards will make it tougher for banks to expand, to protect themselves from unwelcome suitors and to earn the higher returns on equity the market is demanding.

Bankers fault the Fed not for its actions but for its timing. "If the regulators' job is to promote our safety and soundness, they have not done that," says one senior banker. "They have hit us with this just as we are undergoing major consolida-



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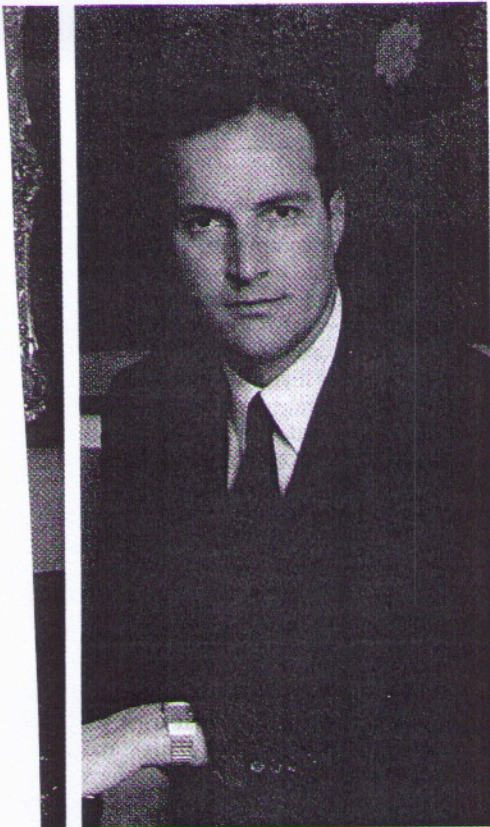
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**Chase's Labrecque: In order to maintain its status as a truly international institution, the bank has undertaken a massive restructuring of its global corporate operations**

cient; the result has been a virtual auction in bank operations. Manny Hanny and BankAmerica Corp. have sold their institutional money management businesses; Citicorp is planning to do so. Sec-Pac sold RMJ Securities, Wells Fargo & Co. its commercial finance unit; First Interstate is selling its primary dealer and U.S. Trust Co. of New York has sold its corporate lending business.

Some of these businesses are profitable, which is another indication of how fundamentally the banks are changing themselves. Bankers have come to accept the hard reality that they can no longer offer something for everyone. To justify their existence, to get the returns the market demands, they must streamline and specialize. If a business is unprofitable, sell it at a loss and put the capital to work elsewhere. If it is profitable but peripheral to your strategy, sell it at a profit and boost capital. Above all, develop a strategy and pursue it before it's too late. "Unless they have a clear-cut strategy that will produce sound returns on common equity, there is no guarantee that their multiples will be any better," avers Salomon's Hanley.

The model restructuring thus far, according to several analysts, is First Interstate's. Formerly a bank that dabbled in a wide range of businesses, California-based First Interstate is giving itself a distinctly

regional look, slicing off much of its corporate business and selling its entire government securities operation in the process. By shrinking its total assets by as much as \$7 billion (or 12 percent), First Interstate will become a consumer and middle-market corporate bank serving clients in the western U.S. It will continue to buy banks (it recently purchased Texas' Allied Bank) that support this strategy, while its large-client corporate business will be focused almost exclusively on companies that operate in its region. Its overseas operations — the bank has 33 branches in 21 countries — are being redirected to support the international business needs of its regional clients. The restructuring cost the bank \$95 million in 1987's third quarter. The hope is that it will raise profits by at least \$75 million annually beginning this year.

The decisions involved in such a restructuring, of course, are among the hardest an executive can make. Figuring out what to kill and what to keep is the diciest dilemma. Why, for example, does Chemical want to keep its money-losing Texas Commerce Bancshares and sell its profitable consumer finance operation? "It's a close call," says Chemical CFO Kenneth LaVine of the plans to sell the latter. Consumer finance doesn't fit Chemical's central consumer strategy of dealing directly with the client; it gets most of its loans from dealers. In the long run, Chemical believes that its capital will get the highest returns only if it backs businesses that dovetail with that strategy. Put that money into the Texas bank, goes Chemical's thinking, turn it around, make it a consumer powerhouse and you'll get higher returns.

In their panic to boost capital, some bankers have sold off businesses on which their futures could depend. "If you sell a good earner just for the profit, you can really damage your business," says First Interstate's Pinola. BankAmerica is one company observers believe may have overdivested. And management at Mellon Bank Corp. almost pawned a crown jewel last spring when it put its consumer finance operation up for sale. Aghast at the shortsightedness of this tactic, the bank's new managers pulled the unit off the block and are trying to wring higher returns out of it (*Institutional Investor*, January 1988).

Like Mellon's consumer finance unit, most of those core businesses that bankers retain are being squeezed for higher returns by means of layoffs, office closings and other measures. "In a deregulated environment, relative costs become very powerful," says Bankers Trust's chief planner, George Vojta. "Up until a year ago, this was probably the area most neglected by bank managements." Predicts Dillon Read's Beim, "Expense controls are going to be more important than revenue growth in 1988."

The cost-cutting has shattered an im-

portant part of banking's culture — the safe, cradle-to-grave career mentality that permeated almost all these institutions. The recent firings at Manny Hanny are a case in point. Employees were directed to a queue at the personnel office where their ID cards and Manny Hanny credit cards were cut in two. If they needed to return to clean out their offices, they would be accompanied by an armed guard.

### Bad-loan blues

Even more stunning than their drive for efficiency is the fact that bankers are finally facing up to the magnitude of their bad-loan problem. No bank that wants to survive or grow in the new era can afford the battering investors give bank stocks as a result of their mounting concern about crippled assets. You may be building your capital base, the market scoffs, but we believe you also stand a good chance of eroding a chunk of it with low-yielding loans and maybe even outright hits to capital.

It's not any new understanding about the likelihood of their getting repaid that is driving the recent wave of LDC reserves. If Mellon has a reserve of 46 percent, Sec-Pac of 54 percent, First Chicago Corp. of 57 percent and most money centers of about 25 percent of their LDC debt, it is quite simply, says Continental Illinois Corp. chairman Thomas Theobald, that "they're responding to pressures from investors and analysts." Bankers fume that analysts are becoming too tough, even undisciplined, in their analyses of bank asset quality — relying, as one CFO charges, "on a general feeling about life." But the pressure isn't about to let up, as analysts and investors call for 50 percent reserves and even outright charge-offs.

With the advent of predatory banking wonderfully concentrating the minds of bankers, make-believe is finally giving way to tough measures. In December Bank of Boston Corp.'s Ira Stepanian became the first CEO of a large bank to end completely his company's reliance on LDC loans for earnings. He charged off \$200 million of the bank's \$1 billion LDC exposure, pumping reserves to 63 percent of the remaining debt, almost all of which he boldly placed on a nonaccrual basis. Chase Manhattan Corp. executives recently set up a separate unit to work down their LDC loans. Citicorp leads the way in debt-for-debt and debt-for-equity swaps, designed to rid their balance sheet of some of these dubious credits.

Two dramatic new techniques could find extensive use in an age when banks prey on each other. Both run counter to the old notion that, as one CFO puts it, "your bad loans are your best poison pill." The takeovers of Crocker National Corp. by Wells Fargo and Texas Commerce by Chemical exemplify the first technique: What both these buyers did, in effect, was buy only the acquired banks' good loans. They emptied the garbage into a separate subsidiary, in the case of Crocker, and a

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separately capitalized bank, in the case of Texas Commerce. In both instances, the bad-loan burden is borne by the shareholders of the acquired bank.

First Interstate is so far the only healthy bank to use this tactic on itself, but more banks may employ it in an effort to boost their stock value. As part of its restructuring, First Interstate plans to put about \$400 million in shaky real estate loans into a separate, publicly traded company, the shares of which will be given to the bank's current stockholders. Though part of the goal is to work those assets down more profitably, the tactic was also designed to burnish First Interstate's stock. "Our future is in buying banks," says CFO Don Griffith, "and for that you need a healthy balance sheet and a good stock price. This makes investors less skeptical of your stock."

Some bankers are considering an even more novel approach: You could call it the junking of bad loans. The message is being trumpeted, like a feel-good TV ad, in speeches to bankers by members of Drexel Burnham Lambert's new financial institutions group: "The Drexel approach is different — we will give banks cash, today, for nonperforming assets," goes the stock speech. Drexel's high-yield specialists are offering to bid for a bank's portfolio of bad loans, sell them at a discount to a liquidating trust (read Drexel's investors) for cash and fund the purchase with notes backed by the assets' cash flows. On top of that the firm will recapitalize the bank. Bankers, promises Drexel (which is believed to have two such deals in the pipeline), "immediately receive cash for assets you sell. Earnings per share begin increasing at once."

A number of banks, including Manny Hanny, are believed to be reviewing this technique, but its appeal is said to be limited by the discount that bankers say Drexel investors require, which is bigger than some banks are willing to shoulder. Like the approach pioneered by Wells and Chemical, Drexel's requires a hit to capital; however, some bankers believe it would cost shareholders less to set up a "bad-loan bank" and work the assets out more slowly. The Drexel scheme is even less likely to work in the case of LDC debt. "You can't junk that," says Citi chairman John Reed, who says he has spoken with Drexel junk czar Michael Milken on the subject. "The reality is that there isn't a big enough market."

There's another dilemma lurking in the back of bankers' minds, one potentially thornier than that represented by bad loans: Split into pieces, some of the nations' biggest banks are worth more than

the whole. Until recently banks were happily immune from the thinking that led to such celebrated takeovers and bust-ups for profit as that of Beatrice Cos. But now people are starting to look at banks the same way. Consultant Cates says his company, for one, last year introduced a new service for banks and institutional investors: estimating the market value of each piece of a bank "as though it were for sale."

To the astonishment of many, bankers — those at Chase, Manny Hanny and First Chicago, among others — are doing breakup analyses of themselves. And while some bankers feel threatened by such analysis (probably with good reason), others, such as SecPac's Flamson, see it as a useful tool to boost value. An analysis of the bank's specialized financial services unit — which includes such business as leasing and commercial and consumer finance — told Flamson that the area "would have a hell of a lot better P/E alone than by being owned by us." One of his options, should he find himself in need of capital to expand, is to take a portion of this subsidiary public. In the same vein, Chemical executives have toyed with the idea of packaging their global capital markets businesses and selling part of the resulting subsidiary.

Even the family jewels are being put on the bargaining table. Bankers have long regarded such hidden pockets of wealth as their overfunded pension plans, the unstated value in their buildings and buried venture capital gains as insurance for a rainy day. Now bankers are moving to bring some of that value into the open and into the hands of shareholders. Citi and Manny Hanny are only two of the banks that have been cashing in on those assets to boost capital. Although some market pundits scoff at these moves as desperate ploys by the banks to conceal the poverty of their operating earnings — as they are in some cases — taken as part of the restructuring picture, they constitute an important effort to show the market their value.

## Future shock

It is clear that as American banking consolidates, it will also change its shape dramatically. Some major banks could be swallowed up, but right now almost all of them are trying to develop strategies that demonstrate to the market that they have a reason to survive in the Darwinian age. What it will all look like is less clear, but from interviews with more than 30 senior bankers, consultants and analysts, there emerges a definite outline of the new tiering within the industry.

• **The niche banks.** Continental Illinois and U.S. Trust of New York, distinguished by their commitment to either a single product line or customer segment, are prime examples. For banks that lack the currency — that is, the stock price or other means to pay for expansion — or the size to earn high returns in several businesses, this strategy is the best hope. It means retreating into the business they do best, much as Bankers Trust did in 1978 when it shed everything but its wholesale business.

U.S. Trust chairman Daniel Davison began his pullback nearly nine years ago, when he strode into a board meeting and presented his directors with a symbol of his strategic plan: a photograph of Wall Street seen through the rearview mirror of a car. His bank finally returned to its original business — institutional trust services — when it sold the last of his corporate-loan portfolio to Dai-Ichi Kangyo Bank in 1987.

In the fall, Contilly's Theobald did much the same. Only months on the job, he announced that the bank would be selling off its consumer banks and businesses and concentrating on providing services for corporate clients only (*Institutional Investor*, February 1988). Most observers agree that Theobald, surrounded by stronger competitors and burdened by ailing stock, had no choice but to return Contilly to its oldest line of business.

• **The regional banks.** Like Wells Fargo, North Carolina-based First Wachovia Corp., Pittsburgh's PNC Financial Corp. and North Carolina's First Union Corp., these banks will dominate their regions' middle-market and consumer businesses and offer competitively priced services to large institutional clients.

These well-capitalized, highly profitable banks have been richly valued by the market. The outstanding common stock of Atlanta's SunTrust, for example, is worth more than all the shares of Chase, although its assets are a mere quarter of the New York bank's. Able to make acquisitions almost at will, some of them could eventually burst out of this category into the superregional group. At least a few will surely buy money centers, bad loans and all; potential acquirers include North Carolina's aggressive NCB Corp. "These banks will be much, much bigger than the money centers," says Mabon, Nugent & Co. bank analyst Lacey Shockley, who bets that "they will be our national banks."

Others caution that these banks could face their own period of restructuring ahead. As they begin to fight over the same turf, will they face the same erosion

# "Having finally figured out how their capital is being used, bankers must choose the most profitable way to deploy this scarce resource."

of margins and the problem of overcrowding that hit their larger brethren? Goldman, Sachs & Co. analyst Robert Albertson says the stresses could be beginning already, pointing out that the premium above money centers that the market has given these banks has declined by 25 percent in the last three years alone.

• **The superregionals.** So far, the only banks firmly placed in this slot are Security Pacific and Bank of Boston. Like the regionals, these companies will dominate their home consumer and middle markets, but they will also present a powerful force in certain products on a national scale and in certain key international markets.

They are received less warmly in the market than the regionals, but they have nevertheless built up the currency to expand, and all are believed to be managed well enough to maintain that. To dominate the West, SecPac, for example, has bought banks in Oregon, Arizona and Washington and next year will add Nevada to the list. On the international front, it has developed a merchant banking presence in New York, London and Tokyo, and it plans to strengthen its full range of banking services in Asia. To solidify the national thrust in its nonbanking products, last year SecPac bought Wells Fargo's commercial finance unit.

Bank of Boston began a massive restructuring in 1984 designed to refocus the institution on its own region while augmenting selected national and international businesses. In addition to its national activity in corporate lending, such as its movie-finance niche, CEO Stepanian says it is also expanding its historic presence in Latin America, especially in consumer banking.

The other candidates for this category are among today's money centers: Chemical, Manny Hanny, Mellon and First Chicago. There is much debate, however, as to whether they will slip into the regional ranks, be taken over or successfully restructure to become superregionals. Chemical, for one, says it's plowing ahead in its quest for superregional status. "We are one of the only money centers that has a national banking strategy," asserts CFO LaVine. The plan: Expand its middle-market and consumer presence in key markets such as Florida, Texas, California and New Jersey. To give itself a competitive edge over regional banks, Chemical intends to couple this strategy with a commitment to investment banking in key international centers that will allow it to securitize and sell the paper its national bank originates. The hoped-for payoff from its recent restructuring — which in-

involved huge staff cuts and the selling of businesses to the tune of a third-quarter charge of \$135 million — is \$150 million a year in additional profits.

• **The global banks.** J.P. Morgan & Co. and Bankers Trust could be characterized as "niche globals," but the only two U.S. banks that stand a chance of being broadly global, virtually full-service institutions are Citi and Chase. What they have that others don't is the infrastructure already in place. "What it takes to be global now is *massive*," says Bankers Trust's Vojta. Given looming deregulation and all the pressures of the marketplace on banks today, "it will be difficult for anyone who isn't already there to have a truly balanced global strategy," says Mellon president Anthony Terracciano, who until last July was head of Chase's global wholesale bank.

Chase is in a tighter spot than Citicorp, and many say it is fighting to stay in the global category. Its P/E multiple is substantially weaker, its LDC loans higher in proportion to its assets and its return on equity lower than that of its uptown rival. Chase president Thomas Labrecque insists the bank will stay on top. To that end, Chase undertook a massive restructuring of its global corporate bank as part of an ongoing effort that in 1986 cost it \$30 million and 3,000 jobs by last year's end.

This year Chase plans to streamline its consumer area (cost: a \$50 million pre-tax charge and the elimination of about 1,000 jobs). Although Chase would like to continue to buy banks around the U.S. to add to its thrifts in Ohio and Maryland and its bank in Arizona, "that strategy is on hold right now," says Labrecque. The bank is gunning for higher returns, he says, and it will wait to see if the banks it already owns can begin to yield the kind of return on equity — around 15 percent — that would justify buying others.

Even Citicorp, whose resources are so vast that it can waste a lot of money before it feels any pain, feels the market's pressure for what chairman Reed somewhat scoffingly calls "*today's performance*." Reed is bearing down hard on costs in his investment banking business, shrinking the municipal bond business, for example, and letting go an estimated 500 people in what is regarded as a first cut only. He has sold parts of Citi's stake in several buildings, including its showcase Citicorp Center (*Institutional Investor*, January 1988). And, of course, he led the way on reserving with his historic \$3 billion addition last May. Reed is also streamlining the consumer area, where several thousand people could be squeezed out. In the short term, he says, the bank "is not in a big

investment mode," concentrating instead on boosting its earnings and ROE.

Citi's restructuring worries many bankers. The stronger that bank becomes, the more likely it is to be the supreme predator in the new age of Darwinian banking. With its market capitalization hovering around \$3 billion, many bankers say, Citi could swallow almost anyone it wants. Indeed, bankers reacted with ire to its \$3 billion reserve. "Reed is trying to knock us all off our feet so he can buy us," says one.

Reed denies this. "It had nothing to do with hurting other banks," he says. Sitting on a couch in his library, his feet stretched out in front of him, Reed hardly looks threatening when he says he is "looking forward to 1991," the year many states open up to nationwide banking. He wants to keep expanding Citi's consumer presence across the country (analysts say that he is especially interested in California, Connecticut and New Jersey). Bank of America — which Reed says he already offered to buy in a friendly deal — and Wells Fargo are two names that keep cropping up when people talk about his wish list. Would he consider taking a hostile run at another bank? "Sure," he says unhesitatingly.

## Strange scenarios

As the new age of predatory banking dawns, some odd things could start to happen. Montgomery Securities' Fredericks suggests that the day will come when small, well-capitalized banks will take over larger ones in hostile deals. André Cappon, a consultant at Oliver Wyman & Co., speculates that some of the money centers could turn to foreign banks for protective alliances. And consultant Cates is among a growing number of observers who believe that in the next few years the laws will change to permit nonbanking behemoths such as Ford Motor Co. to buy commercial banks. When they come, says Cates, "they will play with the pieces in a more Carl Icahn style, buying, selling, trading" bank businesses.

The most astonishing speculation about the future, however, comes from John Reed. "I've never really looked at what exactly it would cost to take us over," he says. But there are industrial companies out there that could easily afford Citi today. With a major overhaul in regulations, says Reed, "we could easily be taken over." It's a highly unlikely scenario, given the way Citi will probably grow in size and value over the next few years, but, says Reed: "I don't think I'd be personally uptight if someone bid for us. We'd be a good buy." ■