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Financial Services Practice Group

MCDERMOTT + BULL - STATE OF THE MARKET FOR EXECUTIVE HIRING

Cautious optimism seems to be the consensus among our firm's clients heading into 2020. Although some pundits are predicting a dramatic and near-term market correction, supporting data is decidedly mixed. Changes in expectations for 2020 include: U.S. economic growth is expected to range from 1.5% to 2.0%, likely down from the 1.9% growth forecast last April, and the 1.8% growth forecast in June. Return on assets is expected to be 0.75%, down from a 0.80% forecast in June (See, Federal Open Market Committee meeting report dated December 11, 2019). What we do know from history is that there will be a material change in the economy in the next handful of years, but forecasting its timing is beyond the reach of every expert. As such, we believe our clients should prepare now so as not to be caught off guard.

In this article, we will (a) take a look back on the hiring trends from 2019 which we think will carry forward into 2020 (many of which are nearly identical to last year's prognostications), and (b) highlight areas of recession preparation.

MARKET TRENDS IN EXECUTIVE HIRING

In 2019, we serviced 27 distinct financial institutions. Our search engagements were balanced, with no single functional vertical representing more than 14% of all engagements. We did notice an uptick in clients driving change through investing in the human capital function – executive management (CHRO); performance management; talent acquisition; and compensation and benefits. Another area of increased activity was board buildout. On a firmwide basis, we built out more boards than in any year in our firm's history.

TIGHT LABOR MARKET – Executive hiring is experiencing a high demand for talent contrasted with a low supply of suitable candidates. This issue impacts nearly all industries, but none more so than community-centric banking. This trend is not specific to any one functional vertical but impacts the entire spectrum of executive leadership. Given the well documented mass exodus of Baby Boomers from the workforce, and the lack of talent development within the big banks, up and coming talent with the willingness to commit at least five years to their next role are fewer and farther between. As the talent pool shrinks, our clients are having to conduct nationwide searches for candidates that used to be abundant in their own backyard. Taking on the intricacies of a national search and a relocation have become commonplace for us and our clients, with 47% of our searches in 2019 necessitating candidate relocation into the market.

DEMAND FOR DIVERSITY AND INCLUSION – Diversity & Inclusion, also known as D&I; or Inclusion & Diversity, have been buzzwords within corporate circles for years. No longer are these simply catch phrases, but instead are now business imperatives. Put simply, a diverse workforce drives innovation through the natural dynamic friction caused by people looking at the same issue through different lenses. Diversity & Inclusion are always one of the top three objectives of our clients when conducting an executive search. In 2019, 59% of our candidates placed were representative of a diverse workforce.

What we're seeing, more than ever, is that candidates are demanding to work for a company that not only speaks of its commitment to diversity and inclusion but demonstrates it in its hiring. Put another way, candidates are looking for institutions that have a diverse employee population and are progressive about bringing diversity of thought into the boardroom.

BOARD BUILDOUT – Community financial institutions have been focused on building out their boards with members who bring functional experience the enterprise can benefit from – marketing, human resources, technology, et cetera. In some instances, seeking expertise outside the industry. This means that many board candidates are gainfully employed in their field of expertise. As such, they don't have the flexibility with their calendars to attend the numerous board and committee meetings. Therefore, we counsel our clients to be more willing to have board members engage electronically. This will give your institution a greater likelihood of recruiting strong board members. Not only is building out your board a way to drive a direct impact on franchise value, but the candidate marketplace is clamoring for board opportunities. Nearly every executive I speak to has a desire to someday sit on a board. Often a prerequisite is prior board experience. This means that you can have access to first-time board members with professional pedigree you may think is out of reach. It isn't.

INVESTING IN HUMAN CAPITAL – As noted earlier, we saw an uptick in our clients investing in strong HR leadership. The change in thinking says, "strategic HR bucks the notion that HR merely takes care of those who take care of the business. Rather, strategic HR must be a driver of the business." HR no longer merely serves employees, instead it develops, empowers, and cultivates people. Strategic HR must be in a position to construct organizational designs which clearly align with business strategies. These designs must enable informed decision-making models, allowing for inter- and cross-departmental integration, which in turn results in increased corporate vivacity and employee retention. Strategic HR (i) drives culture, (ii) optimizes operational performance, and (iii) develops leadership.

What is interesting is that not only were our clients investing in their top HR leader, but in sub-specialty experts in the areas of performance management; training and development; talent acquisition; and compensation and benefits.

RECESSION PREPARATION

BE CANDID WITH YOUR PEOPLE – It's important to be open and forthright with employees. Conversations about a potential downturn and what will be done to manage through the period should be had throughout the company. You should be forthright but not overly specific—i.e., avoid talk like "marketing will be the first to go." The gravity should not be understated, but it can be easy to create unnecessary panic.

Growth-stage companies are full of smart, ambitious people with deeply rooted expansion mindsets. Contraction is against their nature, so dialing back can be difficult. But sharing your contingency plan will provide a sense of focus and integration into the process.

FACTOR IN CUSTOMER EXPERIENCE – Debt collection is particularly vital in a recessionary period--mitigating charge-offs directly impacts the bottom line. Particular areas of focus to be applied by every financial institution as it looks to insulate collection strategies against recession are summarized below.

Experian recently conducted a study of the impact of traditional credit card collection methods and found that three percent of 30-day delinquencies in credit card portfolios closed their accounts after paying their balance in full. And, 75 percent of those closures came shortly after the account became current. It merits notation that the propensity to close accounts was four times higher in young, urban, affluent customers than in any other demographic. Although these numbers may not seem large, personalizing the process will not only maximize results; it will likely lead to customer retention. This is no less true of entities as it is of individuals.

LEVERAGE TECHNOLOGY – Historically, financial institutions have responded to higher delinquency rates by expanding collection staffing. However, new hires often have limited experience. Inexperience generally leads to a far less nuanced client relationship. The explosive increase in smartphone use over the last decade suggests how technology has changed the process and customer expectations. You should leverage the same technological advancements to better understand customer preferences, and to automate the collection process.

The underlying foundation for any recession-readiness program centers on how the you prevent and handle bad debt. It is axiomatic that each dollar of loss prevented equates to a dollar of profit. At the most basic level, you must monitor your portfolios and minimize the flow of accounts into collections. You should closely observe changes in risk metrics across key segments that may point to rises in delinquency—and take preemptive action where possible. You can use advanced data and technology—such as non-traditional data and machine learning—to stress test portfolios under varying scenarios, including economic downturn. The insights can illuminate how certain accounts within lender portfolios will likely perform and lead to specific action plans to engage those accounts: pre-delinquency, during the collections process and after charge-off.

THE INTERSECTION OF ANALYTICS AND RELATIONSHIPS – Collection strategies demand diverse approaches, which is where analytics-based strategy comes into play. As each customer and situation differs, machine learning techniques and constraint-based optimization can open doors for you. You can rethink collections outreach beyond static classifications (such as the stage of account delinquency) and instead prioritize accounts most likely to respond to each collections treatment; this creates an improved collections experience.

Customer engagement is likely the most critical aspect of any recession-readiness program—especially given historical perceptions of the collections process. As discovered through Experian's analytics, many account closures occur after the account is brought current. Applying traditional methods, you may collect an outstanding balance, but miss out on long-term customer loyalty and future revenue opportunities. This, again, is true of individuals and entities.

EFFECTIVE COLLECTIONS, EMPOWERED CUSTOMERS – Only effective technology can move you from a linear collections approach toward more customer-focused treatment, while controlling costs and meeting other business objectives. Advanced analytics and machine learning represent the most important advances in collections. Empowering consumers in a digital, safe and consumer-centric environment affects the complete collections agenda—beginning with prevention and management of bad debt and extending through internal and external account resolution.

Beyond the customer experience, advanced analytics and active monitoring can help you detect fraud exposure and materially reduce overhead, minimize the need to hire staff and may improve compliance during the collections process.

WHICH MARKETS, AND WHAT PRODUCTS – The first step in preparing to manage a company through a downturn is determining how to get to a convergent profitable business model. Does the growth rate need tweaking? Should new geographic expansion be minimized? Will streamlining new product lines be more efficient?

Prioritize the markets and products that will be most profitable. Defer investing in those that will not. The point is to ensure self-sustainability in the event that future capital raises do not materialize. Although a general slowdown across all sectors is anticipated, a number of factors support continued extension of commercial and residential real estate credit (subject, of course, to local market conditions) as well as consumer credit.

CRE prices are currently at some of their highest levels, and access to low cost capital has fueled concerns of overpricing. Deals have become more challenging, and there are often more complex environmental issues that consultants need to highlight, analyze, and discuss with lender and investor clients. Add that to growing global economic and political concerns, domestic political risk fuel recession concerns.

CRE conditions remain favorable as the economic cycle matures. Modest oversupply concerns are emerging for multifamily and industrial property types, while retail faces long-term challenges related to shifts in consumer shopping behavior. Signs of a slowdown in residential sales are emerging in the housing market even as house prices continue to rise across most of the nation. Affordability is a growing concern as income growth lags the rise in house prices and mortgage payments (See, FDIC year end Risk Review for 2019).

You should make sure to maintain the same overall concentration limits for commercial real estate exposure throughout the recovery period to protect your organization and avoid loans on higher-risk assets like malls or old office buildings.

All lenders must adhere to their core values during tough times. While recessions will likely impact approval rates for both consumer and commercial loan applications, you can still go the extra mile to help alleviate the strain on relevant customer segments. Economic cycles come and go, but relationships forged during tough times often last for years.

SCRUTINIZE YOUR P&L – Effective leaders will look at cost as a key area to evaluate and reprioritize when the economy continues to slow. Real estate is often an overlooked expense. These line items can be hidden and turn into big liabilities later. Some real estate will impact cash balances more than others, and some might no longer be considered critical assets. Those should be the first to be eliminated, or re-negotiated.

EMERGING FROM A DOWNTURN STRONGER – Community-based institutions typically have an advantage over large banks during economic downtimes. Large institutions tend to make broad credit portfolio decisions that dramatically impact communities downstream. Smaller lenders, on the other hand, make decisions more locally, allowing them to better serve their local economies. But all lenders must be strategic to ensure this advantage is optimized. Effective communication, leveraging modern lending platforms and technology, training younger lenders, and sticking to core values can help you better navigate what lies ahead.

About the Firm and the Author

McDermott & Bull is a full-service executive search firm serving clients through its offices in North America and Europe. The Firm's Financial Services Practice Group is a partner to an array of financial services firms including investment banks, commercial banks, private banks, credit unions, investment managers, institutional investors and fintech companies. The firm's clients include the likes of Guggenheim Partners, Houlihan Lokey, Silicon Valley Bank, First Republic Bank, BNY Mellon, Moelis & Company and Envestnet.

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