

Too many financial experts may be bad for community banking

The rise of grassroots movements to move money out of "too big to fail" banks requires the establishment of community-based institutions.

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The 2007-08 financial crisis has sparked a growing consumer backlash against many of the institutions seen as the main culprits.

Grassroots movements such as Move Your Money in the United Kingdom and Move Our Money in the United States are encouraging customers to divest from "too big to fail" institutions and move to smaller, more locally based ones.

But how should such new banking ventures be founded to meet the growing demand, especially in these turbulent economic times?

Does it make more sense for founder teams to come predominantly from a financial industry background, or from a public-sector, non-profit or community-based background?

These are some of the questions IESE Prof. [John Almandoz](#) addresses in his paper "[Arriving at the Starting Line: The Impact of Community and Financial Logics on New Banking Ventures](#)".

The role of institutional logics

To adapt to complex environmental requirements, organizations often integrate competing logics. Community banks, like microlending organizations, incorporate both financial and social logics to serve the financial needs of individuals and organizations in a local community.

How those competing logics affect the odds of getting a new community bank off the ground are far from obvious.

The financial logic — which is generally characterized in terms of profit-maximizing objectives and a self-interested, individualistic ethos, with cold emphasis on short-term results — has some clear benefits. It provides needed expertise and offers legitimacy in financial markets.

The community logic — which is based on strong, enduring ties among members of small, close-knit groups — also offers key advantages to community bank start-ups.

By advocating meaningful connections and rich social ties with local individuals and organizations, banks steeped in this logic may increase their chances of success.

This may be true, not only because this message may resonate better with local communities, but also because local leaders in founding teams tend to have greater reputational investment in establishing the bank.

Combining financial and community logics in the same organization may allow it to reap the benefits of both logics, but it may also introduce discord among the founders in the process of starting the organization.

In his paper, Almandoz examines the role of these two logics, individually and in combinations, in establishing a new bank.

Almandoz analyzed the backgrounds of founding teams in bank charter applications to regulators, and conducted qualitative interviews with more than 60 CEOs, prospective CEOs, consultants, bank regulators and bank directors.

The financial logic

According to his research, the greater the proportion of directors with financial and banking experience within a founding group, the less likelihood that group has of successfully opening a bank.

At first glance, this finding may seem counterintuitive, given that a bank is, after all, a financial organization. But it actually makes sense if you take into account motivational factors.

To the degree that those backgrounds are associated with profit-maximizing goals rather than a meaningful commitment to a community, founders with an extensive background in

the financial industry may tend to hesitate more in their commitment, as well as abandon the founding team for self-interested reasons — for instance, when other more profitable opportunities arise elsewhere.

Interviews and statistical evidence pointed in the same direction. As one consultant remarked, "Bankers are always the last people to the party."

Similarly, the chairman of a failing group complained that "everybody put up money, except for the bankers on the board. They would only commit to put up money when we knew that the bank was going to get off the ground."

The community logic

By contrast, a higher proportion of founders embedded within local civic, social and community boards appears to have a favorable effect on the chances of opening a bank.

This is probably due to the fact that teams with more community volunteers and participants have more than profit-making investment reasons to start the bank.

Their greater commitment to the community leads them to be more active in fund-raising to gather investment capital, which is the chief challenge in the start-up process.

They can also draw upon much larger community networks and are hence more likely to receive vital support from the local community, which can be more easily mobilized by community leaders and motivations.

According to Almandoz, motivational factors within the founding team seem to be most critical for the success of these groups.

Mixing logics in founding teams

The success, or otherwise, of mixed teams of founders depends, to a large degree, on the prevailing economic backdrop.

The author's statistical evidence suggests that, during more stable periods, diverse founding boards are more likely to open a bank, perhaps because then it is easier to bring the best from both logics.

In turbulent times, however, diverse boards are more likely to become divided and pull out of setting up a bank.

According to two CEOs, conflict in founding teams was less likely during stable periods when the bank or founding group simply had to execute an unambiguous and preapproved plan, whereas conflict was more likely when opportunities, threats or performance deviated from expectations.

The research on organizations integrating for-profit and social goals also underscores the crucial relationship between the values and motivations of the founders and the likelihood of reaching the point of establishing the organization.

This has vital implications not only for community banking but for similarly complex organizations, such as for-profit hospitals and microlending institutions, which need to recruit diverse professionals and integrate their potentially conflicting logics.

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