TheEffect of the Recession of 2007-2009 in the Community Bank Environment

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Abstract

This study analyzes an issue in the community bank environment in Central Florida from the perspective of those closest to the issue. The methodology implemented is a mixed methods staged multi-design, drawing on the input of bankers, regulators, and consultants. The study is designed to identify the respondents' perspective on systems theory, strategy development, financial strategy, and the effect of the recession of 2007-2009 in the community bank environment in Central Florida.

Keywords: Phenomenological; Systems Theory; Strategy; Public Policy; Ethics, Recession, Banking

1. Introduction

This study is a phenomenological study of economic recession from a systems theory perspective. The issue researched is the impact of the US economic recession of 2007-2009 in the community bank environment in Central Florida. One of the greatest challenges in uncertain times is developing a plan for moving beyond the challenges of uncertainty. Ahlstrand, Lampel, and Mintzberg (1998) note that there are times when the external environment is in such upheaval, no amount of effort and time spent on strategy development and follow through will yield a reasonable solution for the problem. Ahlstrand, Lampel, and Mintzberg (1998) point out, when viewing strengths and weaknesses, the strengths often turn out not to be so strong, and the weaknesses turn out to be greater challenges than expected. This concept is transferable to the economic bubble which burst in 2007. Senge (2006) supported the idea that an action, in one part of a system,is amplified throughout the system. The community bank environment,a system, is a part of the larger U.S. economy, which is a part of the international economy. It is the researcher's goal to look at the phenomenon, the recession of 2007-2009 in the community bank environment, from a *systems theory perspective*.

1.1 Recession

Understanding the issues surrounding community banks and the recession of 2007-2009 requires an understanding of recession. The National Bureau of Economic Research (NBER), a nonprofit organization dedicated to economic research, receives input from more than 1000 professors of economics and business who focus their empirical research in four areas: developing new statistical measurements, estimating quantitative models of economic behavior, assessing the economic effects of public policy, and projecting the effects of alternative policy proposal (http://www.nber.org). The NBER identifies a recession begins when an economic cycle reaches its peak and ends when the economic cycle reaches its low point, known as the *trough* (http://www.nber.org). While Wang and Yang (2012) note that a recession begins with two consecutive quarters of economic decline, the NBER (2011) used the terminology, a significant decline, rather than two quarters of economic decline. For example, the recession of 2007-2009 began with one quarter of decline followed by a quarter without decline (NBER, 2011). The NBER does not predict future recessions: It analyzes prior recessions and researches the effects of proposed future public policy on economic activity. The organization uses an algorithm to define the beginning and end of recessions after a recession has occurred, and identifies the peak and trough of the 2007-2009 recession as December 2007 and June 2009, respectively (http://www.nber.org).

1.2 The Community Banking Environment

Banking institutions fall into the categories of small institutions, intermediate small institutions, and large institutions (http://www.ffiec.gov). Each category is defined by asset size: small institutions have less than $1.122 billion in assets; intermediate small institutions have between $280 million and $1.122 billion in assets; and large institutions have assets exceeding $1.122 billion (http://www.ffiec.gov).

By definition intermediate small institutions are included in the category of small institutions. This study focused on those community banks which fall into the small bank category, and the effect the economic recession of 2007-2009 had on these institutions. Community banks vary from national and region banks due to their local focus; a community focus (De Lurgio, Gilbert, & Hays, 2009). De Lurgio, Gilbert, and Hayes (2009) analyzed efficiency in this sector with year-end financial information from 2006, 2007, and 2008. Their study provided insight at the peak, which identified the beginning of the recession, December 2007, and the first 12 months of the 18 month decline, January 2008 through June 2009 (2009).

1.3 Literature and Concepts

The base literature for this study includes seminal work supported by recent scholarly, empirical studies; and published public policy regarding the banking sector of the economy. The study identifies and defines the methodology of a phenomenological study; systems theory; strategy; public policy; and ethics, as they pertained to the effects of the recession of 2007-2009 in the community bank environment in Central Florida.

A phenomenological study analyzes the experience of a group of individuals as a whole, rather than as independent units (Creswell, 2007). This study analyzed the grouping of individual community banks. While this may be viewed as the lived experiences of individuals or, the experience of individual institutions, it was separated from the researcher's opinion via the descriptions of individuals' personal experiences. The phenomenological research for this study was conducted in two phases, and considered a staged multi-design method (Chambers, Martindale & Thompson,2009): It began with interviews of bank insidersto develop a survey instrument, which was then provided to the respondents. The interviewees included: bank executives, bank regulators, and bank consultants. The survey respondents were community bank executives within Central Florida (US).

Systems theory, also identified as General Systems Theory (GST), defines the interrelationship between components within a system (Drack and Schwarz, 2010; Drack and Wolkenhaur, 2011; Senge, 2006; and von Bertalanffy, 1972). Von Bertalanffy (1972) notes a system cannot be understood by simply analyzing the individual parts because what is visible to the analyst may not actually be indicative of the whole. This is directly related to the fable, *The Blind Men and the Elephant* by John Godfrey Saxe (Ahlstrand, Lampel, & Mintzberg, 1998).

Strategy focuses on competitive advantage in an effort to distance an organization from its competitors and create a sustainable competitive advantage (Porter, 1996). The essence of sustainable competitive advantage is achieved by creating a chain, or link, between all processes to build a system which cannot be easily copied (Porter, 1996). The system should include the processes and physical operations of an organization, and the organization's human capital (Ahlstrand, Lampel, & Mintzberg, 1998).

Public policy, within the banking environment, is implemented through the Office of the Comptroller of the Currency (OCC), the Federal Reserve Bank (FRB), the Federal Deposit Insurance Corporation (FDIC) and the Federal Financial Institutions Examination Council (FFIEC). The FDIC was created in 1933 as an independent agency of the federal government of the United States with the principle purposes of promoting confidence in the banking system, and reducing the effects of financial institution failures in the economy (Ennis &Keister, 2010; Johnson &Trussel, 2012; www.fdic.org).

> The FFIEC is a formal interagency body empowered to prescribe principles, standards, and report forms for the federal examination of financial institutions by the Board of Governors of the Federal Reserve System (FRB), the Federal Deposit Insurance Corporation (FDIC), the National Credit Union Administration (NCUA), the Office of the Comptroller of the Currency (OCC), and the Consumer Financial Protection Bureau (CFPB), and to make recommendations to promote uniformity in the supervision of financial institutions (http://www.ffiec.gov).

The FFEIC is the arm of the FDIC providing the reporting system for community banks and collects the quarterly reporting data through the Uniform Financial Institutions Reporting System (UFIRS) (http://www.ffiec.gov). The colloquial name for the reporting system is *call reports*, and for the ratings, CAMELS, an acronym referring to the analysis of: Capital, Assets, Management, Earnings, Liquidity, and Sensitivity (De Lurgio, Gilbert, & Hays, 2010).

1.4 Ethics

This study identifies the emergence of ethical issues and ethical decision-making. These issues are identified and defined through the work of Kidder (2003) and McCoy (2007). Kidder (2003) identifies four ethical paradigms: Truth versus loyalty; individual versus community, short-term versus long-term; and justice versus mercy. McCoy (2007) identifies seven ethical worldviews: Normative; Kantian; utilitarian; social justice, religious, communitarian, and religious: In search of transcendent. These paradigms and worldviews were used in the study and provided depth to the analysis and information presented.

1.5 Methodology

The research questions are: What were the effects of the U.S. recession of 2007-2009 in the community bank environment from a systems theory perspective? From the perspective of a community banker; what were the effects of the recession of 2007-2009? The study utilizes a mixed methods research approach to analyze the phenomenon. From December 2007 to June 2009 the United States experienced a recession (http://www.nber.org/cycles.html). As a former banker, the researcher is often queried as to whether commercial banks were contributors to the recession or simply caught up in a transitional economic time. This phenomenological approach seeks answers to the research questions in a descriptive manner through interviews with selected senior bank executives; bank regulators; and industry consultants. Interviewing bankers, regulators, and consultants provided a source of validity through triangulation of the thoughts and ideas of each group of interviewees. The interviews were recorded and transcribed. The transcribed data was analyzed for themes and used to develop a survey to be administered to a sample of senior bank executives. The survey reached approximately 25 respondents in Central Florida. The interviews were the qualitative portion of the research and the survey provided the quantitative portion of the research.

Recession is a big picture issue. While some analysts tie the problem to investment banking, commercial banking, speculative real estate investment, or political policies (Guynn, 2010; Higgs, 2010), the 2007-2009 recession was a systemic problem that bled into the world economy in 2008 (Guynn, 2010). Systemic problems are best analyzed and solved using a systems theory approach (Senge, 2006).

Systems theory is based on the premise within a system all things are connected (Senge, 2006). Using the human body to analyze systems theory; a system may be as small as a single cell; an organ; a system, such as the respiratory system; or as large as the entire body. A system can be infinitely small or infinitely large. If one considers a bank the system, then each department is connected to, and dependent upon, each of the other departments. The bank is a part of a larger economic unit, the banking system, and each bank is connected to other banks. If one bank fails, it affects the FDIC, which, in turn, has an impact on the other member banks. The banking system is one integral part of the financial system.

This is a phenomenological study utilizing mixed methods, qualitative and quantitative methods in conjunction with one another. Creswell (2007) noted “a phenomenological study describes the meaning for several individuals of their shared experiences of a concept or a phenomenon” (p. 57). Shepherd and Sutcliffe (2011) insist that a theorist must start close to the phenomenon to be sure they identify the appropriate constructs. Connelly (2009) notes this provides validity for the study. To provide reliability Connelly (2009) notes it is important the researcher identifies the appropriate respondents to elicit valid information. Reliability, in qualitative research, is defined by whether the chosen medium yields similar results when implemented by other researchers or in other studies (Connelly, 2009; Creswell, 2007; Creswell, 2009). This study was directed toward identifying the economic issues surrounding the American economic recession of 2007-2009 in the community bank sector, by interviewing senior managers of commercial banks; bank regulators; and industry consultants. This meets the goals of eliciting valid information from the appropriate respondents and being close to the phenomenon. Interviewing bankers, regulators, and consultants, also reduced the effect of any one particular group’s bias. The interviews were used to identify the main areas of concern and used to create the survey instrument for the quantitative research of this mixed methods approach.

In qualitative research the interview process is used to provide rich information from the interviewees’ perspective, rather than identifying issues from the researchers’ perspective. The interview is comprised of only a few main questions which are followed by supporting questions when necessary to provide more in-depth information. The goal is to ask open-ended, non-leading questions allowing the interviewee to choose the depth and direction of the answer.

The questions should be broad enough not to limit the responses or the richness of the responses (Creswell, 2009). The phenomenological approach is an appropriate methodology for this study.The interview process helps to avoid the concept of *gap-spotting* identified by Alvesson and Sandberg (2011). Alvesson and Sandberg (2011) defined *gap-spotting* as developing research by finding gaps in the literature and systematically attempting to fill the void. In essence, it is an incremental growth in the literature, but does little to introduce new thought which creates new theory (Alvesson& Sandberg, 2011). The interview process is used to identify areas which need additional research from an applied perspective rather than from the researchers' perspective. Through the interview process the degree of depth of the analysis is expanded (Drummond, 2011). This process reduces researcher bias and contributes validity.

Quantitative research is the application of an empirical process where knowledge is acquired through direct observation or experimentation, which makes it easier to track the validity, reliability, and generalizability due to the presence of measurable information (Carr, 1994). Validity is a measure of how well the instrument measures what it is intended to measure and where appropriate inferences are drawn; and reliability is concerned with the consistency of the results obtained, with the instrument, when used by another researcher or with another population (Bannigan& Watson, 2009). Surveys, while not a direct observation, provide direct, measurable and quantifiable information. The validity of surveys is strengthened by the ability of the researcher to limit, and often eliminate, contact with respondents. While not providing the rich data of a qualitative investigation (Creswell, 2007), the separation helps to reduce researcher bias (Carr, 1994).“A survey design provides quantitative or numeric descriptions of trends, attitudes, or opinions of a population by studying a sample of that population. From the sample, the researcher generalizes or makes claims about the population” (Creswell, 2009, p. 145). Combining qualitative and quantitative research methods in the study provides for rich information with a reduction of bias.

John Godfrey Saxe's fable, The Blind Men and the Elephant, described how individuals who can only visualize the area of the elephant they are touching are unable to understand the entire elephant and disagreed with others' perspectives of what the elephant is. The fable is an allegory of how individuals should seek further information and be willing to understand that others' perspectives add value to understanding the whole. Similarly to John Godfrey Saxe's fable, this study sought to analyze the opinions of the industry insiders and developed a survey instrument to providea holistic analysis of the effects of the recession of 2007-2009 in the community bank environment in Central Florida, and provides a new perspective of how the parts of the elephant created one whole elephant.

2. Results: Discussion of the Findings

2.1 The Interview Questions

**Ask interviewees the listed questions. Use their responses to create the survey using a Likert scale format. Most community banks fall into the small bank category. To be sure to analyze based on size, even though all respondents should be from community banks, the survey will include specific questions to identify the size of the bank and whether it is a community bank. This allows the survey to be generic. As a generic survey, it allows for use in future studies in other segments of the banking environment and in other regional areas.*
***The interviews will be used to develop the survey. The survey will employ the use of a Likert scale and rate the answers from the interviews with a five stage Likert scale.*

Interview Questions

Current Position in the Industry

- Chief Executive Officer/President
- Chief Financial Officer
- Chief Operations Officer
- Senior Vice President
- Other

*Important for research questions to: Analyze CEO perception versus other senior officers and the use of "Other" will allow the researcher to run analyses with and without senior management professionals to provide for more depth.

Bank Size

Please select the appropriate size of your bank by total assets. Each category is defined by asset size: small institutions have less than $1.122 billion in assets; intermediate small institutions have between $280 million and $1.122 billion in assets; and large institutions have assets exceeding $1.122 billion (http://www.ffiec.gov).
What is the asset size of your institution?

- Less than $280 million
- Between $280 million and $1.122 billion
- More than $1.122 billion

Systems Theory

Do the effects in one area of the banking environment, such as the community bank sector, roll into or have effects in other areas of the banking environment or the economy? De Lurgio et al, (2009) note community banks were affected by issues within the larger bank environment. Gorton and Metrick (2006) note the commercial banking industry was affected by the off balance sheet transactions in the investment bank industry. Senge (2006) and von Bertalanffy (1951; 1972) identify units operating within a connected system have reactions to occurrences in other areas of the system.
If so, how or in what ways?

Strategy Development and Implementation

Has the recession of 2007-2009 affected the community bank environment in relation to following through with and defining strategy (developing 1-5 year plans)? Survival in the community banking environment is dependent upon a firm being able to manage strategic variables: efficiency ratio, return on average assets, liquidity ratio, equity capital to assets ratio, and loan charge offs or downs, to loans (De Lurio, et al, 2009).
If so, how or in what ways?

Has the recession had an effect in the area of financial strategy and capital budgeting: raising and managing capital?"[C]ommunity banks have been adversely affected by a decrease in liquidity in the overall financial system" (De Lurio, et al, 2009, p. 2). "As the banking industry recovers from the current economic and financial crisis, attention must be paid to efficiency as a potential strategic advantage" (De Lurgio, et al, 2009, p. 11)

Change in Public Policy Affecting the Banking Environment

In your opinion, does the CAMELS rating system employed by the regulators adequately evaluate the financial condition of a bank? The FDIC rated banks based on a number of assessment tools (O'Keefe, Olin, & Richardson (2003). De Lurio et al, (2009) found the CAMELS rating system too cumbersome, including overlapping measures, to provide a true likelihood of bank failure.Johnson and Trussel (2012) used empirical evidence and showed the weighting and valuation system for the CAMELS ratings could not produce a valid depiction of the likelihood of bank failure.
Why or why not?

General

1. What would you like people to know about the challenges of the recession?
2. What questions would you ask bankers to understand their perspective of the effects of the recession in their institution and environment?
3. What questions would you ask the regulators to understand their perspective of the effects of the recession in their arena?

2.2 Analysis of the Survey Results

Once the interviews were completed the researcher created the survey instrument with sub-questions based on the interviewees' responses. The responses to the sub-questions for question three provided evidence the systems theory perspective applied to the financial sector of the economy. Based on the evidence of correlation between the sub-questions for questions three and four, and between questions three and five, there was a connection between a systems theory perspective and implementation of strategy: Actions outside of a firm impacted what actions were taken within a firm. Based on the evidence of correlation between sub-questions for questions three and seven, a systems theory perspective applied, not only to information coming into a firm, but to information going out.

Based on the evidence of correlation between sub-questions for questions three and nine, the respondents felt there was a breach in the system between the regulators and the banks:The regulators did not see the bankers' perspective, and the bankers did not see the regulators' perspective.

Question number eight provided information of what was occurring in the respondents' institutions since the recession. The data analysis showed strong correlation between the actions in the respondents' banks and all other questions in the survey and answered the main questions of the dissertation: What were the effects of the U.S. recession of 2007-2009 in the community bank environment from a systems theory perspective? And, from the perspective of a community banker, what were the effects of the recession of 2007-2009.

3. Conclusion

3.1 Positive use of the study

The study met two goals: It expanded on prior academic knowledge, and it provided feedback for the practitioners. The areas of academic knowledge built upon include: phenomenology, Systems Theory, and strategy. Areas expanded upon, in support of the practitioners included: recession, banking, and public policy.The study expands on prior research completed by De Lurgio, Gilbert, and Hays (2009). The prior study notes the CAMELS ratings do not adequately identify banks headed for failure. By using a phenomenological approach, this study found the regulators may apply the ratings subjectively and the regulators may have been more lenient prior to the recession. This new knowledge gives credence to the idea the CAMELS rating system is not a completely quantitative measurement system. Within the study this is supported by the correlation between the respondents' responses indicating the regulators were lenient in good times, and the regulators needed a plan to create more consistency across all banks reviewed.

This study is an expansion on the use of the phenomenological methodology. The author used a staged, multi-design data collection process to create a mixed method study. The staged multi-design used a two-pronged approach of data collection: The method first uses multiple perspectives and identifies the issues surrounding the phenomenon, and the second stage takes the knowledge garnered from the first stage and provides additional insight from a larger sample of the population. The concept of Systems Theory, defined by Senge (2006) and von Bertalanffy (1951, 1972), was applied to the banking sector of the economy. The study analyzed the impact of large banking institutions and public policy in the small bank arena. It found there is an interconnected system where changes in both the large bank environment and public policy have an effect in the small bank sector of the economy. Specifically, decisions by large banks trickled down to small banks; and economic activities in small banks fed into the state and national economies.

One area affected is the development and implementation of strategy in the small bank environment. Strategy deals with long-term planning: Short-term is defined as within the next twelve months, and long-term is defined as beyond one year. It was found many banks had gone into crisis management mode and could not look beyond the current quarter or year, and the ability to make new loans became limited causing restructuring of strategic plans. Small banks could not see beyond the current year but needed to restructure strategy which is a long-term view. This is a grave challenge for troubled banks.

The recession also affected development of financial strategy and capital budgeting: The ability to raise and manage capital. It was found investors stayed away from the banking sector unless institutions had tangible plans; banks in financial distress could not raise capital; existing investors were hesitant to increase their investment in banks; and new investors were waiting for economic recovery before investing in banks. The ability to raise and manage capital is a key issue for economic recovery in the financial sector.

The NBER provides research for when a recession begins and ends. The challenge is this information is only available after the fact. The concepts identified provide valuable information for the practitioners in the banking industry because they provide insight into the connectivity of the industry and demonstrate how activities in one area of the economy impacted other areas. This includes issues occurring in the large bank sector rolling into the small bank sector; issues in the small bank sector rolling into the large bank sector; and changes in public policy, and regulatory changes affecting banks, rolling into the entire banking sector. Iqbal and Vitner (2011) note:

> The strength of the recovery is likely influenced by the speed at which risk taking returns to the private sector and this is likely determined by the extent of the build-up in imbalances prior to the recession and the perceived appropriateness of fiscal and monetary policies put in place during the recession and early part of the recovery process (p. 31).

3.2 Limitations of the study

There are several limiters to the study. The study includes a population of small banks in Central Florida. One of the goals of research is to apply the findings to other areas. In a phenomenological study it is not possible to prove generalizability of the findings to other areas. Generalizability can only be proven through repeated studies with other populations. If the results are similar, it becomes possible to generalize to populations not studied. The population is limited in size, possibly leading to an issue of scope. This may be offset by the value of qualitative research, where qualitative research is used to create additional areas of interest for quantitative research. The research relied heavily on research in the area of strategy. There is a lack of recent literature in the area of strategy, but this is offset by empirical testing of the seminal writings on strategy (Andrews, Boyne, & Walker, 2006).

3.3 Interviewee and respondent perspective

This study describes the experience of the interviewees and respondents from their perspective, and within the context they experienced the phenomenon, the recession of 2007-2009 in the community bank environment. The recession was found to have impacted strategic planning, financial strategy, capital budgeting, regulator ratings, and regulatory actions. Strategy became difficult to create because many banks went into crisis mode and could not look beyond one year. It became difficult to raise and manage capital. The CAMELS rating system was applied more stringently and bank ratings suffered. Finally, there are areas outside of the banking industry that feed into recession.

3.4 Future research

One of the most prevalent concepts surrounding phenomenological studies is they are base research which brings other ideas to the surface, generating new areas for both qualitative and quantitative research (Creswell, 2007).

- The purpose of this study was to explore the perspective of the recession of 2007-2009 from the community bankers’ perspective. The outcomes from this descriptive, phenomenological study may be tested through future research.
- The study could be replicated to create a longitudinal study either in a small repeated measures design, or a time series design.
- Apply the research to other regions within the US and justify generalizability to these regions in the original study.
- Compare results from other regions and generalize to the US economy.
- National study applying the instrument to a broader audience.
- Is the study generalizable to the international economy?
- This was a descriptive study. Future research could be relational to evaluate the changes in public policy on the reported results of banks, or to evaluate the relationship between public policy and bank policies. Future research could be causal to identify changes in the economy due to changes in public policy.
- Based on the feedback where bankers felt there may be a political decision to consolidate the banks, a review of all public policy passed since 2007 should be analyzed for the impact in the banking environment.

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