

Formula for Success

What Financial Services CEOs Can Learn From PenFed Credit Union CEO James Schenck

How is your credit union weathering the changing face of the financial services industry? The new business model that pits CUs again both major institutions and non-banks demands skillful balance. See how one CEO is taking on the challenge brilliantly.

Part Two of my Conversation with James Schenck

Scott: “Many financial services firms feel the same way. Having just come from the Small Business Banking Conference, where more than a few CUs attended, I’m sure many industry peers are feeling the same as you.

Your disciplined approach toward prioritizing is intriguing. Can you describe this approach a little more? Once again, it seems to me that many of your peers are overwhelmed with technology, so your insights here will assist them.”

James: “A CEO’s ability to say ‘no’ is important. You can’t be all things to all people and invest in all things at the same time. I like to amass resources at a few things that bend the needle.

For example, our forward-facing interfaces between our mainframe and our members have had a big impact. Some person-to-person technology hasn’t reached scale yet so we haven’t invested much in it.

We invest in making sure our membership experience is fantastic. It’s so important to focus our workforce. We take on five or 10 big, hairy, audacious IT projects in a 12- to 14-month period that will bend the needle and [will] avoid the things that aren’t mature yet and which members don’t need.

This keeps us focused on an excellent membership experience. We don’t try to be bleeding edge. We go where the trends are and get great at them. There’s never a lack of good ideas looking for a pilot.”



PenFed Credit Union CEO James Schenck

Scott: “What are the key changes you expect to see in your industry over the next one to three years?”

James: “The entire industry is facing the explosive growth of mobile payment systems – this goes back to the challenge of the ‘flash-to-bang’ time when it comes to innovation. I expect that mobile payment systems will have far-reaching implications for the credit union industry and the financial services industry overall. Firms who are wed to large networks of old brick-and-mortar retail locations will continue to perish.”

Scott: “Besides the reduction of the branch networks, what do you think some of the far-reaching implications will be? Will

there be fundamental changes in how CUs make money, how their organizations are structured, the types of people they hire? Do you feel the way in which CUs are perceived by members and the value they receive from CUs will change?

James: “Cybersecurity. The consumers expect privacy and no compromises. They take it as a given that their information will be protected. It’s even more important now. The cost of protection is high in order to stay ahead of the bad guys.

Scale has advantages because you can leverage your cost per member. It increases the importance of protecting data even more from the bad guys. There are huge financial repercussions on the operations side. The Sony hack is a huge wake-up call. I meet with our head of cybersecurity weekly. You have to be constantly enhancing your security posture.

The CUs that will make money will raise deposits remotely, like the Capital One 360 account, through mobile devices by anyone in the country. That’s why a small branch footprint is key, as is having the best loan prices and saying ‘no’ to things that won’t drive us in the right direction. You need to find the right balance. You can’t be all things to all people.”

Scott: “What impact do you think non-bank competitors like Walmart and others will have on the industry?”

James: “Walmart and others will continue to innovate in order to provide convenience to a vast customer base at the expense of smaller credit unions and thrifts. Scale will become even more important as a result of the introduction of non-financial services firms into the market.”

Scott: “How will CUs such as PenFed scale without expanding their branch network? Does this mean the need for state-of-the-art digital marketing will increase? Please elaborate more on what scale means to you in this scenario.”

James: “Scale means assets and members. Average loans and deposits per member. Scaling technology investments to as many members as possible. Reducing our cost per employee. We are the inverse of a branch-driven organization because we drive value remotely.”

Scott: “What do you think is the critical path to meeting those changes and being an industry leader in the next one to three years?”

James: “Positioning ourselves as the leader of the credit union industry means taking the steps to heavily invest in intellectual talent and allowing that talent to lead and drive the business forward, not simply training it to manage. Our direction forward

will be heavily influenced by our ability to find the right balance between internal development and thinking outside the box as we grow.”

Scott: “A former Marine once told me the average American business manager doesn’t have leadership training until they’ve been a manager for 10 years, but in the Marines, leadership training for officers and NCOs is immediate upon promotion and ongoing thereafter. What is your approach to leadership development at PenFed?”

James: “We work hard on leadership development. There are several outside firms we work with to develop all our directors ... VPs and above. They work with 13 at a time and have personal coaching and leadership development.

Below that level we have motivational leadership speakers come in and work in the call centers and branches. They take 30 to 50 managers at a time and drive our strategic intent down to their levels.

In the military there is different leadership training as you go up through the ranks. We’re building the same thing at PenFed. We strongly emphasize the importance of leadership education and training, and [we] make time for it. We think this helps us set the culture at the top and helps them (our leaders) look ahead.”

Scott: “What is the best advice you have received from anyone during your CEO journey?”

James: “The best advice actually came from a couple of sports analogies.

- 1) With any business or activity, stay in the middle of the fairway.



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2) Leading a high-performance firm is a marathon, not a sprint. Build and lead your employees to have endurance, and don't chase fads."

Scott: "It sounds like 'staying in the middle of the fairway' means maintaining a clear path and direction. Hit the ball straight, don't get into the sand or weeds, i.e., don't chase fads. How can you tell if something is a fad or a sea change? For example, the innovations you mentioned above as well as mobile? Is there a way to spot early on whether something is real or a fad and still stay in the 'middle of the fairway'?"

James: "Apple Pay is an example. It may or may not have a significant impact, so it doesn't make sense to bet the farm there. We can't afford to ignore it, but we won't bet the farm yet until we see adoption across the globe. We'll dip our toe. It's a tradeoff between rushing in and not being fast enough or ignoring it completely. It's a balancing act."

Scott: "What key practices or tactics do you keep coming back to?"

James: "Focus and execution in support of an overarching strategy – having a strategy in place takes the guesswork out of operations by allowing employees to focus on their areas of responsibility related to the proper execution of day-to-day operations. We have to ensure that everyone – from board members to line tellers – know where the organization is going. This underscores the importance of constant communication."

Scott: "This is particularly intriguing to me since so many organizations do not have a clearly articulated strategy that is operationalized consistently. What's the key to creating a leading strategy and making sure it is understood, compelling to employees and executed day to day? Do you have any thoughts on why this [process] is so elusive for many American businesses?"

James: "Some CEOs and boards believe they can be everything at once, but no one can be all things to all people. Knowing who you are is the most important thing. That's why I treat internal communications just like marketing campaigns."

I'm always reinforcing our six strategic intents all over the organization so employees can see how they're moving the needle at all times. We build our reward structure around this. Digital convenience across the world is our strategy. We understand what it takes to drive our specific lines of business and say 'no' to everything else. Having the discipline to say 'no' allows more management and employee bandwidth to say 'yes' to what we're good at.

Constantly reinforcing who you are and why you're not doing certain things is critical. If you do expand, it should be built upon your existing skills. Excellence in member service is particularly important. We have to get that piece right every time."

Scott: "Have you found that member expectations have changed materially in the last year or so? How do you see those expectations changing over time?"

James: "Members are becoming much more driven by great retail experiences, so we don't try to compare ourselves to other financial institutions."

We prefer to compare ourselves with leaders in retail like Zappos, Amazon and Petco. Members want simplicity and personalization. They're expecting more, demanding more and want great functionality. Retailers have set a high bar."

We have to ensure that we have clear metrics for measuring success in creating a great member experience, and we must communicate with our employees about how the organization is doing against those metrics."

Scott: "What is your process for communicating these metrics throughout the various levels of PenFed and for ensuring their meaning is clearly understood so that people know how to make appropriate adjustments while maintaining strategic integrity?"

James: "Here's a balanced scorecard example. Loan growth expectation of 'x' billion dollars, with auto loans, credit cards and mortgages each contributing. We push the expectations for each product down to the individual branch, call center and employee. The numbers roll up daily at each level as well as to the firm. We have a daily new money report that goes to the individual or corporate number. Laying out vision and having



forward

“Moving toward the future or
a more advanced condition.”

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quantifiable measures around key drivers and drilling down throughout the organization is what makes it work.

PenFed is very good at planning. I believe confidence begins with planning. People want to know what is expected so they can align the right resources with realistic metrics and stretch themselves. The whole organization feels good when you exceed your numbers.

I love delivering the best products and services and inspiring the workforce on strategy, focus, metrics and driving execution. Focus and execution separate winners and losers in every organization. Our line managers are worth their weight in gold. They make it happen.”

Scott: “What advice would you give to your credit union peers around the country and globe?”

James: “I believe that it is important for leaders in the credit union industry to continue to foster a spirit of cooperation and collaboration. We should continue to work together for shared success.

I have been fortunate to have developed great relationships with top credit union CEOs, and we all work together in a friendly manner on issues of shared interest even though we’re competitors.

We realize that there is enough market share to allow the largest credit unions to grow multiple times their current size – not at the expense of other credit unions, but at the expense of the bankers.

Most importantly, as credit unions, we must always place our members first. Membership sets us apart from the banking industry, and that is a badge of honor.”

Scott “What are the toughest challenges CEOs of financial institutions have in creating and executing strategy?”

James “The biggest challenge is maintaining safety and soundness through the earning of capital versus raising it through secondary markets. The banks can just raise capital, but credit unions must earn it in order to grow. Knowing where and when to invest and knowing where and when to take well-evaluated and calculated risks are also critical components to the execution of any strategy.”

Scott “How has government regulation changed your strategy and your job?”

James “Government regulation has not changed my strategy or role. The cost of compliance, however, runs several million dollars a year, which does have an impact on mid- to small-sized credit unions. It also consumes much of their management time and focus at the expense of time that could be used to better serve members. To sum it up, it’s a matter of bandwidth, or lack thereof.”

Scott: “How are you adapting to new technology platforms and data mining while keeping data secure?”

James: “Thanks to our relatively low operating expenses, we’ve moved forward with a multi-million-dollar investment in talent acquisition and technology upgrades that will not only improve our members’ experience but will also allow us to gain a better understanding of our members’ needs. The new systems that we’re evaluating also include state-of-the-art privacy features, alerts to potential threats and other means to keep data secure.”

Scott: “James, thanks so much for our discussion. I really admire the way you run PenFed. You are operating on a lot of sound, forward-thinking principles, and I applaud you for that.”

James: “Thank you, Scott. Your questions and follow-ups were insightful and I enjoyed meeting you.”



Scott McClymonds is a veteran leader in the financial services industry and an expert at creating and executing profitable strategies that make businesses grow. His company, CEO Velocity, is a strategic consulting firm that helps CEOs of financial services

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