# LOOK BEYOND LENDING AND FIGURE OUT WHERE YOUR BANK IS HEADING

Will people still want what your bank is selling?

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Perhaps I'm the only one who thinks of the struggle between the community banking and large banking business models in cataclysmic terms. I believe that what's at stake is a battle for how we and the generations coming after us will access banking services.

Comparing multiple banking models

To have a meaningful discussion, we should try to understand the competing models in straightforward terms.

We all know who the big boys are. This is actually a pretty broad section of the industry as there are many banks with big-bank business models that are too big to be rationally considered community banks.

Then there are the small fry, the community banks and thrifts. Collectively, these are generally that part of the banking industry that places a premium on "high touch."  They do not suffer the angst that many of their larger brethren do in the disconnect between the mission-vision-values statements where the marketing people say one thing but the reality in the branch is something quite different. No, these are the banks whose staffs are actually in your face with a smile and an attitude of being genuinely glad to see you.

But there is another business model on the horizon that resembles the mega bank strategy but with a difference. My four children's families are customers of USAA, as I am in the insurance sense, and three of them bank extensively with USAA Bank. They borrow money, do remote deposit capture on their smart phones, and pay their bills through a combination of their USAA Bank checking accounts and electronic bill pay. They are on automatic deposit and debit to a high degree and use USAA debit cards to get cash from ATMs (and they pay no transaction fee).

Not one of them lives closer than 400 miles to San Antonio, USAA Bank's headquarters.

Is this the future shape of the banking business? We need to know, don't we?

Perhaps the traditional assumptions about community banking being a viable long- term alternative to the mega banks may be in serious jeopardy. Will the mega banks and USAA Bank (and similar institutions) become increasingly indistinguishable?  And of course the bottom line question is how many of today's banking customers will resist this type of business model. Will they be sufficient in numbers to preserve some semblance of community banking as we know it today?

There are barriers to entry into the world of "big" and the principal one is capital investment. Systems to achieve scalable activity on a large geographic or national basis at affordable costs are enormous and out of reach of community banks. Credit unions often get a jump on traditional commercial banks as they have generally narrower product lines and confine their activities to those where volumes are high and are of a plain vanilla nature. This means that credit unions are in a way doing more with less and are very effective competition in that sense--especially with the tax breaks most enjoy.

Big banks have an edge over the community banks both in the breadth of their product lines and the ability to beat smaller banks in the pricing sense. We often think of scale primarily in terms dealing with physical volumes (such as checks and electronic debits and credits) but the ability to fund themselves with a variety of sources commanding rock bottom pricing is probably the defining strategic advantage in the costs of funding.

Will Main-Street-friendly be enough to keep your doors open?

So where does that leave the community banking industry?  Will personal service, a smile, and a traditional product line of deposits and loans be enough? There are about 5,000 community banks today but what will those numbers be in ten years?  And how will we define small?

I think the future is limited, frankly, and that likelihood suggests there are only a relatively few options for long-term viability.

First, scale is compelling and it has been for many years.

This trend will continue and accelerate and inevitably means that small will be defined in increasingly the first of the larger terms of size.

Second, delivery systems and access are in flux.

Some banks are adding branches while others are experiencing shrinking face-to-face customer contact. Investment in technologies and non-traditional access are important, so  the costs are formidable.

Third, there will always be occasional and genuine niches for a bank to fill.

These may be both in the product-line sense (types of specialized lending) or geographic.  Either type of niche strategy will likely attract competition as anything of a decent size will attract the attention of someone wanting to poach on the territory.

Fourth, we should redefine, renew and recommit to commercial lending, especially to small business.

This will be the subject of future columns.

Reconsidering how you'll define "success"

For anything like a traditional community banking model to endure and succeed, banks are going to have to carefully consider two questions:

1. What is to be the product line?

2. What is a competitive and reasonable return on equity over time?

The first question demands careful and critical thinking about staffing needs--the types of skills and the types of personalities to accomplish a comprehensive range of community banking business.

The second places an enduring emphasis on consistent performance in all the usual metrics of a high-performing institution.  This is yet another facet of the staffing issue and puts a very high premium on competence and skill sets.

Perhaps you'll conclude that you should join with one or more other competitors in your trade area to survive long term. But have you figured out what you bring to the table and what they will need to bring too?  There needs to be a complementary set of attributes and not an agglomeration of similar or identical skills.

What about your staff?  What do your customers want and need?  Who among your competition has a commitment to your type of business model?  Are any of them likely to be toxic to your customers' expectations and needs?

While there are more questions than answers to community banking's future at this point, the urgent need is to start the process of thinking about alternate and competitive scenarios for each local market place.

Some will fit better than others but the end game, while uncertain, is going to be far reaching. How much of that we can control is our challenge and it's upon us today.

About Ed O'Leary:

Veteran lender and workout expert O'Leary spent more than 40 years in bank commercial credit and related functions, working with both major banks as well as community banking institutions. He earned his workout spurs in the dark days of the 1980s and early 1990s in both oil patch and commercial real estate lending.

O'Leary began his banking career at The Bank of New York in 1964, and worked at banks in Florida, Texas, Oklahoma, and New Mexico. He served as a faculty member and thesis advisor at ABA's Stonier Graduate School of Banking for more than two decades, and served as long as a faculty member for ABA's undergraduate and graduate commercial lending schools.

Today he works as a consultant and expert witness, and serves as instructor for ABA e-learning courses and has been a frequent speaker in ABA's Bank Director Telephone Briefing series. You can hear free audio interviews with Ed about workouts here. You can e-mail him at etoleary@att.net. O'Leary's website can be found at www.etoleary.com.