
FINDING A VIABLE NICHE IN A SHRINKING MARKETPLACE

Second in a series: Time to get this right begins to run out...

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As the number of banks shrink and as "small" increasingly is defined in more expansive terms, there is an urgency for independent banks that don't have a "natural" sort of niche (geographical or product line) to find a way to remain viable over the long term. The issue today is determining whether there are valid business models to remain independent and locally owned and managed.

The threats to survival as an independent are urgent. Compliance costs and issues of scale over the full range of product offerings are pinching operating margins and driving increases in a wide variety of banking industry risks including compliance risk, legal risk, and operating risk. There's simply no escaping these macro-industry trends.

How the credit process is changing

Considered solely in terms of the credit function, commercial lending, especially lending to small and medium-sized businesses, is increasingly becoming a retail delivery product. As discussed in previous columns, this is making contact and interaction between locally based and experienced lenders and the banks' borrowing customers increasingly rare. Credit approvals are becoming automated and centralized in distant processing centers, often hundreds of miles removed from the local market where loans are originated.

There are two primary constituents of losers in this phenomenon: the borrowing customer and the local community.

The borrower gets less benefit from his or her bank in terms of business counsel and input including views on local business conditions while the market place loses both lenders and ownership more intimately connected to the success of the local market place.

This probably will also reduce the flow of credit into local economies though major players will deny that it's inevitable. It's not that big banks don't care or don't want to lend to viable borrowers. It's just that they are not "invested" in the same way as the community banks are.

Regarding community, there's also the tendency of the big banks to standardize their lending product lines. If you as a local business person has an opportunity that doesn't exactly fit the headquarters paradigm, then so be it. Or, one size is presumed to fit all, and what may not work very well for a particular borrower is not material to the success of the big bank.

Multiply this hundreds and even thousands of times and the financial impact to the community can be considerable. The implications and the specific impacts for the customer and the community may of course be diametrically opposite to what constitutes the best interests of the large banks' stockholders.

So how might the independent bank differentiate itself from its large-scale competitors? There are several strategies and a great many more components to each of these strategies. In the lending sense, the first and foremost component has got to be a highly developed sense of the principles of sound lending among the lending staff.

If I owned a community bank today, here are the major components of what I think a successful commercial loan business niche strategy needs to contain for a prosperous and independent future.

1. Train your lenders well. Make sure that they understand sound credit principles and have the opportunity to keep their skills current and fresh.

2. Support them with a state of the art productivity enhancing systems and staff that works smarter rather than just harder. "More work for less rice" is not a winning strategy over the long haul.

3. Incent the lenders for doing the right things the right way. Avoid the tendency to cross- sell for the sake of cross selling products or services alone. Let the glue to the banking relationship be the total value added to the customer from the customer's point of view.

4. Develop a comprehensive sense of how your lenders add value to a customer relationship. Develop a series of "success stories" that you can both replicate and publicize.

5. Make a "product line" out of not only the loan but the service that goes with it. There's value in proper analysis and loan structure. Service should also include the sharing of useful information and your knowledge of the local market. It also means your lenders need to be business problem solvers as well as business generators.

6. Develop a rationale for appropriate loan pricing. Rate is often just a small component of the total relationship though a highly visible one to the customer. Remind your customers that the rate on the loan is a business expense and as a consequence, "Uncle Sam" is picking up a significant portion of the cost. The nominal rate is in other words not the effective rate. The effective rate is often considerably less.

7. Get out from behind your desk. Visit your customers' places of business often and personally thank them for the business.

Borrowers are proud to show off their facilities and they welcome the attention. Besides, you can't learn nearly as much about the customer sitting at your desk as you can sitting at his desk or touring his plant.

8. Think innovatively. Use senior officers, especially the CEO, as prominent "private bankers."

Get these people in front of customers regularly and be sure that they are supported by administrative staff that is capable of producing individualized service of a notably high order. Make it a "wow" sort of experience dealing with your bank from the seniors to the account managers.

I think the most potent sales tool that community banks have that they fail to fully exploit is the fact that their lenders are not just "empty suits." Local bankers working for locally based bankers know local conditions first hand. And they don't just have big push brooms sweeping business in the direction of the nearest branch office.

The direct interaction with a lender often makes a determining difference in building long-term confidence and trust. Trust will be the inevitable result of all relationships built on respect and a genuine interest in the borrower and his business. Some people, some bankers included, can feign a certain level of sincerity.

But it's impossible to fake that indefinitely. People can spot phonies and your customers and mine are among the very astute if we've been developing our business among the best of the local businesses.

And trust is a bonding agent akin to "super glue."

Locally owned and managed banks are as invested in the success of customers' businesses as their customers' owners are. In this day and age and especially given the recent history of lending, that's an alignment of interests that is becoming increasingly rare in our business.

As an industry segment, community bankers don't have much time left to get this right. The time for execution on a long-term survivability strategy built around small to medium sized business credit will not wait on their time table and convenience. The big banks are well into the execution of their Pac man strategies and your bank is probably in their sights.

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.

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