Differentiation through Niches

by Charles Wendel

Increasingly, the best banks, credit unions, and their non-bank competitors generate higher returns by taking the path of niches and specialization. Specialization provides a differentiating element that allows a financial institution to create a sustainable competitive advantage. Developing that advantage is more critical today than ever before as new digitally-enabled competitors continue to pick away at traditional bank activities and find more underserved segments.

As our webinar this week will discuss (March 14 at 2pm) virtually all our most successful clients emphasize some sort of niche approach, whether in the business or consumer space. In the past I have heard banks say, "Everyone is our client"; that approach leads to mediocrity. While many players may emphasize an industry-focused approach to niches, many other options exist, including:

- Type of loan need, e.g, SBA, CRE, or structured finance
- Life cycle, e.g., start up or succession requirements
- True and demonstrable relationship focus, e.g., business and personal trusted advisor
- Industry subsegments
- Out of favor or controversial segments

Below is a list of some of the segments we have seen both from clients and non-bank providers. As expected, most banks engage in the professional segment, but the best players segment further, for example, not focusing on the entire medical segment but rather specific specialties within it. In areas like legal, some banks may focus on the business while others build relationships with the lawyers themselves. Other banks do both.

As you scan the list, you will see that in some cases banks would run, not walk, from some of the niches listed. Many banks avoid even some more traditional segments such as churches and similar places of worship.

In those cases where banks will not play, non-bank lenders, often backed by private equity money, take advantage of a competitive market gaps. In fact more microsegments are being discovered as data analytics uncovers new potential areas and customer expectations grow for dealing with a bank or non-bank that can provide value to them in their specific situation.

Business niches examples:

- Professionals: lawyers, doctors, accountants
- Marijuana farms
- Funeral homes

- Women-owned businesses
- Ethnic-owned businesses
- Start-ups
- Spas and health clubs
- Restaurants
- Time share developers
- Franchise finance
- Churches
- Tow trucks
- Used agricultural equipment
- Strip clubs (!)

Consumer niches examples:

- Military personnel
- Retirees
- Gen X
- Mass affluent
- Uber drivers
- Entertainment and sports figures
- “Next generation” wealthy
- Silicon valley employees
- Private equity investors

Banks should focus on multiple segments, for reasons tied to growth goals and concentration risks. The potential and quality of niches may also change over time and, therefore, proactive management will reexamine each segment at least annually, reviewing concentration limits. Recently, we spoke to the head of one niche oriented firm who said that while they currently focused on about a dozen niches, over the 20+years of the company’s operation, they had serviced more than 50 segments.

Based on our client work, we created a checklist for FIs to consider as they evaluate which segments are most appropriate for them.

- ✓ Review your current customer base for segments/niches already served
- ✓ Determine which segment(s) the bank wants to focus on/should focus on
- ✓ Review bank capabilities/products
- ✓ Address gaps/role of third parties
- ✓ Evaluate staffing needs
- ✓ **Then, make go/no go/niche decisions**
- ✓ Consider select hires/lift outs
- ✓ Develop plan related to affinity groups/COIs
- ✓ Create marketing message/packaging
- ✓ Get the right internal people involved
- ✓ Revisit niches annually

A few comments on the above list:

- FIs need to start by analyzing their current customer base. In some cases, perhaps inadvertently, they will find they already have some sizeable segment focus.

- FIs need to be self-aware of what segments they can succeed with. In one case we completed a project that showed the bank had a substantial number of restaurants, not a high priority for them. Instead, they wanted to serve professionals (as do so many others). However, while senior management had the desire to focus there, the bank lacked the products and the people to make that happen, particularly given the competitive nature of their chose segments. In short, they had unrealistic goals.

- Today, assessing an FI's current digital capabilities versus customer and target requirements need to be given high priority. Partnering with Fintechs to meet these requirements will often be critical to success.

- Buying versus building often makes the most sense in order to gain expertise and jump start an effort. This involves persuading a group experienced in the desired area of focus to join your bank. Obviously, big dollars may be involved as well as a clear multi-year commitment from the bank to the new hires; good bankers will not join unless they believe they can succeed at the bank. But, one bank we know that started this approach years ago has seen a clear uptick in the number and quality of team opportunities to choose from, as the bank's reputation has strengthened.

Probably the most fundamental issue related to niches is the inability of banks to take a frank look at themselves and determine what they are really good at. In addition, a successful niche focus requires a cross-silo approach, one in which HR, IT, Product, and other areas work together to help transform the bank and direct it in to a new area. Easy to say, hard to accomplish.