Here's Your Secret Sauce: Go Vertical. Go Niche.
by Charles Wendel

Want a "secret sauce" that will lift revenues, reduce origination costs and operating expenses, and increase credit quality? Over past decades everything from TQM to CRM to, Big Data to, Digital Banking to, now, AI, has been touted as the answer to a banker's prayers. But what if this "sauce" has been hiding in plain sight? What if many of the best performing banks and other FIs have already demonstrated its effectiveness and offer a roadmap for success using this approach?

In recent work we have done with the leasing and equipment finance industry and in years of working with great banks, it is apparent that developing vertical specializations and niche approaches have provided the key to many FI's success.

Verticals involve an intense marketing and customer service focus on selected industries. Many banks highlight some obvious ones, like doctors and lawyers, while other banks, like Live Oak, cover those but also less obvious segments, such as funeral homes.

Some bankers reading this will say we already do this, but the fact is that they many just put some marketing gloss on standard products and advertise they are the bank to… fill in the blank. Some may even have gone online to read about the industry or their banks may subscribe to a service that provides industry analysis for the banker to review before a client meeting. That's not good enough to compete successfully against a true FI specialist, whether a bank or equipment finance company. Those that excel at verticals attend conferences, develop tailored solutions, and build reputations in their selected areas, and position themselves as advisors rather than order takers.

Almost every bank complains about increased competitiveness; mostly, that is because they are all aiming at the same group of customers and focusing on the same narrow box. Building verticals allows a bank to change its competitive dynamics.

Banks avoid specialized areas for a number of usually not very good reasons:

- Banks say they don't have a good handle on the industry concentrations that already exist in their portfolios; they can and should figure this out.
- Individual bankers want to remain generalists and fight against having clients taken away from them, even if internal experts can provide a better customer experience; the customer and the bank's overall performance needs to come first.
- Bankers view specialization with wariness and as potentially limiting, rather than viewing it as a potential growth path; banks focusing on specializations generate results that say otherwise.

- Some lack faith that they have the products and services to distinguish themselves, therefore, they offer “everything to everyone”; mediocrity to all needs to be replaced by excellence for some.
- Some say, “What if we pick the wrong vertical?” Good point, if you pick only one vertical and it happens to be, for example, taxi medallions disrupted by an Uber event. Vertical players focus on five or more vertical niches. To limit this risk; they also review their industry performance and concentrations regularly. Beyond an overall industry, some banks focus on sub-specialties, ophthalmologists rather than “Doctors”, types of trucks versus “Transportation”, increasing their ability to differentiate themselves

But, against these objections, the power of verticals appears undeniable:

- ✓ Lower origination costs for new clients
- ✓ Higher relationship rather than transaction-based pricing
- ✓ Improved risk management
- ✓ Brand creation
- ✓ Ability to attract experienced and strong teams from other players
- ✓ Creation of barriers to entry
- ✓ Managed concentration risk

(BTW specializations do not need to be industry only. Some banks and commercial finance companies highlight specific types of loan and structuring expertise as a differentiator. That works too.)

How do you determine which verticals to focus on? Begin by asking these types of questions:

- Start by assessing your current business. Which industries are represented in your current portfolio? What industry concentrations already exist?
- Which industries are large in your areas, but not currently captured by your bank?
- Where are competitors focusing? What can you learn from them?
- Which need the products your bank prefers to provide?
- Which fit with your credit culture?
- Which provides an opportunity to lift out a team from another bank? Being able to attract a specialist team and lever their knowledge can position your bank quickly as a player on a desired segment.

Banks need to address their being viewed as a commodity with commodity pricing. Building verticals addresses this issue and can help to transform a bank into a more need-based solutions provider.