Major Growth Opportunity Ignored
by Charles B. Wendel

Last week I summarized a webinar and report focusing on expectations for community banking in 2020 and beyond. At the end of that webinar one of the speakers highlighted an area that he felt offered great growth potential for community banks: small business. As someone who has worked in that space, I agree it is highly attractive; as someone who has worked in that space with banks it is also highly unlikely that community banks will take advantage of that opportunity.

Why is it attractive? Here are ten brief reasons:

1. There are a lot of them. Businesses less than $1mm in revenues represent 95% or more of all companies in the U.S. and, banks can pick their spots, focusing on the segments they prefer and downplaying others.

2. Community banks should be serving…the community. And what's more important to a community than a steadily growing group of small businesses.

3. Many small businesses want the advice and counsel banks can provide. They see their banker as a value-added provider; increasingly, big companies see banks as commodity providers that need to submit the lowest bid.

4. Small businesses offer cheap deposits. Most businesses do not borrow. Small businesses can provide 3x, 5x, 10x in deposits what they require in loans, providing a low cost funding base for other loan activities.

5. Community banks lack many other options. Commercial real estate seems easy, but the last downturn showed it becomes a treacherous trap in a downward economic cycle. Yet, many community banks continue to focus there.

6. The business owner is an attractive target for community banks. Many business owners have accumulated wealth. They may need mortgages, investments, retirement accounts, all of which can provide a bank with attractive interest and fee income.

7. Fintech partners can help banks provide loans and other products required by small businesses with minimal capital investment by the community bank. Forget trying to train your banker to be a sales person; consider levering the third party capabilities provided by Numerated, Fundation, Biz2Credit, or others.

8. SBA lending can help to reduce the loan risk. Community banks should investigate 504 and 7a lending; these loans require documentation expertise, providing another opportunity to work with a partner.

9. The returns are great. ROEs on small business loans exceed most other areas. When the entire relationship is evaluated (loans, deposits, personal business, etc.),t the attractiveness of this segment is undeniable.

10. Ethically, it is the right thing to do. I deliberately list that one last. But, banks should be aware, depending upon where the political winds blow, this may become a bigger area of focus.

OK, so if it's so great, so economically attractive to the bank and of interest to the customer, why will most banks never put enough effort into building a small business franchise for this bank?

1. It takes effort and time to build the business. CRE lending takes little effort versus understanding a small business and its cash flow. But, when a bank does understand a small business, it can unlock a lot of economic value.

2. At most banks small business lacks a committed sponsor. It ranks lower in the inter-bank caste system than other areas. It needs a champion to win bank interest.

3. Banks really do not embrace partnerships. Many community banks fail to understand that THEY HAVE NO OPTION but to learn to work with Fintechs and not just rely on their stolid, high cost Core providers that are consumed by interest in their own bottom lines and not their bank clients.

4. More fundamentally, many banks do not understand how to make the economics work, in part because they remain loan focused and small commercial loans made by banks in the traditional way lose money and destroy shareholder value. Hence the need for streamlined processes and, probably, a Fintech partnership. (Yes, them again.)

5. Legacy and history tie the bank into old ways of thinking that need to be shaken up. Today, beyond a certain number , maybe 15-20+ years, if that, to show stability, the years a bank has been in existence really do not matter to most customers. In fact some customers hear banks talk abut their history and think maybe the bank will be unable to adapt to the current world and the requirements of today's customers…they may be right.

6. No one wants to stick his or her neck out. Let's face it, a small business initiative might fail. Many bankers would rather avoid taking on that challenge versus being pinned with a failure that may hurt their career paths. These bankers, who may have mortgages and kids in college, cannot buy into the concept of taking some chances, unable to follow the motto offered by the title of a book: "Relax, we're all going to die."

As a professional outsider, which is what a consultant should be, it is both frustrating and a bit sad to see the small business segment ignored by the banks that should be most focused on it. But, a banker who does not want to go down that path is readily able to come up with the rationale to avoid doing so. Fortunately for small businesses an increasing number of Fintechs and big banks appreciate their value.