Should You Even Bother With Small Businesses?

by Charles Wendel

Over the years we have completed hundreds of projects for banks and other financial institutions related to building their capabilities and market share with small businesses. Yet, after too many years working in this space, most banks are mediocre at best in meeting the needs of the business banking segment. Frankly, many financial institutions (FI), particularly the smaller ones, seem to be wasting their time and limited dollars and would be better off pursuing other areas.

Why are so many banks/credit unions and others so bad at small business?

They simply do not understand what small businesses want. Every month or so I read about another bank that has decided to develop an advice-based approach to small businesses. The concept centers on providing them with information and other services that will help them manage their businesses. Fact: While banks can put lots of marketing gloss around this idea, most banks are totally unable to deliver as trusted advisors to small businesses.

Why? Consistency and trust are critical to small business owners. I have had the same insurance agent for more that 20 years and trust her. I have had the same accountant for about five years and trust him. (My prior accountant retired after 20 years of working with me.) Banks may need to be willing to position the banker as a sophisticated and quasi-independent advisor much like a Merrill Lynch does with its brokers. But most banks seem unwilling or unable to do so.

They need to look to Goldilocks and the Three Bears. Remember how one of the porridges was too hot and another too cold? Remember that one of the three beds was too soft while another was too hard? Some FIs are simply too small to serve the needs of small businesses while others are too big. Most small FIs lack the sales and marketing skills required to serve this segment and will have difficulty attracting and retaining the type of quality professional that the small business requires. They will also find it increasingly difficult to keep up with technology and new product costs. They lack the ability to leverage their cost base.

In their hearts senior managers of many (but not all) big banks really do not "get" small business. These banks need to feed an ever-growing appetite for growth. Middle market and large corporate loans often provide the BIG numbers management can use to promote growth to investors. Small business requires a tough grind-it-out mentality, a willingness to develop a market over a period of years, not months. Too frequently, big banks need the quick hit and despite their PR messaging lack strategic vision. I remember speaking to the head of a small business group at a top five bank who wanted to know if I had any secret sauce to offer him. Other than replacing him as soon as possible, I had no suggestions.

Here is a telling analytic exercise. Chart the number of people who have run the small business groups of the top five major banks over the past 10-20 years. In some cases the names change almost annually; in at least one case I am not sure who is in charge. At some large banks business banking is a way station for professionals; for the best players it has become a career destination. The banks that show greater consistency in leadership usually also generate higher quality results. No surprise. (BTW some smaller banks have the opposite problem whereby management of this business line needs to change.)

They do not understand the economics. I and others have written about the economics attached to small business lending. In many cases the loan serves as a loss leader requiring the bank to gain revenues from multiple other areas: business deposits, cash management, personal deposits and investments, personal loans, mortgages, etc. But, most banks fail at cross sell. Even worse, internal bank accounting and reward systems often get in the way of capturing true household relationship revenues and profitability.

When I became a banker a long time ago I expected to be intimidated by my banker colleagues whom I assumed were highly analytical and quantitative. How surprised I was when I found that most of them were largely innumerate and lacked a good grasp of the profitability drivers of their portfolios. Within small business that situation has not changed very much in 20 years.

Small businesses do not need another mediocre provider. Any FI considering entering the small business market now or increasing its level of investment better have a clear rationale for doing so. While this newsletter recounts some poor practices, there are many banks (across all size spectrums) providing first-rate services to this segment. Unless you have a targeted approach and a true value added to provide (that is a true value added and not just self-delusion) the effort will fail. That is one reason why FIs should consider teaming up with alternative lenders as an alternative to increased direct activity.

Banks are looking for ways to generate revenue and, of course, small business pops up on the radar screen of bank executives and Boards. However, success requires a level of capabilities and commitment that will challenge many banks and credit unions.