Small Business Banking in 2015 and Today

by Charles B. Wendel

A few days ago, I read an email from someone at a Fintech who had come across a 2015 BAI article I had written on banking small businesses. He thought the article was still relevant (Here is a link to the article). I didn't remember much of what I had written, but when I reviewed it I saw he was right. Some things have changed, but most of the fundamental issues have not.

The small business banking world in 2022 is not as different as it should be versus 2015.

The article began by focusing on the cost of a $100,000 or less loan. Our view was that, without extensive reliance on technology, those loans by themselves were value destroyers. Back then we focused on quantifying the six key components of loan cost: origination, underwriting, loan review, operations, monitoring and collections, and compliance.

At that point our analysis showed that originating the loan was the most expensive part of the process. Many banks have now digitalized much of their loan origination, underwriting and monitoring processes. In the intervening years an explosion in Fintechs has occurred. Many provide leverage to banks, turning an unprofitable loan into a bottom line positive.

At the same time, however, other cost areas have increased in the influence and internal power. Issues related to privacy and fraud have become critical. We have seen the ESG movement, or as one commentor termed it DIE (Diversity, Inclusion, and Equity), eat up a lot of time and personnel dollars at some banks with no quantifiable ROI. Of course, bank management may decide to focus on that area, but should fully explore the business and economic implications of doing so.

While the overall loan cost and its components have changed, other elements generating profits from small business have not. The 2015 article highlighted four focus areas:

Evaluate the profitability of the small business effort on a more holistic basis. Given today's economy, banks cannot rely on loans for revenue growth. Many small businesses are self-governing and reducing their borrowing while more small businesses that may want to borrow may not meet a bank's tightening credit criteria. Banks need to exploit a relationship focus, meaning they must put an increased emphasis on a bank's strengths and needs whether related to deposits, personal loans, owner investments, cash management, etc. The best banks have already been focusing on the entire small business and business owner ecosystem.

Increase cross sales. That again! Given the above, banks need to sell more to each small business customer to sustain and grow their revenue streams. Unless I am mistaken, most banks remain mediocre at cross selling with their present bank staffs. But during the past downturn some banks had success at taking their now underused mortgage sales staff and moving them to focus on other still attractive product areas. This is a time for some sales experimentation. Management should be meeting regularly with line bankers to review and pursue opportunities. BTW, enhancing targeted compensation is critical to this effort.

Process improvement. Yes, it is a bit obnoxious to quote your own writing, but the following from 2015 still hits on a raw nerve: "Like barnacles clinging to the bottom of a ship, banks often

allow processes to become too complex and, once established, fail to revisit them in order to simplify." Maybe your bank is different but at most of the banks we work with, this situation has only become more complex and enervating as support staff flexes its compliance, regulatory, risk, ESG, and other bulging muscles.

Outsource or partner on lending. The good news for banks is that lending partners have proven their value; the processes, policies, and risk management of the top providers have been tested and work with many "name brand" banks using their services. But the opportunity to work with third parties extends well beyond small business lending to include private labeling of additional products and services, improved AI analysis-based target marketing, HR outsourcing, among other areas.

In 2015 many banks remained skeptical about trusting third parties with "their" clients. The best managers now know they need to be open to multiple partnerships across multiple areas.

One note of caution. Sometimes banks rely too heavily or exclusively on offers from their Core providers. Cores continue to vacuum up niche and emerging players but may fail to incorporate them effectively into the larger company. Banks can't afford to wait for their Core provider to get its act together.

Seven years have passed and yet at many banks small business remains a largely undiscovered or undeveloped area. As banks struggle for sustainability and growth, small businesses should receive higher priority.

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