The Homogenized Bank
by Charles Wendel

The dictionary definition of homogenize includes "to change something so that its parts are the same or similar." Increasingly, prodded by regulators and internal compliance officers, advised by the same group of big name consultants, and lead by weary managers, banks are becoming homogenized. Increased homogenization has harmed banks with its customers, opened up the door to non-bank payments and loan players, and may be condemning banks to minimal growth.

One head of a well-respected top-tier commercial bank commented late last year, "The regulators want us to be all alike." And, certainly their actions point that way even though many involve head scratching decisions. Overzealous (almost a decade too late in their rigor and laser-like focus) and sometimes feckless regulators have created a close to paranoid situation at many banks, whereby, management appears more concerned about keeping regulatory peace than meeting customer needs or exploring product/service innovations. The typical banker sees greater risk in going down the potentially risky path involved in offering a new concept versus bowing to internal and external pressures. Unfortunately, that may be the right approach for personal survival at banks today.

For example, the initiative that several top banks (including Wells, US Bancorp, and Fifth Third) pursued to offer an alternative to payday lending made a great deal of sense. It helped the customer avoid the clutches of payday lenders and offered a more competitive rate as well as bringing low-income customers into the banking system. However, faced with regulatory pressures virtually all the top banks offering that product withdrew under pressure. None of the banks was willing to put up a fight. And why should they when groups like the "Center for Responsible Lending" attack them?

Banks have continued to pull back from various businesses in light of external pressures, increased capital requirements, and a strong internal culture of not rocking the boat. Ironically, lack of innovation has resulted in some regulators such as Benjamin Lawsky, New York's bank regulator, saying "If banks do not make significant progress soon [related to the payments system], regulators should consider actively pushing for, or perhaps even mandating, improvements." Even doing nothing provides no guarantee that regulators will not come after the banks.

Where does this leave banking? On the loan side too many banks are now fighting over the same pie, in some cases a smaller pie. This has resulted in a decline in spreads and, increasingly, a willingness by some to stretch credit terms. Homogenization and some related factors may also result in negative longer-term growth. This week's *Financial Times* features an article titled, "Nine reasons why banking growth cannot be taken for granted." Reasons include banks abandoning "flag-planting ambitions" and retrenching; pressure to shrink due to regulatory pressure on capital, liquidity, and structure; technology capabilities at many banks being "creaky"; quality of staff declining; and, new and intense competition asserting itself in payments and lending. Opportunities for banks to grow may be limited across multiple fronts.

The most homogenized product in the world is milk, but even milk producers strive to define themselves as unique. Low fat, chocolate, almond, even flax milk are on offer. Generic milk remains much cheaper than the myriad of specialized products that appeal to a smaller audience but also generate higher margins. Banks need to de-homogenize. I have often quoted the comment that one bank president made to me: "We are all selling the same thing." But the focus needs to be on how a bank distinguishes and differentiates itself while the fundamental product ("the milk") is largely similar from one bank to another. Fortunately, banks can look to best practice players both in the US and overseas for examples of de-homoginization based upon product, channel, and/or service characteristics:

- Umpqua and its approach to branching
- Signature and its emphasis on specialized lending including CRE and leasing
- EverBank and 1st Source and their expertise in commercial finance
- Live Oak and its unique online approach to small business banking
- Eastern Bank and its leading position as an SBA lender
- PNC, Wells and others in cash management and payments
- USAA Bank and its excellence in customer service

Dozens, in fact, likely hundreds of examples of companies avoiding being vanilla milk are available across the banking industry. However, there remain thousands of banks and even some relatively large ones lack sufficient de-homoginization Going forward many will find it difficult to justify their existence. This week Goldman Sachs published a report suggesting the breakup of JP Morgan Chase into as many as four parts in order to generate greater shareholder value. Other banks, much smaller ones, are also considering similar steps as they look to exploit their strengths and eliminate low margin and low potential businesses. The desire for survival and growth should push banks into committing to areas that can define them with customers and investors. I have talked to senior bankers who express reticence to commit to targeted initiatives, suggesting that doing so means they will eliminate or downplay serving certain customer groups. That is exactly what they need to do to generate sustainable earnings and growth.

Going forward, banks that allow themselves to become homogenized will suffer lower returns, reduced growth, an increasingly nervous investment community, and an unsustainable competitive position. Operating as a homogenized institution rather than providing protection, results in a bank being largely defenseless against the internal and external forces it needs to address in 2015 and beyond.