What is Small Business? Avoid Homogenization for Success`

By Charles B. Wendel

Each bank seems to define “small business” differently. Some define the term broadly (to include companies $1-10mm+ in revenues) or narrowly (microbusinesses with revenues less than $1mm). Other go from all the way $0 to10mm+. The critical issue remains that no matter the definition, banks must organize themselves to meet the specific needs of whatever group or groups they wish to serve. Microbusinesses’ needs and potential differ from larger small businesses and those differ from the middle market; you get the idea. Banks pushing for cost reduction may be minimizing those differences, as they bring more internal groups together, providing an opening for other banks, particularly community players.

Revenue size continues to be the key determinant of the small business definition. Despite all the data and analytics available, banks fall back on revenue because of its reliability as an indicator of a company’s needs. While exceptions exist, $1mm companies have much in common with each other, including how owners finance and manage their businesses. The same is largely true for larger small businesses, lower-end middle market companies, with greater differences occurring as complexity increases.

In recent months, banks have been lumping these and other segments together, either because they fail to understand the differences between customer groups or, more likely, to decrease internal costs. Costs may decrease, but in all probability so too will the customer experience as service becomes more homogenized. Twenty years or more ago I remember one small business banking leader at a regional bank who resisted taking on microbusinesses as an additional segment. Rather than seeing this as an expansion of his responsibilities and the opportunity to build his empire, he viewed this change as a trap. He thought the smallest customers would eat up time his bankers should focus on $5mm small businesses not $500k ones. And he was right.

Today, technology plays an essential role in managing smaller clients. One reason the regional banker made the right decision was that he knew small loans to small companies lost money. They became value destroyers because of the high touch nature of lending back then, a time in which a $50k loan could generate internal costs not much less than a multi-million dollar loan. But the economics have now changed due to technology and the opportunity to partner with Fintechs. The best Fintechs allow banks to lend profitably to small companies and establish deeper relationships with them, however, banks’ lending to microbusinesses without Fintech or third-party IT involvement likely continues to lose money on those loans. In short, banks will increasingly need to justify why they are lending small amounts to small companies *without* Fintech involvement. Microbusiness, who they are and how to bank them, differ from other SMEs.

Big banks have left an opening for community banks by over relying on IT and self-service. Despite all the dollars spent on analytics and AI most fail to reach out to their smaller customers. One colleague told me he had been building up a large cash reserve in his business DDA at a big bank, approaching $500K. No one from the bank contacted him to ask about investing it, perhaps hoping the “free” balances will remain there forever. He assured me they won’t. A smaller bank may or may not have the IT to highlight the deposit, but they should have proactive community bankers who know their clients. and reach out when opportunities arise.

Avoid homogenizing your customer base. A January 28th PR release from TD Bank details an organizational change that should reduce costs, but with an uncertain impact on the customer. TD announced, “It has combined its previous Commercial and Corporate and Specialty Banking teams to create a new Commercial Bank,” stating that it “will drive growth, deliver a better client and colleague experience and create efficiencies.” The release goes on to state that the Corporate and Specialty Banking teams -- Asset Based Lending, Equipment Finance, Institutional Healthcare and Higher Education, Commercial Real Estate and Global Trade Finance” will join the Commercial group that houses Middle Market, community and small business lending, deposits, Treasury Management, POS, SBA, and a number of verticals.

Here's the issue. If you are a $1mm or $5mm company, somewhere about 95% of all US companies, what priority do you think your company will have versus all the other groups listed above? Small Business is being lumped in with a dozen or more other groups. Yes, as asserted by the bank it will save dollars as it cuts out executives and bankers, and it may even spur growth, but “a better client and colleague experience?”