TUG OF WAR FOR SMALL BIZ CLIENTS

by Steve Brown

Everyone at some point in their lives has played tug of war. Whether one is serious about the sport or not, it requires technique, stamina and strength. Experts say that while those things are all important, winning the game is actually more about leverage than anything else. In similar fashion, banks always try to increase their leverage to boost profitability and performance - particularly when it comes to small business customers. Lately, these clients have been pulled one way by the national banks and conduits, as independent banks put in extra effort and dig in to retain these lucrative customers. A combination of factors has pulled the industry to this inflection point, driven primarily by improved credit scoring, softness in consumer lending and technological enhancements. Our profitability analysis shows small business clients are up between 24x to 150x more profitable than consumer accounts. National banks are now using credit scores as the primary lending decision tool on small business loans up to $1mm in size. This has significantly reduced the cost of manual due diligence for these banks. In fact, analysis shows direct underwriting costs are as little as $137 for banks using credit scoring compared to $2,739 for more traditional lending. This is particularly interesting when you consider that while some management teams have been using scoring for many years, others are still leery of the process. Whether credit scoring is outside your bank's comfort zone or you are utilizing these tools, the very fact that national banks are scoring commercial credits up to $1mm is changing the landscape. In addition, some studies have even shown that scored portfolios of small business loans under $1mm outperform manually underwritten portfolios. Given extreme competitive pressure, it is time for independent banks to embrace some of these concepts and to adopt a risk management approach to lending on the entire portfolio. To succeed over the long-term, banks should periodically reevaluate their underwriting processes and strategies to make sure they still make sense given changing environments, risk profile and tolerance levels. Another technique many banks report is working well is to split lending teams into "sales" and "underwriting." Sales teams fill the origination pipeline, while centralized underwriting handles the write-ups, analysis and documentation. To be successful, banks have to modify lending programs to ensure incentives, products, pricing and strategies are aligned. Training is critical and loans can be complex, so some banks are also teaming sales lenders with branch personnel to handle the complete customer relationship. Each person has an area of expertise (i.e. lending and funding), but the team approach supports more of the bank's overall strategic vision. As one pulls on the rope connected into their small business accounts, it is easy to see how important it is to continually evolve the approach and strategy. Nothing in this business is static and bankers will find success by evolving their strategies, while ensuring products, incentives and training are aligned to support any shift.

BANK NEWS

Remote Capture

USAA Bank ($26B, TX) reports that their new retail remote capture product, called "Deposit@Home" has captured 200k households and is adding 10k per week.

M&A

Mutual of Omaha (NE) is buying its first bank, Peak National Bank ($208mm, CO) for an undisclosed amount. Mutual of Omaha plans to build a network of community banks and then create an internet bank. The deal should close in the next 150 days.

Competitive Warning

Seeking to expand opportunities, large banks are aggressively ramping up services that connect directly into small business accounting systems and provide automated ordering for goods and services, detailed transaction data (from credit cards), offer accounts payable outsourcing (matching invoices to purchase orders to flag errors) and offer such customers (that do business with them) the same discounted rates these large companies have negotiated on their own behalf with suppliers.

Fifth Third

The Bank announced that it will restate its past 3Ys of financial data due to the misclassification of specific mortgage and C&I loan sales. For last year, the change will move $2B of earnings from operations to a gain on sale.

KeyCorp

The Bank said it could be liable for a $1.7B reversal of tax deduction taken from 1996 to 2004 in connection with lease transactions and is waiting an IRS ruling.