
PIRATE SHIPS AND SMALL BIZ LENDING

by [Steve Brown](#)

Pirate ships sailed by the captains of large national banks have entered the previously calm seas of community bank small business lending. Bristling with guns, loaded with ammunition and carrying enough fruit on board to keep sailors from getting scurvy, these warships are no longer taking prisoners.

While research shows community banks continue to play a vital role in providing financial services to small businesses, these pirates aim to change that. Given that the very nature of customer relationships has changed rapidly, community banks must also move to adapt faster.

Over the years, technological advances, more sophisticated risk management techniques, erosion in interstate banking restrictions, the growing importance of non-banks and greater client demands have all been changing the industry. Such innovation has shifted lending from a traditional personalized approach to one backed by credit scoring, automation and processing speed.

Over the past few years in particular, the large bank pirate ships have been quietly sailing up on community bankers anchored in the harbor and shelling them mercilessly. These interlopers are plundering the treasure of community banks everywhere, eroding industry asset holdings from 20% 20Ys ago to less than 12% today.

As if that weren't enough to deal with, small business clients themselves have also changed the way they do business with banks. These days, many routinely consider financial options across a broad range of service providers and most have an average of 3 different bank relationships. While community banks remain an important provider of financial services to these clients, the market has become extremely competitive. In fact, research finds that while 42% of small businesses used a community bank for their primary loan just 4Ys ago, only about 35% still do so today – a 17% decline.

So, as community bankers look through the strategic spyglass into 2008/2009, we urge everyone to scan the horizon. In so doing, bankers will find that it is commonplace for many small business loans to be originated based heavily on a credit scoring component. In fact, large banks such as Bank of America, Wachovia, Wells Fargo and others will routinely lean heavily on credit scoring for small business loans under \$2mm. After years of research, these banks have found a very close linkage exists between the creditworthiness of the business owner and the creditworthiness of the business itself. This is one reason why large banks place such a heavy emphasis on FICO as part of the small business loan underwriting process.

Since the small business lending seas are so crowded with pirate ships, we felt some advice was in order for those banks setting sail on loan growth targets above 10%. They are as follows: 1) Streamline paperwork. You don't have to switch completely to credit scoring and electronic documentation, but understand that is what you are competing against. 2) Know who your best customers are and consider reducing the rate to retain the customer. While this sounds counterintuitive, know that competitors will find these customers and you could lose them. Consider that it costs 5x as much to get a new customer as to retain an existing one and cutting the rate may

not seem like such a bad idea. 3) Focus on originating larger loans. It costs the same amount to originate a small loan as it does a larger one, but return is substantially higher the greater the loan size. Improve profitability by taking this small but important step. 4) Consider reworking the renewal process. Performing loans that have been on the books for a long time do not need to be renewed using the same underwriting methods as brand new ones. 5) Empower the lender. Review the number of steps in the approval process and increase limits for seasoned officers.

These steps and others should give community bankers cannon fodder to begin firing back at these pirate ships. While boarding parties are everywhere, take some comfort in data that shows most small business customers still want to be served locally. The pirate ships won't sail into the sunset any time soon, but these tips can help community banks from being boarded.

BANK NEWS

Branch Sale

Prosperity Bancshares (\$6.1B, TX) will acquire 6 Houston retail branches of Popular Inc.'s (\$13B, NY) North America unit for a premium of 10.1% (for about \$140mm in deposits). Prosperity will also purchase certain other loans and branch assets. The additional branches will give Prosperity 46 banking centers in Houston and its surrounding area.

Mobile Banking

The global trade association for 700 mobile phone operators will develop a cross-border money transfer service with Western Union. The service will allow users to send and receive money transfers using mobile phones.

Customer Centric

At certain JPMorgan ATM machines, customers can preset preferences to get faster service. Under the bank's "Quick Choice" program, customers can set preferences for specific dollar amounts to withdraw, indicate whether or not they want a receipt and choose their language preference. From then on, the touch of a single button at the ATM delivers cash without having to do anything else.

Copyright 2018 PCBB. Information contained herein is based on sources we believe to be reliable, but its accuracy is not guaranteed. Customers should rely on their own outside counsel or accounting firm to address specific circumstances. This document cannot be reproduced or redistributed outside of your institution without the written consent of PCBB.