Let Us Cultivate Our Garden

by Steve Brown

Voltaire was a philosopher during France's Age of Enlightenment. His 1759 story of Candide (subtitled The Optimist), was one of his best known satires, telling the adventures of an optimistic young man living a sheltered life. Naturally, paradise isn't a permanent state and Candide encounters painful hardships. Candide's travels coincided with Europe's 7 Years War, the Lisbon earthquake of 1755 and numerous plot twists involving the Spanish Inquisition. These events could have overcome Candide's sunny outlook on life forever, but Voltaire allows a happier outcome with Candide's final chapter spent running a farm, living a simple life, working hard and with no time left for philosophy. Voltaire concludes his satire with a practical precept: we must cultivate our garden.

This ancient wisdom seems relevant to modern community banking. Cultivate what you know and stick to the basics. A recent study by Harvard's Kennedy School on the State and Fate of Community Banking found strength in those good old lines of business. Community banks' share of the US bank lending market has decreased by 50% in the last 20Ys, but community banks still maintain an essential role as lenders and supporters of agriculture and small businesses. They provide 77% of agricultural loans and 51% of small business loans.

After the 2008 financial meltdown, big financial institutions focused on consumer, auto, mortgage, credit cards and mostly disdained small businesses. Community banks looked in their back yards, relied on personal relationships, gathered soft information on their neighborhood borrowers and kept their doors open. The authors of the Harvard study note a lower default rate for local banks. In 2013, for instance, the default on 1-4 family residential loans was 3.47% in banks with < $1B in assets whereas it was 10.42% for banks $1B+.

The data shows community banks retain a comparative advantage when lending to small businesses, probably due to a more localized and deeper knowledge base. Nevertheless, the market share is slowly eroding. In 2000, community banks were responsible for 57% of small business loans vs. 51% today.

It's also not easy to cultivate a bank's garden when costs of regulation are rising. Consider Dodd Frank pushed 33% of community banks to hire new staff in order to meet more demanding regulations. According to experts at George Mason University, 25% of community banks planned to hire new compliance personnel in 2014 as well. Compliance costs have hurt results. In fact, for 33% of community banks, hiring 2 additional employees to meet compliance demands would take earnings negative.

Small businesses have had to fight following the financial crisis as well. These businesses are responsible for 50% of all new jobs created in the US, yet small business lending has declined since the crisis ended. Higher lending standards and particularly cash flow requirements restrict banks' ability to lend to some of these businesses and the data shows the impact. New restrictions on credit card issuers have also made it more difficult for business owners to tap into credit card financing.

Given that less credit is available, small businesses have stepped outside the traditional financial channels and are now tinkering with online lenders at higher interest rates (and unpredictable fees).

The Dodd Frank act was aimed at the financial behemoths, but the rule has grown like weeds and had an unfortunate impact on banks of all sizes. Small businesses have experienced collateral damage as well. But, if we all strive like Candide to cultivate the little garden we know best how to grow and understand that regulations affect everyone, then banks and small businesses alike can look to a more prosperous future.

BANK NEWS

Retirement

Research by the Employee Benefit Research Institute finds about 30% of workers say they expect to retire before age 65, yet 40% of baby boomers have nothing saved for retirement and 21% have less than $100k.

Employee Talent

Research by Deloitte finds the most significant challenges business leaders say they face when it comes to keeping talented employees in the next 3Ys are: shortage, motivation and retention of qualified talent (35%); rising cost of total rewards (16%); providing meaningful pay increases in a cost reduction environment (12%) and uncertain economic conditions, pending tax and regulatory requirements (10%).

Mobility

A study by comScore finds 20% of all internet search happens on smartphones and 9% occurs on tablets these days.

Longer Commute

Research by the Brookings Institution of the 96 largest metro areas in the country finds the number of jobs within the typical commute distance for residents declined 7% from 2000 to 2012. The typical commute distance ranges from 4.7 miles to 12.8 miles.

Inheritance

JD Power research finds 71% of investors have named an heir for their inheritance, but only 42% have talked to their financial advisor.

Funding

Zacks notes that bonds account for about 75% of all corporate financing.

Checking Costs

The ABA reports the annual cost of a checking account is about $250 to $300 for the bank to maintain for one year. This includes the cost of processing transactions, providing monthly statements, investing in technology, paying tellers, having ATMs, branches, etc.

Housing

Zillow reports rising home prices in 2014 helped boost home equity a total of $1.7T nationwide.