

MARKET COMMENTARY

Community Banks and Credit Unions: Open for Business



30.2 Million

Small and Midsized
Businesses in the U.S.

Small- and Mid-sized Businesses (SMBs) are growing across the U.S. According to the Small Business Administration's Office of Advocacy (SBA), there were 30.2 million small- and mid-sized businesses in the United States in 2018¹. These small companies made up 99.9 percent of all businesses and employed 58.9 million people², amounting to nearly half of the workforce in America.³

Considering the number of SMBs across the country and the strong and thriving workforce associated with businesses in this category, there is a compelling proposition for community banks and credit unions to court this segment of the market.

Finding the Opportunity in Small Business Relationships

While breaking down the numbers on the small business opportunity paints a compelling picture, it does not fully explain why community banks or credit unions would want to entertain small businesses. After all, many financial institutions in this category are small businesses themselves. Does it really make sense for small local banks or credit unions to target SMBs?

In a word, yes. Small businesses remain a profitable contributor to the overall economy. According to the Small Business Credit Survey (SBCS), a collaboration of the 12 Federal Reserve Banks, 35 percent of SMBs reported revenue growth in 2018, up from 28 percent in 2017.⁴

Optimism runs high at SMBs as well.

Nearly a third of employer firms are growing and 53 percent have ambitions to be larger than they are now⁵.

As companies grow, so does their need for financial services. That is a message that should interest community banks and credit unions, especially considering the array of products SMBs are seeking..

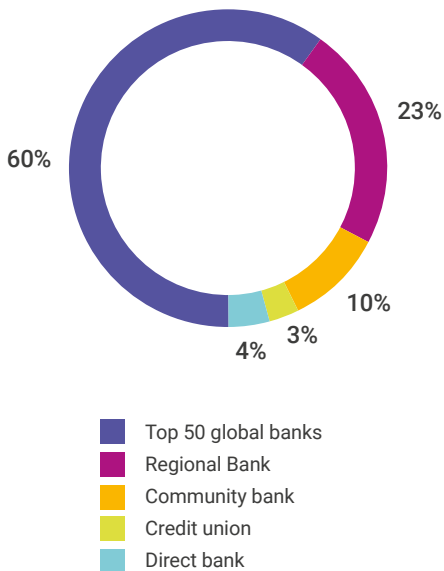
SBCS reports that year-over-year demand for new financing has remained consistent at around 40 percent.⁶ Consistency is good when 60 percent of small businesses rang up average loan values of \$46,348 in the first quarter of 2019 alone.⁷

SMB borrowers were not new startups either but offered a proven operating history with an average age of 7.43 years.⁸ Even better, the average Equifax business credit score for SMB borrowers in Q1 of 2019 was 663.⁹

However, loans are not the only way SMBs finance their operations. Half of companies have access to a line of credit and nearly as many rely on credit cards to pay for expenses, opening more doors for community banks and credit unions.¹⁰

Beyond lending, deposit accounts are another opportunity for banks and credit unions to engage with SMBs. Thanks to growing optimism about the future, 23 percent of SMBs plan to open a new business deposit account in the coming year and 39 percent are interested in a competitive interest checking offer.¹¹

Where SMBs Currently Do Their Banking



While not as lucrative as financing, deposit accounts are often the gateway to serving SMBs long term. According to SBCS, 65 percent of SMBs selected their loan provider based on an existing relationship with the institution.¹²

Why Community Banks and Credit Unions are a Good Fit for SMBs

When it comes to selecting a banking partner, two out of three small business owners opt for a large bank.¹³ Convenience, branch location, perks and online availability all come into play when selecting a financial institution, but often it is the practicalities that win the day.

Most SMBs responding to the SBCS study obtained financing from a large bank simply because they had an existing relationship with the institution, or they believed they would have a higher chance of being funded.¹⁴

Unfortunately, this tendency to stay with what you know doesn't always pay off. High interest rates made for disgruntled business owners in 63 percent of the cases surveyed by the SBCS.¹⁵

Beyond the practical concerns, small businesses want the personal touch. Most SMBs are owned by a single individual or a family. They may know their business, but banking and finances are not their area of expertise. As a result, they are looking to establish a personal relationship with a banking partner.

To put this into perspective, 75 percent of SMB owners want a dedicated banking contact who knows their business and can offer advice, and 40 percent would switch banking providers if they found another entity that would provide it.¹⁶

Building personal relationships is an area where small banks and credit unions can excel, because they are part of the community. The branch manager's son may play soccer on the same team as a small business owner's child. They see each other around town and interact at community events. In short, they are neighbors, and it is far easier to trust the heart of your business to a friend than a large institution.



We know our customers and we have a relationship with them that is very special.”

David Lacy

President and CEO,
Community Bank & Trust

Since 47 percent of respondents to a recent survey say they place their business accounts with the same bank where they do their personal banking,¹⁷ this relationship building can go a long way in supporting community banks and credit unions as well. Small institutions that interact with business owners on a personal and professional front, from family deposit accounts and wealth management, to mortgages, car loans and other financial products, receive a very clear picture of the customer's economic health and habits. This level of transparency pays off for both borrower and lender when it comes time for the SMB to secure business financing.

“We know our customers and we have a relationship with them that is very special,” said David Lacy, president and CEO of the Community Bank & Trust in Waco, Texas in an article published in the American Bankers Association Banking Journal. “We from time to time use our discretion to loan money outside of a box, and that is the fiber, the fabric of community banking.”

It is a “you scratch my back, I'll scratch yours” situation where banks, credit unions and local business owners form a community network that can be beneficial to both sides. For instance, a local engineering firm may bank with a community bank or credit union and even secure a business loan through the institution.

As a result, when it comes time to build a new location, the financial institution contracts with the engineering firm to complete the site plan required for the construction. It's just good business sense to do so as they invest in the community it serves as well as its banking customers.

According to SBCS, small bank and credit union community-building efforts are paying off as 79 percent of SMB survey respondents are satisfied with the lending experience at their small bank, compared to 67 percent of large banks and a trailing 49 percent for online lenders.¹⁸ SMBs doing business with small banks tend to report consistent satisfaction levels as well, with the number of happy customers rising from 73 percent to 79 percent.¹⁹



Individuals want the freedom to interact with a business when it's convenient for them, at any time day or night.”

How Small Banks and Credit Unions Can Attract and Retain SMB Business

While small banks and credit unions have several advantages when it comes to attracting SMBs, they are often at a disadvantage when it comes to keeping them.

Online retailers have placed a premium on immediacy and convenience. As a result, individuals want the freedom to interact with a business when it is convenient for them, at any time day or night. For bankers, that means offering the flexibility of online tools, while still delivering on their core standards of personalized service.

Meeting these standards requires an orchestration between channels, allowing SMB owners to engage with financial institutions in multiple ways without service degradation. An SMB owner may stop in and chat with someone in the morning about a loan but wait until evening to fill out the application online.

For community banks and credit unions, keeping pace with technology is like keeping up with the Joneses. There is always change on the horizon and the push to be in on the latest development.

Selecting the right online tools and capabilities also requires consideration into more than the customer's or member's needs. Community financial institutions face many challenges when integrating some aging technology into new applications, not to mention the specter of changing regulations, privacy demands and cyber threats.

However, digitization investments pay big dividends. For example, Accenture predicts that banks could grow revenue by up to 30 percent by 2022 by strategically digitizing their payments ecosystem.²⁰

To meet the needs of SMBs as well as the institution, small banks and credit unions can start by forming a digital strategy.

Small business owners want their bank to provide omni-channel flexibility.

Despite a decline in branch-banking, face-to-face contact still plays a large role for problem resolution.

83%

will do some of their banking at physical brand in five years (-5 vs. 2017)

40%

want the option to talk with someone in person is there is a problem

51%

feel their bank needs to be up to date with financial service technology

Source: "Small Business Survey," USBank, 2018. Web.



We have come to a moment where banks want to partner with Fintechs for technology and for platforms without developing it themselves.”

Karen Mills

Author, Former SBA Administrator

Successful Digital Strategies Focus on the Customer Experience

Seamless customer engagement should be the primary goal of any digital strategy. Operational enhancements that improve back office efficiency without thought to the impact on customer experience will only cost small institutions in the long run.

First, take stock of what your SMB account holders want. Boston Consulting Group says that customers are moving toward a hybrid banking experience where they seek to handle simple tasks, such as a change of address, online. Personal contact channels are reserved for more complex issues or advice. 43 percent of customers want a hybrid experience from their financial partner²¹

Payments is another area where SMBs are following the technology. Real-time payment solutions simplify the accounts payable cycle for small businesses and their vendors by automating much of the process.

After an invoice is loaded into the business' system, it is automatically pushed through processing to payment. Instead of tracking invoices and gaining approvals, employees are freed to focus on higher value tasks.

In recent years, payment solutions have become more specific and applicable to small business but selecting the right one can be a challenge for a time-starved business owner. However, when SMBs trust their bank or credit union, following their advice on a payment solution makes more sense than contracting with an unknown vendor.

Access to financing remains one of the main needs of SMBs. Business owners are looking for competitive rates but also simplified applications, faster turnaround and more efficient processing. These are all areas where a sound digital strategy can improve the customer experience and keep SMBs loyal to your bank or credit union.

Consider a Digital Partner

Just as SMBs aren't always able to handle intricate financial decisions alone, community institution executives aren't up to the task of developing the technology tools and platforms that SMB customers demand. For small banks and credit unions, gaining access to the talent necessary to create in-house solutions is usually out of budget. That is why most are turning to solution providers.

“We have come to a moment where banks want to partner with Fintechs for technology and for platforms without developing it themselves,” said former SBA administrator, Karen Mills, who has just written a new book called *Fintech, Small Business and the American Dream*.

From March to April of 2019, approval percentages for small business loan applications at small banks jumped four-tenths of a percent.²² It is part of a continuing trend and technology is considered a primary reason for the hike.

Online providers were the first to deliver the improved loan application experience. SMBs seeking financing simply entered information via the web, where it was rapidly cross-checked against thousands of data stores for both accuracy and eligibility.

Recently, small banks and credit unions have begun to partner with solution providers to harness the same power of data and analytics when processing loan applications. The result is faster approvals for the customer and higher levels of loyalty.

Lower default rates for lenders are another benefit of automation, as applications are approved on a much broader base of information, including third-party data that is easily analyzed by sophisticated analytics. Lower default rates for lenders are another benefit of automation, as applications are approved on a much broader base of information, including third-party data that is easily analyzed by sophisticated analytics.



It is our local touch and personalized customer service that sets us apart from larger national banks.”

Jeremy Gray

Senior VP of Credit Administration,
Rock Canyon Bank

Community Banks and Credit Unions Helping Small Business

To support SMBs in the current market and remain a vital contributor to the local economy, banks and credit unions are facing an evolution. Rock Canyon Bank in Provo, Utah, understands this all too well.

The bank found that its customers were suffering from an inefficient loan origination and finalization process that caused delays with loan closings. Instead of continuing with the status quo, bank executives recognized the need for technological innovation.

“It is our local touch and personalized customer service that sets us apart from larger national banks,” said Jeremy Gray, senior vice president of credit administration at Rock Canyon Bank. “We knew that by embracing online eSignature capabilities we could reduce paperwork for our customers and give them faster access to our loan services.”

Often, it takes more than a single capability for community banks and credit unions to remain competitive and meet the needs of SMB customers. Consumers Credit Union in Michigan was lagging larger institutions when it came to offering the online services members needed.

Their core base was incompatible with new products and systems, holding them back from transforming operations to meet modern consumer standards. To maintain market share, the credit union worked with a fintech partner on implementing a new core banking system to better fill the needs of members and small business.

Lea County State Bank in rural New Mexico also understands the value of offering SMBs the tools they need to save them time in everyday tasks. According to Jerry Bell, senior vice president and chief operations officer, the strategic plan for the bank is highly technology focused. Their goal is to provide SMB customers, including many small businesses in cattle, oil and gas, with online and mobile banking tools that deliver anytime visibility into accounts. The latest implementations even allow SMBs to make payments online by clicking a picture of the invoice with a smart phone.

Community banks and credit unions like these are finding ways to remain competitive against larger institutions by partnering with Fin Tech companies on technology solutions. They’re increasing internal efficiency while making the bank a more appealing prospect to customers, particularly small to mid-sized businesses.

Rock Canyon Bank found that loan finalizations times were reduced by 46 percent when implementing e-signature technology. Likewise, Consumers Credit Union has grown its asset size from \$320 million to \$1.1 billion thanks to partnering on technological innovation.

Just as finding the right financial solutions partner is an advantage to small and mid-sized businesses, partnering with the right Fintech company makes it possible for community based banks and credit unions to support the 30 million SMBs in force across the country and to remain vital contributors to their local communities.²³



For More Information Visit
finastra.com



Telephone
+1 800 989 9009

1. "2018 Small Business Profile." U.S. Small Business Administration Office of Advocacy, 2018. Web.
2. *Ibid.*
3. *Ibid.*
4. "Small Business Credit Survey: Report on Employer Firms." Federal Reserve Banks, 2019. Web.
5. *Ibid.*
6. *Ibid.*
7. Priyanka Prakash, JD. "State of Small Business Lending: Industry Spotlight (Q1 2019)". Fundera, May 21, 2019. Web.
8. *Ibid.*
9. *Ibid.*
10. "Small Business Credit Survey: Report on Employer Firms." Federal Reserve Banks, 2019. Web.
11. Jeffrey Pilcher. "How to Win the Small Business Banking Market." The Financial Brand, June 13, 2017. Web.
12. "Small Business Credit Survey: Report on Employer Firms." Federal Reserve Banks, 2019. Web.
13. Jeffrey Pilcher. "How to Win the Small Business Banking Market." The Financial Brand, June 13, 2017. Web.
14. "Small Business Credit Survey: Report on Employer Firms." Federal Reserve Banks, 2019. Web.
15. *Ibid.*
16. "Dear Bank, Will You Be My Small Business Financial Partner?" Personetics, Mar. 21, 2019. Web.
17. Ben Ashworth. "Nav's 2018 Business Banking Study." Nav, Nov. 12, 2018. Web.
18. "Payments in the Digital Age." Accenture, 2018. Web. "The Four Pillars of Digital Transformation in Banking." The Financial Brand, Mar. 27, 2018. Web.
- 19.
20. Rohit Arora. "Small Business Lending Soars at Banks; Technology Is a big Reason Why." Forbes, May 15, 2019. Web.
21. "What's New with Small Business?" U.S. Small Business Administration Office of Advocacy, Aug. 2018. Web.
- 22.
- 23.

About Finastra

Finastra unlocks the potential of people and businesses in finance, creating a platform for open innovation. Formed in 2017 by the combination of Misys and D+H, we provide the broadest portfolio of financial services software in the world today—spanning retail banking, transaction banking, lending, and treasury and capital markets. Our solutions enable customers to deploy mission critical technology on premises or in the cloud. Our scale and geographical reach means that we can serve customers effectively, regardless of their size or geographic location—from global financial institutions, to community banks and credit unions.

Through our open, secure and reliable solutions, customers are empowered to accelerate growth, optimize cost, mitigate risk and continually evolve to meet the changing needs of their customers. 90 of the world's top 100 banks use Finastra technology.

Please visit **finastra.com**

Finastra and the Finastra 'ribbon' mark are trademarks of the Finastra group companies.

© 2019 Finastra. All rights reserved.

North American Headquarters

744 Primera Boulevard,
Suite 2000, Lake Mary,
FL 32746
United States
T: +1 800 989 9009

