FINASTRA

MARKET COMMENTARY

Community Banks and Credit Unions have a Specialty Banking Home-Field Advantage in the Small Business Market

Small- and mid-sized businesses (SMBs) represent an overlooked opportunity for most community banks and credit unions. Currently, the majority of SMBs, two out of three to be exact, bank with large institutions.[1] However, 51 percent said they are likely or extremely likely to consider a smaller local financial institution in the near future.[2]

99%

of all business activity in the U.S. is done by companies with less than 500 employees

Small- and mid-sized businesses (SMBs) account for 99 percent of all business activity across the U.S. Comprised of companies with under 500 employees,[3] this sector is a growing part of the fabric of the nation, driving economic fortune and offering employment to nearly half the country's workforce.[4]

Fortunately, the future looks strong for many SMBs. Revenue growth was up for 35 percent in 2018,[5] according to the Small Business Credit Survey (SBCS), a collaboration of the 12 Federal Reserve Banks. In addition, nearly a third of employer firms are growing and 53 percent have ambitions to be larger than they are now.[6]

Due to the nature of small business, local banks and credit unions have a ready opportunity in the market, particularly as they build upon their specialty lending edge.

Understanding the Home-field Edge in Specialty Banking

When it comes to selecting a banking partner, SMBs go with what they know. For nearly half of business owners, location is the primary factor in selecting a bank, and 47 percent take their business to the same institution holding their personal accounts.[7]

Local and nearby resonates for community banks and credit unions as well. 79 percent of SMBs report satisfaction with smaller banks compared to 67 percent for large institutions,[8] but familiarity isn't the only factor turning community banks and credit unions into hometown heroes.

Smaller banks are more agile than larger institutions and can react quickly to SMB needs. That's an important factor for many small- and mid-sized businesses, as they operate lean, and cash flow problems may arise quickly.

THE FUTURE OF FINANCE IS OPEN

75%

of small- and mid-sized businesses say that personalized advice is key in selecting a banking partner

The inherent agility of smaller banks result in faster turnaround times on loans. Community banks and credit unions also approve nearly twice as many SMB loan requests as large banks do,[9] an important point as SMBs consider growth options.

Beyond practical considerations, community banks and credit unions are more in touch with local culture and business conditions, making them better lending partners for SMBs. This was a critical factor in the wake of the 2018 financial crisis.

During the initial phase of economic recovery, real estate remained depressed across much of the country. As the economy began to gain traction, however, the real estate market trended upward faster in some areas than others. While large banks were limiting the number of real estate or construction loans based on overall national trends, many community financial institutions were willing to invest in area development projects based on the strength of the local economy and construction market.

According to research conducted by JPMorgan Chase and Company, the median SMB holds only 27 cash buffer days in reserve.[10] When a SMB needs financing, it's often for the little things or to float their operations for a short period of time. In these circumstances, specialty lenders are more likely to understand specific SMB woes and be willing to provide loans. In many ways, community banks and credit unions are like specialty lenders, thanks to their deep community ties and connections with the customers and members they serve.

Consider a local restaurant in Eugene, Oregon, focused on serving vegan and gluten-free dishes. A bank located in New York City is less likely to understand the unique nuances of the region and may not be as easily convinced of the restaurant's probability for success. A local bank or credit union, however, is inherently in touch with these community preferences, because they live and work with the same people the business is serving every day.

But in the end, it's about relationships and shared values. 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.

These deep community connections turn local banks and credit unions into hometown specialty lenders as SMBs search for a financial partner—someone they can trust to advise them on maintaining the economic stability of their business and the best way to handle financial matters.

According to 75 percent of SMBs, the ability to obtain personalized advice is key in a banking partner and 40 percent would switch banks to get it.[11]

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

Small banks and small business have a lot in common. Executives at community and regional institutions wear many hats. Your CFO might also be your technology expert, while your CEO does double time as your marketing lead. With a small- or mid-sized business, owners are also responsible for multiple moving pieces of daily operation.

This connection builds understanding and helps community banks and credit unions to play up their home-field specialty lending edge. However, since most business owners turn first to their own bank when it comes to taking out a loan,[12] attracting borrowers starts long before the business considers borrowing.

Thanks to technology advancements and the advent of cloud-based services, small- and mid-sized businesses have a host of options for simplifying daily financial tasks. For instance, a business can now go online and in a matter of minutes complete a loan application and receive an approval. "The check is in the mail" has never been more apropos or simple. As a result, demand for digital online services is growing.

> “While smaller banks have traditionally been recognized for rapid underwriting, their business is at risk from online-only new financial technology entrants.”

Simultaneously, 40 percent of SMBs would consider switching banks to receive more personalized service.[13] Since digital interactions by nature are distant and require little engagement, community banks and credit unions must use digital in a way that builds and strengthens relationships with small business owners. It comes down to finding the digital services that SMB owners want the most as well as those that add value to the bank.

Finding the Right Digital Approach

SMB owners need to streamline their day-to-day operations and offload tasks where they can, and they're looking for banks to provide some of the tools they need to save time and improve efficiency:

- 70% of SMBs prefer to open a deposit account via online channels[14]
- 50% of SMBs would like to apply for a loan on the web[15]
- 67% rank sophisticated online and mobile banking capabilities on their wish list[16]
- 67% relish online tools for cash flow management, forecasting and budgeting directly integrated into online banking features to minimize data entry[17]
- 64% want to integrate online banking with accounting systems such as Quicken[18]

Pushing routine tasks to digital channels is one way banks can improve customer or member relationships while also generating cost efficiencies. Change of address, balance inquiries, transaction records and the like can all be accessed via lower-cost online channels or mobile apps. Placing these tasks in an online environment means that they can be completed when it's most convenient for the business owner, while allowing the bank to dedicate personnel to higher value assignments.

Payments is another area where SMBs value services from their bank. Real-time payment solutions simplify the AP cycle for small businesses and their vendors by automating many payment procedures.

Digitizing the loan application process and combining it with automation in underwriting is another area where community banks and credit unions can make strides to attract and retain more small business customers. While smaller banks have traditionally been recognized for rapid underwriting, their record is at risk from online-only new financial technology entrants.

Lending services from PayPal, for example, have been integrated into the online purchasing transaction so seamlessly that a small business hardly recognizes that they've taken out a loan. In contrast, traditional banks require on average a total of 12 non-contiguous hours to process an application and up to 7-10 days before the paperwork is signed and check is in hand.[19]

Replacing manual loan underwriting with digital decisioning allows banks to process applications faster, with less risk and at a lower cost. Banks have improved and funding turnaround times by as much as 50 percent while boosting internal efficiency by 30-50 percent.[20]

Consider Connected Banking

The concept of connected banking can be simplified in a few words: data sharing. Through the use of an application programming interface (API), data from different, usually unrelated, parties flows seamlessly, allowing the end-user to experience it as if it were coming from a single entity, in this case, the bank.

68%

of business respondents to Accenture's global survey would prefer to participate in an open banking ecosystem through their bank

By partnering with technology providers that offer a connected banking solution, community banks and credit unions realize a world of opportunity. Not only are they able to gain the functionality of digital services, such as payments processing, but they can integrate their core offerings into the platform, providing a seamless solution to their customers and members.

Creating an ecosystem that small- and mid-sized businesses access to fulfill a variety of needs helps time-starved business owners to quickly and efficiently accomplish many of the tasks that eat away at their day.

For example, SMBs would be delighted to find that their financial services provider offers online banking, but when that same bank or credit union also provides services that simplify supply chain management, payments or a host of other time-saving implementations, all from the same portal where they do their banking, that's when loyalty starts to skyrocket.

In fact, 68 percent of business respondents to Accenture's global survey would prefer to participate in an open banking ecosystem through their bank.[21] Trust is the main reason SMBs prefer to work with their established financial service provider.

Banks also win when connecting customers to open banking portals. As customers and members interact with open platforms they create a wealth of data that provides banks with a more complete view of the financial picture. With such detailed data and the insights from platform analytics, the bank can better advise on financial products and reduce risk when lending to SMBs.

Look for a Partner

Across the board, digitizing the most important customer journeys can increase bank revenues by as much as 20 percent and decrease costs by 30 percent.[22] That alone should be enough to make community banks and credit unions consider the importance of developing a digital strategy.

However, just as SMBs need their bank to provide sound financial advice and expertise, community banks and credit unions shouldn't be afraid to seek out a partner to help them gain the digital and online services they need to maintain their specialty lending edge.

A third-party partner can guide community banks and credit unions on a digital journey that meets the needs of SMBs and enhances the financial institution's community standing as a home-field specialty lender. When looking for a partner in digital transformation, community banks and credit unions should consider the following:

- Can the provider deploy the solution quickly, with minimal downtime and interruption to your current systems and operations?
- Does the provider meet all of your needs while minding your budget?
- Does the partner provide a wide suite of capabilities that can be added over time as needed and budgets permit?
- Are the solutions connected, allowing complete visibility of the customer across all applications?
- Does the provider support the integration of third-parties into the provided platform, to allow seamless operation with your existing software or with new systems that could bring value to SMBs or the bank?
- Is the partner continuously innovating and bringing new capabilities to market? Providers should be looking toward the future and working on how to address the emerging challenges on the horizon.

Above all, the partner needs to be flexible and able to meet your needs. They should also understand your position as a home-field specialty lender and work with you on a solution that maintains your standing as a community partner.

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Being the SMB Hometown Hero in Your Community

With the right digital capabilities, it isn't hard for most community banks and credit unions to capture and maintain the home-field specialty lending edge. In the end, it comes down to being true to your brand.

Are you the next-door neighbor who welcomes one and all with a friendly face? Or maybe you're known as a partner to farmers, an institution that goes out of its way to support the heartland?

A community bank in Wisconsin will have a different set of core philosophies than a credit union in California, but these core guiding principles should be based on and aligned to the needs of the community it serves. After all, serving the community is at the heart of the home-field specialty lending edge.

Footnotes

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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**

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