FINANCIAL PERFORMANCE

2017 Commercial Lending SWOT Analysis for Community-Based Financial Institutions

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SWOT Analysis (*noun*) – a quick method used to measure current and emerging strengths, weaknesses, opportunities, and threats facing an industry, organization, product, or service.

It seems appropriate for community-based financial institutions to analyze their market through the SWOT method, given the amount of change the industry is facing as we enter 2017. In recent years, technology has been a game-changer within financial services. Unregulated players have entered the market since the recession and have had a significant impact on the way small business loans are funded. Large organizations have begun partnering with many of these alternative lenders as well. All of this is impacting the market for small commercial loans, and it is time for community-centered organizations to take stock of their strengths and develop a strategy moving forward. So let's look at a SWOT for community-based FIs in the year to come.

Strengths

History of Strong Customer Service – Community-based organizations have a long history of providing "main street" financial services with a human touch. Surveys continue to show customers prefer the service they receive from small financial institutions versus large banks. Customers generally feel that they are treated as a member of the community rather than simply another client. Small institutions should continue to drive this point home through their marketing campaigns and through social media by bringing a hometown flare to everything they do. Even website content can have a dramatic impact on leveraging this strength. Something as simple as including lender bios and community news on the website will help to differentiate your organization from larger competitors.

Local Decision Making – While smaller organizations may struggle to develop economies of scale in loan delivery, there is no doubt they continue to deliver a more personalized loan application, decisioning, and closing experience. The most recent lender satisfaction scores received by the Federal Reserve clearly point to this reality.

Local FIs Truly Understand Local Market Conditions – This is not to say that a lender from a large bank cannot understand business environmental conditions in a smaller market, but we must remember that, very often, loans are approved by lenders outside of the market. This is an important nuance when it comes to the 10-20% of credit approvals that simply come down to managerial discretion. Perhaps the ICBA puts it best as they describe on their website, "Many community banks are willing to consider character, family history, and discretionary spending in making loans. Megabanks, on the other hand, often apply impersonal qualification criteria, such as credit scoring, to all loan decisions without regard to individual circumstances." Here is another perspective from a recent interview with Janet Yellen, "Community banks understand their customers' needs and local economic conditions, and, as a result, they sometimes can be more responsive to local lending requests than large multistate banks. Because they know their customers so well, community banks often will consider a broader range of factors than larger banks when making lending decisions, and they may also be willing to underwrite loans to creditworthy customers that large banking organizations may be unwilling to make."

Weaknesses

Lender Experience Outside of Real Estate – A recent compensation survey by *Bank Director Magazine* points to a shortfall of commercial lenders across the United States. In the past, most community-based institutions have gravitated toward real estate loans, and those lenders who have grown up in the organization have much more real estate lending experience than general C&I experience. If local community-based organizations want to enhance their ability to serve the small business market, they will need to invest in more training of these young lenders. As *Bank Director* recently pointed out, "Forty percent of survey respondents say that recruiting commercial lenders is a top challenge for 2016. When asked to describe their bank's efforts to attract and retain commercial lenders, 43 percent say there aren't enough talented commercial lenders. The same number say they're willing to pay highly to fill these valuable roles within their organization."

Length of Time Required to Render a Credit Decision – The most recent Small Business Credit Survey by the Federal Reserve Bank of New York clearly identifies this as a weakness for community-based institutions. In recent years, large banks as well as alternative lenders have gravitated toward the use of scoring models to speed efficiency in commercial applications. While the overall service level may be higher in those smaller loan shops, turnaround time has proven to be an issue, and in many cases, keeps the applicant from even approaching a community bank or credit union. Approximately 50% of small business owners shop exclusively online for financial products. If they find an online application and are approved for financing without leaving their office, then you may never even see them.

Capital Available for Technological Advancement – In most cases, community-based institutions simply do not have the same deep pockets that larger organizations enjoy. In this age of improved information technology, smaller organizations may struggle to keep up. This is one reason why it is so critical that they are not regulated with the same set of rules as large banks. Still, smaller institutions can take advantage of enhanced technology to improve efficiencies; and they can do this without sacrificing their trademark customer service.

Capacity to Market Online with the Same Impact as Larger Organizations – Deep pockets also allow you to flood both the physical market and the internet with name recognition. Community-based organizations can leverage web presence as well, but they must get creative with their investments to compete against the large banks and alternative lenders. It's hard to beat an alternative lender who has the capacity to advertise at the Super Bowl. Community-based institutions should seek marketing specialists who can help them gain the most benefit for their advertising dollar and train lenders how to effectively use social media, such as LinkedIn, to increase market presence.

Dissatisfied firms reported issues with banks' application processes and online lenders' interest rates.

Opportunities

Take Advantage of Financial Technology to Increase Efficiencies Behind the Scenes – Investment in financial technology has seen record increases in recent years. Much of this is technology that lends itself to the path of community-based financial institutions. Commercial lending platforms available today incorporate not only the ability to attract clients online, but also the capacity to quickly route applications to the appropriate person within your organization. They also allow for much greater efficiency in managing deal workflow, lender pipelines, and incoming financial data from your business client to facilitate the application process. These tools can significantly shorten your loan turnaround time without sacrificing your unique ability to customize each request to local market conditions and local credit approval.

Create a Social Media Presence Targeting Small Businesses – While you are working online today, I challenge you to search "small business loans" or "small business line of credit." Very likely, you will not see a community bank or credit union until page three or later. This is an area where alternative business lenders have taken over. In fact, they are capturing much of your business before you ever even see it. To compete, you should enhance your own market presence online.

Become an Educational Lending Institution – How many times during your career as a lender did a prospect ask for financing without really knowing what type of financing was needed? When you have had to decline loans, did the business owner really understand why and what conditions would have to change in the business in order to become credit-worthy? As a community-based institution, you have a unique opportunity to spend a little extra time with each prospective client. Help the owner to understand the conditions that exists within their business. Help them to understand your analysis and how it impacts loan decisions. There are several tools available to financial institutions today that allow you to help educate your market without crossing the line of offering business consulting services. Most small business owners, whether they realize it or not, have an informal advisory team, as shown by this graphic from the Federal Reserve report.

Work with the Alternative Lending Market to Incubate Requests that Do Not Currently Meet Your Criteria – While alternative lenders can be a threat to business, they can also represent an opportunity. Most community-based institutions decline 50 – 55% of the applications they see for C&I loans. Since the reason for decline is often time in business, high leverage, or some other combination of business metrics, there is a significant opportunity to incubate these relationships. This is part of the reason for the recent joint ventures between large banks and alternative lenders. To have the most impact, though, your strategy should not limit your organization to one alternative lender, but should provide your business loan applicant with multiple options. Such arrangements should also be structured so that they do not penalize your applicant for moving the loan to your organization at a later date, once their condition has improved.

Threats

The Sheer Market Presence of Larger Institutions – Each quarter, we see more banks over $1 billion in assets and fewer below that number. This trend has been influenced by the lack of de novo activity since the recession. The largest five banks in the U.S. now control between 45 and 50% of total industry assets. With those numbers, it is easy to see how community-based organizations can feel like David up against several Goliaths. Community-based institutions, however, maintain a very important role in the financial services industry. It's just that the sheer gravitational pull of these giants can impact everything from pending regulation to rates and services.

Alternative Lenders Still Impacting the Market for Small Business Loans – While a few of the alternative lenders took their punches during 2016, the emerging industry is not going away. Regulatory scrutiny will, no doubt, have an impact in the years to come, but online lenders will continue to thrive. Business Insider estimates that during 2015, alternative lenders originated $5 billion in commercial loans below $250k, representing a market share of 4.3%. As shown in the graph below, that market share is expected to rise in the years to come.

Compliance with New Accounting Standards will Consume Resources – During the next 36 months, financial institutions across the U.S. will be working to prepare for implementation of the new CECL (Current Expected Credit Loss) standard. This will require that institutions spend significant time planning for the collection and analysis of data from multiple disparate systems within the organization. While this is a short-term threat to resources, it could also very easily be seen as an opportunity. In the pre-CECL world, information on small business clients was maintained in multiple non-integrated systems, from the CRM to the GL and commercial loan system to other separate underwriting and analysis systems. The opportunity to connect all of these through API technology will bring about significant changes in the way community-based institutions collect and store financial data and manage current C&I and CRE loans.

Increasing Use of Credit Scoring to Approve Small Commercial Loans Less than $250k – The speed of underwriting for alternative lenders and mega banks will continue to pose a threat to smaller institutions. Increased usage of small business credit scores for loans under $250k by these institutions can impact the market potential for smaller hometown organizations. While your community-based institution still wants to offer the customized personal service already mentioned, some thought should be given to utilizing a low-doc quick-to-market approval process for smaller loan requests, perhaps those below $150k. If done correctly, your lending team will be able to maintain the "close to customer" and the educational advantages of a community institution while also improving overall turnaround time.

During 2017, community-based financial institutions are finding themselves at a crossroads. Changing technology and market conditions along with new lenders in the small business sector will challenge old paradigms for doing business. Based on this SWOT analysis, it is now time to determine your institution's direction. What will you do to maximize your strengths during the next 12 months? How will you address your weaknesses? What is your strategy to engage threats in your market and to maximize opportunities for growth? There is clearly a path to success for the community centered organization. The only question is what you will do to ensure success for your team along that path.

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