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COMMUNITY BANKING

PERSPECTIVE

How to Best Combat Encroachment? Specialize

BY JEFF MARSICO

Richard Fairbank, the chairman and chief executive officer of Capital One Financial Corp. and part-owner of the National Hockey League's Washington Capitals, once said, "If you go where the puck is going, instead of where it is, it is a lot easier."

Community banks may want to heed his advice in developing and implementing strategies to stay competitive.

The flat and sometimes inverted yield curve is often cited as the reason for the decline in community bank profits of late, but a look at 10-year profit trends of financial institutions with less than \$500 million of assets demonstrates that, while the yield curve has made things worse, profits have been steadily declining regardless of the interest rate environment.

Let's review the competitive environment.

Bank of America Corp., for example, has breadth of market coverage that gives it a competitive advantage of having branches where customers live, work, and shop. If location convenience is critical to your



bank's success, how will you compete with B of A or any other large bank?

ING Direct, an online bank established in 2000, has more than \$54 billion of deposits and operates at a net interest margin of near 1%. Its Orange savings account had a yield of 4.10% at press time. Other Internet-only savings products offer even higher rates. If pricing is critical to your

bank's success, how will you compete with Internet banks?

Community banks can realistically claim to have a competitive advantage because of their longevity and the ability to tailor products, particularly loans, more closely to individual customer needs. Larger banks are apt to homogenize offerings over large geographic areas to realize operating efficiencies and control credit quality.

But competitors are quickly encroaching. State Farm Group and Allstate Corp. have banking affiliates, and their agents are long-standing members of communities where community banks thrive. Insurance agents are bred in a sales and service culture. Similarly, brokerage firms either have bank affiliates or distribute bank products. Mortgage brokers are present in virtually every community, and commercial loan brokers are very active in metropolitan markets. All these competitors are calling on community bank customers and developing relationships with them. If building relationships is critical to your bank's success, are

you doing it better than the local insurance agent or broker?

When an industry enjoys profit margins higher than those of other industries, competitors enter the market, and prices become more efficient. That is precisely what is happening in banking.

So what is a community bank to do? For most, achieving necessary scale and competing on price is not a sustainable option.

Community banks used to be indispensable in helping individuals and businesses achieve their goals. Now individuals have Orange savings accounts, and businesses get capital from angels.

Many community banks have evolved into "general banks." They don't target a specific type of customer, they don't offer a specific product that differentiates them from competitors, and they have no specific strategy. Instead of planning for the long term, these banks have more short-term goals, like staying within budget, and they watch with dismay as customers migrate to banks with better pricing, or to nontraditional financial intermediaries. Ultimately, many of these banks will be left with no choice but to sell themselves.

All this may sound gloomy, and that's the point. Community banks used to be indispens-

able in helping individuals to achieve their dreams, businesses to manage their balance sheets and cash flow, and communities to grow. Now individuals have Orange accounts, businesses put their loans out to bid, and start-ups get capital from angels.

How can the community bank regain its prominence within its community? The key is to develop a specialty and deliver it like no other. Business opportunities arise in the midst of market disruption. In your market, are businesses in need of capital, individuals in need of financial advice, and mortgage lenders in need of retrenching?

You must take a close look at the opportunities present or emerging in the markets you serve and build a strategy to meet those opportunities. You can do this. Some of your peers are succeeding.

Bryn Mawr Trust Co. operates in Philadelphia's wealthy Main Line suburbs. Its strategy is to help businesses and entrepreneurs create, manage, preserve, and transfer wealth. Its wealth management division has over three times bank assets under management. The bank's return on assets exceeds 1.7%, and its return on equity exceeds 16%. Bryn Mawr is an example of a community bank pursuing a market-driven strategy. It surveyed the opportunities within its market and delivers what is demanded better than competitors.

Paragon Commercial Bank in Raleigh was established in 1999. Amid rapid growth, it still manages to maintain an efficiency ratio below 55%. Its strategy is designed around serving business customers with \$5 million to \$50 million of revenue in Raleigh, Charlotte, and Richmond. Loans are funded wholesale or through business deposits. There is no expensive branch network to support. Paragon has built its entire business around serving one type of customer.

Has your bank evaluated markets to identify the most promising opportunities? If so, are you pursuing those opportunities with the necessary focus? If community banks are to thrive in helping local individuals, businesses, and communities, they have to be able to respond clearly to the question, "Why bank with us?"

Eric Shinseki, the former Army chief of staff, once commented on the need for the armed forces to change how they do business to address present-day threats by stating, "If you don't like change, you're going to like irrelevance even less."

Community banks must adapt to the new environment by developing market-driven, customer-driven, or product-driven strategies to give customers a reason to bank with them. Your relevance depends on it. ■

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