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Loan Growth: Can Banks Really Move the Needle?

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Loan growth is a burning issue for banks of all sizes, and the slower the recovery, the hotter it has become. As long as the economy remains sluggish, banks face a challenging environment in terms of sourcing and retaining good credit assets.

The situation is especially daunting for smaller institutions. In an environment of muted loan demand, the mega banks — just 1.5 percent of the country's financial institutions — control almost 80 percent of the industry's loan assets. This leaves the rest of the field scrambling to compete in a zero-sum take-away game for any loan opportunities that exist.

In most markets, regional and community bankers are aggressively pursuing new loan demand, in addition to offering lower pricing to protect their existing loan portfolios. The mega banks also appear to be coming downstream to market to small and mid-sized businesses. All

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of this activity puts added pressure on community banks. It is possible for smaller banks to win against this increased competition. But to do so, community banks have to be equipped with the right market intelligence, and they have to have a well-defined operating plan.

Assessing Real Market Opportunity

Most bankers can remember when loan growth of 7 percent to 10 percent per year was an automatic budget assumption. That situation is certainly no longer the case. Forecasts for the next five years indicate that annual business loan volume growth rate will be 5.6 percent annually, while consumer loan growth is forecast to grow only 1.6 percent annually.

Based on these projections, it is going to be tough for banks to move the loan growth needle. To be successful, banks must know what is actually happening in their individual markets; there is little latitude for guessing.

A bank needs to dig deep into market data so it can fully understand the opportunities and challenges within its footprint — and inside its own walls. It must have the data to identify where lending opportunities currently exist, where the market is moving, and which industries and consumers offer the kind of credit potential the bank hopes to see.

Getting Smarter About Commercial Loan Potential

The Federal Deposit Insurance Corp. reported that commercial and industrial loans grew 2 percent in the first quarter of 2012. Despite this relative bright spot, however, expectations for the second half of this year are that growth rates will lag behind those of 2011. Competition for this business will be intense.

A bank must be intelligent about pursuing commercial loans. The first step is to analyze the concentrations and mix of all the industries in its footprint. The next step is to combine the market data with other statistics, such as average revenues, projected growth rate and debt-to-sales ratios for businesses in specific industry segments. An online advisory tool can leverage several industry databases to provide this information.

The medical services industry is an example. Based on statistical averages of that industry's cash-to-sales and debt-to-sales ratios, it is known that physicians in the United States carry about a 6 percent debt-to-sales ratio on average. Considering this information in conjunction with statistics such as industry revenues and growth projections, a bank can project loan growth opportunities for the medical community lying within a specific radius of the bank (or even across the country).

How do these numbers compare with those of industries already represented in the bank's current loan portfolio? It is logical to focus on businesses in industries that the bank already understands and attracts; however, an in-depth market assessment may reveal promising niche industries that the bank should also be targeting.

Making the Most of Consumer Demographics

Banks cannot expect to realize net revenue gains from new loans, if the current customer base is contracting. For this reason it is critical to protect and cross-sell accounts that are already in the house, especially in a relatively flat loan growth environment. Even if there is no immediate credit need, strengthening a deposit relationship now may lead to significant loan opportunities down the road.

A starting point is to analyze product usage patterns among current customers. This done, the customer base can be segmented based on individuals with similar income levels, product preferences, buying habits and other traits.

That information can then be overlaid with market data, such as population numbers and average home prices. Based on what the analysis reveals, the bank can identify the best cross-sell and new prospect targets for certain products.

For example market-area statistics are available for factors such as average mortgage amounts outstanding, the average refinancing amount and term of loans. Using this kind of information, banks can pinpoint new credit opportunities, such as first mortgages, refinances and car loans within a specific radius of each branch location.

One branch might want to direct a mortgage refi campaign to the middle-income homeowners in its footprint. Another branch, located near a neighborhood of high-net-worth consumers, may want to promote car loans to individuals who would be good candidates for wealth management services.

These examples presume that the bank is already offering products and services that fit its customers' needs. It is important to match the product mix to the available customers and prospects.

Aligning the Business Model With Market Needs

Once the bank determines the specific opportunities existing in its market area — and how those opportunities are projected to trend over time — it's time to evaluate if its operational strategy is aligned with those opportunities. A bank needs to determine if the business model should be tweaked to ensure that it is relevant and attuned to opportunities going forward.

This assessment requires that the bank (1) examine whether its products, services and messaging clearly resonate with its target niches, and (2) whether those elements are supported adequately by the people, processes and knowledge that currently are in place. To remain

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competitive, the bank may need to bring new skill sets in-house to support the new operating model.

It is one consideration whether the bank is adept at serving nonprofit organizations or the legal community. It is quite another consideration whether the bank has a deep understanding of an industry's challenges and is proactive in serving its relationships. The same principles apply to consumer relationships, as well.

Alignment Strategies That Work

Shifting the business model. One option currently gaining traction is to create new areas of differentiation within an existing business model — for example developing a new business line oriented to serving a highly specialized loan asset niche that has strong growth potential. Defining specific targets will help distinguish a bank from the competition, as demonstrated by many retail-oriented thrifts that are changing to a more commercially oriented business model. Instead of making such dramatic shifts, other banks are adjusting their business models gradually to focus on the products that will make the institutions more relevant to prospects.

Buying the business. Banks that cannot find sufficient loan growth opportunities, yet are in a position of financial strength, are turning to mergers and acquisitions; more and more mortgage firms are being acquired as a result. This strategy offers a practical way for some institutions to fortify loan models that otherwise are not viable on a standalone basis.

Hiring the expertise. Some banks are diversifying by establishing specialized lending units for certain industries, with an eye to augmenting lower loan volumes with sources of fee income. For example some banks have hired regional managers from the Small Business Administration in order to establish the expertise to compete in the small business lending arena.

Lending Is Happening Now

While it is not easy to move the loan growth needle in the current environment, some community banks are experiencing success. According to analysis produced by BancAnalyst® Profit from Fiserv, from the first quarter to the second quarter of 2012, banks (excluding specialty banks: industrial loan corporations, credit card banks and investment banks) greater than $50 billion in assets averaged 0.98 percent commercial loan growth, while banks under $100 million in assets averaged 2.49 percent growth. This is encouraging news for smaller banks competing in this take-away market. ♦