

# Community banks benefit from larger rivals' over-reliance on tech

BY PETER LEE

Large banks have spent billions on IT to efficiently process standardized products, leaving an opening for local lenders that offer a banker to talk to.



Most senior bankers agree that this year's awful events have underlined the urgency of fully embracing digital banking, as their own staff and those of their business customers continue to work from home and consumers turn away from cash.

But are they missing something?

Prioritizing high-tech over the human touch risks turning banks into mere transaction platforms and threatens to remove the one true advantage that distinguishes them from technology companies.



Edward Barry, Capital Bank

Businesses, especially now, need bankers that can take the time to understand their individual circumstances and problems, offer appropriate financial expertise and advice, and then provide customized rather than standardized solutions.

Take, for example, dealing with applications from US companies for the Small Business Administration paycheck protection program (PPP). The country's largest banks and medium-sized banks saw this as an IT challenge of designing systems that could absorb tens of thousands of applications from small and medium-sized enterprises (SMEs).

They are proud of the tech and no doubt some of it was pretty good. It had to be. Chase received 75,000 applications in the first hour the PPP was open.

But was there anyone to talk companies through the application process?

Edward Barry, chief executive of Rockville, Maryland-based Capital Bank, a small local bank that is strong in Washington DC, tells Euromoney: "Most customers are happy to use technology until they hit a problem and then they want to speak with someone. The big banks made massive investments in online solutions to deal with high application volumes that were beyond the small banks' capacities. But, when customers needed guidance or assurance on the application process, they had no one to speak to."

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Barry says that Capital Bank funded a years' worth of small business loans in five weeks through PPP, with half of those being from businesses that were not previously its customers. Far from being overburdened by the process, the local community bank was able to take market share and help customers of other larger institutions.

Barry says: “Several of our applicants were having quite a traumatic experience applying through the big banks at a time when many small business owners felt that if they weren’t able to access these loans, they would go under. Some of our PPP customers felt as though they had been dropped by the big banks when their calls weren’t being returned. And when you pull the data, a disproportionate volume of PPP loans were funded by community banks.”

Barry sees this disappointment with big banks as an opportunity for community lenders like his to press home a temporary advantage won at the worst point of the pandemic into a permanent shift of customer business.

He expands on this. “Digitizing processes and transactions leads to an increasing commoditization of financial products. The big banks want to use their scale advantage to become low-cost producers and that means customers become units, buying commodity products and services that simply cannot be customized. Many businesses are now waking up to the downside of banking with the low-cost provider.”

Big banks have grown used to boasting about the billions they spend each year on digital. Investors understand the sub-text: this is an investment expense that will boost shareholder returns through lower staff costs. But if banks focus too much on tech, they might risk losing customers.

## **Premium offering**

Barry is no technology luddite, having previously worked at Capital One and Bank of America. In August, Capital Bank upgraded its own online and mobile platform for SMEs to help them stay on top of cash management and working capital.

He has brought in data scientists and technologists while aiming to offer advice – and almost consultancy – to small businesses. Barry suggests that this kind of community banking is a premium service but one which more customers may now see as offering good value.

He has to position his business as a premium offering. Listed as Capital Bancorp, its full year 2019 results show a pre-Covid cost-to-income ratio of 70%, which is far above that of the country’s largest banks, who work around 55%.

Barry likes an analogy. “Now I happen to enjoy a Big Mac. But if I go into my local McDonalds and ask for my burger to come medium rare, perhaps with turkey bacon, and maybe with hollandaise sauce instead of mayonnaise, McDonalds cannot provide that.”

Barry says Capital Bank serves up the ingredients each customer requires: “We like dealing with small customers that have complex needs. The big banks don’t do that well. The key question for us is how large that market is.”

The big banks, of course, won’t accept this.

Talking to Euromoney in August about Chase’s efforts on behalf of small businesses, Brent Reinhard, chief marketing officer for business banking at Chase, was looking ahead to advising the survivors on adapting to a new economic normal. “This is a company that embraces technology and provides it to businesses that wish to self-serve,” Reinhard told us. “But we also have 2,500 business relationship bankers and 10,500 small business specialists in our branches that we can mobilize for those that need advice and guidance.”

The contest between national banks and regional and community banks is a long-established one. The truth is that both need good technology as well good people. Barry says: “In our internal training we focus less now on technical skills which can be automated, even including credit underwriting, and more on leadership and coping with change.”

And he has one last analogy up his sleeve.

“One of my favourite cartoons has the local, traditional barber in a small town watching the manager of a new chain shop opening across the street putting up a sign offering \$10 haircuts. The new chap comes across and tells the local barber he is going to take all his business.

“The next day, the local barber puts up his own new sign. ‘We fix \$10 haircuts.’”