# FORTRESS PARTNERS
## *E*-Memo

**TO:** INVESTORS/MEMBERS/PARTNERS AND FRIENDS
**FROM:** Ed Depenbrok & Jon Bruss
**DATE:** February 28, 2020
**SUBJECT:** Can Community Banks Grow Organic Deposits and Loans, *and* Increase Earnings?

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Over the past several quarters we have observed that both stock analysts and voices inside the banking industry have been commenting on the increasing challenge of maintaining net interest margin (the spread between the interest income earned on loans and investments and the interest expense paid on deposits and borrowings) while growing the balance sheet. In fact, according to the BAI 2020 Outlook, organic loan growth is a top-three business challenge in 2020.

Competition for the lending business, a key trigger for banking balance sheet growth over the past few years, continues to intensify between Community Banks, large banks, credit unions, and non-banking companies, including Fintechs. As we look at 2020 and beyond. We doubt that the intensity of competition is going to decrease. And, it will have an impact on the Community Bank's ability to maintain margins and grow earnings.

Simply assuming that borrowers will come to the local bank—read Community Bank—for all of their loan and deposit needs is no longer enough with all of the choices that are out there—physical and virtual. In fact, we see the innovations of *more* digital access to loans as both a part of the problem and a potential part of the solution for the Community Bank.

In our view, there are a number of things the Community Bank can focus its bankers on to be proactive in the face of tough competition and a changing landscape for all types of lending: Commercial, Mortgage, and Consumer.

**CONSOLIDATION** First, the industry is continuing to consolidate. Last year, about 5% of all banks in the U.S. were merged away through acquisition. Without any appreciable increase in *de novo* (start-up) banks, the number of banks is shrinking. In our part of the country, the Upper Midwest, this is even more pronounced since we have proportionately more banking charters than other regions. Consolidation does present an opportunity for acquiring banks to offset slower organic growth through enhancing earnings by driving efficiencies out of the new combined organizations. Of course, that also assumes that acquiring banks *will not overpay* and *will execute merger integrations effectively*—two major assumptions.

**LIFT-OUTS** Next, industry and competitive activity also has encouraged some banks to enhance their ability to grow through "lifting out" talent from other organizations. Lift-outs have not been restricted to a cadre of Commercial & Industrial (C&I) or Commercial Real Estate (CRE) lenders but we have also seen Residential Real Estate Mortgage Origination teams, Indirect Auto Loan groups and Consumer Loan specialists being lifted out of larger banks recently involved in mergers.

We have observed that both lenders and customers are often open to finding a new Community Bank home after a large bank merger has brought disruption and perhaps a perception of increased bureaucracy into a market (See **LIFT-0UTS**, above).

Finally, we think over the years the community banking industry has surrendered consumer lending to larger banks and direct lenders. Isn't it time to revisit the surrender and determine whether strategies such as lift-outs can be employed to recapture some of the local retail lending that was once a core part of the Community Bank balance sheet?

**INSERTING YOUR BANK INTO THE FRAY** In a recent article,"How to grow confidence in growing loans," Karl Dahlgren, Managing Director of BAI, wrote, "It's the Fintechs and the direct banks that have been driving the recent growth in consumer lending…Loan competition will intensify in 2020 as consumers continue unbundling products offered by their primary financial services organizations as they seek best-of-breed offerings in the financial services marketplace. **Bankers' relationships with their customers are no longer as sticky**." (boldface addition from *E*-Memo authors)

However, Dahlgren does not throw in the towel, but provides three key steps traditional financial services organizations can take to drive organic loan growth.

- **Simplify the loan process** by:
  - Avoiding making customers feel like they are starting over each time they apply. . .
  - Enabling the completion of a loan app from a different channel from which they started—i.e, mobile vs. desktop.
  - Providing an on-screen progress bar to tell customers where they left off and where they can begin to finish the process.
- **Integrate customer data systems** by:
  - Combining deposit, loan, and risk and compliance systems
  - Allowing for frictionless authentication of loan applicants across all products and channels
  - Affording the community banker with a broader view of the customer base and the ability to recognize and leverage trends.
- **Convert more depositors into borrowers** by:
  - Aggressively leveraging the inherent advantage of a community bank adding continuous innovation and the marketing of new credit products that offer a positive customer experience.

**THE KEY TO LOAN GROWTH IS SIMPLICITY**— according to Dahlgren through investments in technology to integrate customer data from disparate systems. Reduce the friction by using technology to create an improved online loan system.

*Simplicity through technology* will give community bank lenders a 360-degree view of the customer allowing them full advantage of the technological innovation provided by the Community Bank.



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