

# Regional C&I Growth: Focusing To Win

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While regional banks long have placed a priority on serving middle-market commercial and industrial firms, the stakes are sharply higher coming out of the Great Recession. Compared with overflowing demand at the top of the market, banks are now fighting over a shrinking pool of borrowers who are much more cautious and demanding.

A common management response is to tighten up the business as it stands, and concentrate on superior execution of the basics. Across the industry, middle-market commercial banks have cut costs, tackled capital and credit quality issues, and redoubled the general marketing and sales outreach to prime customers.

Often overlooked in the rush, however, is the fact that a meaningful number of commercial clients are not yet receiving the level of specialized service that will be needed to acquire and expand banking relationships over the next few years. Increasingly, commercial bankers are expected to exhibit expert knowledge of the industry sectors they serve. Meeting this requirement can make all the difference in a challenging market.

Certainly, many bankers — especially those from the largest institutions — believe that they've already gone as



far as possible in serving “industry verticals.” There’s a decades-long trend of providing dedicated service to concentrated industries, with the healthcare sector being a prominent example.

But there are several reasons why industry verticals warrant a fresh look, especially among regional banks. For one thing, advances in management innovation and information technology have made this kind of organizational structure far more economical and effective than before. Many players haven’t paid enough attention to this opportunity anyway, plus the urgency for growth is much stronger in a tight market.

There are no magic bullets in a commercial banking market that has fallen from heady expansion to sharp contraction. Yet, especially among regional banks, increased use of industry verticals should be high on the list of options for revenue generation.

### CLIENT EXPECTATIONS

One of the most profound and least understood impacts of the recession is its impact on commercial client buying behaviors, particularly in various regional markets that have not received the level of specialized service seen in ultra-dense markets. Many such clients have chosen their banking providers primarily on the basis of credit availability; price; knowledge of banking products; and sales responsiveness.

While these performance attributes remain critically important, more clients are demanding that relationship managers (RMs) also demonstrate industry expertise, provide competitive information and benchmarks, and offer tailored solutions. As one banking executive put it, “generalists know how to ask the right first couple of questions, but not the right fifth and sixth questions.”

Verticals provide several advantages in meeting client demands for sector-specific expertise. They create “hot house” environments where intellectual capital is developed at a faster pace. This, coupled with investments in knowledge management processes, creates an information-based organizational capability that offers the potential for comparative advantage and is not easily replicated. In turn, client entrée is enhanced for relationship managers, permitting the bank to build an even deeper knowledge base.

The performance payoff can be significant. Compared with generalist relationship managers, our research indicates that vertical-focused RMs typically can generate 20% to 30% more revenue per banker, and 40%-50% more profit per banker.

While there is undoubtedly a “chicken and egg” phenomenon at work (where banks build verticals in industries where they have had success), there are underpinning be-

havioral reasons for the performance differences. Advantages include better pricing; more tailoring of deal structures; and an improved ability to select higher quality credits.

To be sure, the specialist model does typically entail a higher cost to serve (e.g., increased marketing spend, higher travel and entertainment outlays, research and information services). It is important to note, however, that the performance advantages identified in our research are calculated on a net basis, with productivity gains more than offsetting the increased costs. This is a vital finding, considering that cost-to-serve is often seen as the major barrier in either initiating or expanding industry verticals.

### A LARGER TREND

Banks have steadily increased their focus on industry verticals over the past 20 years. This shift is part of a larger trend across all professional services (accounting, consulting, and law) as information has become more accessible and clients have become more sophisticated and demanding. At some of the largest U.S. banking companies, up to three-fourths of the large corporate client base is served through industry verticals.

**“Commercial banking leaders must commit to making full investment or run the risk of increasing the cost to serve without getting the productivity uplift.”**

However, the scenario is quite different when it comes to regional banks, middle market companies and small and medium enterprises, where the generalist relationship manager model still predominates. Most recently, along with perceiving barriers to entry in terms of cost and required expertise, regional banks were luxuriating in a double-digit environment for loan growth, lessening the need to go beyond a generalized outreach.

The Great Recession, however, has fundamentally altered market dynamics:

- Loan demand is not expected to recover for several years. Compared with an explosive 20% expansion nationwide in the single year of 2007, total C&I loans contracted by more than 15% in 2009, and we anticipate further contraction through 2010.
- Fee income is increasingly coming under pressure. The annual growth rate in treasury management has

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fallen for five straight years, from 6% in 2006 to an estimated 2% for 2010.

- The market is burdened with excess commercial banking capacity, given that the number of creditworthy customers who are willing to borrow has fallen more than relationship manager capacity.

In an environment of slower growth and intensifying competition, banks are facing extreme pressure to develop unique strengths that will enable them to compete more distinctively and effectively for the shrinking pool of good customers that all institutions want.

Regional banking companies will need to think innovatively, in order to capitalize on the larger trend of industry verticals. The challenge is deploy specialized expertise in a way that is both carefully targeted and highly cost effective, with the goal of capturing incremental client revenues that otherwise would be forfeited to competitors.

In practice, commercial banking industry verticals operate along a continuum ranging from centers of interest (“soft” verticals) to separate lines of business (“hard” verticals).

Distinguishing factors include:

- **Time allocation:** Are relationship managers fully dedicated to a particular industry?
- **Expertise:** Are relationship managers recognized experts, visible within the industry?
- **Marketing and branding:** Does the bank make targeted marketing investments to build brand recognition and imagery in the vertical?
- **Product development:** Does the bank develop products and solutions that are tailored to the particulate targeted industry?
- **Knowledge management:** Is there a system in place to support proprietary industry data, information and viewpoints?
- **Governance:** Does the vertical have distinct performance targets and/or a separate financial performance report?

What we often see in regional banks today are “medium” verticals that demonstrate some of the above characteristics. This often is the result of years of gradual field momentum, where relationship managers, by chance or by preference, gravitate toward an industry, have some initial success and as result, receive incremental marketing investment (e.g., money to attend conferences, dedicated materials).

However, most regional banks stop well short of “hard”

verticals and typically do not develop the knowledge management and product capabilities needed to take full advantage of the accelerating shift in customer buying behaviors.

### WINNING FORMULA

In our work with regional commercial banks, we have seen three primary keys to success in making greater use of industry verticals: 1) Identify high headroom markets; 2) Go deep; and 3) Compete on analytics and information.

**Identify high headroom markets.** For many banks, the decision to invest in verticals is simply based on industry concentration within the regional footprint. This is more of a threshold approach, where the bank is looking for a certain minimum count of sector-specific companies. While this is certainly a practical approach, a strict reliance on density metrics can result in missed opportunities.

A question of equal or greater importance is potential client uptake. For a certain group of prospect companies within a given industry sector, is there a reservoir of unmet demand for specialized service, offering the potential to establish a vertical that can achieve above-average growth and profitability? Identifying such “high headroom” markets is a critical decision factor in establishing an industry vertical.

“Markets” need to be defined relatively granularly, based on trade areas (typically below the state level), to ensure precise deployment of resources. Once markets are defined, there are a variety of factors to evaluate in deciding whether to move ahead, including:

- **Market attractiveness** (as reflected in size and potential growth and profitability);
- **Market specialization** (as reflected in unique industry characteristics, solution requirements, regulation, language/culture); and
- **Market accessibility** (as reflected in the type of competition; intensity of competition; relative competitive advantages; and switching behaviors).

By thinking about markets this way, management can make informed decisions about verticals, not only which industry sectors to pursue, but also in which regions and at what level of investment (e.g., hard versus soft verticals).

**Go deep.** We introduced the concept of soft versus hard verticals earlier based on six dimensions. While there is no right or wrong answer, we believe that for truly high headroom markets, most regional banks could increase growth rates by moving closer to the “hard” end of the continuum.



Customers increasingly are demanding industry-specific expertise and information, and at a minimum this requires:

- Fully dedicated relationship managers to “move down the learning curve,” develop the expertise to be credible with clients, and invest the time to participate in industry associations/events;
- A knowledge management process to capture and share industry and client information that is distinct from what other banks can do; and
- Tailored products and solutions, reflecting the unique requirements of target clients.

Commercial banking leaders must be committed to making the full investment or run the risk of increasing the cost to serve without getting the productivity uplift. They also must prepare for the change management challenges that will inevitably arise. Verticals don’t often sit easily in generalist models, and the case for change needs to be communicated and continually reinforced.

**Compete on analytics and information.** We often hear that banking products are commodities, that there is no real product/service differentiation, and that RMs simply must “work harder.” We hear that from bankers — not customers.

In fact, middle market and small business clients have a keen appetite for information and expertise at a time when the economy is uncertain and competition is fierce. The banker is in a prime position to fill this unmet need. Questions at the top of clients’ informational wish lists include:

- What are the key trends, issues and prevailing perspectives in my industry?
- What are the recent trends in my industry (pricing, credit structures, mergers and acquisitions)?

- What are the financial benchmarks for comparable companies in my industry?
- How is my company doing relative to best practices in our industry sector?

Clearly, banks that can put this type of sector-specific information at the fingertips of their relationship managers will have a competitive advantage in the post-recession environment of the next few years.

Industry verticals are certainly not a silver bullet, but they are a piece of the puzzle in the commercial middle market, especially for regional banks. The recession has provoked a secular change in customer buying behaviors, tilting the emphasis from general offerings to sector-specific products and service, and verticals increase the odds that relationship managers will be able to develop the skills and experiences to meet those needs.

We do not advocate a wholesale reorganization around verticals, but rather an increased focus to improve the odds for above-average growth. Banks that move quickly and decisively have a chance to create real comparative advantages and distinguish themselves from peers.

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