

# Commercial Customers: Coping with an Uneven Recovery

BY DONALD M. RAFTERY

As commercial bankers lift their sights to 2012, they face a market share battle over a limited set of opportunities for loan origination and fee-based services. But there still are growth possibilities for players that can meet a fuller set of customer needs, particularly business owners considering mergers, acquisitions and recapitalizations.



While growing numbers of middle market companies and small businesses are reporting improved market conditions and financial performance, uncertainties abound and the outlook for loan demand remains moderate. Many business leaders do not yet see a growth scenario that would justify borrowing for expansion. Others are skipping bank loans and funding capital investment as well as new hiring from cash flow or retained earnings.

The largest U.S. banks face the challenge of stemming market share losses and reclaiming customers following a meaningful shift in business customer relationships to regional and larger community banks. About half of the small businesses and middle market companies that obtained bank credit over the past year borrowed from a lender outside of the top 20 banks in the United States. In other words, smaller banks that hold perhaps no more than 30% of the industry's total assets won

approximately 50% of the commercial lending market for small and mid-size companies.

In the meantime, many companies are still financially impaired, leaving a patchwork landscape for credit origination. In many respects it is a tale of two commercial lending markets. One market is composed of a large, growing number of mid-size companies that are experiencing improved market conditions, getting back on their feet financially and seeing a normalization of loan approvals. The other is composed of a significant group of lagging companies, more than a third of the market, that remain hunkered down.

In the majority of cases, business owners have a de-leveraging mind-set, seeing more benefit from debt reduction than from borrowing for expansion. Even those companies considering increases in capital expenditures are shying away from borrowing, instead funding expansion outlays from retained earnings or current cash flow. This is potentially a double hit to banks — modest loan growth across a number of market segments, plus withdrawals of business deposits to finance capital expenditures.

Even among reviving companies, many business owners do not see strong organic growth on the horizon. As a result, nearly a third are considering a form of “strategic event” over the next 24 to 36 months, including options such as selling the business; acquiring or merging with a competitor; or raising non-bank capital.

This scenario introduces a potentially important shift in commercial banking competition. On the one hand, many companies expect to go through major changes that will impact their circumstances and banking requirements, putting even more bank relationships in play. On the other hand, a potential flurry of strategic events will create new opportunities for commercial banks that can work in partnership with their clients.

### LOOKING BEYOND LOANS

A meaningful portion of sellers will be looking for advisory services and many will have expanded wealth management needs following the completion of sales transactions. Potential buyers however, will have significant acquisition financing needs. Acquirers also have need of advisory services, and newly-acquired and -combined entities present opportunities for new sales or expanded use of treasury management services, derivatives and other non-credit products.

More expansively across the commercial customer base, companies are seeking long-term financial partners that can provide advice in optimizing cash flow to improve efficiency, save money and free up borrowing capacity. Banks that can help their customers take full advantage of cash

management tools will strengthen client relationships and retention as well.

There are several actions commercial banks can take to win a larger share of these emerging opportunities:

**Expanded calling.** While bankers traditionally network with accountants and attorneys in their outreach to commercial market “centers of influence,” this strategy needs to be actively expanded to include business brokers and private equity firms.

**Strategic dialogue.** In working with clients, relationship managers need to expand the context beyond current needs for products and services, as well as actively engage business owners in a strategic dialogue about where they see their companies going over the next few years. Are certain owners looking to sell? Do others aspire to expand via mergers and acquisitions to cut costs, gain scale or increase pricing power? Do some foresee a significant need for capital to expand and/or reinvigorate a product line?

**Advance positioning in wealth management.** The time to win wealth management opportunities stemming from the sale of a business comes long before a contract is inked. By virtue of reputation, non-bank competitors, such as Goldman, Sachs & Co., often may be the favored candidates to manage money stemming from a company seller’s single largest payday. In order to overcome this mind-set, bankers need to start early in building client rapport, articulating the value of their firm’s wealth services, and preemptively answering the question: “Why keep those funds with our institution?”

**Targeting.** Winning commercial banks will be proactive in identifying clients and prospects with high-value emerging needs, particularly those centered on strategic events. Superior customer research is essential to this quest.

With loan demand only partially in recovery, commercial banks will be locked in competition for a limited set of opportunities going into next year. But alert competitors will make additional headway by: 1) contributing to overall business performance improvement through enhanced cash management; and 2) helping companies and their owners as they reconsider strategic options and take actions to sell, expand or restructure. The various teams involved in cash management, wealth management and acquisition finance will play a central role in this progress.

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