COMMUNITY BANK SURVIVAL

What will it take to bring your bank to the next level? Bankers and others weigh in on four key elements: people, M&A, branches, technology

By Steve Cocheo, executive editor & digital content manager

Pennsylvania's Lehigh Valley was once synonymous with Bethlehem Steel, the country's second-largest producer. Bethlehem, bankrupt since 2001, lives on only in memory—that plus five towering blast furnaces that remain on the home plant property, reminders of the past.

David Lobach, Jr., notes this essential piece of history of the market his bank serves, and very successfully. The bank opened the year the steel company went under. Lobach, chairman, president, and CEO of $741 million-assets Embassy Bank of the Lehigh Valley, remains high on his bank's potential. But he admits that he wonders about the future.

"Where are community banks in their business life cycle?" he asks. "Have we peaked? Or are we still in growth mode? I think about this all the time."

Lobach shares the same frustrations many community bankers do, including regulatory burden, notably, as well as rapidly shifting technology.

"The more we spend on things that don't matter," says Lobach, "the less we can spend on things that do matter." Since the Sarbanes-Oxley Act (Embassy is a public company) and the Dodd-Frank Act, he says, bankers have watched entire new regimens of regulation, and new regulators, arise. He can't help thinking of those cold blast furnaces, even though the bank has been doing well. Not all community banks have fared as well, but even for those that have, the question remains: Is that success sustainable?

Part of how Embassy succeeds is strong emphasis on teamwork and culture. Lobach notes how fintech entrepreneurs and other nonbank competitors exploit "friction"—factors in regulated banking that make it more difficult for customers to obtain what they want.

"We have to think about what we are *not* doing," says Lobach, "so we don't make opportunities for these entrepreneurs." Every bit of friction breeds a bunch of apps.

Lobach says he loves being a banker, "but I don't like the way the pendulum has swung."

In Florida, John Corbett, president and CEO at $3.9 billion-assets CenterState Banks, Inc., Davenport, says, "It's a fact of our business that the U.S. government plays an outsize role." Corbett says Washington has been engaged in "regulatory arbitrage" since the financial crisis, closing many small banks, deciding who would and wouldn't be helped, and also making it "hard to be a big, bad Wall Street bank." He says the sweet spot of banking today seems to be $5 billion to $10 billion.

"You don't get up in the morning to build a business around regulatory arbitrage," says Corbett, who helped start CenterState Bank of Florida, N.A., in 1992. "But you have to know that it is out there."

It's not just regulatory costs that concern community bankers. Running a successful bank is never a slam dunk, but currently the challenges have ramped up ominously: They include thin margins that may or may not improve with an uptick in rates; greater requirements for capital with fewer sources; new rules and new scrutiny covering mortgages and every consumer financial product; heavy new risk management requirements; and the aforementioned technology revolution affecting every aspect of business. All of these weigh more heavily on community banks than on their larger counterparts.

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Despite that, many banks are doing well. McCall Wilson, president and CEO at Bank of Fayette County, Tenn., says the $352 million-assets lender is having its best year ever. "Our branch network has finally paid off," says Wilson. The bank's deposit share has grown significantly.

In Munster, Ind., part of the greater Chicago market, Peoples Bank SB is coming off its second acquisition in 18 months, which will put it in the range of $850 million. Ben Bochnowski, president and COO of the former mutual, says Peoples, publicly owned, continues to balance its four prime "boxes": community, shareholders, customers, and employees.

Yet even these players, and many more interviewed, face challenges to their traditional banking models, and are weighing adjustments. They recognize that growth always offsets a lot of costs, and that the current stellar state of credit quality also helps. But not all banks are in growth markets, and credit quality is always cyclical. Hence for many community banks, there is a greater sense of uncertainty about their future.

DISRUPTION OR DISTRACTION, OR BOTH?

Even leaving aside the impact of new regulations and compliance, community bankers can find it hard not to be affected by all the talk about "disrupters" in finance. There is much talk among the consulting fraternity about changing business models that can't be discounted. Yet the viewpoints are hardly unanimous.

"I think the community banking model has a very bright future, but there will be fewer people participating in that experience," says Matt Pieniazek, president of asset-liability management advisors Darling Consulting Group. "There is a finite amount of opportunity."

Community bank investor Joshua Siegel counsels moderation. Community banks can be revolutionary, evolutionary, or stagnant, he says. Most should be striving for evolutionary, he suggests, concentrating on what they do well, while not ignoring new technologies that they can adopt as they go. For all the talk about fintech and such, says Siegel, when you get past the hype, exciting new apps serve a small part of America, for now.

Referring to a new app called Digit, which sweeps excess checking balances into insured savings to force thrift (and keeps the interest as a fee), Siegel says, "Most of America doesn't need funky things. I don't think people in Olathe, Kans., are itching to sign up with Digit."

By contrast, Paul Schaus worries that community bankers will always be behind, these days.

"The velocity of change is faster and faster," says Schaus, president and CEO at CCG Catalyst Consulting Group. He says that those in denial could wake up some morning to the shock that the world and their business model don't match. Schaus gets "relationship," he says, "but without the right product experience, it won't fly."

"We're at the point in banking where it's not the banks presenting change to the market, it's banks that are catching up to the market," says Schaus. "Nowadays, people are demanding services that banks don't even offer yet."

"'Relationship' is the antithesis of app. Even millennial customers want to *talk* to someone," says EagleBank's Paul.

"You don't build a business around regulatory arbitrage," says Corbett of CenterState, "but know it's out there.

Wouldn't it be great if a banker could obtain a "Community Bank Survival Kit" containing everything needed to thrive?

Truth is, after speaking with executives at community banks of multiple sizes, bank investors, consultants, and more, the overwhelming conclusion is that no one "kit" would suit.

But there *are* key issues to consider. One of which is that a banker's best survival kit may be between his ears. As evidence of that, read how bankers and others feel about four key elements of survival—people, M&A, branches, and tech innovation.

PEOPLE: STILL THE CORE

"It's all about the people," one way or another, is something heard from many of those interviewed.

Consultant Don Musso, head of FinPro, Inc., is in his late 50s and believes strongly in what some might scoff at as the "cult of the millennial." He's outfitted his own headquarters with a pool table and other features younger people like to see in a workplace.

Musso says that some of the more enlightened bank CEOs he works with tend to see themselves competing with the Googles of the world for present and future talent, not for experienced bankers.

"What good is hiring someone with 30 years of experience in an antiquated model?" he asks. Similarly, when making an acquisition, a buyer needs to consider the workforce that will be inherited—does it fit the future?

Not all bankers interviewed shared Musso's hard-nosed view, but they all are thinking hard about the human element.

At $506.9 million-assets United Bank, Atmore, Ala., Robert Jones, president and CEO, hasn't put all his chips on millennials. But he has found them a very interesting group of employees to get to know and work with.

One factor that sets United Bank apart is that it is a Treasury-accredited Community Development Financial Institution. Jones points out that millennials are known to be interested in work that has a positive social impact. The bank's CDFI efforts fit that well. They see the bank having a mission. "You can't compete with Wall Street offers, but you can show them what you do and give

Looking ahead has never been so critical. Consultant Paul Schaus: "People are demanding services that banks don't even offer yet"

them some autonomy," says Jones.

Millennials also tend to be very technology oriented, and Jones has taken advantage of that. Five millennial employees serve on the bank's Emerging Tech Group.

"They are our hunters," says Jones, seeking out new ideas. One that's saved United "a ton of money," according to Jones, is using Google Hangouts. This free app enables the bank to have meetings around its 19 offices in Alabama and Florida that used to require staff travel and time. Hangouts, multi-media capable, "are much better than a conference call," says Jones.

But there's more than youth in the people decision these days. Market intelligence is ranking higher than ever in the HR decision process.

In Okeechobee, Fla., drive-through lanes are a good deal larger than anywhere else in CenterState Bank's system. Corbett says that Florida is a polyglot collection of markets. The bank has four regional presidents and eight community presidents. They adapt the bank to the market. And that's why Okeechobee drive-throughs are bigger—so they can allow cattle ranchers towing cow trailers to easily use them.

"You either have the right people making local decisions," says Corbett, "or you are not going to be a player."

Today's best community banking leaders, maintains Darling Consulting's Pieniazek, "just seem to put the right people on their bus."

M&A AND GROWTH: WHAT SIZE?

Any rule of thumb about the size a bank "must" be should be treated critically. Joshua Siegel suggests that $1 billion could be a good target in cities, and $500 million in suburbia—but nothing is coast-to-coast gospel. Siegel says in many rural communities, an $80 million bank could do quite well. "Even if the whole market is only 3,000 people," says Siegel, "if you have 2,800 of them, you have a bank."

You used to hear that you had to be a $1 billion or $2 billion bank to survive, observes Trey Maust, copresident and CEO at Lewis & Clark Bank, a young $137 million-assets institution in the Portland, Ore., area. Now, he says, the larger you are, the more of a generalist you can be—you can spread more types of activity and staff over that asset base.

When you are smaller, Maust continues, you have to specialize. It doesn't have to be a product specialty. You could specialize in a region or a geographic footprint of some definition. But you have to narrow the focus *somehow*.

Achieving scale is one reason for making an acquisition, and every bank at one time or another wrestles with that option. Knowing why you want to do an acquisition should be a basic, experts say. Sam Kilmer, senior director with Cornerstone Advisors, points out that some mergers might be done for geographic reach, some to pick up new business lines, some to bulk up, some to achieve

"Find merger]partners that make sense," says Peoples' Bochnowski. "It's not just for the sake of getting bigger."

"Where are community banks in their business life cycle?" asks Embassy's Lobach. "Have we peaked?"

scale economies, some for expertise. The bank has to be clear what it is looking for.

For example, Rheo Brouillard, president and CEO at $1.4 billion-asset Savings Institute Bank and Trust Co., Willimantic, Conn., acquired Newport Federal Savings Bank, in Rhode Island, about two years ago. The bank needed to expand its markets to grow loans, and to bolster its mortgage lending reach.

"It's gone very well," says Brouillard, adding that the company is scouting for another deal in the near future.

Peoples' Bochnowski's take on the mergers: "We have to find partners that really make sense. We're not an aggressive acquirer, and if there's not a cultural fit, we won't do it. You can't just do things just for the sake of getting bigger."

Maust agrees, saying, "I'd rather be smaller with a strong margin than larger with a mediocre margin."

Not every banker feels a pressing need for acquisitions. Says Embassy's Lobach: "We like organic growth. We like that because we do it well, and we can always get better at it. Maintaining our culture is very important to us, and to our board."

In the end, it's the growth that matters. It makes so many things possible. How community banks achieve it will always vary. As a community banker pointed out in an article in the July issue, if you operate in growth markets, organic growth is not only possible, but preferred by many. But in slow- or no-growth markets, M&A may be your only option.

BRANCHING: STILL MORE YEA'S THAN NAYS

We didn't interview any community banker who didn't indicate that the future holds branches that are fewer in number, smaller in size, and devoted more to sales than to transactions. *They get it.*

You don't have to search long on the web to find views that branches are, or should be, disappearing. CCB Catalyst's Schaus, for one, is concerned that community banks are too caught up in the "symbolism" of the local branch, not unlike the way people feel about the local Post Office.

But the majority of those contacted still see the value of a physical place of business. "What I always go back to is that most people like to look at a physical building when they are banking," says Barry Lockard, president of $442 million-assets Cornhusker Bank, Lincoln, Neb. "It's hard for them to just push their money into cyberspace. They like to drive by and see where that money is."

"Even if people don't come in, they like the idea of still having a place to come to," adds Brouillard.

Cornerstone's Kilmer notes that every month that goes by, customers are less inclined to visit branches. However, he says the branch must be considered in context. People value community banks because they are in, and of, the community. "That matters," says Kilmer, as much as banker service on community organizations and boards. "The power of the branch, if it is done right, makes a powerful billboard."

Lobach agrees: "There are some things about 'old school' that is still 'good school.' The branch works for us. But our approach, from the beginning, was not to have one on every corner." The bank has seven, each of them featuring sit-down teller stations, and "no cattle lines."

At $970 million-assets FirstCapital Bank of Texas, N.A., Midland, every branch has been redesigned over the last two years.

Tools and tips to consider for your bank's survival kit

Suggestions and ideas distilled from the research and interviews conducted for the main article.

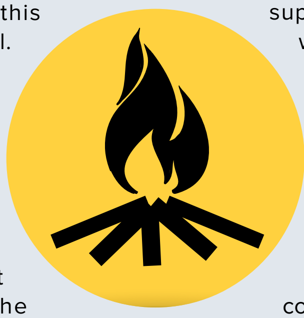
• *Don't be afraid to be "boring."* Ask how any new program or product will improve shareholder returns and customer service, or strengthen your brand. If you can't get a definite answer, is the proposal worth the expense?

• *Celebrate "community"—it's still a strength.* Main Street still appreciates bankers who serve their communities. But also consider new ways to do that (see http://tinyurl.com/citizensedmond).

• *"Friction" breeds nonbank apps—find it and kill it.* Look, with a customer's eye, at how you deliver products and services for friction—things that make it difficult for customers to obtain what they want—to reduce the opportunities for tech-based competitors.

• *Second-guess the urge to merge.* Too many mergers happen for unclear reasons. Know why you want to do an acquisition. If it's for expertise versus deposits, for example, then employee retention, compensation, and cultural fit are much bigger concerns.

• *Consider "buying the banker," instead of buying the bank.* Some community banks prefer this approach (see http://tinyurl.com/ServisFirstBank).



• *Hire with the long-term game in mind.* Hiring for experience makes sense, but be sure the experience is relevant—e.g. a check processing expert won't likely lead you through the challenge of mobile pay.

Place millennials (or comparable folks) in a position to help contribute to your tech savvy or suggest new ideas, new ways of doing things.

• *Look beyond bank competition and beyond banking for ideas and challenges.* Supplement bank peer groups with participation in other business' groups as well as conferences.

• *Rethink your branches (already).* It's been on the "do list" for years. That could include fewer of them; sit-down teller stations; instituting a "concierge" to handle most typical needs; supplement in-person staff with video tellers.

• *Consider branch alternatives.* Try LPOs in place of a branch, or rely more on officers calling on customers, using an Uber-like banker-on-call app (for more, see http://tinyurl.com/uberbank)

• *Be willing to work in two worlds.* Banking is undergoing a long-term transition. Having a foot in the present and one in the future isn't an inconvenience—it's a fact of life.

• *Maintain your perspective and be realistic.* It's easy to be overwhelmed by information. Much of what hits bankers is noise, and shouldn't be the basis of strategic decisions.

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“We took out teller lines and replaced them with a concierge desk,” says Ken Burgess, chairman. “The person behind that concierge desk can handle most of a customer’s daily needs.” At the same time, the bank makes extensive use of video tellers (see Threads, p.10.) and offers a mobile banking app for smartphone and tablet devotees.

CenterState Bank’s Corbett says that even as customers go more and more to electronic channels, having at least one branch in a community is considered critical. “That’s because sales *still* happen in the branch,” he says. Online account opening has not been stellar, in his experience. “There is a sales element in the branch that isn’t going away.”

Local geography and business mix still dictates some strategy. Patrick Frawley, CEO of $3.5 billion-assets Community & Southern Bank, Atlanta, Ga., notes that there are some markets where he doesn’t feel a physical presence is needed. The bank’s business reach is such that commercial bankers can easily drive to the customer in a relatively short time. Lewis & Clark Bank relies on a home office and two loan production offices. Maust likes the flexibility to come and go in a given market that LPOs provide.

TECH INNOVATION: DON’T GET DAZZLED

With the exception of regulatory overkill, nothing is a bigger source of community bank angst and frustration than technology innovation. In particular, the fast-changing world of mobility and its close ally—analytics/big data.

One of Lewis & Clark Bank’s slogans is, “We are bankerpreneurs,” and Maust, a former “big four” accountant, prides himself on his staff’s expertise.

But one of Maust’s frustrations is that community banks are too much hostage to their vendors’ timetables and willingness to innovate in a specific area. The typical core-processing relationship—and all that’s bolted onto it—comes fraught with other people’s priorities, up-front costs, and termination costs, he says. All maddening to a young banker like Maust who would like to be able to quickly try things, ramp up when they work—and ditch them when they don’t.

Recently, Maust learned of a cloud-based small-business lending platform from a company called Mirador, endorsed by the Oregon Bankers Association. The technology intrigues Maust, but so too does the pricing—a bank pays only for what it uses—and the ability to drop the relationship with no significant exit costs.

Says Oklahoma banker Jane Haskin, president at $201 million-assets First Bethany Bank, “The difficult part for bankers is to know which steps to take first. So many of the new products that are available through the core processors require one product to be in place before another desired product can be implemented. It is almost like having a road map guiding you along, but technology is changing so rapidly, you aren’t sure of the destination.”

One of the big companies bankers watch is Amazon. “Amazon gets high ratings because its technology is so good,” says Chris Nichols, chief strategy officer at Florida’s CenterState Bank. The unfortunate message, he suggests, for community banks, is that the technology is far more important to many people than is the human factor.

Banker Ronald Paul, for one, doesn’t subscribe to that line of thinking. His $5.5 billion-assets EagleBank, Bethesda, Md., serves northern Virginia; Washington, D.C.; and Maryland, a market with the third-highest population of millennials in the country.

“The word ‘relationship’ has a lot of meaning here,” says Paul, “and the word ‘relationship’ is the antithesis of an app. Even our millennial business customers want to *talk* to someone.”

Indiana bank president Bochnowski, a millennial himself, maintains that technology is important, yet will never do what a banker at Peoples Bank does, but it will *enhance* it. He sees the need to leaven technology with humanity.

“Our mobile app does almost everything Chase’s does,” says Bochnowski, but meanwhile, he adds, a customer can connect with real people.

Bank investor Siegel says community bankers should maintain perspective and ask, “What do I need on hand to keep *parity*? That’s your survival kit. Often, community banks don’t need the hot things, at least not ‘right now.’ Just make sure you are not falling behind.”

One related suggestion from community banker Joshua Guttau, CEO and CFO of TS Bank, Treynor, Iowa, is a good note to conclude this report. Over the last three years, Guttau and his team at the $505 million-assets bank have dropped out of some banking peer groups and joined peer groups in other businesses to help broaden their horizons beyond banking. He also sends his people to relevant nonbanking conferences.

“We’re not looking vertically within the industry for ideas,” says Guttau, “but looking horizontally across [various] disciplines to understand how industry changes can be adopted or leveraged.” ■

A never-ending story . . .

This report has touched four of the key survival factors for community banks, but has certainly not exhausted the subject even for those four factors, much less others not covered here. Look for continuing coverage in the next issue of *Banking Exchange* (and beyond), and on banking-exchange.com in a new section, called “**Survival Strategies**” within our Community Banking channel as we delve into more detail.