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STRATEGY FOR BANKING IN A TIME OF CRISIS

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Regional and community banks need to balance making tough near-term choices, with their one-two year digital and growth strategies.

Like all business leaders, in recent days, banking executives' attention has dramatically shifted to the unprecedented dual public health and financial crises resulting from the Coronavirus. In the immediate term, CEOs and their teams are rightfully prioritizing employee health and safety, business continuity, and protection against extensive downside risks and threats to the broader financial system.

This crisis is impacting banks of all sizes - but even before the current crisis, community and regional banks were under immense pressure due to the following challenges:

- Larger competitors making massive investments to improve or launch direct channels capable of competing for customers in smaller markets
- The continued influx of compelling new fintech entrants across the value chain
- Rapidly changing customer demands across all segments, with the expectation of digital-first service
- Acceleration of M&A activity including dramatic plays such as Morgan Stanley's recent acquisition of E-Trade and LendingClub's acquisition of Radius Bank
- The war for talent heating up

And now a global pandemic.

While the current crisis will impact the challenges facing regional and community banks in different ways, overall, the pressure is only likely to increase. So what to do?

We believe that in addition to the urgent crisis management currently underway, banks should not put their growth and digital strategy efforts on hold, which may seem counterintuitive, given the current climate. But however the Coronavirus crisis unfolds over the next year, the fundamental challenges are not going away, and the virus will only exacerbate some obstacles. Those banks that focus exclusively on crisis mitigation and cost-containment will be left further behind coming out of the crisis.

Going into 2020, it was our strong view that banks (and smaller banks especially) had less than 18 months to launch a compelling digital and growth strategy or risk losing substantial market share. That timeframe has likely been compressed further by cost pressures, and accelerated customer expectations for remote service and digital collaboration, resulting from the current crisis.

While it is difficult to think about strategy in times of crisis, that is exactly what the best organizations do. They can take tough near-term choices, while also investing through the downtown. Here are the opportunities that we think that all banks – but especially regional and community banks without fully formed growth and digital strategies – need to pursue right now.

Near-Term Strategic Choices:

Unfortunately, the reality is that the choices that banks need to make right now are unlikely to help near-term profitability. But by making some short-term investments, we believe that banks have a unique opportunity to significantly strengthen customer loyalty, improve resilience, and buy time to make some of the broader strategic shifts coming out of the crisis.

HOW CAN WE BETTER SERVE AND DEEPEN OUR RELATIONSHIPS WITH CURRENT CUSTOMERS?

Individuals and small business owners are extremely concerned about the impact of the crisis on their finances, and many are already beginning to lose work and face tough decisions. In times like these, banks can build trust and deepen relationships by proactively addressing these massive challenges.

- **Providing education and advice:** Banks should not wait for customers to call, but could use client data and analytics to identify those most likely to be vulnerable, and proactively reach out with education and advice including understanding some of the other services that the bank is making available to help clients
- **Helping small business owners weather the storm:** Regional banks can play a critical role in maintaining liquidity for small service businesses, which have been shuttered including extending payment terms and reducing short-term rates
- **Promoting public health and social responsibility:** Banks can support the right customer behaviors and market their digital services by encouraging customers to use self-service and digital channels
- **Waiving fees**: During the last financial crisis, public opinion cast banks as villains. In this one, they have a real opportunity to create a lasting connection to the community, regain trust, and strengthen their reputation. Therefore, banks should consider waiving fees (and some already are), especially for clients most directly impacted by the crisis. A small gesture to help clients today could be meaningful in deepening the relationship for the long-term.

HOW CAN BANKS PROTECT THEIR MOST VALUABLE ASSET – TALENT?

Given the financial pressure that banks are under today, many executives' first instinct might be to institute furloughs or layoffs. Some large financial institutions have committed to zero layoffs in 2020, setting a high bar for the industry. Smaller firms with less balance sheet protection should look to creatively exhaust alternative options before considering furloughs or layoffs. Over the long term, this will pay enormous dividends in terms of winning the war for talent and creating a differentiated culture. It will also be important to stay connected and strengthen remote working culture and connectivity.

STRATEGIC CHOICES TO INVEST THROUGH THE DOWNTURN

Regional and community banks should also consider the near-term choices they are facing in light of the longer-term strategic plays.

- **What is the endgame?** Banks need to define a clear vision of what ultimate success looks like to them. Is it about driving growth and playing a dominant role in your region, or playing defense long enough to get acquired and generate an acceptable return for shareholders? There is no universal answer that is right for everyone – but the answer to this question matters a lot. And this is where leaders have to start before taking on some of the harder-hitting business questions.

- **Where should I call home?** Smaller banks need to weigh difficult decisions on market expansion or retraction carefully. And what should that expansion look like to them? Neighboring states, counties, or broader? To similar demographics (e.g., focus on underserved rural counties), or pivoting to reach new customers. These are tough questions, and the answers will depend heavily on the answer to the first question on the endgame, as well as the bank's investment appetite, and opportunities and challenges with the current customer base.

- **Prioritize commercial, small business, or retail?** Back in the day, smaller banks focused primarily on providing retail, mortgage, and small business banking services to their local customer base. In recent years, this approach has changed dramatically as commercial banking accounts for a more significant percentage of revenue and a disproportionate percentage of profitability. As banks weigh where to place digital bets, they need to carefully consider whether to go all-in on retail or spread the wealth to emerging lines of business (including wealth).

STRATEGIC CHOICES TO INVEST THROUGH THE DOWNTURN CONT.

- **Optimize for the client segments of today or tomorrow?** Does the most optimal growth come from maximizing the opportunity with existing clients or acquiring new ones (or some of both, and in what proportion)? This is a particularly vexing question for several reasons. In theory, it is much easier to grow with existing clients than acquire new ones, which requires significant marketing investment and client acquisition costs. The challenge, particularly for smaller regionals located in smaller markets, is that the current customer base may be saturated. Therefore new client acquisition may be the only way to drive significant growth that will allow you to meet the vision, and this means competing directly with bigger, established competitors and for dramatically different demographics.

- **What products and services do clients need most (aligned with where you can make money), and how can we create a world-class digital experience?** Many clients would like a digital-first experience for most products, services, and transactions. But smaller banks may not be able to afford it and will have to place smart bets. They will need to determine which digital customer journeys to prioritize for which client segments, and how digitization will accelerate changes to their branch strategy. Banks can also look to create new revenue streams by offering new products and services to customers through API-enabled partnerships. Finally, they will need to take a clear-headed look at identifying ways to differentiate the digital experience and form emotional connections with their customer base that align with their core competencies, and are true to their brand.

- **How to execute the strategy?** Many banks make the mistake of starting at the end – focusing on shiny objects, acquisition targets, or core platforms – before they've thought through the strategy. After answering the prior questions, leaders can look at different options to execute, including buying capabilities through acquisition, partnering with a digital-first player that specializes in accelerating innovation for smaller banks, and/or launching a new direct-banking channel unencumbered by legacy architecture. Banks can also look to reduce their cost-to-serve and increase agility by making investments to modernize their core platforms.

Naturally, some of these broader strategic choices have been pushed to the side by the current crisis. But it is possible to take decisive action on near-term priorities to protect clients, employees, and the business while also keeping the bigger picture in mind. Doing so can help banks avoid shortsighted and costly mistakes in a crisis - such as excessive cost-cutting, or creating long-term damage to talent, culture, and reputation - while positioning for growth coming out of it.

If you would like to share ideas, please reach us at Isaac.halpern@capco.com and lane.martin@capco.com

AUTHORS

Isaac Halpern, Partner
Lane Martin, Partner

ABOUT CAPCO

Capco's Cybersecurity Practice brings deep industry expertise, proven risk management capabilities, security technology expertise, and regulatory compliance experience. We have extensive experience advising financial institutions on strengthening their security posture by building a business case to secure funding and identifying strategic investments for the years ahead to stay ahead of the ever-evolving threat landscape.

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