How to Choose a Commercial Bank – Start with the Banker

by Stephen Friedman in General and Miscellaneous | March 4, 2011

Product Based Criteria – Branches, Rates, Terms, Fees

As a commercial banker, out in the marketplace peddling my wares, this is a topic that I discuss with business owners on a daily basis. If I am to convince a company to move its business over to my bank, the first thing I need to figure out is what they are looking for. What are the criteria that they will use to make a decision? No business owner wakes up in the morning thinking, "You know what, I am going to change my banking relationship today. I have been with my existing bank long enough and its time for a change. I feel like getting raked over the coals through the credit approval process, disclosing every piece of financial data my company and I have generated over the last three years. And I really want to open new checking accounts and have to notify three dozen vendors and clients that they need to direct their electronic debits and credits to a new account. " No, a business owner would generally prefer a root canal over changing banks. Their call to me is usually triggered by one of three things, 1) A credit need that is not being addressed to the company's satisfaction by the incumbent bank, 2) A negative service event that crossed the company's pain threshold, or 3) Price shopping. And I can't forget what has become the most common reason why I'm getting the call: My bank was taken over by the FDIC and was sold or is being liquidated.

Over time I have found that the primary reason the company has reached this point with their existing bank is because they used the wrong criteria in selecting their bank in the first place. For businesses that are not heavy users of credit, the initial banking decision was usually based on which of the major banks had the closest branch location, were offering the best deal or already provided personal banking to the company's owners. For heavy users of credit, the decision generally came down to the most lenient loan terms and/or the lowest pricing. These are product based decisions in an industry where the products have become commodities. Most business owners view their banks as a place to transact their money in the most efficient, cost effective manner. Currency flows through banks, like voice and data travels through telecommunication networks. Any differences between banks with respect to products offered or prices of those products are marginal and will not have a material impact on the user's success. So if bank selection is based on product differentiation and pricing, you might as well put on the blind fold get spun around three times and see if you can pin that tail on the donkey.

Bank Financial Strength is a Given

Then what are the right criteria to use in making your banking decision? After the recent wave of bank failures, let's take it as a given that you only want to work with banks that are financially strong. While this can take a little digging to uncover, the information is readily available on the FDIC's website, as well as through different bank rating services like bankrate.com and Bauer. A financially troubled bank, particularly one operating under a regulatory enforcement action, will likely be restricted by the regulators from providing you the commodity like products and services at competitive prices that we discussed early. More importantly, the bank will be inwardly focused. Satisfying regulatory concerns will trump satisfying you, the client.

Knowledge Based Criteria – Your Banker is the Differentiator

Once you've cleared the financial hurdle and are only focused on financially strong banks, I believe that the most important consideration in choosing a bank is the banker. Not to say that the bank itself is unimportant, it's just less important than the banker you are working with directly. Since the products themselves are commodities, your banker is the key differentiating factor. And guess what, your banker is practically free. There is no extra fee or charge levied on your bank statement for banker time and talent devoted to you. It comes with the account. I say practically free, because in most cases, the cost of your banker is the differential between the actual dollar costs to the customer of banking from one bank to another, which as I have stated earlier tends to be marginal. The reason for this is that banks that compete on price, if they want to be profitable, have to have a low cost structure. Since the principal cost for a bank is people, that means they must pay their people less, which results in a lower level of competency. This is particularly true when it comes to small to mid size business banking, which I equate to businesses with less than $40 million in sales. As banks work with companies above this sales threshold, the employee cost declines as a percentage of the company's profit

contribution to the bank, so the bank can afford to pay up for talent. If your bank is doing both, offering the most competitive prices and has the most talented bankers, then be careful. Their economic model is flawed and will likely catch up to you as the client in some way as time goes on.

Keeping the Credit Spigot Open is the Key to Growth

So why is having an experienced, technically competent banker important and what kind of value should you expect them to bring to your business? Helping to address and resolve issues surrounding finance is where a skilled banker can have the most direct, positive impact on your company. This is particularly relevant for credit intensive businesses. Small to mid size businesses often don't have room in their cost structure for a full time Chief Financial Officer. The CEO/Owner knows the numbers, but generally from a different perspective than the CFO. CEOs intuitively understand return on investment, without the need for detailed spreadsheets and graphs. They can quote from memory annual sales dating back to the inception of their company and know every expense that the company incurred, but generally are much less focused on the balance sheet and other key financial measurements and analysis. Balance sheet measures like book leverage, tangible net worth, and working capital make up at least half of a bank's credit decision. However CEOs often don't have the expertise in-house to track and manage these key ratios, as well as other important financial disciplines like financial planning, payback periods, lease vs. buy, financial risk assessment, financial analysis, shock testing, and peer comparisons. A good banker can help you in all of these areas.

The importance of this financial expertise to your business cannot be overstated. I believe that one of the most important factors in a company's long term success is continuous access to capital, both debt and equity capital. What determines this is a company's level of profitability and growth in relation to its level of debt. Bank debt is the cheapest form of capital, therefore mathematically the more you can borrow as part of your overall capital requirements, the higher the return on your equity investment, in the short term. The flip side is that the more you borrow, the greater the financial risk in your business. Banks wants to get paid back faster than other forms of capital, which increases the fixed cash outflows of your company and therefore raises the sales level required to break even. The bank also has a priority security position in the assets of the company, so if you can't meet your break even sales level, you are at risk of losing everything. Working with a banker that understands this and advises you accordingly is worth its weight in gold. On the surface, the banker that can get you most the credit, with the most lenient terms at the lowest price would seem to be the obvious choice. But it is often the beginning of a company's demise. Without the financial expertise as to how to appropriately use such a credit facility, it's like being handed a loaded gun without any firearms training.

Your Banker Can Serve as a Facilitator for Improvement in All Business Disciplines

You can turn to your banker for issues outside of finance as well. Bankers have the advantage of working simultaneously with multiple businesses of different sizes and in most industries. We have access to their leadership and their financial data. We observe best practices across the various disciplines, marketing, sales, production, human resources, and information technology. We get to see what's worked and what hasn't. We have access to outside resources who are experts in each of these areas. You should view your banker as a facilitator to help you improve in all facets of your business and to resolve obstacles that stand in your way. Whether it's devising a new compensation structure, expanding your product line, implementing a succession plan, your banker can serve as a resource.

Credibility – You Work So Hard To Build It, But It Can Crumble in a Second

In addition to the consultative role that we can play to help your business to continuously improve, we are your advocate and spokesperson within the bank. Especially when it comes to credit related issues, most often the credit decisions within the bank will be made by bankers that have never met you or stepped foot inside your facilities. They will be basing their decisions on the written and oral analysis as presented by your banker. You need to evaluate whether your banker has the knowledge base, experience, critical thinking skills, presentational skills, and credibility to best tell your story. While in many respects the numbers do speak for themselves, more often than not there are gray areas and complexities that need to be thoroughly analyzed and clearly and persuasively explained. The ultimate decision maker within the bank needs to have all of the relevant information in an understandable format in order to reach the appropriate conclusion. You need to be confident that your banker can accomplish this on your behalf.

A company rarely evolves in a linear fashion. There are peaks and inevitably valleys. A good banker is going to maintain an ongoing dialogue with you and be proactive in addressing small problems before they become big ones. In this same manner, your banker will have similar conversations within the bank, to insure that all key players are informed so that surprises are kept to a minimum. That way your credibility is maintained, as well as your banker's. Once credibility is damaged it's hard to repair. Let's say leverage at your company has been creeping up. Your banker should be questioning why and making you aware as to the level that is going to start making folks within the bank uncomfortable. The goal isn't to micromanage your business, it's to provide you with the information that you need as a business owner to make tactical adjustments so that you don't jeopardize access to bank credit, your cheapest source of capital.

Conclusion – A New Vision of your Bank

I encourage you to think of your bank differently. A bank's products are commodities, but its people can prove to be an invaluable resource in your company's success. Once you open an account, your bank's personnel are now part of your team, for no real added cost. You wouldn't hire the B team for your business, so don't settle for it from your bank. Lean on and demand more from your banker. We are in a knowledge based economy. Your banker should offer a separate and distinct set of skills that you can rely upon to help you to make the right strategic decisions in leading your company forward.

And while changing banks can be perceived as being as desirable as a root canal, it's really not that bad. I would think of it more in terms of your bi-annual dental checkup and cleaning: It's a little bit of a nuisance, but it sure feels good when you're done.

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