



Smaller Loans Can Be Profitable Too

by [Steve Brown](#)

Have you ever visited a dog or cat caf?? These are happening places found usually in big cities where pet lovers who don't have their own pooches or kitties can go to get some furry love. The trend began in Asia in the late 1990s and has spread around the world. Visitors can enjoy a freshly brewed coffee and then pay for a set amount of time to play with the cats or dogs that are freely roaming around the shop. These specialized cafes have been popping up around the world and increasingly they are turning to crowdfunding to raise money.

It's no secret that there are more alternatives to banks when it comes to funding small businesses nowadays. These companies are aggressively trying to steal market share from banks. Big banks too have been paying more attention to the small business marketplace of late and alternative lenders have become more formidable competitors. In addition to vying for banks' bread-and-butter loan business, alternative lenders have also started going after credit card customers. Their goal is to lure away small businesses with high carryover balances by promising lower financing costs and then restructuring them as loans.

Online lenders are also likely to get a boost once the SEC approves new equity crowdfunding rules designed to open up the gates to participation by smaller investors. Some of these businesses may not be viable lending candidates for banks, but bankers should be concerned about the apathy affect. If small businesses feel they have other sources pressure will mount on loan pricing over time and customers may be lost.

We're biased, of course, but we think banks bring a lot to the table. Unfortunately, banks are also caught in a hard place, as they may find themselves in a position of needing to turn away some customers due to regulations and or higher profitability hurdles. Perhaps some loans can be justified by digging further into the finances and potential of the business. The benefits can be large and ongoing if a bank can develop a long-term relationship that becomes a real source of revenue.

Consider a study by the Boston Fed that found small C&I loans do in fact add value for community banks. The study found this to be true both in absolute terms and relative to the value contributed by larger C&I loans. You might be surprised to know the smallest C&I loans (\$100,000 or less) were found to be valuable for banks. On the other hand, Fed data suggests that small CRE loans, which are inherently transactional in nature, could also be a less important focus for banks unless the customer relationship is deeper than just a loan.

C&I loan business can be hard to come by, so banks need to stay focused on businesses that are likely to form deeper relationships. The information a bank requires to onboard these kinds of loans can also offer clues on other services the customer may need or may be getting from a competitor. Every area of the bank benefits from a broad relationship with a customer and providing those additional products and services offers a huge benefit to the borrower as well. It's win-win for the bank and for the customer.

Despite the existence of alternatives, many small businesses still prefer to work with a community bank partner and we think that is great. The risk continues to grow though as online players gain traction and customers use the internet to shop around. So visit that cat caf? down the road, and while you pet Fluffy over a cup of coffee, ask that business owner if there is anything your bank can provide for them, and hopefully you can open the door to a new relationship.

ECONOMY & RATES

Yesterday

Treasury yields fell 3bps as Empire Manufacturing and Industrial Production both came in lower than expected.

Today

Yields are unchanged in what should be a quiet day.

Rates As Of: 05/18/2015 11:12AM (PDT)

Treasury	Yields	MTD Chg	YTD Chg
3M	0.01	0.00	0.00
6M	0.07	0.00	0.00
1Y	0.20	0.00	0.00
2Y	0.57	0.00	0.00
5Y	1.53	0.00	0.00
10Y	2.23	0.00	0.00
30Y	3.02	0.00	0.00
FF Market	FF Target	Fed Disc	
0.00	0.25	0.00	
Prime	Unemployment	Oil	
3.25	0.00	\$0	

[More Market Rates](#)

BANK NEWS

M&A Activity

1) Hamilton State Bank (\$1.6B, GA) will acquire Highland Commercial Bank (\$122mm, GA) for an undisclosed sum. 2) Heartland Financial USA (\$6.2B, IA) will acquire First Scottsdale Bank (\$108mm, AZ) for about \$17.7mm in cash or roughly 1.05x tangible book. 3) Kitsap Bank (\$1.0B, WA) will acquire Fife Commercial Bank (\$85mm, WA) for an undisclosed sum. 4) First National Bank of Northern California (\$915mm, CA) will acquire America California Bank (\$134mm, CA) for about \$21.5mm in cash or roughly 1.20x tangible book. 5) Farmers State Bank (\$140mm, SD) will acquire Fulton State Bank (\$68mm, SD) for an undisclosed sum. 6) First Commonwealth Bank (\$6.3B, PA) will acquire First Community Bank (\$101mm, OH) for about \$14.75mm in cash or roughly 1.2x tangible book. 7) WashingtonFirst Bank (\$1.3B, VA) will acquire direct mortgage lender 1st Portfolio Holding Corp (VA) for about \$7.7mm in stock. 8) Madison County Bank (\$306mm, NE) will acquire Winside State Bank (\$27mm, NE) for about \$4.3mm in stock.

Junk Status

Moody's Investors Service downgraded the city of Chicago's credit rating to junk bond status (Ba1), citing its \$20B pension fund shortfall and other significant issues. Chicago is the lowest rated large US city behind only Detroit.

Cyber Risk

The SEC has joined other regulatory agencies in calling cyber attacks the top risk companies are facing.

Security

Accenture reports close to 90% of the financial firms it surveyed say they plan to increase spending around cyber security, fraud detection and prevention.

New Tech

Mitek announced it has rolled out new imaging technology (Photo Verify) for banks that allows customers to use their smartphone to take a photo of their driver's license to verify their identity.

Workplace

Pew Research finds Millennials (18 to 34Ys old) have now surpassed Gen X as the largest generation in the workforce. Millennials reached 53.5mm vs. 52.7mm Gen X and 44.6mm Baby Boomers.

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