KEY CONSIDERATIONS TO ESTABLISHING A

Member Business Services Program

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Executive Summary

When approaching the overarching and varied concept of expanding, or in some cases launching, a member business service program, take a deep breath and proceed with caution. Deciphering the differences between retail and business services is no small task.

While fundamental concepts are similar in that the program will fall under the general category of banking, providing services for a business requires a completely different approach to products, services, and lending.

It's essential to determine some of the steps necessary to establish a successful service program as well as to verify appropriate technologies to achieve outlined goals. An effective program includes a comprehensive line of products and services that assist small businesses in financial management. These include, but are not limited to, business checking accounts, with overdraft protection, business loans, lines of credit, small business payroll services, issuing of credit cards for employees, merchant processing, remote capture, and separate 800 number call centers.

The first question to ask is: what market are you in? Whether a mom and pop operation; a small business; a trade association; or a select employer group (SEG), the variables that constitute a winning business services program are based on the concept of attracting new members, increasing deposits capabilities and generating more loan volume.

The bottom line: Credit Unions must demonstrate to prospective business members that they will provide the same value they do for retail members. This initiative is achieved, in part, by enhancing operational structure support products, providing exceptional services and adjusting core system functions.

Industry Overview

In order to better understand the aforementioned subset services, it is prudent to investigate market indicators. To date, there are approximately 2,000 Credit Unions providing member business loans; however, there are more than 25 million small businesses located in the United States which spend an estimated $5 trillion dollars annually.

With community and regional banks either consolidating or being acquired by national financial institutions, Credit Unions are presented with an unprecedented opportunity to capitalize on the needs of business owners of all sizes. Business owners are looking for a centralized single point of contact that will assist in the process of lending as well as deposit services.

Psychology plays a significant role in the manner in which a prospective business owner will approach a Credit Union. The number one question business owners have is: will you be there when I need you?

Often, the business owner might only need service once or twice a week, but they need to be assured that they will receive answers to their questions immediately. Otherwise they may be enticed by regional or national banks that offer the same services – and deliver. According to a recent report released by the Office of Advocacy of the Small Business Administration, the number of small business loans outstanding under $1 million increased by 15 percent between June 2006 and June 2007.

A subset of loans—those between $100,000 and $1 million—increased more than twice as much, by nearly 32 percent, the data showed. Overall, the total dollar value of small business loans increased by approximately eight percent.

Smaller loans under $100,000, which include business credit card loans, increased in total dollar value by 9.4 percent. At approximately 58 percent, larger lenders, defined as those with more than $10 billion or more in assets, dominated the micro business loan market. Micro loans, defined as under $1 million, declined for multibillion dollar lending institutions from 42 percent in 2005 to roughly 32 percent in 2007.

While member business loans are a small percentage of the average Credit Union's overall loan portfolio—approximately four percent of all loans—they remain a segment representing tremendous opportunity.

The aforementioned statistics with regard to loan scope and volume is critical as a Credit Union that can provide comprehensive competitive loans will be in the position to offer other critical business services in tandem. In short, business owners require loans for a number of reasons including commercial real estate, office space, and equipment. This is the launching pad to better understanding the breadth and depth of business service client relationship.

In order to determine if a Credit Union is approaching this all-important business service segment correctly, let us take a look at five key variables: Strategy; Services; Structure; Sales; and Servicing.

Strategy

While a comprehensive business services program might seem overwhelming, it becomes less daunting when due diligence is applied, a process, that when executed properly, results in a sound strategy. The basis of a Credit Union strategy includes observation, education, effective policies, and the ability to manage risk.

Before proceeding, a Credit Union should determine its competition.

- Who is the competition?
- What are they offering that is different?
- Why should you compete?

Formulating a strategy requires an honest assessment of existing services and applications. From inception to complete roll out, a Credit Union should assume a three- to five-year time frame. To meet this all-important objective, Credit Unions must answer the question:

Do we abandon existing programs and start from square one, or do we enhance existing services?

To answer the aforementioned question, it is perhaps best to ask another:

Is the market share large enough to underwrite the initiative?

Often Credit Unions are placed between a rock and a hard place. For many, they remain on the fence because their business services are steady but not growing enough to warrant additional staff and dedicated services such an 800 number call center. This is a flawed approach resulting in the Credit Union sitting on the proverbial fence for years to come as competition proliferates.

This is not a strategy. Too often Credit Unions react rather than act. When a Credit Union develops a sound strategy it can achieve milestone goals. While it is best to be a defensive driver, for example; it is often best to be offensive when growing a business model. To this end, it is logical that a successful business owner would select a Credit Union that is progressive.

In order to take an offensive approach, determine the market and what specifically it is comprised of currently. As noted earlier, this should result in percentages of the following segments: sole proprietors; mom and pop sized business; small businesses; large commercial businesses; trade associations; and SEGs, among other segments.

For each segment, a Credit Union should ask the following questions:

- What type of business is it?
- What are its unique needs?
- What are its respective goals?
- Who is the competition?
- Can we offer a compelling program to do it better?

When answered thoroughly, these responses will provide the necessary information for a Credit Union to develop a winning strategy, which is based, in large part, on the services offered.

Services

In order to be effective, a Credit Union is required to have services in place that will allow them to cast a small, medium or large net, depending on the prospective business member.

Regardless of respective size, a business owner wants to have the peace of mind that all services are securely in place as his or her main objective is generating sales and prospering – not fretting over traversing the banking services landscape. Services have to be fluid, attainable, and easy to use.

Having the ability to cast a wide net defines a Credit Union as not dabbling within the business services model but facing the issue seriously - head on. A "net" of this size, however, is not cheap. A Credit Union must be able to know inherent costs. Therefore, before service offerings can be deciphered, a Credit Union must develop a budget figuring that within the first three years the investment will fall between $200,000 to $500,000 dollars for a retrofit, while a complete conversion can cost upwards of $1 million dollars.

The dollar amount will fluctuate depending on market share and the region a Credit Union is operating in. While a Credit Union can assume it will hire new employees, not all services have to be created in-house, which can decrease investments. For example, a Credit Union can partner with a third party to provide proprietary point-of-sale hardware and software for traditional, home-based, mail order/telephone order, and Internet businesses.

In today's market, for example, there is a need for business owners to secure high quality, underwritten "real time" loans. Credit Unions can partner with a third party cash management service company to secure both SBA and non-SBA loans. In addition, Credit Unions can partner with third party technology consultants that offer advanced guidance on critical services such as remote capture. In order to provide a full suite of services, often a Credit Union will have to outsource services to trusted partners.

Questions that lead to the decision of going outside of the Credit Union include:

- Will you bill or outsource?
- Will you hire companies to integrate with third party providers?

For a Credit Union to be competitive, the following suite of services for commercial and business products requires investigation and consideration:

- Business checking/deposit accounts
- Online e-banking
- Business credit cards and lines of credit
- Wires, ACH, merchant, and cash services
- Business auto loans
- Payroll services
- Lockbox services
- 24/7 access to channels
- Remote deposit capture
- Investment property loans
- Lockbox services

- Account analysis
- Dedicated member support

Understanding the difference between retail and business accounts is critical. On average, a business will open three separate checking accounts in the first year of business. Each month at least 14 checks will be written per account. These accounts often carry larger balances than member accounts, which in turn equates to higher fee income for the Credit Union. On average, 60 percent of business owners prefer to visit a branch location with an approximate average of 18 visits per month. Using account analysis provides the ability to capture cost on the entire transaction account.

Attracting business service accounts requires a robust suite of online banking service offerings. In short, national banks flood the market with advertising that speaks to this issue. If a Credit Union does not offer user-friendly online services, it will lose a large percentage of available business.

Among critical services, as earlier noted, is remote capture, which is the fastest growing service in the financial services industry and a natural extension of branch capture. In 2007, for example, the percentage of remote capture business was seven percent; the following year than number climbed to 15 percent. This is supported by the Federal Reserve which indicated last year that it will decrease the number of processing centers. In order to compete, a Credit Union must provide business owners the ability to cash checks from their place of business.

This is not only a convenient time saver; but for small to mid-size businesses and home owner associations, it also provides the ability to expedite cash flow which is a major concern for this demographic. For the Credit Union, it means casting a wider net in terms of members as business is not limited to branch location. Also, user fee revenues are increased.

According to a recent survey, business uses deposit services at a rate of 98 percent. Cash management services are used 51 percent while lending services are used 28 percent by business owners. It is estimated that there are 1,800 businesses within two miles of the average branch location. This equates to $80 million in deposits and $130 million in loans.

A further exploration into the importance of service offerings will be covered on the Structure and Sales sections.

Structure

Developing a sound structure that will support an outlined strategy and services is essential. The key component of a Credit Union’s structure is its technology and core operating system.

Differentiating between business and commercial applications is critical in determining requirements. For the business segment, the Credit Union will need to offer business loans and business checking, while the commercial segment includes remote capture, lines of credit, commercial lending, account analysis, cash management, including relationship pricing, positive pay, visa/credit debit, and online banking at a minimum.

The commercial segment is a different model; however, there is an overlap. As noted in the section on strategy, by identifying a strategy which includes the target market, the appropriate equation will emerge.

As previously noted, a Credit Union's budget will inform whether a system is upgraded, revamped or built from scratch. Again, many variables need to be addressed before this decision is made. Regardless of size and scope, however, a Credit Union serious about launching banking services will likely incur a heavy investment of time and money. In order to support this progressive step, a third party technology consultant will often provide valuable insights.

The majority of Credit Unions do not have the proper technology in place to support a business services program. The review of needed services should include core processor, commercial loan capabilities, cash management suite, sales management, portfolio management, document preparation, credit analysis, and automated loan origination.

A member business service technology should provide:

- Streamlined automated processes
- Increased volume
- Increased efficiency
- Increased profit margin
- Increased product capabilities
- Integration of existing products and services

Along with an investigation and assessment of core operating system, a Credit Union must determine how products such as credit cards, merchant process, and loans will be integrated into the business service program. Interviewing prospective vendors and managing the process will further enhance the communication arm of this strategic initiative.

Evaluating operations such as account analysis, sweep accounts, portfolio tracking, commercial loan funding, ACH, payroll taxes, among others, is imperative.

Sales

When it comes to selling services, Credit Unions are well-positioned because of the inherent ability to focus on enhancing member relations. If a Credit Union, for example, has a chief executive officer of a local business as a member, why not attract that business as well? Or, instead of providing services to members of the SEG, why not also provide services to the SEG?

In order to approach these available markets, a Credit Union must first determine:

- Field of membership

When approaching a prospective business owner keep in mind that they are all looking for the following:

- Fair pricing
- Easy access to accounts
- Progressive product and service selection
- Superb communication from Credit Union
- Experienced advisors
- Attentive service

Since Credit Unions are tuned into member needs, it is a logical progression to tune in to those members' business needs. This approach, however, requires far more than providing existing member services.

A Credit Union will have to roll out a dedicated staff whose prime focus is business services. Business service members require a high-touch relationship. Without a focused field staff and dedicated services, a Credit Union will not be able deliver a winning business services model required to maintain and sustain long-term business service relationships.

A progressive, serious Credit Union with the goal of launching a business services program should expect to hire a business service manager who assembles a skilled team in commercial underwriting, commercial banking, and sales management.

Business owners want a decentralized delivery system. They do not want to wait in the same line as retail customers. They want specialized service. In past years, Credit Unions offering business services would bring in specialized staff once a week to handle related accounts. In today's market, this is not acceptable.

In order to sell the service and be successful, the business service program has to be in place 24/7. Again, business owners have a lot on their minds. They do not want the additional burden of remembering which days a business services account representative will be in particular branch or a time frame in which they can call for support. The process has to be streamlined and separate from the retail channel.

As noted earlier, business checking accounts options will attract new relations. To remain competitive, a Credit Union should offer two business checking accounts: basic and interest-bearing accounts. These accounts should include free check cards and online banking, which includes bill pay, e-statements, e-notifications services, and free overdraft protection.

Along with an effective sales force, a solid marketing plan is required. To this end, a Credit Union can reach small business owners via print advertising in regional business journals, industry publications, web promotion, e-mail campaign, and direct mail.

Servicing

When strategy, services, structure and sales are in unison, a system of checks and balances must be in place in order to ensure proficient operation. This is the all-important “servicing” approach which is often expensive. Member business loans, for example, can cost Credit Unions 10 to 30 basis points.

Each subset service has variables that are unique to the overall operation. As noted earlier, Credit Unions, like all financial institutions, are successful when they properly execute risk management. This includes ascertaining loan size, loan-to-value ratio, determining the financial health of the member’s business. Risk management should be based on criteria to determine oversight intervals. For example, a business owner with solid collateral might be reviewed yearly instead of quarterly, which lowers oversight which in turn lowers overhead.
Credit Unions must monitor property tax payments and adequate insurance coverage. Additionally, keeping a finger on the pulse of both industry-specific and macro-economic trends will provide necessary oversight.

While the aforementioned will require employee oversight, software programs, for example, can be deployed to ensure that loans are performing at desired levels as well as handling bill and payment processing tasks. Integrating software into the core system requires oversight and guidance, a service best left to third party consultants as they handle these issues on a regular basis while a Credit Union handles them on an infrequent basis.

Without adequate staffing and servicing, member business turnover will be realized. Often, Credit Unions do not properly train and educate staff on new product lines, which presents the possibility of members getting frustrated and pulling accounts.

Conclusion

Establishing a member business service program requires a significant amount of time and resources. The market, however, favors Credit Unions as this segment of the financial industry is known for its personal approach to members.

As the Federal Reserve continues its plans to limit processing centers, community, regional, and national banks will look to secure the largest share of the remote banking market. This fact, along with recent industry trends which provide Credit Unions with more leverage to become cross-tier lenders, has presented a window of opportunity when approaching the business segment.

Credit Unions that do not act on this unique time frame will be outmatched in the years to come. Now is the time for action. A Credit Union should ask: where do we see our member business services program in three years? Before considering your answer, investigate how many of your current members are sole proprietors, members of trade associations or chief information officers of regional companies – these members potentially represent the future of a thriving member business service program.

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