Globalization is real and is just as real for the banking industry, if not more so, than most industries. Information technology advancements coupled with the sophistication of banking are combining to break down the geographic barriers which traditionally separated many of your competitors from your customer base.

In terms of technology, this probably started to some degree with the wiring of funds from bank to bank, but has now progressed significantly with ATMs, online banking, and the Internet. The technology is readily available in this day and age to everyone, and everyone has been and is increasingly using it to pursue the business of your customers in a variety of ways. This is not just a matter of soliciting the deposits of your traditional customers, but also increasingly attracting their business in a variety of other business lines on the borrowing side of the equation.

The potential for funds to flow out of the hometown bank and therefore out of rural America has increased dramatically over the past several years. Many of your lending customers are now going outside of your community to place their loan business as well. Banking over the Internet and all forms of online banking are going to accelerate this potential flow of funds outside of your area and at the same time accelerate the potential for loan placements and other banking related services to be performed for your traditional customers over long distances. What does community reinvestment really mean in this new environment where your geographically defined market is really breaking down in a lot of ways both in terms of deposits and loans? The competition for deposits and lending will take on a more regional, national, and global perspective as we move forward. Rates from all over the country are going to impact you in ways even more dramatic and more direct with your customers than in the past.

Globalization of the marketplace—that customers have access to banking service, anytime, anywhere—means that our traditional manner of looking geographically at banking does not always give us the answers. The financial institutions that solicit your customers’ business do not care about the fact that your customer is located in a small community. Those competitors have determined “by the numbers” that your customer(s), at a certain rate plus or minus so many basis points, is a customer qualified for a certain banking product. Consumers can obtain not only consumer loans and credit cards, but also auto loans and mortgages with financial institutions they have never and will never physically visit. As just a personal banking consumer in a small town, my everyday needs can really be met in a variety of ways without the local community bank if I choose to do so. As long as your rates are competitive, I will likely continue to patronize your bank and more likely so if you have established a strong loyal relationship with me over the years. However, if the rates are not competitive and I do not have external loyalty-related reasons to stay with your bank, it will become increasingly more convenient to take my business to financial institutions which might be located anywhere.
What do you do to counter this trend or to anticipate it and carve out another niche of business? You have to look at your business in a new way, primarily on a less geographic basis. Even if you think your scope of activity has limited geography it can serve, you have to look at segments of the market in which you have strong core competencies and enhance your capabilities and encourage growth in those areas.

What does that mean to rural America? Some of us are going to get left out. If you have one, two, or three banks in a small town and none of them choose to serve the housing real estate market, or the farm real estate market, or the auto loan market, or the small business market, some segment of your community is left out and will be impacted. Your expertise and leadership as rural financial institutions are needed in many different ways in small communities and your forced specialization or narrowing of your niches will impact that community. This is not to say you should not narrow your niches, you may have to in order to be competitive and remain a viable financial institution. It is to say, however, if you have to narrow your niches, it will have an impact on the rural community you serve.

COMMODITIZATION OF THE BANKING BUSINESS

Not only are you competing with the whole world now, but many of your traditional products are becoming commodities: CDs, money market accounts, auto loans, credit cards, home mortgages and home equity loans. A consumer can obtain all of these products quite easily in a variety of locations and in a variety of ways. If you couple that easy access with all the affinity marketing with other products and services which are completely unrelated to the banking industry and the impact of securitization and secondary markets on the industry, you have all the signs which indicate you are dealing in a commodity. These products come from credit card companies, car companies and dealerships, retirement clubs, financial institutions advertising in the paper with 800 numbers, and now on the Internet. Globalization of the marketplace and information technology enhancements are part of the reason for that, but it goes beyond that.

Your own sophistication of the banking business in terms of process, partially accommodated or facilitated by information technology, has driven many products to the level of being a commodity. You have developed ratios for car loans, home loans, credit card applications, and home equity loans. You do not need to personally visit with the consumer to decide if you are going to make a car loan or a house loan. You can place a customer service representative behind an 800 number, an on-line banking service, and take the information submitted, send the paperwork to be signed, or if in-person signing is needed, handle it through a regional or local agent on a fee basis. All of your standard underwriting, loan ratios, and related parameters and procedures for making a loan process routine have been a part of driving some of your banking services to commodity status.

This lending by the numbers games, coupled with the ability to offer a deposit product via advertising in the paper, on-line services, or the Internet put a large share of your banking activity in a category which can be automated to a high degree with less and less human intervention. This deposit and loaning by the numbers game with a very automated/mechanical process has produced the capability for you to perform the service at low margins. Couple that with the fact that you are in a global marketplace and customers can handle these transactions by mail, voice phone call, or computer on-line services, turns these products into low
margin and therefore requires higher volumes to make them profitable lines of business.

When I bought my first car, I did not know there was another place to go for a car loan other than the bank. This week I got in the mail from United Airlines an affinity program that gives me 30,000 frequent flier miles if I secure a mortgage loan on my house from one of these companies. Not only that, in the same envelope they had a flier on three different mortgage companies, all of which were offering some kind of frequent flyer mile package with their mortgage. And think about this for a minute, if I was in the marketplace for a house mortgage today, would I get the loan from my local bank or, at the very least, would I check out the frequent flyer mile offer? Many local Chamber of Commerce supporters will still support our local community bank at every turn; however, certainly not all consumers will have that same level of loyalty.

The financial industry has taken some additional steps in banking circles with loan pooling processes and securitization mechanisms designed to make use of the secondary market. These make it easier for small town rural financial institutions to provide certain services and obtain additional funds or minimize their risks, but they also do the same for many other financial institutions across the country, all of which are your competitors.

All of this points to very stiff competition for the rural banking institution. The slim margins and the consequent necessity to have volume work against many rural financial institutions. As the customer base narrows, the ability of the institution to function with a full array of services for rural customers certainly has the potential to diminish. All of that may not be good news for the smaller, more rural based financial institutions which cannot maintain the scale of the larger institutions or, if they do, they do it in only limited fields (perhaps agricultural lending is their only specialty left). Certainly you can be the commodity provider; however, your bank probably wants to be more than that and most of your rural communities would like you to be as well.

How do you react or adapt to this commoditization trend? If you have a way to deliver the commodity products and a full line of them, your community can still thrive and perhaps do so even better than before. Some of the products that are available to community banks may actually be additional options to what was provided before and some may even be more efficient and economical for the consumer, but it may require you to look at the banking business in a different way. Instead of taking in a certificate of deposit from your neighbor and lending the related funds to the business across the street from the bank and the traditional making of money by figuring out your margin between those rates, you may now have to become a sophisticated servicing agent. Your bank may accept the deposits on behalf of others in some cases or broker their investment of funds, and on the other side of the equation place the loan elsewhere through some pooling or secondary market mechanism. You become, in a sense, a facilitator of financial services in your community, marketing and selling a whole line of products of which only a few are products provided entirely by your own banking organization. If the community bank can be effective in that strategy, perhaps rural America has a way to win even bigger than before. The question is how you structure that type of financial institution in a manner which is profitable. If you handle only the commodity-type products and the servicing side of the equation, your community bank is going to look considerably different than today. The levels of profitability will certainly be more difficult to sustain, which directly affects your bank but indirectly affects your rural community as well.
THE INFORMATION AGE BRINGS WITH IT A NEW KIND OF CUSTOMER

Let me suggest that if rural America and its financial institutions are going to prosper in the Information Age, or at least if it is going to help its rural community prosper, it may have to do something else. The rural-based community bank may need to find a way to serve the needs of the information-based service-type business. This is not the consumer who desires to sit in front of the television and use the remote control to pay the bills and do banking electronically. The Information Age customer we are talking about is a new kind of customer with a different set of needs than the typical agricultural borrower or the typical small business located in a rural community. This is a customer with a business that is based not on hard assets but based on intellectual property and knowledgeable workers, and is a business whose value is based in part on the demonstrated ability to execute a business plan, not on the accumulation of farm real estate, equipment, grain, manufacturing plant facilities, machinery, or inventories of raw materials and/or products. Our lending institutions in small rural towns in many cases have been used to make hard, tangible asset-based loans, taking security agreements and mortgages on assets which they can touch and feel in many cases. Some of those financial institutions made the transition to the Industrial Age by establishing methods and procedures for lending to industry, but again much of that was very hard asset-based; plants, machinery and accounts receivable financing were part of the package. If rural America is to remain successful in the Information Age, its economy has to be part of the Information Age. That means an economy based increasingly on businesses with more intangible assets, intellectual property, service agreements, and a solid business plan. A very small percentage of the information-based business is typically in tangible personal property or real estate; it is in computers, software, patents, intellectual property, and similar items. These are not assets and types of loans which most rural-based financial institutions are used to handling; nor, quite frankly, do some of the regulators have much tolerance for their venturing into these areas because of the banks’ lack of experience, track record, or perhaps demonstrated expertise in these areas.

Can the rural banking institution play in that marketplace and help their rural customer base play in that marketplace, or will a whole new mechanism of financial institution develop which will bypass the traditional banking institution in the information age? This new customer, particularly on the business side of things, is becoming a larger percentage of the market. Will the rural financial institution be in a position to provide a business loan to an information age-based business which is running $1, $2, $3, $10, $20 million dollars in service revenues out of a building worth $500,000 with furniture worth $50,000, and a couple of computers on the desk?

If we want our rural areas to succeed and generate new businesses, we should not ignore such a significant sector of the economy. If this is truly the Information Age, rural communities should be a part of it if they are going to have any chance of narrowing the gap between the performance of rural and urban economies. Being part of it will require financial services for information based-businesses.

This scenario could play out two or three different ways for rural America. First, the traditional banking institutions may find a way to deliver the deposit and loan products that an Electronic Age requires of them and specifically the type of lending services needed by Information Age businesses. Second, other types of financial
institutions or facilitators may find a way to service this part of the market for rural America, and that may be possible with the electronic media that are available today without necessarily having the player be the local geographically based community bank. These financial institutions will be information-based and will choose the niches in which they operate. Third, the financial institution players who choose to understand and work this marketplace do not choose to play in rural America because it is a small part of the overall global marketplace and it is not economically efficient to deliver these kinds of services to rural America. The first two scenarios bode well for rural America, but the third is also a potential result and is not appealing to rural communities desiring to be successful in the Information Age.

CONCLUSION

Financial institutions and most often rural community banks have played leadership roles in community after community in rural America. The ability of these institutions to adapt to the globalization of the marketplace, the commoditization of many of their products, and the transition to an increasingly information/service-based economy will be key to the success of many communities. Although this scenario carries with it the potential for decline of rural community banking as the primary financial delivery mechanism, it also carries with it some unique opportunities for community banking and the rural communities they serve.

The prosperity of community banks will continue to have a major impact on the prosperity of their respective rural communities. There will be those institutions who recognize that the Information Age produces opportunities for rural America that have not existed for some time. Information Age technology and telecommunications provide rural America with some advantages unlike any it has seen in many decades. Some rural financial institutions will take this situation and carve out a niche far larger or more profitable than any small town rural banking institution could have imagined a short time ago. Those same institutions will continue to be leaders in bringing the financial products needed to rural America. Those same institutions will likely continue to be the strong leaders in their rural communities, and any plan of action for enhancing access to capital in rural areas should consider community banks a key player in the financial delivery system.