

## **Is Now a Good Time to Pursue Niche Banking?**

By Jim Neckopulos

As the banking industry continues to adjust to the financial crisis of the past three years, different business models are being formulated or revisited to identify the best opportunities for profitable growth. One particular business model enjoying resurgence is “niche banking.”

For the purposes of this article, “niche banking” is defined as focusing on a particular segment of customers, having unique or well developed expertise, offering select products and services, using focused channels or some combination of the above. Specific examples of niche banking include banks that focus on customers in particular industries (e.g., Silicon Valley Bank), provide private banking and wealth management services (First Republic Bank in San Francisco or Wintrust Financial in Chicago) or offer unique products, such wealth management services, commercial insurance premium financing, jumbo mortgages, short-term accounts receivable financing, and certain administrative services. Why is now a good time to pursue niche banking? This article explores some of the key reasons and critical success factors for successfully pursuing this strategy.

### **Key Reasons for Pursuing Niche Banking**

Traditionally, niche banking, like community banking, has been pursued as an alternative to the typical large regional and national bank business model, which focus on mass markets but offer little innovation around their sales or service models. These larger, mass market bank models have generally focused on reducing operational costs, increasing process standardization and efficiency and cross selling their customer base to grow revenues and profitability. Niche banking provides a welcome alternative to these types of institutions. In addition, because many of these larger banks are significantly distracted by changes in the banking and financial services regulations -- including compliance issues (particularly related mortgage lending) – a window of opportunity appears to exist for niche banking.

Most niche banking models have been developed to work toward providing a better customer experience. In other words, creating and organizing the bank, its selling and relationship management activities and its customer service to meet specific stated needs and preferences of well-defined, targeted customer segments. Today, there is an added impetus for pursuing a niche banking strategy – the realization that trying to meet the needs of a broad customer base is very expensive and has taken on increased complexity given recent changes and demands mandated by legislation such as Frank-Dodd.

The potential benefits of successfully pursuing and executing a niche banking strategy are compelling and include:

- Organizational clarity around well defined objectives supported by focused, aligned strategies and initiatives
- Targeted investments with higher ROIs
- Enhanced profitability
- Deeper client relationships and increased customer loyalty
- More quality referrals from customers

While various niche banks may achieve these results in different ways, the common link across these different approaches is a focus on drivers that create enhanced value to both the bank and its customers. The remainder of this article examines the identified benefits and, in particular, their increased attractiveness in the current environment.

### **Well defined objectives and focused initiatives**

One of the most significant potential benefits of pursuing a niche banking strategy is that it is much easier to limit the number of supporting strategic initiatives to a vital few. As a result, these initiatives can be more easily articulated, defined in terms of success metrics and demonstrably aligned with the bank's vision and strategy.

For example, over the past few years, several banks have chosen to serve high net worth or mass affluent customer segments. For the most part, these banks have created relationship and service models that are very different from the conventional retail and commercial banking model. The emphasis of these new models is in creating a unique customer experience, as reflected in delivery channels, relationship managers that function as concierges and extraordinary levels of service, particularly in support of phone and online channels. All of the elements of this niche model reflect and align with how these customer segments want to do business, whether it relate to banking, making travel arrangements or pursuing other interests. The defined objectives and related success metrics are clear: "we must fit into the lifestyle of these customers." Therefore, the vital few initiatives pursued by banks serving this niche must support this vision and its defined objectives.

### **Targeted investments with higher ROIs**

Very much related to the first potential benefit of niche banking models described above is the ability to target investments that support the vital few initiatives. It is much easier to develop the business case for capital expenditures related to technology when the desired outcomes are very specific. For example, implementing a CRM system that only captures key information about a customer -- such as what products and services they use and when and how (through what channels) they transact business with the bank -- is somewhat helpful. However, investing in a CRM system that not only provides this information but that also provides a feedback loop to test how well the bank is meeting customer expectations and the strength of the bank's value proposition has a much higher potential ROI. In a niche model, it can be much easier to establish hypotheses that can be tested and measured against very specific objectives and therefore result in making better investment choices and getting superior returns on investment.

A good example of how niche banks are able to pursue and execute these focused, high-ROI types of investments is seen in what Umpqua Bank accomplished with its entry into the wealth management business. Umpqua Bank's website states: "We never thought of ourselves as simply a bank. We're really more like knowledgeable neighbors, the kind you invite in for a cup of coffee, seek advice from and chat with over the fence. And we're here to help you bank like you live."<sup>1</sup> Based on its customer knowledge, insights and feedback related to customer needs, the Bank was able to confidently and successfully invest in developing a wealth management business and know that it would achieve an attractive return on this business investment.

### **Enhanced profitability and deeper relationships**

One of the most significant potential benefits of niche banking models is an ability to dramatically increase profitability. For banks seeking to enhance their performance, developing offerings targeting

specific customers may be the key to raising their profile and reducing their efficiency ratios. For example, the higher average asset and deposit balances of some segments justify the costs of introducing new, more expensive offerings. In fact, one study has noted that mass affluent customers are roughly 30 times more profitable than those of the mass market.<sup>ii</sup>

This highly-positive customer economic model often arises from the deeper relationships that niche banks are able to develop with their customers. Given that niche banking models focus on customer preferences, there may be a greater likelihood that customers will look to a niche provider to meet more of their banking needs.

Additionally, while niche banks target prospects they believe are attractive, prospects who ultimately become customers often proactively seek to be affiliated with a niche bank. Sometimes this phenomenon is related to business connections (such as an industry affiliation), a common ethnic heritage or a social cause or awareness (e.g., banks that promote themselves through and/or create social networks). For example, in Colorado the “recreation economy” generates about 4 percent of the state’s gross product. A few banks in that state, including Vectra Bank, have been successful in executing a niche strategy around this industry.<sup>iii</sup> In other cases, a customer’s affiliation with a niche bank is related to an emotional attachment to the brand, i.e.: banking at this niche institution says something about the customer and/or makes a customer feel a certain pride. Whatever the source of the attachment, there is a two-way connection and shared passion between the bank and its customers.

#### **Increased customer loyalty**

Given their focus and affinity-based relationship with customers, niche banks have traditionally had very loyal customer bases. Niche banking models emphasize and successfully execute higher and more personalized service levels. Numerous examples of niche banks excelling in truly “over and above” service – meeting customers at their home or office, assisting family members of the customer and other actions underscore niche banks’ commitment to this important competitive differentiation.

Additionally, niche banks often have more experienced personnel, who bring deep industry or other specialized expertise; small and middle market businesses particularly value this. Lower turnover rates of bankers and support personnel at niche banks can help foster long-term client-bank relationships. Bankers who know a customer’s business can gain a significant competitive advantage. Finally, in today’s environment, with many of the large national and regional banks distracted by merger integration activities, regulatory compliance issues and class action law suits, niche banks have been able to maintain their a focus on customers and their needs, which has served to further enhance customer loyalty.

#### **More quality referrals from customers**

The potential benefits identified above highlight why niche banking can be an attractive model. These benefits also explain why successful niche banks tend to get more – and higher quality -- referrals from their customers. Loyal, committed customer are more receptive to being cross-sold other products and services and to refer customers.<sup>iv</sup> Moreover, as national and regional bank customers have become more dissatisfied on several levels– whether related to service, products, channels or the ability to meet lifestyle needs -- it has been easier for niche banks to solicit and

obtain referrals. The ability of niche banks to offer an alternative banking model more attuned to all of a customer's needs and preferences is a powerful driver of customer referrals. Further, social networking has facilitated and accelerated the referral process, as "word of mouth" accolades about banks that "get it" spread virally. Some niche banks have even added dedicated capabilities, such as mobile sales forces, to optimize flexibility and meet customer desires and needs swiftly and conveniently. The ability to successfully offer an alternative banking model more attuned to a customer's day-to-day preferences and needs is a powerful driver of customer referrals.

Finally, prospects referred by a niche bank's customers often share an affinity with those customers. As a result, these referred customers are more likely to have a profile that is attractive to the niche bank. This creates a virtuous customer growth and profitability cycle for the niche bank.

## **Conclusion**

This article has defined niche banking and provided strong support for the attractiveness of a niche banking business model. Niche banking has long had a place in the U.S. financial services landscape. In the past, a small number of banks who understood the success factors critical to niche banking did very well on many levels, generating profitability, deep relationships and customer loyalty. Fast forward to today: over the past two to three years, the reasons to consider a niche banking strategy are even more compelling. As large national and regional banks continue to be distracted, banks that can create a niche-oriented, customer-based business model – one that is focused on a particular segment of customers, leverages a unique or well developed expertise, offers targeted products and services or does all of the above -- have a great opportunity to create value and drive profitable growth.

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<sup>i</sup> South Umpqua Bank website: [www.umpquabank.com](http://www.umpquabank.com)

<sup>ii</sup> “Growing a New Niche in Retail Banking”, Gemes, Konik and Moss, Strategy + Business Magazine, January 2008

<sup>iii</sup> “Finding A Banker Who Knows Your Industry”, Gomulinski, Boulder Business Report, October 2010

<sup>iv</sup> See, for example, “Retail Banking Strategies in Europe”, Groeneveld and Wagemakers, Economic Research Department, August 2004