Harland Clarke Webcast 10/25/18
Competing in a Land of Giants TRANSCRIPT

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Nathan: Good day, and welcome Harland Clarke's *The Informed Banker Webcast: Competing in a Land of Giants*. This webcast is being recorded, and a replay will be provided to you within a few days. If you have questions, please use the question box located in the control panel. The questions are private are only seen by the presenters. I will now turn the call over to Christine Ahlgren of Harland Clarke. Christine, you have the call.

Christine: Thanks, Nathan, and welcome to all who've joined us today for this month's installment of *The Informed Banker*. This series is designed to bring you succinct timely information on topics that are critical to community financial institutions. Today's session as Nathan mentioned, *Competing in a Land of Giants*, will be presented by Jon Jeffreys of Callahan & Associates. He'll discuss how leaders can build an emergent culture that embraces certain kinds of risk taking, tolerates failure, and encourages learning at every level. Jon Jeffreys has been a managing partner at Callahan & Associates since 2014. He also serves as a member on the Board of Directors for Callahan & Associates, as well as myCUmortgage.com. We're thrilled to have him here. Jon, the floor is all yours.

Jon: Great, thank you, Christine. Good afternoon everyone. It's a pleasure to be talking with you today about *Competing in a Land of Giants*. Really, what I think the talk today is about is about competition and how we compete and how we think about competition in new ways. Nathan, if could, go to the poll. Before we get started, I think it would be important to think about who is our competition. Really quickly, please just pick one. Who do you think your fiercest competition is? Is it large banks? Is it community banks? Is it credit unions? Is it FinTechs?

You need to look at your organization and think about competition. Who is the fiercest competitor that you face? All right, here are some results. About 65% of folks think that large banks are the competitors, 18% community banks, 35 credit unions, and 35 FinTechs. Great, I think that's real interesting, and that ties in well with the theme of today's talk. As we look at bank market shares and how that's divided, in 2014, there's a chart that shows what these giants are and what their share of the market is. Nathan, if we can go forward to the bank market share slide.

In 2014, there were 14 institutions that had over $100 billion in assets, and these giants hold about 59% of deposits. You have 14 institutions that hold 59% of deposits. Then you have 12,000 community financial institutions that are fighting over 41% of market. I think that this is really important for us to take stock in, the fact that there are these mega institutions out there, the money center in super regional banks that really are competing in different ways. They have a different level of scale than is out there. Yet, there are about 12,000 financial institutions, community financial institutions that are out trying to differentiate in the marketplace.

One of my points of view is what's the goal of the large banks? Do they have anything in common? How might we use that to compete? We really are competing in this land of giants. The goal of the large banks is really to drive the consumer market towards commoditization. Here you see the second point of how do we – or how do they make it more cost-effective to serve when there's really no differentiation needed?

On the next slide, you can see that competition is expensive. For many of these large banks, their shareholders don't have a large amount of patience. I think when we look at, if they're our fiercest competitor, what are they trying to do? They're trying to level the playing field. They're trying to make it harder to differentiate. They're trying to make the consumer feel like their products are a commodity because it's expensive, and it's much easier to compete that way.

If we go on, I think it's clear; competition's hard. Slaying giants is hard work. No one says it's easy. What I really want to do is talk about three themes that I would suggest for how you think about approaching the marketplace. I'll give you a disclaimer upfront, which is I know very little about any of the markets you're in, so this isn't necessarily a playbook for what to do but rather a way to think about your strategy and how you compete as you go forward. It's lenses which you can look through and perhaps think about your opportunities and your market in a new way as you evaluate how we might want to compete going forward.

The themes that I'm going to talk about are how we do we think about your business like a monopoly? How do we play Monopoly? The second is what if we thought about this as a football game? The third is can we look at what these FinTech companies are doing, and is there anything we can learn from that? If we go back to what if we think about our business as a monopoly? Going on, you say wait a second, Jon. Monopoly is illegal, right? There's this thing called antitrust out there. You can't really think of your business a monopoly, right? We'll get Department of Justice here so fast that it's not worth it.

I think it's a framework, and it's a framework for how you might think about your business. On the next slide, you see that monopolies have three things in common. The first thing they have in common is they have no competition. The second thing is they start off narrow in both scope and scale, and third, they're both highly profitable. Put yourself in the shoes of an investor, right. We can argue whether these are monopolies are not.

What would you rather own, Google or United Airlines? If you look at Google, they have very little competition. There's a little bit, but certainly, when they started there, they reinvented and dominated the search business and the advertising business. They start off narrow and then have eventually gone and gotten different scale and different reach, and they're highly profitable. Yet, if you look at an airline, airlines are almost commodities. What does Warren Buffet say? "The best way to become a millionaire is to start with a billion dollars and invest in an airline." I think it's a framework to think about how might we compete? How might we build monopolies? How might we think about this in other ways?

As we go on to the next slide, how do you think about your organization? Can you build monopolies? I'm talking about demographic. Can we own Gen Y, Gen Z, Millennials? Is it a demographic or geographic? We're going to own this community. We're going to have a monopoly of this geographic area. Is it about a job to be done?

I know in a previous *Informed Banker Series*, my colleague, Jay Johnson, talked about the notion of jobs to be done. Can we own a job? Can we be the go-to place for that job for people? Maybe it's a product. We want to be the place where people go to look for first-time home buyer loans, for example. We want to own wealth management or small business lending in our community. Think about where can we build monopolies?

One of the ways that I think about organizations taking this back to their shops and having a discussion with their management team, how does this apply? Look around your community. Look around your organization. Look around your geographic region. Who are the competitors that have built monopolies that you cherish? Then step back and say how do they do it? If we were going to replicate that or emulate them, how might we do it, and are there ways that we might be able to focus on building a monopoly of our own somewhere? That's theme number one how we're going to compete against giants is can we think about our business or lines of business in some sort of monopoly format?

The second line on the next slide which is what I call football. You're going to say, Jon, you have a slide here about Michael Porter from Harvard Business School. What's this have to do with football? We'll get there. Michael Porter says, "The essence of strategy is choosing what not to do." What I find, especially in a lot of the smaller financial institutions that we work with, is they’re not really good at saying no. You go in and say can I see your product list? It looks like a wine list at a high-end restaurant where they have all these products. It’s really confusing, and if you put yourself in the customer point of view, it may be really hard to differentiate or digest what’s out there.

What types of choices do we have to make? If we go forward, if you think about your business like a football team, and it’s football season here. Imagine you’re the general manager of a football team. What are the types of decisions you have to make? First, you have to decide how do you play the game? In football, the rules are defined. You have to play offense. You have to play defense. You have to play special teams.

If you were the coach or general manager, you have some choices to make. Where do you invest in and for what? What do you want to be good at? What do you want to be great at? I grew up in Pittsburgh, so because of that, I am a life-long and die-hard Steelers fan. I think, in practice, this can take on some very different things. If we go on, in the 1970’s, the Steelers focused on defense. The Steel Curtain, that was really the – they wanted to have the best, fastest defense you could have and swarm the ball and take away. That was really the basis of which they were invested, so they focus on defense.

Then if you go forward, in the mid-2000s, hey, we want to be really good at running the football, so we’re going to invest in an offensive line. We’re going to invest in running backs, and we’re going to run the ball and be really good at that. That’s going to be our basis for competition. Then, if you go forward ‘til today, hey, we want to be a passing team, so we’re going to invest in a quarterback and wide receivers. I think that this is a good example for you to think about your organization and how you compete. What are the types of things that you want to play? Where do you want to focus? Do you want to be a defensive team? Do you want to be a running team? Do you want to be a passing team? Where do you want to focus?

One of the things that I get all time is, well, Jon, in football, you can’t just walk up and say, Mr. Referee, we’re actually not going to play defense today. That’s not an option, so you have to play all things. It’s really a question of where do you want to focus? Where do you want to make your investments on the margin to try and compete? What we find is, as you think about your organization, as you get into planning and you think about how might we try and differentiate ourselves in this crowded marketplace, understanding where to say no, understanding what do we need to stop doing so that we can focus on running the ball or playing defense? We have limited resource. We don’t have the deep pockets that some of those giants might have. We have to be smarter about where we invest than others. That's my second point here is how might we think about our organizations like trying to build a football team?

The third point I make as we go on is these FinTech companies. The way that I frame it is there are companies that want to try and make us irrelevant. I think what these have in common and Lending Club is simple and OnDeck, Rocket Mortgage, etc. is that they have already tried to play monopoly. They started with a monopoly. They made some choices. Take Lending Club, for example. They started by saying we want to get in the debt consolidation game and focus there. SoFi started. We want to get in the student loan refinance business. Rocket Mortgage is clear; we want to get in the mortgage business, and OnDeck is the small business sector. They started with a monopoly focus, and over time you can see how they've grown out.

As we go forward, they started with this laser focus. They have a monopoly mindset, and because of that, they played ball differently. I think that one of the challenges that a lot of community financial institutions have is this notion of trying to become all things to all people. One of the questions that I really challenge people with as they get into their planning process is can we really truly in our heart of hearts be all things to all people? I actually think the answer to that is probably no. If that's the case, have we made the right choices? Have we gone back and asked the hard questions?

As we go on, you have some questions to ask as you get through strategic planning. In my experience, these are great to do in strategic planning, but strategic planning doesn't have to be a once a year event. Strategic planning should be throughout the year and a process that you have that's ongoing, but you have choices to make. The essence of strategy is what not to do. That means that any decision you make probably has some consequences. Here are some questions that I think are really effective as you get into strategic planning to think about and will help you understand how do we want to compete? How might we go about trying to differentiate ourselves, and how might we try and slay these giants?

I think the first one is what does success look like, and are all of our stakeholders aligned on what success looks like? I think one of the cons to my football analogy is it's really easy to know how we're keeping score. That's part of the game. How do we want to keep score running a retail financial institution? Is it market share? Is it asset size? Is it loan growth? Is it number of customers impacted? Is it, for those stock-based organizations, stock price? There are many different ways in which you can balance and measure success.

The first question I always start with is do we actually know how we're keeping score in the game that we're playing? I think that's the most important. Next is what are you already good at, and is that enough? Can you build upon your strength? How are you seen in the community? How are you perceived? Do you have some monopolies that other people might cherish, and if so, how did you get them? I think the last two are also critical to ask and what I find is many organizations don't spend the time asking them. From the customer perspective, what makes you different? Now, I think one of the reasons why I urge organizations to think about from the customer perspective and not the general public perspective, you want to talk to people that have already made a buying decision, that have already chose to do their banking with your organization.

For my job, I fly a fair amount. I go around the country and talk to organizations, so if Boeing called me and said, Jon, do you have any tips on how we can make a Boeing more comfortable or a better plane, I'd have all sorts of ideas for them. That's not going to cause me to go buy an airplane, so I think, in the same way, you may be able to go out and get some perspectives from non-customers. They're just opinions. You really want to find out what makes you different from people that have already chosen to do business with you. Why did they pick you? How did they compare? What was the basis of competition? Once you then understand from the customers what makes you different, then you can sit back and say how do we leverage that? How do we amplify what we're doing? Is that unique enough to take us forward?

Going forward, some of the things that I would urge you to do next, I know many organizations are right in the middle of strategic planning for next year. Some of the questions that I would urge you to ask are what are the segments of the market that we want to own? Where do we want to build those monopolies? The second is how do you own that market and create a basis in performance that has no competitors? In that, be explicit. Where do we want to focus? Where do we want to play offense, defense, run, pass, but then more importantly is where do we not want to focus? What segments do we not want to focus on? Where do we want to avoid? What might we say no to? I think with this framework we can think about competing in nontraditional ways.

As we go on, one of the themes that I would think about is we have a really fierce competitor. The banking sector is hypercompetitive. We have a set of competitors that have extremely deep pockets that can compete, and 65% of you thought that they were your fiercest competitor. This isn't an easy task to compete. I think that if you recognize what in my opinion the banks are trying to do, the large banks, which is drive banking towards commoditization. Make it really hard to differentiate. If they're doing that, you may need to step back and say, well, how do we play against that? There's an old saying that "you can't beat the competition by becoming the competition."

I hope with the framework that I provided today, which is how do you think about your business and lines of business as a monopoly, how do you think about playing football? How do you make some choices about what to do, what not to do? Then try and learn from these FinTech companies. Hopefully, if you can understand and apply some of those questions in your planning process, you'll be able to think about how we might want to compete on some different ways that can help us gain market share against the larger banks. Christine, with that, I guess I'd open up to any questions that the group may have.

Nathan: I do have some questions here, Jon. We see mega banks investing huge sums in technology. How might we think about this given our limited resources?

Jon: Yeah, I think that's a question that we get a lot. You see… in *The Wall Street Journal* and other places of J.P. Morgan investing a billion dollars here and a billion dollars there, significant sums of money. I think that we need to step back. What I urge organizations we work with is watch what they're doing. They're going to have some winners, and they're going to have some losers. For smaller community-based organizations, it's probably okay to be a second or third to market. If some of these innovative companies want to go out and pilot some things, that's probably okay. Then, as different areas stick and become more table stakes, they'll be other competitors in the market, other vendors to the market that offer solutions likelier at a much reduced cost. What I urge people to do is pay attention and watch, but then be prepared to be second or third to market. I don't know that you have to be first to market in a lot of these things.

Nathan: All right, thank you. Oh, Christine, go ahead.

Christine: Hi, Nathan, and thanks for jumping in with the questions. My computer was not agreeing for a moment, but I'm here. We do have one more question, and I want to remind folks, if you have any questions for Jon, you can feel free to enter them in the chat box on your screen. The question I have now is, Jon, for years our competitive advantage has been service/customer intimacy. How might we sustain this in a digital world? That's a really important question that I get asked a lot as I work with banks and credit unions. How do you create engagement with your consumer when a lot of the activity is happening through electronic channels?

Jon: Yeah, no, I think that's the million dollar question or billion dollar question even. I think that the way I would start that one is I think there's the classic framework where you compete on innovation, service, or price, and I think for most community financial institutions, they probably don't have the scale or desire to compete on price. I don't know that that's where most people want to play. Then you say innovation, or service, or intimacy. Innovation is fairly high risk, and that gets to the previous question that Nathan asked. I think that, Christine, you used a key word, which is engagement. I think that often times the word service or customer intimacy really could've been a synonym for engagement, or we had a really high-touch engaged customer base. They really looked to us, and that segment was engaged.

I think with digital channels engagement looks differently. We need to think about how do we engage people when they're not going to come into a branch anymore? How do we engage people when they're probably not going to call our call center anymore? What does engagement look like on an email channel, on a marketing strategy, on a mobile application, and how do we get our customers that information that historically they'd of gotten in person? I think that becomes an interesting challenge. That's it. There are lots of other organizations we can learn from. We can go look at other types of retailers.

Zappos is one, but one of my favorite examples is actually Nordstrom's. People go out to Nordstrom's corporate website and look at their investor presentations. I find that fascinating how they've transitioned from a brick and mortar high-end retailer. They made some choices playing football about who they want to serve. How they have then taken that into a digital world and what percentage of their sales now happen online and how they view the physical presence augmenting and supplementing the virtual, I think that they've done a really neat job. It's out there, and it's approachable and a lot of similarities to look at there.

Christine: Thanks, Jon. I think that really helps, and as I mentioned, we hear that a lot. The branch traffic is diminishing to some degree, and for some folks, that's the plan. That's the strategy, so they have to figure out ways to get that engagement level up through non-personal activities. Others still do want to drive traffic to branches because that's part of their business model, so it's an interesting challenge that we face as technology continues to permeate all things.

Jon: It is, and those people that say retail is dead is I think just wrong. We see lots of community financial institutions continuing to build physical branches or physical presence. They just look different. You don't need a teller line with 15 teller windows anymore. That's not what they're there for. They're there for a different purpose. It's really how the member and customer experience influenced what's the physical invest made to look like, and how is that supplemented by the digital world?

Christine: Exactly, well, lots of exciting challenges on the forefront. I don't have any additional questions here, so it looks like we might wrap up this call. As a follow up to today's program, we'll be sending out an email that will provide a link to a real quick three-question survey to understand the value you found from today's presentation and to request any ideas you might have for topics in the future. Please free to share that recording that will come with the survey and a transcript as well with anyone that wasn't able to make today's session. Additionally, we have another *Informed Banker* coming up on November 15. We also have an expert from Callahan & Associates, Alix Patterson, who will be talking about appealing to the next generation of account holders.

Jon, thanks again for all you've shared with us today, and I'd really like to extend a sincere thank you to the many financial services professionals who made time in their busy schedules to be with us today. We really hope to see you again in the future *Informed Banker* sessions. That concludes today's session. Thank you for joining us this afternoon.