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Article

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Banking Expectations: Do Bankers Really Understand the Needs of the Small Business Customer?

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This study examines the expectations that both small business firms and bankers have regarding the bank selection process. The purpose of the study is to determine whether or not bankers understand the needs of the small business customer. It is based on a nationwide survey of 115 small business firms and 296 banks. In seven instances, statistically significant differences in expectations are noted. The results suggest a communication gap in the small business/commercial bank relationship.

I. INTRODUCTION

The economic conditions of the 1990's have ushered in a new era for both small business and the commercial bank. For small firms to survive, they will need a banking partner that not only understands their business, but also one who stands ready and willing to meet their ever expanding service requirements. By the same token, commercial bankers that once relied on the highly profitable corporate market will find it increasingly necessary to tailor their services to the small business market. As new and sometimes less expensive markets have developed, corporate borrowers have increasingly turned away from the banking industry.

It is not surprising, that the success or failure of the small firm has been closely linked to an understanding banking partner. Unlike large firms that have ready access to both debt and equity capital markets, the small firm typically has nowhere else to go (Walker & Petty, 1978). A

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recent report of the Small Business Administration found the commercial banking industry to be the most significant source of debt financing for small business firms (US Small Business Administration, 1989). Bank loans not only provide the mechanism whereby small firms can finance current operations, they often provide a major portion of a small firm's initial operating capital (Van Auken & Carter, 1989).

Similarly, it is not surprising that a recent study by the Consumer Bankers Association of 64 commercial banks, found that all 64 banks had plans to expand their small business market in 1993 (Robert Morris Associates, 1993). With greater use by medium and large size companies of nonbank borrowing alternatives such as private placements and commercial paper, bank profits have fallen. To take up the slack, bankers have had to turn their attention to the small business customer. The types of activities these banks are looking at included, SBA lending, offering more small business products and services, small business advertising, and allocating more staff to small business development.

If the success of small business is, in fact, dependent on the type of relationship maintained with the commercial banking industry, and the success of the banking industry is, in turn, dependent on the type of relationship maintained with small business clientele, both parties must clearly understand each other to prosper in the 1990's.

In looking at the academic and practitioner literature in the fields of small business and banking, we found numerous articles dealing with how small business firms should and do select a banking partner. The banking needs and desires of small business have been studied for years. We did not find literature, however, which discussed bankers' expectations concerning small business needs. In other words, what issues do bankers think are important to small business firms in their banking relationships. If both parties understand each other, one would expect to find that the factors small businesses consider important in the bank selection process are the same factors which bankers consider important to small businesses. Literature in this area is hard to find.

This study attempts to answer the question of whether or not bankers understand the needs of small business. It is based on a comparison of the banking expectations of 115 small business firms and 296 commercial banks.

II. PAST RESEARCH

The academic and practitioner literature dealing with the topic of bank selection generally falls into one of three major areas—descriptive studies

directed at the business owner, descriptive studies directed at the banks, and studies which provide actual survey data. A brief overview of the types of articles in each of these areas follows.

The descriptive literature dealing with business firms typically emphasizes either why it is important to have a good relationship with a bank or the types of things business owners should consider prior to beginning the relationship. In a recent article entitled "It Pays to Shop for a Bank That Will Treat You Right" (Petty, 1989), the author points out the importance of conducting all of the company's business at one bank. By so doing, one can often times receive preferential treatment and lower rates. Other authors, like Cappello (1989), outline the actual process that should be followed in finding a new bank.

The descriptive literature directed towards banking practitioners focuses on relationship banking. Turnbull and Gibbs (1987) advocate a market segmentation approach as a way of improving market performance. By specializing their services to specific groups of customers, banks can gain a competitive advantage. Competitive advantage can also be gained by offering a limited number of products and services based on the individual bank's expertise. Otis (1989/1990) states that banks in the 1990's will survive by becoming a member of a firm's core group rather than attempting to serve the entire customer relationship. The approach used in these type of articles is to provide banking practitioners with a framework to use in marketing their banking services to their business customers.

Articles describing surveys relate to both small and large firms. Some of the small business surveys focus on limited geographical areas. For example, Schlesinger, Unsal, and Zaman (1987), surveyed 174 small businesses in the State of New York and found that interest charged on loans, ease of borrowing, and offering full service banking were the three most important factors related to bank selection. Price was also found to be a very important factor by Buerger and Ulrich (1986) in a survey of 475 small businesses in Pennsylvania. On the other hand, two later studies found that the small business owner was primarily interested in the issues of confidentiality and professional personnel. One by Prince and Schultz (1990) was based on a survey of 508 affluent small business owners in a variety of industries. The second, by Freeman and Turner [5], related to bank strategy and was conducted by the Consumers Bankers Association. In addition, the Prince and Schultz study found that the cost of service was not a major concern.

Unfortunately, most of the recent large business surveys focus on business firms operating outside of the United States. For example, the

Turnbull and Gibbs (1989) survey of South African companies, the Rosenblatt, Laroche, Hochstein, McTavish, and Sheahan (1988) survey of Canadian firms, and the Chan and Ma (1990) survey of corporate banking behavior in Hong Kong, found that quality of service and quality/knowledge of staff were some of the most important factors related to bank selection. In the Turnbull and Gibbs study, price was also found to be a significant factor.

The existing literature is clearly an important source of information in developing an understanding of the factors relevant to small business firms in the bank selection process. Its weakness lies in the fact that it sheds little light on whether the banking community shares the same views as to the importance of these factors.

III. METHODOLOGY

Data concerning banking expectations were obtained by means of a nationwide mail survey of both the business and banking communities.[1] The business survey was mailed to the chief executive officer of a total of 1925 firms. The sample was randomly constructed to include firms in all industries (except financial services) and firms in all 50 states.

The bank survey was mailed to the chief executive officer of 966 commercial banks. This sample was also randomly constructed to include banks in all size categories as measured by 1991 total asset levels and banks in all 50 states. The names and addresses of both firm and bank chief executive officers were obtained from a commercial mailing list supplier.

For purposes of this study, a small firm was defined as one with 1991 sales level of less than $5 million. As a result, each business firm respondent was asked to indicate their size level in terms of the following four categories.

Small Firms - (Sales less than $5M)
Medium Firms - (Sales between $5M and $50M)
Large Firms (Sales between $50M and $500M)
Very Large Firms (Sales over $500M).

These size categories are the most common ones used by bankers in differentiating business market segments.

Similarly, each bank respondent was asked to indicate which of the four market segments specified above they served. We could then

Exhibit 1
Factors Affecting Bank Selection

A.	Bank charges competitive prices for products and services.
B.	Bank can deliver all the products and services you require.
C.	Bank is efficient in its day-to-day operations.
D.	Bank is innovative and provides you with new ideas/ products and uses current/new technology.
E.	Bank has a strong reputation in the community.
F.	Bank has the ability to provide a long-term business relationship.
G.	Bank provides a personal banking relationship.
H.	Bank is located in a convenient location for your business.
I.	Bank is willing to accommodate your credit needs.
J.	Bank can make decisions quickly.
K.	Bank has a knowledge of your company's business.
L.	Bank provides some products and/or services at below market rates.
M.	Bank is financially healthy.
N.	Recommendation from business associate or friend.
O.	Other (please specify).

compare the small firm responses with responses received from only those bankers which marketed services to the small business community.

In addition to the above, the survey instruments asked general demographic questions as well as questions dealing with the type of banking relationship each firm maintained. It then provided each respondent with a list of factors business firms can consider prior to establishing a banking relationship (See Exhibit 1). The list of factors and survey instrument were designed after reviewing relevant literature and talking with several bank managers and business people in the local community. It was also pretested in a mailing to over 400 small and medium size firms located throughout the United States.

The business respondents were then asked to rank the three factors they consider most important in the actual bank selection process. Firms which normally had relationships with more than one bank were asked to answer as if they were selecting a primary or lead bank. The bank respondents were asked to select the three factors which they believed small business firms consider most important in selecting a banking partner. In all cases, respondents had to specify a first, second, and third choice.

By limiting the choice of factors to three, we hoped to keep the survey simple and thereby increase response rate. With 15 selection factors possible, we felt that most respondents would have a difficult time providing a meaningful ranking of all 15 factors. Furthermore, in most decision-making situations, the ultimate decision centers on only two or

three key items. The goal of the survey was to determine whether or not bankers were able to identify these key items.

IV. RESULTS

Responses were received from 384 of the 1925 business firms and 305 of the 966 banks. Of the 384 business firms, 115 or 30 percent, represented the small market segment. The bank response was substantially higher with 296 of the 305 banks (97%) serving the small business customer. This result is not at all surprising inasmuch as commercial banks can typically provide services to all size firms.

Demographic Data

Table 1 shows that over 70 percent of the small firms responding to the survey operate in either the service or retail industries. As one would expect of small business firms, in general, they also conduct operations within a single state (Table 2). The firms, however, did not represent young start-up organizations since over 70 percent had been in business over 10 years (Table 3).

Sixty-six percent of the small firms surveyed used a single commercial bank for their banking affairs (Table 4). While the type of banking organization utilized varied from local to regional (Table 5), over 70 percent of the small firms had been with their existing bank for more than five years (Table 6). One could conclude from this data that the small firms in the survey were generally satisfied with the type of service provided by their existing bank.

The majority of banks in the survey (83%) could be characterized as small or medium size institutions with 1991 total assets levels of under $500 million dollars (Table 7). As a result, they represent a fairly accurate picture of the banking industry inasmuch as 95 percent of the banks in the United States as of December 31, 1991 had less than $500 million in total assets (Federal Deposit Insurance Corporation, 1991).

Respondent Factor Rankings

The factors which small business firms and banks identified as being most important in the bank selection process were determined by two separate methodologies. The first utilized a weighted average rank scoring system. In this case, each factor which was selected as the first choice was assigned a score of three, each second choice was assigned a

Table 1
Type of Firm

Industry	
Service	44%
Retail	27%
Manufacturing	15%
Wholesale	6%
Construction	5%
Agriculture	2%
Transportation	1%

Table 2
Area of Operation

Location	
One state	75%
Several states	15%
Continental USA	6%
International	4%

Table 3
Age

Number of Years in Service	
Less than 5 years	8%
5–10 years	20%
11–20 years	37%
21–50 years	28%
over 50 years	4%
No response	3%

Table 4
Banking Organizations

Number Used	
One bank	66%
Two banks	23%
Three banks	9%
More than three banks	2%

Table 5
Type of Banking Organization

Area of Operation	
Local	27%
State	33%
Regional	23%
National	10%
International	3%
Don't know	4%

Table 6
Length of Time with Primary Risk

Years	
Less than 5 years	26%
5–10 years	27%
11–20 years	30%
21–50 years	13%
Over 50 years	1%
Don't know	3%

Table 7
Size of Bank

1991 Total Asset Level	
Less than $100 million	50%
$100 million to $500 million	33%
$500 million to $1 billion	9%
Over $1 billion	8%

score of two, and each third choice was assigned a score of three. The combined scores for each factor were then divided by the total number of responses received in each group to determine the rank score for the individual factor. The maximum score possible for any one factor was 3.0. Such a score would result if the selection factor was identified as the first choice by all respondents.

Since the weighted average rank scoring technique assumes an interval measurement scale, the second methodology was based on

categorical measures. In this case, the percent of the sample selecting each factor as the first, second, and third choices was calculated and these percents added together to arrive a cumulative factor proportion or score. The results of both of these methodologies are presented in Figures 1 and 2. In each figure, the small business factor scores are listed from high to low along with the corresponding bank score for each factor.

In viewing these two figures, two observations are apparent. First, the top six factors which small business firms consider in selection a banking partner are the following:

1) that the bank is willing to accommodate credit needs;
2) that the bank is located in a convenient location;
3) that the bank can deliver products and services;
4) that bank provides a personal banking relationship;
5) that the bank is financially healthy; and
6) that the bank charges competitive prices.

Second, there were substantial differences between the rankings provided by the small business and bank respondents.

Since the primary purpose of the study was to determine whether bankers really understood the needs of small business customers, we analyzed the differences we obtained in weighted average rankings between groups as well as the differences obtained in cumulative factor proportions. These results are presented in Figures 3 and 4. In Figure 3, the difference between the small business weighted average rank score and the bank rank score is plotted. In Figure 4, the difference between the small business cumulative factor proportion and the bank factor proportion is plotted. Since the bank number is subtracted from the small business number in preparing these figures, the bars to the right of zero indicate the factors which small business firms consider more important and the bars to the left of zero indicate the factors which the bankers consider more important.

Since respondents were only asked to rank three out of fifteen possible factors which they consider important, the measurement scale of our data can best be described as being a "truncated ordinal" measurement. As a result, is was necessary to select a simple statistical procedure for both reporting and analyzing our data. Since a *Student-t* test for differences in weighted average rankings and a non-parametric *Z*-test for differences in cumulative factor proportions were least likely to influences by the measurement scale of our data, these techniques were

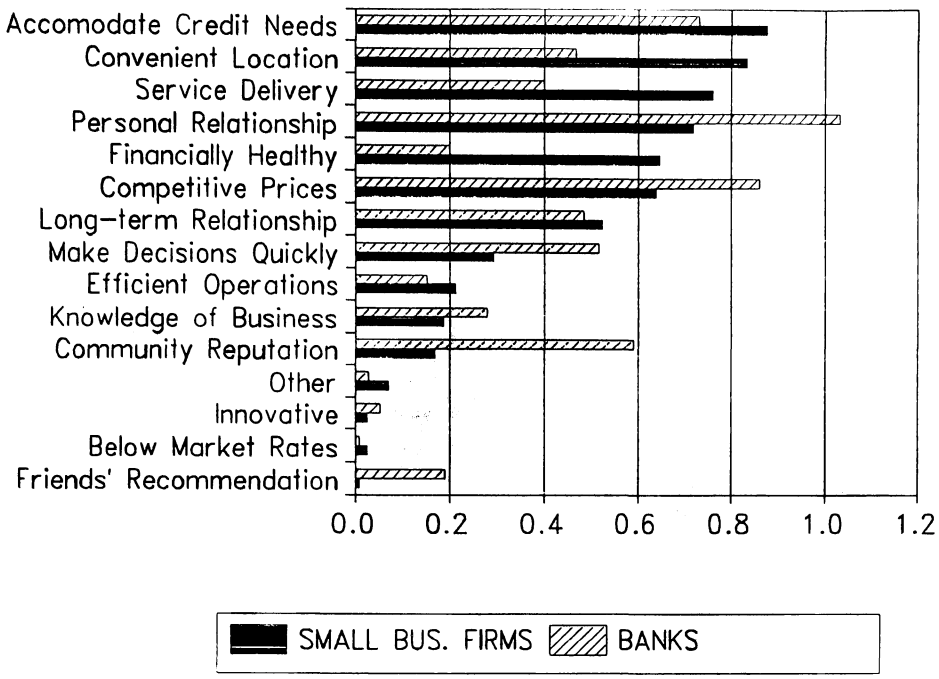

Figure 1
Respondent Factor Rankings

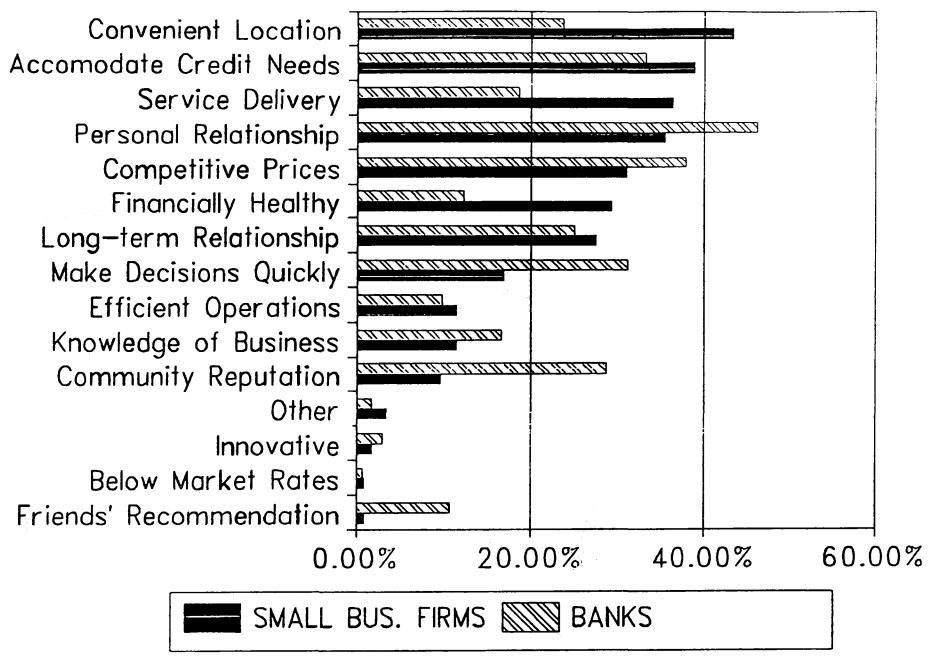

Figure 2
Respondent Cummulative Factor Proportions

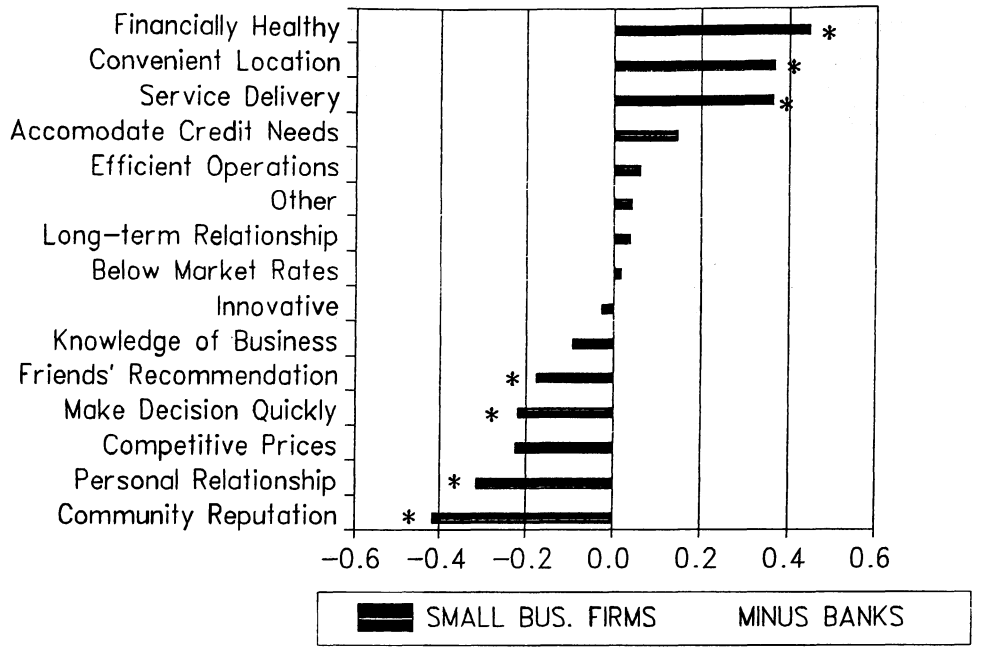

Figure 3
Difference in Factor Rankings

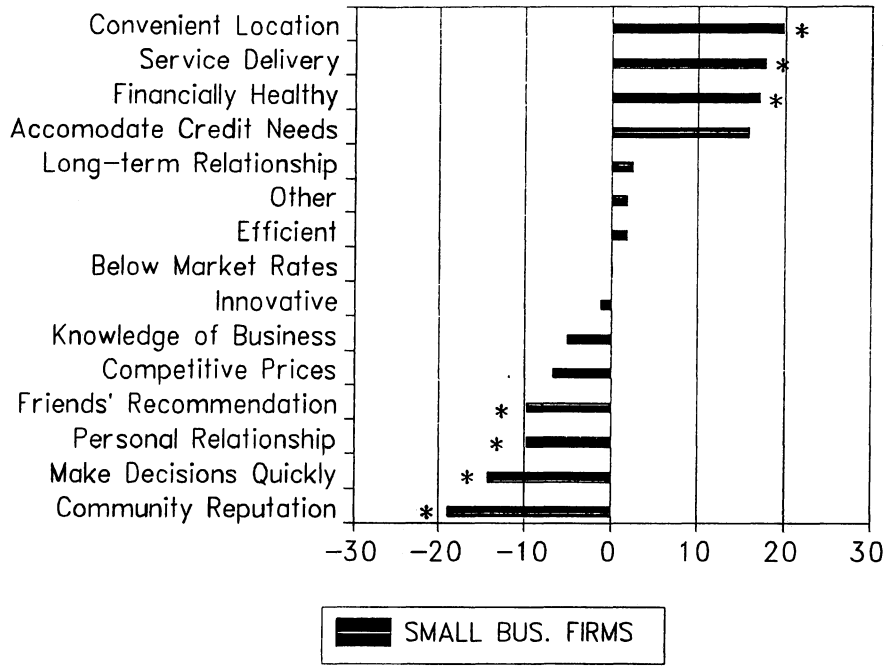

Figure 4
Difference in Cummulative Factor Proportions

utilized in testing whether the differences noted in Figures 3 and 4 were significant. As expected, a total of seven differences between small business firms and banks were noted at an 0.05 level of significance.

Small business firms placed far more importance on the financial health of the bank, a convenient location, and the ability of the bank to provide products and services than did the bankers. On the other hand, bankers expected small business customers to place more importance on the bank's community reputation, personal relationships, the ability to make quick decisions, and a friend's recommendation. While the individual scoring systems used to identify significant differences may be subject to criticism, the fact that the same seven selection factors were identified as being significant under both testing methodologies suggest that these results are not dependent on the scoring system. Rather there clearly do appear to be differences between banker's expectations and small business firm's desires in the bank selection process.

V. DISCUSSION

In looking at the top six reasons why small business firms select a bank it is not surprising to find that the ability of the bank to accommodate the small firm's credit needs ranks at or near the top of the list depending on the measurement scale utilized. The majority of small business firms have limited access to investment capital. Without bank financing many would not be in a position to even begin operations or support growth. Since the differences between the small business scores and bank scores for this factor were not found to be statistically significant in either test, one could conclude that the bankers also believed that it was important to accommodate the small firm's credit needs. After all, this is the fundamental nature of the banking business.

In addition, the bankers seemed to have a reasonably clear understanding of the importance of offering competitive prices (i.e., number six) to the small business customer. The differences in scores on this factor were also not determined to be statistically significant under either testing methodology.

What was clearly the most interesting finding of the study was the fact that there were significant differences found between the small business firm scores and the bank scores on at least seven of the bank selection factors.

As expected, small business firms placed great importance on their banking partner's financial health. These days, if a bank is not financially healthy it will not be around long enough to take care of customers's

financial needs. While having a personal banking relationship was also deemed important, it was not nearly as important as having a bank that is conveniently located and one that can deliver the types of products and services needed. Convenience and pride of service has been the hallmark of small business for years. Why not expect the same from a banking partner? The lower relative bank ranking in the product and service area could indicate that bankers are taking their small business customers for granted. Perhaps small business product and service needs are incorrectly believed to be less demanding than the needs of the bank's larger corporate customer.

As a group, the bankers in this survey expected small business customers to be far more interested in their organization's reputation in the community and recommendations of a friend or associate. Such thinking explains why bankers have historically encouraged their employees to be active in the local community. By being highly visible in the community and supporting all kinds of worthwhile activities, bankers feel they are more likely to attract business customers. Unfortunately, such a conclusion cannot be supported by the current survey data. It was also interesting to find how little importance small business customers placed on the ability of the bank to make quick decisions. On the initial list of 15 factors, the small business firms ranked quick decision-making only eighth overall.

Finally, it is important to recognize that small business customers, in general, are interested in having a personal relationship with their banker and do in fact consider this factor in the bank selection process (i.e., No. 4). Whether it should be viewed as the most important issue as the bankers data indicates in both Figures 1 and 2, is another matter.

VI. CONCLUSIONS

This study attempted to determine how well the banking community understands the needs of the small business customer. It was based on a nationwide survey conducted during 1992. The results are based on responses from a total of 115 small business firms and 296 commercial banks.

While two separate measurement and testing methodologies were utilized, each produced similar results. The top six bank selection factors identified under both methodologies were:

1) willingness to accommodate credit needs;
2) convenient location;

3) delivery of products and services;
4) personal relationship;
5) financial health; and
6) competitive prices.

Of these, bankers were only able to properly identify the importance of accommodating the small business customer's credit needs and importance of offering competitive prices to small business customers.

Significant differences were noted in the case of the other four small business selection criteria. In addition, the bankers placed far more importance on their community reputation, friends' recommendations, and the ability to make quick decisions than the small business firms. Such results suggest quite strongly that bankers, as a whole, do not totally understand the needs of the small business customer. If the financial health of both groups is to prosper in the 1990's, attention will have to be directed to this area in the future.

NOTE

1. This study is part of a larger study dealing with the bank selection process of business firms in general.

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