Bauerle's Bank Notes

Uber Banks

September 2, 2014

When I stopped to fuel my car last week, I noted that all 18 gas pumps were being used. Thursday, mid-morning: full house. Brisk foot traffic kept convenience store clerks busy, while the adjacent bank branch sat empty. No traffic, no parked cars other than two employees' vehicles, and no outward and visible signs of life. The contrast is one about which I have written previously, arguing that banks must recast their retail business *now*, before Internet platform companies overtake them. What was different last week was that two of the cars stopped for gas bore the pink mustache monikers that mark them as gypsy taxicabs dispatched via Lyft.

Licensed and regulated taxicab operators have been fighting pitched battles against Lyft and Uber, the two leading Internet-based ride-sharing services, as they like to call themselves. (For convenience, I refer below to such services generically as Uber.) The venue is state and local public utility commissions nationwide. The Boston Taxi Drivers Association claims its members have lost 30% of their business to Uber. In Chicago, since last year, the sales price of a taxicab license ("medallion" in the trade's parlance) dropped 10%, from $348,000 to $312,000, according to Business Week. In New York City, where a taxi medallion costs roughly $1 million, operators eye Uber nervously.

The banking parallel to Uber is Internet financial intermediation. Lending Club Corporation last week filed its IPO registration statement with the SEC. The company's CEO portrayed his company as an Uberbank (my word, not his), offering "frictionless" loans to borrowers and investors, i.e., creditors. (Since when is credit frictionless?) According to Lending Club's March 2014 securities filings, made as a result of its earlier public issuance of notes,

> Our goal is to transform the banking industry to make it more cost efficient, transparent and consumer friendly. We replace traditional bank operations with an online marketplace that uses technology and a more efficient funding process to lower operational costs and deliver a better experience to both borrowers and investors.
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> Our model has significantly lower operating costs than traditional bank lending and consumer finance institutions because there are no physical branches and related infrastructure, no deposit-taking activities, an automated loan underwriting and servicing process and other technology-enhanced processes. We believe that the interest rates offered to borrowers through our platform are generally better, on average, than the rates those borrowers could pay on outstanding credit card balances or unsecured installment

> loans from a traditional bank.
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> We also believe that our marketplace enables investors to earn attractive returns and enjoy a more direct, low cost access to consumer credit as an investment asset class. Investors include both individuals and institutions. We believe that diversity of our investor base allows us to rely on more predictable funding sources with a wide range of investment strategies and risk appetite, which helps us facilitate a wide range of loans. (emphasis mine)

That's a "Yo' momma" aimed at every U.S. bank. And it's working. The Wall Street Journal reported last Wednesday,

> For the first six months of 2014, Lending Club originated $1.8 billion in loans, generating $86.9 million in revenue on that, up from $718 million of loans originated and $37.1 million in revenue for the same period of 2013.
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> As of now the vast majority of Lending Club's lenders are individual investors, yet the company has been increasing the amount of loans offered to mutual funds and hedge funds. In the prospectus, Lending Club said it generated roughly $2.5 million from "management fees" on what it's lent to these larger investors in the first six months of 2014, roughly double the amount in 2013.

The growth trajectory mirrors other Internet darlings, like eBay. The IPO is expected to be one of the ten largest ever among Internet platform companies. Prior funding rounds have placed a value of $4 billion on Lending Club. The company's website offers a running tabulation of the volume of loans made (>$5 billion, including $1 billion in Q2 2014 alone) and interest paid to investors ($494 million) in the same way McDonald's in its early years posted on its road signs each 5 million (later billion) hamburgers served. The website derides bank competitors by featuring media comments like, "Companies like Lending Club are cutting out the middle man − banks − to offer consumers the opportunity to lend money directly to others and obtain a higher return." In reality, Lending Club substitutes one middle man, itself, for another, banks, and hijacks their profits in the process.

To meet the challenge, banks must own up to the competitive threat. They must take prompt corrective action because they are in troubled condition whether or not they choose to recognize it. Legal battles like taxi operators' against Uber are not enough. Neither are staff reorganizations or other band-aids like hanging "loan sale" banners on branches. Rather, the business model needs to be reformulated. Doing that requires resources beyond those most regional banks have on staff.

1. Branches must be made over into profit centers rather than expense sinkholes. We offer our Branch Makeover Service for that.

2. Personnel must be taught how to listen to customers rather than push products at them. Employees must learn to view themselves not as shift workers who leave the bank behind when they go home, but as ambassadors who are "always on," representing the institution when they are out and about in the community. Banks' corporate directors especially need to practice that behavior. In the works at our company are tutorials designed to meet that need; stay tuned for details.

3. Capital planning and balance sheet management must change to reflect

the newest wave of bank product commoditization brought to us by Lending Club et al. Regional banks will not be able to match Lending Club's access to capital markets. So they will require strategies that build on strengths they have but Lending Club does not. Our experience makes us a useful business partner for this purpose too.

4. Marketing has been a low priority for most banks since the 2008 crisis. That also must change. While fundamental marketing precepts remain the same, the means and methods today must different if the needed effect is to be achieved. With fresh capital from their IPO's, Lending Club and GE's retail bank, Synchrony Bank, soon will flood Internet, smart phone and other media channels with their message that they are "transforming" banking. Conventional banks must have an effective response prepared. Most do not.

Two Lyft pink mustached vehicles out of 18 being refueled while the adjacent bank branch sat tomb-like is a cautionary tale. Lending Club is banks' Uber nightmare in the making. The status quo is not an option.

James F. Bauerle
Keevican Weiss Bauerle & Hirsch LLC
11th Floor, Federated Investors Tower
1001 Liberty Avenue
Pittsburgh, PA 15222-3725
phone - 412-355-2605
fax - 412-355-2609
email - jbauerle@kwbhlaw.com