Community banks have long been the backbone of the US banking system. Since their inception, they have served as a driving force behind the growth of small- to mid-sized businesses from major cities to rural outposts across the country. While they face challenges similar to their larger, historically more diversified competitors, down markets often present community banks with unique opportunities.

Community banks are frequently able to capitalize on customers’ growing dissatisfaction with larger banks. Uncertainties caused by the credit crisis, and a dismissive attitude and lack of flexibility are causing increasing numbers of individuals and businesses to seek services provided by community banks. Their success in capitalizing on this sentiment is contingent on community banking leadership’s ability to recognize and react quickly to its customers’ changing needs (see “People Versus Process” sidebar on page 5).

Unlike larger competitors, community banks see their success as inextricably linked with that of the community as a whole, both with business and individual customers. Many have weathered the past decades by maintaining an aggressive yet conservative strategy based on a focused mission to serve their communities.

Yet, they must do more with less. With shrinking net interest income, they must meet burdensome regulation and compliance edicts; Bank Secrecy Act (BSA) and Graham Leach Billey (GLBA) are examples that carry stiff monetary penalties for non-compliance, embrace new technologies and services, and offer competitive products and rates – while still providing the personal touch.

Success depends on leadership that seizes appropriate opportunities, meets challenges and builds cohesive cultures. To augment Korn/Ferry’s experiential data, a number of senior-level executives provided insights concerning the state of community banking. Additionally, we surveyed executives who are regularly involved in the hiring process at both national and community banks and using Korn/Ferry’s behavioral assessment methodology, analyzed the similarities and differences in what large banks and small banks look for when hiring a business leader.

### Market Opportunities for Community Banks

Community banks have four significant competitive opportunities: local decision making, customized solutions for small business, remote deposit capture, and full investment management.

1. **Local Decision Making.** Though larger regional and national banks have tried to infiltrate smaller markets, their protracted processes, rigid internal standards and credit committees (often several time zones away) have not provided the service desired by customers.
Customers want to work directly with individuals who make decisions. Community bank executives are actively vested in the community, having developed long-term relationships and an intimate knowledge of the unique nature of the small business owners’ needs. This knowledge facilitates quicker resolution.

“We make all decisions within a 24-hour time period, and I’d say I make 90 percent of the decisions on the spot,” says Forrest Bancshares Inc.’s Palen. Korn/Ferry’s research supports the notion that the ability to judge people and make complex decisions is “Mission Critical” for community banks (see “People Versus Process” sidebar on page 5).

2. Customized Solutions for Small Businesses. The primary economic driver of smaller and rural communities is small- to medium-sized businesses. These businesses want to deal with local decision makers. Because they possess intimate knowledge of the area, the individual and the business potential, community banks are able and willing to provide a customized approach to serving small businesses. Small businesses have fundamentally different and more rapidly changing needs than many of their larger competitors, and therefore require a bank that is able to make quick adjustments to its products and service approach.

Though the US Small Business Administration estimates the number of small businesses at 60 million, larger banks have no motivation to service this market. Stringent guidelines make it impossible to provide flexibility to this group of customers. Furthermore, they do not have the infrastructure to serve this client base. Profit margins are viewed as too small to warrant the investment.

3. Remote Deposit Capture. The ABA Banking Journal’s 12th Annual Community Bank Competitiveness Survey found that 38 percent of the 656 participants offered remote deposit capture in 2008, more than double that in 2007 (16 percent).

“Smaller banks with technology can stay at the leading edge,” Downers Grove National Bank’s Russ points out. His bank uses remote deposit capture and has always embraced new technologies, being the first in the community to have an ATM and open a branch in a local grocery chain that remained open seven days a week. Of 33 local banking service providers, his bank is currently ranked number one.

Rural community banks use remote deposit capture to better meet the needs of customers located far from the banks’ physical locations. Others use it to maintain relationships with businesses and individuals who have relocated to other areas or states. Satisfied customers are reticent to sever an established positive banking relationship, valuing the quality and comfort in dealing with individuals who know them and understand their needs.

The Panel

Korn/Ferry’s analysis is based on information culled from in-depth conversations with many of the nation’s leading community bank executives. We appreciate the “on the record” contributions of the following executives:

- Ron Bentley, CEO of Chemung Financial, a $1.8 billion community bank with 20 locations in New York
- Tom Herr, chairman and legal counsel for Citizens State Bank of Chatsworth, one of the oldest family-held and operated community banks in Illinois with two locations
- Ed Palen, president of $130 million holding company Forrest Bancshares Inc. and its three banks
- Mark Primeau, CEO of Laconia Savings Bank, an $850 million community bank with 17 locations in New Hampshire
- Jim Russ, chairman and CEO of Downers Grove National Bank, a $270 million suburban Chicago community bank founded in 1955, operating with three locations
4. **Full Investment Management.** Many community banks offer full investment management services to an underserved market. Larger banks accept a minimum portfolio, usually $3 million, providing no investment options for a broad spectrum of middle-class individuals.

Community banks offer what members of this market desire: personalized service, a custom tailored approach to investing and a trusted advisor who is going to be there for the long term.

Citizens State Bank of Chatsworth is capitalizing on its unique position. Two brothers, one a CPA and the other a CFC, provide a full range of investment services to customers through Herr Capital Management, a firm with a main branch in Chicago. “They are accustomed to working with high net worth individuals, a benefit to our customers,” says Herr.

The potential is incredible. The US Small Business Administration estimates that 3.6 million small business owners are at least 45 years old, making the relationship and expertise of community banks more valuable. As retirement nears, business owners will seek advice on transitioning and selling their businesses. Banks offering investment management will realize an excellent cross-selling opportunity to established business customers.

Income from investment management is increasingly important to the bottom line. “With shrinking net interest margins, it’s critical to supplement loan income with that from other non-interest areas like investment management,” adds Herr.

**Competing on Customer Service**

As technology narrows the gap between products offered by large and small banks, community banks must distinguish themselves and communicate their value to new and existing customers. While the four areas outlined above represent excellent growth opportunities, superior service delivery is required to retain a competitive edge.

According to Palen, the personal touch means everything. “I’ve had customers say ‘I know I can get it a little cheaper from the big banks, but I get such good service from you, I’m going with you.’” “Our customers value our community banking business model,” says Chemung Financial’s Bentley. “They want a relationship where they know who the banker is. In the bigger banks, relationship manager turnover is high.”

The value of hiring and staffing to community banks is reflected in that characteristic being rated as “Mission Critical” in the Korn/Ferry research results (see “People Versus Process” sidebar on page 5).

“To survive periods like now, when the Fed is micromanaging the world’s economic systems, you have to have strong relationships,” adds Russ. At each monthly board meeting, all directors and officers scan a list of the organization’s largest customers and must indicate those they have contacted during the month. “We stay close to our customers,” he says.
Community banks also provide a new, alternative experience to individuals in larger markets. Herr explains, “We’ve been successful in the Bloomington/Normal market because people like the environment offered by a community bank. They walk in and have a quick transaction with people who know them.”

According to Laconia Savings Bank’s Primeau, providing a higher level of service starts with the atmosphere set by the management team. “We communicate our core values to associates and make sure they know the mission,” he says. “We provide fair compensation and benefits and good training. But the most important aspect is communicating the attitude that employees are the most valuable part of our organization in delivering service. We treat people in a highly valued way. That really sends a message.” Employees are loyal and committed to the success of the company. Laconia Savings Bank was named one of New Hampshire’s Top 20 Best Companies to Work For in 2006 and 2007.

Bentley believes banks must continue to invest in people to compete on service. “Many banks advertise superior service as a market differentiator, but few provide the tools and training to enable employees to do so,” he says. “I’ve been with too many banks that talk about this, but it’s just rhetoric.”

After taking the helm at Chemung Canal Bank, Bentley developed and instituted a service training program with systems to measure service quality. “CanalCare is our service promise,” he says. “We’ve trained more than 300 people on our service quality standards.”

Making service a major focus has affected the organization’s culture, processes and reward systems. “Since service was a major portion of everyone’s job, all job descriptions had to be revamped so that employees know it is an expected part of the job and will be evaluated at review time,” says Bentley. “There are significant rewards for meeting standards. We make it clear that if someone doesn’t buy in to CanalCare, they won’t be a part of our team.”

As with larger banks, growth strategies for many community banks include mergers and acquisitions. In the 2008 ABA Banking Journal’s Annual Community Bank Competitiveness Survey, 37 percent of participants indicated that they plan to acquire another bank within the next five years.

Managing expansions, mergers and acquisitions requires assimilation training and careful recruiting to maintain culture. Herr explains, “For decades, we’ve been fortunate to have intelligent, good people in our rural farm community who are focused on service. In Bloomington/Normal, the workforce and environment are very different. Our strength is that a community bank is an extremely nice place to work. Due to size, we can’t offer the same salary and benefits as the large banks. However, we do provide things that the bigger banks do not.”

These have been the carrots in recruiting senior officers from other larger banks. “They can make decisions and have more control over their operations. They don’t have to look to regional departments to get things done,” says Herr.
People Versus Process

As part of the research for this paper, Korn/Ferry conducted a survey to analyze the similarities and differences in what large banks and small banks look for when hiring a business leader. We surveyed senior-level executives who are regularly involved in the hiring process at both national and community banks. Using the Korn/Ferry Advantage™ Leadership Worksheet, we asked participants to force rank 20 leadership characteristics into three categories: “Mission Critical,” “Important” and “Less Important” for the fictitious role of Bank President.

While there was naturally considerable overlap in what the large banks and small banks viewed as mission-critical characteristics in a candidate for Bank President (see chart below), both want leaders who can “Inspire Others” and “Act with Honor and Character.” These leaders also need to be able to “Understand the Business” and “Make Complex Decisions.”

Nevertheless, the survey uncovered some telling differences. The community bank respondents were more likely to focus on a President’s ability to deal with people-centric aspects of managing an organization, while large bank respondents were more likely to focus on an executive’s operational style. Among the community bank participants, there was more emphasis placed on one’s ability to make difficult people calls when required – i.e., sizing up people and hiring and staffing – and less emphasis on organizational positioning skills. For large banks, mission-critical skills included “Dealing with Trouble,” which includes command skills and conflict management. For larger banks, personal and interpersonal skills were rated as less important.

Korn/Ferry Leadership Characteristics

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<th>Importance Rating</th>
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<th>Large Banks</th>
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<tr>
<td>Mission Critical</td>
<td>Inspiring Others</td>
<td>Inspiring Others</td>
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<td>– Common</td>
<td>Acting With Honor and Character</td>
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<td>Understand the Business</td>
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<td>Mission Critical</td>
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<td>Less Important</td>
<td>Organizational Positioning Skills</td>
<td>Personal and Interpersonal Skills</td>
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The implications for a recruitment process are clear. Certain characteristics, such as an executive acting with honor and character, and effective communication skills, are prerequisites to running a bank of any size. Additionally, successfully managing any business will always require a certain amount of balance between the people and operational aspects of leadership. However, the research does indicate that the next wave of community bank leaders will be those who are able to navigate the human capital aspects of their roles more adeptly and more regularly than their counterparts at larger organizations.
Overcoming Economic and Regulatory Challenges

The economy, costs of regulation and compliance, and limited resources represent major challenges for community banks. Palen is intensely aware that customers are dollar conscious, particularly in today’s economic climate. He acknowledges having lost several deals because his rates and terms were less favorable than some offered by larger banks.

Bentley concurs. “Just being a community bank doesn’t guarantee success,” he says. “You must be competitive in price, product and technology.”

The current regulatory burden is seen as a key factor affecting community banking. “Demands are greater all the time,” says Palen. “Everybody wears more hats and does more jobs. With limited staff numbers, this raises special concern about internal control. It is difficult to divide jobs and duties.” This can unfortunately result in employee burnout, a threat to smaller community banks’ competitive edge.

Regardless of costs, regulation is here to stay. Laconia Savings Bank takes a realistic approach, embracing regulatory compliance as part of the bank’s culture. “We take it seriously, proactively being as compliant as we can. Rather than resist it, we learn from it,” says Primeau. “We make sure the top embraces this instead of dismissing it. Attitude filters down.”

Citizens State Bank of Chatsworth is intent on maintaining the character of a family bank while finding ways to comply with all regulations. “We’ve converted from outside to inside core processes,” says Herr. “All basic functions are now in-house. This gives us a better handle on the numbers and reporting.”

Leading the Way

As the demands of community banking have grown, so has the need for strategic leadership. According to Bentley, it is critical to have leaders with a long-term vision for the bank who can build a team capable of translating that vision into reality. “This is a challenging, complex business requiring strong leadership,” he says. “A good leader provides the training and tools for people to be successful.”

“For employees to succeed, the CEO and board must provide strategic direction,” adds Primeau. “Top management’s role has become more of a balancing act,” he says. “A big part of the CEO’s overall perspective is compliance and regulation. But the list of priorities has not changed the fundamental focus of most CEOs.”

Palen agrees. “It seems we are spending less time on our core business and more with compliance and BSA,” he says. “Regardless, you still have to find a way to do business.”

Doing business locally means engaging in all aspects of the community, including serving on local boards and participating in events and organizations. Executives must be visible and enjoy interacting with residents to build ongoing relationships.
This responsibility is often an obstacle in management succession plans. A major concern of boards and bank executives is how an outsider would fit in the bank and the community, since tenure has traditionally been cradle to grave. With a significant number of CEOs in their 60s and 70s, management succession is a critical issue. When asked to identify the most difficult positions to fill at community banks, 50 percent of respondents to the ABA's community bank survey cited business leaders.

According to Herr, the key to making good hires is ensuring a match between management philosophies. His recruitment efforts have been successful due to careful assessment in this area. Many candidates from larger banks bring broad experience, but desire the challenge and opportunity offered by community banks. Many began their careers in community banking and welcome the chance to return.

Bentley came up the ranks in various banks ranging from community banks to large regional enterprises. “Having been in different sized organizations, I appreciate the community banking environment,” he says. “I like the opportunity to know clients, employees and the community.”

As far as other management roles, Palen recently appointed the organization’s first compliance officer—a role that he predicts will become more formalized at local banks due to the increasing complexity of the regulatory environment. “My branch manager used to handle the compliance duties,” he recalls. “But with increased regulation, compliance eventually consumed all of her time. Compliance officers are in short supply, since most people in smaller banks who have responsibility for compliance learned on the job without formal training.”

**Community Banks Are Here to Stay**

Leaders are very positive about the future of community banking. “There will always be a place for well-run community banks whose focus is its community, customers, employees and investors,” says Russ. “Our challenge is to remember who we are.”

“In an age of bank mergers and consolidations, more people are looking for community banks,” Bentley concludes. “But it’s not enough to be in the community,” he cautions. “Local banks must remain relevant and competitive.”
Ted Johnson is a Client Partner in Korn/Ferry’s Boston office and a member of the Global Financial Market.

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