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SENIOR CONSULTANT
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Wirehouses Find Small Business Gold Mine

Stephen C. Winks

You may believe the characterization that commercial banking for small businesses is a dull, low profit, heavily administrative enterprise, but many wirehouse brokers are finding new ways to serve the small business market and are being rewarded handsomely for their efforts. Merrill Lynch and now Salomon Smith Barney and Prudential are offering traditional commercial banking services to small businesses with 25-250 employees. These firms have lines of credit between $750,000 and $3 million; have 401(k) plans, profit sharing plans and/or defined benefit plans; have cash management needs and the substantial personal accounts of their principle officers. These wirehouses have learned that by managing the liability side of the small business balance sheet they gain control of the highly profitable asset side of the firm's balance sheet.

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Because of the bureaucracy of banks, their slow decision-making, high fees and the complexity required to accomplish very simple tasks, many small businesses find the Merrill Lynch Working Capital Management Account (WCMA), the Salomon Smith Barney Business Finance Managed Account (BFMA) and the Prudential Business Edge Account very attractive. Banks are not attracted to small businesses and have priced their lines of credit, including Small Business Adminis-tration fees at 4% or more. Merrill Lynch offers lines of credit at 50 basis points without the administrative hassle and stress requiring the CFO to jump through hoops just to fully utilize the account. Clearly brokerage firms can't match the convenience of banks in their physical presence, and since brokerage firms are not geared to accepting cash deposits, some small retail businesses, e.g., restaurants, are not well-suited for broker-mediated banking services. But many businesses, particularly the professionals, are perfectly suited. Brokers focusing on small, professional businesses have a smaller number of larger and far more sophisticated clients and find it financially and intellectually more rewarding than the retail business.

The opportunities to serve small businesses and their principals are endless and are the most professionally rewarding accounts one may have. Yet, the banks are not eager to compete in the small business market as is indicative in their pricing, thus leaving an almost uncontested market. The complementary commercial banking services make the high level professional investment counsel of the investment management consultant more cost-effective to deliver at the lower end of the market. The consultant, in effect, becomes an outsourced CFO for small firms which couldn't afford to engage that expertise on a full-time basis. The brokers are out-banking the banks, and small businessmen will not likely let the bankers back in.

The success of the wirehouse consultants managing the liability side of the small business balance sheet foretells how the financial services industry will evolve. Clearly, the small business owner has always had the opportunity to buy investments from the major wirehouses, but it is only when a very small number of wirehouse consultants defined themselves as a reliable one-stop financial services solution for all the small businessmen's financial needs to include credit – lines of credit, mortgages, and other asset-backed financing – that the wirehouse consultants uniquely differentiated themselves.

This is not to say that the transitional role of the commission broker is not legitimate; it is recognizing that in a market increasingly driven by choices, what you have to sell is no longer relevant in keeping your clients when making the right decision is essential. Everything you do is subject to scrutiny, measurement and realization. These consultants are unique not because they offered credit services but because they are becoming advocates for the small businessmen. They, in effect, are buying agents engaged to act on the small businessman's behalf, not bankers who are representing the bank's best interest. It is this philosophy of always acting in the client's best interests that will drive the Internet and the evolution of the financial services industry.

The role of the consultant and the free market is to seek out inefficiencies in pricing and services. If banks are not responsive in their pricing or do not have a genuine interest in serving the credit needs of small businesses, then the investment management consultant can and will structure their practice and services around the small businessmen. The consultant provides faster, better and less expensive service than an unresponsive, large banking bureaucracy which offers no accountability for the ultimate client experience.

In the now emerging advice business model delivered via the Internet, the role of the financial services organization is not to create financial products but to assure the client is being well served. Only if you can better serve the client through product innovation will a product focus work because it is at odds with the client's best interests. Thus, the new business model which incorporates both the asset and liability side of the client's balance sheet into a single delivery of financial products and services foretells what is about to occur within the financial services industry at-large. ■

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