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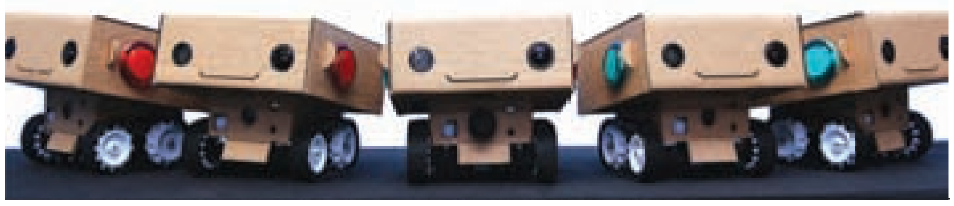
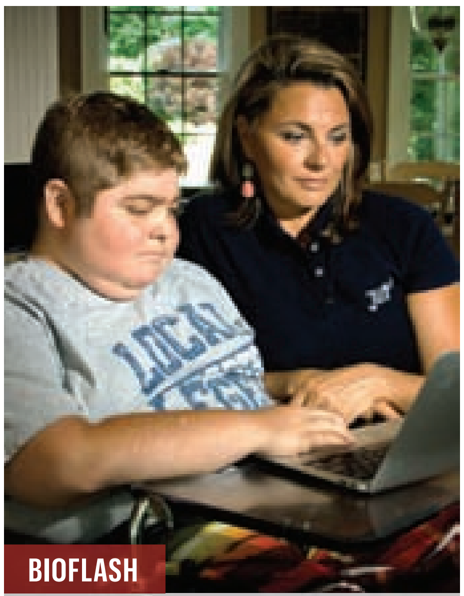
TECHFLASH

MEET BLABDROID, A ROBOT YOU'LL WANT TO HANG OUT WITH 13





BIOFLASH

PARENTS CLING TO HOPE FOR DRUG APPROVAL 12

Tough times for SMALL BANKS

Federal regulations and changes in consumer behavior threaten many community institutions throughout the state. 16

HOSPITALITY

Restaurants gear up for wage fight

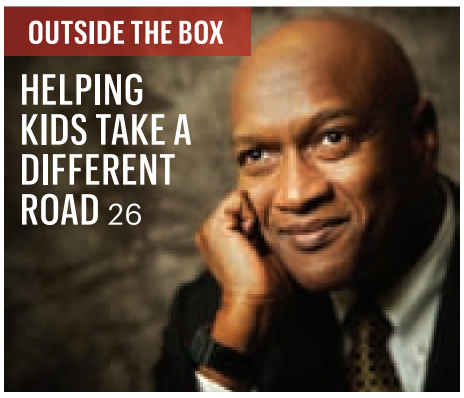
The Massachusetts Restaurant Association knew a minimum wage increase was coming. But the group was blindsided by a much larger jump that would be required of employers of tipped workers. JON CHESTO, 3

HIGHER EDUCATION

Simmons faces big enrollment drop

The administration at Simmons College in Boston has had to react to a 12-percent decline in undergraduate enrollment since 2009. CRAIG DOUGLAS, 6

OUTSIDE THE BOX



HELPING KIDS TAKE A DIFFERENT ROAD 26

THE LIST THE LARGEST BANKS IN MASSACHUSETTS 20

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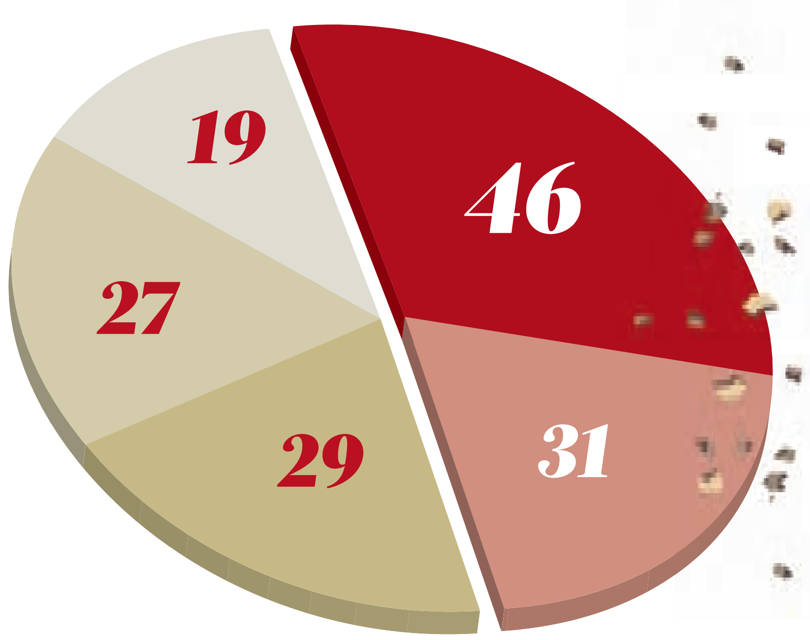
COVER STORY

VALUABLE ASSETS

There are still 50 banks in the state that have fewer than $250 million in assets. Here's a closer look at how all of the state's banks can be grouped in terms of size.



TOTAL ASSETS	NUMBER OF MASS.-BASED BANKS
▶ Less than $100 million	19
▶ $100 million-$250 million	31
▶ $250 million-$500 million	46
▶ $500 million-$1 billion	27
▶ More than $1 billion	29

Source: Federal Deposit Insurance Corp.

BANKING ON CONVENIENCE

States that are similar in size to Massachusetts, based on population, show a wide range in the size and diversity of their banking sectors.

STATE	POPULATION	BANKS	EMPLOYEES	BRANCHES
Massachusetts*	6.6M	153	46,248	2,218
Indiana	6.5M	134	16,823	2,284
Missouri	6.0M	309	30,626	2,394
Tennessee	6.5M	181	19,698	2,259
Washington	6.9M	66	15,084	1,864
Arizona	6.6M	25	3,143	1,338

Source: Federal Deposit Insurance Corp., U.S. Census Bureau
**Massachusetts' employment number includes custody banks such as State Street Corp.*

COMMUNITY BANKING'S SLOW DEMISE

Federal regulations and changes in consumer behavior threaten many small banks throughout the state.

BY MATTHEW L. BROWN
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For Wellesley Bank CEO Tom Fontaine, community banking in Greater Boston faces a stark challenge: If the region's smallest banks can't find ways to grow, they won't survive.

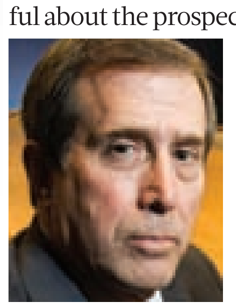
"You're going to die," he said. "The expenses will kill you. … The next generation of customers is going to demand more. And if you can't offer the products and services customers want, there will be consolidation."

Fontaine has grown his bank's assets from $250 million since becoming CEO in 2009 to $400 million today. But one-third of the roughly 100 banks in Greater Boston are still smaller than Wellesley Bank was four years ago.

These tiny banks have grown since the financial crisis, but the gains they've made have largely been erased by skyrocketing overhead costs. The profit increases they reported through 2012's strong housing market have fallen hard and fast back to earth while expenses kept soaring, squeezing profit margins.

Through the first nine months of this year, net income at the 35 smallest banks within the Interstate 495 loop have fallen collectively by 30 percent compared to the same period a year ago, according to the Federal Deposit Insurance Corp. All but 10 reported year-over-year profit declines.

The men and women who helm these smaller banks know their situation is precarious. Their banks aren't big enough or rich enough to take the risks necessary to increase business or expand quickly. They are worried about their banks' legacies, many of which stretch back more than a hundred years. They're fearful about the prospect of depriving their communities of generations-old institutions with reputations as friends of small businesses, local charities, schools and social organizations. They know that jobs are always sacrificed in mergers, a threat to many of the 20,000 or so people who currently work at the state's community banks. During the last 10 years, they've seen the number of banks in Massachusetts fall 27 percent as rivals disappeared through mergers and acquisitions.


Peter Conrad

These small community banks are becoming relics of their towns' gilded age. Consumers and regulators don't behave or operate the way they did 150, 50 or even five years ago – and a bank's long history is no longer a guarantee of its continued viability. Customers walk into branches less frequently, and many are choosing to park their money with online and out-of-state rivals. Regulators, meanwhile, have become much more strict with community banks following the abuses that led to the Great Recession – even though community banks played little or no role in those abuses.

Not every bank CEO is sitting still. After joining Wellesley Bank, Fontaine embarked on an aggressive growth strategy, an approach that increased its assets by 60 percent in four years. The 100-year-old bank went public in early 2012, and has doubled the size of its branch network, most recently by opening a branch in Boston's Financial District. Through the first nine months of this year, Wellesley booked a $2.3 million profit compared to $1.7 million a year ago, a 35 percent increase.

The bank's efforts – including a new marketing campaign and the high-profile Boston office – have also boosted its visibility. That can be a difficult task for small banks in a market like Greater Boston, which is overflowing with community banks that all seem to look and act the same.

"There's just so much choice," Fontaine said. "I live in Wellesley. Do I really need 20 branches to make my choice? It's just like car companies. GM realized it didn't need 15 versions of a family car. There are a lot of banks with really no differentiation."

As a result, many small banks failed to capitalize on the public's bad feelings about big banks in the aftermath of the financial crisis.

Co-operative Central Bank CEO Peter Conrad, who runs a central bank for about 50 small banks in the region, said his clients' inability to gain loan or deposit market share during and after the crisis has been discouraging to him. But big banks have important advantages that restrict community banks' ability to make substantial gains in profits and market share. The multistate banks can offer better loan pricing, and the combination of large branch networks and complete technology offerings make them more convenient.

Mutually owned community banks are still generally well capitalized, and that protects them from the earnings pressure and pressure to grow felt by their publicly owned competitors. That protection is greatly diminished after the missed opportunities and sharp cost increases of the last five years, though, and community bankers have to ask themselves a couple of very important questions.

"Can you grow?" Conrad said. "Can you remain viable long-term?"

Well-capitalized community banks used to be able to "bleed a little bit for a long time," Conrad said. Now, the implications are more serious, and the leaders of small community banks must at least begin to admit that they'd be better off merging with larger, more successful banks.

"(Today) every community banker is entertaining invitations to lunch with other community banks," Conrad said.

No Massachusetts mutual banks have merged so far this year, but banking analysts say the market is ripe for mergers. Small banks are holding out until they're in serious trouble before agreeing to merger deals.

W. MARC BERNSAU

Meetinghouse Bank CEO Tony Paciulli says he chose to take his bank public rather than pursue a merger with a bigger bank. But he recognizes Meetinghouse, like other small banks, still faces challenges.

The Community Bank in Brockton was in dire straits when it merged with Eastern Bank late last year. Stock bank acquisitions often happen when the acquired bank is suffering, as in the cases of Rockland Trust's acquisition of Somerville-based Central Bank last year and its recent acquisition of Middleborough's Mayflower Bank, which reported quarterly losses before the acquisition.

Boston-based Meetinghouse Bank, one of the smallest in the region, was approached by other banks about merging. But CEO Anthony Paciulli "did not see that as a viable route" to sustainability, because he didn't want to see the bank disappear. Instead, the bank went public about a year ago.

But Meetinghouse still needs to tackle the challenges that other banks its size face, even with the increased capital from public shareholders. Meetinghouse, with about $77 million in total assets, lost $46,000 in the first three quarters of the year.

Meetinghouse opened a new branch, its second, in Roslindale shortly after going public, and Paciulli said he plans to open two more in the next couple of years. To him, offering stock, growing aggressively and accepting the risks that go along with that strategy are still better than merging with another bank.

"We're 100 years old," Paciulli said. "Your legacy and personality changes considerably when you merge. We thought we had a great future in front of us."

Marblehead Bank has become more aggressive in going after small-business loans, in part because they can be more profitable than home mortgages. The terms for small-business loans are typically short and their rates adjust.

"The small-business market has got a lot of legs to it as far as profitability," said Julie Livingston, the bank's CEO.

For Livingston, who has been with Marblehead Bank for 35 years, those loans are also a symbol of what the community loses when it loses its small banks. "We can cut out some of the hoops the larger institutions make you jump through," she said. "And we're finding loans, like the $5,000 line of credit, that some bigger banks won't look at. If a community bank is merged out of existence, the mill owner can't walk in and say, 'Hey, Joe, I need $100,000 by the day after tomorrow.'"

Marblehead reported about $187 million in assets in the third quarter. Year-to-date, the bank booked a $112,000 profit compared to a $65,000 loss a year earlier.

Some community bankers know they can't compete directly with big banks on price and convenience. "(But) we do a very good job of living off the leftovers and the crumbs of the much larger banks," said Robert Terravecchia, CEO of Weymouth Bank.

A decade ago, a conservatively run community bank was expected to realize a return on assets – a measure of how well a bank uses its assets to make profits – of about 0.75 percent, maybe 1 percent. Today, Weymouth Bank's return on assets is between 0.3 percent and 0.4 percent because increased expenses have taken a bite out of profits – a typical decline among smaller banks that have a tough time absorbing all the new costs.

"That's less money into capital, and I have to grow a little slower," said Terravecchia, whose bank has about $215 million in assets today. "If we make a big enough mistake, we go away."

Put that situation on top of rapidly rising costs, and Terravecchia said executives like him can find it very difficult to run their banks. Weymouth's recent growth – it turned a $520,000 profit through Sept. 30 compared to $490,000 for the first nine months of 2012 – does not provide much comfort for Terravecchia.

Modern bank technology is expensive, but the real killer is compliance, Terravecchia said. A decade ago, Weymouth didn't have a dedicated compliance department: Those tasks were carried out by employees within the bank's other departments. Today, it has a compliance department staffed with three employees who each make salaries pretty close to six figures, Terravecchia said. The primary culprit: regulations stemming from the Dodd-Frank Act of 2010, which was aimed at curbing the abuses in the financial industry that led to the Great Recession.

To grow, Weymouth has tried to do more commercial real estate lending and has found a bit of a niche in HEAT loans, which help finance residential energy efficiency projects.

But Terravecchia says the deck is still stacked against small banks like his. Community banks can't compete on technology or offer the breadth of services that the big banks can, but still need to comply with nearly all of the same regulations those big banks face. And if a community bank is in trouble, it can't count on a taxpayer bailout.

"If management and the board are engaged, committed and passionate, they'll find a way to make it happen. If they can't, they'll merge," he said. "Someday, if we're gone, people will grit their teeth and say, 'I wish we had a community bank around.'"