ABA BANKING JOURNAL

Smarter Lending for a Better Economy

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August 5, 2020

We have been dealing with an unprecedented series of events this year, but for better or worse, we are all in it together. The COVID-19 crisis has interrupted the economy, affecting all consumers, as well as the approximately 30 million small businesses that propel financial activity around the world. The U.S. Labor Department reported nearly 21 million workers were unemployed as of June 5, with many more of the working population at risk.

Where do we go from here, and what do community banks and credit unions need to do to navigate through this? Here is my insight on the small business landscape and how community banks can take steps towards building more resilient infrastructures for the future.

1. Embrace "bionic banking"

We've been going through a digital transformation for a while and there's no doubt that the coronavirus epidemic has expedited the shift towards contactless engagements. Most people are demanding and expecting seamless digital experiences in nearly every aspect of life. When it comes to banking, customers want embedded features and fast results, whether they are transferring funds or applying for a loan—and if your financial institution doesn't provide it, they will likely go somewhere else.

Digital banking technology has allowed financial activities to become more automated and less visible. Our transactions are being incorporated into other services and products, such as wifi-enabled household appliances and virtual assistants. This expanding "Internet of things" is changing how people spend and manage their money.

Small banks should be looking to embrace digitization and providing online solutions to customers wherever possible, which includes giving people the ability to manage their accounts online as well as offering a good mobile app. Put pressure on your vendors to expose more banking services into the digital space. Then, encourage and educate your customer base so they can learn to use these new features. If you want customers to adapt, start removing in-person assistance for simple tasks that are provided online (such as checking an account balance) and have a bank branch employee on hand to show them how to use the digital service on their smartphone or via a bank-branded ATM.

Personal touch is the attraction of community banks and credit unions, but customers want that personal service combined with the technology of a big bank. Minimizing personal touch means you will need a solid back-end verification solution with strong data source connection to review and verify the information that customers are submitting digitally. Most large banks are already providing these digital features and small banks will need to keep up in order to compete.

A year ago, I'd have said that the digital wave would hit the banking beach in a few years. Now we will measure that wave in months. It is soon going to be a bionic banking world and people will expect their community banks to provide frictionless digital access and immediate service.

2. Organize, prioritize and engage

It may be a long road back to "normal" economic activity, but this is a crisis that can be overcome. Smaller banks should reassess their lending portfolios (for both consumer and business clients) so they can pay immediate attention to high-priority items. This means reorganizing your accounts so you can prioritize the most urgent tasks; COVID-19 affects different sectors in different ways, so some clients will need more consideration and attention than others.

First, organize your accounts into three groups: highest, high, and medium/low risk. Highest-risk clients include accounts that are currently delinquent. High-risk clients are those that have gone delinquent in the recent past or have exhibited (or are exhibiting) slow payment. Medium/low-risk clients will be the accounts with "normal" to excellent payment history. Once you have segmented these accounts, you can figure out what you should be doing for your clients and your portfolio.

You will need to start managing and scoring your accounts more regularly that you used to – monthly is ideal in the short term. Pull the consumer reports, Dun and Bradstreet reports, and any other information you have readily available (DDA data, if banked) to monitor your client's financial state. Trade line data will inform you as to which bills they're paying and which ones they aren't. Often, businesses going through financial difficulties will reprioritize their bill payment order. Non-collateralized loans will experience payment delays before collateralized loans or leases. If you have access to a business's DDA accounts, you may notice that its direct deposit habits change.

Next, prioritize your accounts based on the information you're gathering. See who is highest risk, and be prepared to spend more time with those clients. Keep in mind: with all the loan forbearances and forgiveness, it may be difficult to tell who's really in trouble, because some items won't be reflected in credit reports and scores. Your bank should be keyed into a data source that can analyze a businesses cash flow in lieu of a credit report. (Digital solutions like Plaid offer instant bank verification, analyzing real-time and historic transactions so you can authenticate accounts.)

Finally, it's crucial that you engage your customers, especially the ones who are struggling. This is the time to solidify good relationships. All available bank employees should be reaching out to small business owners to see what they can do to help. Nobody wins when an account goes delinquent. Helping your clients will also help you—it's a service for your organization, the small businesses and the community at large.

3. Reconsider portfolio segments and prepare for the worst

Once you've reorganized your accounts, you should be looking to build a stronger portfolio and ranking your clients' resilience to economic stress. Small banks need to adapt to the financial volatility and, in some cases, prepare for the worst. Reexamine the segments in your portfolio and consider the realities that small businesses are facing.

According to the Small Business Coronavirus Impact Poll taken June 3, 2020 by the U.S. Chamber of Commerce, “Most small businesses report being at least partially open. 79 percent of small businesses are either: fully (41percent) or partially (38 percent) open.” This varies by region, as “51 percent of small businesses in the South report they are fully open.”

While it seems that we’re on the road towards recovery, many small business owners are still apprehensive. According to the same poll, “more small businesses are anticipating a longer window before things return to normal. More than half (55 percent) of small businesses believe it will take six months to a year before the U.S. business climate returns to normal, up from 50 percent last month and 46 percent two months ago. Six percent say it never will return to normal. Meanwhile, two-thirds (66 percent) are concerned about having to close again, or stay closed, if there is a second wave of the coronavirus. More are anxious about this in the West (77 percent) and Northeast (74 percent) than in the Midwest (62 percent) and South (55 percent).”

In general, we are seeing urban businesses reopening more slowly than rural businesses, and businesses in the South reopening faster than other parts of the country. This reflects the different geographies and different attitudes towards the coronavirus that also resulted in varying degrees of economic lockdowns. But even if all the businesses reopen, consumers must be ready to come back or the reopening is meaningless and, in fact, more costly to the business.

You should give the businesses that can survive the opportunity to survive. It should be no fault of the bank if a client’s account is lost even when the bank should be doing everything they can to support them. Lenders will have to do what they can to help small businesses regain their traction while also bracing for the rough road ahead.

4. Get ready for the renewal phase

The economy will rebuild and lenders must prepare for the renewal phase. This means embracing the innovation and entrepreneurship of startups. The small businesses that suffered as a result of the COVID-19 crisis did not close their doors because they failed in the market—the government forcibly closed them down in many cases. Those entrepreneurs are still out there, and they still have the desire and drive to run their own businesses.

The renewal phase is that time of a major uptick in small business loan applications from startup businesses. We expect to see this phase start sometime in the fall, once economies have reopened and the school year begins. The question is whether banks will lend to these business owners. What will banks do when tens of thousands of startups apply for loans? Will they be considered riskier than other applicants? Small banks are generally not thrilled about loaning to startups, but the economy will need startup businesses for a strong recovery. Therefore, lenders will have to reassess their risk modeling and decide how negative behavior resulting directly from the coronavirus pandemic will be evaluated.

“When we are over the worst of the health crisis, attention will turn to rebooting the economy,” writes the Cato Institute’s Chris Edwards. “We will need an army of startups to help create that V-shaped growth trajectory that unemployed workers will desperately need.” The V may look more like a Nike swoosh, but the upward trajectory will be greatly assisted by these new businesses.

Lenders will need to determine if they’re in the startup game or not. If these startup businesses don’t get help from their community banks, they will seek it in other places, such as nonbank fintech companies. Small banks should be ready to assist the coming wave of startups and use the opportunity to develop crucial relationships.

5. Play to your strengths

Remember your strengths as a small bank: you know your community and you offer service with a personal touch. Use your local connections, your creativity, and your innovation to help your clients build a better future. It's win-win when you put money into the community because helping them helps you. (This is why you and your team worked 18-hour days during the first two rounds of PPP lending.)

Reach out to your customers and provide support wherever you can. Get creative and help businesses innovate. Offer guidance and try to come up with some resourceful ways they can help their employees and keep things flowing. Connect small business owners with other members of the community by tapping into your networks of knowledge, such as the local Chamber of Commerce. Also keep in mind that you don't need to have an SBA loan in order to use SBA resources, so get your small business clients set up with SBA mentors who can help guide them.

Be in and of the community. Smart lenders will focus on assisting businesses in adjusting to a post-coronavirus world. In many ways, it will be easier for community banks to adapt because they're often more connected to their clients and able to maintain closer relationships.

Looking ahead together

Going forward and looking ahead, we'll need to focus on how to help small businesses recover so we can rebuild the economy together. We should ask ourselves: where can these business owners turn to for funding today? What are their best bets and what does the loan process look like now?

Take a close look at your organization and consider how it can improve internally so you can start building more resilient lending infrastructures for the future. Banks will likely need to continue administering risk-aware loans to small businesses in the coming months, but they must also be preparing for the next phase.

Community banks should focus on their strengths—and their positive role in the community—while making efforts to support local businesses and provide customers with the digital solutions that today's culture demands. Protect your portfolio by nurturing your relationships and help get those business owners to where they can thrive.

The small businesses we lost did not all disappear forever. When they do come back, make sure they want to come back to you.