Making Business Lending Work For Your Credit Union

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Managing the Impact of Business Lending for Members on Your Credit Union's Standards, Your Culture, and Your Long Term Financial Health

A Credit Union "Think Piece" from

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Business Lending For Credit Unions: What Does It Take To Make It Work?

Forget all the debate about pricing advantages and tax status. *The fundamental strength, and competitive advantage held by credit unions lies in their* **rapport with their members.** Surveys show that credit unions treat their *members* differently than banks treat their *customers*. And there is nothing like better service to build loyalty.

It is ironic that many credit unions are diluting that advantage as they expand member services. All too often a simple focus on adding services overlooks the need to maintain and build that member rapport. After all, most banks offer a *huge* number of products and services — but that does not automatically give them high customer loyalty!

The most significant "bank-like" service credit unions are adding to their offerings is *business lending to members*. Sometimes, frankly, that is partly a result of "bank envy," if you will. But clearly credit unions want to meet their members' needs, *including members who run businesses*, and business lending has the added appeal of providing a new, previously untapped source of revenue to support the credit union's goals.

The Business Lending Challenge

The problem is that business lending services in credit unions *always* involve an outside source, at least at first. And bringing in those services also brings in *ways of thinking developed in other environments*, thus **diluting the credit union's service culture.**

That's the heart of the issue: *Where does the core thinking about business lending take place?* Is it …

- *Outsourced*, where the real thinking is done *outside* the credit union?
- *Imported*, managed on an *"island"* within the credit union?
- *Integrated* into the culture, values, vision, and standards of the credit union?

Outsourcing Thinking About Business Lending

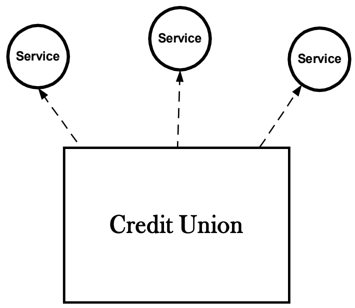
Some credit unions get their start in business lending by *outsourcing* most of the work of analyzing and structuring business loans. Common ways to use outsourcing might include:

- Working through a service organization of some kind, or
- Taking participations in business loans originated by other credit unions and banks.

There are, of course, *pluses and minuses* to this approach. On the **plus** side:

- Outsourcing presents opportunities to satisfy members' needs and attract revenue without building a business lending function within the credit union.

On the **minus** side, we find:



OUTSOURCED

- The member may have to work with staff from other organizations who approach things differently, who have a different member service culture than you do, reducing satisfaction;

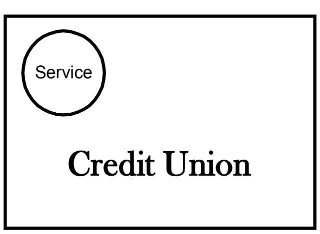
- The less in-house experience and knowledge the credit union has about business lending, *the more dependent you are on someone else's efforts to protect your credit union* from significant losses, with potentially serious consequences.

Members put their faith in the credit union in part because they do *not* expect the credit union to put too much faith in others to look after members' interests. With careful management, the credit union can do much to ensure that outsourced services fit seamlessly with member expectations, *but* it is difficult to manage those outsourced relationships without some fundamental understanding of the distinguishing features and, especially, the *risks* of business loans.

Imported Thinking

Many credit unions have taken the path of creating in-house business lending functions. To do that, they are required to hire experienced commercial lenders.

There is a certain irony to this practice: credit unions deliberately set out to work differently than do banks, and then they turn an important function over to individuals who have experience *only* with the banking way of doing thing. They often discover that:



IMPORTED

- Commercial lenders bring their own traditional commercial banking points of view to their new positions within the credit union.

- Because they are necessary and knowledgeable, delivering a highly valued service, they are often largely left to manage the business lending function much as they see fit.

- They become an island in the credit union, operating under a culture that is different from the rest of the organization.

There are certainly some **pluses** to this approach:

- Business lending can be implemented quickly, bringing in experience that would take a long time to grow internally, even if that were allowed.

- Compared to the *outsourced* approach, the business lenders are surrounded by, and in constant contact with, other credit union staff. Culture and values are more likely to "rub off" on the imported employees and influence how they work with members, and with the credit union's resources.

Nonetheless, to the extent that the business lenders are largely left to themselves – and that may be difficult to avoid if no one else in the credit union has business lending knowledge – there are some **minuses** with the "imported island of business lending" situation:

- In terms of managing risk to the credit union, these lenders are essentially *self-regulated*. If you consider how self-regulation or "voluntary compliance" plans have turned out in any number of professions and industries, you can see ample reason to have doubts about this approach.

- In banking environments where commercial loan officers were required to get approval from management, where loans were reviewed and audits performed, many banks suffered, or even *failed,* due to business loan losses. The risks associated in an environment with fewer of these checks and balances can be significant.

- Other credit union staff may know little about the business lending function, and do a poor job of *promoting* it to members and supporting it. At the same time, the business lenders may have little understanding of other credit union services and functions, and may fail to direct members to them when appropriate.

The simple truth is that business lending carries **risks** that are both *quantitatively greater than* and *qualitatively different from* the traditional consumer lending that credit unions have provided to their members for a long time. Make no mistake, those risks can eventually lead to losses that wipe out a credit union, something that we have seen more often in recent years.

To manage those risks while taking advantage of the opportunities that business lending provides for the credit union and its members, business lending needs to be *integrated* into the credit union environment and culture.

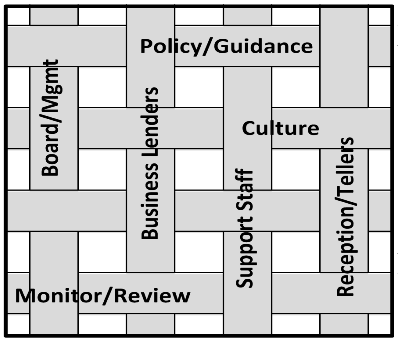
Integrated Thinking About Business Lending

Compared to having business lending activity *outside* the credit union (*outsourced*), or isolated on an *island* within the credit union (*imported*)*,* an *integrated* approach makes business lending *everybody's* concern, within the credit union, as well as making the business lenders aware of all of the other services and functions of the organization.

Think of it as a "bun" that wraps around the business lending function. The business lenders still hold most of the expertise, but other staff at various levels are monitoring their activities, providing guidance, and identifying relevant member needs.

Ask yourself **whether you can answer "yes"** to the following questions:

- Do the members of your board and top management understand how the practices, and especially the *risks*, of business lending differ from the kind of lending they are already used to? Does the leadership provide active guidance to the business lenders, rather than simply responding to what they do?



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- Is there an explicit written policy in place that guides business lenders in the types of transactions they should and should not pursue, the qualifications they are looking for among members with business interests, the protections (terms, collateral, etc.) that the credit union must apply to any business loan?
- Are business loans reviewed by someone other than the business lenders themselves? Are loans monitored by staff to assure compliance with loan terms?
- Do other credit union employees know how to recognize business credit needs among their members, and refer them appropriately?

If you cannot answer "yes" to all of these questions, there's a good chance that your business lending function is too isolated from the rest of your credit union's operations and culture.

Remember, good intentions, either among your business lenders or across the credit union as a whole, will not protect you from the potentially devastating consequences of failed business loans. More comprehensive and deliberate action is required.

Effective *integration of thinking about business lending into the "fabric" of the credit union* requires practical **training** (the nature of business lending, best practices, balancing protection against opportunity, etc.), the development of **policies and standards**, and explicit **ongoing two-way communication** to ensure appropriate guidance, monitoring, review, and adaptation to changing conditions.

Business lending is simply too important to be left to business lenders!

About Jeff Judy & Associates

Over the past several decades, Jeff Judy's training and consulting activities have taken him all across North America, as well as to Europe and Asia. He has trained thousands of bankers and financial services staff in financial and credit analysis, risk management, building relationships, working with regulations, and implementing effective processes. In addition, Jeff consults with management on developing effective policy, credit portfolio management, and corporate culture issues. Jeff's proven effectiveness in the classroom and in the boardroom ensures that strategies adopted by the institution's leadership are reflected in daily practices on the front lines.