Observations & Insights

from

Jeff Judy & Associates

Determined to Master MBL the *Hard* Way?

Don't Let Pride Keep You from Taking Advantage of Banks' Experience

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L*earn from banks??!!* Sometimes I get the feeling that while credit union management will pay attention to banks as *competition*, they have a hard time believing there is anything banks can teach them about serving their members.

That's why I see some big mistakes, and even some major problems, on the horizon for Member Business Lending at some credit unions. Call it pride or what you will, some credit unions shut themselves off from great lessons about business lending, simply because they come from the banking world.

And most of these lessons come back to a fundamental understanding of how *business lending risk* is different from long-practiced traditional consumer loans.

All Risk Is Not Equal

Member Business Lending is anything *but* a straightforward extrapolation of consumer credit practices. Compared to lending to individuals against their homes or to purchase an automobile, business lending is very different in several ways …

Number & Unpredictability of Financial Inputs

When you provide credit to support a member's purchase of a home, or of a car or, say, a boat, the number of *financial inputs* into your decision is limited. Employment and income drive much of the analysis. Market conditions may factor in home equity and mortgage decisions, but even that market received little explicit attention until the recent unpleasantness in the housing situation.

***Many more factors* go into the borrower's ability to repay a *business* credit**. Many things can change a borrower's profitability, their ability to generate the cash to repay their loans. Businesses usually have *competition*, working to claim those same profits from the same customers. They face changing prices from their *service and material providers*, sometimes very unexpectedly. Even *legislation and regulation* can suddenly and significantly impact a business's financial health.

Higher Probability of Problems

The more "inputs" into their financial health, the more things can go wrong. That makes the **probability of problems** *higher* for the business borrower. While the default rates are pretty predictable for consumer lending, making it easy to prepare for those write-offs, every member business loan is unique to some extent. There are more ways they can go wrong, and preparing for defaults is much more complicated.

Higher Impact of Problems

Unpaid business loans have a much greater impact on the entire credit union, due to their size. One business default can do the damage of five, ten, or even higher multiples of consumer credits.

Think in terms of Katrina-like catastrophic events: very rare, but *devastating* when they occur. Even after long experience, many commercial banks still put too much attention on protecting themselves from common problems, and too little on rare but devastating defaults. Don't let that mistake cripple your credit union.

Problems Demand Earlier Detection

Given the greater risk of business lending, **detecting early indicators of possible repayment problems is crucial** to timely, effective action.

Beyond financial data — which needs review, not just filing, as it comes in —the first signs of trouble are often behaviors that need to be covered in the loan agreement. For instance, if the #2 person in the business (or several key team members) should leave, are you notified? Does the business suddenly become slow to provide financial information on the expected schedule … often a sign that that information contains some bad news?

You can't afford to wait until a payment is missed to decide that you have a problem on your hands. You need both the agreement to identify triggers for a serious conversation with the borrower and the mindset, the will, to take action when those triggers are pulled.

Too Proud to be Smart?

Smart people learn from their experiences, from their mistakes and the challenges they tackle … as do smart institutions and organizations. The *really* smart ones learn from the mistakes and challenges that *others* have overcome.

Prejudices and rivalry interfere with that learning. Many banks feel they have little to learn from credit unions, and many credit unions feel there's little to be learned from banks. It seems to be a matter of pride, of feeling superior, on both sides.

Banks have been learning about business lending through trial and error for a long time, but ***there's no reason for you to do the same!*** Why learn those lessons the hard way, when banks have done the work for you?

Don't let your attitude toward the banking industry, or your pride in your own approach, blind you to lessons others have learned the hard way!

Jeff Judy's booming voice and unique instructional style have been enjoyed in classrooms and auditoriums across the globe. Jeff is in demand as a trainer for individual financial services institutions as well as regional and national trade associations. His practical, down-to-earth approach consistently wins him high ratings from participants in his seminars and workshops. Jeff also consults on policy and process, as well as educating audiences through his frequent interviews and articles in trade journals and through his own biweekly electronic newsletter, Jeff's Thoughts. **For information about Jeff's work with credit unions**, *along with more articles in the "Insights" series, visit* www.JeffJudy.com/creditunions.html.