
DON'T LOSE MUTUAL TRUST TO THE INTERNET

How can banks maintain "human trust" in modern business world?

* * *

Business operates today at speeds that are almost unimaginable by standards of only a few years ago. Yet there is one traditional and very old-fashioned potential bottleneck that can slow things down to a crawl: people.

What I'm really talking about is trust.

How do we get to know one another, borrowing customer and commercial lender, to the point that we trust each other sufficiently to enter into a lending relationship?

The answer to how this happened in the past is not necessarily indicative to how it may be done in the future. The implications can range from significant to enormous for borrowers and for the strategic business models of banks heavily engaged in commercial lending to small- and medium-sized businesses.

Where and how traditional trust is unraveling

In commercial lending, the raw inputs for an affirmation of mutual trust have probably been unchanged over the last 100 years. These include mutual knowledge of each other's circumstances; an understanding of the inherent risks in each other's businesses; and an attention to detail that probably all reasonable people understand and practice.

The landscape is further complicated today by an unprecedented level of distrust, and suspicion of a significant portion of the non-banking public toward banks and banking.

Regulators have fed and reinforced these suspicions with intrusive and heavy-handed involvement in judging safety and soundness of banks' lending practices. Regulatory oversight has reached unprecedented levels, and as many bankers have to admit, some of the popular perception is self-inflicted due to the manner in which banks exposed themselves to both credit risk and reputation risk during the last business cycle. But I'm confident that we'll figure this how to deal constructively with this in time.

But perhaps more fundamentally, there are changes to commercial lending processes going on. In part they are technologically driven, but increasingly they come from the need to reduce the cost of product and service delivery.

It's not surprising that all banks are anxious to trim salary costs how and where they can. In the credit sense, there are two immediately evident ways that this is being accomplished:

1. By making the credit approval decision in a less labor-intensive way (normally by increased reliance on behavioral credit scoring).
2. By delivering and administering credit in a centralized and much less personal way.

The result of these cost pressures and their enablement by advances in technology are becoming hurdles and impediments through a reduced level of direct contact between borrower and lending officer. It also becomes more difficult to identify product specific solutions to customers' banking related needs.

Lenders at larger institutions are well into the process of a conscious tradeoff between cost and first-hand functional knowledge of their customers. Lenders at smaller institutions find that their larger competitors can offer better loan rates, broader product offerings, and present a stronger case for long-term presence. Yet neither side of this divide seems to feel that it necessarily enjoys a significant long-term advantage over the other.

The other side of the desk

It's typical among lenders to think of these competitive issues and problems as being almost wholly one sided--the bank's side. But what do the borrowing customers think about these developments? Do you suppose that any of them are looking at the same marketplace with concerns and long-term reservations of their own?

Consider ...

Many of them have built and nurtured their businesses with the long-term help of a local bank. Relationships have been forged and tested through a variety of business challenges ranging from local and regional economic conditions to how well they, the business owners, have executed their own business plans. They have appreciated the value of their bankers' occasional business advice and counsel and directly benefitted from the investment that the banks and bankers have made in developing relationships of mutual trust.

After all, they have made from their side of the desk a similar long-term investment in their own relationships with the bank.

Personally, I think the challenges to the old fashioned, labor intensive model have and will continue to significantly change the way most banks generate business at the smaller end of the deal-size spectrum. After all, small commercial lending transactions are often installment loans in nature and may not differ greatly from consumer installment transactions either in their underwriting or administration.

The interesting challenge (and the significant business opportunity) is in the larger commercial transactions--not necessarily those of considerable size but those of both size and potential that favor more intensive sorts of relationship cultivation for risk management and business development.

The value of retaining "personality"

Personal interaction between banker and customer and the banker's knowledge of the specific transactions and risks are still valuable to both the bank and to the customer.

The bank benefits from the firsthand knowledge of the credit risks and from the opportunity to develop future loan business and the cross selling of other products.

The customer benefits from the relationship too. How else does he develop an informed and concerned "partner" who is committed to his success and who benefits in the business sense from an increasingly successful and growing loan book?

This creates some significant opportunities for the community bank. As the market tends to redefine the relationship of borrower and banker, the bank must redefine how it will interact with the borrowing customer. This need not be so different in function than present-day technique and practice but may well have some stricter size parameters associated with how it's to be done and require a redistribution of some of the functions associated with credit administration. Process change will be key.

What will it look like?

To me, a successful commercial lending function in the future has got to be an old-fashioned combination of mutual trust and understanding built on a foundation of sound underwriting and administration. What's not fully in place for this new model is the manner of performing back-office tasks and taking the drudgery of the mechanical processes off the backs of the lending line staff.

At the end of the day, the banks that can figure out how to "afford" the continued interaction of lending officer and customer will be the winners. They may not yet be configured to accomplish this as effectively and as efficiently as they must become. I believe that commercial lending will always be an intensive interpersonal activity and that the customer and the banker will always mutually benefit from their direct interactions.

This has some huge implications for banks and their lending business models particularly in the way they build and maintain mutual trust. Some basics of our business just don't change. And the very large banks are handing their community bank counterparts a potentially enormous competitive advantage.

We'll explore ways to turn this into a sustainable competitive advantage in a future column.

About Ed O'Leary: Veteran lender and workout expert O'Leary spent more than 40 years in bank commercial credit and related functions, working with both major banks as well as community banking institutions. He earned his workout spurs in the dark days of the 1980s and early 1990s in both oil patch and commercial real estate lending.

O'Leary began his banking career at The Bank of New York in 1964, and worked at banks in Florida, Texas, Oklahoma, and New Mexico. He served as a faculty member and thesis advisor at ABA's Stonier Graduate School of Banking for more than two decades, and served as long as a faculty member for ABA's undergraduate and graduate commercial lending schools.

Today he works as a consultant and expert witness, and serves as instructor for ABA e-learning courses and has been a frequent speaker in ABA's Bank Director Telephone Briefing series. You can hear free audio interviews with Ed about workouts here. You can e-mail him at etoleary@att.net. O'Leary's website can be found at www.etoleary.com.

You can get word about these columns the week they are posted by subscribing to ABA Banking Journal Editors Report e-letter. It's free and takes only a minute to sign up for. [Click here.](#)