

WORKING SMARTER WITH SMALL BUSINESS BORROWERS

Getting "by the numbers" helps you and your prospect

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Years ago I learned just how compulsively secretive some small business borrowers can be. They would almost want to get under the desk when they came into the bank to tell me their latest numbers or other business performance indicators.

I don't blame them for their concerns. But such behavior can be a little disconcerting at times and it makes the process of business developing among small business borrowing prospects occasionally difficult.

How to size up a prospect fast

Fortunately an experienced colleague gave me some advice early on that served me well through the years. I'd almost forgotten about until I was in a recent conversation with a bank client about how to filter borrowers' information quickly and efficiently.

I'm not talking about formal credit analysis but rather determining in the minimum amount of time just how attractive a prospect's financials are from an inspection that consists of little more than a "peek" at the numbers.

The "tip" lies in a skill that most of us acquired in the fifth or sixth grade--the drill of memorizing our times-tables.

Through knowing our times-tables, the exercise of performing "short division" in our heads is easy. Short division is essentially the exercise of dividing any number, 1 to 12, by any other number between 1 and 12. Most of us can and still do it in our heads. That's the key to a preliminary screening of small business prospects without make it seem that we're too intrusive.

Imagine a small business owner that you've prospected for a long time--but the catch is that you've never seen his financial statements. You have an indirect sense of the relative success of the business, but you're not sure and there's no way to know, short of looking at the financials themselves. The prospect never seemed ready to move his business nor did he ever give you an inkling about what his numbers looked like.

Then one day, on a periodic follow-up prospect call, he hands you his balance sheet and income statement, and asks you how much you'd lend on the numbers.

He really doesn't expect a sharp pencil answer on the fly. But your challenge is to detect in a matter of a moments whether you have a high interest in his business or a low one. Our mental arithmetic doesn't have to be precise--only accurate.

What to look for

Here are a few basic indicators that will give you at least a sense of his credit worthiness:

- • Balance sheet: We're interested in the current ratio, the quick ratio, and the debt-to-worth ratio. Ultimately, we want more information than this but we've got to start somewhere. For the first look, we can't use a calculator, pencil, or paper. We can do these three ratios in our heads and with them, have a first cut at liquidity and solvency.

- • Income statement: We want to know gross profitability and net profitability. These can also be done in our heads and we are able to know something about profitability.

The three basic building blocks of all credit analysis are liquidity, solvency, and profitability.

Based on these calculations, performed in our heads in an approximate way, we know whether the next prospecting steps are likely to be fruitful or not. And we can respond appropriately and on the spot.

These short-division skills likely were at the root of your wonderment and mine when we were new credit analysts, when we'd see how quickly our bosses or the other credit sachems could make such rapid and amazingly prescient observations about a borrower's financials.

I remember how I would run the numbers on a calculator, check and recheck, and still wonder whether I'd overlooked something before even uttering a response on my opinion of a set of financials.

"What's wrong with my bookkeeping?"

Another aspect of dealing with a reticent borrower that's more difficult to solve is the common reluctance of a small business owner to appreciate the value of independently prepared financial statements. There are a variety of disciplines applicable to financial statement presentations and unfortunately for the borrower, they tend to be progressively expensive.

For most purposes, audited financials are a luxury. While we'd usually prefer them, we don't typically need audited numbers at the smaller end of the size spectrum. What we do need to understand and express to our customers in easy to comprehend terms is why we want more information of a certain type and quality.

Receivables and inventory, for example, are two categories of collateral that require frequent and constant monitoring. We owe it to our customers to give them a cogent and reasonable case for information that is responsive to our needs. A "review statement" of the inventory and receivables accounts often suffices to significantly improve our comfort level with the validity of these numbers.

Be open about this. We should simply and directly tell our clients why it's good for them and how different types of statements will help them manage their businesses.

Making the case in my terms does not necessarily make the case in my customer's terms. How often do we encounter the small business borrower who viscerally understands that to shorten the number of days of inventory or receivables turnover reduces the size of his balance sheet? They often don't see the direct and immediate connection between turnover and the absolute levels of inventory and receivables, which in turn are supported by money borrowed from us.

In my experience, many borrowers come to understand that-but, in the cauldron of running their businesses, it's not

always top of mind, if it's even clearly understood.

Doing our job and helping our clients

These are the tips we can share with our borrowers. If the insights are good, I think you can count on the customer to remember where he got the idea or the information.

Our job, once the business owner is our customer, is to help him with useful tools and information. Ideally we should teach him what we know and why we need to know it. By then, we're probably well down the road to cementing a relationship with value-added components for dealing with us, as opposed to our competition.

Community bankers have a natural advantage this way.

We get to talk and interact with our customers and prospects. Our locally based and often intuitive judgments are frequently superior to those of the larger banks whose credit underwriters are in remote locations and whose business developers rely primarily on a large broom to sweep the various prospects toward the nearest branch.

Where's the value added of that business model for anyone but the bank?

We have to be smarter at our prospecting and delivering of our value proposition. Loan proceeds are fungible, one bank to the next, but our savvy and skill is what will make the difference--the value-added in the long run of dealing with you or me.

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 e-mail him at etoleary@att.net. O'Leary's website can be found at www.etoleary.com.

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