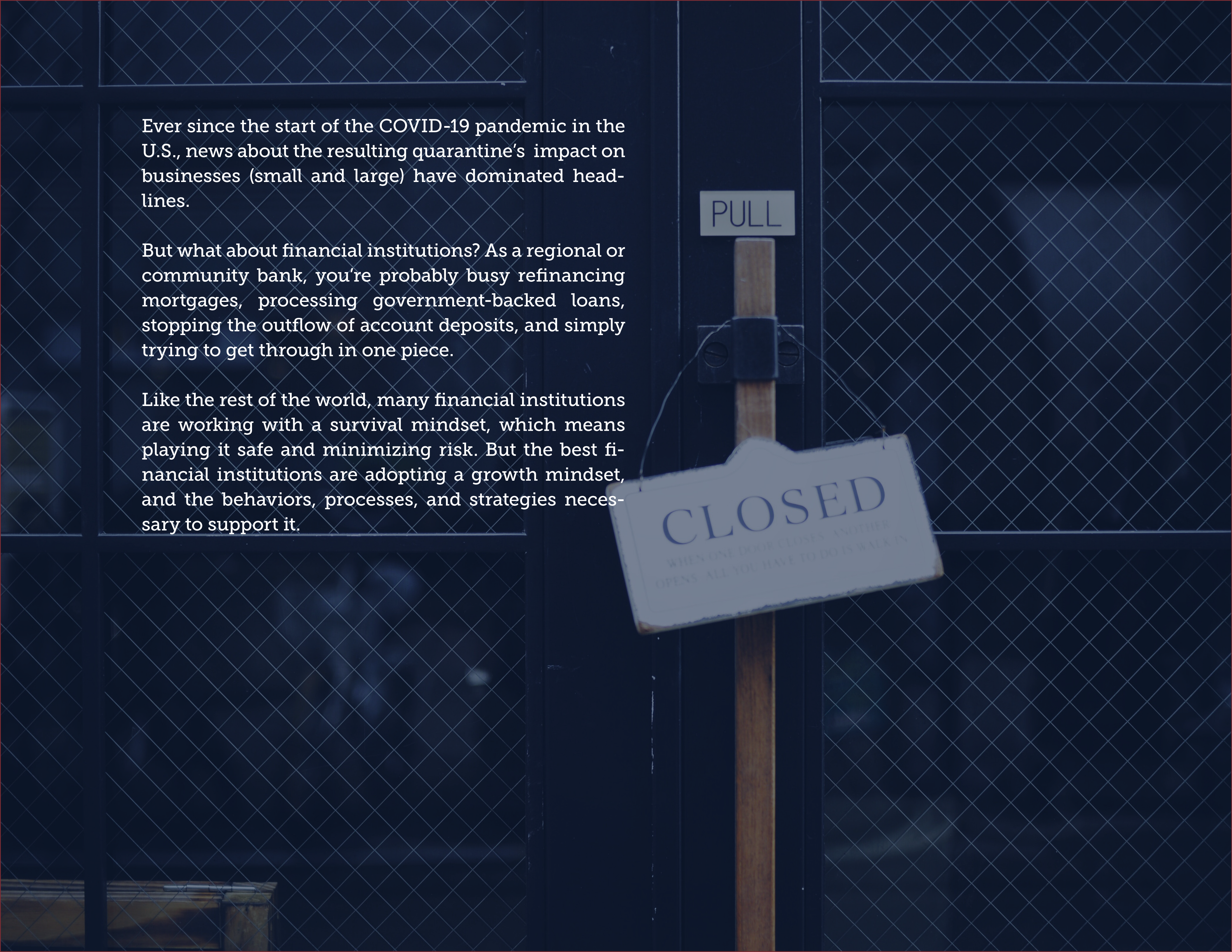
The 2021 Community Bank Playbook:

A Primer for Growth in the Post-COVID-19 Environment

LENDINGFRONT



Ever since the start of the COVID-19 pandemic in the U.S., news about the resulting quarantine's impact on businesses (small and large) have dominated headlines.

But what about financial institutions? As a regional or community bank, you're probably busy refinancing mortgages, processing government-backed loans, stopping the outflow of account deposits, and simply trying to get through in one piece.

Like the rest of the world, many financial institutions are working with a survival mindset, which means playing it safe and minimizing risk. But the best financial institutions are adopting a growth mindset, and the behaviors, processes, and strategies necessary to support it.

How can you emerge from this crisis powerfully, positioning yourselves to thrive and grow in the new economy? How can you capitalize on this crisis—rather than let it go to waste?

Simple: continue to lend.

The most astute financial institutions will, counter-intuitively, expand their lending in a way that grows revenue while still managing (or even reducing) risk.

Here's how.

First, A Temperature Check

Most financial institutions are focused on meeting immediate needs and conserving capital. You might be slowing or even pausing your lending activity. You're probably focusing on securing established relationships, rather than creating new ones.[1] We understand.

According to CBRE's lending figures, overall deal closings were up 15% in Q1 2020, compared to Q1 2019. However, the January-February high wasn't long lived. In March 2020, as COVID-19 began to spread in the U.S., business loan closings dropped 12%, with no end in sight.[2]

Lending to small businesses can seem risky, but it doesn't need to be. In reality, it's an opportunity to boost your brand—especially during a time when capital will be more scarce. The most forward-thinking financial institutions are capitalizing on small businesses' capital needs—needs that existed long before coronavirus, and will continue to exist long-after.

[1] Crain's New York, "Local banks rush in where big banks fear to tread"
[2] CBRE, "U.S. Lending Figures Q1 2020"

Small Business Capital Needs Are Expanding — Not Shrinking

According to the pre-coronavirus Federal Reserve's 2019 Small Business Credit Survey, 43% of small businesses sought external funding in 2018. More than half of those businesses, 53%, experienced a financing shortfall, meaning they obtained less funding than they sought. Of the total 64% of small businesses that reported needing (not necessarily seeking) capital in the past year, more than two-thirds wound up using personal funds.[3]

These needs have only been heightened as a result of the current crisis.

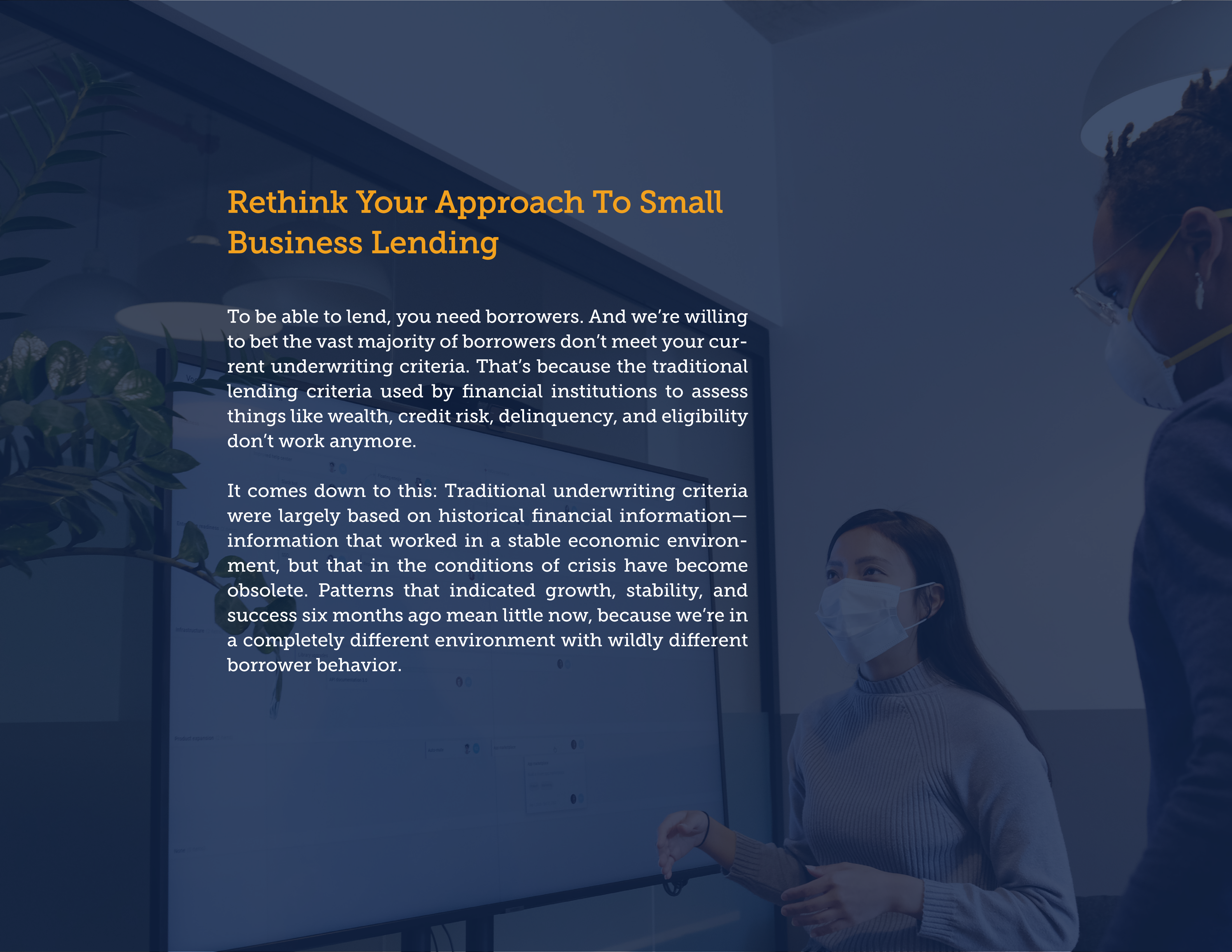
[3] Federal Reserve, "2019 Small Business Credit Survey"

According to McKinsey's series of small business sentiment surveys, which surveyed U.S. businesses with less than $500 million in annual revenues, 54% of business owners said their ability to work and run their business had been reduced by COVID-19. 53% said their income had been negatively impacted, and 49% said their business felt less secure. 34% believed their current cash on hand could only last a month or less.[4]

The crisis isn't just changing the way small businesses manage their finances, it's changing the expectations they have for their community banks. The same survey asked respondents to report the top 3 expectations they have for their banks. Number 1? Make it easy for me to get line of credit for my business. If lenders can do that, the economy can avoid a capital drought—and pave the way for growth in the post-COVID-19 environment.

The first step?

[4] McKinsey & Company, "Tracking US small and medium-sized business sentiment during COVID-19"



Rethink Your Approach To Small Business Lending

To be able to lend, you need borrowers. And we're willing to bet the vast majority of borrowers don't meet your current underwriting criteria. That's because the traditional lending criteria used by financial institutions to assess things like wealth, credit risk, delinquency, and eligibility don't work anymore.

It comes down to this: Traditional underwriting criteria were largely based on historical financial information—information that worked in a stable economic environment, but that in the conditions of crisis have become obsolete. Patterns that indicated growth, stability, and success six months ago mean little now, because we're in a completely different environment with wildly different borrower behavior.

Tax And Financial Statements = Irrelevant.

Statements from 2019 can't be used as indicators of success in the current, let alone the post-COVID-19 environment.

Collateral = Unreliable.

As bankruptcies rise, the value of collateral becomes increasingly questionable, and ultimately, untrustworthy.

Credit Scores = Damaged.

Credit scores are declining across the board as small businesses struggle to make payments during closures, rendering them a red flag for nearly every potential borrower—despite the fact that there's nothing fundamentally wrong with the business itself.

Owner Wealth = Drained.

In an effort to keep business afloat, owners are tapping into their own wealth. The two-thirds of small business owners who were using their own funds in 2019 has likely multiplied—and are at even greater risk than they were then.

So, What's The Secret To Profitable Post-Covid-19 Lending?

The smartest financial institutions are doing everything they can to gain better data and visibility into business' true performance. In the current climate, ensuring long-term success for your financial institution requires taking a short-term approach to lending.

01. **Make shorter-term loans.**

    Lend in shorter time-frames—whether six, nine, or 12-month loans—rather than sticking with traditional, multi-year business loans. This reduces your time risk, and gives business owners the opportunity to demonstrate that they can pay you back in the short-term before you agree to make any large, long-term loans down the road.

02. **Lean on real-time cash flow.**

    Rather than looking weeks, months, or years into the past, assess small businesses based on their real-time cash flow. This helps you gauge how quickly the business is recovering from the crisis—whether it's for the most part back to its standard operations, struggling but stable, or in irreversible decline. This can help you make smarter, more informed decisions about who to lend to—and it can help you keep tabs on the business once they're a customer, increasing visibility and reducing risk.

03. **Switch from monthly checks to daily ACH payments.**

    Similarly, adjust your payback periods from monthly (paper check) payments to daily ACH payments to reflect your short-term, digitized approach. Especially when there's no reliable historical markers to go off of, daily ACH payments can be used as a way for business owners to demonstrate their credit-worthiness. It also makes the payments more consistent and predictable for both you and the borrower.

04. **Tie payments to performance.**

Agree in advance to tie payment terms to performance, allowing you to delay payments (when necessary) for your small business customers that need built-in recovery time. With a clear view into real-time cash flow and performance, it's much easier for you to base your payment terms off of this data.

05. **Gauge customer sentiment through reviews.**

Looking at business reviews through sites like Google and Yelp can help you get a sense for customer loyalty, sentiment, and attitude. While it can be difficult to discern the value of a small business's customer base during closings, these reviews offer a glimpse into how things were running before the crisis. If people loved a business before COVID-19, they're likely to continue to love it after.

06. **More efficient delivery methods.**

Banks with a digital presence are online and open when you're not. It's as simple as that. With the ability to receive, process, and even auto-approve (or reject!) loans through their digital channels at any time, from any location, you can process, underwrite, and fund more loans in a fraction of the time—and at a fraction of the cost.

07. **Automate the automatable.**

Automation doesn't just speed up the underwriting process. It frees up your loan officers to focus on more valuable tasks—building high-value portfolios, developing commercial relationships, and more.

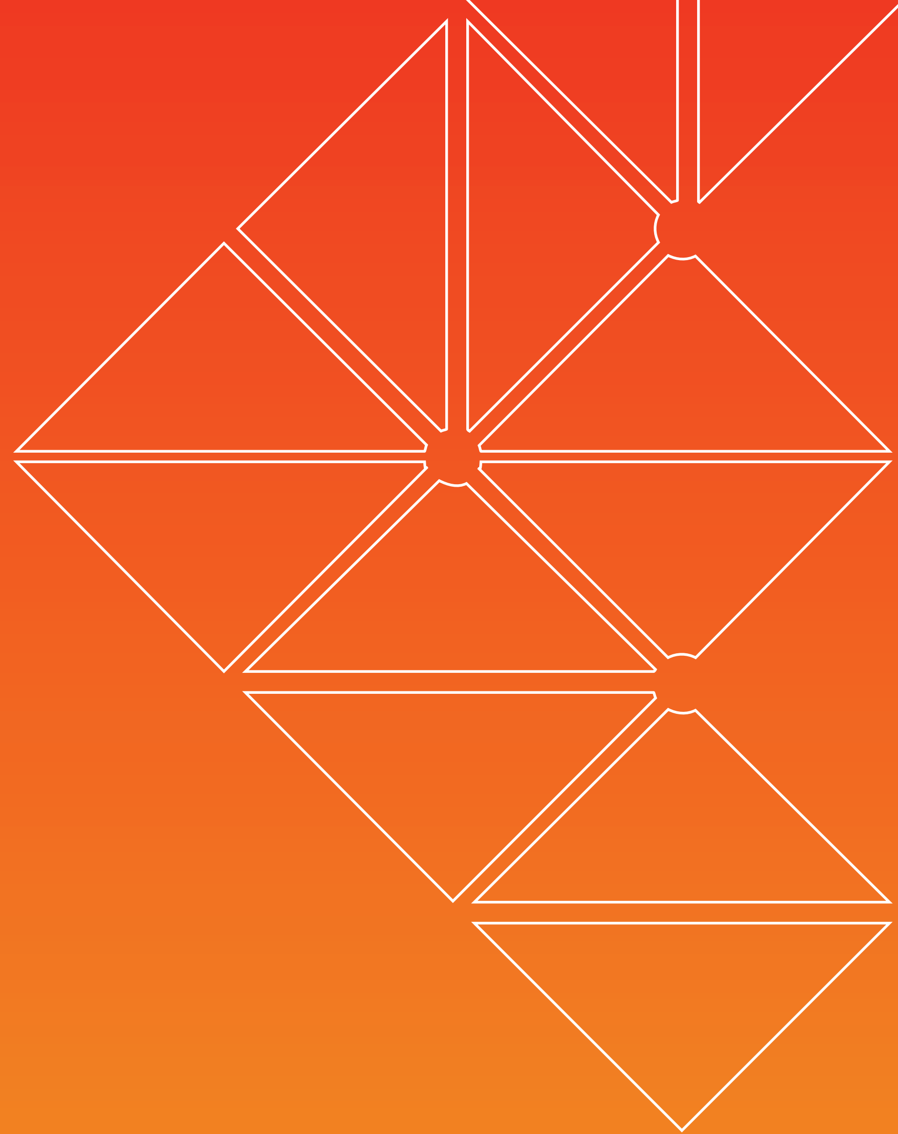
Small business borrowers have always sought convenience. In a report from 2015, more than 60% of small business owners expressed a preference for applying for loans entirely online—and that was over 5 years ago.[5]

Now, as businesses struggle to emerge from the COVID-19 crisis, they don't just prefer digital—they depend on it. Delivering it is the key to your success.

With increased automation and digital channels, business owners can get a loan decision in a matter of minutes instead of in three to five weeks, and actual cash in a matter of days instead of the average three months.[6]

This is how you can meet your customer base's number one expectation for you—making it easy for them to access capital—and boosting your bottom line in the process.

[5] Javelin, "Small Business Demands Better Digital Banking Tools"
[6] McKinsey & Company, "The lending revolution: How digital credit is changing banks from the inside"



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