The Relationship Between Lenders & Small Businesses

Why Increased Small Business Lending is Critical to Economic Recovery

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While opinions on government spending for bail-out programs and stimulus packages vary widely, the current legislation to funnel $30 billion to banks for lending targeted specifically at small business enterprises may just be the type of focused program that people representing both sides of the aisle have been calling for.

Much of the country's hope for economic recovery is tied directly to the creation of eight million new jobs in order to reduce the stubborn unemployment rate. The number is staggering and it is one of the primary reasons why the recovery is moving at such a slow pace. In fact, at the present time the monthly jobless rate does not indicate that jobs are being created in any real meaningful manner. To the contrary, higher new unemployment filings happen more frequently than months when jobs created are positive. While there is no single solution to creating jobs and reducing the time before the recovery is considered underway, we do know that a large portion of these new jobs are going to be created through the growth of small business. To realize that growth, lending to small businesses is going to have to be robust.

Small businesses, defined as those having fewer than 500 employees, employ one-half of all Americans. It is also interesting that small business is credited with creating 64% of the new jobs over the last 15 years. However, in flashing forward to current times, what we know is that since the onset of the credit crisis, small business employment has contracted by five million jobs. Compare that to three million jobs lost over the last two years by large businesses.

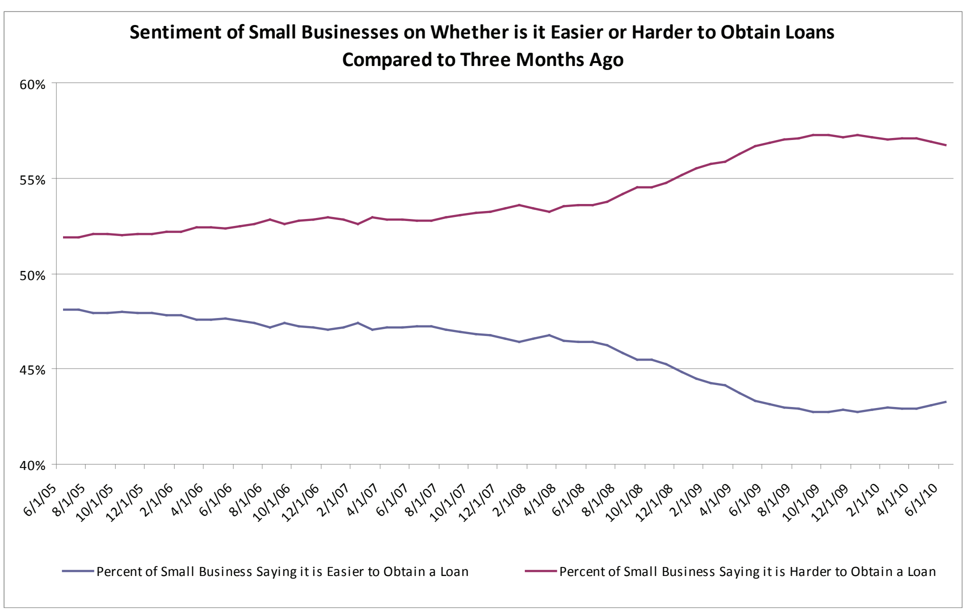
Federal Reserve Chairman Ben Bernanke noted in July 2010 that lending to small businesses at the end of Q-1 was down 5.6%, an amount equal to $40 billion less than the same time in 2008. The reasons why lending to small business is down are varied and continue to be debated. Economists have reported that there is not much evidence of a broad refusal to lend, but while the debate rages on there are at least three components that most parties would agree have been included in the small business credit crunch.

1) Small businesses needs top line growth and more profitability to justify lending, difficult achievements during recessionary times

2) Weak economic fundamentals and battered balance sheets have lowered the appetite for new lending at all sizes of companies

3) Entrepreneurs say that banks are denying loans to credit worthy borrowers due to an overreaction to the bad loans of the last economic expansion and heightened scrutiny by lenders

While the reasons for the drop in small business lending are unclear, what is clear is that the ramp up in lending required to fuel jobs recovery is not happening. For their part, banks say they have not so much tightened credit as returned to more traditional underwriting standards after a period of being too lax. Kevin P. Watters, chief executive of business banking at JP Morgan Chase, said the bank was taking a second look at borrowers that initially were denied loans, and was eager to make loans. "We're really trying to get those healthy borrowers to invest again," said Watters. Chief Executive Officer, John Stumpf of Wells Fargo & Co. who lay claim to the



Source: The National Federation of Small Business

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Why Increased Small Business & Start-Up Lending is Critical to Economic Recovery

biggest small-business lender label for many years, says that they are "sitting here with tons of liquidity and we're marching double time in search of more loans." Bank of America Corp., the biggest U.S. lender is trying to "make every good loan we can" according to the company's President of Global Commercial Banking, David Darnell.

The increased level of small business lending that will be required is not going to come from any single bank, nor any single organization such as the Small Business Administration. Nor will community banks alone be able to solve this situation. This is an effort that is going to require all parties.

For the small business owners that are seeking capital, the most important tasks at hand are to focus on customers, increase productivity, and cultivate relationships with lenders.

Customers

Call it what you want, top line growth, sales, revenue, bookings or new orders, whatever the terminology nothing is more important today than your customers. Talk to them. Know how they feel about your products and your people. Of critical importance is awareness to how your business can help them today and over the next 6 – 12 months. Take good care of your customers. Provide them with quality goods and services. Last but certainly not least, don't be afraid to manage your pricing. Most customers will accept a small up-tick in pricing from a supplier they can count on if you give them the chance. Dropping a point or two of margin to your bottom line is crucial in this day and age, and managing your prices is one of the quickest ways to accomplish this.

Productivity

Just because you are focusing on customers doesn't mean that productivity gains slip through the cracks. It's not just about working harder or working smarter. It's doing both to ensure that your organization operates in a more efficient manner. Over the last three years many organizations have taken measures to reduce costs however, only a small number have truly focused on productivity improvements and doing what they can to achieve improved performance now.

Lender relationship

A good relationship with your bank or financial services provider is essential to your organization's success. A few years ago a hotel chain used the term 'no surprises' as the tag line in their advertising. If the only time you reach out to your lender is when a 'surprise' is coming, you may be getting your own surprise in the future. Business owners would be amazed if they knew how much their bankers enjoy learning more about their operations. Sharing your strategies, your accomplishments and your concerns with your lender will strengthen your relationship, provide you with more support when you need it, and eliminate the need to 'surprise' a person who should be viewed as a partner.

Bankers and small business lenders also need to consider the plight of the small business person and the entrepreneurial spirit. There needs to be a willingness by the government and lenders to find middle ground between good underwriting standards and a level of risk that allows good organizations the ability expand. Remember that many entrepreneurs have borrowed in the past against equity in their real estate holdings or the value of their equipment. The collapse in real estate values and a similar decline in equipment valuations have posed a real challenge to the small business owner in his ability to fund expansion.

In an effort to improve lending, Fed Chairman Bernanke indicated that currently more bankers "are emphasizing cash
values in evaluating creditworthiness." Reacting to complaints that the Fed's own bank examiners are contributing to the overly tight standards, Bernanke said that the central bank is conducting training programs with examiners to drive home the message that encouraging loans to small businesses that can repay is positive for the banking system.

Energizing small business is going to require that capital made available to small business greatly exceed levels provided in 2008. The law of big numbers and a higher level of risk tell us that not all of these loans will have the desired result. Unfortunately, that means that government assurances and guarantees are going to be necessary. However, based on the current economic outlook and the slow pace of the recovery, focusing on small businesses and the job growth that will follow would seem to be one area of focus that provides movement in the right direction.

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