Meeting precise needs

Article by Antreas Athanassopoulos, General Manager of Retail Banking, National Bank of Greece, at "EFMA Journal" (issue January-February 2013)

The economic crisis has constrained SMEs in particular, who are facing a sharp reduction in demand, disrupted rules on commercial credit supply and a revised relationship with their banking institutions. National Bank of Greece's *Antreas Athanassopoulos* offers some advice.

During a normal economic environment small firms typically strive for differentiation. But in a crisis environment this is difficult to say the least. The doctrine in such situations has primarily been to find ways to reduce business running costs. Such activity is not straightforward since small businesses are perceived as cost leaders, and therefore there is a minimal scope towards such direction.

The reality is different and small businesses have significant cost inefficiencies that are called to doctrine without expert support. Funding costs and general short-term obligations from creditors constitute 40-60% of business turnover before the crisis. During the crisis, obligations have remained stable while turnover has been slashed, gauging very pressuring ratios of obligations to turnover.

The economic crisis quickly became a liquidity crisis for many banks, while small businesses suffered primarily from the lack of commercial credit. This led small businesses to apply for extra credit from a banking system that was experiencing liquidity and credit difficulties. Therefore, banks contributed into the liquidity squeeze at a secondary level. As a result, many small firms were driven out of business due to their inability to pay in cash for their supplies.

Innovation and small business
Despite the fact that the crisis has primarily hit small businesses, it is the same sector that drives innovation and new employment in the period after the crisis. Banking institutions need to support these activities, giving primary attention to the scope of business and scope of lending. Business plan financing is always a tough question for any credit underwriter, but in most cases a business plan acts as a proof of concept from the business point of view while the banking system is making small steps to find ways to judge the essence of business plans.

Retail or non-retail?
By keeping small business banking together you create a self-funding discipline, while developing a service model for more than the 30% of everyday customers of the bank. Small business banking should evolve over time into a total banking segment capable of addressing the personal and business behavior of the customer, especially in terms of the lending function. We must be aware that the vast majority of small business banking customers do not bear a credit product and therefore day-to-day banking must be turned into a profitable business.

Lending in small businesses is for scope
The crisis has taught us that small business lending should always be linked to proven scope of lending, something that is often neglected with unpleasant consequences. Since in many continents the accounting books of small businesses are very generic and not transparent, working capital quite often were used as cheap consumer loans, mixing up the repayment process. The choice of products is always quite important and small businesses should never be offered pure revolving credit products without some discipline into the capital repayment options. Banks with such practices found their portfolios in situations with interest payment only since the customers had more or less lived with the idea of permanent working capital. On good days, permanent working capital can fund growth, while on bad days it may sink the boat. If on the other hand you try to convert revolving credit into term credit during crisis you run the risk of generating delinquencies unless you find ways to reduce customer interest rates.

A new way to look at cash, credit and customer service

Cash management between business and household should always be kept aside, whereas credit assessment between business and household should always be looked together. Small business credit underwriting should be expanded and the living expenses of the household should be brought into the equation. That is to say, when a lending application is assessed, the credit officer should look into both the company and the family balance sheet.

Credit scoring tools proved useful during the growth days as they transferred the responsibility of credit decisions from people to statistics. There is no doubt that people-driven decision making is better but it costs more money. On the other hand the inability of scoring tools to capture specificities has cost even more money in terms of provisions. In the path after the crisis, statistical tools should only be used for type-A error. It may cost more, but overall it costs much less in the life cycle of the loan.

In small business we should not finance collaterals, but only use them for loss given default mediation and thus pricing. We finance the business risk and not the collateral. In times of crisis the collateral does not prove such a safe harbour.

The critical role of 'knowing your customer' in small business banking is beyond any dispute. Customers must be asked many more questions regarding their business and their scope of lending to what we are already asking via the typical simplified questionnaires. Undoubtedly, the customer visit from credit officers should be an art and science and its supervision should be an issue of paramount importance.

Small business customers are peculiar with regards to their customer service requirements. As their finances are not always neat, they often appear at branch desks with last minute requests. Complicated customer service hierarchies with multi-layer decision-making and response the day after do not always help. The customer service process for small businesses is a costly business where one needs to combine automation and front line decision-making power. Risks are minimised while decisions and initiatives at the front are monitored.

Overall, a hybrid business and operating model is needed to address the challenges of SME banking. This model shall combine elements from commercial and retail banking in a unique recipe and combination. The task is difficult since it is requires breaking the internal silos of banking segments and also using imagination and effort in order to keep what it needed and dissolve what does not work from the old recipe.