PROCRASTINATING BIZ LENDING SUCCESS

by Steve Brown

A recent study finds 95% of people procrastinate and 20% are classified as chronic offenders. This being the case, many have probably put off collecting the information we provide below. Updated research on small businesses shows which ones are the riskiest and which are the safest. It also provides some statistical information lenders may want to use this year. By using such general information, combined with other more specific factors (such as maturity, prepayment structure, debt coverage, etc.), bankers can better refine loan pricing. To begin, government research finds that in rough terms, 10% of small businesses close each year of operation. Therefore, at year 2, about 80% are still in operation and at year 4, the number drops to 60%. While different agencies generate different information, this rough rule of thumb is reasonable for bankers to use. The data also shows that about 33% of small business closures occur because they are sold by the owner and are not really "failures" at all (owners usually become interested in pursuing other opportunities and simply move on or retire). When it comes to small business survival, research finds small business success increases when a number of general conditions are present. These include age (the older the business the better); size (the larger a business, the better); capital (businesses that start with at least $50k in capital tend to survive much longer than those with less); education (college degree for the owner); and starting small (businesses begun from a home office have higher success rates). Interestingly, there is no discernable relationship between geographic location and survival rate. Of all these factors, when it comes to loan defaults, analysis finds that after a business has been operational for more than 2Y, cashflow and debt load overwhelm nearly all other factors. Meanwhile, common characteristics of failed businesses include owner age (tend to be started by younger entrepreneurs); category selection (service or retail trades); and a low level of capital (usually start with very little). At the extreme, research shows the main external reasons that push businesses into bankruptcy include greater competition, higher rent, more expensive insurance, declining real estate value, high debt load, an inability to refinance and tax problems. For those trying to monitor and fine tune loan pricing, we provide some general business categories that lenders may consider either riskier (or safer) than others. Safe businesses include medical groups, law firms, insurance brokers, real estate management, dental practices, accounting firms, surveyors and carpentry contractors. Meanwhile, some of the riskiest include pet breeding, sightseeing transportation, video tape rental, travel agencies, food stores, small cell phone stores, quarrying, catalog and mail order, vending machine operators, restaurants, bars, boutique apparel stores, book stores, novelty retail, transportation services, antique stores, boat dealers and hobby shops. While these categories are general in nature and individual loan characteristics matter, they should help get you started. Since small business is such a robust sector of independent bank lending, it pays to capture more data. Don't procrastinate.

M&A

In an effort to expand its private banking effort and capture a greater amount of manageable assets (particularly deposits), Merrill Lynch will purchase First Republic Bank ($10.7B, CA) for $1.8B of cash and stock, or 3.27x book.

BANK NEWS

M&A

United Bankshares ($6.7B, WV) will buy Premier Community Bankshares ($901mm, VA), which operates under the Marathon Bank and Premier Bank brands, for $198mm in cash or stock, or 2.81x book.

M&A

Citigroup will purchase the Egg internet banking unit of Prudential Plc. for $1.1B. The unit gives Citi a scalable distribution banking platform in the U.K. as well as over 2.9mm new customers.

Pre-M&A

The market is abuzz after talks between Bank of America and Countrywide were disclosed and confirmed. Speculation is that both JP Morgan and Citigroup are also attempting to capture the mortgage giant as well.

Citi Cuts

After spending rose 15% for the firm in 2006, Citi's CEO Charles Prince pledged to cut expenses by $1B in order to jump profit 2.4%. Tactics will include headcount reduction as well as moving some operations to less costly locations.

Buying Back

Bank of America said it will spend up to $14B to buy back close to 200mm shares over the next 12 to 18 months. It is interesting to note that the company still has 63mm shares remaining to be purchased under a similar plan approved last April. Meanwhile, National City also announced it will buy back up to 75mm of its outstanding common stock (the company also has an existing share repurchase program still open with approximately 43mm shares remaining).

Promo

Key Bank launched "Key4Women," an online club with tools to help women business owners gain more education. In addition to product information and educational materials, the site offers the ability to network with other professional women.