CAPTCHA-ing More Small Business Lending

by Steve Brown

To keep the bots at bay on the Internet, developers years ago came up with the CAPTCHA - technology that asks users to key in distorted text to prove they are real. Now, some years later, Google said it has come up with a way to do that automatically using machine learning and advanced risk analysis. It is termed reCAPTCHA and it uses machines to challenge suspicious activity and/or users. If it works as well as billed, it could be used by banks for fraud detection, to authenticate users of online and mobile services and a host of other things.

Technology like this is interesting as it eventually makes its way down to small businesses. Since community banks account for more than 50% of the country's small business loans, anything new that reaches this customer is something worth monitoring.

When it comes to small business lending, Fed research finds that since the 2008 financial crisis, activity among community banks has been declining. Worse yet - the research points to the downward trend and indicates it goes back to more than 10Ys prior to the financial crisis.

The research found that large banks and nonbanks have been chipping away at community bank small business lending for years. These two groups have been seeking to not only beef up their own small business loan portfolios, but also to engage these potentially lucrative small business customers with other services.

Now, nearly 10Ys after the crisis, the ripple effects are still being felt in small business lending within the community banking industry. These days, the latest and potentially most vexing threat comes in the form of nonbank and alternative lenders like PayPal and Amazon, which are using sophisticated technologies, new underwriting and social media marketing to engage small business borrowers and offer loans to those online and automatically. This group of business owners might otherwise have gone first to a local community bank.

Community banks are certainly not blind to these threats. The good news is that community banks still have considerable leeway to counter them as well. While the small business market is arguably still attractive to big banks, the larger bank lenders are being far more selective in their own lending strategies and making far fewer loans to small businesses than they did preceding the crisis.

Further, several studies throughout the early 2000s have established a significant link between loan defaults and the proximity of borrowers to their lender. According to DeYoung, Glennon, and Nigro research, borrowers located at least 50 miles away from bank lenders were 22% more likely to default on their loans, while borrowers at 25 miles away were only about 11% more likely to default. This gives community banks another good reason to service local business customers.

As community bankers, you often add value for your clients since they are not simply considered a transaction or an account but often a neighbor as well. One way to attract and keep business customers is to promote and empower your employees, especially if there is already a relationship with a customer. This way the client's needs grow along with the experience level of the banker serving that client.

No matter your approach today, continually adapting it to the forces changing around you will keep small business owners reaching out to community banks for loans and other opportunities. Good luck in your battle out there, as you seek to CAPTCHA more small business customers!

BANK NEWS

HVCRE Changes

The ABA reports that regulatory staff from the OCC, FDIC and Fed indicated revisions to the high volatility commercial real estate (HVCRE) capital rules may be proposed this summer. Potential changes reportedly include a simpler definition of what constitutes HVCRE and other capital simplification pieces. Community bankers will be watching with fingers crossed for a simpler way to do this.

Important Resignation

Richmond Fed President Lacker has resigned, after admitting he had a conversation with a financial analyst 5Ys ago where he may have disclosed nonpublic confidential information about policy options the FOMC was considering. The meeting in question was one where officials discussed what they might do related to large amounts of bond buying and the firm (Medley Global Investors) told its clients the details a day before the Fed officially released them. Such information could have given investors in the know a significant advantage. For his part, Lacker said he did not intend to reveal confidential information, but when asked by the analyst about the confidential information, did not decline to comment or indicate his inability to comment.

New Revelation

Wells Fargo now says an internal probe looking at business practices at the bank has surfaced new abuses in the merchant services unit. Certain employees in this unit reportedly falsely reported sales and pushed small businesses into expensive contracts they did not understand. This new issue follows the one from last year where up to 2.1mm consumer accounts were fraudulently opened by employees without customer knowledge in order to meet sales goals.