Minimizing Errors And Small Business Loan Risk

lending business customers risk management

Summary: Small-business loan delinquency rates have climbed a bit since their 2013 low. Some tips to manage this rising risk.

People make mistakes all of the time when it comes to grammar. Whether it's (its) your (you're) issue or theirs (they're, there), problems abound, leading many writers fumbling for effect (affect) on you too (to).

Small-business loan delinquency rates are still low, but they have climbed a little from their 2013 low. Defaults are also slowly rising, from 1.5% in 2015, to 1.8% in 2017, to a forecast of 1.9% in 2018, according to PayNet's Absolute PD Forecast Default Rate Chart. To help navigate through this rising risk and minimize errors, we have five tips to share.

Tip 1: Look for knowledgeable, capable owners. This seems obvious, but we want to highlight its importance anyway. It is critical that owners have significant experience in the given business area, to support their loan and this is especially true as delinquencies rise. Look for evidence that the borrower knows how to run a business profitably.

Tip 2: Find confident borrowers. They should be confident that their business will succeed and working diligently to make that happen. When this is the case, borrowers should be confident enough to give your bank a personal guarantee. This is not an absolute way to make sure that the borrower will repay the note, but it does increase motivation to repay the loan. The business owner should also have clean business and personal credit histories to boot.

Tip 3: Watch for the owner's attitude toward the business. Confidence is good, but other factors matter as well. Passion, dedication, enthusiasm, tenacity, and the ability to think through changing situations are even better. Look for these qualities and see if they are reflected in the business plan. To do so, check to see if it includes reasonable projections for costs, revenues, inventory, capital, staffing, facilities, and so forth. Optimism is important, but drive and desire are critical to success.

Tip 4: Check for room to grow. Businesses must understand their financial structure and hold a comfortable amount of capital to help protect your bank. This should be an important element in any plan to survive life's twists and turns and business owners should recognize that. Far too many businesses have no room for error or surprises, or to support growth and new ventures. Check continually to be sure borrowers are not stretched too thin, be sure they have enough fuel to thrive, and help them with expertise and support as needed to keep them growing.

Tip 5: Look for collateral. To further secure your loan it is critical to look at the underlying collateral. Bankers know this and they know collateral won't magically turn a bad loan into a good one, but its liquidation can soften a loss.

Overall, it all gets down to prudent underwriting and ongoing support of the customer once you make any loan. Factors particularly in focus include such things as: ensuring the customer has a good business plan and professionally prepared financial statements, has a strong capacity to repay the loan, a good payment history, is committed and focused on their business. These go along with making sure your bank has a good relationship with the customer, is protected by collateral, understands the risk and economic climate and has taken precautions to ensure repayment.

Overall, keeping your business model simple, honest and straightforward, helps ensure your business loan delinquency and default ratios stay low. Banks that take the time to help business customers fully understand their situation can help build a realistic, shared sense of the customer's ability to repay loans. In the end, this will help both your borrower and your bank.

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