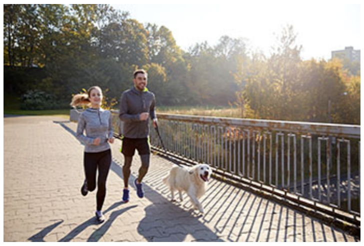

Risk-Based Loan Pricing Strategy

lending business customers customer profitability

Summary: A risk-based pricing strategy can give community financial institutions a chance to improve market share without also increasing risk.

Whistle Labs recently launched a wearable device for dogs that manages the animal's health much like the Apple Watch does for humans. It is amazing what products can be developed with a big enough market and a keen strategy. Another type of strategy, risk-based loan pricing, is more for bankers though.

Community banks and smaller credit unions currently have 9% of all small-business loans under $100K. A risk-based pricing strategy can give all of these community financial institutions (CFIs) a chance to improve market share without increasing risk.

The Fed's small business credit survey indicates that 77% of small-business loan applicants had a financial challenge of some kind in the past 12 months. Nearly 33% of applicants had either failed to make a loan payment or made a late loan payment. Often, there are reasons why business customers may gravitate to big banks or online lenders instead of CFIs to help them out.

The data finds these business owners apply for loans at large banks for three main reasons.

First, they have a relationship with the bank, one that presumably has gone well on both sides.

Second, the business owners feel they have a chance of being funded, which typically means that they have positive cash flow in a deposit account, no negative payment history on a loan, or both. These are the minority of business owners looking for loans.

Third, they expect that, because of the combination of a bank's large size and their preexisting relationship and history with that bank, they will get a good price on a loan (especially since they have a pristine financial record).

The Fed's survey shows that hopeful borrowers with less stellar financial records often apply to online lenders. They value the speed at which online lenders make decisions and see a higher chance of being funded. They see online lenders as more willing to take credit risk. In this instance, borrowers are trading speed and likelihood for higher interest rates.

CFIs can compete with both big banks and online lenders with a risk-based pricing strategy. You have relationships in place, and a low bureaucracy level, so that means you can often respond to a loan request more quickly. You can also use existing, in-house information to market specifically to customers and create a pre-qualification process to fast-track returning business customers.

Perhaps most importantly, CFIs can dump the single interest-rate model and use risk-based pricing for business customers. Risk-based pricing lets banks set individual loan rates that make sense for each borrower's particular history and circumstances. That includes favorable rates for borrowers with great credit and higher rates for those whose histories include losses or delinquencies.

We can help too of course, if you need it. We have a customer profitability tool, which helps you determine the best loan price, based on the relationship. It is an important tool and it doesn't have to be complicated. Contact us today to show you how.

RETAIN AND GAIN CUSTOMERS WITH OUR PROFITABILITY SOLUTION

Profitability FIT is an outsourced profitability solution that measures performance on both a customer relationship and account basis. Contact us today for more information.