Digital Technology: Key to Providing Profitable Small Business and Consumer Loans

By Bob Shifflett, Senior Vice President, BSG Financial Group

While the majority of banks clearly understand, monitor and document their loan loss ratios, many do not know the cost to produce a loan. Yet, for small business and consumer loans, processing costs are 10 times larger than loan losses. Identifying and controlling these costs—which include loan officer and assistant time, expenses for hardware, software, compliance, loan operations and review, collections and vendor fees—is the key to profitably delivering these increasingly desirable segmented loans and competing with non-bank lenders.

A study by consultant Davis Steward of CE Solutions shows the cost of a consumer loan to be $1,150 or more, while Charles Wendel, president of Financial Institutions Consulting (FIC), reveals that a small business loan costs over $3,000 to originate and deliver. Wendel reports that net income for a typical $100,000 loan, which requires the same amount of effort to originate, underwrite and manage as a loan for $1 million or more, ranges from $600 to a mere $150. Likewise, net income on a $20,000 consumer loan, even one that is underwritten to protect against losses, is approximately $1,200, making it only marginally profitable.

As a result, many banks avoid making these loans, or they do so unprofitably and inefficiently in order to serve their customers and markets. The opportunity for growth, however, is promising. Today, small business loans under $100K represent more than half of all business loans, although community financial institutions—those with fewer than $10B in assets—hold only 9% of them. The market for consumer loans under $30K is equally impressive at $1.4 trillion, although the majority of community bank customers hold them with non-bank lenders, credit cards and other funding alternatives. Capturing these consumer loans is even more important when you consider that they average $6,000 for every checking customer, which means if your bank has 20,000 checking accounts, your customers could potentially carry $120 million in loans for the segment.

There is also an opportunity for streamlining existing loan processes. In his new book, "Creating Strategic Value Through Financial Technology", Jay Wilson of Mercer Capital quotes William Easterlin, CEO of Queensborough National Bank: "I need something [technology] that is going to help me make the loans I'm already making, but far more efficiently." Easterlin understands the importance of automation and the efficiencies that digital lending technology can provide to help community and regional banks better serve their customers and do so profitably.

Digital lending technology, which financial institutions can license and own rather than partnering with a non-bank entity, allows your bank to originate, process and deliver small business and consumer loans for as little as $200 each, instead of thousands. The technology automates the entire loan process—from application and underwriting to monitoring and renewal—allowing customers to apply for a loan from your bank's website using a computer or smart device, 24-7. With the right digital lending technology, your customers get a loan offer in one minute and an approved loan in about five minutes, including fully completed, e-signed documentation.

The right technology can also be tailored to your brand, utilizes your underwriting criteria and keeps the loans as assets on your balance sheet. More importantly, the technology automatically manages all compliance, adverse action, renewals and loan monitoring without generating any paperwork or requiring loan officer involvement, unless desired.

In a recent Banking Exchange article, G. Michael Moebs, economist and CEO of the economic research firm Moebs Services reported that efficient institutions that use this technology "have seen what nonbank lenders are doing and adopted it—namely moving away from traditional underwriting methods to using decisioning software."

In addition to the efficiency and financial benefits that digital technology provides, Baker Hill reports that institutions that adopt new digital technologies also:

- Generate more revenue than those that do not. A study that tracked digital banking customers over a two-year period showed that monthly revenue per customer jumped by nearly 11-13% in customers who engaged in digital banking products.
- Double the average number of product holdings per customer (includes primarily loans, certificates of deposit, mortgages and credit cards).
- Experience lowered attrition, with 35% of digital customers more likely to remain with their bank than non-digital customers. Conversely, according to an MX Consumer Survey, 38% of consumers say they have reduced how often they bank somewhere due to a poor digital experience.

By adopting digital lending technology, community and regional banks can derive significant efficiencies in the way they deliver loans, drive revenue and, most importantly, provide the experience customers want.

Bob Shifflett is an accomplished banking industry veteran who has spent much of his career at the 500 financial industry organizations serving community banks, thrifts and credit unions with both in-house and outsourced software and service solutions. He assists banks and credit unions with compliance solutions, as well as services to increase income and consumer satisfaction, including digital lending and overdraft management strategies. Bob can be reached at (502) 581-1511 x252 or bshifflett@BSGfinancial.com.