

How Technology Is Transforming the Business of Commercial Lending

By Dan Welbaum

Using technology to achieve strategic business objectives.

With the years of experience required to master its arcane jargon and comprehend its unwieldy documents, the practice of commercial lending has sometimes been likened to alchemy. But the intelligent application of technology is at last beginning to transform commercial lending from a mystical art into an efficient science. This article reviews the state of today's business-lending market, discusses the impact of new technology trends on the lending process and describes a financial institution that is gaining efficiency and profitability benefits from its investment in new technology.

A New Business Climate

After years of minimal growth, we are now seeing a marked change in the commercial lending business climate. Expansion is the word of the day, and as usual, small to midlevel businesses are leading the way. Demand for capital is increasing, and banks are welcoming a return to a business-lending climate not seen in some time.

Eighty percent of banks expect to increase lending to midmarket businesses by at least 10 percent this year alone, according to a recent Mid-Market Lending Survey co-conducted by the American Bankers Association (ABA).¹ The study defines midmarket businesses as those that generate sales between \$5 million and \$75 million or that have credit limits between \$500,000 and \$15 million.

Even credit unions—which have traditionally focused on consumer lending—are jumping on the commercial lending bandwagon. According to Keith Leggett, senior economist for the ABA, in 2004 credit unions increased their commercial lending by 51 percent over 2003. Just 19 percent of credit unions currently offer business loans, and credit unions ac-

count for only one percent of the entire commercial loan market. So there is plenty of room for credit unions to expand into the commercial lending business; and industry analysts have expected them to do so even more aggressively in 2005.²

Research from the bank-consulting firm Omega Performance indicates that many lending institutions believe the greatest loan growth potential is in the small-business sector—primarily in commercial real estate, credit lines and term loans, which currently comprise about 90 percent of origination volume in the small-business market.³

Paul DiGiacomo, online banking manager at Coatesville Savings Bank in Coatesville, Pennsylvania, says his institution is living proof of the current growth trend in the small-business sector. With its 10 locations across rural southeastern Pennsylvania, Coatesville Savings has a strong banking presence among the Amish, and, according to DiGiacomo, even the fiscally conservative Amish are increasingly bullish about commercial loans.

"We've found a profitable niche in agricultural lending to the Amish," noted DiGiacomo. "They are very conservative, but they're very savvy businessmen and they're taking advantage of today's favorable rates to expand their businesses." He indicated that the bank is seeing a marked increase in the Amish business community's interest in borrowing.

"They need operating capital, and they're borrowing to buy commercial property and equipment to expand their operations," he said. "Our agricultural loans to the Amish are currently generating more than \$20 million worth of new business each month."

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Increased Efficiency = Improved Profitability

Industry experts agree that to fully benefit from the income opportunities available in today's increasingly favorable marketplace, commercial lenders must demonstrate the operational efficiency necessary to keep pace with customer demand.

"As evidenced by the information in our Mid-Market Lending Survey, businesses are now primed and ready to increase their lending activity," said James Cheesen, the ABA's chief economist. But he says that to take full advantage of the opportunity, banks "need to find efficient ways to serve their commercial customers' needs."

Unfortunately, commercial lending departments have generally lagged behind other banking units in adopting new technology.

In recent years, technology visionaries have been telling lenders that to make more profitable commercial loans, they must implement more efficient loan-origination and -processing tools. Industry technologists have urged lenders to create commercial lending departments in which entire work processes can flow seamlessly, with minimal need for manual intervention.

A recent commercial lending report from TowerGroup indicates that bankers who are willing to adopt a new attitude toward technology⁴ stand a better chance of restoring profitability to their commercial lending businesses. The report also suggests that banks can leverage new technology to enhance risk management and achieve strategic commercial lending objectives.

Managing risk and increasing growth are key industry issues in light of the worldwide economic recession that occurred earlier in this decade. Many lenders were left reeling as commercial loan demand dropped by as much as 20 percent and credit losses increased fourfold. And the road back from this low point has had some twists and turns.

"Commercial lending units at major wholesale banks are still struggling to regain [their] growth and profitability," said Lee Kidder, director of the Wholesale Banking practice at TowerGroup and author of the commercial lending report. He notes that "a large part of the problem [is because] the commercial loan process at many banks is still largely a manual

operation." Kidder believes that commercial lenders must now make a focused effort to trim redundancy and expense from their lending processes.

Profound Market Changes

The competitive makeup of the commercial lending industry has taken on an entirely new look in recent years. According to Rex Heimburger, a 25-year banking industry veteran and vice president with Fiserv Lending Solutions (a business unit of financial software and services provider Fiserv, Inc.), there has been a marked change in the competitive mix of commercial lenders.

"It's no longer one commercial bank versus another commercial bank—now you have to consider thrifts, credit unions, and so forth," Heimburger said. He also pointed to an evolution in branch structures, noting that "competitors can now come from outside the geographic region of a bank's customers. For example, a commercial loan may be booked in one location or state, while the loan collateral is held in multiple locations or states. Lenders need to be thinking about these kinds of issues when they're evaluating software solutions."

"In addition, the commercial lending market is highly diversified, with different types of lending being done all over the country," Heimburger continued. "The market varies by geographical location, local economy, local industry, and lender policy. So when commercial lenders are thinking about technology solutions, they should consider both flexibility and scalability to meet current and future market needs."

One of Heimburger's colleagues, Tom Cummings, is another Fiserv vice president who began his career on the lending side of the banking industry. In recent years, he has witnessed a major shift in how loans are negotiated. "Increasing competition has made the loan-negotiation process more difficult and complex for lenders," said Cummings. "Of course, the competition is great for borrowers, but it puts tremendous pressure on lenders who are still willing to take the risks."

In the past, sheer loan volume in a lightly competitive lending market has often masked the problems that result from inefficient origination, processing and document-generation technology. But according to Kidder, these problems are greatly magnified in today's hyper-competitive business arena.

“Intense competition,” said Kidder, “squeezes interest-rate margins—to say nothing of the rigorous new requirements for operational risk management and more transparent reporting. [So] it is not surprising that many commercial lending executives are looking for more robust and economical lending systems.”

This is particularly true for banks pressured to make commercial lending more viable. And today’s industry observers are challenging technology providers to do a better job of helping lenders become more efficient, push more commercial loans through their pipelines and generate bigger profits.

The Value of Integrated Efficiency

Banking consultant Steve Williams recently wrote, “Despite ongoing evolution, commercial loan technology still suffers from a heavy dose of fragmentation.”⁵

To make his point, Williams listed the wide variety of systems that many banks currently have in place for originating and processing commercial loans:

- A stand-alone customer relationship management (CRM) system or database for sales calls
- A series of documents for credit approval
- A stand-alone system for cash flow analysis
- A stand-alone system for loan document preparation (*not* interfaced to the bank’s core-processing system)
- A server- or host-based system for loan exceptions (documents, recordings, *etc.*) with potentially a separate system for loan-covenant and financial statement tracking
- An array of spreadsheets for portfolio reporting
- A series of forms and transmittal sheets used to move files between commercial loan officers and the back-office loan operations center

Williams openly campaigns for something better. He believes the next phase of commercial lending technology needs to be built around a business model that features integrated work flow—a technological shift that has greatly influenced mortgage lending in recent years. “While the mortgage-loan industry moves steadily ahead in [automation and integration], the commercial side of the bank still waits,” said Williams.

While he does take technology providers to task over the lack of workable solutions that are available to commercial lenders, Williams also believes that lenders must demonstrate a greater willingness to resolve their technological issues.

Catalysts for Change

While outlining technology’s potential benefits for commercial lending, Kidder stresses in his TowerGroup report that simply throwing technology at the problem is not a viable answer. Like Williams, Kidder notes that lessons learned from previous CRM initiatives should alert bankers that they cannot simply “install” new technology and wait for the rewards. “[It] requires a strategic commitment from executive management, organizational and process changes, [and] a new model of relationship banking,” he said.

In another TowerGroup report, Kidder singles out the pressure of risk management as perhaps the most compelling of all the forces presently acting on commercial lenders to trigger a range of strategic technology initiatives.⁶

“Commercial lending will inevitably move to adopt a fully integrated ... technology model,” he said. “What’s holding back that move now isn’t a lack of available technology—it’s the traditional business culture of commercial lending. The irresistible force that will make the breakthrough possible is the strategic necessity for banks to minimize the risks associated with their loan assets.”

Pulling It All Together

Heimbürger concurs with Kidder’s assessment. “For many commercial lenders, the process of pulling credit, decision making, generating documents, and performing the qualification to underwrite the loan is still highly fragmented. What’s really needed is a consistent, single access point for all information—so it needs to be entered only once.”

Instead, information about a particular commercial loan customer is too often simply jotted down on scraps of paper and then routed to several personnel for executing the various risk-management tasks, such as credit checking and financial analysis. This usually means the same information is entered into computer systems multiple times from multiple locations in the bank.

“Ideally, you want a technology solution that enables you to enter and retrieve information from a single location,” Heimburger noted. “From there, everything can automatically flow to wherever it’s needed. The loan origination solution should serve as the official launch platform from which every task needed to perfect the loan is executed.”

This is especially important for the efficient management of loan documents. “With increasing lender consolidation and portfolio purchases, documents are not always consistent,” said Bruce Bates, vice president of Zions Bancorporation. “Even seemingly standard provisions are sometimes missing. It doesn’t matter how much a lender may hope for a particular right or treatment—if it’s not in the document, the right doesn’t exist.”

Stand-alone, 50-state-compliant document preparation solutions are already in use. “However, in many cases they’re not tied to the loan origination solution or the core-bank processing system, which means that loan information must be manually entered into a bank’s systems more than once—perhaps several times,” said Cummings.

Technology Helps Achieve Business Objectives

The ABA Mid-Market Lending Survey Report indicates that commercial lenders are beginning to improve their efficiency. “With more than 80 percent of survey respondents demanding greater automation in their front-office operations and planning integration initiatives over the next two years, the study validates what we’ve already been seeing at our commercial lending clients,” said Mike Pennell, vice president, product and marketing, at Capital-Stream, the software and consulting services firm that helped co-author the Mid-Market Lending Survey.

“Leading banks are now investing in technology and process improvements to drive business growth and profitability through more efficient, consistent, and integrated front-office operations,” Pennell stated.

The ABA survey report also indicates that such technology initiatives can help lenders achieve their business objectives. For example, the ABA found that integrated systems used to prepare loan documents can decrease data entry effort by 32 percent. And

automated processing can improve the turnaround time for approving credit and issuing final documents by as much as 72 percent.

What Lenders Should Look for

Technology providers are responding to the needs of commercial lenders. As a result, a new crop of innovative software solutions is now available to lenders who are interested in boosting efficiency and productivity.

According to Heimburger, lenders who are shopping for new loan origination software (LOS) should take the time to thoroughly evaluate every potential solution. “Ask a lot of questions,” he said. “For example, how flexible is the solution? Does the software enable you to access loan files from a variety of perspectives? If not, your productivity can suffer.” Heimburger identified at least five “points” in the functionality of a modern LOS through which lenders should be able to gain direct access to their loan files:

- Borrower structure
- Collateral structure
- Borrower or collateral location
- Repayment method
- Loan type

In addition to improved flexibility, Heimburger says lenders should look for a solution that automates the notoriously labor-intensive document creation process—a huge slowdown for many commercial lenders.

“If lenders are using older technology—or perhaps even processing loans manually—they’re forced to become extremely familiar with every applicable rule, regulation, and document,” Heimburger said. “And not only at the federal level, but for every state in which the lender does business—otherwise the loan may not be correctly perfected. For most lenders, this is far too time- and cost-prohibitive. So they should look for software that can automatically determine *and* generate all the documents that are needed for every loan—regardless of complexity.”

Heimburger also noted that all the loan documents generated by a modern LOS should be fully warranted for compliance. “As regulations change, the software should automatically update the documents to reflect those changes,” he said. “This removes a big burden from the lender’s compliance office by

placing the responsibility for document updates and regulatory compliance squarely on the LOS.”

“For example, you may be a Kansas-based lender who wants to make a commercial loan in Iowa,” postulated Heimburger. “With today’s new software solutions, you should no longer be forced to make complex decisions about whether or not the loan makes sense from a risk perspective. Nor should you need to worry about having to secure the resources required to generate the documents that are needed to perfect the loan. Also, the LOS should free the lender from the burdensome responsibility of researching and determining the myriad of state and federal regulations that apply to every individual loan.”

Heimburger further said that lenders should make sure their new software solution addresses several key functionality issues that have plagued software designers in the past. “Avoid a software system that forces you to enter the same borrower data multiple times—that lack of integration only slows down the lending process,” he said. “Also, you should look for an LOS that can effectively track loan and document status throughout the entire lending process. You don’t want to be digging through files manually and calling staff members for updates.”

Cummings stresses that lenders who are software shopping should pay attention to another traditional challenge in commercial-lending software: ease of use. “If you have a software package that’s hard to learn and use, it will be difficult for lending staff to become productive—much less proficient,” he noted. “The commercial-lending process is difficult enough without the lender’s origination software being hard to use.”

The Benefits of Integrated Technology

Coatesville Savings Bank, a Pennsylvania state-chartered thrift with \$255 million in assets, has integrated its business lending systems using the Fiserv *easyLENDER* Consumer/Commercial *iDM* software system.

“With the help of this software, we’ve been able to pursue new business-lending opportunities,” said Coatesville’s DiGiacomo. “We installed a new loan origination system because we wanted to satisfy a greater range of loan needs in our market—which

will help us to both add new customers and better retain our existing ones.”

Since the new solution was implemented in late 2004, DiGiacomo said the bank has already realized notable cost savings. Bank loan officers can now get all necessary loan documents delivered automatically, right at their fingertips. DiGiacomo says that document changes are quick and easy with the new software. “Previously,” he noted, “we had to wait until our staff forms checker got the change, made the change, and then sent the document back to us for approval. We’d return the form and then wait until the final documents were ready. Now, we can make document changes as we go—which saves us both time and money.”

The new software has also enabled Coatesville Savings to add a new business line to its commercial lending department. “Without having to add additional resources, we’ve gained the capability to offer agricultural loans,” said DiGiacomo. “After just six months, we’re generating more than \$20 million per month in new loan business.”

According to DiGiacomo, the bank has now developed a fully integrated lending process. “When we were looking for a new LOS, we wanted improved efficiency,” he said. “We needed the ability to take a loan application with customer information coming directly from our core banking system. We wanted to be able to just hit a button to complete the application; instead of printing out a piece of paper and going to another terminal to upload the information into our core system.”

“With the volume of loans we process, it’s imperative that we save as much time as possible,” he continued. “With our LOS now tightly integrated into our core-processing system, we’re saving more than 40 minutes per loan in data-entry time—which allows us to more effectively allocate our resources.”

With the capability to process loans more quickly and efficiently, Coatesville Savings can now generate more commercial loan business. “We no longer waste time and energy sifting through files trying to determine what’s needed, pulling all the documents together and filling them out one by one,” said DiGiacomo. “Now it’s a one-time data-entry function—just push a few keys and Poof! It’s done.”

What Lies Ahead

Despite recent advances in loan-origination software technology, there is still work to do before commercial lenders can truly reach the totally automated process championed by observers such as Kidder and Williams.

For example, given the competitive nature of today's commercial lending marketplace, there is a need for more advanced tools to aid the credit-decision process. Some technology providers are producing software solutions to provide small-business credit scoring and make the risk-management process faster and easier. Fiserv's Cummings noted the value such systems can provide: "They can help lenders speed the loan process along and make it safer and more cost-effective to market business loans."

Cummings also points toward ongoing advancements in Internet-based lending for small- to medium-sized business loans. "We're seeing more interest in moving to Internet-based originations for commercial loans in the \$250,000 to \$500,000 range," he said.

Effective Technology = Good Business

Many commercial lenders are realizing how important effective technology can be to the achievement of their strategic business objectives. Going forward, this realization will generate a sea change in the methods

lenders have traditionally used to control costs, gather information, process loans and manage risk.

In this efficient, streamlined, fully automated environment, the origination process for business loans is now becoming less of a mystical art and more of a profitable science.

Endnotes

- ¹ Mid-Market Lending Survey Report, co-sponsored by American Bankers Association and CapitalStream, August 25, 2004.
- ² Lee Conrad, *CUs Aim to Knock Out Banks' Commercial Loan Portfolios*, USBANKER, July 1, 2005.
- ³ Joe Sparacino, *Finding Big Business in Serving the Small Business Market*, COMMUNITY BANKER, Jan. 2005.
- ⁴ TowerGroup Examines the Value of STP-Driven Technology and Process Change for Wholesale Banks' Commercial Lending Units (released via PR NEWSWIRE, July 19, 2004). Also, Lee A. Kidder, *Straight-Through Processing in Commercial Lending: A Solution Waiting for Awareness of the Problem*, COMMERCIAL LENDING REVIEW, Nov. 2004, at 11.
- ⁵ Steve Williams, *Commercial Loan Automation—Please!* GONZO-BANKER, Mar. 4, 2005.
- ⁶ TowerGroup Examines How the Rising Star of Risk Management Will Help the Financial Services Industry Overcome Deep-Rooted Obstacles to More Effectively Leverage Technology (released via PR NEWSWIRE, Aug. 20, 2003).
- ⁷ Bruce Bates, *The Four Seasons of Loan Documentation*, COMMUNITY BANKER, Mar. 2005.

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