

Climbing back

Lessons learned from the financial industry **Interviewed by Matt McClellan**

One of the consequences of the financial meltdown is that business owners can expect a more hands-on approach from their bank.

“The lenders are going back to how banking has been since the beginning of time,” says Kenneth M. Haffey, CPA, CVA, partner with Skoda Minotti. “They want to be more closely aligned, understand what their customers are doing even better, see how they are running their businesses and determine how they can help them at different times with their lending needs.”

The days of a lending institution making a loan based strictly on if its calculated ratios predict that a business will be able to pay the loan back are long gone. Entering numbers in a spreadsheet is a poor substitute for asking in-depth questions to their customers.

Smart Business spoke with Haffey about how banks are becoming more of a financial partner than just a lending institution.

What types of challenges does the finance industry face today?

One of the challenges is working in this interest rate environment. In my life, I never thought I would see 4.5 percent 30-year mortgages or treasury rates down in the very low single digits. That puts pressure on financial institutions because they work off margins. Lending out money at this rate and bringing in money at that rate — that differential provides the margin.

They have some fee income that will hopefully cover some of the operating expenses, but the margins have been squeezed because they can only go so low on deposit and loan rates. When people are getting 0.4 percent for a one-year certificate of deposit — it’s almost not worth the gas driving to the bank to make the deposit.

The next challenge is credit quality and the credit market. Many companies are struggling to make their loan payments. With so many organizations having trouble paying their loans, the banks have been forced to tighten down on credit and loan covenants. Tighter loan covenants make it more difficult for organizations to make money in the traditional ways.

What must financial institutions do to adapt and succeed today?

You, people you know, people you work with, successful businesses, etc., have



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been paying their loans down all through these tough economic times. We hear that loan delinquencies are up, but there are still lots and lots of people paying down their loans. So now banks are sitting on larger mounds of cash than they’ve had for some time. They are trying to invest that cash in U.S. treasuries, which are safe investments earning one percent or so.

Next, they are being told by the regulators to lend out more money. Their ratios are out of whack. They have lots of liquid assets, short-term investments on their balance sheet that otherwise in a normal situation would be money lent out to customers. For financial institutions to start improving their margins, they need to do more lending.

What needs to happen next?

Lending needs to pick up some steam. We’re starting to see, hear and feel that now. I was in two separate meetings with two local bank presidents in Cleveland this week and both told me that they have been loosening the purse straps a bit and have been funding more loans over the last two to three months. That will start improving their margins first and foremost, getting them back to more profitability. The regulators will feel better about that.

Hopefully the underwriting they are do-

ing is sound so these loans won’t end up on a watch list. But there are fewer companies found creditworthy than there were a few years ago, so the banks are working harder to make sure the companies to which they’re making loans will be able to repay the loan. It is starting to happen.

On an investing end, that should improve interest rates for depositors to make people more interested in depositing money and committing it for some time period. That allows the asset liability matching that banks do to stabilize themselves.

What lessons can other industries learn from the challenges of the finance industry?

Be innovative but don’t go into things blindly. It didn’t make sense to me or to a lot of people when we received pieces of mail stating you could have a 1.2 percent mortgage for a period of 18 months and then it will reset. Many smart people and organizations went along with that just because it was available, like lemmings jumping off a cliff. Many bankers moved in the same direction offering these loans. It was very visible because lots of people touch banks.

Other industries can learn that if looks, smells and walks like a duck, it generally is a duck. Does having a duck make sense for your organization?

Don’t just do something because others in your industry are doing it. Some very well run financial institutions got into this lending. The notion was that there will always be value in real estate. Then if someone has a problem, they’ll sell off the real estate and that’s that.

Well, banks are in the business of lending money, not owning and selling real estate. If there is a lesson to be learned here, it’s to truly make sure that industry trends aren’t something to blindly or hurriedly jump into because your neighbors in your industry are doing it and you want to keep up with the Joneses. <<

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