The reckless Business Banker

Assume, for instance, that a business banker concludes that it would be easier to forgo business development calls, credit investigations, and all the other steps of the commercial lending process. Instead, the reckless banker decides to extend credit to any commercial customer who signs an IOU promising to repay the loan principal, plus interest, by a specified date.

With this new lending policy, the business banker is remarkably successful as a disburser of money. Without the time and paperwork constraints imposed by a formal lending process, the lender is able to process dozens of loan closings in the course of a day. And there is certainly no shortage of willing borrowers. <u>The reckless lender will be able to charge higher-than-market interest rates due to the speed of the loan decision process and the easy credit terms granted to the borrower.</u> Measured by the number of loans made, the amount of credit extended, and the profitable interest rates charged this business banker stands above all peers.

However, when the maturity date for the first loans pass and only a trickle of borrowed money comes in, the business banker grows concerned. A few days later, the lender telephones a delinquent borrower, the owner of a restaurant, and discovers the loan was used to buy a couple of new four-wheel drive vehicles primarily used for personal, not business, purposes. Furthermore, the borrower phones to say "I can't come up with the money right now—maybe in a few weeks when business picks up." Hanging up the phone, the reckless business banker says, "How can any business owner use a loan to purchase assets that do not produce revenue for the company? I thought the borrower would use the money to add a few more booths and remodel the restaurant. The next time a customer comes in looking for a loan, I'll ask exactly what the loan purpose is."

With a sinking feeling that the loan to the restaurant owner might end up being a partial or total write- off, the business banker decides to call on a couple of other borrowers who have defaulted on their promissory notes. The first visit takes the lender to a retailer of children's clothing. To the business banker's dismay, the store is packed to the ceiling with inventory, but not a customer is in sight. On approaching the owner, the lender learns that the loan was used to meet the payroll. "It was either that or lay off some of my employees, and I couldn't bear to do that," remarked the owner. The business banker requests and receives the clothier's most recent financial records, which reveal that 75 percent of the store's assets are in obsolete inventory, and only 5 percent are in current inventory. "I wish I had done a financial analysis of that business to determine the repayment source," thinks the business banker walking out the door.

The reckless business banker's next destination is a wholesale candy company that failed to repay a short-term obligation. While pulling in to the candy company's parking lot, the business banker notices it is deserted except for two workers loading boxes onto a truck. When the business banker inquires whether the workers are employees of the candy company, one of them laughs and says, "I hope not! No, we work for a supplier. The owner of this company stopped paying his bills several months ago, so our boss told us to come and get our candy. We're picking up the last of it now."

As the business banker returns to the bank, there is a sinking feeling for failing to do a credit investigation before making the loan. Back in the office, there is a memo on the desk directing the business banker to attend a meeting later in the day. The subject—"More than 90 percent of your loans are in default and the loan review committee wants to know why."