At which point should banks divide between sales and back office in the SME credit business?

DUE TO A RELEASE OF THE SALES DEPARTMENT FROM CREDIT-HANDLING, BANKS COULD REDUCE THE DURATION TO CREDIT-PAY-OUT AND OPEN CROSS-SELLING OPPORTUNITIES.

DIPL.-KFM. FELIX SCHWARZE
PROF. DR. MARK WAHRENBURG
JUN.-PROF. DR. ANDREAS HACKETHAL

Problem definition

Since July 2004 German banks have to comply with the “Minimum requirements for the credit business of credit institutions” [BaFin 2002]. Banks are required to cast two independent votes for a credit decision: One vote of the sales department, and a second vote of the back office. But there are no regulations organizing the tasks around a credit proposal, like creating the credit file, data input, and composing the credit claim decision.

As part of a wider research project on the optimal organization of SME credit processes (see former article of the EFL quarterly for a description) and in light of the new legal requirements we examined ways of how banks can accelerate the cycle time from application to pay-out. Although cycle time is traditionally viewed to be more crucial for consumer credit, it is also growing in importance as a differentiating factor in the markets for loans to small and medium sized enterprises (SME) [see for example Deutsche Bank 2004].

Duration from request to pay-out

115 of the largest 500 German banks answered that the average number of days that elapse between an application for a loan and the pay-out of the loan amount is 10.8 days (figure 1). For 15% of the banks the average cycle time even exceeds 15 days.

The results show that the duration is longer for smaller banks (significant Pearson’s correlation between cycle time and total assets: -0.233, p<0.05). There are two reasons that might explain this phenomenon:

Firstly, bigger banks can realize scale-effects. Therefore, they can handle credit proposals more efficiently.

Secondly, the same loan is relatively bigger for banks with a smaller asset base, leading to relatively larger amounts of equity to back a given loan. As a consequence more loans will require the involvement of the top management or the credit committee in the approval process. An extended cycle time might therefore also be the consequence of the fact that these decision bodies do not meet every day.

Allocation of activities

To find further determinants for the cycle time besides bank size we examined the division of labor between the sales department and the back office. As part of our questionnaire we collected data on the time allocation of customer representatives. Ideally, customer reps spend most of their time advising their clients and selling financial services [Hölzer 2004].
Indeed, related research shows that clients highly appreciate trustworthy advise and are willing to accept slightly higher interest rates in turn [ASU 2003].

Our findings stand in stark contrast to this ideal world. On average, customer representatives spend less than half of their working day in direct contact with their SME clients. They spend the rest of their day with administrative tasks like handling of credit proposals, monitoring of credits, services for their clients (e.g. payments), and with their own education.

A detailed examination of the sales activities shows that the majority of the customer representatives have to advise apart from loans, on investment products (in 84.3% of the banks in the sample), payment products (73.6%), and others (76.9%).

On the other hand, SME credit advisors must handle credit proposals as well. In the majority of the questioned banks they are involved with requesting necessary documents (in 80.5% of the banks in the sample), drawing up the handover certificate (64.5%), and

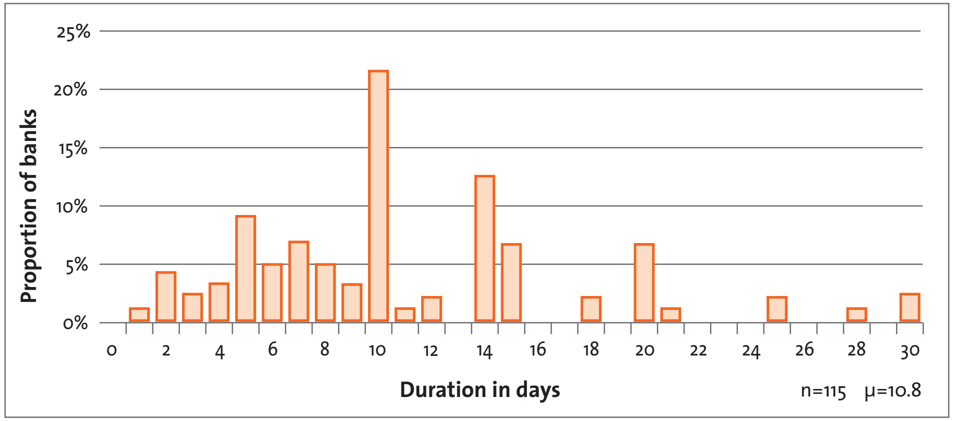

Figure 1: Average duration in days of handling from the application for a loan to pay-out.

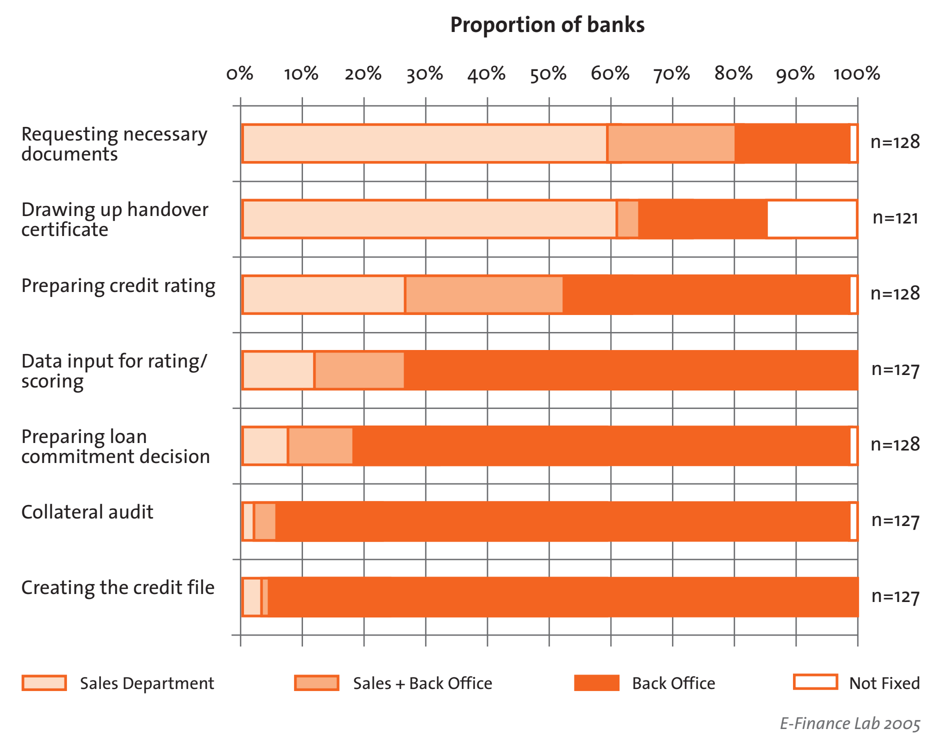

Figure 2: Allocation of credit-handling to sales department and back office

preparing the credit rating (53.1%) – see figure 2. According to these results bank representatives of SME clients are exposed to tension between the actual sales process of different products and an extensive administration of credit proposals.

Reducing the duration to pay-out

To analyze the connection between the duration to pay-out and the allocation of administration-activities we compare the means of allocation to sales department and back office (figure 3).

The analysis shows that for all mentioned activities apart from collateral audit the duration from credit request to pay-off is shorter if the sales department is not involved and the activity is handled by the back office. The differences of the means are statistically significant for data input and requesting the necessary documents by the back office.

Conclusion

The bank representatives of SME clients have to be experts in a variety of different financial products. Further, a closer cooperation and interaction in handling the credit proposals is required. The results of the "Credit Process Study" show that banks which released the sales department from handling activities have shorter durations from credit request to the actual pay-out. Consequently, banks should allocate pure administrative activities to the back office. This would enable the customer representatives to spend more time with their clients, to provide more targeted services, and to open up new sales opportunities in cross-selling.

References

ASU (Arbeitsgemeinschaft selbständiger Unternehmer e.V.) (2003): Auswertung der ASU-Umfrage zur Mittelstandsfinanzierung durch Banken, *http://www.asu.de/www/doc/67f098b0f09ef0f126d271764cf270fc.pdf*

BaFin (2002):
Minimum requirements for the credit business of credit institutions, circular letter 34/2002, 20.12.2002, Bonn.

Deutsche Bank (2004):
Deutsche Bank strengthens its business in Germany with a clear focus on customers and growth, Press Release, 01. November 2004, Frankfurt.

Hölzer, K. (2004):
Rethinking the Credit Process – neue Wege bei der Kreditprozessgestaltung (I),
in: Die Bank, 04/2004, S. 234-238.

More information about the "Credit Process Study": *www.efinancelab.com/kreditprozess.*

	Time in days, when the activity is done by...	
Activity	**...sales department**	**...back office**
Requesting necessary documents	11.3	9.2*
Drawing up handover certificate	10.9	9.8
Preparing credit rating	10.9	10.8
Data input for rating/scoring	12.8*	10.4*
Preparing loan commitment decision	12.6	10.7
Collateral audit	8.3	10.8
Creating the credit file	12.7	10.8

The difference of the means from involved/not involved is
* statistically significant (p<0.05)

Figure 3: Average duration at given allocation of the activities

efinance lab