



Remaining in Risk Position – A Focus on Credit Relationship Management

Bobbie Martin, Senior Consultant, Micro/Small Business Program
Joe Hagan, Senior Vice President, TNS Multi-client Programs

October, 2010

There is little question that the current state of the economy has had an immobilizing effect on small business lending both from risk-adverse financial institutions and debt-wary businesses. Despite some let-up in the credit market, lending remains in a heightened risk position. Small businesses are seeking credit not only to pursue expansion opportunities but to maintain cash flow and, often times, for basic survival. Unlike large corporations that may have better access to funding or federal bailout money, small businesses are labeled a risk if they cannot demonstrate adequate cash flow, secure operating histories or establish a solid asset base.

The economy is widely expected to continue making progress, albeit at a slow pace and possibly with a few setbacks. As this year unfolds, more financial providers show signs of renewed focus in developing better small business lending solutions. And to help set the stage, the government is issuing a \$30B government fund that will support new lending from community and other banks. To win share in this still restricted market, providers will need to evaluate how they can grow "relationships".

Managing credit relationships across the small businesses' entire spectrum of needs requires specialized solutions that add value at critical points in the business' financial life cycle. More than ever, credit relationships need case-by-case evaluation, supported by current creditworthiness and long-term ROI. Risk-adjusted pricing is vital in today's credit environment as is the flexibility to set optimal pricing based on risk level, regional influences and segment group.



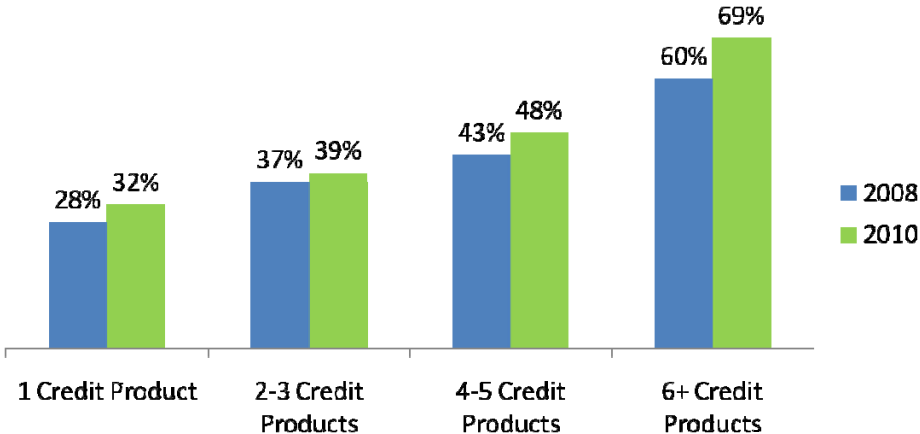
Cash Flow Remains Top Concern Among Small Businesses

Lingering effects from the depressed economic climate have intensified cash flow issues, with one in four businesses indicating distress. At the peak of the financial crisis, with credit lines and access to credit drastically reduced, credit line utilization increased. At the same time, collateral values decreased. Without adequate cash flow to pay down debt, some businesses were left with more debt than

anticipated. Slow spending growth across all industries has also hindered revenue growth, which in turn, has contributed to the inability to get credit.

The days of easy credit are over. There is no doubt that borrowers have become riskier for providers. Potential borrowers are often businesses that do not have the cash flow to maintain current business productivity or inventories. The greater the number of credit products owned and/or missed payments incurred, the more likely the business is to be worried over cash flow. Seven in ten businesses with 6+ credit products consider cash flow as their biggest issue – a 15% increase since 2008; and 74% of businesses with 6+ missed payments do so – an 8% increase.

Managing Cash Flow a Big Concern:



The majority of businesses have taken steps to trim down their debt and improve cash flow over the past two years and have successfully reduced their outstanding credit balances over the same period. However, businesses with 6+ credit products or with 6+ delinquent credit payments have racked up huge increases in their outstanding balances – 65% to double, respectively, since 2008. These two latter groups of businesses are most concerned about their cash flow and claim it has not been easy to get new credit.

Interestingly, slightly more than one-fifth of businesses that have only one credit product and no delinquencies also express that it has been difficult to obtain credit. This subset of businesses are more likely to have substantially greater cash flow issues, economic concerns and outstanding balances than their segment counterparts that claim few setbacks in acquiring credit. They are also more apt to have sales revenue between \$50K and \$250K.

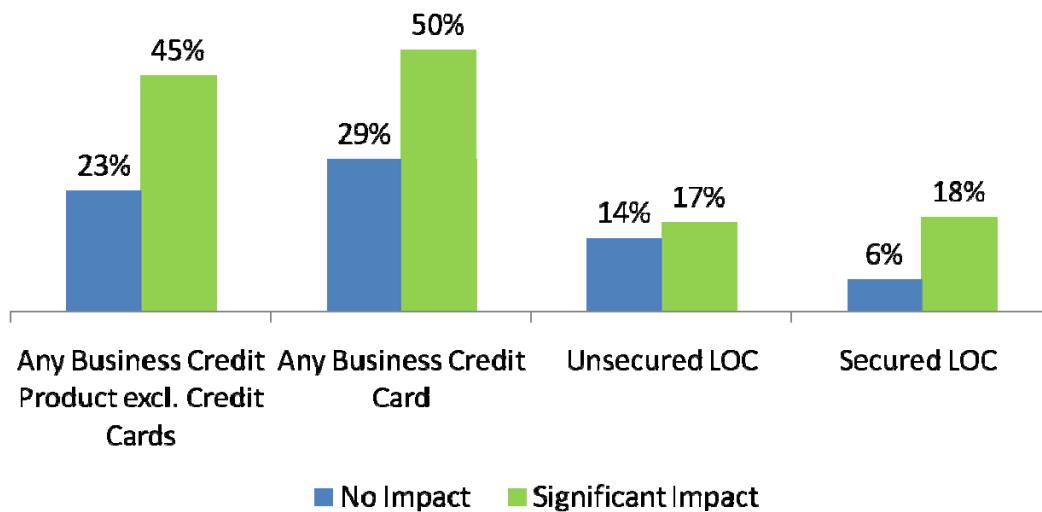
Economic Impact on Financial Decisions:

Only a few short years ago, financial services providers operated in a less restrictive environment to meet their customer borrowing requirements. Opportunities existed across most risk tiers and within

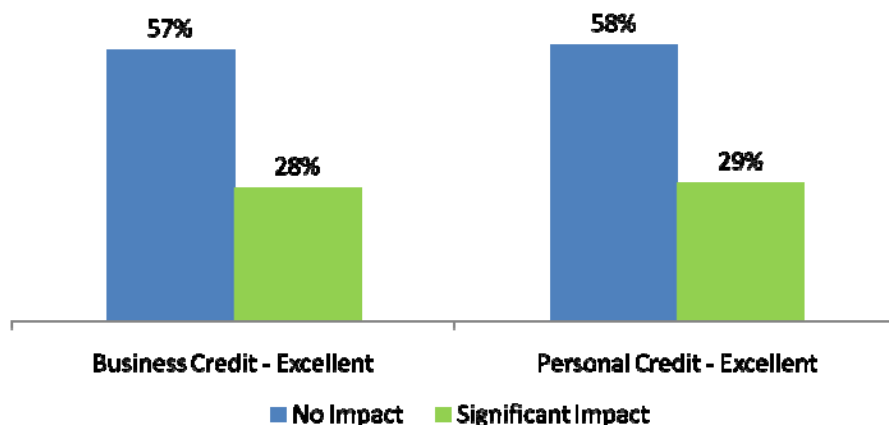
every market. Today, the models used for credit approval are reflective of a constrained economic environment.

Small businesses are reacting differently to the economic mayhem depending on their cash flow concerns and funding prospects. Small business borrowers, particularly those using secured LOCs or business cards, are more likely to indicate the economy will have a significant impact on their financial decisions than non-borrowers. These customers are likely to have current cash flow issues and are looking for new funding for maintenance, inventory and expansion.

Credit Product Production:

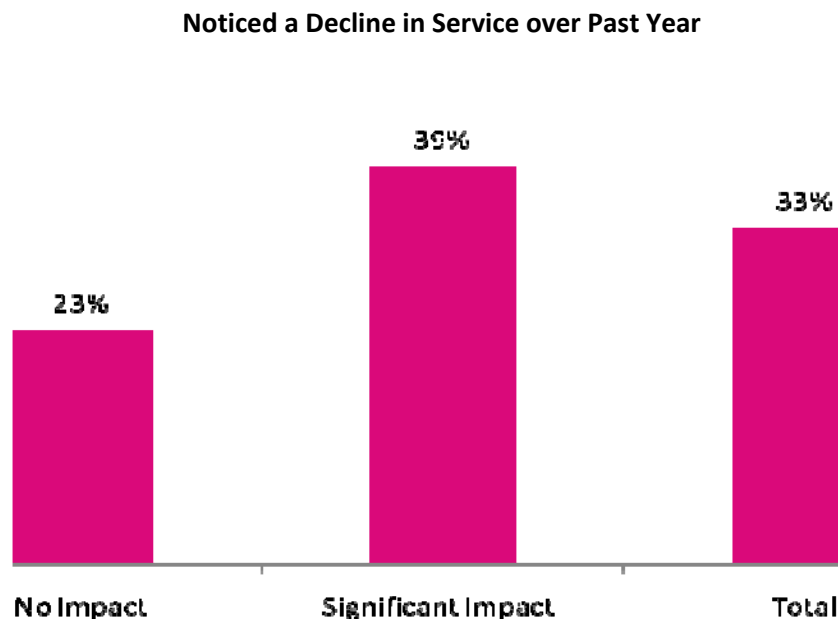


Businesses that perceive a significant economic impact on their financial decisions are under no illusions that their provider will rate their credit as "excellent". One-third of this group has missed credit card and loan payments in the last 2 years and one-fourth have overdrawn their checking in the past year.



Retention More Important than Ever During Poor Economic Conditions

At a time when businesses are concerned with containing costs and reducing debt, there is an increased need for providers to place emphasis on customer retention. Businesses that are most at risk of defecting are also the most likely to perceive a significant impact on their financial decisions as a result of economic concerns. To make matters worse, four of ten of these businesses indicate that their level of personal service has declined.



Stepping up the focus on customer loyalty during poor economic times can help withstand the retention and commitment fluctuations in the economic cycle.

Focusing on risk-adjusted profitability of different business segments is fundamental to retaining and growing credit share in this new era. Much of the trend to use more complex credit determination methods is fueled by the economic slowdown and past repercussions from less restrictive lending. Accurately segmenting small businesses for the appropriate lending solutions will be paramount to ensuring high credit quality and managing credit relationships.

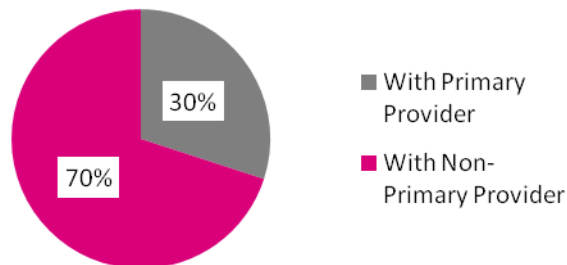
Competitively, providers will need to have strong retention and cross-sell strategies to capture and retain a portion of the shrunken and sought after pool of credit dollars. Providers will need to look beyond the credit relationship and embrace the total relationship. Although fewer small businesses use personal credit or personal credit cards for financing, many have personal relationships built on the deposit side. Targeting businesses with deposit-only relationships can facilitate the building of a credit relationship.

With slow growth in new credit and lower overall credit volume, competition for credit share is heating up. Secondary, tertiary and other non-primary providers are proving strong credit competitors for banks. Because they have had to shop around for credit, businesses are more likely to use multiple providers. With diminished credit dollars, providers will need to focus on cultivating and expanding relationships with existing customers by cross-selling and bundling products across different credit tiers. Overall, non-primary banks maintain strong share-of-wallet for outstanding credit balances. Small businesses are likely to have a majority of their total credit dollars with a secondary or tertiary provider or other non-primary provider (70%).

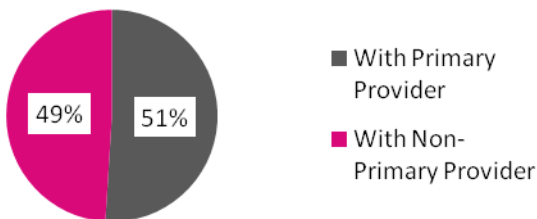
Businesses whose financial decisions are most affected by economic concerns are likely to have borrowed across multiple providers or with non-primary providers. These businesses tend to be price shoppers and are motivated to switch for credit discounts and lower credit rates. The proportion of their total credit dollars with non-primary providers is 63% compared with 49% among businesses that see no economic impact. Businesses that are less impacted by the economy have higher retention for a number of measurements.

Credit Loyalty by Economic Impact on Financial Decisions:

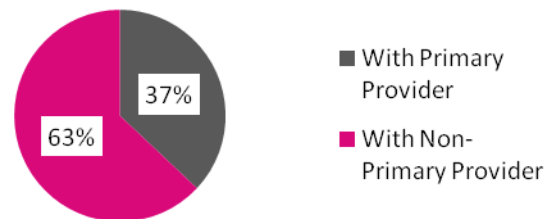
**Percent of Total Credit Outstandings
(excl. CC) with Primary and Non-
Primary Provider**



**By Economic Impact on Financial
Decisions - No Impact**



**By Economic Impact on Financial
Decisions - Significant Impact**



Looking toward the future

In today's environment, small business lenders are looking at new approaches to extend credit to their long time customers, particularly those with temporary and immediate financial strain. At the same time, many small businesses are reevaluating debt and modifying their credit behavior.

The good news is that financial services providers are showing signs of renewed interest in lending and tentatively stretching their arms out to potential borrowers. The response has been hampered by several situations – finding borrowers that qualify and a low demand for new credit as small businesses wrestle with taking on more debt.

Because of the slow growth in new credit and lower overall credit volume, competition for credit share is stronger than in past years. To remain competitive in marketing to a smaller pool of customers, providers will need to use special measurements for adjusting risk-based pricing within local and regional markets. Branch relationship managers remain good contacts for marketing credit products.



Going forward and amid stronger competition, relationships with credit customers will require a more direct focus on cultivating existing customers and developing multi-product, multi-faceted credit relationships. Increasing the focus on customer relationships during less than stellar economic times ensures that providers can balance lending standards with case-by-case customer needs.

About this study:

The information provided herein is an extract from TNS' 2010 Micro and Small Business Study. The study includes a series of in-depth reports and analyses. The results are based on data collected in an online survey of more than 4,800 small businesses in the U.S. with sales revenue up to \$10MM. The study was conducted from May 2010 to June 2010.

Study respondents include small business owners and business executives responsible for the financial decisions of the company. The study examines the full scope of business preferences, needs and behavior for business and personal products and channels across all the major financial providers. Specific coverage of relationship development, marketing tools, financial objectives and economic perceptions also lend to the value of the study.

Contact Information

Bobbie Martin
+1 512 258 2143

bobbie.martin@tnsglobal.com
Joe Hagan

+1 615 758 8570

joe.hagan@tnsglobal.com

About TNS

TNS, which recently merged with Research International, is the world's largest custom research agency delivering actionable insights and research-based business advice to its clients so they can make more effective business decisions. TNS offers comprehensive industry knowledge within the Consumer, Technology, Finance, Automotive and Political & Social sectors, supported by a unique product offering that stretches across the entire range of marketing and business issues, specializing in product development & innovation, brand & communication, stakeholder management, retail & shopper, and qualitative research. Delivering best-in-class service across more than 70 countries, TNS is part of Kantar, the world's largest research, insight and consultancy network. Please visit <http://www.tns-us.com> for more information.