

Money Guy



TRIED TO GET A BANK LOAN LATELY?

by Harold Montgomery

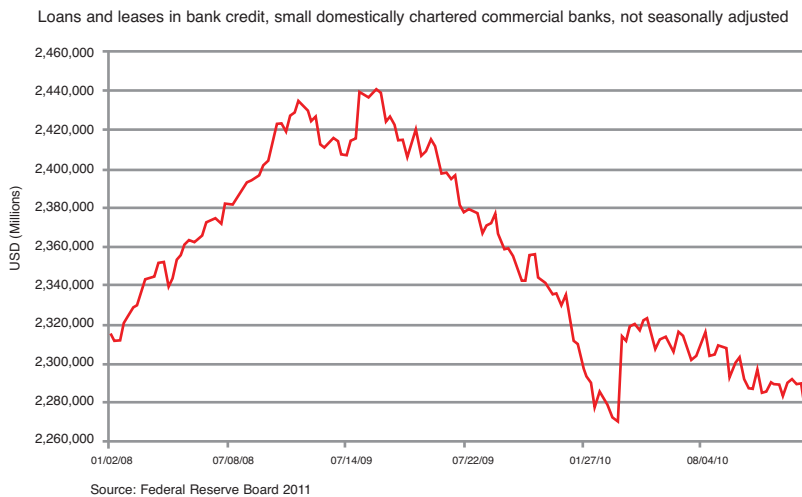


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Don't feel alone if you didn't get one, you're in good company. Most small businesses in the U.S. didn't get bank credit in 2010, and 2011 isn't starting off great either. Despite what you might have been hearing about how much liquidity banks have these days (and they do) lending isn't yet coming back to anywhere near pre-crisis levels. In fact, the dollar amount of total net loans outstanding at small banks seems to be declining. The Federal Reserve Bank tracks lending activity in smaller banks and over the last year, the totals are down. Community banks and credit

unions are the primary resources for small businesses when it comes to financing expansion, inventory and other loans that make the economy grow. Unfortunately, the data show that banks have been running off their loan books for the last year. On the following page is a Federal Reserve Bank chart showing the outstanding loan balance at small U.S. financial institutions between January 2008 and January 2011.

The trend line on this one is pretty clear—total loans outstanding rose aggressively during 2008 – up more than \$120 billion. But, from January 2009 to



January 2011, loan balances fell over \$160 billion. If the average loan amount were, say, \$250,000, then that would mean 640,000 loans to small businesses were taken out of the system. That's 640,000 small businesses that didn't have expansion capital, and couldn't hire anyone, buy more inventory or spend or invest that money productively. If each one had hired just two people on average, the unemployment rate would drop about 1%. To be fair, not all of those businesses needed the loans and couldn't use them productively. Many of them saw serious slow downs in demand and didn't need the money. However, now, GDP is growing again, and now is when small businesses need capital to meet increasing demand. This decline in bank lending is now working against a recovery.

There are good reasons the banks won't or can't lend right now. One is asset valuations. One of the key causes of the financial melt-down in 2008 and 2009 was uncertainty about asset valuations and collateral values. Banks love to lend against a hard asset like a car that, in the worst case, they know they can seize and sell. But if the value of that car is uncertain or falling, the system doesn't work. This happened in 2008 thanks to a relatively new accounting rule called Financial Accounting Standards Board Ruling #157 (FAS 157 for short).

FAS 157 called for businesses, includ-

ing banks, to adjust the value of assets on their books at the prices which similar assets fetched in the most recent sales or trades for that asset. So, when a bank like Lehman Brothers started to have liquidity problems, management sold some assets at fire sale prices to get cash fast. That caused owners of like assets to write their asset values down accordingly to new, lower levels. That write-down caused those companies to have credit problems forcing them to raise cash and sell assets at fire sale prices. Those sales caused others to have credit problems, sell assets cheap and... well, you get the idea – it's a self-reinforcing negative valuation spiral. One bank's bad news all of a sudden became every bank's bad news. The Fed had to step in and buy some of the assets that were in free fall so banks and others could mark a stable value and stop the spiral. Hence the TARP and other similar programs from the government.

None of this is really good news for small business. As you can see from the Fed chart above, loan volume is continuing to drop as we start 2011. The trend lines and news out of banking both suggest that the situation won't change for the better for some time to come – at least 2011. Where do small businesses go to get credit they need to grow?

My company faced this issue throughout 2009 and 2010. We're in the business of acquiring merchant residual streams

from ISOs – something we have been doing successfully for almost ten years. But, in 2009, financial markets were in no condition to support our cash-intensive business model. Yet, the need for liquidity for merchant portfolios was still clearly present in the market. Furthermore, it was clear to us that the situation would persist for an extended period measured in years. In my experience, lenders are the last ones to show up in the merchant acquiring space and the first to leave.

To best access the financial markets in this new environment, Calpian went public toward the end of 2010. (Our new ticker symbol is CLPI.OB). It was an exciting event for Calpian, but most importantly, it opened up a world of financial options which allow us to continue on with our business plan. We're now traded and active in the markets at a new level which allows a solid platform for growth and one the financial markets can see, understand and finance.

Being public takes the guesswork out of valuation. The stock market values a company's assets every day and banks like that kind of benchmark for their loans – it's visible, objective and well-informed. Banks, who are not typically players in our industry, know that the shareholders of a company like Calpian are watching the company closely and probably understand the business model as well or better than the bank does. Drastic changes in share price (and therefore company valuation) are a signal to banks to look more closely at their credits.

Unfortunately, going public isn't an answer for every company. It's time consuming and expensive - among other issues. Generally the barrier to being a public company has risen in the last decade making it harder for small companies to access this vital part of the business world.

Banks will return to lending – they have to, but it may take the rest of this year before they're fully back in the game. ■