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Credit Risk Ready Podcast

Host Linda Keith, CPA, With Joel Block

Business Know-How: Key Strategy

Questions for Your Business Borrowers

Hi, this is Linda Keith CPA with Credit Risk Ready, a podcast where we interview senior credit and lending professionals from community financial institutions across the United States, their regulators, and banking advisors to better understand and mitigate credit risk.

Today, we're going to learn what our most successful business clients are or should be considering now to solidify their successful transition or to recover from the challenges of the pandemic recession. In other episodes, we cover financials, sales and marketing, and actionable insights. This time, we focus on intellectual capital. For each point, we'll provide you the key strategy question that will unlock the insights to getting it right in this ever-changing and increasingly complex business environment. Use these questions in your conversations with your business borrowers and prospects to understand their plans as they're moving forward, and perhaps to help them by giving them food for thought.

Our guide on this journey is Joel Block, a longtime venture capitalist hedge fund manager, which he refers to as 'gobbledygook for professional investor,' who lives in a Shark Tank world like on TV. Since selling his publishing company to a Fortune 500, Joel keynotes and consults on disruption-resistant success strategies. What I appreciate about Joel is he can apply these ideas from Wall Street to Main Street.

Joel, welcome back to the podcast.

Joel Block:

Hey, Linda. Thanks for having me.

Linda Keith:

Joel, your report on 29 trends for 2021 and beyond includes five insights for intellectual capital. It is hard to choose, but since two focus on money, one of my favorite subjects, well, we'll start with them. So, first up, "What you know about money matters." Especially in small to mid-sized businesses, people get into business because they are good at something, or maybe because it's what they studied in college.

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Why is understanding the finances so important for every business owner/manager? Can't we just hire professionals to take care of that?

Joel Block:

Well, I mean, look; you have to hire people who know the ins and outs just right. But there's a certain minimum standard that everybody has to agree that they need to know. I think if you don't have a minimum standard in place that you know a certain amount about what's going on in your business, I think you're going to be at risk. I think you're really going to find yourself in a really tough spot someday. Who ends up getting swindled? Who gets embezzled? People who aren't paying any attention.

Linda Keith:

Right.

Joel Block:

I'm not saying that you got to be paying attention to every single thing every single minute, but you need some good internal controls. You need some good housekeeping. But at the same time, if you don't pay any attention and everybody knows you don't pay any attention, you are ripe for big problems.

Linda Keith:

Well, from a lender's perspective, one of the things that I actually cover in the tax return analysis training that I do with lending and credit professionals is that a red flag would be if a business is not spending enough on legal and professional services. If they don't use outside experts and they're anything more than a tiny little hobby business, that should tell you something as a lender that they're not getting and utilizing legal and accounting kind of professional help. So, it turns out to be an indicator of credit risk.

And there's another one, too, which you might not have guessed, Joel, but it's one that I see and talk about a lot. When a lender asks for financial statements, tax returns, a copy of their partnership agreement, those sorts of things, if they aren't forthcoming with them, or they obviously had to sort of scribble them up real quick to get to the banker, that's a clear indicator that they don't have good business practices either. A major risk factor for a lender is a business owner who's really good at baking but has no idea the legal and financial aspects of running a bakery.

Joel Block:

That's absolutely true that they should have all their forms in a certain place, and they should be very easy to send out or whatever. But go back to that first thing you just said because I thought that was really important. If businesses are not spending enough money on professional services. Here's the thing. If you've got an employee, let's say that you've got a controller or somebody that they're handling your money. They know that there's no audit. There's nobody coming in to take a look every so often, and they know you're not paying attention as the business owner. They may just feel a little bit more emboldened to put their hand in the cookie jar. That's just not what you want to have happen. Part of the thing is if they know that somebody is looking every quarter, or every month, or whatever the cycle

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is, they're going to be a lot less likely to do some damaging behavior. Because the likelihood of being caught will be so much higher.

So, it's the very good point, Linda. I think you're absolutely on target.

Linda Keith:

Well, and once again, that mitigates the bank's risk.

Joel Block:

If the bank's risk is lower, the owner's risk is lower. But let's go back to why it's important to understand money. You can play golf. You can swing the club and hit the ball, and maybe once in a while, you get a good hit if you're not too good of a golfer. But if you really want to be a good golfer, you have to really have some mastery of those clubs. You really need to know how to hold the clubs, how to grip the clubs, which club is used when. I mean, better golfers understand that very, very well. I would say the same thing is true for business people. Better business people understand it very, very well. Just because you like baking doesn't mean your baking business is going to be successful. If you're going to be a baker, then you need to pay more attention than just to baking.

You can do that in a couple of ways. One is you can self-educate, which is hard to do. You can find a partner, which is a good idea. That's not always the right solution for everyone. I still would not give 100% delegation to any single person. I still would keep an eye on things a little bit. I don't care if this is a closest relative. You hear these horrible stories that close relatives, you damage one another. Money is a funny thing and it makes people act in a bad way sometimes.

I would just say that everybody needs to have a minimum set of skills. Financial literacy. If you don't know how to read your own financial reports, take a class. Have your financial professional help you. You really need to take some responsibility for understanding this. It seems so basic, but if the lenders are identifying people that don't know A from B, that's a business that just on the doorstep of having a problem sooner or later.

Linda Keith:

I am a CPA and a long time ago I was in a public accounting practice. I remember that we were sometimes a little reluctant to spend a lot of time explaining things because some of our business borrowers were so focused on what our fee was that they just wanted you to get their tax return done, get the financial statement done, et cetera. Yet the business owners who would engage in the conversation about, "So, here are your financials and I know you were starting this new profit area in manufacturing. I'm just wondering, how's that working for you? Do you feel like the financial reward is paying off?" The CPA can ask the kind of questions and, for that matter, the lender, the banker, can ask the kind of questions that get into that conversation. Every time there's a conversation like that the business owner/manager learns more about a way to look at things financially.

Joel Block:

Yeah. What you're pointing out... Listen. Critical for the business. Critical for the bank.

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Linda Keith:

Well, you got to understand, Joel, it was 30 years ago.

Joel Block:

The thing is that it works exactly the same. It hasn't hardly changed.

Linda Keith:

Oh, really? Darn.

Joel Block:

Not one bit.

Linda Keith:

Oh, man.

Joel Block:

Pretty much. Accountants turn on the clock and whatever the clock says, that's how much the bill is.

Linda Keith:

That's crazy. When I was working in public accounting, I noticed a bunch of us didn't wear watches. I finally asked the question about it. It turned out that because in our workspace we had to bill by the quarter-hour, we really didn't want to even have a watch on the rest of the time. We were so tired of being time focused.

Joel Block:

Yeah.

Linda Keith:

So, let me just wrap this particular topic up with a key strategy question. This is aimed at the owner, but I would suggest that it should be aimed at the lender as well. What enhancements can you add to your financial skill set? We have people in lending in particular who have more of a sales background than a financial services background. One of the things they do and need to do is to build up the financial piece. We also have people that are in lending and credit who are more financial and need to build up the sales piece.

But I think everybody touching business needs to ask this question: what enhancements can you add to your financial skill set? That's a great one. Let me give you another money one. "When it comes to money, everything is rigged." After you help us with this one, I can't wait to tell you how I approach business contracts with much, much bigger businesses than mine very successfully because of applying these very ideas. The business clients and community banking; they're often small to mid-size, but they may be contracting with and supplying much bigger businesses. So, first, what do you mean by everything's rigged?

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Joel Block:

Let me tell you something. Being in the money business... I'm deep in the money business, as are banks and you, too, Linda. I mean, we're all in the money business.

Linda Keith:

Right.

Joel Block:

There's a couple of things that consumers need to really understand about how money works. Money is a very, very complicated thing. In college, I studied interest rates for two years. People are thinking, "How's that even possible? I mean, how much is there to learn?" But it's very complex. There's a lot.

When you go to Las Vegas and you go to those casinos, of course it's rigged. When you do roulette, the odds are not even. They're rigged to the house, of course. But it's so okay, it's so expected, that we don't even call it rigged. We just call it the house advantage. I mean, everybody just knows that the house has an advantage. That's how it goes. Not a big deal. We all know that those hotels were not built by winners. Okay? We all kind of know that, but we have whatever reason we go there. "Today may be my lucky day."

In their regular life, they don't expect the odds to be tilted against them. This is really about business rules. Businesses write rules that affect their relationship with their consumers. Banks need to really understand the business rules. Companies may not call them business rules, but they all understand what they are when you finally get into the weeds. The reason this is important, by the way, is because consumers have a lot more power than they've ever had before.

Linda Keith:

Social media?

Joel Block:

Yeah. Social media to push back. So, let me give you a couple of examples. Let's say, for example, you go and buy an insurance policy for your house. This insurance policy; it's a general policy. Then there's a flood, and that's an exclusion. Floods aren't covered in the policy. So, so much water comes down off of the hill. Unfortunately, that's not covered. You're shaking your head going, "But I bought insurance. I thought my house was covered." Well, these insurance companies have been in business for a hundred years and have billions and billions of claims. They have a ton of experience. It's all computerized. They know everything about how often things happen. If you want to buy flood insurance, that's an upsell. You can buy one of those riders that gives you flood insurance, but they know exactly what all their exposures are. Consumers do not.

It's not that it's rigged in an illegal way. There's nothing wrong with the insurance company excluding it. But they do what's in their interest. Consumers don't always know what's in their interest or what's in the company's interest. They don't know. What they need to assume, though, is that the company is not doing something to be nice. They're doing it because it's in their interest.

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Linda Keith:

Right.

Joel Block:

A couple of years ago, we went and turned in all the phones or converted the family phone plan, because they said we were going to save money. For about three months, the bill was lower. Then the bill ended up going higher. I mean, it's kind of the way that it works. Every business has the right to write down its own rules and every consumer has the right to say "yes" or "no." Usually, they will say "yes." But sometimes companies are so egregious. For example, the cable companies have a lot of problems with this where consumers just don't like their service for whatever reason, and then they push back on social media.

Lenders really need to be paying attention to the business rules. Are these companies being egregious with the way that their customers do business? Or are they relatively fair in their relationships with their customers of the business the bank is lending to? Everything that happens in business is somehow slanted in one way or another, usually toward the company.

Linda Keith:

It's whoever wrote the contract, Joel. Whoever wrote the contract, their attorneys are protecting them. If they can get you to use their contract instead of you getting them to use your contract, then we automatically know that their lawyers were not trying to look out for me.

Joel Block:

Yeah. The contract is part of it and just the general business rules. How we make refunds. How we charge escalations. How we transfer information. Not only the legal part, but the business parts. How do all the business rules that our company does... How we take deposits. How we make refund. All the different things about that is all the business rules that businesses use to operate. Attorneys write those things down and, certainly, the writing attorney is the one that has more control. But banks need to be paying attention to this because this really matters.

Linda Keith:

So, let me give you a couple of banking examples. I had a debit card for my business banking account. I get a notice that they're changing their VISA application and they just need me to sign this new one. Well, I don't sign things I don't read. I'm on a big crusade to get people to quit doing that and quit expecting anybody else to do it. So, they said, "Okay, sure. We'll send it to you." Seven-page, small print, just to change something for their benefit, not mine.

But I read it anyway. On the last page, they wanted my employees who also had access to use the debit cards to sign. I thought, "Okay, that makes sense. That's like a signature card thing." Right? But when I read it, in the fine print it said that if an employee used a card that they and my company were liable for those charges. I called the bank. I said, "You've got to be kidding me. You're telling me that my employee is going to be liable for anything that I tell them to put on a card? That's not happening." He says, "Well, they signed it." I said, "Well, right. If you ask them to sign it, they just think it's a signature card. None of them understand that they have just taken on liability." We argued it back and forth. What I ended up

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saying is, "I won't sign this. I won't." Well, they ended up changing it for me, but they said it is a national appli-... I said, "I don't care who wrote it. This is wrong on the face of it."

The other thing I have done, Joel, is whenever somebody wants me to sign a contract and it has things like, "If we have a dispute, I agree to pay their legal fees." Whatever. If I think that is reasonable, I will simply add another paragraph that says, "If we have a dispute and I prevail, you'll pay mine." In other words, I never let them protect themselves if I don't protect myself the same way.

Joel Block:

Yeah. That's an example of a business rule where it's one-sided.

Linda Keith:

It's totally. Then we often on these real estate deals or refinance, they'll send a notary public to our house, right, and want us to sign a hundred pieces of paper. I always tell the guy that calls to make the appointment. I'll say, "By the way, we plan to read the documents." I actually had a guy say, "They don't pay me enough to be there long enough for you to read the documents." I said, "Then you need to find someone else who will come out and let us read the documents." Then I called the company and said, "By the way, you need to pay these guys enough that we actually can read what we're signing. Because we're not going to sign things we don't read."

Joel Block:

Listen, everybody's entitled to write whatever business rules they want. That's fine. The customers have the right to say "yes" or "no." I'm just telling the banks through this podcast make sure you're studying the business rules of your customers.

Linda Keith:

Right.

Joel Block:

Because if they're too egregious, there could be problems. That could negatively affect you, and that's something that's not part of your underwriting process. But it's a secret little area that should be.

Linda Keith:

Well, the key strategy question you gave us is, "Are the ways you ask customers to work with you reasonable?" I think what you and I have just agreed to is that's something the lender needs to ask for their own self, their own bank. As well as wondering or seeing how they can determine whether the ways that their business borrower works with customers resonates with the customers and seems to be reasonable for them, too.

Joel Block:

That's right. I've never seen anybody have a list of their business rules written down. A lot of times these things just evolve over time. You kind of have to look for them. They show up with customers that get upset that they don't like something. That's like a contract or some other kind of thing. That's where that stuff shows up.

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Linda Keith:

All right. So, we do have, oh, I don't know, two minutes for the last one. The last one I'm picking is, "Legacy thinking killed the Golden Goose."

Now, this is always a danger, but especially in such a disruptive business environment. So, tee this one up for us.

Joel Block:

Well, I mean, look. I don't remember if we've talked about this on this episode or a previous episode, but there are all these millennial people. Younger people. There's old fogies like me, and certainly not you, Linda.

Linda Keith:

No, because I'm a young fogie.

Joel Block:

You're a young fogie. There's new people coming into the workforce that think in a different way. They have different values. They value real estate. They value owning things differently. They value borrowing differently. If you keep thinking the old way, the world is going to pass you by. That whatever has been working for you, the Golden Goose that's been driving all your cash flow, there is a very unfortunate possibility that that will start drying up. Because you have to be very careful that you don't nurse a dying business model.

Linda Keith:

Yes.

Joel Block:

That is really something that's common in a lot of businesses. They don't realize that it's dying. That their business model is not working anymore. Maybe a third party, an outsider, has to point this out to them. But if you don't pay attention to this, and if you aren't asking questions, sitting around the table, and getting feedback, you're probably having some problem in your business. Maybe you don't realize that that's what it is, but in a lot of cases, the world has moved past you and you're not keeping up. Very, very few companies have done a good job.

One of the few companies that's done a wonderful job of this is AT&T. They keep re-inventing. First, they were in phones. Then they got into mobile phones. Then they got into high-speed cable. Amazon is a different story. They're not reinventing all the time. What they do is they just keep raising the bar. They keep their competition at bay by raising the bar. Every company has to do something that is appropriate for them. But if you're having problems, you need to think about your business all the way down to the bones, including, "Is the business model we're operating still viable in the new world?"

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Linda Keith:

It's so easy if you're having some struggles to blame it on something. Pandemic recession. "It's not our business model, it's the recession." Well, I'm sorry, it could be your business model.

Joel Block:

Yeah. Listen, it might be the recession, but I'll tell you what. This one- or two-year period that we're dealing with right now... Things are coming back to normal. They're going to come back different. People have gotten used to not going to movie theaters as much. They've gotten used to not going to restaurants as much. So, they may still go back to restaurants, but maybe they're going to go to different ones. Because their patterns and their habits have all been broken.

Linda Keith:

Yeah.

Joel Block:

People are going to reorganize. That's another part of what we called the other episode "The Ownership Shuffle" is that people are going to shuffle their behaviors. Things are going to come back in a different way. When that happens, companies that were doing wonderfully before, they just figure, "Well, we're taking a dip during this pandemic." They may not come back the same way. They can come back better. They may come back worse. Because the people that are their customers are not the same. We're all different as a result of this experience.

Linda Keith:

So, that key strategy question for this last one is, "What are you doing that is no longer producing optimal results?" Again, this is a great dual question for your business borrowers, but frankly, for the person listening to this podcast. What are you doing that is no longer producing optimal results?

Well, my, my, my. Here we are again. I did not get to cover "Social media's business rebellion." I didn't get to cover "Constant disruption is the new normal." So, do be sure to use the link in the show notes to the full report *Competing on Capital: 29 Business Trends for 2021 and Beyond*, as well as following that link to Joel's podcast, Profit From the Inside: Straight Talk on Business and Profits With Insiders in the Know. Joel, thank you, thank you, thank you for helping us out today.

Joel Block:

Absolutely. Happy to do it, Linda.

Linda Keith:

Thanks for joining us on the Credit Risk Ready podcast. Subscribe, comment, or share on social media to stay connected and spread the word. Join me next time as we bring our bank, our customers, and our communities through the recession safe and sound.

Take care.

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Resources

Winners take the Inside Track. Here's the intel you need to join them...

- The Business Trend Report for 2021:
Competing on Capital: 29 Business Trends for 2021 and Beyond
<http://bit.ly/Bullseye-Trend2021>
 - Podcast:
Profit From the Inside: Straight Talk on Business and Profits With Insiders in the Know
<https://bullseyecap.com/index.php/blog/>
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About Joel Block

Joel's a futurist and longtime venture capitalist/hedge fund manager (gobbledygook for professional investor) who lives in a Shark Tank world like on TV. Since selling his publishing company to a Fortune 500 company, Joel's cage-rattling keynotes expose Wall Street insights and the inside track on high-velocity innovation, empowering business executives and their teams to "Disrupt Their Competitors' Future."

Savvy industry leaders come to Joel for the high-impact advisory services that drive our disruption-resistant success strategies. His unique approach to innovative business model development helps structure, implement, and enable sustained results.

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About Linda Keith

Linda Keith, CPA, draws on her 30-plus years of experience consulting with and training lending institutions; background in public accounting; 15-plus years as CFO of the family residential construction company; and experience as an examiner with the Washington State Auditor's Office and as adjunct faculty in Accounting Principles and Managerial Accounting to help lending and credit professionals say “yes” to good loans.

Of course, you know those are not consecutive years or she'd be over 100 by now!

Linda is known by her clients to be both practical and funny. In fact, there is a movement afoot to change the 'P' in CPA to stand for 'Playful'. The fact is, people absorb ideas and learn better when they are having a little bit of fun. So, Linda brings the fun along with her practical knowledge and depth of understanding to provide credit analysis training and presentations that make a difference.

She is the founder of [Lenders Online Training](http://www.LendersOnlineTraining.com), a virtual classroom approach to improving tax return and financial statement analysis capabilities; the host of the [Credit Risk Ready Podcast](http://www.CreditRiskReady.com); and a [consultant/trainer on credit risk](http://www.LindaKeithCPA.com) to banks and credit unions across the country.

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Online training on credit analysis

Resources for banking, *Ask Linda* blog

Podcast: Assessing, Managing and Mitigating Credit Risk and download of the *Credit Risk Readiness 2018 Study*