ENTREPRENEURS AND BANKERS[1]

Third in a Series

by Harry A. Carpenter

Why does it sometimes appear that your banker had his/her last creative thought well over 25 years ago? It is no secret that there is animosity between entrepreneurs and bankers. Most entrepreneurs consider bankers business adversaries because of what they view as the latter's conservative and unsophisticated attitudes about the credit and financial service needs of entrepreneurs.

What has remained a mystery until recently is **why** this animosity between bankers and entrepreneurs exists. The entrepreneur may say, "It's no secret why I don't like bankers: They think they understand the business of money, but in reality all they understand is the business of banking. They have a very unsophisticated view of the financial-services market; they seem to believe that a certificate of deposit (CD) with 10-percent interest rate is a good investment.

The banker may respond to that accusation by saying, "It's no secret why entrepreneurs are so difficult to do business with. The investment deals they want to borrow for are almost always risky . . . frequently very risky. They don't understand that bankers are risk analysts, not risk takers. They don't understand that we are loaning the public's deposits, not the bank's capital. Because of that, we have an obligation to the public not to risk their funds by making loans available for speculative deals. Those deals belong with venture capitalists, not banks."

These typical attitudes—both of which, by the way, are accurate perceptions—on the part of both groups does little good, if any, for either. Entrepreneurs end up missing out on immense profit opportunities made available to them through bank credit, and bankers miss out on a highly profitable market segment: entrepreneurs.

Over 13 years ago one of the first private banking groups in the country was started at United Bank of Denver. They specialized in handling the needs of active investors (entrepreneurs). During the first five years this group of private bankers went from $19 million in loans outstanding to $70 million; they went from $23 million in deposits to $120 million. During the period when the bank's net profit from all sources (its commercial, retail, and trust departments) was about a 1.25 percent average annual return on assets, banking utilizing private investors earned 5 percent.

The biggest problem in getting a successful program implemented is the lack of understanding that exists between the targeted market segment—entrepreneurs—and bankers. There are two kinds of people in the investment world: passive affluent investors, and active investors (who may be affluent or who are upwardly mobile at a fast enough rate that they soon will be affluent). Following is a comparison of bankers' and entrepreneurs' personalities, which will point out why bankers, who are passive investors, and entrepreneurs, who are active investors, do not get along. For one thing, they have opposing personality traits.

Active Investor Traits *(Entrepreneurs)*	**Passive Investor Traits** *(Bankers)*
Profit Motivated	*Income Motivated*
Risk-oriented	*Security-oriented*
Credit-driven	*Deposit interest rate-driven*
Utilizes profit for more investments, more wealth	*Utilizes income to purchase consumer lifestyle*
Motivated to gain control over own destiny	*Motivated to gain power over others*
Strong individual ego	*Strong team ego*
Thinks bankers uncreative	*Likes and trusts bankers*
Considers bankers business adversaries	

1. Presented at the annual conference of the International Society of Arboriculture in San Antonio in August 1986.

Active Investor Traits *(Entrepreneurs)*	**Passive Investor Traits** *(Bankers)*
Has minimum net worth of $150,000 excluding consumer goods, especially primary residence	*Always has strong net worth* ($1 million minimum) as long as personal possessions are included (because of the quality-of-life drive)
Show lowest possible individual, declared, annual income	Shows large declared family income
Nontraditional taxpayer	Traditional taxpayer
Provider of consumer goods	User of consumer goods

The terms "passive" and "active" are not pejorative. Passive is not synonymous with "wimpy," and active does not mean "preferred." In fact, these terms used to define homogeneous groups of people at opposite ends of the spectrum are based on logic.

Active investors are those individuals who are actively involved in achieving their own wealth. Their tolerance for risk is usually greater than their need for security. They want to control their own environments, gather tremendous amounts of information about things over which they want control in order to reduce the odds to an acceptable level of risk, and usually perceive risk as a result of risking their own capital.

Passive investors are those individuals who come by their wealth passively. Their security need is usually greater than their tolerance for risk. They want to impact the world by wielding power over others . . . corporate executives, politicians, bankers, etc. are examples. The more affluent the passive investor, the greater the desire to hold power over others. They innately understand (and sometimes resent) the fact that they are not in control of their own environments because their power base is granted to them by others—voters, stockholders, etc. They usually perceive risk as greater than it actually is. Their wealth is almost always earned as a result of risking others' capital.

Looking at these personality trait differences, it is not difficult to understand why almost all active investors have difficulty respecting almost all passive investors, and vice versa. Why don't politicians understand the needs of the small business community any better than they do when it is from this segment of the business sector that re-employment has come? For the same reason they understand very well and sympathize with the needs of big business: they are passive investors with traits compatible with big business.

The active/passive concept has broad meaning in the total marketplace, and entrepreneurs (active investors) who need to sell their products and services to large industries (passive investors) should make an effort to understand that the person upon whom you depend to buy your products is motivated by things that are total opposites of your "hot buttons."

Perhaps the best way to apply the above information to how entrepreneurs can form stronger, less hostile banking relationships is to use a typical entrepreneurial loan example: Let's assume that you want to borrow $300,000 from the bank to purchase a small office complex to convert to condominium office space. (Active investors would rather gamble on themselves than on anything else.) Of the $300,000, $150,000 will go as the down payment; the remainder of the cost of the building will come from the sale of the office units. The other $150,000 is to pay tradespeople for the actual conversion of the building. Let's further assume that you are not a real estate developer or contractor, but a business owner who earns over $100,000 per year.

The first place most potential borrowers go in the bank for such a loan request is to the commercial real estate department. And, according to loan policy, the first thing the commercial real estate lender is going to ask you for is a three-year pro forma that shows you know what you are doing.

Your response is, "But I am not a contractor or a developer, I'm an entrepreneur. I don't have a three year pro forma . . . or experience, but I'm working with a very experienced contractor." You explain to the banker that you have substantial net worth and that you are willing to assign whatever the banker wants as collateral. The banker will quickly tell you that banks do not make loans if it appears the bank will be dependent upon liquidating collateral of personal assets because the borrower lacks experience relative to the venture.

You then point to your business income and state that if for any reason the condo conversion does not work, you have substantial personal cash flow from which you can repay the loan. The banker is probably going to explain to you that the *bank is not operationally equipped to monitor your* accounts receivable. If the deal cannot be structured so it complies with bank loan policy and operational capabilities, the lender cannot make the loan.

You may feel that it is the banker's job to understand how to make a whole range of commercial real estate loans, whether to individuals for business purposes, or to businesses involved in the real estate business. "After all," you may say, "a commercial real estate loan is a commercial real estate loan." Not true.

While there is not space available here for the long explanation of the difference between a business-purpose loan to an individual and one to a business, the fact is they are substantially different. And the commercial banker's job is to structure commercial real estate loans for businesses, not individuals. Each loan type requires a totally different kind of expertise. Unfortunately, the expertise required to make a business-purpose loan to an individual is not present in most banks.

The commercial banker may suggest you see a "personal" or "retail" banker who makes loans based on personal as opposed to business assets. When you talk to the retail/personal/consumer banker, you may find the largest loan that the individual has ever made to a person is $50,000 . . . and that was for a new Mercedes and had a monthly installment repayment plan of five years. He/she probably doesn't understand loaning into your cash flow. In other words, banks are not organizationally structured to handle the needs of entrepreneurs. That is why private banking groups designed to handle the needs of active investors are springing up all over the country.

It is important for entrepreneurs to understand that bankers have an obligation to take the conservative approach. If you ask them to get in bed with you on a gamble, you are asking them to violate their primary responsibility: the public trust. However, if you have personal assets to offer as collateral and that are in no way involved in your speculative loan request, if you have a personal cash flow that is in no way involved in the success (or failure) of the proposed investment, an active-investor private banker can help you.

It is equally important that bankers understand that an individual with sufficient personal assets (for collateral) and cash flow (for repayment) outside of the speculation contained in the loan purpose represents perfectly safe loans, provided the banker takes a different approach in structuring the loan than is currently used in either commercial or retail banking areas.

There are banks in various areas of the country with active-investor private banking groups. They understand the needs of entrepreneurial active-investor borrowers and do take a unique, less conservative view of how to structure a loan, while maintaining strong controls over loan quality and, thus, their obligation to protect depositor dollars.

While many banks claim they have a private-banking area, most of them have a limited view of who profitable customers are. Most private-banking areas define their responsibilities as assisting people whose net worths exceed $1 million to better manage their assets. And, since the only group of people who want bankers as advisors (instead of facilitators) is passive investors, that is the group for whom these areas are structured. In other words, while they help people manage existing assets, they don't help you achieve the assets by giving you access to creatively structured credits. In general, that will not fill the needs of an entrepreneur.

Banks with active-investor private banking groups have creative credit programs that target active-investor entrepreneurs as their customers base. They define their responsibilities as helping their customers achieve their financial objectives, not just in helping people manage already acquired assets. Thus, there is a total difference in banker attitudes. With an active-investor private banking program, you won't have to ask the question of your banker: "Where were you when I needed you?"

There is little doubt that the more information bankers have about the banking needs of entrepreneurs, the better they will be able to adapt non-traditional banking strategies and techniques to achieve that objective.

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