To improve market responsiveness and streamline complex operations, many commercial lenders need to establish a target operating model. One-off projects won’t suffice.

Complexity long has been a challenge in commercial lending. Success depends on quick responsiveness to a diverse set of clients, products and markets — complicated by the individual negotiations and deal creativity of relationship managers. Loan origination is rife with improvisation and ad hoc activity, defying efforts to streamline the business.

But even though the industry is attacking the complexity challenge with fresh determination, progress is slow. Refinements in particular areas end up not improving the overall workflow. Elaborate new software systems may require extensive customization, yet only succeed in a digital replication of inefficient processes. All too often, speed-to-market and the overall customer experience are not improved.

In many cases, the problem boils down to an essential management issue — patchwork versus framework. Although bright leaders and determined teams are tackling pieces of the puzzle, their efforts are not guided by a shared vision — what is the whole picture eventually supposed to look like as we strive for improvement?

To cut through this uncertainty and the lost opportunity it represents, many banks need to establish a target operating model for commercial lending. This entails an end-to-end review that defines required processes; where they will be performed; and how. Typically more attention is needed on the activities that support loan origination, but servicing must be folded in as well. At a large bank, the model helps to clarify the activities of thousands of people and dozens of essential steps in the overall workflow.

The payoffs are many. A key goal is to improve customer responsiveness and sales productivity by slashing the administrative burden on relationship managers, who often spend more than two-thirds of their time on internal processes and paperwork. Common operations can be consolidated. A roadmap can be developed to migrate the organization, and information technology can be better fitted to business requirements.

It may seem counter-intuitive that such a comprehensive effort is needed in commercial lending, given the voluminous balance growth seen in recent years. But behind the scenes, performance pressures are mounting. Spreads are eroding even as the commercial side is being called upon to do even more to offset the crawling consumer side, fueling a battle for market share that will require a sharpened customer outreach. Regulators are exerting more pressure for consistency. Meanwhile there is growing frustration with various performance initiatives that have not yielded desired traction.

For many banks, the development of a target operating model is essential in clarifying how the commercial lending organization can move ahead.

**COMPLEXITY DRIVERS**

The complexity in commercial lending reflects a variety of significant and oft-conflicting influences on the business. It starts with multi-faceted customer needs but also includes product design and management, underwriting and risk management, regulatory compliance, back office processes, staff
skills and technology applications (Figure 1: Complexity in Commercial Lending).

Customer needs. There are huge variations in customer profiles and needs (including the size of the credit facility), yet typically only a short window of time to respond. RM efforts at “instant customization” then must be threaded through an internal maze of processes and decision makers, chewing up time and resources.

Product management. Products must allow for significant variations in customer requirements while providing standardized outputs for booking, funding, servicing and credit management.

Underwriting. Credit and risk management processes are not always in sync (or well communicated) with sales processes and/or customer requirements.

Regulation. Following the financial crisis, regulators are paying closer attention to commercial lending. They are concerned about objective decision-making and the separation of duties between sales and credit management, as well as the clarity and consistency of underwriting and risk management processes. Much of this regulatory focus ultimately falls on the shoulders of the relationship managers.

Loan services. Operating processes (e.g., closing/booking) need to be aligned with sales and credit processes to ensure that customer expectations are met.

Roles and skills. The delivery of a commercial lending product requires a breadth and depth of skills. Some roles are inherently task-based, such as data entry. Others require a high level of expertise, such as the paralegals who review loan documents.

Yet many institutions have failed to separate skill- and task-based roles. This leads to process fragmentation, excessive hand-offs and a diffusion of accountability. As a result, the workflow is disorderly and the customer experience suffers.

TRIAL AND ERROR

Solutions have remained stubbornly elusive, despite considerable effort and expense on workflow redesign programs and new technology platforms.

RM process redesign. Acknowledging the pivotal role of relationship managers in winning new business, some lenders have focused their streamlining efforts on freeing up more RM time for prospecting and client development. This makes a lot of sense given that commercial bankers in the field typically are devoting only a third of their time to customers, with the rest spent tending to origination and servicing processes.

These programs tend to fail, however, by leaving larger questions unaddressed and even creating new problems.

Figure 1: Complexity in Commercial Lending

Commercial lending depends on a complex set of interrelated factors. A target operating model helps to ensure that issues are addressed systematically and the needs of all stakeholders are met.

Source: Novantas, Inc.
New servicing routines can become counterproductive by detracting from the customer experience. Critical tasks and activities may be left dangling, unmatched with the appropriate staff roles. Tangled interactions between the front office and the back office may not be clarified.

“Lean” programs. Lean programs strive for the double win of increasing value for customers with fewer resources. Based on a scrupulous study of workflows and the elimination of waste, such programs are intended to identify a series of highly specific steps that can be taken to enhance efficiency and effectiveness.

Many banks have invested heavily in this concept, some even creating dedicated Lean departments. But well-intentioned Lean programs often get off track.

For one thing, organizations may recruit Lean professionals with little or no experience in financial services, who then attempt to apply the techniques and tools in a stringent manner more suitable for a manufacturing environment. Another problem is that Lean principles often are applied too narrowly, implemented in a focused area without considering the overall impact on the operating model. Although specific processes may be improved, holistic issues are typically left unresolved.

Such flaws have left banks trapped in a defeating cycle — applying Lean principles, failing to obtain results, stopping the program and starting over again. Program credibility is eroded as this continues, with disaffected staffers distancing themselves and becoming more dismissive of Lean as a “flavor of the day” project.

Technology platforms. On the servicing side of commercial lending, banks have made a lot of progress in migrating from a collection of separate software applications to more comprehensive systems that span multiple processes and teams. But the origination side has been problematic, with expensive initiatives seldom coming to full fruition.

Ostensibly the origination side should be well-positioned for progress, given the robust, commercially-available applications in the market. These platforms are capable of supporting a great variety of commercial lending products, and they also integrate well with servicing applications and enterprise content management systems.

Figure 2: Commercial Lending Process Model

The target operating model is based on an explicit understanding of the commercial lending value chain, including human capital and technology enablers.

<table>
<thead>
<tr>
<th>ORIGINATE</th>
<th>UNDERWRITE</th>
<th>CLOSE</th>
<th>MANAGE COLLATERAL</th>
<th>SERVICE</th>
</tr>
</thead>
</table>
| • Engage the client  
• Gather information  
• Price the deal  
• Structure the deal  
• Pre-screen the deal  
• Issue term sheet | • Gather documentation  
• Assess credit  
• Prepare loan package  
• Obtain deal approval | • Create documents  
• Satisfy conditions  
• Appraisal review  
• Close the deal  
• Quality assurance  
• Book the deal  
• Fund the deal  
• Post-closing | • Pledge assessment  
• Store documents  
• Retrieve documents  
• Record collateral  
• Secure collateral  
• Release collateral | • Maintain client file  
• Process payments  
• Issue advances  
• Record payoffs  
• Remove deal record |

PEOPLE

(Organization, roles, responsibilities, performance measurement and compensation)

TECHNOLOGY

(Platforms, databases, tools and vendors)

Source: Novantas, Inc.
Complexity Challenge in Commercial Lending

However, the payoffs often are limited by various implementation and organizational problems. Technologies are rolled out without a careful understanding of the organization’s specific workflow requirements, and without developing management consensus on common objectives across the many business lines and departments. The all-too-common workaround is to recreate inefficient old processes on the new system, requiring extensive customization and sending implementation costs through the roof.

The effectiveness of these programs is furthered hampered by the seemingly unending stream of client-specific considerations in originating and servicing a commercial loan. Bankers believe that all commercial loans are unique, driven by the size and shape of the risk; the number of elements to consider in underwriting; and the differentiated structures of payments, covenants and conditions. Systems and teams need to accommodate such variations yet still converge on managing the common elements — principal, interest, repayment schedule, and maturity terms.

TARGET OPERATING MODEL

As we have seen, addressing the complexity challenge is as much about vision and cohesion as it is about technologies and techniques. Each element — client needs, origination and servicing processes, staff roles and skills, business units and technologies — needs to be understood in relation to the other and fitted into a vision of how a streamlined system is supposed to work (Figure 2: Commercial Lending Process Model).

To develop this model, the commercial bank will need an end-to-end review and redesign of its lending operations. This includes defining key processes, where they will be performed, and how. Three particular issues are critical:

- **Process transparency.** The origination pipeline is particularly in need of attention. Far less is formalized in a growth-intensive setting that emphasizes case-by-case responsiveness; the technology is newer; and market and regulatory changes are driving new approaches.

- **Four major groups are affected by origination process clarity, including customers, relationship managers, line of business management and production staff. Operational cohesion with loan originations in progress is an obvious focus, but the commercial lending group also needs a clear picture of business development.**

In that spirit, the first step is to investigate the full cycle of key origination processes and set a vision for how they should work and link together. This includes the processes by which leads are developed into specific lending opportunities; how working concepts are vetted for fit with the bank’s criteria for new business; how a proposal is generated and turned into a term sheet; and activities required for negotiation.

**Figure 3: Credit Event Complexity**

The approval of a credit facility typically entails numerous “credit events,” including formal and informal staff interactions in meetings, reviews and conversations.

![Credit Event Complexity Diagram](source: Novantas, Inc.)

* The chain of credit events often includes multiple iterations of the preview and pre-screen discussions with the business unit.
Role clarification. Once the processes are defined, the question turns to work roles and organizational structure. Of course all banks have organizational charts, but in the throes of booking new business, formal structures often devolve into something resembling giant contingency teams, with lots of confusion and overlap between roles.

The target operating model seeks to tame this chaos by carefully matching defined processes with staff work roles. Such role definition is key in offloading processing burdens from relationship managers, and in reconsidering organizational structures.

In addition to the various loan origination roles, a target operating model defines the work roles for loan fulfillment. Depending on the bank, these roles can include processors, loan closing coordinators, documentation specialists and bookers. In addition to process efficiency, clear role definition is critical to a good customer experience.

Credit approval. High on the list of concerns is the complexity (and often uncertain) routing of activities that lead up to the approval of a credit facility. The approval process entails a number of formal and informal staff interactions, including meetings, reviews and conversations. At some institutions, as many as 10 of these “credit events” precede the funding of a loan (Figure 3: Credit Event Complexity).

The struggle lies in the loose definition of these events, leaving key decision processes to become black boxes — undecipherable, unpredictable and certainly not efficient. One consequence is that relationship managers are forced to become internal lobbyists for credit approval. Rather than relying on a predictable process, they must work their network of connections to “pre-sell” their deals.

Poorly-defined credit events also squander staff resources, both in figuring out what needs to be done next and in dealing with the crush of required participants. Some events may include from three to seven staffers just to issue a term letter, regardless of risk level.

One of the most contentious issues centers on the final sign-off on deals, committee approval versus individual (or signature) approval. Generally, it helps to move deals along when higher levels of decision authority are closer to the transaction point with the client, which is the argument for signature approval. But that leaves regulators to question the purpose of credit committees, and whether sales urgency is having too much influence on critical underwriting processes. Most banks have a big knot to untangle.

Finally, the target operating model helps to clarify technology requirements. As the vision for processes and work roles is fleshed out, the organization gains a robust context for selecting and implementing technology components, based on an explicit understanding of the bank’s functional requirements. This can include determining the role of a customer relationship management application; or an enterprise content management technology such as imaging and electronic forms; or the right software bridges between origination and servicing processes.

ROAD MAP FOR CHANGE
Recent years have seen a vigorous loan expansion in commercial banking. Now the industry is turning the corner into a more challenging environment — not without promise to be sure, but presenting more difficulty in meeting high expectations.

"Though various executives and departments may show a lot of initiative, overall progress can remain muted, a victim of organizational disconnects. A target operating model can provide a roadmap for change, one that has well-defined processes, work roles and appropriate technology utilization.”

“Looking internally for upside potential, bankers have had high hopes that new technology applications would help them to finally deal with some of the long-standing complexity issues that have dogged the industry. But results have been mixed, with cumbersome processes still strongly detracting from RM client responsiveness and operating consistency and efficiency.

In many areas of the bank and not just commercial lending, the problem with incremental improvement is that it tends to take on a life of its own, to the point that it actually becomes an impediment. Though various executives and departments may show a lot of initiative in their specific domains, overall progress can remain muted, a victim of organizational disconnects.

For commercial lenders, a target operating model can provide a roadmap for change, one that has well-defined processes, work roles and appropriate technology utilization. This is critical in deciding how best to utilize available tools to maintain competitiveness, enhance market differentiation, improve the customer experience and achieve growth targets.”

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