LENDINGFRONT

Propelling Your Small Business Loan Growth in the Digital Age

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> "If you think Amazon and Goldman Sachs are going to stop with small business lending, they're not. They are going to move into mid-market lending and into deposits. What is at stake is not just small business lending. It is the entire business relationship."

- Jorge Sun, CEO and Co-Founder, LendingFront

Bank credit is the jet fuel that powers the growth of small business in America. But what happens when businesses turn to alternative fuel sources for their funding?

Banks remain the dominant source of credit for small businesses [1]—but the days when banks were the only game in town are long gone. Dramatic strides in technology have made it possible for a range of providers to deliver capital to small businesses. In an era of smartphones and other mobile devices, digital technology is transforming the loan application, underwriting and fulfillment process. Armed with digital solutions, lenders are accelerating turnaround while offering credit at varying interest rates and terms. These changes add up to more choice for customers, but they are creating serious competitive pressures for banks.

Faced with intense competition, banks are hungry for greater efficiency in the small business lending process, and are seeking ways to:

- Streamline processes
- Improve loan quality
- Enhance the customer experience
- Manage risks
- Deploy human capital efficiently
- Reduce per-loan expenses
- Boost loan growth

...all while staying meticulously in compliance.

Banks are finding the answers to these challenges in cloud-based, white labeled digital lending technology that can be seamlessly integrated with existing systems and processes—including their core.

[1] "Small Business Facts: Spotlight on Community Bank Lending." Daniel Brown, regulatory economist, U.S. Small Business Administration. Released by SBA Office of Advocacy, September 2019.

Many non-bank competitors have already harnessed the power of digital lending, and they're coming at community and regional banks from all sides. Companies that have already developed lending options include big technology firms like Amazon and PayPal [2], large financial companies with deep pockets such as Goldman Sachs [3], and small but nimble innovators in the financial technology space such as Square and Stripe.

The Amazon-Goldman Sachs collaboration has been trumpeted as "a wake-up call for banks" by Ron Shevlin, managing director of fintech research at Cornerstone Advisors. Banks' initial instinct may be to dismiss their partnership, which would use the Marcus platform to provide lines of credit of up to $1 million to lenders that sell their goods over Amazon, according to Shevlin. But banks that see receivables financing as a business they don't want or need could miss lending opportunities and lose market share, Shevlin said [4].

Or worse. As Jorge Sun, CEO and Co-Founder of LendingFront put it, "If you think Amazon and Goldman Sachs are going to stop with small business lending, you're wrong. They are going to move into mid-market lending and into deposits. What is at stake is not just small business lending. It is the entire business relationship."

Large banks—with their emphasis on transactions and perceived advantages in convenience and pricing—are also a persistent and formidable force.

In this fast-moving digital world, banks can propel themselves ahead of the formation by rethinking how to engage with business customers through technology. Banks already know that customer relationships are one of their special strengths--but by themselves, relationships are no longer enough. Loyalty increasingly is tied to convenience, and convenience increasingly means the ability to get a small business loan remotely and on the run.

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Smaller banks have been notoriously slow to invest in technology, often because of the very real challenges of managing the costs and integrating new applications into core systems. In fact, in 2018, only 11% of small banks had a digital origination channel for small business lending.[5] Most relied on manual, paper-based processes for originating, underwriting and servicing small business loans.

[2] "Amazon Joins Paypal as Top 5 Small Business Digital Lender," The FInancial Brand, June 2019
[3] "Amazon unveils small business credit line with Goldman in latest tie-up between tech and Wall Street." Hugh Son, cnbc.com, June 10, 2020.
[4] "Amazon and Goldman Sachs: A Small Business Wake-Up Call for Banks." Ron Shevlin, Forbes, June 15, 2020.
[5] 2018 FDIC Small Business Lending Survey, Federal Deposit Insurance Corporation.

In an era when digital solutions are no longer just "nice to have," they are looking for ways to ramp up quickly to compete digitally. Banks that cling to outmoded technologies run a very serious risk of being left behind by customers, who are constantly barraged with opportunities to borrow faster, more conveniently, less intrusively, and at more favorable prices.

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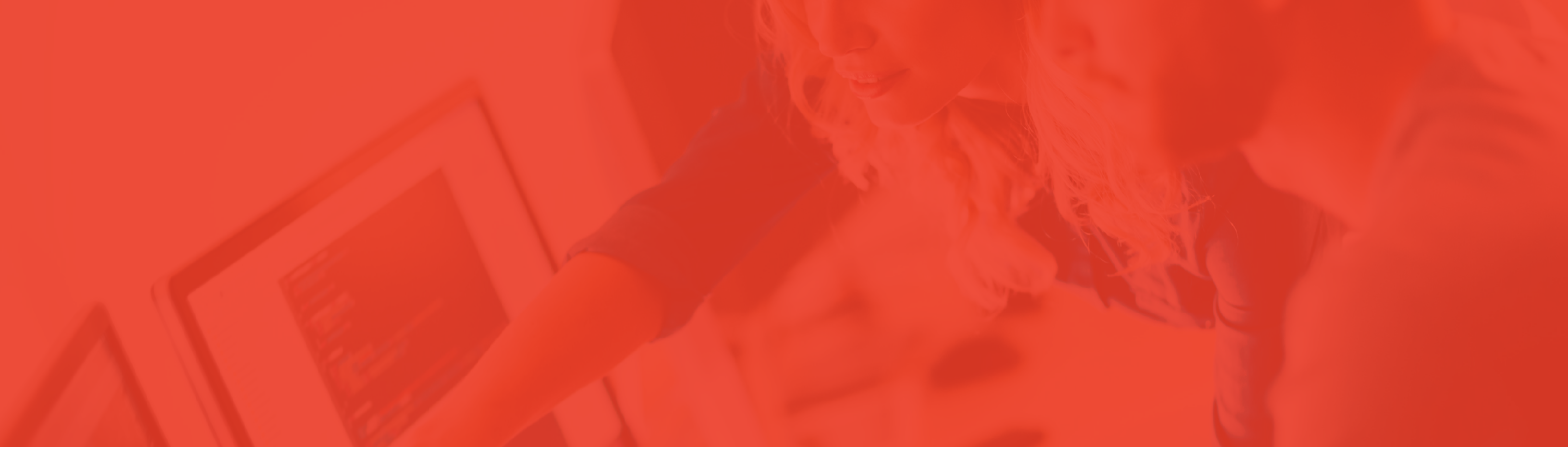
Fortunately, change does not have to be costly or disruptive. Banks can adopt cloud-based digital lending with minimal interruptions, positioning themselves to provide faster decisions while managing their credit risk and getting more loans over the finish line. The minute a bank realizes that a downloadable loan application on its website isn't digital technology, a conversation can begin about how to compete more effectively by embracing innovation.

The Starting Point: Robust Relationships

Community and regional banks have abundant strengths that make them a natural fit for servicing the credit needs of small businesses. Banks' deep links to small businesses begin with the checking account, a treasure trove of information about business activity. And one of their natural advantages is that they bring an advisory dimension to the customer relationship. The recent flood of government-backed lending under the Small Business Administration's emergency Paycheck Protection Program (PPP) has highlighted how important it is for small businesses to have a banking relationship during times of economic strain. Businesses that had relied on fintechs for microcredits suddenly found the flow of credit was tight as secondary market-dependent companies came under funding pressure. The lesson many borrowers learned was that fintechs are transactional, while banks are relationship-driven—a positive message, from the standpoint of any banker.

Smaller banks' continued relevance as lenders is in large part a tribute to their relationship emphasis. A 2018 study by the Federal Deposit Insurance Corporation showed that even large banks—defined as those with assets of $10 billion or more—consider banks under $10 billion as top competitors. One-third of large banks said they consider the smallest local banks, those with $1 billion or less in assets, as a top-three competitor for small business lending.[6]

[6] 2018 FDIC Small Business Lending Survey, Federal Deposit Insurance Corporation.



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One direct result of the Covid-19 pandemic and the PPP is that thousands of banks have reinforced their lending relationships with businesses nationwide—including existing and new customers. According to the Small Business Administration, banks with $10 billion or less in assets originated an astounding 45 percent of Paycheck Protection Program loans, even though they account for only 15 percent of industry assets.[7]

There can be no doubt that small businesses and their credit needs matter to banks, as they do to the economy as a whole. In fact, 99 percent of all U.S. businesses are considered small businesses, according to the Small Business Administration.[8] They are drivers of economic growth and employment, and they are a significant source of revenue to the banking industry. Banks cannot afford to watch this business slip away because of a failure to keep pace with customer requirements and expectations for convenience and speed.

[7] Forty-five percent figure is from "Paycheck Protection Program (PPP) Report: Approvals Through 08/08/2020," Small Business Administration. Fifteen percent figure is calculated from FDIC Quarterly Banking Profile, Second Quarter 2020. See time series for "Ratios by Asset Size" then scroll to "Share of Industry Assets," lines 18-20

[8] 2018 Small Business Profile, Small Business Administration Office of Advocacy.

Numerous forces are at play in today's lending environment:

Covid-19 is driving a need to change how lenders evaluate small business borrowers. The traditional underwriting criteria utilized by banks look backward, not forward. However, last year's financial statements, credit scores and asset valuations proved less relevant as Covid-19 destabilized the entire economy.

But it is possible to look forward and to make smart decisions on that basis. What matters to a small business is not profit, but real-time cash flow. Banks that have the technology to look at business bank accounts and glean a relevant snapshot of a small business's revenue and expenses have the ability to understand whether the business is recovering or is in an irreversible decline. New ways of screening applicants and rating their creditworthiness are emerging, and digital lending solutions—through their ability to aggregate data from a wide variety of sources—are key to these developments.

Fintechs are chipping away at the edges of traditional banking relationships. Emerging fintech lenders that specialize in efficient decision-making have made huge inroads in lending by focusing on loans to customers that banks have by and large forfeited—the so-called low-hanging fruit. While banks focus on larger commercial loans, they have sometimes ceded smaller credits to other lenders, and fintechs have flooded in to fill the gap.

Banks may be content to serve larger borrowers. However, it's risky to assume that emerging lenders will stay in their sandbox just because they're making the $25,000 and $50,000 loans that most banks say they can't underwrite profitably. Small businesses that demand convenience and speed in funding are being trained to get what they want from others. As small

[9] "Making Small Business Loans Profitably." Charles Wendel, Banking Strategies, July 7, 2015. Anecdotal accounts in interviews with bankers during 2020 put the break-even figure as high as a $250,000 loan.

businesses evolve and grow, there's no guarantee that they will find their way to a bank. Banks that want to compete for their business will have to know how to reach them quickly and in a way that makes it easy for the borrowers to complete loan applications and upload all relevant documentation.

Digital and mobile access matter more than physical branch locations to entrepreneurs. Local small business owners don't work 9-5, so when they go looking for a loan, they aren't going to bend to bankers' hours. They want a relationship with a bank, but they want it on their terms. Once upon a time, the small business owner showed up in the branch to get a loan, but that world has moved on. Every minute they spend at the bank is a minute they're not spending with customers. Chances are the business owner has already experienced 24/7 banking services as a consumer; they expect it on the business side too.

As customer expectations evolve, the lending environment is changing, too. A clear trend has been underway for several years toward fewer, smaller, smarter bank branches that are designed to optimize the customer experience. Covid-19 may have accelerated the trend by proving that it's not strictly necessary for lenders to rely on face-to-face interactions in their physical branches. Every bank in America has had to learn how to deliver services remotely, something many of their competitors had already figured this out.

There will continue to be a need for face-to-face meetings with customers, but with digital platforms in place these meetings can be less focused on completing transactions and more focused on active listening and providing advice and guidance. That's something customers will take time out of their day to do.

Banks can harness technology to make smaller loans more profitable, but they have to move fast. Small business loans are generally defined as loans under $1 million. Many banks say it is difficult to turn a profit on loans under $100,000, and some cite even higher break-even points.[9] But businesses need these loans, and that means many banks are either passing on the opportunity or making the loans at a loss. Why are new players making money on these small-balance loans when a community bank says it can't? The answer is that new players are using technology that streamlines the process and significantly reduces the average cost of originating a loan. If it cost significantly less to process small credit requests, margins would improve quickly.

Banks need ways to get a greater share of loan applications over the finish line. Reality check: A bank incurs costs on every loan application it receives, whether the loan is for $5,000 or $5 million. A bank that says "no" to an application has already incurred costs for reviewing it, but it gets none of the interest revenue. Innovative technology can help banks find ways to reduce the "no" rate safely and soundly while making it less costly to underwrite the loan in the first place.

Technology can give banks insight into gaps in their lending relationships. Banks that take a comprehensive look at the business relationship may be able to uncover opportunities to offer existing customers additional services—such as treasury management and payment processing. If the bank is lending to a small business, why doesn't it have the business checking relationship? Payment processing has surged in tandem with e-commerce in recent years, yet many banks have never even attempted to get a piece of the transactions, which generate small transactions fees but in potentially large volumes. Digital lending can produce a flow of information that enables banks to help customers see where they can provide more services that solve a customer need. At a time when fintechs are putting pressure on every facet of the customer relationship, banks and their customers alike can benefit from a careful assessment of how they can do more together for the sake of efficiency.

Lending digitally to small-dollar loan customers who might otherwise go outside the bank for credit also expands relationship opportunities. Such customers may have needs for services other than loans, and cementing the relationship through a loan improves the banks' chances of serving them in other ways.

Banks can make productivity gains when they shift to the right digital lending technology. Automating the application process frees up lenders who used to spend their time chasing down documents to ensure that applications are complete. Liberating lenders from the mechanics of the loan application means they can focus on bringing in larger deals that are more valuable to the bank, or on engaging directly with important and new customers. When lenders can develop new relationships and deepen existing ones, they can get more done without undertaking the expense of expanding the staff.

The competition never sleeps. Because community banks are dependent on physical branches and people-driven processes, the door has been flung wide open for newcomers to step in with better solutions that are more appealing to small business customers. Innovation never stops, so banks need to think creatively about how to catch up and participate in the digital lending boom before all they see is their small business customers' backs. Partnering with fintechs has been one of the most significant technology trends of 2020.[10] For small banks, white label digital technology can communicate to customers that they are still dealing with their bank.

Choosing the right digital lending solution can transform a bank into a real player in the competition for vital small business relationships. Community banks need to be able to efficiently meet the capital needs of small businesses, and that includes finding ways to approve small credit requests profitably. Banks and their customers alike are more satisfied when application approval rates climb, because businesses don't have to look elsewhere for funds, and nobody is wasting time or resources on loans that don't get approved. Big Techs and big banks have cracked the code for lending profitably to smaller businesses; with the right solution in place, community and regional banks can, too.

It is possible for banks to digitize the lending process so customers don't have to speak with a loan officer during every step of the process. Banks can embrace automation without ceding control, abandoning their underwriting culture, or increasing risk. They can do it seamlessly, while maintaining their identity as the customer's financial institution of choice.

And most importantly, with the right digital solution in place, banks can mobilize their lending officers to spend more time pursuing new business and serving the most profitable commercial customers.

[10] "The banking tech trends that will dominate 2020," American Banker, January 7, 2020.

LENDINGFRONT

Ready to Learn More?

LendingFront enables lenders to deliver capital to small businesses more efficiently than ever before. For more information on how to get started, contact your Salesforce or LendingFront representative

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