Small Business Lending Landscape

Opportunity Finance Network
February 11, 2016

Agenda

- Small Business Financing Initiative Overview
- Industry Webinar Series
- Today’s Topic and Presenters
- Small Business Lending Landscape
- How can mission-driven small business lenders respond?
- Questions and What’s Next
Goldman Sachs 10,000 Small Businesses is a $500 million investment to help small businesses in the United States create jobs and economic growth by providing entrepreneurs with a practical business education, access to capital and business support services.

The program is based on the broadly held view of leading experts that greater access to this combination of education, capital and support services best addresses barriers to growth.

Small Business Financing Initiative:
Multi-faceted program to increase the scale of small business lending by mission-driven lenders

2014
- Workshops
- Forum
- OFN Conference
- Leader Award

2015
- Collaborative
- Forum
- OFN Conference
- Leader Award

2016
- Collaborative
- Webinars
- TA Memos
- Forum
- OFN Conference
- Leader Award
Small Business Finance Collaborative

- 24 leading mission-driven small business lenders nationally
- Intensive two-year program of peer learning, training, and technical assistance
- Goal: Aggressive growth in small business lending
- Promotion of best practices and collaboration that support scale
Small Business Financing Initiative

Industry Webinar Series

<table>
<thead>
<tr>
<th>Topic</th>
<th>Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>Small Business Lending Landscape</td>
<td>February 11, 2016</td>
</tr>
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</tr>
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</tr>
<tr>
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</tr>
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</tr>
<tr>
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</tr>
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</tr>
</tbody>
</table>

To learn more and register: [www.ofn.org/small-business-financing-initiative](http://www.ofn.org/small-business-financing-initiative)

Today’s Presenters

Nick Elders  
VP, Technology Solutions  
Community Reinvestment Fund

Bryan Doxford  
SVP, Community Lending  
Excelsior Growth Fund

Pam Porter  
EVP, Strategic Consulting  
Opportunity Finance Network
Today’s Webinar: Small Business Lending Landscape

- Goals:
  - Overview of the rapidly changing small business lending landscape
  - What can mission-driven lenders learn?

- Agenda:
  - Market size and trends
  - Traditional lenders
  - Alternative sources
  - Emerging new entrants

Small Business Market Opportunity

<table>
<thead>
<tr>
<th>Size by Employees</th>
<th>Number of Firms</th>
<th>% of Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>0 employees</td>
<td>21.3 million</td>
<td>79%</td>
</tr>
<tr>
<td>1-4 employees</td>
<td>3.6 million</td>
<td>13%</td>
</tr>
<tr>
<td>5-9 employees</td>
<td>1.1 million</td>
<td>4%</td>
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<tr>
<td>10-19 employees</td>
<td>0.6 million</td>
<td>2%</td>
</tr>
<tr>
<td>TOTAL with less than 20 employees</td>
<td>26.6 million firms</td>
<td>98%</td>
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<tr>
<td>ALL Firms in the US</td>
<td>27.3 million</td>
<td>100%</td>
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Source: SBA Office of Advocacy, 2014
Businesses Need Small Loans

Four Factors Driving Changes in Small Business Lending

- Tighter banking regulations force banks to vacate “small” loans (loans under $1.0M)
- Availability and wide-spread use of “Big Data,” machine learning, and data modeling
- Historically low interest rate environment has private equity chasing yield
- Technology and the Internet are transforming banking and lending from physical to virtual
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Who is Lending to Small Businesses?

- Banks
- Traditional non-bank lenders
- Emerging lenders

Bank Lenders: Market Size

- Total U.S. small business loan market estimated to be $186 billion
  - 95% of small business loans on bank balance sheets
  - 35 largest bank holding companies held 39% of all small business loans outstanding in 2013.
  - Loans of $100,000 and under account for 90% of small business loans.
- Disintermediation affects banks primarily

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1 Loans under $250,000
2 Goldman Sachs Research *The Future of Finance*, as reported in the WSJ
3 SBA Annual Report 2014
By Victoria Williams, Washington, DC. U.S. SBA. 2014
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Small Business Loans Represent Declining Percentage of Total Bank Lending

![Graph showing the percentage of Small Business Loans as a proportion of total bank lending from 2004 to 2014.](image)

Source: U.S. Small Business Administration, Office of Advocacy based on FDIC data.

SBA Lending Growing Faster than Bank Lending

- Small Business Administration:
  - SBA 7 (a): $23.6 billion in 2015 (up 23%)
  - 504/CDC lending: $4.3 billion in FY 2015 (flat)
    - Down 25-30% from highs in 2012-2013
    - But 2016 will see return of 504 refinance program
  - Community Advantage: $100 million in 2015 (up 83%)

Source: Small Business Administration
Mission-Driven Lenders Serving Low Income Communities

- **Mission-driven lenders demonstrate strong growth in small business lending volume**
  - **198 OFN members:** 63,081 loans in 2014 totaling $656 million up 20+%
  - **24 Small Business Finance Collaborative members:** 8,356 loans totaling $402 million up 20+%

- **Research demonstrates impact:**
  - **CDFI Fund Impact Study:** “CDFIs do indeed ‘fill the gap’ that is left by conventional lenders.”
  - **SSBCI Study:** “States working through mission-oriented lenders have the greatest success in reaching underserved borrowers.”

Many Initiatives Focus on Replicating and Scaling Small Business Lender Success

- **Small Business Leader Award for Mission Driven Lenders**
  - Recognizes excellence, growth, and impact

- **Wells Fargo Diverse Community Capital**
  - $75 million debt and grant program to CDFIs that focus on diverse entrepreneurs

- **Sam’s Club**
  - Helps minority and women entrepreneurs make sound decisions when borrowing
**Emerging Small Business Lenders or “FinTech”**

**Definition:** Financial technology companies using digital innovation to disrupt institutional banking systems

**Sectors:** Credit scoring, small business lending, payments, investment management

Three major ways FinTech will reshape finance:

1. Cut costs and improve quality of financial services
2. Develop clever new ways of assessing risk
3. Create a more diverse, and hence stable, credit landscape

Source: Accenture The Future of FinTech and Banking

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**What are All These Companies Focused on?**

Data provided by: CB Insights
Who are the Emerging Small Business Lenders?

Three overarching categories of lenders

- **Balance sheet lenders**: Lenders who raise capital from investors, and then carry the loan risk on their balance sheets
- **Peer to Peer**: Lending platforms which match borrowers with investors, and charge an origination fee
- **Brokers**: Platforms which guide borrowers to different online loan products based on the borrower’s needs and profile
Global FinTech Activity

Source: Accenture and CB Insights

FinTech Growth: Funding and Deals

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Market Size Projections: No Definitive Estimate...

- PwC: $150 billion+ by 2025
- IOSC: $70 billion within next years
- Financial Times: $25 billion by 2019

...except it is growing fast

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FinTech Lenders Have a Common Business Model:

- Relatively high interest rates
  - APRs of 7-200%, unsecured, 1-5% orig. fees
- Low operating expenses
  - Limited underwriting – driven by technology
  - No brick and mortar presence
- High margins offset high default rates
  - Default rates of 6-10% (vs. <1-3% SBA)

- Huge Sales and Marketing budgets:
  - Lending Club: $172 million in FY15
  - OnDeck: $60 million (est) in FY15

- Cost advantage: Data and loan performance measurement on a large scale helps refine the algorithms
What does this all mean to small business owners and borrowers?

Online Innovation Promises Borrowers Unprecedented Speed and Ease of Use

- Applications typically take very little time to complete
- Process automated with algorithms that access applicant credit histories and social media profiles
- Alternative lenders offer fast turnaround times
  - Loans disbursed within 48 hours or faster
- Search Engine Optimization and Ad Tracking drive marketing
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Possible Benefits to Borrowers

- Higher approval rates mean that those who were previously denied credit can now access it
  - Alternative lenders approved 62% of small business loan requests in Jan 2015. Comparatively, big banks approved just 21%

- Ease of application
- Faster turnaround
- Millennial small business owners are 5x more likely than Boomer owners to consider P2P lending

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Risks to Borrowers

- Lack of transparency in cost of borrowing
  - A.P.R. is rarely disclosed

- Automated daily ACH payments create cash flow challenges for entrepreneurs

- Lack of reporting to credit bureaus
  - Can lead to “stacking”
  - Limited ability to build credit

- Business model focused on success of lender not borrower
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Small Business Borrowers’ Bill of Rights

- Transparent Pricing and Terms
- Non-Abusive Products
- Responsible Underwriting
- Fair Treatment from Brokers
- Inclusive Credit Access
- Fair Collection Practices
- Concern: APR not disclosed

Launched: Summer 2015
To date: 37 signatories; 13 endorsers

More information: www.responsiblebusinesslending.org/

FinTechs Do Not Have a Monopoly on Technology

- **LiftFund**: MMS and Nortridge Software
- **Accion US**: Best alternative lender by Business News Daily
- **SBA**: SBA One – “one-stop shop”
- **Loan Service Providers**, such as Prudent Lenders
- **Opportunity Fund**: merchant advance product; Lending Club partnership
- **AEO**: TiltForward used by microlenders
- **CRF/Spark**: Technology platform for SBA lending
What can mission-driven lenders learn from the recent rise of alternative lenders?

Current Lending Market
Time Consuming Process

Situation:
- On average, a small business owner spends 24 hours researching and applying for credit.  

Solution:
- Create an online loan application.

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Current Lending Market
Ambiguity in Online Process

Situation:

- Some online lending is extremely costly and terms can be unclear to borrowers.

Solution:

- Responsible, mission-based lenders to provide affordable loan capital. Borrowers are informed (educated) on loan terms and conditions upfront.

How are CRF and EGF Responding?

- What can we learn from the rise of alternative lenders?
- What are the implications of the rise of alternative lenders for the communities we serve?
- How can CDFIs partner with each other and with FinTech partners?
Questions?

Contact us:
- 10ksb@ofn.org
- www.ofn.org/consulting

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