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AUTOMATED LENDING: A MANDATORY UPGRADE

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eBook

Automating SMB lending is an imperative, not a luxury.

Auto manufacturers are reshaping the driver experience by developing cars that drive themselves. Marketers are propelling customers through the buying cycle by deploying tools that manage email campaigns. Retailers are ensuring that customers find what they want and need by leveraging software to replenish inventory without any manual effort. Automation spans across industries of all kinds to drive profitability, reduce labor burden and enhance the customer experience. Yet only half of all banks in the U.S. have deployed automation tools to process loans.[1] It's a mistake that will cost many lenders billions of dollars.

The cost of doing business.

Jenny owns a bakery. She's looking to expand but needs some additional capital—approximately $50,000. She decides to apply through a community bank but is rejected. The reason is not because of her credit. It's not due to her business history. It's simply that the cost of underwriting is too high for the bank. Given that underwriting a loan is the same whether Jenny is seeking $5,000, $50,000, or $250,000, the available net interest margin (NIM) is quickly overtaken by high underwriting costs. Thus, lenders focus their resources on larger, more profitable loans, which are often beyond what the small business owners need. This is creating a gap between lenders and borrowers.

As if that's not enough, economic conditions are leading to increasing cost of capital and risk of default.

Given the challenges facing financial institutions (FIs), many banks have not answered the cry from SMBs seeking capital. In a study by Phase 5 as reported in The Financial Brand, nearly half of the surveyed small businesses did not receive any offers of support from their banks and credit unions during the pandemic.[3]

The market beckons, but few respond.

SMBs want capital, but only a fraction of the total banks in the U.S. have responded. In fact, approximately 1/7th of community banks currently have their SMB loan portfolio with concentrations greater than 20%. And according to census statistics, these 600 banks combined funded about $72B in Q4 2022 alone.[2] The rest are leaving money on the table.

But it's even more than just potential revenue. American Banker estimates that the use of process automation could save banks up to $70 billion by 2025. Clearly, too many banks are missing out on too much.

The capital gap is more acute within certain business communities:

Rural small businesses rely more heavily on small banks, with 62% of loan applications going to them. Comparatively, 53% of urban small businesses apply for loans from larger banks, with only 43% reaching out to smaller banks.

Black-owned businesses receive less than 2% of small business loans. This is despite Black Americans making up 13% of the total population. In fact, studies have shown that Black-owned firms are twice as likely to see loan rejections, with less than 47% of financing applications being approved.

Women-owned small businesses receive only 16% of small business loans, even though women own roughly 30% of small companies. Overall, research has shown that women are more likely to be rejected or face more stringent terms than their male counterparts.[4]

It's not just about cost.

Margins are not the only barriers that hamper well-intended lenders. For instance, banks must contend with the following:

Heavy manual process — Time-consuming, manual processes for prequalifying borrowers and underwriting loans. In addition, SMBs don't always have good bookkeeping. Thus, lenders spend a ton of time going back and forth with the borrower to get the required information.

Resource constraints — Limited staffing resources to provide the attention needed for small business loans when they can focus on loans with higher returns.

Risk — More automation may mean less human supervision. In some cases, banks may compensate for their misguided concerns by raising loan rates, which can weaken competitive positioning.

Despite these challenges, technology can provide a solution.

Automated SMB lending isn't out of reach.

Automation does not require a wholesale change in processes or infrastructure. However, done correctly, automating entire workflows can redefine what's possible for banks and credit unions.

These are some of the critical automation paths you'll want to consider for accelerating your SMB lending business.

- **Prequalifying businesses:** The ability to collect data is essential. But applying the insights is equally important. For example, banks can utilize intelligent solutions that use robotic process automation (RPAs) to classify transactions into a P&L that can then be used to support loan offers and underwriting.
- **Decisioning:** Lenders can benefit from deploying a decision engine using the bank's risk rules. This allows uniform application of policies that are balanced between business growth and "help data" from transactions and more traditional metrics including credit history.
- **Underwriting loans:** Relying solely on credit scores can doom loan performance. Instead, automation technology helps banks:
    - Aggregate, review, and validate information about the borrower and business through external data sources
    - Conduct checks on borrower and business background, OFAC list check, bankruptcy, delinquency
    - Generate a soft offer within seconds of the borrower submitting an application
- **Closing and boarding process:** Automation can streamline processes from pre-qualifying borrowers to closing and boarding. Banks can leverage technology to synthesize insights for reviewing individual loans and generating closing documents.

So what?

Lenders not leveraging automation technology are either leaving money on the table in failing to capture the SMB lending business or throwing money away by pouring resources into inefficiencies. Conversely, the right technology will accelerate growth for banks and credit unions.

Unlock new revenue opportunities

Optimize lending staff resources

Drive compliance

Reduce customer acquisition and lending operations costs

Ultimately serve more businesses in their communities

About Lendio

Lendio is the nation's leading small business financial solutions provider. With its diverse network of lenders, Lendio enables small business owners to apply for multiple business financing options with a single application. To date, Lendio has facilitated more than 330,000 small business loans for more than $12 billion in total funding, including $9.8 billion in PPP loan approvals as part of government COVID relief. In addition to creating access to small business capital, Lendio offers time-saving financial SaaS products designed to streamline business operations. Lendio is a values-driven organization striving to provide equal access to capital to underserved communities and America's smallest businesses. For every new marketplace loan Lendio facilitates, Lendio Gives—an employee contribution and employer-matching fund—provides a microloan to low-income entrepreneurs worldwide. In addition, Lendio ranks on Fortune's Best Workplaces in Financial Services & Insurance and Inc.'s Best Workplaces three years in a row. More information about Lendio is available at www.lendio.com/lil.

Reach out to intelligentlending@lendio.com to learn more.

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[1] Cornerstone Advisors (compiled using FI Navigator, FedFIS, and our own database that analyzes bank system selection and deployment).
[2] Federal Census Bureau synthesized by Cornerstone Advisors 2022
[3] Financial Brand: Banking's Critical Role In Saving Small Businesses
[4] 25+ Essential small business lending statistics [2022]