How **Digital Lending Solutions** for Small to Mid-Sized Businesses Can Increase Efficiency and Maximize Profitability

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Executive Summary

When considering the viability of the small business lending market, banks and credit unions often struggle to deliver these all-important loans quickly, conveniently and profitably. Among the hurdles are legacy core technology limitations, budget shortages and regulatory concerns.

While these apprehensions are theoretically warranted, banks and credit unions are leaving money on the table by not adopting forward-thinking digital lending solutions. According to the American Bankers Association's "The State of Digital Lending (2018)" (ABA Report), only half of larger banks (assets above $1 billion) surveyed and 38 percent of smaller banks use a digital loan origination channel.

The Federal Deposit Insurance Corporation (FDIC) 2018 Small Business Lending Survey found that between 2008 and 2017 the number of small banks in the country dropped by nearly a third and small-bank assets dropped by more than 14 percent. Larger banks, conversely, increased assets by 13 percent. In December 2017 small banks held just 17 percent of all banking assets, but interestingly this banking segment managed nearly 53 percent of all small loans to businesses.

"Despite the importance of banks to small businesses and the importance of small businesses to the larger economy, very little comprehensive information is available about small business lending by banks," the FDIC report stated. "In particular, evidence is scarce about how banks define small business lending, what approaches they take to meet the needs of these customers, and whether small banks and large banks approach small business lending in significantly different ways."

The purpose of this white paper is to identify and address the current state of digital lending practices as it pertains to banks and credit unions, while identifying pain points as well as opportunities. Additionally, industry experts will provide insights related to small business lending solutions that streamline the process via real-time, white label, cross-channel, end-to-end and secure digital lending platforms.

Identifying and Leveraging Profitable Commercial Lending Products

To remain competitive against megabanks and emerging fintech lenders, community and regional banks and credit unions have to first determine which lending products will meet customer and member needs and then price those loans appropriately, while ensuring profitability.

Whether a traditional term loan, a short-term loan, an SBA loan, an equipment loan, a commercial real estate loan or a business line of credit, a number of factors must be considered to ensure that these loans are not only best-suited for qualified borrowers, but make fiscal sense.

"Business is all about measuring results, and the challenge related to lending, which we are all trying to figure out, is what these lending costs are," said William Phelan, president of the Skokie, IL based PayNet, Inc. that provides company credit assessments to improve profitability for commercial lenders and increase access to capital for America's Main Street.

"We are trying to figure out the technology legacy systems and processes for banks and what the costs are for them," said Phelan. "Tech may look good on paper, but you have to be able to show results."

According to PayNet data, and from a credit standpoint, it costs the average bank or credit union approximately $5,000 to underwrite one loan in-house. Phelan said it becomes "prohibitively" expensive for a credit department to manually underwrite loans. As a result, many smaller financial institutions have historically backed away from small business lending.
In the last few years, however, he said the fintech revolution has changed the industry's topography.

"The whole digital lending world is changing rapidly," said Phelan. "Banks are dipping their toes in the [fintech] water."

While banks under $10 billion struggle to compete for large loan balances, Cornerstone Advisors' Senior Director Joel Pruis noted that "the small business lending market is wide open" to credit unions and banks of all asset classes. He added that Cornerstone Advisors has experience in this space as a financial and technology consulting firm that has served the banking and credit union industry for more than 15 years.

"Whether a bank has $25 million in assets or $1 trillion in assets, both can make a $75,000 small business line of credit or term loan," said Pruis. "More importantly, the small business segment is ripe to support the second growth priority – commercial cash management/fee income."

According to the ABA Report, lines of credit are most often used to finance day-to-day operations, such as accounts receivable (70.5 percent), inventory (85.6 percent) and working capital (88.6 percent).

"Small and large banks generally offer the same types of loan products, use similar underwriting criteria to evaluate small business borrowers, and accept the same collateral, with a few exceptions," the report stated.

"Thus, although small and large banks may approach small business lending using distinct business models, the process appears to involve many common elements and be somewhat relational in nature for both small and large banks."

Defining the User Lending Experience

The leading digital lending obstacle for smaller credit unions and banks has been integrating digital lending solutions with an existing core technology platform. In most cases, core technology providers have all but made data integration with third party providers burdensome or near impossible. As a result, C-level banking executives understandably have shied away from adopting digital lending solutions.

"The core platforms—the big players in the space—haven't moved quickly to help banks interact with their customers in real time. Innovation is difficult and so typically you see innovative new solutions built from start-ups," said Velocity Solutions' Director of Digital Lending, Chris Rentner. "What now exists is a gap between what customers expect in their daily lives and what is offered from their financial institution related to customer experience and back office work flow and business processes."

Rentner founded, and was the CEO of, the digital lending software company Akouba Inc., a white label SaaS-based digital lending platform that enables financial institutions to underwrite loans efficiently and profitably to small and medium-sized business customers. Akouba was acquired by the Fort Lauderdale, FL based Velocity Solutions, LLC in 2018. With more than more than 400 financial institutions using its technology solutions, Velocity provides digital revenue enhancement and compliance solutions to regional and community banks and credit unions.

"Akouba is a natural fit in our efforts to expand the breadth of our product suite. We already serve the consumer lending space with our small-dollar, short-term lending platform, CashPlease," said Velocity Solutions' Executive Vice President of Corporate Development Mike Triggiano. "The acquisition of Akouba provides a natural progression to providing an end-to-end digital lending platform."

The industry demand for a real-time, white label, cross-channel, end-to-end, secure digital loan origination solution that can handle multiple products is due, in part, to consumer expectations resulting from "one-click" conditioning. Banking customers want the same immediacy with loan applications and approval as they do with an online shopping experience at Amazon. With a solution like Akouba, customer data is securely transmitted to the financial institutions so lending decisions can be quickly made and funding can occur faster.

"It is so important to be able to break down the walls of disconnected, disparate systems that have been siloed for years—even decades—so it's a huge difference from what every financial institution in the marketplace is accustomed to," said Rentner, who underscored the importance of a dedicated and secure channel where lenders and borrowers can communicate.

In a concerted effort to close the small business lending "credit gap," and prior to Velocity Solutions acquiring Akouba, Rentner partnered with PayNet. The goal was to integrate data analytic capabilities allowing financial institutions access to PayNet Credit History Reports, PayNet MasterScore v2 and risk management solutions as well as financial statements and tax return information directly linked to the Akouba platform.

"There is a digital lending revolution coming," said Phelan. "We can sense this wave coming as we attend conferences and other industry events."

PayNet Senior Vice President of Marketing, Rissa Reddan, added that in the last year, many banks have inquired about digital lending solutions. "There is an aspect to helping bankers understand the ecosystem and the players within it, so they can get the lay of the land and map out their digital lending plan," said Reddan. "We are seeing more and more banks embrace innovation and are looking to get to the forefront. The sea change is in full force."

Cornerstone Advisors has worked with over 1,200 clients during its history and is typically actively engaged with 200-plus banks and credit unions at any given time, said Pruis. He agrees with Rentner in that legacy technology platforms have created a barrier for the adoption of digital lending solutions. As a result, many financial institutions have been slow to enhance online offerings and have not been able to meet the lending demands of the individual consumer or small business borrower.

"Functionality has been stale from some of the legacy platforms," said Pruis. "More recent platforms, like Akouba, have a fresher approach to the technology."

From Pruis's perspective, technology barriers aren't the only reason financial institutions have been hesitant to enter the small business lending market. He explained that over the last 10 years, since the Great Recession, these banks and credit unions have focused almost solely on growing commercial real estate portfolios.

"We are seeing that the growth in the commercial real estate portfolios is slowing, so banks are looking at new categories like C&I loans and they need a platform that can automate and expedite loans," said Pruis. "They can't do a $50,000 small business line of credit loan the same way they did a $3 million commercial real estate mortgage."

Determining Lending Criteria that Maximizes Profitability

According to the 2016 "Federal Reserve Small Business Credit Survey Report on Employer Firms," borrowers have different perceptions about the lending process when applying online versus applying in a branch. For example, 42 percent of those polled said that the in-branch application process is off-putting compared to 26 percent that applied online. Timing is another key factor, with 45 percent experiencing disappointment waiting for loan approval for in-branch applications whereas only 17 percent felt this way when applying online.

"Community banks have real, true customer relationships and yet they do so much paper pushing and manual processing of information," said Rentner. "We break down all of those barriers and give back tons of time to those employees to create even better relationships with customers and build on existing relationships."

Determining what issues confound C-level executives is critical to increasing digital lending solution adoption rates. According to the ABA Report, banks that were polled cited integration with core systems (60 percent), compliance, (57 percent) and ensuring a superior customer experience (53 percent) as the biggest hurdles to offering a digital lending technology solution. "Digital lending fundamentally changes the business case and experience. The application is online, so borrowers can easily fill it out at home at their convenience. In a well-designed portal, the questions are intuitive, stepping the customer through the process in a straightforward manner," the report stated. "Borrowers can usually upload most supporting documents right in the application; there's no need to photocopy or hand-deliver documents."

Cornerstone's Pruis echoed the findings in the ABA report, adding that the firm's credit union and banking clients are not interested in having their staff spend time filling out lengthy application forms in a branch setting. Their potential borrowers also prefer to enter primary lending criteria online to quickly determine if they qualify for a business line of credit.

"If they can a get a quick response from a company like Akouba, then they are much more likely to go back and complete the rest of the process," said Pruis. "They don't want to feel like they are entering a black hole of underwriting and then have a lengthy wait for a response."

Harvard Business School's "The State of Small Business Lending: Credit Access during the Recovery and How Technology May Change the Game (2014)" noted that it takes borrowers 25 hours to complete a manual loan application, but only 30 minutes to complete an online application. On average, the manual process requires 28 tasks and a processing cost of $4,000 to $6,000. Conversely, an online application requires nine tasks and the cost to the financial institution is between $600 and $900.

While this streamlined approach is seemingly a no-brainer for C-level executives to pursue and adopt, there are concerns related to regulatory compliance, which Rentner said is understandable. However, he noted that this concern has been addressed in part due to Akouba's close working relationship with Finastra's LaserPro solution, an advanced regulatory compliance technology. As a result, Akouba can configure and meet the unique credit policy and risk rating metrics of each institution.

"We are one of the only digital lending platforms that have connectivity with LaserPro—the eight hundred pound gorilla in the document compliance space in banking," said Rentner. "We aren't a black box. Credit policy questions are critically important. So we clearly identify in simple, clean language the credit policies that empower the financial institution's employees from vice presidents to chief lending and risk officers."

Digital Lending Takeaways

With over 6,000 community banks and 5,000 credit unions in the United States, the opportunity for small business loans is considerable. By determining how these potential customers prefer to utilize a bank's products and services, C-level executives can offer white label, secure and compliant digital lending solutions.

As more and more banks look to fintech companies as collaborators, as opposed to competitors, seamless, real-time integration of data via a secure portal will enhance relationships between consumers and their banks and credit unions.

According to the ABA Report, 71 percent of banker respondents said their bank was interested in using a third-party digital platform for consumer loan origination. For all banks, the strongest interest was in partnering for auto loans (71%) and unsecured personal loans (71%), as well as home improvement loans (56%) and student loans (44%).

Looking back to the Great Recession, Phelan said there has been a continuing credit supply shock since then, with the big banks pulling out of many local communities across the country. This vacuum created a space for fintechs like Akouba that offer digital lending solutions and intuitive banking technologies to banks and credit unions to help them fill the small business loan credit gap.

"It is these types of technologies that will help banks with some of these lending issues they have been plagued with for so long," said Phelan. "Whether banks decide to buy or build a business banking operating platform, they can learn a lot from the experience of fintech lenders."

AKOUBA™

Akouba provides financial institutions a secure cloudbased platform that reduces the cost and time required to issue a small business loan. The platform, configured to each lender's underwriting principles, allows small businesses to apply and track their application electronically, with results delivered within 48 hours. The financial institution retains control over the decision, the pricing, the credit policy, the loan dollars, and the customer experience. Loans are automatically booked and funded to the financial institution's core.

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