AKOUBA™ by Velocity Solutions

WHITE PAPER TRILOGY

The Battle for Small Business Lending

Part 1: The Competition is Charging the Battleground

Akouba™ by Velocity Solutions
www.myvelocity.com/akouba

The pandemic has certainly dealt a devastating blow to small businesses across the country.

Small business owners have been plagued with problems since the onset of COVID-19. Many have permanently closed, many were denied PPP loans either through a faulty system or megabank neglect, and some who did receive PPP funding may soon need additional funds in the future.

Big Banks Serving Big Businesses

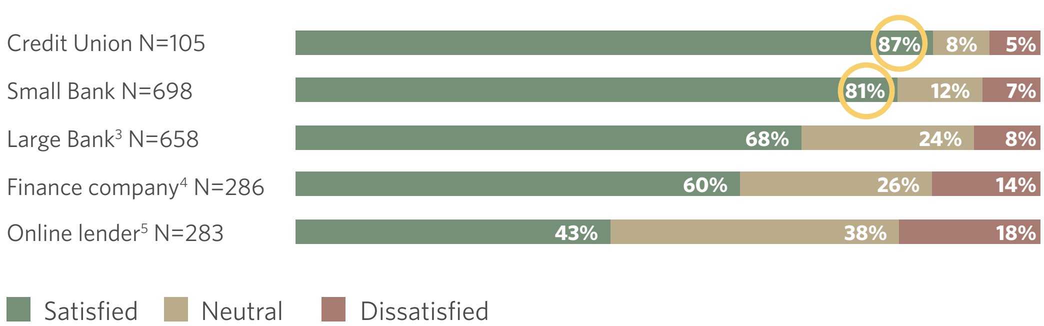
But in a cruel twist of irony, it has become even harder (in some cases) for small business owners to obtain credit. Government programs such as PPP and EIDL certainly helped, but a good deal of those relief efforts were fraught with problems, executed poorly, confusing to applicants and still left a huge credit chasm. And what did the big banks do? They tightened their underwriting standards for small business loans, requesting more detailed information on cash flow, revenue or potential growth that many smaller businesses simply do not or cannot maintain in this pandemic-ravaged marketplace. Larger businesses seeking credit are far more likely to maintain the more traditional, detailed types of information requested by lenders. So, in a time when our local business owners need more support than ever, the big banks are catering to the big businesses.

And to twist the knife in even deeper, many community banks—the main source of credit for many small businesses—have disappeared or consolidated over the past decade.

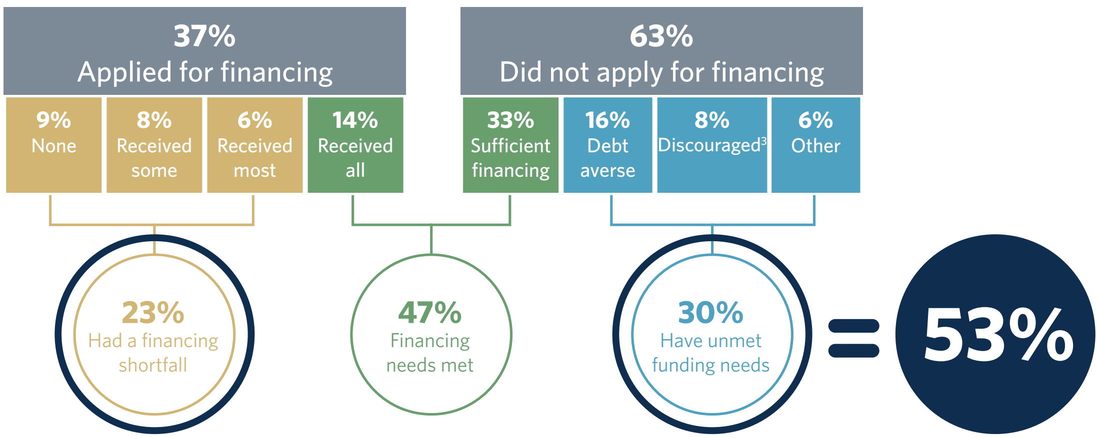
The Federal Reserve's 2021 Small Business Credit Survey (fielded in Sep-Oct 2020) mostly focuses on effects of the pandemic. It is not surprising that after all the chaos that these small business firms suffered, small banks and credit unions are rated highest for providing satisfaction to small banks and credit unions.

Applicants were most satisfied with credit unions and small banks.

LENDER SATISFACTION[1,2] (% of loan, line of credit, and cash advance applicants approved for at least some financing at source)



Taking a closer look at the businesses that applied for and did not apply for financing in the survey, the outcome is even more surprising. By combining those who had a financing shortfall with those who reported completely unmet funding needs – we are looking at 53% of firms in this survey who STILL need financing!



Where Do Small Businesses Get Funding?

So, let's talk about all the options available to small businesses for obtaining funding. As mentioned, there are the government programs such as PPP and EIDL and traditional banks. Some P2P lenders offer business loans, but it is not a regulated channel and interest rates tend to be higher.

The Neobanks/Fintechs have exploded onto the scene, but even with all the recent press around these new "It" banks, the industry is still young, and hasn't quite penetrated the small business lending market...yet. All of these credit sources come with their own benefits and disadvantages, but what is very clear is that such an unprecedented level of demand for small business credit creates a fertile breeding ground for competition.

Government Programs (PPP & EIDL)

- Use of working capital funds not clearly defined
- Loan forgiveness rules are unclear

Traditional Banks

- Many have drastically tightened underwriting standards since pandemic

P2P Lenders

- Not regulated
- Interest rates usually higher
- Anonymous lenders

Neobanks/ Fintechs

- Young industry- not many offer business loans yet

The New Competitors Follow Their Own Rules

With this sort of dynamic in the small business lending marketplace, the lines begin to blur. The Neobanks have essentially erased the lines and redrawn them with a whole new set of rules that we have never seen before. These Fintechs are seeking bank charters—and succeeding! The movement in 2021 alone has been staggering and borne from a digital-first mentality that has pervaded almost every area of our transactional lives. We are seeing more of a direct competitive threat than ever to community financial institutions. And the threats encompass not only small business lending, but the *entire spectrum* of a financial institution's offerings.

Fintechs Seeking Bank Charters:

Obtained bank charters through application or acquisition

- **Varo**: First Fintech to obtain a national bank charter in February 2020
- **JIKO**: Purchased Mid-Central Federal Savings Bank in September 2020
- **Square**: Opened as a bank March 2021
- **LendingClub**: Purchased Radius Bancorp in February 2020

Applications and/or applications PENDING

- **SoFi**: In March 2021, announced that they will purchase Golden Pacific Bancorp Inc.
- **Brex**: Filed for an industrial bank charter, February 2021
- **FIGURE**: Applied in November 2020

Source: https://www.americanbanker.com/list/the-many-paths-fintechs-are-taking-to-bankings-mainstream

What Does this Mean for Community Banks and Credit Unions?

There's no question that the competition is changing, growing and morphing into new types of categories we haven't seen before. But, while Fintechs are becoming more of a force to be reckoned with, there is an increasingly positive push towards community financial institutions in the area of small business lending, specifically. Both national and regional publications and organizations are promoting the benefits of securing small business credit from community financial institutions.

Just a few examples:

Forbes

Financing Your Small Business with Small-Business Loans – What You Need to Know
March 2021

"If your current lender isn't budging, you may need to try a new bank, particularly a community bank. Establishing relationships with community banks is far easier, in my experience. Community banks are more likely to consider you holistically alongside your cash flow, credit and collateral factors."

Litchfield Independent Review
INDEPENDENTREVIEW.NET

LETTER: Community banks make a difference in their communities
April 2021

"Community banks offer nimble decision-making on business loans because decisions are made locally. Megabanks must often convene loan-approval committees located in another state, far away from their customers."

ICBA®

About Community Banking
Often referred to as *America's Favorite Lenders,* community banks:

- Comprise **99% of all banks**
- Provide **more than 60% of all small business loans**
- Make **more than 80% of agricultural loans**
- Have **more than 50,000 locations** nationwide
- Employ **nearly 750,000 people**

Provide **more than 60% of all small business loans**

We know the following:

- ✓ Small businesses are most satisfied with community-sized financial institutions
- ✓ More than half of small businesses still need funding
- ✓ Financial publications and organizations advocate for community financial institutions

So, the question is…why aren't MORE community financial institutions offering small business loans?

Top 5 Reasons Community Financial Institutions Do Not Offer Small Business Lending

1. Traditional loan processes are manual and inefficient
2. Not profitable: small loans cost as much as large loans to process
3. Lack of staff to manage loan processing and underwriting
4. Confusion around changing regulatory guidance
5. Lack the internal technology resources to build a platform

These are significant obstacles and daunting barriers to entry for a community-sized bank or credit union. But there is one solution ***powerful enough*** to obliterate all of these obstacles and defeat the competition. This solution allows community financial institutions to profitably offer small business loans that are efficient, convenient and compliant. And that is ***the power of a digital loan platform.***

Don't miss Part II of The Battle for Small Business Lending – White Paper Trilogy: *Go Digital or Get Defeated*
