Small Business Lending Landscape

Pam Porter, Opportunity Finance Network
Agenda

- Review small business landscape
- Taking a customer’s view of online lenders
- How CDFIs can differentiate
- Discuss how CDFIs and mission-driven lenders might respond to changing landscape
Our panel

- Frank Altman  CRF
- Dave Glaser  Montana CDC
- Adrian Gonzalez  Accion Texas
- Brenda McDaniel  Kentucky Highlands
- Pam Porter  OFN
Small business market opportunity

<table>
<thead>
<tr>
<th>Size by Employees</th>
<th>Number of Firms</th>
<th>% of Total</th>
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<tbody>
<tr>
<td>0 employees</td>
<td>21.3 million</td>
<td>78%</td>
</tr>
<tr>
<td>1-4 employees</td>
<td>3.6 million</td>
<td>13%</td>
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<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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And 23% report that they sought credit last year*

* Reference Federal Reserve Bank of NY and Philadelphia study published Summer 2014
Who is lending to these small businesses?

- Traditional sources
- Non-traditional sources
- Emerging sources
Flat growth of loans less than $1 million

Tight Credit
Commercial loans of $1 million or less held by banks

Source: Federal Deposit Insurance Corp.
The Wall Street Journal
Minority borrowers experience much higher denial rates

SBA: Minority-owned firms more likely to be turned down by lenders:

• Small firms 3x more likely
• Large firms 2x more likely
Women entrepreneurs face challenges accessing capital

- U.S. Senate Committee on Small Business and Entrepreneurship:
  - 8.6 million women-owned small businesses create or maintain 23 million jobs – 16% of all U.S. jobs
  - Only 4% of all small business loans go to women
  - Less than 5% of federal contracts go to women
  - Business training and counseling for women not reauthorized or funded
Mission-driven lenders increasing lending much more rapidly than banks

- Small business lending by CDFIs:
  - 183 OFN members up 43% from 2012-13
  - $300 million to $437 million

- Others:
  - SBA 504
  - 7(a)
  - ?
Mission Driven Lenders more effective at serving Low Income communities

- **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.”
New lenders are changing the small business landscape

**Bloomberg News:**
- Rising alternative-lender market in the U.S. was $3 billion in 2013 alone

**The Financial Times:**
- Some investors view peer-to-peer lending as an asset class and expect it to do $25 billion in annual business globally by 2019

**The New York Times:**
- OnDeck has done $900 million in small business loans in last 5 years
- Lending Club and Prosper > $4 billion in loans in last 2-3 years

**The Coleman Report:**
- More than $100 billion has been pushed through technology platforms since 2006 to finance small companies
Growth at **Just One** Alternative Lender (OnDeck)
Alternative Lenders Going Mainstream

- **Forbes 100 ‘Most Promising Companies’** in the U.S. in 2014:
  - **Lending Club** ($98M in revenue; 379 employees)
  - **OnDeck** ($65M in revenue; 240 employees)
  - **Kabbage** ($17M in revenue; 80 employees)

- **Square, Inc.**, the small-business mobile payment company that expects $1 billion in revenue in 2014, launched **Square Capital**, to issue merchant cash advances

- U.K. regulators plan to **require banks that deny credit to small businesses to refer those applicants automatically to alternative lenders**
Venture Capital Moving Into the Space

Record Quarter for Lending Startups

Venture capital investment in lending startups hit a new high in the first quarter, reaching $302.8 million.

Source: Dow Jones VentureSource | WSJ.com
What’s Driving This Rapid Transformation of the Small-Business Lending Landscape?
Technology plays a role....

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
Do Alternative Lenders have a monopoly on Technology?

- **CDFI Accion Texas**, -- MMS and Nortridge Software
- **SBA** – SBA One – “one stop shop”
- **Loan Service Providers**, such as Prudent Lenders
- **CRF**: Process platform
- **Opportunity Fund**: merchant advance product

Yet, technology has not (yet?) driven explosive growth
Alternative 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 & mortar presence

- High margins offset **high default rates**
  - Default rates of 6 - 10% (vs. <1-3% SBA)

- **Volume-driven returns**
  (Example: Lending Club made $7 million on revenue of $98 million in 2013 on loan volume of $2 billion)
Are These New Lenders Taking Market Share?

Probably some...although not clear

Most alternative lenders accept near-prime FICO scores or above (650+).

Some accept sub-prime FICO scores (<650).

Commentators assert that borrowers are underserved
What can Mission-Driven Lenders Learn From the Recent Rise of Alternative Lenders?
Peer-to-peer lending companies:
- Lending Club, Prosper, Indiegogo and Funding Circle

Merchant cash advance companies:
- RapidAdvance, AdvanceMe, Square Capital

Online companies specializing in business lending:
- OnDeck and VMC Capital

Online lenders that lend only to online companies:
- Kabbage and PayPal

Online “matchmakers” that connect borrower with lenders:
- Lendio, Boefly and Biz2 Credit

Google Search “small business loan”
Our panelists: What take-aways did you have from this review?

- CRF
- Montana CDC
- Accion Texas
- Kentucky Highlands
Bigger picture

- How can/should CDFIs differentiate?
- 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?