Rethinking SMB Lending

small business lending

Summary: Small businesses have been at the heart of the post-pandemic economic recovery, but high inflation and hiring challenges are contributing to a negative outlook for them. By rethinking the lending process, CFIs can support SMBs through these tough times, while also increasing their own revenue opportunities, cutting the cost to serve, and minimizing risk. We explore how.

Small but mighty, bees play a crucial role in securing our food supply. While foraging for nectar and pollen to sustain their brood, they accomplish pollination — a plant's reproduction process in which pollen is transferred from flower anther to stigma. More than 90 US crop types rely on bee pollination, with the European honeybee responsible for pollinating crops that make up one-third of food on American dinner plates. It is estimated that bee pollination adds $15B to crop value.

Similarly, small and medium-sized businesses (SMBs) — which in 2019 accounted for 44% of economic activity — have been the backbone of the economic recovery in the post-pandemic world. However, although the NFIB Small Business Optimism Index increased 0.5 points in January to 90.3, it remains below the 49Y average of 98. While inflation is starting to ease, it continues to be a major concern for small business owners, as do hiring challenges.

Community financial institutions (CFIs) can play their part in supporting SMBs through the economic downturn by rethinking their lending practices. According to McKinsey, this could lead to a significant impact on a financial institution, including:

- A 10%-15% increase in revenue by boosting conversion rates.
- Operational efficiency gains of 20%-30% due to streamlining and digitizing the process.
- A 10%-25% reduction in nonperforming loans by enhancing risk models and standardizing decision-making.

Four Ways to Rethink Lending

Typically, SMBs experience uncertain outcomes and lengthy loan processing, as credit ratings may be slow to come by and financial institutions view them as high-risk borrowers. This, in turn, leads to these businesses being charged higher interest rates.

CFIs can address these challenges and position themselves as a **lender of choice by adopting the following four strategies:**

1. **Zero in on target segments.** To create tailored offerings for each SMB customer, CFIs need to identify target segments, gain a deep understanding of their business and growth potential, and address their specific pain points. Maintaining a diversified loan portfolio is key to managing risk and enhancing asset quality. One way to generate loan opportunities is for an institution to become embedded in the customer's operations by offering back-office and merchant services. This gives a CFI a unique view of the customer's performance, allowing the CFI to anticipate the business's lending needs, while also providing the full banking experience that customers crave.

2. **Streamline the process.** The customer experience needs to be at the center of the lending process. Questions such as how long it takes to complete a loan application, whether it is user-friendly for the applicant, and whether it leads to the borrower selecting the right loan product, are crucial to redesigning and digitizing the customer journey to suit the needs of today's SMB customer. This includes offering an end-to-end digital process while maintaining access to a relationship manager at every step. On the back end, by reviewing legacy policies and credit-decision making processes, CFIs can increase automation and speed to funding, while limiting manual intervention to the riskiest and most complex cases.
3. **Leverage analytics.** CFIs have access to a wealth of information about their SMB customers. However, this information might be stored in disparate systems with no ability to connect the dots and develop insights for cross-functional use. What's more, borrowers leave a significant digital footprint as they interact with lenders and their affiliates. By aggregating the data — both legacy and from other data streams — and applying analytics, CFIs can gain valuable insight and predict possible business outcomes. This should enable them to make sophisticated lending decisions and tailor their offerings to each individual business.
4. **Redesign the delivery model.** To deliver the optimal customer experience, CFIs need to have the right infrastructure in place. This includes integrating the right technology platforms with existing systems, partnering with a fintech, or, as some financial institutions have done, opting for a design, installation, and configuration of computer infrastructure where none existed before.

By reimagining the lending process, CFIs can continue to play a vital role in the communities they serve by supporting their business customers through the downturn and beyond. What's more, they can identify opportunities to grow their loan book and cut their costs of funding, while minimizing risk. A win-win for everyone.

EXCESS LIQUIDITY THAT YOU WANT TO INVEST?

ECONOMY & RATES

Rates As Of: 03/07/2023 08:29AM (GMT-0700)

Treasury	Yields	MTD Chg	YTD Chg
3M	4.93	0.05	0.51
6M	5.22	0.05	0.46
1Y	5.11	0.10	0.40
2Y	4.94	0.12	0.51
5Y	4.29	0.10	0.29
10Y	3.98	0.05	0.10
30Y	3.91	-0.01	-0.06

FF Market	FF Disc	IORB
4.57	4.75	4.65
SOFR	**Prime**	**OBFR**
4.55	7.75	4.57