Can Electronic Cash Flow Data Help Underwrite SMB Loans?

small business lending

Summary: More and more CFIs are using alternative cash flow data to determine the creditworthiness of prospective small business borrowers. They are partnering with fintechs and other nonbank providers to access and analyze prospects' electronic cash flow information. A nonprofit research organization analyzed these practices and we provide a summary of the results.

Cash is king — and for millennia, businesses have been monitoring how much they have of it on hand. Cash flow reporting in the US dates back to 1863 when the Northern Central Railroad detailed its cash receipts and cash disbursements within a summary of its financial transactions for the year. In 1902, the United States Steel Corporation reported the major reasons why the amount of its "funds" changed, defined as current assets minus accounts payable. Seventy years later, accounting bodies began recommending funds statements and by the late 1980s, the Financial Accounting Standards Board (FASB) called for formal cash flow statements to be included in financial reports.

Now, cash flow — as measured by electronic data across various online platforms — is also considered an effective alternative way to determine whether a small business should be granted a loan.

The Benefits of Cash Flow Data

While reviewing historical data to determine whether a business pays its bills on time is valuable, it's also a lagging indicator, according to fintech executive Scott Steinberg. His company, Enigma Technologies, aids financial institutions in reviewing aggregate online account information on prospective borrowers. "What people want to understand is: What is the current health?" Steinberg said.

FinRegLab, a nonprofit research organization, analyzed the effectiveness of cash flow- based underwriting in its report, "The Use of Cash-Flow Data in Underwriting Credit: Small Business Spotlight." It analyzed lenders' use of prospective borrowers' electronic cash flow information — bank account records, feeds from accounting software, and transaction information from ecommerce platforms and payment processors — to reduce costs and improve accuracy in underwriting, particularly for smaller loans to smaller companies.

The nonprofit found that cash flow metrics generally performed as well as traditional credit scores, and can be even more valuable when determining the creditworthiness of small business borrowers with little or no credit histories. Beyond this, cash flow metrics can provide additional insights into credit risk. Data derived from bank accounts or from accounting software can provide a more detailed and timelier view of the business' overall finances — inflows, outflows, and cushions on an ongoing basis — than traditional credit reports and scores or annualized financial statements.

Loan Underwriting Initiatives

FinRegLab's report also listed a number of traditional institutions, including community financial institutions (CFIs), that have now launched initiatives to underwrite loans based on cash flow data, either on their own or in partnership with fintechs and other nonbank providers.

Here are some examples of CFIs putting cash flow data analysis to good use in their underwriting practices:

- Eastern Bank, a CFI in Massachusetts, worked with several fintechs to develop a product that automates its underwriting processes, which includes account data consideration for existing customers. That product is also now being sold to other CFIs through a spinoff company.
- A network of CFIs and several regionals partnered with an online lender to provide platforms for underwriting small business loans using cash flow and other data, with same-day decisions and funding within three days of approval.
- Opportunity Fund and Lending Club, a community development financial institution (CDFI), partnered with two other online lenders to share customers, online application technology, and credit assessment tools, including those used to assess cash flow data. This process helped them to better and more quickly reach underserved populations and more established businesses.

Consider working with fintechs and other nonbank providers to access and analyze the cash flow metrics of prospective small business borrowers. Even when used in tandem with traditional underwriting practices, cash flow metrics can provide additional — and timelier — insights into the creditworthiness of prospective borrowers, particularly those with little or no credit histories.

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ECONOMY & RATES

Rates As Of: 08/09/2023 05:36AM (GMT-0700)

Treasury	Yields	MTD Chg	YTD Chg
3M	5.57	0.02	1.15
6M	5.53	0.00	0.77
1Y	5.35	-0.02	0.64
2Y	4.77	-0.11	0.35
5Y	4.12	-0.06	0.12
10Y	4.02	0.06	0.15
30Y	4.19	0.18	0.22

FF Market	FF Disc	IORB
5.33	5.50	5.40
SOFR	**Prime**	**OBFR**
5.30	8.50	5.32