Private Equity Firms Take a Larger Slice of the Lending Pie

small business lending business customers competition

Summary: Private equity firms are actively targeting the lending market for small and midsize businesses, and they have deep pockets to use in their pursuit. In order to remain competitive, CFIs must focus on and highlight their expertise in this area.

The World Pie Eating Championship has taken place for the past 31 years in Wigan, England, but it's not cherry pies that the contestants wolf down. Competitors consume meat and potato pies, which they must completely swallow and prove that they have consumed by showing an empty mouth. When the contest initially began in 1992, contestants raced to eat as many pies as they could as quickly as possible. Bowing to the UK government's healthy eating guidelines, however, contestants now race to be the quickest to eat a single 12cm x 3.5cm pie. This year's trophy went to a Wigan native, who inhaled a full pie in 35.4 seconds.

Financial institutions may not be racing to consume food, but they know a little something about dealing with others who are vying for a larger piece of the pie. As the current economy spurred many financial institutions to scale back their lending over the past few months, particularly to specific market segments, private equity (PE) firms have been closing the resulting lending gap. We recently discussed how PE firms have been funding large syndicated loans, but they have also been making moves in the consumer and small business lending spaces.

The Lending Landscape

Amidst ongoing concerns about the economy, liquidity concerns among regulators, rising funding costs, and sector weakness, financial institutions have largely been reining in their lending activity on multiple fronts. Despite ongoing demand for loans, big banks' loan approvals to small businesses were at only 13.4% in May and June. Small banks' lending activity to this group, though still down overall, saw a slight uptick from 18.7% to 18.8% in June, the first increase since January 2023, according to the June Biz2Credit Small Business Lending Index.

Having benefited from a similar imbalance in the lending market following the 2008 credit crisis, PE firms have jumped in. "We expect to grow further by filling the void that regional banks are leaving as they pull back from certain types of lending," Dan Pietrzak, co-head of private credit at KKR, said in a recent Reuters interview. Pietrzak noted that his firm is specifically targeting lending opportunities that smaller banks have been backing away from, such as consumer and auto lending.

Unregulated, non-bank lenders accounted for 75% of the lending market in 2002, up from 54% in 2000 — 18% of which Apollo Global Management believes came specifically from private credit. There is no shortage of funding among PE firms, which currently sit on roughly $1.9T in dry powder that they are eagerly looking for places to put to work, according to global market data provider Preqin Pro. That's up from $250B in 2010. Preqin predicts that the growth of private debt asset lending to small businesses will continue to soar going forward, with an expected compound annual growth rate of 10.8% that is set to reach $2.3T by 2027.

Remaining Competitive

While community financial institutions (CFIs) may not be able to slow the PE industry's rising share of consumer and small business lending, there are steps that institutions can take to position themselves more competitively and remain nimble.

Now is the time for CFIs to focus on their strengths, particularly the intimate knowledge they have of their local markets and the needs of small business customers with whom they already have relationships. Staying active in lending, particularly with their best commercial customers, will help offset the lack of other lending opportunities.

Here are some tactics that CFIs should consider in order to increase their consumer and small-business lending opportunities:

- **Revisit product strategies for small and medium businesses.** One way of doing this is to dig into the data available on existing customers to determine product offerings that can supplement and add value to the existing products business customers are already utilizing. With the World Bank estimating that small- and medium-sized businesses have unmet financing needs of roughly $5.2T each year, there are plenty of lending opportunities.
- **Use analytics to tailor product offerings.** Using analytics to tailor product offerings to individuals and businesses is a great way to enhance relationships with these customers and demonstrate your organization's in-depth knowledge of their needs. This can include areas such as back-office functions like accounts payable services. Analytics can also help provide a more thorough picture of the risks that may be involved in further lending to specific businesses.
- **Ensure the application process is painless.** It is equally important that the online and mobile user experience for borrowers is as streamlined and friendly as possible, allowing borrowers to quickly and easily apply online and have plenty of real-time transparency about where their applications stand. This will help your institution stand out, compared to others with cumbersome manual processes.

Remaining competitive on the lending front, particularly as PE firms and alternate lenders more aggressively target this market, requires proactively working alongside small- and medium-sized businesses to demonstrate your CFI's expertise and accessibility for this group.

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ECONOMY & RATES

Rates As Of: 09/18/2023 05:39AM (GMT-0700)

Treasury	Yields	MTD Chg	YTD Chg
3M	5.56	0.00	1.14
6M	5.49	0.01	0.73
1Y	5.43	0.07	0.72
2Y	5.04	0.18	0.61
5Y	4.48	0.22	0.47

10Y	4.33	0.22	0.46
30Y	4.41	0.20	0.45

FF Market	**FF Disc**	**IORB**
5.33	5.50	5.40
SOFR	**Prime**	**OBFR**
5.31	8.50	5.31