# Taking Advantage of Opportunities in Small Business Lending

A new survey suggests automation could help banks struggling to turn their small business lending ambition into action
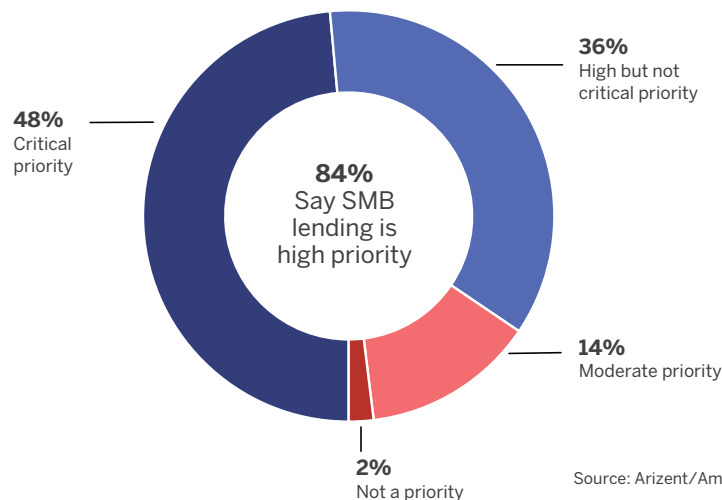
Small business lending represents a key growth market for most banks, but it also serves as one area in which many are not realizing their full potential. The challenge is a result of a number of banks having struggled to adopt efficient technologies for marketing and underwriting these types of loans. This dynamic has the potential to leave a key customer demographic underserved. Ultimately, banks are presented with a unique opportunity to deliver on an unmet need, but also face the threat of attrition from competitors that beat them in deploying more efficient and effective solutions.

In June 2023 Arizent Research surveyed 103 retail banking leaders to understand the state of automation in small business lending at U.S. banks, where they are most likely to have deployed automation and what benefits they are experiencing. The results suggest that while small business lending is a key growth market for most banks, few have systems in place to offer products to this market cost effectively. As more financial institutions adopt technology to address this underserved segment, those that fail to adapt risk falling behind and even losing current customers to their competition.

## Small business lending is a key priority for banks

The vast majority of banks recognize the attractiveness of the small and medium business (SMB) lending market -addressing SMB lending needs is a critical or high priority for 84% of banking leaders (see Figure 1).

**Figure 1: More than eight in 10 banks say SMB lending is a high priority**



- **48%** Critical priority
- **36%** High but not critical priority
- **14%** Moderate priority
- **2%** Not a priority
- **84%** Say SMB lending is high priority

Source: Arizent/American Banker, 2023

As a result of this focus, almost nine in 10 (89%) bank lenders have set at least moderate growth targets for their SMB loan business over the next two years. Whether these lenders have the tools at their disposal to achieve these ambitious goals remains an open question, however.

## Banks face key challenges as they attempt to serve the SMB market

Most banks report they are struggling with multiple areas of the SMB lending process. More than half of banks report challenges related to manual underwriting processes (57%) and difficulties in identifying and targeting borrowers (60%). Obtaining information about borrowers is problematic for 43% of banks, as well.

Even when they have first-party information available, banks face difficulty converting cross-selling opportunities. Nearly seven in 10 banks report cross-selling across all bank products is only successful about half the time — leaving a lot of opportunity on the table, and introducing potential for attrition in an attractive customer segment if the competition finds ways to overcome these challenges more quickly.
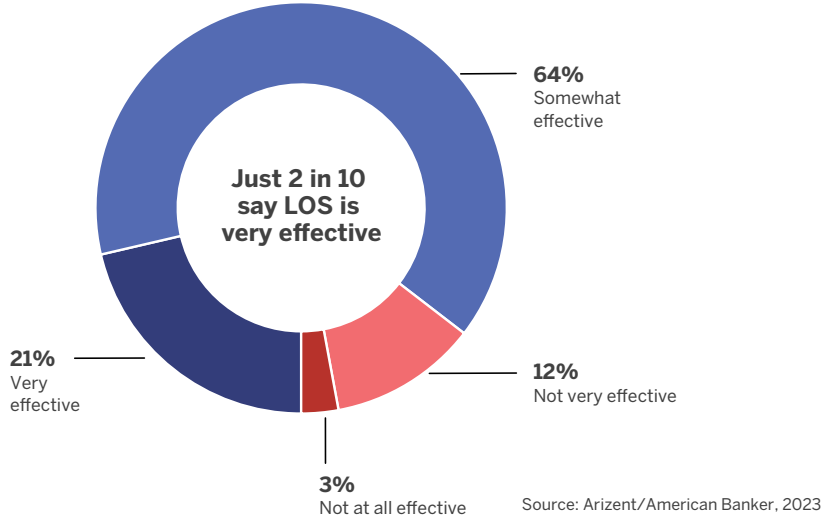
## The systems banks use to originate SMB loans are insufficient to meet efficiency demands

In many cases, the systems banks use to support SMB lending are insufficient. In fact, most of these systems aren't built with SMB lending in mind. SMB lending sits in a unique place in that it requires some of the rigor of commercial lending, but often relies on the business owner's credit. As a result, neither commercial LOS providers nor consumer solutions meet the unique needs of this market.

"Most loan origination systems were originally designed to facilitate workflow requirements in commercial real estate or commercial and industrial lending," says Philip Taliaferro, Senior Vice President and General Manager at Lendio. "In contrast, small business demands greater borrower self-service, heightened reliance on third-party data, transaction data analysis and machine-assisted decision-making."

Nearly eight in 10 banks (79%) say their loan origination systems are less effective than they could be (see Figure 2).

**Figure 2: Few banks have a highly effective loan origination system**



**64%** Somewhat effective

**Just 2 in 10 say LOS is very effective**

**12%** Not very effective

**21%** Very effective

**3%** Not at all effective
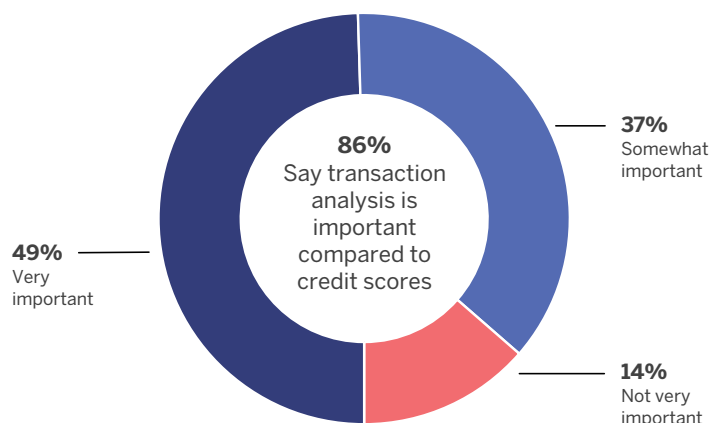
Source: Arizent/American Banker, 2023

## Transaction analysis makes SMB loan origination more effective

Not all loan origination systems are ineffective at supporting SMB lending. The ability to conduct detailed transaction analysis is a key factor in this equation (see Figure 3).

Small and medium sized businesses often lack a robust credit history that can be tied to the business independently of the owners, forcing banks to use personal credit history as an incomplete proxy for the business itself. As a result, banks turn to other metrics to support their decision-making processes.

### Figure 3: Most banks agree that transaction analysis is important for SMB lending decisions



**86%**
Say transaction analysis is important compared to credit scores

**49%** Very important

**37%** Somewhat important

**14%** Not very important

Source: Arizent/American Banker, 2023

For example, nine in 10 banks (86%) see transaction history as important as credit scores when considering underwriting an SMB loan.

Recent research from the Bank of International Settlements also suggests the use of expanded datasets that include information such as transaction analysis can lead to more equitable and effective lending practices than the use of traditional metrics such as credit scores—particularly when combined with machine learning capabilities tuned to draw objective insights from that information.[1]

However, due to the complexity of transaction analysis, only those banks with effective loan origination systems are likely to use highly detailed transaction analysis data. The banks that report having very effective loan origination systems (21% of those surveyed) are substantially more likely to be leveraging highly detailed transaction analysis data (68%) than banks that report less-effective systems (of which only 17% are performing transaction analysis).

[1] https://www.bis.org/publ/work1041.htm

## Automation drives efficiency and growth

Automation is advancing in a variety of areas, as well. Banks are leveraging automated third-party data pulls to make the underwriting process more efficient. Client-facing self-service tools can make closing and onboarding a more streamlined operation. Rule-based automation and artificial intelligence are also helping make the decisioning process more robust.

Where banks have successfully automated their processes, they are clearly benefiting. More than half the banks surveyed report benefits from automation in three areas: increased efficiencies (66%), improved competitive positioning (62%) and revenue generation (53%).

Additionally, recent research from NYU suggests systems that automate the evaluation of lending criteria can help overcome the human biases that can become embedded in more manual processes.[2]

"Automation can be a scary concept for banks as they think about making critical processes like SMB lending more efficient while continuing to manage risk effectively," says Taliaferro. "But without the growing number of technological tools that can help them produce a detailed analysis, banks are stuck in a position where they aren't fully evaluating risk and, worse, are likely missing valuable opportunities to expand their business."

## Targeted automation options can help banks accelerate their progress

Through automation banks can better serve the SMB market. In fact, among the banks surveyed, those with aggressive SMB growth targets are twice as likely to have fully automated their marketing efforts for borrower prospecting than banks with less aggressive SMB growth targets.

Some use cases for automation in SMB lending include:
- Using automation to draw on a richer mix of third-party data during the loan origination process.
- Using transaction analysis to prequalify potential borrowers for loans and develop highly targeted marketing campaigns.
- Monitoring of business health post-funding and identifying opportunities for early renewals and changes to loan product
- As the bank closes more SMB loans, the pool of data becomes richer. The increasingly sophisticated insights drawn from that broadening pool of data support better decisioning, increasingly targeted cross-selling and prospecting campaigns and, ultimately, a growing, thriving SMB lending business.

Banks that identify and adopt the automation technologies that unlock these opportunities will find themselves with a sustainable competitive advantage over their competition, given the size of the addressable market and its relatively untapped nature. The more efficient banks can become at identifying and targeting SMB loan prospects, the more quickly and capably they can address a pressing unmet need in the marketplace, increasing their potential to attract and maintain this high-priority customer segment.

[2] https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3939384

# Methodology

This research was conducted online during June of 2023 among 103 respondents. To qualify, all respondents work in the retail banking unit at a bank or credit union with $500M - $100B in assets and have knowledge of SMB lending practices. All respondents are management-level or higher. This was a blind data collection effort; Lendio was not identified as a sponsor of this research.

## About Lendio

Lendio's mission is to fuel the dreams of small business owners. Our Intelligent Lending technologies make small business lending worth it at any size. From sophisticated transactions analytics, to fully automated loan decisioning, Lendio Intelligent Lending has a solution to help you serve your SMB customers.

For more information, please visit Lendio.com to learn more!

## About Arizent Research

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