



Small Business Lending : Challenges and Opportunities for Community Banks – Before, During and After the Financial Crisis

Julapa Jagtiani and Catharine Lemieux
Presentation at the
Community Banking in the 21st Century Conference
September 30, 2015

The opinions in this presentation are the authors' opinions and not necessarily those of the Federal Reserve Bank of Philadelphia, Federal Reserve Bank of Chicago or the Federal Reserve System.

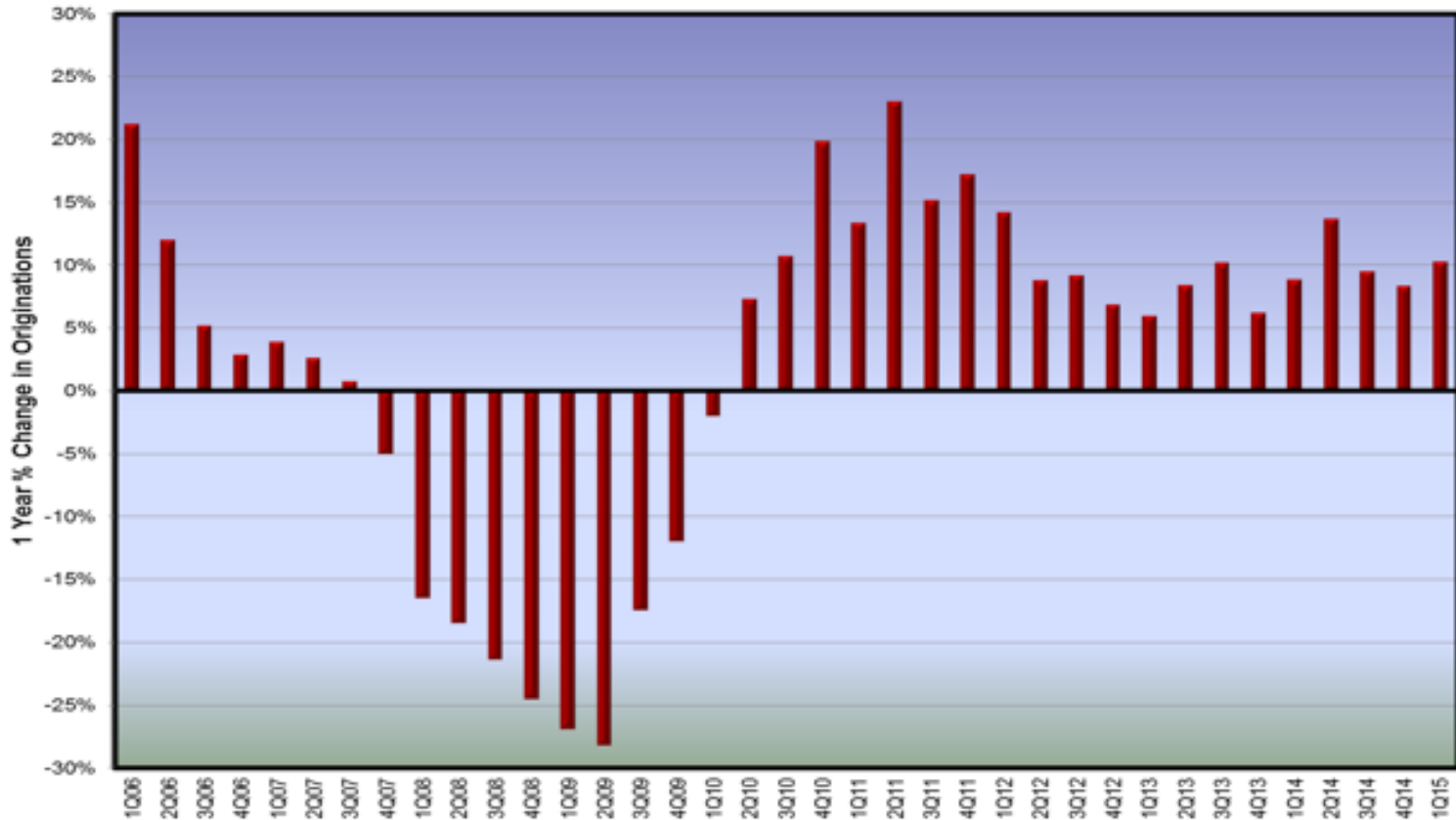


SINCE 1902

CONFERENCE OF STATE BANK SUPERVISORS



Small Business Lending Index: Year Over Year Change (2006:Q1 to 2015:Q1) Sources – PayNet Small Business Credit Conditions Report





Lender Type Distribution for Small Business – Comparing 2005 vs. 2015

As of 2015:Q1

Lender Type	% Share
Banks	61.3%
Corporations	26.9%
Finance Companies	11.8%
Total	100%

As of 2015:Q1

Lender Type	% Share
Banks	56.3%
Corporations	28.3%
Finance Companies	15.4%
Total	100%

Source: PayNet|Small Business Credit Conditions Report





Agenda

- Small business lending from the bank perspective
- Funding for small businesses from the business perspective
- New entrants in the marketplace

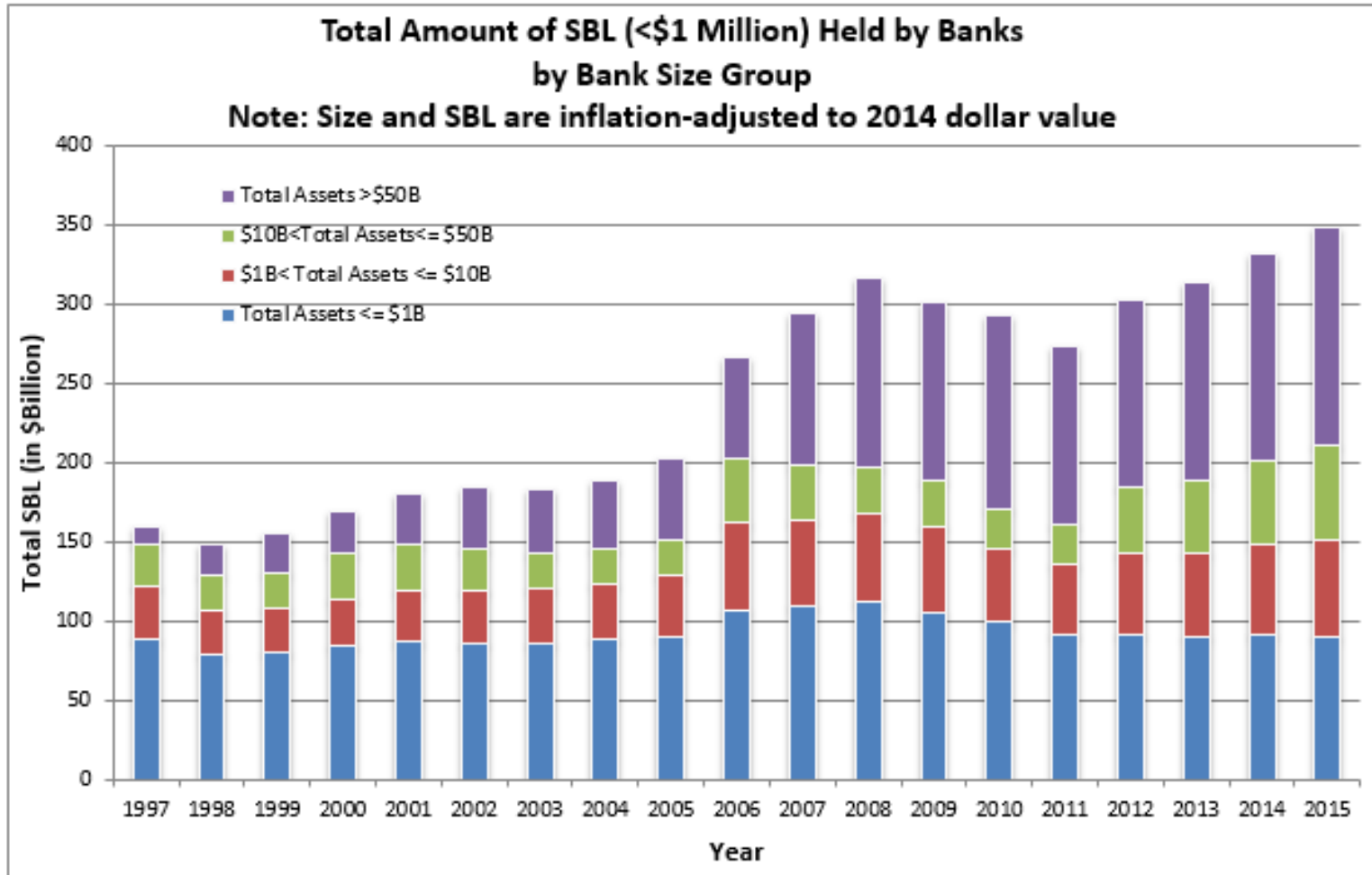




Bank Perspective

- Prior to the crisis community banks dominated the market
- During and after the crisis large and regional banks began to focus on financing businesses
- Most recently the largest banks have 60% of the small business loan market
- True even for the smaller business loans



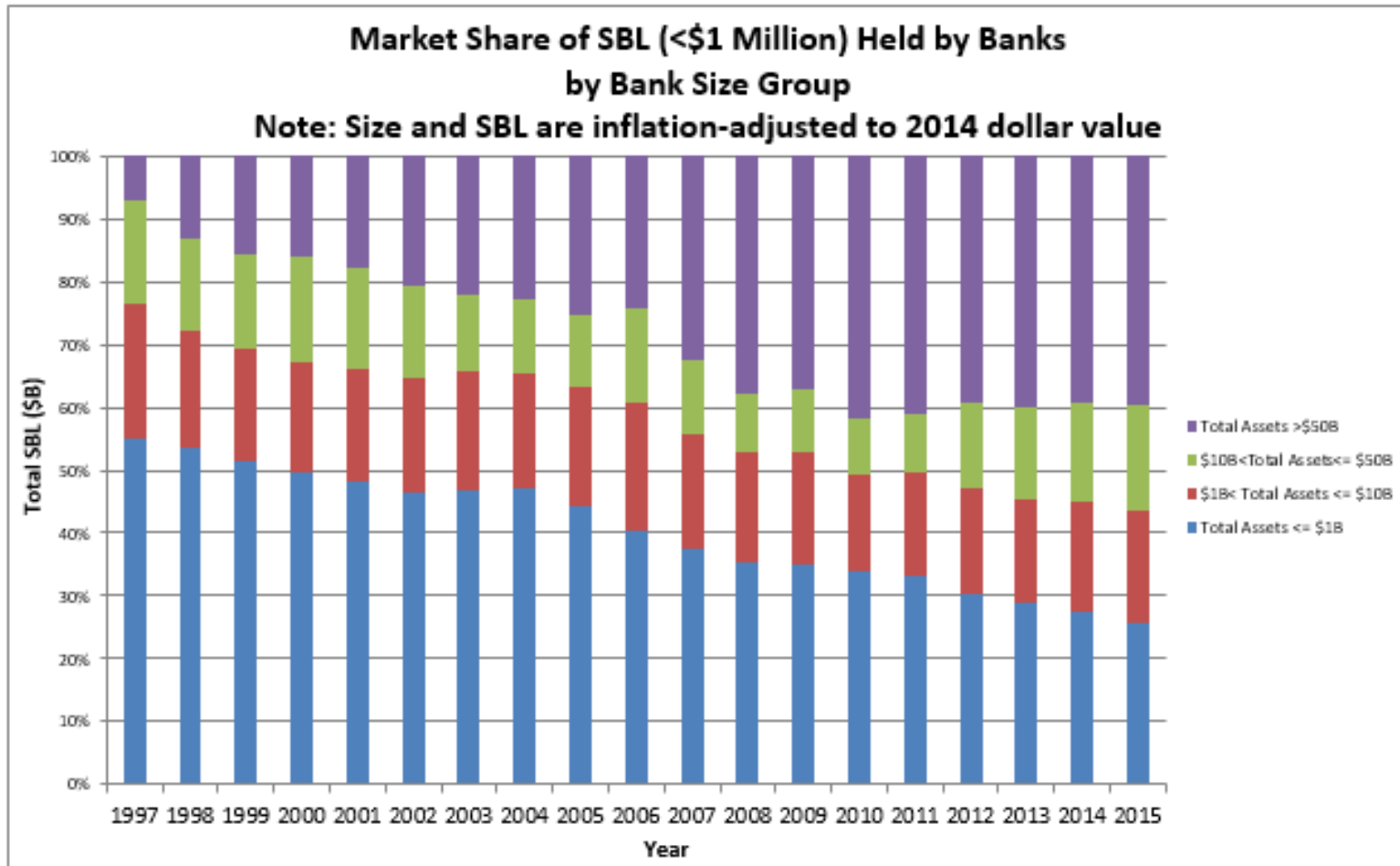


Data Source: Call Reports



SINCE 1902

CONFERENCE OF STATE BANK SUPERVISORS

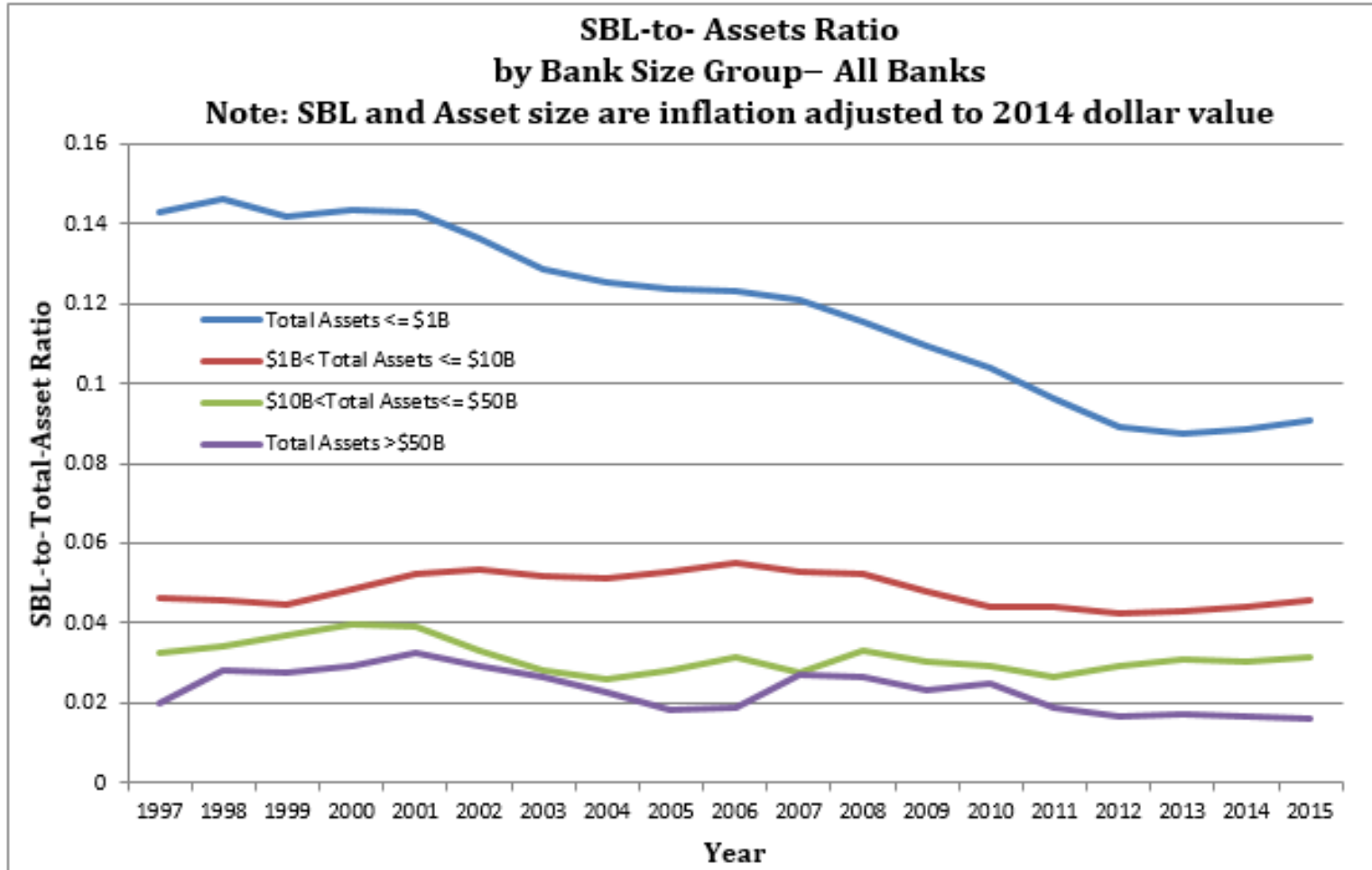


Data Source: Call Reports



SINCE 1902

CONFERENCE OF STATE BANK SUPERVISORS



Data Source: Call Reports

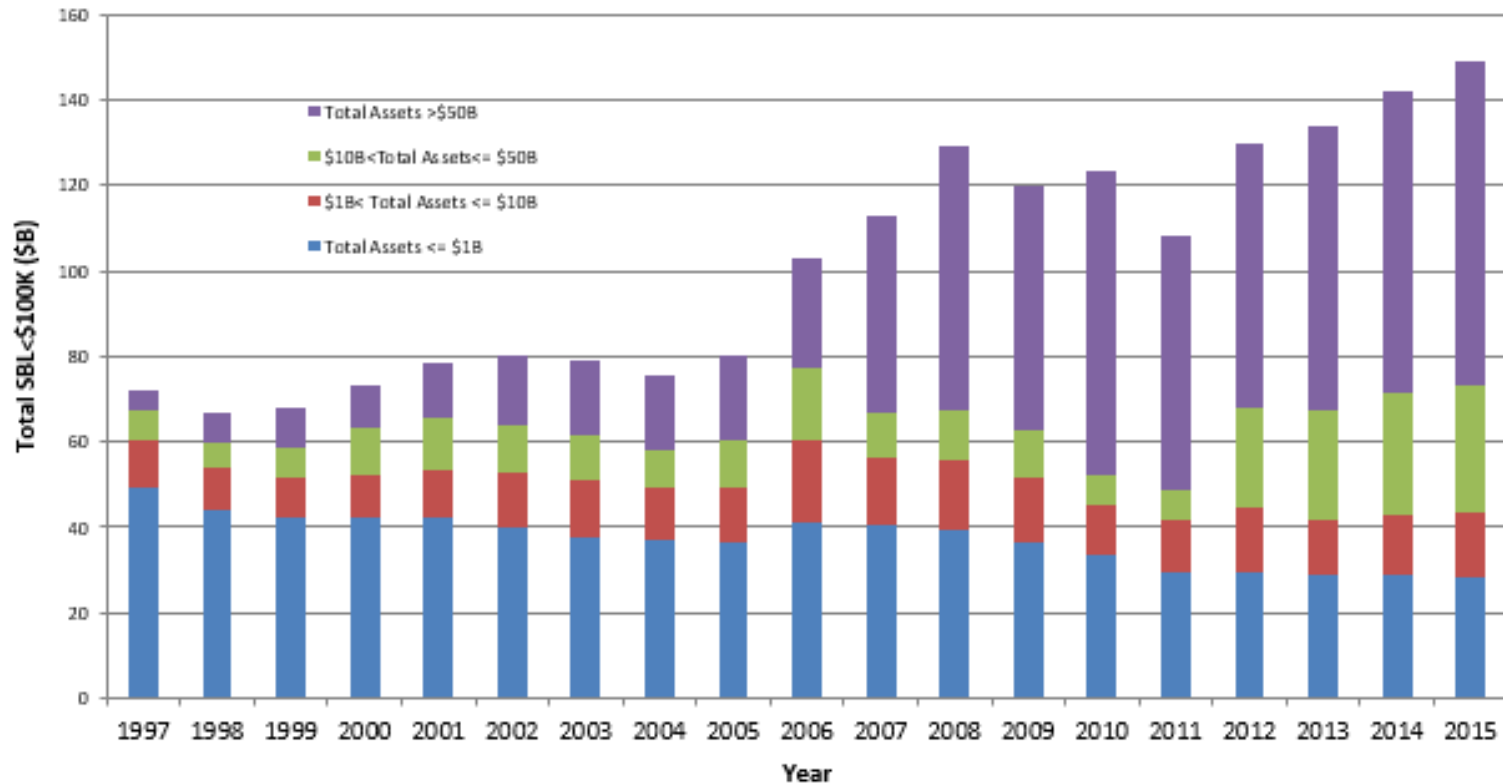


SINCE 1902

CONFERENCE OF STATE BANK SUPERVISORS



**Total Amount of Small SBL (<\$100K) Held by Banks
by Bank Size Group**
Note: Size and SBL are inflation-adjusted to 2014 dollar value

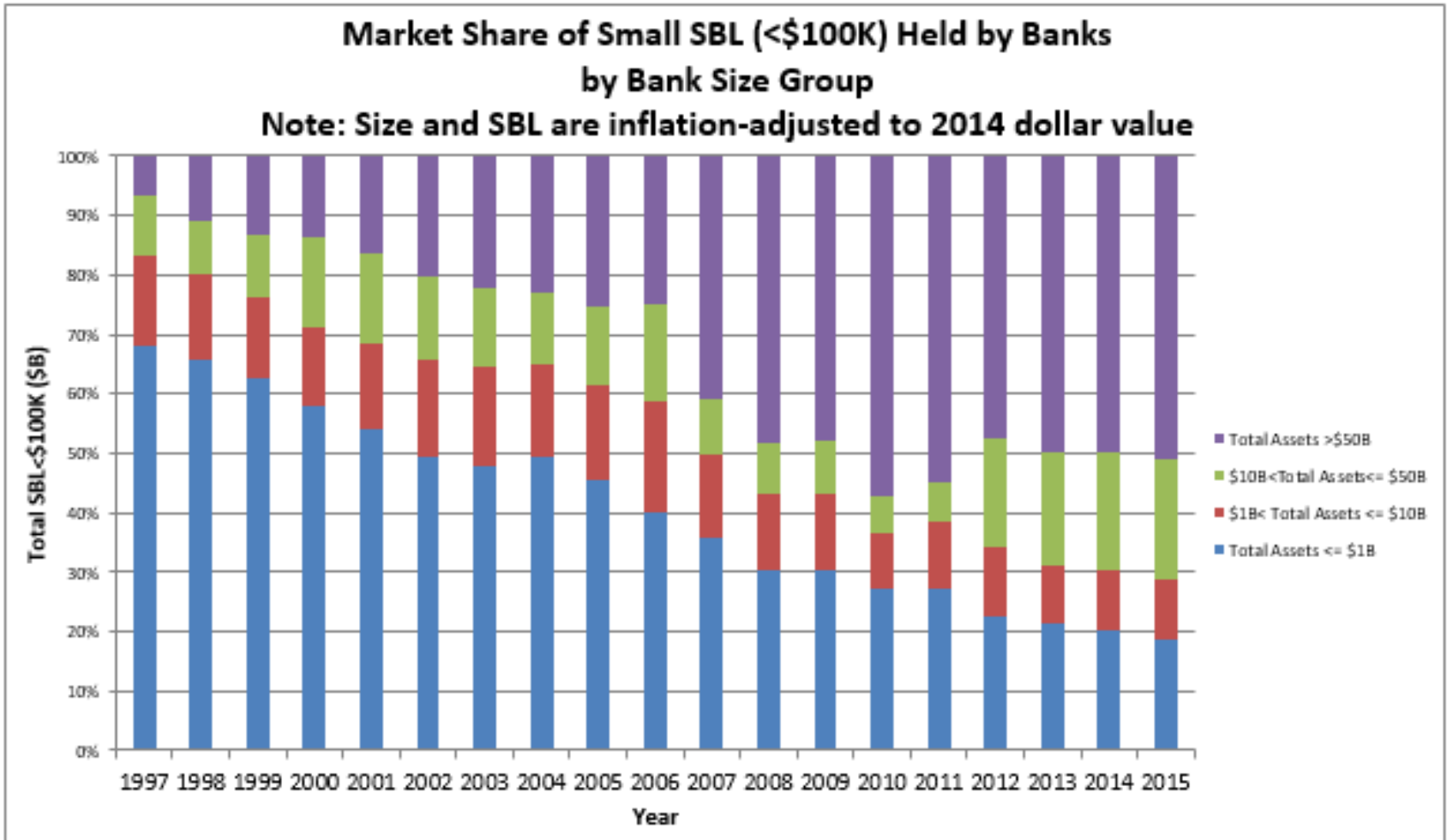


Data Source: Call Reports



SINCE 1902

CONFERENCE OF STATE BANK SUPERVISORS



Data Source: Call Reports



CONFERENCE OF STATE BANK SUPERVISORS



Growth of Small Business Lending by Large and Regional Banks

- Large bank originations by large and regional are concentrated in counties in the northwest and eastern seaboard in 1997
- By 2013 the concentration is even more pronounced



SINCE 1902

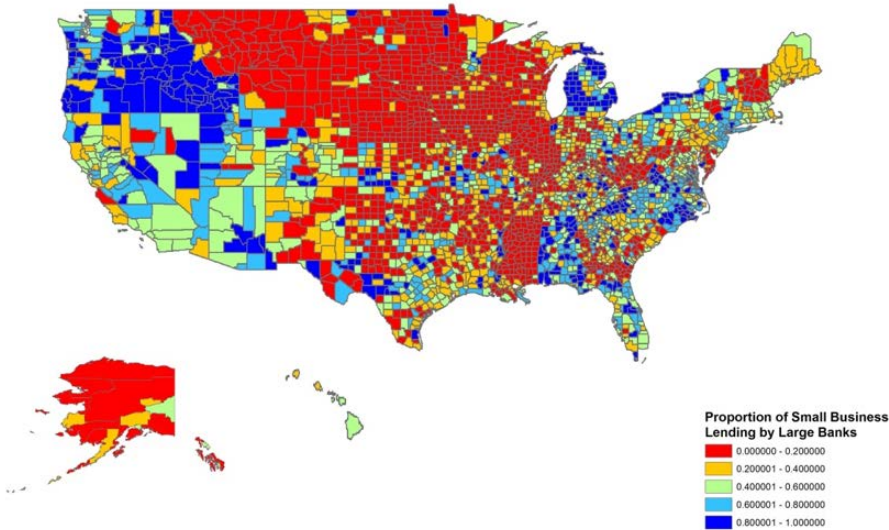
CONFERENCE OF STATE BANK SUPERVISORS

Community Banking in the 21st Century

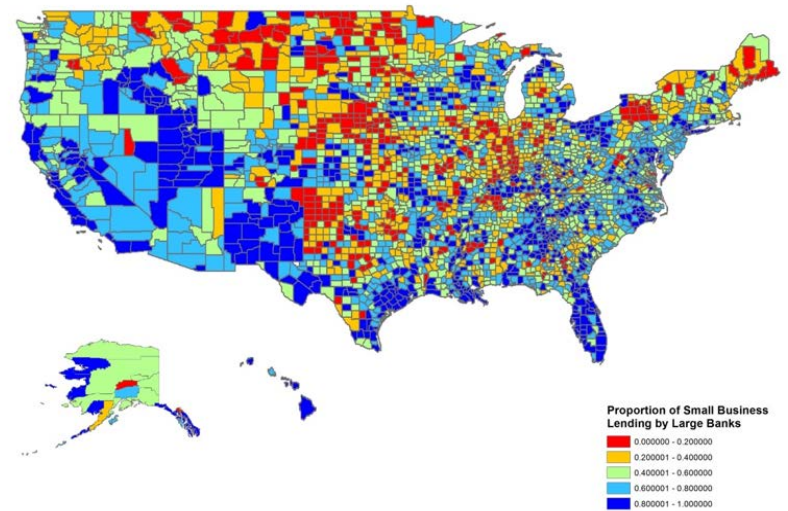
Research and
Policy Conference



Percent of Newly Originated or Purchased Small Business Loans by Large Banks (> \$10 Billion) by County
Source: Community Reinvestment Act Data 1997



Percent of Newly Originated or Purchased Small Business Loans by Large Banks (> \$10 Billion) by County
Source: Community Reinvestment Act Data 2013



CSBS

SINCE 1902

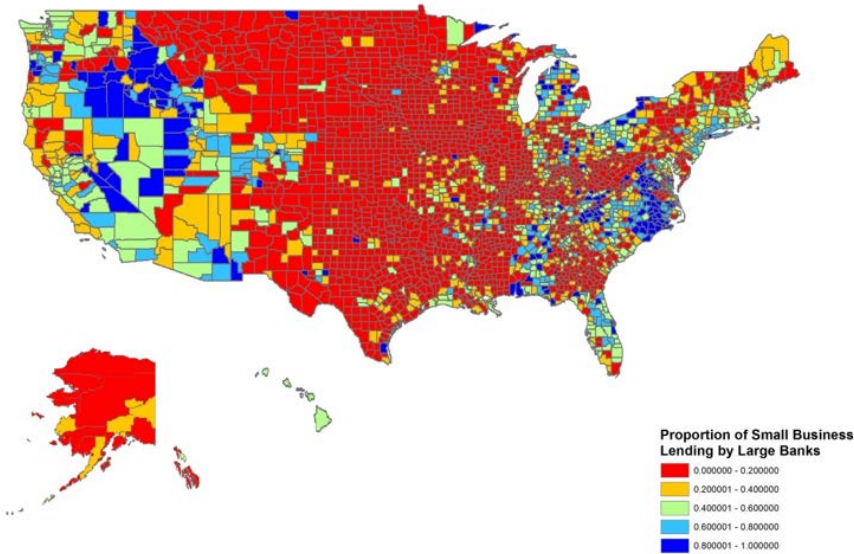
CONFERENCE OF STATE BANK SUPERVISORS

Community Banking in the 21st Century

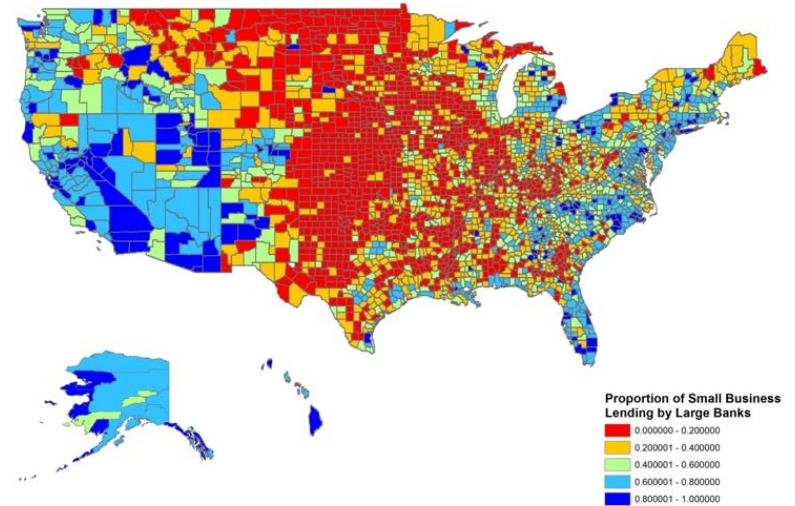
Research and
Policy Conference



Percent of Small Business Loans Held by Large Banks (> \$10 Billion) by County
Source: Call Report Data 1998



Percent of Small Business Loans Held by Large Banks (> \$10 Billion) by County
Source: Call Report Data 2013



SINCE 1902

CONFERENCE OF STATE BANK SUPERVISORS



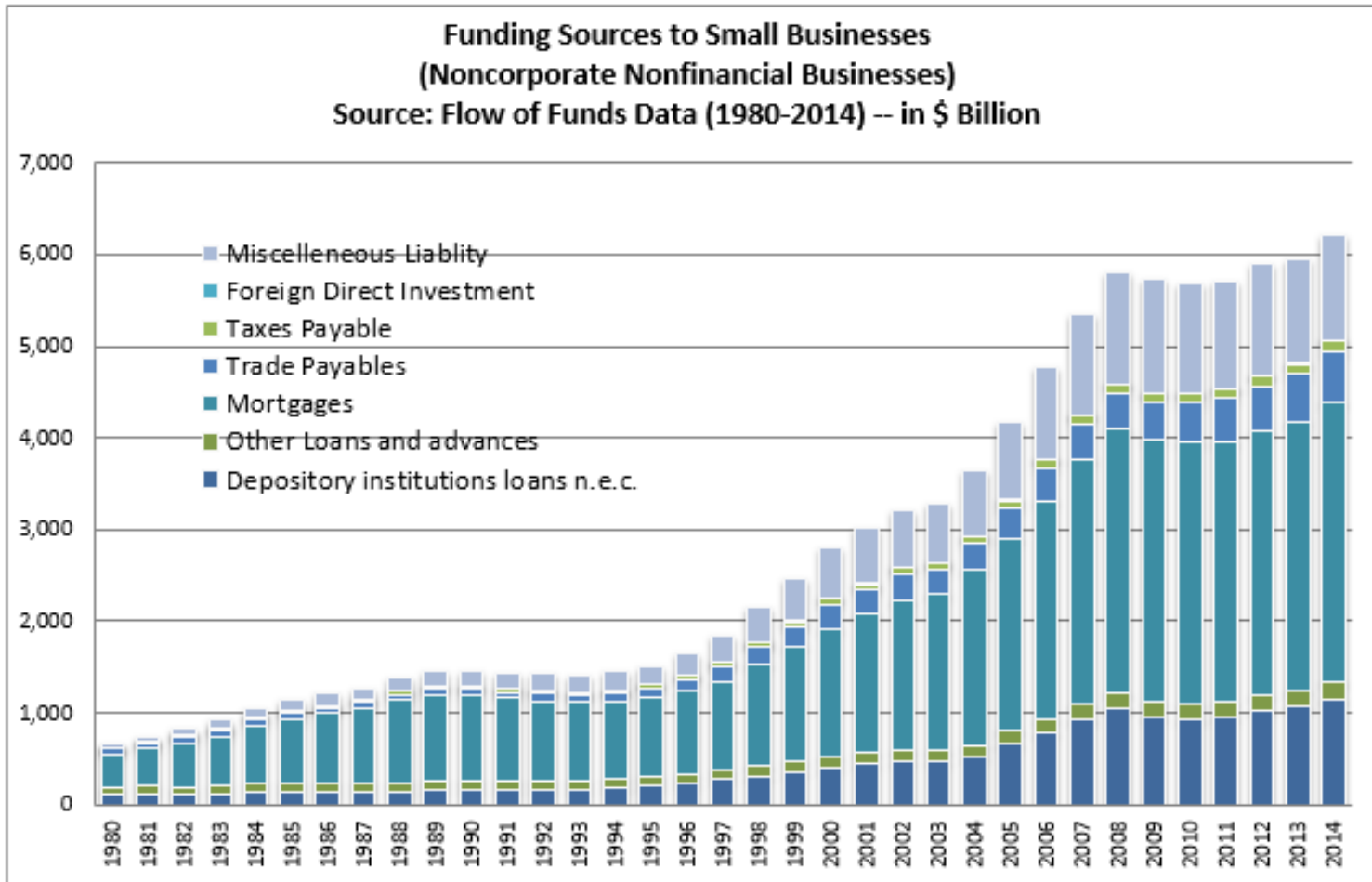
Funding from the Small Business Perspective

- Over the long-run mortgages have been the major source of funding for small businesses
- Commercial and Multi-family mortgages predominate but during the crisis home mortgages became more important
- Loans from nonbanks are increasingly important



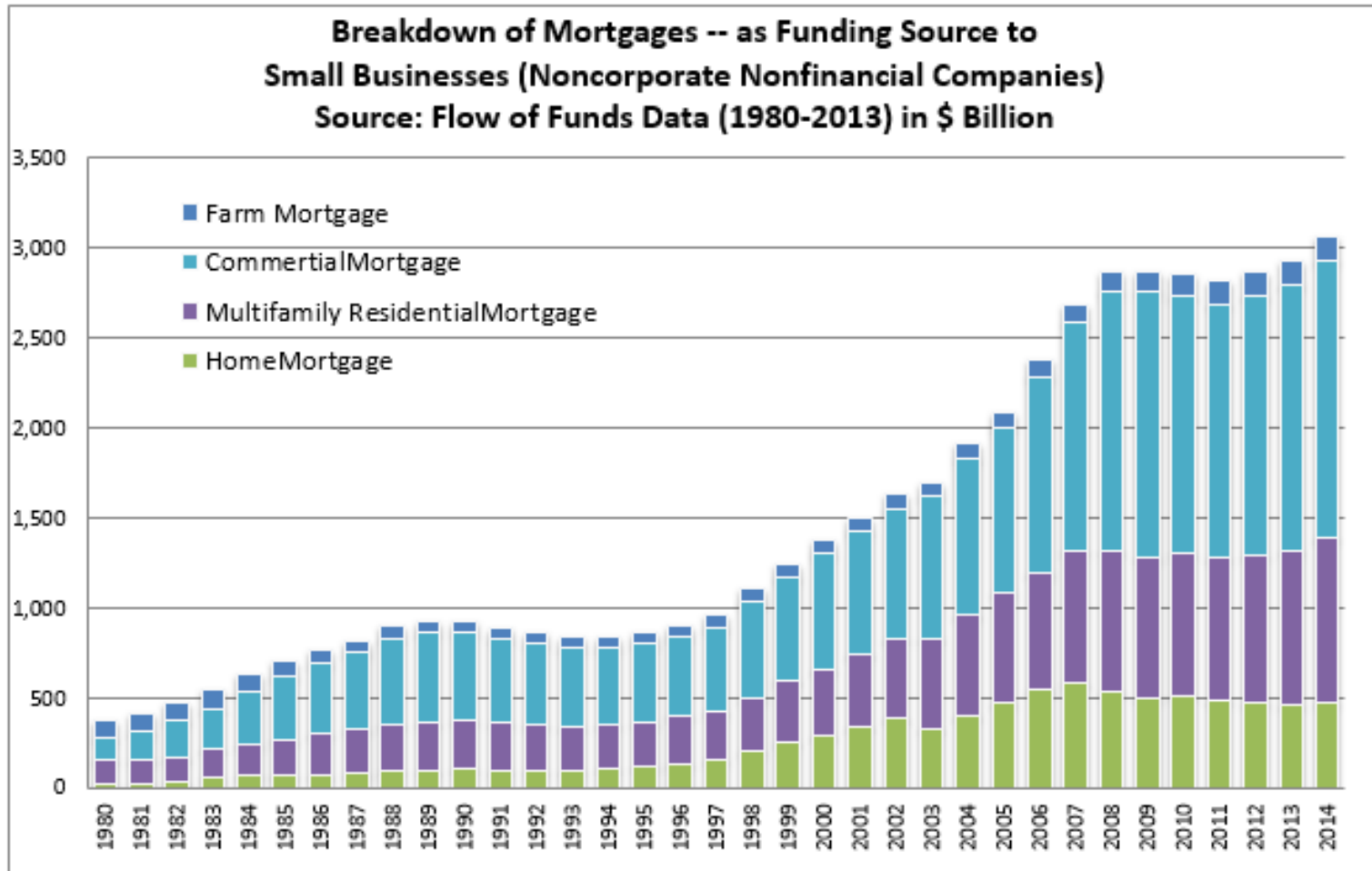
SINCE 1902

CONFERENCE OF STATE BANK SUPERVISORS



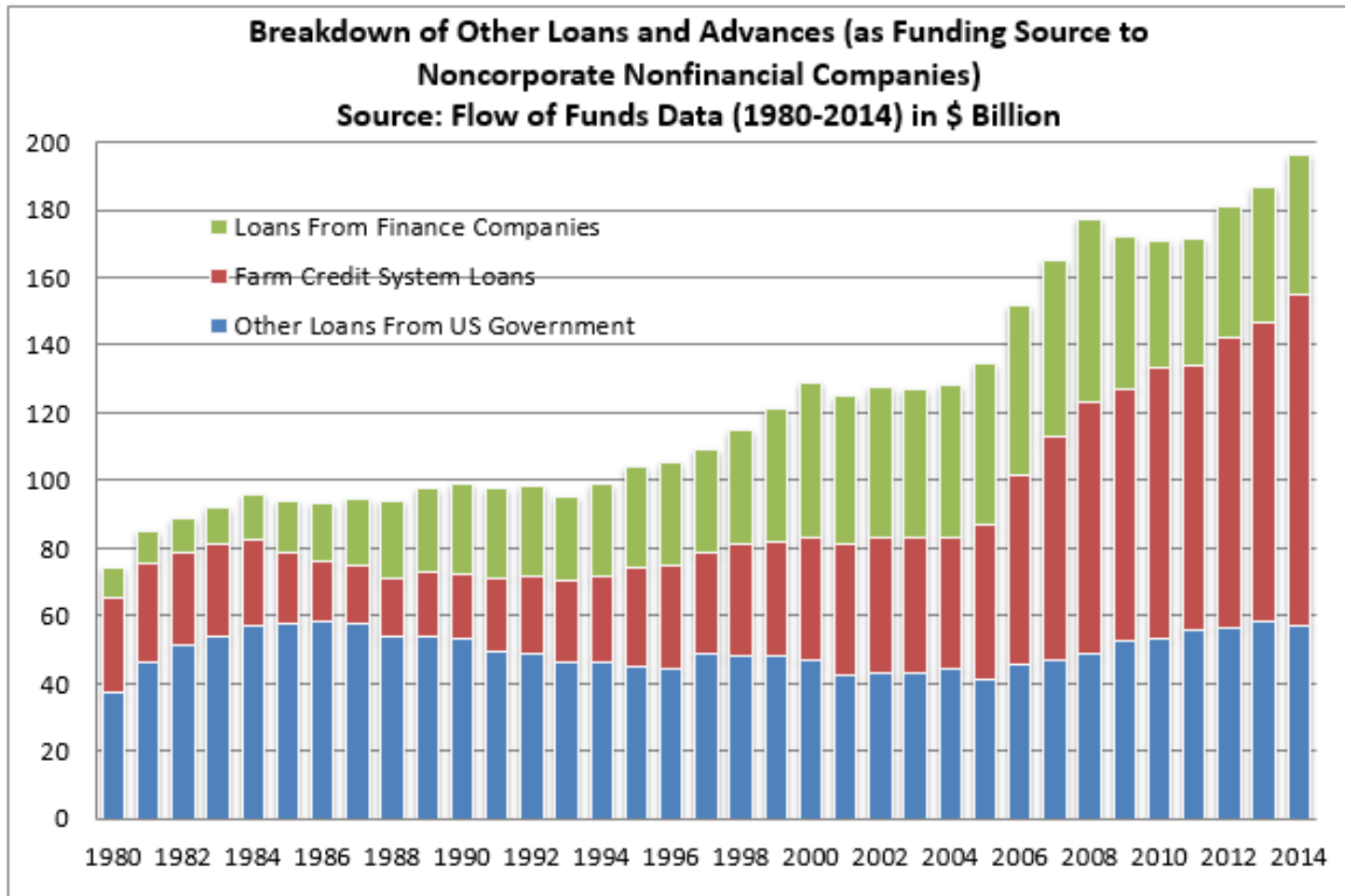
Data Source: Flow of Funds Data





Data Source: Flow of Funds data





Data Source: Flow of Funds Data



SINCE 1902

CONFERENCE OF STATE BANK SUPERVISORS



NonBank Small Business Lenders

- Growth
- Types of lenders
- Loan products



SINCE 1902

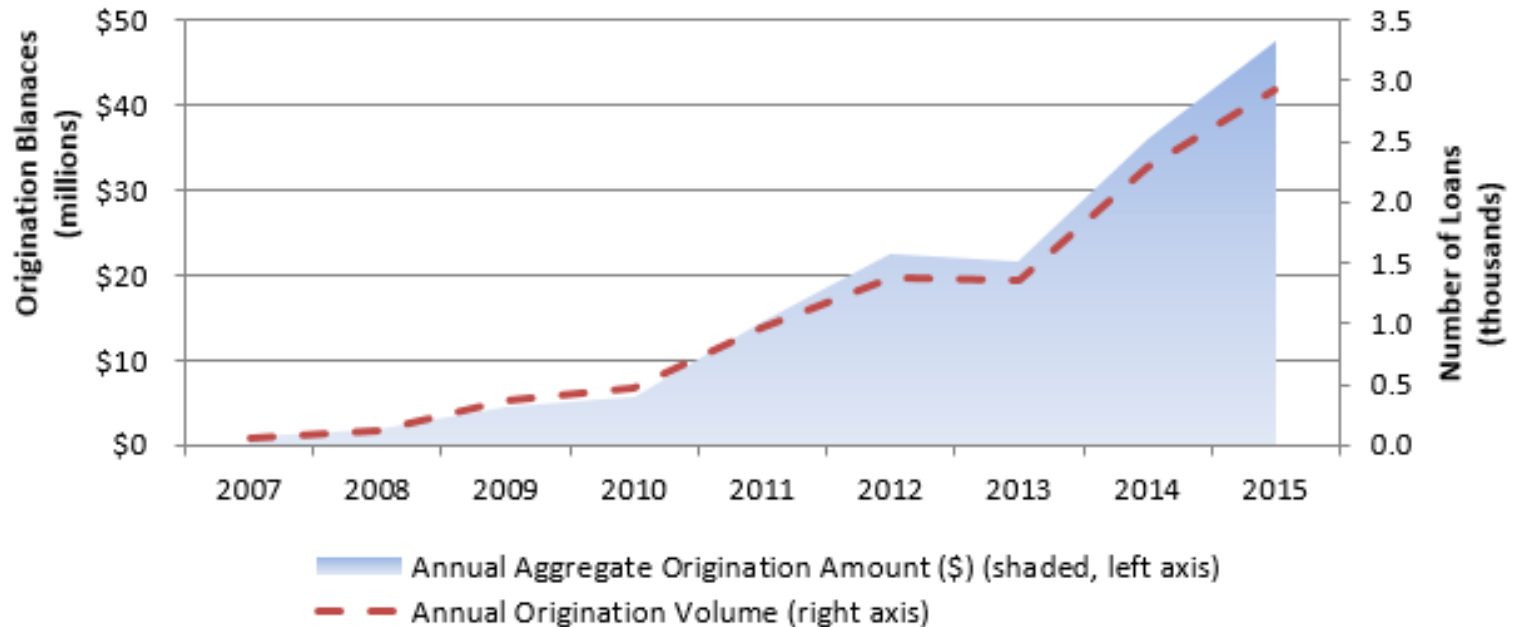
CONFERENCE OF STATE BANK SUPERVISORS



Lending Club Small Business Loan Annual Originations

Small Business Loans with Maximum Balances of \$35,000

Source: Lending Club





The Growth of Nonbank and Other Alternative Lenders	
Marketplace Lenders	
Lending Club,	<p><u>Launched lending platform for consumer loans with balances <\$35k (including small business loans) in 2006</u></p> <ul style="list-style-type: none"> • From launch through first quarter 2015 issued nearly \$9.3 billion in consumer and small business loans. • Small business loans with balances <\$35k grew 68.1% from 2013 to 2014. • In 2015 \$23.2M small business loans with balances <\$35k originated through second quarter. <p><u>Expansion of Small Business Loan Offerings</u></p> <ul style="list-style-type: none"> • March 2014: Launched new unsecured small business loan product with loans ranging in amount from \$15k-\$300k. • January 2015: Google partnership. • February 2015: Alibaba partnership.
Funding Circle USA	<p><u>Founded in the UK in 2010; Expanded to the US in 2013</u></p> <ul style="list-style-type: none"> • >\$1B small business loans funded in the US and UK as of April 2015 (>10k loans) • Lending ~\$75M a month as of April 2015 • > 40k investors participating in the marketplace as of April 2015
Balance Sheet Lenders	
OnDeck Capital	<p><u>Established in 2007; IPO in 2014</u></p> <ul style="list-style-type: none"> • Originated more than \$2B small business loans since 2007 launch. • Loan originations increasing at 159% compound annual growth rate from 2012 to 2014. • Originated \$416M small business loans during 1Q2015, up 83% from the prior year.
Kabbage	<p><u>Founded in 2009</u></p> <ul style="list-style-type: none"> • Originated more than \$750M small business loans since 2009 launch. • Tripled its daily small business loan origination volume in less than a year (2015: \$3M a day vs 2014: \$1M a day).
Payments Processors	
PayPal Working Capital	<p><u>Launched in September 2013</u></p> <ul style="list-style-type: none"> • Funded \$500M to 40k businesses as of May 2015. • Raised maximum loan amount to \$85k from \$20k. • Net receivables grew 26.3% during 1Q2015, from \$99M as of December 31, 2014 to \$125M as of March 31, 2015.
Square	<p><u>Began Offering loans in 2014</u></p> <ul style="list-style-type: none"> • Loaned more than \$100M to 20k small businesses within a year of launch.



ALTERNATIVE LENDERS – UNDERWRITING AND TERMS

ALTERNATIVE SMALL BUSINESS LENDER	LOAN AMOUNT	INTEREST RATES	APPLICATION AND FUNDING TIME
Marketplace Lenders			
LendingClub	Consumer Small Business Loan: \$1k-\$35k Small Business Loans: \$15k-300k	Annualized rates of 8%-32% (including origination fees, which are 1%-6% of balance)	Pre-approval in minutes. Approval and funding process typically takes 7 days.
Prosper Marketplace	Consumer Small Business Loan: \$2k-\$35k	5%-36% Plus 1%-5% origination fee	Online application. Funding occurs 2-8 business days after investors are secured.
Funding Circle USA	\$25k-\$500k	5.49%-22.79% Plus 1%-5% origination fee	Loan application takes less than 10 minutes. Funding in under 10 days.
Balance Sheet Lenders			
OnDeck Capital	Term Loan: \$5k-\$250k Line of Credit: \$20k maximum	Aggregate effective interest rate of 37.7% on all loans.	Application and approval in minutes. Funding within 1 business day.
Kabbage	Line of Credit: \$2k-\$100k	Loans are paid off over 6 months. No "interest" charged. Fees are 1%-12% for first two months, and 1% for each of the remaining two months.	Application and funding in minutes.
Fundation	Working Capital Loan: \$20-\$150k Business Expansion Loan: \$20-\$500k	APR from 8% Plus 2%+ origination fee	Application takes 10 minutes. Funding can occur in as little as 3 business days.
Payments Processors			
PayPal Working Capital	Maximum loan of 15% of annual PayPal sales, up to \$85k.	Single fixed fee based on PayPal sales history, loan amount, and daily repayment deduction.	Application and funding in minutes.



Nonbank Lenders Competitors or Partners?

- Bank consortiums
- Referral agreements
- Licensing technology



SINCE 1902

CONFERENCE OF STATE BANK SUPERVISORS



Conclusions

- The competitive landscape in small business lending is changing
- Community banks are losing ground to large banks and to nonbank lenders
- There are opportunities to leverage the efficiencies of nonbank lenders in various ways

