

# Fintech and Banking

Can We Reach Small Business Lending  
Utopia?

# Fintech and Banking: Can We Reach Small Business Lending Utopia?

**Karen G. Mills**

Senior Fellow, Harvard Business School

Former Administrator of the U.S. Small Business Administration;

Member of President Obama's Cabinet

Digital Lending Conference

November 2, 2017



H A R V A R D | B U S I N E S S | S C H O O L

## WORKED FOR PRESIDENT OBAMA AS HEAD OF SMALL BUSINESS ADMINISTRATION (2009-2013)

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# FLYING ON AIR FORCE ONE

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# MEMBER OF PRESIDENT OBAMA'S CABINET

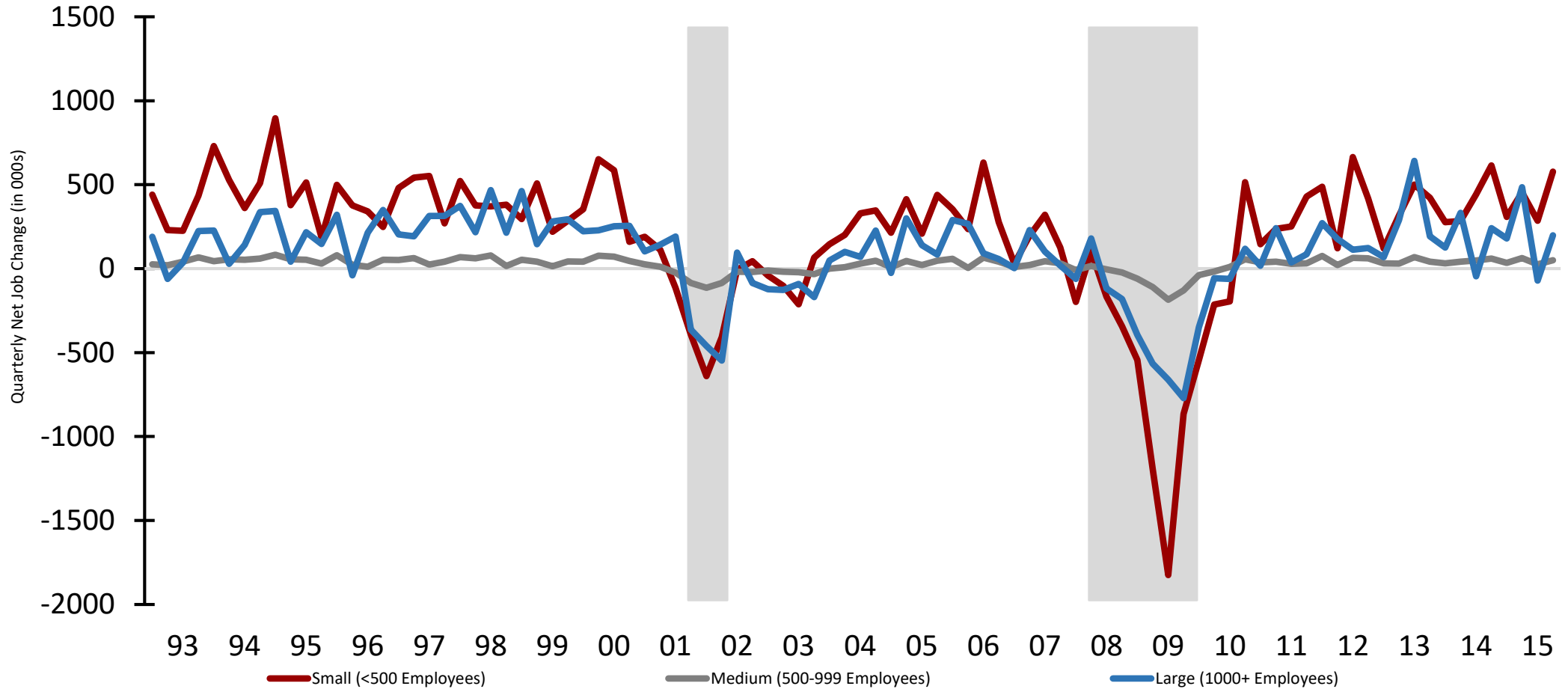
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Responsible for America's small businesses and entrepreneurs



# SMALL FIRMS HIT HARDER IN THE CRISIS

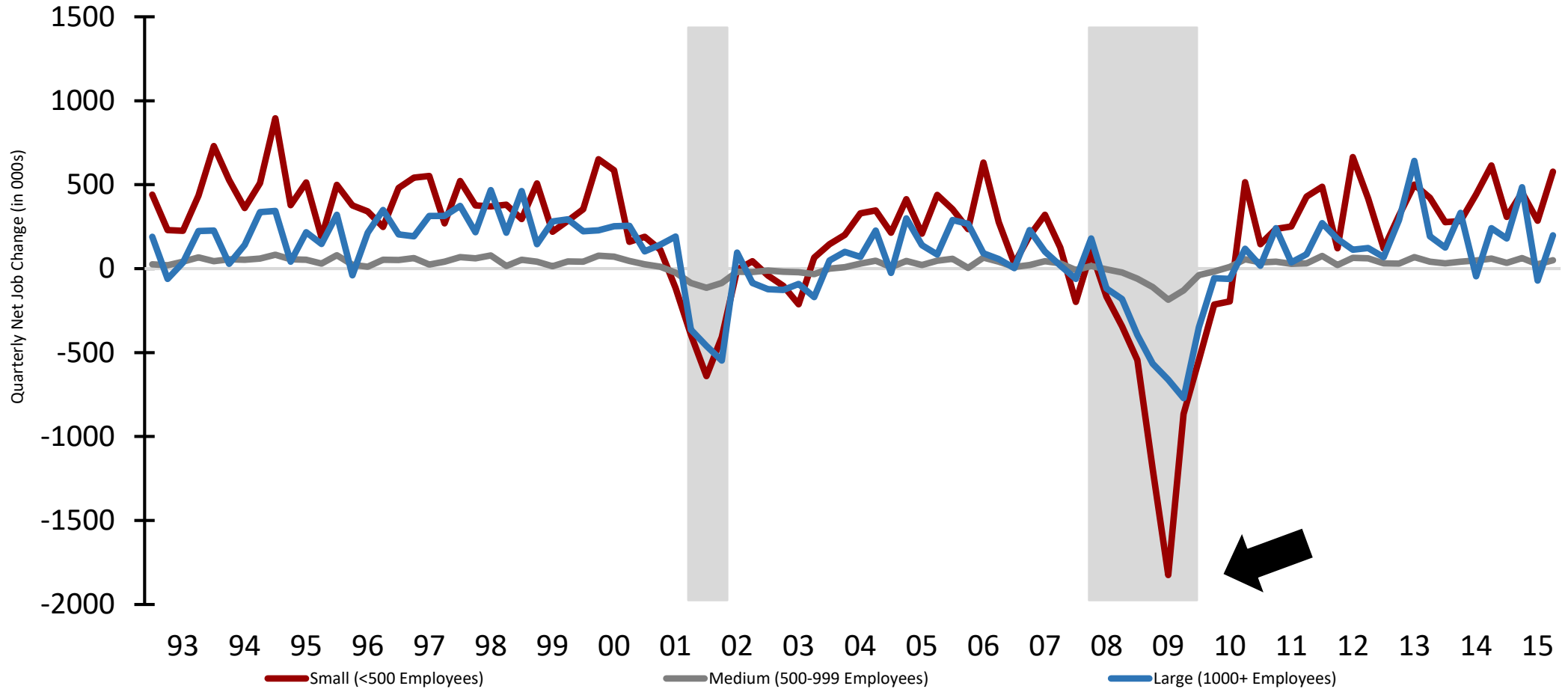
Job losses in small firms accounted for 60% of total job losses



Source: Bureau of Labor Statistics, Business Dynamics Statistics (latest as of 2Q15).

# SMALL FIRMS HIT HARDER IN THE CRISIS

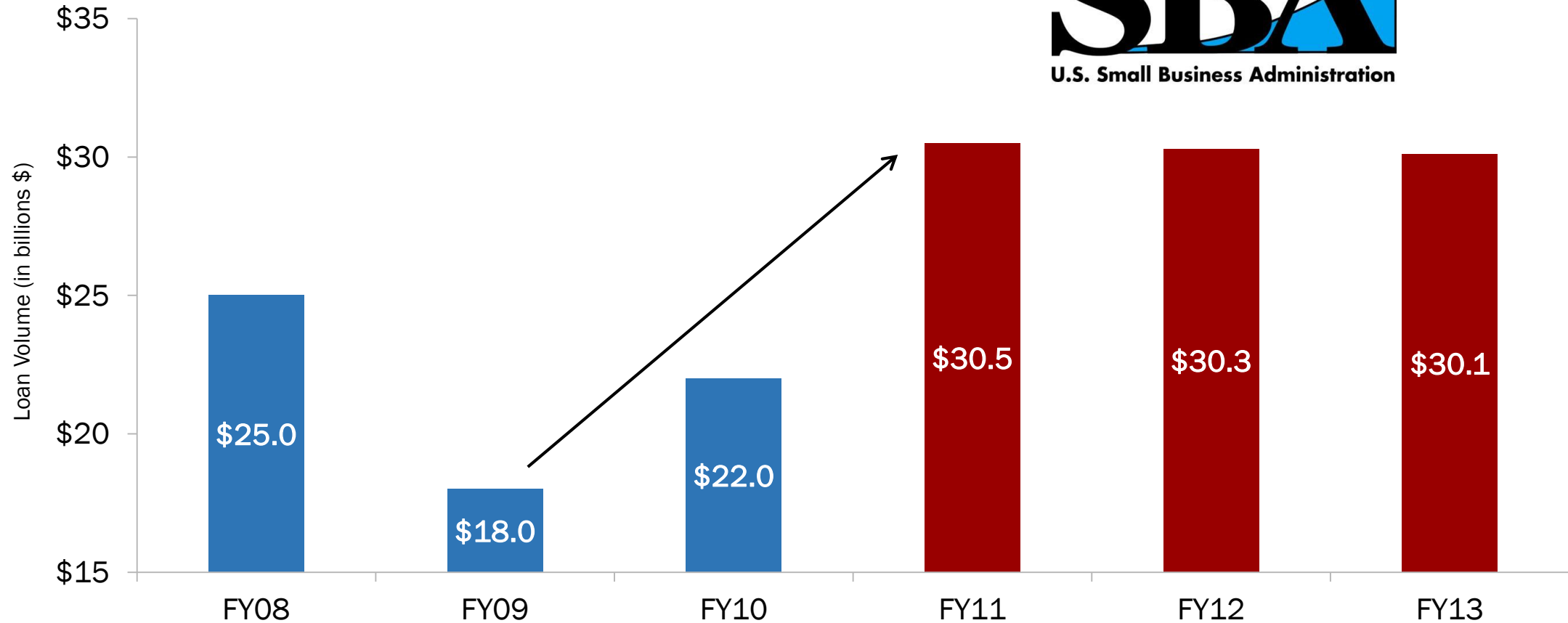
Job losses in small firms accounted for 60% of total job losses



Source: Bureau of Labor Statistics, Business Dynamics Statistics (latest as of 2Q15).

# TURNAROUND IN SBA LENDING

Swift action to spur SBA lending, resulted in record year in '11, '12, and '13

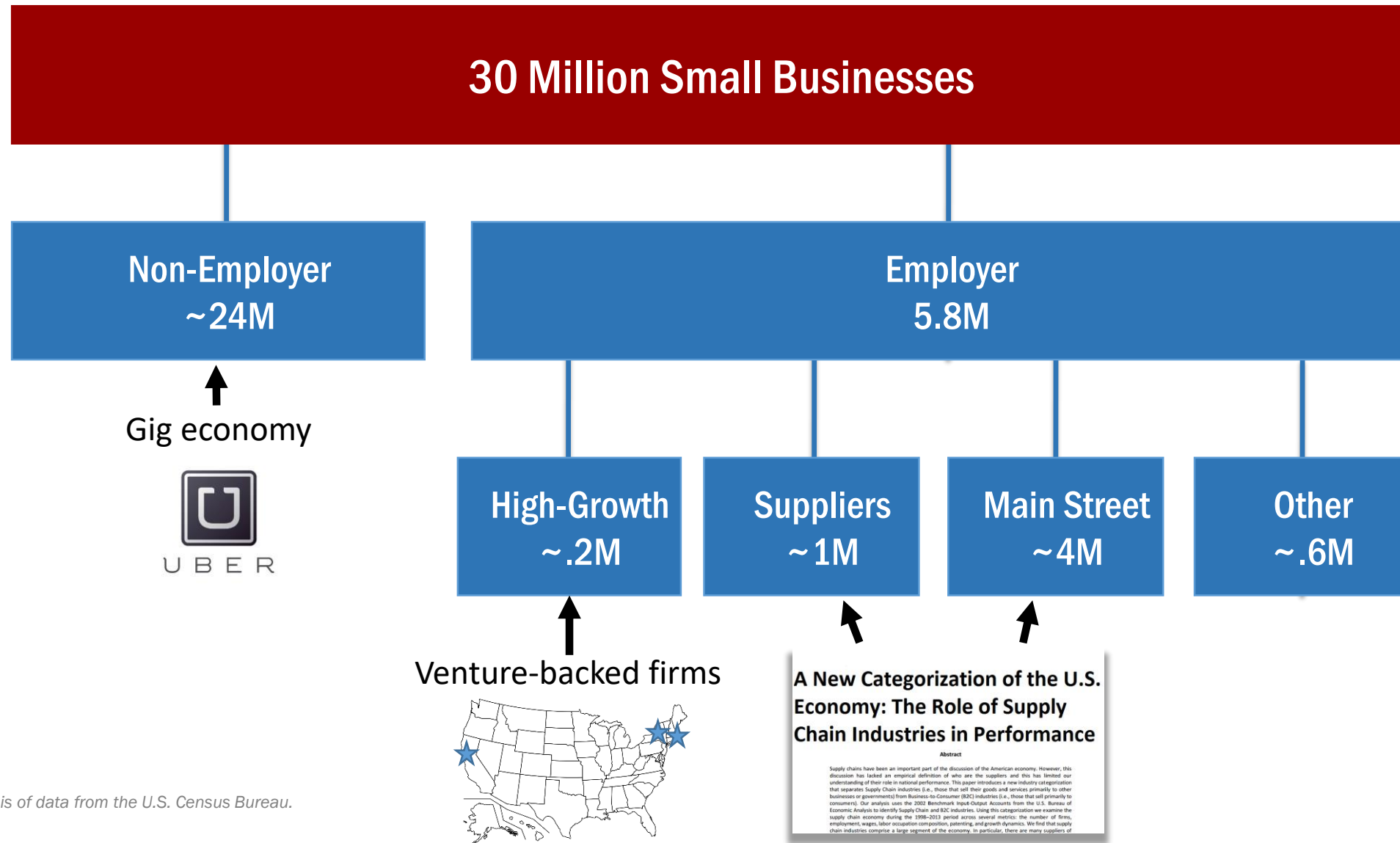


Source: Small Business Administration. 7(a) and 504 total of loans enabled since Fiscal Year 2008. As of May 2014



# WHY WORRY ABOUT ACCESS TO CREDIT FOR SMALL BUSINESSES?

Small businesses account for half of U.S. jobs

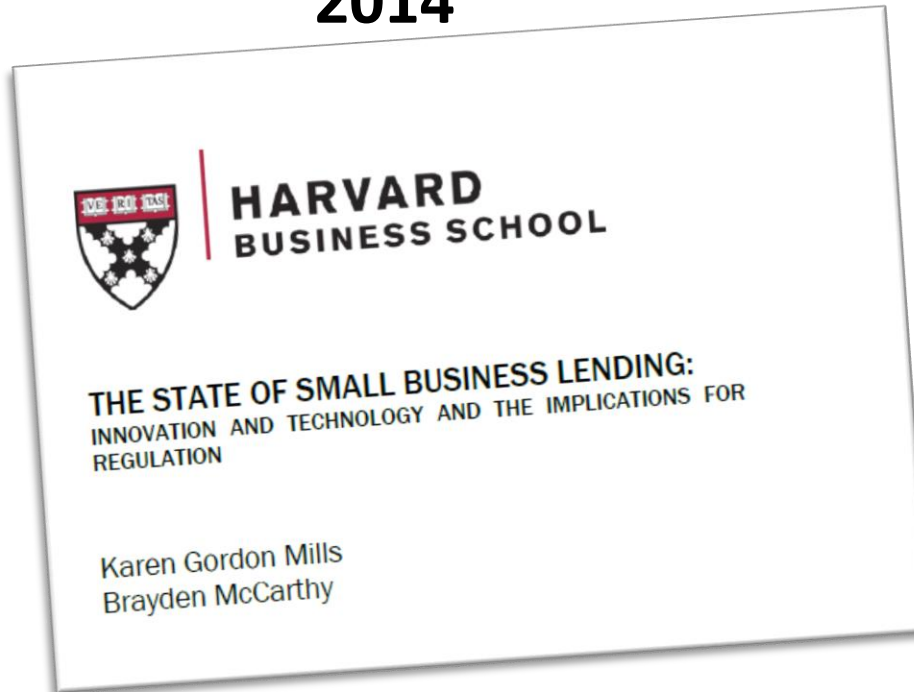


# HBS WORKING PAPER

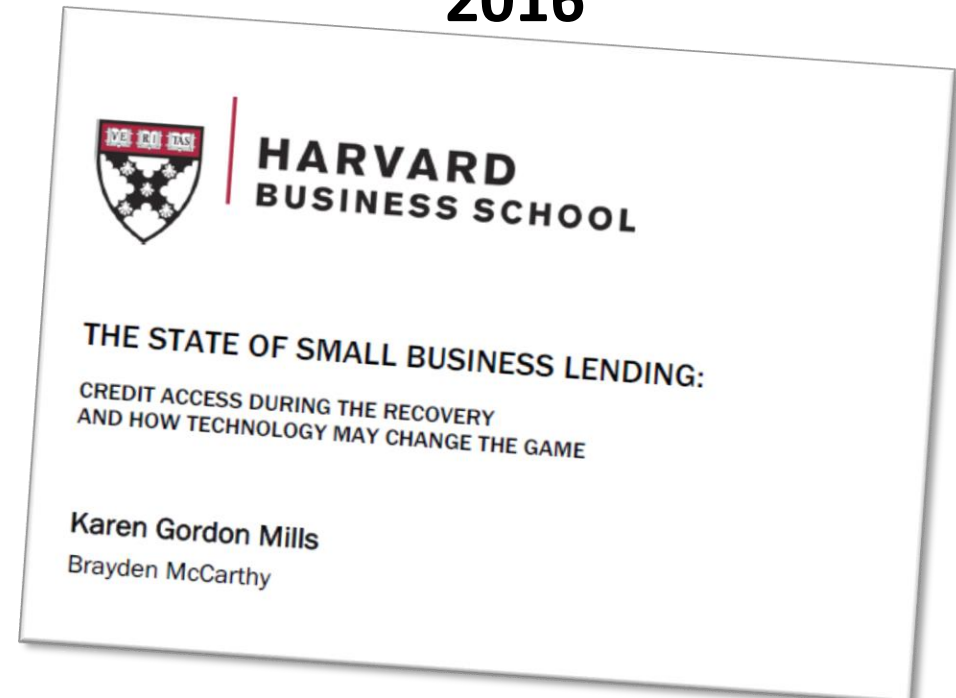
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2014

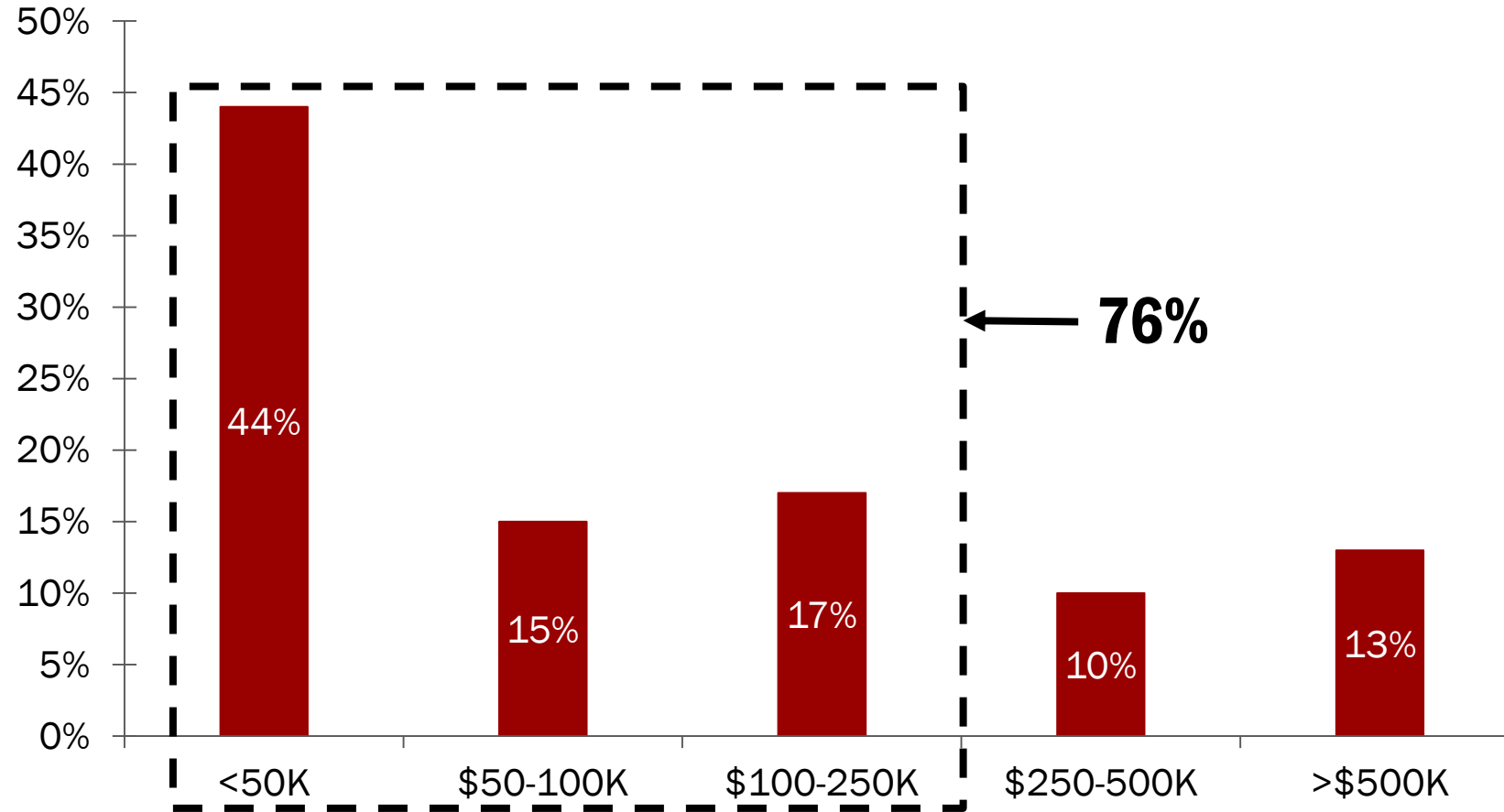


2016



# CURRENT GAP IN SMALL BUSINESS LENDING: SMALL DOLLAR LOANS

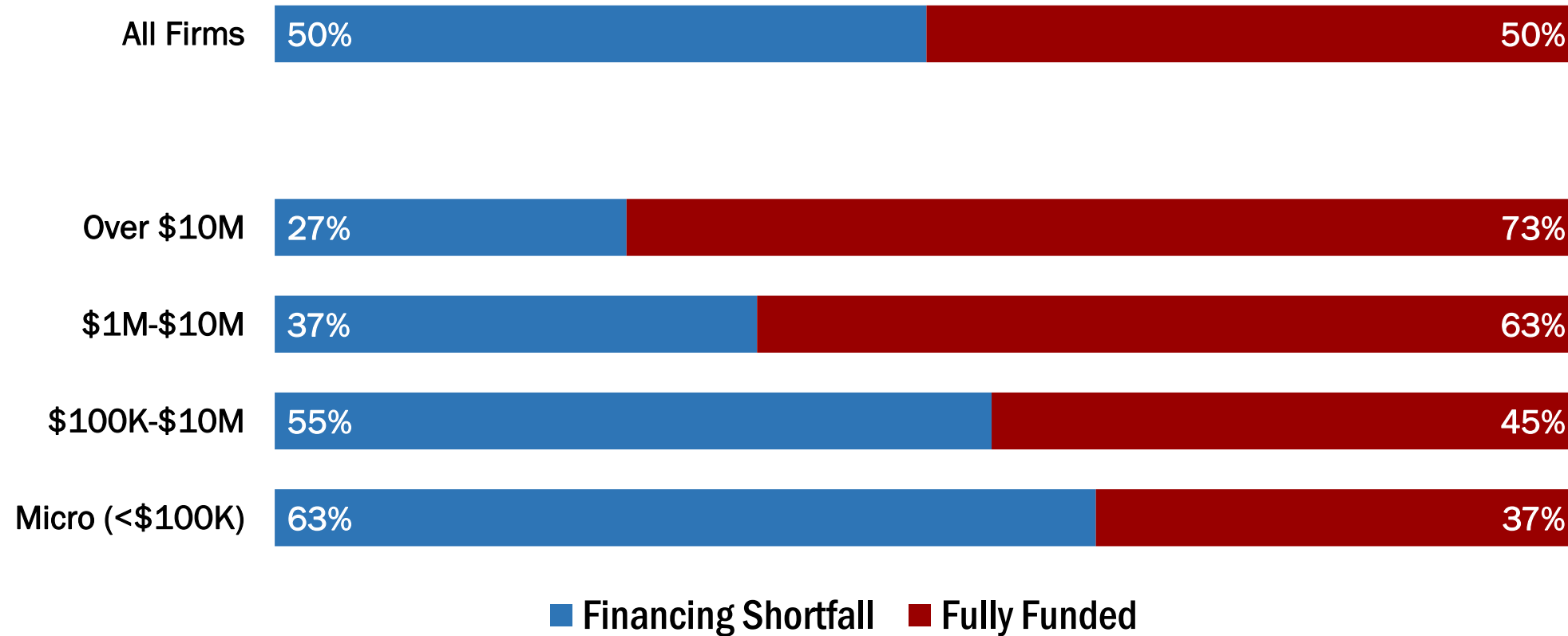
About 75% of small businesses want loans below \$250K



Source: Federal Reserve (New York), "Small Business Credit Survey", Fall 2013

# SMALL FIRMS HAVE MORE TROUBLE GETTING LOANS

Loan applicants receiving full funding versus those funded partially or not at all



Source: "2015 Small Business Credit Survey," Federal Reserve, March 2016.

# PHASE 1: EXPLOSION OF NEW FINTECH LENDERS

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## PHASE 1

### Online Lenders Enter

- Rapid emergence and growth of hundreds of new online lenders

# TECHNOLOGY CHANGED THE GAME: NEW ONLINE LENDERS OFFER MANY SMALL BUSINESS PRODUCTS

Short-Term Loan	CAN CAPITAL	quarterspot	OnDeck	DIRECTCAPITAL	bizfi	RAPID ADVANCE
Medium-Term Loan	Funding Circle	LendingClub	BOND STREET	Dealstruck	FUNDATION	STREET SHARES
SBA Loan	smartbiz	CELTIC BANK	LIVE OAK BANK			
Short-Term Line of Credit	OnDeck	Kabbage	BlueVine	HEADWAY CAPITAL		
Medium-Term Line of Credit	Dealstruck	The Credit Junction	LendingClub			
Invoice Financing	BlueVine	FUNDBOX	TRIUMPH BUSINESS CAPITAL			
Personal Loan for Business	AVANT	Upstart	Pave			
Equipment Loan	eLease	BALBOA CAPITAL	Funding Circle	bsb LEASING	DIRECTCAPITAL	

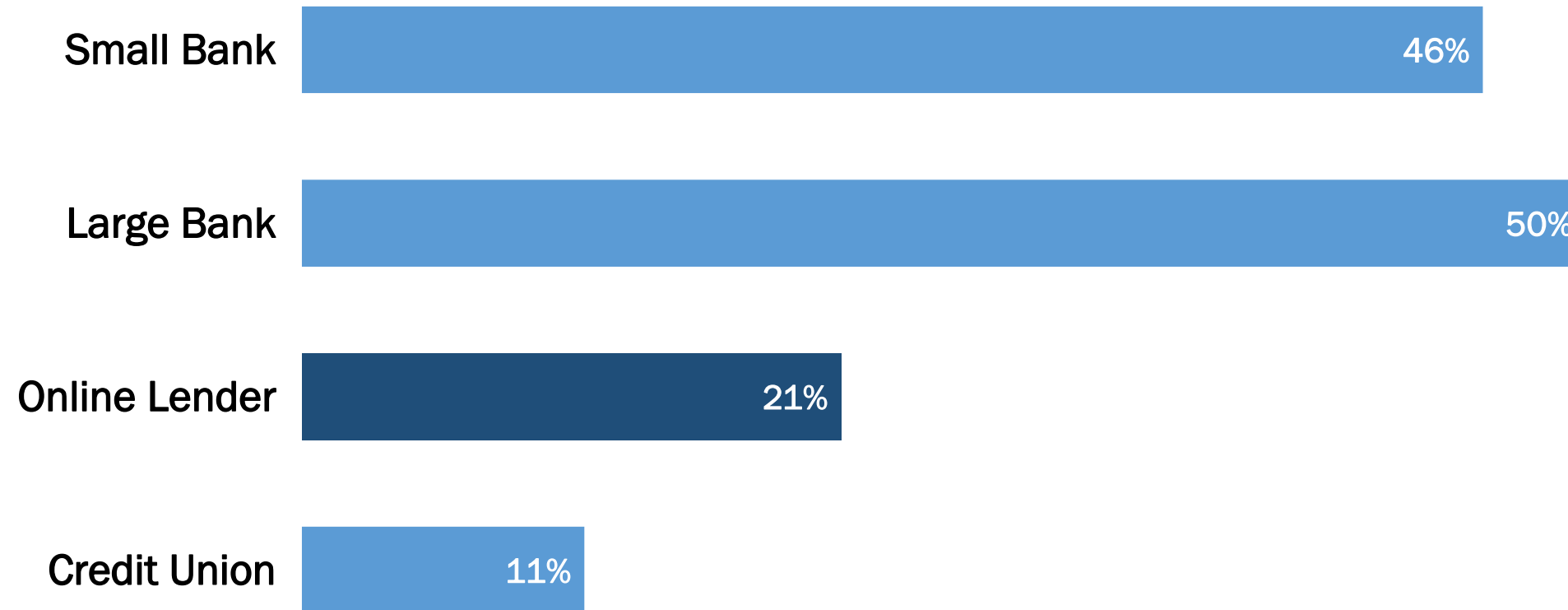
Source: Fundera Presentation. September 2016.



# STRONG EARLY RESULTS: 21% OF APPLICANTS APPLY TO ONLINE LENDERS

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Percent of small businesses applying



Source: "2016 Small Business Credit Survey: Report on Employer Firms," Federal Reserve, April 2017.

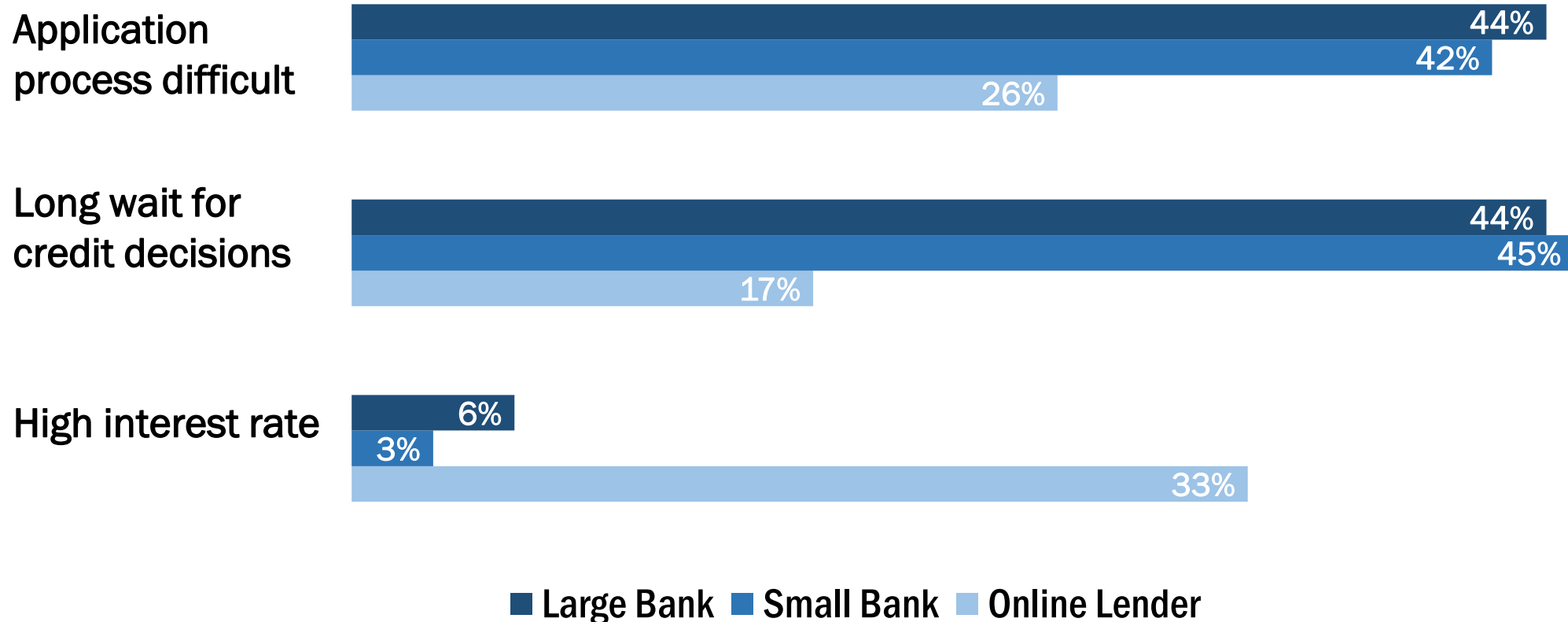
## ONLINE LENDING: WILL DAVID SLAY GOLIATH?

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# BORROWERS LOVE THE EASE OF THE APPLICATION, BUT NOT THE HIGH INTEREST RATES

Percent of borrower firms dissatisfied



Source: "2016 Small Business Credit Survey: Report on Employer Firms," Federal Reserve, April 2017.

# ONLINE LENDING IS ENTERING PHASE 2 OF MARKET DEVELOPMENT

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## PHASE 1



## PHASE 2



- Rapid emergence and growth of hundreds of new online lenders
- Partnerships between incumbents and online lenders

# DON'T COUNT OUT THE BANKS AND TRADITIONAL LENDERS

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**Borrower  
Acquisition**

**Borrower  
Experience &  
Satisfaction**

**Customer/  
Product Fit**

**Cost of Funds**

**Underwriting &  
Compliance  
Costs**

## INCUMBENTS

JPMorganChase 



WELLS FARGO

COMMUNITY BANKS

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## DISRUPTORS

OnDeck 

 Funding Circle

CAN CAPITAL

 FUNDBOX

 fundera







# DON'T COUNT OUT THE BANKS AND TRADITIONAL LENDERS

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# DON'T COUNT OUT THE BANKS AND TRADITIONAL LENDERS

	Borrower Acquisition	Borrower Experience & Satisfaction	Customer/Product Fit	Cost of Funds	Underwriting & Compliance Costs
<b>INCUMBENTS</b>   <b>COMMUNITY BANKS</b>	✓	✗			
<b>DISRUPTORS</b>   <b>CAN CAPITAL</b>  	✗	✓			







Source: Author's analysis and "The Brave 100: The Battle of Supremacy in Small Business Lending." QED Investors and Oliver Wyman. 2015.

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<b>DISRUPTORS</b>   <b>CAN CAPITAL</b>  	✗	✓	?		







Source: Author's analysis and "The Brave 100: The Battle of Supremacy in Small Business Lending." QED Investors and Oliver Wyman. 2015.

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<b>DISRUPTORS</b>   <b>CAN CAPITAL</b>  	✗	✓	?	✗	

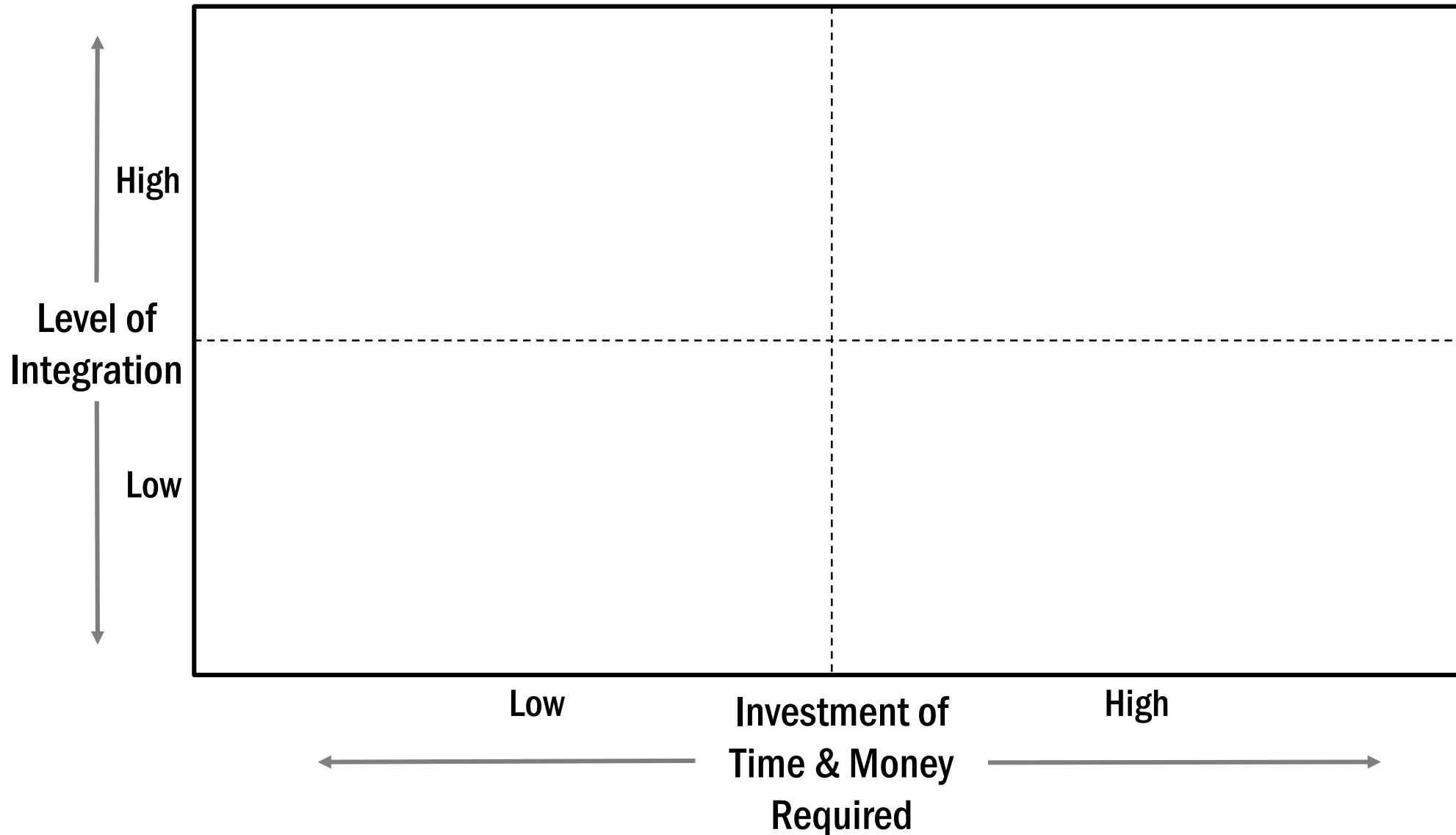
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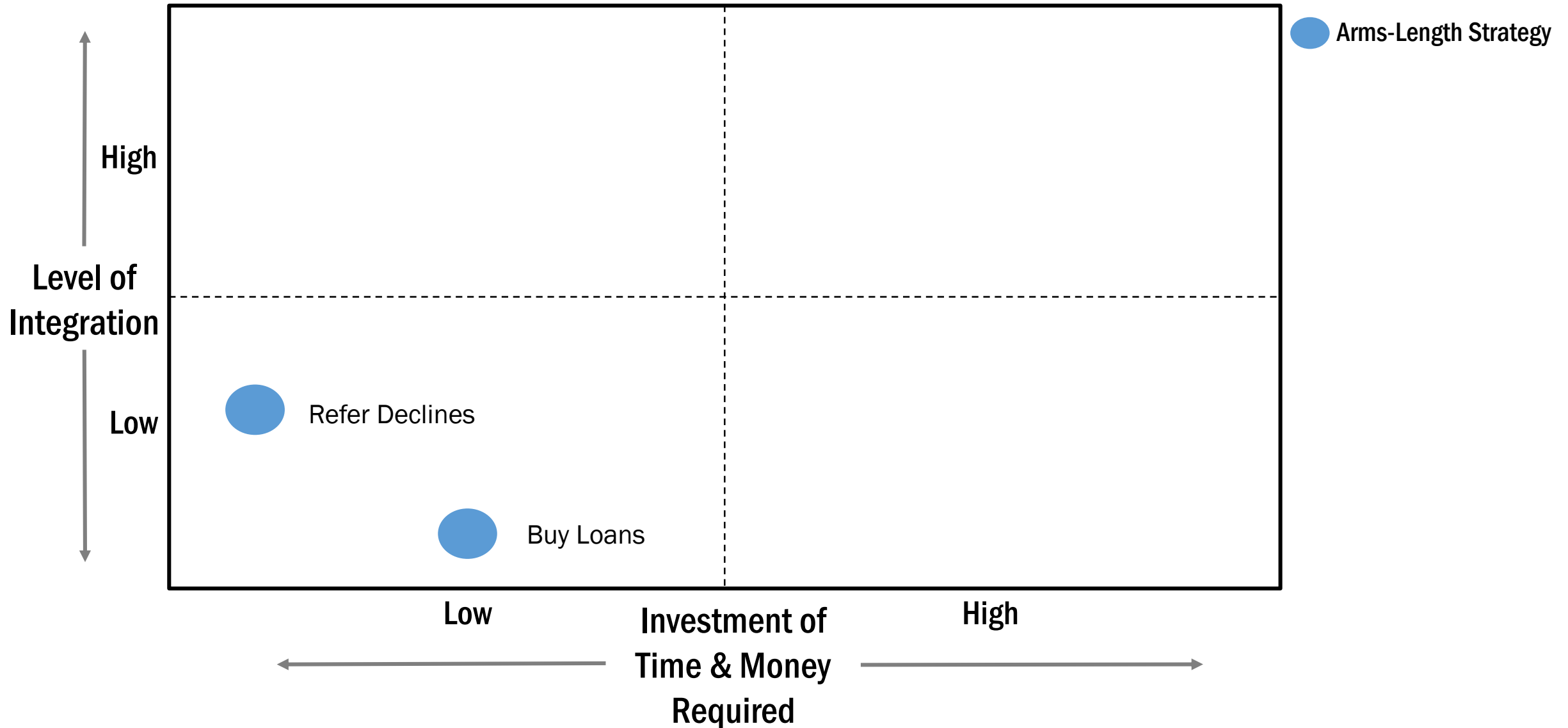
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<b>DISRUPTORS</b>   <b>CAN CAPITAL</b>  	✗	✓	?	✗	✓

Source: Author's analysis and "The Brave 100: The Battle of Supremacy in Small Business Lending." QED Investors and Oliver Wyman. 2015.

# BANKS AND INCUMBENT LENDERS: OPTIONS FOR STRATEGIC RESPONSES

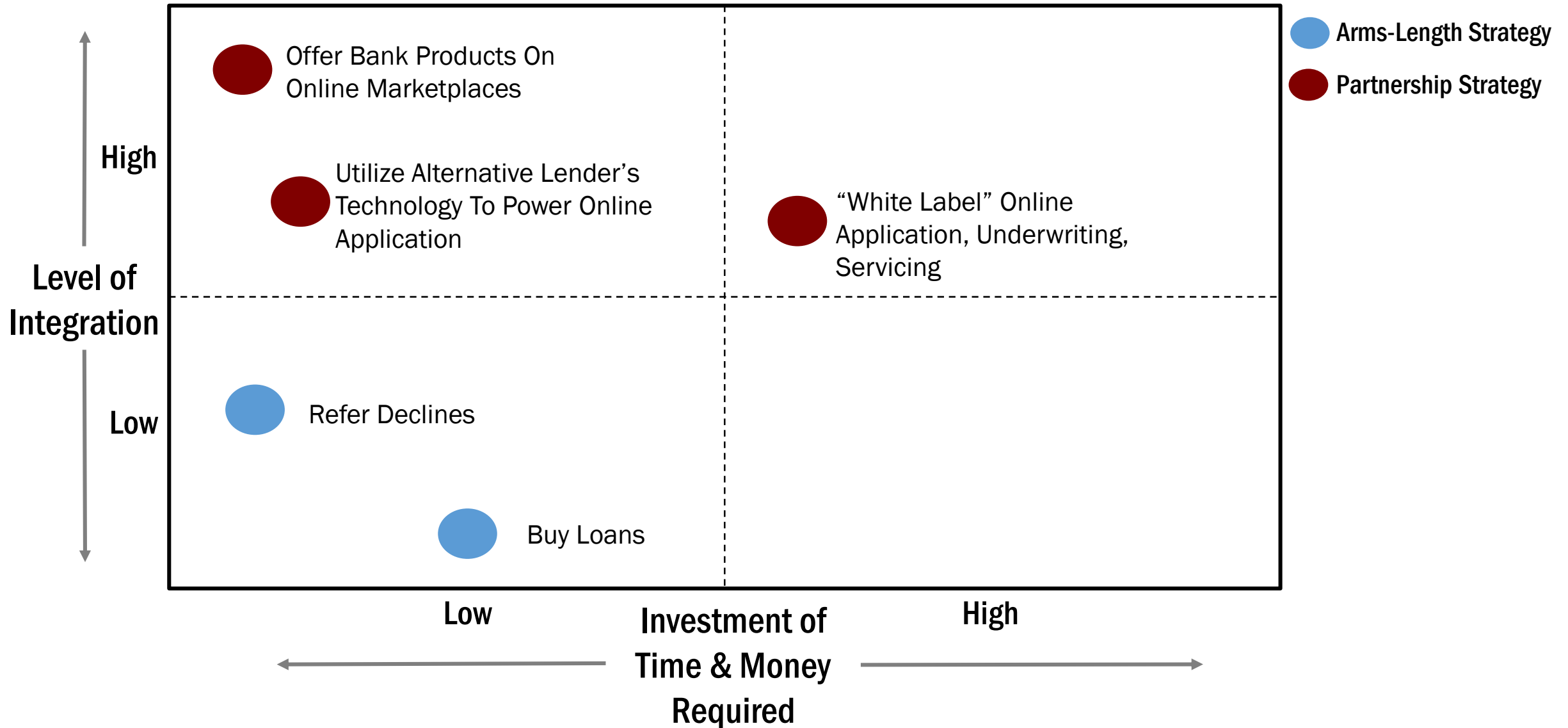


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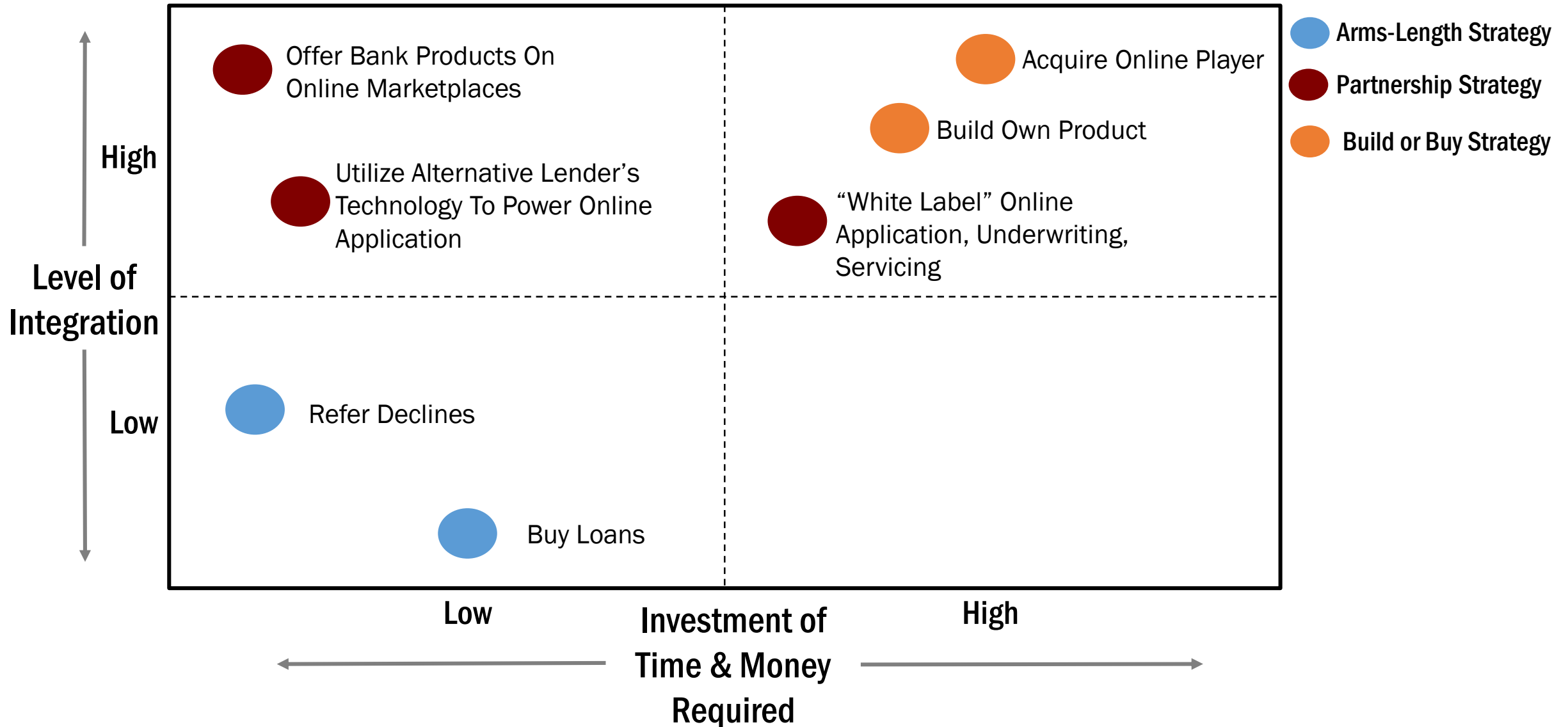




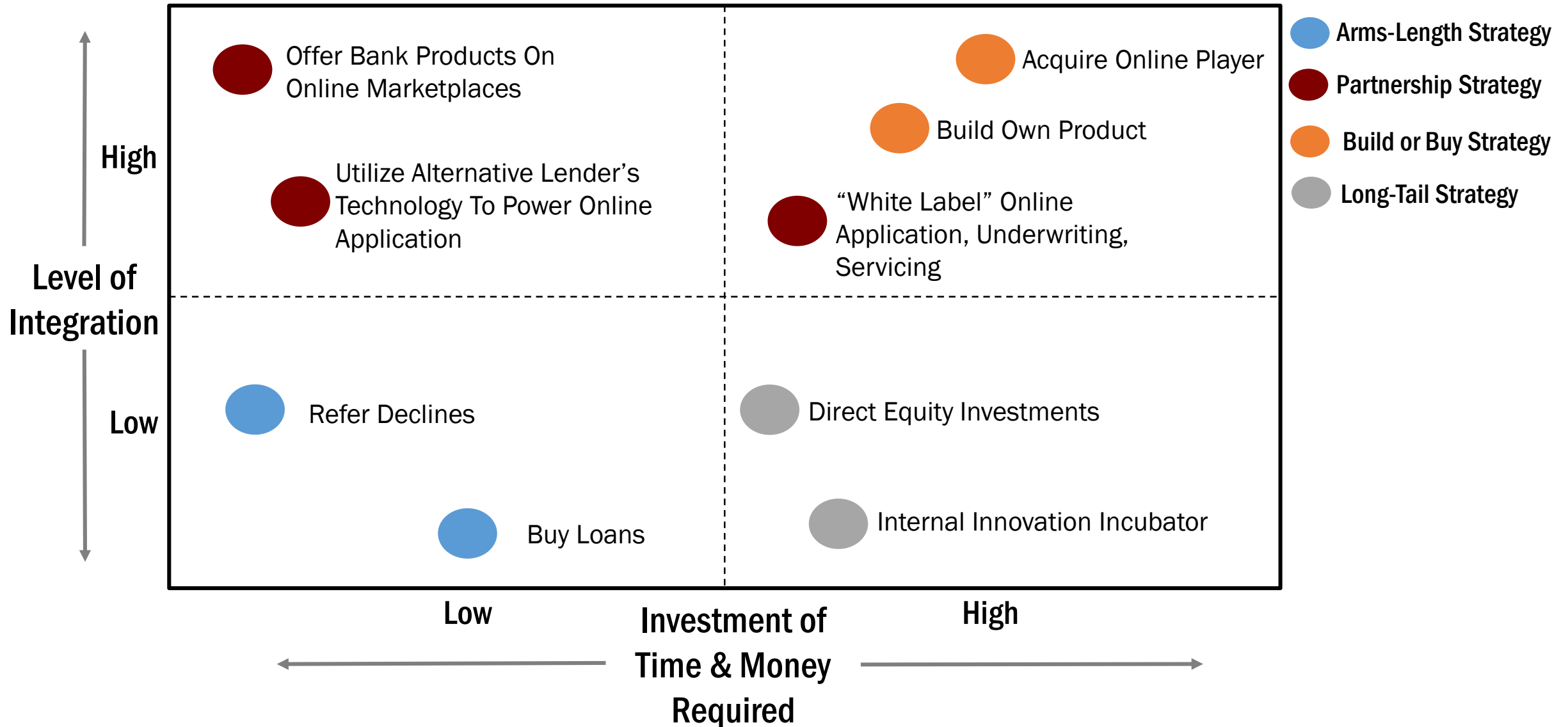
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# INNOVATION INSIDE BANKS: CASE EXAMPLE

## Eastern Bank



- 200 year old mutual bank
- Top SBA lender in New England
- Legacy systems



## Eastern Labs 1.0



- ““We should worry about people putting us out of business, but we should also put ourselves out of business.” – Bob Rivers, Eastern Bank CEO
- Labs received 1% of annual gross revenues
- Worked from glass box in lobby



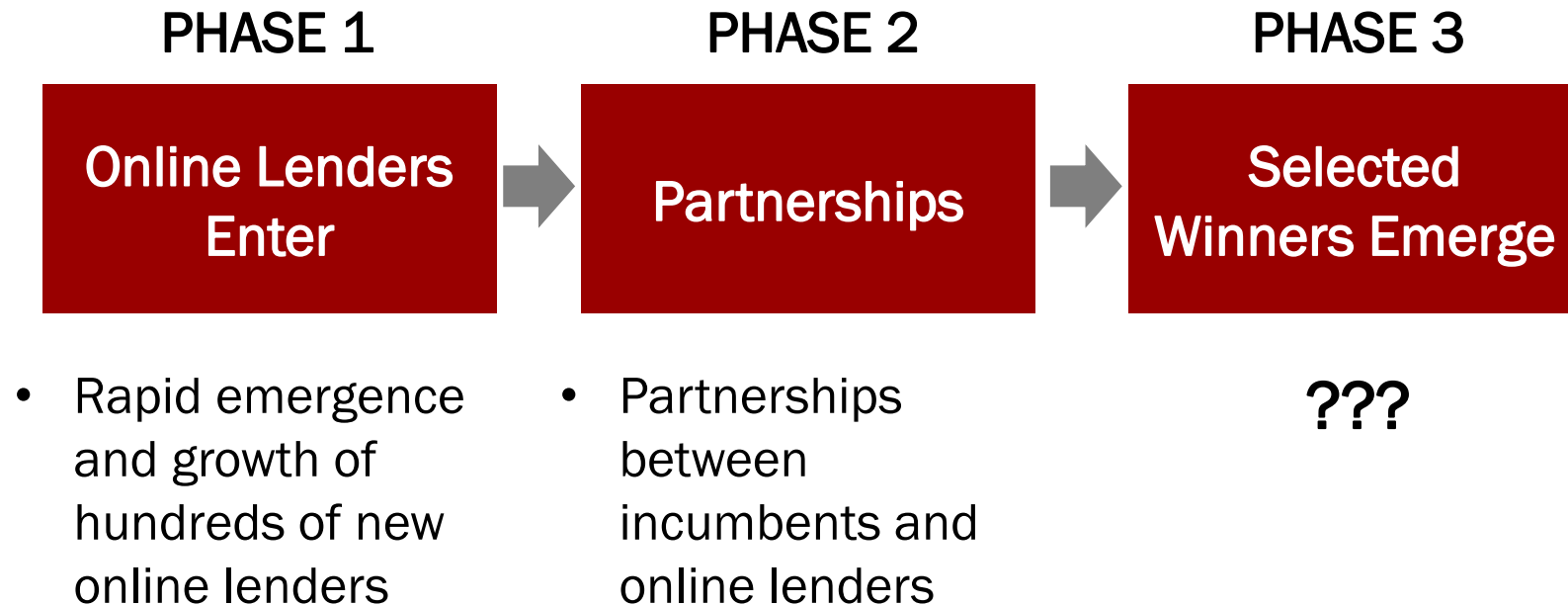
## Numerated



- Numerated spinout in May 2017
- Eastern 25% ownership
- Top-tier investors
  - FIS
  - Venrock
- Success for Eastern?

# PHASE 3: WHO WILL BE THE WINNERS?

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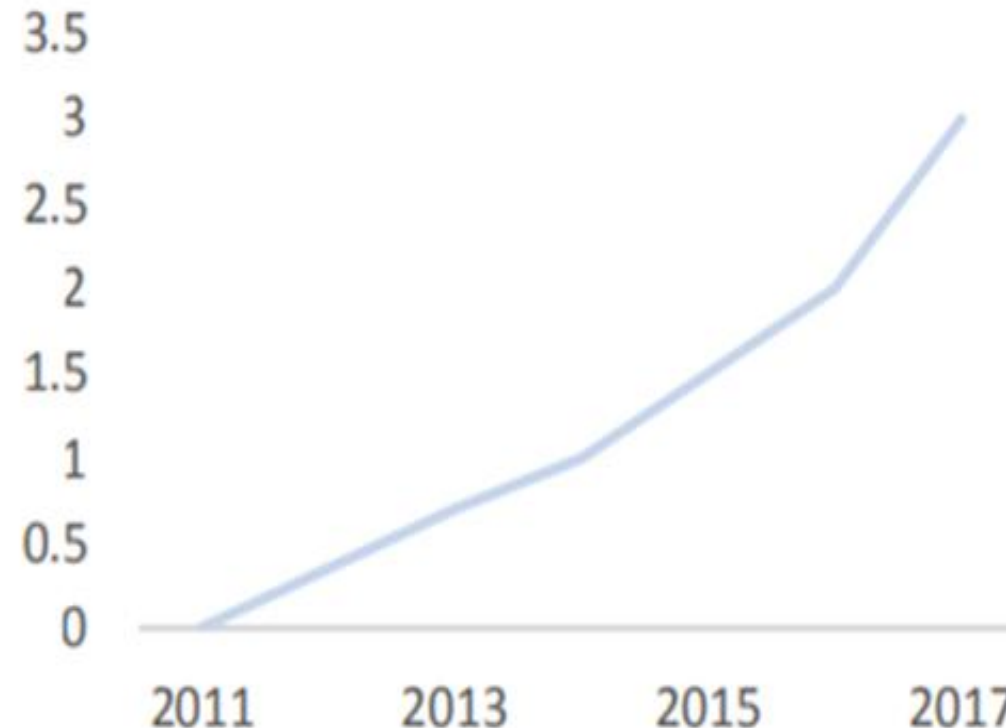


# PLATFORM PLAYERS ENTERING

Platforms like Amazon have accelerated their lending volumes

<u>Players to watch</u>
Paypal
Alibaba
Square
Amazon
AmEx

Loans through Amazon Lending (\$ billion)

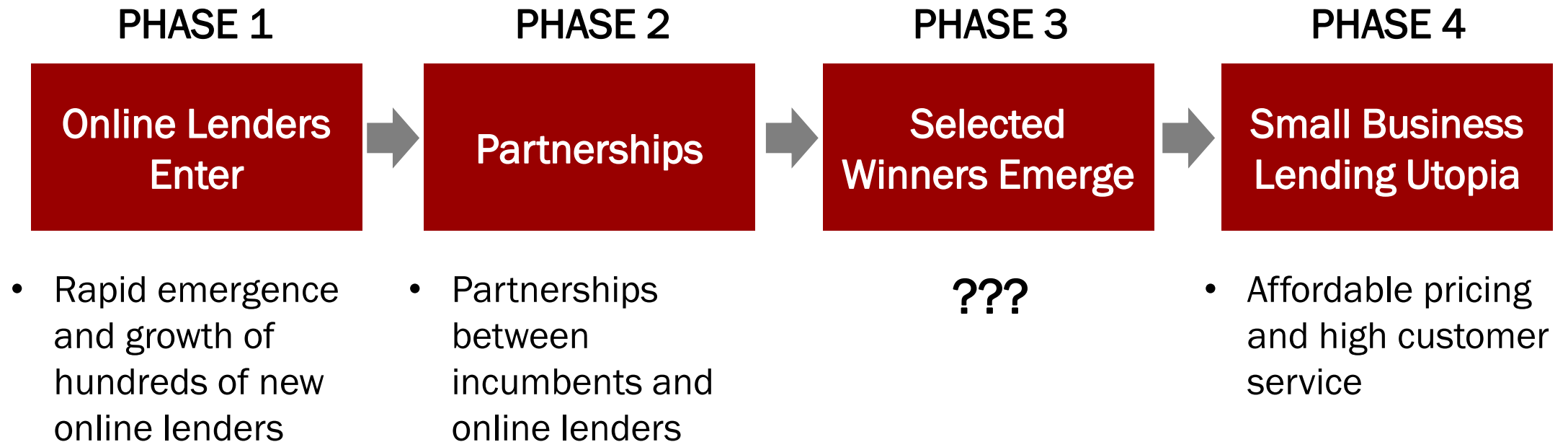


## Amazon Lending Statistics

- 20,000 small businesses
- \$3 billion total loans
- \$1,000 to \$750,000
- 6-14% interest rates

# PHASE 4: SMALL BUSINESS UTOPIA

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# WHAT ROLE WILL REGULATION PLAY?

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**National  
Credit Union  
Administration**



**Federal  
Reserve**



**Federal  
Deposit  
Insurance  
Corporation**



**Office of the  
Comptroller  
of the  
Currency**



**Office of the  
Comptroller  
of the  
Currency**



**Consumer  
Financial  
Protection  
Bureau**

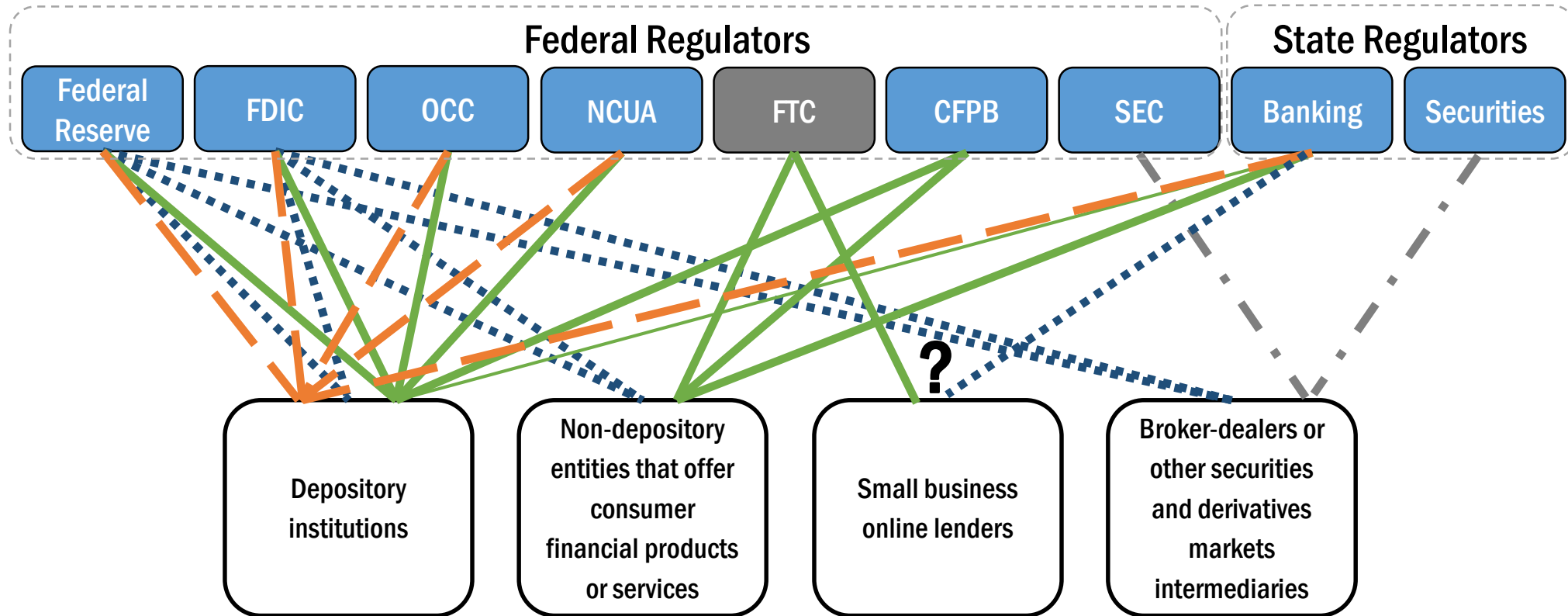


**Securities  
and  
Exchange  
Commission**



# CURRENT STATE: SPAGHETTI SOUP – MULTIPLE REGULATORS

Currently little oversight of small business online lenders



- - - - - Safety and soundness oversight
- . . . . . Consolidated supervision or systemic risk-related oversight
- Borrower financial protection oversight
- . - . - . Securities and derivatives markets oversight
- Financial Stability Oversight Council member agency

- FDIC:** Federal Deposit Insurance Corporation
- OCC:** Office of the Comptroller of the Currency
- NCUA:** National Credit Union Administration
- FTC:** Federal Trade Commission
- CFPB:** Consumer Financial Protection Bureau
- SEC:** Securities and Exchange Commission

# REGULATORY QUESTIONS

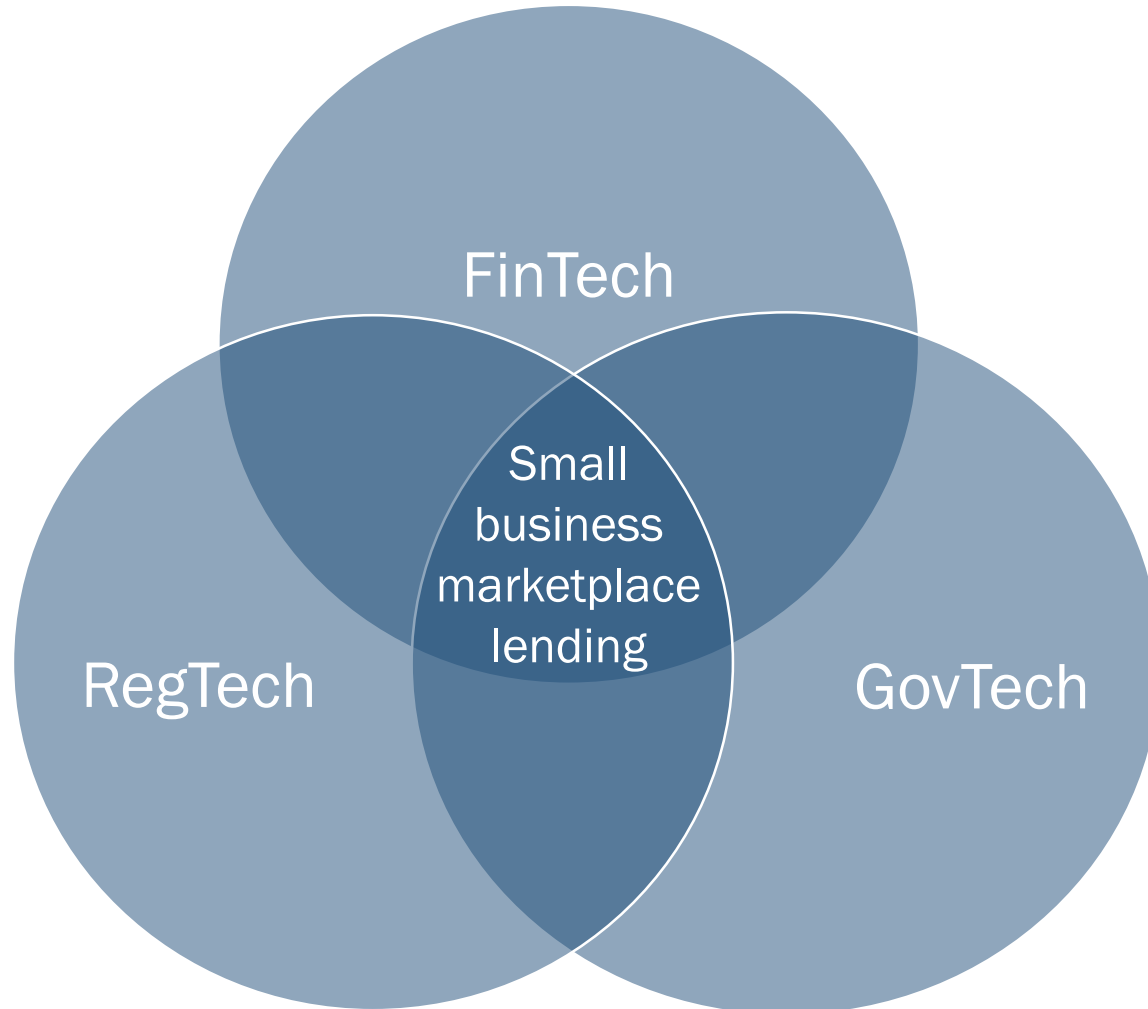
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1. Who should get a non-bank charter?
2. How can we make sure bad actors do not hurt small businesses?
3. How can we improve third-party guidance to allow for partnerships?
4. How can we collect data on small business loan originations without creating undue burden?

# ONE GUIDING PRINCIPLE: “DO IT SMART”

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Small business lending is at the intersection of FinTech, GovTech, and RegTech



1. Issue clear, succinct, joint guidance
2. Engage industry
3. Use technology
4. Be data driven

# WHAT IS CHANGING IN THE SMALL BUSINESS LENDING LANDSCAPE?

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## TRADITIONAL

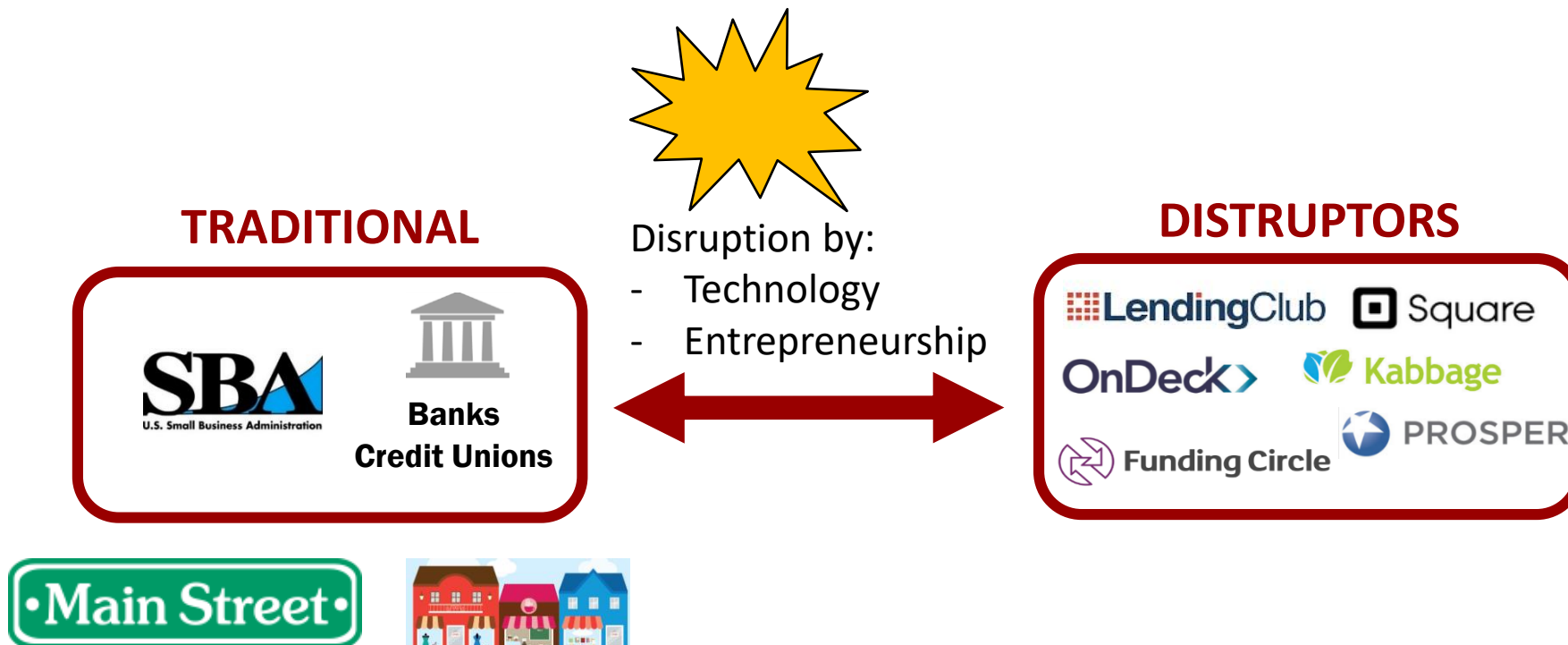


**Banks**  
**Credit Unions**



# WHAT IS CHANGING IN THE SMALL BUSINESS LENDING LANDSCAPE?

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# WHAT IS CHANGING IN THE SMALL BUSINESS LENDING LANDSCAPE?

## REGULATORS



National Credit Union Administration



Federal Reserve



Federal Deposit Insurance Corporation



Office of the Comptroller of the Currency



Office of the Comptroller of the Currency



Consumer Financial Protection Bureau



Securities and Exchange Commission



## TRADITIONAL



Banks  
Credit Unions

Disruption by:  
- Technology  
- Entrepreneurship



## DISTRUPTORS

LendingClub Square

OnDeck Kabbage

Funding Circle PROSPER



# WHAT IS CHANGING IN THE SMALL BUSINESS LENDING LANDSCAPE?

## REGULATORS



National Credit Union Administration



Federal Reserve



Federal Deposit Insurance Corporation



Office of the Comptroller of the Currency



Office of the Comptroller of the Currency



Consumer Financial Protection Bureau



Securities and Exchange Commission



## TRADITIONAL



Banks  
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# WHAT IS CHANGING IN THE SMALL BUSINESS LENDING LANDSCAPE?

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National Credit Union Administration



Federal Reserve



Federal Deposit Insurance Corporation



Office of the Comptroller of the Currency



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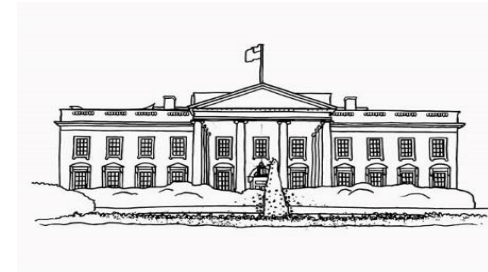
Consumer Financial Protection Bureau



Securities and Exchange Commission



## WHITE HOUSE



## TRADITIONAL



Banks  
Credit Unions

Disruption by:  
- Technology  
- Entrepreneurship



## DISRUPTORS

LendingClub Square

OnDeck Kabbage

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# WHAT IS CHANGING IN THE SMALL BUSINESS LENDING LANDSCAPE?

## REGULATORS



National Credit Union Administration



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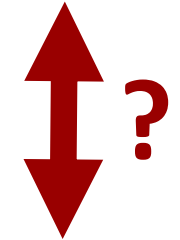
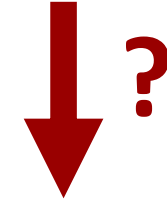
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## DISRUPTORS



## CONGRESS



# SMALL BUSINESS OWNERS

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