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Small Business Lending Landscape

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OPPORTUNITY FINANCE NETWORK™

Agenda

- Review small business landscape
- Taking a customer’s view of online lenders
- How CDFIs can differentiate
- Discuss how CDFIs and mission-driven lenders might respond to changing landscape

Our panel

Frank Altman	CRF
Dave Glaser	Montana CDC
Adrian Gonzalez	Accion Texas
Brenda McDaniel	Kentucky Highlands
Pam Porter	OFN

Small business market opportunity

Size by Employees	Number of Firms	% of Total
0 employees	21.3 million	78%
1-4 employees	3.6 million	13%
5-9 employees	1.1 million	4%
10-19 employees	0.6 million	2%
TOTAL with less than 20 employees	**26.6 million firms**	**98%**
ALL Firms in the US	**27.3 million**	**100%**

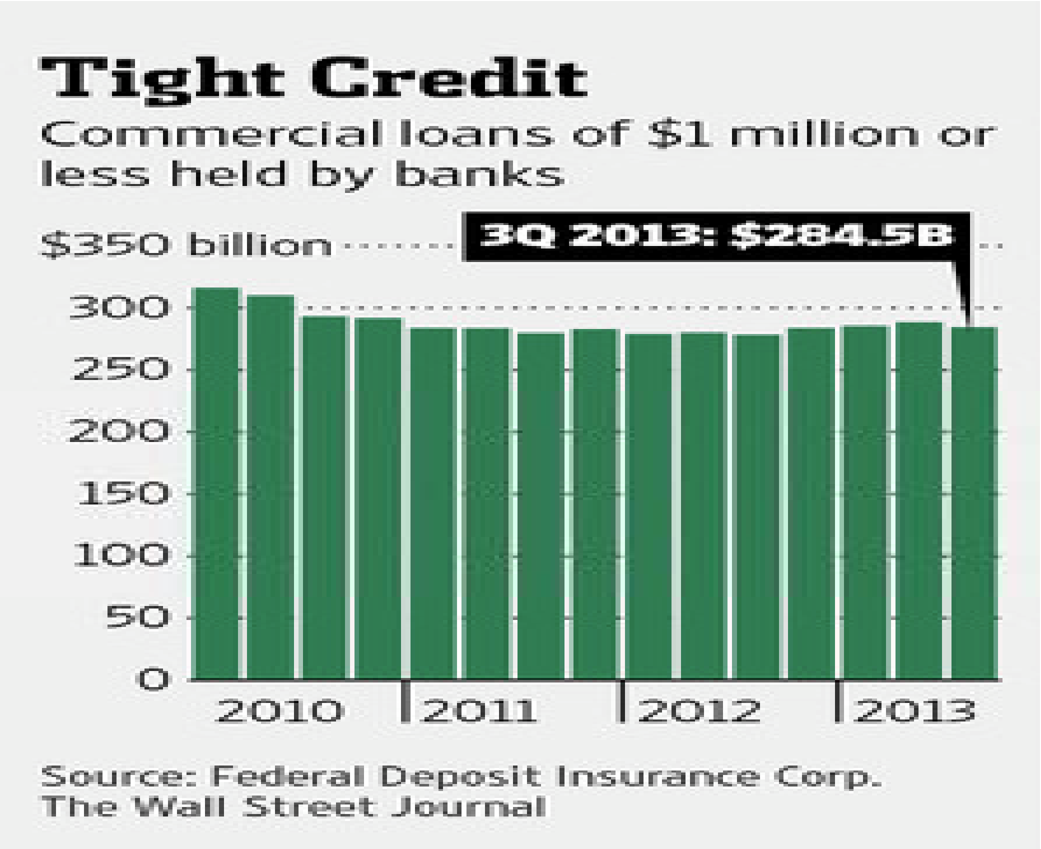
And 23% report that they sought credit last year*

* Reference Federal Reserve Bank of NY and Philadelphia study published Summer 2014

Who is lending to these small businesses?

- Traditional sources
- Non-traditional sources
- Emerging sources

Flat growth of loans less than $1 million



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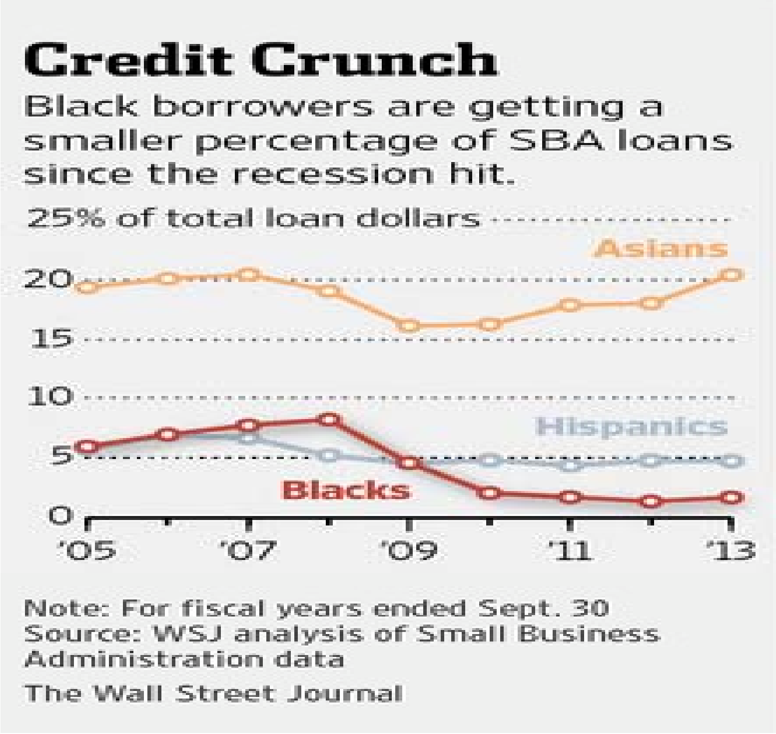
Minority borrowers experience much higher denial rates



SBA: Minority-owned firms more likely to be turned down by lenders:

- Small firms 3x more likely
- Large firms 2x more likely

Women entrepreneurs face challenges accessing capital

- U.S. Senate Committee on Small Business and Entrepreneurship:
  - 8.6 million women-owned small businesses create or maintain 23 million jobs – 16% of all U.S. jobs
  - Only 4% of all small business loans go to women
  - Less than 5% of federal contracts go to women
  - Business training and counseling for women not reauthorized or funded

Mission-driven lenders increasing lending much more rapidly than banks

- Small business lending by CDFIs:
  - 183 OFN members up 43% from 2012 -13
  - $300 million to $437 million
- Others :
  - SBA 504
  - 7(a)
  - ?

Mission Driven Lenders more effective at serving Low Income communities

- **CDFI Fund Impact Study: "**CDFIs do indeed 'fill the gap' that is left by conventional lenders."
- **SSBCI Study: "**States working through mission-oriented lenders have the greatest success in reaching underserved borrowers."

New lenders are changing the small business landscape

Bloomberg News:

- Rising alternative-lender market in the U.S. was **$3 billion in 2013** alone

The Financial Times:

- Some investors view peer-to-peer lending as an asset class and expect it to do **$25 billion in annual business globally by 2019**

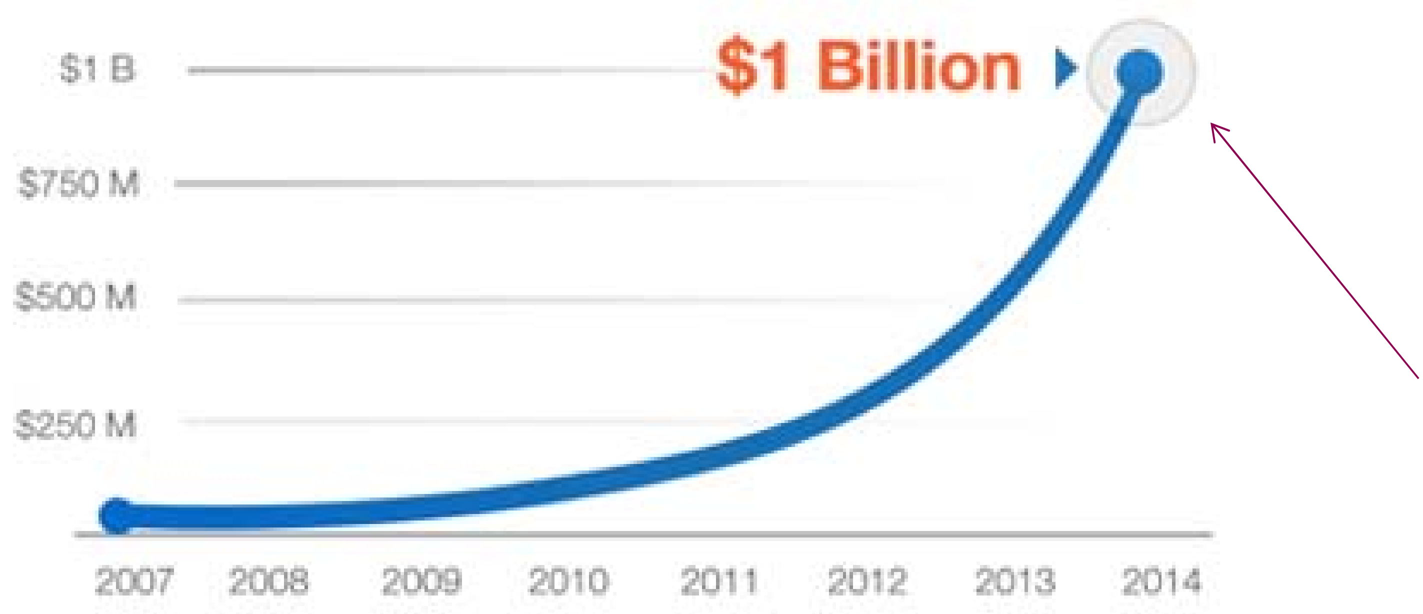
The New York Times:

- OnDeck has done **$900 million in small business loans** in last 5 years
- Lending Club and Prosper **> $4 billion in loans** in last 2-3 years

The Coleman Report:

- More than **$100 billion has been pushed through technology platforms** since 2006 to finance small companies

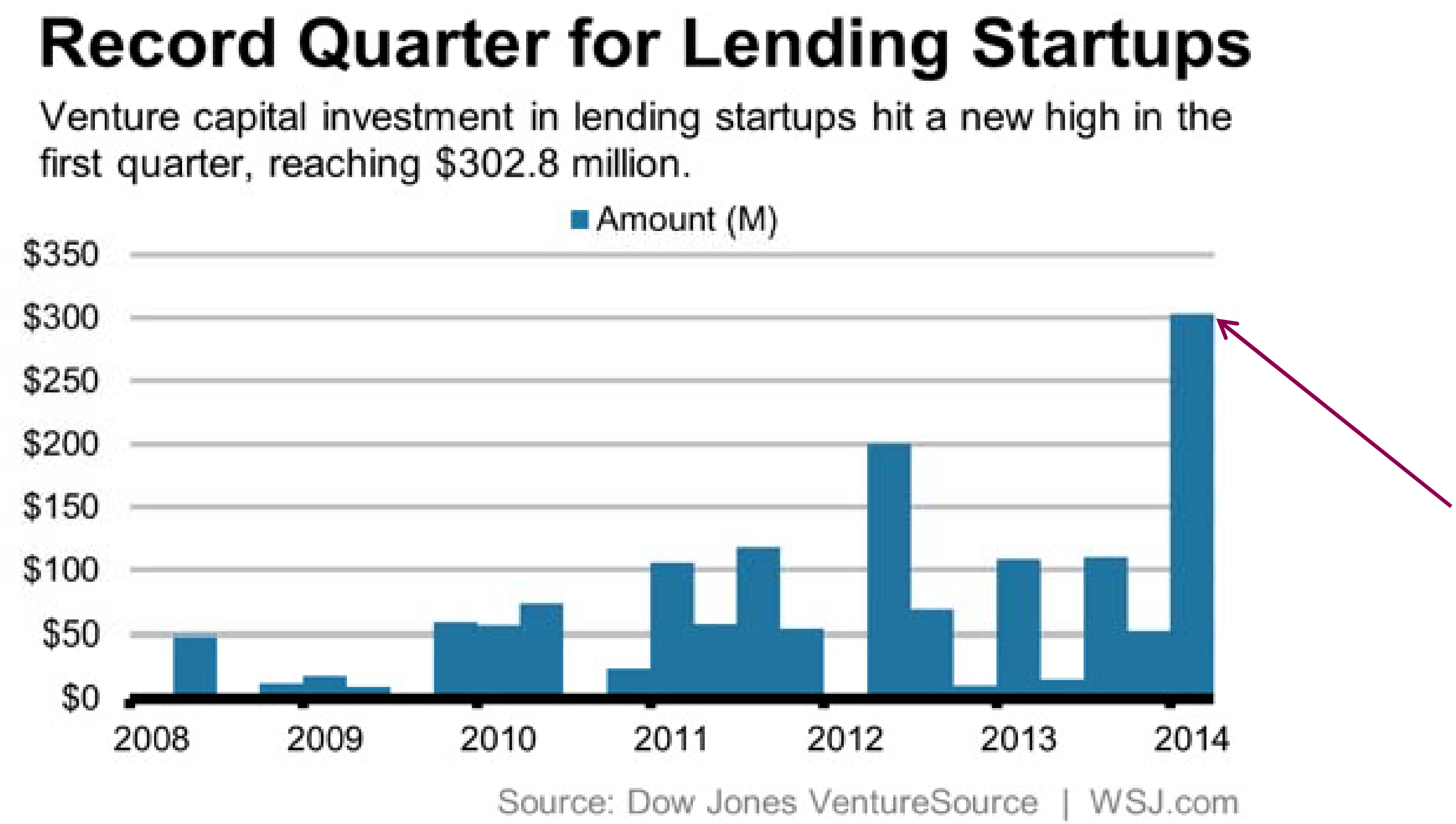
Growth at **Just One** Alternative Lender (OnDeck)



Alternative Lenders Going Mainstream

- **Forbes 100 'Most Promising Companies'** in the U.S. in 2014:
  - **Lending Club** ($98M in revenue; 379 employees)
  - **OnDeck** ($65M in revenue; 240 employees)
  - **Kabbage** ($17M in revenue; 80 employees)
- **Square, Inc.**, the small-business mobile payment company that expects $1 billion in revenue in 2014, launched **Square Capital**, to issue merchant cash advances
- U.K. regulators plan to **require banks that deny credit to small businesses to refer those applicants automatically to alternative lenders**

Venture Capital Moving Into the Space



What's Driving This Rapid Transformation of the Small-Business Lending Landscape?

Technology plays a role….

Online innovation promises borrowers unprecedented speed and ease of use:

- Applications typically take very little time to complete
- Process automated with algorithms that access applicant credit histories and social-media profiles
- Alternative lenders offer fast turnaround times
  - Loans disbursed within 48 hours or faster
- Search Engine Optimization and Ad Tracking

Do Alternative Lenders have a monopoly on Technology?

- **CDFI Accion Texas**, -- MMS and Nortridge Software
- **SBA** – SBA One – "one stop shop"
- **Loan Service Providers**, such as Prudent Lenders
- **CRF**: Process platform
- **Opportunity Fund**: merchant advance product

Yet, technology has not (yet?) driven explosive growth

Alternative Lenders have a common business model:

- **Relatively high interest rates**
  - APRs of 7-200%, unsecured, 1-5% orig. fees
- **Low operating expenses**
  - Limited underwriting – driven by technology
  - No brick & mortar presence
- High margins offset **high default rates**
  - **Default rates** of 6 - 10% (vs. <1-3% SBA)
- **Volume-driven returns**
  (Example: Lending Club made $7 million on revenue of $98 million in 2013 on loan volume of $2 billion)

Are These New Lenders Taking Market Share?

Probably some…although not clear

Most alternative lenders accept **near-prime FICO scores** or above (650+).

Some accept **sub-prime FICO scores** (<650).

Commentators assert that borrowers are underserved

What can Mission-Driven Lenders Learn From the Recent Rise of Alternative Lenders?

- Peer-to-peer lending companies:
  - **Lending Club**, **Prosper**, **Indiegogo** and **Funding Circle**
- Merchant cash advance companies:
  - **RapidAdvance**, **AdvanceMe, Square Capital**
- Online companies specializing in business lending:
  - **OnDeck** and **VMC Capital**
- Online lenders that lend only to online companies:
  - **Kabbage** and **PayPal**
- Online "matchmakers" that connect borrower with lenders:
  - **Lendio**, **Boefly** and **Biz2 Credit**
- Google Search "small business loan"

Our panelists: What take-aways did you have from this review?

- CRF
- Montana CDC
- Accion Texas
- Kentucky Highlands

Bigger picture

- How can/should CDFIs differentiate?
- What can we learn from the rise of alternative lenders?
- What are the implications of the rise of alternative lenders for the communities we serve?