PROFILE OF A SMALL BUSINESS LENDING APPLICANT

By Allen Taylor

The Federal Reserve Board of Cleveland, in February, concluded that online small business borrowers are more satisfied than businesses who have not borrowed money while bank borrowers are the most satisfied of all. This conclusion was published in a working paper titled "Is 'Fintech' Good for Small Business Borrowers? Impacts on Firm Growth and Customer Satisfaction."

Based on a survey of small business borrowers conducted from September to November 2015 by the Federal Reserve Banks of New York, Atlanta, Cleveland, Philadelphia, St. Louis, Boston, and Richmond, the data indicates that small business loan applicants who apply for loans from online lenders don't have it easy even though it is easier to get a loan from online sources than from a bank.

Ann Marie Wiersch, senior policy analyst at the Cleveland Fed, said, "We find that firms that apply to online lenders tend to be smaller, newer firms. They tend to be less profitable and are less likely to say revenues are growing. From that standpoint, we are likely to see, by traditional metrics, that they are somewhat more risky borrowers or less creditworthy."

Fifty-two percent of the 5,420 survey respondents applied for a loan from a small bank, 42% with a large bank, 20% to an online lender, and 9% to a credit union.

Eighty-three percent of online lender applicants had annual revenues of $1 million or less. In contrast, 61% of those that sought credit through traditional lenders only were smaller firms. Forty-eight percent of the online lender applicant pool were in business five years or less compared to only 36% of the traditional bank lender applicant pool. Online lender applicants were also less likely to be profitable and twice as likely to cite credit availability as a top business challenge.

Minority-owned businesses outweighed other businesses in the online lender applicant pool by 22%.

When it comes to debt, the Fed found that online lender applicants are as likely to hold debt as traditional bank borrowers, but have less of it. They are also less likely to pledge collateral than traditional bank borrowers.

Regarding the reasons for seeking a loan, online lender applicants are more likely to borrow for business expansion, operating expenses, or to refinance existing debt. Factors influencing where small businesses apply for a loan are weighted toward online lender applicants for every reason other than existing relationship with the institution. Online lender applicants value the perceived chance of being funded by 64% to 35%, cost of the loan by 60% to 54%, speed of decision by 50% to 33%, product flexibility by 45% to 36%, and application ease by 45% to 36%. Traditional borrowers prefer banks over online lenders based on relationship by 66% to 31%.

Online lender applicants are also more likely to apply for multiple loans. In fact, the survey revealed 50% of them applied for three or more loans, 18% applied for two, and 32% applied for just one. Only 17% of traditional bank borrowers applied for three or more loans while 57% applied for just one; 26% applied for two. Traditional bank borrowers were more successful as 83% received at least some of the funding they applied for versus 77% of online lender applicants. Just 20% of online lender applicants received the full loan amount applied for, but more than half of traditional lender applicants were approved for the full loan amount.

Reasons for credit denial among

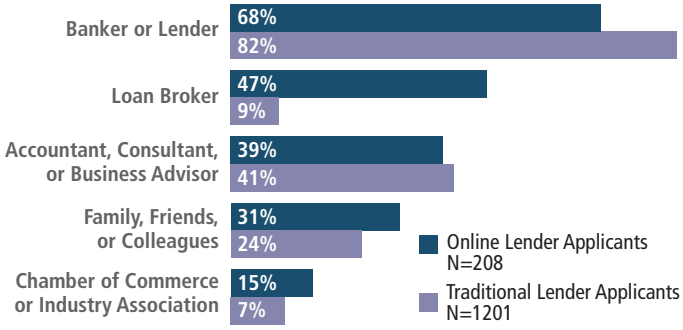
CHARACTERISTICS OF CREDIT APPLICANTS

Firms that applied with an online lender N=209[6]		Firms that applied with a traditional lender N=1204[7]
83%	**ARE YOUNG FIRMS** Share of applicants in existence 5 or fewer years	61%
48%	**ARE YOUNG FIRMS** Share of applicants in existence 5 or fewer years	36%
54%	**ARE FIRMS WITH GROWING REVENUES** Share of applicants reporting an increase in revenues in the past 12 months	58%
38%	**ARE PROFITABLE FIRMS** Share of applicants operating at a profit	58%
25%	**ARE FIRMS WITH CREDIT CHALLENGES** Share of applicants reporting credit availability is a significant challenge	12%
36%	**ARE MINORITY-OWNED FIRMS** Share of applicants that are minority-owned firms	14%

Note: Online lender applicants are defined as those firms that applied for financing at one or more online lenders, including firms that applied at both online and traditional lenders.
[6] In total, 209 firms applied for financing with an online lender, defined as a nonbank online lender, including alternative and marketplace lenders. The N values for each variable shown in the table vary from 185 to 209, depending on the number of respondents that answered the question.
[7] In total, 1,278 firms applied for financing with a traditional lender (large banks, small banks, and credit unions). The N values for each variable shown in the table vary from 1,109 to 1,204, depending on the number of respondents that answered the question. Firms that applied only to "other" lenders (including government loan funds and community development financial institutions) are excluded.

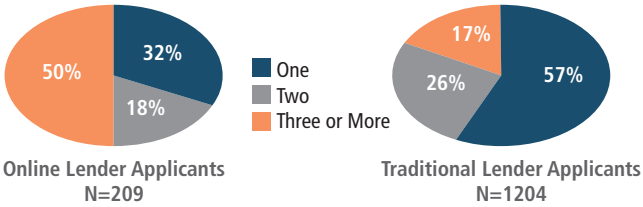
Source: 2015 Small Business Credit Survey, responses for employer firms; authors' calculations

SOURCES OF FINANCING ADVICE



Note: Select answer choices shown. Respondents could choose multiple options. Online lender applicants are defined as those firms that applied for financing at one or more online lenders, including firms that applied at both online and traditional lenders.

NUMBER OF FINANCING APPLICATIONS SUBMITTED



Note: Shares calculated based on the number of products applied for and the number of sources per product. Online lender applicants are defined as those firms that applied for financing at one or more online lenders, including firms that applied at both online and traditional lenders.
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both applicant pools included low credit score, insufficient collateral, weak business performance, and insufficient credit history. Online lender applicants, however, were denied more often for each of those reasons. Traditional lender applicants outweighed online lender applicants only in the "unsure" category.

Finally, the survey measured satisfaction levels of loan applicants and discovered that online lender applicants were less satisfied than traditional loan applicants.

"Some of what drives satisfaction is transparency," Wiersch said. "Borrowers understanding the interest rate, for instance."

Even when approved for a loan, online lender applicants were less satisfied than traditional lenders with the overall experience. Typical reasons included interest rate, repayment terms, lack of transparency, wait time, and the application process. Online lender application satisfaction levels were lower for the first three reasons than satisfaction levels for traditional borrower applicants and higher on the last two. In fact, online lender applicants were less satisfied with interest rates and repayment terms by 85% to 29% and 66% to 23%, respectively.

The Fed conducted a similar survey of small business owners in 2016 with similar results. The biggest difference, according to Wiersch, is that dissatisfaction with interest rates was lower last year than for 2015.

Data extrapolated for this article comes from the Cleveland Fed report titled "Click, Submit: New Insights on Online Lender Applicants from the Small Business Credit Survey."

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