Seeking the cloud

Better lending support for minority-owned businesses

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Introduction

Fast and fair access to funding is critical

According to a study conducted by the Global Strategy Group for Color of Change and UNIDOSUS, more than half of African American and LatinX-owned businesses will need financial assistance to survive the economic effects of the COVID-19 pandemic.[1] Unfortunately, government programs designed to provide relief to small businesses were ineffective for many owners of color. While requests for temporary funding averaged $20,000, only 1 in 10 who sought relief was granted the requested assistance.[2]

Recognizing that minority-owned businesses are an important part of the economy, fueling job growth for 7.2 million Americans,[3] Community Development Financial Institutions (CDFI) have committed to supporting disadvantaged firms even in difficult times.

The COVID-19 pandemic, however, presents unprecedented challenges for CDFIs and other financial institutions serving these markets.

In this environment, fast and fair access to funding is critical, so financial institutions need to rise to the challenge, using technology to level the playing field for lending services.

Automating workflows improves decision and funding time by as much as 50%

As minority communities struggle to make a comeback from the COVID-19 crisis, rapid access to funding is critical. A small business study conducted by Mastercard reveals that more than a third of business owners have experienced cash flow problems due to missed payments since the start of the pandemic, and half are only one missed payment away from closing up shop.[4]

Financial hardship has a way of trickling down from businesses to the community at large. According to Pew Research, 61% of Hispanics and 44% of black Americans said that they, or someone in their household, had lost a job due to the financial fallout of the global health crisis.[5]

Financing can fill gaps in cash flow and position businesses for growth during critical times like these, but gaining funds in a timely manner is typically a challenge for most small businesses. The process for a typical SBA loan can take 60 to 90 days, for example.[6]

On the other hand, digitizing the end-to-end lending process drastically reduces time to funding, putting cash in the hands of borrowers faster and more efficiently.

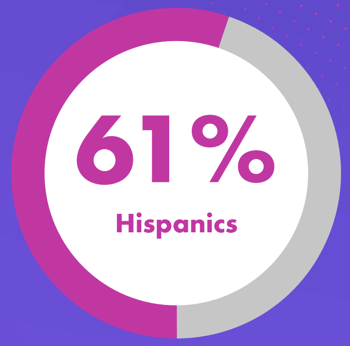
Achieving a streamlined end-to-end lending process begins with straight-through processing (STP) to automate critical workflows. Automation is one of the key factors in improving lender efficiency and time to funding.

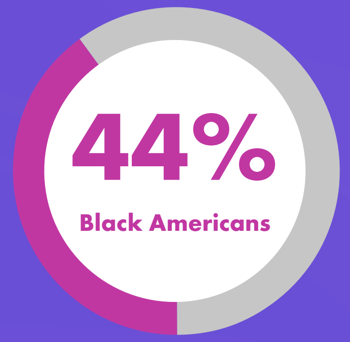
The high number of human touchpoints in a typical lending process results in errors and inefficiencies that delay credit decisions and funding. Automating workflows reduces the need for human intervention by up to 80%,[7] improving decision and funding time by as much as 50%.[8]

STP also improves data access, by creating single point of entry for all. This approach reduces errors as well as the time it takes to complete lending applications by eliminating much of the duplicative data entry that plagues lending processes.

Shared data access then supports faster and more consistent collaboration between front and back offices. For example, a loan officer in the field accessing systems remotely will now have the same view of data as the back office, facilitating a faster and more complete application process.

This anywhere, anytime availability to the application process, when combined with reductions in data entry, can deliver 12% growth.[9] Growth makes it possible for financial institutions to extend more opportunities to minority businesses.





said that they, or someone in their household, had lost a job due to the financial fallout of the global health crisis

Process automation and data access key to community support

Technology is leveling the playing field

CDFI lenders are committed to fostering diversity and equality by supporting minority communities where access to funding can be limited by several factors. For instance, minority business owners tend to have lower net worth and are less likely to own valuable assets, such as a home. These factors can weigh against borrowers when held up against traditional lending standards.

Technology has been shown to level the playing field when it comes to credit decisioning. For one thing, automating key parts of the decisioning process can remove the risk for human bias and result in fairer and more advantageous credit decisions for minority communities. However, the improved data access realized from digitizing the end-to-end lending process has far broader implications.

The SBA indicates that 68% of minority firms actually represent a low credit risk.[10]

The findings suggest that traditional risk assessments do not provide a fair evaluation for many minority-owned businesses and that a different approach to credit decisioning could help the financial institution meet the needs of more borrowers.

By bringing together workflows from origination through underwriting and reporting into a unified environment, banks and credit unions have access to the complete lending portfolio, enabling peer assessments and analysis of the market at large. With a better understanding of market risk, financial institutions can easily configure financial ratios to enable assessments that more accurately represent minority communities, while also protecting bank profitability.

A broader view of data provides additional insights as well. For instance, lenders can review the bank or credit union's exposure by size of credit, industry segment and geography, delivering additional perspective for taking on more risky borrowers.

Streamlined data access can also support lender initiatives to spread awareness of CDFIs within the community. According to the SBA, only 11% of Black-owned firms and 7% of Hispanic-owned firms applied to CDFIs for financing.[11] The low number of applicants suggest that minority communities aren't aware of services offered by these financial institutions, something that better marketing could remedy.

Lenders who adopt end-to-end digital workflows across the lending process gain more targeted insights from data, allowing them to personalize marketing messages to individual segments of the community. Targeting messaging can do more than spread the word about CDFI lending opportunities. More personalized messaging can help borrowers overcome hesitancies about borrowing by educating on lending opportunities and the value of CDFIs.

CDFIs unite in the cloud

A faster and simpler road to digital adoption

While straight through processing and automated workflows have been shown to reduce turnaround times on loan applications and support more targeted credit decisioning, CDFIs face several barriers to adoption. Digitizing the multiple workflows into a seamless environment can be costly and the road to implementation lengthy for financial institutions who embark on the journey alone.

When it comes to digitizing processes, 86% of financial institution executives cite legacy IT technology as one of the most significant obstacles.[12] The disparate nature of banking core systems makes it difficult to design a digital end-to-end lending solution that can smoothly transfer information, a necessity for straight through processing.

A faster and simpler road to digital adoption utilizes cloud-based platforms and APIs. While it might be easiest to think of the cloud as a location, it is really a series of interconnected servers.

Platforms built on the servers' house software applications used to run and automate banking processes. Application Programming Interfaces (APIs) provide a connection layer, allowing applications on the platform to connect to the outside world and for financial institutions to connect to applications.

Utilizing cloud-based platforms and APIs, financial institutions can cleanly and easily unite products and services to deliver a digitized end-to-end process. However, there is a danger in taking a piecemeal approach to digital adoption.

Often, financial institutions will try to append different solutions onto the core. Results are often suboptimal, as applications from multiple providers may not always play nice when forced to work together, and solving issues can be time consuming.

Partnering with a single platform vendor eliminates many of these challenges. For one thing, vendors thoroughly vet products for compatibility before releasing them to financial institutions. This approach not only ensures a seamless operating environment, but financial institutions are also freed from the complicated tasks associated with product testing.

Utilizing one platform vendor also provides financial institutions with a single source of support should they decide to make changes or need additional services. One of the advantages of cloud-based platforms is the plug-and-play nature of products. As the lending landscape changes, leaders in the cloud-platform space will be continuously innovating to meet market demand. As these new products are released to the platform, banks and credit unions can seamlessly plug into the new offerings.

Overall, cloud-based platforms delivering an integrated end-to-end solution have been shown to deliver performance-boosting results that support CDFIs in their mission to bring financing to minority communities:

25-30% reduction in time to loan approval for new customers

50% reduction in time to loan approval for existing customers

58% reduction in total time to originate a loan

Additionally, financial institutions have realized operational efficiency gains of 40%, spurring a 12% growth in the value of loan originations, without increasing staff. As CDFIs work to expand credit access across minority communities, digital end-to-end lending platforms are delivering faster time to funding at reduced costs, making it possible for lenders to fulfill their mission and deliver more opportunities to the regions they serve.

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With over 30 years helping financial institutions and software companies systemize public policy, Mitch is an experienced financial services lawyer, business and thought leader in lending and account origination, underwriting, fulfillment and servicing. He has experience in private practice and as a general counsel before joining Finastra in 2004.

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