Transforming Small Business Credit:
Technology and Data Adoption in Mission-Based Lending

Research Highlights Lessons Learned from Pilot Programs and Technology Initiatives by Community Development Financial Institutions

FinRegLab has released an updated qualitative study highlighting lessons learned as mission- and community-based lenders adopt electronic cash-flow data and platform technologies to expand lending to small businesses. Based on five pilot programs and extensive interviews, the report provides a range of practical tips and considerations for individual lenders and membership organizations leading new technology initiatives. It also includes a broader discussion of how the use of technology intersects with operational and cultural considerations as mission-based lenders work to scale their programs.

Mission-based lenders, including community community development financial institutions (CDFIs) and minority depository institutions (MDIs), have long been a vital source of capital for entrepreneurs who struggle to obtain loans from mainstream lenders, particularly during economic downturns. Their willingness to work with small businesses that may lack traditional credit, collateral, and established business histories, along with providing high-touch technical assistance and support, help these lenders to meet the needs of underserved entrepreneurs. Since the COVID-19 pandemic, record business formation levels and growing interest in supporting small businesses have prompted mission-based lenders to further increase their capacity for and focus on small business lending. Although mission-based lenders have historically faced resource and technology constraints, recent data and technology advancements are facilitating efforts to scale lending to smaller and younger businesses.

The study notes a broad spectrum of practices and technological complexity among mission-based lenders in adopting electronic cash-flow data. While lenders differ in their transition toward automated and standardized underwriting practices, even those taking smaller steps are laying the groundwork for future advancements. A few lenders are starting to develop machine learning models to underwrite more efficiently and accurately. But data and technology are just one strand of what it takes to substantially scale small business lending. Lenders are also having to consider cultural and strategic shifts as they adapt traditional high-touch approaches to larger geographic footprints, explore digital channels for customer engagement, test automated lending practices, and consider how to make programs more self-sufficient.

Empirical Analysis of Using Cash-Flow Data to Underwrite Financially Constrained Businesses

FinRegLab and researchers from the New York University Stern School of Business have released a new study of fintech lender data to assess the impacts of incorporating cash-flow data into underwriting models that rely primarily on entrepreneurs' personal credit scores. The study finds that common cash-flow metrics can help lenders underwrite more accurately, particularly when evaluating early-stage companies and financially constrained entrepreneurs that lenders consider to be higher risk.

With regard to individual lenders' data and technology adoption, the paper finds:

- **Many mission-based lenders are initially focused on speed and efficiency gains from transitioning to electronic bank account data and underwriting platforms.** Even this first step can help increase access to credit, as paper bank statements and tax returns are often stale, incomplete, and burdensome to collect. Electronic data feeds are helping to position mission-based lenders as viable alternatives to high-speed, high-cost online loans.
- **As performance data accrues, mission-based lenders are looking at ways to increase the accuracy of their underwriting to further increase credit access.** Some lenders are just beginning to transition beyond relationship-based lending, while others have enough historical data and technology support to develop machine learning models for underwriting.
- **The range of vendors that are willing to work with mission-based lenders has expanded, but vendor selection and internal change management can still be challenging.** Lenders often lack dedicated staff with technical backgrounds to conduct vendor evaluations and have to manage upfront and ongoing technology costs. They underscored the importance of defining needs and goals clearly up front and assisting employees in adjusting to new ways of working.

With regard to broader ecosystem questions and initiatives, the paper finds:

- **Intermediary organizations' technology initiatives are helping smaller lenders, but finding a single utility solution is difficult.** Pooling information, organizing peer learning cohorts, negotiating discounts, and providing subsidies is helpful, but one-size-fits-all options are tough because lenders vary widely in their size, goals, operating cultures, and technology expertise.
- **Digital marketing, small business loan marketplaces, and referral networks are promising but challenging avenues for expanding customer acquisition pipelines.** Lenders are increasingly shifting away from or supplementing traditional "boots on the ground" outreach with digital channels such as email marketing, websites, and social media. New channels hold promise but may attract applicants with much different interest levels and risk profiles.
- **Secondary market initiatives that help mission-based lenders recycle their funds more quickly into additional lending are critical for increasing lenders' origination capacity and liquidity, especially in an increasingly uncertain economic environment.** Initiatives to help lenders attract additional capital through loan participations or other secondary market mechanisms are allowing them to recycle funds into more small business lending.
- **Substantially increasing the scale of small business lending raises important questions about mission-based lenders' strategies, cultures, and relationships.** Lenders are calibrating how far to go in relying on digital channels versus physical offices, standardizing processes, and adopting automation. These issues have major implications for efficiency, scale, risk, and credit access, as well as relationships with other stakeholders. Lenders are also increasingly exploring changes to pricing and product offerings and looking to reduce dependence on external subsidies to improve loan portfolio economics as they expand their programs to reach more small businesses.