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# America's small business credit opportunity

Expanding credit access without increasing risk

# Contents

# Executive Summary

- This report lays out new research into the small business credit landscape in the US and investigates how Open Finance can be used to widen access to credit.
- The research shows that there is a high demand for credit among small businesses in the US to drive all aspects of their operations.
- Small businesses are so reliant on external credit for both expansion and survival, that neither failure to access finance previously nor the current economic climate are a deterrent.
- 21% of SMBs surveyed, the equivalent of 6.825 million businesses, wanted to take out credit in 2022 but were unable to. Of these businesses, 78% cited issues with the application process specifically as the reason they couldn't access credit.
- 65% of those surveyed intend to apply for credit in 2023. Of those that won't, 19% say it's because the system is too off putting.
- Improved data sharing through Open Finance is the biggest opportunity to widen access to credit while not increasing risk for lenders.
- Enabling small businesses to share data digitally stands to:
    - Increase approval rates through greater ability to assess creditworthiness.
    - Encourage more applications due to a more convenient process.
- There is evidence that this approach will succeed because there is high willingness for businesses to share their financial data with lenders - 73% of those surveyed said they would share their financial data directly with credit providers.
- If banks and lenders in the US can successfully address the issue of time-consuming, complex applications through Open Finance, there is a $13.7 billion additional revenue opportunity.

# Research methodology

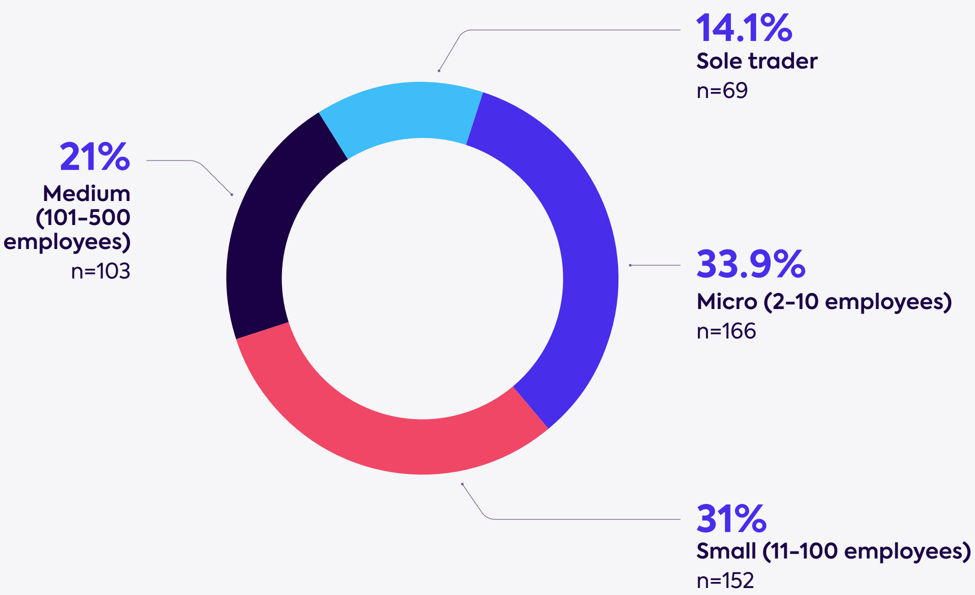
To get a clearer picture of the SMB credit landscape in the US, we conducted our own research and analyzed existing reports and data.

For our research, Codat worked with the international research data and analytics group, YouGov. All references to the SMB population are calculations that have been made by Codat. We recognize that these are estimations based on the total SMB population in the US and should not be used as definitive data. These are indicative figures that demonstrate the potential scale if similar proportions in line with the research we conducted were seen across the US.

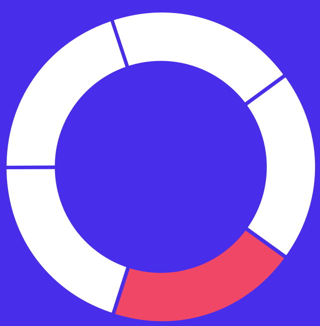
Fieldwork was carried out online between January 4-12 2023 and the total sample size was made up of 490 senior decision makers at US SMBs. The questions were designed to uncover their motivations for accessing credit, the barriers they face, and their attitudes towards data sharing for better credit options. The sample was made up of those in different business types, sizes, and industries. For the purposes of the survey, an SMB is defined as a company with between one and 500 employees.

All figures, unless otherwise stated, are from YouGov Plc.

### % SURVEY SAMPLE BY BUSINESS SIZE



# The state of small business finance



**1 in 5**

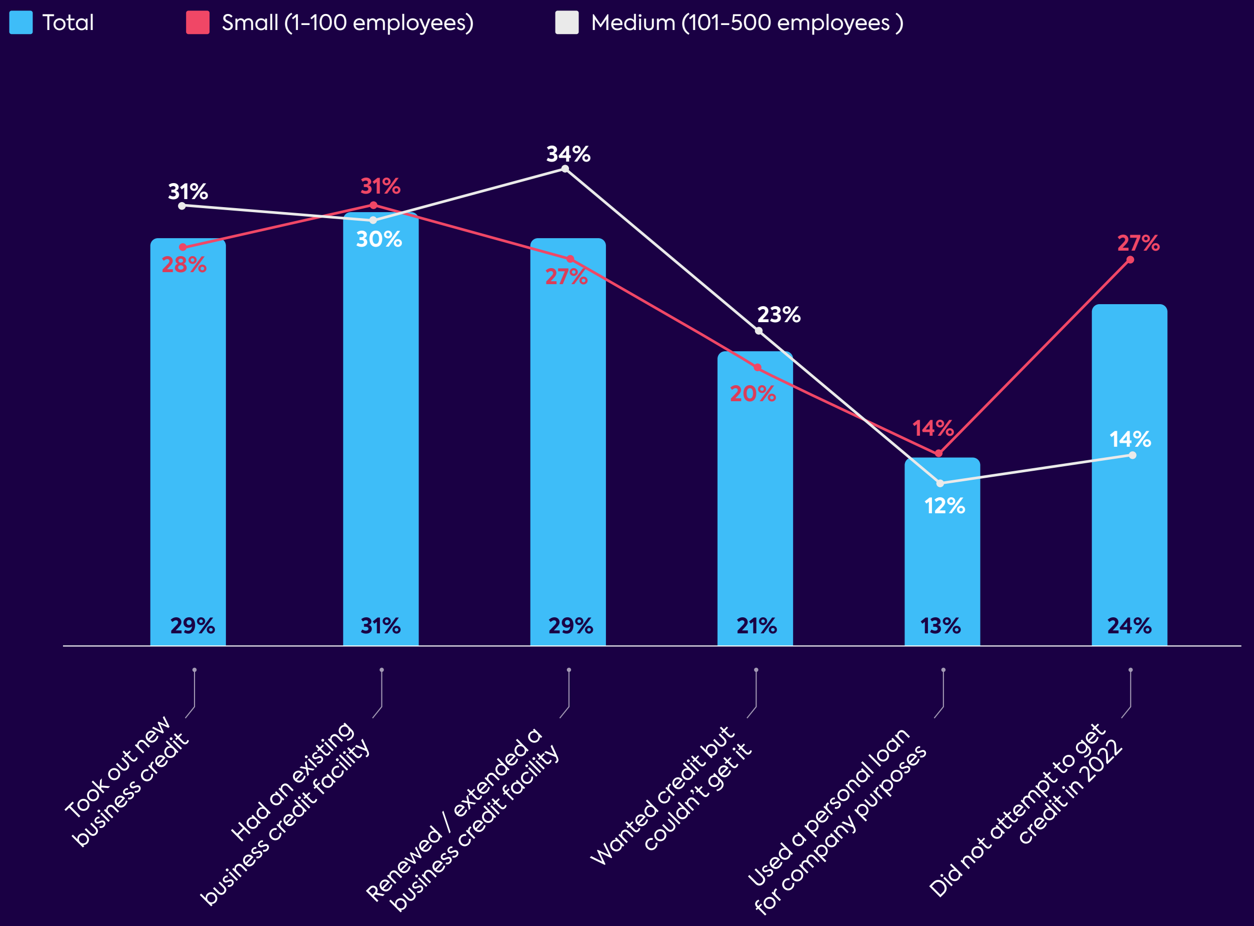
small business leaders (21%) say they needed business credit during 2022 but couldn't get it

## Demand for credit in 2022 was high

According to our research, almost half of businesses surveyed (47%) took out new credit or expanded an existing credit facility in 2022, significant when considering the 32.5 million small businesses in the US. Nearly a third (31% – equivalent to just over ten million SMBs) had already accessed funding. In contrast, just 24% of businesses surveyed did not try to get any form of credit whatsoever in 2022.

This is our first solid indicator of the critical role credit plays for SMBs in the US. But while most businesses are interacting with credit in some form, the data also tells another, more concerning story.

## USE OF CREDIT BY SMALL BUSINESSES IN 2022




Thinking about your company's use of credit in 2022....Which, if any, of these were true of your company during 2022? n490

Among the small and medium business leaders that did not access credit in 2022 (either did not attempt to, or needed to but couldn't), the most common reason was that they didn't need it. This was the reason cited by 56% of SMBs surveyed. Interestingly, the smaller the company, the less likely they are to require additional funding. Most (61%) organizations with between one and 100 employees surveyed did not need it, compared to less than a third (12 out of 38) of business leaders who were asked with between 101 and 500 staff.

# What prevented businesses from accessing credit?

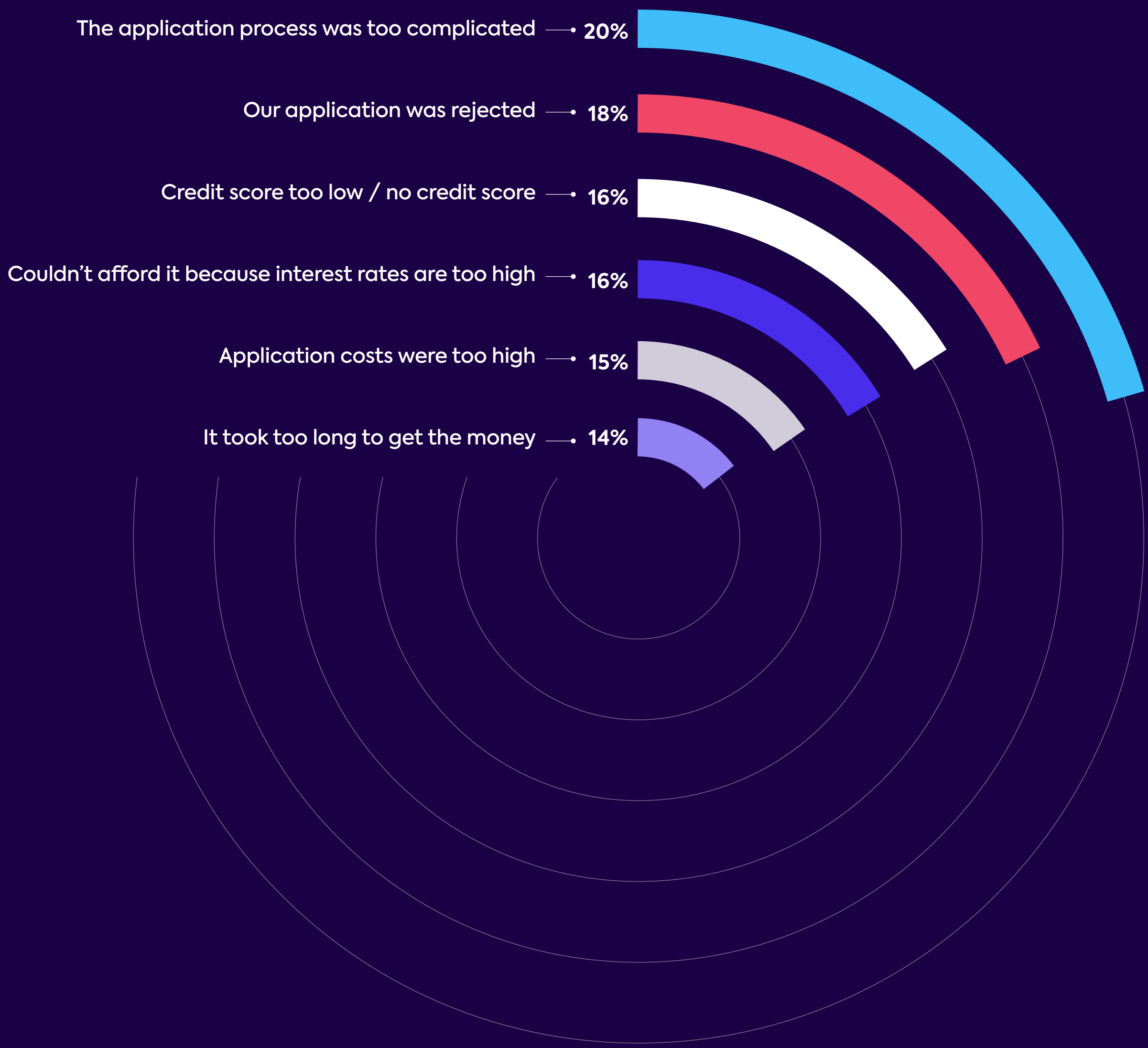
The research reveals that 21% of US SMBs surveyed needed credit in 2022 but were unable to access it, which could be equivalent to around **6.825 million businesses.** Of this 21%, the most common causes - reported by 78% - were application-related problems. This refers to application costs (such as origination fees) being too high, the application process being too complex, and it taking too long to get the money. For a third (33%), high-interest rates making loan repayments unaffordable posed the main stumbling block. Simultaneously, a further 13% of SMBs surveyed felt the need to take out a personal loan to fund their business in 2022, indicating that it was more feasible than securing one for their business.

Among the businesses that did not attempt to access credit, or needed it but couldn’t get it, 20% said the process was too complex. Again surprisingly, this rose to ten of 38 among the larger SMBs. A further seven out of 38 said their application was rejected and for five of 38 it would have taken too long to get the money. It’s therefore clear that the application process itself is a significant barrier to small businesses accessing finance.

**6.8 million**

SMBs couldn’t access credit they needed in 2022

## REASONS SMALL BUSINESSES COULDN'T ACCESS CREDIT IN 2022




You previously said your company did not access, or tried and were not able to get credit in 2022...Which, if any, of the following prevented your company from doing so? (Please select all that apply).

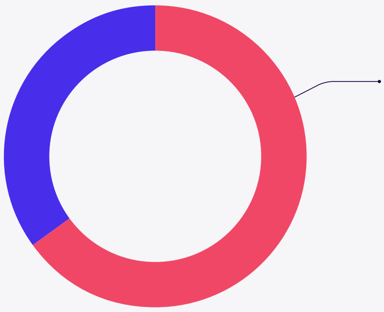
# SMBs are persistent in their demand for credit in 2023

Looking at 2023 and beyond, the anticipated demand for credit does not seem to have been impacted by the shifting economic climate. Most (65%) small businesses in America will try to access credit over the next twelve months. This could represent over **21 million businesses**.

The need for credit is high among all businesses, although it does increase with size - 81% of medium-sized businesses (101-500 employees surveyed) are likely to try to access external funding in 2023 compared to 61% of smaller businesses (1-100 employees).

Nestled within the high demand for capital, the data highlights flaws in the credit system for small businesses. Not only is demand high, but it is also persistent. Of the small businesses surveyed that sought credit in 2022 but couldn't access it, 92% intend to apply again in 2023.

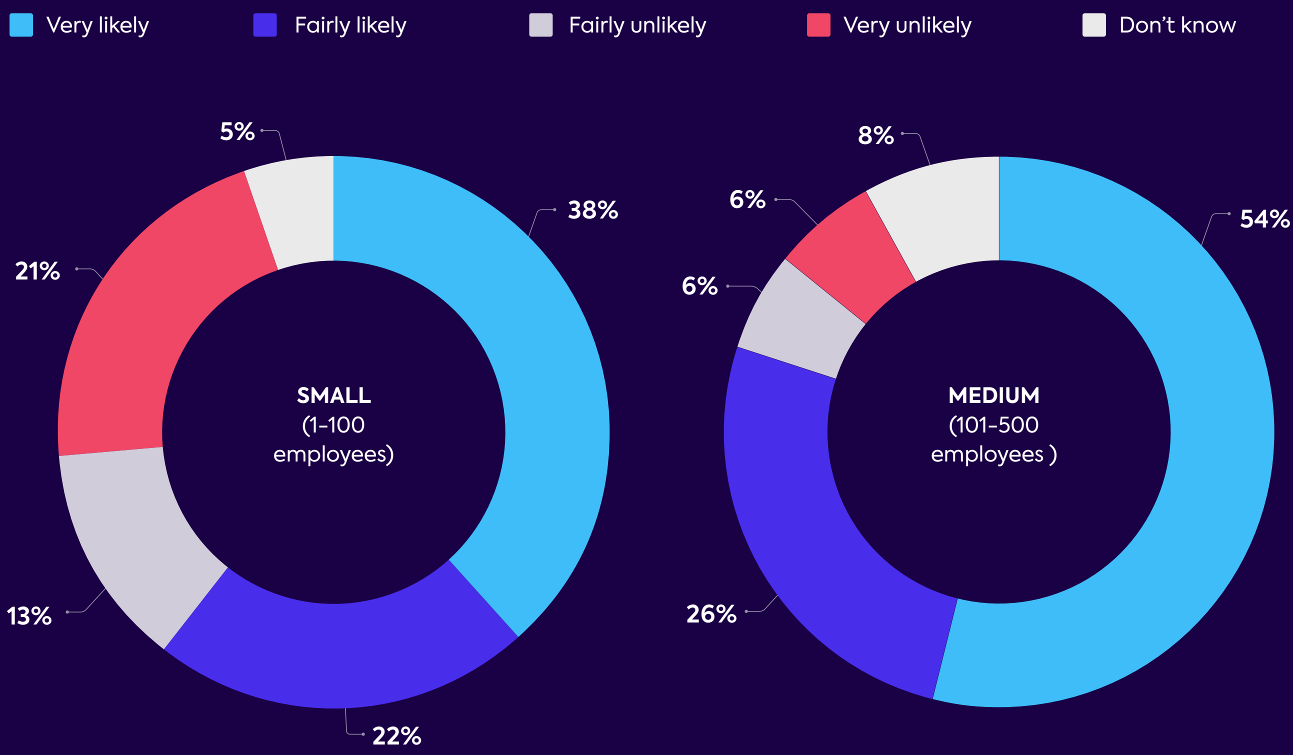
The US small business market is highly dependent on external credit to operate, and the needs of SMBs are often not being met.



**65%**

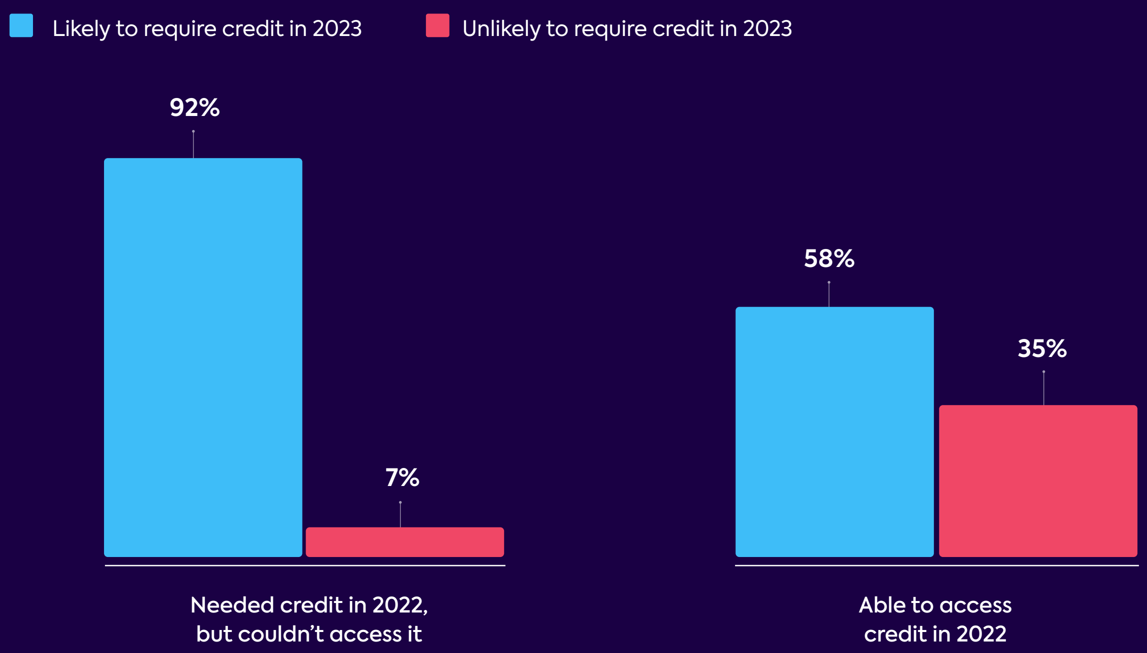
of US SMBs are likely to access credit in 2023

## HOW SIZE OF BUSINESS IMPACTS LIKELIHOOD TO APPLY FOR CREDIT IN 2023




How likely or unlikely is it that your company will attempt to access credit in 2023? Question broken down by company size demographic: Small (1-100 employees) n387 and medium (101-500 employees) n103.

## ABILITY TO ACCESS TO CREDIT IN 2022 VS LIKELIHOOD TO REQUIRE CREDIT IN 2023



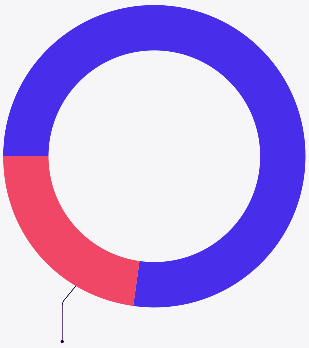

How likely or unlikely is it that your company will attempt to access credit in 2023? n490. Question broken down by SMBs able to access credit in 2022 and SMBs unable to access credit in 2022.

# Expansion and survival are equal and overlapping drivers for accessing credit

Nearly a quarter of SMBs surveyed need credit in 2023 to hire staff (24%) and a quarter (23%) to pay their existing staff. The macroeconomic situation is also playing its part with 27% needing to access credit to help their business manage the impact of inflation. Despite some borrowers being unable to afford loan repayments due to high-interest rates, the economic environment is a net driver of credit as more borrowers require credit to deal with its impact.

The largest single reason for needing credit in 2023 is to help with day-to-day cash flow. So there is an important place in the market for short-term, fast funding, given that, as we saw earlier, 14% of businesses who didn't access credit in 2022, couldn't get what they needed fast enough.

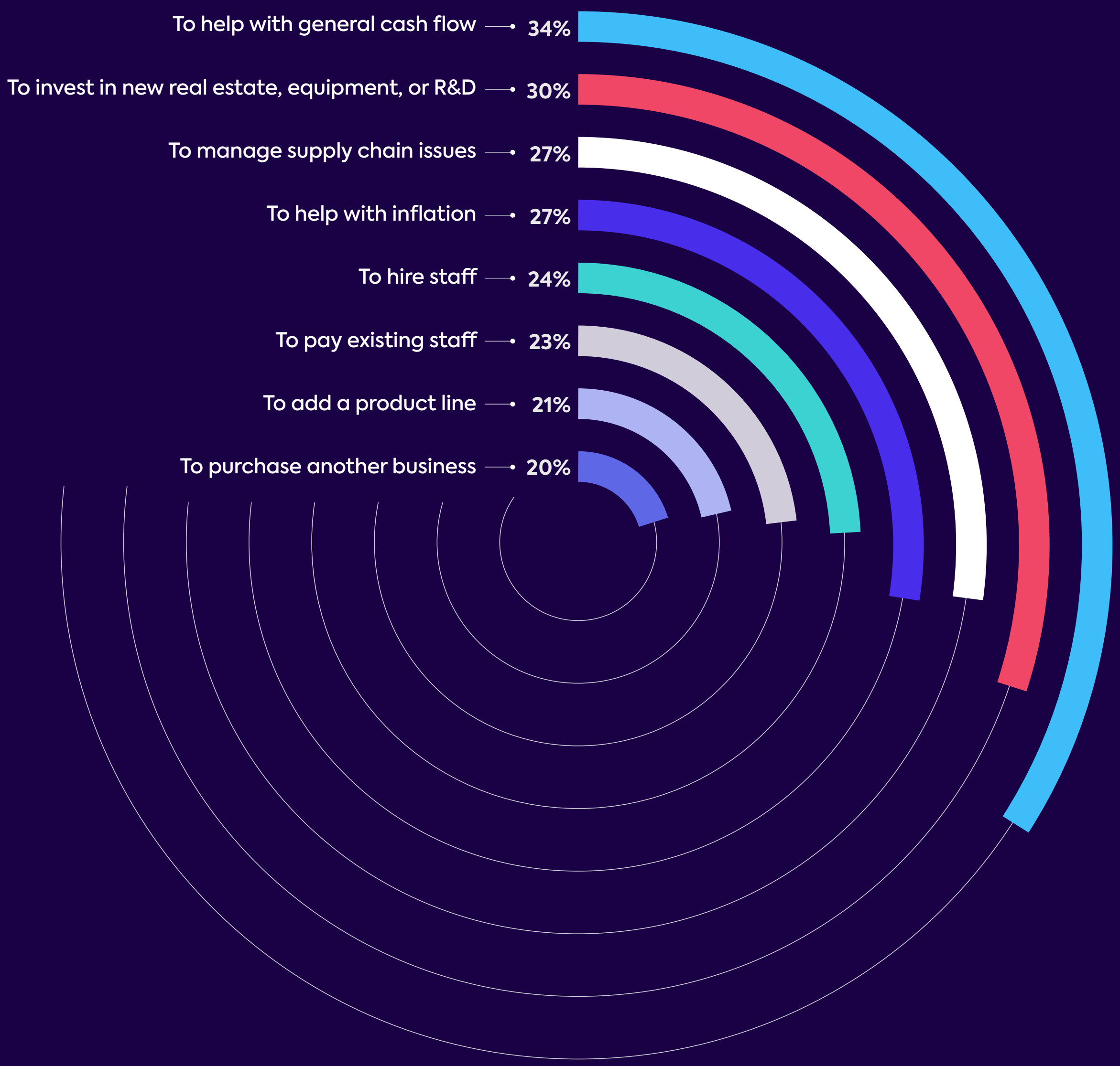
When responses are grouped, the data tells us that 78% of SMBs need credit for activities related to expansion and 75% need it for activities related to survival. Smaller businesses are more likely expecting to need funds for survival (78%) than their larger counterparts (69%). It's clear, therefore, that there is a large overlap in these areas. Most businesses are engaging in both expansion and survival-related activities. This overlap shows us the critical nature of credit to the US market – it's required by most businesses to operate effectively across multiple areas and to plan and prepare for both positive and negative outcomes.



**23%**

of SMBs need credit to pay their staff

## WHY ARE SMBS LOOKING FOR CREDIT IN 2023?




NET

**78%** of SMBs needed credit for expansion relation activities

**75%** used credit for survival related activities

You previously said your company was likely to attempt to access credit in 2023...Which, if any, of the following will your company likely access credit for in 2023? (Please select all that apply) | Net 'Expansion' is defined as the combination of the following categories: 'To purchase another business', 'To add a product line', 'To hire staff' & 'To invest in new real estate, equipment or R&D'. | Net 'Survival' is defined as the combination of the following categories: 'To pay existing staff', 'To help with general cashflow' & 'To manage supply chain issues'.

# An off-putting system is driving borrowers to other sources

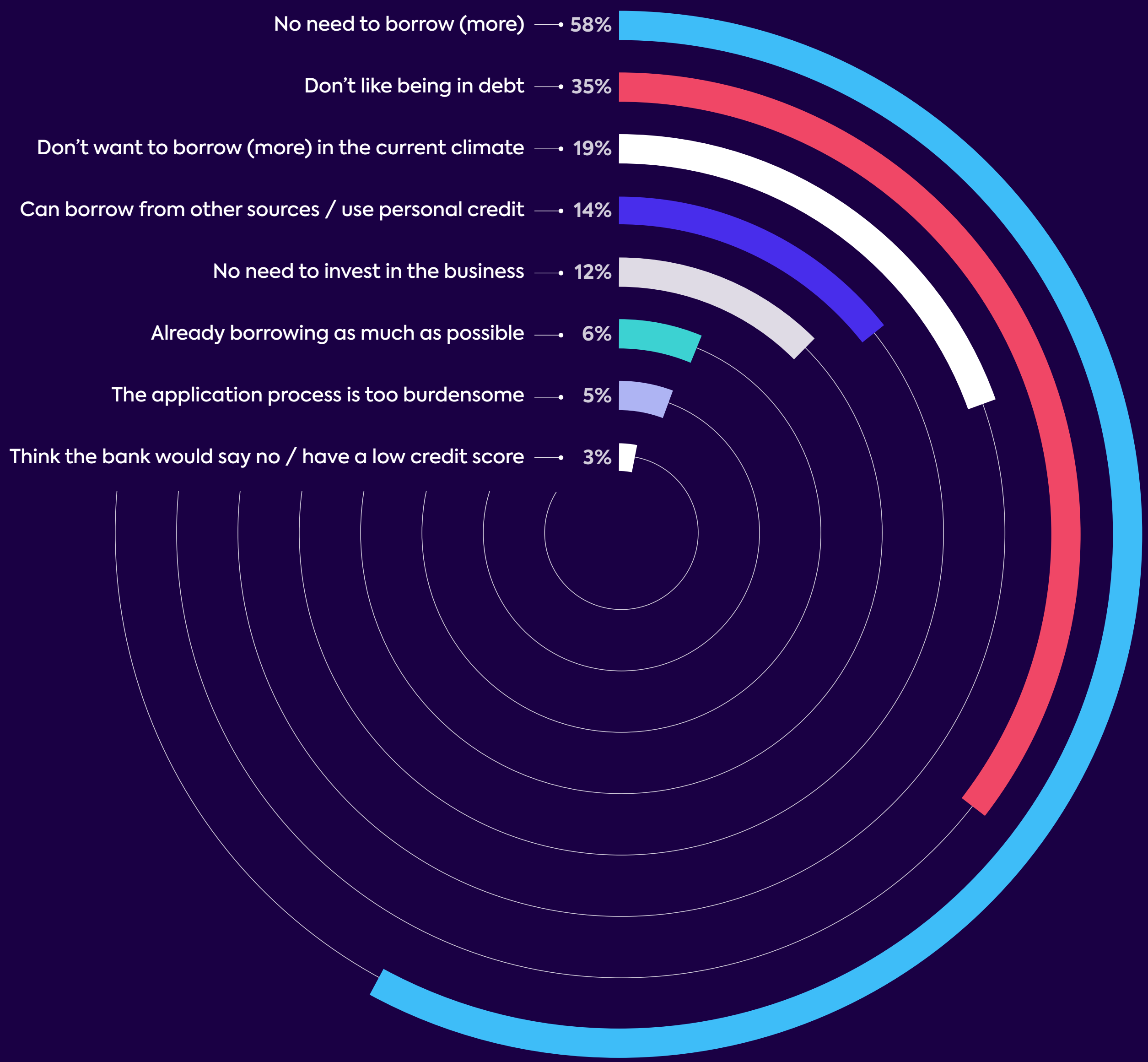
Among the small businesses unlikely to access credit in 2023, the vast majority (81%) say it's because they don't need to invest in the business, don't need to borrow more, or don't want to borrow more given the economic climate. For this segment, the situation is fairly conclusive.

What the research also shows however, is that 8% are unlikely to access credit in the coming year because they simply aren't able to – in other words, they're already borrowing as much as they can or they have a poor credit score and so a bank would say no. For 19% – which could be equivalent to **1.78 million small businesses** if upscaled – the current lending system is so off-putting that they have decided against trying to access credit. The fact that 14% are more likely to borrow from other sources such as personal credit, is a further indicator that the system is ripe for improvement.

**1.7 million**

would-be borrowers find the system so off-putting that they won't apply for credit

## WHY ARE SMBS NOT LOOKING FOR CREDIT IN 2023?




**OF THOSE WHO WILL NOT ACCESS CREDIT IN 2023: NET**

**81%** do not need or want credit

**8%** have no ability to access credit

**19%** find the application system too off-putting

You previously said your company was unlikely to attempt to access credit in 2023...Which, if any, of the following are reasons for this? (Please select all that apply) Net 'Do not need or want' is defined as the combination of the following categories: 'No need to invest in the business', 'No need to borrow', 'Don't want to borrow more' & 'Don't like being in debt'. | Net 'Have no ability' is defined as the combination of the following categories: 'Already borrowing as much as possible', 'Think the bank would say no'. | Net 'Application system too off putting' is defined as the combination of the following categories: 'The application process is too burdensome' & 'Can borrow from other sources'.

# Lack of access to credit threatens business survival and the economy

For borrowers, the impact of an outdated and unsuccessful system is quite simply the inability to access the funding they need, when they need it. Lack of access to funding means, at best, stunted growth and at worst, going out of business. Factoring in that US SMBs account for 47.1% of employment, the knock-on impact to the economy is vast.

Previously we looked at the critical nature of credit to the US SMB ecosystem. It's a key element to a host of overlapping functions, including survival and expansion-related activities. These include securing cash flow, managing the supply chain, hiring new staff, and paying existing staff. SMBs are such a large part of the US economy (99.9% of all businesses and 44% of all US economic activity) that activities within both categories - survival and expansion - are core contributors to its prosperity. A thriving SMB ecosystem will drive growth and, much in the same way, thousands of SMBs going out of business unnecessarily will cause economic damage to no end.

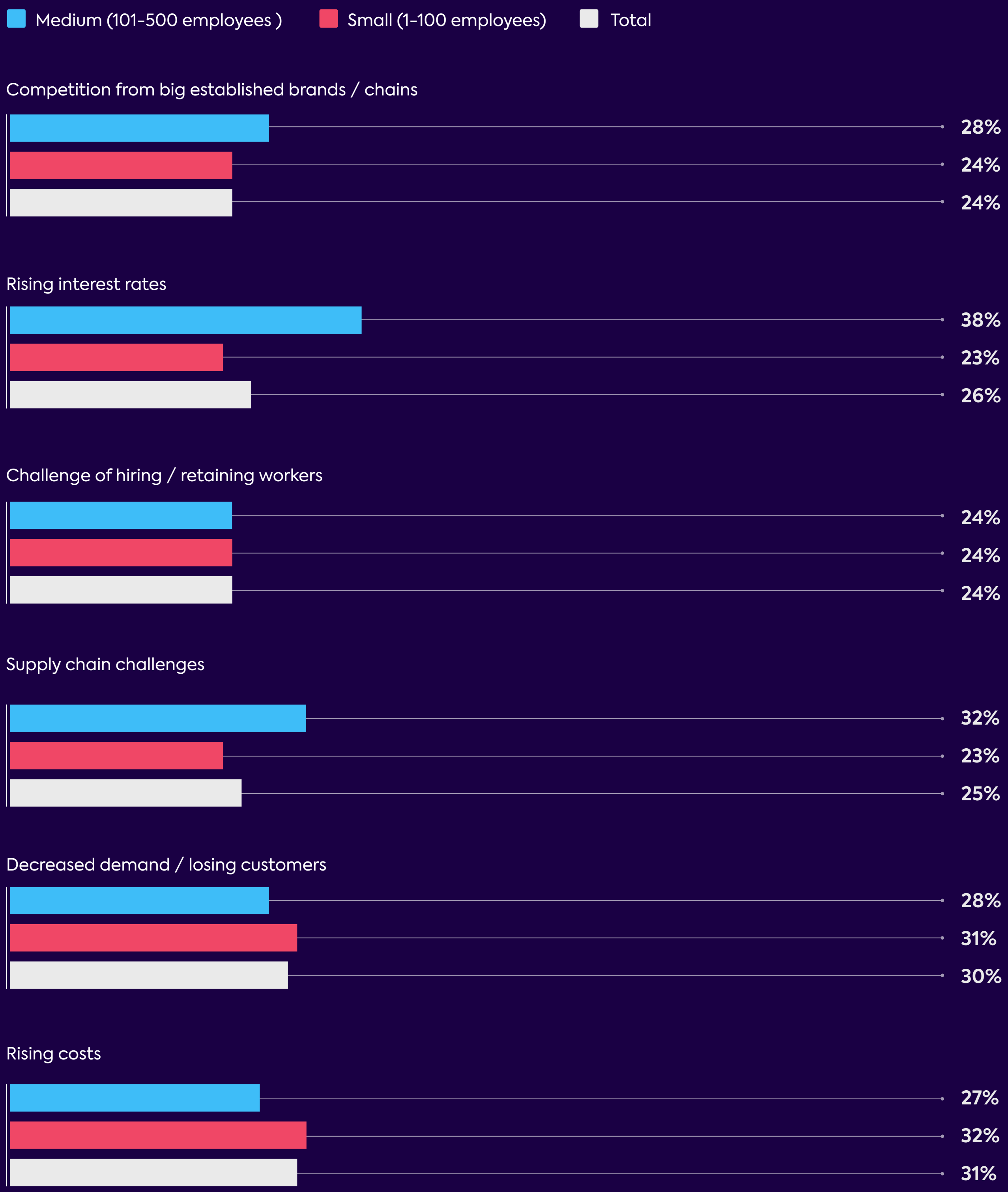
SMBs already operate on the edge - around 8% or 2.6 million fold each year - and the data from our research provides evidence that access to credit (or lack thereof) significantly impacts financial distress. A huge majority (78%) of small and medium businesses surveyed reported that some factors outlined in the survey made them worried about going out of business in 2023 - and most of those worries are derived from the state of the economy.

The impact of poor SMB access to credit is tied to worries about going out of business. A dominant 90% of the businesses likely to seek credit in 2023 are fearful of going out of business. Whereas only 58% of those unlikely to seek credit this year are worried about the same thing. This clearly indicates a link between access to external credit and business survival - although we should note that relatively speaking, 58% is still a high proportion of SMBs to be worried about having to shut down.

Inability to access credit only makes these misgivings worse. Pretty much all (98%) of businesses that needed credit during 2022 but couldn't get it, are apprehensive about going out of business in 2023.

**A thriving small business ecosystem will drive growth.** Thousands of businesses folding unnecessarily will cause economic damage to no end

## FACTORS CAUSING SMBS TO WORRY ABOUT GOING OUT OF BUSINESS IN 2023




**NET** | **78%** of small businesses are worried about going out of business in 2023

Which, if any, of the following makes you worry about going out of business in the next 12 months (i.e. in the year 2023)? (Please select all that apply). Net 'Worried' is defined as the selection of any worry category with the exclusion of the 'My company does not have any worries about going out of business' category.

# Widening access to credit through Open Finance

Looking back to 2022, the reality of the landscape is one where access to credit was crucial for 76% of SMBs. Yet still 21% weren't able to access the credit they needed.

The inability to access finance is causing many SMBs to worry about the survival of their business. Plugging this gap represents a large opportunity for credit providers. Our research shows that Open Finance can provide the means to increase both loan approval rates and completed applications.

13.8%

of loans are approved by big US banks

## Getting more businesses approved

**Loan acceptance rates in the US are low, particularly at larger banks where most small businesses attempt to access credit.** According to the 2021 Biz2Credit Small Business Lending Index™, the average loan approval rate at big US banks sits at just 13.8%. This is particularly notable when compared to other developed markets, such as the UK, where the loan approval rater was 75% between Q3 2021 and Q2 2022, according to the SME Finance Monitor. For smaller banks – with less than $10 million in assets under management – the approval rate creeps up to 19.1%, and 24.7% for alternative lenders, over 10% higher than at big US banks.

# Lack of data causes more businesses to be rejected than need to be

Analysis of multiple sources, including America's Small Business Development Centers (SBDCs) and Community Development Financial Institution Pathway Lending, revealed that the most common reasons for unsuccessful loan applications are:

- **A bad or non-existent credit rating**
- **Operating in a risky industry**
- **Not operating for long enough**
- **A lack of supporting documentation and financial statements**
- **Too much existing debt**
- **Weak cash flow**

Some of the reasons above, like 'too much existing debt', indicate a lower likelihood to repay credit, whereas others like 'a thin credit file' simply indicate a lack of positive indicators that they will. While lending to genuinely uncreditworthy businesses in the first category causes a bad outcome for lenders and borrowers, it's clear that a proportion of unsuccessful applications are a result of 'data issues'. In other words, the lender doesn't have the confidence that the business will repay the loan because they lack the level of insight required to judge risk and affordability correctly. The decision comes from a lack of data rather than something inherently wrong with the SMB.

| | |
|---|---|
| **CREDITWORTHINESS ISSUES** | A bad credit rating |
| | Operating in a risky industry |
| | Too much existing debt |
| | Weak cash flow |
| **DATA ISSUES** | A non-existent or 'thin' credit rating file |
| | Not been operating for long enough |
| | A lack of supporting documentation and financial statements |

For example, when faced with a lack of supporting documentation or a business that hasn't been running for very long, the provider doesn't have the data to know if the applicant can afford the loan, and it doesn't have an up-to-date overview of the business's financial performance. Ultimately, this lack of insight leads to a higher rate of unsuccessful applications. A view which is supported by qualitative data from lenders:

> "**Consuming multiple data sources for prospective lenders is a must in our business.** We have one source of truth, one place to tackle problems, one place to access data and make decisions."
>
> Dimitry Gershenson, Co-Founder and CEO, Enduring Planet

Access to comprehensive, verified, real-time data from the financial systems used by SMBs empowers lenders to eliminate the 'data issues' from the decisioning process and ultimately the ability to increase their acceptance rate without increasing risk exposure.

# Getting more businesses applying

From the SMB perspective, the main process-related reasons as to why those who were prevented from accessing credit were that the application process was too complicated (20%) and that it would have taken too long for the funds to reach their account (14%).

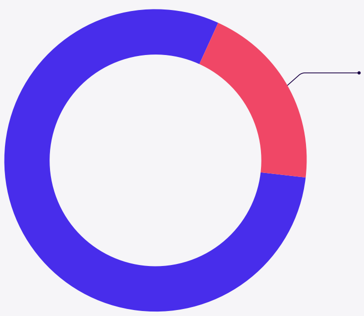
By making the application quicker and simpler, therefore, lenders will be able to increase the number of completed applications from creditworthy businesses.

The biggest cause of complexity and delay in applications is the supply and processing of data to underwrite. Manual and paper heavy processes mean it can take weeks or even months to actually receive any funds in the business’s account.

Digital data submission can cut down this time from weeks to minutes. SMB financial systems can be connected to lenders almost instantly, enabling the direct analysis of accurate, real-time data, which enables providers to make faster, more informed decisions.

SMBs will also be aware of exactly what data providers are using in their decisioning and have confidence that it represents an up-to-date view of their business’s finances.

The ability to connect their financial systems also means that SMBs will not need to spend valuable time regathering and submitting applications. They’d only need to approve the resharing of their selected data with the lender in question.



**20%**

of SMBs say the application process is too complex

# The opportunity for lenders

As we saw earlier in this report, 21% of SMBs in the US needed finance in 2022, but weren't able to access it. For most of those businesses, application problems were the reason they couldn't access credit, followed by high-interest rates making the cost of borrowing too high - which may in part be caused by an absence of data to give the lender confidence in the SMB's ability to repay the loan.

Excluding businesses that stated that their credit score was low, still leaves 13.7% of all US SMBs surveyed that needed finance in 2022 not being able to access it due to the limitations placed on them by the existing system only. If this were representative and upscaled it would be equivalent to **4,452,500 SMBs**.

If US lenders can address the systemic issues of complex and time-consuming applications, to allow these 13.7% of businesses to successfully access capital, there is a $13.7 billion opportunity.

## ADDITIONAL REVENUE OPPORTUNITY FOR LENDERS

| | |
|---|---|
| **Eligible SMBs** | 4,452,500 |
| **Average SMB loan size** (according to the Federal Reserve) | $56,000 |
| **Typical interest rate of a business loan in 2022** (according to the Federal Reserve Bank of Kansas City) | 5.50% |
| **Additional loan opportunity =** Eligible SMBs **x** Average SMB loan size | $249,340,000,000 |
| **Additional revenue opportunity =** Additional loan opportunity **x** Typical interest rate of a business loan | $13,713,700,000 |

As with the previous example, it's important to note that this model is purely illustrative. It focuses on revenue opportunity and as such does not factor in costs associated with servicing the loans.

Better access to data, as demonstrated above, provides opportunities across multiple fronts to improve this situation for SMBs, without negatively impacting risk for lenders. If the system were to improve, there is good evidence that SMBs would be receptive.

# Open Finance: the evidence for success

The main cause of the barriers to access credit is a lack of data flow between the systems that small businesses use and lenders. The small business credit landscape is not fully optimized for lenders or borrowers.

The overall issues with SMB access to finance are:

- **An unfriendly application process due to a fundamentally outdated system**
- **Lenders lacking accurate insight to make informed decisions**
- **A difficult macroeconomic environment delivering inflation and high-interest rates**

We have discussed the ways in which the system can be improved, without compromising lender's exposure to risk or their ability to generate profit.

The technology needed to enable small business data platforms and lender decisioning systems to integrate and communicate with one another already exists. Lenders can use universal APIs, like Codat's, or build the integrations themselves.

But progress in the industry to implement the necessary technology has been slow, particularly when it comes to traditional banks. However, once momentum builds and the pieces fall into place, there is evidence that the improvements will be well received.

# Are SMBs happy to share their data?

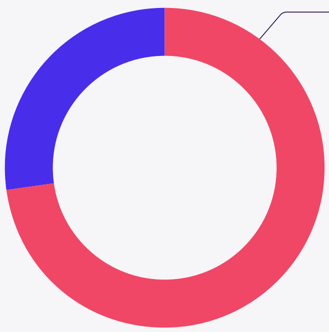
In short, yes. Nearly three-quarters (73%) of small and medium businesses surveyed are happy to digitally share data with lenders directly from their financial systems on the understanding that this may result in better rates and an easier application process.

This is true of almost every single business surveyed that experienced application problems in 2022 (98%). And, of those likely to access credit in 2023, 92% are happy to share their data with lenders. Figures that, when coupled with the persistence of businesses we saw earlier in this report, convey the clear message that issues with the SMB credit landscape do not stem from the businesses themselves harboring a reluctance to cooperate with lenders.

Bigger businesses are even more receptive to sharing data digitally.

Larger SMBs (101-500 employees) are nearly all (84%) happy to share at least some data with credit providers compared to (a still large majority) 71% of smaller SMBs (1-100 employees).

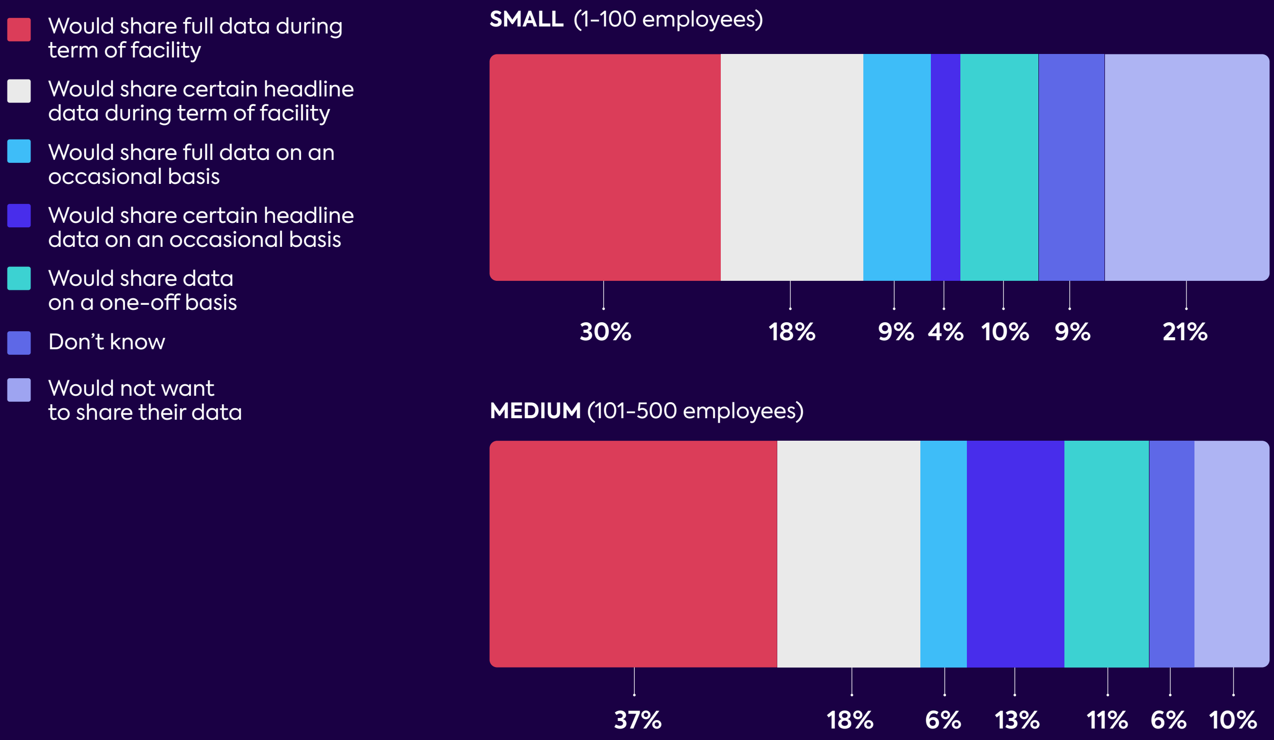
Changing perspective and looking at the reluctance to share data, the data reveals that the smaller the business, the less likely they are to want to share any data whatsoever. A fifth (21%) of smaller businesses (1-100 employees) don't want to share their data under any circumstances. A number which increases to 42% of sole traders, and decreases to just 10% of larger businesses (101-500 employees).



**73%**

**of small and medium businesses** are happy to share data with a lender directly from their financial systems

## SMB ATTITUDES TO SHARING DATA WITH CREDIT PROVIDERS DIRECTLY FROM THEIR FINANCIAL SYSTEMS



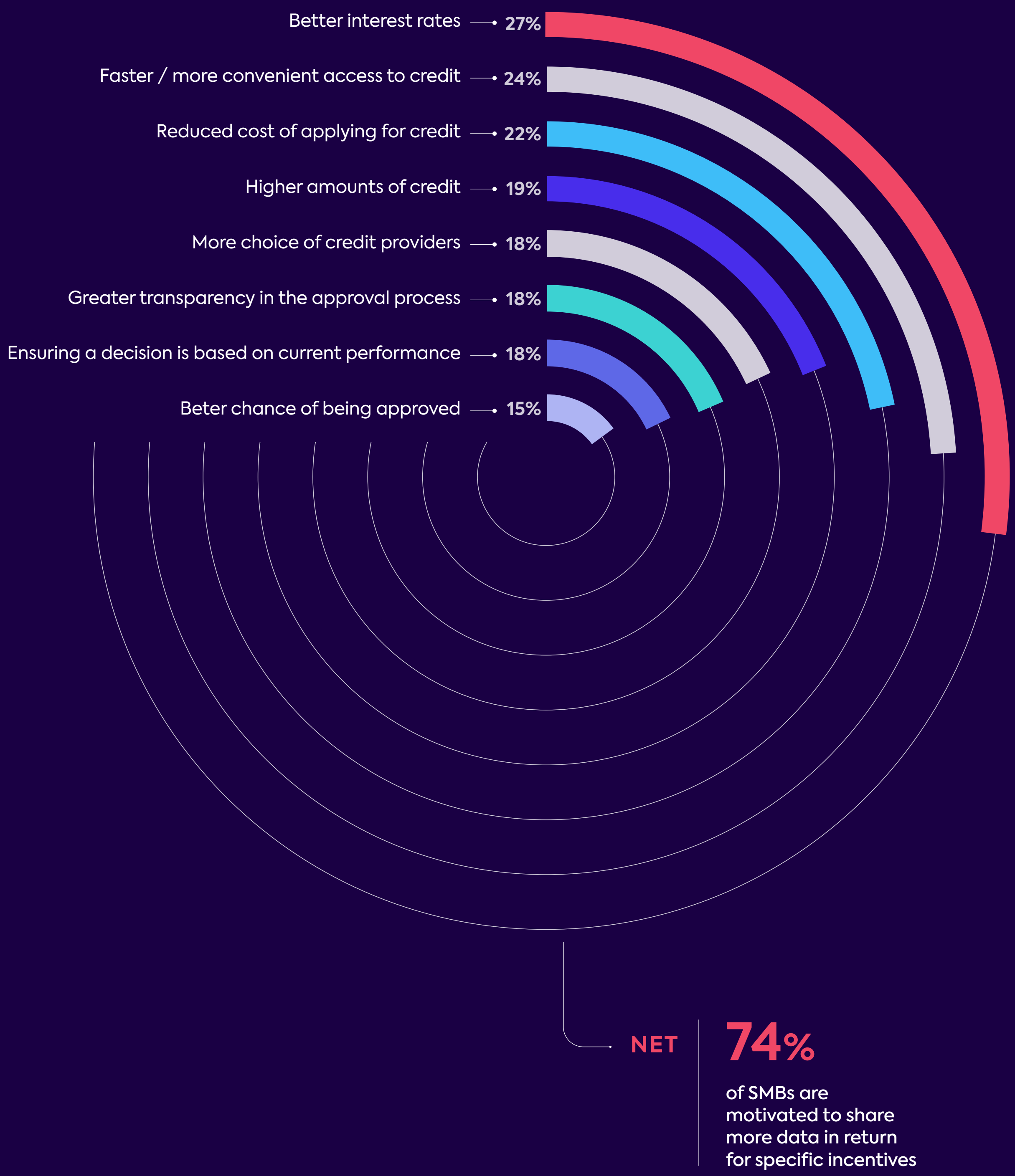

If a company were to use a credit facility (loans, credit card, merchant cash advances, invoice financing etc.) some lenders / banks might want you to share data with them directly from their financial systems (e.g. QuickBooks). Some lenders would want access to your systems 'left open' so they could look at your information for the term of the facility rather than as a one off when you apply. This would be in exchange for better rates and an easier credit application / renewal process. Which ONE of the following statements best applies for your company? Question broken down by company size demographic: Small (1-100 employees) n387 and medium (101-500 employees) n103.

The research also looked at the impact of specific incentives in relation to motivation to share business financial data. It revealed that perceived economic threat has a significant impact.

Of the businesses surveyed that do not want to share their company's financial data regardless of the incentive, only 43% are worried about going out of business due to macroeconomic forces in 2023. On the other hand, among those which are motivated to share their data, 79% are worried about macroeconomic forces including rising costs, rising interest rates and supply chain challenges. It seems as though, understandably, the importance of credit to help shore up a business through tough times leads to a greater willingness to share data.

When it comes to the most popular incentives to share more of their data, better interest rates is the most popular, chosen by 27% of SMBs surveyed. Faster approval and access to funds came in second, chosen by 24% of SMBs.

## WHICH INCENTIVES MOTIVATE BUSINESSES TO SHARE THEIR DATA?




As a reminder, if a company were to use a credit facility, some lenders would want access to your systems 'left open' so they could look at your information for the term of the facility rather than as a one-off when you apply. This would be in exchange for better rates and an easier credit application / renewal process.Which, if any, of the following, would be an incentive for your business to share more of your company's financial data? | Net 'Motivated' is defined as the selection of any incentive category, with the exclusion of the 'None of these' category.

# A successful blueprint for the future

The research also revealed a trend of using alternative lenders to circumvent some of the existing credit system issues and that doing so could be improving access to capital for SMBs.

Firstly, we can be confident in saying that awareness of alternative lenders is high among the US SMB population – 73% of small business owners have heard of them in some capacity. This level of awareness is particularly high when compared to other countries, such as the UK, where awareness of alternative lending options is only 37%. The awareness seemingly translates into trust, with 54% of businesses surveyed open to the idea of alternative creditors and 35% already having used their services.

Compared to more established credit routes, alternative providers tend to be more progressive with their application processes and ability to leverage data, something which is reflected within their market. Of the businesses motivated to share their data in return for specific benefits, 95% would consider using or are already using alternative lenders. In contrast, of those unwilling to share their data regardless of the benefit, a tiny proportion (4%) would consider using or are already using alternative providers.

Finally, the data shows that where 65% of SMBs are likely to seek credit over the coming year, within the pool using alternative lenders, this increases to 90%. This suggests that the system offered by alternative lenders has begun to address unfriendly process-related issues and is resulting in more successful credit access.

The traditional business lending landscape can learn from these insights. Processes driven by data portability, and supported by SMBs willing to connect their platforms and share their data can result in significantly more credit access by businesses and underwritten by lenders.

Even though success has been seen via alternative lenders, we cannot rely on them to resolve that issue of SMB access to credit. The vast majority of the market is still made up of traditional lenders like banks, and as the cost for alternative lenders to raise capital increases, interest rates are being pushed out of reach for many SMBs in need of credit. So as promising as these progressive approaches are, the problem won't be solved until the rest of the market adopts changes too.

# Conclusion

There is an immense gap in the business banking market: **6.8 million small businesses couldn't access the credit they needed in 2022.** This is endangering small businesses whilst also representing a significant financial opportunity for providers.

Despite the access challenges, demand is still high: **65% of SMBs will look for credit in 2023.**

Leveraging technology to improve data flow can achieve higher loan acceptance rates and increased application success rates without increasing lender's risk exposure.

Progress has been slow, but the evidence suggests that Open Finance will be a success: **73% of small businesses are willing to share their financial data directly with lenders**. The alternative lending market has shown promising signs derived from technology-driven processes, but this only represents the tip of the iceberg.

It's down to the lending industry as a whole to use the technology at its disposal and revolutionize the landscape.

codat

**Codat's universal API** connects fintech providers and financial institutions to all the major **accounting, banking, eCommerce** and **payments platforms** their customers use, to turn building connected features from their biggest challenge to their greatest differentiator.

Codat has built the infrastructure to solve the connectivity problem for SMB lenders and is used by over 100 credit providers worldwide to incorporate real-time data for underwriting and improve SMB access to capital.

To learn more about how we can help you lend to more businesses without increasing risk, contact a member of our team via info@codat.io or visit our website.

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