Lowering thresholds, raising performance: How lenders can reach more SME borrowers sustainably

Finecta™

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What you'll learn from this ebook

This ebook has been created to help lenders and insurers understand how new technologies can help deliver smarter trade finance and insurance decisions for underserved SMEs. In short, it allows finance businesses to lower their loan provision thresholds while mitigating borrower default risks.

Foreword:

How data technology innovation can bring lenders and SMEs closer together

There's a yawning gap in the business world which could, if we're not careful, turn into a black hole. A black hole into which countless small and medium-sized (SME) enterprises might fall.

We're talking, of course, about the growing difficulty SMEs face when it comes to accessing finance. Research this Spring revealed that lending to small firms has hit rock bottom - which is a less than ideal place to be immediately after a pandemic and in the midst of a cost of living crisis.

The quarterly Small Business Index (SBI) run by the Federation of Small Businesses (FSB) found that fewer than one in 10 firms had applied for finance in the first three months of 2022 - the lowest level since records began. And worryingly, only 19% of respondents described the availability of credit as 'good'.

In response to the findings, the FSB's national chair Martin McTague called for a culture change, with lenders "taking an objective approach to small business finance".

At Finecta, we believe a culture change is not only necessary but entirely possible. Because there are tools available now that allow finance providers to build a sustainable portfolio of SME borrowers, particularly in the sphere of cash flow-based lending.

Businesses are able to access unique new datasets and create blocs of borrowers, turning what might have previously been a low return proposition on an individual basis into a fruitful source of income when taken en masse.

All in all, this approach leads to smarter lending decisions and allows more small firms to access and manage vital funding, meeting their cash flow needs and promoting growth opportunities all round.

In this ebook we explain how the new data technology works and what benefits it brings to providers in trade and invoice financing and trade credit insurance. We also consider why, in an economically turbulent world, an ability to unlock finance and protect cash flow is becoming a number one priority for SME owners.

If adopted by forward-thinking lenders, our sector will help to close the yawning gap between SME borrowers' needs and their real-life experience of applying for finance.

Read on to learn more.

Shifting sands:

How the SME lending landscape is changing

In the UK, from the 1970s and pretty much all the way to the financial crash of 2008, small business lending was concentrated among a handful of big banks.

After the crisis, increasing regulatory burdens on large institutions nudged the market to open up. Alternative lending propositions entered the scene with the aim of meeting the needs of smaller borrowers.

Today, British SMEs have a plethora of options from which to choose, with challenger banks and other lenders eager to reach new audiences and meet the needs of the underserved.

UK Finance, the banking industry trade association, says its members are providing invoice finance and asset-based lending products to around 35,000 businesses, with a combined turnover exceeding £245 billion in 2020.

Contrast this with research from the FSB which found that in the first quarter of 2022, 61% of UK small firms were affected by late payment of invoices.

The same number sought traditional overdraft or loan products. One in four applied for asset-based lending including invoice finance, while 7% applied to peer-to-peer platforms and 5% resorted to crowdfunding.

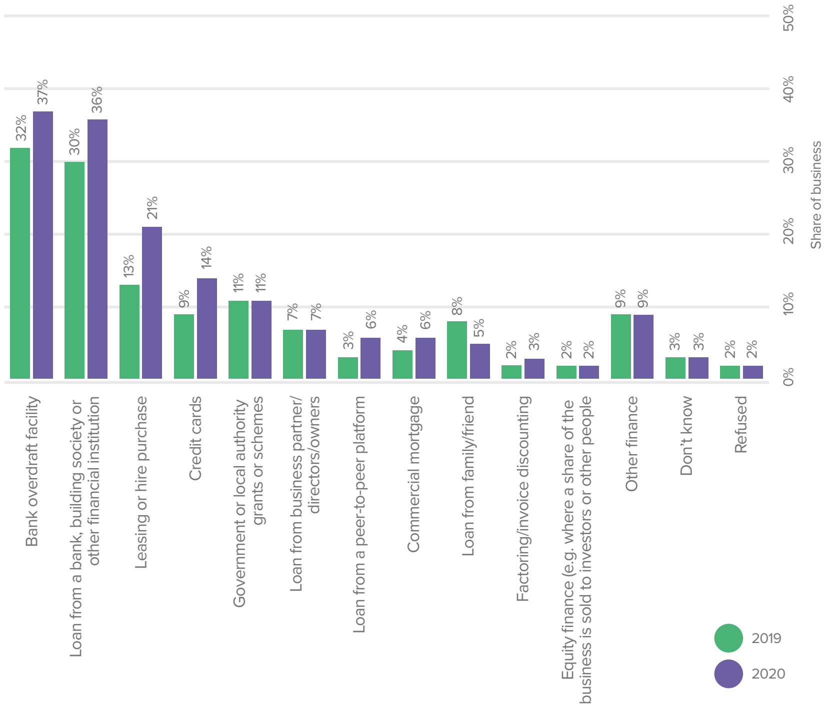
But consider this: three quarters of SMEs are not seeking invoice finance or asset-based loans for one reason or another, representing a huge opportunity for lenders to hone their propositions and disrupt the market.

5.6 million
SMEs in the UK

5.3 million
businesses recorded between 0 and 9 employees

99%
of UK businesses are classed as SMEs

Types of external finance applied for by SMEs in the UK in 2019/20



Challenges facing modern SMEs in accessing finance

Globally, micro, small and medium-sized enterprises' unmet finance needs are worth $5.2 trillion a year - 1.5 times the current market.

Yet when seeking trade finance, it's not always obvious to SMEs what their options are. Many providers of trade finance lending don't list their minimum or maximum loan amounts, preferances and tolerances. It's likely that many micro businesses may well fall outside of their value thresholds and risk appetites.

It's also widely reported that onerous loan applications can be a deterrent to some entrepreneurs.

But with so many UK small firms feeling the impact of late payment of invoices, it's clear that there's a problem to be solved.

Add to this fears that GDP performance is set to remain below 5% across many countries through 2022 and we can see that there's a real need to help cushion SMEs during hard times ahead.

Indeed, lack of cash or cash flow is the number one reason small businesses fail, 80% of which fold during the first 18 months of trading.

So, what can lenders do to broaden options and make life easier for SMEs? We discuss the tools available to modern finance businesses in the next section.

The tools to deliver a smarter lending landscape for SMEs

The UK's SME landscape is incredibly diverse. And for this reason, lenders need a wide range of tools at their fingertips in order to serve this market effectively.

Traditional credit scoring is unable to provide an accurate - or even fair - picture of a micro business's ability to repay finance. But it is possible with other datasets.

Modern digital platforms allow real-time access to an SME's trading history, enabling instant lending and risk decisions based on up-to-the-minute information from the business's accounting system.

Using new technology, lenders are also able to establish a direct connection to each customer to provide constant validation of their risk positions. Additionally, fraud can be minimised by having visibility of an SME's customer concentrations, allowing lenders to weed out rogue trading partners.

This approach can help lenders benefit from the many advancements in trade finance, such as open account financing and payables financing.

The key to improving the financing process is providing fast, cost-effective connectivity between partners.

How Finecta supports lenders to meet SME finance needs

Finecta has developed the Gateway 2 Finance (G2F) data engine to specifically address the needs of today's lenders and SME community.

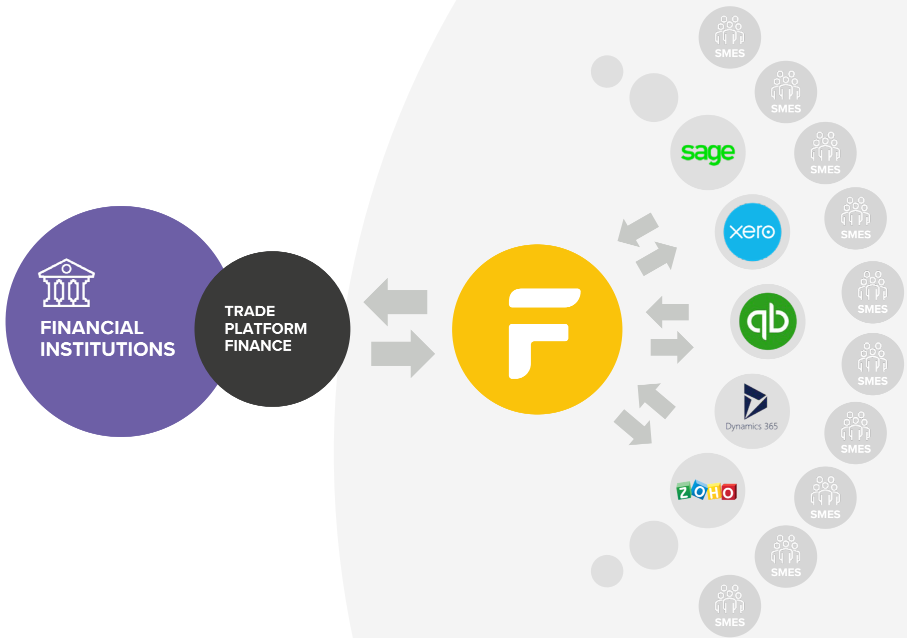
Built around four core functions of trend visibility, risk assessment, insight analysis and friction reduction, the platform takes a single integration API approach, enabling lenders to seamlessly plug into large numbers of customers quickly and on their terms.

G2F connects to 50 real-time data points including customer payables and receivables, trading history and DSO and DPO statistics within an SME's accounting or ERP system.

It's also possible to provide payment options and send instructions to customer accounting platforms, simplifying bill settlement.

At the same time, small business borrowers are empowered to share relevant data in a matter of clicks, saving hours of form filling, error correcting and uploading.

Finecta's library of connectors is growing all the time and helps take the pain out of linking to a variety of different cloud systems used by SMEs of all shapes and sizes.



Finecta use case:

Enhancing insurance decisions with real-time data and insights

Products: Gateway 2 Finance, Hipster

Partner: Nimbla

Nimbla protects small and medium-sized businesses against customer default. The platform gives SMEs the flexibility to insure from a single invoice to their whole book in minutes. Their proprietary risk engine gives insight to the user which helps mitigate risk, improve credit control and ultimately improve efficiency and profitability.

How does Nimbla use Finecta?

Finecta's partnership with Nimbla offers validated, cleaned and enriched data, debtor ratings and credit wrapped invoices ready for immediate financing.

Transaction data comes direct from the source accounting system, making it extremely difficult to forge. Suppliers and debtors are verified and rated via Nimbla's world class platform. The information itself flows instantly between Finecta's Gateway 2 Finance data engine, Nimbla and the financier - and it all happens within the customer's accounting system.

How does this lower the threshold for lending?

The three-party process reduces both the risk and cost of each loan, calling upon the tools provided by Gateway 2 Finance and Hipster. Nimbla embeds an automated credit wrap within the lending flow, removing lender admin on limit requests, reporting and policy admin. Gateway 2 Finance provides access to real-time, from-source data, while the embedded Hipster product grants access to lending and insurance services within accounting platforms and aligns interest in post lending activities.

How does this benefit SMEs?

The partnership provides peace of mind to small businesses when issuing invoices, particularly to new customers. By providing instant access to credit ratings and information about any previous payment issues, SMEs are able to make an informed decision about insuring and/or financing an invoice. Conveniently, this is all completed within an accounting system for an efficient and seamless process, freeing up company directors and managers to focus on winning more new clients - with confidence.

Where next:

Five recommendations for lenders and SMEs on improving lending user experiences

Having reviewed the challenges facing SMEs in an era of economic turbulence, it's clear more needs to be done to support the aims of business owners and help them through this difficult period.

But lenders also need support too - to help them find opportunities in a market that perhaps requires too low a threshold to be of interest. To help square those circles, here are five recommendations from Finecta:

1. SMEs in isolation might seem as if they offer a poor return to many lenders, however, when served as a collective, SMEs become a whole new value proposition. Using modern API technology, it is now easy for lenders to quickly build lucrative portfolios of borrowers.

2. Finance industry leaders should work to raise awareness of the benefits of cash flow-based lending to SMEs to diversify options and provide a broader range of solutions to small businesses. With only a quarter of small businesses using finance products opting for trade or invoice lending, there is an opportunity to build a bigger market.

3. Finance applications need to be simplified where possible and decisions informed by both real-time and historic data. Lenders have never had such good access to high quality information. By adopting the right tools, better outcomes are possible.

4. Micro businesses and SMEs struggling to secure finance should harness the power of accounting and ERP platforms. Not only will this deliver efficiencies in the day-to-day management of bookkeeping and finances but it will also open up access to all sorts of professional services, including finance - which can be managed within the platform itself.

5. To gain an edge over competitors, lenders should consider developing bespoke finance products alongside core platforms to take advantage of increasingly popular technologies such as crypto. Bridging the gap between fiat and digital currencies will enable finance companies to deploy new types of collateral.

About Finecta

Finecta has been built from the ground up by fintech engineers and entrepreneurs with decades of experience in trade finance.

Our team has been on the leading edge of trade finance systems for decades and has provided the thought leadership that led to the first B2B trade portals.

We are highly experienced in trade finance, blockchain, ERP and cloud integration, as well as the practicalities of customer deployments in this new world of data privacy, compliance and security.

Finecta believes in a financial market where buyers, suppliers, financers and all trade participants are directly connected in a secure standardised way, whether through the use of blockchain, direct APIs or both.

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Information sources for this ebook:

Lending to small businesses hits all-time low, new study finds, with six in ten impacted by late payment

How banks can reimagine lending to small and medium-size enterprises

Types of external finance applied for business according to small and medium enterprises in the United Kingdom (UK) in 2019 and 2020

Business Statistics

Invoice and asset based lending

SME lending and competition: an international comparison of markets

The top 9 reasons small businesses fail

Trade finance for SMEs in the digital era