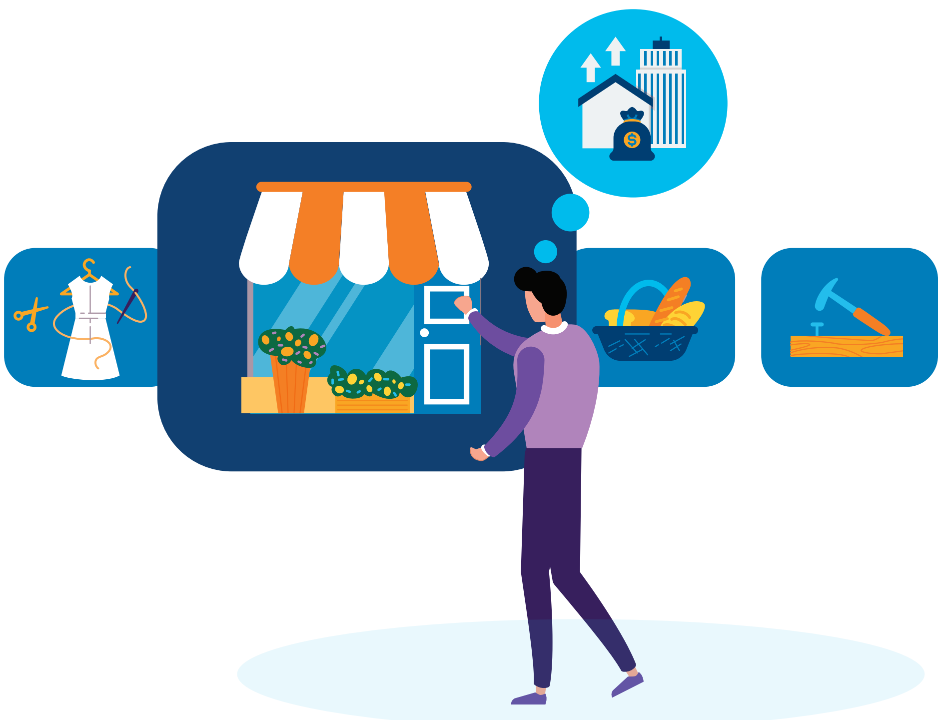
eBOOK SERIES

Chapter 1

Move money, and quickly

The small-to-medium ticket loan market is no backwater. Around 99% of firms in industrialised countries are small to medium-sized enterprises.[1] Together, they provide about 60% of jobs and produce around the same proportion of gross domestic product.[1] They need a lot of loans and leases. Yet, approximately 53% of SMEs complain that they struggle to access finance for growth.[1] And the retail lending market, worth trillions of dollars globally, has been described by TSB Bank in the UK as "stacked against consumers".[2] It's a high-volume market, and there's a lot of unmet opportunity.

The primary reason? Cost. Small ticket lending is expensive. It's a low-margin job. Since it doesn't make much for the bank in the first place, the logic follows that banks can't commit a lot more cash to do it only slightly better. As well as cost, the systems that sit behind the lending process, from origination to delivery, require high levels of human touch, are complex, siloed, and worse – old. Archaic legacy systems create much of the cost problem.



Traditional systems tend to only look at past data for credit assessment and as a result, are responsible for turning down some good borrowers and putting off many more. If you could fix both those things – the cost of lending and the systems for approving and delivering loans – a lot of hay could be made.

53%

of SMEs complain that they struggle to access finance for growth.[1]

[1] https://www.oxfordeconomics.com/recent-releases/the-big-business-of-small-business
[2] TSB, Consumers Matter: Loans, p.3

The fast-moving COVID-19 pandemic has brought this all into focus. In a short space of time, small businesses in every sector, in almost every market, have required immediate loans to remain even partially operational. Governments asked banks to move that money, and to do it very quickly.

We know that average 'time to cash' for commercial lending is nearly three months – in many cases because of worthwhile anti-money laundering and know-your-customer processes. But a lot of businesses don't have the reserves to wait that long anymore. Very suddenly, big banks are struggling to do something fundamental to their purpose: to get money to their customers, when they need it most."

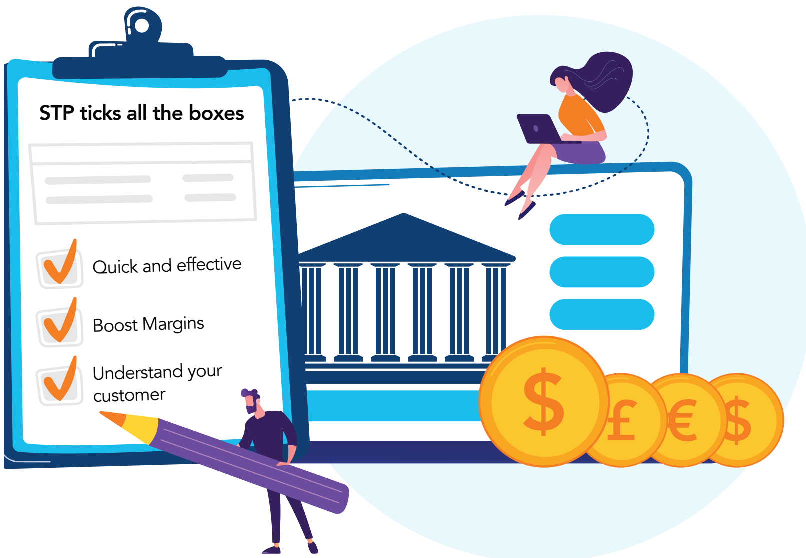
– Snehal Fulzele

SVP and General Manager, Q2 Lending

But this is only one chapter in a story that has been building for some time. Despite endless change management, traditional banking looks old. It's a digital laggard, currently unable to deliver on the experience that other sectors have managed to develop at speed. And these sectors do not limit themselves. Google, Apple, Facebook, and Amazon all have the skills and most importantly, the data to step into this space if they wish. Consumers increasingly used to a seamless digital experience will welcome it. In fact, a viable digital process is a must-have in order to compete. Certainly, some fintechs have made inroads on the market lately, but serious competition for bigger banks is relatively nominal at the moment. However, in a heartbeat, the competition could be fierce. Banks should feel threatened.

So how can banks lend small amounts quickly and cheaply but with lower levels of risk? We don't think that the answer is simply "technology". Yes, systems need upgrading, but the right technology alone won't deliver the change that's needed. Instead, banks need to approach lending as an information problem.

In fact, a viable digital process is a must-have in order to compete



An approach that ticks all the boxes

That's where straight-through-processing (STP) comes in. STP ticks all the boxes: it's a quick and effective digital process. It delivers money to customers in hours, not weeks or months. It increases the profit margin on small-ticket lending. And it means banks can do more deals. But it also does a lot more than just shift money quicker. Because STP is built around infrastructure that collects, stores, and uses so much more information about customers, it means that lenders can provide them with more personalised experiences — experiences traditionally reserved for high net worth customers or companies with large credit facilities.

Financial Institutions (FIs) can advise customers better because they have more time and more customer-centric knowledge. They can sell them more useful products, more cheaply. They can spot and address risk in a much more targeted way and provide a detailed audit trail for regulators. And they can connect STP to other third-party applications both in and outside the bank to provide their customers with seamless financial experiences that meet their needs and exceed their expectations.

This e-book is about solving the high cost of lending with STP. In it, we'll explain how the technology works and how it can deliver all kinds of benefits to FIs and their customers. And we'll explain how FIs can make the transition. But if you come away with one thing from reading this, it should be that STP is really an outcome. If you have commonality in technology, if you have the information on your customers, if you have the economic context, then you can have a quick decision about lending. That's STP.

STP is more than a process, it's an outcome

To understand why STP is such a compelling solution for small ticket lending, it helps to have a better grasp of the problem – from both perspectives, the institution's and the customer's.

The first thing you have to understand is that when a person walks into an FI wanting a small ticket business loan or looks at options for leasing (some office equipment), the FI will treat them in most cases as a new customer. Twenty years ago, that would have been fine, if not a little irritating for the customer and the bank employee moving all the paperwork. Today, it's a problem.

On requesting a loan, a chain of events is set off that today looks utterly different from most other buying experiences. The customer's experience isn't a good one, and neither is the bank's.

One U.S. lender captures the realisation that many lenders are coming to:

"We're not a technology company, but we understood how technology investments could improve the customer experience and enhance our impact in helping small business owners access the financing and support they need to thrive."

Typically, the information about the loan would be recorded initially by phone or fax – only sometimes by software. Then it would go through a series of confirmation processes at both ends, reviewed, counter-reviewed, and either kicked into an exceptions queue or punched into the payment system manually. Each person in this series of events would be operating in a different environment. And the disunity of each stage requires high levels of human interaction with the system. Humans, errors, delays. That's expensive.

– Darpan Saini
SVP Product and Engineering, Q2 Lending

How the loan process actually works – or doesn't

Let's start with the FI. To begin with, institutions providing small ticket loans to good businesses can charge between 4%-13% interest[3,4]. But they're borrowing between 5%-7%. And the cost of originating and servicing that loan – from initiation to payment, and even securing repayment – can also be high. The margin on these deals is wafer thin. The size of the margins does help to explain why small ticket lending isn't a change priority for FIs. That's the macro picture.

Then there's the chain of events. At a lot of FIs, different loan requests get different treatment – a lasting outcome of the golden era of commercial lending, when semi-independent lending departments bought different IT systems to run their respective portfolios. These siloed systems don't work together, and the technology they use only works across part, not all, of the lending cycle. Put simply, they're built on 30-year-old technology and operate using 30-year-old rules. The market looked very different in 1990.

Customers must typically complete a lot of paperwork – even if they're already an account holder. Then, it can be three to five weeks before they receive a decision, and nearly three months for the cash to reach their account. For small businesses in need of money, waiting three months for funds (or around a month to get turned down) is only going to cause reputational problems and a potential loss of business.

[3] https://www.valuepenguin.com/average-small-business-loan-interest-rates
[4] https://apps.newyorkfed.org/markets/autorates/obfr

Macro trends are finally forcing change

This process, characterised by rigid and iterative manual processes, legacy systems, and a largely monolithic approach, hasn't been adequate for a while. On a technical level, the process could perhaps survive if it wasn't under today's more significant macro-level pressures. Put simply, the process can't deliver the experiences that customers – both commercial and consumer – now demand.

Today, most people expect seamless digital experiences when it comes to retail and communications. And they expect it in other areas that touch their lives. In an attempt to bring more speed and ease to banking, both fintechs and challenger banks have entered the lending market, meaning that many customers are acutely aware of, and increasingly prefer, online options for banking. Not wanting to be caught out, many of the big banks have gotten involved in some small way too. But so far, most of their focus has been on smarter-looking front-end interfaces, with the processing technology at the bank remaining untouched.

Meanwhile, small-ticket commercial and consumer lending and even leasing in most cases needs to be fully available online, and it needs to be quick and easy. To deliver this, traditional FIs should partner with third parties offering fully integrated single platform solutions that provide lenders with a complete view of the customer – including their assets, activities, and risks. It also should be possible to upgrade the platform while it's in use and release new functionalities without interrupting business. STP can achieve these requirements.

Small-ticket commercial and consumer lending and even leasing need to be fully available online

About Q2

Q2 is a financial experience company dedicated to providing digital banking and lending solutions to banks, credit unions, alternative finance, and fintech companies in the U.S. and internationally. With comprehensive end-to-end solution sets, Q2 enables its partners to provide cohesive, secure, data-driven experiences to every account holder – from consumer to small business and corporate. Headquartered in Austin, Texas, Q2 has offices throughout the world and is publicly traded on the NYSE under the stock symbol QTWO. To learn more, please visit Q2.com.

Interested in finding out more about tackling the high cost of lending and how you can solve it? Speak to an expert today.

For more information go to Q2.com