How Big Data's Use in Commercial Lending Can Level the Playing Field for Entrepreneurs

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In the U.S., there are nearly 28.8 million small businesses, including franchises, which account for 48 percent of the private workforce, as reported by the U.S. Small Business Association. While they serve as a backbone to the U.S. economy, small businesses have been at a disadvantage when it comes to receiving commercial lending from banks due to a lack of modernizing of the lending infrastructure. To benefit both the borrower and the lender, we must improve transparency and the loan process to protect and ascertain the true value of small businesses.

In 1970, the Fair Credit Reporting Act (FCRA) ushered in a new digital infrastructure made up of data, scores and rights of consumers to ensure the successful growth of the consumer finance industry and the consumer driven economy. Credit card companies proliferated, and the "Big Five" credit and rating agencies were established.

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Like many established markets, regulation helped to create a market where a superhighway of financial products could flourish. This provided consumers a new lingua franca -- the credit, or FICO, score, which dictates whether individuals are able to get a mortgage, auto loan or credit card. FICO typically gives the best rating to those individuals who consistently pay on time, have limited credit card debt and

no negative collections activity, judgments or previous bankruptcy filing. However, the unintended consequence of the credit score was that it eventually became the standard by which individuals, and specifically their businesses, are judged by financial institutions for being eligible for investment and capital.

When researching for our book, *What's Your Business Worth?,* Daniel Priestley, Scott Gabehart and I discovered that nearly 67 percent of all businesses are under-financed. Following the 2008 financial crisis, banks, and especially smaller community banks who were more likely to lend to smaller firms, were hit hard, leading them to become more risk adverse. Regulatory overhauling responded to the crisis by forcing banks to convert capital and make fewer risky loans. In its report on small business lending, Harvard Business School revealed that this forced the fewer than 6,000 community banks throughout the U.S. to place a greater focus on the borrower's own profile, including personal income, higher personal credit thresholds, including higher credit scores, and higher collateral requirements.

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Typically, when initiating the commercial lending process with a financial institution, business owners and entrepreneurs are asked two questions -- What is your credit score and what is your current income? -- the same questions that individuals are asked when they are seeking a personal loan, highlighting a benchmarking process that works to disadvantage small business owners.

These two questions hold the key for the bank to begin looking at financing options for small businesses yet are not truly indicative of how their business is progressing or what the business owner has built. These older scoring methodologies must be updated beyond the variables that are included in a FICO score for commercial lenders to make improved lending decisions.

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Luckily, advances in big data technology have begun to force commercial lenders into holistic adaptation -- incorporating new data insights to new small business owner demands in efforts to make lending faster and more efficient. Big data provides transparency to both borrowers and lenders, giving borrowers more information on the terms other businesses are receiving, while lenders are able to mitigate risk by having a thorough understanding of the businesses' valuation, revenue, capital and collateral. Overall, it will be beneficial for both parties if loans are better able to reflect not just the primary shareholders' credit worthiness but the businesses' value and worth.

If the economy and the banking sector can find a way to better marry the supply of available funds to the demand for lending from the business owners this would usher in a full-scale revolution in commercial lending. At BizEquity, we believe that in order for this to occur there needs to be a new, fair and open lending act and data infrastructure established for the small and midsize business, one that rewards the business for its value. For in the end, modeling credit based solely on risk and not the potential capacity for growth will forever short wire the business and the commercial lending industry.