A Clear and Present Opportunity for More Credit Unions to Serve Small Business

A Credit Union Industry White Paper from

CU*influential*^{sm}

WHAT YOU NEED TO KNOW:

- **There are 33.3 million small businesses in the United States.**
- **Small businesses employ 61.6 million people, or 45.9% of the entire U.S. workforce.**
- **3/4 of small business owners are concerned about access to credit and there is a strong credit demand.**
- **Most (72%) of small businesses applied to large or small banks for credit in 2023 while only 7% applied to credit unions.**
- **Online lenders are gaining in popularity, but many charge predatory rates.**
- **Historically, in order to offer member business loans and lines of credit, SBA 7a and 504 loans, USDA loans, construction lending and commercial real estate investments, credit unions have either hired former bankers or joined member business lending CUSOs.**
- **Now a secure, "prospect to payoff" end-to-end cloud-based commercial/member business lending and SBA *loan origination and hosted servicing platform* is available to all credit unions, opening the doors to membership, asset and revenue growth.**

Introduction and Background.

In the early days of credit union Member Business Lending, large credit unions hired former bankers, small and mid-size credit unions joined a member business lending CUSO (usually run by a former banker) and everyone else that wanted to put member business loans on the books without hiring a former banker or joining a CUSO, purchased participation interests in commercial loans and treated them as investments.

Some outstanding member business lending CUSOs such as Oregon's CU Business Group, the Michigan Business Connection, Cooperative Business Services in Cincinnati, and Member Business Financial Services in Philadelphia - to name a few - have expanded their original credit union client base by providing underwriting and servicing for individual credit unions in other states so more credit unions could offer conventional commercial loans and SBA loans. For example, Member Business Financial Services, a CUSO originally created in 2008 by American Heritage Federal Credit Union and 5 partner credit unions in Pennsylvania, has grown to serve the underwriting, servicing and portfolio management needs of nearly 100 credit unions in the Mid-Atlantic and northeast United States who can now offer business lines of credit, commercial real estate loans, term business loans, SBA 7a and 504 loans and residential investment property loans. Cooperative Business Services, a CUSO originally chartered in 2003 to serve the business lending needs of credit unions in Ohio, now provides commercial real estate loans (purchase or refinance; retail, office, industrial, multi-family, medical/dental & more), construction financing, term loans, and SBA loans, up to $30,000,000 for member credit unions in 16 states.

Yet, in 2023 less than 10 percent of business loan applicants turned to credit unions for their financing needs. Thousands of credit unions are not members of a business lending CUSO, nor do they have the tools necessary to independently offer conventional commercial and SBA loans to their small business members and potential members.

There are 33 million small businesses in the U.S. 77% of business owners are concerned about the availability of credit. Yet in 2023 only 7% of applicants applied for a business loan with a credit union.

Why? Primarily because business lending has historically required more expertise and ongoing analysis than consumer lending and the paperwork is different. Small business entities don't have paychecks or W-2s. That means that credit unions need to be able to interpret P&L statements and perform multiple key ratio analyses to determine liquid capital, accounts receivable turnover, inventory turnover, debt to assets, debt to equity, interest coverage, return on equity and on ad nauseum. Also, commercial and SBA loan documentation is much more complicated than consumer loans. So, it is the complexity of business lending that has kept most credit unions out of the game. ***Until now***.

A Look at The Rapidly Changing Lending Market

Before we arrive at the solution, let's take a deeper dive into the current small business lending environment and the opportunity it presents for credit unions.

How large is the small business lending market? Small Businesses drive the American economy. Consider the following excerpts from "Small Business Statistics of 2024", published by Forbes Advisor[1]:

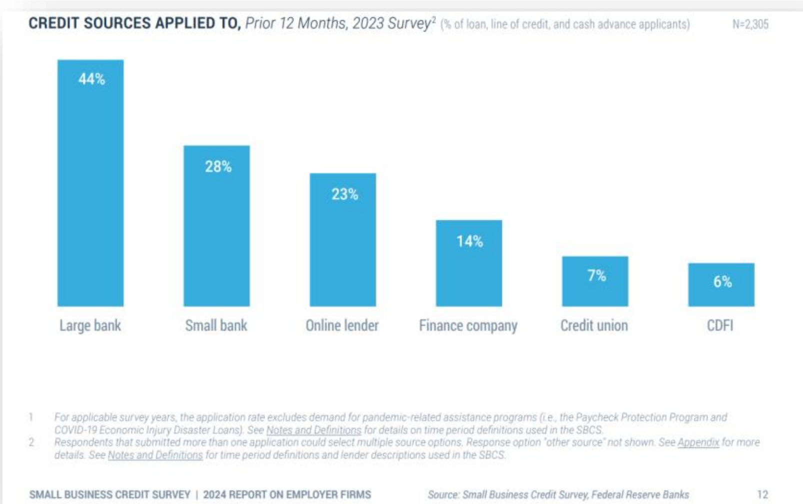
- **Almost all businesses across the U.S. are small businesses.** While large corporations often grab headlines, it's small businesses that form the bedrock of the American economy. Recent data from the U.S. Small Business Administration reveals a remarkable figure: 33.3 million businesses in the United States qualify as small businesses, making up 99.9% of all U.S. businesses. This number not only reflects the dominance of small enterprises in the business sector but also shows their significant role in generating

[1] "Small Business Statistics of 2024", Kelly Main, Forbes Advisor, January 31, 2024

employment and contributing to economic stability, a trend that remains relevant in 2024.

- **Nearly half of all U.S. employees are employed by a small business.** The impact of small businesses on the U.S. job market is more significant than often perceived. Although a majority of small businesses, over 80%, operate without any staff, these entities still employ a total of 61.6 million people. This figure represents 45.9% of the entire U.S. workforce, a remarkable statistic especially when considering that fewer than 20% of small businesses have any employees. This data not only shows the importance of small enterprises in job creation but also their role in sustaining the economy. It's clear that the growth of small businesses is integral to the nation's employment health and overall economic success.
- **Small Businesses need capital.** According to a 2024 survey by Goldman Sachs, about 77% of small business owners are concerned about their ability to access capital and 28% of loan applicants said they had taken out a loan or line of credit with payment terms they felt were predatory. The difficulty in getting more traditional forms of credit shows how sharp interest rate hikes by the U.S. Federal Reserve, exacerbated by the failures of renowned business lenders such as Silicon Valley Bank and Signature Bank, are constraining bank business lending. "The Fed's quarterly Senior Loan Officer Opinion Survey, released in January, showed the net share of banks offering more stringent loan terms for small businesses were more than twice the historic average since 1990."[2]

How do small businesses finance their operations? The clear majority of small business owners apply for traditional business loans from financial institutions such as banks, credit unions, online lenders and finance companies. The three most popular sources of capital are business lines of credit, business term loans, and SBA guaranteed loans and lines of credit.



As the chart at left illustrates 72% of small business loan applications are made with commercial banks in 2023. While member

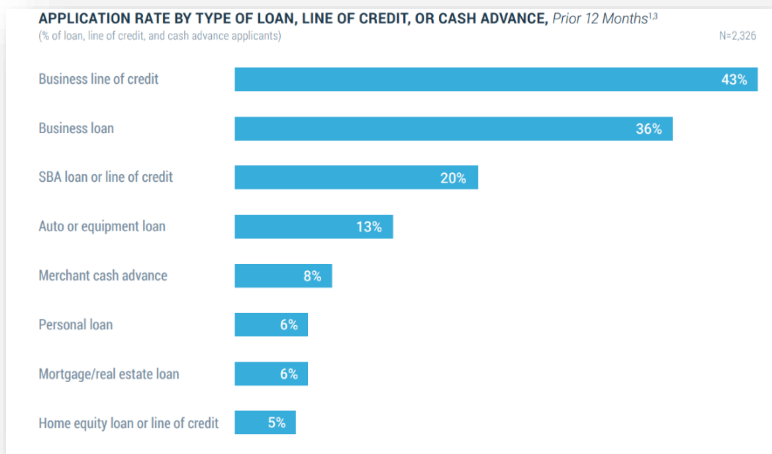
[2] "US Small Businesses Struggle for Credit, One Year After Regional Turmoil," Reuters, March 8, 2024

business lending has grown significantly over the last 20 years, credit unions remain at the bottom of the pack.

Until now, a majority of credit unions have not entered the business lending arena due to a lack of expertise in understanding and managing credit risk and documentation requirements.

While many credit unions have hired former bankers and have established highly qualified underwriting and servicing operations in-house, many other credit unions use the services of a member business lending credit union service organization (CUSO) such as Cooperative Business Services, LLC in Cincinnati or The Michigan Business Connection in Ann Arbor. Yet the vast majority of credit unions do not lend to small businesses.

Even SBA 7a and 504 loans – which offer the guarantee of the federal government – are offered by only a few credit unions. For example, according to the Small Business Administration, of the 32,203 SBA 7a loans approved during the first quarter of 2024, only 799 (2.5%) originated from credit unions. For the period January 1, 2020 through March 31, 2024 only 6,724 (3.2%) of SBA-guaranteed loans were issued by credit unions while 207,819 were originated by banks.



Considering the fact that there are an equal number of credit union and bank charters, this should serve as a wake-up call for credit unions. Commercial and SBA lending is an excellent opportunity for more credit unions grow their loan portfolio by helping to meet the increasing need for availability of credit by America's small businesses…the backbone of the American economy.

New Bank Capital Requirements Will Further Limit Access to Credit. While America's small business owners are struggling to access capital needed to operate and grow their businesses, as interest rates rise, and banks continue to tighten lending standards, the Federal Reserve's Basel III Endgame proposal would require higher bank capital requirements and make matters even worse.

Consider these key findings from Goldman Sachs *10,000 Small Businesses Voices* survey of 1,556 small business owners:

Of the small business owners who have applied for a new business loan over the past year (28%), 70% reported it was difficult to access capital. In contrast, 61% of loan applicants in the April 2023 Goldman Sachs *10,000 Small Businesses Voices* survey said it was difficult to access capital in the prior three months. Seventy-six percent say difficulty accessing affordable capital has negatively impacted their business and 73% say rising interest rates are having a negative impact on their business.

Bank failures have resulted in tighter business credit restrictions. Many online lenders are charging predatory rates. Small business owners are hanging on by a thread.

As the Federal Reserve is seeking public comment on its Basel III Endgame proposal, 84% of small businesses are concerned that the proposal will negatively impact their ability to access capital in an already difficult market. In July 2023, the Federal Reserve proposed a rule that will require large banks to further increase the amount of capital they hold.

"Small business owners are hanging on by a thread, but the thread is getting increasingly thin as capital is becoming more difficult and more expensive to access, meaning many businesses are having to halt growth plans and consider cost cutting measures," said Jessica Johnson-Cope, CEO & President of Johnson Security Bureau and Chair of the National Leadership Council for 10,000 Small Businesses Voices. "Small business owners appreciate the work of Congress to examine the impacts of the Federal Reserve's Basel III Endgame as we are concerned the proposal will only worsen the ability of many small businesses to access capital."

Rising bank interest rates hurt small business. 68% of small business owners have outstanding business loans or lines of credit.

- Of these, 58% have a fixed interest rate, while 42% have a variable interest rate.
- 63% of those with outstanding loans or lines of credit say rising interest rates have impacted their ability to service their existing debt obligations.
- 68% of those with outstanding loans or lines of credit say they would not be able to maintain current operations or grow their business without their business loan or line of credit.[3]

Higher capital requirements for commercial banks may have a negative effect of the availability of small business credit and many borrowers will look elsewhere.

The emergence of online lenders. Online lending has become a viable option for many small business owners. While many large financial institutions have not been able to give small businesses the funding they need to grow and scale their businesses, online lenders have been able to provide streamlined support in owners' time of need. For example, as reported by the Federal Reserve

[3] This data is based on a survey of 1,556 Goldman Sachs 10,000 Small Businesses participants conducted from August 29-September 7, 2023.

Banks 2024 Small Business Credit Survey, 23% of business credit applications were submitted to online lenders as just 7% were submitted to credit unions in 2003. Online lenders received 23% of applications from small businesses.

Many online lending companies offer a quick application and funding process. Sometimes they wire loan proceeds in as little as 24 hours and do not require a hard inquiry on credit reports. They also tend to be more open to lending to business owners who might be rejected by big banks because of their updated application considerations and tendency to look at the bigger picture.

A significant drawback of these quick online options is that many options come with higher APRs. Some online loans carry interest rates that top 20%, whereas traditional business loans are likely to have rates under 10%. However, for many small businesses, fast and timely funds help increase production, manpower, diversification, and scalability. For many, this quick support supersedes the higher interest. These online lenders will continue to give small businesses—everything from the local mom-and-pop corner store to the growing startup—the ability to grow their business, hire new people, run marketing campaigns, launch new products or services, compete with larger competitors, and invest in new supplies.[4] Unless, of course, more credit unions get in the game.

The Credit Union Solution

Credit unions have the unique opportunity to level the playing field with community banks and online lenders by establishing profitable and rewarding relationships with small businesses. More credit unions can offer small business lending and provide working capital loans and lines of credit, term business loans for equipment financing, SBA 7a and 504 loans, commercial real estate loans…and, in the process, acquire millions of dollars in deposits and access to the consumer lending and deposit needs of hundreds of thousands of employees.

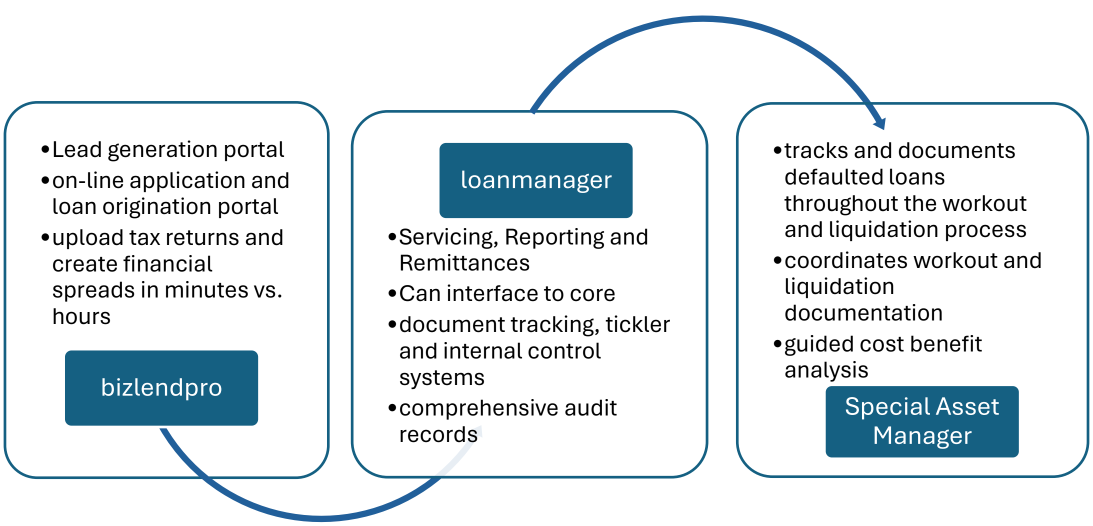
All it takes is the right tools. In order to provide safe and sound credit to small business members and potential members, credit unions need a secure end-to-end business lending platform supported by borrower and lender portals that allows seamless collaboration between the lender, borrower and all additional business relationships often required to secure a business loan. The platform should support lead generation, document uploading, automated financial spreading capability, closing and documentation tools to simplify audits and compliance, application document management and data validation, participation accounting, fully customizable tickler tracking and borrower notification, loan workout and liquidation non-accrual accounting, and more.

[4] https://www.bluevine.com/blog/improving-access-to-credit-for-small-businesses

INTRODUCING THE INDUSTRY'S ONLY INTEGRATED, END-TO-END SECURE BUSINESS LENDING PLATFORM.

Commercial and SBA Loan Origination, Servicing and Management Made Easy. I recently met with the management team of PCFS Solutions, a 40-year-old commercial lending provider that manages over 700,000 loans for more than 400 banks, credit unions, credit union service organizations, community development financial institutions and other non-bank commercial lenders across the commercia lending market, including 25% of the top SBA lenders. PCFS Solutions develops innovative high-quality lending solutions that streamline the lending process through automated efficiencies that simplify the business lending and servicing functions. Over the years the company has evolved from its initial software product, SBA Loan Manager, to the financial services industry's only end-to-end business lending solution. The company's mantra states "PCFS Solutions platform connects the people, data and processes for cost-effective business lending."

To accomplish this mission, PCFS Solutions has developed and integrated their latest hosted web solutions, **BizLendPro**, **Loan Manager, Servicing Portal** and **Special Assets Manager** into an end-to-end business lending solution for SBA 7a and 504 loans, USDA guaranteed loans, conventional commercial lending, construction lending and commercial real estate investments.



The traditional business credit application requires the business owner to allocate significant time away from business operations to meet with the lender during working hours. By moving the application process to the cloud, borrowers enjoy the convenience of securely uploading financial statements and other documents while lenders have the flexibility to expedite credit and financial analysis, establish tailored checklists to ensure compliance and quick loan approvals, leaving no room for missing information or documents.

All loan application data and related documents are stored in a single data file. With this truly connected solutions, the lender and borrower electronically collaborate on gathering all of the necessary information and documentation required to efficiently complete the loan process.

For SBA lending, the most up-to-date SBA loan application and funding forms are pushed out through ongoing software updates to ensure compliance with the latest SOP and regulatory requirements. SBA lenders can produce SBA forms, manage checklists, correspond with borrowers in real time, and submit a complete loan application to the SBA via eTran integration with the click of a mouse.

Loanmanager is a comprehensive solution that manages the entire loan process from application through servicing to payoff or liquidation, ensuring data is entered only once. This minimizes manual processes and eliminates errors. The system handles all aspects of loan accounting and disbursement within a single database compatible with most general ledger systems. From the application point, Loanmanager tracks good faith deposits, disbursements, payments, non-accrual status, charge-off shadow accounting, and REO. It can seamlessly backdate transactions and automatically recalculate subsequent activity, providing real-time results for all monetary transactions without the need for overnight processing.

For SBA lenders, Loanmanager includes all standard and required reports, featuring a fully automated 1502 reporting system that maintains and reconciles to Guidehouse's (Fiscal Transfer Agent) trust account, as well as all other investor account balances. Reports can be generated with a single click, eliminating the risk of late settlement penalties.

Loanmanager's robust tickler system enables lenders to track loan covenants and includes ticklers for all SBA loan authorization requirements. Its comprehensive communications features allow lenders to email or mail borrowers regarding important events and deadlines. Additionally, loan manager supports loan securitization and participation management, making it a complete Loan Accounting Core system.

For SBA lenders, the system includes all standard and required reports. A fully automated 1502 reporting system maintains and reconciles Colson's trust account, and all other investor account balances. Reports can be generated with the click of a button eliminating late settlement penalties.

Special Asset Manager Loan Workout and Liquidation Solution

The Special Assets Manager (SAM) is a comprehensive liquidation management and tracking solution that guides lenders through the cost benefit analysis needed to determine the best liquidation plan. It tracks and documents defaulted loans throughout the workout process while coordinating all documentation in one convenient place.

SAM provides credit unions with the ability to create custom workout plans to manage and track any type of liquidation. All steps are linked to a To-Do list to keep track of actions that require a lender's attention. Bankruptcy tracking is linked to Outlook to notify the lender of upcoming bankruptcy actions. All documents are stored with the loan record for easy organization and audit requirements. For SBA lenders, the automated SBA-10 Tab populates from the database to the SBA forms and creates a bookmarked PDF to submit to the SBA Service Center.

Together, **Bizlendpro**, **Loanmanger, the Servicing Portal** and **Special Assets Manager** create a prospect to payoff solution to facilitate the prospecting, underwriting, documenting, funding, boarding, servicing, auditing and workout processes a secure, collaborative, hosted online platform.

ABOUT PCFS SOLUTIONS

PCFS Solutions began as an Orange County, California based PC Financial Systems (PCFS) in 1983 with the launch of its first software product, SBA Loan Manager. Quickly becoming the industry standard in simplifying the complexity of SBA lending and reporting, by 1998 had PCFS developed loan origination systems SBA Form.Wrx and Credit.Wrx which included easy integration of SBA loan and conventional commercial loan origination systems into one database, enabling operation as one complete system or as stand-alone applications. By 2013, PC Financial Systems became PCFS Solutions and launched Special Assets Manager (SAM) which addresses the specialized needs of loan workout and liquidation. Continued and progressive enhancements and integration of their core SaaS products resulted in the development of a complete “prospect to payoff,” end-to-end business lending platform.

Kevin Danker, Vice President of Product Implementation & Support, joined PCFS Solutions in the early 1990s, bringing with him many years of banking experience and an extraordinarily strong loan operations background. In addition, he has also worked in the computer services industry, dealing almost exclusively with banking clients. Kevin’s well-rounded computer system and loan operations background are important factors in PCFS Solution’s success in the conventional business credit and SBA loan servicing software market.

Kevin says it best, “For more than 30 years, our company’s energy, resources and passion remain focused on developing innovative high-quality lending solutions that streamline the lending process through automated efficiency that simplify business lending and servicing processes. Our systems are designed and supported by our own in-house technical experts in San Diego, California, and we provide dedicated live customer support before and after the software is installed. In addition, we provide timely software updates to meet the needs of the ever-evolving lending regulations.

“We have created the industry’s only end-to-end business lending solution. We continue to look across the entire business lending process to find opportunities to add value, such as **BizLendPro and Servicing Portals.** Both products are hosted web solutions with many future enhancements planned to help lenders process, service and analyze their commercial lending portfolios. We are committed to continuing to develop products and services of quality, innovation, and richness of features to create smarter solutions for smarter lending, and smarter business for our clients.”

For over 30 years, San Diego based PCFS Solutions has been a leader, delivering a unique end-to-end business lending platform that starts with borrower engagement and collaboration ending with loan payoff or workout. PCFS Solutions connects the people, data and processes for cost effective business lending. The flexible lending platform allows the lenders to build the right lending solution for a business and easy scaling as the business grows. Loans may begin as applications, but they live most of their life as a loan. This means they require monthly maintenance. Inefficient and inaccurate loan monitoring systems can cause substantial loss for lenders and can quickly wipe away profits. Lenders need a solution that is flexible, scalable and easy to use, delivering professional grade accounting capabilities along with reliable, fully automated reporting.

PCFS Solutions' loan serving platform offers powerful and comprehensive loan accounting, reporting and remittance capabilities along with simplified loan workout and liquidation. The business loan accounting system features industry-leading accounting functionalities including participation accounting for both secondary markets and other types of investors.

The robust platform can service most common business lending programs such as SBA 7a, SBA 504, USDA, Conventional Commercia Lending, Member Business Lending, Construction Lending and Commercial Real Estate Investments, all designed to meet the lender's needs and help overcome the most substantial lending challenges.

Conclusion

In a nutshell, Small Business is the backbone of the American economy and Small Business needs more credit unions to provide access to credit. While commercial banks are business owners' historic go-to for working capital and equipment financing, banks are facing new stringent capital requirements and the majority of business owners who applied for credit with large and small banks have recently reported difficulty accessing affordable capital. As an alternative, business owners have turned to fintechs for capital, but many online lenders charge excessive interest rates. The shifting business lending paradigm presents a clear and present opportunity for more credit unions to take a leading role in small business lending.

In this competitive market, the lender who can manage end-to-end business for a complete and streamlined "prospect to payoff" wins. This capability is available to credit unions from PCFS Solutions.

As of December 31, 2023, there were 33.4 million small businesses and 4,604 credit unions in America. That is an average of 7,233 small businesses per credit union so it's easy to assume that every credit union has dozens, hundreds, perhaps thousands of small business owner/operators in its field of membership. The opportunity for credit union growth through safe and secure small business lending is clear and present. The timing is perfect and the **industry's only integrated business lending platform** is with PCFS Solutions.

For information and a demonstration of how PCFS Solutions can help you manage and meet your members' and prospective members' small business credit, and create new growth opportunities for your credit union, please visit https://www.pcfssolutions.com , email our Sales Team at sales@pcfssolutions.com, or call 714) 674-0009.

About CU*influential*sm

CU*influential*sm is a corporate communications firm dedicated to the growth of the credit union industry by cultivating a collaborative culture between credit unions, CUSOs and small business. Founder Mike Hales is a former bank president, former chair of the California Bankers Association Sales and Marketing Committee, a Credit Union Service Organization (CUSO) president, National Association of Credit Union Service Organizations (NACUSO) board member, and a veteran bank and credit union consultant.

Mike is a graduate of the *ABA School of Bank Marketing Management and Strategic Planning* at the University of Georgia, and the NACUSO/Pepperdine University Graziadio School of Business and Management *Designing and Implementing Collaboration and Business Networks* certificate program. He is also a graduate of Lincoln University School of Law and author of "*The Handbook of Consumer Banking Law*" © Prentice Hall and "*The Language of Banking*" © MacFarland & Company.