

# Small Businesses' Perceptions and Understanding of Online Alternative Loan Products: Findings from Online Focus Groups

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*Organized by the Federal Reserve Bank of Cleveland and the Board of Governors*

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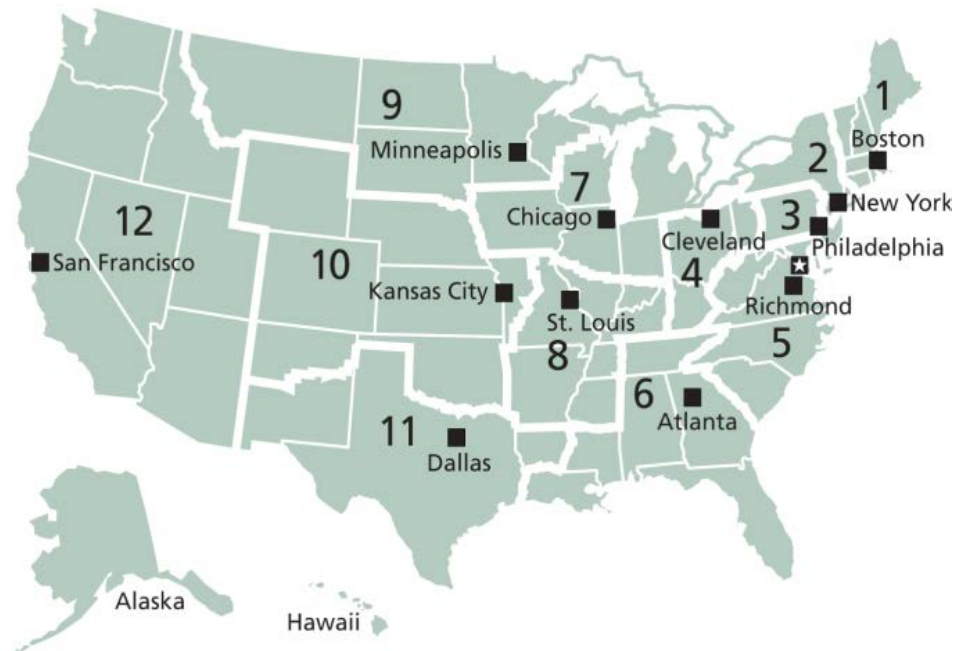
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- **Convening stakeholders**, including practitioners, financial institutions, nonprofits, governmental agencies, and the philanthropic and private sectors,
- **Conducting and sharing research** to examine economic challenges facing low- and moderate-income communities and attendant policy implications; and,
- **Identifying emerging issues.**



# Today's Presenters

- Barbara Lipman, *Project Manager, Division of Consumer & Community Affairs*, Federal Reserve Board of Governors
- Ann Marie Wiersch, *Senior Policy Analyst, Community Development*, Federal Reserve Bank of Cleveland

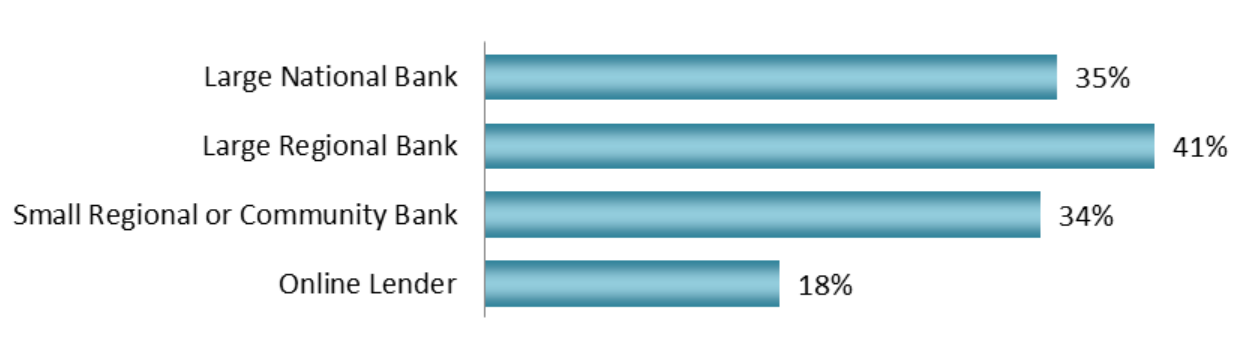


# The Online Alternative Lending Industry: Players and Products

- Online alternative lenders are nonbank credit providers
  - Merchant cash advance providers
  - Marketplace platforms (peer-to-peer)
  - Other direct lenders
- Small business credit products
  - Loans
  - Cash advances

# A Small but Growing Industry

- Growth driven by borrowers' unmet demand for credit



*Source: 2014 Joint Small Business Credit Survey (Federal Reserve Banks of Atlanta, Cleveland, New York, and Philadelphia)*

- Other evidence of growth:
  - Investors demand for notes
  - Venture capital investment
  - New partnerships

# Focus Group Study Initiated to Explore Borrowers' Perspectives

- Gauge small business owners' perceptions about alternative lending
  - Their approach to credit decisions
  - Their impressions of online alternative lenders
  - Their understanding of the products offered
- Surface issues to inform future research





# About the Online Focus Groups

- Two focus groups, 44 business owners
- Online discussion format, three days of questions, professionally moderated
- Participants' businesses varied in size and across industries, geography
- Discussion topics
  - Day one: Managing business and financial challenges
  - Day two: Process for seeking short-term credit, virtual “shopping”
  - Day three: Evaluation of mock credit products, recommendations

# Business Challenges and Financial Decision Making

- Challenges managing business finances



“Managing cash flow is the hardest thing I face. The second hardest thing, as well as the third, are managing cash flow.”

- *Business owner from Texas*

- Participants would consult a variety of sources for advice, including their banks, but some did not view banks as a likely credit source

# Participants' Initial Impressions of Online Lenders



The wild west

Seems shady to me, a scam



Identity theft

High APRs



Pay day lenders

I do not trust them



Wants to do business quickly

Place I would trust



Less overhead, better rates

More variety of products



# “Shopping” Appears to Change Participants’ Impressions

- Participants found websites to be appealing.
- Some participants that held unfavorable initial impressions shared very positive impressions after shopping.
- Others shared concerns about data security, high rates, and loss of control over their merchant accounts.

# Mock Product Comparisons

Scenario: Suppose you needed \$40,000...

## Product A

- Need FICO 500+
- You provide sales history and bank account info
- Decision and funding within 3 to 5 days

## Repayment:

- You owe \$52,000. The lender takes 10% of your credit card sales receipts each day until paid off

## Product B

- Need FICO 650+
- Sales history and account info pulled electronically
- Decision and funding within 1 day

## Repayment:

- You owe the original \$40,000 plus 28 cents for every dollar you borrow; repaid in one year

## Product C

- Need FICO 700+
- You provide three years of tax returns and financial statements
- Decision and funding within 4 weeks

## Repayment:

- You owe monthly payments of \$3,440. Your effective APR is 6%; loan is repaid in one year

# Confusion about Product Costs

**Product A:** \$40,000 borrowed, \$52,000 repaid with 10% of sales receipts, assuming one-year repayment.

*What is your best guess of the interest rate?*



28%



On the high side of 50%



About 23%



5%



9.8%



Not sure, maybe 20%



30%



25%



A little less than 10%

# More Confusion about Costs

*Suppose you repay Product A in 4 months. How would paying back more quickly affect your rate?*



I assume the rate would be lower



It would not affect the rate



The effective interest rate would be higher



I really don't know



The interest rate is irrelevant since  
I still have to pay \$12K on \$40K

# Challenges Comparing Products

- Respondents self-identified as financial decision maker
- Said it was “Easy” to compare products

- Qualified answers with “I think” or “I’m not sure but ...”
- Admitted difficulty on some specific questions or ...
- ... Did not answer correctly

- Almost to a person ... recommended making products easier to understand and compare



# Participant Recommendations



- They want information about loan products – especially costs – to be clear.



- They don't want to feel they can be taken advantage of.



- They want ironclad protections for their business data.



- They want to do business with firms they are sure are reputable.

# Key Findings Summary

- Online alternative lender websites are alluring, but trigger concerns about data security and privacy.
- Small businesses find it difficult to compare credit products using information typically provided on online alternative lenders' websites.
- Virtually all the focus group participants said they want clearly stated product features and costs and an easier way to compare product offerings.

# Policy Questions

- How would standardized disclosures affect borrowing decisions?
- How will concerns about data and privacy affect borrowers and the industry?
- How will online alternative lending change the nature of small business banking?

# Closing Thoughts

- The online alternative lending industry is growing and evolving.
- With greater market penetration will come greater experience, more competition, and changes in borrower expectations.
- Future research should track industry developments from the borrowers' perspective.

# Resources

## ALTERNATIVE LENDING

through the Eyes of “Mom & Pop”  
Small-Business Owners:  
*Findings from online focus groups*



- Please visit the Federal Reserve Bank of Cleveland website for the complete [report](#).
- For more information, please contact [Barbara.J.Lipman@frb.gov](mailto:Barbara.J.Lipman@frb.gov) or [AnnMarie.Wiersch@clev.frb.org](mailto:AnnMarie.Wiersch@clev.frb.org).

## Questions?

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# Wrap-Up / Closing

Thank you to today's presenters and to all participants for joining this session.

## Next steps:

- All session materials are available on our web site and in the next few days we will be posting an audio file of today's session.
- If you have topical suggestions for future sessions, or any questions about this program, please feel free to contact us at [communities@stls.frb.org](mailto:communities@stls.frb.org)
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