A New Perspective on Small Businesses Lending

How financial inclusion in SMB lending can **be achieved using alternative credit data**

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Traditional credit data may not give lenders the full picture of creditworthiness

89% of lenders leverage alternative credit data to evaluate small business applicants.[1]

Small businesses present unique opportunities and challenges for financial institutions. Lenders looking to expand their small business lending portfolio often have trouble finding reliable information to more accurately assess SMB credit risk. Alternative data can **close the information gap and give lenders clearer insight** into small business creditworthiness.

Survey results from the 2023 LexisNexis® Risk Solutions Alternative Credit Data Impact Report revealed a number of **key insights into the many ways lenders are utilizing alternative data** to identify and assess new and/or thin file organizations as well as refine segmentation among more established, high-performing businesses.

Understanding how alternative data can be leveraged to target and evaluate small businesses can help lenders approve more newly-created businesses, drive portfolio growth and deliver exceptional customer experiences.

New business creation has slowed (-7% from 2021) — will slowing creation rates impact small business lending portfolio growth?[1]

In 2021, business creation soared as entrepreneurs took advantage of a rebounding economy and low interest rates. Now, with rising interest rates, inflation and growing economic uncertainty, **conditions for new business creation have become harder to navigate**.

Still, **small businesses comprise 99.9% of all U.S. business** — representing tremendous opportunity for lenders, but also significant potential risk.[2] Newer businesses often have little to no trade history or credit footprint — with many failing shortly after launch or never coming to fruition after the initial conception phase.

Evaluating small businesses with traditional data can be murky — lenders who want to capitalize on these opportunities need a new perspective on risk.

35.3%
of small businesses have a credit history[3]

78%
of small business owners use their own funds to launch their businesses[2]

1 in 2
small businesses with credit history have thin files[3]

Lenders face significant challenges in assessing risk for nascent small businesses

Alternative data can help shed some light on the viability of newly created businesses.

While it is true that new business formations are on the rise, we are finding that many of these new businesses never grow to be active businesses. Many entrepreneurs take initial steps to form an entity but for any number of reasons never follow through.

*Alternative data can be an important tool to help **delineate preforming young businesses with the potential for growth** from businesses that fizzle out shortly after creation.*

Though business creation has slowed, credit utilization is on the rise, with a resulting increase in risk.

Over the past year, businesses have been starting to show signs of stress as overall utilization and tradeline delinquencies are on the rise. Businesses considered highly leveraged with a revolving tradeline at 75% utilization increased 19%.[3]

The challenge for lenders now is how to continue to identify potential new small businesses and opportunities to grow with their existing small business customers amidst a shifting risk landscape.
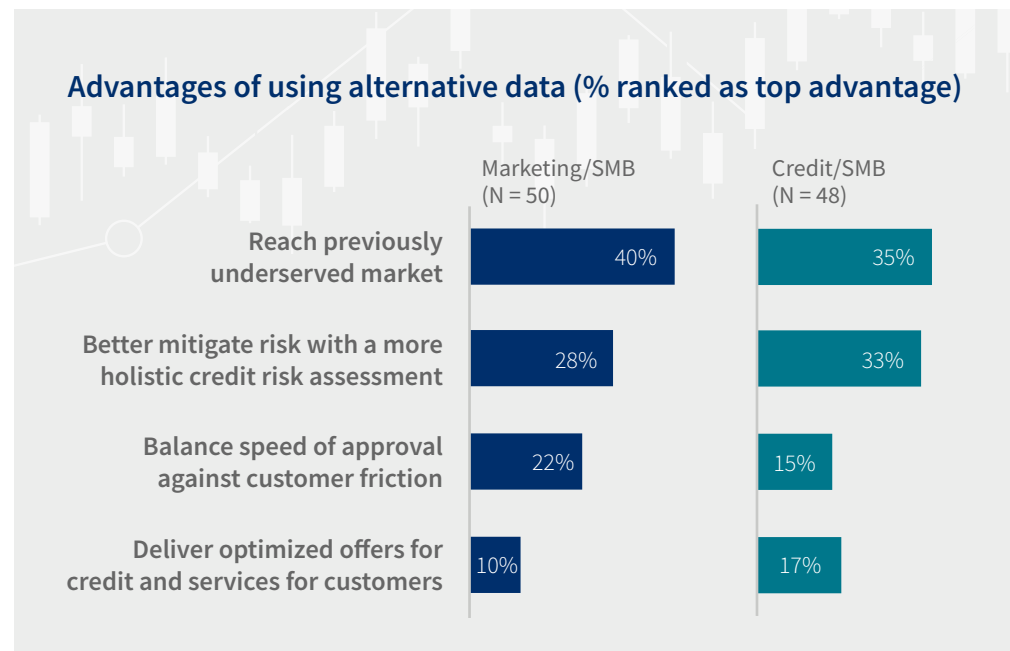
Lenders are turning to alternative credit data to gain additional insights to fuel portfolio growth

82% of responding lenders leverage alternative credit data on small business applicants to achieve credit portfolio growth.[1]

Identifying new growth opportunities starts with the ability to see and evaluate younger small businesses. Financial institutions that focus on small business lending ranked **reaching previously underserved markets** as a top advantage of using alternative data for both marketing (40%) and credit risk assessment (35%). In addition, 33% of respondents ranked better **risk mitigation** as a top advantage in credit risk assessment specifically.[1]

*By blending alternative data with traditional credit data and business-authorized representative insights, lenders gain an increased ability to score businesses and identify risk, leading to **more confident risk decisions**.*

Advantages of using alternative data (% ranked as top advantage)

	Marketing/SMB (N = 50)	Credit/SMB (N = 48)
Reach previously underserved market	40%	35%
Better mitigate risk with a more holistic credit risk assessment	28%	33%
Balance speed of approval against customer friction	22%	15%
Deliver optimized offers for credit and services for customers	10%	17%

These results support the finding that as alternative data becomes best practice for financial inclusion, lenders begin looking for other use cases where non-traditional credit indicators can apply. While financial inclusion is the top ranked advantage when looking at marketing, that gap narrows as lenders move into risk assessment.
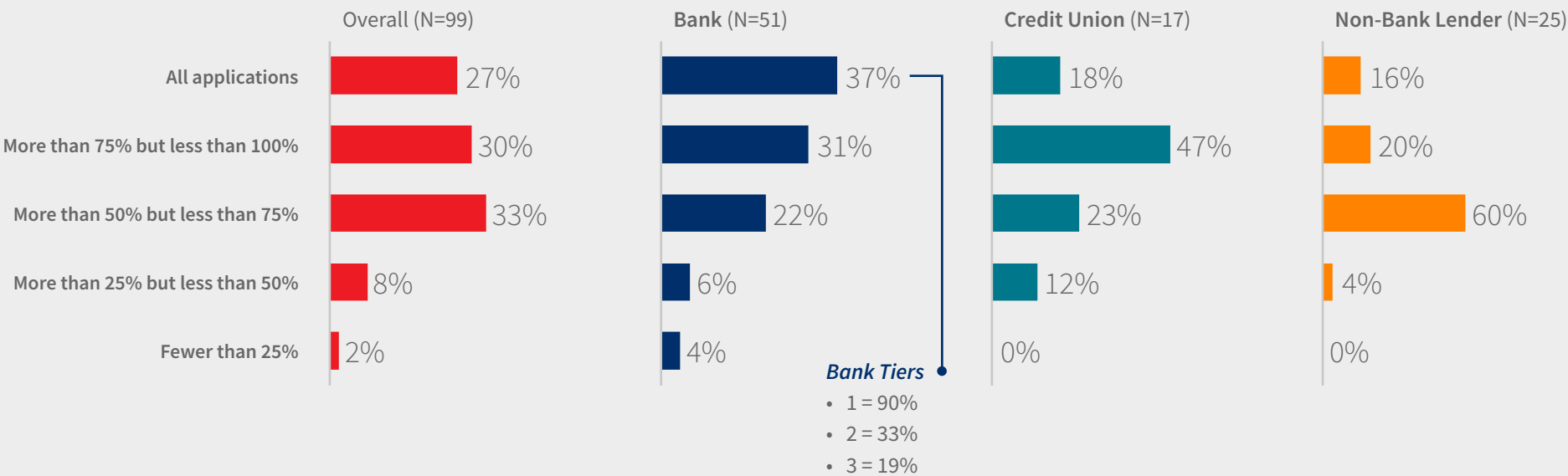
Adoption of alternative credit data isn't just for credit invisible applicants

57% of lenders are using alternative data to evaluate the credit risk of 75% or more of their small business applications.[1]

By leveraging alternative credit data insights across applicants, lenders can continue to refine risk strategies and manage overall portfolio risk and profitability.

Across sectors, frequency of alternative data usage varies significantly when assessing new small business accounts. **Banks (37%) are more likely to utilize alternative data** to assess all new accounts than any other financial sector — the **next highest being credit unions** at 18%. 90% of Tier 1 banks (banks with portfolios exceeding $1B) use alternative data to help assess all SMB applications.

Frequency of using alternative credit data[1]

	Overall (N=99)	Bank (N=51)	Credit Union (N=17)	Non-Bank Lender (N=25)
All applications	27%	37%	18%	16%
More than 75% but less than 100%	30%	31%	47%	20%
More than 50% but less than 75%	33%	22%	23%	60%
More than 25% but less than 50%	8%	6%	12%	4%
Fewer than 25%	2%	4%	0%	0%

Bank Tiers
- 1 = 90%
- 2 = 33%
- 3 = 19%

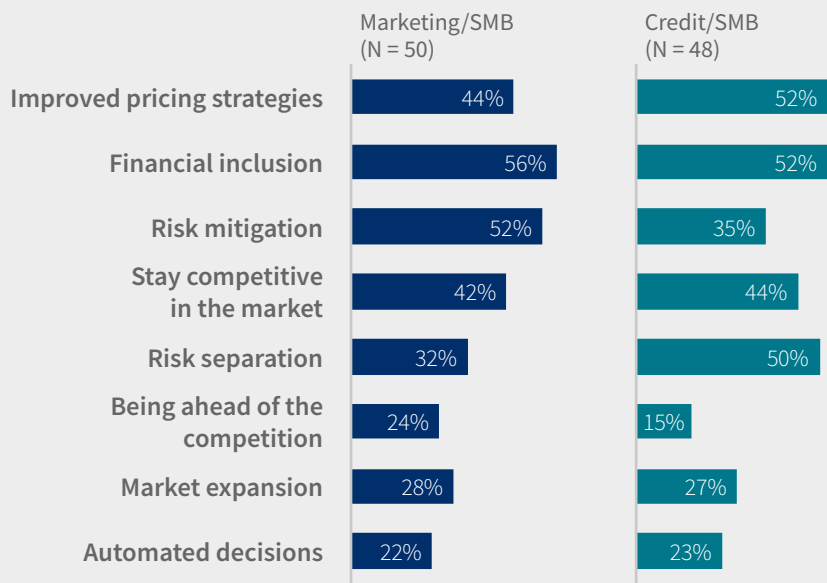## Alternative data is a powerful tool for segmenting risk.

Alternative data can help give lenders a more detailed picture of business creditworthiness, allowing them to **refine their risk strategies, enhance segmentation efforts, and offer more attractive and profitable conditions**. 52% of respondents focused on marketing cited risk mitigation as a top business driver for adopting alternative credit data.

Completing the picture of business creditworthiness enables SMB lenders to **better understand potential risk and more effectively segment customers**. Lenders can then leverage these insights to help optimize lending terms — empowering them to mitigate attrition and drive profitable growth.

Top drivers for alternative data adoption

	Marketing/SMB (N = 50)	Credit/SMB (N = 48)
Improved pricing strategies	44%	52%
Financial inclusion	56%	52%
Risk mitigation	52%	35%
Stay competitive in the market	42%	44%
Risk separation	32%	50%
Being ahead of the competition	24%	15%
Market expansion	28%	27%
Automated decisions	22%	23%

52% of respondents focused on marketing cited risk mitigation as a top business driver for adopting alternative credit data.

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Take a proactive approach to portfolio management with alternative credit data

55% of lenders leverage alternative credit data for credit portfolio management of their small business customers.[1]

Businesses with a delinquency over 90+ days past due increased 26% in the last year.[6] As risk in existing debt portfolios continues to shift, lenders can leverage enhanced insights and take a proactive approach to understanding which small business customers are increasing or decreasing in risk — then develop targeted strategies to engage them to maximize recovery.

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Improve risk evaluation of over 98% of small business applicants with small business credit solutions from LexisNexis Risk Solutions.

Help small businesses thrive in a rapidly changing economy and grow your business lending portfolio with confidence by identifying opportunity where others may only see risk. Connect business and authorized representative insights to improve credit risk assessment and extend more competitive offers so you can grow with your small business customers.

Ready to transform your small business lending portfolio?

Learn more:
risk.lexisnexis.com/financial-services/credit-risk-assessment/small-and-mid-sized-business-credit-risk

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Sources:
1. LexisNexis Risk Solutions 2023 Alternative Credit Data Impact Report
2. The State of Small Business in America | U.S. Chamber of Commerce (uschamber.com)
3. LexisNexis Risk Solutions, InfoHub February 2023 Report