SPARK

Ignoring Underserved Markets Comes at a Cost

How mission-driven lending benefits the community — and the entire industry

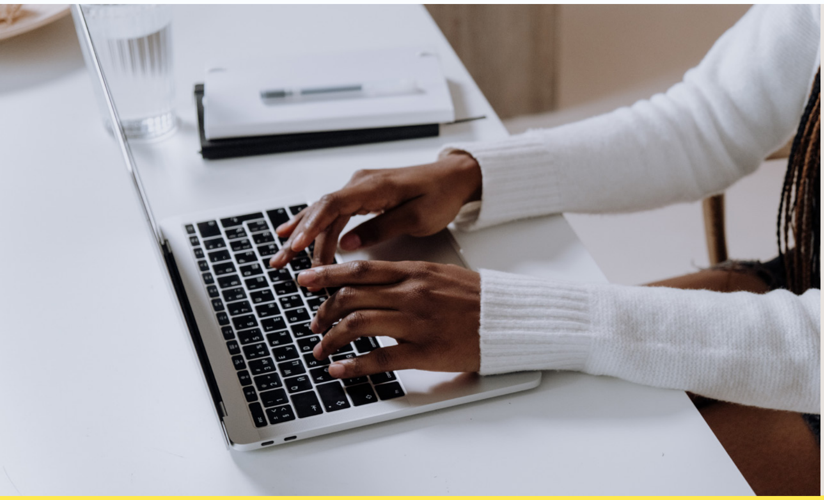
Do More Together

For centuries, banks have played a crucial role in the community, providing home mortgages, small business loans, and (of course) a safe place for people to store their money. When individuals in society have a monetary or financial need, oftentimes the first stop on that financing journey is the local bank branch. But what if your community doesn't have a bank branch? What if, after finding a banker to speak with, you are told, "You don't meet our criteria."? What if, based on past experience and demonstrated market failures, you simply don't trust the traditional banking sector?

Discrimination, lack of access, structurally enforced barriers like redlining, and various other types of market failure have led to banking and credit deserts in underserved urban and rural communities. Underserved markets are generally overlooked by mainstream players in a profit-oriented and shareholder return-dominated industry. As if the profit perception issues plaguing under resourced communities weren't enough, over policing, lack of quality education, food deserts, high unemployment, and poor quality healthcare also contribute to community strife. Small Business ownership and entrepreneurship is a potential pathway to prosperity for many in under-resourced communities, but with so few options available and predatory lenders actively targeting these vulnerable communities, more needs to be done to lift these communities up. Banking as it is today, with its inherently high credit standards and profit-driven mentality, cannot and will not be the answer alone. It will take a coordinated and intentionally designed ecosystem operating on entirely different motives to be the sustainable and systemic change many of us seek.

Under the current banking framework, profit continually outweighs public benefit.

When banks can't or won't help, there are several existing programs and policies designed to fill the gap. Arguably, Small Business Administration (SBA) lending, the Community Reinvestment Act (CRA), a broad and diverse network of social service and nonprofit organizations, and Community Development Financial Institutions (CDFIs) should be enough. But the very existence of predatory lenders, payday lenders, money stores, check cashing stores, etc. that have fully penetrated and actively serve many users in these communities means these solutions aren't completely working — at least not for everyone. In our work, we see opportunities to optimize, network, and coordinate the players in the existing ecosystem, wringing the inefficiency out of the system and delivering a better result for the end beneficiary — the small business owner.



In this report, we take a look at the key challenges that underserved markets face, how technology plays a crucial role in correcting the disparity, and what banks stand to gain from mission-based and anti-discriminatory lending. →

How Did We Get Here?

There's a long history of banking discrimination in America. From color-coded maps of minority communities that informed loan decision making (called redlining) to lack of internet access for online banking, these markets have largely remained underserved because of policies and high bars put in place to keep them there.

Some of them still exist today.

Mainstream banking is driven by the "mortgage credit box:" the full landscape of loans available to borrowers. But getting inside the box requires fitting into the mold these banks say make it easier to serve customers effectively (and allows them to remain profitable). Those without a certain credit score, sufficient collateral, or U.S. citizenship are almost always excluded from these traditional loan offerings.

True, serving these markets has not traditionally been a profitable endeavor.
This is often because:

UNDERWRITING IS MORE DIFFICULT BECAUSE OF THE UNMET QUALIFICATIONS.

Banks have established a threshold of credit score, income, and net worth levels that deem some consumers more profitable than others. The less requirements achieved, the less confidence the bank has in recouping their investment.

THE COST OF CAPITAL IS TOO HIGH.

Unlike for-profit banks, mission-based lenders do not have billions of dollars in deposits at their disposal to reloan to underserved markets. Mission-based lending is typically grant-funded, which requires additional overhead to manage.

THE RISK OF DEFAULT IS TOO HIGH.

Due to unmet qualifications of applicants outside of the box, banks perceive a higher likelihood of default on the loan. Paired with a lower appetite for risk, lenders are unwilling to meet the needs of the underserved market. Yet, the higher risk can't and won't decrease until these markets are better served. This creates a cycle of perpetual underserved nature. Until there is a change in lenders' willingness to take a chance on borrowers in underserved markets, the problem will remain.

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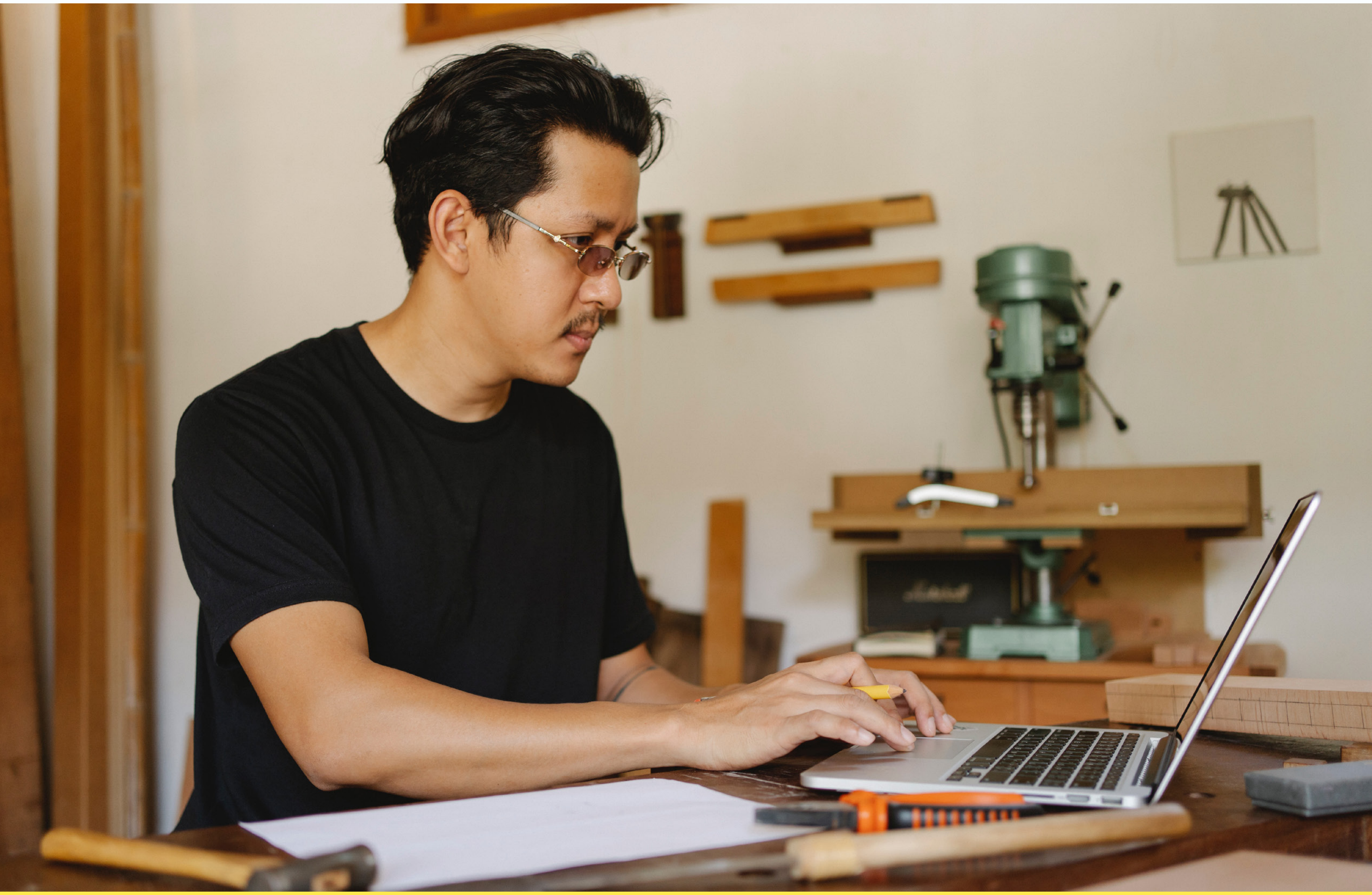
Technology to the Rescue

There is light at the end of the tunnel. The industry is beginning to see how technology can create opportunities to engage more actively in underserved markets. For example, data science and artificial intelligence (AI) are opening doors to new and more complex ways to assess creditworthiness well beyond the traditional credit score. Automation and APIs are creating new avenues to connect disparate systems that can reduce costs while increasing access to new outlets (like Venmo for payments, digital-only banks, etc.) that can be game changers for previously underserved markets.

WHAT ABOUT FINTECH?

In general, fintech leaders have not helped address market disparities, as they tend to focus on "simple" loans that are often met by those who fit in the box. Inherently, their value has been in increasing speed to capital versus access to capital. Because of this, fintech lenders who play in underserved markets tend to fall into "predatory lending," charging exorbitant interest rates to account for higher risk borrowers who don't meet their requirements.



Serving Others Serves Banks

Can banks benefit from lending to underserved markets? **Yes — in more ways than one.** The more people who participate in an economy, the stronger it becomes. Conversely, if underserved communities continue to exist, so do the inefficient systems that serve them in order to fill the gap.

A pure profit mindset will never successfully change the trajectory of underserved markets. Until there's a willingness to incorporate more goals beyond just making profit, the needle will fail to move. Mission-driven lenders are making strides by placing emphasis on other benefits besides profit alone, including:

- Deeper community outreach and engagement
- Increased economic development in underserved areas
- Greater job growth and retention
- Better training and borrower education, increasing the likelihood of business success and loan repayment

Under these goals, mission-driven lenders measure success through their impact on the community, not the shareholder.

Like other parts of society (from education to food security), when there are wide disparities in access to resources within a community or market, the industry cannot function effectively nor reach its potential to have a lasting impact. By continuing to ignore underserved markets, the lending industry loses the opportunity to build a more inclusive, accessible, and thriving economy. We believe that when institutions like mission-driven lenders have the right technology, they will not only drive more engagement with underserved communities, but increase mainstream participation in these markets, forging fundamental positive changes for the industry.

SPARK Champions Mission-Driven Lenders

SPARK is the cloud-based, mission-driven loan origination platform to lead banks and CDFIs alike into a new era of lending.

At SPARK, we believe in the power of mission-driven lending because we've seen its impact firsthand. We know the effect that increased access to capital can have on the lives of borrowers and their communities. And we believe it's worth sacrificing pure profit for — so much so that we've been championing mission-driven lending since our founding.

- WE UNDERSTAND THE NEEDS AND MOTIVES OF MISSION-DRIVEN LENDERS BECAUSE **WE WERE BORN FROM ONE** OURSELVES.

- WE WERE ESTABLISHED AS A **PUBLIC BENEFIT CORPORATION** TO ENSURE DECISIONS GO BEYOND PURE PROFIT MOTIVES.

- WE WERE BUILT TO **SUPPORT SBA LOAN PROGRAMS**, WHICH WERE CREATED SPECIFICALLY TO INCREASE ACCESS TO CAPITAL IN UNDERSERVED MARKETS.

- WE **ACTIVELY SUPPORT AND PROVIDE DISCOUNTS** TO MISSION-BASED LENDERS FOCUSED ON SERVING MINORITY, BIPOC, WOMEN AND VETERAN-OWNED BUSINESSES LOCATED IN UNDER RESOURCED COMMUNITIES.

It's our vision to streamline the connections between traditional lenders and mission-driven lenders through SPARK technology. In doing so, we can help traditional lenders better meet the needs of underserved markets by ensuring access to partners that support their growth into the mainstream. And we can provide ways for mission-based lenders to partner more effectively with those in the mainstream over time, bringing the needs of underserved markets to light for a more equitable lending system.

SPARK

Join the next generation of lending at lendwithspark.com.