

Give small businesses **control** of their financial data

Financial access in a post-COVID world



Plaid, a financial technology company, has partnered with Public Private Strategies, a small business advisory firm, to produce this brief highlighting opportunities for data and private sector innovation to support small businesses' futures.

Executive summary

Digitalization is increasingly critical for small businesses, particularly in light of the COVID-19 crisis. Yet many small businesses face challenges accessing their financial data. This is often because the data is stored with a financial services provider or a payroll company that does not offer data connectivity. When small businesses do not have this access to their financial data, innovation in the financial products and services designed to help them is hampered.

Digital products and services for small businesses have proliferated in recent decades. For small companies often reliant on founders to manage many or all aspects of their operations, digital services assist with financial accounting, tax withholdings, working capital and credit needs, inventory management, and more. Small businesses that adopt these digital tools report significant benefits in growth, profitability, and employee satisfaction.¹ But more than half of businesses are still in the early stages of adopting digital tools, and only one in ten claim to have them fully implemented.²

Financial data is essential to powering these digital tools. Small business owners should be able to access and control this data in order to meet their business needs. Accounting platforms need to pull in expense reports, credit card transactions, invoices, and other data to create an actionable picture of business finances. Innovations in extending credit to small businesses rely on alternative data to provide a real-time picture of a business' ability to manage credit.³ Such services are becoming even more critical in light of the COVID-19 crisis, as traditional underwriting may not adequately capture the financial state of a small business navigating unprecedented circumstances.⁴

Yet for many small businesses their ability to control their data remains out of reach. Fundamentally this is a technological challenge - while many banks and payroll providers have begun offering data connectivity, many still don't. But the industry has begun recently to establish greater connectivity,⁵ and policymakers are now signaling an increased desire for consumers and small businesses to control their data.⁶ These combined forces will encourage the type of innovation we've seen around consumers in financial technology, where thousands of fintech companies in North America serve consumers.⁷

Expanding small businesses' control of their financial data will boost demand for the financial technology sector to build more products and services that help the small business ecosystem thrive. In this brief, we examine the current state of small business data access, identify gaps and opportunities, and highlight ways that providers can take action to expand data access in order to help small businesses rebuild from the COVID-19 crisis stronger and more resilient to future shocks.

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¹ <https://www2.deloitte.com/us/en/pages/technology-media-and-telecommunications/articles/connected-small-businesses.html>

² https://ric.randstadusa.com/hubfs/PDFs/RUS_Workplace%202025%20white%20paper_2020.pdf

³ <https://finreglab.org/press-release-cash-flow-empirical-research>

⁴ Managing and monitoring credit risk after the COVID-19 pandemic - McKinsey

⁵ Plaid, Payroll Data: The Next Frontier for Open Finance

⁶ Consumer Financial Protection Bureau, Advanced Notice of Proposed Rulemaking on Consumer Access to Financial Records

⁷ <https://www.statista.com/statistics/893954/number-fintech-startups-by-region/>

Small businesses lack control of their data

Small businesses can use a range of services to manage their finances. They might hold cash in a business bank account, have an outstanding loan with an online lender, and pay their employees using a digital payroll service. These three service providers often have no business relationship with each other, and may even see each other as competitors. But to the small business, the data generated by the use of each of these tools is critical.

Small businesses often experience challenges when they try to access their financial data, perhaps to share it with a lender to apply for a loan based on their cashflow, or an accounting product to better manage their finances. Rather than being able to share their data with one seamless connection, they often have to manually download and upload documents, or even print files and carry them to their local bank. This is because in many cases, firms providing services to small business owners have not built secure data sharing capabilities. This stands in contrast to the consumer financial sector, where data access is the norm and an ecosystem of financial technology companies have come forward to build products that are powered by consumer-permissioned data.

WHAT WE LEARNED FROM THE PAYCHECK PROTECTION PROGRAM

The COVID-19 crisis highlighted the gaps that exist in small businesses' access to their financial data. The Paycheck Protection Program (PPP) provided an especially clear example.⁸ The PPP required that small businesses share information about their payroll with lenders in order to apply both for the initial Small Business Administration (SBA) loan, and ultimately for the forgiveness portion of the stimulus package. On the front end, this meant that small businesses needed to export data from their payroll providers, whether that was a third party provider or their business bank account, calculate the loan amount for which they were eligible, and pass on that data to their lender in a format that could be readily interpreted and reviewed. Such connectivity for payroll data was not readily available,

forcing businesses to spend considerable time and energy to manually download and upload forms and paperwork across payroll companies and lenders.

Plaid and several other technology companies recognized this gap and put to use our expertise in building data sharing integrations to establish connectivity across several payroll providers and SBA-backed lenders.⁹ Several thousand small businesses leveraged this connectivity in their loan application process. Research on the first round of PPP found that fintech providers expanded access to the program, and provided loans to historically underserved communities.¹⁰ These new fintech relationships bode well for the future of financial access in the small business community.

⁸ <https://www.nber.org/papers/w27659>

⁹ <https://www.cnbc.com/2020/04/06/plaid-gives-lenders-access-to-start-up-payroll-data-for-sba-loans.html>

¹⁰ Erel, I., & Liebersohn, J. (2020, August 10). Does fintech substitute for Banks? Evidence from the Paycheck protection program. Retrieved March 10, 2021, from <https://www.nber.org/papers/w27659>

Data helps small businesses thrive

Small businesses generate financial data as they go about their daily operations: managing cash flow, accessing and using credit, issuing invoices, receiving customer payments, and paying employees. Four examples highlight how financial technology providers build tools for small businesses that are powered by permissioned data: financial management, digital onboarding, employee benefits, and credit access.

Financial management

Bookkeeping and accounting are essential to a business' financial health. Digital tools emerged starting in the 1990s to streamline these processes, and over half of small businesses reported using a digital bookkeeping solution in 2018.¹¹ These tools are only as powerful as the information they take in, since their purpose is to provide a holistic and actionable picture of a businesses' financial standing. Small businesses that hold a range of accounts at different providers - a business checking account at a community bank, a line of credit with an online lender, and a payroll account with a small accounting provider - stand to benefit from increased connectivity across those services, which when aggregated can provide a more holistic picture of the business's finances.

Digital onboarding

Small businesses generally need to verify themselves when they sign up for financial products and services online. This encompasses both identity verification and Know Your Customer (KYC). These processes can be arduous, paper-heavy, and expensive for providers.¹² With control over their data, small businesses can pull in information on themselves from across their digital footprints to provide necessary validation before enrollment.¹³

Employee benefits

Small businesses that outsource payroll services tend also to rely on those payroll providers to connect their employees with certain benefits. While this is a time and cost-saver for employers, it can limit the types of benefits employees can access based upon their payroll provider's business relationships. Under an open finance ecosystem, control of data would extend to permissioned financial data, including data held at payroll providers like pre-tax income. By giving small businesses more access to their data, payroll providers can also grant small businesses' employees access to their own payroll data, which includes important information like income, retirement contributions, and benefits.

“All businesses, no matter the size, should be able to establish a business credit profile. The emergence of alternative data, like bank transaction data, is providing means to establish that business credit profile, which can open new opportunities for funding, partnerships, and growth.”

JOSEPH PASCARETTA,
*General Manager, Global Small
Business at Dun & Bradstreet*

¹¹ <https://clutch.co/accounting/resources/why-small-businesses-lack-accounting-resources-2018>

¹² <https://www.temenos.com/us/news/2017/12/18/how-banks-can-improve-business-customer-onboarding/>

¹³ <https://www.pymnts.com/news/b2b-payments/2019/how-smb-digital-banking-demands-change-the-kyc-challenge/>

Credit access

Accessing credit is a challenge for many small businesses - half of small businesses say that the process of obtaining financing is difficult or takes too long, and many say they need to re-apply from scratch each time they're rejected for a loan.¹⁴ Often these problems are structural in the financial services industry: for example, the costs to underwrite small business loans manually can be greater than the income from the loan.¹⁵ As a result, traditional financial institutions sometimes rely on personal credit scores as a shortcut to underwrite business loans: 86% of businesses relied on their owners' credit scores to obtain credit.¹⁶ This is a problem in part because business owners have different debt profiles, and underwriting business loans based on personal credit scores is not always reflective of the businesses' profitability or likelihood to repay.

Recent innovations in credit products have broadened and deepened capital access by small businesses.¹⁷ Prior to COVID, a new set of lenders offering strong user experience and speed of decisions emerged, and incumbent financial institutions also increasingly looked to innovate upon their products with data. Small business adoption of online lending grew steadily in the 2010s, from 19 percent in 2016, to 24 percent in 2017, to 32 percent in 2018.¹⁸

In addition to simplified applications and faster decisioning processes, some online services also innovated around the use of alternative data to power underwriting. New research highlights the potential for alternative data to expand credit access and serve underserved portions of the small business marketplace.¹⁹ Financial institutions increasingly look to adopt similar data-driven technologies, either by building in-house tools, or by white-labeling fintech products: 81% of regional and community banks reported working with fintech firms as of 2017.²⁰

¹⁴ <https://www.fedsmallbusiness.org/survey/2020/report-on-employer-firms>

¹⁵ <https://www.fmsinc.org/FMS/Resources/Perspectives/2017/Digital-Lending-Technology>

¹⁶ <https://www.smefinanceforum.org/sites/default/files/blogs/SBCS-Employer-Firms-Report.pdf>

¹⁷ https://home.treasury.gov/system/files/231/Opportunities_and_Challenges_in_Online_Marketplace_Lending_white_paper.pdf

¹⁸ Update on Online Lender Applicants from the Small Business Credit Survey, Federal Reserve

¹⁹ <https://finreglab.org/press-release-cash-flow-empirical-research>

²⁰ <https://independentbanker.org/2017/02/make-online-lender-partnerships-work-for-you/>

Paths Forward

Small businesses showed remarkable resilience in the face of the COVID-19 crisis, opening outdoor dining spaces and shifting paper practices to digital to keep their customers safe. Where dining rooms will one day move back inside, the shift to digital is here to stay.

To ensure small businesses reap the benefits of the data they generate, it's incumbent upon the financial services ecosystem to build data-driven tools and technologies that support these businesses. We're already seeing both new entrants and established incumbents incorporate consumer-permissioned data into their systems. The future for small businesses is bright when they can control their financial information and share it with the parties that offer them the most supportive services.

Plaid is a fintech company which builds the technical API infrastructure that connects individuals, financial institutions, and fintech developers – giving consumers power over their own financial data.

Launched in 2013 and headquartered in San Francisco, a quarter of US bank accounts are now linked by Plaid to a range of fintech apps that can help consumers carry out essential financial tasks such as save for retirement, make a budget or transfer money.