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Browsing to Borrow: “Mom & Pop” Small Business Perspectives on Online Lenders

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Browsing to Borrow: "Mom & Pop" Small Business Perspectives on Online Lenders

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Executive Summary

This report discusses findings of a study conducted by the Federal Reserve Board and the Federal Reserve Bank of Cleveland to gauge small business owners' perceptions of online lenders and their understanding and interpretation of information online lenders use to describe their credit products. The Federal Reserve has an ongoing interest in small businesses and their access to the credit they need to succeed and grow. As the small business credit market evolves, prompting discussion about borrower protections, the perspectives of small business owners are an important consideration.

Nonbank, online lenders are becoming more mainstream alternative providers of financing to small businesses. These nonbank lenders offer small-dollar credit products including cash advances, lines of credit, and various types of loans, typically under $100,000. Borrowers can apply in minutes and receive funds in days or even hours, expedience made possible with data-driven technologies. The industry's growing reach has the potential to expand access to credit for small firms, but also raises concerns about product costs and features, and the manner in which these are disclosed to prospective borrowers.

The study used online focus groups, a method of gathering participants' perceptions through online discussions. The online format allowed for the collection of detailed responses, as well as insights into the complex decision processes of potential borrowers. As part of the study, participants evaluated sample loan products, presented in a format mimicking the language used and content provided by online lenders. They also visited the websites of actual online lenders and shared their impressions.

The participants recruited for the study operate small businesses ("Mom & Pops") with at least one but no more than 20 employees, and less than $2 million in annual revenues, from a wide range of industries, located across the United States. Additionally, all participants had sought credit for their businesses in the prior 12 months. Two separate focus groups were conducted with a total of 42 small business participants. Given the relatively small sample size, this study was not designed to derive conclusions about a representative sample of borrowers; rather, the intent was to surface key issues that could guide future research, data collection, and policy analysis.

Key Findings of the Study

- **Participants already are familiar with online lending.** Nearly all of the study's participants were at least somewhat familiar with online lending for small businesses, and most were familiar with at least one or two lenders on a list of the more prominent firms. While some had positive views of online lenders, more had negative initial impressions of the industry. These negative impressions appear to be based, in part, on sales calls from lenders or brokers and frequent email and mail solicitations.

- **Participants preferred websites with detailed product information.** When browsing online lender websites, participants reacted most favorably to sites that they thought offered the most detailed information on products, costs, and borrower qualifications. Participants were most skeptical of sites that provided limited information, especially those that withheld product details until visitors entered their business and contact information.
- **Participants found sample online products confusing.** When presented with three sample online products, participants found the descriptions difficult to understand or lacking detail about costs and features. However, participants responded positively to a sample disclosure table clearly displaying interest rate, payment amount, fees, and other product terms. Importantly, nearly all said this level of detail, even if estimated or presented as a range, should be available to potential borrowers before they apply and turn their businesses’ financial data over to the lenders.

Participants were nearly unanimous in their call for clear disclosure of product costs and terms, and the findings suggest that improved disclosures could benefit both lenders and borrowers. Online lenders could engender trust and grow their customer base. Borrowers could evaluate competing products based, not only on the costs and features offered, but also the degree to which the lender is forthright about product details. Therefore, future policy discussions should focus on how best to inform prospective borrowers so that they can choose the credit products most suitable to help their small businesses thrive and grow.

Overview of Small Business Online Lending

Nonbank Small Business Online Credit

Online lenders are part of the emerging fintech industry that is providing a variety of data-driven financial products and services. Nonbank, online lenders are becoming more mainstream alternative providers of financing to small businesses. According to the annual Small Business Credit Survey (SBCS) conducted by the 12 Federal Reserve Banks, awareness of online lenders has grown, and business owners increasingly turn to these companies for funding. In 2016, some one-in-five credit applicants (21 percent) sought financing at an online lender, rising to nearly one-in-four (24 percent) in 2017.[1]

While no comprehensive and independent data source currently exists, consensus among industry analysts is that the volume of online lending to small businesses is relatively small—perhaps $12 billion last year. However, analysts project that online lenders will continue to grow, expanding their market share of small-dollar loans.[2] More importantly, while they likely will represent a small share of total small business credit for the foreseeable future, online lenders already have had outsized effects on the credit landscape, especially in the market for small-dollar loans (under $100,000). The simplified application processes and quick turnaround on approval and funding provided by online lenders are raising expectations for fast and convenient service among borrowers and are increasing competitive pressures on traditional banks.[3]

The industry is comprised of lenders that utilize three types of business models: (1) balance sheet lenders that raise capital and lend directly (for example, OnDeck, Kabbage, RapidAdvance); (2) marketplace platforms that connect small businesses with lenders or investors (for example, Lending Club, Funding Circle); and (3) payment processing firms and retailers that offer working capital to their merchants (for example, Square, Paypal, Amazon). What these online lenders have in common is that borrowers apply, are processed, underwritten, and serviced online. Borrowers can receive funds in a couple of days or even hours.

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1 "2017 Small Business Credit Survey: Report on Employer Firms," Fed Small Business, www.fedsmallbusiness.org/survey/2018/report-on-employer-firms.

2 The size of the industry and estimates vary significantly depending on which products and lenders are included. S&P Global Market Intelligence estimates that the five prominent lenders (OnDeck, Kabbage, Credibly, Square Capital, and PayPal Working Capital) will grow at a compound annual growth rate of 21.5 percent during the five-year period ending in December 2021 (see https://pages.marketintelligence.spglobal.com/rs/565-BDO-100/images/DigitalLending_Public_Web.pdf). PayNet, Inc., which provides small business credit information to lenders, forecasts that online lending will grow to become "a substantial and established provider" of credit for small businesses over the next 5 years, especially for loans under $250K. See William Phelan, "Financing through Fintech: Online Lending's Role in Improving Small Business Capital Access" (testimony before the United States House of Representatives, House Committee on Small Business, October 26, 2017), https://smallbusiness.house.gov/uploadedfiles/10-26-17_phelan_testimony.pdf.

3 "Record of Meeting," Community Depository Institutions Advisory Council and the Board of Governors, November 18, 2016, page 1, www.federalreserve.gov/aboutthefed/CDIAC-meeting-20161118.pdf. See also, "Record of Meeting," Federal Advisory Council and Board of Governors, May 12, 2017, pages 6 and 14, www.federalreserve.gov/aboutthefed/files/fac-20170512.pdf.

The credit products offered by online alternative lenders are known by a variety of names, including merchant cash advances (MCAs), working capital loans, marketplace loans, funding programs, capital advances, or simply, business funding. While the product terms vary significantly across funding types and different lenders, products generally fall into one of two categories:

- **Cash advances:** Advances allow businesses to convert future credit card or payment account receivables into capital. While the distinction may be unclear to the borrower, these products differ from term loans in that advances entail the sale of a set percentage of the borrower’s future receivables for a specified dollar amount. For example, $50,000 in capital is provided in exchange for $65,000 in future receipts, repaid with daily swipes of 10 percent of daily credit card sales. Depending on the speed of repayment, equivalent annual percentage rates (APRs) can exceed 80 percent or even rise to triple digits.
- **Loans and lines of credit:** Loans with fixed terms, usually three to five years, feature set payment schedules, and interest rates in the range of a typical credit card (10 to 30 percent). Shorter duration loans and credit lines share many of the features of cash advances in that they require daily or weekly payments, have higher interest rates, and may lack a fixed term. Equivalent APRs range from 25 percent to 80 percent, and funds are often repaid in six to 18 months.

Note that for purposes of this study, lenders utilizing any of the three business models and offering these types of products are referred to as “online lenders.” Though some online lenders specialize in specific types of financial products that are not structured as loans—such as merchant cash advances or credit lines—it is clear that small business owners view these companies collectively as lenders. To this point, when asked about initial impressions of and interactions with online lenders, focus group participants offered the names of numerous companies, including those that offer MCAs and other specialized products.

Online lenders use both traditional metrics (such as business or personal credit scores) and other business metrics (such as credit card sales and shipping data) in proprietary algorithms to make credit decisions. Low credit scores or minimal credit history generally are not barriers to obtaining funding, as long as the business can demonstrate revenues are sufficient to be tapped by the lender for repayment. Many lenders obtain online access to a prospective borrower’s accounting software, merchant accounts, and payroll data in real time. Moreover, they can monitor these data continuously throughout the life of the loan.

Online lenders have touted their ability to reach underserved borrowers, and data suggest they may be increasing credit access for certain small businesses. For example, an analysis of SBCS data showed that applicants to online lenders are more likely to be smaller (revenues under $1 million), newer (in business less than five years), and minority-owned firms as compared to businesses applying to traditional lenders only.[4] A separate analysis found that online borrowers

[4] Ann Marie Wiersch, Barbara J. Lipman, and Brett Barkley, “Click, Submit: New Insights on Online Lender Applicants from the Small Business Credit Survey,” (Federal Reserve Bank of Cleveland special report, October 2016), www.clevelandfed.org/newsroom-and-events/publications/special-reports/sr-20161012-click-submit.aspx.

have characteristics similar to the businesses that were denied credit from banks, suggesting that online lenders provide credit to small businesses that likely would be denied financing otherwise.[5] For such borrowers, online credit, albeit more expensive, may reflect their relative risk and provide a much-needed capital source. Such an expansion of credit access may be viewed as a positive development as long as the credit products are suitable, the businesses can handle the debt, and the owners understand the costs and terms of credit.

Implications for Small Business Potential Borrowers

While recognizing the promise of online lending, small business advocates have raised a number of concerns from the perspective of borrowers. For one, the 2017 SBCS reveals far-lower satisfaction rates for customers of online lenders, than those of more traditional financial institutions—even when approved. More than half (52 percent) of online lender applicants expressed dissatisfaction with high interest rates, and one-third cited unfavorable repayment terms. That a large share of applicants flag these issues raises the troubling prospect that many borrowers may not fully understand the cost of credit products they are considering.

In general, credit extended for a business or commercial purpose is not covered by the federal Truth in Lending Act (TILA), which requires lenders to clearly disclose lending terms and costs to borrowers.[6] In practice, online lenders use a wide range of descriptive terms and phrases when presenting product information. For example, products may express the cost of money in terms of “interest,” “simple annual interest,” “cents on the dollar,” “fee,” “factor rate,” or as part of a “lump sum repayment.” In addition, products may entail repayment through a variety of methods, including traditional installment payments via direct monthly, weekly, or daily draws by automated clearing house (ACH), or direct draws from merchant accounts or credit card receipts. The lack of consistency across products can make it difficult for business owners to estimate interest rates and costs, and to compare products.[7]

Questions, too, have been raised about some features of online products, such as the automatic diversion of sales receipts for repayment. Some observers have argued that the owner’s loss of control over cash flow puts some small businesses at risk.[8] It is also the case that online lenders

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[5] Mark E. Schweitzer and Brett Barkley, “Is ‘Fintech’ Good for Small Business Borrowers? Impacts on Firm Growth and Customer Satisfaction,” Working Paper 17-01 (Federal Reserve Bank of Cleveland, February 2017), www.clevelandfed.org/newsroom-and-events/publications/working-papers/2017-working-papers/wp-1701-is-fintech-good-for-small-business-borrowers.

[6] TILA is implemented through Regulation Z, which does impose certain substantive protections applicable to credit card holders, including where the card is issued for business use. Online alternative small business lenders, however, do not typically issue credit cards.

[7] Barbara J. Lipman and Ann Marie Wiersch, “Alternative Lending through the Eyes of ‘Mom & Pop’ Small-Business Owners: Findings from Online Focus Groups,” (Board of Governors and Federal Reserve Bank of Cleveland, August 25, 2015), www.clevelandfed.org/en/newsroom-and-events/publications/special-reports/sr-20150825-alternative-lending-through-the-eyes-of-mom-and-pop-small-business-owners.aspx.

[8] Tim St. Louis, Eric Weaver, Gwendy Brown, Caitlin McShane, “Unaffordable and Unsustainable: The New Business Lending,” (Opportunity Fund, May 2016), http://www.opportunityfund.org/assets/docs/Unaffordable%20and%20Unsustainable-The%20New%20Business%20Lending%20on%20Main%20Street_Opportunity%20Fund%20Research%20Report_May%202016.pdf.

have invested heavily in aggressive marketing campaigns. Some rely on brokers who may steer new small business customers to online products that pay the highest commissions but are not necessarily best for the businesses. Also, some merchant cash advance companies engage in “stacking” (providing a cash advance to a business that already has one) to augment the inflow of borrowers. Small business advocates report some firms that take on added debt loads may not fully recognize the costs involved, and could potentially jeopardize the financial health of their businesses.[9]

[9] St. Louis and others, *Unaffordable and Unsustainable*, pages 6-7.

About the Study

The Federal Reserve's interest in online lending stems from several concerns, prompting this study. For one, the Federal Reserve has an interest in ensuring small businesses have the credit they need to operate and thrive. Small businesses are important economic engines in their communities and contribute significantly to national economic growth and employment. For another, the personal and business finances for many small business owners and their families are intertwined.[10] Finally, the smallest businesses are of particular concern as they may lack the financing options of larger businesses and the in-house financial expertise to guide their credit decisions.

The financial technology and algorithms used by online lenders may enable credit to be underwritten and delivered with greater efficiency, convenience, and lower processing costs—a development that certainly can benefit small businesses. At the same time, concerns about small business borrower protections persist. As debate in policy circles intensifies with respect to the need for oversight of fintech lenders, the perspectives of small business owners are an important consideration and are of interest to the Federal Reserve.

The Online Focus Groups

This study aims to gauge small business owners' perceptions of online lenders and their understanding and interpretation of information online lenders use to describe their credit products. It expands on a 2015 study, *Alternative Lending through the Eyes of "Mom & Pop" Small-Business Owners: Findings from Online Focus Groups*.[11] In the earlier study, most participants were unfamiliar with online lenders, and many expressed concerns about privacy and security of their business information were they to use these lenders. As part of the study, participants were asked to compare three mock credit products on cost and other features. Although most of the participants initially said it was "easy" to compare products, many of these same participants said they were "not sure" or answered incorrectly when asked specific questions about product costs. Virtually all said they would like to see clearly stated features and costs to make it easier to compare product offerings.

The current study revisits the topic, as the industry has evolved and online lenders have become a more common source of credit over the last three years. Among other updates, this study recruited small business owners that had sought credit for their businesses in the prior 12 months. This ensured that their responses were more grounded in actual experience rather than in a future, unspecified need for credit. Also, while participants were again asked to compare examples of credit products, this study attempted to more closely replicate a credit shopping experience. The products were presented mimicking the language, content, and formatting used by online lenders, making product comparisons more realistic.

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[10] The Federal Reserve's SBCS has found that a majority of small business owners rely on personal credit or collateral to secure financing for their businesses (www.fedsmallbusiness.org/).

[11] Lipman and Wiersch, *Alternative Lending*.

The previous study demonstrated that online focus groups are an especially effective way to convene geographically dispersed owners busy running their small businesses—a notoriously hard-to-reach demographic.[12] Therefore, the online approach was used again for this study. It is important to note that focus groups are designed to gather insights, not to measure incidence. Results should not be interpreted numerically or otherwise generalized to the wider population of small businesses. For an overview of the focus group methodology, see box 1. Appendixes A, B, and C provide information about participant selection and focus group topics.

Box 1. Overview of the Small-Business Online Focus Groups

Participants (owner or financial decision maker):	• Small businesses with 1 to 20 employees (excluding the owners) and at least $200,000 but less than $2 million in revenues. • In business at least 2 years (as required by some online lenders). • Business sought credit within the prior 12 months.
Process:	• Two separate focus groups were conducted in November 2017, with a total of 42 participants. • Both were professionally moderated by Harris Insights & Analytics.* • The online bulletin boards ran day and night; participants responded at their convenience. • New questions were posted daily for three days. The boards remained open a fourth day for closing comments and follow-up questions. Participants typically spent 30–45 minutes each day answering questions.
Topics:	• Day 1 – financial concerns and recent experiences seeking credit; • Day 2 – impressions of online lenders and virtual “shopping” exercise; and • Day 3 – product evaluations and participant recommendations.

* In addition, Harris Insights & Analytics provided an independent observation report on the focus groups, which informed the authors’ own analysis as they identified the key findings.

[12] An online focus group also is known as an asynchronous (or “bulletin board”) focus group because it does not occur in real time. This method is increasingly used by banks and other financial services firms for conducting consumer research.

Themes and Observations

This section summarizes the discussion among the focus group participants and presents their views in their own words.[13] It tracks the flow of topics covered during the focus group, as described in appendix C.

Cash Flow and Other Top Business Concerns

Asked about the toughest part of running their businesses, most participants cited the challenges of managing their cash flow. Some specifically noted that their ability to make payroll and their customers paying in a timely manner are worries that keep them awake at night. In addition to these concerns, other top challenges included finding and retaining staff and managing those employees, generating new business while continuing to meet client expectations and staying competitive, and dealing with the complexity of taxes and the regulatory environment (cited by some who desired to provide health care benefits). Participants also mentioned the demanding hours required of an owner; keeping pace with technology; finding mentors; and the general pressure, responsibility, and uncertainty of running a business.

Banks Are Still the Go-To Credit Source

Participants were asked to rank in order of importance a list of factors they might consider in making decisions about where to go for business credit. Overall, participants ranked “best price” first, followed by “a lender I know and trust.” The factors “likelihood application will be approved” and “quick/easy application process” were also important to participants.

With respect to where they would turn for funding, participants overwhelmingly prefer traditional financial institutions to online lenders, personal connections, or using their credit cards. As one participant put it, “I would most likely try a traditional bank first. I’m looking for credibility and reliance. Then I’d look online just to see my options.” Among those most likely to consider an online lender, a typical response was, “I feel these types of lenders are more flexible with their approval process.”

Borrowing Experiences Are Mixed

Participants that recently applied for financing at banks were generally pleased with the terms of their products and their interest rates. They did, however, express concerns about the stringent borrower qualifications, time-consuming paperwork, and long wait until approval and funding. That said, several participants that applied at their current bank remarked that their good relationships with their bankers helped to make the process easier.

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[13] Verbatim quotes are presented as they were typed into the online focus group bulletin boards by the participants themselves, with only minimal editing for space and clarity, or to remove names of specific lenders.

Experiences with banks were generally positive.

“Sticking with a proven lender saves time and trouble… Everything was transparent.”

— Traditional-bank applicant and owner of a writing services business in Oregon

“The process was very clear but time consuming. The bank needs a lot of information for the application, which is not always easily accessible.”

— Traditional-bank applicant and owner of an art gallery in Iowa

Some participants were not successful in obtaining credit from their banks, including several who said they were customers in good standing. They reported being frustrated with banks’ requirements (like personal guarantees) and said they believed that banks were “unwilling to take a risk” on small businesses.

Bank customers who were denied financing expressed frustration.

“I learned - once again - that despite many years with our bank, including taking out and paying back several previous loans, that the bank is really only interested in our current financial position.”

— Traditional-bank applicant and video production business owner in New York

“I … started the process by meeting with a local bank that I was doing all my banking with. After turning in P&L’s, reports and statements, the bank would not give me the loan… I then met with a smaller community bank and [was approved]. I switched all of my accounts after this.”

— Traditional-bank applicant and party rental business owner in North Carolina

Participants that recently applied at online lenders remarked favorably on the application process, convenience, and speed of funding. The concerns they expressed were related to unforeseen fees or costs and frequent or high payments.

Online lender applicants were positive about the process, but less so about costs.

“The process was a whole lot less complicated than when I bought my house.”

—Online lender applicant and co-owner of a restaurant in Arizona

“I wish I had been more diligent to look at the fine print on the loan. The fee was astronomical.”

— Online lender applicant and owner of a skin care spa in Utah

Initial Perceptions of Online Lenders Tend to be Negative

About one-quarter of the participants had submitted a full or partial application to an online lender. All participants, regardless of whether they had direct experience with online lenders, were asked, “What comes to mind when you hear the phrase ‘online lender’?”

Some participants shared positive perceptions, and others relayed neutral or uncertain views. A majority of the participants, however, conveyed negative impressions.

“competitive rates because they have less overhead”

“more willing to deal with business loans”

“easy process”

“faster loan approval turnaround”

“easy, quick and painless”

“higher interest rate”

“scam, identity theft”

“barrage of calls and snail mail”

“loan shark”

“business payday loans”

“red flags”

“not trustworthy”

“fly by night”

Participants were asked whether they thought their personal records, including financial information, would be as secure with an online lender as they would with a traditional bank. While some expressed concerns about the security of information with an online lender, most participants appeared to be resigned to what they perceived as vulnerabilities in both online and traditional financial institutions. Some participants suggested that the type of financial entity was less important to data security than the people in charge of the data. Several cited recent high-profile data breaches, and one participant noted, “even credit bureaus are hacked.”

Bothersome Solicitations through Ads, Calls, and Offers

All but two participants said they were at least vaguely familiar with one or more online lenders when shown a list of 15 of the most prominent companies. Some said they recognized the names of lenders that offer other services such as payment processing. Several recalled television advertising. Many said they recognized names through solicitations. In fact, more than three quarters of the participants reported receiving some type of contact from online lenders, either in the form of email, mail, phone calls, or offers.[14] Most participants expressed strong, unfavorable reactions to the solicitations they have received. They used words like, “annoying,” “junk mail,” “spam,” “deceptive,” and “a scam” to describe email and mail contacts. These communications appear to have been a factor in some participants’ top-of-mind negative perceptions of online lenders.

Participants also used words like “not credible,” “ridiculous,” “unsolicited,” “irresponsible,” and “shady” to describe pre-approved financing offers from both online lenders and credit card issuers. Interestingly, several participants noted that they saved mailers from lenders, filing them away “just in case” they ran into cash flow issues or needed a new funding source.

Importantly, since the study included a number of small business owners who had previously applied for credit at one or more online lenders, many of these participants (and also some who had searched, but not actually applied) found themselves on the call lists of lenders and brokers. They described frequent bothersome—and at times aggressive—calls from brokers selling credit products.

[14] Note, this depiction of market penetration is provided for background on the experiences of the study’s 42 participants. Like other numerical indicators provided throughout the report, these figures should not be viewed as representative of the experiences of a broader population of small businesses. Furthermore, the study includes only business owners who recently searched for credit, increasing the likelihood that they would be familiar with a range of lenders.

Participants often receive calls, email, and mailers from online lenders. While some reported they "know of" certain lenders because of mail and email promotions, they strongly dislike sales calls.

"I get these calls and emails almost every day. The worst part is they almost never take 'no' for an answer."

— Owner of a vehicle equipment wholesale business in Missouri

"I must say … how angry these folks make me taking up my limited valuable time with sales people who cannot take a nice polite 'no' for an answer."

— Owner of a retail business in North Carolina

"I get calls twice a week and emails all the time. You just want to shut it off and not be bothered by it."

— Owner of a machine shop in Wisconsin

"I just feel violated because I never applied for any loans. It's a scary feeling wondering how these people get your information."

— Owner of a medical transport business in Louisiana

"I received 20+ calls a week after I secured a loan with [an online lender]."

— Co-owner of a parking lot maintenance business in Arkansas

Virtual Shopping Experiences

Participants were asked to visit a few online lender websites and browse as if they were shopping for a $50,000 loan, keeping in mind the pieces of information they would be looking for if they were actually researching financing alternatives for their businesses.

- The *most common* details participants reported they looked for:
  - application process and information required by lender for the application
  - approval requirements/qualifications
  - interest rates, fees, and other charges
  - repayment terms (frequency, length of term, method of repayment)
  - maximum available loan amounts
  - time to approve application and speed of funding

- Other details some participants looked for:
  - background information on the lender
  - customer reviews
  - share of applications that are approved (approval rate)
  - cost savings for early repayment

Overall, the websites that provided the most information were most appealing to participants. Numerous participants noted that even though a borrower's actual interest rate may vary based on credit history and qualifications, they wanted at least some information upon which to compare options and to make decisions on whether to apply. Participants reacted positively to websites that provided details on rates or costs, as well as financing examples and charts comparing credit products.

While browsing online lender websites, some participants found things they liked.

"[Lender gave] simple upfront information with no worry of hidden fees, charges, etc."
— Owner of commercial print shop in Oklahoma

"The websites were well designed and the information was pretty easy to find."
— Owner of a management consulting firm in Maryland

"They sure make it sound and look easy."
— Co-owner of a home construction business in Kentucky

"[Lender] offered a lot of information up front like term loans, lines of credit, interest rates, loan qualifications and restrictions. They offer a lot more information and this is something I like to see."
— Co-owner of a parking lot maintenance business in Arkansas

"All of the information was given clearly and I liked their comparison chart."
— Owner of a courier business in New York

Conversely, participants were put off by websites that provided little or no information without entering their contact information. Some noted that in order to access the details that were important to them, they would have to enter information about their businesses. On these sites, many found it challenging to find the details they had been seeking on product terms, interest rates, overall cost of the credit, and repayment arrangements. Several perceived that lenders were attempting to “hide” or “conceal” true costs by excluding basic information about their products from their sites or by using terminology with which they were less familiar (for example, “simple interest” or “factor rate” versus APR).

Some participants relayed concerns about what they found (or didn’t find) while visiting online lender websites.

“I hoped to see rates, terms and what I qualified for. [The site] wouldn’t provide any information without an email or contact info.”
— Co-owner of an architecture firm in Illinois

“I couldn’t get info unless I signed in. I wanted to know how much interest, and if I paid back quickly, was there lower interest.”
— Owner of an event staffing agency in New York

“None of the companies I looked at gave solid information. They were all vague statements about how low their rates are, but there were no published rates, loan amounts and credit score information to compare.”
— Owner of a healthcare services business in Illinois

“All these sites are a lot of clicking around and not getting very far without providing information that I’m not ready to provide. I don’t want to be solicited for the rest of my life just because I was looking for some information.”
— Owner of a stone fabrication company in Illinois

“I was wondering if my IP address was being tracked because I was getting solicitations through my email while researching.”
— Co-owner of an executive search firm in Massachusetts

Some participants were surprised by the number and variety of online lenders. Moreover, the attitudes of a number of participants who initially stated they would not consider an online lender shifted to positive after visiting some of the websites. For example, one participant stated he would consider one of the online lenders next time he is seeking a line of credit. Another participant had strongly negative top-of-mind perceptions of online lenders, stating, "My first thoughts are: scam, identity theft, sucker, victim." After visiting seven of the online lender sites and being particularly impressed with two, she said she "may look into [some] this week."

Product Evaluation and Comparisons: Confusion Prevails

Following the virtual shopping exercise, participants were shown three sample online credit products for $50,000 and asked a series of questions to gauge their reaction to the products and the information provided. The product examples mimic the language, content, and formatting found on actual lender websites; however, no product or company names were used in the examples. The three sample products were as follows:

- **Product A** is a fixed-fee business loan repaid with a percentage of receipts from each sale. The borrower chooses the percentage and the fee is set accordingly.
- **Product B** is a short-term (one year) loan with weekly payments and a fixed interest rate.
- **Product C** is a merchant cash advance repaid with a percentage of each credit card transaction. A fixed factor rate and repayment amount are provided.

Product A

"Our loans have a single, fixed fee that you'll know before you sign up. There's no periodic interest, no hidden fees, and no late fees."

Sample loan:
Business's annual sales: $500,000
Loan amount: $50,000

Repayment percentage options*	One-time fixed fee**	Total to be repaid
30%	$2,300	$52,300
20%	$3,500	$53,500
10%	$7,700	$57,700

* Repayment percentage is the percent of each sale that is deducted to repay the loan. Choosing a higher repayment percentage lowers your fee. Choosing a lower repayment percentage results in a higher fee, but more flexibility for your business since you'll get to keep a larger percentage of your sales.

** Your actual fee is based on your business's sales history, your loan amount, and the repayment percentage you choose.

Product B

“Apply online in just minutes, and receive funding as fast as one day to grow and invest in your business. Rates as low as 9%.”

Sample loan:

Loan amount: $50,000
Repayment period: 12 months
Payment frequency: Weekly
Simple interest*: 9%
Interest cost: $4,500

Total payback amount: $54,500

* Simple interest calculates the total amount of interest you pay as a percentage of your loan amount. It is not an annualized rate. This rate excludes any fees, including a one-time origination fee of 3.0%.

Product C

“Our cash advance product offers flexible payments and no hidden costs.”

Sample product:

Business’s annual sales: $500,000 (about $2,000 per day, on average, Monday–Friday)
Merchant cash advance amount: $50,000
Cost: 1.2 / factor
Repayment amount*: $60,000

* We either take a small percentage from your daily credit card sales or a daily ACH payment from your bank.

Rather than fixed payments like traditional business loans, the repayment for a merchant cash advance is totally flexible and is structured to fluctuate with the cash flow of the business. There is no set payback period with merchant cash advances, because the payments are aligned with the income of the business.

Our merchant cash advances don’t use interest rates, but instead a fixed cost or “factor rate” that does not change throughout the duration of the MCA.

As for preferences among the products, participants tended to evaluate the options in terms of which made the most sense for their businesses. Not surprisingly, participants with business models that rely on invoice payments rather than credit card sales found Products A and C (with repayments based on daily sales) to be less appealing and somewhat less intuitive. Product B generally was preferred by these businesses likely because it most closely resembles a standard term loan. In general, participants found those products that were not applicable to their business model to be more confusing, and it’s likely that business owners would filter out these products during an actual credit search.

That said, the goal was to ascertain participants’ understanding of real products. Note that in the 2015 focus group study, participants were provided with a comparison chart summarizing the hypothetical features and costs in a consistent way for three credit products. In this study, inconsistencies across the product descriptions largely reflect what potential borrowers actually encounter when searching the online marketplace for credit. Several useful findings emerged from this exercise:

- **Whether or not the products were applicable to their businesses, participants found it challenging to identify interest rates or estimate costs on any of the three products.** When asked to estimate the interest rate on the products, many participants said they did not know or declined to guess. Those that did provide a figure were far more likely to underestimate than overestimate the rate. See, for instance, the box below showing “best guesses” of the interest rate for Product C. In addition, participants had difficulty comparing the costs of the products to other offline alternatives. For example, when asked whether Product B was more or less expensive than taking an advance on a credit card with a 21.9 percent rate, the majority of participants guessed it was less expensive (although it is, in fact, more costly at 23.4 percent).

What is your “best guess” of the interest rate on Product C if repaid in one year?

“20%”	“53%”	“27%”
“10%”	“18–20%”	“very high”
“12–21%”	“24%”	“I have no idea”

Note: The interest owed on Product C is 20 percent of the principal value. While the product description does not provide a percentage of receipts used for repayment, assuming steady monthly sales and consistent daily payments, the effective interest rate is on the order of 38 percent, and higher if funds are repaid sooner than one year.

- **Most participants found aspects of the product descriptions confusing or lacking sufficient detail.** Others only became aware of missing information after they were asked to identify and compare costs. These participants had initially characterized the products as “straightforward” or “cut-and-dry,” but, when probed further, reported difficulty estimating costs without more clarification.

- **Participants were confused by terminology used to describe all three products**. For Product A, “repayment percentage options” was a confusing term for some participants who thought this was an interest rate, rather than a share of sales. For Product B, participants most commonly conflated “simple interest” with the APR. In addition, the phrasing of the statement “this rate *excludes* any fees, *including* a one-time origination fee of 3%” (emphasis added) perplexed some participants. For Product C, the term “factor rate” was the main source of confusion for a majority of participants who stated they had not heard it before.

- **Participants strongly disliked that information they considered important appeared in fine print or footnotes.** For example, for Product B, participants were presented with fine print, stating that “The typical simple interest rate charged is 24%.” This triggered annoyance among virtually all the participants, including those who initially found the product attractive. Most of these participants noted they would no longer consider this product, some for reasons of cost (“way too high” and “a deal killer”), and some because they felt the presentation of this information was “misleading” or “terribly deceptive.” Several others were less deterred and thought the additional information was useful, but “should have been presented upfront.” Participants also were asked whether they had noticed fine print when they had visited websites in the virtual shopping exercise. All but a few reported they had not noticed fine print, with several commenting they would now know to look for it.

- **Participants tended to make (sometimes mistaken) assumptions about the products based on past experiences with traditional bank loans.** For example, some participants assumed their borrowing costs would decline if the loan were paid off quickly even when, as was the case in Products A and C, that repayment was presented as a total amount owed rather than an interest rate. Asked about the impact of faster sales growth on total repayment and interest costs on these two products, a number of participants assumed that, as with conventional loan products, they would incur some savings by repaying early. Others were uncertain, especially about the impact on the interest rate they would be paying. (In fact, total repayment amounts on these two products would be unchanged, there would be no savings on interest, and effective interest rates would rise because of the shortened repayment period.)

Many participants were confused or uncertain about the impact of early repayment on their total costs and interest rates. This was particularly true for Product C, though Product A also was confusing to some.

"The stronger the sales the faster you could pay off the loan which would in effect lower the interest rate." (referring to Product A)

— Owner of a commercial janitorial business in Washington

"Obviously repayment could be quicker. However, if you are locked in to a certain percentage rate and cannot change it during the term of your loan, it wouldn't affect your interest rate." (referring to Product A)

— Owner of a commercial print shop in Oklahoma

"If the sales were stronger and I had gone with the 30% option I would be paying it back very quickly to not incur more interest." (referring to Product A)

— Owner of a medical billing practice in Kansas

"Your daily repayments are going to be higher and you will pay off the loan quicker, which in a normal world would lower the interest. But I think with this product it would stay the same." (referring to Product C)

— Co-owner of a parking lot maintenance business in Arkansas

"I think the total repayment amount might be less. With a faster repayment, the effective interest rate might be less. With higher sales, you would likely pay back the loan more quickly." (referring to Product C)

— Co-owner of a video production business in New York

"If sales increased, I would definitely plan to [pay] the loan back much sooner and have a lesser repayment amount." (referring to Product C)

— Owner of a retail food products business in Georgia

The different presentations of information for each of the Products A, B, and C reflect the variety of products and product descriptions in the online credit marketplace. At the same time, most participants found the lack of standardization in presentation and the inconsistency in terminology across the descriptions of product costs and features to be problematic.

When asked about their difficulty comparing products, participants said they wanted transparency and consistency in lenders' descriptions of costs and terms.

"It's difficult to decide [between products] because the information is not presented in a consistent way.

— Owner of a management consulting business in Maryland

"I'd do my best to compare apples to apples as much as possible."

— Owner of a vehicle equipment wholesale business in Missouri

"It is difficult [to compare when] they are using different models and different terminology to try to get our business."

— Owner of a manufacturing business in Colorado

Impressions of a Standard Format for Credit Product Costs

Following the product review exercise, participants were presented with a stylized sample disclosure box, as shown on page 22, and asked their impressions of the format.[15] Not surprisingly, participants overwhelmingly liked the format and the wealth of information contained in the table. Among their comments: "I like this and see what is important to me!"; "This is exactly how I would like to see the breakdown"; "This is straight to the point"; "It has everything a borrower would want to know"; and "I would prefer a standard format like this when comparing loan rates."

[15] In 2016, several lenders in coordination with a nonprofit organization, launched the SMART Box disclosure initiative, aimed at developing a format for voluntary disclosures in loan documents that would present total cost of the loan, APR, and other repayment terms. The effort is voluntary and still in its early stages. The online focus group exercise presented here, while covering some of the same metrics, is not meant as either an endorsement or a critique of the SMART box effort. For more information on the SMART Box Model Disclosure Initiative, visit http://innovativelending.org/smart-box/.

Sample Disclosure Box

Loan Amount	$50,000
Repayment Amount	$58,000
Term	12 months (weekly payments)
Total Cost of Capital	$8,000 (loan cost), $0 (fees)
Annual Percentage Rate (APR)	30%
Average Weekly Payment	$1,115
Cents on the Dollar	16.0 ¢
Prepayment	Does prepayment of this loan result in any new fees or charges? **NO** Does prepayment of this loan decrease the total interest or loan fees owed? **YES**

Participants were then asked what information presented in this box was most important and what additional detail was needed.

- APR, repayment amount, frequency of payments, and prepayment penalties were cited as most important;
- Cents on the dollar was most frequently mentioned as being the least important;
- Among items noted as missing were the compounding method (monthly, weekly, daily), clear information on the effect of prepayment on amounts owed, and whether there are penalties or additional fees if payments are late or if it takes longer to repay than anticipated.

Participants were nearly unanimous in their desire to receive this information early in the process, even if figures are estimated, provided as ranges, or are averages based on a “typical” customer of the lender. Nearly all participants said this information should be available to a prospective borrower before they apply, as the information would be very valuable to them during their credit search. Participants noted that receiving the disclosure box at signing was far too late, as they would already have invested a lot of time into the loan process and turned over their financial information to lenders. As a practical matter, too, businesses may have already committed the anticipated funds, making it difficult for them to back out if the costs and terms are not as expected. Drawing from personal experiences, participants were concerned about the current practice of submitting applications to multiple lenders just to get details they could use to compare products. Several mentioned related concerns about the impact of lenders’ credit checks on their credit scores as they went about exploring their credit options.

When asked when in the process they wanted product details, participants said as early as possible to help them make informed decisions about where to apply.

“I would like preliminary information [average APR and costs] before applying so that I don’t waste my time.”
— Owner of a party rental company in North Carolina

“Even if they have to give a range, it makes the process much more transparent.”
— Co-owner of an environmental consulting firm in North Carolina

“The earlier the better but definitely not at the time the loan closes… I think it’s too late even at the time of approval…and [if] it’s a poor or too high rate, I may back out.”
— Owner of an architecture firm in Illinois

“Before [I apply] allows me to compare lenders. After I submit a loan application, I would expect a lender to send back an updated version of this chart with the actual terms. I would expect something like this to be on the actual loan documents, but if that’s the only option, it’s too late in the process.”
— Co-owner of an IT services business in South Carolina

“I would like it before I apply. This way I can have a basis of comparison with other companies.”
— Owner of a home electronics business in New Jersey

Participants’ Recommendations

Participants were asked what suggestions they had to ensure that online loans best serve the needs of small businesses. Many recommended clearer product descriptions and suggested that information be presented using concepts and terminology already familiar to them; that is, discussed in a manner typically used for traditional credit products. For product details they deem important, such as interest rates, total cost, and repayment amounts, they want the disclosures to be:

- provided up front, before the prospective borrower provides any personal information;
- expressed in clear and easy-to-understand language;
- standardized and consistent;

- inclusive of all costs (that is, no hidden fees); and
- explicit about the impact, if any, of prepayment.

They also want a clear sense of the borrower requirements, both in terms of qualifications (credit score, years in business), and information that will be required of them. Other suggestions included requiring a loan rate or cost calculator, disclosure of borrowers' rights, and prohibiting weekly or daily repayment schedules due to the hardship it places on businesses' cash flow.

Many participants said they would like to see guidelines for consistent presentation of information across credit products as well as some measure of borrower protection.

"I should be able to enter hypothetical numbers on the site (how much, credit score, etc,) and they should be able to give me a general range of interest and payment amounts."

— Owner of a theatrical production company in New York

"Keep it simple and upfront. As a small business owner, I don't have a legal team to read through 15 pages of [jargon]."

— Co-owner of a restaurant and catering business in Iowa

"Give business owners some protection from the predatory lending and constant calling by every lender under the sun."

— Owner of a vehicle equipment wholesale business in Missouri

"A standardized information sheet would be helpful, not unlike a car manufacturer label or a HUD disclosure statement."

— Co-owner of a home construction business in Kentucky

"I'm not a fan of asking for more regulations but I think we need to ensure all small business owners are protected. Loan sharks come to mind."

— Manager of a medical billing practice in Kansas

"There should be a law that requires all institutions to present information up front prior to any of my information being solicited. There should be legal ramifications if my information is used improperly or a 'bait and switch' occurs."

— Owner of a healthcare services business in Illinois

Issues for Consideration

As noted earlier, the findings discussed in this report are based on online focus groups with 42 small business owners and should not be considered representative of the nation's small business population. That said, these discussions are informative and provide insights into the experiences of actual and potential borrowers from online lenders. They also suggest areas for policy consideration and future research.

Observations on Trust

Although price is a primary consideration when seeking credit, other factors matter in borrowing decisions. As previously noted, "a lender I know and trust" ranked second by participants in a list of factors. This may be one reason why banks are still the go-to source for credit for the majority of participants. Banks are where most participants maintain their accounts, and some said they value their banks because "they know me," and are "safe" and "regulated entities." Participants who have used an online lender were more likely to rank other factors more highly than trust, such as "likelihood of application being approved," or "quick/easy application process."

Since online lending is a relatively new industry, potential borrowers tend to seek out signs of trustworthiness. For example, when shown a list of companies, participants who said they were not familiar with online lenders gravitated toward name brands they recognized as providers of other products and services. In the virtual shopping exercise, quite a few participants sought out user reviews and third-party endorsements in order to ascertain the trustworthiness of the sites they visited. In some cases, where participants indicated they would not use online lenders, positive impressions of a website appeared to increase their trust level such that they would consider using their products. Interestingly, data privacy and security concerns about online lenders were less of a deterrent as compared to the 2015 study. Although some voiced this concern, most participants seemed resigned to the possibility of data breaches at all financial companies, not just online lenders.

That said, many of the participants do mistrust online lenders, and their perceptions of the industry may be influenced by repeated and persistent sales calls and spam emails, which the business owners find bothersome and intrusive. Negative impressions of the websites tended to reinforce mistrust, especially when participants suspected fees and costs were "hidden" or that the advertised "as low as" rates were not what they actually would be offered. When visiting online lender websites during the study, participants often reported they could not view key product details—items essential to their decision whether to apply with a certain lender—unless they entered their business and contact information. Several connected this request for their information to the potential for unwanted contacts from lenders and brokers.

Trust through Better Disclosure

As most participants made clear, they want to work with lenders they can trust. Based on their responses, better disclosures are one way for lenders to establish trust with potential borrowers.

In this study, three sample products were presented to participants mimicking the language and content actually used by online lenders. Many of the participants said they were unsure or answered incorrectly when asked specific questions about repayment amounts or interest rates. Generally, participants recognized their difficulty evaluating and comparing these products, and that may account for their unanimous, enthusiastic response to the sample disclosure box on page 22. They didn’t necessarily know—or care—about technical distinctions between traditional loans and other credit products, such as cash advances. But, they strongly favored an “apples-to-apples” comparison that could give them more confidence in their choice of products and lenders.

Questions remain, however, on how best to design disclosures that include sufficient (but not overwhelming) details, in a visually compelling format, and early enough in the shopping process to actually be useful for decisions about whether and where to apply. Research on consumers shows it is difficult to balance these elements in practice.[16] Experience with disclosures for consumer credit is apropos because many small business owners are consumer-like and rely on personal credit. This experience also underscores the importance of testing model disclosures in the field. Controlled experiments, while challenging and costly to implement in the past, have been shown to significantly improve the effectiveness of disclosures.[17] Today, financial technology could be harnessed, not only to market credit products to businesses, but also to conduct such experiments cost-effectively. This technology also might be used to develop cost calculators, prepayment scenarios, and product comparisons tailored to the *specific situation of individual borrowers*—tools many participants said they would want.

It is important to acknowledge that better information will not necessarily lead to better borrowing decisions. Some decisions may be rushed because the owner has an urgent need to quickly acquire inventory or to make payroll. Some small business owners may be less financially savvy when it comes to using the information disclosed or simply less motivated to comparison shop.[18] For some, sorting through myriad credit options still would be a challenging task.

Generally, though, improved disclosures could benefit all players in the online credit market. Online lenders could engender trust and increase their customer base. Borrowers could evaluate competing products based, not only on the costs and features offered, but also on the degree to which lenders are forthright about product details. As one participant noted, if sufficient product details are not provided, “I will run, not walk away.” Certainly, online credit products, even with high APRs or total repayment amounts, can serve small businesses well and help them capitalize on opportunities. Going forward, policy discussions should aim at how best to inform prospective borrowers so that they can choose the credit products most suitable to help their small businesses thrive and grow.

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[16] See, for example, Jeanne M. Hogarth and Ellen A. Merry, “Designing Disclosures to Inform Consumer Financial Decisionmaking: Lessons Learned from Consumer Testing,” *Federal Reserve Bulletin* 97 (August 2011), www.federalreserve.gov/pubs/bulletin/2011/articles/DesigningDisclosures/default.htm.

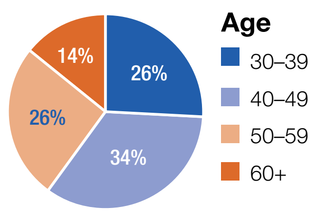
[17] “Review of Literature on Product Disclosure,” Prepared for Financial Conduct Authority, Oxera Consulting, October 29, 2014, www.fca.org.uk/publication/research/review-of-literature-on-product-disclosure.pdf.

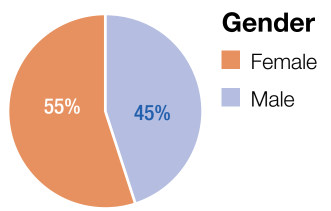
[18] That said, numerous participants noted that the comparison exercises and follow-up questions in the study prompted them to more carefully consider aspects of credit they had not previously. This suggests disclosures could play a role in educating potential borrowers by raising their awareness about product features and costs.

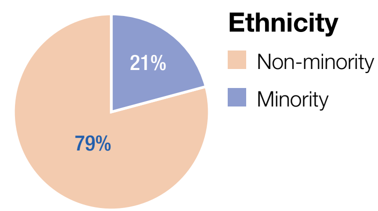
Appendix A

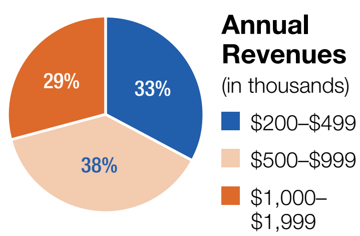
About the Participants and Their Businesses

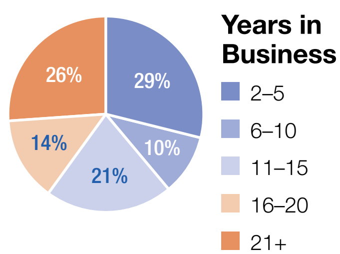
A total of 42 participants took part in the two national online focus groups. They were identified and recruited through a detailed screening process (see appendix B). The pool of participants ranged across revenues, geography, and industry. Participants came from 22 states across the United States and operated in a variety of industries. As seen in the charts below, they were a diverse group reflecting various demographic and business characteristics.

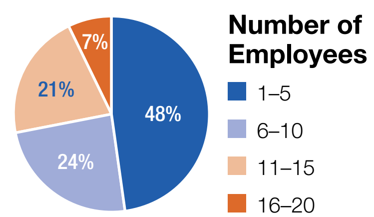












Industries

Architecture
Art gallery and framing
Bookbinding
Commercial janitorial services
Construction site preparation
Courier service
Engineering
Environmental consulting
Event staffing
Executive search
Flood restoration
Greek restaurant
Healthcare services
Home electronics installation
Home construction
Hygrometer manufacturing
Iron works
IT consulting
Law office
Machine tooling
Management consulting
Medical billing
Medical spa
Medical transport
Motion picture equipment
Parking lot maintenance
Party supplies rental
Pest control
Photography services
Pillow manufacturing
Printing services
Restaurant and catering
Retail food products
Retail general merchandise
Skin care spa
Software content management
Stone fabrication
Theatrical production
Travel agency
Vehicle equipment wholesale
Video production
Writing services

Appendix B
Focus Group Screener Questions

The qualitative research team at Harris Insights & Analytics and their partners recruited participants for the online focus groups using the criteria noted in box 1 on page 8 of this report. Participants were asked a series of screener questions to determine if they met those criteria. Below, items italicized and in brackets are instructions for the interviewer to probe more deeply on specific questions or to terminate the interview if the criteria are not met.

Besides yourself, how many employees, either full or part time, are in the company that you work for?

1. 1–20 employees *[Terminate if no employees other than the owner]*
2. 21 or greater *[Terminate]*

Which of the following statements best describes your involvement at your business?

1. I am the sole owner of the business
2. I am part owner of the business
3. I manage the business, but don't own it
4. Not an owner or manager of the business *[Ask to speak to; otherwise, terminate]*

Which of the following best describes your role in financial decisionmaking for your business? (Select one.)

1. I am a final decisionmaker in all financial business decisions
2. I share the decisionmaking in all financial business decisions
3. I have no involvement in financial business decisions *[Ask to speak to the financial decisionmaker; otherwise, terminate]*

Does your business fit into any of the following industries?

1. Nonprofit organization *[Terminate]*
2. Retail Trade
3. Health-care
4. Technology
5. Marketing research *[Terminate]*
6. Lending industry, such as a bank, credit union, or loan firm *[Terminate]*
7. Other

Please describe your business. *[Categorize for purposes of obtaining a mixture of industries]*

How long has your company been in business? *[If less than two years, terminate]*

Is this business your primary source of income? *[If "no," terminate]*

To ensure a wide range of respondents, which of the following best describes the total annual revenue for your business before taxes? Your best estimate is fine.

1. Less than $200,000 *[Terminate]*
2. $200,000 to less than $500,000
3. $500,000 to less than $1,000,000
4. $1,000,000 to less than $2,000,000
5. More than $2,000,000 *[Terminate]*

We are interested in understanding your familiarity and experience with different lending sources and ways of obtaining funds. Have you ever applied to any of the following sources to obtain funds or loans for the purposes of operating or growing your business, debt consolidation, or refinancing?

1. Traditional financial institutions such as a bank or credit union, either in person or online
2. Online lenders such as merchant cash advance companies, peer-to-peer lenders, or online direct lenders *(We do not mean an online application to a bank or credit union)*
3. Credit cards, either business or personal
4. Other *(Specify)*

We are looking for a mixture of respondents who have applied/have not applied at online lenders. When was the last time you applied for credit?

1. Within the past 6 months
2. Within the past 6–12 months
3. 1+ years ago *[Terminate]*

Which of the following online funding sources have you heard of:

- Lending Club
- Prosper
- CAN Capital
- Rapid Advance
- OnDeck
- Kabbage
- Amazon Capital
- PayPal Working Capital
- Square Capital
- Swift Capital
- Credibly
- BlueVine
- Bizfi
- Any other online direct lenders, merchant cash advance companies, or peer-to-peer lenders you have heard of? *(Specify)*
- None of the above *[If answered “yes,” applied to an online lender, but can’t name, terminate]*

Did you apply for a loan or other forms of credit at any of the following sources for the purpose of operating or growing your business, or for debt consolidation? *[List each company respondent heard of; looking for a mixture of respondents who have/have not applied at online lenders.]*

Did you receive any of the funds you applied for at ________? *(Companies that the respondent said they applied to)*

[Recruit a mix of those who have and have not received funds from an online lender.]

What age group do you fall into? *[Terminate if less than 18]*

What do you consider to be your ethnic background?

Invitation for Bulletin Board: Based on your responses, we would like to invite you to participate in an online “Bulletin Board” style focus group sponsored by the Federal Reserve to discuss some topics regarding small business lending needs and lending practices.

(Participants committed to spending 30–45 minutes each day for three days answering questions and were provided with a $200 incentive upon completion.)

Appendix C
Focus Group Topic Guide

During the online focus group, participants logged into a secure internet site each day over a period of three days to respond to questions. They could view questions one at a time and were able to see others' responses only after posting their own. The groups were professionally moderated by Harris Insights & Analytics (formerly the Nielsen Company), with Federal Reserve staff observing and conferring with the moderator on follow-up questions for participants, when needed.

Summary of Day One Questions – Introduction, Financial Concerns, and Recent Experiences Seeking Credit

1. Introduce yourselves by talking a bit about your business and some interesting things about what you do, e.g.: What your business is all about; how long you've been doing this; your role and responsibilities. What do you like most about running your business? What gives you the greatest satisfaction and joy? What's the toughest part about running your business?

2. Think about what's required to keep your business up and running and able to meet your financial obligations. What's your business's biggest financial concern today? What is the one thing that's keeping you up at night and making you nervous?

3. Have you ever been faced with a business problem or opportunity where you needed cash to fund it? What did you do? How did you handle it?

4. When it comes to getting the money you need to meet a financial challenge or fund an opportunity for your business, what's the biggest challenge you face?

5. Think about your most recent experience applying for a business loan. Tell the story about the process you went through applying for the loan, noting everything you remember, including:
    - What the business loan was for
    - What specific lenders you chose to apply to (and why you picked them)
    - What you may remember about the terms of the loan (the cost of borrowing the money, how you have to pay it back, things like that)
    - What you saw or heard that you liked
    - What you may have been confused by or concerned about
    - What you learned during the process

6. Did you get approved for the loan? Did you take it out? If so, has it worked out the way you thought it would? Any surprises?

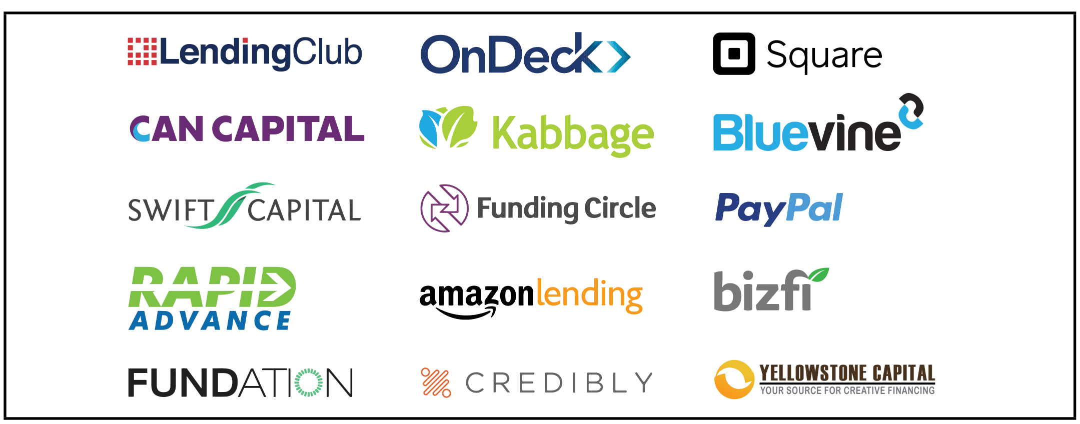
Summary of Day Two Questions – Impressions of Online Lenders and Virtual “Shopping” Exercise

1. Think about specific places you go to, or might consider going to, to secure a business loan. Here is a list of some of the factors that you might take into consideration when making decisions about where to go to get your business loan. How would you prioritize each factor (and please list any additional factors)?
   - best price
   - quick and easy loan application process
   - lender offers terms that best meet my needs
   - can get my funds ASAP; quicker than other lenders
   - likelihood applicaton will be approved
   - low monthly payment amounts
   - flexible repayment terms
   - a lender I know and trust

2. In general, which of the following sources are you most likely to consider for a business loan? Which are you least likely to consider? Why?
   - a traditional bank, savings and loan, or a credit union
   - an online lender not affiliated with a traditional banking institution
   - business or personal credit cards
   - personal connections

3. What comes to mind when you see or hear the phrase “online lender”? How do you think online lenders compare to traditional banks? How are they the same? How are they different?

4. Here are the logos of a number of online lenders:
   - What’s your reaction to seeing this list?
   - Which of these online lenders had you heard of before this research?
   - How familiar are you with what these companies have to offer?



5. Thinking back, have you seen information or ads from any of these (or other) online lenders? What do you remember seeing? Where did you see them?

6. Have you looked for information about an online lender?
   - What was it like? What did you have to go through to get all the information you needed?
   - Which online lenders did you look at?
   - What did you think about what they had to offer?

7. Have you ever been directly contacted online, by phone, or in other ways by a sales person or broker who wanted to present, talk about, or sell you an online loan? Describe your experience with any solicitations you have received.

8. Have you ever received a pre-approved loan offer from an online lender?
   - If so, did you investigate it?
   - Did you accept the offer?
   - How did you feel about being offered a pre-approved loan? Any concerns?

9. Today, many business owners are focused on making sure their financial and personal records stay secure and protected. Do you feel your personal records (like your social security number and your bank account information) are as secure with an online lender as they would be with a traditional lender like a bank? Why do you feel this way?

10. We’ll be talking more about loans from online lenders. To prepare for our discussion tomorrow, please go online and visit a couple of websites of the online lenders listed or others you may know. *[Participants were again shown the box from question 4.]* Please go to at least one you haven’t visited before. **PLEASE, don’t apply** or provide any personal information.

11. As you browse a few of the online loan websites, assume you are shopping online for a loan of $50,000.
   - Check out how the different lenders present what they are offering.
   - Please take notes about what information you would look for, and how easy or difficult it is to find these details. Also, note how easy or difficult it is to compare information from different lenders.

Summary of Day Three Questions – Product Evaluations and Participant Recommendations

1. Let’s talk about what you saw, and what you learned, when you went online and looked at a few online lender sites last night. For the online lender websites you visited:
   - What information were you looking for?
   - How easy or difficult was it to find that information?
   - Which one site did you feel gave you the best information and what makes you feel this way?

2. What do you think is the most important information you need when applying for or taking out a loan with an online lender?

3. Let’s assume your business needs a $50,000 loan and you find the following on an online lender’s website. *[Participants were presented with Products A, B, and C one at a time and asked about each product. See pages 16 and 17 of this report for product descriptions.]*
   - Is this a product you would consider?
   - What do you like about what you see here?
   - What concerns you?
   - Is there anything confusing?

4. Is there any additional information you would like to have before deciding if you would want to apply for this loan from this lender?

Product-Specific Questions

5. **Product A** - Which repayment option would you choose and why: 10%, 20% or 30%? What would you expect the interest rate to be? Let’s say your sales are stronger than expected. How do you think this would affect your repayment? What about the interest rate?

6. **Product B** - Do you estimate this product would be more or less expensive than taking an advance on your business credit card at 21.9%? *[Next, participants were presented with fine print noting 24% typical simple interest rate.]* What’s your reaction to seeing this new information? Where in the description of the loan should this be presented? How does this information affect your willingness to consider this product? Did you notice similar “fine print” during your search of online lender websites yesterday?

7. **Product C** - What would you expect the interest rate to be if you repaid in one year? Let’s say your business expands and sales jump to $3,000 per day. Please think about the following and answer as best as you can using the information supplied by the lender. How do you think this would affect your daily repayments? What about the total amount you repay? What about

the interest rate? Do you think it would be higher, lower, or the same? What about how quickly you’d pay it back?

8. Let’s say you are considering all 3 products and need to decide which works best for you.
   - What information would you focus on? What is most important to you?
   - Do you find it difficult to compare information from different online lenders because it is not presented in a consistent way?

9. Here’s one way of presenting information so that each and every website product description you look at would be consistent. As you look at it, consider what you said was important to you. *[Participants were presented with a sample disclosure box in the format shown on page 22 of this report.]*
   - What’s your reaction to this way of presenting online lender information?
   - What do you like best about what you see here?
   - Is there any information here you don’t need?
   - Is there anything missing?

10. Which items would be most important to you if you were comparing products?

11. At which point in the process would you most like to have this information?
    - Before you apply (even if the rates and amounts are averages or estimates)?
    - After your application has been approved (with the actual rates and terms)?
    - Or, at the time the loan closes?

12. Based on what you have learned about online loans, what specific recommendations would you make to ensure that online loans best serve the needs of small businesses?

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