2024 BABSON COLLEGE ENTREPRENEURSHIP RESEARCH CONFERENCE

Technical University of Munich

Cutting Through the AI Hype: Balancing Technology and Humanity in Finance

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AI isn't just tech buzz; it's revolutionizing how we connect, communicate, and close deals. In small business financing, the personal connection remains crucial. With the rapid integration of AI technologies—from automated customer interactions to deep-dive analytics—we must consider if we're sacrificing essential personal interaction in small business financing.

The integration of new technologies like mobile banking and sophisticated credit scoring systems has dramatically reduced the number of unbanked individuals in the EU, from 31 million to 13 million between 2017 and 2021[1]. These tools have also reduced human bias and enhanced decision accuracy. However, they pose challenges in maintaining genuine, trust-based relationships between lender and business. As digital processes start replacing face-to-face interactions, there's a risk of losing valuable context and nuanced information crucial for lending decisions towards specific type of small entrepreneurs.

Balancing Technology and Personal Relationships

Entrepreneurs can captivate lenders' interest with their passion, sharp business instincts and acumen. Entrepreneurial traits like these can be particular relevant for those lacking traditional collateral or credit histories. And here's a wake-up call: a whopping €14 billion demand for microloans remains unmet each year across Europe[2]. In our study, we show that micro-entrepreneurs struggle accessing loan sizes between €2000- €50.000 from traditional institutions. This is, despite small businesses being the lifeblood of the economy. Microenterprises, for example, with an annual turnover of 2 million or less comprise 93.5% of all European enterprises and employ almost 29,4% of SME workers[3].

Microlenders were able to bridge the gaps of unmet needs, as small businesses and start-ups often face barriers, such as skill gaps and under-developed networks in addition to financial access. By heavily relying on personal interactions between lender and entrepreneur, the wealth of nuanced information lead to more favorable lending conditions and borrower loyalty. Studies have demonstrated the current inability of AI tools to distinguish individuals ability and willingness to meet financial obligation, even though these individuals are in identical financial situations. Thus, whether an entrepreneur defaults on a loan is not just a result of numerical predictions, but the crux lies in understanding the context.

Our case study at a microfinance institution revealed that while AI decision-making tools are essential to enhancing organizational efficiency, their effectiveness still depends significantly on the discretion of the decision-maker. Interviews with company managers highlighted market pressures to adopt AI assessments to improve efficiency and reduce loan processing times. However, a detailed analysis of nearly 2600 applications showed that evaluators often bypass video call

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[1] WSBI-ESBG (2022) Number of unbanked adult EU citizens more than halved in the last four years. The World Savings and Retail Banking Institute (WSBI) and The European Savings and Retail Banking Group (ESBG). https://www.wsbi-esbg.org/number-of-unbanked-adult-eu-citizens-more-than-halved-in-the-last-four-years/

[2] OECD/European Commission (2023), The Missing Entrepreneurs 2023: Policies for Inclusive Entrepreneurship and Self-Employment, OECD Publishing, Paris, https://doi.org/10.1787/230efc78-en.

[3] Di Bella, L., Katsinis, A., Lagüera-González, J., Odenthal, L., Hell, M., Lozar, B. *Annual Report on European SMEs 2022/2023*, Publications Office of the European Union, Luxemburg, 2023, doi:10.2760/028705, JRC134336.

protocols in low-risk situations—particularly with entrepreneurs over 50 or from migrant backgrounds—preferring in-person assessments. Despite AI's predictions of low repayment risks, this preference surprisingly leads to fewer loan approvals. In-depth interviews suggest that such entrepreneurs might benefit from additional training and guidance to ensure long-term business viability. Experienced evaluators opt for more personal screening methods with these groups to prevent over-indebtedness and enhance successful outcomes.

Navigating the Future: Ensuring Inclusive Financial Practices

Hence, as we integrate the digital tools and AI-support into financial services, the results of our study indicate that lenders should continually ask themselves: "Are we enhancing the outreach to our entrepreneurs and increase their opportunity to gain financial access to run a successful business?" If we aim to increase our affords to give financial access to small businesses in Europe, it requires a balanced approach whether the technology enhances, not replaces, human interaction. Let us not lose sight of the human touch that is essential to meet the diverse needs of all entrepreneurs

Key Strategies for Balancing AI and Personal Relationship:

Authenticity and Trust: Digital financial transactions require robust technological safeguards and ethical frameworks to ensure trustworthy interactions.

Value Beyond Technology: Rather than focusing solely on technical aspects of AI, consider how its interaction with humans creates added value. The effectiveness of AI tools depends on the users and the organizational context.

Organizational Awareness**:** Encourage asking context-specific questions to understand fairness-related risks and how AI impacts them within your organization.

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