LEAN INTO LENDING

VOL. 1

RISE OF THE BORROWER

TABLE OF CONTENTS

// INTRODUCTION

Lending Traditions

You're a farmer in the fertile crescent. It's been a long time coming, and today is the day. You are finally going to get that new ox. Without it, it would take two additional weeks to plow your lentil field this year, which will definitely lower your yield. You know that you'll have more than enough crop to purchase an ox at the end of the harvest, but you need it right now. And right now, you're broke.

You go to the local ox dealership and find a three-year-old model that fits your needs perfectly. You negotiate your future bushels of lentils so you can take the ox now. The dealer knows you. He knows your farm. So he agrees. One final chiseling of your name on a clay tablet, and the ox is yours. When you harvest in late summer, you'll pay for the ox and your loan obligation will be met.

Lending has been around for a long time, and the fundamentals of lending haven't changed that much. Over the years, some aspects of lending have improved. Advances in technology have made it easier to attract and learn about prospective borrowers, track loans, and calculate interest without having to reference the ox-to-lentils exchange index.

Despite new tech, real changes in lending have progressed slowly. For centuries, banks dominated the lending industry. Much of the lending experience we know today hails from the era of austere banking institutions, with their cathedral-esque architecture, marble floors, and gold-colored stanchions connected by velvet ropes.

Getting a loan during this time was a momentous, often lengthy ceremony, complete with underwriting, supercilious looks, approvals, piles of documents, throat clearing, signatures, and instructions. Borrowers got used to the concept that if they needed money now, the lending process was the requisite mental stress test.

THE RISE OF PRIVATE LENDERS MADE LENDING MORE COMPETITIVE, BUT NOT NECESSARILY MORE INNOVATIVE.

The wide adoption of computers brought lending software applications, making private lending much easier. If you wanted to be a mortgage lender, you could buy a mortgage-lending application. If you wanted to be an auto lender, you could buy an auto-lending application. This software made it possible for a small business to lend like a bank. And so they did.

The rise of private lenders made lending more competitive, but not necessarily more innovative. Throughout the 90s and early 2000s, you could go to a private lender and have the same basic lending experience you could at a bank. Loans began to pop up to meet different borrower classes. From prime to deep subprime, loans became available to everyone.

In the last decade, cloud applications have disrupted the way we look at technology. Now, lenders can access their software and data anywhere with a decent internet connection, meaning entire companies can work from home, and lenders may never see their borrowers face to face. Still, it seems most lenders haven't fully realized new tech's ability to enhance their product and customer experience.

Book Overview

This eBook will explore lending—where it came from, how it stands today, and most importantly, where we anticipate it going in the future. Our primary message (and what we imagine you'll be most interested in) is that emerging technologies and inventive strategies can open up new possibilities in lending. We will give some concrete examples, showing how tools like APIs or the cloud can improve aspects of your business. But the key message we want to impart is not about any specific technological advancement or software feature, but a change in mindset:

> **THE INDUSTRY IS READY TO REWARD THOSE WHO LEVERAGE TECHNOLOGY TO BETTER SERVE THEIR BORROWERS' NEEDS.**

We're writing to lenders, but we're also writing to non-lenders to encourage their first steps into the industry. We want to address those who are already looking for and implementing new solutions, as well as those who are hesitant or even skeptical about investing time and resources into new technology or new lending models. Experimentation and innovation can feel daunting, but we'll explain how modern solutions make it easier than ever to explore those avenues and reap the rewards of thinking outside your current box.

This eBook will cover the most useful—and yet most challenging—aspects of establishing a forward-thinking lending business:

- Lending trends, namely the ways the internet and computing have revolutionized lending in the past, and how it continues to do so now.
- The rise of the borrower, and how they've elevated their expectations in response to expanded financing options and better user experience.
- Scaling with new capital, and how you can win over investors with a strong proof of concept and clear visibility into your operation.
- The key ideas that lenders should implement, such as developing new products, diversifying product offerings, and starting to build their ideas now.

But before we dive into all of that, let's talk about the experience most borrowers get when they apply for and then pay off their loans.

Neglect of the User Experience

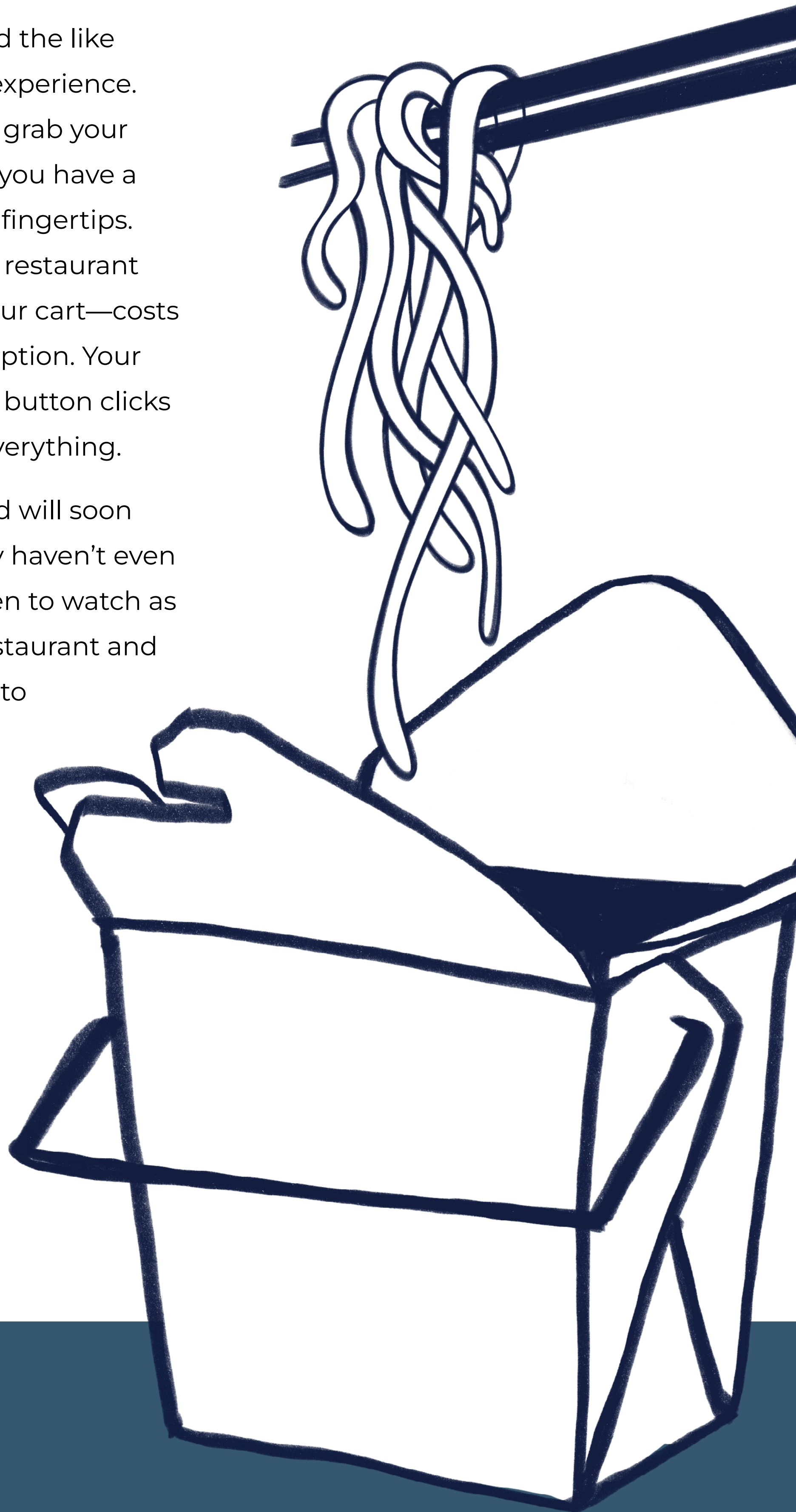
Think about a loan you've had. Maybe it was for a major life decision, like a mortgage on a new house or financing a first car or educational degree. Maybe you decided to buy a TV or a smartphone with a payment plan. Maybe you relied on a medical or payday loan to get over some unanticipated expenses. Or maybe you just use a credit card to buy lunch sometimes because you get great cashback on dining. How would you describe your experience? Odds are, there are some aspects of the process that frustrated you. Here are some real-life examples from members of our team:

- During a prospective car buyer's experience, there was miscommunication (or maybe some deliberate wheeling-and-dealing) between the salespeople and the lenders, and prices and rates kept going up as she got closer to closing on the deal.
- One borrower was surprised to still be receiving requests for due diligence items from his mortgage lender after he'd moved into his new house. He thought the mortgage was closed, and then felt concerned when the lender was still asking questions a month later.
- When signing up for a credit card online, a borrower reached the final step of the process. The screen said Submitting your Application – Do Not Close this Window. And then the app crashed.
- One borrower managed to pay off an online loan. He got the regular confirmation email showing his payment had gone through, but never any kind of notice that the debt was paid off. And yet for months and months afterward, he kept getting emails from the lender about how he could pay off the loan.

Now, none of these experiences were bad enough to keep these people from getting another loan in the future. But each of them will likely be a little more wary next time they shop for a loan. Alongside the amount financed and a low interest rate, they'll be looking for lenders who offer a better user experience.

Let's look at GrubHub, Doordash, and the like as an example of an improved user experience. If you're hungry, all you have to do is grab your phone and open the app. Suddenly, you have a myriad of restaurant options at your fingertips. After a few short scrolls, you find the restaurant you like and start adding items to your cart—costs and fees clearly displayed for every option. Your meal is assembled, and two or three button clicks is all it takes to finalize and pay for everything.

You now have an assurance that food will soon arrive at your door, and you probably haven't even left the couch. You keep the app open to watch as your delivery person drives to the restaurant and then to your house. You know when to make your excited trip to the front door, because a little car icon on a map shows you exactly where your food is. It's the same food you could've got from ordering take-out the old fashioned way, but the apps create a better user experience at every step of the way.



But even companies with a remarkable application process can drop the ball when it comes to customer experience during the rest of the loan's life. Imagine if companies like DoorDash or Grubhub neglected user experience after the initial transaction—no way to track the food as it comes to you, and no notification when it arrives. After a half hour, you check your front porch and find a cold burrito. You probably wouldn't be too eager to order again.

If loans have a positive user experience—that is, if it's easy to apply and make payments, if the terms are understandable, and if borrowers have greater choice and flexibility throughout— they'll be encouraged to borrow again and again. For the lenders who want to offer a better lending experience, now is the time.

2

// LENDING TRENDS

New Technology

The old technology of the lending industry was less than ideal. Instead of pushing lenders to innovate, it actively made lending more difficult. Now, though, we're seeing rapid advancement that is breaking lenders free from those previous constraints. And as the focus on the borrower continues to grow, new tech is merging together to create a new ecosystem that is driving a better lending experience.

Here are the technological advancements we see leading the push towards the future of lending.

Modern Software Structure

In the past, lending required a disjointed process where the steps of customer acquisition, underwriting, servicing, and closing loans were each performed through a different software. This process was a pain point not only for the lender but for the borrower, too—they had to wait days to see if they could qualify for a loan, visit their bank to make payments, and spend a whole afternoon at the bank when the time came to pay the thing off or refinance through another lender. These barriers slowed down the process for everyone involved.

Developers have attempted to create a single platform that addresses every aspect of the loan lifecycle. Unfortunately, systems that try to do it all seldom do it all well, and don't hold a candle to software that was designed for more specific roles. More and more lenders have started to build integrated lending platforms, grafting together the best software solutions for different aspects of the loan lifecycle.

In the most successful implementations we've seen, the lender chooses software that will act as their core and system of record, usually lending or banking core software. With their core software covering loan servicing, lenders will choose origination software, integrated services, data warehousing, call center and telephony services, or whatever else they require in order to run their lending business. All of these pieces are often connected in a hub and spoke model, with the core software as the hub. Communication between components is done via a lender-developed middleware application.

The middleware application usually reflects the lender's core strengths. If the lender is good at origination, they may have a custom-built origination system within the middleware. If the lender is great at payments, communication, or providing a killer customer portal, those may be handled by the lender-built software. This structure enables lenders to easily shed spokes that are no longer cutting-edge and replace them with the latest and greatest.

APIs & Webhooks

APIs are a pretty simple concept, with a technical implementation. If you're not really into computers and code, you may not be familiar with what they are. APIs make it possible for two pieces of software to communicate, even though they weren't developed by the same people and probably don't even use the same coding languages.

A lending application may or may not offer an API, although it's becoming more common. If you need the option to have your own company systems talk to your loan software, an API is essential. Some software is built on its own API, but more commonly APIs are added as an additional feature. Software built on its own API is preferred, because it means that the API is the software, so it will always be kept up-to-date and functional.

Some examples include:
A lending application might send a webhook notification every time a payment is made. Why is this valuable? Imagine a lender who services their loans in-house, but outsources collections on any loan that is 120 days past due. The collections company uses different software to take payments and track collections efforts. If a severely past-due borrower makes a payment to the lender, it will be much easier to have the lender's system automatically notify the collections company.

WEB·HOOK

/Webhük/

A webhook is a message that a software application sends when triggered by an event or other conditions.

A·P·I

/apī/

API stands for application programming interface. An API is a way to create, read, update, or delete information that's housed within a software application from outside that application.

If the collections system has an API, and the automatic notification is sent in a way the API will understand, the payment can be automatically added to that system with no human interaction needed. The automatic notification between the related systems does a lot to improve accuracy and remove humans from communications like this. If the webhook can be configured without any programming, all the better.

APIs and webhooks make it much easier to communicate with a software system. APIs invite you to reach out to make changes, while webhooks are premade computer-to-computer push notifications. When working to implement a lending system where customization may be needed, APIs and webhooks are essential.

If you're a lender without a development staff, you may be wondering, "How can I provide the best experience if I can't program a connection between services?" Even without developers you can still leverage connectable software that offers an API or webhooks. There are popular platforms available, like Zapier, that enable communication between applications. While this may not be an ideal solution, it is often far preferable to expensive development, especially when establishing a proof of concept. If you are trying out a new software or data service, consider connecting it in this way until you're ready to commit.

Cloud-Based Software

Lending tech is rapidly moving to the cloud. What does this mean for lenders? Cloud-based software is a huge upgrade from the old-school way of doing things. For starters, it's much easier to update. If you've ever used a Windows machine and been annoyed by an automatic update restarting your computer, you know exactly what we're talking about. With cloud-based software, vendor updates take place behind the scenes. No versioning, no restarts, no action required.

Cloud software is often backed up by the vendor. Do you remember using Carbonite or similar services to backup your desktop data? If you've ever had the hard drive on your computer go bad, you know how annoying it can be to re-download all your apps and try to recover your data. Cloud software is often backed up redundantly. If your database goes down, there's likely a standby database that will take over with only a few seconds of disruption in service. You probably won't even notice. Data also may be backed up regularly across multiple data centers to protect it against a catastrophic event.

Data Visibility

One of the most valuable things any company does is collect data. New lending applications give exceptional visibility into this data, including some that offer direct database access. Lenders are finding more and more value in the data they collect. Modern lenders often want to run their own analytics or warehouse their data to increase its usefulness. Any lender that wants to improve their products or borrower experience should demand the best data access.

Flexible Software

When you're first choosing a software, configuration options may seem like they'll only introduce more complexity. But integrating with an inflexible software causes headaches down the road, when they want to pivot and their software won't budge. We've had lenders tell us they hate their current software, but they're keeping it anyway because changing core software is too hard.

Unfortunately, we've run into many lenders who picked software that only facilitates a single lending model and don't leave room to adapt. These servicing applications work fine until an unexpected change comes along, like a shift in the market or a new regulation. Later this year, the CFPB's Small-Dollar Rule will go into effect, and lenders who are tied down to inflexible software are panicking over how to comply. The ability to pivot to a new loan type or meet changing conditions has cost many lenders millions, and it has put some out of business.

And flexible software isn't only about hedging your bets. Flexible software design drives lending innovation because the old limitations no longer apply. Think back ten years ago. How odd would it have been to see an auto lender who also provided credit card lending, maybe offering better cashback on fuel and auto maintenance? Pairing different loan products may be unconventional, but with versatile software it's more than possible.

An innovative product offering doesn't have to be that diverse, either. For example, consider a credit card that caters to new mothers. The card is open for a total of nine months and gives preferential interest rates on purchases for the new baby. At the end of nine months, the card is closed, and the balance is rolled over into a traditional installment loan. And this kind of product offering is just the beginning. We anticipate that new technology will soon generate products that have not yet been considered possible.

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Anyone can be a Lender

When we talk about loans, most minds will turn to traditional lending institutions, like banks, credit unions, and private lenders. But there are also lenders whose primary business is an entirely separate industry. Amazon, for instance, lets customers use Buy Now, Pay Later plans, and offers business-to-business loans for companies that sell on their platform. There are retailers who offer financing for big-ticket items like furniture, electronics, or major appliances. We've even seen law firms that provide legal services as you need them, and then have you pay them back in installments. Modern lending software makes it easy for greenfield lenders to make their first foray into lending with confidence. If you're wondering what it takes to enter the fintech space, you might be surprised how simple it is.

For an example of an alternative finance company, look no further than Starbucks. On their mobile app, they use points and rewards to encourage customers to pay in advance for coffee they'll get in the future. In doing so, Starbucks—almost by accident—became a bank. Few people would have imagined that gift cards and loyalty points could raise $1.6 billion, but Starbucks has leveraged the program to raise massive deposits without any interest from their creditors. Any company can get into finance, and those who have a foothold in another industry may be well positioned to make the start.

Consider the vacation market. Airbnb and Vrbo have changed what it means to go on vacation, but there's no reason they should stop there. What if they changed their market even more by becoming lenders?

Imagine you're a home-sharing company and a customer is booking a place to stay on your rental app. They're trying to book it ahead of time, but that can be expensive and they don't have all the money right now. So they back out and decide not to book the vacation. You lost a sale and they're missing out on a vacation. But what if you offered them a loan? The terms can be whatever you want them to be: they can pay before the trip or after, they can pay interest or not. But now, you've made the sale and you also have the potential to grow your business and make even more money.

In another situation, let's say one of your property owners keeps getting complaints about their bathroom. It's outdated. The sink doesn't drain. It doesn't look good on my Instagram feed. If the owner updated it they would get better reviews and book more dates, but they don't have the money to remodel a bathroom right now. So you offer them a loan. They're able to update the bathroom, the reviews are better, and more people book the home. Now you collect the money from their bookings until the loan is paid off.

Vacation rental companies aren't the only ones who can start lending. What if consumers' favorite sports teams offered financed season tickets? What if clothing stores offered financing for back to school clothes? These options build borrowers' trust while increasing revenue for the company that provides these conveniences. Anyone who uses a credit card is already willing to finance their purchase, so why not make that financing part of your business model?

3

// RISE OF THE BORROWER

Changing the Negative Connotations of Loans

It's no secret that loans have a negative reputation. Many borrowers are cautious about getting into debt, and some view the entire industry with suspicion. And even if a loan is generally good, people aren't really excited about them, at least any more than they would be excited about tax season or their phone bill.

If lenders want to change the way borrowers look at loans, they need to change their marketing and user experience. These aren't just two disparate areas that both happen to need fixing, though; they're intrinsically linked. Your marketing sets the tone for the entire life of the loan, and borrowers' experiences then shape public perception of your company. If their experience doesn't live up to your advertising, they're going to share about it. In previous sections, we've focused on how new technology has empowered lenders, but it empowers borrowers as well.

Buy now

Most potential borrowers are going to start looking for a loan with an internet search. If the first thing that comes up when they search your company's name is a list of complaints to the Better Business Bureau, you can bet they'll be looking elsewhere. What's more, social media platforms can (and regularly do) rocket negative consumer experiences to the forefront of national conversation. They say any exposure is good exposure, but that might not hold true if a company is trending because they repossessed someone's car on Christmas Eve.

You, of course, have no direct control over what borrowers say about you. (Although you can do a lot to make their experience something they'll want to rave about, which we'll cover later.) What you do have control over is your own marketing. We're not just talking about a catchy slogan or a jingle that gets stuck in your head. When we talk about changing the negative connotations surrounding loans, we mean rewriting the whole story.

The best example from the past decade is the Buy Now, Pay Later model. In essence, these are zero-interest, point-of-sale loans that are typically issued by a retailer or one of their partners. The selling point for borrowers is that if they make payments on time, they'll pay no more than they would using cash up front. The lender makes money from the customers who miss payments and then end up paying late fees and interest, or from deals and discounts with the retailer. What's interesting about the Buy Now, Pay Later model is that they're seldom called 'loans'. Borrowers agree to all the same terms, but just calling it a 'payment plan' or 'financing option' circumvents the knee-jerk reaction they would have to getting a 'loan'.

This isn't just rebranding, either. Buy Now, Pay Later and other new lending models are only able to drop the 'loan' label because they're distinct products that borrowers are excited to use. The point isn't the name, but the underlying change in user experience that spawns the new name.

Pay later

Elevated Customer Expectations

Tech has already improved user experience in many industries, and video rental is a perfect example. Before the inception of Netflix, people had no option but to go to the nearest Blockbuster (or other video rental store) if they wanted to rent a movie. Now, everyone has access to thousands of movies available on various streaming platforms. The takeaway here is that before an alternative was presented, no one really had other options. It was inconvenient to drive all the way to Blockbuster just to rent a movie, but that's just the way things were done. If anyone tried to open another Blockbuster now, it just wouldn't work—customers have permanently raised their expectations. Similarly, Netflix can't expect the innovations they made a decade ago to secure customer loyalty today. They've recently discussed plans to raise subscription fees, limit password sharing, and introduce advertisements—which has subscribers ready to jump ship (New York Times, 2022).

With countless businesses improving on the quality of their services and technology, borrowers are starting to expect more from their lending experience. Borrowers expect to easily access their accounts and track loan and payment information. They want to see their current balance and the payments they've made. They want intuitive websites and apps that make it clear where they should go next.

As with other industries, customers probably won't see a vital issue with the way things are done until someone points out that it could be done much better. As for the application process, that day is already here; borrowers are familiar with the speed at which online lenders can approve them, and will probably think twice about getting a loan from anyone who tells them applying will take even a half hour of paperwork. When it comes to servicing and collections, borrowers' expectations will vary. Some will accept a mediocre experience, but others have seen how tech companies have transformed customer experience in their industries, and will expect similar service from their lender. We can only expect their standards to rise.

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The Power of the User Experience

At the end of the day, a borrower can probably find loans that look similar on paper from a dozen different lenders. What distinguishes one lender from the next is a strong customer experience, and as we established in the last section, their experiences make up a huge part of your online presence through user reviews and the things people say on social media.

In the digital age, your user experience is your marketing, for better or for worse. So how can lenders turn that to their advantage?

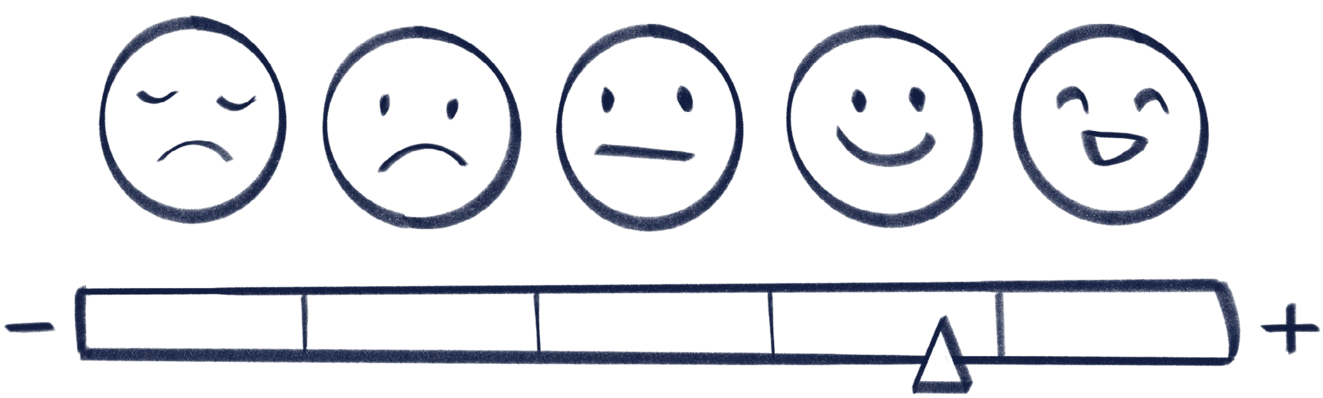
Consider this: In an ideal world, what would your borrowers say about your company? This varies from lender to lender, but there are definitely some consistent answers out there.

It's important to put thought into how you shape your borrower's experience. If you want them to talk about how your loans expanded their financial options, you need to follow through by putting those choices in the borrowers' hands. For example, you could let borrowers choose from multiple payment plans, giving them an option between paying their loan off quickly and with less interest, or over a longer period with more interest, or any comfortable place in between. A decade ago, offering customizable payment plans may have been a technical headache, but modern software can handle those calculations with ease.

Suppose you want to cultivate a reputation as borrower-friendly. In recent years, we've seen an uptick in the number of lenders offering hardship relief programs, letting borrowers delay payments while they handle an unplanned change in jobs or a family crisis. For the lender, these programs just cost a bit of patience (and they may pay for themselves if interest continues accruing while payments cease), but for the borrower, it can be an act of goodwill that helps them avoid financial ruin.

With a customer portal that's integrated with your servicing platform, you could let borrowers select those options themselves, like a button to skip a payment or lower the payment amount for a few months. Many lenders already offer these options to borrowers who repeatedly struggle to make payments, but why not improve user experience across the board by giving every borrower the power to make that choice? Whatever you want your borrowers to praise you on, the loans you offer need to deliver. That might mean taking a hard look at your product, putting yourself in the borrowers' shoes and asking if you'd be a satisfied customer. It might also mean taking a hard look at your tech stack and software to determine if you have the resources you need to build and service the products you want to put on the market. If you do, then you're one step closer to innovation. If you find your tech and software lacking, then you should look into upgrading.

A vital way to improve your user experience is to leverage available data about your prospective borrowers. If you gather the right data from the right



furnishers, your customers will spend less time filling out applications, you can improve many aspects of your servicing and collections, and you can even expand your market.

The old mindset said a credit report was the gold standard of underwriting information. Now data is readily available to help lenders understand an applicant's buying behavior, bank account history, work history, payroll cycles, address permanence and much more.

Instead of asking your applicant for a lot of data, get the minimum and use data furnishers for the rest. Pull the data you need in order to paint a real picture of who the borrower is. When do they spend, where do they work, what is the best way to contact them? Beyond this, use data to expand your customer base. Don't just pull U.S. credit data, use a service that provides international data to find qualified borrowers who are new to the U.S. Don't totally rely on the same old credit score, pull alternative credit information to find those with a thin credit file who are eligible for a loan.

Data should be used far beyond making the original loan decision. While servicing the loan, wouldn't it be nice to know the best phone number and time to contact a borrower? Would it improve your collections to know what day of the month the borrower typically has the highest balance in their bank account? It's surprising what data is available, and it may be even more surprising what you can learn from properly analyzing it. There are great options out there that will help you keep up-to-date borrower information, tell you who they are, predict their behavior, and better encourage them to make loan payments.

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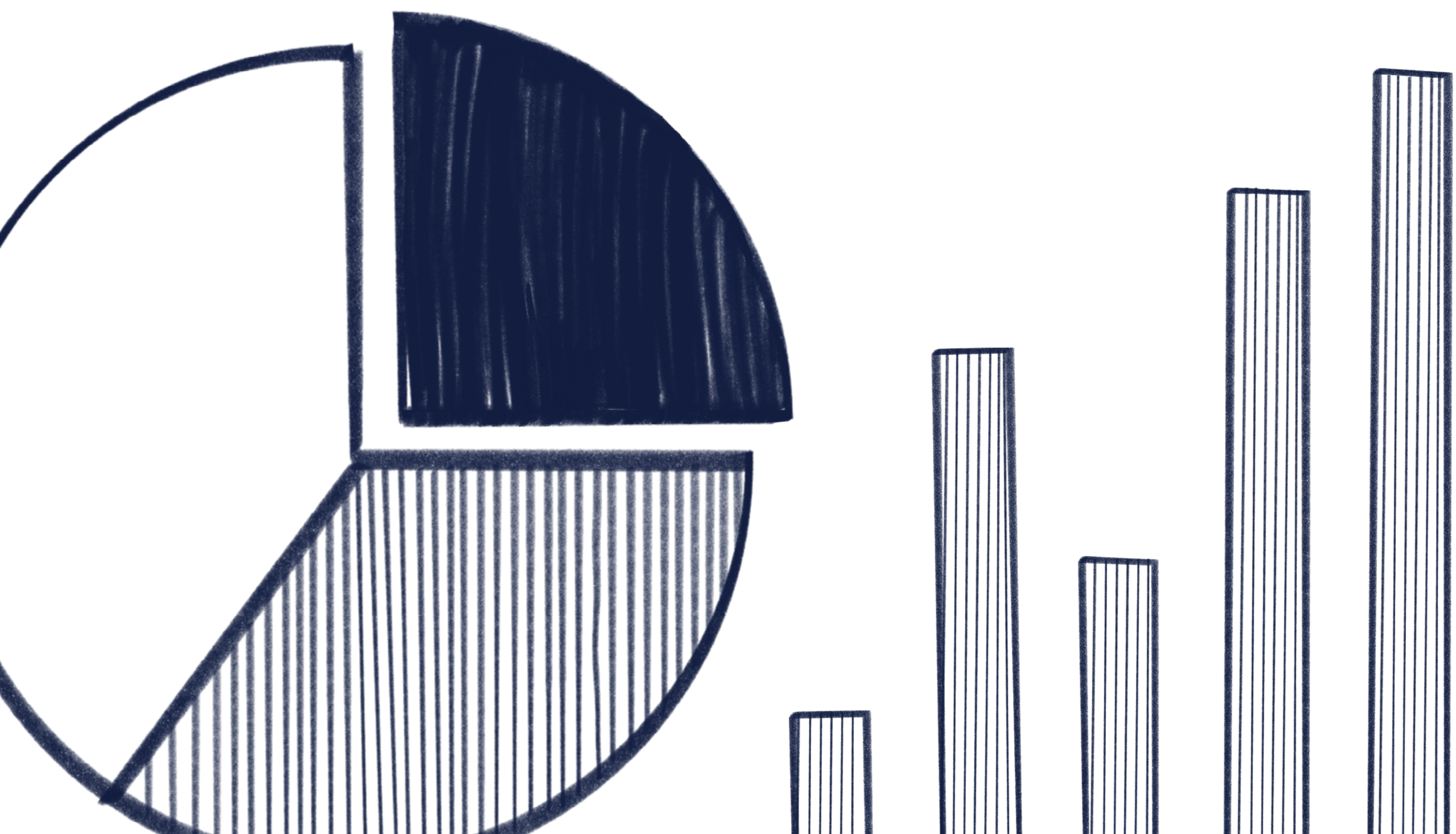

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// CONCLUSION

The End of Complacency

The age of complacent borrowers is drawing to a close, and there's never been a better time to be a lender. Since time immemorial, banks and lenders haven't needed to worry about a top-tier customer experience. Borrowers couldn't imagine a better system, and even if they could, those options weren't on the market. But the advent of more powerful technology has empowered a new wave of lenders to build better user experiences, attracting customers by making it easier than ever to get a loan and pay it back. These lenders have brought excitement and disruption to the market, and borrowers are eager for more.

Whether you're a traditional lender, a fintech, or a greenfield lender considering entering the industry for the first time, now is the time to invest in more powerful tech and build a better user experience. Modern, adaptive software can turn your ideas into products that will delight your borrowers, make you money, and revolutionize the marketplace.

We'll be the first to admit that it's a little bit easier said than done. It'll take an investment of both time and resources, as well as a commitment to new and innovative ideas. From our vantage point in the industry, we've seen the exciting things lenders are doing to secure funding and build out their products. We've learned enough that we're writing two more ebooks on those specific topics, working with new capital and creating innovative products.

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