RETURNING TO HEALTH:
New Digital Opportunities
In Unsecured Lending
Returning to health: new digital opportunities in unsecured lending

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Unsecured lending: a market in flux

Following the 2008 financial crisis, challenging market conditions put traditional lenders under enormous pressure to shore up their capital reserves. The priorities were cutting costs, saving money and taking less risk. At a time of rising demand for personal/student loans and overdrafts, banks adapted to reduce lending in products like micro-unsecured loans; with manual solutions, the high cost to serve this segment could not be supported long term, particularly where there was also a significant risk of default. This created a gap in the market (see Figure 1).

With strong backing from private equity firms, tech-savvy payday lenders were quick to exploit this gap. Using technology to make rapid lending decisions, these providers became increasingly dominant from around 2012. With little competition from traditional lenders, they quickly usurped the ‘old guard’ of non-traditional lenders (doorstep lenders, logbook loans and pawnbrokers) that had previously offered small loans with high interest rates.

Precisely because the customer acquisition methodology was so frictionless, customers often failed to understand the terms and conditions linked to payday loans. This led to multiple complaints to the Financial Ombudsman Service about the need for simplification and transparency, and dissatisfaction amongst customers who felt they were being treated unfairly. As more people started looking for payday loan alternatives, non-traditional financial institutions took advantage of technology innovation to create new lending platforms (including peer-to-peer and crowdfunding sites).

Examples of start-ups include education loan firms like Prodigy Finance and StudentFunder and personal loan firms like LendingWorks and Zopa. Personal loans are not the only products being re-invigorated. Now mortgage products are also being offered by companies like LendInvest, which has made loans of more than £500 million to date. And we’re seeing non-traditional lenders make inroads into the SME space, with initiatives like Funding Circle (which now has HM Treasury backing) becoming the world’s leading marketplace exclusively focused on small businesses (the company’s lent over £1.3bn to more than 15,000 businesses in the UK, USA, Germany, Spain and the Netherlands1).

In what’s become an extremely fast-moving marketplace, with multiple players jostling for position, there have been a number of critical changes, not just in unsecured lending but also across the wider consumer credit sector. This means lenders now face unprecedented challenges from three key sources: robust consumer-oriented regulation, financially sophisticated and market-aware consumers (who like to shop around) and the reinvention of core banking services by non-traditional financial institutions.

The lending decision engines used by the biggest payday lenders were more complex and comprehensive than anything the UK’s biggest banks had at their disposal. Digitally powered decision-making enabled rapid customer acquisition processes and low cost to serve. As a result, payday firms grew fast and reaped attractive returns.
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Figure 1: Market gap following 2008 financial crisis

1 https://www.fundingcircle.com/uk/about-us
Rebuilding trust and placing the customer front and centre

From 2013, tightening credit regulation of the unsecured lending market meant some 50,000 consumer credit firms required FCA authorisation to remain in business. Securing this authorisation proved challenging, however, and around 50 percent of payday lenders – including well-established names like Cash Genie and The Cash Store – exited the market. The remainder had to evolve fast by overhauling their business model to meet high-cost short-term (HCST) lending rules in order to secure FCA authorisation.

Strong regulatory controls and processes have increased the cost to serve, while historically low interest rates mean overall lending business models are much less profitable than before. In this environment, it’s even more important for firms to invest in the systems, governance and products that meet consumer demands, facilitate customer acquisition and lower the cost to serve.

There’s been a decisive shift in industry dynamics from firms offering high-risk products that didn’t meet customer needs to firms offering products and services tailored closely to customer requirements. This has forced a rethink in strategies and business models for all providers. From now on, the leaders will place customers front and centre in everything they do.

Instead of operating by traditional payday lending rules, leaders are broadening their product base to attract new customers and challenge offerings from high-street financial institutions. Innovation’s the name of the game, and it’s an area where non-traditional financial institutions excel. These products are less about rates and payments, and more focused on providing immediate access to credit at point of need.

This innovation drive carries valuable lessons for traditional lenders. Various products have been launched onto the alternative lending market, which point towards lucrative new areas of growth. For example, players in the high-cost short-term credit (HCSTC) market are moving from offering a single short-term payday loan product to longer multi-instalment loans.

Guarantor loans also seem to be attracting renewed interest from lenders. Companies are offering competitively priced credit and rewarding successful payment histories with rates on subsequent loans that can decrease over time. There are also products offering responsible lending features including credit bureau reporting, online financial literacy videos and tools, amortising loan balances, and flexible repayment schedules.

We’re seeing the atomisation of financial products. This includes finance instalment loan sign-up at the point of online purchase on third-party e-commerce sites. This presents a major opportunity for UK banks, which can easily provide these services by utilising existing payments and digital infrastructures.

2 Non-traditional financial institutions have had support from the Financial Conduct Authority’s ‘Project Innovate’ programme, set up in 2014 to oversee and support these businesses from a seed-to-launch perspective (https://innovate.fca.org.uk).
New products for new needs

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New capability models required

To design and develop innovative products like these, management and organisational structures must support new ways of working, including development of new capabilities in areas such as decisioning, collections and forbearance.

Strong alignment between Business and Technology functions is essential for creating products and delivering them to market via cost-efficient digital channels. Business must have a clear definition of the customer experience, with a product proposition that includes the minimum viable product (MVP) and its core features. Meanwhile, Technology must be able to configure the MVP to provide a repeatable digital lending experience through easy-to-use menus.

While companies must be prepared to launch new products quickly, with design processes now under increased scrutiny, it’s essential to be able to prove compliance with stringent regulatory requirements (the FCA’s new Consumer Credit Sourcebook (CONC) regulations, for example) at every stage of the product development lifecycle.

Figure 2 shows the new capabilities that lenders need to develop. Central to this is the ‘Risk & Decisioning Engine’ with deep analytics capabilities in customer credit and operations to accelerate decision-making for new products and ensure regulatory compliance.

Capability Model
A reference model was developed for an organisation offering unsecured loans.

Figure 2: A new capability model for the unsecured lending market
Know your market: customer acquisition via integrated marketing

Customers are willing to pay a premium for products and services that are easy to get, easy to access and easy to understand.

The capability model shown left is key to rapid design and launch of new products. But what about ensuring that products are targeted at particular customer needs?

First of all, lenders must clearly identify the priority customer segments. Having done so, they need to factor in the various regulatory requirements for products targeted at customers who are sub-prime, vulnerable, unemployed, disabled and/or facing financial difficulties.

It’s mandatory to include a comprehensive income, expenditure and affordability assessment as part of any lending decision so customers are not misled and do not become victims of poor pre- and post-sales practices.

Current controls over lending and increasingly sophisticated competition from other lenders mean the cost per acquisition has risen to a point where it’s essential to increase the lifetime value of each customer by facilitating cross-selling: a wider family of financial products from the same organisation enables this to happen by allowing customers to move from one product to another.

In today’s marketplace, marketing needs to become smarter. An integrated marketing strategy that includes coordinated direct mail programmes, TV campaigns (specifically advertising mid-week), search-engine optimisation and digital campaigns, and strategic partnerships with affiliates will allow lenders to focus on higher quality, lower cost customer acquisition while maximising reach and enhancing brand awareness.

These strategies should focus not just on acquiring new customers, but also driving more profitable relationships with existing customers using data to deliver more relevant services across a broad portfolio of needs.

New products need to reflect the applications with which customers are familiar, and fit with their lifestyles. In a market where consumers are increasingly turning to online/mobile solutions to fulfil their personal finance needs, lenders must be equipped to cater to these preferences.
New development capabilities with multi-speed technology

Lenders need to change how they develop and deliver products. The objective is to create a ‘multi-speed’ IT delivery organisation, with more ‘Agile’ delivery methods that impact the customer-facing layer running in parallel with traditional (waterfall/sequential) methods. Third-party delivery into the organisation via application program interfaces (APIs) will also need to be coordinated.

To change at the pace that’s required, lenders will need a shift in mindset from traditional design-build-test-deploy software development methods. Supplemented with practical governance and an integrated toolset to support end-to-end traceability, Agile approaches should make delivery in highly regulated environments less traumatic than would otherwise be the case.

Challenger organisations are releasing MVP versions of new products. This enables them to gauge demand, quickly test new features and react rapidly to real-time data showing how customers use their products. Lenders can emulate this approach through Agile, with the goal of achieving continuous delivery. Acquiring this technical agility often drives a shift from internal development delivery. Acquiring this technical agility often drives a shift from internal development of custom-built back-end systems to using API-driven third-party systems to power core functionality (e.g., loan management or risk decision-making).

Migration to a micro-services architecture enables independently testable/releasable services that can be launched rapidly in line with business needs. Increased configurability (in business logic and workflow) could further enhance the agility of the application architecture. For example, the move to a cloud-based, API-driven third-party Loans Management System allows companies to focus on customer experience areas where they can differentiate themselves in the market.

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**Target application architecture model**

A view of HCSTC lender’s target architecture

Figure 3 illustrates how this new application architecture could look.
The digital lender: from idea to execution

With consumer lending at its highest since July 2010, there are outstanding opportunities for companies that can create new, technology-driven product offerings to target a range of customer segments. The following priorities are key to realising these opportunities:

1. Be ready to meet customers’ unmet needs
   Lenders need to listen to their customers, understand how their behaviours are changing and identify any needs that are not being met. Taking advantage of the enormous quantities of customer data at their disposal, they’ll be able to align lending products and servicing methods to meet customer preferences. As they do so, they should consider extending their product portfolios with small, short-term, flexible loans that are easy to obtain and easy to access at the point of need. By adopting transparent fee structures (so customers can easily understand what they have to pay back and when) they’ll safeguard their reputations and brand image.

2. Use technology to lower the cost to serve
   Non-traditional financial institutions have demonstrated how technology can be used to lower the cost to serve/acquire and improve customer service. Traditional lenders can learn from their example. The priority should be to build solutions that are joined-up, easy to understand and easy to support, with fully integrated digital solutions at the heart of the new lending offering (focused on online and mobile channels). If it’s proving too hard, too restrictive or too time-consuming to integrate these capabilities with legacy systems, they should consider starting from scratch or collaborating with third-party platforms. Whatever decisions are taken, understanding and investing in the right technologies through the right partners will be vital.

3. Ensure ease of access
   Many consumers are tech-savvy and like to conduct their transactions online. Firms should develop channels that provide rapid, easy access to the services that consumers require. This means developing full-service mobile and internet finance offerings (backed with automated lending processes). It also means keeping things simple. Lenders should revisit their operating models to ensure they are lean and agile. Time to completion can be reduced by streamlining end-to-end loan applications and incorporating seamless fulfilment processes. Where possible, opportunities should be seized for optimising the channel mix.

4. Enable rapid, accurate decision-making
   Simply carrying out an online credit check will not suffice in a highly regulated environment where people have multiple bank accounts, varying access to services, and different employment schedules and incomes. Innovative credit approval checks will be needed, based on a wider suite of data and artificial intelligence technologies. These will complement controls, processes and governance procedures that enable comprehensive, rapid and accurate due diligence for every lending decision.

5. Extract value from data
   If lenders can use their customer data to develop a behavioural economics capability, they should be able to offer customers interesting deals from the merchants they like to shop with. Best-in-class analytics will fulfil an essential function by providing a truly single view of the customer. The opportunity lies not just in using the transaction to make a loan, but also in earning a margin from sellers by matching them with consumers. It’s where digital businesses like Groupon have been so successful. And they’ve done so without having access to the customer data that lenders possess.
About Accenture

Accenture is a leading global professional services company, providing a broad range of services and solutions in strategy, consulting, digital, technology and operations. Combining unmatched experience and specialized skills across more than 40 industries and all business functions—underpinned by the world’s largest delivery network—Accenture works at the intersection of business and technology to help clients improve their performance and create sustainable value for their stakeholders. With more than 375,000 people serving clients in more than 120 countries, Accenture drives innovation to improve the way the world works and lives.

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