Two Days at Lendit

by Charles Wendel

Lendit is an annual conference held this week in New York that focuses on lending offered by nontraditional lenders. Attendance has exploded in recent years. The two-day session, which was sold out with about 2,500 attendees, brings together established and new players in Alternative Finance (AF) or as one company leader prefers to term that activity, "digitally enhanced lending." Lending topics discussed centered on consumer, real estate, and, in particular, small business. I felt I had to attend, even though I was not a speaker, because so many of my clients, prospects, and colleagues asked me if I would be there. This conference has become a meeting place to reveal and test new lending innovations and announce new partnerships, including Lending Club's CRA- focused activities with Citibank and the referral relationship between OnDeck and Prosper.

I will get into substance shortly, but the sense of energy, commitment, excitement, innovation, and enthusiasm seemed palpable at this meeting. How many conferences have we been to that we leave energized and have pushed us to be more creative and challenge traditional views? While bankers participated, the focus and stars of the conference were the nonbank innovators, among them: CAN, Fundation, Fundera, Funding Circle, Lending Club, and OnDeck , among others.

Recently, I was discussing the AF world with the retail head of a top 50 bank, someone I have known and respected for many years. Frankly, his comment about Alternative Finance surprised me: "I've seen this rodeo before." He meant that in his view the AF initiative, like CRE lending or residential mortgages in recent years, would blow up and these hotshot lenders would disappear. FACT: Alternative Finance is part of the permanent consumer and small business lending landscape. Absolutely, positively, many will disappear due to insufficient origination, poor risk management, and/or various operational problems. To the credit of the AF industry itself many speakers at the conference predicted a shakeout and proactively warned against the "irrational exuberance" that occurred during the last decade, mentioning the likelihood of fraud or a loan platform's failure occurring in the next few years.

Why do these lenders and their investors see such a substantial opportunity in small business? Noah Breslow of OnDeck cited a Federal Reserve study that calculated it took 33 hours for a small business to find and apply for a loan, a major time commitment versus the efficiency and quick turnaround AFs believe they can provide. He also mentioned that small business loans as a percent of all business loans made by banks had declined from 35% in 2008 to 24% in 2013 and specifically cited the drop in community bank lending in this area from 44% to 22%. Further, working with FIC's data analytics partner, we estimate that banks only view about 10 percent of companies below $10 million in revenues as "qualified" to become bank borrowers. The other 90 percent represents over $1T in potential lending. Even if that number exaggerates the opportunity, nonetheless, it indicates how much revenue banks are leaving on the table for others to pursue.

Poor efficiencies in the small business loan process and a gap in marketing focus, among other elements, have created an opportunity for AFs to fill in this space. Larry Summers, the former Secretary of Treasury and a Lending Club and Square Board member, spoke at Lendit and commented that he would "not be surprised" if within ten years AFs generate 75% of "non-subsidized" small business loans (and 30-40% of direct consumer lending). Whether you agree with him or not and even though such a prediction is likely to be inaccurate, his words merit consideration. The potential impact of anything like that type of change could redefine the financial services business and erode a bank's performance.

Cooperation not competition. One of the conference's recurring themes centered on the desire of many AFs to work with rather than compete with banks. Among the reasons for this: banks can provide access to a large number of potential borrowers; many AFs need to build scale, and banks can help them do so. AFs believe they can provide significant value to banks related to revenue growth, improved operating efficiencies, and enhanced risk management. For example, many data scientists at AFs have focused on screening borrowers by not only reviewing balance sheets and tax returns as banks do but also evaluating the cash in bank accounts and multiple other data elements. Banks may be surprised to find that some AFs exceed banks in the detail and rigorous of their credit decisioning process. The "rodeo" comment above indicated that one senior banker thought the AFs were acting like cowboys in a Wild West show. And, while cowboys always exist, most AF lenders focus on nailing risk issues, leveraging both data and experienced lenders in their process.

At least three areas of opportunity. As AF's focus on working with banks develops and their capabilities matures, three key areas provide opportunities to forge mutually beneficial relationships:

1. Turndowns
2. Market expansion or enhancement
3. Platform integration

Turndowns- Whether as loan aggregators, direct, or marketplace lenders, AFs can review loans that do not fit bank screens and oftentimes find one or more alternative lenders to meet customer needs. A referring bank receives a fee for sourcing the loan and maintains control over the ongoing relationship.

Market expansion or enhancement - AFs can help banks develop loan programs for the 90% of small business prospects they currently avoid or for areas in which a bank operates with limited capabilities. The Lending Club/Citibank deal is one recent example of this approach. AFs can provide the operational and risk management help that banks need but may lack in certain lending areas.

*Platform solution/integ*ration – As banks determine priorities, some will find that integrating their marketing focus with the support that an AF provides addresses b reduces cost, increases quality, and enhances growth. Can a bank fully integrate one or more business lines with the platform solutions that the most sophisticated AFs can offer? Yes, and some banks will do so.

Alternative Finance remains a dynamic industry that continues to develop in light of market opportunities and investor preferences. Banks whatever their size should assess the benefits that AFs offers and determine whether and how they should partner with them. Appropriately, a banks' appetite to cooperate with alternative lenders seems to be growing quickly.