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The Financial and Service Opportunities of Digital Lending Technology for Community Institutions

By Jeffrey Harper, President, BSG Financial Group

According to recent studies by both Goldman Sachs[1] and Ernst & Young[2], financial institutions stand to earn $30 billion in the next eight years by utilizing digital lending technology, which allows banks and credit unions to offer loans – for example, small business loans under $100,000 and consumer loans under $30,000 – online and in minutes from their website or via mobile phone. When contemplating this revenue opportunity, compare it to two decades ago, when NSF revenue tripled from $12 billion to $34 billion and interchange grew $6 billion to $18 billion between 2000 and 2010.

Online lenders like LendingClub and Prosper have capitalized on this market opportunity and have grown handsomely by offering the convenience of applying for loans digitally and getting funds quickly. Their focus on automating the lending process has helped them:

- Outpace bank and credit union lending[4]
- Capture the majority of unsecured consumer loans in 2015
- Double their outstanding portfolio balances every year since 2000

The dramatic success of non-bank lenders, in fact, led industry advisory firm Bain & Company to say, "Banks need to accelerate investments in digital lending if they are to avoid a material decline in profits and loss in market share." Likewise, consulting firm McKinsey & Company declared that financial institutions that do not adopt a digital lending solution could lose 60% of their retail and small business profits to non-bank entities in the next five years.

Technology Changes Everything

With digital lending, traditional loan profitability scenarios do not apply. For the past 20 years, many community institutions stopped making these loans altogether, because the cost to underwrite and service them far outweighed the income to be earned. Despite the fact that customers needed the money, it was simply not profitable, forcing accountholders to seek the funding elsewhere, such as from a credit card, an alternative lender or even a competing institution.

Online lending technology changes the profitability scenario by streamlining the entire lending process – from application and underwriting to set up, review and renewal – via an end-to-end technology platform. Automating the lending process in this way can reduce the expense of processing and managing a loan from approximately $2,400[4] to $250[5] or less. These efficiencies can give an institution the opportunity, with only minimal effort, to re-capture loans previously lost to other funding sources, while improving customer service and reducing costs.

Additionally, with the right digital lending platform, the institution is able to utilize its own underwriting and risk-rating standards to manage risk and security. And because the institution controls the technology, it is able to keep all of the loans on its balance sheet as working assets, unlike partnering with fintech companies that typically retain ownership of the loans.

The financial opportunity that digital lending technology provides gets even better when you consider that in addition to garnering new loans and customers for your institution, it can also assist with managing existing loans. This added benefit is significant considering financial institutions currently hold more than $250 billion in small business debt that could easily and efficiently be renewed or refinanced using a consumer-friendly and efficient digital solution.

Digital is Key

Meeting consumers' ever-increasing digital demands with an online lending solution just makes sense. A study by MagnifyMoney found that financial institutions with the highest digital adoption scores grew their assets 16 times faster than those less likely to adopt new digital technologies.

Further, banks that score highest in digital excellence measurements have reaped the lion's share of financial rewards, according to BCG Perspectives in its 2016 Retail Banking Excellence (REBEX) benchmarking study. The report cited a 50% higher average pretax profit per customer than the median, while operating expenses per customer were 30% less. These impressive numbers are probably why more than 70% of financial institutions worldwide say that redesigning or enhancing the customer's digital experience is one of their top three strategic priorities in 2017.[6]

Today's consumers, especially millennials, seek easy, quick solutions. They use their phones to accomplish the majority of their daily activities, and they will readily switch banks if they have a poor digital experience. With digital lending, your institution can reap the financial rewards of offering accountholders the ability to apply and get approved for the funds they need from their internet-enabled phone or desktop computer... anytime, any day, and all in less than three minutes.

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[1] https://www.scribd.com/document/268857182/Goldman-Shadow-Bank-Report-May-2015

[2] http://www.ey.com/Publication/vwLUAssets/ey-alternative-lending/$FILE/ey-understanding-alternative-lending.pdf

[3] http://newsroom.transunion.com/transunion-analysis-finds-fintechs-outpacing-traditional-lenders-in-personal-loans-issued-to-near-prime-and-prime-borrowers

[4] BAI Banking Strategies (https://www.bai.org/banking-strategies/article-detail/making-small-business-loans-profitably)

[5] R.C. Giltner & Associates, LLC

[6] Digital Banking Report (http://onlinebankingreport.com/subscriptions/browseresearch.html)

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