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How to Use Post-pandemic Crisis to Your Advantage:

Action Guide for Alternative Lenders

Nick Varnitski and Eugene Protasenia, Founders at Armada Labs, exclusively share actionable tips on how alternative lenders can effectively handle the post-pandemic economic crisis with “lending 3.0” digital solutions.

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NEW OPPORTUNITIES FOR ALTERNATIVE LENDERS

It may sound surprising for some, but even crisis presents opportunities, and finding these helps to stay ahead of the game, while others struggle.

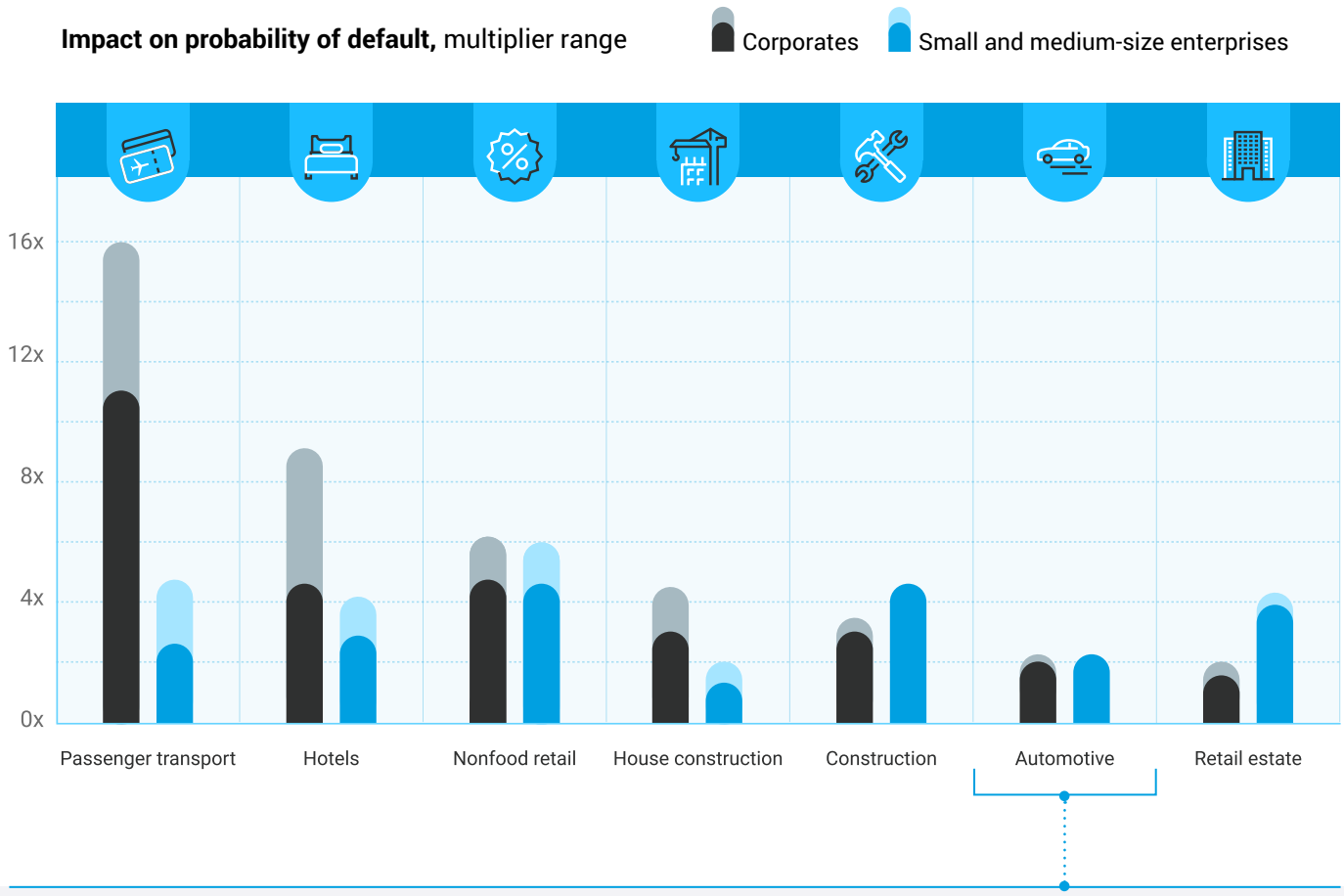
Let's see what opportunities the pandemic has created and how your lending business can reach these.

1 Increased Demand for Loans

At times of crisis, like the ones we are coming through now, businesses (both enterprises and SMEs) urgently need financial backup. Hence, they need more working capital than usual. As a result, the most vulnerable industries are the most demanding ones.

Sector analysis shows that probability-of-default shocks differ among subsectors.

Impact on probability of default, multiplier range



Automotive subsector focus, qualitative scale

- ↑ Maintenance and repair of motor vehicles
- ↑ Manufacture of parts and accessories for motor vehicles
- ↑ Sale, maintenance, and repair of motorcycles and related parts and accessories
- – Manufacture of tires and tubes; retreading, rebuilding tires
- – Wholesale trade of motor-vehicle parts and accessories
- – Manufacture of bodies for motor vehicles
- – Manufacture of trailers and semitrailers
- ↓ Manufacture of motor vehicles
- ↓ Manufacture of motorcycles
- ↓ Sales of cars and light motor vehicles
- ↓ Sale of other motor vehicles

Source: **McKinsey&Company**

At the same time, the crisis didn't damage businesses engaged in e-commerce, healthcare, food delivery, and other industries that answered urgent safety needs. Rather, those hit the golden mile due to the soared demand for the for "contactless" services.
Speaking of SMEs, the U.S. government has been actively supporting those during the current recession. Specifically, it introduced a Paycheck Protection Program (PPP) that targets businesses of all sizes. Around 600 large companies received the maximum program's allowed amount of $10 million. Small businesses benefited from the program the most as over 87% of the provided loans were less than $150,000 each.

Passenger transport, hotels, and nonfood retail businesses are the most exposed to default post-pandemic.

2

New Consumer Markets

When the government's and institutional bank's ability to provide financial aid is limited, alternative lenders must react. Meanwhile, the crisis creates new consumer segments to serve.

One of the broadest, hence prospective segments is "gig-economy" workers, constituting 36% of the U.S. labor. Specifically, those are Uber drivers, Amazon couriers, Instacart shoppers, and other service providers who receive work assignments from mobile apps.

Per the American Labor Code, these workers are classified as "independent contractors." And these are the ones who have been dealing with more risks since the pandemic began. As the demand for taxi drivers and home delivery has soared, these contractors grew highly exposed to the virus. Four in ten workers don't receive sick-leave benefits and can't cover even a $400 emergency expense as a result. In this light, they will have to ask for loans, and it's up to you to win them over with a competitive loan offer.

Four in ten U.S. workers don't receive sick-leave benefits and can't cover even a $400 emergency expense.

3 New Digital Services for Consumers

Besides new markets, the current crisis should bring new “tech” opportunities to alternative lenders, the modifications to existing lending infrastructures, as well as encourage them to promote new lending offers. The main business benefit here will be an increased loyalty of the current consumer base.

Before the post-pandemic, IBM and Bank of America announced their plans on creating a unique-of-its-kind public cloud platform for alternative finance. The solution should facilitate regulatory compliance and provide security, speed, and efficiency, all ensured by cloud technology.

Around the same time, Santander began offering a mortgage payment holiday for the consumers who were financially hit by the crisis. With the same directive in mind, Kabbage launched a dedicated federal program, covering salaries, rents, and other expenses for small lenders, to help them recover from the economic crisis.

Also, Kabbage teamed up with Lendio, Finix, and Fundera to launch a platform where consumers could buy gift certificates to support the local SME sector at times of the crisis. The certificates can be redeemed at any time but small businesses receive the revenue within one business day of purchase.

Besides this, Revolut and other fintechs added a charitable-giving feature within their apps through which consumers could donate funds to people affected by the recession.

Further, we will discuss the next-gen alternative lending solutions to help you reach new opportunities and speed up your recovery.

WHAT YOU CAN DO RIGHT NOW

Before jumping to responsive measures, there's a set of quick actions you need to perform as groundwork.

- **CREATE A SPECIAL TASK FORCE** responsible for crisis management. Even if it consists of one to several persons, it will be worth the effort.
- **KEEP AN EYE ON CHANGING REGULATIONS** and react fast. When automating processes, see if you can "reassign" your employees to other tasks.
- **ADDRESS EXTERNAL RESOURCES** as now is the right time to hire external part-time employees to save on costs.

Overall, you should define the processes you can change quickly to recover your ROI asap. In many cases, technology solutions may be the right answer to the problems your business struggles with.

INNOVATIONS IN ALTERNATIVE LENDING:

Best Practices to Enhance your Current Lending Solution

Alternative lenders had already passed the stage of digital transformation 1.0, essentially, when they made their operation digital. Now, it's time for digital transformation 2.0 and new solutions to help you beat the competition and come out from the crisis stronger.

Forward-looking businesses can seize the opportunity and migrate to new business architectures faster than they could before post-pandemic. Besides the earlier mentioned cloud, there are AI-based lending platforms that enhance customer experience with digitized end-to-end journeys. Next, we will share what is required to create this solution, dissecting the development process step by step.



BUILD A NEXT-GEN DIGITAL LENDING SOLUTION

1

Research & Develop

The essential preparatory phase that you start with analyzing your assets and reviewing current market trends. Based on the collected data, you prepare and implement an action plan, split by iterations, which we will further review.

2

Start with a Minimum Viable Product (MVP)

An MVP is the base of any future product, a demo or test version that helps you verify if the market truly needs your product. Typically, the MVP covers up to 80% of use cases to deliver to the business needs much faster. Make sure to include easy-to-support technology as early as at the planning phase to navigate the further actions; develop software internally or contact third-party vendors.

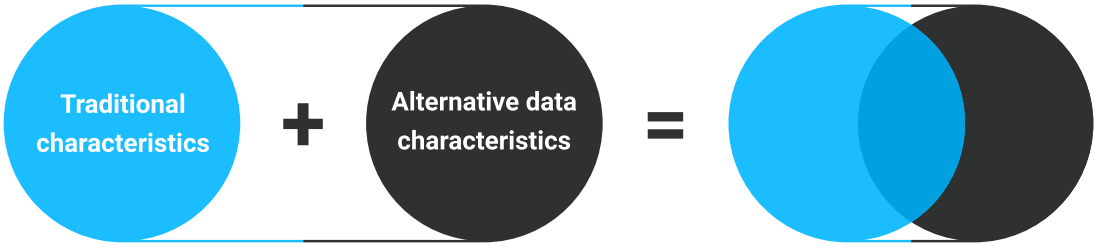
An MVP covers **up to 80%** of use cases to deliver to the business needs much faster.

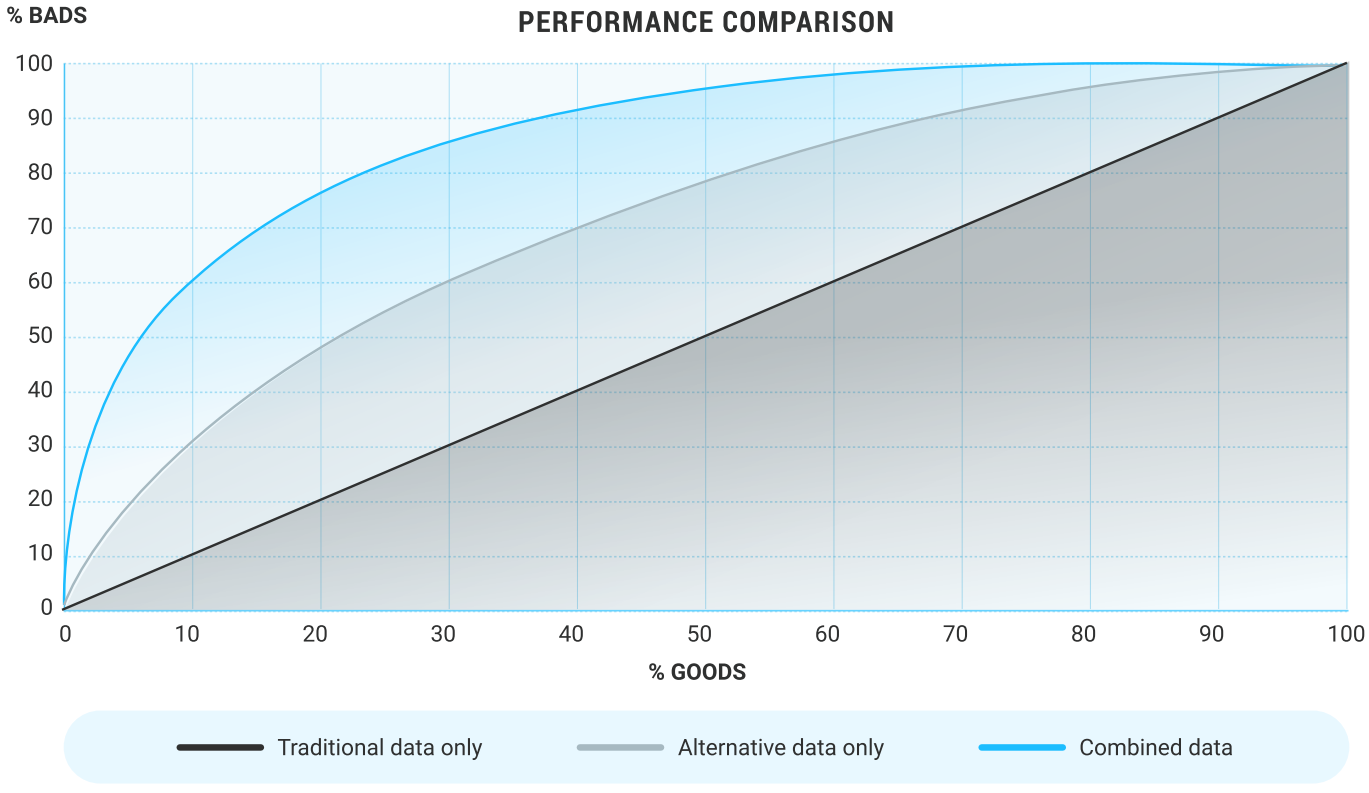
3

Migrate your Data

After all the required data is gathered and structured, you may start planning the future application's infrastructure. Keep in mind business continuity as consumer behavior changes constantly. Leverage alternative sources to collect the data about your clients — this will increase your credit scoring accuracy hence business performance.

The below chart reflects FICO's research conducted on a digital loan origination project based on Machine Learning. It shows that traditional and alternative data sources combined can produce even more powerful credit scoring models.





Source: **FICO**

4

Maintain & Support

If you equip your solution with easy-to-support technology, as we stated earlier, this will allow you to easily support it with new functionalities while using the same vendor. Selecting the right technology will guarantee you the continuous support of your product. Sticking to a particular vendor will also save you from trouble and unnecessary risks you might have if you were to change vendors.

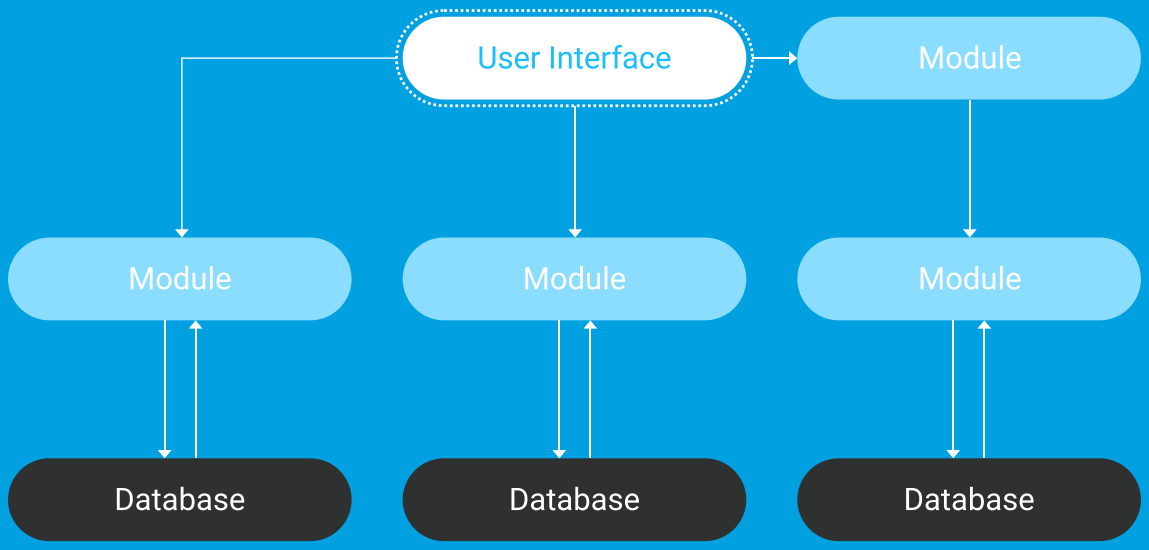
MODULAR ARCHITECTURE IN ALTERNATIVE LENDING SOFTWARE

Modular design is an important aspect you should consider at the planning stage. Architecturally, a next-gen alternative lending solution consists of independent modules, or units, which allows you to make modifications and changes as fast as the market demands. You are not putting the whole technology stack at risk in this case, as every application process is carried out as a separate service.

A next-gen modular lending solution can be modified as fast as the market demands.

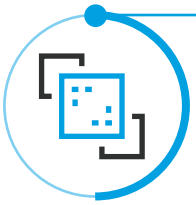
Per the modular architecture, the functionality is split into modules communicating with one another through APIs. Each module can be updated, scaled, and deployed independently.

Modular architecture



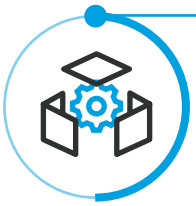
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In the business context, the modular architecture introduces the following benefits:



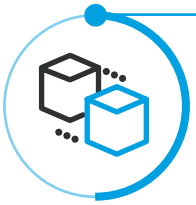
MORE FLEXIBILITY

in maintenance since all components are independent of each other. Plus, if one of the modules has a bug, it won't affect the entire application.



SIMPLE LOGIC

due to the division into small components. This makes the application's management easier to understand as you focus on a particular module related to a business goal you are currently pursuing.



FLAWLESS SCALABILITY

when modifying a particular module. As we said earlier, each module is independently scalable, which makes the whole process more cost-effective.



FASTER TIME TO MARKET

which helps you stay ahead of the curve. Working with individual components, you roll out every update with no delay, which would be impossible if you had to update the entire system.



HIGHER ROI

which means reasonable investment for your business in the long term. Integrating new modules or modifying each one separately ensures the sustainability of your digital lending application.

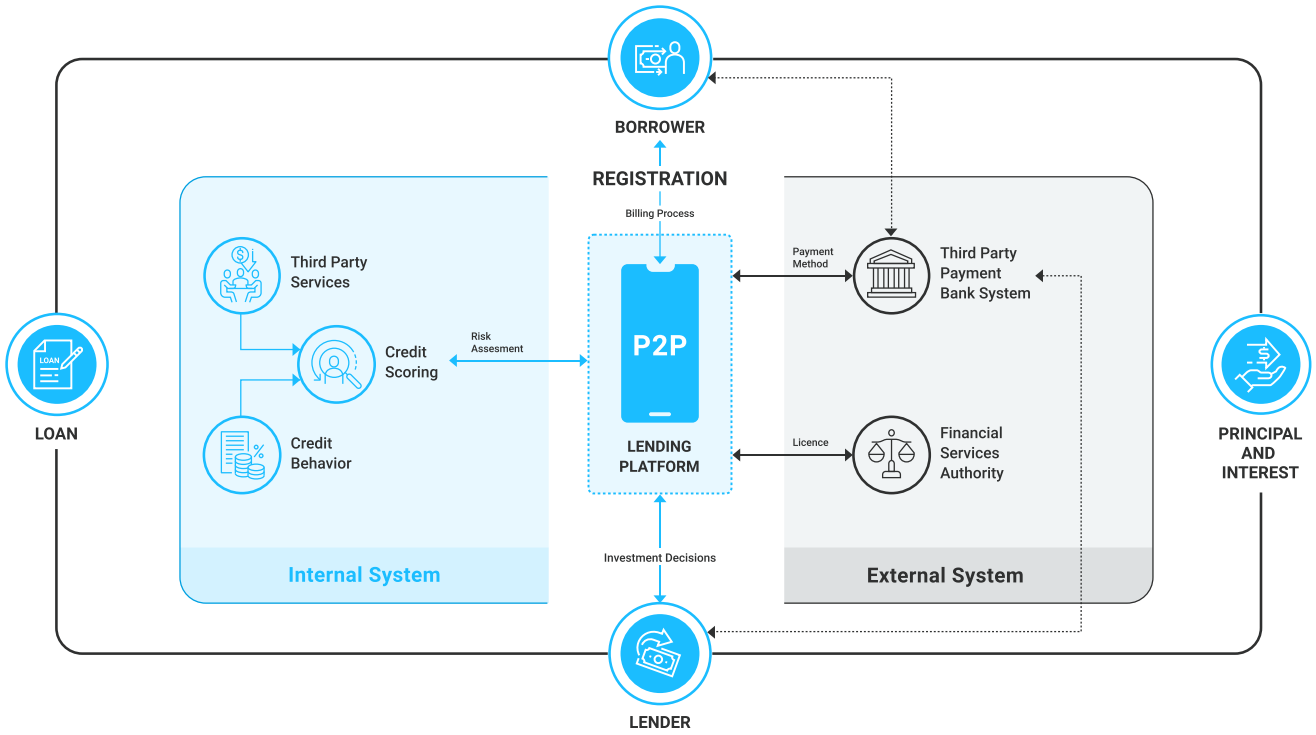
HOW DOES LENDING 3.0 BENEFIT YOUR BUSINESS?

As a result, your next-gen digital lending platform positively impacts the critical aspects of your operation, allowing you to optimize business processes, improve end-users' experience, serve a broader clientele, and leverage more data. Let's dwell on each of these benefits.

1 It Optimizes your Lending Processes

ecosystem. In essence, this is a whole new business model that combines the Internet and finance. Per the model, users collect funds in small amounts and lend them to the eligible applicants. Fund transfers are carried out through the Internet. In all other aspects, the basic operation in P2P lending much resembles institutional lending..

P2P Lending Business Process



Source: **Elsevier B.V.**

The P2P lending solution brings parties together, even if they are located in different parts of the world, which guarantees direct, quick, and seamless access to capital. Also, it utilizes non-traditional underwriting tools such as chatbots and videoconference, providing 24/7 digital communication between lenders and consumers.

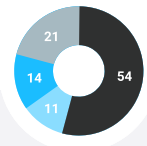
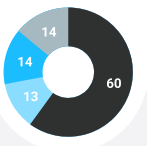
A P2P lending solution connects users from different parts of the world, which guarantees direct, quick, and seamless access to capital.

2 It Improves the End-users' Experience

Users play a vital role in technology adaptation. The first experience defines if the first-time consumer will be converted into the repeated one. Thus, if the target market well accepts your newly updated technology, then the users will readily adopt new workflows and tools.

The U.S. mortgage market is a good example showing how consumer behavior differs among different borrower segments. From McKinsey's related research, we can see that online channels are equally important as offline ones in attracting first-time home buyers. This segment is more cautious than those who applied for home mortgages earlier and takes more time to choose a lender. Some apply to several lenders at once as a precaution.

First-time and repeat buyer show clear differences in needs and behaviors.

	FIRST-TIME BUYERS % of respondents	REPEAT BUYERS % of respondents
Choice of lenders	Banks 76% Non-banks 24%	Banks 55% Non-banks 55%
Sources used to research and choose a lender Top 3 sources	Realtor 39% Friends/family 37% Online search 31%	Realtor 27% Lender website 24% Online search 24%
Primary reason for choosing lender Top 3 reasons	Exceptional customer experience 20% Best rate 18% Existing relationship /realtor referral/friends /family recommendations 17%	Best rate 23% Lower rate 16% Existing lender relationship 16%
Speed of journey	% borrowers that took more than 3 days to select lender 19% % borrowers approved within 10 days 34%	% borrowers that took more than 3 days to select lender 31% % borrowers approved within 10 days 42%
Customer experience Top 3 improvements desired by customers	Getting things right first time 23% Pre-approved within 24 hours 21% Quick, clear 24/7 status 21%	Getting things right first time 23% Single point of contact 21% Receiving a customized list of docs, early in process 18%
Comfort with digital mortage propositions		

Comfortable with online only
Comfortable with online and phone support
Comfortable with online, phone, and in-person support
Not comfortable with online

Source: **McKinsey&Company**

Finally, we can see that most first-time and repeat buyers feel comfortable with digital mortgage offers. This proves the point; consumers choose alternative lending solutions, so it is your job to provide them the convenience and transparency. This should be primarily done through UI/UX to encourage them to return to your lending platform to make another deal.

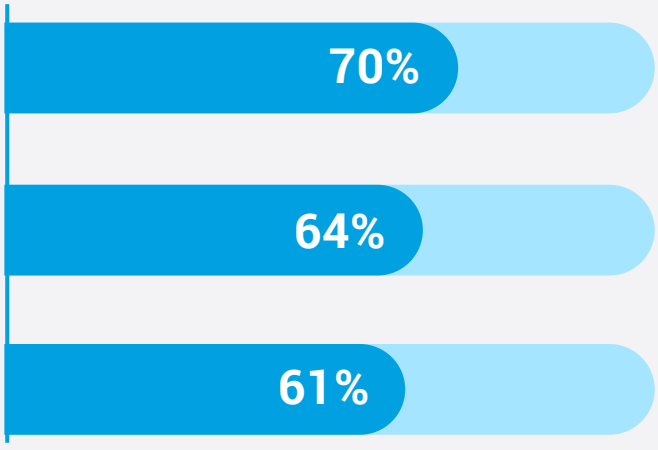
3

A single solution for Investors, Employees, and Consumers

In practice, your target market is broader than it seems at first glance. Primarily, it encompasses your investors, employees, and, finally, consumers. Satisfying the former two segments increases your chances of creating an efficient onboarding for the latter.

Of course, the consumer segment alone is also versatile. It comprises different age groups with different needs and credit capacity. P2P lending serves for better financial inclusion of both the unbanked and underbanked consumer segments; both have been increasingly using mobile banking applications for the last several years.

Mobile banking users who agree with these statements



Mobile banking is the primary way I access my bank account

I would research a bank's mobile features before opening an account

I would switch from a bank if they offered a poor mobile experience

Millennials and Gen X are likely to constitute a major part of digital loan consumers. They are tech-savvy individuals who seek new, great experiences, and next-gen lending solutions can give them these. Their influx into digital finance defined many trends to follow as they brought food delivery, cab booking, and other "online" habits to solution providers' attention. The pandemic only intensified these habits.

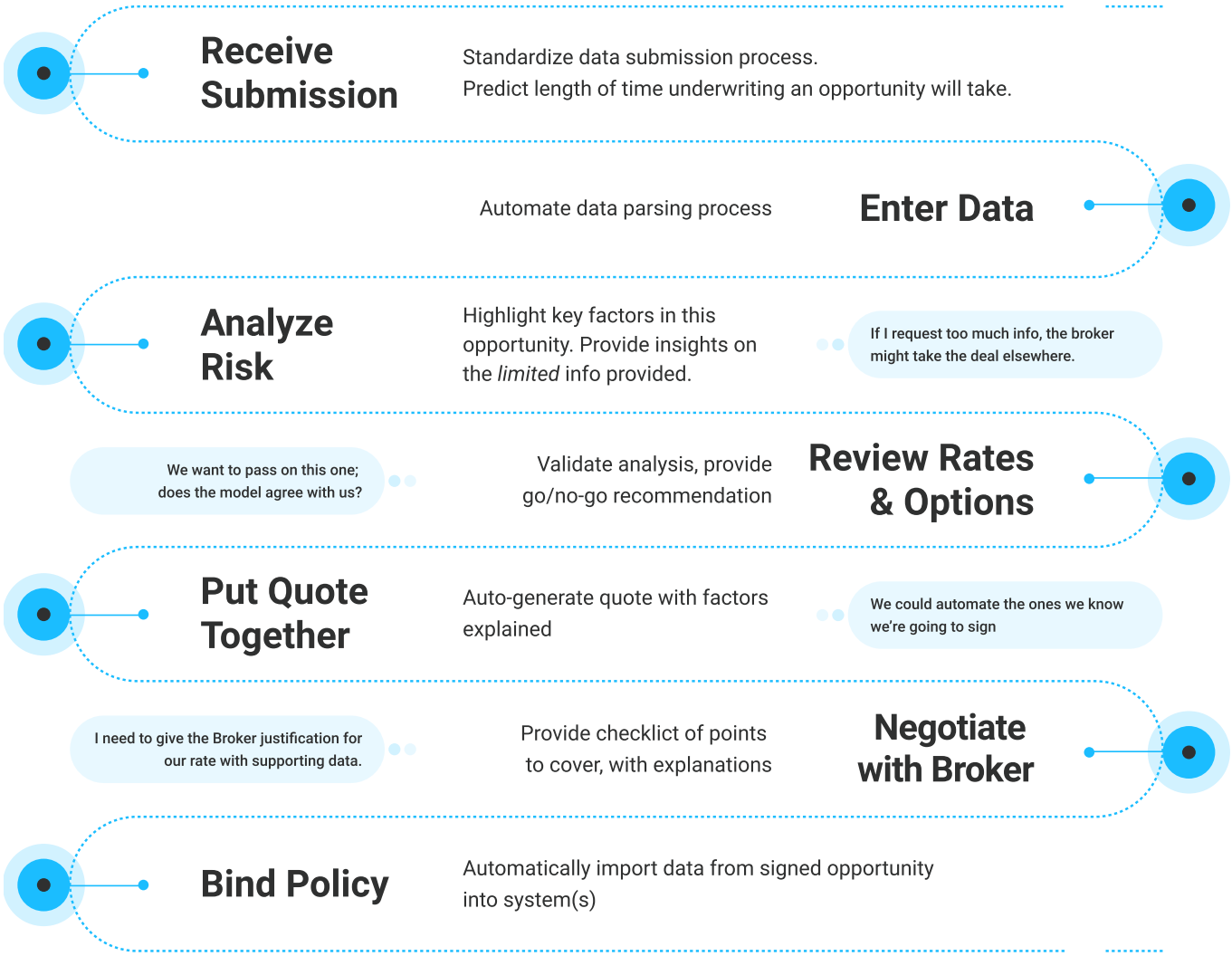
P2P lending serves for better financial inclusion of both the unbanked and underbanked consumer segments.

4 It has Access to Alternative Data Sources

We have already stated that Machine Learning helps to improve underwriting procedures. Specifically, the technology allows you to predict consumer behavior and possible challenges that are the most likely to occur.

The proliferation of apps and smartphones, in turn, has led to the availability of more information about consumers. With sophisticated ML- and (or) AI-based analytical tools, lenders can get more insights about users' spending habits, repayment schedules, and other behavioral data.

A few years ago, researchers from Ironside presented how machine learning can enhance insurance underwriting. The results of their research are presented as a journey map in the below infographic.



Source: **Ironside**

In terms of more practical examples, machine learning tools can improve various underwriting tasks, such as:

- Evaluating claim risks of each individual through alternative data sources' overview;
- Detecting "trial" lawsuits and other potential outcomes based on the severity of the case and local laws;
- Generating risk quotes based on the historical data, and more.

Finally, these are AI-powered digital lending chatbots, such as Ally and HSBC, that improve the overall consumer experience. They operate round-the-clock, providing prompt support and feedback. In perspective, chatbots can save support agents' time on more complex consumer issues while handling simple repetitive requests.

Chatbot-based messenger services, in turn, can replace irritating agent calls. For example, ING Bank's chatbot has a built-in messenger that estimates the waiting time depending on the number of users in the queue. While waiting for their request's application, the user can play various in-app games to make their waiting less boring.

THE TIME FOR CHANGES AND INNOVATIONS

To finalize, here's the list of essential measures you should always keep in mind when developing a next-gen alternative lending software:

- Introduce virtual operations and onboarding
- Address cybersecurity and fraud threats
- Create modular, future-proof solution architecture
- Comply with new regulations and programs
- Gather and analyze versatile data sources
- Reconsider your automated underwriting with new tools

Be inclusive in technological challenges that you are facing and create realistic game plans based on these. Primarily, your action plan should include the MVP to improve in iterations. Quick reaction to ever-changing market demands will bring you quicker business results.

Think innovatively and be ready to adopt new technologies and create an entirely new consumer-centric journey. Since new behavioral patterns become a reality in today's world, you should leverage the opportunity and support the transformation in your digital lending solution.



"In today's era of volatility, there is no other way but to re-invent. The only sustainable advantage you can have over others is agility. Because nothing else is sustainable, everything else you create, somebody else will replicate."

— Jeff Bezos

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