Go-to-market Strategies for Fintech Lenders

Exploring Your Options

ensemblex

BACKGROUND

Over the years our team has met with hundreds of visionary fintech founders. Many have impressive product and technology backgrounds, but few have extensive backgrounds in lending. Founders without 'fin' backgrounds often find new and unique challenges launching a fintech, and so these founders often ask for our guidance on their go-to-market strategy. Years of experience has taught us that there is no playbook or one-size-fits-all answer. Founders face a full range of options, from 'turn-key' solutions to complete DIY. This paper explores three go-to-market operations strategies to consider.

OPTION 1: BUILD OR ASSEMBLE THE INFRASTRUCTURE YOURSELF

OK, you probably do not need to build every component of your product's value chain. Some infrastructure components are commodities where ownership offers little competitive advantage. However, you might consider obtaining state lending licenses, securing a partner bank, raising debt capital, building out customer service and collections operations, standing up a credit function, and contracting for all the infrastructure you will not build (say, originations system, LMS and fraud monitoring services, to name a few).

If your founding team has deep experience in financial services, has strong knowledge of the FS ecosystem, are well capitalized and can afford a longer launch timeline, this may be a strong option. Building and assembling the entire customer journey can give you more control over product and customer experience, and you ultimately may stand to keep more of the economics for yourself.

You should be aware that these benefits come with a caveat – in our experience most fintech founders simply don't have the depth of financial services experience, credit expertise, cash reserves and requisite time to build a successful fintech product from scratch. Risk and cautionary tales abound.

As an example, we spoke with one serial tech entrepreneur who took the go-it-alone approach to his lending fintech. In retrospect, he discovered that starting a fintech lending business isn't the same as a software start up. Credit or fraud mistakes may take months to detect, and by the time you realize there's a problem, it might be devastatingly costly. In hindsight, he acknowledged the team had little idea how to construct a sound credit policy, forecast losses or monitor diligently enough to detect a costly blow up. Eventually losses came in millions of dollars over forecast.

Numerous companies we know have tried to build out their own product ecosystem. Many chose infrastructure partners that they later came to regret. After the fact, these companies chose sponsor bank partners that turned out to be exceptionally difficult to work with, drawing out contracting and delaying launch by up to a year. Other partners operated as a "black box," providing limited insight into program performance and proved difficult to collaborate with. Some companies regretted their choice enough that a complete re-launch was the only viable option.

Option 2: Use a Banking-as-a-Service Company

Over the last several years Banking-as-a-Service (BaaS), and their close relatives Cards-as-a-Service, Lending-as-a-Service, etc., have become increasingly popular options for fintech founders to bring their product to market.

For those not familiar, BaaS players enable third parties (e.g. fintechs, non-financial brands, enterprises) to offer regulated banking products like deposit accounts or credit cards to end customers through APIs with banks. While they come in many varieties, BaaS players are essentially middleware technology companies connecting banks and a la carte fintech infrastructure companies to third party app providers.

The sales pitch of a BaaS company is compelling on the face of it: "insanely fast credit card issuing!" "Build in minutes, launch in weeks!" "Create a credit card in 4 days!" "Launch in as little as two weeks!" "Infinite scale and global reach!" "Speed, scale and compliance!" Most BaaS companies feature slick websites and promises of lightning speed to market. They've done all the heavy lifting of finding the right partners, building the ecosystem and bringing a financial product in a box to your front door. It's at your fingertips by signing a single contract.

In our estimation, there are many potential risks and drawbacks to consider with BaaS companies.

First, despite the headlines, speed to market may not be as promised. Several of the BaaS companies admit in private that "launch in weeks" is a well-known industry hyperbole. Perhaps in the absolute best-case scenario (i.e. the product has few if any custom features and the stars align) the speed-to-market headlines could be achieved, but the typical client launch timeline was weeks or months in excess of what was advertised. If you're considering BaaS, make sure you ask for median and worst-case launch times and hear from real customers.

Next, BaaS companies generally offer limited control of the product and end-customer experience. Buying a "bank in a box" means you are likely sacrificing some flexibility to deliver your optimal client experience. One user of a BaaS company shared that during account opening, the "happy path" worked well, but many clients fell out for KYC and fraud flags. In those situations, turn-around time was painfully slow, the process was opaque and the company was powerless to do anything about it. The result was many customers fell out of the process and found other options before they could be contacted for verification.

BaaS can be expensive and you cede a large part of the economics of your product. Some BaaS companies come with implementation fees approaching $1MM, with account opening fees, monthly user fees, transaction fees, and interchange shares of up to 40% on top of that. If you outsource most of the financial and infrastructure components of your business, you can reasonably expect that you ultimately will not own the majority of the product economics. You may get to market quickly, but at what long term cost to your business?

Another drawback to BaaS is lack of credit expertise, a critical part of any lending product's success. Some BaaS players offer "off the shelf underwriting models" and all will run compliance checks on your credit policy. Few, if any, BaaS companies offer comprehensive credit advisory or have proven track records managing credit businesses. That means you are still on your own when it comes to the crucial credit function for lending products.

Another risk to consider when going with a BaaS solution is your contingency plan in the event your BaaS partner fails. Re-platforming is expensive and difficult. We've heard directly from fintech players and former BaaS company employees that BaaS is sticky. Once you've built your go-to-market product on their platform, it is incredibly time consuming and costly to switch. As a result, you may be stuck with an inflexible platform with limited ability to change as you scale your business.

Finally, in choosing a BaaS partner you are often committing to the BaaS company's partner bank and trusting they have done proper due diligence. Many may have thoroughly vetted their bank partners, but it's possible they have not. A recent example of this is the OCC action against Blue Ridge Bank, a bank partner to several BaaS players and fintech clients. Many BaaS companies claim they will handle compliance due diligence for their clients. But what if their due diligence fell short? It could leave you exposed and in a scramble in the event of a regulatory action.

Now that we've covered some of the drawbacks to BaaS, let's consider where it may be a perfectly suitable option. With hundreds of fintechs leveraging BaaS solutions, there are surely use cases where BaaS is a compelling solution.

One strong use case is if you are a non-financial brand looking for add-on products to deepen your existing customer relationships while adding an ancillary revenue stream. This is one of the most compelling use cases we have seen. BaaS players have done the heavy lifting of enabling the launch of off-the-shelf financial products. With minimal distraction, you can launch a financial product, create another customer touchpoint, and capture an incremental revenue stream.

An extension of this is if you are a non-financial brand looking to embed payments in your product. Payments are becoming a basic functionality expectation for most online businesses, and it's largely commodified. There are dozens of players well suited to enable this component functionality.

Another good use case of BaaS is if your financial product does not involve significant credit risk. In our experience, deposits, debit cards, payments, and e-wallets are potentially strong use cases for BaaS. The products are generally simpler economic and operational models than cards or loans. For lending products, most BaaS companies do not offer in depth credit expertise. Those that do are generally offering off-the-shelf models that may not work for your product or customer segment and are not a substitute for a high-quality internal credit function.

Finally, a BaaS partner might be right if you are a start-up whose primary objective is to get to market quickly to validate you can acquire customers efficiently. Provided your customization needs are not extensive, BaaS is frequently faster than other options.

Option 3: Hire a Launch Partner

If you are a fintech founder looking to launch a lending product but lacking in-depth financial services expertise, you are a great candidate for a launch partner model, in which you partner with a team that brings the credit and operating expertise to allow you to get to market and grow successfully.

An expert launch partner can help you navigate the complex ecosystem quickly to make the right strategic and tactical decisions. For example, they can guide you to the right build vs buy tradeoffs. Where you will leverage external systems and functionality, a launch partner can help you choose the right partners, such as partner bank, capital providers, associations, originations systems, fraud monitoring, core processors, loan management systems, customer service and collections functions. An expert partner can also negotiate favorable pricing and terms on contracts on an expedited timeline, allowing you to get to market quickly.

Additionally, a launch partner can help you validate product-market fit, identify low-cost acquisition channels, deliver robust financial product design, and optimize brand messaging. They can help ground your unit economic assumptions and ensure a compelling business plan.

Critically, a launch partner can help you build in-house credit expertise. A robust credit policy is crucial to satisfy your partner bank and regulatory requirements. Equally important, a high-quality credit function allows you to optimize approval rates while achieving your desired risk adjusted margin, setting your company up for long-term profitability and resiliency.

The launch partner is the happy medium between total DIY and the total outsourcing that is BaaS. With a launch partner, your infrastructure is custom to the extent that it is economically and strategically advantageous. This allows you to build the unique experience that you want for your customers and to capture better economics without taking on excessive risks or start-up costs.

THE ENSEMBLEX DIFFERENCE

Ensemblex is the go-to partner for lenders who want to accelerate growth and reduce risk. Our team has deep lending expertise. We combine the discipline and scale learned from managing $1+ billion P&Ls at large banks with the scrappiness and urgency of a start-up. We were among the first to actively use ML techniques for consumer underwriting, and we have been building and implementing ML models at our own companies and for our clients for over a decade. From launching new products to optimizing to changing market conditions, we help our clients start, scale, and adapt their lending businesses.

Learn more and meet our team at www.ensemblex.com or contact us at info@ensemblex.com.