Taktile
State of Lending Report

Paving the Path to Profitability

Discover how lenders navigate success in uncertain times

Taktile

Never guess.

Conducted by Taktile, this State of Lending report presents insights from a global survey of risk teams and credit experts on how recent macroeconomic changes have affected the strategic objectives and operations of lending organizations.

Contents

Executive summary

Surveying lending organizations across the globe confirmed that increasing profitability is the top strategic priority of lenders.

Asking how they plan to become more profitable revealed a key dilemma: Most lenders need to decrease defaults and lower customer acquisition costs while achieving significant growth goals at the same time.

Analyzing how lenders are performing relative to these goals uncovered some impressive best practices among a select few.

Lenders that are the quickest to update their credit policies and the most proactive in adjusting their risk selection tend to be the closest to achieving their performance goals.

But the vast majority of lenders still rely on complex and outdated credit decision infrastructures that restrict them from reaching the level of agility required to reach their goals.

A deeper look exposed a key issue: most credit teams are not sufficiently enabled to quickly and easily self-serve when building and optimizing credit policies.

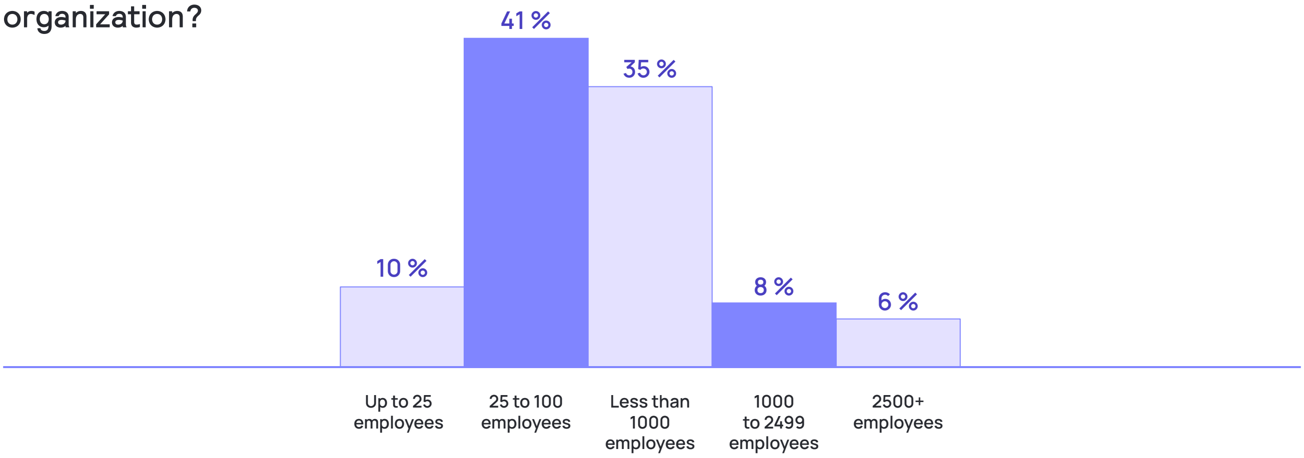
However, survey results show the path to more profitable growth is clearing.

To increase their agility, lenders are highly motivated to improve the sophistication of their credit decision infrastructures. They want to rely less on engineering teams and focus more on empowering their credit teams to optimize credit policies.

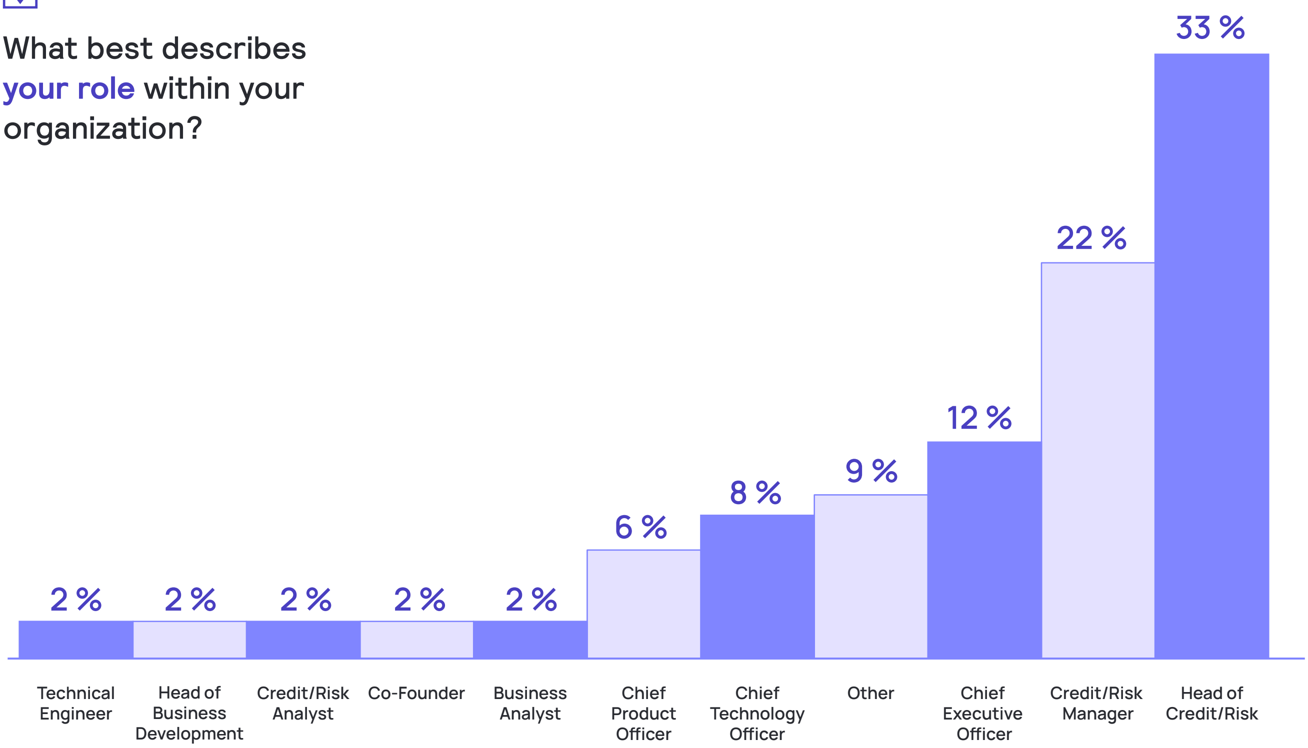
The lending industry has undoubtedly entered a new era – but with the rise of advanced credit decisioning tools and strong demand for new lending products, lenders have an unprecedented opportunity to adapt and prosper in the new status quo.

Survey demographics

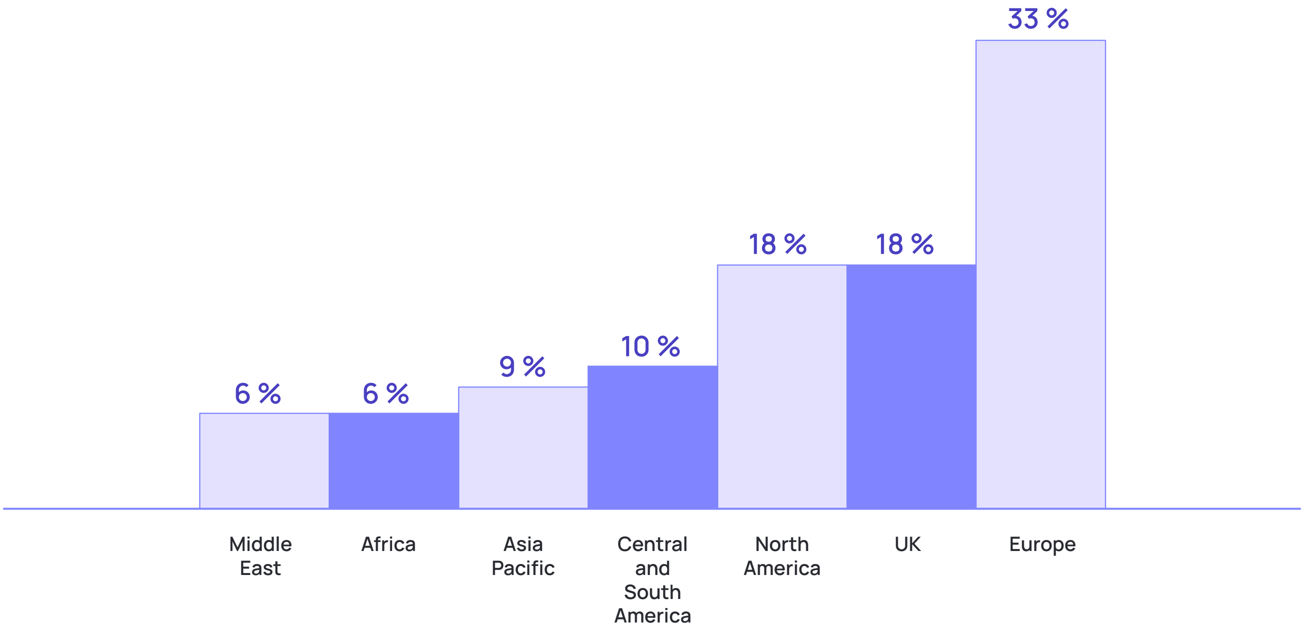
What is the **size** of your organization?



What best describes **your role** within your organization?



In which **regions** do you offer lending products?



Inflation reduction measures lead to lenders prioritizing profitability

While most traditional financial institutions and established lenders have learned how to navigate interest rate cycles in the past, the stark rise in interest rates posed challenges for many fintechs and required a pivotal mindset shift.

> *With the backdrop of a challenging macro environment, growth alone cannot win the market. Lenders who can improve unit economics, focus on efficiency, and improve decision accuracy can capitalize on these challenges and build a competitive moat in this market.*

Seema Amble, Partner
andreessen horowitz

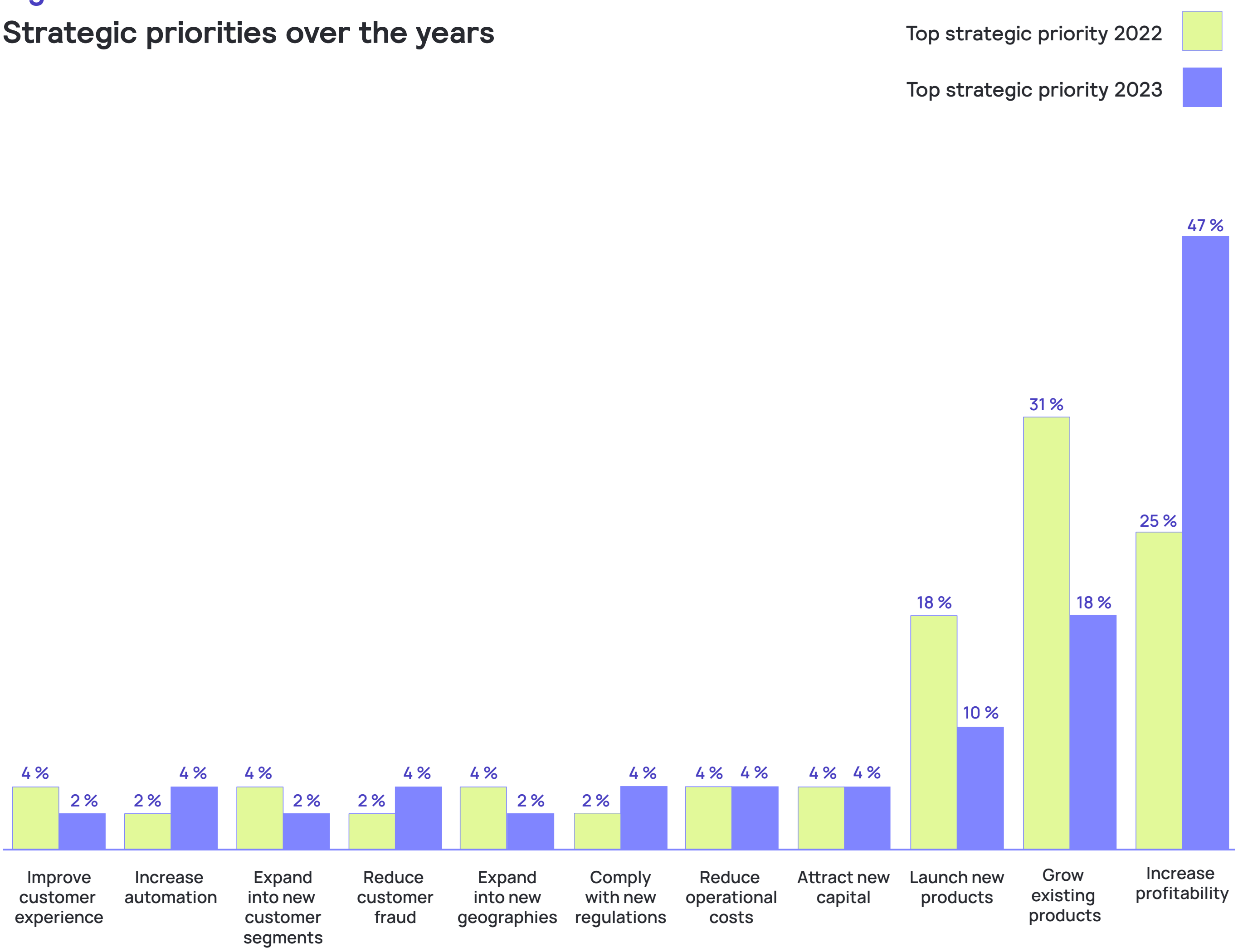
For venture-backed fintechs in the lending space, the squeeze on profit margins and increasing investor demands for profitability meant the earlier "growth at any cost" model was no longer economically viable.[1]

Now, lenders recognized the need to prioritize profitability to ensure sustainable long-term success.

Nearly half of survey respondents identify increasing profitability as their top strategic priority, signaling a departure from their previous emphasis on growth and launching new product offerings.

[1] PitchBook (2023): Q1 fintech valuations show how the market wants profitability

Figure 1:
Strategic priorities over the years



Rising interest rates squeeze lenders' return on capital

Increasing profitability is especially challenging for lenders when interest rates are elevated, as the subsequent rise in capital costs and (often) non-performing loans can negatively impact their return on capital.

This is supported by survey findings, as we observe that:

Higher interest rates make obtaining new capital more expensive and, therefore, securing new debt facilities more challenging

67%

of lenders are negatively affected by increasing costs of capital

44%

of respondents report that higher interest rates have negatively impacted their access to new debt financing

This trend is highly prevalent in developed markets where debt facility providers find it difficult to pass on their increased capital costs to lenders with already small net interest margins.

Rising interest rates quickly impact the ability of borrowers to make loan repayments

37%

of survey respondents report that rising interest rates have negatively impacted their customer default rates – a trend especially common among B2B lenders in the UK, which supports a recent report of rising defaults in the sector[2]

As a result of these factors:

43%

of survey respondents report that growing interest rates have negatively impacted their return on capital

These shifting dynamics have significantly impacted lenders over the last year and are a driving force behind the urgency to increase the profitability of their operations.

> ***Rising rates are changing a lot of credit patterns that were taken for granted during the last 10 to 15 years. Success for lenders will come from sticking to fundamentals of credit assessment while setting the agile infrastructure that allows them to optimize their credit frameworks as they gather and process the new data.***

Belkacem Krimi,
Global Chief Risk Officer

Funding Circle

[2] PYMNTS (2023)
UK SMB Loan and Mortgage Defaults on the Rise

Lenders identify multiple levers for achieving profitability

To counter these difficult market dynamics, lenders are trying to work on a variety of levers to optimize the core of their operations.

Many respondents report significant room for improvement across several key performance indicators (KPIs).

Lenders want to optimize their customer acquisition costs and default rates to achieve profitability fast

46%
of respondents plan to increase their customer conversion rate by 5 percentage points (p.p.)+

34%
want to reduce their customer default rate by 5 p.p.+

Figure 2:
By how much do you need to increase your customer conversion rate to achieve your strategic objectives?*

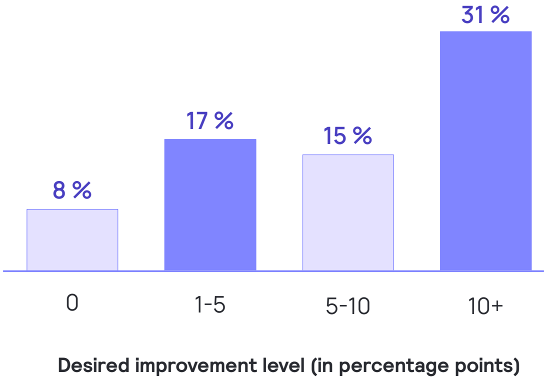
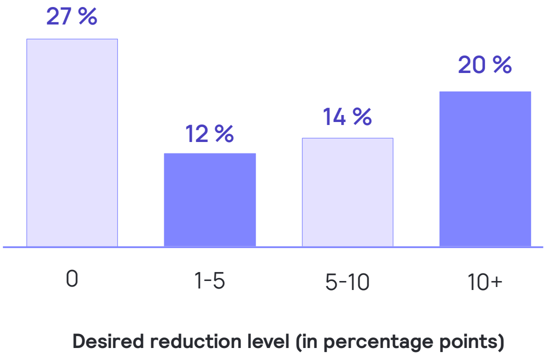


Figure 3:
By how much do you need to reduce your customer default rate to achieve your strategic objectives?*



The cost of acquiring customers (CAC) and the loss caused by customer defaults have a significant impact on the profitability of lending operations. Therefore, to increase profitability quickly, lenders want to approve more customers (to lower their average CAC) and reduce default rates at the same time.

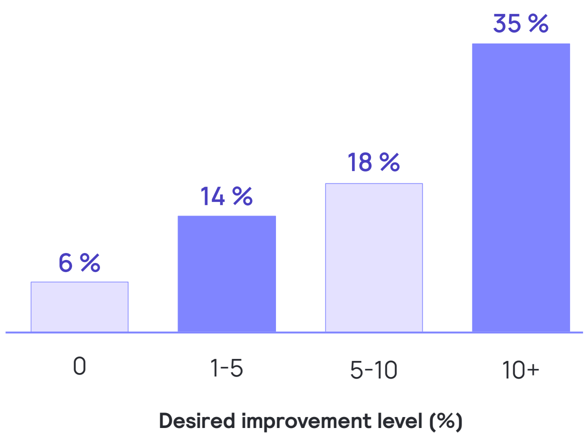
* This graph omits survey respondents that did not disclose their performance goals

But lenders still plan to grow their portfolios

35%

of lenders want to increase their portfolio growth rate by 10%+, with emerging markets showing high growth ambitions

Figure 4:
By how much do you need to increase your portfolio growth rate to achieve your strategic objectives?*



With almost 80% of adults worldwide still either underbanked or unbanked,[3] large growth potential remains for lenders – especially for those operating in less mature credit markets.

75%

of respondents that operate in Africa want to increase their portfolio growth rate by over 10%

Africa, one of the fastest-growing fintech regions, still lacks sufficient access to financial products.[4] As a result, lenders are highly motivated to grow their product offerings in this region.

[3] BCG & QED Investors (2023): [Global Fintech 2023: Reimagining the Future of Finance]

[4] BCG & QED Investors (2023): [Global Fintech 2023: Reimagining the Future of Finance]

* This graph omits survey respondents that did not disclose their performance goals

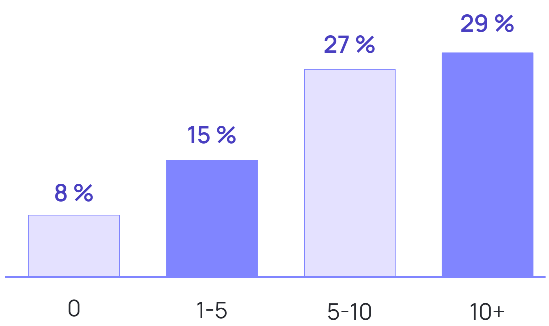
Automation is a key profitability lever

56%

of respondents express a desire to increase their automation levels by 5 p.p.+, with almost a third wanting an improvement of 10 p.p.+

Reducing the amount of manual work required to assess credit decisions is not only a highly effective way to reduce operational costs, but it also speeds up the credit decision process. This can be the catalyst for lenders to improve their conversion rates, especially among lower-risk customers that can obtain loans from a variety of providers.

Figure 5:
By how much do you need to increase your automation levels to achieve your strategic objectives?*



Credit decisioning software will become a critical component of the software stack of every lending organization. It leads to better and more timely decisions, and empowers credit risk teams to operate with confidence in a more timely and independent manner. In turn, better decisions lead to lower defaults and expand the market opportunity for lenders.

Carlos Gonzalez-Cadenas, Partner

Index Ventures

* This graph omits survey respondents that did not disclose their performance goals

Agile credit decisioning uncovers path to profitable growth

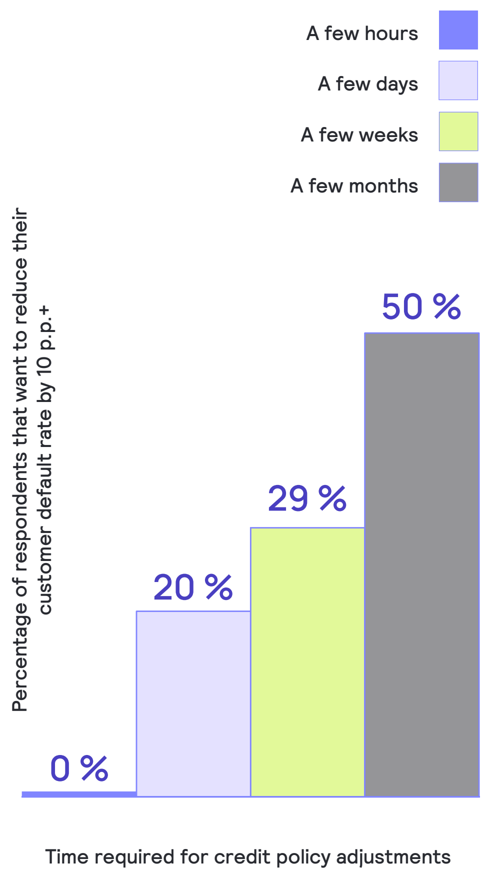
Analyzing lenders based on their performance relative to the goals highlighted in the previous section uncovered that the most successful lenders are those with the most agile approach to their credit decisioning.

Lenders that make credit policy changes the fastest and are the most proactive in adjusting their risk selection tend to be the closest to achieving their performance goals

Lenders who can adjust their credit policies in a matter of hours do not report significant room for improvement in performance metrics like customer default rates.

However, for less agile lenders, the need to improve customer default rates by more than 10 p.p. increases almost in step with how long it takes to adjust their credit policies: days (20%), weeks (29%), and months (50%).

Figure 6:
Desire to reduce customer default rate by 10 p.p.+ based on policy adjustment speed



The same trend is prevalent among lenders who update their credit policies most frequently.

40%

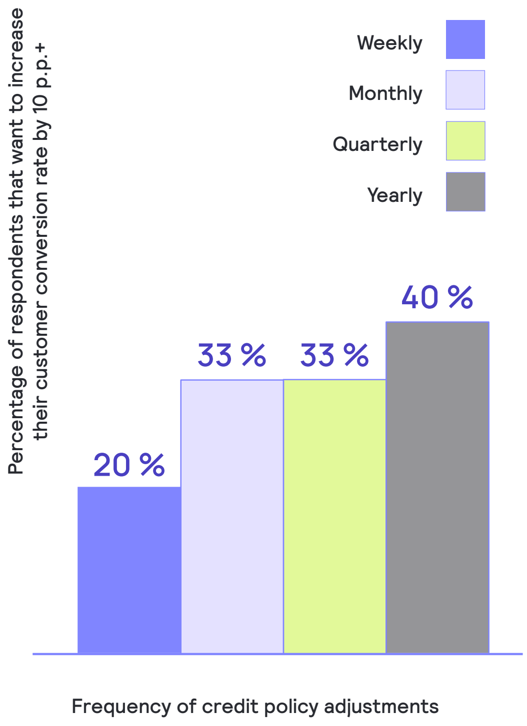
of respondents that update their credit policies yearly want to improve their customer conversion rates by 10 p.p.+

VS

20%

of respondents that update their policies weekly want to improve their customer conversion rates by 10 p.p.+

Figure 7:
Desire to increase customer conversion rate by 10 p.p.+ based on policy adjustment frequency



80%+

of respondents who adjust their policies weekly and do so in a matter of hours (versus weeks or months) have enabled their credit teams to adjust policy thresholds

29%

of organizations that leverage software providers for their credit decisioning make weekly policy adjustments (versus 18% for those that built-in house)

Our findings reveal that lenders who operate with a higher level of agility have unblocked their credit teams to fully own their risk selection. This is made possible through sophisticated credit decision infrastructures that empower credit teams to create and adjust credit policy logic and thresholds without the help of technical engineering teams.

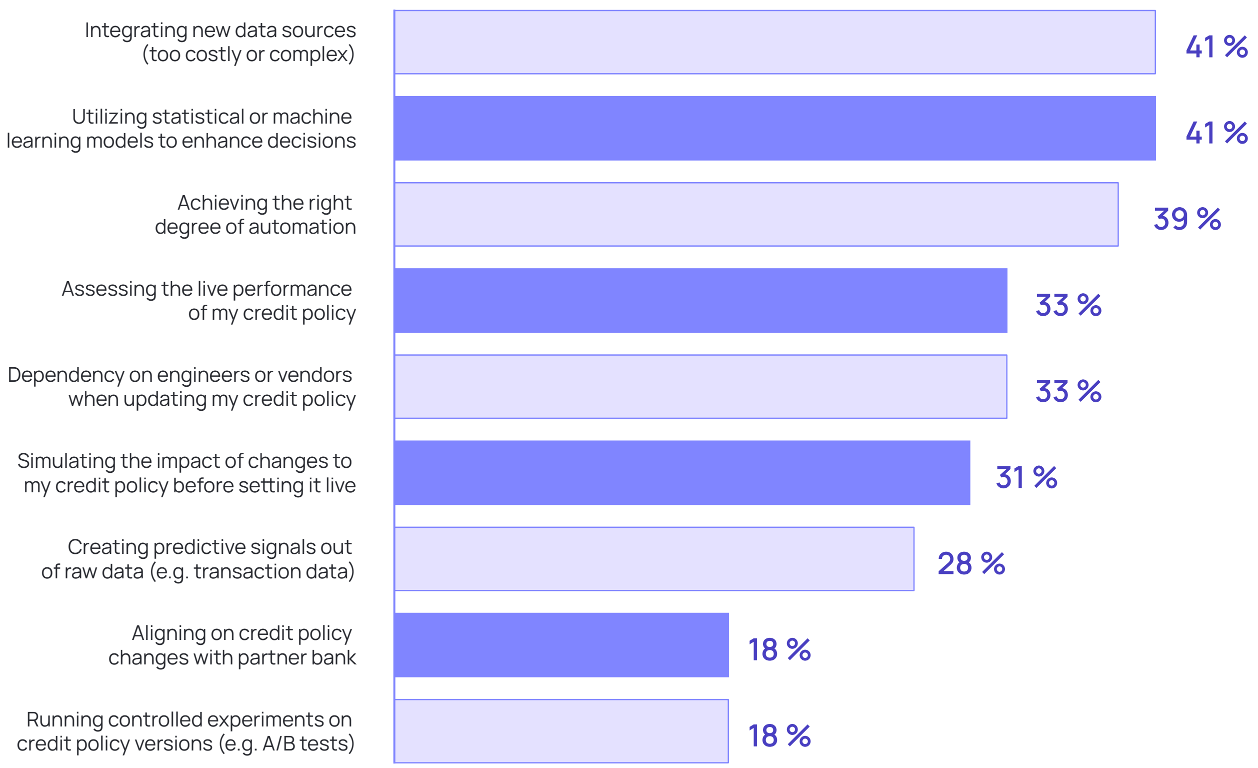
High-performing lenders that use credit decisioning software (compared to an in-house built tool) also face less complexity when it comes to adjusting their credit policies.

Rigid credit decision infrastructures prevent most lenders from becoming agile

While a select group of lenders have cracked the code and are quick to adjust their risk selection to achieve their desired KPIs, most lenders lack this capability.

They face major challenges with their credit decision infrastructures that prevent their credit teams from optimizing their risk selection in an agile way.

Figure 8:
What are the biggest challenges you face with your credit decision infrastructure?
(Select all that apply)



Poor credit decision infrastructures slow down policy optimization

33%

find their dependency on engineering teams to be a major blocker

41%

of respondents identify adding new data sources as one of the biggest challenges they face

Most lenders are not able to adjust their policies as quickly or as frequently as they would like to. Credit teams face long wait times for new data sources to be added and for engineering teams to make credit policy adjustments.

Alternative data including things like cash flow data and asset reports have meaningfully improved consumer and lender outcomes by offering a more holistic approach to one's finances. Many lenders today use Plaid's suite of credit products to embed cash flow data in their underwriting models so that they can more easily gain deeper visibility into a user's finances and offer more personalized, affordable loans to consumers.

Sukhpreet Bains,
Credit Partnerships Lead

PLAID

Many lenders cannot improve the accuracy of their risk assessment in a data-driven way

33%

of respondents report difficulty in assessing the live performance of their credit policies

41%

find building and deploying predictive models a major challenge as it requires a lot of technical expertise and historical data on customer defaults

Lenders that lack insight into the live performance of their credit policies and the ability to leverage predictive modeling in their credit decisions find it challenging to improve their risk assessment criteria.

Automation continues to be a challenge for B2B lenders

39%

of B2B lenders struggle to achieve the right degree of automation

On the automation front, lenders operating in the B2B segment are still trying to unlock the most effective ways to accurately automate credit decisions.

Assessing the risk of B2B borrowers tends to be more complex than B2C (particularly from a data collection perspective). Therefore, on average, lenders tend to undertake more manual reviews. This not only increases costs for B2B lenders but it hinders their ability to grow at scale.

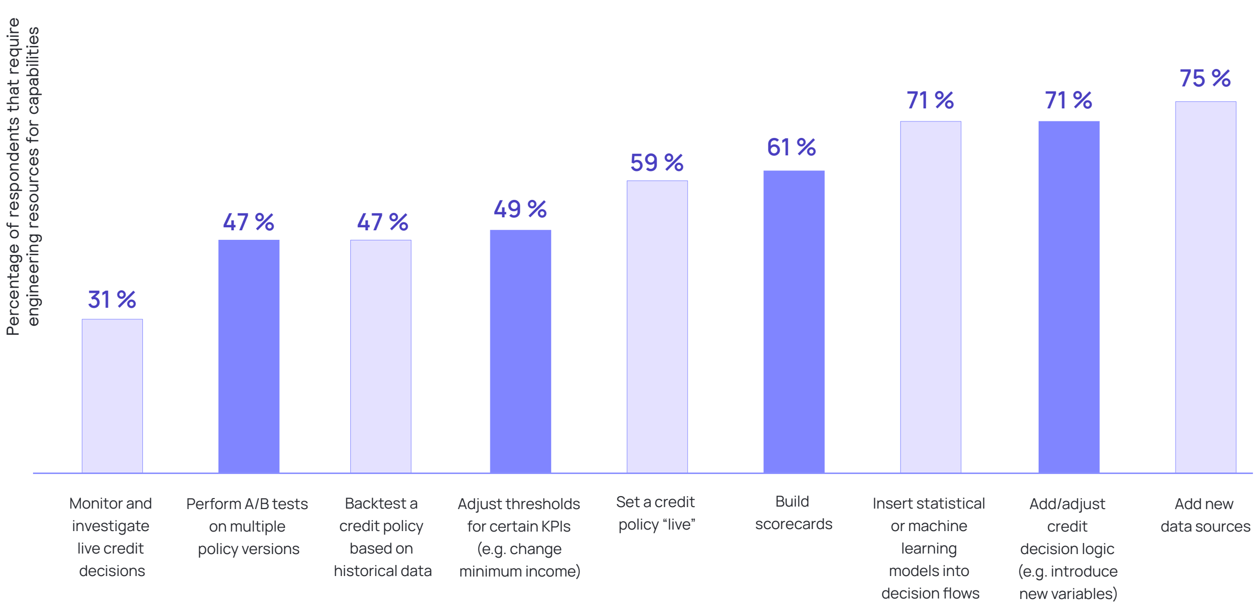
Credit decision infrastructures need to **empower credit teams to self-serve**

A deeper look at the challenges lenders face with their decision infrastructures reveals a key dilemma: credit teams are not sufficiently enabled to self-serve when it comes to building and optimizing their credit policies.

Survey results find that the majority of respondents (86%) have built their decision infrastructures in-house, with high levels of dependency on engineering teams.

This highlights how complex it is for lenders to design and develop decisioning solutions in-house that enable their credit teams to work in a truly agile way.

Figure 9:
What capabilities do you require engineering resources for in your credit decisioning?



Credit teams that cannot self-serve find it challenging to improve the risk assessment accuracy of their credit decisions

The vast majority of respondents (75%) have not enabled their credit teams to add and experiment with new data sources in their credit decisions.

25% of respondents have no ability to perform A/B tests on their credit policies, and 22% cannot perform backtests based on historical data. Furthermore, almost 20% cannot utilize predictive models in their credit decisions at all.

Again, this sheds light on the real complexity lenders face when it comes to being agile and enhancing the accuracy of their risk assessment.

A critical piece of our credit decision infrastructure is the ability for our teams to quickly iterate on and improve predictive models to make better data-driven decisions.

Matt Mollison,
Staff Software Engineer - Machine Learning
branch

Lenders rely heavily on engineering teams to adjust credit policy logic and thresholds

71%
of respondents require engineers to create and adjust credit policy logic

49%
of respondents rely on engineers to adjust policy thresholds

These lenders also tend to be the furthest from reaching their desired metrics

40%
of respondents who rely on engineers to add and adjust credit policy logic want to reduce their customer default rate by 5 p.p. + versus 18% who have enabled their credit teams to self-serve

The slowest-moving organizations tend to have the highest reliance on engineers

100%
of respondents who take a few months to implement policy adjustments rely on engineers to add and adjust credit policy logic

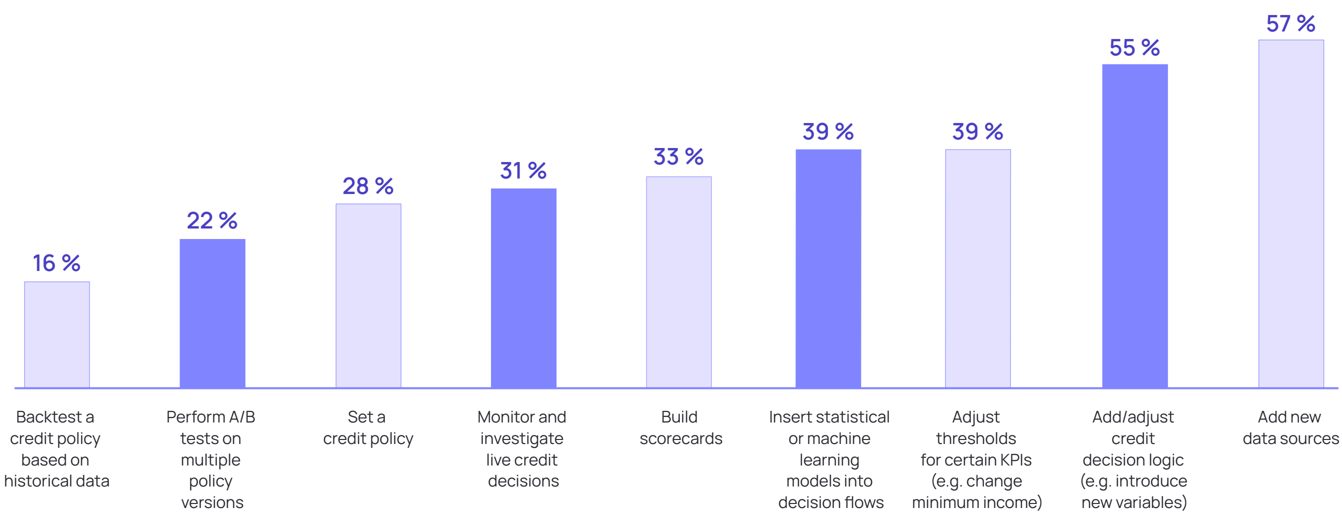
Lenders identify decision infrastructure improvements as a top priority

To meet their ambitious performance goals, lenders realize they need to improve their credit decisioning capabilities to empower their credit teams more.

Top 3 capabilities where lenders want to empower their credit teams:

1. Adding new data sources
2. Adding and adjusting credit decision logic
3. Adjusting thresholds for KPIs

Figure 10:
Strategic investment priorities



Ease and speed of integrating new data sources are crucial to improving risk selection accuracy

57%

of respondents want to improve their ability to integrate new data sources into their credit decisions

The most important area for investment is enhancing the ability to add new data sources to credit decisions. This trend is prominent across the entire industry as new data sources ultimately help lenders accept more of the right customers.

However, B2B lenders are particularly motivated to enhance their data integration capabilities, as this is a major lever to increase automation. A third of B2B lenders plan to integrate new payments data sources, and a quarter want to leverage e-commerce data in their credit decisions.

The difference between the consumer and the small business lending market is that there is a much larger pool of financial data on which to base a lending decision when it comes to SMBs. Not just a credit score and a set of bank transactions, but financial statements, invoices and sales information kept in the eCommerce system... therefore, incorporating more of these data sources stands to give SMB lenders a greater competitive advantage.

Philip Low,
Head of Partnerships
codat

Lenders want to empower their credit teams for faster, more frequent policy optimization

39%

of respondents want to enable their credit teams to adjust credit policy thresholds

55%

of lenders want to enable their credit teams to change credit policy logic

77%

of respondents say they want to better enable the head of credit and credit managers to make credit policy changes

At the same time:

37%

of respondents want to increase the frequency of their policy optimizations

Indicating a real push towards agility as a key lever to achieve profitability.

27%

of respondents want to make weekly credit policy adjustments

and

39%

of respondents want to make monthly credit policy adjustments

Lending experts see a promising future for the industry

Survey respondents (84%) remain optimistic about the lending industry

This is supported by the fact that customer demand for lending products is still high, with 42% of respondents reporting that the current interest rate environment has had a positive effect on demand.

While the transition to a higher interest rate environment has been challenging for many, it has been an incredible catalyst for change – igniting a new wave of innovation among lenders and the finance industry as a whole.

Product innovation in the fintech sector has scaled rapidly. Software providers are empowering fintechs to build lending products quicker than ever before. And open finance data providers like **Plaid**, **Codat**, and **CRS** are enabling lenders to better assess borrower risk and cater to completely untapped customer segments.

These factors, coupled with the growth of automated decisioning solutions that allow credit teams to become truly agile and proactive in their risk selection, mean lenders now have the tools to consistently optimize their KPIs to accept more of the right customers and less of the wrong ones. And ultimately, grow more profitably.

> ***The current macro environment undoubtedly poses tests for lenders, but it also presents opportunities to build durable, disciplined lending franchises that hold up even in suboptimal market conditions.***
>
> ***We're excited to invest in and lend to vertical market software businesses that leverage their distribution and data advantages to layer in fintech products as a value-added service to deepen customer relationships, solve access to capital problems for their customers, and increase monetization.***

Conor Witt,
Vice President

upper 90

Methodology

Conducted by Taktile, the State of Lending survey ran in April 2023. It was distributed to 400 lending organizations across the globe and received a completed submission rate of approximately 15%.

All survey respondents are credit and risk professionals from fintech and traditional lending organizations, with a significant proportion of respondents in the following roles:

- Chief Executive Officer
- Head of Credit
- Head of Risk
- Credit Manager
- Risk Manager

Disclaimer

The information provided in this report is for general informational purposes only. Taktile does not guarantee you will achieve any specific results if you follow any advice in the report. It may be advisable for you to consult with a professional such as a lawyer, accountant, business advisor, or professional engineer to get specific advice that applies to your specific situation.

About Taktile

Taktile is a modern decisioning platform that is revolutionizing how fintechs and financial services harness data to steer their business.

In a world increasingly run by automated decisions, Taktile's interactive decisioning platform empowers financial services teams of all sizes to take full control over building, refining, and evaluating their automated decisions so they can adapt quickly, reduce risk, and deliver better results.

Founded in 2020, Taktile has offices in New York, London, and Berlin and is backed by leading VCs, including Index Ventures, Tiger Global, and Y Combinator.

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Never guess.