Understanding the role of technology in Community Finance

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Executive Summary

Background

In partnership with The Finance Innovation Lab and Innovate Finance we've surveyed the community finance sector to understand the role of technology in the industry.

This is an interim report setting out the high-level results and findings from the survey. We plan to use the results to inform a technology toolkit that we'll launch across 2021 to help the sector to optimise their use of technology.

The survey highlights a high level of ambition throughout the sector to further develop their use of technology. It also identifies challenges with legacy technologies, IT capability in the businesses and funding.

Fair4All Finance will seek to address these challenges through the development of our technology transformation toolkit and targeted support.

We hope this report gives community finance providers an insight into how technology is being used by their peers in the industry. And that it helps to navigate the technologies on the market.

We also hope the report and upcoming toolkit gives current and future suppliers of technology solutions a valuable insight into what matters most to community finance clients and how to best serve the sector.

Thank you to all of the providers who completed the survey – we really appreciate your time and insights.

Headline Findings

- **93%** of providers expect they'll need to **substantially increase their technology in the next five years** - in many cases in order to survive
- **37%** of lenders are undertaking or planning **significant technology change**, with many looking at replacing their core technology
- **Funding** is by far the main perceived barrier to the sector optimising its use of technology, with **insufficient capability** and **inappropriate products from suppliers** behind in second and third place
- **70%** of providers **use open banking** for affordability and credit risk checks
- **43%** or providers are **collaborating with others**, while 26% aren't currently but would like to

Summary

There's a level of energy within the community finance sector to address the way that technology can be used to make products and services more accessible and relevant to the consumers of tomorrow.

And there is broad recognition that it's not an option to ignore the opportunities presented by technology.

Our survey has highlighted three areas of systemic change required for the sector to optimise its application of technology

1. Providers who attribute their inability to grow and remain relevant to the constraints of their legacy systems need to develop or update their IT strategy and plan a roadmap - particularly in light of the evolutions in the supplier product landscape

2. There's a shortage of IT capability in the sector, particularly across the smaller providers and even among some of the larger organisations. Without IT expertise and experience, providers can become over-reliant on their suppliers and less likely to plan or undertake strategic change enabled by technology
3. Funding of technology is tight across the sector. And the ability of each provider to manage and fund its own silo of technology is likely to become even more difficult as their legacy systems are replaced

93% of lenders expect they will need to substantially increase their use of technology in the next five years, in many cases in order to survive.

For the sector to be sustainable, the way that technology is delivered and funded for the smaller lenders will have to be challenged. Building silos of technology services for 400+ lenders is highly unlikely to deliver long-term financially viable and relevant technology solutions.

Survey Findings and Insights

The community finance sector is engaged on the topic of technology

We sent requests to complete the survey to credit unions and Community Development Finance Institutions (CDFIs) in England, Scotland and Wales via their trade associations. We received responses from 54 different providers.

48 of these were credit unions, representing between 15-20% of the market. The other six were from members of Responsible Finance, including five CDFIs, which represents over 50% of their membership offering personal loans.

We surveyed software usage across five key areas of functionality

1. **Core accounting and loan management** – this is the core system at the heart of every lender, recording and reporting all financial transactions and activity in the business

2. **Customer Relationship Management (CRM)** – a system that facilitates the management of interaction with current and potential customers/members and is a means of analysing customer data from across the business. It's either a standalone system or is a feature of the core loan management system

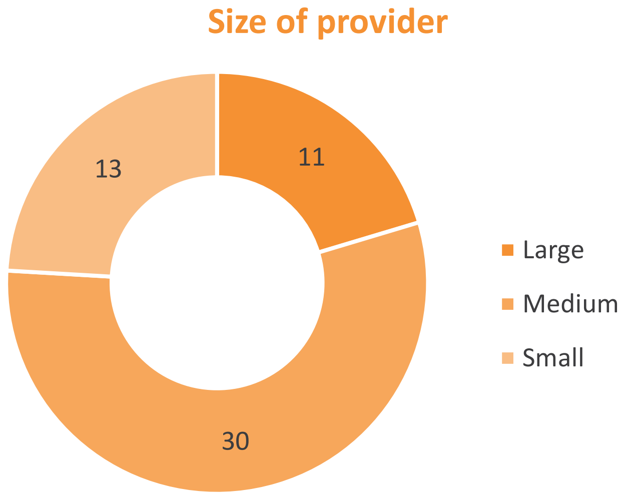
3. **Customer engagement** – any technology that acts as an interface between the business and its customers/members; for example an online banking website, a mobile app for a customer to apply for loans or service their account, a chat app that enables customers/members to interact with the business

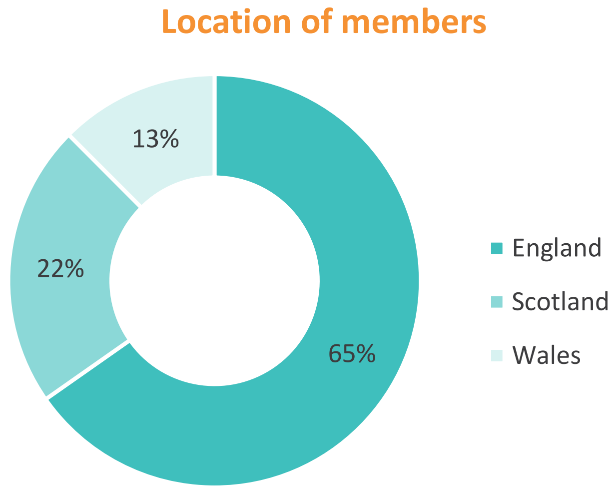
4. **Loan decisioning system** – a rule-based system which uses data held within the business eg Credit Reference Agency (CRA) data and/or bank account transactional data to either make a decision to approve, refer or decline depending on the configuration. It's either a standalone system or is a feature of the core loan management system

5. **Open banking** – in the context of this survey, the branch of open banking we're referring to is the online access to customers/members bank account transactions that are analysed for affordability and/or behavioural trends that could inform credit risk.

We also asked which sources of CRA data the lenders use.

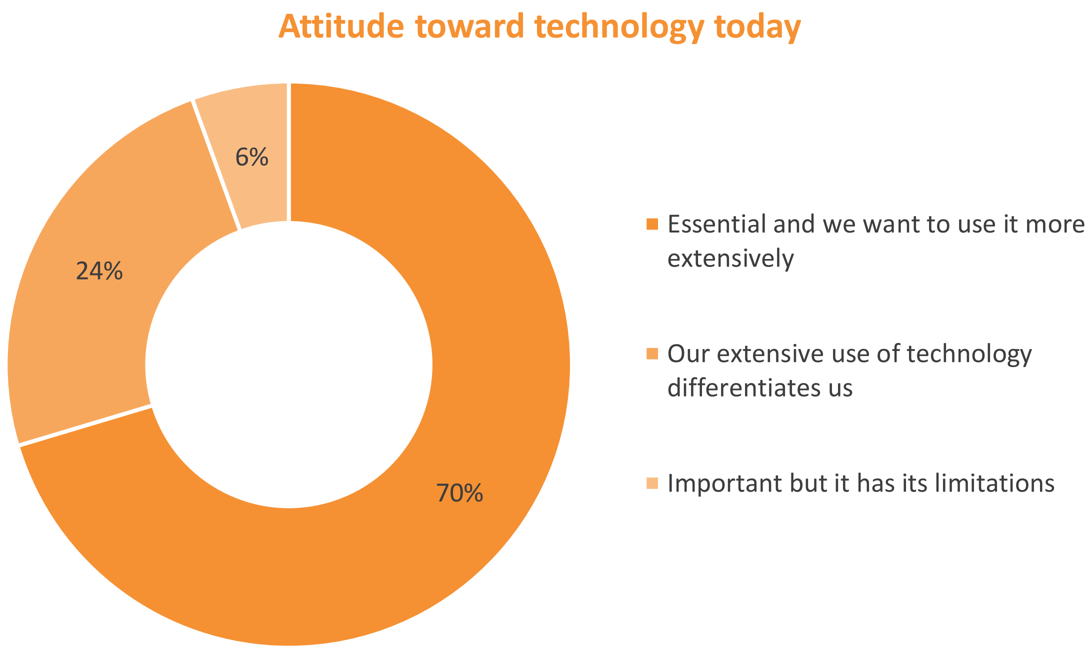
In order to identify trends related to size of business, we've segmented the community lenders into large, medium and small. We've done this based on number of customers, number of people and size of the loan book. Similarly we've recorded the countries they provide lending services in.





Community finance providers recognise that technology will play a vital role in their future

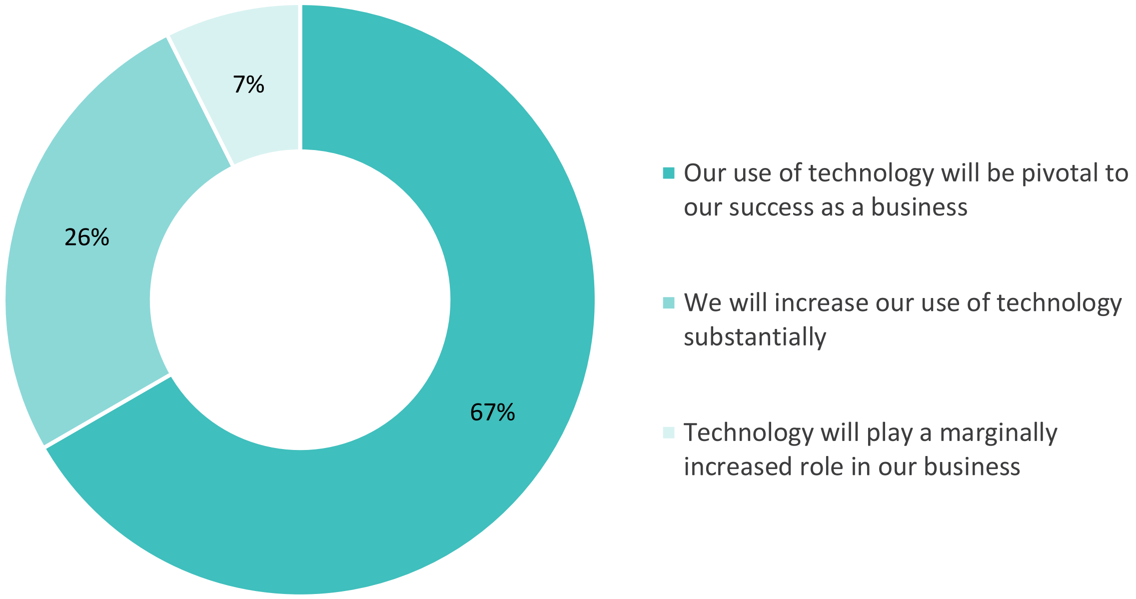
94% of the respondents recognised technology as being essential or a differentiating factor in their businesses today



Larger providers with more operations people put more weight on the importance of technology. Efficiency gains achieved by using technology - to automate processes or interact with customers digitally - translate into compelling business cases for large providers. Whereas providers with fewer than 10 people are less likely to achieve significant operational cost savings to justify the expense.

All respondents recognised their future use of technology would increase, with 67% saying it would be pivotal to their success

Outlook on the role of technology over the next five years



Even small community finance providers thought their future success would be determined by their use of technology, with 54% reporting that it would be pivotal to their success.

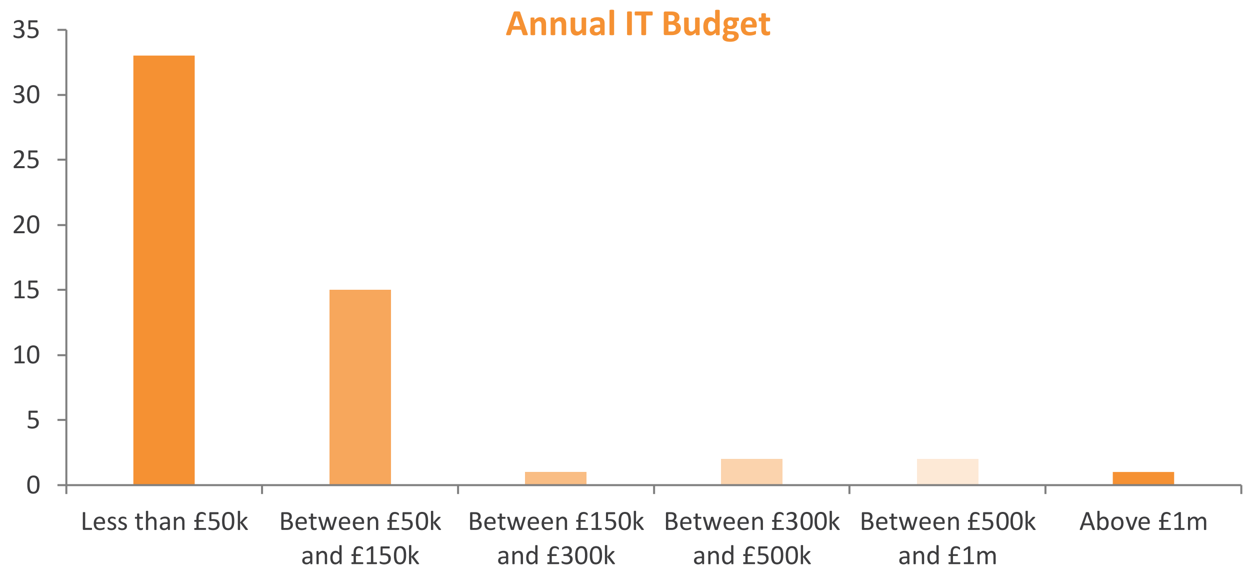
There is a general acknowledgement that - no matter the size of the provider - ignoring technology is not an option if you are to remain relevant and engage with younger people.

"The use of the right technology (or indeed the lack of it) will make or break the sector in terms of remaining relevant to the up-and-coming generations."

"The young generation have been using technology since they were 5 or 6 years old. They cannot live without it. To survive credit unions will have to give them technology."

"Whether we like it or not, technology is now vital to maintaining our place in the financial services market and allow us to compete to a degree with others in the marketplace."

The pace of change and implementing the sector's vision for technology is made more challenging by the small budgets allocated to IT



77% of small and medium sized community providers deliver their IT on an annual budget less than £50k. Even some of the largest providers run their IT on less than £150k, with only one surveyed exceeding an IT spend of £1m per annum.

For a quarter of all providers this equates to under 5% of their operations budget. And for half it equates to under 10%.

Of the 33 providers reporting IT budgets under £50k, only one had more than 5,000 loan customers and three had more than 10 people. Small-scale operations can 'get by' with minimal automation in back office technology and can handle a high-touch customer experience without needing to make significant investments on the digital customer journey.

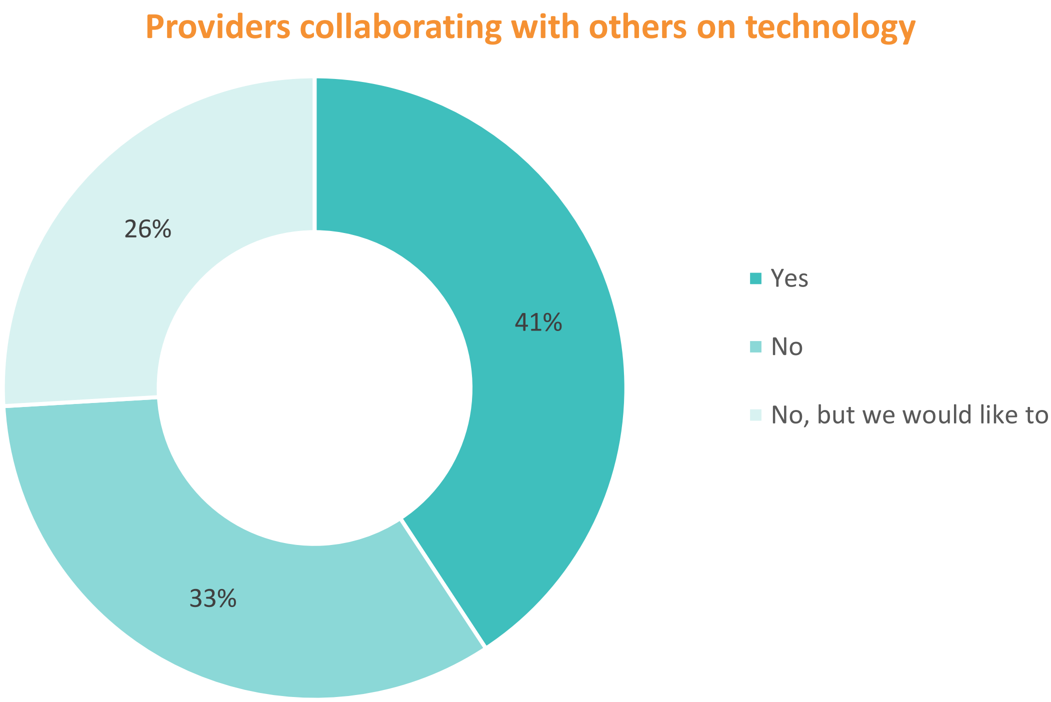
To an extent they balance their expectations of what technology can provide and the role they want it to play with the available funds. To remain relevant to younger people this may not be a viable way to allocate investments in technology in the longer term.

Many industry participants, particularly suppliers, refer to the low cost of Curtains (the loan management system supplied by Kesho, recently acquired by Omnio) as the reason why small lenders can operate on such small IT budgets. This is often cited as a reason why the sector finds it difficult to upgrade to modern technologies.

Our survey extends that observation to not only apply to Curtains, but to most of the technologies that have been used by community finance for around a decade or more. Over half of Kesho / Omnio (Curtains) clients reported IT budgets under £50k with only two over £150k, whereas only one of the 15 e-cfs (Conaccess), Caroma or Progress clients reported an IT budget over £50k.

However, small IT budgets are not necessarily a barrier to progression if the model of IT consumption is challenged. Today most providers run their own technology stacks, many of which are operated on premise on servers owned and operated by the provider.

While over 40% of providers reported their collaboration with others, there were few examples of collaboration that would achieve economies of scale or collective buying power



Some providers are wary of advancing technology at the expense of customers, members or volunteers who are less digitally literate and have been cautious in extending their use of technology. This is particularly applicable to the consumer engagement technology used.

"A more face to face approach helps to reduce barriers to access to finance."

"We have many clients who are not digitally savvy (typically older client base) for whom we need to pay particular attention to how technology is rolled out. "

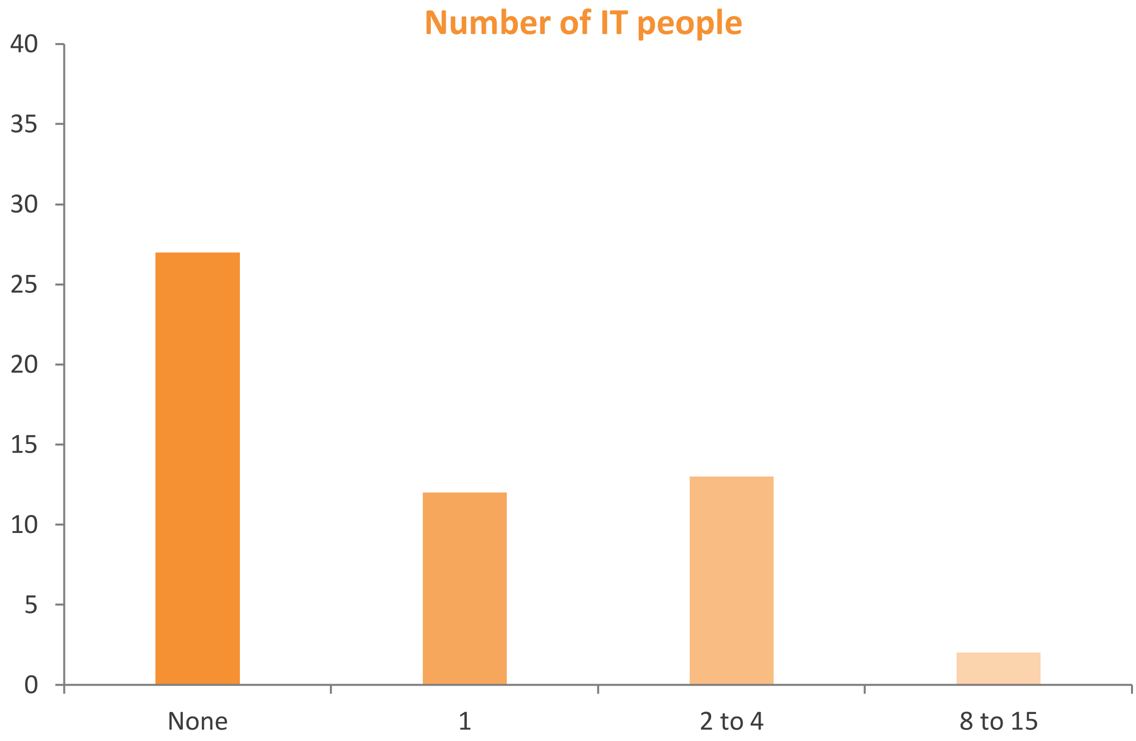
"As the volunteers get older, the membership are younger and take to technology easier than we do."

Covid-19 has had an effect in the pace of change. Many have recognised an accelerated shift to digital engagement with customers and branch closures have forced providers to use technology to facilitate remote working.

"99.7% of all loan applications are online. 85% of those users make an application using a mobile device."

"The true value [of technology] is how we have been able to maintain our products and services to our members through Covid lockdown and office closure."

IT professionals bring valuable practical and strategic skills to their teams



Half of the community finance providers surveyed had nobody on their teams whose role was primarily technology focused. The effect of this is recognised in their ranking of 'insufficient technology capability' as the second biggest barrier to technology optimisation in community finance.

Benefits for individual businesses in having IT capability on the team include

- advocacy for technology in senior management decisions including allocation of appropriate IT budgets
- confidence to embark on strategic change programmes enabled by technology
- alignment of technology investment with business strategy
- keeping up to date with technology innovations and trends

62% of providers with IT people were either planning or in the midst of significant technology enabled change. 78% of providers who don't have an IT person reported they were planning only incremental changes to their technology.

This trend is mirrored in the likelihood of lenders working to current IT strategies, which align technology investments with their business strategies. 70% of providers with IT people reported having an IT strategy in place, whereas that figure was 37% for those without any IT people.

The supplier base of technology applications is growing fast with the emergence of FinTechs and is proving hard for many to navigate

Businesses in most industries today typically use 'off the shelf' technology solutions, either installed on premise, in their datacentres or in the cloud.

Only where technology is a strategic differentiator, or where there are few peer organisations in the sector (eg government) do businesses elect to build their own technology. For example, Monzo and Starling Bank are using technology and unique digital customer experiences to differentiate themselves in the retail banking industry. They have built their own technology using teams of in-house developers.

In community finance, with few IT people working in the sector, there is naturally a high dependency on a network of strong suppliers of software or technology services.

Only three of the providers surveyed have built their own core platform and are not dependent on a third-party supplier. Two are using technology as a differentiator and have in-house development capability. The other is small and able to operate on a basic in-house application built with a local consultant.

FinTech – a confusing or helpful word?

41% of lenders surveyed reported engaging in some way with FinTechs and a significant number have implemented their solutions.

Of the 32 lenders who said that they either hadn't engaged with FinTechs or weren't sure, 21 listed FinTechs in their list of technology suppliers according to the Bank of England definition "FinTech is technology-enabled financial innovation, which is changing the way financial institutions provide – and consumers and businesses use – financial services."

Terminology used in technology can confuse the market and alienate people who aren't close to it. Is it helpful for this sector to continue referring to innovative technology suppliers as FinTechs?

As such a fragmented market of over 400 lenders in the UK, community finance providers need to decide whether they are leaders or followers of technology innovation and adoption. Many see themselves as 'fast-followers' – not taking the risk of being pioneers, but equally not being left behind. However an industry needs its leaders to allow others to assume the position of fast-follower.

Our survey identifies leaders in the community finance sector as early adopters of new innovative technology and a wave of providers following close behind. Interestingly only 6% of respondents ranked the supplier credentials with peer providers as the most important factor in selecting a supplier.

As we would predict, the larger the provider the more likely it is they will use technology across all functional areas, such as loan decisioning technology. 15% of small lenders use loan decisioning technology compared with 65% of large lenders. This reflects the ability to handle low volumes of underwriting decisions versus the effort to configure a rule-based decisioning tool, and the relatively high impact of each bad lending decision on small providers.

Curtains is the core accounting and loan management system used by 22 of the 48 credit unions surveyed. 19 of these credit unions have developed relationships with FinTechs to augment their implementation of Curtains with niche solutions, although integration with Curtains is by exception.

Omnio (the supplier of Curtains) is developing reseller relationships with selected FinTechs. These are intended to formalise integration with the core system, provide a sales platform for the FinTechs and achieve economies of scale in their pricing.

Incuto is building a strong and supportive client base across credit unions. The initial implementations of Incuto have focused on online and app solutions, along with loan decisioning tools with focus on a core loan management solution that works across their client base.

Nivo has proven popular with lenders with a chat tool taking members or customers through the onboarding and loan origination process. Many Nivo users are now focusing on integrating the data flow with their core systems.

"Adding Nivo to our member services technology has meant that we are able to move much faster in member services, however the lack of ability to integrate with our core system is unfortunate."

Technology innovators have successfully introduced open banking to the sector as an affordability assessment tool primarily, extending to credit risk assessment in some cases. Given that open banking launched in 2018, the fact that 70% of the lenders use open banking is indicative of the valuable role that the technology can play.

Almost all community finance providers use CRAs to provide data into their underwriting process, although some are questioning whether they will continue to play a role in the future of their businesses. TransUnion data is used by twice as many lenders as either Experian or Equifax.

The CDFIs surveyed use an entirely different technology stack to credit unions. While there are good reasons why the technologies are better suited for one over the other, there are functional areas such as decisioning, customer engagement and even CRM where there should be sufficient overlap to use similar suppliers.

We will provide more specific details on the features of the individual technologies in the toolkit we'll start publishing in early 2021.

Core accounting and loan management system

Supplier	Providers using
Kesho/Omnio	22
Incuto	7
Progress	6
Caroma	4
Conaccess	4
Viva	4
TCS	3
Bespoke custom build	3
Wellington	2
Fern	2
Anchor	2
Street UK	2
Mambu	1
Custom (Future Design IT)	1
Total	63

Customer / member engagement

Supplier	Providers using
Bespoke custom build	10
Kesho/Omnio	9
Nivo	8
Incuto	7
Progress	5
Viva	4
Soar	4
TCS	3
CU Apps	3
Anchor	2
NestEgg	1
Wellington	1
Fern	1
Just Borrow	1
Salesforce	1
Total	60

Credit Reference Agencies

Supplier	Providers using
TransUnion (prev Call Credit)	30
Equifax	15
Experian	13
Total	58

Customer Relationship Management

Supplier	Providers using
Kesho/Omnio	15
Incuto	7
Bespoke custom build	6
Progress	4
Caroma	3
Microsoft	2
Wellington	2
Fern	2
Viva	2
Street UK	2
Salesforce	1
TCS	1
Anchor	1
Total	48

Open banking

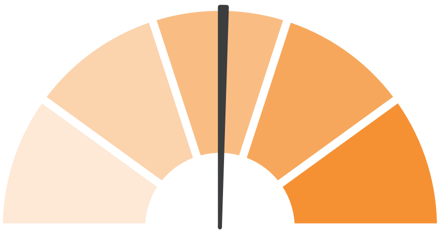
Supplier	Providers using
TrueLayer	12
Lending Metrics	11
Experian	5
TransUnion	5
Account Score	4
Credit Kudos	2
NestEgg	1
Yapily	1
Total	41

Loan decisioning

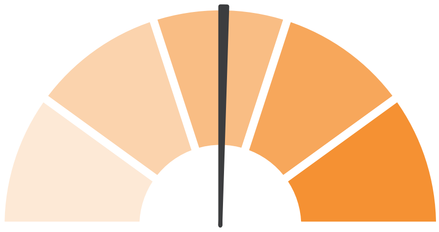
Supplier	Providers using
NestEgg	5
Kesho/Omnio	5
Lending Metrics	4
TransUnion	4
Experian	4
Bespoke build	1
Progress	1
TCS	1
Acumen	1
Total	26

Modern technologies are raising the standards and increasing expectations

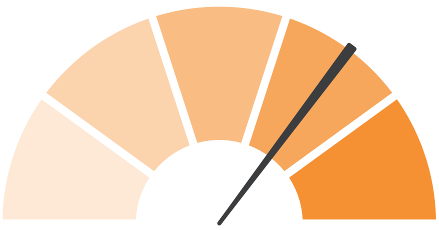
Core accounting and loan management system



Customer Relationship Management

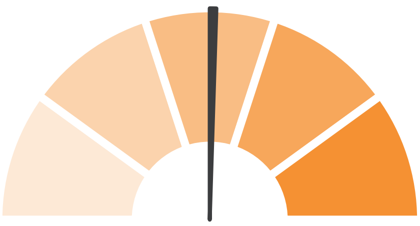


Customer / member engagement



Open banking

Credit Reference Agencies



Loan decisioning

We don't plan to publish individual supplier satisfaction ratings because the small number of respondents per supplier doesn't give us a sound statistical base to give a true and fair reading.

However, at an aggregated level we can observe that satisfaction levels are higher with modern technologies, both in the back office and customer facing technologies.

The satisfaction rating for core accounting and loan management systems that have been used by the sector for over a decade were rated an average of 5.5 (out of a maximum 10) compared with the newer technologies achieving a rating of 8.1. It should be noted that there were four times as many legacy loan management systems in our sample than newer technologies.

There are many reasons why the rating may not be an absolute indication of the relative difference in how good the suppliers and their technologies are, but the gap is sufficiently wide to indicate that suppliers of legacy technologies are generally not keeping pace with providers' expectations. Contrasting comments made by respondents about their core loan management systems adds context to the relative ratings.

"Our supplier failed to deliver the straight through loan processing we required."

"[Our new supplier's] product development is highly responsive to individual client requirements/ preferences."

"Clunky, out of date, no discernible progress."

"Extremely happy with [our new loan management system]."

FinTechs that specialise in specific areas of functionality generally received high scores. Of particular note, FinTechs with a client base of five or more and ratings above 8 were

- Nivo for their customer engagement chat app
- NestEgg for their decisioning software
- Lending Metrics for open banking and decisioning software

"... engagement with our app and members area on our website has shot up! We are delighted."

Where providers report positively about their core technology, they typically rate the suppliers of other technology highly. There is a combination of factors that could be the reason for this

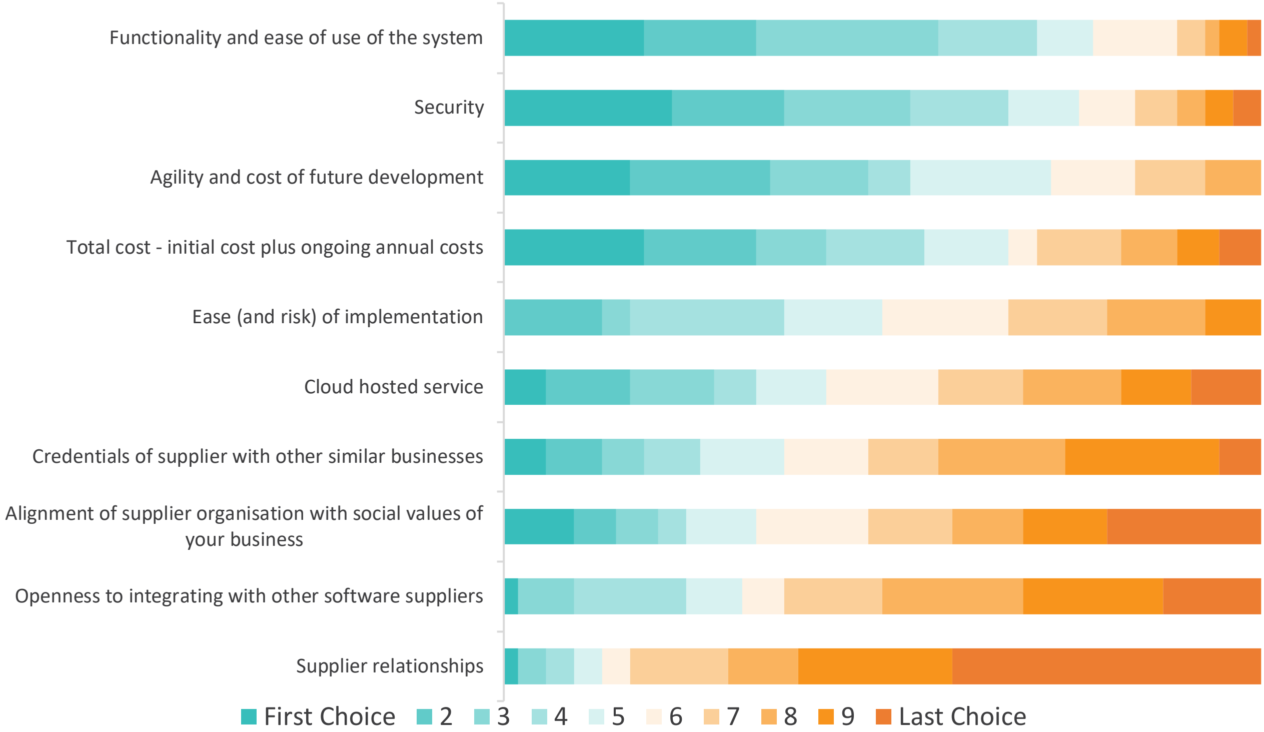
- Their core technology integrates well with other technology services making peripheral systems more useful
- The providers typically have people dedicated to IT, which is likely to lead to better informed supplier decisions, but also make them feel more invested in successful IT and therefore score the survey more generously
- They are generally larger businesses with bigger IT budgets, so able to afford the more expensive technologies that would not be accessible to many of the smaller lenders
- The individual respondent could simply be more generous in their ratings across the board

The criteria used to select technology suppliers reflects the strategic priorities of a business

Selecting and procuring a technology solution should be project managed from the initial market scan through to the signing of contracts. The criteria used in selecting a supplier varies by provider, and to some extent by application. However, they should align with the IT strategy and form the basis of decision making throughout.

Respondents were asked to rank the criteria in selecting a supplier by importance to their organisations.

Order of importance when selecting software



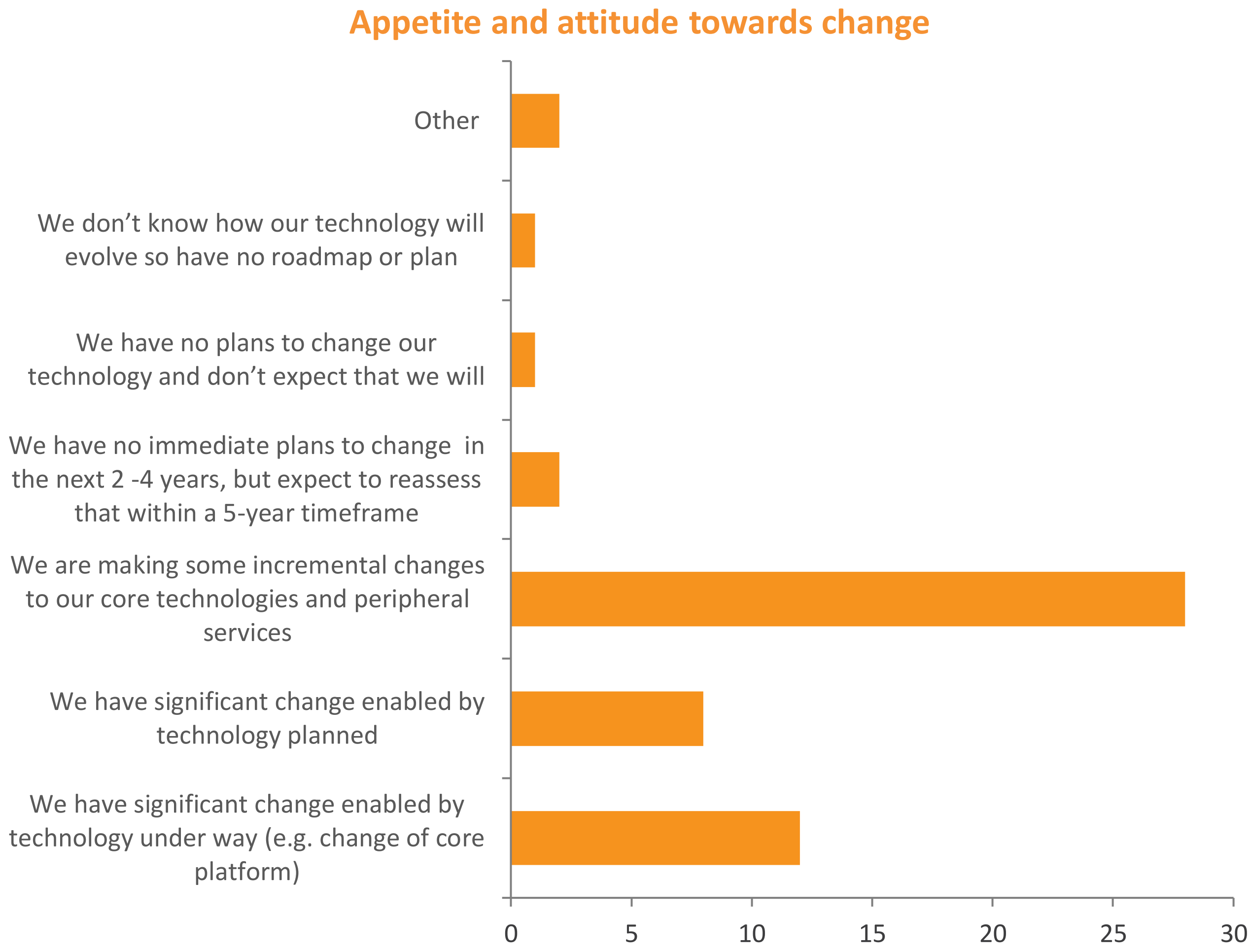
While functionality of the technology was ranked the highest when selecting a technology supplier, security was chosen as the first answer by more respondents than any other.

'Agility and cost of future development' was ranked third (first for 17% of lenders) possibly reflecting respondents' experiences with some existing technology suppliers not meeting these expectations.

No provider selected 'ease or risk of implementation' as their first choice, which is a little surprising given some well-publicised implementation challenges in the sector.

Analysis of the ranking by size of business shows 'total cost' as the highest ranked attribute of importance by small providers, whereas 'functionality and ease of use of the system' is the first for large providers, and 'security' for medium-sized ones.

Incremental or wholesale transformation of technology are each applicable strategies in different contexts

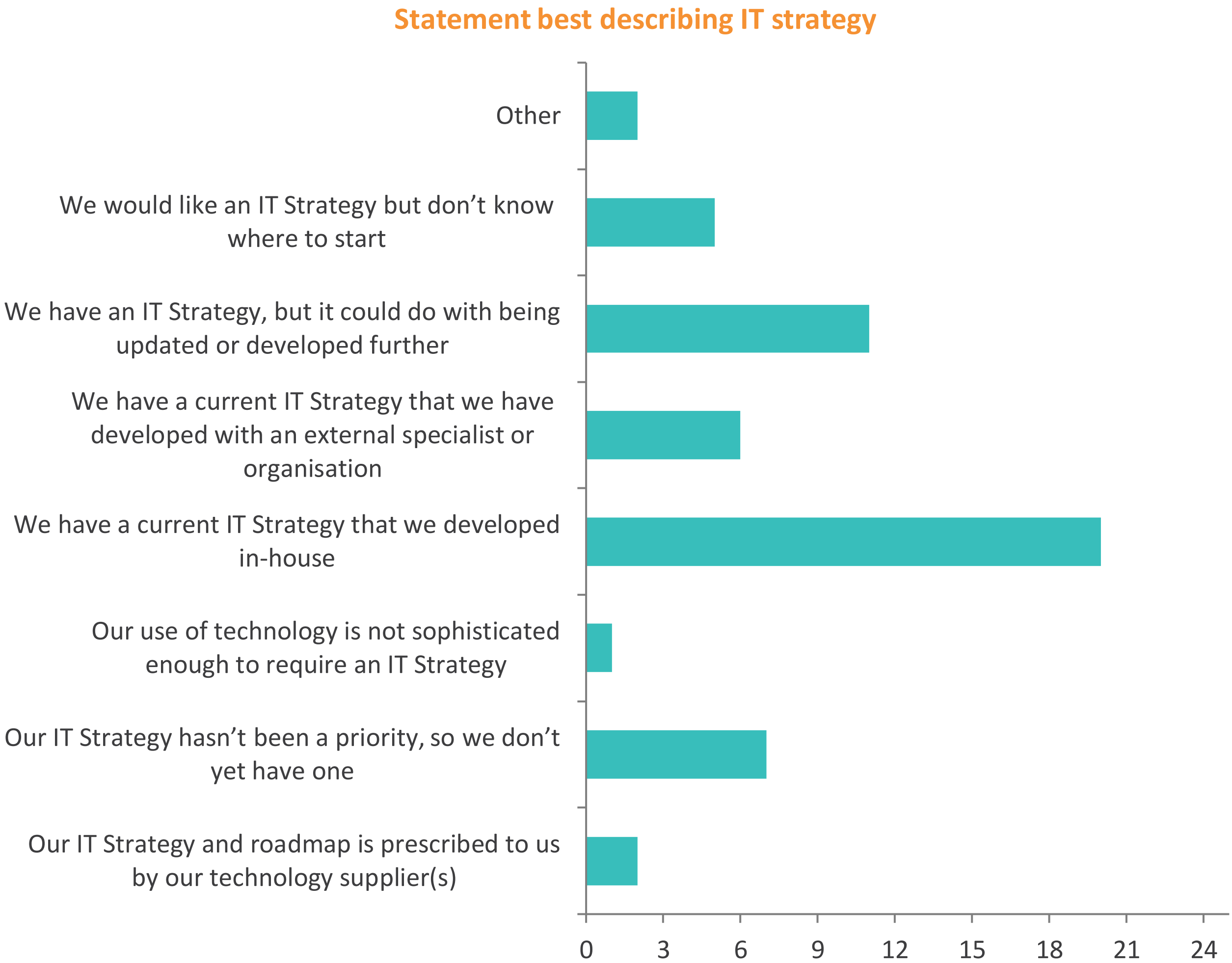


Around half of providers reported incremental changes planned for their core technology and peripheral services. Incremental change to business technology is a valid approach to building out technology capability and augmenting with new technologies. However even incremental change should always fit with the wider strategy and should take the provider in the direction of their technology target state.

Planning and project management of incremental change is important to deliver in line with business expectations of cost, schedule and benefit. And it helps to avoid pitfalls, including sleepwalking into an unintended accumulation of multiple point solutions resulting in

- Multiple manual hand-offs between systems
- Where interfaces can be built, the development and maintenance of bespoke interfaces which have to be tested and changed with software upgrades
- Multiple points of failure and areas of cyber security exposure
- Many supplier relationships to manage and pay

37% of lenders surveyed are undertaking or planning significant technology change, many of which relate to replacement of their core technology



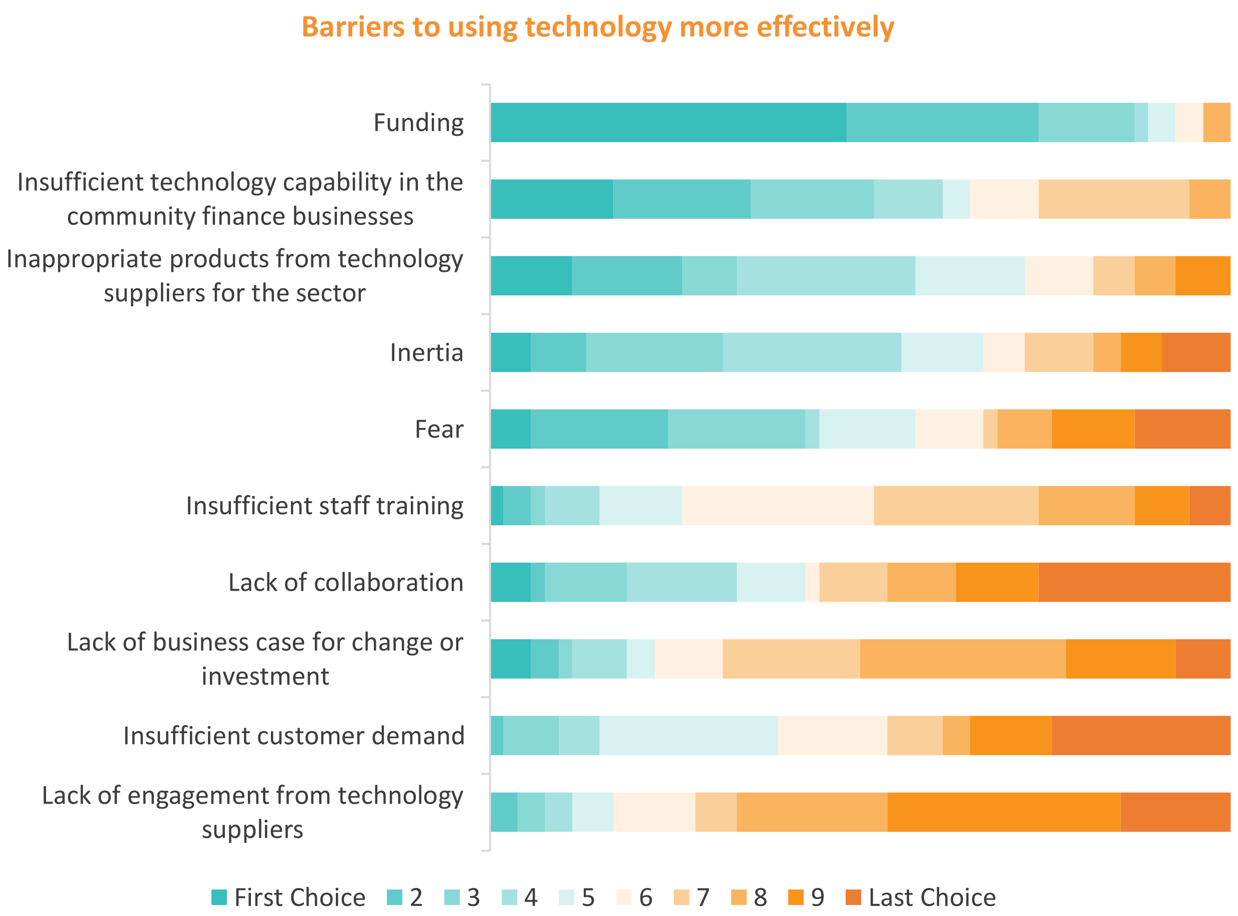
The majority of businesses undertaking this level of strategic change have current IT strategies and people dedicated to IT on their teams.

There are two instances of lenders who have not prioritised their IT strategy but are still undertaking significant change. This could simply be a misunderstanding of what an IT strategy needs to be.

However in these cases we recommend that the change programme is paused to allow alignment of the programme and the technology solution with the strategic objectives of the business.

Funding is considered by most as the biggest barrier to using technology more effectively in the sector - but unsustainable funding is unhelpful

Asked to rank the biggest barriers to the sector optimizing its use of technology, 48% of providers ranked funding the highest. Insufficient capability and inappropriate products from suppliers ranked some way behind in second and third respectively.



Funding as a barrier ties back to the small IT budgets allocated by individual providers to their investment and maintenance of technology.

It's very hard for any organisation with fewer than 10 people on the team and less than 2,500 loan customers (which makes up approximately 50% of the survey respondents) to make a return-on-investment for technology enabled change - the opportunities to make sufficient cost savings or revenues are unlikely to exist.

The cost of implementation is only the start of paying for technology services. In fact as more technology is sold as a service hosted in the cloud, the upfront cost is small compared to the ongoing 'subscription' or 'transactional' pricing commitments.

Given the strength of feeling in comments made about collaboration, it's a little surprising to see lack of collaboration ranked at seventh with over 25% putting it at the bottom of the list. 43% of lenders are collaborating with others, while 26% aren't currently but would like to.

"Massive impact if we can collaborate."

"... it is only through collaboration that we are able to consider developing this."

"Joint purchasing and combining of resources at scale would give a better chance of competing with high-cost lenders."

"Unless credit unions open to the idea of cost sharing through merger it cannot happen. There needs to be critical size."

Next steps

During 2021 Fair4All Finance will continue to work with Innovate Finance and The Finance Innovation Lab to launch a series of technology toolkits.

These will start by helping lenders to assess their current use of technology and develop IT strategies that align technology with the business strategy and goals.

Further toolkits will provide an objective analysis of the supplier market and help with selection processes and implementation.

We'll also be considering opportunities to provide meaningful sector-wide support with targeted funding of initiatives.

In everything we do in this space, we'll remain independent and will not seek to interfere with the market dynamics of the technology suppliers serving this sector.

And as an important biproduct to our work, we hope suppliers will be able to use our insights to provide even better products and services to the community finance sector.