Exploring what it takes to transform lending from branch based to digital

A conversation from our first ThinkIn with Frédéric Nze, Founder and Executive Chairman of Oakam and Faisel Rahman OBE, Founder and CEO of Fair Finance, exploring Oakam's journey from bricks and mortar to app only.

(Faisel) Who is the Oakam customer and why do they need finance?

(Frédéric) Oakam's customers are around 60% female mostly in their mid-30s. They come from a wide range of nationalities and backgrounds. Around 30% get their main income through benefits, and 70% are in employment.

Either they have no credit record, or there is poor or patchy data available. They lack the common utility bills and other collateral required to pass most KYC processes, and they display unstable incomes which creates some challenges for affordability assessments.

'What characterises our customers is they have been failed by the data held by credit reference agencies and by traditional credit assessment systems.'

We've seen big increases in the number of our customers who are working in the gig economy or are on zero hours contracts.

People who've recently moved to this country are often invisible to the credit systems, or they live in multi-adult households where it's difficult to prove their identity because household bills aren't in their name.

Can you talk us through Oakam's journey from physical branches to a digital business?

One of the challenges we faced, was how difficult, expensive and slow it was to scale the branch network.

We looked at different models, from franchising, partnering with retailers, to kiosks. We were initially very committed to the retail model. We believed it was 'impossible' to underwrite 'credit invisibles' without some sort of face-to-face interaction.

We started to see an increasing number of customers coming into the branches with smartphones - this was 2015-16 when smart phone penetration in the UK passed 80%.

Our customers started to complain about the experience for repeat lending. It's important to remember that many of our customers have two jobs, or quite a few children, or simply they lived quite far from our branches, so attending a face-to-face meeting for the loan assessment generated a high transaction cost which was all at their expense. And to top it off, the loan assessment could last up to 30 minutes.

So, our first step towards 'digital' was to hack a mobile app on which they could fulfil repeat lending. We developed and launched it in three months and five months later we had 65% of our customers using it regularly and empty branches.

Once we started on this journey, we could not revert, so we looked at how we could underwrite digitally. This step was the most difficult! It took us 2 years and costed us dearly - higher fraud rates, covenant breaches – to get to parity. Store underwriting gave us great conversion and a massive advantage in fraud screening, but it just did not scale well.

By trial and error and accumulating rich alternatives to traditional credit data, we finally cracked it. We reached parity between robo-underwriter and human-underwriter.

At this stage, lending was cracked but what had made us a successful business was the intangible benefit of the 'CreditBuild' proposition. The advice we could give in store, the emotional and social links we were able to create with the face-to-face model had to be re-invented through the UX of the app.

'Once you know a customer, it's much easier to lend. We had to crack that first loan using the app.'

This is a long journey, but it's the most exciting part of our new model. We gather so much more data about our users that we create an intimacy that is beyond what we could in stores, it might not replace a smile, empathy etc but it is 24/7 in the user's pocket and can be much more reliable at large scale.

The branches created a hub, which generated stickiness. We offered financial education, supported our customers through their admin formalities like tax credit or benefit claims. As a result, we had a very high level of referral. 52% of new customers came from a friend – this gave us a very low customer acquisition cost and high retention.

Those metrics were hard to replicate through purely digital channels, but not impossible. We needed to go beyond 'transactional lending'.

Can you talk us through some of the pain points you experienced and what you might have done differently with the benefit of hindsight?

When we saw the strong signal of high adoption of the app we should have shifted more aggressively. We tried to do both - save the branch model and retain staff while we moved to the app.

We temporarily fell in a very poor in-between: neither a great retail operation, nor a great tech business. This caused the culture to become very challenging. We also saw a dip in customer engagement. Overall, it was a horrible time for us.

How did the customer profile change – did you lose customers on the journey?

The profile did change slightly, as we were finally able to offer a proposition that was much more attractive to millennials, which are a large part of the thin file segment.

Some of our stores tended to over-represent certain demographics or nationalities and as a result excluded other groups.

Retail is great if your customers are from the same segment and can easily identify with the other customers they see in the branches. But the aspiring millennial for example might not see these branches as serving their needs. In the app you don't see who else is in the virtual queue. This made us fundamentally more inclusive and achieve a greater reach.

Apart from the shift to digital, the biggest change to our customer base has been driven by Brexit and the reduction of migrants coming into the country.

How did the customer relationship change?

At first, we lost intimacy. Our employees lost the knowledge they had of the customers through conversation. But we gained another type of intimacy, one linked to being in your pocket, in your smartphone 24/7, and having access to 1000 times more data points - different data points with all the opportunities and challenges they bring.

Customers have stayed very loyal, responsible and informed.

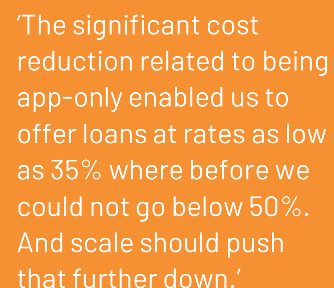
They knew the branches carried a cost premium because of the high operating and transactional costs and so they were very aware that a digital solution could be of direct benefit to them - that's been a big part of our success and a key reason why they've been really keen adopters.

What is the future for microlending in the UK? Will there still be a role for face-to-face lending?

Technology has a significant role to play for both the third sector institutions and commercial ones.

In the next few years, I anticipate big positive changes in access to and cost of provision enabled by technology as organisations like Fair Finance and others in your space adopt digital.

For us, the immediate impact of moving to the app was that we were finally able to scale, run a sustainable model and effectively deliver our core proposition - to help customers build access to cheaper credit.



'The significant cost reduction related to being app-only enabled us to offer loans at rates as low as 35% where before we could not go below 50%. And scale should push that further down.'

But we certainly haven't cracked it fully yet. In our branches we were able to lend to around 40% of applicants. Now we decline a lot more, mainly due to the rules around affordability.

This is a big area where customers have been negatively impacted by some of the regulation implemented over the last few years. The emphasis has moved towards procedure instead of customer outcome. This where the community sector has a significant advantage and partnerships could be fruitful.

Where we're declining applicants, it's likely that many of these people would be better serviced by a face-to-face loan arrangement underwritten by the not-for-profit sector.

At the moment, there's an imaginary wall between our sectors, and that needs breaking down. It's about effective collaboration in the interests of the customer.

What are the main opportunities for innovation?

The major one is that many of our customers are not just looking for a loan, they're looking for access. They understand they have to fix and/or build their credit score in order to level up and access mainstream financial products.

We're evolving our products to offer credit building tools through our mobile interface. We will continue to operate as a lender of first resort, but at the same time open up our platform to other lenders from other sectors that might be able to provide cheaper or more appropriate products.

We're also looking at our brand and upgrading our core digital product. We want to expose the credit building benefits of our loans more explicitly and give our customer more choice.

Our app guide users to share information and engage in tasks that build good financial habits, improve their financial standing and grow their credit score.

With every new feature on the app, we're moving further away from simply providing a loan – towards helping customers achieve their goals. No one wants a mortgage they want a home - our customers want to improve their financial standing and resilience and work towards their bigger goals.

For example, we can offer graduation to mainstream finance for customers who qualify for cheaper credit than we currently provide. And for customers who don't qualify for a small loan from us due to affordability, we could recommend them to the community sector.

What is the role of the not-for-profit community sector for the last mile or excluded communities?

There's a growing role for partnerships in this sector where there is a physical 'last mile' challenge for issues like Know Your Customer (KYC).

A blended model can enable partnerships to deliver the best of both worlds: digital for convenience, for alternative data gathering, for standard scoring, and face-to-face for non-digital data validation, for users that are in the grey economy, for forbearance.

'There's a role for joint working to encourage digital adoption, better manage forbearance, ease the mental health burden related to financial stress and so on. There's so much more that can be done better when we combine the best of human and digital.'

Specific channels could be set so that the rates applied, the product rules, etc. could be favourable to the specific channel - recognizing the value add and impact element from community and not-for-profit partners. Contributions could easily be tracked and rewarded.

For example, we deal with 40,000 applications every month, of which we can only digitally serve a small fraction. But we have a post code for each applicant and could refer them, with the customer's permission, to the right organisation when face-to-face interaction is necessary.

We have stricter requirements from the FCA as to affordability checks and doing so online creates a large set of false positives. Again, these people would benefit from face-to-face.

Some community organisations cannot offer larger loans, so they could graduate customers to our near-prime product, which has rates comparable to, or sometimes lower than, a lot of mainstream credit cards.

'We are open to sharing our technology platform. We can white label our mobile app and other parts of our tech stack for other providers' operations. This would enable us to create standard pools of assets (benefiting from a standardised credit score). Should we achieve this, we could attract better capital for all parties involved.'

These are just a few ideas for industry-changing collaborations that could be easily conceived and implemented. I get quite excited when I think of all the possibilities.

How can community funding organisations work with fintech?

There is so much tail wind in this space - politically, from the FCA policy team and sandbox, and from FinTech start-ups.

My perception is that there is a feeling that for-profit and 3rd sector are different species and don't really mix. The reality is that we can and we should for the benefit of the customer.

My guess is that those with the capability to develop partnerships will grow faster, attract more funding, and deliver more impact. It will boil down to understanding where you truly and uniquely add value to your customers or members.

Finally, is there any advice you would give to the community sector looking to move to a more digital model?

One thing to keep in mind is that 'digital transformation' a misnomer.

We retained some of the history, experience, data, and mission but the majority of everything else we left behind. Sadly only five out of 300 staff from the branch days are still with the company. So, this wasn't a matter of reskilling and adapting: it was wholesale.

The other thing I'd advise is to think carefully about your organisational strengths, value add, and partners. Focus on where you have a unique proposition and drive towards that.

'What we ended up doing is closing a profitable business and creating a new one.'

As an industry, you have two advantages: lower financial and regulatory thresholds and no challenges to the fact that you are mission driven. These are significant assets to have - don't let them go to waste.

Shoot for the talent that will enable you to deliver your mission. I have been on the board of a few charities and we often compromised on talent because we felt that commitment to the mission was demonstrated and as a result, we stalled the growth and impact of the organisation.

Finally, treat your relationship with customers as truly commercial - don't settle for a lower quality of service on the back of the feeling that you are helping. Offering excellent service needs to be at the core of everything you do.

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About Frédéric Nze

Frédéric graduated with MSC in Science in Mathematics and a MSC in Economics.

Over the last 25 years he has worked in the world of Decision Science (now known as Data Analytics), specifically in the defence, lending and insurance sectors.

Frédéric has founded three businesses: a data analytics consultancy, a micro-lender and more recently an alternative credit data business.

Born in the Republic of Congo, Frédéric moved to France as a teenager and has lived across Europe and the US ever since. He is now primarily based in London with his family.

About Faisel Rahman

Faisel has worked in the field of financial exclusion for 25 years. Initially with the Grameen Bank and World Bank in Bangladesh, for the last 17 years he focused his work in the UK and Europe.

In 2000 he set up one of the UK's first microcredit programs in London's East End, and in 2005 launched Fair Finance a social enterprise tackling financial exclusion in the UK. During this time Faisel has been the elected President of the European Microfinance Network (2010-15) and a columnist at the Guardian Newspaper on issues of financial exclusion.

In 2007 he was made an Ashoka Fellow and in 2009 was recognised as a Young Global Leader by the World Economic Forum. He received an OBE from the Queen for services to Community Finance in 2014, and in 2015 was awarded an honorary doctorate by the University of East London for his work in helping thousands of families escape the poverty trap.

In 2019 Faisel was made an Honorary Fellow of Social Enterprise UK for his contribution to shaping, guiding and championing the UK's social enterprise sector.