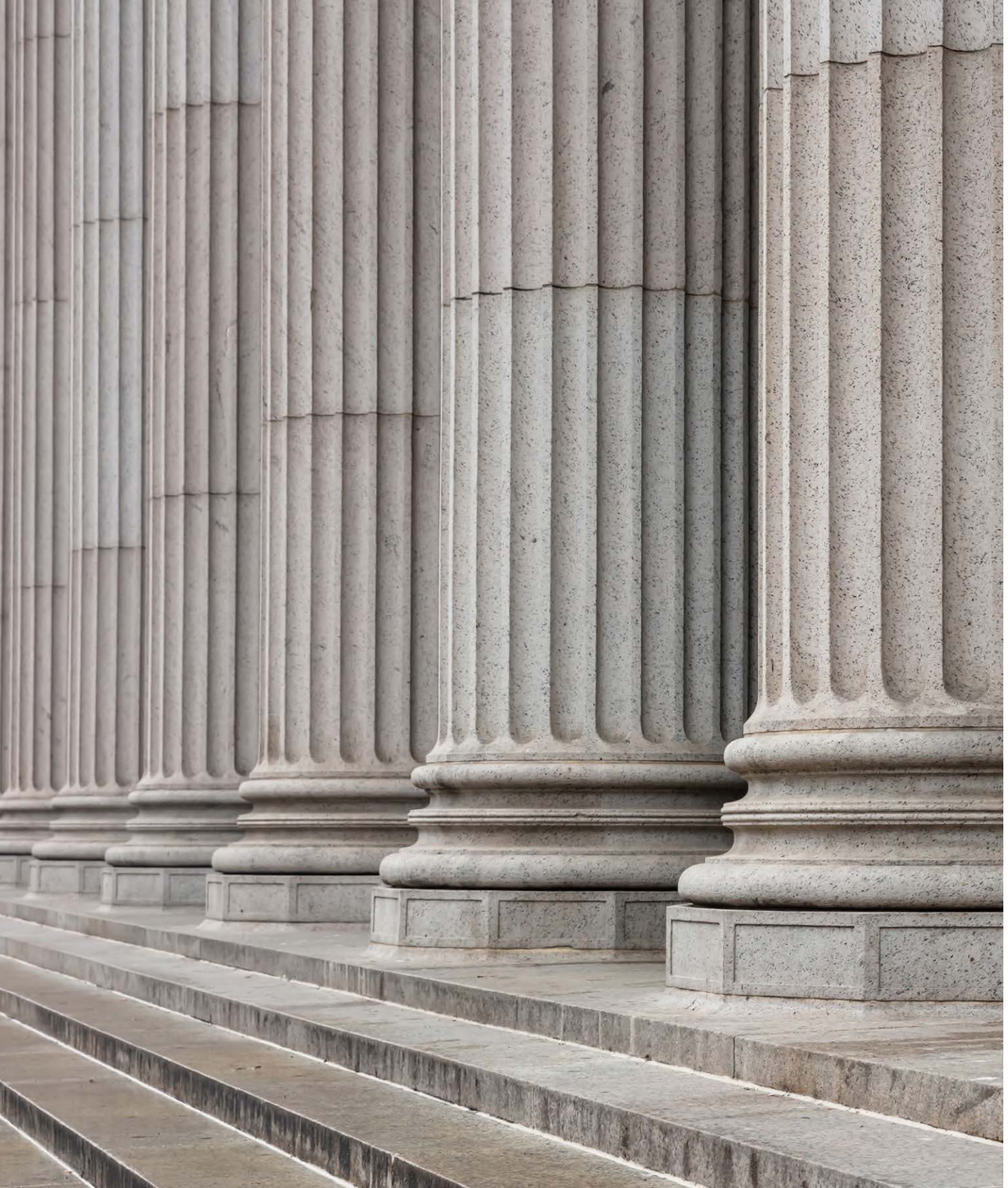
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The high-performing lender's guide to digital transformation using AI and automation





FOREWORD

When humans invented the barter system in 6000 BC, little, did we know that 80 centuries later, the world would be so very different? In 1754 BC, the concept of lending took birth, where the interaction was purely human to human. In the last four decades, lending has made huge advancements starting with computerization. From computerization to artificial intelligence, it's been a dream run for the lending industry. But there's something phenomenal and unique about how the last seven to eight years have unfolded.

We saw banks losing market share to a new category of service providers called the Fintechs. The customers are expecting more than just financial assistance from the borrower. The narrative has shifted from the exchange of capital to building memorable experiences for the borrower. For a lot of banks, it was a moment of self-reflection. Several questions had to be answered – Why are we losing this market share? How has the customer expectation changed so dramatically? Why can't we run lending the same way we used to? What's AI? Most importantly, what should we do to win back customer's confidence, market share, and drive hypergrowth?

There's more to digital lending than just being a buzzword. Two aspects take center stage when we talk of digital lending – fast, efficient, effective credit decisions, and hassle-free, superior lender experience. No level of process re-engineering can bring these ideas to life unless it's complemented by the new-age technologies like AI, machine learning, NLP, OCR, intelligent automation, blockchain – the list is long.

The only way to execute these two concepts alive is by augmenting human intelligence with digital technologies. No level of human intervention can substitute for machine learning. It's time for banks to acknowledge that if they were to grow fast like the Fintechs, it can't happen by solving the same problem with more of what they use to solve it. Banks must take advantage of the new age technologies to drive growth-focused transformation at-scale.

If banks don't act now, the gap between them and Fintechs may widen so much; it will not be possible to catch up. This moment is an inflection point for the banks. Non-traditional players have disrupted digital lending. It's time for the traditional banking players to level the playing field. It's time for them to begin their pursuit of delivering superior experiences using digital.

As you go through the next few pages, you'd find answers to these questions – Why should banks transform lending? Who are the stakeholders, and what's it in for them? What's the business's economic value from this approach? And most important of all, how to bring this transformation to life? Read on.

The dawn of digital-led lending



The Threat of Irrelevance

80% of the heritage financial firms will become irrelevant by 2030, says Gartner.[1] Seems fictional? Not really, if you look at the numbers.

For the period 2013-18, the personal loan market share for fintech has increased from 5% to 38%; it has reduced to 28% from 41% for the banks, as per a report by TransUnion.[2]

Mortgage Banker Association reports a consistent rise in the cost of loan originations for banks. Similar trends are being observed across various parameters, which doesn't augur well for the traditional lending companies. The business models in the lending business are getting disrupted at an astronomical pace. The shift of customers from conventional banks to Fintechs and digital lending platforms is getting accelerated due to low switching costs, better experiences, and many others. The biggest threat to banks is not the competition but the inertia to do away with old ways of lending.

This new business model's adoption will help traditional and established banks offset the differentiation that fintech enjoys. It will also help them win back the market share and drive profitable growth. While technology will be a crucial catalyst to drive this paradigm shift, it's interesting to see how the banks build their strategy to displace competition. It's not just about putting together a set of technologies that get them out of this mess. There's a lot of art and science behind this transformation. Several stakeholders are involved across the lending chain – underwriters, credit risk analysts, sales and marketing teams, digital and technology leaders, finance, and strategy.

The payoffs for the banks and their customers are massive.

Faster approvals, shorter lending turnaround times, lesser frauds, more savings, better customer experience, retention rates, lower customer acquisition costs, improved profitability, rapid loan growth, and improved credit quality.

That's a lot to ask for if you knew AI was a mere fantasy. Now, let's take a step back and get into various stakeholders' shoes and objectively look at this problem statement.





The tipping point for the modern day lenders

CHIEF DIGITAL OFFICER

- Archaic systems
- Scalable systems that exhibit agility, high-performance, low-code, easy integration, and high ROI

HEAD OF UNDERWRITING

- High credit risk
- Sub-optimal pricing
- Low credit risk
- High credit quality
- Utilize more data to get better insight into potential borrowers
- Fraud detection and credit operations

HEAD OF RISK

- Reactive risk monitoring post first-party frauds
- Real-time and proactive risk monitoring (for early warnings, etc.) and measurement (for regulatory purposes)

CHIEF OPERATING OFFICER

- Siloed approach
- Low operational efficiencies
- High costs of loan originations

- Hyper collaboration between sales, operations, technology, and strategy teams
- High operational efficiencies
- Low costs of loan originations

CHIEF GROWTH OFFICER

Sales and Marketing leaders

- Linear growth
- High customer attrition
- Poor customer experiences
- Low margins

- Non-linear loan growth
- High conversions of applicants
- High cross-sell ratio to existing customers
- High customer loyalty
- Consistent, personalized, and omni-channel customer experiences
- High margins

Barriers on the way to transforming lending



We'll now look at the reasons behind the *as-is* state of various stakeholders in the banks. Most of the reasons will find the root of their problems in specific categories like data management, improper allocation of resources into revenue-generating activities, manual operations, customer journeys fraught with unimaginable hassles, and long lending approval cycle times.

Let's now look at a typical lending cycle and then unpeel it layer by layer from a stakeholder standpoint.

Stakeholder	Customer acquisition	Loan origination
 **Underwriter**	Missing customer data leading to poor decisions and loan losses	Poor collaboration with stakeholders leading to low efficiency and productivity
 **Sales and Marketing**	Excessive time spent brokering between customer and operations leading to poor CX and lower cross-sell ratios	Low level of collaboration with operations team leading to poor utilization of sales bandwidth
 **Customer**	Hassles of excessive paperwork	Long wait times for loan approvals
 **Risk**	Compliance incidents arising from improper customer verification leading to first party frauds	Inability to process holistic data and drive accurate credit risk score-backed decisions
 **Operations**	Manual effort to secure customer information for onboarding and regular checks	Manual operations that result in higher turnaround times



Inability to capture the customer data for analysis & appropriate pricing

Customer data arrives at the desk of the underwriter and operations team in various shapes and forms. It could be a physical document or in a digital format. It could be a manually written document or a computer-generated one. It could also source from a third-party database that comes with its unique structure. This mix of structured and unstructured data makes life for operations teams and underwriters tough, given the high manual-intensive nature of work. Limited data leads to decision making that's prone to errors. So what does it lead to?

Increased probability of low credit quality and eventually low profitability for the lender.



Excessive time spent non-revenue generating back-office work rather than growing the business

Who would want a salesperson to spend more time with the back-office team and less with the customer? No takers for this no-brainer, right? Most of the sales reps at banks spend time broker conversations between customers, underwriters, and back-office teams, which leads to low utilization of their bandwidth.

The time that should go into revenue generation and market expansion go into back-office work, which leads to low growth.



Underwriters stuck in the weeds with manual efforts

The underwriters receive a considerable volume of loan applications. For most of the banks, there are limited resources available to expand the underwriting operations. This massive imbalance between their ability to process applications and the enormous volume of applications results in long cycle times, incorrect decisions to rush through the applications, and many others.

Underwriters need to spend a vast amount of energies on high risk – high reward transactions, and complex loan applications. But as it turns out, they spend an equal amount of energy on all the applications.

The lack of prioritization leads to low effectiveness, which separates the hyper growing banks from the average ones.



The customer goes through the hassles of physical documentation submission

By not encouraging acceptance of customer data in digital format, banks are creating growth barriers for themselves. The aversion to not accepting digital format results mostly from their inability to process a mix of structured and unstructured data. It leads to poor customer experience for the banks and shorter customer lifetime value.

Eventually, it reduces customer acquisition and hinders long term growth sourced by cross-selling products to existing customers.



Long time to get the approval

Because of the manual nature of operations and collaboration between all the stakeholders, the customers have to go through long loan approval cycle times. For example, consider a working loan application from a corporation that enjoys an excellent credit risk score, healthy financials, besides many other parameters.

It makes no sense for the customer with an excellent credit history to wait for an inordinately long approval cycle. Working capital needs can be urgent and any delays cause indelible damage to business growth.

Banks need to solve these challenges to be able to drive aggressive growth.

Pushing the envelope on digital for lending hypergrowth



The way out for banks is to find the intersect between what's prompting customers to switch to newer platforms, what's high on impact and easy to implement, and what aligns with their strategic objectives. Digital technologies can catalyze this transformation. Let's double click on some high impact digital-led use cases in the lending value chain.

Exhaustive and accurate data management from disparate sources using AI, machine learning, and NLP

The more data the underwriters have access to, the better would be the credit decision. In the real world, with no automation support, scaling up this model is not practical. Usually, underwriters refer to data points in hundreds while evaluating a borrower's creditworthiness during the KYC and onboarding process.

AI, OCR, big data analytics, and NLP can help them scale this up 100X times without manual analysis. Imagine the credit quality banks can achieve with such a holistic analysis.

The other big headache for banks is missing or inaccurate data while onboarding during customer onboarding. By working on such data, banks are exposing themselves to high credit risks. Underwriters can now use various data remediation techniques to remediate incorrect or missing data. It leads to lesser errors, profitable underwriting, and improved productivity. Further, the data resides in siloed systems, which leads to inaccurate determination of the credit risk and, consequently, more frauds and less profitability.



Augmented underwriting

Underwriters are under tremendous pressure to run profitable and efficient underwriting. Both these attributes require high-accuracy credit decisions and agile operations. None of these two are possible without augmenting human actions with technology. While we have discussed facets of this approach in previous sections, let's take a quick deep dive into how augmented underwriting benefits the banks.

Banks can augment rule-based underwriting with machine learning models to improve their accuracy. These machine learning models continuously train themselves as they evaluate customer data and creditworthiness. Through supervised learning, the bank can refine these models and better control the credit decisioning process.



By applying automation to this decisioning process, underwriters can free themselves from cumbersome sub-processes like evaluating credit risk scores, reviewing all applications with the same rigor, and not utilizing the past data for quicker decision making. The underwriters can tweak the rules and models to ensure a balanced mix of man and machine intervention.

Automation of loan originations

If we place customer acquisition, customer data management, and credit decisioning together in a box and apply digital to it, the output is automated loan origination. Before using digital, banks also need to streamline their processes else; results remain sub-optimal. Let's review how this works in real life.

The bank begins the customer onboarding process by asking for customer data and processing it. A mix of physical files and digital documents arrives on the desk of the underwriter. The analog–to–digit tools extract the relevant data, remediate, and edit the data with zero human touches. It then looks for additional datapoints before moving into the decision phase and finally uses AI and automation for credit decisioning. And to streamline this process, automated workflows are put in place that enables smooth collaboration between cross-functional teams (sales, operations, underwriting).

When all of this comes together in a well-orchestrated way, the loan origination system is set up. There can be different maturity levels of this ecosystem depending on the extent and scale of processes covered, volume of technology intervention, and stakeholder involvement.





Digital lending's moment of truth

This moment is the tipping point in the history of modern-day banking. Never before have banks witnessed competition in the form of alternative lending. There are several reasons why banks should invest in digitalizing lending. However, eight of them stand out very clearly. Let's look at them in greater depths.

The current global economic turmoil

The COVID-19 pandemic has rendered many organizations financially needy. Their creditworthiness has plummeted to an all-time low. Even corporations with an impressive credit score a year back are now struggling to make ends meet.

Banks need systems that can sense and monitor the credit risk on a real-time basis. They need to create models that can intelligently advise them of the credit risk exposures they carry in this new normal. All these data points – both leading and lagging indicators should be baked into the bank's credit decisioning.

In these times, the data banks typically use for evaluation turns obsolete in a matter of a few weeks, not even months. This paradigm shift will influence not only their lending capabilities but also their collections strategies. It is the right time to put systems in place that allow the bank to use real-time business data sourced from countless legitimate sources – with the ultimate aim to serve their customers better and profitably.





Rising competition and lending alternatives for consumers

We can’t overemphasize how important it is for banks to look at how the lending business’ tide is turning against them. Owing to low entry barriers, availability of funds from confident investors, a stronghold on the new technologies, and zero legacy tech debt – several fintechs now serve as trusted alternatives to traditional banks. Banks have seen a sharp dip in their market share in the last few years. Some segments, like the millennials, might do away with traditional banking in another few years. The rise of P2P lending platforms, easy and quick access to credit, and many others don’t augur well for the banks averse to digitally transforming themselves.

The rise in fraudulent activity and the need for robust risk monitoring

There has been a steady rise in fraud in the lending space for banks. No bank is safe these days regardless of the countless manual-extensive measures companies put together. First party frauds have become the new normal in this pandemic. OCC mandates all banks to have a robust risk management system comprising policies, processes, personnel, and strategies to deal with various risks.

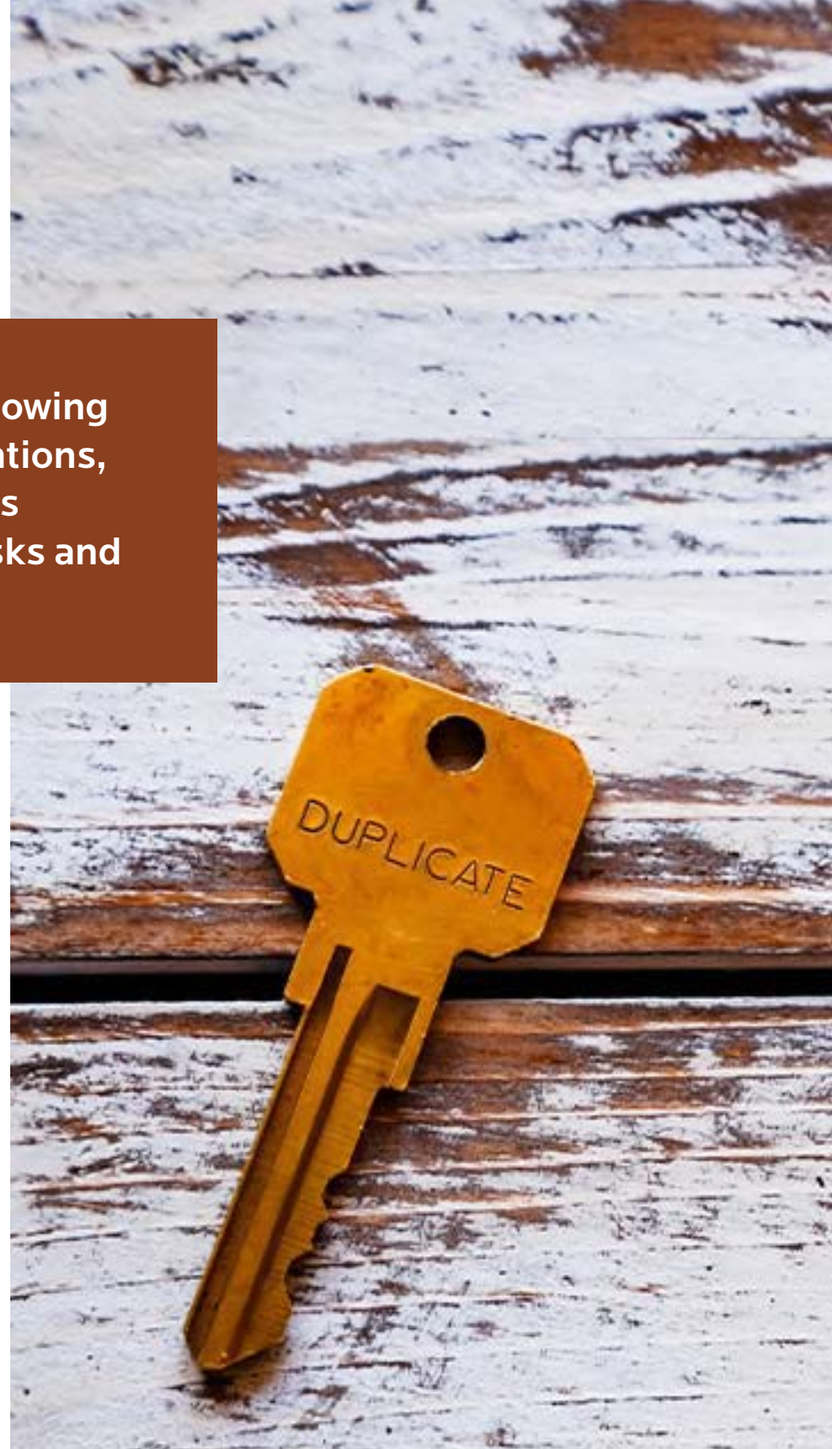
While there are required well-drafted policies, processes, and guidelines in place – much of it is left to the bank who has the final say on what technology the banks decide to use.

With revenues and market share going down, losing out margins due to these avoidable first-party frauds led losses would be the last thing a bank would want to go through.

Similar to the rationale for averting fraudulent acts, the banks need to be extra vigilant to prevent potential losses due to regulatory non-compliance. The middle and back office at banks is under tremendous pressure to drive growth.

With a high volume of loan applications flowing in, a high dependency on manual interventions, and sub-optimal data management, banks expose themselves to high operational risks and regulatory oversights.

Banks need better tools to detect fraudulent behaviors and minimize regulatory fines. Automating systems and reducing overdependence on manual checks is the first step towards the larger goal of staying one step ahead of regulations



Traditional ways of operations are not sustainable

Banks are losing their market share to a new category of the competition. To survive in the long haul, banks must think long term as they invest in digital transformation programs. Customer experience, process re-engineering, process automation, minimizing human intervention, augmented decision making, holistic data management sit at the core of all transformation programs.

If they don't find ways to transform themselves, either they would run out of business in the long term or wait for a larger entity to acquire them. Traditional methods of underwriting, sales, and credit decisioning can't fuel sustainable and profitable growth anymore.

Enable non-linear scaling

In the long term, the returns from investing in manual headcount are no match to what banks can leverage from digital interventions. The gains from digital interventions are non-linear across various metrics – financial growth, customer experience, cost savings, and service levels. New outputs either required more unique inputs or more modern ways of processing the information.

To drive non-linear growth, banks need to eliminate friction, reduce costs, and surge revenues. There can never be a better time than now to think of these objectives.





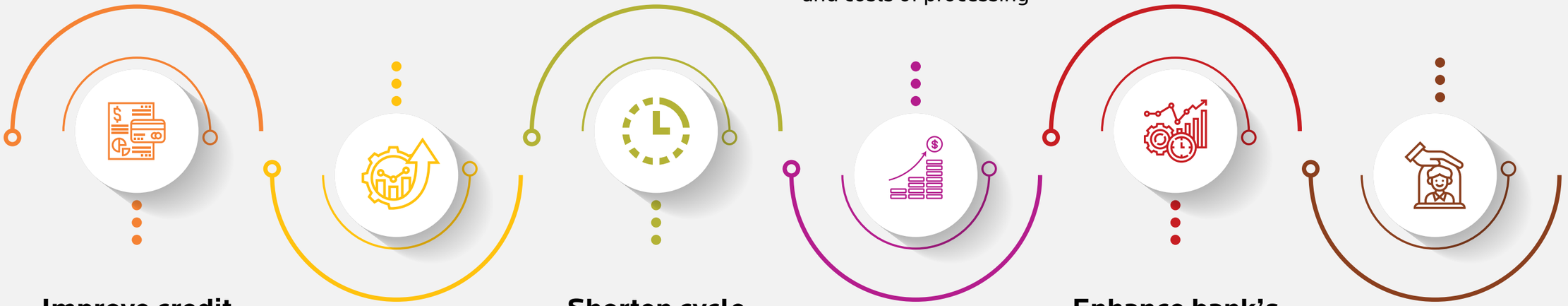
Superior customer experiences

Customer experience has gained immense attention in the last few years. While it remains an area of focus for the banking industry, it's the mid-tier and the small-scale banks using CX to differentiate themselves from the large banks. That's how Fintechs gave the larger banks a run for their money.

Customer loyalty and customer acquisition both are inherent to a bank's growth. CX will always be at the core of all such transformation programs.

The business economic value of digitalizing lending





Improve credit quality

Enhance credit quality with more accurate and extensive customer data

Grow fast

Achieve rapid and profitable loan growth using AI

Shorten cycle time

Speed up loan growth with faster loan closures

Improve profitability

Increase profitability by minimizing loan losses and costs of processing

Enhance bank's efficiency

Improve the bank's efficiency ratio

Retain more customers

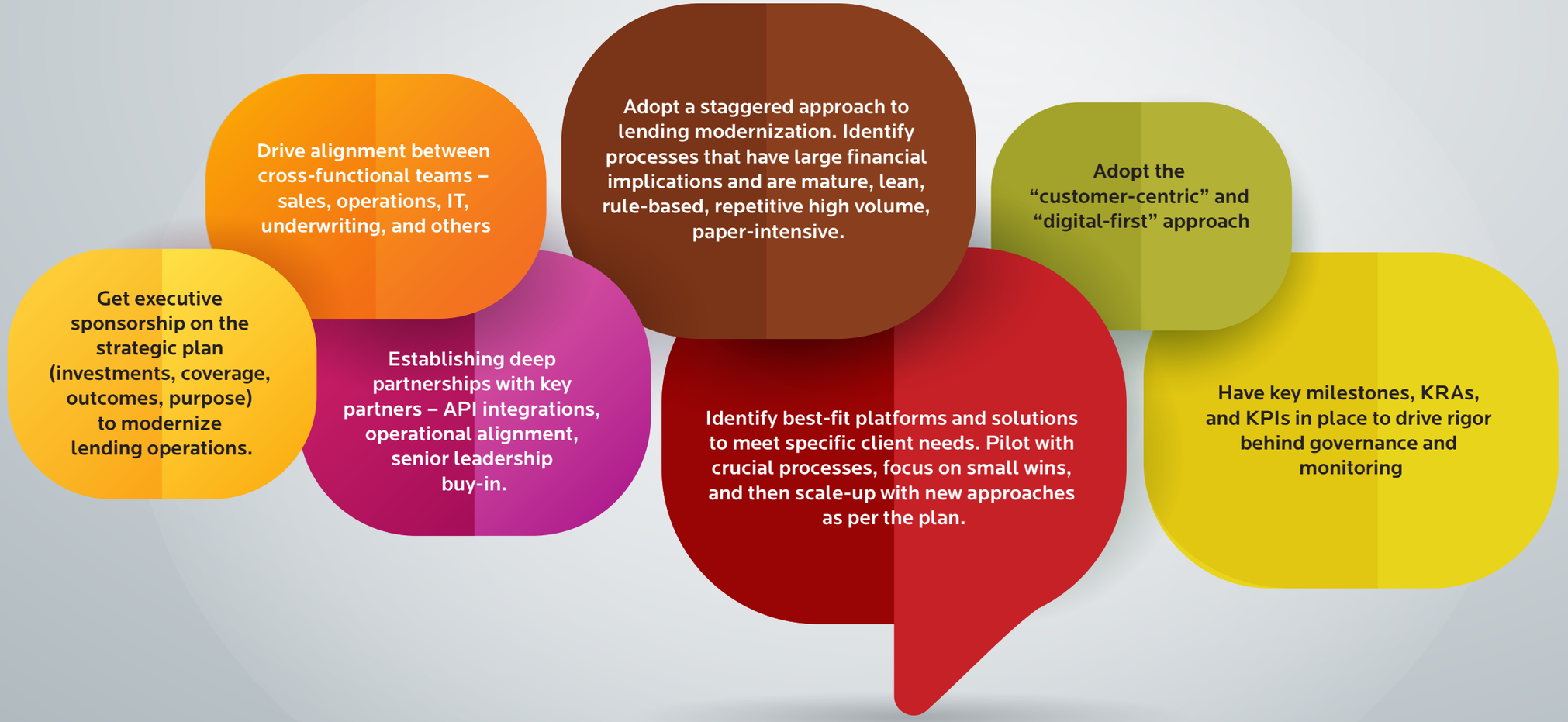
Retain customers with superior experiences


Margins
Loan growth
Customer retention
Customer acquisition rates
Efficiency ratios
Credit quality
Sales' facetime with customers
First-party fraud
Operational costs
Customer attrition
Loan losses
Loan cycle time

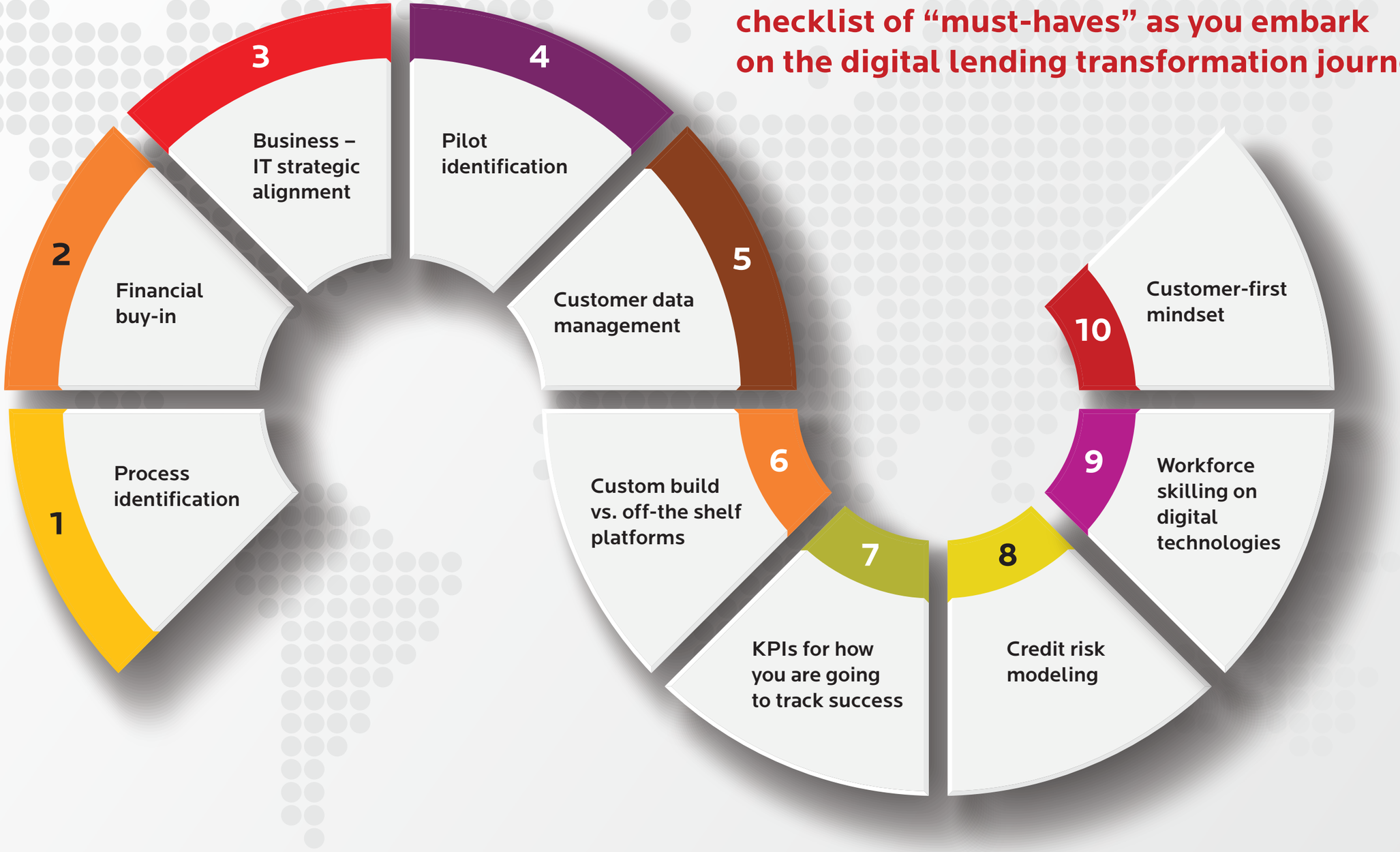
General principles for successful digitalization of lending operations



As banks embark on digitalizing their lending operations, we recommend these seven guiding principles to drive maximum gains.



For your ease, here's the recommended checklist of "must-haves" as you embark on the digital lending transformation journey.



Transformation roadmap

Sub-Process	Documentation	KYC/Onboarding	Data Remediation	Credit Decisioning
Without Digital	Paperwork received by the bank after customer submits the application	Bank checks the documents for sanctity and missing information and forwards for credit risk checks using third party sources	Goes back to customer for missing data OR inadvertently process the loan application without	Refer to policy guidelines and follow the rule-based approach
With Digital	Documents received in physical and digital formats Data scrapping and scanning	All digital documents read by OCR to extract data and run financial and KYC data checks	Apply quality control checks to remediate data and cleanse missing or incorrect data	Use machine learning credit decisioning models in combination with rule-based policies to arrive at the credit decision
Digital Interventions	AI	OCR, NLP	Advanced analytics, Machine Learning	AI, Automation
Impact	Superior CX	Quicker onboarding Low first party frauds	Lower first party frauds Better credit quality	Faster decision making Superior CX
Measures of Success	High customer satisfaction index/NPS score	Low NPAs/credit defaults Lower costs of originations	Lowered regulatory penalties Low NPAs/credit defaults	Loan closure time High customer satisfaction index/NPS score


Five key takeaways

Digital lending is not a solution. It's a journey.



- There's more to digital lending than just placing a set of digital patches to fix process issues.
- Digital lending requires a clinical approach comprising change management, customer centricity, digital adoption, tech-business alignment, and strategic intent to accelerate.

The inevitability of digital lending.



- Banks can't and must not be averse to digitally transforming lending operations.
- There are enough cues for the banks to correct themselves – declining market share, drop in revenue and margin growth, mushrooming alternatives to credit, and unsatisfied customers.
- Fintechs are beating banks on all fronts by being faster, better, and cheaper. The man and machine combination will triumph over purely manual ways of working.
- Touchless, instant, hassle-free loan processing is the new normal in lending.

Digital is the antidote to irrelevance.



- Traditional ways of running underwriting need AI-led acceleration.
- Digital technologies will enable faster and smoother customer onboarding.
- Machine learning models will outshine rule-based, policy-led decision making.
- Automation and workflows are essential to an effective and efficient collaboration between cross-functional teams.

The most appropriate time to bring digital lending to life is now.



- The ongoing pandemic is a classic example of why the future of lending is reliant on modern-day technology.
- The balance sheets are fraught with excessive credit risk. Regulations are at their volatile-best.
- The need for working capital and credit is enormous. This trend is an excellent opportunity to surpass customer expectations.

Start with small wins. Scale-up for the big wins.



- Pick the right processes as you work on your pilots.
- Processes that are mature, lean, rule-based, repetitive high volume, and paper-intensive are the best candidates.
- Adopt the "customer-centric" and "digital-first" approach.
- Put adequate measures and checkpoints in place to distinguish success from failures.

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Engage with us to run outcome-based digital transformation with innovation at its core

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