LEND ACADEMY

PODCAST TRANSCRIPTION SESSION NO. 159 / CHRISTOPH RIECHE

Welcome to the Lend Academy podcast, Episode No. 159. This is your host, Peter Renton, Founder of Lend Academy and Co-Founder of LendIt Fintech.

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Today's show is sponsored by LendIt Fintech Europe 2018, Europe's leading event for innovation in financial services. It's coming up on the 19th and 20th of November in London at the Business Design Centre. We've recently opened registration as well as speaker applications. You can find out more by going to lendit.com/europe.

Peter Renton: Today on the show, I am delighted to welcome Christoph Rieche, he is the CEO and Founder of iwoca. iwoca is a really interesting company, they're based in the UK, they operate in three countries in Europe. They have been around for quite some time and they have a very much automated technology-centric approach to their business and we talk about that in some depth, how they do their underwriting. We talk about the types of customers that they are interested in, we talk about the state of small business lending in the UK and much more. It was a fascinating interview, I hope you enjoy the show.

Welcome to the podcast Christoph!

Christoph Rieche: Thanks for having me, Peter.

Peter: Okay, so I like to get these things started by giving a little background for the listeners. So tell me how...I think you're originally from Germany, right, so how did you end up in London running a small business lending operation?

Christoph: It's been a while that I'm in London. I came here in 2003 to finish my studies, here for 15 years now and was attracted by London as a financial center, as the middle of the world and so started in finance, started in government after university and then seven years later, I decided I wanted to set up my own business and was really passionate and excited about the opportunity to fix small business lending.

Peter: Okay, so what was sort of the genesis around that like did you sort of have an a-ha moment where you thought small business lending is just broken or what was really the moment when you decided to do that?

Christoph: I was keen on setting up my own company so I was researching a lot of themes in finance and I have really found small business lending the most exciting one so I felt that solving a real structural macroeconomic problem was a great challenge. I liked the idea to have the small business owner access financing so that they can do what they love, invest in their company, pay their staff and suppliers on time in case of cash flow gaps.

I also felt that technology could be a real enabler, that was in 2011 where I think you've seen the first years of data being much more available through electronic sources and becoming a real game changer when it comes to scoring small businesses and solving the problem. I think these three key points are still the same today. I'm still as excited and in a way we have made a lot of progress over the last seven years. I think that we're still at the beginning of our journey.

Peter: Right, right. So why don't you just tell the listeners what you actually do, what segment of the market you're in and who are the typical customers.

Christoph: So we are focusing on really the long tail of businesses and I think you would probably classify them as micro and small businesses rather than small and medium sized businesses. Our customers tend to generate anywhere between 50,000 in annual turnover and 2 million. I'm just looking at the UK, there are about 2 million of them in that bracket of annual revenues.

Peter: Okay.

Christoph: And back in 2011, it was well documented that they didn't have the access to finance that they needed to invest and grow their businesses. Seven years on, this problem has just become worse so while we have funded nearly 20,000 businesses to date, we also have to recognize that small business lending has dropped by more than 10% in nominal terms and so the problem just got much bigger ever since we started.

So we didn't quite succeed yet in fixing the problem and reversing this disturbing trend of ever declining credit to small businesses. But we have made progress and I think over the next few years we'll make a much bigger impact than we've already done.

Peter: Okay, so then what's behind that decline then? Is this just something that...obviously banks are the primary lender to small businesses still today, is it a continual pullback from the banks, I mean, you also have other fintech lenders out there that are making inroads as well, so what is behind the decline?

Christoph: I think behind the decline is a real retrenchment, an ongoing retrenchment by banks to lend to this segment. To give you a few numbers that we find interesting, the outstanding stock of credit to small businesses with less than 2 million in annual revenues was about 40 billion when we started and it's 36 billion today.

During the same period, consumer lending as well as lending to large corporations has significantly grown in the region of 50 to 80%. Another sort of statistic that we find interesting to monitor is the number of business overdraft approvals that banks make on a quarterly basis to this segment.

When we started the company, there were about 60,000 business overdraft approvals per quarter; that number has halved so you can see the retrenchment was most visible in the overdraft market. Why banks are not lending to this segment? Probably for a few reasons, one is that the cost to service small businesses is relatively high and complex relative to the more attractive consumer lending businesses that they have that they have been scaling so significantly. It's significantly easier to service a consumer than the small business.

I think another weakness is related to their risk appetite, post financial crisis, their risk appetite has certainly been reduced and small businesses, particularly at the micro end they exhibit somewhat of a higher risk profile that gradually they have not been that keen to serve anymore.

Peter: Right, right. So tell us a little bit about the terms on your particular loan product. I know you're really not competing with banks directly, but can you just tell us a little bit about sort of the range of interest rates and length of the loans and what sort of your products offer?

Christoph: We offer a credit line to our customers. Our customers can get approved for our credit line after a relatively short 5 minute online application and then draw down funding if and when they see fit through our online portal and funding is then arriving in their account in a fully automated way.

They really like the speed, the convenience, the straightforward process that we offer them which still compares to relatively cumbersome processes that they would experience when approaching a bank. Many of them wouldn't have a personal bank manager anymore so they would be in our segment typically with phone based systems or not really well advanced online products so we are really refreshing from that perspective that funding is available pretty much instantaneously.

They also have a lot of flexibility once they have the credit line and repaying us at any point that they want without paying any additional fees so our customers can take funds for a few days or a few weeks or a few months and pay for the time that they have the funds. So these are the strong points of the product which enabled us to gain pretty significant visibility in the market.

Over the last quarter, we have been approving nearly 5,000 small businesses for our credit line across our markets which are Germany and Poland, as well as the UK, of which the bulk is in the UK, our home market.

Peter: Right, so then what's the typical size of the credit line that you're approving these businesses for?

Christoph: Typically the size is between 10,000 and 15,000 pounds; we have a relatively large range. We provide credit lines that are as small as 1,000 pounds going all the way up to 150,000 pounds in the UK and so it really caters to this large breadth of small businesses that turn over in the region of 50,000 pounds per year all the way to a few million.

Over time, we have continued to broaden our focus to become ever more inclusive from that perspective and also servicing the demand from slightly larger customers that we weren't necessarily able to do when we just started out because we were so capital constrained that we wouldn't be able to make these relatively large loans as we do today.

Peter: Right, right, and so then tell us a little bit about the typical small business that comes to iwoca. I imagine you're across a broad range of industries, but maybe you could give us some sense of the kinds of businesses that are applying to you today.

Christoph: If I look at the population of small businesses that we have been serving with credit, we would be over indexing in service related industries. These tend to be relatively asset light by the nature of their business and therefore they would find it particularly difficult to approach banks for funding. But we do serve all of the segments of the economy ranging from manufacturing to agricultural businesses to servicing across both B2B and B2C. We're very industry agnostic, but from the way we see the demands, we would have slightly higher concentration in service driven businesses.

Peter: Right, okay so I want to talk about your underwriting because it's something that's quite fascinating. You already mentioned automation here so does everyone who comes to your website today...tell us, what level of automation do they get? Does everybody go through an automated process, do 50% of businesses go through that process where no human actually looks at the application or how automated is it?

Christoph: So the vast majority of the customers are coming to us wouldn't have human intervention in underwriting. We have a system where we're facing some human intervention as the exposures that we're underwriting become larger.

Peter: Sure.

Christoph: And then this sort of increasing exposures...we're still incredibly automated so even when we're writing a credit line of 150,000 pounds, that might take only a few hours from application to be approved. I would sort of say there are two levels of automation.

One is to apply fully an automated scorecard which really serves the vast majority of customers in the micro and small business as well, but in also being incredibly fast by automating the processes that you would go through when doing due diligence on a small business to have all of the information that we require or gathered in an electronic way, that information being analyzed and processed also in an automated way so that a human is able to process this information really swiftly and see particular strengths or weaknesses of the business as they look at the data.

Peter: Right.

Christoph: That really enables us to cater to the wide breadth of small businesses that come to us.

Peter: Right, and so what kinds of data are you able to get at in an....obviously, you've got to be able to pull in financial information, but what kinds of data are you getting at to help you make this automated decision?

Christoph: The data that we're looking at would range from credit data on the business, on the directors of the company that are having an important position in a small business as well as transactional data that we could infer from bank transactions, as well as a range of data that is in the public domain. That could range from data that is on general registers where company performance is registered to website data to local data, it's a sort of fairly broad range of data that we take.

Peter: Okay, so then I also noticed when you go to your website, you have your phone number in multiple places on your website and I imagine there are some people who want that human connection. I'm curious about how many people reach out to you during the application process and what percentage interact with you over the phone?

Christoph: So we found that small businesses are really grateful in having direct access to our customer service and therefore, have kept the lines open and it's important to us to serve them as swiftly and frankly and competently as possible.

If you look at our reviews on TrustPilot, we're registering reviews on all customers that are coming to us for funding, you'll see over and over again that they're saying that the service level has really been outstanding. They're mentioning individual names of employees that we have that dealt with them. The personal touch is very important to us and I think has helped us to distinguish ourselves in the market.

Peter: Okay, so then someone helps them out over the phone and they get to the end of their application, then how quickly do they get their money? I mean, once they've finished...like you said, you make an automated decision, I presume that's very, very quickly, but then how quickly do they get their money?

Christoph: So the fastest transaction I'm aware of was...from start to money in the account is three minutes.

Peter: Three minutes?

Christoph: Yeah, one of our partners was able to dispatch funds directly from within the account and therefore that obviously significantly increased the time that or the speed at which money travels and that's been the fastest to date. I wouldn't say that is the median or average...

Peter: Right.

Christoph: ...but when we're saying instant we can serve an increasing amount of customers in an instant way.

Peter: Right.

Christoph: The median amount of how long it takes to get approved is probably about half an hour and so a large proportion would be instant, but then, you know, there's a number of our customers that as I mentioned earlier where we're doing some manual underwriting that might take a few hours which is skewing up the median.

Peter: Right, got it. So then I'm curious, when you talk to your customers what do they care most about because obviously when there's lots of different parts to the puzzle here...there's interest rate, there's speed of funding, there's the total cost of the loan, there's monthly payments, what is it that they care most about?

Christoph: Our customers…what mostly they care about is the access to funding which they are looking to have in as painless a way as possible. So a small business owner is incredibly busy and has to juggle lots of different challenges, financing is only one of them, and we have customers that have a range of different uses of our facility, but for those who are looking to make relatively quick investment decisions, waiting for a few weeks is just not an option so speed of access to financing is most important to them.

We have other customers who are using us only occasionally to bridge a cash flow gap and for them it would be important to use it in a more flexible way, for a few days or a few weeks. Across our customer base, we see multiple use cases, but in general and I think that's sort of a very easy comparison to make, is that it just takes a much shorter period of time to get access to financing from us versus a relatively cumbersome process that they would have with their main bank if they do get access through their main bank. So the opportunity cost of not having the funding is certainly quite significant.

Peter: Right, right, got it. So then what about repeat loans, you know, they've basically gone through the process, they've been approved for a line of credit, they've drawn down on it, they've paid it all back and then they come back again. Is that something that you see with a large percentage of your customer base?

Christoph: Absolutely, a credit line by definition is much closer to a business overdraft and so our customers are using their credit line quite frequently, but again, within our customer base you will see really different patterns of how they're using it. Those who are using them to bridge shorter term cash flows gaps, they would use it a couple of times per year or a couple of times per quarter, you know, a number of times for a short period of time.

But then you have other customers that will be using it to finance short-term stock which they're selling through their business and really using this facility on a more ongoing basis to grow their revenues. So typically as part of our credit line, our customers would be using us relatively rarely only as a one off....although that also exists for some businesses…

Peter: Right.

Christoph: …who are looking to make a relatively isolated short-term investment.

Peter: Okay, so I want to talk about partnerships here for a second. I know you've got a few different interesting partnerships and I know you were on stage last year at LendIt with George from Tide, so maybe you can give us an update on that partnership and others that you have struck recently.

Christoph: The partnership with Tide was really a massive breakthrough for us. It's certainly the fastest way the small business is able to access financing through their bank account, or in Tide's case a digital account. As they opened this to their businesses at the end of last year, we've really seen an explosion of people coming to us through Tide and a significant proportion of their members to date has been looking to get approved by us.

That really shows the strength of an integration that is as seamless as the one that we have built with Tide and through the numbers that have come to us really goes a long way in showing that an integration that is not just based on the manual handover of customers, but rather through a completely integrated partnership is very, very powerful.

Peter: Okay, so maybe we should just step back a bit. How does it work, I mean, because Tide is sort of like a business current account, alternative checking account kind of thing and is there like a little button on the app that says, I'm interested in taking out a loan, how does it work exactly?

Christoph: So over the course of last year, we have opened our own infrastructure to third parties by building our own lending API. So Tide is using our lending API in the same way as our website is using our lending API so they have access to the full functionality that we're offering to our customers. They could integrate that functionality into their digital account and provide de facto a credit line, brand it in primarily as a Tide product although there is a mention that the product is processed and coming from us as the lender of record, but they're really using the same processes that we use for our customers and we have seen that this lending API has become very popular and we're probably at now about a dozen companies or so that are using it.

Peter: Okay, that is interesting. So do you see that as a big growth area of your business as far as these partnerships bringing in...you don't just get one or two, you get big chunks of borrowers coming in, is that sort of a bigger focus for you these days than developing and sort of marketing your own offering?

Christoph: We're active on both fronts, but our vision has always been to provide financing where and when small businesses need it and that's really been the tool to get there. If you're fully automated and if you can offer instant financing to small businesses on the platforms at which they are transacting, and that might be a digital account or a bank account, but it can be as much another operational platform where they do business or where they buy their goods then that's a really powerful proposition to customers and can really change the way how they think about financing.

Currently, it's still a very active decision to say, I might need financing, what are my options, shall I go to a bank and then you go over actively in the market to see what your options are. If you are making financing part of their natural day to day business then the use financing becomes much more frequent and will help the business much more than this relatively one off decision to get a business loan. I think that's quite similar to what you're seeing in consumer finance.

Smartphones wouldn't have the same kind of penetration today if it wasn't for the really fluid access to credit for financing devices, but if you're going into a shop to upgrade or buy a mobile phone, you're not feeling that you have to go to Barclays to get a loan so that you can pay for the phone, but you're leaving the shop with a sense that you have a contract that gives you access to an amount of data. So I think the ability to integrate ourselves in the broader SME ecosystem has an enormous amount of potential to really fill that void that banks have left in trade finance and can be a game changer for our customers.

Peter: Right, right, for sure. So can you give the listeners a sense of the scale you're at today, I mean, as far as loan volume, how big is your team, that kind of thing?

Christoph: In terms of volume, we're approving around 5,000 or so businesses per quarter and have taken a fairly significant share of the number of transactions that banks will do in business overdraft. If I just look at the UK then we would probably do close to 10% of approvals relative to all of the approvals that they're making in business overdraft. And while our customer base is typically consisting of smaller businesses relative to theirs, we've taken a visible chunk of the market.

In terms of the team, the team has grown quite a bit; we're about 200 now in our London offices. We have scaled and automated our operations so with these 200, I think, we can service a much bigger chunk of SMEs relative to what we do today.

Peter: Okay, we're almost out of time, but I want to get a couple of more things here. Firstly, let's move over to the funding side of your business. You're not a peer to peer lender or a marketplace lender, but who is providing the capital for you to provide this money to small businesses?

Christoph: So from the starting point, we were pioneering in a segment of the market where there wasn't much data so it took us a number of years to really build the track record by doing thousands of transactions to our customers. So we were privileged that we could find financing partners, both in terms of equity as well as debt that was supporting us to lend off our own balance sheet and among our investor base are VCs, mass merchant banks like Commerzbank or Intesa, the Italian bank.

As of today, we still primarily run our risk on our own balance sheet and we have grown our debt facilities to about 150 million pounds and pretty much every quarter we're increasing that size to adjust it for the growth that we have. We're roughly growing about 100% year and year for most of the last few years.

And going forward, I think we'll have some risk on our balance sheet, but we'll probably also start adding an off-balance sheet element to the business to be able to cater to a wider range of the market and provide financing that is longer in term and closer to loans that banks are making to businesses. So I think it is going be quite exciting for us in the next few years to continue to evolve our model and serve the broad small business space in the markets that we're operating in through a range of products, a credit line, but also a longer term business loan.

Peter: Right, okay, interesting. So then finally, what's your vision for iwoca, I mean, obviously you're in the UK, Germany and Poland, do you want this to be a global business in multiple geographies? Are you really going to broaden your product suite in the UK, I mean, what does the future hold for iwoca?

Christoph: We are operating in the UK and Germany, two out of the five largest economies in the world, as well as in Poland which is one of the fastest growing economies in Europe so I think we have in these regions a huge amount of scale ahead of us. I do think that we'll be expanding into more regions, but I think our focus is on getting it right in these markets and really scale up to a material size relative to the banking sector in each of those.

In terms of where will we go, I'm really thrilled to see the innovation across the ecosystem. You're seeing more and more new entrants in the market that are competing with banks on services that they provide, transactional services, whether that's in just the traditional digital account or the traditional bank account which becomes more and more a digital account, but then related to that payment, foreign exchange, the way how accounting is introduced into the notion of the financial partner.

On our side, we're of course coming from the credit and I think in the end these services somehow belong together because they're all highly relevant to a small business and if you can access these services through one platform then that has a massive value add.

Peter: Right.

Christophe: I'm keen to see how this will develop, this popular topic of unbundling to re-bundling and our partnership with Tide really shows how powerful these two elements can be together and I'm sure there will be a lot happening over the next few years and seeing how this continues to converge.

Peter: Right, I am sure there will. Anyway, we're going to have to leave it there, Christoph, I really appreciate you coming on the show today.

Christoph: Thank you very much.

Peter: Okay, see you.

Christoph: Thanks, Peter.

Peter: When I hear about the reduced amount of funding to small businesses in the UK or really anywhere in the world, it is a little bit disheartening, but when I talk to people like Christoph I'm fully encouraged again that this is a temporary phenomenon. We are going to see companies like iwoca scale to be able to fill that gap. I am convinced of it, it's such an important thing. Small businesses and micro businesses are a driving force for economic growth in the economy and they need capital to grow, they need capital to expand employment and it's companies like iwoca and many others, of course, that are leading the charge in this way.

Anyway on that note, I will sign off. I very much appreciate you listening and I'll catch you next time. Bye.

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