PODCAST TRANSCRIPTION SESSION NO. 260-ANDY RACHLEFF

Welcome to the Lend Academy Podcast, Episode No. 260. This is your host, Peter Renton, Founder of Lend Academy and Co-Founder of LendIt Fintech.

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Today's episode is sponsored by LendIt Fintech USA, the world's largest fintech event dedicated to lending and digital banking is going virtual. It's happening online September 29th through October 1st. This year, with everything that's been going on, there'll be so much to talk about. It will likely be our most important show ever. So, join the fintech community online this year where you will meet the people who matter, learn from the experts and get business done. LendIt Fintech, lending and banking connected. Sign up today at lendit.com/usa

Peter Renton: Today on the show, I am delighted to welcome Andy Rachleff, he is the President & CEO of Wealthfront. Now, he's also somewhat of a Silicon Valley legend, he co-founded Benchmark Capital, one of the most successful VC firms in the Valley back in mid-90's, but he has since moved on from there and he co-founded Wealthfront just over a decade ago. I wanted to get him on the show because I feel like they have such an interesting story to tell and the movement from just offering wealth management services to becoming more of a fully-fledged fintech platform with digital banking offerings is interesting and he's very passionate which you'll see in this interview.

We talk about their new checking account offering called Wealthfront Cash, we talk also about what his vision means when he says Self-Driving Money, how that's actually going to work. He doesn't share everything about it, but he gives us certainly some insight there, we talk about their fascinating credit product for their portfolio line of credit, we talk about the fintech space more generally as far as other digital banks and what the future holds for Wealthfront. It was a fascinating interview, I hope you enjoy the show.

Welcome to the podcast, Andy!

Andy Rachleff: Thank you for having me.

Peter: My pleasure. So, you have quite an interesting background and one I know is familiar to many of us in fintech, but why don't you just get started by just giving some of the highlights of your career to-date.

Andy: Well, I was a career venture capitalist, I spent almost 25 years in the venture business, the last ten of which I co-founded and was a partner at Benchmark Capital. I retired 15 years ago from the venture business with the intent of focusing my time on social good. So, I started teaching at Stanford Graduate School of Business where I've been teaching for the past 15 years. I became a Trustee at the University of Pennsylvania.

My wife and I started an innovative cancer research funding initiative and in partnership with a foundation called the Damon Runyon Cancer Research Foundation and as part of my work at Penn, sitting on the Endowment Investment Board which I now Chair, I came up with the idea for Wealthfront so it was quite an accident.

Peter: Okay. So then, just tell us a little bit about that. The story in Wealthfront has been around for some time now, over a decade, I believe or about a decade, so what was the Aha moment or what was the impetus to start Wealthfront?

Andy: Well as I said, it was an accident. I was sitting in a Penn endowment meeting and I think that the premiere university endowments were the best managed pools of capital in the world. Most people don't know how they invest because they don't have access to manage or to invest like they are more financial advisors.

When I saw what they did, a lot of it was manual and spreadsheet-based and I thought, God, if you automated this, you could democratize access to it and bring it to the masses and this was something that was....that it hit me because over my years as a venture capitalist many of the people that I have recruited to my portfolio companies who went on to financial success by virtue of their companies being acquired or having gone public would come to me for investment advice. I could never tell them to do what I do because they couldn't afford the minimums. So, that's how we got started, it took a little while before we found product market fit and fortunately, we did.

Peter: Okay. So, why don't you tell us a little bit about that journey because you started off really as a wealth manager, Robo-Advisor and you've pivoted or you've moved into a broader area. Now I see you talking about digital banking a lot, maybe we'll talk about that here so, was it always the plan to move into a broader kind of offering or how did you....tell us about that pivot.

Andy: Well, I wouldn't call that a pivot. To me, a pivot is when you don't have product market fit and you iterate on the market in order to find… what I would call it an expansion of the vision or an expansion of what we do. Now, we happen to jump all over that change because we seemed to have hit a nerve. So, let me go back for a moment and just give you a little bit of background.

Peter: Okay.

Andy: I would describe Wealthfront as a next generation banking service, it helps young professionals manage their money. We're specifically focused on millennials who save, people who are 25 to 40 years old, that's for whom we have built our service. We do this by providing a high interest checking and low-fee investment management service all through a five-star rated mobile app. Now, the vision for the business is to automate all of your finances, we call this Self-Driving Money and so what I mean by that is we intend to make that possible for you to direct deposit your paycheck with us, we'll pay your bills and then route the remaining money to the most appropriate financial destination, depending on your situation and goals.

So, we started with investing, we thought there was a lot to be done there. As the vision became more and more clear about automating all of your finances, we realized that we needed to have a base account into which you could direct deposit, but we needed to offer bill pay and checking and all sorts of other services on that account. But, to get to market more quickly, we just launched the high interest cash account last year and it took off so quickly that we decided to go all-in on that and focus on that first and use investment management as an add-on service versus banking as the add-on service.

Peter: Okay. Yes, because I noticed when....I travel around the Web and I've been on your website a bit in the last week. I see the ads coming up and the ads are all about the bank account, it's all about......

Andy: Because that hits more of a nerve, people hate their banks. You know, it's funny, banking is only one of two industries that a negative net promoter score.

Peter: Right.

Andy: The other one is cable. (both laugh) People don't hate their investment service nearly as much, but what we find is if you join us as a banking client, the odds are you're going to get, just on your own, use our investment service as well.

Peter: Okay, okay. So, I want to talk about Self-Driving Money in a bit. I want to dig in into something you said the other day which really surprised me and we were talking on our LendIt Fintech Digital community and you said that you had roughly, I think it was 400,000 customers, but just to service those customers, you have, you said, 12, I don't know what you call them, you didn't call them customer service people.

Andy: We call them product specialists.

Peter: Product specialists, okay, so you have 12. Now I think any bank out there that have 400,000 customers would have a multiple of 12, certainly would be probably in the hundreds. So, how is it that you can offer...now, let's face it, a banking product, it has some complexities so, how were you able to offer that sort of service with just 12 people?

Andy: Well, first of all, if we can't automate a service, we don't offer it. We think long and hard about what features we're going to deliver and make sure that we don't deliver them until it's fully automated and it's simple and easy to understand and convenient. So, once you do that, that eliminated a lot of the problems. And then, we've taken a very, very different approach to customer support. Rather than hire low cost people in the Philippines, we hire very, very capable people.

As a matter of fact, because we started in investment management, all the people that we hired are licensed as financial advisors. Now, they don't give financial advice, but they're very, very capable people; we have chartered financial analysts, we have CPA's, we have licensed financial advisors. So, these are very capable people and we ask them to spend half of their time focused on providing technical support and the other half trying to figure out what is it about the product that needs improvement in order to avoid getting that phone call again. So, their job is to design themselves out of a job.

Peter: Interesting.

Andy: Now, the nice thing is we never have to fire anyone because we grow so quickly that all we do is we keep adding the number of clients each one serves, but it's not a burden. As a matter of fact, we believe we offer rather radically better customer service than anyone else with that really low ratio of reps to clients and we offer radically faster access. So, at the height of Shelter-in-Place, if you called us you would get a rep in ten seconds. Now, I tried calling Wells Fargo Bank to close an account and every time I call, I was given a message that it was going to be three hours.

Peter: Wow! (laughs)

Andy: So, by A-automating and by B-focusing on what created, what was the root cause of the outreach from the client and designing that away, you can offer radically better service and with much more talented and capable people and you need a lot of fewer reps.

Peter: Right, right, that's super interesting. So then, can you give me an example of something that was a pain point for customers that you sort of automated away or you added some kind of offering to make sure they didn't call in?

Andy: Well, it happens every single day, but I would say that the most common theme is speed.

Peter: Right.

Andy: Every time we make something faster, we get rid of customer e-mails and phone calls. So, for example, a few years back when you electronically transfer money, the client has the right to pull back that money and say that they made a mistake. Now, as a result, most brokerage firms require a three-day wait or longer before they release the funds because they want to make sure that the client doesn't transfer the money to you, the money gets invested and they pull it back. That would create a risk.

So, most brokerage firms will not invest that money right away. We relied on it, used to rely on a third-party brokerage firm to act as the broker for our clients. We ended up bringing that in-house and by doing so, we were able to reduce that time from three days to one day. That probably got rid of 30% of our tickets.

Peter: Wow!

Andy: Isn't that amazing? When you transfer securities, it used to take ten days on average to electronically transfer securities from one account to another, we reduced that to five. Again, the number of tickets went down. So, whenever there's confusing language in the product making sure that we simplify it even if that means taking away functionality, simplicity usually wins.

Peter: Right, right. So, I want to go back to Wealthfront Cash, your bank account, and the big challenge I always see is there's obviously many offerings now from fintech companies offering bank accounts obviously in partnership, for the most part, with existing banks, but the big challenge is getting your customer to direct deposit their payroll in there. How have you been able to get your customers to make that switch?

Andy: Well, number one, you have to provide differentiation and we're by no means done. We shipped our first checking features on top of the high interest cash account on June 29th so that included direct deposit where you can actually get paid two days early. Number two is we allow you to pay your bills and friends from the account so you can use things like Venmo and Cash Up and we give you a debit card so you can immediately withdraw cash from an ATM or spend via the debit feature.

In another couple of weeks, we'll have mobile check deposits, every few weeks we'll keep adding more features. We'll very shortly, thereafter, offer the ability to send checks. So, by the end of the first quarter, we will have a super set of the features of all of the other online checking accounts so, no one will have more features than us. And, I would say the major differentiation, so all the basics.....the major differentiation will be number one, we can pay interest on our checking account.

Other people require you to have a savings account on which you get paid interest, we pay .35% on your checking balance. That required extra development which is why it took a little longer for us to bring out those services. Now, taking a little longer to get paid in your checking account was important for convenience and it also set up our Self-Driving Money functionality which is now in beta and which will start to roll out at the beginning of September.

So, the two things that will differentiate us are number one...actually, three things that will differentiate us will be number one, that we pay interest on your checking balance, others do not; number two, we can automate your finances by routing the money around from that account and get it to where you need it to go immediately where there's typically latency at the system, in the banking system, that's how banks make money is on float, and number three, a delightful experience. You know, our mobile app is the highest rated app in the Apple App Store, the highest rated financial app so there is a difference in functionality or usability on all these apps.

Peter: Right, right, for sure. So then, I'm curious....you talk about making money and Wealthfront....obviously with investing, you make a few basis points on assets under management, I guess for the bank account, are you looking at this as a separate business line where you intend it to be profitable or is this more of a like a way to sort of maintain a closeness with your customers?

Andy: Well, we don't think of these as separate businesses. It's funny, the number of investors who have talked to us seem to think of it that way. We think of it as a relationship with our clients and we look at the profitability of the relationship overall, we earn money in a number of different ways. We earn a little spread on the interest rate that we pay to our clients so we earn more than .35%, we keep that spread.

If our clients use their debit cards for purchases, we make interchange revenue on that, that's the way all the other challenger banks make money. We lend money, we have the fastest, simplest and cheapest way to borrow with our portfolio line of credit so we make a net interest margin on that, we earn an advisory fee on our investment services. Over time, you'll see us offer more and more financial services. In each case, because we only deliver products that we can automate, we have a much lower cost to deliver those services and we always share the savings with our clients.

Peter: Right.

Andy: So, that's something that....you always get more value from Wealthfront accounts than you will from anyone else.

Peter: I want to talk about this portfolio line of credit because I was looking into it and it's super interesting because it seems to me you’ve got one of the lowest cost credit products on the market. I mean, I think it was like two and three quarters percent of what......

Andy: 2.6% is the lowest.

Peter: 2.6, yeah 2.6, so that really.....for people who have...obviously, it's an asset-backed loan because you've got the deposits there, so I guess I'm curious about that product. Are people using this for margin lending to increase their investments, so how are they using it?

Andy: They're using it for short-term cash needs so people pay them off incredibly quickly. So, you can't use it to leverage your Wealthfront portfolio, we put in place some limits to keep them from doing that. So, it's most often used for things like I need to make a down payment on something, I need to exercise my stock options, I need to buy a house and I need the cash quickly, but I don't want to recognize gains in my investment portfolio or I want to pay taxes.

So, we always see a big surge around quarterly estimated tax times and people pay them off, generally, in less than a month so that's good and bad. It's really good for our clients that they pay it off, we make a lot less money because they pay it off so quickly.

Peter: Right, right, for sure, okay. What bank are you working with on this, on Wealthfront Cash?

Andy: We work with Green Dot as the enabler of the checking features, but we also broker our deposits to ten different banks that pay the high interest rate. So, we have to work with multiple parties in coordinating the settlement of all that is where the secret sauce is and making it a more capable and enjoyable service.

Peter: Right, right, okay. So, I want to talk about Self-Driving Money because this is something that I'm fascinated about and I believe this decade we're going to see some really major advances in automation of financial services. So, you've touched on it, I guess the question, what's the barrier, do you think it really is a thrust with the customer, is it technological, what's the barrier for really wide adoption of, you know, Self-Driving Money right now?

Andy: Well, I think that you have to figure out which market wants it first. You know, this is the challenge of product market fit, something that I have spent a lot of my career focused on, the last 11 years I've taught a course at Stanford. I was actually the guy who coined the term.

Peter: Okay. (laughs)

Andy: And so I've taught a course on it for 11 years and what most people don't realize is that you don't iterate on the product, you iterate on the market so figuring out who wants it first and using that as the beachhead into which you launch into adjacent markets is the challenge. So, part of our intellectual property is figuring out who needs that first and marketing to them and then over time, broadening the market for it. That I'm not willing to share because I don't want to tell my competitors where they should start, it's taken us a long time to figure all of these out.

Peter: Fair enough, we'll be watching carefully, (both laugh) because to me...I mean, I look at it and think it's just data, it's just a data play, all the information is out there, but whether it's investing for a savings account, whether it's paying down your credit card debt, whether it's asset allocation, I feel like all the information is out there.

Andy: Hey, it's a simple matter of software.

Peter: Right.

Andy: Making it all work.

Peter: It is.

Andy: There's certain people who are more inclined to be early adaptors than others and so what we've figured out, what we believe we figured out is who they are and we served them first and then over time, what we find is the more sources and destinations for that money that we can support and the faster that we can make those transfers, the more people will like us, the more they'll tell their friends and we'll grow organically.

Peter: So, do you think then, let's just say by the end of decade, we will have a substantial number of people whose financial lives are automated for the most part and an AI engine in the background is making good decisions for them.

Andy: Well, it doesn't necessarily have to be AI, you can just automate what you're already doing. The number of people, I think that's part of how you solve this, is you don't have to apply fancy techniques. If I can just automate the mundane tasks you currently go through to move your money around to the most appropriate place.....this is why I've said over and over again that we serve millennials who save which we think represents maybe 20% of the 90 million millennials in the United States, we're not going after all millennials.

For example, I think Chime has done a superb job serving the unbanked and people living paycheck to paycheck. Now, they don't have multiple accounts, they don't have this problem so they will find absolutely no value in Self-Driving Money. You can think about having an electronic assistant that takes care of those mundane tasks of moving your money around, but someone who's saving money typically has an investment account and they have a bank account, they might have a mortgage, they may have some student debt that they need to pay off. So, taking that off of their hands so that somebody is doing that for them, there's tremendous value on that.

Peter: Right, right, and would also extend to the potential, say that they could refinance, say that student loan, interest rates have gone down, refinance the house, refinance the student loan and those sorts of things will also.......

Andy: Of course. but we wouldn't just do it, we would ask you.

Peter: Right.

Andy: And so that's how we build trust. First, you have to show someone what's possible and then ask them if you would like us to do it for you.

Peter: Right.

Andy: Think of us as an assistant.

Peter: Yeah, got it, okay. So, we're running out of time....

Andy: But an assistant that can do things that your assistant can't do (Peter laughs) like moving money immediately.

Peter: Right, right, got it. So then, you mentioned Chime already and obviously there's a lot of companies in the digital banking space.....

Andy: None of whom are differentiated. What amazes me is they all offer the same thing, they all appear to offer the same thing which is a very thin layer of software on top of an infrastructure provider. They haven't really done much. That's why I refer to most fintech companies as "big fin, little tech."

Peter: Okay. So, you feel like you're differentiated then really is the technology that you've put in place.

Andy: It's the investment we've made in product. Over half of our employees are engineers, that's not true of any other fintech companies.

Peter: Right, right. So, like how many employees do you have?

Andy: Two hundred and twenty.

Peter: 220,okay. And then, what about...do you share your AUM number that you've....the total amount....

Andy: The last time we published it, it was something in the order of $19 Billion.

Peter: Okay, it's up dramatically than last.....

Andy: Excuse me, it was in the order of $15 Billion.

Peter: Okay, okay. It's still up dramatically......

Andy: But that doesn't include the cash deposits and we don't yet share that.

Peter: Sure, yeah, yeah, okay. So then, where are you on the journey to profitability?

Andy: That's always a choice. I think we were on a path that we could have gotten there this year and we chose to prioritize growth over profitability. So, I think that that's probably been pushed out until next year.

Peter: Right, right. And do you feel like....I'm curious about the profitability metric because it seems like we're in this stage where, you know, you've got a background on the VC community where there's still large amounts of money being thrown around to some of these fast growing digital bank or fintech offerings, do you see that….. putting on your VC hat for a second, do you think that's a mistake to really focus on growth so much. Some of these companies really have a long, long way it seems like from a pathway to profitability.

Andy: You know, it's funny, Peter, this is question that comes up every time there is a financial crisis or every time there is a recession. We once did an analysis for a blog post that we wrote a number of years ago to determine what's the primary driver of the valuation of a company and it was really clear that, by far, the number one driver of the valuation of a growth company is it's growth rate, actually, the rate of change of it's growth rate. Is the growth rate increasing, staying steady or decreasing.

Number two was whether or not the margins were increasing and everything else was a distant third. So, as long as companies that have declining growth rates, generally, aren't worth very much. Now, you have to pair that with a steadily increasing margin.

Peter: Right, okay, because that's, I think, the knack on many of these digital banks is the margins are not increasing there.

Andy: Well, I think a number of them are just trying to prove whether or not they can get a direct deposit and then they'll figure it out from there.

Peter: Right, right, okay. So then, looking over the next 12 months, what are you and Wealthfront mostly focused on?

Andy: Well, what we're focused on is building out the Self-Driving Money functionality. Number one, completing the checking features and, by the way, checking features are a commodity so by the end of the first quarter or so, as I said, we'll have a super set of whatever everybody else has. There's not much more that one can do in that regard. What we can do is pay higher and higher interest rates and that's'......we're working hard to try to be able to do that and the real value added is on our auto pilot, our electronic assistant that moves the money for you.

So, you'll see us add more sources in destinations for that money, you'll see us improve the speed with which we move that money. Think about it, you're more likely to trust us and leave your money with us if you know we can immediately get it to another financial institution immediately whereas if it's going to take us three day, which is more the norm, then you're going to be less likely to move your money over to this new institution. So, there's a long way we have to go in terms of enhancing our ability to automate your financial life.

Peter: Okay, Andy, we'll have to leave it there. It's fascinating, I'll be following along your progress with great interest. I appreciate you coming on the show today.

Andy: Thank you very much for having me.

Peter: Okay, see you.

You know, Andy and I were chatting after we stopped hitting record there and he was lamenting the fact that so many fintech companies today are not producing new products, not producing enhancement to products in a quick enough fashion. It feels like there isn't enough emphasis on the technology side of things in fintech. I thought that was an interesting take because I think if you talk to many of the CEOs, they would argue that they focus tremendously on tech so, obviously, that matter's up for debate.

The way he says it, it should be acceleration of new enhancements coming out on your products on a regular basis and that's what they're committed to do at Wealthfront and really, it's going to be so fascinating to see the traction they get. It's early days with their checking account, the traction they get with Self-Driving Money, as I said, whether they call it autonomous finance which is what some people call it, Self-Driving Money, this is a decade where it's going to happen and that is going to be fascinating to see who the first movers here that actually get adoption into this more automated way of managing your finances.

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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