EXECUTIVE INSIGHTS

How Lenders Use Digital Intermediaries to Turn Consumers Into Customers

In the increasingly crowded consumer lending products space, digital intermediaries have quickly become the ultimate matchmakers, efficiently pairing the right people with the right products at the right price.

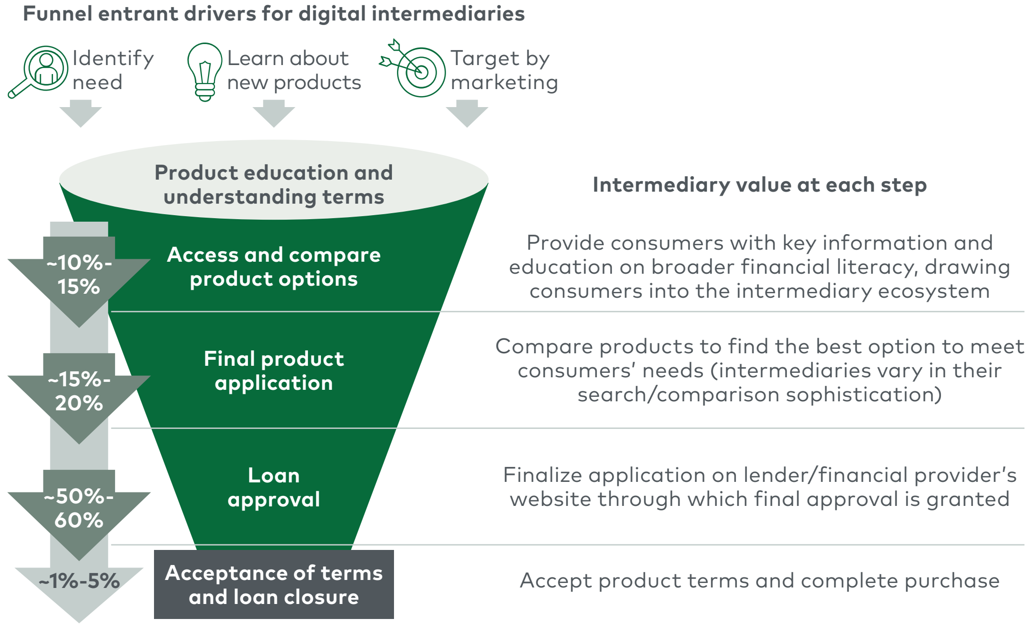
By providing value-added solutions throughout the purchase funnel for consumers, in particular by enhancing product comparisons and matching, digital intermediaries make customer acquisition highly efficient for lenders. Such efficiency combined with the return on spend that digital intermediaries generate is why lenders currently allocate as much as 50%-60% of their customer acquisition budget to them. Indeed, because digital intermediaries provide targeted leads of consumers who are at the bottom of the purchase funnel, they generate better yield compared to broad ad distribution. And by efficiently and reliably connecting consumers to the appropriate financial instrument, they drive significant value above what can be achieved by going to individual lenders.

Now, as the U.S. consumer financial products landscape continues to fragment across large banks, regional/smaller lenders and specialized lenders — each of which is seeking to reach a similarly fragmented consumer base whose needs vary based on age, attitudes and behaviors, risk tolerance, credit history, and other factors — those players are becoming increasingly reliant on digital intermediaries to efficiently reach consumers and turn them into customers.

Digital intermediaries drive value for consumers and lenders

Digital intermediaries, which are websites and other online tools that educate and engage with consumers, operate throughout the purchase funnel, enabling consumers to access and compare personal finance products like credit cards and mortgages to find the ones that best meet their needs (see Figure 1).

Figure 1
Digital intermediaries along the purchase funnel

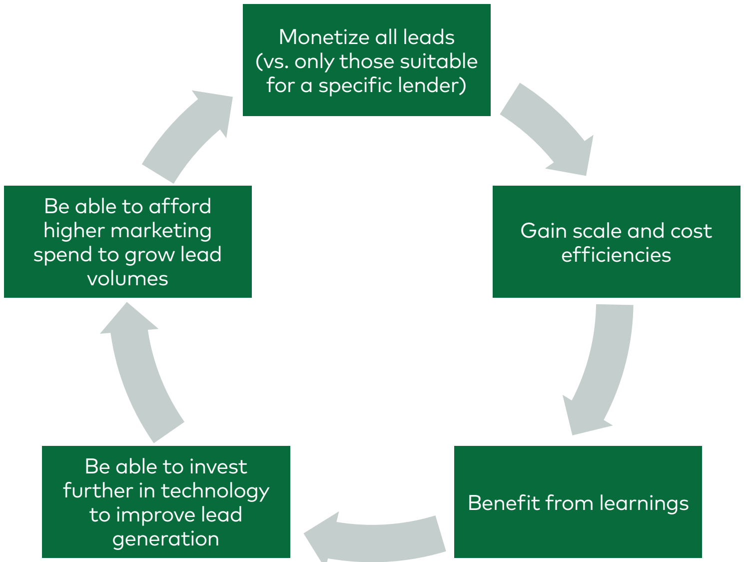


Source: L.E.K. interviews, research and analysis

To generate consumer leads, digital intermediaries leverage various methods, primarily educational content, referrals from other affiliates, and paid or organic search, as well as, to a lesser extent, ads and paid leads. What makes them so powerful is their matchmaking abilities; platform features such as credit score integration, prequalification, price comparison and product education enable digital intermediaries to match consumers to the most appropriate lending products.

But features alone don't ensure success. The most successful digital intermediaries benefit from a broad panel of lenders and advantaged lender negotiations, as well as monetized consumer leads, robust marketing capabilities, sizable consumer databases and active cross-selling. They subsequently generate a virtuous cycle and, with it, a flywheel effect that drives growth (see Figure 2).

Figure 2
Virtuous cycle of growth for successful digital intermediaries



- Successful intermediaries enter a virtuous cycle that enables them to gain scale and grow their marketing channels ahead of lenders
- Consequently, when intermediaries reach scale, they are able to offer lenders cheaper access to customers than going direct

Source: L.E.K. research and analysis

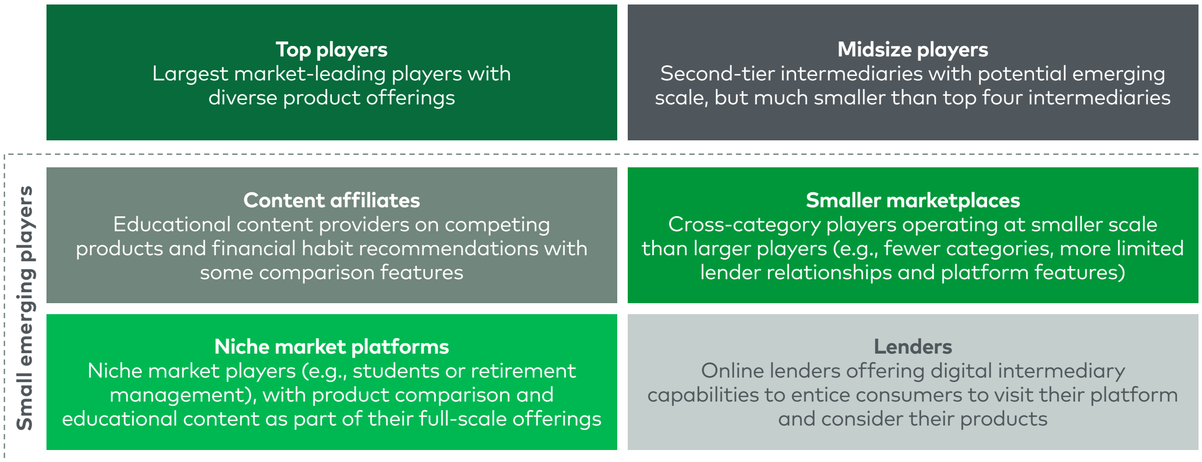
The landscape of digital intermediaries is diverse

Large, well-established digital intermediaries such as NerdWallet, Bankrate, Credit Karma and LendingTree together account for an 80%-85% share of the consumer lending products market. Having grown primarily through acquisitions, they each have a wide range of product offerings, many of which are similar.

Midsize players such as Mint and WalletHub are much smaller but have the potential to increase their scale by offering more specialized tools or value propositions (e.g., budgeting tools, educational content, Q&A capabilities or prepaid debit cards). Players such as Credit Karma and Credit Sesame, which started out by providing consumers with free credit score ratings and basic credit card recommendations, have since expanded their offerings to include personalized recommendations on home and auto insurance, personal mortgage loans, and other financial management services.

Then there are the small emerging players. They include content affiliates such as LendEDU and ValuePenguin, marketplaces like Lantern and CreditSoup, niche market platforms such as Purefy and SmartAsset, and lenders like OppLoans and Upgrade. Each of these players serve niche markets (e.g., students) and needs (e.g., educational content) or are used as marketing tools to supplement core offerings (e.g., lenders offering intermediary capabilities). Smaller players and markets are also often prime targets for acquisition by larger operators looking to expand their product offerings and/or customer base (see Figure 3).

Figure 3
US digital intermediary landscape



Note: Bankrate acquired The Points Guy (2012) — primarily an education/reviews website with integrated intermediary functions — and creditcards.com (2010), a smaller intermediary
Source: L.E.K. interviews, research and analysis

Underlying dynamics for mortgages, credit cards and personal loans remain stable

After recovering from Great Recession declines, mortgage originations remained relatively stable in the lead-up to the COVID-19 pandemic, supported by a period of fairly low 30-year fixed mortgage rates ranging from 3.7% to 4.7% and stable, positive macroeconomic factors, including declining unemployment and low inflation.

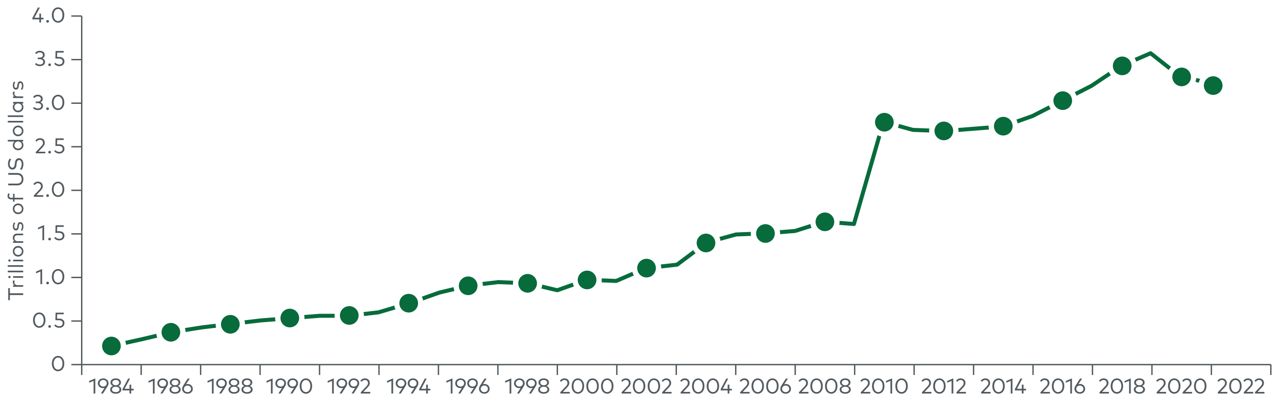
Strong origination growth during COVID-19 was fueled by slashed mortgage rates, with the average 30-year fixed rate at roughly 3.1%. However, the 30-year fixed rate has since increased (averaging about 6.4% for December 2022) as a result of the Federal Reserve's efforts to tame inflation through steadily raising interest rates, leading to a significant slowdown in the U.S. housing markets and a steep decline in mortgage originations in 2022. Freddie Mac forecasts a 2023 30-year fixed rate of 6.4% (based on its most recent quarterly forecast from December 2022).[1]

Over the longer term, mortgage origination volumes are forecast to stabilize to pre-COVID-19 levels of some 6 million to 9 million originations per year by growing at a rate of anywhere from flat to up to 1% each year. That includes annual fluctuations due to changing mortgage rates.

Credit card originations, meanwhile, recovered to pre-pandemic levels in 2021. Credit cards are expected to benefit from the current high interest rate environment; TransUnion's December 2022 report forecast credit card originations in 2022 to be 14% above 2021 levels and in 2023 to be 5% above 2021 levels.[2]

While annual fluctuations may occur, longer-term growth is expected to be roughly 1%-3% per year as consumption patterns reset and there is a return to pre-pandemic credit card dynamics. Notably, credit card loans help illuminate the historic strength of the financial products market as they have steadily risen over time despite small corrections across economic cycles (see Figure 4).

Figure 4
US balance sheet for credit card loans to individuals (1984-2021)



Source: St. Louis Federal Reserve

Finally, as consumers continue to wrestle with higher inflation, they have increased their personal loan debts. TransUnion data from Q3 2022 showed a year-over-year increase of 15% in consumers with access to a personal loan and an increase of 15% in the average personal loan debt per borrower. Over the longer term, annual personal loan volume growth is forecast to be in the 8%-10% range as consumers consolidate variable rate debt and use loans for large expenditures that they'd put on hold during COVID-19 (e.g., travel, weddings).

The solid historical performance of origination volumes, particularly over the past decade, has been driven by a combination of a favorable macroeconomic landscape and beneficial supply and demand trends. Now, as the economy cools and interest rates rise, it is having mixed effects on these financial instruments, but the ability of consumers to do research on and shop around for financial products is becoming ever more important (see Figure 5).

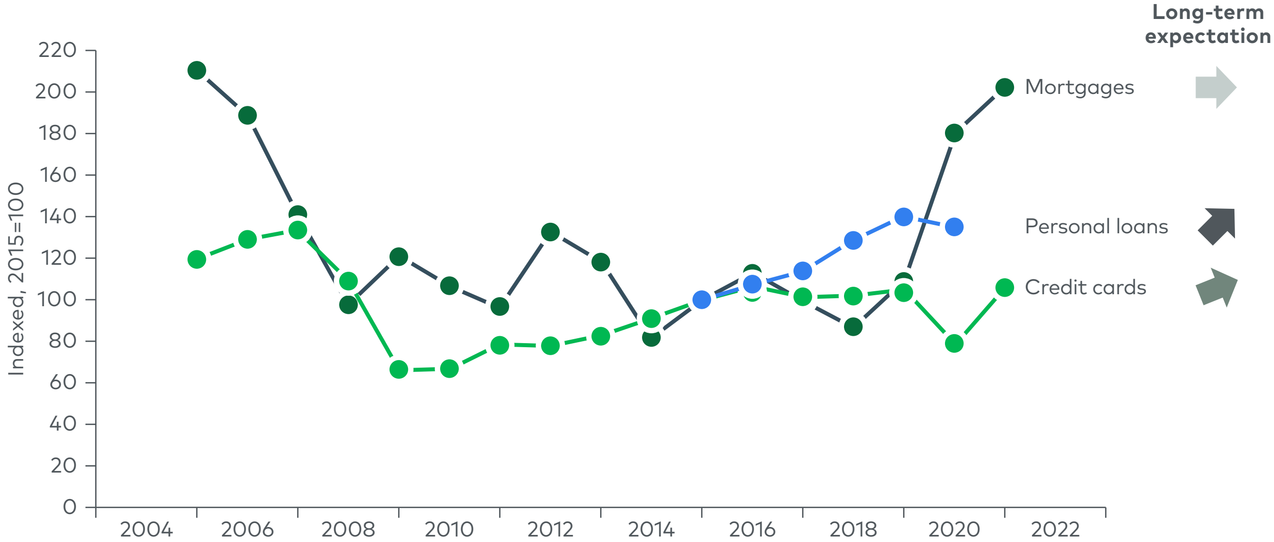
Sound fundamentals underpin the digital intermediaries market

A number of macroeconomic conditions make the underlying market for digital intermediaries an especially strong one:

Low interest rates: Despite the Federal Reserve's campaign to steadily increase rates, they remain within the range of historical norms; the target rate is forecast to decline

Figure 5

Total number of US originations, mortgages, credit cards, personal loans* (2015-20)



*Data limited to 2015-2020

Source: Lending Tree; The Wall Street Journal; TransUnion; Consumer Financial Protection Bureau

by approximately 1.3 percentage points through 2025, based on a summary of economic projections from the Fed's Open Market Committee.[3]

Higher inflation: Highly inflationary environments like the current one result in high consumer prices, which creates a need for greater borrowing as well as an increased need to shop around for the best rate.

Low unemployment rate: The U.S. labor market has sound fundamentals, including a historically low unemployment rate, which means consumers have higher disposable income, so they spend more. This disposable income is being stretched by the current inflationary environment, but continued low unemployment preserves a population of potential borrowers (as evidenced by recent credit card origination and personal loan borrowing data).

Positive consumer sentiment: Consumer sentiment is a strong indicator of economic performance as consumers may pull back spending and borrowing during times of pessimism and spend or borrow more when they're feeling optimistic. Currently, consumer sentiment may present a headwind, but only temporarily.

Rising household income (HHI): Growth in real median HHI (as it grew pre-COVID-19 from 2014 to 2019) improves consumer spending capability and makes financial products such as credit cards, mortgages and personal loans more affordable. HHI growth represents an important tailwind, assuming inflation continues to cool.

Positive demand-side trends: Consumers are increasingly financially conscious, aware of multiple product offerings, and seeking to take advantage of the most efficient financial vehicles available and apply them to a widening range of spending uses. In the meantime, new players in the credit card and lending space, alongside emerging digital payment methods like buy now, pay later programs and mobile wallets, are adding complication and nuance to the landscape.

Positive supply-side trends: Lenders are expanding access by launching more competitive product offerings for a wider range of use cases (e.g., travel credit cards, vacation loans) to a broader customer base (e.g., subprime borrowers).

Changing dynamics are fueling consumers' need to shop around

As noted above, macroeconomic indicators began shifting in 2022, and the Federal Reserve has increased the federal funds rate to temper persistently high inflation driven by strong post-COVID-19 consumer demand, government stimulus efforts, and a raft of supply chain challenges resulting from lockdowns, labor shortages and other macro disruptions such as the war in Ukraine.

In the meantime, mortgage rates have been steadily rising (with some slight declines more recently), as the 30-year fixed rate exceeds 6.3% — well above 2021's range, which largely hovered around 2%-3%.[4] This has dampened home sales in the immediate term, though transactions are expected to grow as macroeconomic challenges moderate.

Such shifts place more pressure on consumers to make the best choice possible when shopping for financial products. After all, when the cost of borrowing increases significantly, lenders' credit appetite may contract somewhat, leaving consumers without the option of defaulting to their existing lender or mainstream bank.

This creates a strong opportunity for digital intermediaries to become an even more important tool for consumers, as they provide a centralized way to compare offers across financial instruments, bringing clarity to the various trade-offs available and allowing consumers to choose the products that best suit their needs.

Digital intermediaries that have already established trust with consumers within the favorable conditions of the past decade will be well positioned to win in this environment. But that doesn't mean there isn't room for newer entrants as well. One way those that are newer to the market can increase their chances of success is by specializing within a particular product area and establishing strength there. Another is by providing consumers with a wide array of options and clearly articulating the trade-offs among them, though this avenue can be a difficult one.

Digital intermediaries have a long runway for growth

Digital intermediaries will continue to take share from traditional intermediaries, even as lenders grow their own direct-to-consumer offerings, because they offer a sustained, trusted relationship on a relatively frequent basis that is more useful than the traditional, relatively transactional lender-based relationship.

And in the current environment, the opportunity is especially ripe for established digital intermediaries and emerging players — as well as their investors. Established players can leverage their incumbent position and brand power to grow relationships with consumers by helping them find the best possible financial instruments during changing economic conditions. Emerging players, on the other hand, can look to enter underpenetrated markets and can provide consumers with unique content to establish themselves and build relationships. Investors, meanwhile, need to understand the markets that the various digital intermediaries serve — as well as their unique value propositions — and apply that understanding while the fundamentals underpinning this opportunity remain strong.

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Endnotes

[1]FreddieMac, "Quarterly Forecast: Rapidly Rising Rates & Declining Demand Driving a Housing Market Slowdown." https://www.freddiemac.com/research/forecast/20221021-quarterly-forecast-rapidly-rising-rates-declining-demand-driving-housing-market

[2]TransUnion, "More Pronounced Changes Expected in Consumer Credit Market in 2023 Even as More Than Half of Americans Remain Optimistic About Their Financial Future." https://newsroom.transunion.com/2023-consumer-credit-forecast/

[3]FRED Economic Data, St. Louis Fed, "FOMC Summary of Economic Projections for the Fed Funds Rate, Median (FEDTARMD)." https://fred.stlouisfed.org/series/FEDTARMD

[4]FRED Economic Data, St. Louis Fed, "30-Year Fixed Rate Mortgage Average in the United States (MORTGAGE30US)." https://fred.stlouisfed.org/series/MORTGAGE30US#0

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