Disruption-Proofing Your Firm

What Lenders Can Learn From the Consumer-First Revolution

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ROOSTIFY

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Whether it's spoken with admiration or with dread, "disruption" is firmly embedded in our cultural lexicon. The press is full of stories of ambitious young companies with bold new ideas, using Internet-enabled approaches to upend markets full of established players - and sometimes eliminating those established players entirely.

For industries that have not yet encountered the radical change fuelled by the Internet era, dire warnings are still repeated: it's inevitable, it's unavoidable, it will be devastating. Like cold weather on a certain TV drama, Disruption is Coming, and established businesses will have to change or die. The mortgage industry is no different.

But while "Change or Die" is an attention-grabbing op-ed headline, it doesn't say much that lenders can actually use. How much of the risk of disruption is real and how much is hyperbole? What form is that disruption likely to take? Most importantly, what opportunities would it create, and what actual steps can a lender take to be on the right side of the future?

These are the questions we'll examine in this white paper - and try to provide answers to. Before we tackle how lenders are positioned, however, let's take a look at why disruption happens in the first place.

How Disruption Happens in Established Industries

What happens to a stable, long-standing market to suddenly turn that market on its head? The easy answer is "the Internet happens," but just focusing on technology misses a deeper root cause: latent customer discontent. Let's start by briefly examining some of the most infamously disruptive business cases of the last few years.

Ride-sharing Apps and Traditional Taxis

Uber and Lyft have become the poster children for disruptive startups. Ride-sharing is the first example most people think of, so much so that "the Uberization of —" became a frequent trope for business press opinion pieces.

From San Francisco to London, ride-sharing apps have transformed paid transportation in the cities in which they operate, over the vocal objections of established taxi companies. While Uber in particular receives a lot of scrutiny for its controversial labor and regulatory practices, the core of the ride-sharing app success is quite simple: it provided a better experience to consumers.

In the traditional market, taxis were often scarce outside of very specific urban zones. For anyone who needed a ride outside, say, a popular downtown area, getting a taxi was an ordeal. You had to call a taxi company, explain what you wanted to the dispatcher and routinely wait 30 minutes or more for a car - which sometimes would not arrive at all. Once you were in your taxi, it wasn't clear how much a trip would cost until you arrived. Since not all drivers took credit cards, there was a very real possibility you could arrive at your destination, discover your driver was cash-only, and not have enough to cover your fare.

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Uber and Lyft made it simple to summon a car in a few taps, get an accurate estimate of your fare cost, pay seamlessly with a credit card and get real-time updates on when to expect your driver to arrive. Taking a taxi changed from complex and time-consuming, to effortless and near-instant, practically overnight. Taxi companies protest that these services have unfair advantages, but when you examine the situation through the lens of the consumer, it's clear why the market tilted so strongly toward Lyft, Uber and the services like them.

Apple and the Music Industry

The rise of Apple as a player in music sales is probably the most famous disruption story of the early 2000s - and foreshadowed many others over the next decade.

Music sales at the turn of the millennium were generally restricted to CD albums, while exposure to new music largely came from FM radio stations that concentrated airtime on a small number of singles from a handful of artists. As a result, a consumer wanting to buy their favorite song from the radio would have no choice but to buy the artist's entire album, with no way to listen to any of the other songs beforehand. Considering that the average album in 1999 was priced equivalent to $25 in 2017 dollars, that favorite single could turn into a very expensive purchase if the consumer didn't like the rest of the album.

When the iTunes digital music store launched in 2003, it offered consumers the first legal online merchant with music from all five major record labels. It also boasted a user-friendly interface and simple sync with Apple's iPod portable music player, making it easy for consumers to take their purchased music on the go.

Crucially, the iTunes store also allowed consumers to buy just the individual song they actually wanted, at a 99-cent price point that most users found reasonable. Buying a hit radio single became both simpler and dramatically less expensive, allowing consumers to secure much more value from their money spent on music.

While MP3s had been available previously (both from a handful of legal outlets and far more numerous illegal ones), usability and selection issues had limited adoption outside of tech enthusiasts. The superior experience Apple offered versus physical media helped push digital music into the mainstream. By 2006, storied brick-and-mortar merchant Tower Records was in liquidation, and by 2008 Apple was the top-selling music store in the United States.

Netflix and Pay Television

In the mid-2000s, pay TV service providers were infamous for being expensive, opaque and indifferent to customers. This was especially true for the cable industry, with American Customer Satisfaction Index surveys in both 2004 and 2007 giving a cable company the lowest satisfaction score of any company in the United States.

Among more general service complaints, consumers expressed frequent dissatisfaction with the industry practice of bundling. In order to gain access to a popular channel like HBO, consumers had to buy an expensive premium service tier that included hundreds of other channels they often had no interest in.

Likewise, for decades there was only one option for watching their favorite shows: be in front of the television when the network decided to air it. A scheduling conflict meant missing an episode - and, for serial shows like 2004 hit Lost, perhaps a critical piece of story. DVR services introduced in the late 1990s made it possible to record a show to watch later, but these needed to be set up in advance and often contained limits on the number of episodes that could be saved.

In 2007, DVD-by-mail service Netflix began offering on-demand streaming of some of its library. While the content available was mostly older movies and TV shows, consumers could choose what they wanted to watch, when they wanted to watch it, without commercials or arbitrary waits between episodes. The service was a huge hit - in 2013, Sandvine estimated that consumers watching Netflix accounted for a third of North American online traffic in the evenings.

Besides its own success, the model Netflix introduced helped revolutionize the pay-video industry. Consumers enthusiastically embraced the anywhere, anytime model of TV viewing, and grew increasingly impatient with the traditional “appointment TV” model that imposed an arbitrary schedule on their viewing.

Netflix and the similar services that followed - including Hulu, Vudu, Amazon Prime Video and others - made it possible for some consumers to forgo cable subscription TV services altogether. These consumers relied solely on Internet video services to watch TV, sparking a great deal of consternation in the pay TV industry about a “cord cutting” trend.

Ultimately the pay TV industry was forced to change its offerings to meet consumer demand and expectations, adding streaming offerings alongside traditional TV packages. In 2015, HBO launched a standalone streaming-only service for consumers who did not subscribe to any pay-TV services - a move that had been dismissed as impossible by industry insiders just five years earlier.

The Takeaway: It’s Not Just Technology

While disruption is often framed as being caused by “technology” or “the Internet,” these famous cases illustrate that technological change doesn’t tell the full story.

While the Internet enabled these disruptions, it didn’t cause them. In all three cases, the root cause of the market upheaval was that consumers were unhappy with the status quo. There are two main aspects to this: general customer satisfaction and customer choice.

In all three examples, consumers were being taken for granted. The established players - taxi companies, record labels and pay TV providers - had no perceived incentive to care if their customers were happy, because there was no real alternative where consumers could take their business. With that status quo, it shouldn't be surprising that consumers flocked to new services that were better designed to meet their needs.

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Another common thread in all three cases is control. Consumers traditionally had little to no control over how they could get a ride, buy music or watch a TV show. Their access was dependent on arbitrary business decisions by the incumbents. The disruptors all provided a model that offered much more flexibility and consumer choice, allowing users to take control over their experiences. In all three situations, tolerance for inconvenience or barriers for the sake of incumbent business benefit quickly deteriorated, and having a choice in the "how" and "where" soon became a consumer expectation rather than a perk.

Disruption in the Mortgage Industry: Assessing the Risk

We've seen how past market upheavals have played out, and what conditions set the stage. So when it comes to disruption, is the mortgage industry vulnerable?

By the customer satisfaction measurement, the answer is yes. While getting a mortgage is the most significant transaction most consumers will ever make, many regard the process with dread. Getting a mortgage is frequently perceived as a painful, onerous chore that grinds on at a glacial pace, comes rife with unexplained costs and has no regard for borrowers' time or convenience. For an increasing number of people, for instance, applying for a mortgage is sole time they will encounter or operate a fax machine.

By the customer choice measurement, the industry is also at risk. For many consumers the mortgage process is very opaque, with little knowledge or communication around what's going on. From the lender perspective, buying a home includes several individual transactions such as the title search or acquiring mortgage insurance. This can be unclear to consumers, who often perceive "getting a mortgage" as a single event.

Since providers for these individual transactions are often chosen independently by the real estate agent or lender, borrowers often find themselves expected to pay for services they had no say in choosing. With no role in the selection process, the borrower has no way of knowing if they got a good price or if they're getting a reasonable service level for their money. In an age of online comparison shopping, consumers are increasingly unwilling to accept such opaque transactions.

A largely offline mortgage process further restricts the consumer's control over their transaction. The borrower is at the mercy of the lender's schedule, which dictates how and when things will move forward. The borrower must track down and deliver paper documentation when and where the lender asks for it. For interactions that the lender requires to be done in-person, the consumer must either burn valuable paid vacation or take unpaid time off work.

Besides metrics of consumer satisfaction and choice, there's a third warning indicator for the mortgage industry. A recent Accenture study found that consumers increasingly view their bank relationships as strictly transactional, and feel little need to stay with their current bank for future financial needs. If a new, disruptive alternative did surface, many consumers would feel little hesitation to jump ship.

> DISRUPTION IN MORTGAGE LENDING IS LIKELY TO COME IN THE FORM OF A DIFFERENT EXPERIENCE, RATHER THAN A DIFFERENT BUSINESS MODEL.

Of course, home lending is a very different industry than media or taxis. The financial industry is less open to innovation than many others, with good reason. Finance is one of most regulated areas in the US, arguably second only to health care. The Consumer Financial Protection Bureau issues regular dictates on how lenders conduct business, and the market is largely influenced by Fannie Mae and Freddie Mac, both government-sponsored enterprises that purchase the majority of mortgages originated. Periodic disasters such as the 2008 mortgage crisis have reinforced the need for caution in financial practices.

What this difference boils down to, however, is what aspect of the industry is open to disruption. The "innovations" that led to the 2008 housing crisis were related to relaxed lending standards and questionable securities practices, not the actual mortgage process itself. While it's obviously important to exercise caution, being cautious does not require also being consumer-unfriendly. The truth is, the process of getting a mortgage can become much faster and less onerous, without requiring a drop in loan standards.

As a result, disruption in mortgage lending is likely to come in the form of a different experience, rather than a different business model. And as mortgages are inextricably linked to home sales, disruption in mortgage will drive a larger disruption opportunity in residential real estate.

Taking Action Against the Risk of Disruption

As we've discussed, new technology itself doesn't cause disruption - it just enables disruption rooted in existing consumer dissatisfaction. While it can be tempting to try to push back on technology altogether as a way to avoid this, the past decade has shown us that eventually, technology usually wins out. A much more effective way to protect your organization against disruption is to address the root cause by keeping your customers happy.

The first step to assessing your organization's risk, and mitigating it, is to step back and take a hard look in the mirror. Viewing your organization through the eyes of your customers, what makes sense, and what seems confusing or unnecessarily difficult? Is there anything involved in your mortgage process that might make the average consumer say "*I can't believe we still have to do —?"* Those are the issues you'll want to address.

This can mean changing practices and policies that make sense to you, but not to consumers. It's easy to accept an established, inefficient process as just "how it is," and to dismiss new approaches as unworkable. This is a problem for many organizations, not just lenders. And while sometimes that's true, it's also very easy for institutional idiosyncrasies to color perceptions of how things need to be done.

Instead of just assuming that change is impossible, critically examine your processes through the eyes of a customer with no institutional context for why things are a certain way. A consumer doesn't care that they're being inconvenienced because of a quirk in their lender's organizational structure – they only know that they're being inconvenienced, and they don't appreciate it. If the lender recognizes that that organizational quirk is a competitive disadvantage, it might not seem so impossible to change the process around it.

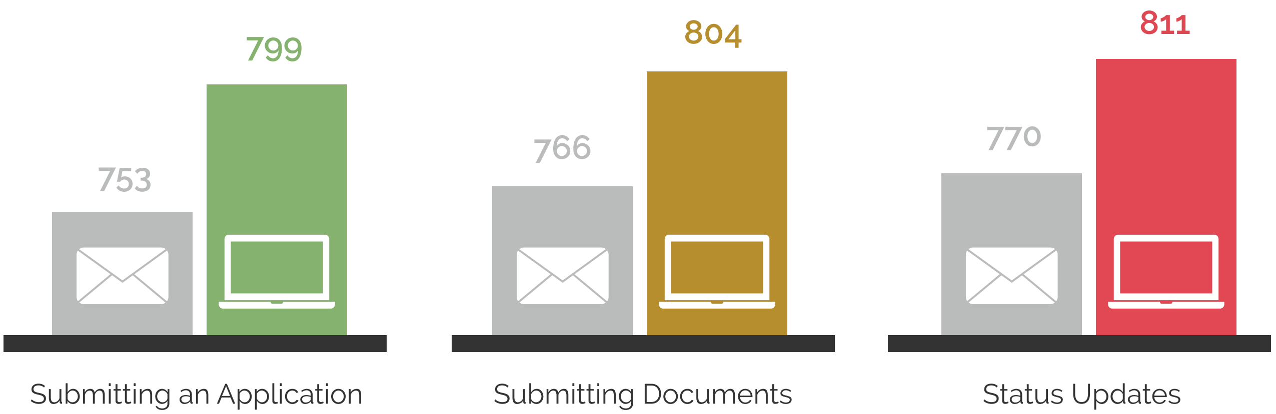
When you identify a part of your process as negative for consumers, the next step is to consider how you can improve it, and give your customers the experience they want. And what is the experience consumers want?

They want to be able to conduct their mortgage transaction online.

Embracing the Digital Consumer Experience

J.D. Power recently surveyed over 4,000 consumers about their recent mortgage experience, and found higher satisfaction scores among those who had gone through the process online. Digital mortgage customers scored 799 for submitting an application, 804 for submitting documents and 811 for status updates, while those who relied on mail or fax scored 753 on application, 766 on docs and 770 on status updates. Across the board, the satisfaction scores for traditional mortgage customers were roughly 40 points lower than their digital counterparts.

Customer Satisfaction Ratings, Traditional vs. Digital Mortgage



Source: J.D. Power 2015 U.S. Primary Mortgage Origination Satisfaction Study, http://www.jdpower.com/press-releases/2015-us-primary-mortgage-origination-satisfaction-study

This shouldn't come as a surprise – virtually every transaction consumers make, even the notoriously painful ones, are now available online:

- Applying for a job is now almost entirely an online process. A mailed resume will likely be immediately recycled, and a phone call or in-person inquiry about available positions will be redirected to the business's website.
- Most routine DMV transactions, such as renewing a license or submitting a form, can be done online in a few clicks.
- Filling out tax forms may be a headache, but submitting them is not. According to the Treasury Dept, 87% of Americans filed their taxes electronically in 2015.
- Even health care is moving online. Major insurers like Anthem and Kaiser now offer video chats with doctors for minor ailments as an alternative to visiting an urgent care clinic.

For younger consumers in particular, offline processes can often seem cumbersome and counterintuitive. As millennials begin to enter the housing market in earnest, this trend is only likely to accelerate. More and more prospective homebuyers will enter the mortgage process having made every other significant transaction online, and will not understand why homebuying should have to be different.

It goes further than just offering some sort of online experience - it has to be a *good* experience. At one time consumers might have forgiven an incomplete or difficult-to-use digital offering. But at this point, internet tools are sophisticated enough that many people expect every online experience to be polished and user-friendly. Make sure your digital mortgage offering is designed around your customers' needs.

> MORE AND MORE PROSPECTIVE HOMEBUYERS WILL ENTER THE MORTGAGE PROCESS HAVING MADE EVERY OTHER SIGNIFICANT TRANSACTION ONLINE.

Moving your mortgage process online and offering a consumer-oriented experience helps you address the root causes that put you at risk for customer defection to a potential disruptor.

A Consumer-Centric Online Experience

- **Intuitive.** An archaic or overly complicated UI can frustrate your consumers, and also increases the chance that they'll abandon their application unsubmitted.
- **Clearly explained.** Particularly for first-time buyers, a mortgage application can seem vast and intimidating. Offer an easy-to-understand explanation of the information you're collecting and why, in language your borrowers will be familiar with.
- **Designed for communication.** Your customers like to be kept up to date. Take advantage of the speed and ease of electronic communication to keep them in the loop, and make it easy for them to contact you with any questions.
- **Fully functional.** An online application that restricts options or requires a phone call to progress is more likely to irritate your borrowers.
- **End-to-end.** Consumers are now accustomed to both searching and transacting online in the same experience. The mortgage application represents a small fraction of the overall home loan closing experience. Consumers want to manage the entire process in one place.
- **Mobile-friendly.** Once relegated to games and social network surfing, smartphones are quickly becoming central to consumers' financial lives. A 2014 Federal Reserve study found that 52% of smartphone owners with a bank account used mobile banking. In the three years since the study, that number has probably only increased.

Your applicants get an easy-to-use, easy-to-understand process that respects their time. A modern, online mortgage system allows consumers to apply for and close a home loan on their own schedule, rather than requiring them to take time off work to visit a bank during business hours. Likewise, they can acquire and submit their documentation without needing to mail sensitive documents, visit in-person or locate a fax machine (and possibly Google how to use one).

Your customers also get greater transparency into what goes on with their loan and when. Gaining visibility into the various process stages and the players involved helps reduce anxiety and reassures your applicants that the loan is continuing to move forward.

Real-time communication also has a significant impact on overall customer happiness. In the JD Power survey, the satisfaction score for loans that took more than two months to close was 686. However, that score increased to 859 when consumers were proactively updated in the same scenario. The fast, easy communication enabled by an online experience can offer a measurable increase in how much your customers want to work with you.

686

Customer satisfaction score for loans that took more than two months to close

859

Customer satisfaction score for loans that took more than two months to close, *when consumer is proactively updated*

Source: J.D. Power 2015 U.S. Primary Mortgage Origination Satisfaction Study, http://www.jdpower.com/press-releases/2015-us-primary-mortgage-origination-satisfaction-study

The digital process isn't just good for your customers. Besides just reducing a potential threat, an online mortgage process offers benefits to your organization as well.

- **A higher volume of applications.** Besides making it easier for prospective clients to find you, the flexibility and ease of use offered by an online application reduces barriers that might otherwise prevent a potential applicant from contacting you.
- **More complete applications, with fewer errors.** Online applications can allow consumers to pull information like income and assets directly from their financial institutions, rather than providing it manually. This direct-from-source information greatly reduces the chance of errors - and the time and costs of later fixing them.
- **Faster closing times.** Electronic documentation and real-time communication don't just make things easier for your customers. With less time spent manually processing documents or making phone calls to everyone involved in the

transaction, your loan officers will be able to shepherd loans to closing in less time. The greater accuracy of digitally-verified applications also means less risk of time lost correcting mistakes.

- **Referrals and repeat business.** A happy customer is a customer who returns for their next loan – and tells their friends and family about their great experience.

Conclusion

The sweeping business and cultural changes sparked by the Internet have posed challenges to established enterprises across many industries, and this is especially true for traditionally more conservative fields like finance and mortgage lending. But while proclaiming the death of traditional companies at the hands of flashy disruptors may make for catchy headlines, it's far from a foregone conclusion.

By proactively examining their business process through the lens of consumers and being willing to make changes accordingly, established players can minimize their risk of losing market share or (just as importantly, mindshare), to "digital only" banks and VC-backed upstarts.

Because what's better than winning your customers back from a rival? Never losing them in the first place.

Roostify was founded by three technologists frustrated by their homebuying experiences, and is dedicated to enabling a more efficient, transparent mortgage process for lenders, agents, and homebuyers. Banks and mortgage brokers nationwide trust Roostify's software platform to deliver more loan volume, faster closes, and happier customers.

*To learn more, visit us at **www.roostify.com**.*

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