PITCHIT FINTECH STARTUPS PODCAST NO. 31-GAURAV 32-NEAL DESAI

Welcome to PitchIt, the fintech startups podcast, one founder, one startup, one investor at a time. I'm your host, Todd Anderson, Chief Product Officer, LendIt Fintech.

(music)

Todd Anderson: On Episode 32, I talk with Neal Desai of Kafene. Kafene is a mission-driven company with the goal of empowering flexible ownership solutions. They use technology to bring innovation, to list own purchasing options for furniture, appliances, electronics, tires & wheels and a whole lot more. When talking with Neal, flexibility is really the key word to all of these, they really do work with their consumers to give them options, not only when purchasing an item, but also during payments, if you miss a payment. These are consumers that are typically sub-prime borrowers and in many cases tend to deal with predatory financial products which Kafene is not.

Until the Kafene product approves almost anyone so you don't have to worry about missing out on accessing an item that you need for your home or your family and they have multiple payment structures which help give you that choice which best suits kind of the situation that you're currently in. Companies like Kafene is kind of where the real change is beginning to happen in financial inclusion, not only are they giving options in terms of the consumers or it's not just as one predatory option, but they're also doing it at a fair rate and a lot fairer than some of the other options out there. Neal and I get into the overall mission of Kafene, why they targeted that subprime consumer, "buy now, pay later," raising capital and a whole lot more. So, without further ado, Neal Desai of Kafene. I hope you all enjoy the show.

(music)

Todd: Welcome to the podcast, Neal, how are you?

Neal Desai: Doing great, Todd, very excited to be here.

Todd: Oh, excited to have you. So, if you can just tell the audience a little bit about yourself, you know, where were you before your current role at Kafene and starting Kafene? So, what does your journey look like in terms of fintech, prior to the current venture?

Neal: I started my career in 1999 out of Princeton as a Derivatives Trader on Wall Street. It was there that I really honed my skill in managing financial risk and I took that skill set to a company called Octane Lending in 2016. Octane Lending is a fintech lender and using that skill and some other tips and tricks I picked up from Wharton along the way, I helped scale that company from about 11 people when I joined up to about 100 by the time I left to start Kafene which was in July of 2019.

Todd: As a founder, did you always want to start your own company, is it something that you saw a problem in existence and say hey, I think I can solve this, I can create something, I can solve this or is it always eventually being an entrepreneur was just a matter of time when.

Neal: I really got pulled into in. I was quite happy for most of my professional career, but I've always just been super interested in the problem of financial inequality. From the earliest I can remember, I've always wondered why are some countries rich and why are some countries poor and here in the US, you can re-frame that question as how is it possible that we're such a wealthy country overall and yet there are so many people who could barely get by. And over the last few years, it's just really begun to crystallize and this is what I should be doing, I should be focused on this problem and as I started to gain confidence around some of the potential solutions here, it was just inevitable that I had to start Kafene to help tackle the issues.

Todd: So, before jumping into exactly what you guys offer, how'd you get the name Kafene?

Neal: I'm not going to lie, there was some (inaudible) involved. We were trying to come up with a name that was going to capture the idea that we're different. We don't want to look at, you know, financial inclusion and lending and credit the same way as a lot of the incumbents, we wanted a name that would resonate energy and something unique that would cause a consumer to stop and just say, wait a second, let me take a closer look at this.

Todd: So, if you can tell the audience what exactly you guys offer and ultimately, who is your target customer?

Neal: So, we are a point of sale financial solution for the under-banked and if you think about the under-banked or the subprime population, however you want to refer to that proof of over 100 million people in this country. It is very difficult for them to access credit or credit-like products. Now, if you think about how a consumer might access $300, 400, 500, the good news is they do have solutions. The can go to a pawnshop, they can go to a payday lender, they can borrow the money from friends, there's some availability. Where the system really breaks down is if a consumer that is relatively under-banked needs several thousand dollars.

When I tell you a story about one of our first customers, you know, it was a woman with a family of six, the refrigerator broke, okay, she didn't have a credit card, doesn't have a banking history, needed to purchase a new refrigerator which she was able to do using Kafene, was walk into an appliance store where Kafene helped facilitate the financing between the appliance seller and her so that she could get financed for $1,200 to go buy a new refrigerator. The best part about it is that Kafene system is flexible so if she was, at any point, unable to make her payments, we would absorb and accept the goods back so that she's not in a debt trap. That philosophy under grows our entire system, all of our financing is designed to be flexible in nature.

Todd: So, why focus on the subprime, I mean, you mentioned a little bit the open....the issue that you guys were solving, there’s been a lot of talk about the under-banked, you know, how and why did you specifically focus on subprime? And then, second question to that is you mentioned it, about the flexibility, how tricky can it get if someone does not make a payment and you have to essentially go and get the good from them?

Neal: In terms of why subprime, I think it's really two factors. Number one, I have a very unique skill set in both technology and financial risk and subprime is incredibly hard, okay. So, my background just happens to be very well suited towards this problem. The second element is mission and I'm blessed that I have a Co-Founder, James Schuler, who is a perfect complement to me on the technical side. We are both incredibly mission-driven to make an impact here, we both believe that there's not enough talent serving this community and so to both of us it just felt that we were going to help tackle this problem given our backgrounds like who's better suited to do so.

I want to talk about flexibility for a moment because it's really important and central to what we do. To understand why our system is flexible, you have to understand a little bit more about this demographic, the under-banked demographic, in the first place. This is a 100 million people in the US, it is a demographic that I think is oftentimes characterized as being comprised of bad actors, that is simply not true. The problem with this demographic is that they just don't make enough money, this is an income problem not a behavior problem so anytime there is stress in their life, they're going to have a hiccup or an issue with respect to any kind of credit tor credit-like product that they have.

If you don't build flexibility into what you are offering, you are inevitably, number one, not going to realize the maximum economic return and more importantly, number two, you're destined to put that customer in a worse situation than when they started. So, central to our thesis in serving this demographic is that everything we offer has to be flexible. It's good for us, it's good for them, it is central part of what makes this work.

Todd: The example that you gave about the woman that had her fridge go out, she financed the fridge using Kafene, now say, for example, she missed the payment, you just have to get the fridge back. The consumer won't be in a debt trap, but then over time does it become an issue for you guys in holding the risk of that piece of equipment. So, eventually, does that lose it's original value and then all of a sudden, do you end up with too much inventory or is the behavior, what you guys have seen, so far, that it's going to be few and far between and it's not something that will dramatically impact how you guys operate?

Neal: So, on that specific example where the customer is unable to make their payments on time, we almost always try to work with the consumer so it is incredibly unlikely that if a customer misses one payment we're going to show up with a truck. We try to work it out, we are super flexible with things like modifications and deferrals and other technical terms for this basic human decency. What is the impact of all of that with respect to our credit performance and with respect to our profitability, I think it's important to understand that there is tremendous economic potential in this demographic.

Yes, we sometimes have to take losses, yes, we sometimes have to collect goods, most of the time, however, the customers are able to make their payments and acquire ownership and what is staggering about this is as we get deeper and deeper and build more and more operating history, I firmly believe what I used to think was tens of billions or hundreds of billions of unlocked economic potential is probably in the trillions. It is really amazing, with a little bit of flexibility and decency, how consumers are able to actually to afford their goods.

Todd: Now, I want to go back. You mentioned something how serving this segment is hard and part of that, I presume, is it's really serving them with a product that's fair and not exorbitant in terms of fees and cost because, ultimately, a lot of people have tried to and are serving the segment, but they're essentially gouging the consumers.

Neal: Yes.

Todd: And so, they were saying alright, we'll take a bigger risk on you, but you're going to pay this higher amount of a fee, all these extras on top and I'll give it you, but I'm essentially taking that risk. The hard part comes in is to give it to them in a cost that looks closer to what say maybe a prime or super prime type borrower would find.

Neal: Yeah, that's right. What we've seen historically, in the subprime, in the under-banked space is that there is a small set of consumers who can make the payments and the people that are facilitating the service try to take as much money from them as they can. We've a very different world view, we want to get as many of the customers out there to acquire ownership, we want to get as many of the customers out there as we can to be able to make their payments, whether or not there's a gap or two, one or two or three payments missed, we don't really care. If the majority or the vast majority in our case of customers are making their payments, we don't have to gouge them, right, we don't have to do things like charge late fees. In fact, our system isn't even good to handle late fees, it's never been part of the central philosophy that we have.

Todd: So, "buy now, pay later" and I think you guys would fall into that category of BNPL, it's obviously been arguably the hottest segment in fintech, maybe crypto is fighting it for top billing right now, but have we learned enough, thus far, that this type of lending is safer than say a credit card or potentially a non-secure consumer loan to buy a product? I don't think I've seen much data out there to say alright, this, for sure is one way or another, but, thus far, have you guys seen within your own segment that it's a safer way to go than some of those other products that might be out there today?

Neal: Traditional "buy now, pay later" is debt that's been repackaged as something different, but it's still debt and I do have concerns that consumers might be taking on debt that they don't quite understand because it's being distributed so easily, that does give me some concern. I think where Kafene is differentiated is, again, this is not debt, this is a flexible solution, but I'll tell you another story.

We had a customer who was looking for a specialty camera to buy his daughter for her 16th birthday, he doesn't have a credit card, he couldn't just go into the specialty camera store and finance it. Rather, he applied through Kafene, signed up for our financial service and we were able to facilitate that purchase for him, he paid us back. So, I think that it's important to distinguish traditional "buy now, pay later" which is a debt product from Kafene's payment structure which is not debt and provides, in my opinion, a much needed service in the market that doesn't exist.

Todd: The reporting alongside a lot of these, you know, "buy now, pay later" isn't uniform and to be honest with you, I think the way it's currently been structured, at least from a high level step back point of view, consumers have been hit worse by a non-payment than they've ever gotten credit for making a hundred payments on their purchases because there's no uniformity. I guess my question is A) do we need uniformity for this type of credit product and then B) how can we, you know, help consumers to better understand that what they're doing at "buy now, pay later" could be as risky as a credit card in terms of the credit reporting aspect.

Neal: I would love to say that the "buy now, pay later" community was going to self-regulate, but I think the world has shown over the last few decades that it's just incapable of self-regulation. I do think there is a strong argument to make uniform some of the reporting requirements. I think as important as uniformity is just fairness and a lot of what the "buy now, pay later" guys do is that they will report negative behavior in an attempt to try to get the customer to pay, but not report positive behavior because it costs money. We are already reporting both types of behavior to two out of the three credit bureaus and we hope to have all three online within the next six months.

Todd: Do you think credit cards, more generally, are something that eventually will go away or with "buy now, pay later" it's just the options increase and the consumer has a wider view or wider choice to eventually choose the product that's best for them?

Neal: Credit cards are fascinating, right, they feel ubiquitous, but if we remember that credit cards are only 50 or 60 years old, we can unpack what a credit card is. A credit card is two things in one, a credit card is a product which is an available credit line, essentially just pre-approved buying power, but it's also a delivery mechanism and it's a delivery mechanism that transmit that buying power from the consumer to the merchant.

I don't think the idea of an unused, always available credit line is ever going to disappear. What we feature is revolving credit, there's always going to be need for that. In terms of the delivery mechanism itself, that's evolving and it's evolving quickly. We happen to use virtual card-based technology that looks and feels like a credit card to deliver list-owned products, right. So, I don't think the credit card will ever disappear, but I do think that the way that we think about credit capacity and the delivery mechanism are evolving.

Todd: So, I want to kind of step back a little bit. You know, you've mentioned it, it's in your ethos, it's in your mission, what do you think the current state of financial inclusion, financial health is today? I think fintech has, for the most part, talked a lot about this especially since it's kind of coming of age say five, six, seven years ago, but I'm not sure it's ever really done a better job at getting more people at lower or equal cost than traditional financial institutions. So, it really hasn't delivered on that "promise", what do you think the current state of financial inclusion and wellness is today?

Neal: Yeah I think you hit the nail on the head. It's getting better incrementally, but it's really got a long way to go. I think in order for us to really create a system that has greater financial inclusion, there has to be an entire ecosystem of players that are aligned towards the two mandates of both fairness and profitability. Fintech, as you referenced, has the potential to not only help identify the target consumer set that would most benefit from a product set that's being developed, but it also has the ability to distribute that product in a more efficient way.

We haven't seen a ton of that yet, I think a lot of work that has been done on a fintech is on building the infrastructure to help facilitate that so I do have to say we couldn't have started Kafene four years ago or five years ago. The data availability wasn't there, the virtual card technology wasn't there and so incrementally, the whole ecosystem is being built, but I think the first layer that's been built is the infrastructure. The layer that we're now building is the actual identification and distribution, we'll get there, it's just going to take some time.

Todd: What about the concept of credit score? You know, a lot of these people that we've been talking about don't make enough money yet the current credit score, in many ways, is built upon going into debt to prove that you can pay off the debt and then you're given this number that says, okay, I'm a prime, subprime, super prime, whatever prime type of borrower. With all the data that we currently have available to us, isn't there a better way for us to say, Neal or Todd is X credit risk based upon… he's been paying Netflix for five years, his oil bill is never late. I know some of that are starting to be included in credit scores, but the credit score itself, has it really changed that much or has it just gotten this boost, so to speak?

Neal: The more you look into what a credit score is good for, the sadder the situation becomes, in my view. I'm going to tell you a statistic that continues to blow my mind about our population base. Forty percent of our consumers, and this is an average FICO population of 550, we're really dealing with the unbanked here, 40% of our consumers pay us back in 90 days and the average payback is $2,000 and this is a population that can't get a credit card because their credit score doesn't reflect their actual economic potential. There are incremental gains, as you mentioned, being made every day towards making the credit score a bit more reflective of the appropriate buying power or economic stability of the consumer base, Kafene's view is that we're not going to wait for credit scores to catch up.

I think the distance between the data that we're generating and where the credit bureaus are able to distribute that in a single number is just widening, we are going to profitably launch revolving credit in a credit card-like functionality for these consumers within the next year or two. We've identified a set that deserves greater access to credit products than their credit score would indicate and so unless the credit bureau somehow magically catch up, we'll just build our own data set and provide a better, more comprehensive service suite.

Todd: Do you guys use credit scores in your product?

Neal: We only use credit scores today as a gut check on whether or not our credit system is rank ordering the same as the credit bureaus do. We are within six months of moving away from credit scores entirely because our modeling is far more predictive than the credit bureaus could ever be and so we'll probably move away from using credit scores entirely in the near future.

Todd: Do you think we'll get to a point where it's like it ends up being a split like banks still use credit scores yet fintechs have moved on because they found alright, these data points, you've been talking about it for the last few minutes, you know, provide me with a better insight into this customer in a more real-time than whether or not their FICO someone reported in August were already here in October.

Neal: I do. I think the entire market's going to (inaudible). I don't think a prime lender who is targeting that 750 FICO customer is ever going to really care about the stability of their utility payments because the 750 FICO gives them all the information they need and it's cheap. Now, we have to invest nearly $10 to 15 to pull together all of the data that we need to meaningfully approve a 550 average FICO customer and as I mentioned, we can get away with approving over 70% of them, it's expensive, it's time consuming. But, we believe there's significant economic power here and that we can do it profitably and distribute a more fair solution. So, I think what you're going to have over time is more and more companies like us who are willing to make the investment in alternative data and they're able to really monetize that.

Todd: Have you guys seen or is there any data yet like how much a product like a Kafene can help boost a score or how other lenders might perceive that said borrower when they've shown the wherewithal and willingness to repay and are good borrowers when maybe from that initial outside looking in alright, this is way too risky for us.

Neal: We're starting to do the work so I'm a little bit reluctant to put a number out there yet because we haven't measured it perfectly, but we do find that our customers' credit scores increase, we also find, however, that we are able to offer our repeat customers significantly better terms than whatever increase they would get just based on a credit score boost. So, we have customers that have been with us two, three, four times, they enjoy the benefit of greater approval amounts, lower pricing and greater and greater flexibility through their repayment cycles.

Todd: I mean, ultimately, part of it is loyalty. I mean, you're the one that gave them this opportunity to get access to a refrigerator like the first example we highlighted and part of that is I'm going back to the person that said yes because they viewed me probably with more compassion than a number from Citi or Chase might view me. I'm definitely going back to them versus, you know, I'm going to try through Chase, Citi again and again and again till they finally let me in.

Neal: Yeah, I think that's right. Our customers are quite loyal to us and we're quite loyal to them. The biggest challenge we have is to be able to rollout additional products fast enough to satisfy the demand from our consumer base. I think they see good customer experience, they see fairness, they see competitive pricing from us and they ask us, why can't I open a bank account with you guys, why can't I get a credit card with you guys. My answer to that is always we'll get there as soon as we can.

Todd: Yeah. Final question before we shift a little bit in our conversation. The best piece of advice that you've received, so far, building Kafene?

Neal: It's come from numerous sources, but I was still surprised when I heard it and now I think it's just absolutely right and that is, raise way more money than you ever think you'll need and the reason I think that's so important is that oftentimes entrepreneurs are worried about dilution. I think if you are going to really have meaningful impact, you've got to be able to think bigger, you've got to be able to think on a larger time scale, you've got to be able to attract the best talent.

That stuff costs money and it's something that I think like most entrepreneurs were surprised when I had first heard, but I really believe that in today's day and age, more money means greater acceleration, greater ambition and it's going to lead to a significantly better outcome and it's something that all entrepreneurs should really seriously consider.

Todd: So, I want to shift a little bit. How big is the team at Kafene today, everyone distributed, you guys in an office, is there kind of a central location of the team?

Neal: Yeah. We have about 80 fulltime employees, we are largely distributed though New York City continues to be the center of activity, about 35 to 40 of our employees are in the New York City area and so we are moving towards an in-office hybrid model pretty soon. We're testing it now, people seem to really like it, I think everyone, you know, obviously, wants to have some flexibility around their schedule, but the day-to-day camaraderie of being in the office I think is more valuable than people oftentimes give it credit for.

Todd: While I was going through, you know, some research for this episode I was looking at, I think it was an article talking about you guys went into hibernation mode last year, talk a little bit about that. Obviously, I'm sure it was a trying time as a founder, at any point during that period you think alright, we're just not coming out the other side and then what kind of kept you focused enough. Obviously, you made it and now, you're on the other side and helping these consumers.

Neal: That was a really difficult time and we were early. So, we actually went into hibernation about a week before most of the cities and states started to quarantine and other people caught on. That decisiveness came from, again, my prior career as a trader, I'm able to make tough decisions under stress. That doesn't in any way diminish the fact that it was stressful, however, the reason we were decisive and we were able to make the call quickly was because we had investors and other partners in our ecosystem that we knew were going to be supportive.

They encouraged us to yes, lean up, but also keep our eyes on the long term prize, keep building, focus on driving whatever value can be driven while being in a relative hibernation state. I don't think I was ever scared that we weren't going to come out of it, I was just disappointed that we probably couldn't make as much progress that we could have and not have. We also had to candidly really evolve and grow as managers pretty quickly, so many of our employees were dealing with personal issues related to the crisis, we had to figure out how navigate all of that.

Todd: Was there on big benefit that you learned from that either hibernation period or even just this last time in COVID and kind of locked down?

Neal: The biggest learning was that there was no way that me and my Co-Founder, James, were going to be able to do this ourselves. The sheer scale of what we had to deal with and the amount that we had to get done in a distributed way and in a way where, you know, funding wasn't guaranteed, meant that we had to really learn how to manage our team better and in doing so I think we were completely amazed at how much our team cares, how productive they were and it has fundamentally altered the way that we run the company. We view ourselves now as stewards of the other stakeholders here and much less the way we used to which is that it was our job to get everything done.

Todd: As a Founder/CEO, how do you kind of stay up and make sure that you're not falling behind another tech or just some of the trends out there. I mean, me who follows fintech as closely as I can, I mean, I find it hard to keep up and I'm not even running a growing fintech company.

Neal: Information and the pace of change is just moving so rapidly that it's not possible to stay up-to-date on all of it. I try to, you know, do the things that one would normally do with respect to reading and networking to try to understand broadly what's going on, but in order to really successfully understand, I try to keep it pretty narrow. My information seeking is generally along the financial inclusion and credit and credit-like areas where I feel like I'm fully caught up, the other areas I'm content to be two or three beats behind where the industry really is.

Todd: So, you mentioned the piece of advice that you got before which was, you know, you'll never have enough money, essentially, so make sure you raise more than you might think you need, clearly, fintech's arguably the hottest segment out there for raising capital, seems like everyone can get capital, what advice would you give to another founder other than obviously the piece that you got about raising money that you found through the process that either helped you or that you might think could help another founder that might be tuning into this?

Neal: I'm so glad you asked that question because the prior answer I gave was incomplete, right, and this is the other side of it. The other side of it is, raising money is not the same thing as building value. If you're able to build value, the money will always be there and that's the goal, build value for your stakeholders, build value for your customers, etc. This environment is unique, it is fairly easy to raise money relative to historical context, but just because you raise money doesn't mean you'll be successful, really got to focus on not letting fundraising be the benchmark. Make sure you have actual benchmarks that are more fundamental to the actual process of putting something in the world that is meaningful.

Todd: So, we have just a few minutes left here, I'd like to end with a little bit lighter questions, a little more fun. Do you have a favorite book and the last book that you read, I see some books over your head there so.

Neal: (laughs) One of my favorite books related to the conversation that we're having is a book by Dan Ariely called "Predictably Irrational." It's a few years old at this point, but it is a super approachable way to think about how oddly we, as a species, are wired. We all know we're not rational and yet we're all irrational in these patterned ways, we all make the same mistakes. I think it's just a fascinating read on how people really behave and I would have encourage anyone to read it, it's something you can read in a few hours and it'll just…. certainly changed my view of how the world really works and how people really work.

The last book I read, you know, last night I read the "The Giant Jam Sandwich" to my seven-year old and four-year old, great little story from growing up so that's always important to me as well.

Todd: Do you have a favorite sport or sports teams that you root for?

Neal: Favorite sport is tennis, I'm not really a big sports guy other than that though so.

Todd: I've gotten some interesting answers on that question. One person said underwater hockey which I didn't even know that was a thing.

Neal: I didn't even know that was a thing, yeah.

Todd: I've got squash, tennis, very rarely do I talk to someone who watches like normal set of sports. (laughs) I guess you guys are all too busy building companies to really pay close attention.

And then, final question, biggest inspiration in life?

Neal: I think it changes over time. You know, in general, I tend to be inspired by people who are either devoting themselves to service or people who are really obsessed with the build. I don't think it will be fair to single out a specific person at this moment just because the more I get into this, the more I realize that it's a network like maybe you see a person, maybe you see a figurehead, you're like oh, that person did this, it rarely ever works out that way. It's almost certain it takes a team and takes an entire ecosystem of people to really move the needle.

Todd: Well, Neal, I greatly appreciate you coming on the show. Tell the audience how they can find Kafene.

Neal: You can go to www.kafene.com, it's got some pretty good content there related to our core business as well as just a bit of who we are and what we stand for. I look forward to hearing from any of your listeners that want to contact me directly, my information's on the site.

Todd: Alright, well thank you very much, I wish you and the team at Kafene continued success and hopefully, we can get you back sometime in the future.

Neal: I would love that, thank you very much.

Todd: Alright, thank you.

(music)

Thank you for listening to the latest episode of PitchIt, the fintech startups podcast. I encourage you to take a few minutes to write a review or rate the episode. Ratings and reviews both help us to improve the show for future episodes. If you’re interested in learning more or would like to be considered for a future episode, please reach out anytime to Todd, T O D D, at lendit.com and until next time.

(music)