

## **Fintechs and Banks: An Unequal “Partnership”- Part One**

by Charles Wendel

Years ago I consulted with the legacy Wachovia Bank, headquartered in Winston Salem. Back then the bank-teamed credit and line bankers on each commercial loan, terming their working relationship an “equal partnership.” In fact, when you spoke with management offline, many admitted that the credit people were a bit *more equal* than line personnel. That situation reminds me of what is developing between Fintechs and banks; the nature and extent of their “partnership” appears to be dictated by a bank’s limited requirements and demands, not the Fintech’s capabilities or desires. The Fintechs (whether primarily lenders or software companies) may not view themselves as vendors, but their bank clients do.

Banks are determining what they want from Fintechs and then asking them to deliver on specific requests rather than the broader “solutions” that many Fintechs would prefer to provide. Frankly, in doing so some banks may be losing a great opportunity to lever third-parties expertise. Nonetheless, banks appear to be increasingly set in what they want from Fintechs and how they will work with them.

The range of capabilities that a Fintech can provide includes origination software, marketing support, enhanced risk management and decision insights, and second-look lending for loan turn downs. Fintechs can transform a bank’s approach to small business lending and help to build its franchise with these customers. But, many banks are pursuing an incremental approach and are hesitant to move beyond fulfilling some basic, immediate needs. They are looking to solve a near-term problem, not develop a long-term third-party relationship...at least not initially. Banks with a limited focus may, for example, ask software-oriented Fintechs to provide a webform application versus the platform that they could provide and which could transform their business model.

At the same time, some of the same Fintech lenders that a few years ago said that they only would work with banks in a “deep” or “integrated” manner are now breaking up their offer into modules such as providing simply a digital origination capability or document capture. These Fintechs are willing to pivot from their initial strategy to get their foot in the door with a major bank with no guarantee of further business. Fintech lenders are now competing with the Fintech software companies that specialize in improving the origination process. At the same time more Fintech software companies are entering the fray.

In the last month I have spoken at or moderated panels at several conferences, including Lendit, CBA Live, and Source Media’s Retail Banking Conference. The focus has largely been on how to work with Fintechs, the current status of these efforts, and industry expectations. These meetings have provided the opportunity to speak with about 30 bankers, almost all of whom work for priority Fintech targets. Based upon those meetings and our client experience, we prepare this summary:

- Some speakers state that 2017 is the year of bank partnerships, suggesting that multiple significant deals will be announced. While there certainly may be some big transactions, we think 2017 is the year that many banks finally realize that Fintechs provide them with value and begin to figure out how best to work with them. There will be small steps forward, but no tsunamis; slow analysis and decision making.

- With little exception, banks see the need for a digital platform that will enhance the customer experience. Therefore, Step One for many banks focuses on providing customers with a digital experience and the cost reduction they can realize from a more streamlined and to the extent possible paperless process. Going beyond that first step, when Fintechs discuss referrals, lending algorithms and other innovations, some traditional bankers see risk and a methodology whose staying power has been untested by a downturn. Yellow warning lights start to flash.

- At least for the moment most banks do not want integrated partnerships with third parties. While some banks see the upside in that type of relationship (not just reduced costs but potentially greater revenues for current and new customers), others want to take a slower approach. They see more business and personal risk in jumping into a marriage with a vendor rather than pursuing long-term dating. They are also willing to work with multiple vendors with different vendors each focusing on their strongest area.

- Despite the issues that can exist with internal IT groups, some larger banks are considering building a digital solution internally. These banks are often part of a large international group that has accomplished similar initiatives elsewhere in its footprint. Still other banks comment that they may work with a Fintech as a stopgap for a period of time until their internal group can develop the necessary software. Some Fintechs are marketing to these banks hoping for a near-term transaction, while the banks may be willing to take the longer term internal path.

- Of course there are banks that see Fintechs as providing relationship value and are actively working with them to enhance their business model. These banks tend to be mature small business players and place strong internal emphasis on this segment, pursuing a growth strategy aimed both at serving current customers and extending their market penetration. While more banks should consider that level of commitment, in our view they will remain the exception with the majority of banks being highly selective in how they use vendors.

- Consolidation within Fintechs will occur as some fail to generate sufficient loan volumes (most tie their revenues to loan generation) and private equity investors grow impatient with the uncertain future. More on this topic next week.

These are still early days in the world of Fintechs working with banks. And, they can work together with great success for each party, but not without some substantial work on both sides. Next time we will write about the challenges banks are creating for Fintechs, how banks should evaluate their Fintech options, and the actions each should take to best work together. Fintechs may need to change their marketing and sales approach to work

with banks while banks need to excel at due diligence and implementation management in order to pick the optimal partner or partners.