Fintechs and Banks: An Unequal "Partnership"- Part Three
by Charles Wendel

Two weeks ago we provided a summary of the current state of Bank/Fintech partnerships, particularly related to small business lending.

Last week, we focused on the steps Fintechs must take to adapt to bank culture and priorities related to Fintech's offers. Fintechs need to operate with an approach that acknowledges most banks are focusing on addressing specific, targeted pain points versus the type of deep, integrated partnerships many Fintechs are pursuing.

This newsletter focuses on issues that banks need to consider in selecting a partner. A rigorous selection and due diligence process is more important than ever for the banks, particularly as the range of capabilities that Fintechs offer increases while their competitive environment becomes more volatile.

Bank Priorities. Step One begins with a bank deciding what it hopes to accomplish by working with a FinTech. That is often not as easy as it sounds, as different players within a bank may see the bank's needs and what a vendor has to offer differently.

Many banks will initially highlight the desire to "improve the customer experience" before getting down to specifics and the near-term problems they want to solve. Almost unanimously, we hear from banks that their initial focus is tied to simplifying and reducing the cost of the loan origination process by introducing or enhancing a digital offer. Depending upon the bank this might entail an entirely new digital origination platform or, at first, a more limited initiative. For example, one bank focused on digital document capture.

The bankers we know are very open to a third-party solution in the area of digitalization. While their IT groups could provide a solution, both cost and the time required to complete development point to the use of a specialized IT vendor for most banks. Many bankers recount projects delayed or abandoned due to internal IT constraints. (Conversely, many bankers are skeptical concerning the value of a vendor's enhanced risk management capabilities. This is due both to the bank's risk managers and their culture as well as a Fintech's lacking the years in business required to demonstrate that its portfolio can perform well during a downturn.)

But, just as banks want to develop long-term relationships with their customers, so too should they select a partner who can meet both immediate and other potential needs.

Fintechs can offer targeted data-based marketing to highlight priority customers and prospects, "enhanced" risk analytics, second look turn down lending, among other capabilities. Today, a bank many be interested in one or none of these offers. Nonetheless, it makes sense for a bank to enter a relationship with a vendor with whom they could ultimately partner up in these areas.

Banks need to spend more time on prioritizing why they are considering Fintech:

- While cost reduction may be an immediate need, is it an end goal of working with a third party or a first step? Alternatively is the answer "We don't know yet."
- For example, is it likely that the bank would want to take advantage of target marketing based upon data analytics or enhanced risk management based upon additional data sources?
- Might the bank eventually want to be able to refer internal turndowns to other lenders in order to meet customer and prospect needs while retaining non-loan business?

Management needs to reach some tentative consensus on these issues in order to select the right vendor for the bank. Bluntly, we see banks making decisions without agreeing on these and other basic issues. A mistake.

Due Diligent: More Critical and Rigorous than Ever. Banks evaluating a vendor need to address questions in multiple areas, some "soft" and cultural and others quantitative and requiring competitive insights. Too often, banks rely on their own limited knowledge base and, thereby, pick the wrong partner. Those banks wishing to integrate with a Fintech from day one and take advantage of its multiple strengths have even greater internal challenges related to IT, risk management procedures, reputation risk, and the sustainability of the partner, among other issues.

Of course banks already have long lists of areas for their due diligence focus, including the Fintech's technology and ease of adoption, ability to meet compliance and regulatory requirements, quality of credit and risk management (when appropriate), economic solvency, and management history. The list goes on. However, there are some other areas that might be missed in a traditional due diligence process that are also important.

Reality Check. Can the vendor do what he says he can do? Has he done something similar for others? What do current customers say? What do competitors say about the Fintech? We have seen instances in which vendors say they can do just about anything the banks wants; the reality is often different. Also, speaking with other Fintech competitors often reveals valuable background information.

Culture. *What is the core mission of your potential partner?* Software provider? Risk analyst? Lender? Does the core mission of the potential partner match with he bank's goals? Are the vendor's capabilities aligned with the bank's goals now and over the next two-three years?

Implementation. Providing a bank with a digital solution only begins a transformation process. Too often we see FIs failing to increase loan volumes after they spend dollars on improving the customer experience. Vendors need to play an ongoing role in helping the bank to lever its digital capabilities and should be making practical best practice-based recommendations related to marketing, compensation, and other areas. Few Fintechs seem to have the staff and expertise required to provide implementation help. Banks need to make sure they do not overlook this topic and that a day one plan is in place.

"Good bye" risk. It is not an exaggeration to suggest that any private equity owned Fintech will change hands over the next three-five years, as PEs strive to monetize their investment. But what does that mean for the bank and its customers, if the Fintech changes hands or is consolidated into another player? Banks should press Fintechs for an answer to this question. Expect the names of Fintech players to change as sales occur and some investors grow weary of lower than expected returns. At the same time new players will enter the Fintech area whether as independent startups or as add on service from core processors or other bank operating systems. These changes are not surprising, but banks want to minimize any potential disruption.

The Future. We are still in inning two or three of a much longer game. And while increasingly the banks are in the driver's seat versus Fintechs, to paraphrase Bette Davis in a classic B&W movie, *All About Eve*, "Hang on, it's going to be a bumpy ride."