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

Based on our experience with clients and recent discussions with many banks and Fintechs, last time we discussed our view of the current state of play of Bank/FinTech "partnerships."

In short, banks are more comfortable in working with vendors to solve their immediate pain points, particularly related to originating a small business loan digitally. In contrast, banks seem less interested in a deeper relationship with a Fintech that might include multiple facets such as a software platform, marketing support, risk analytics, and turn down loan referrals. Banks are "go slow" and targeted in their focus while many Fintechs market broader solutions. As we noted last time, banks pursuing an incremental approach may be losing out by failing to leverage what the Fintechs offer, but they perceive the risk of teaming as outweighing what is to them the still to be proven benefits of partnership.

This newsletter focuses on the need for Fintechs to understand how banks operate and, then, work within those parameters. Some will find that the challenges of doing so, as well as increased competition, fail to justify the effort and time necessary for success.

What steps should Fintechs take to succeed with banks and other FIs?

Consider a "wedge" strategy. Recently, one prominent Fintech developed digital documentation collection software for a major U.S. bank. Initially, the Fintech had proposed a much broader relationship. However, the bank wanted to address a specific, targeted pain point. The Fintech could have said they did not do that type of limited work and moved on. Instead, they met the bank's needs, avoided another competitor coming in, and gained a foothold with this major target. Obviously, they have no guarantee about future opportunity, but their approach showed a willingness to meet customer desires.

Modularize. Recent meetings with bankers indicate that the trend at most banks is away from integration and toward specific problem solving. As one reader commented in response to FIC's last newsletter, banks are more comfortable buying a "thing" than committing to a relationship. Building those relationships takes time and effort, and Fintechs may need to rethink their sales and organizational approaches to get there.

That said, even recently I have spoken with other Fintechs that take a different stance. One decided to walk away from a bank that was interested in only part of their fuller solution. Another said they would only pursue integrated partnerships with banks, ones that fully leverage the Fintech's capabilities. These companies may be remaining loyal to their stated focus, but this strategy eliminates the vast majority of bank buyers.

Increasingly, though, their approach is an exception. One bank looking for a digital origination capability mentioned a Fintech they were evaluating. While doing so ignored

their stated strategy the Fintech was now splitting its offer into modules, something it had not done previously. This player has decided to compete against companies that specialize in providing a digital origination platform, but they risk losing credibility if their offer falls short of these specialist providers. And, by the way, their economic model requires revenue from loans they fund, not part of the current opportunity.

Deemphasize enhanced risk analytics and black boxes. Some small business origination platforms offer proprietary risk management analytics based upon client experience and third-party sources. From what we hear most banks are wary of applying "enhanced" analytics and "automated" decisioning to their own portfolios. We have heard bankers say multiple times that Fintech decisioning models have yet to go through a downturn; many bank risk leaders are openly skeptical of their reliability as well as the credit experience of Fintech personnel.

Create a business case for the bankers. Two main factors driving a bank's working with a Fintech are an improved customer experience and reducing loan origination costs. One banker recounted that his bank had outsourced a consumer loan product. In his words while many activities were outsourced, "the expenses stayed." While cost cutting ultimately is up to each bank, the Fintech needs to quantify the economic benefits of any proposed solution.

Build a relationship management approach rather than a sales focus. One banker suggested his disappointment in those marketing Fintech solutions. To paraphrase, "The Fintechs used to come in and tell us what they did. Now they ask us what we want and say they can fulfill our needs. They don't push back enough to suggest alternatives to our approach."

He went on to suggest that the Fintechs were so anxious to make a short-term sale that they were failing to create a long-term relationship. I observe something similar, that is, sometimes-sloppy Fintech sales staff who do not build multi-month marketing plans and follow up rigorously.

Look outside the U.S. Some Fintech lenders have achieved much more substantial bank partnership success outside of the U.S. For example, Kabbage has a number of relationships with large international banks. Biz2Credit just announced a partnership with Oriental Bank in Puerto Rico. Fintech execs often comment that reaching agreement with banks is easier outside the U.S., likely due in part to the complexity of our regulatory structure.

Rethink banks as partners. One Fintech lender decided that, given the cost involved in capturing and integrating with a bank, they could obtain a better return elsewhere. Walking away from a losing situation will make sense for some Fintechs. Obviously, they need to find more attractive revenue sources beforehand. At a minimum Fintechs should balance out their business sources between banks and others.

Consolidate. There are too many Fintech companies operating in the small business and consumer spaces for the amount of opportunity that exists. Specifically related to Fintech platforms for small business, competitors include multiple single purpose companies, Fintech lenders disaggregating their offers, core systems providers, and others. More competitors, both domestic and foreign, seem to be entering this segment monthly.

The reality all competitors face with banks consists of: slow decision making, continued high concern over reputation risk, frequent personnel changes within small business groups and decision makers, unclear levels of commitment from top management, and dumb/desperate competitors operating without strong pricing discipline. For many of them, revenue growth and positive net income are more distant than they and their investors expected. Patience is not a virtue for private equity firms. Proactively exploring consolidation now (both within small business and across other loan product categories) rather than hoping to be approached may make sense.

But opportunity still exists. Despite the above comments, bank partnerships will remain attractive for many Fintechs. Fintech expectations need to be adjusted and, in many cases, time frames for strong returns extended, but banks will remain the key financial services provider for most consumers and businesses. Fintechs that are able to leverage the bank customer base can build a sustainable profit engine.

Recently, one Fintech leader bristled when I referred to his company as a vendor. He preferred a description like "integrated solutions provider." But, the fact is that banks view him and his peers as vendors and moving from vendor to relationship partner will take time and commitment.

Next week we will discuss how banks should manage their Fintech assessment and decision-making process.