Is 2018 the New 2017 for Fintech Partnerships?
by Charles Wendel

At the end of 2016 and in early 2017, I attended several conferences at which prominent experts stated that 2017 was going to be the year of Fintech partnerships, particularly in small business banking. As the year draws to a close, Fintech activity focused on improving mortgage lending and enhancing operating systems has been strong…in small business, not so much. But, 2018 may be different for the banks and the Fintechs increasingly anxious to work with them.

I should have known better, but much of the banking industry has taken longer than I expected to understand and appreciate the value that a Fintech relationship can bring to business banking. Why? Some of the reasons include:

Other business lines demand focus ASAP. Banks have limited bandwidth related to pursuing new ideas, particularly those involving IT, and banks address the biggest pain points first. Areas such as mortgage with its high volumes, regulatory issues, and increased competition have been given the priority at many banks versus small business and other consumer areas.

Internal career concern over working with a Fintech and the project failing slowed bank commitment. For some small business execs, the perceived downside of sponsoring a Fintech far exceeds any upside.

Lack of a digital strategy. Many banks say they want to "be digital" but have no idea what that means. Internal consensus has been hard to reach on basic issues related to a digital strategy, slowing action.

Startup versus bank culture. Banks and Fintechs need to adapt to each other's concerns and requirements. A bank cannot expect a quasi-startup Fintech to meet the same hurdles it puts up for an established vendor. I have heard more than one Fintech recount cases in which the cost of proposed insurance and other requirements would exceed the revenues they would earn from a bank contract. BTW, conversely, some Fintechs have been slow to invest in areas related compliance and customer privacy, areas critical to banks.

Reputation risk. While the PR image of Fintech lenders has improved, concern continues both about the interest rates they charge and their survivability.

Small business being an overall lower priority. Period. More than one banker has commented to me that little interest exists within his bank to invest time and dollars in a small business solution. These banks remain poor targets for Fintechs; however, we see some Fintechs continue to pursue them despite their low odds of success.

Why do we think banks may have reached a tipping point, whereby the cost of delaying action now overcomes a bank's traditional desultory pace and (for vendor contracts) an often torturously slow decision-making process?

The customer has awoken to what Fintechs offer. In many cases small businesses now actively consider a Fintech lender in evaluating their borrowing options. Transparency and speed are two of the watchwords of Fintech offers, and banks want to emulate the positive customer experience they provide.

To a great extent small business Fintechs are a proven commodity. More bankers believe Fintech are part of the long-term financial landscape. Many Fintechs now have a substantial number of clients and have demonstrated their value. Banks such as Chase, Regions, Citizens, Umpqua, Centier, and others all speak positively of their small business Fintech relationships. Further, Fintechs have succeeded in other areas.

Cost continues to be a major concern. More senior managers are looking at the cost structures. This is particularly true of the 30% of US banks with efficiency rations exceeding 70%. Every analysis FIC has completed or seen quantifies that small loans lose money (except for those made by the very biggest small business lenders).

More banks are refocusing on deposits. More banks want deposits and will value them more as rates rise. The average small business deposit account is 3-5X or more the average consumer account. Banks need a loan offer to attract small businesses. Fintechs allow banks to offer a loan and refer it to a third-part while keeping deposits and other ancillary business. In addition, some businesses that will never borrow want to believe their banks have the appetite to lend to them should the occasion arise.

Banks' understanding of what a Fintech is has changed as has much of the Fintechs' emphasis. Four or five years ago when I first became involved in the space, small business Fintech was all about lending. Fintechs wanted loan referrals and saw banks as a key origination source. Today, much of Fintech emphasis centers on their ability to help transform a bank's traditional paper-based origination, underwriting, monitoring activities from analog to digital, reducing processing costs and spurring productivity. Fintechs' flexibility in how they work with banks has increased just as banks have become more aware of the solutions Fintechs offer.

The "next generation" of bankers is having impact. Small business-oriented Fintechs have been knocking on banks' doors for four years or more. During that time, younger, more tech savvy bankers have continued to be hired and move up the ranks. No doubt, the final decisions are usually made by "old guys", but in several instances we see millennials pushing the way forward.

2018 may not see a tsunami of Fintech-related announcements, but expect two-three or more times what we saw in 2017 as banks and Fintech learn how to work with each other and appreciate the value each provides. Good news for Fintechs and banks!