**Note to Banks: You Won!**
**by Charles Wendel**

*Lending Times*, an online publication that specializes in writing about Fintech lenders, reported the following: "In a pessimistic new report, researchers from Morgan Stanley have concluded that while Fintech companies style themselves as disruptors they will do more to strengthen than undermine incumbents in the long term." The Morgan Stanley research stated, "As incumbents [e.g, financial institutions] pick up investment while VCs reduce investment, we tilt towards a world where incumbents are less susceptible to disintermediation and more likely to co-opt new technologies."

Although some do not seem to realize it, related to Fintechs banks are in the driver's seat. Why? Fintechs may need banks even more than banks need Fintechs.

- Banks continue to serve as the payments and lending hubs for most consumers and businesses
- While some leakage may be occurring with segments such as Millennials, customer loyalty and inertia as well as regulatory requirements may protect bank revenues for many years
- Fintechs trying to originate loans without banks suffer from high origination costs and/or the need to stretch traditional credit criteria. Many of the "high tech" alternative lenders rely on decidedly low-tech origination methods, including direct mail and loan brokers. *Lending Times* also noted fast growth in Elevate Credit's Elastic line of credit aimed at non-prime consumers. The article stated the company had doubled its lending in the last year. But, loss rates were not discussed.
- Many Fintechs are running out of time as VC investors becomes impatient in the face of continued losses, and new investment dollars become increasingly scarce for many companies.

Morgan Stanley looked back to the dotcom era as an indicator of what is to come for Fintechs: "Only five disruptors have survived as standalone entities out of over 450 Fintech firms launched during the dotcom era," the report said. Even in niche areas such as robo-advisor more FIs have been building their own capabilities or signing up partners: "Independent start-ups in the robo-advisor space will struggle to be profitable given the high cost of acquisition and intensifying competition."

By NO means can the banking industry declare victory and hope that Fintechs will disappear. Fintechs provide more traditional players with the opportunity to exploit third-party capabilities to lower costs, improve the customer experience, keep millennials in house, and build new revenue streams. Again to quote Morgan Stanley: "We think however that established financial advisors, banks, insurers, etc. will keep automating parts of their value chain…to improve the infrastructure for established incumbents."

- Fintechs can introduce technology much faster and cost effectively than many internal IT groups. Example: a bank wanting a digital origination platform for its consumer or business loans could take 12+ months to develop internally. Fintechs can provide those capabilities within months.
- Fintechs allow a bank greater planning flexibility. For better or worse, many banks want to pursue an incremental approach to technology decision making, one that first addresses internal pain points. Working with a third party allows a bank to try partnering with one vendor on a particular project and either expand or perhaps end that relationship as it adds more Fintech-based functionality.
- Fintechs want banks as their clients and, today, will demonstrate great flexibility in what they provide and charge.
- Fintechs will continue to improve their offer to banks as they learn from other clients and apply those learnings to enhanced capabilities.
- Changes to internally develop IT projects can be time consuming and painful.
- Sorry, but banks are not technology firms and may not be able to attract and retain the same level of talent as Fintechs. As the head of Orchard Platform wrote in a recent blog: "We seek out engineers with a demonstrated intellectual curiosity that are independently interested in mathematics and programming and who bring these interests and experiences wherever they go. People with the kind of passion for programming that doesn't clock out at the end of the day. We take our work to happy hour." That's not a typical bank approach.
- Time may be running out for banks to stake a claim with the best Fintechs, those that have a sustainable future.

Banks need to understand that Fintechs can help in many areas, including:

- Providing a digital platform
- Reducing loan costs
- Allowing the bank to focus on new segments such as students or SBA

lending

- Improving marketing effectiveness
- Enhancing credit decisions and risk analytics
- Improving the customer experience both through streamlined processes and facilitating a loan offer for a non-bankable customer

The list of ways in which to exploit Fintechs is long and growing. Despite the strong position of banks and their need to leverage Fintechs, many banks continue to seem clueless about how to work with them or how to establish priorities.

We'll focus on that topic next time.