The Revolution That Never Happened
by Charles Wendel

This month's *Inc.* magazine features a provocative and remarkably candid column by Thomas Goetz, an entrepreneur and founder of a Fintech startup. Financial Institutions (FIs) and Fintechs should consider and act on the implications of his message.

He begins his article: "When my company... launched in 2013, we were part of an epidemic of startups seeking to change [the industry]. There was great enthusiasm on the part of entrepreneurs and investors alike for bringing technology – particularly information technology to [the industry], to unleash a wave of transformation… it seemed that change required a revolution." He went on: "The return on that investment has been dismal at best. Disruption never happened, and I'm doubtful that it ever will. Unlike so many industries [this one] has proven allergic to updates that would emerge, uncork a radically new model, and push the incumbents aside."

Goetz is writing not about financial services but about his "digital health" company, Iodine and its experience in the health care industry. While financial services differ from health care, enough parallels exist to make his perspective highly relevant to Fintechs and traditional FIs.

Goetz asks why it has been so difficult for a radically new model to succeed. He answers:

"There are many reasons for this, but most boil down to 'healthcare is different.' It's highly regulated, which makes rapid transformation difficult." *Comment*: So too is banking, with regulators demanding more time and expense dollars than ever on compliance related issues. Regulators are also increasing their focus on Fintechs, potentially impeding their success.

"The incumbents are massive enterprises with multiple services, so challenging them is nearly impossible." *Comment*: Too big to fail banks have gotten even bigger and more powerful since the economic crisis. And, banks benefit from the power of inertia, at least with certain customer segments. However, smaller FIs may lack the internal IT capabilities and resources to compete by themselves.

"It isn't a market-driven industry that responds to better, cheaper, faster. You can't price shop." *Comment:* This is one area in which segment-targeted digitally enhanced competitors can outperform banks, although many customers seem to choose not to price shop. SoFi, for one, has positioned itself as a disruptor by focusing on certain products and customer types that seem to appreciate "faster, cheaper, better." One open question concerns the number and financial attractiveness of customers (whether consumer or business) seeking "better, cheaper, faster" and the extent to which these customers can sustain Fintechs. Note that currently SOFI is applying to become a bank, an implicit recognition of the power of the banking license.

For many FIs "better, faster, cheaper" is not enough for action. FIs themselves, in part due to regulators, take a belt and suspenders approach to proposed Fintech-related changes and want to be as sure as possible that any upside of working with a vendor significantly exceeds the downside and meets any regulator concerns. However, FIs will increasingly explore technology-fueled changes in areas such as trading, ALM, and fraud management to meet compliance requirements and reduce operating costs. "Fear" of offending regulators rather than "greed" or possible revenue growth from new or potential customers often results in faster bank decisions and actions.

"The government is the biggest customer." *Comment*: For Fintechs regulators may be one of the biggest hurdles, particularly related to consumer activities. And, at least currently, the CFPB seems to be able to roam into whatever area it desires. That is why many Fintechs are spending time and dollars to increase their transparency and form industry associations.

"All the incentives take a belt and suspenders approach to proposed changes and are misaligned." *Comment:* Oftentimes there are more reasons for a bank NOT to do something than to act. That includes working with third parties, again in part because of the restrictions regulators have established and the liability and reputation risk FIs are open to (in addition to personal risk) if problems occur.

What does all this mean for Fintechs and for FIs? Goetz says that what is happening in health care is that, rather than revolution, "Many successful businesses spotted some niche and made it incrementally better…There's tremendous opportunity−and honor−in that position, even if there's no jackpot." In financial services, while a SoFi might be a revolutionary company that can make a jackpot, few others are likely to do so. However, they can still generate non-unicorn like sustainable and healthy returns. As with banks, targeted segmentation strategies are critical to success.

FIs have an opportunity to sift through the many Fintechs offering their services and work with them to make their "traditional" offer better whether related to an improved customer experience, origination, marketing, risk, or other areas. Many banks need Fintechs more than they know; virtually 100% of banks can benefit from one or more capabilities that a Fintech provides.

A recent study by Tata sums up a likely scenario for FIs and Fintechs: "In each product category, new entrants pose a competitive threat to banks, but the conditions are not always ripe for disruption. Instead, many Fintech innovations are being launched to sustain or improve existing products, making them attractive for both new entrants and existing banks. Therefore, as long as incumbent banks are incentivized to adopt these solutions, rather than ignore them, disruption could be less of a factor." In many cases cooperation between the supposed disruptor and the FI will be the chosen oath to success for both.

As for those who remain revolutionaries and fail to adapt to market and financial services realities, Goetz's comments about health care may also apply: "The lesson I draw is pretty simple: It's all too easy to believe your company is part of something huge and inevitable, to believe that external forces will carry you to greatness. But it doesn't always happen that way…After all, in most revolutions, it's the revolutionaries who die first." A bit ominous for sure, but, more positively, it is also true that revolutionaries can forge a path that benefits others. In this case, the others include financial services companies and their customers as well as some Fintechs.