**Vendors To Banks: You're Fired!**
by Charles Wendel

Here is a somewhat surprising phenomenon. A small, but we think increasing number of vendors in the finance and payments spaces, are limiting their reliance on or even giving up on banks as partners, citing the expense and overall difficulty of working with them.

Why should banks care about this? Certainly, there remain many players that want to provide services to and with banks. But:

- Banks should want as much competition for their business as possible
- They should ensure that to the extent possible their internal processes encourage cooperation with vendors
- These same internal processes that make life miserable for some vendors may also be making life miserable for the banks themselves
- Some of the vendors that offer the most capabilities and leverage to banks are discovering that, despite their hopes and intentions, competing with banks may be a more likely route to success than cooperation.

Let me outline three examples of what we see in the alternative lending space and their view of bank partners:

1. **Industry regulations discourage entrants.** One well-regarded alt fin, in operation for several years, aimed to partner with banks. But recently, management said they had decided not to pursue that route. Basically, the time investment required, the infrastructure they would need to develop, and the personnel costs they would have to absorb all pointed them away from banks. Naively, I think, they were willing to make the necessary investments if they had a bank client that justified doing so. The fact is that unless they had most of the infrastructure already in place (including proactively addressing compliance and privacy hurdles, among others) no bank would likely sign with them. They made the right business decision and the current banking regulatory and compliance, rather than the specific actions of any bank, pushed them that way. The continued tangled web of bank regs and compliance requirements are driving away some providers from banks.

2. **Costs to vendors are more certain than revenues**. The company mentioned above never signed a partnership deal with a bank. However, the company in the second case example did and, then, pulled the reins on establishing more partnerships. Signing on their first and only bank was relatively easy, but they quickly found that getting the bank to execute well and building a bank franchise was a continual struggle with an uncertain payoff.

This alt fin vendor found that the bank client was asking for significant upgrades in several areas without a clear path for generating the volumes that justify doing so. The vendor is struggling to determine the cost involved versus the likely payoff from making the investments. My contact there said he was operating within a limited timeframe to make the relationship profitable or they would exit, a potential issue for the bank and the alt fin. Alt fins will and must respond to what their economic analysis reveals and, while they know they need to invest time and dollars to succeed with a bank, they have limited patience. A long investment cycle that offers an unclear payback is unacceptable.

3. **Bad execution by banks; bad implementation planning by banks and the alt fin.** Related to the above, case three is a composite example based upon the experience of a number of alternative finance players and banks. The alt fin creates the bank partnership, starts the technology, referral and/or market expansion-focused relationship, and then what? Usually, the alt fin's compensation rests mainly on the loan volume that a bank generates. But, some alt fins have found that even with a digital capability and the analytic insights they provide their banks, bank loan volume fails to show a significant increase. That should be no surprise as many banks may plug in the technology without changing their lending approach or its effectiveness.

   Recently, a senior banker I spoke with said his bank and its alt fin partner had more or less mutually agreed to abandon their partnership, since the volumes generated were so low. While the bank is interested in having a digital capability and working with an alt fin lender going forward, the bank exec said that it was not among his current top five priorities. Instead, and appropriately, they are focusing on issues such as process streamlining compensation, metrics, and other more foundational areas the bank felt they needed to get right before partnering. Without dealing with those issues first, a partnership, no matter the good intentions, is doomed. In addition this banker said that senior management's focus currently centered on wealth management and that the small business group did not have the internal emphasis required to make a partnership work.

What does this mean for banks considering an alt fin partnership or already in one?

- Nothing new here, but if senior management is not on board in understanding what is required to work successfully with alt fin providers, the initiative will fail, and banks deserve to be "fired".
- Two years ago, there were up to 200 small business platforms. Today, the number has declined, and a handful of players have established themselves as leaders in this space and operate with the capabilities and capital required to work with banks. A bank's due diligence process needs to evaluate these and other areas.

- The alt fin industry continues to segment its focus. Some companies are concentrating on working with the largest banks while others may have the streamlined infrastructure in place to work with mid-sized and smaller banks. In some cases over the past two-three years, alt fins, anxious to build volume and market presence, pursued the wrong targets. Similarly, some banks deceived themselves about the size of their opportunity and level of internal commitment. Banks need to make sure they are lining up with the right player.

Good news: alternative finance is still evolving. Many alt fins and related companies remain committed to working with banks and reaping the potential opportunity they offer. Increasingly, they realize that they need to address bank needs rather than hoping that banks adapt to them. More “alternative” ideas are being evaluated and developed for offer to the banks.

Rather than firing a bank, the best alternative finance companies will “pivot” and experiment until they find an offer that proactively meets a bank’s priorities and provides mutual benefit to vendors and banks. Stay tuned.