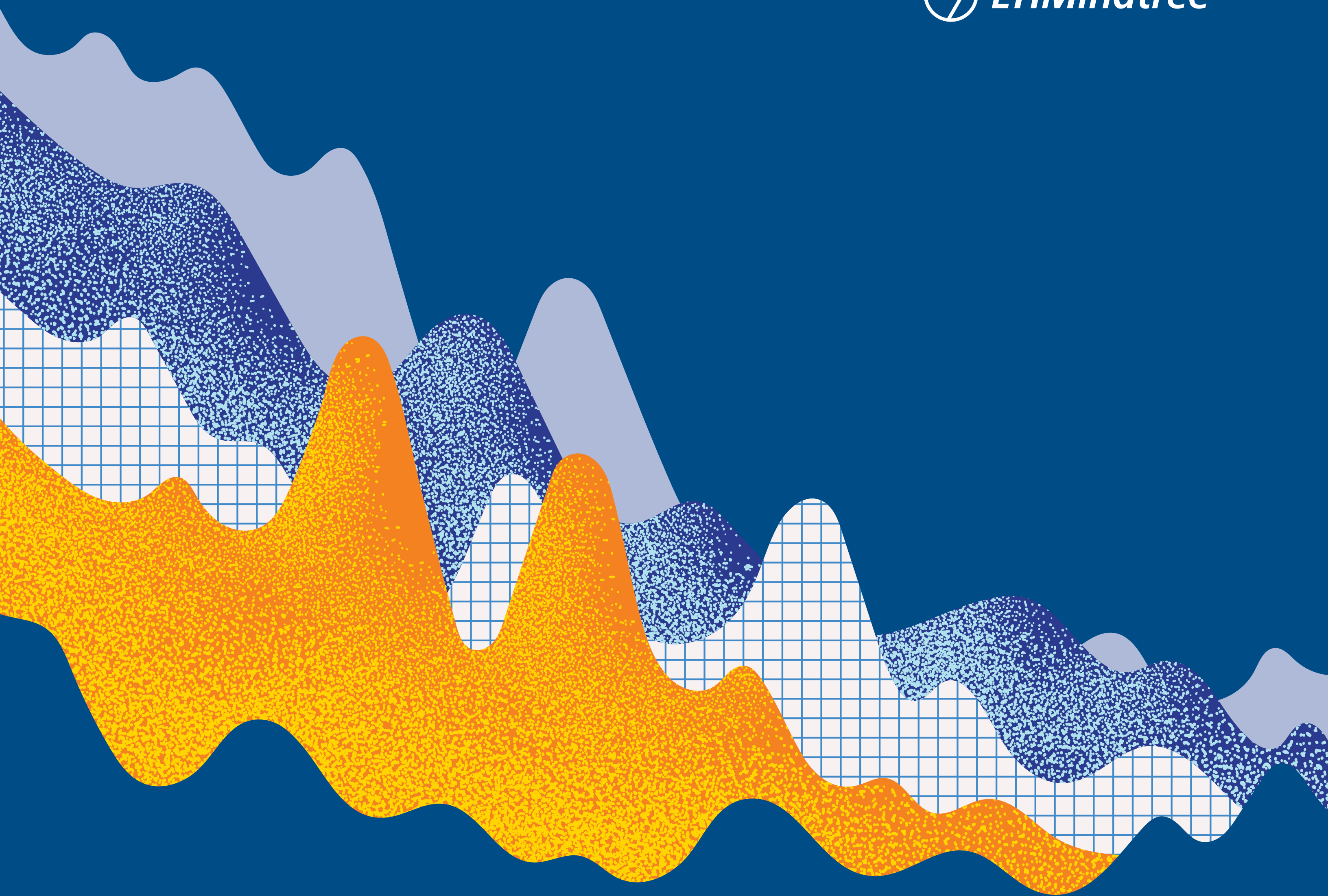

POV (Part 1)

To Compete or Co-operate?

How **Banks and Fintechs** Can Co-Exist in Today's Eco System.

The Emergence of Fintechs in New Digital Economy

The story of the birth of Oak North is revealing. After being denied a line of credit for their business expansion plan, the founders of Oak North found an alternate source of funding through the treasury department of one of their clients. This experience motivated them to find alternatives to unlocking liquidity for SMEs like them. Thus, was born Oak North—a credit scoring solution for SMEs that relied on the power of data and analytics to capture a segment that has been historically under-served by banks.

The Fintech revolution started in the wake of the 2008 GFC. Regulators around the world introduced regulations to de-risk the markets. However, they also de-regulated/dropped entry barriers into the high-stakes world of finance to foster competition. Since then, there has been an astronomical rise in the number of fintech operating around the world.

Number of Fintech Start-ups by Region

Source: Statistica

5,779

America's

3,583

Europe, Middle East, Africa

2,849

Asia-Pacific

Fintechs and Banks – Why Build A Symbiotic Relationship

The global Fintech market is expected to grow to $325 billion by 2030. At USD 98 billion, overall global fintech funding across M&A, PE, and VC deals have soared to a new high in H1'21.

Does this buzz signal the end of banking as we know it? Not quite, in our opinion. There has been a lot of interest in fintechs, but their ability to gain scale or turn a profit is still in the 'testing phase'. While business-facing fintechs like Oak North have had more success in becoming profitable, customer-facing fintechs like Revolut have struggled to turn a profit despite impressive growth in funding activity, revenue, customer base, etc. Moreover, **the regulatory scope is slowly extending into the space**—as evidenced by the DOJ's successful suit to block a deal between Visa and Plaid or by the Jan 2021 FCA announcement that BNPL firms would be given a set of rules to abide by after all—which can have a significant impact on fintechs like Klarna.

However, this does not mean that banks can afford to stay complacent - as Jamie Dimon, the CEO of JP Morgan Chase, argued in a rather sensational letter to shareholders. In his letter, Mr. Dimon states that '**banks are playing an increasingly smaller role in the financial system**'. He outlines that they face extensive competition from Silicon Valley, both in the form of fintechs and Big Tech companies. As the importance of cloud, AI, and digital platforms grow, this competition is likely to become even more formidable. Traditional banks are encumbered by challenges such as heavy regulation and legacy systems. This provides banks with a powerful motivator to collaborate with fintechs to access their specialized products, services, and/or specific innovative technology, thus enabling banks to meet the bar of heightened customer expectations and demands.

For their part, fintechs benefit by having access to a well-defined and stable client base. An alliance with a bank also serves as a stamp of trust for the fintech's services in the eyes of the customer. Furthermore, fintechs can benefit from a bank's tremendous internal knowledge stores in legal and regulatory areas. But perhaps most importantly, with bigger budgets, banks can provide a flow of capital to further develop fintech services. All these factors make a partnership with a bank particularly appealing to fintechs that are looking to scale.

Areas of Partnership

The success of aggregator platforms like Airbnb and Uber suggests that consumers are open to origination-focused relationships. Accordingly, **fintechs are capitalizing on this opportunity for customer intermediation with intuitive, seamless, personalised, and on-demand access to banking services on the back of regulations like PSD2.**

Drawing on McKinsey's estimates that banks earn a 22% ROE from origination and sales (as opposed to a 6% ROE on credit provisioning), areas like lending origination are a natural choice for collaboration between banks and fintechs. In recent years, interest in B2B fintechs has gained prominence. One big driver of B2B investment has been major bank venture arms like Citi and Santander, which have an incentive to support fintechs that they may themselves use one day. Another example is the strategic partnership UBS has forged with Broadridge, a global fintech leader. UBS Wealth Management USA is anchoring clients on Broadridge's new wealth management industry platform that leverages leading technology to optimize advisor productivity and client experience, while mutualizing investments in technology, innovation, and security.

Conclusion

While the debate surrounding the impact of fintechs on 'old world' bank-centric intermediation model is likely to continue for time to come, one thing is clear; the cost of inaction is too high. Fintechs may not result in wholesale disintermediation of banking into peer-to-peer systems or in full-blown tech intermediated banking. Nonetheless, this new wave of technology-led disruption in banking will lead to a reshuffling of cards. **In this coming Great Restructuring, the most digitally-able incumbents and the most financially-able challengers will become the new dominant forces.**

Author profiles

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Snigdha comes with over two decades of experience in designing and implementing technology led capital market solutions for US based hedge funds and investment management firms. She brings a blend of technology and business domain expertise, and currently helps LTIMindtree's banking and financial services clients in defining their IT transformation roadmaps.

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Amit has over two decades of experience of working with global banking and capital market firms. He brings in domain, pre-sales and solutioning expertise for implementing business centric technology solutions and works closely with several Fintech partners of LTIMindtree.

LTIMindtree

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