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POV (Part 2)

To Compete or Co-operate?

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

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Collaborating With Fintechs - Key Models of Engagement

McKinsey's Global Banking Annual Review suggests that if retail and corporate customers switch their banking to digital companies at the same rate that people have adopted new technologies in the past, **the industry's ROE, absent any mitigating actions, could fall to an unsustainable 5.2% by 2025.**

From FIs like JP Morgan to banks like HSBC and Santander across the lake, industry giants are taking note of and responding to this evolving market force. In fact, **in a world's first, the UK Government along with Tech Nation, have spearheaded an initiative to bring together banks and early-stage fintech companies.** The initiative, launched in Sep 2020, introduced a Fintech Pledge to **establish standards for 'efficient and transparent commercial partnerships' between traditional banks and fintech firms.** So far, 19 signatories have signed the pledge—ranging from banking giants like NatWest and Barclays to insurers like Swiss Re and asset managers like Fidelity and Investec.

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Engagement Models

In working with our clients across the globe, we notice that the actual partnership model established between a fintech and a financial institution is driven by following underlying considerations. These include:

1. Scope of Innovation/Joint Offerings

Fintech partnerships are often driven by a desire to boost non-traditional revenue streams. Accordingly, **the scope of partnership ties in with the bank's strategic vision and can range from building eco-systems to introducing new variations of existing bank services, to leasing the bank's infrastructure/core platform as a service to enable fintechs to deliver their products.**

Some Examples:

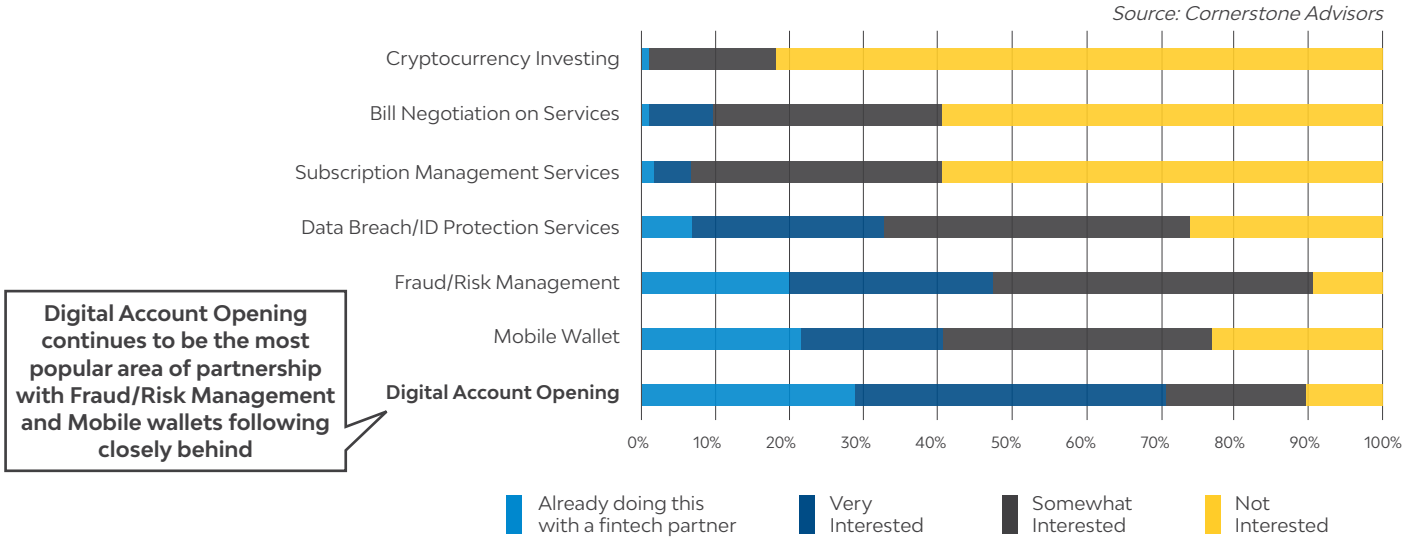
- Customers Bank tied up with Oak North to work around the challenge of extending PPP credit to small business owners in the face of invalid past correlations (due to the pandemic) by leveraging the ON Credit Intelligence Suite.

- Citi is building a fintech marketplace, signing data access agreements to customer-approved accounts with eight start-ups and data aggregators. The first companies covered by the data sharing agreement include BillGO, eMoney, Envestnet Yodlee, Expensify, Finicity, Intuit, MX, and Xero.

2. Appetite for Disruption

Supplementing the need for prioritizing innovation initiatives with strategic organizational objectives is the bank's appetite for disruption. As mentioned in our previous post, banks encounter challenges like heavier regulations, legacy systems, and disparate technology stacks. These challenges preclude banks from taking a wholesale approach to innovation. Instead, banks often focus on point solutions like Digital Account Opening, which can deliver material impact to the ease with which clients can access a bank's service, addressing a key customer expectation without significantly altering core processes.

[Aside] Most popular areas for partnership between Banks and Fintechs



3. Financial Commitment

An important aspect to consider while deciding its fintech partnership strategy is the financial commitment that a bank is willing to make. Successful collaboration models range from (a) arms-length, R&D, focused models tasked with running joint pilots and POCs to (b) non-equity partnerships with benefits like a higher-degree of flexibility with regards to exit options to (c) fully-embedded fintech subsidiaries.

As is the case for Visa, a firm need not have a one-size-fits-all strategy for all fintech collaboration initiatives. Visa's engagement spans from acquisitions like Tink to its Fintech Partner Connect program, which appears to be driven more by an 'investment bet' rather than from the perspective of operational integration with Visa's internal services.

4. Ability to Exert Influence

Closely related to the financial commitment a bank is willing to make is its desire to have conclusive influence in a fintech's decision-making process, especially during the commercialization phase. For financial institutions, especially larger banks, it is important to have the ability to exert such control. It is perhaps for this reason that several leading capital-rich clients we work with have opted to launch upshot fintech labs that, although seeded with capital from the parent, are separate from the main operation.

5. Brand Commitment

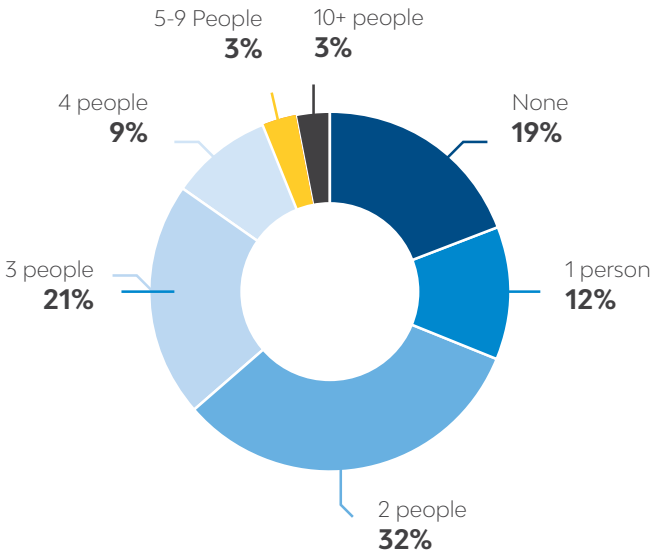
One of the key motivators for banks and fintechs to cooperate is the brand uplift that both parties can realize. A bank's backing is a vote-of-trust in the fintech's services and can go a long way in increasing access to funding and/or establishing trust among consumers (to use the services directly). In turn, access to the fintech's innovations allows the bank to meet surging customer expectations.

However, embedded in this promise of mutual benefit is the intractable implications to the bank's brand by its endorsement of the fintech's services and vice versa. As the controversy around Apple Card tagline 'Created by Apple, not a bank' suggests, it is important to consider where each brand in the partnership should be positioned. Equally important is to consider any potential societal/regulatory implications of the partnership. For instance, a 2019 working paper by the Federal Deposit Insurance Corporation shows that simple digital footprint variables like operating systems (Mac vs Windows vs Android), email hosts (Gmail vs Yahoo), check out time, etc. can outperform the traditional credit score model in predicting who would pay back a loan. Using **such variables can have a profound implication within the policy framework of 'disparate impact' that is used to govern discrimination. A bank needs to consider such factors before it decides to use a fintech's technology.**

6. Resource Availability

The Cornerstone Advisors 2020 survey of financial services executives in the US shows that **nearly two-thirds of the institutions have no more than two people working full-time on finding, vetting, negotiating, and deploying fintech partnerships.**

Fintech initiatives require resources to strategize, integrate, and deploy solutions within an organization. Any fintech initiative must therefore consider the availability of key resources to realize the benefits the organization is aiming for.



7. Cultural Alignment

Banks and fintechs are structured differently. The hierarchical, risk-averse, slow-moving processes of a bank can often be a source of frustration for flat, youthful fintechs. Establishing an alignment in priorities and culture is just as important as finding strategic alignment in business objectives.

LTIMindtree is a global technology consulting and digital solutions company that enables enterprises across industries to reimagine business models, accelerate innovation, and maximize growth by harnessing digital technologies. As a digital transformation partner to more than 700 clients, LTIMindtree brings extensive domain and technology expertise to help drive superior competitive differentiation, customer experiences, and business outcomes in a converging world. Powered by 84,000+ talented and entrepreneurial professionals across more than 30 countries, LTIMindtree — a Larsen & Toubro Group company — combines the industry-acclaimed strengths of erstwhile Larsen and Toubro Infotech and Mindtree in solving the most complex business challenges and delivering transformation at scale. For more information, please visit **https://www.ltimindtree.com/**

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