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Understanding Fintech Disruptors: Why Financial Institutions Have to Act not React

A WHITE PAPER PRESENTED
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Executive Summary

Financial institutions are being challenged by numerous big fintech disruptors. This is an undisputable fact. But these aren't the typical competitors financial institutions are used to dealing with, such as big banks. Rather, big fintech outliers like Amazon, PayPal, Facebook, Google and Walmart are slowly morphing into viable financial institutions.

In a recent Financial Brand article, "Amazon Forges Financial Alliances as Banks Execs Brace for Full Invasion," the writing was underscored on the proverbial wall.

"Banks and credit unions keep bracing for the Amazon doomsday. Meanwhile, the giant ecommerce platform has already outflanked traditional banking providers in payments, lending, credit cards, business lending, and more through a series of industry partnerships," the article noted. "The more you dig, the more you find. And this is just the beginning."

There isn't a unified approach to offset the big fintech threat.

While some financial institutions have been trying to combat this fintech trend, others are taking a wait-and-see approach. As a result, there isn't a unified effort to offset the big fintech threat. There is good news in that customers and members are loyal and trust their financial institutions for loans, credit cards, checking, direct deposit and other banking services. But in today's digital-first culture, financial institutions have to be careful. Why? Over time customers and members may grow fickle with antiquated banking services and opt for rapid, ease-of-use transaction platforms offered by fintech juggernauts that are looking to become top-of-wallet. The threat is real.

There simply isn't time to sit on the sidelines, especially in light of the COVID-19 pandemic that is changing the way consumers approach businesses and banking interactions. This troubling time period; however, presents a unique opportunity for the financial services industry to fully embrace its grassroots ethos of "people helping people" and connect with fintech operators that share a similar vision and approach.

The purpose of this white paper, "Understanding Fintech Disruptors: Why Financial Institutions Have to Act not React," is to provide financial institutions with actionable intelligence to differentiate "good" fintechs from "big" fintechs as well as providing guidance on how to be competitive in this new landscape without being left behind.

Big Fintechs are Making Noise

Financial institutions have long enjoyed a mutually beneficial relationship with many fintechs that provide add-on services designed to serve customer/member and employee needs. These proven fintechs that have been operating in the credit union space, for example, understand the industry ethos of "people helping people." These are the "good" fintechs that aren't looking to become financial institutions, but rather develop and offer technologies that compliment a financial institution's existing suite of banking services.

Big fintechs are different in that they look to absorb financial institutions and banking member/customer market share. The first step in this process is usually offering branded credit cards. For example, Amazon has more than 21 million credit card users. This is the consumer acquisition entry point. Their next step may well be to provide banking services, but for the time being these services are being pieced together by big fintechs partnering with other third party technology providers, such as direct deposit, loans, checking accounts and advanced digital channels.

It is only a matter of time before big fintechs aggregate critical banking services, such as checking accounts, loans, digital channels, under one banner and begin to operate like a traditional financial institution. In October of 2019, for instance, Walmart and Green Dot entered into a seven year agreement with Green Dot serving as the issuing bank and program manager for the Walmart MoneyCard program, Daniel Eckert, senior vice president, Walmart Services and Digital Acceleration, said in a released statement.

"Over the years, Walmart has brought to market many innovative industry-defining financial services offerings to serve our customers, including several introduced through the

Walmart MoneyCard program managed by Green Dot," said Eckert. "With this expanded relationship, and by leveraging Walmart's footprint and existing offerings with Green Dot's cutting-edge capabilities, we'll be uniquely positioned to offer an unmatched set of customer experiences that sit at the nexus of omni-channel retail and tech-enabled financial services."

Amazon Lending lent an estimated $1.5 billion to sellers in 2017 and $1 billion in 2018. PayPal makes more than $1 billion in working capital loans every quarter (70 percent of them in neighborhoods where banks have shut down branches)."

- American Banker

Eckert also announced that Walmart and Green Dot established a new fintech accelerator, TailFin Labs, LLC. The mission is to develop "innovative products, services and technologies that sit at the intersection of retail shopping and consumer financial services."

In early 2020, American Banker reported that big fintechs are aiming to change the banking model by 2030 with a focus on checking and lending services. The publication's article, "The Banking Tech that will Dominate 2020," noted that in 2019 Facebook launched its Libra digital currency project and Google partnered with Citigroup on checking accounts. Additionally, Apple launched Apple Card with Goldman Sachs and Facebook announced Facebook Pay, a payment mechanism that works with Messenger, Instagram, WhatsApp and Facebook.

"Big tech companies, meanwhile, expanded their small-business lending efforts. Amazon Lending lent an estimated $1.5 billion to sellers in 2017 and $1 billion in 2018. PayPal makes more than $1 billion in working capital loans every quarter (70 percent of them in neighborhoods where banks have shut down branches, according to the company) and Square Capital has made $5.5 billion worth of loans to 275,000 sellers over the past five years," the article noted. "Stripe launched its own working capital arm, Stripe Capital, in September (2019)."

Accepting Reality and Moving Forward

Financial institutions have to accept that big fintechs are looking to steal market share—their customers and members. In the banking industry, this phenome of disruption has been experienced. It started with checking accounts, then check cards, and then online banking, and, of course mobile banking, followed by a 360-degree view of customers and membership. It was at this juncture that executives learned the difference between an account and customer/member centricity. These are the critical reinventions of the banking model.

Today's market demands faster and easier services from financial institutions, a conditioning model based off transactions with big fintechs. Consumers, for example, enjoy Amazon's ease-of-use, one-click shopping methodology. Members/customers, in turn, are increasingly expecting this type of streamlined retail approach for banking services. Therefore, financial institutions must focus attention on protecting customer/member relationships by offering enhanced technologies that allow for faster and easier transactions across all channels. The ability to empower management and employees is also becoming a factor.

More than a 25 percent of consumers polled said they would be willing to open a savings account with Amazon. The same survey found that between 15 to 25 percent would be willing to open accounts with Google and Apple.

— McKinsey & Company

Big fintechs are continually evaluating shortfalls in traditional financial service institutions in hopes of building a better mouse trap. To this end, financial institutions must develop a new approach to account opening, product offering, transactions, messaging and customer/member support. There no longer can be a lag time between these critical touch points.

While big fintechs are beginning to offer banking services other than credit cards, these entities do not yet have a proven, trustworthy banking model. But "yet" is the key word. According to a recent McKinsey & Company report, more than a 25 percent of consumers polled said they would be willing to open a savings account with Amazon. The same survey found that between 15 to 25 percent would be willing to open accounts with Google and Apple.

In order to compete against big banks and big fintechs, financial institutions must partner with "good" fintechs. This relationship will result in a full automated, forward-leaning fintech platform that offers a proven suite of banking services—the best of both worlds. This partnership would allow a financial institution to create enhanced touchpoints—from mobility to online to call/video center to messaging to email to the proper use of bots. An example would be a car loan or mortgage loan program. The process must be seamless, fast and easy. Fintechs are all automated. As such, financial institutions have to abandon delays related to paperwork or fax transmissions and also become fully streamlined.

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For many small-to-mid-sized financial institutions, budgeting is an understandable concern. Partnering with a proven and successful consulting firm ensures that this investment of time and resources is fully maximized.

A partnership with a seasoned consulting firm includes developing a strategized and unique request for proposal (RFP) document, complete with hundreds of specific questions. Once the RFP is diligently completed, the consultant sends the document to vetted tech prospects—good fintechs. During this three to six month discovery process, onsite demonstrations, continued vetting practices and fierce negotiations are undertaken by the consultant on behalf of the financial institutions. After a deal is reached with a vendor, the consultant's role ensures the successful implementation of technologies with existing operating systems.

Conclusion

It's not "if" big fintechs will steal away market share, but "when." In some cases the latter has already occurred or is occurring. The COVID-19 pandemic has changed how people bank, shop and interact. The far-reaching societal behavioral repercussions of this pandemic will be significant and long-lasting.

Financial institutions must continue to seek partnerships with good fintechs that provide technologies that will thrive in a post-COVID-19 society. These include wearables, contactless cards, enhanced digital wallets and other methods of touchless or cash-free payment methods.

Financial institutions are now battling three competing fronts: big fintechs, big banks and the fallout from COVID-19.

In so many ways the year 2020 is a call to action because even before the pandemic analysts were forecasting that the traditional banking model may go the way of the dinosaur sooner rather than later. And despite having various degrees of loyalty from respective customers and members, financial institutions should have a sense of urgency over this fintech disruptor movement and what respective business models look like during and after the pandemic.

Financial institutions, now perhaps more than ever, should look how to combat this big fintech threat because it can't be neutralized by one financial institution, or a handful of financial institutions. Rather, a consortium approach is required because many financial institutions are now battling three competing fronts: big fintechs, big banks and the fallout from COVID-19.

While understanding how COVID-19 will impact the industry is difficult, the answer to the fintech disruptor dilemma is actually simple: Financial institutions have to focus efforts solely on making banking transactions safe, fast, easy and secure. This has to be the priority, and it is a goal that can be achieved by partnering with industry experts, such as consulting firms with a proven track record.

What side of the field is your financial institution on?

In this new normal, financial institutions must take steps now to ensure they remain the primary financial institution (PFI) for respective customers and members. And analysts are beginning to see a distinct movement within the industry placing these customers and members in play. On one side of the field is technology and on the opposing side are financial services. The trend is for the latter moving closer to the former. So the question is: What side of the field is your financial institution on?

About the Author

Sabeh F. Samaha is president and CEO of Samaha & Associates Inc., a Miami, Fla. – based consulting group that works collaboratively with financial institutions to help improve business processes by optimizing efficiency and increasing revenue opportunities. Whether it is vendor contract negotiations, system conversions or mergers, Samaha Associates, understands what