Partnership Principles

Reshaping the Industry in Partnership with Fintech Startups

Financial Services Perspective

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EFFECTIVE BANK-STARTUP PARTNERSHIPS OFFER BOTH ENTITIES THE SUREST CHANCE TO PLAY A ROLE IN REBUILDING THE FINANCIAL SYSTEM.

Several years ago, the consensus was that banking as we knew it was over. Buoyed by exponential growth in smartphone use, big data, and a power shift to the consumer, a surge of financial technology (fintech) startups entered the scene and vowed to disrupt banking as usual. A *Wall Street Journal* headline from June 2015 captured the mood: "Bold Bet That Banking Industry Is Poised for Serious Disruption."

> **"IN FIVE YEARS, THE BIGGEST BANKS IN THE WORLD WON'T BE BANKS; THEY'LL BE TECH COMPANIES."**
> **— Brett King, CEO of Moven, an app-based banking service, as quoted in *The Wall Street Journal* article "Bold bets that banking industry is poised for serious disruption"**

While startups have provided technology to banks for decades, this ominous warning that startups were now working to displace – not enable – financial institutions was seemingly reinforced by an influx of capital. In 2015 alone, an estimated $47 billion was invested in fintech startups globally.[1]

While two-thirds of Americans prefer to handle their financial dealings online, 76% of those consumers don't trust the security of new online banking and payment services. This increased from 72% the year before.[2]

It became increasingly apparent that traditional banking institutions not only still had a pulse, but that startups might not be able to survive without them.

Moreover, the tangible benefits of a fintech partnership became increasingly clear to traditional financial institutions. Eighty-seven percent of banks that have partnered with fintech startups report that the arrangement enabled them to cut costs; 54 percent claimed those partnerships increased revenue.[3]

> **"A LOT OF PEOPLE SET OUT SAYING, 'WE ARE GOING TO DISPLACE THE BANKS.' WE REALIZED ALONG THE WAY THAT YOU REALLY HAVE NO CHOICE BUT TO WORK WITH THE BANKS."**
> **– Sheel Mohnot, Venture Capitalist at 500 startups, which focuses on Financial Technology, as quoted in *The New York Times*, Feb. 22, 2017**

Driving those cost reductions and revenue gains are technologies that enable innovative customer experiences. Those innovative experiences – everything from robo-advising to automated underwriting processes – have kick-started innovation for traditional institutions, and allowed them to beat competitors to market without massive resource drain.

Today, with advantageous benefits of a fintech partnership readily proven, financial institutions are in a race against their traditional counterparts to partner with or acquire the right startups first, reaping the benefits of agile, innovative, lower-cost solutions to evolving customer expectations – before their competitors do.

The question for banking institutions now isn't so much if they should partner with startups but *how* to partner with them. Within this piece, we will explore the most prevalent challenges to a bank-startup partnership and provide a framework for addressing these challenges head-on to ensure greater success and more valuable outcomes in a collaborative pursuit of the future of banking.

KEY INSIGHTS:

- Financial institutions are in a race to partner with or acquire the right fintech startups first, in pursuit of innovative, low-cost solutions to evolving customer expectations.
- Risk, culture, and management are among the key obstacles to successful fintech startup partnerships.
- North Highland's working framework for higher-value fintech startup partnerships covers three critical elements: partnering, planning, and people.

THE CHALLENGES OF PARTNERSHIP

Startups offer banks a lower-risk, lower-cost opportunity to jump the learning curve on bleeding-edge technologies – most of which are increasingly mandatory to meet the evolving demands of consumers – and take advantage of world-class tech talent.

Conversely, banks offer startups a proving ground with valuable name recognition, regulatory infrastructure and controls, opportunities for scale and, perhaps most importantly, data – rich, deep customer data, the very type needed to fuel emerging artificial intelligence and cognitive technologies.

However, the industry's rigid regulatory environment and tight information security practices pose a major barrier to entry for startups.

In order to overcome those barriers and optimize the value of a startup partnership, banks must acknowledge and address three of the greatest stumbling blocks to a bank-startup partnership: risk, culture, and management.

Risk: 71 percent of financial institutions claim that the biggest barrier to successful startup partnership is cyber security.[4]

Startups are inherently risky. And particularly in the post-financial crisis regulatory environment, large banks go to great lengths to avoid risk as much as possible. Increasing risk associated with data breaches has traditional institutions applying strict safeguards to protect customer information – safeguards they expect their startup partners to match or adhere to.

Satisfying regulatory vendor risk management requirements will be onerous and slow for startups. Traditional banks will also be challenged to provide startups with both the data to inform and the autonomy to try new, sometimes risky things. These challenges require new processes and safeguards to ensure that data is secure and that innovation is fostered.

Culture: 41 percent of financial institutions that don't plan to make a startup acquisition cite "culture clash" as a deterrent.[5]

Startups work in ways that are fast, decentralized, autonomous, and driven by the voice of the end user. In the face of changing customer demands, startups are applying these agile ways of working to constantly reprioritize their backlog and to quickly shift funding and resources to respond to the customer.

In contrast, traditional financial institutions are typically functionally siloed and methodical in their decision-making. Within a traditional financial operating structure, a sudden change to customer demand would trigger an elaborate process, including the building of a new business case, approvals, and resource alignment – all of which is likely to be slowed by internal struggles across lines of business.

Couple these cultural clashes with competition and you've got a recipe for disaster. Most financial institutions have their own technology groups made up of people who deeply understand the enterprise and the regulatory environment. But stubborn self-reliance can result in missed opportunities to run ahead of competitors, especially in more cutting edge (e.g. cognitive) technologies where talent is rare and the learning curve is steep.

Similarly, loyalty to existing technology partners offering competing solutions may taint the new startup partnership before it even begins.

Management: Only 19 percent of financial institutions said that their procurement processes were "highly effective."[6]

A startup partnership should focus on creating a capability that can't readily be built through a transactional relationship with a vendor. A successful approach to partnership goes beyond vendor management to embed a sustainable, partnership-enabled competency. This includes enhanced processes, governance, oversight, and policies around due-diligence, data sharing, gain-sharing, and risk scoring/risk management. Banks will also require a policy for managing new liabilities and potential brand conflicts.

For example, data-sharing alone raises several new considerations. What happens if there is a massive data breach? How do we ensure that all relevant data from across business units is shared to avoid a siloed customer experience? And how do we best capitalize on risk vs. reward?

Given these myriad considerations, onboarding and ongoing management can be exasperating for banks and painfully cumbersome for startups. Banks should identify ways to streamline and templatize the process to ensure consistency and compliance.

THE FRAMEWORK

While these partnership challenges are significant, they're addressable and well worth the effort to overcome. A working framework that incorporates three critical elements of a bank-startup partnership – partner, plan, and people – can improve the odds of success for banks and significantly boost cost savings and revenue gains.

1. Partner

When considering a partner, ask yourself two questions: First, what are the greatest challenges or largest blind spots the financial services industry faces? Next, what trends and emerging technologies offer the greatest potential to differentiate and grow your business within the space?

The answer to those questions – and the identification of the startup companies most likely to bring these differentiating technologies to life – will help banks narrow in on the top targets for partnership or acquisition. Initially, it's less important to find a partner you'll work well with and more critical to find the one that provides the greatest potential to transform your business.

Banks can also zero in on startup opportunities by identifying what's missing from their current operations. In other words, focus on finding partners that will make you faster and more efficient at what you already do best.

> **"STARTUPS SHOULD CREATE SERVICES AROUND THAT [CORE BANKING SYSTEM] THAT REMOVE THE FRICTION, WHERE PEOPLE DON'T LIKE DEALING WITH BANKS."**
> **– Chris Skinner,** *The Finanser*

From the opportunity gap, banks can narrow potential partners based on an assessment of how well they would support current strategic priorities, and align with gain-sharing models, risk tolerance, and brand standards.

When a prospective partner is identified, an understanding of this organization's business model, goals, and objectives are key to forming a mutually-beneficial relationship. Use this understanding to co-create a vision for the partnership, stemming from a strategy that reflects the interests of both parties. Partner companies should then identify measurable sources of value that align with this vision, supported by clear timing milestones and objective metrics that measure value creation and define success.

2. Plan

The plan streamlines ways of working within a banking enterprise and acclimates startups to a more regulated environment. It also defines the resources – including time, money, and technology—that both partners must contribute in order to maximize the value of the partnership. However, the intention is not to dictate what is produced, and the plan should be designed to support agile ways of working.

While owned and managed by an enterprise-wide function such as compliance or legal, the plan should be informed by all groups to include the technical specifics required to create the most efficient ways of working possible.

The critical path forward will be unique for each institution, however at minimum the plan should clearly establish the requirements – regulatory, functional, and cultural – of both parties, including:

- **Process:** Develop a living guide to enable startup partners to navigate your procurement and governance requirements. Define the processes and then establish the compliance and governance requirements at each phase.

  Establish startup onboarding playbooks to quickly and easily prepare your teams for startup interaction. Every firm will have different requirements, contact lists, and communications best practices which will need to be mapped and documented to guide both internal and startup teams through the process. Consider integrating vendor risk management processes and controls documentation to the extent possible.

  While organizations should keep an ongoing eye on mitigating risk, successful processes are also designed to foster and reward innovation. Day-to-day partnership interaction should enable ideation and iteration through continual building, testing, learning, evolving, and repetition. Throughout the partnership, organizations should provide frequent and consistent communication to startup partners, embedding periodic self-evaluations of progress with key partnership stakeholders.

- **Change Management:** Take a holistic approach to ensure both directly and indirectly impacted groups are prepared for change. Those team members who will be working directly with the startup will need to be thoughtfully trained and empowered. Likewise, carefully designed change management strategies will boost success rates enterprise-wide in advance of a new technology rollout. This extends from vendor risk management to product and development teams to the actual teams that will be using the new technologies.

- **Employee Engagement:** Include as much detail as possible around the cultural norms of the bank and create opportunities for startup teams to engage authentically with their banking counterparts. Train and empower change champions from the bank and the startups who can walk-the-walk to show others how a successful partnership can work. When it comes to guiding employee interactions, several structural considerations enable successful interaction:

- Dedicate people to the startup partnership, and ensure that this team has sufficient time and resources to make the partnership a priority.
- When possible, give the combined team physical space that is protected from the distractions of the existing working environment.
- Appoint a leader to the partnership. This leader should be a strong networker who is comfortable challenging the status quo, and has the trust of decision-makers.

• **Product Portfolio Management:** Incorporate a program management function to bring together the relevant parties on both sides and help the startup navigate the plan. Develop and manage an enterprise-wide view of all technology development and releases to ensure transparency of how time, money, and resources are dedicated to not only the startup, but to all of the firm's initiatives.

3. People

In managing a startup partnership, your smartest and most technically proficient employees won't necessarily be your go-to people. Instead, banks should identify people who are flexible enough to match a startup's working style and who are solution-focused, rather than barrier-focused; people who have demonstrated a bias for action and accountability, even in autonomous scenarios.

Often these types of resources have a history of working in an agile culture, and ideally the team is cross-functional and includes marketing, compliance, and IT to represent the most critical elements of the product at hand. North Highland recommends that banks adopt a change management strategy wherein multiple pools of willing and ready resources are identified and trained to rapidly deploy with a startup.

YOUR NEXT MOVE

Partnering with startups offers banks lower risk and typically the lowest cost path to beating competitors to market with differentiating innovations. To make that process more effective and valuable, banks need a strategic approach to partnering, onboarding, managing, and staffing those exploratory opportunities.

Now more than ever, Marc Andreessen's famous quote rings true: "We have a chance to rebuild the system . . . You shouldn't need 100,000 people and prime Manhattan real estate and giant data centers full of mainframe computers from the 1970s to give you the ability to do an online payment," Andreessen told *Bloomberg* in 2014.

Effective bank-startup partnerships offer both entities the surest chance to play a role in rebuilding the financial system. While the complete transformation of a traditional financial institution into an agile, customer-centric one would take copious amounts of time and resources, all banks can partner with startups to benefit from their best practices and respond to evolving customer expectations and emerging technology now.

ABOUT OUR FINANCIAL SERVICES PRACTICE

North Highland partners with financial services and management organizations, including 20 of the top 25 global financial institutions, to help them convert disruption and regulation into growth opportunities. Through proactive risk management, innovative process improvement, and customer and employee experiences that differentiate, North Highland helps financial services organizations of all sizes grow and innovate in an uncertain market.

ABOUT NORTH HIGHLAND

North Highland is a global management consulting firm known for helping clients solve their most complex challenges related to customer experience, performance improvement, technology and digital, and transformation. We add value and support our clients across the full spectrum of consulting, from strategy through delivery. We bring the big ideas, then we make them real. North Highland is an employee-owned firm, headquartered in Atlanta, Georgia, with more than 3,000 consultants worldwide and 60+ offices around the globe. The firm is a member of Cordence Worldwide (www.cordenceworldwide.com), a global management consulting alliance. For more information, visit northhighland.com and connect with us on LinkedIn, Twitter and Facebook.

1 "Digital Bank of the Future," Livemint, Sept. 28, 2017.

2 "2017 FinTech Survey," Blumberg Capital, Oct. 11, 2017.

3 Survey conducted in Q2 2016 by Mayer Brown of 70 financial services respondents from 30 banks with global revenues greater than US$10 billion; 20 insurers with gross written premiums greater than US$5 billion; and 20 asset managers with assets under management greater than US$50 billion

4 "Hyperfinance," Simmons & Simmons, April 6, 2017.

5 "Hyperfinance," Simmons & Simmons, April 6, 2017.

6 "Hyperfinance," Simmons & Simmons, April 6, 2017.

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