

FinTech 2.0:

Creating new opportunities through strategic alliance

How financial technology firms and digital ecosystems can leverage banks' core competencies through equal partnerships, to innovate and grow in the B2B space

Passion to Perform



Executive Summary

The degree to which the payments industry has changed in just a decade is off the scale. We've witnessed the arrival of new currencies, technologies, business models and forms of transactions; all within an environment of global economic upheavals and increasingly comprehensive regulation.

The most significant change has been the arrival of new players; non-bank financial institutions (NBFIs) that bring a groundswell of innovation and are turning market models on their head.

Digitalisation has come in overwhelming waves, driven by the growth of e-commerce – first in the B2C, and now the B2B space – and the proliferation of smart devices. With it has come continuous innovation to meet the demand for technologies that drive efficiency, lower transaction costs and boost convenience.

Innovative and nimble new players – fintechs and digital ecosystems – have entered the payments game, creating increased competition for already-pressured banks. But without access to a client base, the expertise to navigate the regulations and licensing of the finance industry, client confidence, and robust global infrastructure, these new entrants can only go so far on their own.

Collaboration between incumbents and new players will be essential to fully comprehend the effects (both positive and negative) of technological developments on the industry's risk profile.

Disruption in payments will continue, with ongoing innovation shaping customer behaviours, business models and the structure of the industry.

The time has come for one further change; a shift in mindset from one of competition to collaboration. By exploring strategic partnerships, traditional banking providers and new innovators can together create long-term success and revolutionise the payments market and wider financial sector for the benefit of all.

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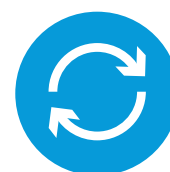
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The digital age

The ongoing process of financial innovation

The turn of the millennium saw the advent of a host of new players that would go on to change the financial sector forever. The trend towards digitalisation and technological innovation has been transforming many areas of financial services, from market provisioning to deposits and lending. Across different corners of the industry, these developments all share common characteristics of improved interoperability, simplicity and added value.



One of these areas that has seen radical change has been payments, with innovators such as Paypal, M-Pesa, Alipay, Stripe, Payoneer and Samsung Pay revolutionising the way we expect to make and receive (instant) payments for products and services. In recent years, the payments arena has been characterised by the rapid ascension and widespread adoption of novel concepts. These fall into a few different avenues of change – from streamlining payments or integrating billing, to mobile payments, security developments, or cryptocurrencies and peer-to-peer transfers. Such innovations continue to make payments increasingly cashless and invisible, while enabling data-driven engagement platforms for customers.

As you will have noticed from everyday life, many new consumer functionalities are being built on existing payment systems and are significantly changing customer behaviour. ApplePay is a recent example. The solution enables increased consumer access by using an existing payment network ecosystem to connect parties already on the platform. It makes payments more convenient for customers by combining a range of existing payment technologies within one customer experience, including NFC (near-field or 'contactless' communication), tokenisation (a security measure), and existing POS (Point of Sale) hardware. Even more successful is the Starbucks App, which now has 13 million users in the US and is used for 16% of its total payments.¹

In addition, recent years have seen the emergence of new payment rails, such as digital currencies and blockchain technology, as well as movement from central banks to update legacy payment systems to real-time ones. Both approaches will be needed to extend beyond simple money transfers to modernise the entire financial system infrastructure.

Payments innovators

- + Paypal
- + M-Pesa
- + Alipay
- + Stripe
- + Payoneer
- + Samsung Pay
- + ApplePay
- + Bitcoin
- + Square
- + Google Wallet

New market players

So, who are these new players and what do they do? Two groups in particular have had a radical effect on payments, altering mindsets and expectations around the speed, method and convenience of transactions: the first group comprises financial technology firms, or 'fintechs', and the second digital ecosystems.



Fintechs approach financial services from a technology background. Although they have permeated the landscape in several different areas, the majority have focused on payments; identifying, improving upon and competing with existing products within banks' value chains. Fintechs often begin as small start-ups that select a niche element of the transaction process (usually from the 'last-mile' of bank-client interaction). They then create an alternative that is more efficient, better rooted within the context of client usage, or automated to a higher degree than traditional bank products – offering superior convenience and eliminating the remaining frictions in payment processes, as well as potentially lower costs.



In contrast, digital ecosystems or marketplaces operate in non-payment spaces, providing services such as entertainment, advertising and retail platforms for merchants and consumers². For these firms, the focus is on financial transactions occurring within their own marketplace. In particular, they look to improve end-customer satisfaction by enhancing clients' transaction experiences via safer, easier and more transparent methods. In contrast to fintechs and smaller start-ups, these digital ecosystems start with an existing client base and a known brand – both critical for success. While both fintechs and large ecosystems (such as Amazon) largely began by focusing on consumer improvements, business-to-business solutions are equally relevant and viable.



The next stages

Does this make fintechs and digital ecosystems the enemy? In revolutionising and fragmenting the payments space, these two sets of newcomers are market disruptors and competitors to traditional banking models. The changes they have wrought are just the beginning of a longer cycle of digital structural change. In line with this cycle, competition will soon become stiffer for both fintechs/digital ecosystems and traditional banks. Indeed, up to one out of three payment start-ups will likely fall by the wayside within their first four years, and over the coming years banks will also begin to disappear.³

Banks have faced stiffening competition for some years and now realise that innovation (especially around solution suitability, flexibility and time-to-market) is critical if they are to retain their market-leading position. Particularly in the greenfields of the B2B space, the earlier banks enter this new realm of services, the greater their opportunity to influence market developments and set industry standards. But as customers' demands continue to grow, it will become increasingly difficult for financial institutions to cater to all customer needs.

And while new players began life as disruptors, as structural change takes its course the landscape is set to become far more hostile for all players. For fintechs, the next decade will bring greater market consolidation as the giants of digital ecosystems outpace, absorb or impede start-ups that cannot compete.⁴ How can fintechs succeed in such an environment? The outlook is far from bleak; global investment in fintech ventures tripled to US\$12.21 billion in 2014⁵ and it is evident that some newcomers do grow significantly and sustainably. However, many fintechs have struggled to survive with a single, niche offering, and such offerings are most effective when integrated into an end-to-end treasury offering, as part of a one-stop service. And beyond solving a key market problem or securing ongoing funding, long-term success requires a combination of market insight and experience that fintechs and digital ecosystems are ultimately unable to provide alone. Equally, many are unwilling to become banks, and manage the increased regulatory scrutiny of being defined as such.



Working together to innovate:

In order to create the best environment to nurture and launch new technological offerings, many players are now considering collaboration rather than competition. Financial institutions must consider what sections of their business they would like to retain, and in which areas partnerships would deliver better value to customers. For banks, the fintech culture and role as disruptor can be used as an advantage, with fintechs' position outside of bank walls providing the necessary gateway to innovation. Partnership projects can exploit a "sandbox" approach to experimentation – with the freedom to test new ideas away from banks' infrastructural and cultural constraints – and can sidestep internal obstacles to innovation, such as over-familiarity with antiquated payment methods, or the parameters imposed by investment or regulatory pressures.

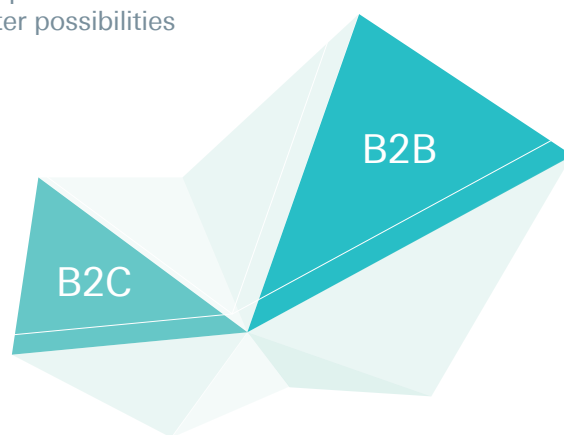


For fintechs, entering into equal partnerships with traditional banking providers is an immediate way to address a lack of payments-market experience or regulatory expertise; leveraging synergies and creating a stronger proposition by bringing together the core competencies of both parties. Such partnerships allow fintechs and banks to offer clients cutting-edge added-value digital services while co-educating and sharing the burdens of compliance, risk and investment costs.

Bank-fintech partnerships are well-established in the B2C (business-to-consumer) space. Many retail banks, for example, have created technology 'accelerators' or 'incubators' to seek early access to fintech innovation. Fintech advancement in the B2B (business-to-business) arena is still in its comparative infancy, with the relative inertia driven by various complexities around the definition of user experience and cost-saving potential, as well as a variety of decision-makers and stakeholders with differing priorities.

However, the B2B sector holds even greater potential than the retail advances so far, with online sales estimates for B2B revenues in 2020 double those of B2C.⁶ Innovation in this sector will be driven largely by CFOs and treasurers, who, accustomed to the prevalence of technology in their personal lives, now expect the same capabilities and level of convenience for their corporate cash management operations. In addition, the B2B sector boasts greater possibilities for the application of financial technology.

2020
B2B revenues double
those of B2C by 2020



Market drivers

The current market landscape

In both the B2C and B2B space, a confluence of industry-specific pressures is driving collaboration between traditional banking providers and new fintechs/digital ecosystems. What are the particular economic, regulatory and cultural circumstances that are hampering in-house innovation for banks?



Regulation:

The regulatory burden is well-known, and perhaps the biggest barrier to bank investment in innovation. The necessary prioritisation of compliance means investment is poured into obligatory updates to meet new standards for reporting, anti-money laundering, anti-fraud and know-your-customer requirements – such as FATF recommendations (Financial Action Task Force on Money Laundering) or the fourth AML EU Directive. Ongoing due diligence has increased operational costs, and new capital adequacy rules have demanded higher levels of capital be held on banks' balance sheets; further diverting cash away from innovation. Coupled with the low interest-rate environment and investor demands regarding returns on equity, the cost of doing business is increasing for banks, in turn squeezing already thinning margins and reducing funds for speculative innovation.

While regulation remains a double-edged sword for traditional banks – both a burden and protective force – the regulatory environment has resulted in an uneven playing field that requires different levels of financial and legal assurances from incumbents and new market entrants. For example, banks are severely restricted in the amalgamation and utilisation of customer data, whereas fintechs and large digital marketplaces are currently under no such restrictions and benefit from a knowledge-lead in developing more targeted services and offerings.

That said, some regulation has indirectly resulted in circumstances more conducive to innovation. The format standardisation brought about by the Single Euro Payments Area (SEPA), for example, has advanced technological developments and encouraged other points of differentiation between bank services. Such advantageous effects are, however, few and far between.



Cultural and infrastructural limitations:

Another key obstacle to in-house bank innovation is the post-crisis cultural mindset. Risk appetites are lower than ever, and understandably so. Eroding margins have induced many banks to act more protectively, leading to further retrenchment and an increased aversion to non-core activities or more creative “out-of-the-box” projects. While new technology has dramatically shortened product development cycles, banks have failed to increase the rate at which they bring new solutions to market. Some banks have implemented large scale platform projects, proving that they still have the technical skills necessary, but they lack tolerance towards failure – a crucial ingredient for creativity and innovation.

Much of bank infrastructure continues to be siloed, in contrast to technology-driven corporates who operate in more open ecosystems – breaking down traditional barriers between sectors and integrating technological functions. As well as lacking the fertile atmosphere of such “cross-pollination”, some banks – inherently cautious – are lagging behind in the skills and language of the internet age.

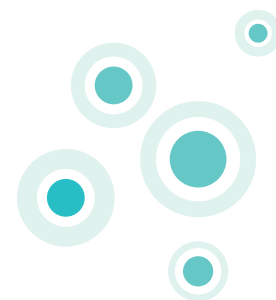
Fintechs, in contrast, have evolved in a more creative and nurturing environment, free of the burden of bank regulation and expensive, complex legacy systems. Nonetheless, there are risk and compliance considerations to contend with; specifically e-money and banking licenses. A lack of harmonisation means regulatory requirements differ between countries and regions, although this can allow for regulatory arbitrage, with some European countries (commercially-friendly and encouraging of innovation) more suitable than others. Such variation in policies around new businesses and innovation is also the reason that most of the large digital marketplaces so far have come from countries like the U.S., China and India, although the venture capital environment is also a deciding factor.

Whether in the B2C or B2B space, most new offerings will eventually need access to users’ underlying payments infrastructure and will need an institutional partner to help get to market. Furthermore, key to the success of a new product is public trust and confidence around security, privacy and data protection; something that new or unfamiliar corporate brands may lack.

Two of the greatest difficulties fintechs face – particularly in the B2B market – are access to a sufficient client base (of corporates and their treasurers) and the ability to successfully scale-up a functioning solution for mass usage. While nimble and innovative, these corporates often lack the necessary global reach, processing infrastructure, financing capabilities and client-knowledge and experience to translate an in-demand market solution into a viable vehicle for long-term growth.



FinTechs
Open ecosystems evolved in a more creative and nurturing environment



Banks
Siloed and lagging behind in the skills and language of the internet age

Challenging expectations

Really, it is the man on the street that is behind these developments. Fast-moving fintechs and digital ecosystems may be dictating the pace of progress, yet ultimately both they and traditional banks are being steered by changing customer preferences. Given this, what do end-customer technology ideals look like today, and how do they manifest in the B2B space?



The expectations of retail and corporate clients are higher than ever, and are broadly consistent across various sectors and contexts. End-users are already prescribing the shape of technological process over the next decade, with technology expected to be:

- + **Efficient.** Users want processes to be streamlined and cohesive, with key functions 'bundled' for user convenience. For example, this might mean that ordering a service is simultaneous and synonymous with accepting an invoice and authorising a payment,
- + **Real-time.** The trajectory of digitalisation has led to near-instant transactions and up-to-the-second visibility over cash-flows,
- + **Integrated and flexible.** Users expect a one-stop portal with seamless reconciliation across their user profiles, (for example between different accounts and financial services), that is also standardised and agnostic (i.e. compatible and interoperable with other systems),
- + **Accessible.** Users expect channel convergence and access to services on multiple devices (both online and offline) through a consistent, easy-to-use and instinctive interface with clean, modern aesthetics,
- + **Individualised and contextually relevant.** The capacity for personalised, tailored products has become increasingly important; in line with the increasing sophistication of Big Data analytics, which can more clearly define user profiles. Users expect advisory services, information and suggestions reflecting their transaction and activity history and other user-specific data,
- + **Intuitive.** Artificial intelligence has been conceptualised for some time, but we are at the start of a trend towards technology that has advisory capacities and can search for, anticipate, and consult on user needs.

Such factors are already built into technology in the B2C space, but will eventually become as prevalent and valuable in the B2B arena, where treasurers' roles are expanding to liquidity and cash management alongside supply chain and working capital functions. However, corporates have low risk appetites for fronting fintechs directly and accepting the counterparty risk, instead the majority expect their bank to front the fintech and be the corporate's contractual partner.

Unfortunately, many existing standardised payment options hail from the 1970s and were primarily designed for payroll. The options – from ACH and BACS (automated clearing) to correspondent banking – are limited, and can be costly, inefficient or slow. Additionally, they can lack the capacity for data-rich flows in a world where such data is increasingly valuable for providing value-added and targeted client services. These legacy processes need to be updated to systems that drive efficiencies and support the digital age, and it is in this area that fintechs will effect change. Treasurers wish to reduce paperwork and manual processes – from opening and closing accounts to making FX or salary payments – and be advised minute-to-minute based on the specificities of their circumstances and wider supply chain environment.



The treasury of the future:

Imagine the following scenario: a treasurer or CFO on the street in New York logs on to his banking portal via an app on his mobile device. He has a real-time overview of all his cash positions and can see that a delivery has been accepted and simultaneously paid for in Kenya via an m-POS, with an integrated FX component. His portal analyses global data and alerts him to a potential short-term spike in demand for his product in Asia. It also suggests the best potential means of financing a productivity increase; a proposition he can accept at the touch of a button. His bank, which previously would have had to request years of historical (perhaps unstructured) data, can view his accounting and ERP systems, make an instant credit-risk score and offer him appropriate financing in that moment.

This seamless and integrated picture is the future of B2B technology – and it is fintechs with a strategic growth plan, which incorporates a traditional bank as a partner and ally, that will be best placed to design, offer and maintain the components that produce such digital connectivity.

Going forward, the distinction between traditional and innovative financial institutions will become clearer. Financial institutions will be required to create a fuller, more customer-driven virtual experience, and in doing so, may well alter the role of primary account providers. Increasing customer demand and growing trust in fintechs may enable non-traditional firms, which excel in creating digital customer experiences, to assume control of the customer relationship, while traditional institutions focus on manufacturing financial products.

Looking ahead, full-service virtual banks could offer a comprehensive suite of financial products by partnering with a range of niche alternative providers, such as P2P lenders and automated asset managers, thereby allowing that network of alternative providers to compete directly with full-service retail banks. In the future, financial institutions could leverage virtual channels to offer frequent customer interactions and non-financial value-adds, widening their service above and beyond needs-based transactions in order to strengthen customer relationships.

Innovation is not simply adapting existing processes or frameworks for app-based use, or use via different channels and devices. It is more dynamic change, such as the technology-enabled introduction of a new business model. Examples are widely apparent outside the financial sector (consider Uber) and usually include payments. Similar change can be expected – and is being demanded – in the B2B space. Corporate expectations have shifted, no longer willing to accept off-the-shelf products dictated by banks. Instead, they are demanding new systems that are truly fit-for-purpose.

These technological expectations exist alongside demand for advisory and consultation services; elements best provided by an experienced and trusted banking specialist with market insight and a global overview. What is more, we may also see the nature of customer demand change, with increased willingness to purchase the additional information and analytics surrounding digital payments.

Recommendations: The process and practicalities of partnership

Having decided that partnerships are the way forward, the question then is how best to go about it. What factors need to be taken into account, when considering a strategic partnership?

Focus on core competencies

Of course, banks and fintechs have different comparative advantages and weaknesses; factors that need to be identified and combined if they are to deliver technological offerings that meet changing customer expectations. For both parties, a partnership should liberate them to focus on their core competencies and contribute these areas of expertise to the innovation process.

Fintechs boast the skills, mindset and regulatory freedom to be innovative, to leverage Big Data and be nimble and flexible in responding to market needs and changes. Crucially, the fintech firm contributes technological expertise – from familiarity with and understanding of the language of the internet, consumer behaviour, and modern web and smart-device technologies, to algorithm-based data analysis instruments and the interplay between implemented hardware and software.

Lack of restrictions by historic internal siloes and legacy systems allow fintechs to provide a bridge between bank and market. They can work more closely with customers and merchants to comprehend and respond to the “life-context” into which these technologies should fit. While banks currently can only respond with the classical channels of credit or debit, transfer, or cash payments, the day-to-day customer usage of banking services requires more accessible options. Fintechs, with their superior technology and technical expertise, are best placed to innovate for these market problems and the practicalities of trade.

In contrast, banks bring experience and tried-and-tested infrastructure. Alongside specific financial knowledge – namely around risk and crisis assessment and management, compliance, local regulatory specifics and treasury needs – banks have the operational power and wherewithal to excel in clearing, settlement, straight-through processing, liquidity and FX functions. On the regulatory side, as well as being well-positioned to manage the risk of a new venture, banks already have the necessary licenses in place.

In addition, banks’ on-the-ground market and customer knowledge and pre-existing client base are of immense value to fintech projects. Indeed, customers may not trust an unfamiliar brand or digital marketplace with their data or cash, but will continue to trust their bank’s discretion and security. Familiarity, reputation and reliability are vital. A banking provider’s global reach is another essential resource for a fintech partner.



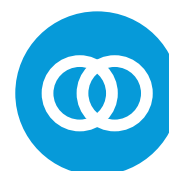
A partnership should liberate them to focus on their core competencies and contribute these areas of expertise to the innovation process.

Identifying a suitable partner

Once the corporate's needs have been identified in line with its business model and strategic objectives, a partner fitting that criteria must be selected. A successful alliance will be the result of well-balanced mutualism; two parties that bring complementary core competencies and resources together to innovate and offer a new value proposition that benefits both, as well as addressing a market need.

It is the negation of weaknesses and combination of strengths that is the source of competitive advantage in a fintech-bank alliance – and it is key that bank and fintech are not so closely aligned that their competencies are competing.

Nonetheless, a partnership with a strong foundation comprises a bank whose geographical footprint and breadth and depth of services is closely in step with the fintech's ambitions. For example, on occasion, divergence between payment preferences or regional regulations may make a single-country focus preferable; prioritising a market where conditions are sufficiently favourable to generate an attractive return. While many viable products will be designed with a multi-country focus – in order to target a greater market size and return on investment – a nationally- or regionally-focused fintech whose plans do not include global growth would be misguided in pairing with a global bank. Similarly, fintechs must consider a bank's client base in relation to whether their technology offerings are aimed at corporate or retail customers.



Many viable products will be designed with a multi-country focus – in order to target a greater market size and return on investment

A banking partner should be an enabler for fintech growth, offering holistic support, guidance and financing to facilitate innovation, and leveraging their global coverage and client expertise to the benefit of the fintech, the product and end-clients. This must not come at the paradoxical expense of restricting innovation or sacrificing opportunities for expansion. A fintech's ideal partner, regardless of reach or client base, is a bank with a strong and widely-regarded reputation. While a fintech will usually benefit from increased valuation upon the announcement of such a partnership, the bank will bear the entirety of reputational risk on its side.

Demonstrable focus:

Continuity of focus is equally vital. Banking partners must demonstrate a proven dedication to innovation and financial technology development. A partner whose own digital strategy is uncertain can prove a fatal blow to a fintech's sustainable growth. Should the bank wish to withdraw from the partnership, it may prove overly complex or time-consuming to switch to a new banking partner – particularly if an in-progress product, already embedded in one system, has to be transferred to another.

Fintechs seeking evidence of a bank's commitment to strategic digitalisation should look for indicators such as open APIs (Application Programming Interfaces; increasingly utilised to seamlessly connect niche third-party components with proprietary ecosystems) and investment in global interoperable formats (such as ISO 20022 or other SWIFT initiatives). Plans such as Deutsche Bank's opening three innovation laboratories – in Berlin, London and Silicon Valley – show clear long-term commitment to experimenting with technological innovation, as well as to deepening relationships with start-ups.

In turn, a bank will look for a fintech with a market-leading business model that focuses on the value proposition. From a bank's perspective, choosing which fintech to invest in and partner with may be a more complex process, as there is a large and fast-changing field to choose from. The search needs to be driven by an awareness of where a fintech can complement or add value to a bank's existing value chain.



Sustainable business models:

In addition to technical skills and tangible assets, the bank must consider the fintech's combined expertise and management set-up. For example, a fintech primed for success will possess not only technical excellence and strengths in innovation and creativity, but also human resources from a variety of backgrounds – including banking and regulation – with the focus on offering a comprehensive market understanding and a client-centric approach. For instance, although fintechs are not currently regulated to the same degree as banks, a bank will look for a fintech that meets their own values and standards in terms of AML and KYC checks, data handling and storage, security and so on. In fact, some fintechs may have market-leading algorithms for these processes; a clear indication of a fintech ready and willing to partner with banking providers.

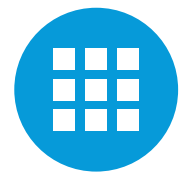
With the recent surge in fintech companies and a significant number of start-ups entering the market each month, picking a winner may lie outside banks' in-house capabilities. But through a network of venture capital companies, incubators, accelerators, innovation labs and other specialist institutions, banks can remain close to the market and access expertise that enables them to identify and approach suitable partners early on.

Finally, it is worth noting that there may be time and cost savings to be derived from exploring existing bank-fintech relationships. A pre-established provider-client relationship will allow the partners to bypass the time-consuming and costly process of onboarding and compliance requirements (such as KYC, AML and embargo filtering regulations). This means that fintech firms that have already been onboarded as a banking client may find partnership with this existing banking partner the simplest option.



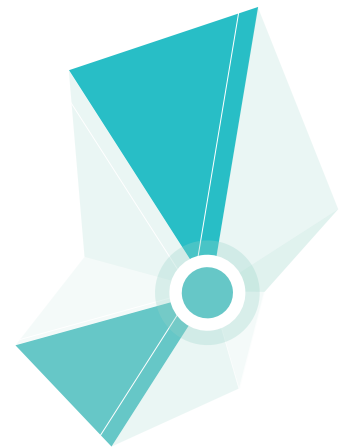
Types of partnership

After identifying a strategic partner – asking the “who” question – banks and fintechs alike must then address the “how”: the practicalities of working together. Partnership models can differ significantly – for example, should the two parties embark on a mutual effort with a product under both brands, or would it be preferable for the bank to leverage a fintech-offering as a white label product (where the bank would pay a licence fee)?



Banks may eventually go on to solve legacy problems and become capable of offering modern digital banking on a level with fintechs. However, the latter will continue to face the challenge of accessing a sufficient client-base and establishing critical customer trust; where a strategic partnership is unsuited or not possible, a white label relationship will at least overcome those barriers.

A fintech will also need to decide whether an exclusive relationship will best suit their goals, a decision that should be based on their business model and the nature of the service they provide. On the one hand, such a relationship would ensure full support from the bank partner and access to their client-base. Yet exclusivity can limit the potential for growth in other markets, and of course with other banks. In incubator or accelerator-type relationships, for example, the trade-off for receiving investment may be a bank equity stake in the fintech company – a decision that can have long-term implications. Ideally, a fintech would partner with an institution that is fully engaged but open to further collaboration where it is necessary to support the growth of both the fintech and partnership solution. For example, the fintech-bank might engage new players to roll out an offering in a region where the bank lacks a local footprint. Regardless, these decisions need to be made and agreed upon by all stakeholders early on in the partnership process, and must remain closely aligned to the fintech’s five- and 10-year plans throughout.



A partnership should liberate them to focus on their core competencies and contribute these areas of expertise to the innovation process.

There are three likely scenarios for fintech-bank alliance. The first would result in a disaggregation of ownership over customer-relationships. Such a partnership would be launched between a financial institution with no retail banking presence, and a technology player with existing customer trust and relationships, that had expertise in the creation of online experiences. Together, the partners would leverage their respective expertise to create a new kind of online seamless, digital customer experience with a full suite of financial products. This structure would allow the technology player to increase their access to data and their centrality to the lives of their customers, without creating excessive pressure on

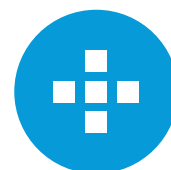
their balance sheet or significantly increasing their regulatory exposure. PayPal's partnering with Discover Financial Services to allow consumers to pay via their PayPal accounts at cash registers is an example of such a structure.

Secondly, a partnership might enable an ecosystem of alternative providers of niche financial services. Such providers continue to mature and offer reliable alternatives to traditional institutions' products. Initially, connections develop among these niche providers through bilateral or multilateral partnerships. Eventually, some traditional banks shift their focus to managing customer relationships as "depositories of trust", and serve as a central platform that connects to niche providers' products. In place of traditional banks, digital wallets such as PayPal, or online marketplaces such as eBay and Amazon, may evolve to become those central platforms. These networks of non-traditional niche providers collectively meet customers' banking needs, and compete with traditional full-service banks. They also provide the ability to seamlessly mix-and-match niche providers that fit clients' needs in a manner not possible within today's full service financial institutions.

A third scenario would entail a financial institution actively exploring innovations in mobile, and other virtual channels' transactional services in order to meet evolving customer demands, thereby embedding their service more integrally into their customers' daily lives.

Factors for long-term success

On top of the fundamentals of the “who” and “how” of partnership, “non-core” factors (such as the cultural environment that is generated alongside the financial and technical components) are equally important for partnership sustainability.



These strategic partnerships need to create a new, unified, team that innovates together; something that can only be achieved with clear-cut roles and pre-defined responsibilities, from outset to distribution. It might be decided, for example, that once the solution is ready for market it is the role of the bank to trial the solution in one of their innovation centres, then soft-launch the solution among selected clients, and finally leverage their existing client base to distribute the offering. Both partners should also be aware of the potential damage of “scope-creep”, which can be avoided by implementing accurate and detailed blueprints from the start.

In order to be commercially viable, strategic partnerships must be long-term and sustainable. For both parties, complete stakeholder understanding and buy-in at the beginning of the partnership is important for ongoing harmonious productivity. The partners in question must share similar or compatible cultures and values (e.g. around client-centricity and discipline), and be able to meet the needs of all stakeholders within and outside the partnership, including those of clients, clients’ clients, regulators and investors.

Mindset alignment:

An adaptable attitude, open to potential shifts in mindset, is necessary on both sides. In order to exploit the advantages of such a partnership, banks must approach the fintech counterparty as an equal partner rather than a vendor. Both sides must meet as equals and bring equal intellectual value to the venture.

Bank attitudes to risk may also need adjustment, as risk in a partner-relationship differs in nature to that of a vendor-relationship or within in-house innovation. It may be necessary for banks to adapt the ways in which they accept and mitigate risk – whether regulatory, reputational or in data-management – throughout a fintech partnership. Banks are accustomed to viewing smaller or less-established corporates as risky in a vendor role; but the very nature of fintechs means that they are usually new players, perhaps with untried and untapped potential. In part, this can be solved through due diligence, but it also requires a novel approach to collaboration.

Mindset Alignment: What's Needed

The following facts are crucial to being best prepared for change. Banks will need to accept:

- + the realities of digitalisation, and the need to invest time and resources in this change,
- + that digitalisation can become the new differentiator for banks,
- + that existing business models will have to change, and could even be cannibalised through new alliances with fintechs,
- + that there will be risk of failure (but also opportunity for success),
- + that leadership and talent will become more important than management. Senior management must have a strong vision to successfully lead the transformation into the digital age. Middle management must hone its crucial "assessment and judgment competency" to decide which ideas are worth pursuing. On-the-ground staff can be a main source of innovation, when empowered and supported,
- + that decision-making logic within the organisation must be improved; with a "fast track" decision-making process – on key strategic themes around digitisation – presented straight to the board, bypassing any cultural or hierarchical obstacles,
- + and that banks must focus on execution capabilities.



In light of the different nature of these partnerships, the bank mentality needs to accept that solution delivery will come at a different pace. While vendor relationships theoretically begin with access to a finished product, bank/fintech partnerships will entail a slower process of constant improvements in terms of innovation and delivery. In addition, while banks cannot launch a product to fail, fintechs have a 'fail fast' attitude, learning through failing and with their robustness tested and proven by surviving failure. It is therefore essential that banks approach fintech projects with an open mind and longer-term perspective. In this regard, there is much that can be learned and assimilated from the methods of market leaders such as Google and Facebook. Specifically, banks can benefit from holding regular "hackathons", to encourage collaboration and innovation and allow fintechs or start-ups to submit new solutions for products or services.

Fintechs should be equally prepared for the cultural differences that exist within banks, but refrain from underestimating the scope for cultural change within the banking sector. They will also need to be sensitive to the process that banks are

currently undergoing, which involves deep and rapid shifts to the sector and to traditional business models. As well as inverting attitudes to re-categorise new players as allies rather than competitors, banks are currently re-assessing and refining their long-term digitalisation strategies. Fintechs must be accepting of the disparity in the pace of change between long-established banks and new, more nimble players, and be willing to co-operate and align themselves with bank efforts to integrate. The advantages of these alliances stem from the divergence between bank and fintech strengths, but this difference must also be carefully managed to avoid rifts in communication and expectation.

Technical compatibility:

One of the biggest technological obstacles to digital change is banks' legacy systems. In the B2C space, technical change has occurred very much at the superficial front-end of customer interaction, making change both easier and faster. But for the B2B space, banks and fintechs need to ensure technical compatibility and connectivity is in place before embarking on a partnership.

This may mean technological updates and infrastructural overhauls for banks, to ensure systems and processes are flexible and interoperable at the back-end, and enable the facilitation of open APIs (a day-to-day norm for fintechs but still largely underused in banking). The ideal partnership is one that does not require overly heavy investment into achieving connectivity, but easy, low-cost connections will only be possible if banks' infrastructures are up-to-date.

Change can also be facilitated in part by information and education. For example, discussing the use of APIs in the treasury or corporate space can stir anxiety around security. Most banks continue to use outdated communication protocols with their corporate clients – many of whom are technology-based or tech-driven companies – that limit message or file size or message frequency.

Going forward, banks will need to embrace APIs as a protocol that allows them to communicate with clients in real-time in an almost unlimited manner. This will be crucial for new solutions reliant on accessing up-to-date bank data such as FX rates, and failure to use APIs in these instances could leave such solutions open to risk. That said, the introduction of APIs into the sensitive environment and rigid infrastructure of banks – quite rightly concerned with protecting client information and internal systems – will require an attitude shift and better understanding of the technology in play.

Banks are only at the beginning of a journey; one where the bulk of their data will need to be converted from unstructured to structured, in order to leverage the possibilities offered by Big Data analytics. In addition, fintechs should be wary of underestimating the adaption to the regulatory environment and end-to-end due diligence necessary on their side in order to work with banks.

Ultimately, entering into any partnership will require adaptation and flexibility from both sides. But these challenges are dwarfed by the wealth of potential.

Real-world application

What does a bank-fintech partnership look like in real life? While different strategic alliances have already given rise to significant developments, these have so far been more abundant in the B2C and, to a lesser degree, B2b (business-to-small-business) space. Consider the several micro-payment services that have sprung from partnerships between tech firms and established banks, such as Cringle-DKB, Simple-BBVA, Earthport-Bank of America Merrill Lynch, or (previously) Lendstar-Commerzbank. These are “win-win-win” scenarios, as the market/customer gains a new and useful product, the bank improves its service and remains competitive, and the fintech successfully introduces and grows an offering it might not otherwise have managed.

Over the next decades, digital structural change will transform every industry. The treasurer’s world will shift from one of siloed people, systems and processes, to a completely digitised and automated end-to-end workflow that is more transparent, interlinked and often manageable in real-time. There will be less delay or friction in accessing information, requesting services, generating granular reports or analysing KPIs, and we can only imagine what more remains to be discovered.

In the near future we are likely to see many of these new B2C solutions adapted for treasury applications. For example, smart-device-enabled payments (e.g. m-POS or e-transfers) will likely be used for corporate collections, as well as enhancements in e-invoicing, supply chain finance workflows, clearing, and other currently fragmented components of trade and treasury processes, all of which will significantly benefit customers if further integrated. In the next phase of B2B developments, banks should be able to put their overview of customers’ cash management information to wider use, in order to provide liquidity forecasting, notify customers about contextually-significant currency pairings, advise on optimal payment methods for client transactions or opportunities for account consolidation, and a host of other as-yet-unknown automated advisory services. As in the B2C space, such collaborations are likely to begin at the front-end of financial services.

Where to focus geographically:

Fintech-bank partnerships, although likely to consider solutions with multi-country potential, may have a differing focus across regions – in part due to regulatory divergences, but also according to local market needs and banks' legacy circumstances. Mature markets are unlikely to foster the most significant developments. Instead, colossal newly-digitalised markets in areas such as China, India and Africa are likely to be targeted, thanks to their great appetite for technological developments and their capacity to leapfrog entire generations of developed-market technology. Established markets have historically had advantageous resources, but elsewhere new technology such as Project Loon (a Google initiative to bring internet access to remote locations via high altitude balloons) can provide 4G internet infrastructure and capabilities to developing markets overnight.⁷

Within developed markets, European firms are hard-pushed to compete globally with fintechs from Silicon Valley or China. However, the EU has just announced its digital roadmap for Europe, aimed in part at making Europe a competitive market on equal footing with other regions (the Digital Single Market).⁸ And while the US still enjoys by far the largest share of global investment in fintech, Europe has the highest rate of growth with an increase of 215% in 2014 (to US\$1.48 billion). Within Europe, the UKI (United Kingdom and Ireland) accounted for 42% of European investment, followed by the Nordic countries, the Netherlands, and Germany.⁹

Regulatory variation:

However, even within the EU, variances in policy approaches have created an uneven playing field. Some countries are particularly risk averse when it comes to data privacy; an area where mindsets will likely change, at least to reconcile the current discrepancy between the privacy expected when using banking services and that expected from ecosystems such as the social media giants (e.g. Facebook). In addition, regulatory arbitrage exists between EU countries – for example, between the UK's FSA, which has created a supportive and commercially-friendly environment, and Germany, where policymakers are primarily concerned with the potential links between fintech and cybercrime. Such diverse requirements can be a barrier to offering pan-European solutions.

For every kind of strategic alliances, the most beneficial change would be more standardised regulation, especially between banks and non-bank players. In order to facilitate progress, a fair and relevant regulatory framework needs to be applicable across the board, particularly around data usage, risk and transparency. Regulation needs to adequately stimulate competition and encourage progress, while also providing an even foundation for all participants. There is still some way to go to ensure that regulation meets these objectives and is up-to-date with marketplace developments.

Conclusion

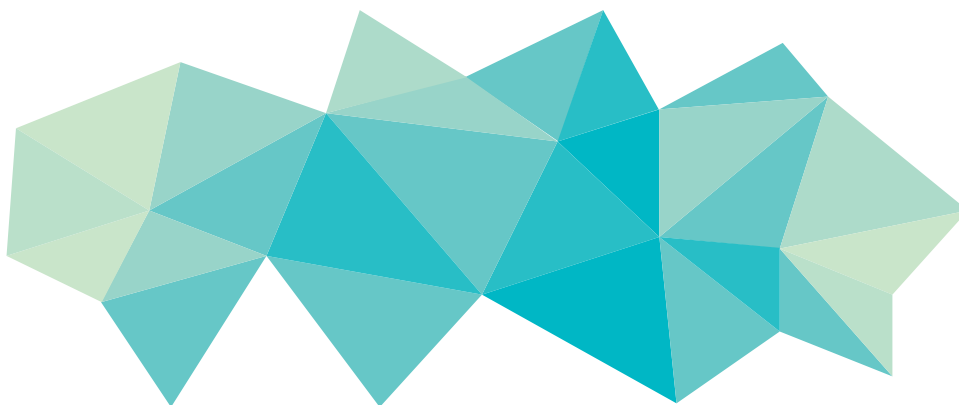
Fintech innovation is, by its very nature, a constant force. It will continue to change the way we interact and conduct business, not least because we have only just embarked upon the first wave of exciting developments in its application for the B2B space.

Players who wish to safeguard their market share must develop a strategic plan for remaining competitive, while complying with a changing and increasingly complex regulatory environment and managing market risk.

Fintechs, and huge digital ecosystems in particular, have entered the market with a bang. Yet, in order to maintain their position, they must find a way to meet their regulatory, investment and risk needs in order to focus on their core competencies. They may find partnering with a global banking provider to be the most strategic approach in this regard, and many of the developments of coming years will likely evolve within such alliances. Several market-leaders have realised that bank alliances are the way forwards.

On the other hand, banks will be under increasing pressure to innovate, and as such, it needs to become a part of their DNA and culture. Banks, and their employees, will need to absorb the lesson from fintechs that, in this time of digitalisation, client-centricity is the holy grail, and innovation, far beyond benefits such as cost-savings, will bring new opportunities for client-centric offerings.

The payments space will undergo significant shifts in this new era of digitalisation, including alterations to business models, customer behaviours and traditional trade and treasury functions. But by combining their strengths and creating synergies, forward-looking fintechs and banks can be at the cutting-edge of these changes, and together lead the advance into the digital age.





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