Unit 7 Case Study : Scotiabank's Take on Partnerships in FinTech

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This week's case study from the Harvard Business School course pack is about the company Scotiabank, who claims that it is the concept of partnerships that needs to be focused on more in and greater overall fintech revolution (Hsieh et al., 2019). We have seen a number of case studies focus on how blockchain could make partnerships easier, either through the sharing of information through R3's distributed ledger Corda or lending to small businesses through decentralized crediting/lending platforms like Dianrong in China. Hsieh et al examines how Scotiabank's partnership with the fintech company Kabbage helped grow the company as well as the different kinds of partnerships that have come about in the Fintech space. Scotiabank has been around the Canadian banking scene since 1832, but their partnership with the fintech firm Kabbage in 2017 marked an interesting turn for both Scotiabank and the fintech scene in general. Up until that point, fintech and banking companies hardly collaborated with one another and saw each other as competitors. The B2B collaboration scene was not particularly strong at the time of this case study's writing, and the Scotiabank-Kabbage partnership was a pivotal agreement that set a new trend for the business world. A partnership between such a large bank and a newer Fintech company only established in 2009 is quite the move to make. Analyzing the partnership in 2023, we can say in hindsight that the move may not have been in Scotiabank's best interest, but what can we learn from such an atypical partnership that was a departure from the norm during the time?

1. What are the success factors in the Scotiabank-Kabbage partnership?

Fundamentally, Scotiabank is a bank in Nova Scotia, Canada that has always been interested in the digital payments space. Kabbage was a technology company through and through that operated within Mexican markets while being an American company. Kabbage, like many tech companies, adopted an agile test-and-learn approach. The nature of the tech industry makes it so that non-traditional data and advanced analytics can be rather easily incorporated. Banks like Scotia just don't have the same philosophy when it comes to product design, so Kabbage was able to complement Scotiabank's skillset. The nature of tech and well-designed user-interfaces helps put the customer first, since complex banking procedures and agreements can all be mapped in a simple app or UX/UI design to make it much easier for small businesses to navigate the world of lending. Also, traditional financial industries are limited in the kinds of data they can work with and collect, but Kabbage would allow for Scotia to collect far more user data from the application that the clients would actually be using. Having more data means you can do more analytics, so artificial intelligence and other analytics tools can be leveraged on it. Ancillary tracking like real-time geolocation, for example, could be enabled through a Kabbage-made application which could then help grow Scotia. The amount of data Kabbage brought into the picture could enable a bank like Scotia to get more information that could complement the county's own credit bureau, which was only useful for rating larger businesses within Mexico to begin with. This partnership gave Scotia the data it needed to assess the risks of the small businesses applying much better.

Another kind of benefit of the partnership altogether was the ability for Scotiabank to operate within Mexico and obtain more clients in a jurisdiction they had somewhat of a footing in. Not only was Kabbage proficient in a different skillset than Scotia, but they also enabled Scotia to expand their own market presence. Mexico and Canada both have a rather large number of small businesses that account for a significant portion of their respective GDPs, so giving out loans to these businesses seems like a great business venture for those that can properly manage the risks!

Sure, the partnership may have been temporarily beneficial between the two companies, but more than anything, this was one of the first proper partnerships business-to-business between a Fintech company and a banking company. These two types of companies were seen as fierce competitors in the past, but now we were seeing a bank working with a fintech company so both could grow one another.

2. Under what conditions is the same model applicable? When will the Scotia-Kabbage model not work?

Something to note, as of 2023, Kabbage has actually filed for bankruptcy after a legal bout regarding their abuse of Paycheck Protection Plan (PPP) loans during COVID (Wieder, 2022). After the PPP program was released by the Trump administration, Kabbage rather aggressively gave out loans to small businesses. These loans were given out much too easily and when the borrowers were unable to pay back their loans, there was a harrowing forgiveness process for the small business involved. Clearly, something went wrong with the partnership, since Scotia no longer has a profitable relationship with Kabbage.

Partnerships are technically a merger, but they can still be created without any actual transaction taking place. Essentially, terms are defined beforehand what the companies are responsible for and then there was a 50:50 split in terms of cost obligations. A big thing to realize is that Kabbage never actually got past the testing phase of their application. They were always promising tomorrow that the right innovation would come, but that hasn't happened as of 2023 even when Bank of America acquired Kabbage.

The Scotia-Kabbage model was an early Fintech-bank partnership. It can be argued that the very existence of the partnership helped launch the blockchain industry forward, since this kind of partnership was rare at the time. The thing is, unless blockchain companies stick with certain standards, adhere to transparency, accountability, integrity, operate within regulatory clarity, and try to educate the public on their own findings, fintech-banking partnerships might be a little risky. There needs to be some sweeping regulations and guidelines in place and until then, banks need to realizer there will be risks involved with partnering with Fintech firms.

3. Under what circumstances should Scotiabank seek fintech partnerships?

Macheel (2016) seems to agree with me that Scotiabank's partnership may have been a little too early and without enough safeguards in place. Kabbage was still only in the proof-of-concept stage. Tech products can't be approached with just frameworks and theories, so you have to learn by doing. Macheel comments on how during 2015, banks were more interested in internal R&D regarding blockchain, but by 2016 banks started to think partnerships with Fintech companies were the best way to go. It might be best if fintech companies see themselves as mores software companies as apposed to financial engineering firms.

A big issue with these partnerships actually comes from what Hsieh et al. described as affordances for fintech - a lack of regulation within the marketplace lending space. Kabbage acted more like a financial engineering company when they processed PPP loans during COVID. Operating with unsecured lending, great risk appetites without a significant amount of data to complement the decision, and proprietary credit scoring models that were not open-sourced all ended up actually hurting the Scotia-Kabbage partnership.

Macheel recommends that banks instead join some kind of blockchain endeavor like R3's Corda distributed ledger and instead connect together R&D departments between different banks. The risks for partnering up with a startup might not be worth it, especially after COVID brought a lot of the blockchain companies to their knees for fraud cases. Having a consortium of innovators that actually work for their respective companies could be a better way to partner in the future. Banks just need to invest in their own internal R&D departments and blockchains like Chained or Corda can help facilitate research between the partners.

4. Identify a sector (e.g., international payments, blockchain, lending, or wealth management) and a geographic market where a fintech partnership would create value for Scotiabank, and explain why.

Diversity management may not be a particularly common practice yet, but many management teams are beginning to place importance on diversity, equity, and inclusion (DEI) efforts within the workforce. Scotiabank actually has a presence in Peru, and Ledesma & Martinez-Hague (2021) analyze how well Scotiabank Peru does in terms of upholding DEI initiatives. They find that the company does okay, but there are issues like a lack of details regarding internal and external recruitment processes, for example. Being able to navigate different cultures is challenging, since there could be certain principles or values that one culture holds that another culture does not hold. The employment and recruiting roles could do with a potential makeover, where a Fintech company focuses on creating open-source or auditable software that creates a recruitment process that keeps both local culture as well as global DEI initiatives in mind. Workshops and training work well, but there is definitely more that can be done for ethical and transparent recruiting and a fintech partnership for a recruitment-focused fintech app in Peruvian markets could be a great next step for Scotiabank.

5. Based on your answer to question 4, what recommendations would you make to Scotiabanks's executives for a three-year plan, choice of partner, reason for the partnership, and suggested procedure (i.e., what partnership model to follow)?

Businesses are, at the end of the day, made up of people. Recruitment systems via blockchain could be what companies need to not only recruit employees who are good for the company or support employees who do well, but also better hold employees accountable for their actions. Decentralized Human Resources Management (HRM) could find innovative solutions for recruitment, wage management, reward management, and occupational health/safety. The issue with technology like this in general is that it requires partnerships between not only software-focused fintech firms, but also the school administration and law firms. The software could end up adding benefits to the recruitment process like building decentralized career networks, provide cheap and safer verification for candidate credentials, facilitate performance reviews, and conduct interviews.

Scotiabank should seek a fintech partner who is willing to get school boards and relevant law firms on board with the project. They would not only need to design the transaction network, but also create a transaction environment where all the necessary data could be held. Scotiabank needs to understand the scope of such a project, so a 50:50 split should be used with only the amount of money they can afford to risk. Also, there would have to be little to no licensing agreements from the fintech firm to Scotiabank, but it is debatable whether or not the software would even be able to provide utility for anyone for a long time. The scope of these projects means they need to include a large number of business entity types. The best fintech firm for this job would be one that is good at building their own clients or relationships on top of building out the software.

6. What challenges is Scotiabank facing in the blockchain sector? What are the implications of for the bank's blockchain partnership strategy?

El Salvador is known as a country that is trying to experiment with Bitcoin as the nation's currency of choice. The unfortunate reality is that despite their progressive view on blockchains and Bitcoin, The Canadian Press (2019) reports that Scotiabank has withdrawn from El Salvador, 9 Caribbean countries, and the Dominican Republic. In November of 2018, Scotiabank sold its operations in El Salvador, while the country would proceed to make Bitcoin the second major currency of the nation behind the US dollar (Martin, 2023).

Scotia doesn't really have any of their own blockchain R&D going on internally. They were relying on other companies through partnerships to get the job done. Today, their pull in the blockchain and fintech space might be waning. A few key mistakes made only a few years too soon ended up hurting their market presence. It may be beneficial to try and reopen negotiations between the government of El Salvador, Scotia, and El Salvador's private sector. While the locals may not be buying cryptocurrency yet, if the company can find the right tech-savvy people in El Salvador's private sector to champion a fintech project there, they can learn from their past mistakes and come up with a better partnership model.

Conclusion

All blockchain companies are having a tough time right now. The technology is promising, but it's far too risky to innovate in industry right now because of the amount of R&D that is needed. Not only is the technology not particularly profitable right now, but many companies are getting hit with lawsuits as well. The Scotia-Kabbage partnership didn't really last the test of time and future partnerships may not either. Maybe we need academia to step in for innovation? It really does't look good for industry as of late-2023. While the Scotia-Kabbage partnership popularized fintech-banking partnerships, we can see that Kabbage itself took a hit after giving out too many PPP loans to small businesses. A recruitment system developed by a Fintech company in El Salvador, for example, could help Scotiabank find better employees, but such a system is not easy to develop either.

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