

WHERE FINTECH LENDING WILL LAND

**AND WHAT IT MEANS FOR BANKS:
THE TIME IS RIGHT FOR
STRATEGIC COLLABORATION.**

FOCUS ON EUROPE.

THE TIME IS RIGHT FOR STRATEGIC COLLABORATION.

Bank leaders by and large saw the arrival of financial technology companies (fintechs) as a challenge. Lately, though, they've started to see things differently.

Traditional bankers are becoming increasingly open to the idea of collaborating with fintechs of all types, with an eye towards improving their own firms' offerings and accelerating growth. In fact, according to a recent UBS global survey, 38 percent of banks already had a partnership with a fintech as of July 2016, and that number was expected to rise to 51 percent within the year.¹

The timing is right. As the lending fintech world enters a more mature phase, fintech leaders are also looking beyond their own organizational boundaries for new ways to better the odds of their companies' long-term survival and success.

At issue is whether these forays will deliver on their potential. Banks stand to gain capabilities in five distinct areas via fintech collaboration, but only if they move forward with a clear understanding of the fintech universe and an informed perspective on how to make such a relationship work.

That is, banks need a purposeful strategy to combine the strengths of traditional banking with the innovative solutions offered by lending fintech. They need to be prepared to "lead in the new," by capitalizing on fintechs' abilities to maneuver and analyze massive quantities of data, and by pivoting wisely to leverage the insights they generate.

¹ Source: UBS Limited, Q-Series Report, "Global banks: Is FinTech a threat or an opportunity?", 26 July 2016.

FINTECH HEADWINDS

Fintechs naturally fall into one of two different categories, the “fintech fins,” which work directly with consumers, and the business-to-business oriented “fintech techs,” which concentrate on providing specialized technologies for banks.” As **FIGURE 1** shows, there are also two distinct groups within the fintech fin category: peer-to-peer marketplaces, and online lenders (growing evidence of an evolutionary trajectory from fintech tech to fintech fin likely means that these classifications are not static).

Historically, the online lenders attracted the most funding (42 percent). But venture capital funding for fintech fins dropped sharply in 2016, both in Europe (with a total of \$589 million, down approximately 50 percent in 2016 from 2015) and in the US (down approximately 67 percent in 2016 from 2015).²

Accenture’s analysis indicates that fintechs face difficulties—both in scaling up and in becoming profitable—that may explain this uncertain investment climate. For example, 40 to 50 percent of fintech fins report negative earnings before interest and taxes (EBIT). In addition, these businesses have spent heavily to sustain customer acquisition rates. They show an above-average cost to serve and their marketing expenses often reach 50 percent of their overall operating expenses.³

As a result, many of the players in the fintech fin category remain relatively small. On average, a European lending-focused fintech generates annual revenues of about € 30 million (US \$33 million). While double-digit annual revenue growth is not uncommon, very few players report revenues above € 100 million (US \$109 million), and those that do show little recent growth, as **FIGURE 2** illustrates (for fintech fins, such growth has mostly been associated with increased RWAs that are making banks not to take additional lending risk).

FIGURE 1: LENDING FINTECH TYPES

Within the Fintech world, there are two primary clusters of businesses: Fintech-Fins, and Fintech-Techs. Different models (and levels of maturity) exist within each cluster.

	FINTECH-FIN	FINTECH-TECH
BUSINESS MODEL	 P2P MARKETPLACE	 ONLINE LENDING
KEY - FEATURE	Risk taken by the investors	Risk is transferred from the investor to the platform
YEARS OF ACTIVITY	10 years old or even less	10 years old or even less
RELATIONSHIP WITH BANKS	Loans are generated by partner banks and then transferred through loan notes	Represent an alternative to traditional lending offered by Banks
		Offer Advanced Credit Scoring, Credit Automation, NPL management and Regulatory monitoring/ reporting (RegTech)
		Specialization of Services
		Some were founded in the '80s
		B2B approach. Fintech provide infrastructures to banks

² Source: Accenture Research analysis based on CB Insight data.

³ Source: Accenture Research analysis based on Company data. Analysis done on 8 cases of Traditional Banks, 3 cases of Direct Banks (mBank, Bankinter, Fineco) and 2 cases of Lending Fintech (Lending Club, Lending Tree).

FIGURE 2: REVENUE GROWTH AND PROFITABILITY

The majority of the most profitable fintech players in Europe are those providing tech services, along with a few from the online lending platform area.



LEGEND:  P2P Lending Marketplace  Online Lending Platform  Fintech-Tech

Notes: the analysis was made using the latest data available as of April 2017 of a selected sample of European Lending Fintechs plus three US Lending Fintech.

Source: Accenture Research based on Bureau van Dijk standard reports.



Additionally, few companies that offer online-lending platforms have shown significant profits, and the path to profitability is not guaranteed. Among European fintechs, the most profitable players have been the “techs.” But as **FIGURE 3** shows, it has taken even successful fintechs from 8 to 14 years to become profitable. Many spend significant time “waiting in the lobby”.

In this environment, European lending fintechs are entering a new phase, likely to be characterized by:

- consolidation, as established firms seek to enter new markets, increase their customer base and build scale;
- a quicker exit time from initial venture-capital funding; and
- blurring boundaries between fintech fins and more traditional banks (eg., obtaining approval for some banking services, obtaining a banking license, acquiring minority stake of a bank).

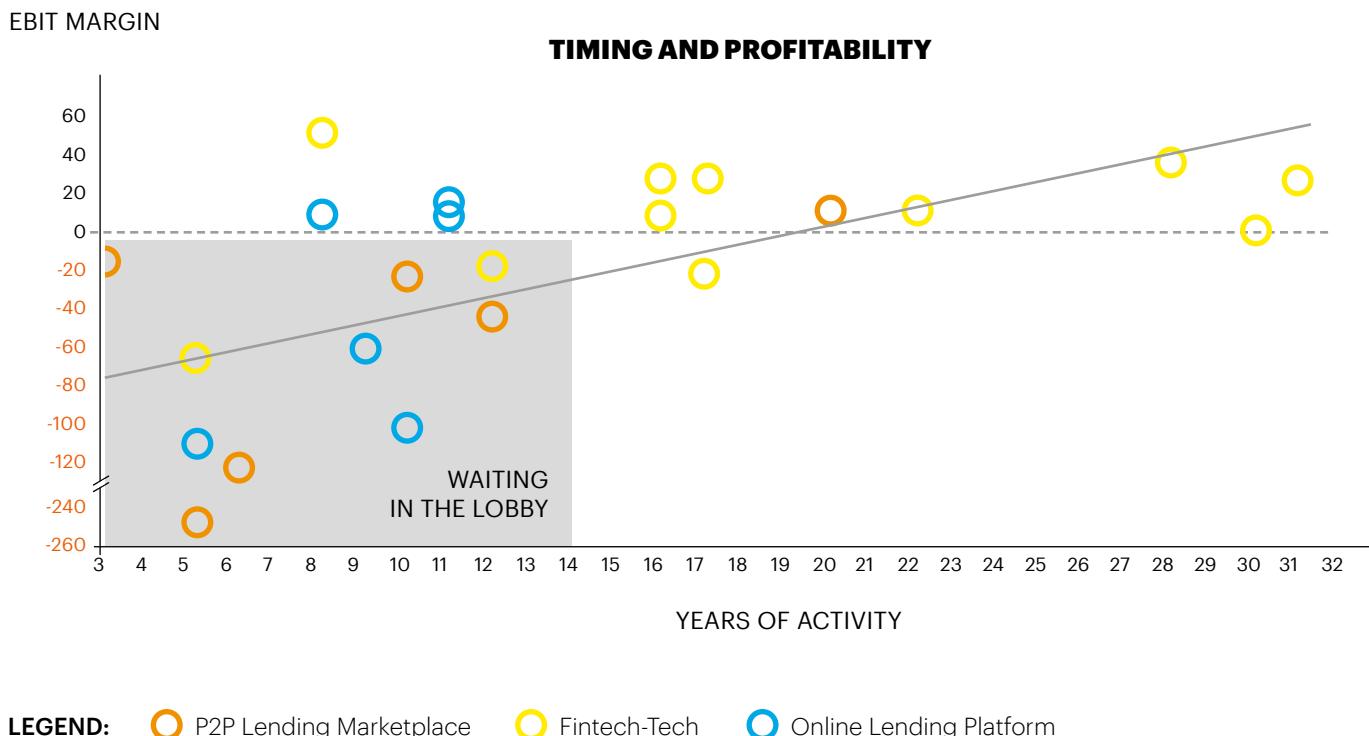
As these developments solidify, fintech leaders (particularly fintech fin leaders) are increasingly interested in the potential benefits of integration with the larger financial system.

Through such transactions, fintechs seek to improve their financial viability, attract more clients and, in some cases, obtain guarantees for deposits. They hope to play to their strengths, including the ability to offer an enhanced user experience and utilize advanced credit models, and take advantage of the flexible regulatory framework in which they operate.

These kinds of explorations signal fintechs’ desire to survive on their own and avoid threats such as customer fraud, cybersecurity and privacy breaches, and low profitability. But they’re also indicative of the kinds of vulnerabilities that are causing fintech leaders to warm up to the idea of collaborating with their incumbent competitors.

FIGURE 3: YEARS TO PROFITABILITY FOR FINTECHS

Profitability takes 8 – 14 years, and a positive outcome is not certain.



Notes: the analysis was made using the latest data available as of April 2017 of a selected sample of European Lending Fintechs plus three US Lending Fintech
Source: Accenture Research based on Bureau van Dijk standard reports.

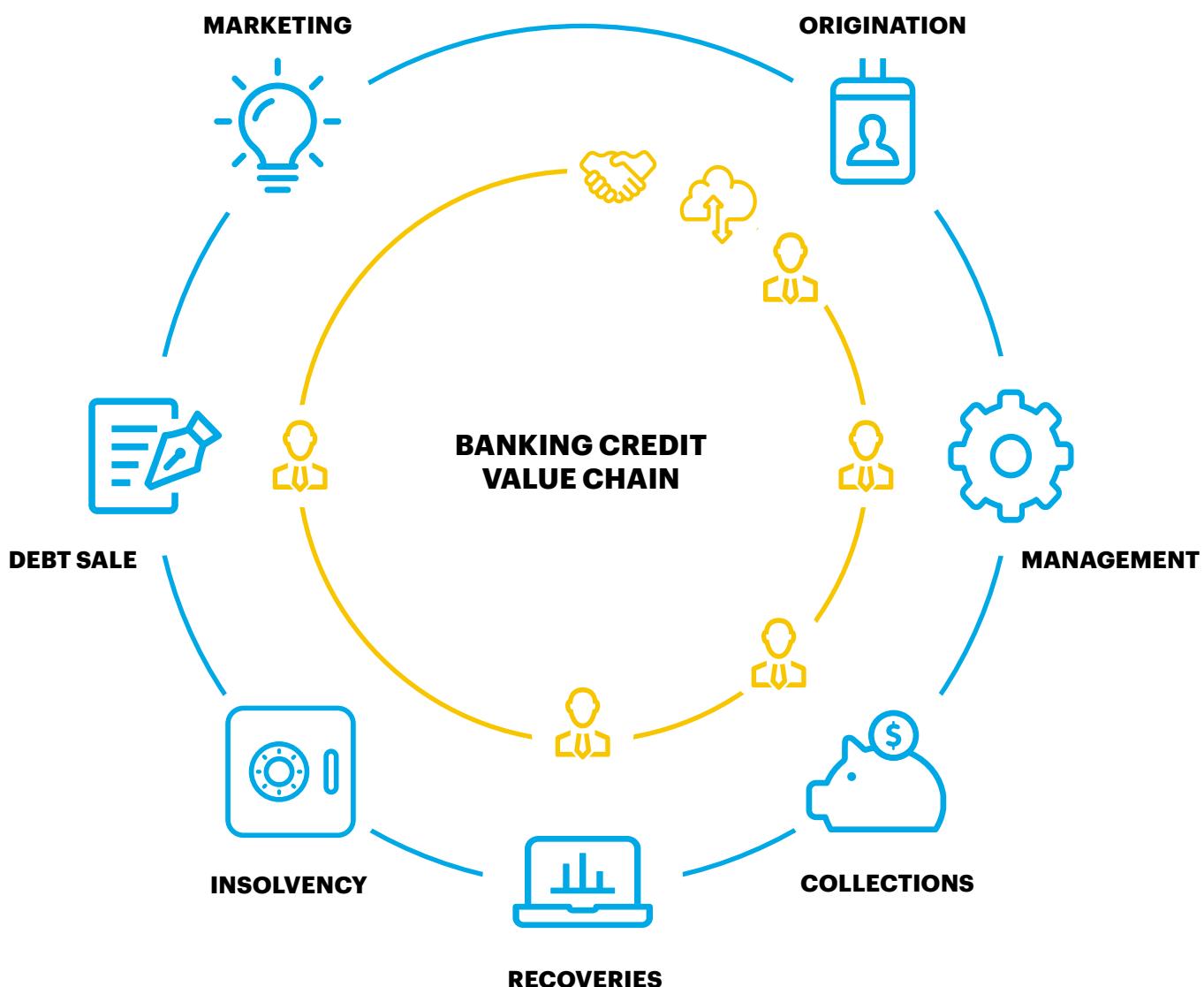
IMPLICATIONS FOR BANKS

Our analysis has found that banks' revenues at risk from fintech competition are typically in the range of 2 to 3 percent from lower loan origination, lower net income, and fewer customers acquired.

On the flip side, banks can gain a potential 3 to 5 percent in revenues by collaborating with fintechs, through enhanced customer acquisition, more fee-based revenues, better pricing accuracy, and lower cost of risk.⁴

That's because although fintechs may have struggled to grow profitably, they have been proficient innovators at every stage of the credit-banking value chain. As **FIGURE 4** shows, they are operating in marketing, customer origination, management, collection, recovery, insolvency, and the sale of debt.

FIGURE 4: FINTECH SERVICES ALONG THE BANKING CREDIT VALUE CHAIN
Fintechs offer services end to end.



LEGEND: P2P Marketplace

Online Lending

Fintech-Tech

⁴ Source: Accenture estimates.



By tapping that expertise, traditional banks stand to move much more swiftly and effectively than they could otherwise, to introduce new products, streamline processes, enhance customer experience, and increase revenues. For example, banks could also define new credit products and tender fintechs to collaborate to supply them. Such as, issuing RFPs for end to end provision of a micro-credit capability. Allowing the collaborative fintech platform to develop away from some of the barriers to innovation scaling, while still inside a company, providing commitment and support from the bank, plus clear guidelines on regulatory

and risk parameters that banks are well familiar with, but a small fintech provider may not be.

Specifically, banks may be attracted in five key areas (shown below) to enable better selectivity, predictive ability, and portfolio quality. The option(s) they pursue—internal development, acquisition, or partnership—will depend on their current status and the maturity of the fintech offering in the area under consideration. Collaboration decisions aren't binary; a spectrum of options are available to all parties since some entrants are playing as fintech fin and fintech tech as a hedge.

I CUSTOMER ANALYTICS:

Many traditional banks have been stymied in their efforts to boost business strategies by leveraging big data and analytics because they must deal with multiple databases that have not been integrated, and also because they have limited skills (data scientist expertise) to bring to bear.

They can, of course, begin to develop better capabilities on their own, by assessing big data needs, taking steps to integrate data, and recruiting data scientists. But they should also consider acquiring or partnering with a fintech, as a way to embed big data and analytics into all core business processes more rapidly, allowing them to get more comfortable in expanding lending opportunities and services and provide new ways to harness the power of data, and move more efficiently towards becoming more fully data driven.

SUCCESSFUL FINTECH PLAYERS IN CUSTOMER ANALYTICS INCLUDE ONDECK, LENDING CLUB, AND FERRATUM.

I COMPREHENSIVE CREDIT SCORING:

Many banks' scoring models are not tailored for specific products or segments; what's more, these models are primarily designed for (and focused on) the retail/private sectors, leaving desirable markets such as students and micro-, small, and medium-sized enterprises (SMEs), underserved. In addition, many banks have yet to apply adaptive technologies such as machine learning to credit scoring.

In contrast, many fintechs have developed flexible and comprehensive scoring algorithms based on big data, artificial intelligence, and unconventional information (e.g. network quality) to evaluate creditworthiness and process continuous risk-related knowledge.

Banks can start to assess the potential of accessing fintech capabilities in this area by conducting a comprehensive internal assessment of their own credit-scoring capabilities, and considering the ways in which existing IT, risk, and credit-scoring capabilities currently operate and might be better linked. However, acquiring or partnering with a fintech can be a viable alternative path (and a good opportunity) if the bank can address such key critical factors as compliance issues and the implications of the potential loss of exclusive ownership of structures and databases.

FINTECH PLAYERS WORKING IN THE AREA OF COMPREHENSIVE CREDIT SCORING INCLUDE KREDITECH, IWOKA, AND MODE FINANCE.

PROVIDING A FULLY DIGITAL CUSTOMER JOURNEY:

Most banks still rely on traditional points of contact (typically, their branch systems) and greet customers at the front end with standard functionality and solutions.

In this area, banks should consider leveraging the online digital solutions offered by fintechs, inspired by the GAFA-like (Google, Apple, Facebook, and Amazon) customer experience. These are characterized by user-friendly interfaces and fast online end-to-end processes that guarantee customers consistent and continuous interaction. Pursuing such a strategy should also accelerate the bank's internal evolution path, by streamlining direct engagement of Bank's internal IT groups, which are generally busy keeping their existing processes in tune and are thus limited in their ability to muster the resources, time, or expertise to get ahead in this regard.

FINTECH PLAYERS THAT FOCUS ON THE CUSTOMER JOURNEY INCLUDE WONGA AND LENDING TREE.

PROVIDING INTEGRATED DIGITAL PLATFORMS:

Banks' IT solutions often lack continuity, and few banks have undertaken deep, enterprise-wide IT transformation programs. Thus, few banks currently offer customers an integrated digital experience offering comprehensive, end-to-end online solutions.

In contrast, many fintechs have developed digital applications that serve as a central hub for all existing products / services or as a virtual marketplace. In the case of peer-to-peer lending, for example, such an approach yields better deals for customers and banks alike, by enabling hybrid lending strategies, and matching borrowers' and investors' risk preferences, to originate loans that would otherwise be rejected.

To gain these abilities, Banks should survey what fintechs have to offer; it may be faster and less expensive for a bank to obtain some needed capabilities externally to optimize credit processes overall.

FINTECH PLAYERS WITH DIGITAL PLATFORM OFFERINGS INCLUDE FUNDING CIRCLE, FERRATUM AND ZOPA.

I PORTFOLIO MANAGEMENT:

Fintechs can maximize value from asset rotation so as to generate funding for new loan origination and enable a continuous and easy-to-manage selling process. They rely on an integrated origination and securitization structure and contractual structure to enable fluid portfolio management.

Banks have much to gain from collaborating with fintechs in this area. By doing so, banks should undertake a sensitivity analysis of their portfolios and examine best practices in lean asset disposal, while maintaining a focus on compliance issues. Moreover, banks could look to tailor deposits using pricing to match the requirements of asset rotation more specifically – as a P2P player does.

FINTECHS ACTIVE IN ROLLING PORTFOLIO MANAGEMENT INCLUDE ONDECK, LENDING CLUB, AND FUNDING CIRCLE.

DEVELOPING AND EXECUTING A PARTNERSHIP STRATEGY

Many banks have created new organizational models in the credit area on their own, often forming new units to handle credit data analytics and credit data quality management. However, as Accenture Chief Strategy Officer Omar Abbosh has said, “For long-established or traditional firms, finding ways to scale innovations to become materially successful is extremely difficult. That’s why incumbent companies are vulnerable to disruption from new entrants.”

But new entrants can and do face considerable hurdles as well, as we’re seeing. While fintechs have made significant inroads into financial services markets, the reliability and capitalization issues they’re facing have opened up mutually beneficial alternatives to direct competition.

Collaborative strategies can lead to better outcomes for banks and for fintechs by helping both develop and refine productive ways to evolve. And banks, in particular, should consider such strategies as viable opportunities to grow revenues, optimize processes, and become more fully data-driven organizations.

FINTECH TYPES

I A FINTECH-TECH: NCINO

nCino, a Fintech Tech based in the U.S., sells software to banks by subscription to manage their loans and their operations. The software provides cloud-based operating solutions that aim to simplify the loan process and thereby increase transparency, efficiency and profitability while ensuring regulatory compliance.

Through a single platform, nCino gives banks the power to manage all aspects of the commercial banking process from onboarding to account opening, to treasury management services, to loan origination and approval, while providing quality control along the way. This end-to-end solution combining customer relationship management (CRM), loan origination, workflow, enterprise content management, and instant reporting capabilities allows banks to generate more loans, reducing costs and ultimately driving more revenue for the bank.

I A FINTECH FIN: FUNDING CIRCLE

Funding Circle is a peer-to-peer lending marketplace that allows investors to lend money directly to small and medium-sized businesses.

Funding Circle, based in the U.K., is a rare “unicorn” with a more than \$1 billion market valuation. Funding Circle’s platform directly connects businesses in need of cash with investors looking for good returns; businesses can borrow money while whole or fractional loans can be purchased by individual and institutional investors.

Investors make money from the interest charged on purchased loans while Funding Circle makes money by charging borrowers an origination fee and by charging investors an annual servicing fee. Investments with Funding Circle are not guaranteed and investors may lose money if the underlying loan goes into default.

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