BearingPoint®

Co-Opetition in the Banking Industry

Overcoming the rift between Financial Institutions and FinTechs

BearingPoint.

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Situational Background

Shrinking profit margins, changing customer behavior, exponentially increasing use of mobile devices, digitalization and rising competition exert pressure on the banking industry. Some call the development a "Revolution", emphasizing its speed and disruptiveness. Others name it an "Evolution", accentuating its fundamentality. Overall, the rapid technology development simplifies the market entry for new players and fuels the competition between established and new market entrants. The new competitor species is not only aiming at snatching market share from banks, but is attacking banks' business models.

Challenges for Banks		Chances for FinTechs
• Shifting of Business to more cost-efficient digital channels • Structural need for change as IT is a constantly limiting production factor • Reduction of overcapacities without significant increase in profit	**Technology**	• Creation of products and services by consequently leveraging technological progress, networking intelligently and applying interdisciplinary skills • Adaptable IT infrastructure • (Still) less regulatory requirements
• Rethinking the Business Model to remain competitve • Establish a sustainable, digital end-to-end organization and enable manage-ment and work force accordingly • Profoundly increase the drive for change	**Organizational Culture and Structure**	• Competitive advantage through short time-to-market cycles • Highly adaptable and very flexible • Flat hierarchies supporting effcient and quick exchange of information, internal- and externally
• Product-oriented organizational structures, processes und systems • Profit and cost targets are often prioritized higher than the desires and need of the customers • Traditional customer segmentations lose their effectiveness when "going digital"	**Customer Orientation**	• Product and service development centers consequently positioned around the customer • Customer-focused product and service offering • Seamless customer interaction supported by open systems including opportunity to gather information/data about the client
• Products and services within the banking industry lack differentiation and are thus interchangeable for the customer • Branches do not represent a competitive advantage anymore • Missing differentiation leads to decreasing customer loyalty	**Differentiation**	• Systems and products that are easy to access and available mobile 24/7 • Simplification of banking by increasing convenience and fun due to seamless (mobile) technological integration of basic and add-on services • Offer of specific and client-focused products as well as services that are cost transparent

The so called FinTechs (a neologism created from the terms financial services and technology) have been seen to even attract the more traditional banking clients with services tailored to their expecta-tions, while banks struggle to innovate accordingly. Most FinTechs position themselves by consequently taking advantage of technology development and by leveraging an in-depth understanding of clients' needs, which banks seem to be falling short in covering. FinTechs are able to offer additional or compe-titive, easy and flexible alternatives or add-ons to banking solutions at a lower cost level, as flat hierachies and permeable organizational structures usually enable them to quickly adapt to market changes and to benefit from shorter time-to-market cycles. Their customer focus, the transparency of offerings as well as the capability to innovate clearly distinguish them from banks.

The creation of a unique customer experience through the individualization and personalization of products and services will become even more important for banks in the future. As digitalization blurs industry borders, even Retail, Telecommunication, IT and Technology companies are expected to compete with banks in attracting customers. Banks' survival will thus depend on their ability to offer services which meld with the digital life of their customers and which provide unique and exceptional customer experiences. Other "online" industries lead the way in entertaining the client and banks should be aware that state-of-the-art functionalities combined with innovative usability is a major differentiator.

Rather than pushing customer centricity, banks often still focus more on increasing efficiency and achieving higher levels of operational excellence within their established business model. In contrast, FinTechs have started to make an impact on certain parts of the banking value chain by overcoming typical inefficiencies clients often perceive. These include high costs, a lack of transparency or tedious processes. The offer of easy to access and easy to use products and services has contributed to the success of many FinTech companies.

Although banks may have played down the power and disruptive potential of FinTechs at first, it has meanwhile become quite clear that the FinTechs have come to the party to stay.

Investments as key to cooperation?

The first FinTech successes have proven that their business models are scalable and attract investors which fund further growth. For sure, not all FinTechs will be able to survive on the market in the long run, as they a) usually depend on external capital to fund their business to a significant extent and b) are "mono liners" i.e. they focus on one part of the value chain and do not offer the full breadth of a banking service portfolio. Thus, they operate in a more or less fragmented and partly intransparent market which is still not widely regulated. In any case, FinTechs are perceived as attractive investment opportunities and the volume of investments has just begun to rise. Banks have also started investing, given the valid business opportunities that seem to manifest themselves and in an effort to prevent FinTechs from eating up their market share.

However, banks' investments in FinTech companies have not been seen to correspond to the banks' earnings structure. As of today, the majority of the investments focuses on payments and the credit segment, whereas banks also earn a significant portion of revenue in other banking areas. Furthermore, the investment formats differ as well.

Some banks invest mainly as Venture Capitalist (VC) whereas others have started cooperating on eye level or by offering their banking infrastructure for white labelling purposes. Not only is it relevant for banks to determine "how to cooperate", but also to find an answer to the question "why to cooperate". For some banks, FinTech investments only serve as an attractive money making opportunity, whereas others do not want to miss the party or pursue clear strategic goals. Not all banks may be clearly managing and structuring the investment process as regards the overarching investment strategy or the concrete business area of investment.

Cooperation or Competition?

On the one hand, FinTechs have understood that they either need access to a critical number of customers and/or a bank's infrastructure. Thus, many have opened up for cooperation. On the other hand, banks have become aware of the disruptive potential of FinTechs and their capability to innovate and digitalize. Hence, banks have acknowledged cooperation with FinTechs as an opportunity to increase flexibility, speed and innovativeness.

Even though banks and FinTechs have recognized that they may benefit from each other, we do not see a development characterized by a perfect symbiosis or by cooperation under equals. Both parties are still struggling for their piece of cake as regards to customers and market share.

Some banks have already discovered that sharing and combining strengths could lead to a win-win-win-situation which may enlarge the pie and allow for increased customer satisfaction. Some banks and FinTechs are willing to share parts of their strengths and work together.

The partial congruence of interests allows them to share knowledge and offer new or improved products and services together. Nonetheless, as long as there is no complete takeover or exclusivity agreement, both players still remain competitors. This dilemma between cooperation and competition can thus best be described as **Co-opetition**.

The Co-Opetition Rationale

For the Financial Services industry and for FinTechs there is much more at stake than mere market share. It is the battle for today's gold – the battle for reliable customer data. Hence, they also find themselves in the race together with other financial institutions and banks as well as large technology companies, social media players, telecommunication providers and any other company which may have a commercial interest in acquiring customer data.

Only recently, the initiative "Financial Innovation Now" kicked off in the USA. It "is an alliance of technology leaders working to modernize the way consumers and businesses manage money and conduct commerce."1 The focus is on promoting policies that foster technological transformation to make financial services more accessible, safe and affordable for everyone and to enable these innovations. Some of the largest global brands support this initiative. Should they succeed in reaching their goals, the battle for "the banking customer" is expected to further intensify the shift in market power.

Particularly technology companies have been quite successful in terms of customer communication and interaction. They have effectively created platform systems on which they offer an impressive product portfolio and services to their (future) customers. As the number of customers using their platforms rises, the more insights and customer data these firms retain. Therefore, it is important for banks to facilitate the contact to the customer and to keep in touch with the customer via several channels and touchpoints. The goal could be the creation of a system which is not only used for banking business by the customer, but which offers additional features, thus underpinning the uniqueness of the experience and allowing for effortless interaction. This could be achieved by providing exclusive access to a broad range of FinTech and third party products and services. Access has to be straightforward and the features have to be easy to use, transparent, quick and flexible, with improving functionality continuously over time.

This opens up a whole new perspective for banks and FinTechs: To build up a joint digital Ecosystem.

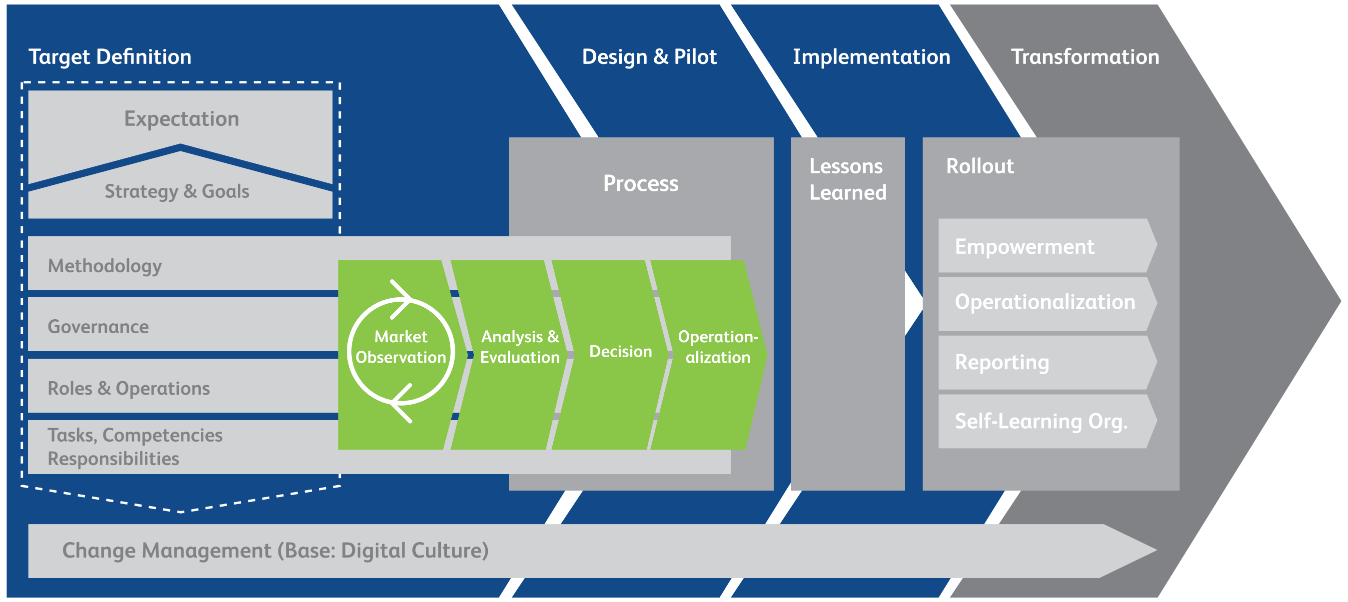
See: https://financialinnovationnow.org/

Getting Started

Cooperation with FinTechs provides banks with a way to improve client satisfaction and thus retention. Likewise, cooperation with banks can provide FinTechs with access to the banks' client base. Irrespectively of the way in which the cooperation may take place, it is important to acknowledge that this type of collaboration is not only about investing, but also about securing a return on investment given the increased value provided to the customer. To ensure this, the collaboration should be set up in a holistic way, accommodating the needs of both parties with respect to strategy, governance and operational responsibilities.

Given this backdrop, it is more than recommendable to anchor the related activities around a structured approach that allows to chart the co-opetition territory and pave the path to leveraging the cooperating partners' strengths whilst moving quickly in establishing the collaboration.

In the following, the move toward co-opetition will be viewed from a bank's perspective. The three-step initialization process is followed by a medium-term transformation phase, during which the new setup is embedded in the organization's daily operations. In the following, we will take a more detailed look into the initialization phase:



Target Definition

Given the confirmed interest to venture into cooperations with FinTechs, banks should clearly define their strategic objectives related to the endeavor. Is the collaboration – or co-opetition – focused on e.g. strengthening certain business areas or customer segments to increase revenues and/or improve the holistic view of the client based on e.g. improved behavioral client data.

Following the elaboration of the strategic goal, a structured market research should take place to find attractive and fitting FinTech companies with suitable add-on services that may be leveraged. If the overall strategy focuses on strengthening certain specific business areas or customer segments, the envisioned FinTech cooperation should take this into consideration.

As a result of the market research process, some potentially attractive FinTechs should be identified.

Due to the fact that technological and service-related developments are not assumed to stop, it is recommendable to continuously monitor the market of potential cooperation partners under consideration of the given or improved selection parameters.

Of course, it is pivotal to analyze and evaluate the strategic fit of the FinTech target, which can take place along a set of previously agreed criteria. In case the prospective cooperation partner offers growth potential in line with the defined strategy, supposedly contributes to improving customer experience and the related value, no matter of which nature the FinTechs business may be, first discussions should be triggered and the elaboration of a mutually sound business case should take place. Moreover, an internal risk and feasibility assessment should be performed in order to fulfill compliance requirements

in line with any applicable rules related to introducing new products and processes at an early point in time. As a result of the "Target Definition" phase, a sustainable decision whether to venture into a cooperation is possible.

Design and Pilot

Should the outcome of the "Target Definition" phase have been positive, the parties enter into negotiations on the scope of the collaboration and the level of integration between both parties. Here, the implementation of a service relationship (cooperation) is thinkable as well as the integration of the FinTech and its service offering and/or its technology into the bank. The level of integration is usually influenced by the short- to mid-term expected strength of the FinTechs USP, respectively the client-facing added value resulting from jointly offering combined or complementary services.

If a mutual decision is taken in favor of a cooperation, a clear concept related to the future setup should be elaborated together. During this phase, it is also important to gain some practical proof of how the future collaboration will work and present itself in the market. The goal should be to fathom how the seamless interoperability of the FinTech with the bank's client services and outreach area as well as internal operations can be realized. Also, should the bank take on the role of a facilitator which manages and bills the services of one or multiple FinTechs, the introduction of a suitable and scalable platform that allows handling and billing of multi-tenant business for the bank is highly recommendable.

Implementation

After piloting, it becomes important to not only remain in testing mode, but to implement the entire process, knowledge and way of working in the organizations' daily operations. This usually means that habits have to change in order to achieve the desired organizational change especially in the sales channels related to the envisioned business enhancement and transformation. A main obstacle is to overcome the expectation of delivering quick results. Although the mere "Implementation" may take place rather quickly, the following "Transformation", which aims at melding the newly paired bank and FinTech activities, usually represents a more medium-term process.

Thus, when talking about entering cooperation with FinTech it is not only the cooperation itself, but also the entire transformation of an organization which has to be accompanied by a specific digital change management.

Managers have to keep in mind that not only the products and processes of FinTechs are different, but that their way of working and possibly even their whole culture is "digitally different".

On the one hand, and particularly at the beginning of the process, these cultural differences might hamper cooperation. On the other hand, they provide an opportunity to develop or reinforce a bank's own digital culture. Hence, banks can not only benefit directly from an improved product and service offering, but also from a push related to their digital capabilities.

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Key takeaways

1. FinTechs are venturing into traditional banking areas and have come to the party to stay.
2. Banks and FinTechs can mutually benefit from each other in a so-called “co-opetition” model.
3. It is recommendable for banks to determine their strategic goals related to potential collaborations with FinTechs and then go on the lookout.
4. Potential collaborations with FinTechs should only be pursued in case of a proven strategic fit and a sound bilateral business case.
5. Obtaining upfront practical proof of how the bank’s and FinTechs operations shall be interlinked is pivotal for sustainable success.
6. On bank side, the operational handling and billing of FinTech services, e.g. via a multi-tenant compatible platform, is recommendable.

The development of a flexible, digital ecosystem which helps banks to accommodate the increasing speed of market developments, caters to innovativeness and allows them to redefine their business models is key.

Be a game changer and embrace innovative FinTech players by making them part of your business! Join the Party and avoid running into the ROI = Risk of Ignoring.

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