

Start-up revolution: a brave new world of bank business

High-potential, scalable technology start-ups are increasingly on the radar of banks looking for new and profitable sectors. These ‘new economy’ companies – active in the fields of technology, software, e-commerce, data management and digital platforms – often have impressive rates of growth and enable access to a valuable ecosystem. But do banks have what it takes to become start-up compatible?



Start-up revolution: a brave new world of bank business

High-potential, scalable technology start-ups are increasingly on the radar of banks struggling to make headway with historic business models; but do banks have what it takes to be start-up compatible?

Limited revenue opportunities, public pressure and tightening regulation have forced banks to refocus their business on 'classic' retail and business banking.

However, it seems increasingly clear that this plan may not deliver the sustainable growth hoped for. Increasing competition and a low-interest environment have continued to squeeze margins, and banks are looking for new revenue streams.

One area that has been identified by some financial institutions as a potential gold mine is start-up businesses in the 'new economy': companies active in the fields of technology, software, e-commerce, data management and digital platforms.

Historically entrepreneurs have been largely shut out from the global banking community until their ideas have become commercial propositions, large enough to talk about a trade sale or initial public offering (IPO).

Now banks, including Commerzbank¹, Crédit Agricole² and Deutsche Bank³, are reappraising this previously ignored segment.

Banks that are looking to become attractive to start-ups must be alert to conflicts that can arise. Their own rigid and standardised processes and structures contrast with the demands of businesses that are used to operating with far greater agility, outside the bounds of other more established sectors.



IN 30 SECONDS

- Banks seeking alternative sources of revenue are finding increasing potential in start-up businesses in the 'new economy'
- These technology firms are often mass-market-focused, with low costs, scalable business models and links to a valuable network
- Becoming start-up compatible is a major challenge due to their rapid growth and demands for sophisticated products, faster service and delivery
- Banks will need to adapt existing structures, processes and resources to make the most of this lucrative customer segment

USD 40 bn

Uber's market capitalisation after only five years⁴

Exponential growth

Over the past 10 years, there have been more changes in the business landscape than at any other point in history, apart from the industrial revolution. This is testament to the power of tech start-ups to change the way we do business and live our lives.

Being mass-market-oriented with low labour and capital costs means their business models are highly scalable and allow fast growth in national and international markets.

One example is the transportation network platform, Uber⁴. Set up in 2009 in San Francisco as a local cab agency, within five years Uber became a global leader in transportation, operating in 50 countries and valued at around USD 40 billion.

Of course, we tend to hear far more about tech start-up success stories, which can skew the reality that the failure rate is high.

But, in our experience, even if only 10–20% of these companies reach profitable maturity, engagement is still an attractive prospect to banks because of the services they will need if they do reach a certain size, including complex cash management solutions and capital market activities.

The advantages of the ecosystem

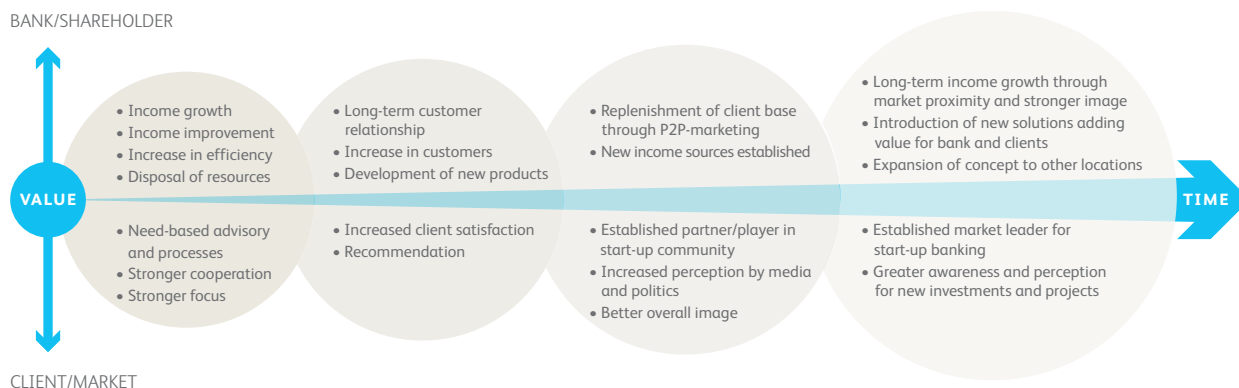
Start-ups tend to operate in ecosystems made up of investors, sponsors and other start-ups. This community of companies is an attractive proposition for banks to tap into for a number of reasons.

The German online platform Rocket Internet⁵ is one of the most active and efficient examples of a start-up ecosystem in this field. Through an extremely efficient network, Rocket Internet identifies business models⁶ and provides capital, know-how and expertise. Sector-specific experience and a large pool of highly skilled experts with marketing, IT, business and law backgrounds allows Rocket Internet to help start-ups rapidly enter the market at a high frequency, allowing a quick return on investment.

Relationships with such networks of investors, business incubators and accelerators can offer access to start-ups that have already overcome hurdles of quality and development.

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Figure 1: Nurturing start-up relationships adds value over time
Benefits of start-up relationships for banks



Source: BearingPoint Institute

This creates opportunities for banks to provide simple and standardised products like current accounts and electronic banking solutions to start-ups in their seed-fund phase. The start-ups that become commercially viable will soon have more sophisticated finance demands, like complex cash-management solutions and capital market activity, which creates more profitable long-term business for banks.

On the retail side, the company's employees are also attractive new clients, particularly in the portfolio management business. IPOs and trade sales create enormous private wealth and, potentially, new clients for European banks' ageing private-client business.

Apart from the financial advantages, start-ups offer banks a regional footprint and image. For global finance institutions, which can be perceived as remote and aloof, this is particularly valuable.

Beyond clients – start-ups as business partners

Banks can also leverage the start-up opportunity by teaming up with potential rivals looking to disrupt the status quo in financial markets and disintermediate banks from their traditional customer relationships.

10-20%

Even if only this proportion of start-ups reach profitable maturity, engagement is still an attractive prospect for banks

Digital platforms targeting lending, fundraising and supply-chain finance have emerged in recent years, firing up the public's imagination and threatening to eat into banks' profits. Credit platforms, for example, offer borrowers the chance to meet interested investors, and payment service providers bring new and future-oriented solutions. Companies like PayPal⁷ can establish a real market presence in a very short timeframe. In the French market, Linxo⁸ and Bankin⁹ are two start-ups offering unified mobile account management to multi-banked individuals.

So how can banks get closer to the start-up ecosystem? A first level of involvement is through open collaboration, organising events or challenges around specific needs or topics. In October 2014, Société Générale hosted a 'hackathon' to develop ideas for apps tied to banking and the internet of things – resulting in no less than 30 project proposals¹⁰.

At the next level, banks can initiate partnerships combining their experience with ideas from start-ups to deliver mutually beneficial offers to the market.

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ARE YOU READY TO ENGAGE WITH START-UPS?

Ask yourself:

- Do I have access to start-up clients?
- Can I provide sufficient and relevant services from the funding phase to an IPO?
- Can I commit enough resource for marketing and internal adjustments?

Begin your service transformation by:

- Defining how you will recognise start-ups
- Breaking down barriers between different standards of customer care for start-ups
- Bringing on board experts with experience of start-up networks, venture capitalists and other investors
- Defining specific targets and preparing KPIs

‘The bank’s role is key in supporting start-ups as they in turn create jobs that sustain our economy. Crédit Agricole is a main regional player, and we aim to support our territories’ growth. Building relationships with start-ups will enable us to identify disruptive ideas to enrich relationships with our customers.’

BERNARD LARRIVIÈRE, INNOVATION DIRECTOR, FÉDÉRATION NATIONALE, CRÉDIT AGRICOLE

Thirdly, there is the potential for financial involvement through corporate investment funds, joint ventures or other shareholding opportunities. BBVA Ventures, for instance, seeks strategic opportunities that can support banks’ innovation agenda¹¹. Among others, they invest in a portfolio of disruptive businesses in the areas of financial technologies, big data or e-commerce.

Finally, banks such as Crédit Agricole¹² and Commerzbank¹ have launched their own private business incubators in Paris and Frankfurt am Main, respectively, to support the potential of nascent developments and secure future strategic advantages.

Making the change to become start-up-friendly

In their rush to discover the next tech start-up gold mine, banks must not underestimate the challenges of developing this rich seam.

The dynamics and idiosyncrasies of start-ups can create friction with the boundaries of financial institutions’ processes and structures. Making a bank start-up-compatible is rarely possible without substantial changes to service offerings.

Figure 2: How can banks collaborate with start-ups?
Development stages in the relationship between banks and start-ups



Source: BearingPoint Institute, BPCE

30

project proposals resulted from a Société Générale 'hackathon' in 2014¹⁰

The necessary changes can easily be derailed by organisational issues, stemming from lack of buy-in or disagreement over priorities, or else progress peters out.

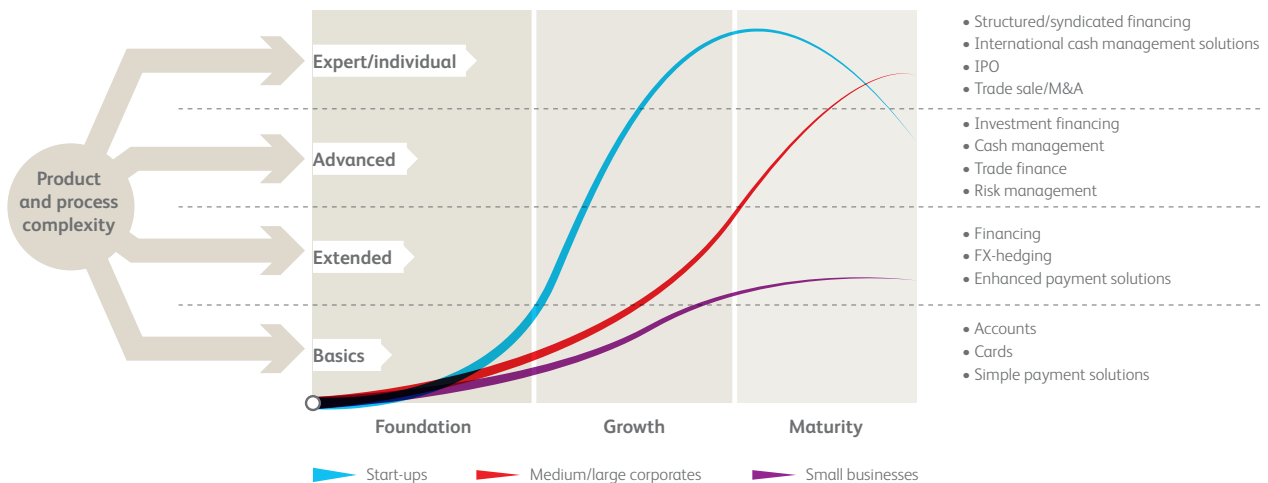
Existing client and product processes usually do not allow flexible offerings due to a high degree of process standardisation.

Over the past two decades, banks have developed specific product packages that suit the respective purpose of companies of a certain size and maturity stage. Whilst this approach may work with most companies, start-ups tend to have different requirements because of their fast-growing nature. The speed at which revenue can increase means they can quickly find that their needs are no longer catered for by a bank's off-the-shelf offering. More individual and complex solutions are needed.

To tap into the full potential, banks need a comprehensive approach that includes changes to how banks classify their customers, which

Figure 3: Start-ups require faster service and delivery than other business clients

Lifecycle of product demand



Source: BearingPoint Institute

usually dictates the level of service a bank offers. The first step is to recognise the varied nature of start-ups and the need to work differently to accommodate them. Start-up-friendly banking requires special teams that can recognise start-up potential and advise them in the early stages, where companies of this size would normally be lower down a bank's priority list. The focus of those teams on start-ups helps the bank to optimise the service towards their specific needs.

Rethinking how you do business

Taking advantage of the undeniable potential offered by start-ups requires banks to make significant changes to their processes. Thorough project scoping and planning is necessary for a move into serving start-ups and requires concept experience, methodology and market know-how. Client segmentation, communication methods and key performance indicators (KPIs) have to be rethought, whilst still remaining compliant with regulations and other standards. Current banking rating systems focus on figures from the past like revenue, but start-up business is much more future-oriented and requires forward-looking indicators like revenue forecasting.

As a first stage, banks need to identify whether they have an accessible portfolio of start-up clients. Start-up hotspots are usually focused on specific areas, such as Berlin or London.

An honest assessment of banks' own offerings is also necessary. They must consider whether they are able to provide sufficient and relevant services to start-ups from the seed-fund phase to the IPO.

An appraisal of the resources required to move into this space is also advised. To get the attention of start-up clients will most likely require significant commitment of investment in marketing and other internal capabilities – processes as well as the skills of bank employees.

Standardisation, popular with banks to keep costs down, can impose unnecessary barriers for start-ups and these need to be identified and removed. Accounts or payment systems that might be suitable for a regular small business do not allow for the speed of growth start-ups tend to achieve, so can become quickly outmoded. In addition, bank service levels are often segmented by revenue bracket, which can be obstructive for businesses that may need to move quickly and easily between the different stages of customer care in order to get the services and products they need.

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The very flexible nature of start-ups means they are more willing to change suppliers quickly if they experience an unfinished or inappropriate product

This inflexible situation can be exacerbated if a division's focus on meeting their budget makes them reticent to upgrade client services.

Once the decision to serve start-up clients has been made, being able to identify them is a basic prerequisite. A definition using clear criteria will help to avoid potential start-ups being handled like any other regular small business in a branch.


Strong cross-network communication can create or ruin reputations fast

Banks must remember that start-ups are streamlined for performance and efficiency: bank services need to fit this ethos. Start-ups are generally far less tolerant of sub-standard service than other bank users.

The very flexible nature of start-ups means they are more willing to change suppliers quickly if they experience an unfinished or inappropriate product.

Reputation damage associated with such losses can be severe due to the strong cross-network communications within start-up communities, which quickly pass around negative feedback. At the same time, getting it right can quickly create new client relationships due to positive recommendations.

Reforming a bank's offering in this way needs the input of experts experienced in interactions with start-up networks, venture capitalists and other investors. Overall, a bank needs to define a specific target and work from this to prepare internal and external measures. Tracking progress of these initiatives is crucial to keep up the momentum and spot possible problems.

In realising a start-up-friendly banking transformation, an objective, external perspective can be invaluable in offering both a neutral appraisal and access to the necessary skills. 



KEY TAKE-AWAYS

- Limited revenue opportunities, public pressure and tightening regulation have forced banks to seek new sources of business
- Start-up firms in the ‘new economy’ – companies active in the fields of technology, software, e-commerce, data management and digital platforms – offer a potential solution
- Mass-market-oriented, with low labour and capital costs, these firms’ business models are highly scalable and allow fast growth in national and international markets
- By targeting these firms, banks can nurture profitable relationships within their valuable ecosystems of investors, sponsors and peers
- Banks can also mitigate competitive threats by teaming up with potential rivals looking to disrupt the status quo in banking and financial markets
- Banks are investing in new ways to engage with this community, such as collaborative events and products, investment opportunities and dedicated business incubation units
- Becoming start-up compatible is a major challenge due to these firms’ rapid growth, complex product needs and demands for faster service and delivery
- Start-ups are streamlined for performance and efficiency: bank services need to fit this ethos. Start-ups are generally far less tolerant of sub-standard service
- Banks must be prepared to deliver a comprehensive range of bespoke products and services from seed-fund phase to IPO, and adapt existing structures, products, processes and resources to maximise success
- An objective, external perspective can be invaluable in offering both a neutral appraisal and access to the necessary skills

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