Why banks must rely on fintechs

Ralph Mogicato, a fintech angel investor, explains why banks and fintechs will work ever-closer as the former rely on the latter for something interesting and new to offer to clients to service their wealth management needs. Disruption in any dramatic way looks unlikely.

Because most banks are not innovative by nature, they will increasingly rely on fintechs to drive client interactions and engagement within wealth management. As a result, they are more eager than ever before to get these companies on board.

This is according to Ralph Mogicato, an entrepreneur and independent senior adviser, who says this explains the hype and potentially large bubble emerging in this space.

This also explains the shift in what fintechs are focusing on. "The original fintech companies were supposed to be disruptive. However, today every start-up which writes a line of [programming] code calls itself a 'fintech'," says Mogicato. "There are not many firms which are genuinely disruptive."

As a result, while some fintechs will inevitably be successful, many won't survive for long.

But there will be no 'brave new world' along the lines of earlier predictions. Instead, Mogicato says banks need to work out how to get the most value for their wealth management businesses from collaborating with fintechs today.

And the consequences for banks which don't take these developments seriously will be severe, he predicts. "In the medium term, they will be less interesting and relevant to their clients. And in the long term, they won't be in business at all if they don't offer attractive prices, good execution and a quality service."

A NEW FINTECH FOCUS

Against this backdrop, now is the moment for more fintechs to enter the limelight – given that their agility and pace provide them with the opportunity to implement their ideas without the baggage of legacy systems.

It is in this way which they will be critical in providing a competitive advantage to

RALPH MOGICATO
Angel investor and entrepreneur

those banks shackled by a heavy level of financial regulation and compliance issues. Testament to this trend is the number of innovation labs and accelerator programmes which have sprung up around the world – and initiated by some of the world's largest banks.

Further, a recent study by Accenture of global investment in fintech ventures in the first quarter of 2016 showed that this reached USD5.3 billion, a 67% increase over the same period last year. The report also noted that the percentage of investments going to fintech companies in Europe and Asia Pacific nearly doubled, to 62%.

Perhaps most notable about the report, and backing Mogicato's observations, is that collaborative fintech ventures – those primarily targeting financial institutions as customers – are gaining ground over so-called 'disruptive' players that enter the market to compete against those institutions.

For example, funding for collaborative fintech ventures, which accounted for 38% of all fintech investment in 2010, grew to 44% of funding in 2015, with the remaining investments made in ventures competing with institutions.

Yet, the proportion of competitive fintech ventures in Europe and Asia is much higher than in North America, reflecting the earlier stages of maturity of fintech markets, outside of London.

However, while so-called 'disruptors' may compete against banks at first, they often end up aligning with them through investments, acquisitions and alliances, said the report. It highlighted BBVA's recent stake in Atom, a mobile-only bank in London that launched last week.

DRIVING CHANGE

In the years to come, Mogicato believes that many financial institutions such as banks and insurance companies will still exist, but they will have been able to use fintechs in ways to help to transform their businesses.

To get to this stage, however, more banks need to start focusing on change management. "If they don't get the basics right, such as the right core platform and clean up their application landscape, then they will fail," explains Mogicato. "They will prove to be too slow and it's too expensive to survive."

As a result, he is positive about fintech. "Banks must be more focused on their client and their needs, which means better products and faster execution. Banks can do more with start-ups which can produce software for business-to-business applications."

In particular, the back-end must work and be flexible, and straight-through processing is a crucial component of this. But this is a key area of the business which most banks have ignored. They neither renovated what they have already, nor put in place a new one.

Without this, what most banks have, says Mogicato, is akin to putting a Ferrari engine in an old-timer – it won't work.

Yet the banks aren't the only firms in the ecosystem which need to adapt. Core banking providers such as Avaloq and Temenos, for example, are confronted by new technologies such as blockchain.

These firms have responded in other ways, by building their own 'app stores' – where banks can plug into their platforms new solutions from start-ups.

SET FOR SUCCESS

It has also become clearer which kind of fintech has the biggest potential to create a splash.

What to look for when investing in a start-up

It is generally quite easy for fintechs to raise money and get a first meeting. The elements they need to survive over time, however, include:

- *A good and highly-motivated founder team*
- *A good simple idea – complexity is not good*
- *Fast execution of the idea*
- *Find one or two existing clients using the product or service*

Payment-oriented firms, for example, and those at the retail end of the business with customers as their focus, are going to be big – the most likely among all fintechs to become the future 'Ubers'.

Robo-advisers will be the other big disruptive force, with the more successful ones which get the formula right to be the defining element of wealth management – driving the future of advisory and marketing in the near future.

The game-changing firms, therefore, are those which can be unencumbered by the constraints of the traditional way of thinking in wealth management.

Yet banks need to do more in their pursuit of fintech. They need clearly identified long-term goals in collaborations with such firms – such as increasing the company's revenue or profit.

For fintechs, they need to ensure what they offer is tangible with valuable output. This will prevent them falling prey to cost-based decisions when pressures increase, explains Mogicato.