Strange bedfellows. Banks and start ups need to collaborate

By Peter Alkema

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New customer preferences threaten the traditional business models of financial services companies and large banks, where growth and success has typically relied on fixed-cost infrastructure and manual processes. The greenfield, customer-centric innovations of fintechs are hot topics in every boardroom in the industry.

Nearly 30 new banking licenses were granted to start-up banks in the UK just in the last decade, many of these with fully digitised processes and ambitions of exponential growth through disruption of high street banking. In the USA, Google has banking licenses in over 30 states; and in South Africa, bank customer digitisation and process innovation is already well advanced, in some cases even more so than in developed countries. However, if digitisation is just an early stage in achieving outlying performance in a largely undisrupted industry, then the race for exponential growth is wide open.

Collaboration

The broader financial services landscape in South Africa has seen a groundswell of fintech-related initiatives, most of which indicate a preference for collaboration between large banks and start-ups. Established banks in South Africa are creating these ecosystems for entrepreneurs and harnessing next-generation thinking so they can stay ahead of the curve in the race for digital disruption and exponential growth. These leading institutions are aggressively partnering and purchasing start-ups or white-label capabilities to increase the innovative offerings in their value chain.

Last year Standard Bank announced a range of physical and virtual incubators, aimed at helping early stage entrepreneurs with facilities, mentoring and an expanded network. Standard Bank benefits from access to disruptive technologies in these incubators, plus it is investing in social entrepreneurs whose disruptive ideas can benefit society. Barclays has a global accelerator programme called TechStars, which includes a physical presence in Cape Town and offers a 13-week programme for start ups that includes access to senior executives, industry experts and mentors.

RMI Holdings CEO Herman Bosman says its tech incubator, Alpha Code, is an enabler for start-ups and offers investment opportunities for the company, which has a good track record of picking industry winners - Outsurance, Discovery, MMI and FirstRand. Nedbank's Business Accelerator focuses more on established entrepreneurs and provides a media platform through *702* and *Cape Talk* for young companies to gain exposure and achieve continued growth.

Some conditions for disruption are already in place: Traditional banks have huge infrastructures, operate under extremely restrictive regulation and have cost to income (CTI) ratios above 50%.

Start-up banks, in comparison, are lean and can achieve below 10% CTI, easily achieving the very thin margins needed to entice and switch ever more price-sensitive banking consumers. On the other hand, much of the main banks' infrastructure can be considered its strength - robust IT platforms that offer very high-volume transacting; cross-border trade and settlements through a multi-national presence; and very strong and trusted brands linked to vast networks of bricks and mortar points of presence that support a 70%-banked mass market population.

The nature of disruption is likely to exploit the cost and regulatory burden, while successfully attacking the infrastructure benefits. The problem for start ups is that the incumbents understand this and are already doing it.

Arguably there is also a long, slow burn of customer growth to the left of the exponential curve as the huge unbanked population in South Africa trickle into the slowing economy. This is a dual challenge for local banks: To the left – bank the unbanked; to the right – achieve outlying performance with digitised, profitable customers. Innovation investment in South African banking is indeed driven by technology and improved customer-centricity, but first-mover advantage will depend on sorting the hype from genuine long-term value.

Regulation still favours big banks

Technology start-ups within the fintech arena are swiftly building trust with these digital narratives through the convenience and simplicity of their offerings, but so far they seem unlikely to convert this to the life-partner trust levels that big brand banks still enjoy. Here the burdensome regulation works in favour of the established banks; they have simply worked a lot harder and a lot longer to achieve compliance and credibility in the industry. The successful banks of the future will build on this by moving the disruptive business models from incubation to transformation so they diversify their trust equity into the digital convenience that fintech offers.

Some would argue that partnerships and incubators are still mainly peripheral activities for established banks and that disruptive thinking and innovation needs to extend right through an enterprise to truly harness its full potential. The counter argument is that many of these fintech solutions are still in the hype cycle phase and the bank's periphery is the correct place for them until they are proven for mainstream.

In his latest book, *Zone to Win*, Geoffrey Moore argues for four different zones within an organisation that enable prioritisation and planning of resources to take advantage of disruptive innovation, while also actually running a successful business on established, currently profitable business models.

The performance and productivity zones rely on a model of sustaining innovation to make profit and manage costs respectively. These are the areas of hard numbers and established technologies. For a bank, core business revolves around large volume lending and deposit taking that requires robust transactional banking platforms. The Incubation zone is more than a think tank for playing with cool stuff, it has an executive level mandate to position the organisation to catch the next wave – arguably the partnerships and ecosystems that banks in South Africa have created in the last 10 years.

The difficult part, Moore predicts, is scaling the profitable, disruptive innovations into the transformation zone, where the enterprise has decided and announced that it will run a new line of business that is mission-critical to the evolution of their industry. Companies who fail to do this successfully are overtaken. Examples Moore cites in the tech world include Blackberry, Netscape, Lotus and Nokia.

Banks do not want to be on this list but they cannot rely on their traditional shock absorbers of regulation, size, infrastructure and brand value to keep themselves off the list.

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