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Banks v fintech

An uneasy symbiosis

Fintech has made inroads, but the incumbents still dominate day-to-day banking. For how long?

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THE VIEW FROM the 39th floor of One Canada Square, the pyramid-capped central tower of London's Canary Wharf financial centre, is one most bankers would envy. Looking across into other buildings, you can just about see into the corner offices of higher-ups at HSBC, Barclays and Citigroup. The bosses of lesser banks languish dozens of floors below. But this particular floor does not look like a home to financial Masters of the Universe. The trendy decor is reminiscent of a Facebook or Google office, and so are the staff: casually dressed 20- and 30-somethings cluster around MacBooks perched on the tables of a free café. The meeting rooms are whimsically known as "sandboxes", and a bell rings daily at 3pm to invite everyone to help themselves to a freshly baked cookie.

Level39, as it is modishly known, is a startup "accelerator" whose members are mostly fintech companies. In subsidised digs—shoebox offices start at £1,700 a month, hot desks at £325—dozens of small teams work feverishly to become the next Square, Stripe or Lending Club. There are now so many of them that floors 24 and 42 have also recently been turned over to the scheme, set up two years ago by the Canary Wharf Group, the area's developer, to diversify its appeal to a new breed of tenants.

The banks are doing what the old adage tells them: keeping friends close but enemies closer. Not only are a number of them based within a stone's throw of Level39, some also pay for the opportunity to hobnob with its inhabitants. Others run their own startup-mentoring programmes, exchanging cash and staff time for a small stake in a budding enterprise. BBVA, Santander, HSBC and Citi are among those that have set up fully fledged venture-capital-like arms to deploy hundreds of millions on such enterprises.

Most fintechers do not feel half as warmly towards their incumbent rivals. One dismisses them as “the Kodaks of the 21st century”, another as “financial vacuum-tube makers in the age of the transistor”. They see banks as tomorrow’s telephone copper wires, vestiges of an earlier age, and believe that in essence banks cannot adapt. “How often have you seen an incumbent really reinvent themselves?” a startup founder asks. The best thing anyone can say about banks is that they will always be around. “People like to whinge about them but they will never leave,” says Neil Rimer of Index Ventures, a fintech investor.

Bless the current account

And why would they? Day-to-day banking is not such a bad deal. Customers can store their money safely and get at it instantly, usually even from abroad these days if an ATM is to hand (remember travellers’ cheques?). They can cash in their pay cheques and settle bills. This costs them little or nothing, and everything is backed by a government guarantee. Banks built the credit society and continue to dominate it. In America about 70% of consumer lending is for mortgages, a sector banks have almost to themselves (thanks in part to government meddling).

Moreover, banks have done fairly well with moving their services onto the internet and then to mobiles. These are two major transitions that have fundamentally changed the way people handle their financial affairs: few industries successfully manage even one. Given their size, banks are perhaps not as incapable of evolution as their fintech critics make out.

So it may not be surprising that fintech has failed to break through in what most people would recognise as day-to-day banking. No startup has successfully made a play for the centrepiece of people’s financial lives, the current account. Banks are making a good-enough job of this in a highly regulated environment unappealing to many outsiders. A handful of entrepreneurs have tried. Prepaid payment cards five years ago were seen as a viable alternative to banks, at least for some people, but after a burst of excitement fizzled out. Beyond apps that aggregate data from users’ various pots of money to help them budget, the most creditable attempt to date to replicate a bank account was made by a startup called Simple. It was taken over by BBVA last year for just $117m—or $0.117 billion, in venture-capitalist language.

The threat the fintechers pose to incumbents is that they might just seize the profitable add-ons

Yet bankers who cheered at the capitulation of a fintech darling making a grab for their core business missed the point. The threat the startups pose is not that they will topple banks as linchpins of the economy. Most fintechers are not interested in the complicated, regulated bits of banking. The threat they pose to incumbents is that they might just seize the profitable add-ons, from loans to payments services and investment advice—anything that generates fees. It now seems increasingly likely that they will manage to “unbundle” at least some of these extra services banks offer their clients. That will leave today’s lenders with fewer revenues to maintain their costly rump services.

A bank whose customers go to Prosper for loans, Currency Cloud for holiday money and FutureAdvisor for investments will find it increasingly hard to support its existing cost base. For a retail bank, something like half its individual borrowers are already unprofitable. If more of them peel off to fintech newcomers for this and other services, that figure is bound to rise. Any loss of the banks' firm grip on mortgages—which has so far barely been challenged—would certainly be keenly felt.

The most credible part of fintech's *braggadocio* is the comparison drawn between banks and telephone copper lines. It should haunt bankers. In the same way that AT&T, BT and their peers have fought to avoid being turned into "dumb pipes" delivering the vibrant internet's content, unbundled banks may find themselves becoming "dumb stores of value", funnelling money to more glamorous fintech products.

Bankers are well aware of this. They are keeping a close eye on how their products compare with those of the newcomers, and many of them understand their limitations when it comes to innovating. "If you want to come up with a new product in a bank, any one of 50 people internally can shoot it down. If you're a startup, you can go visit 50 venture capitalists and you only need one of them to give it a green light," says Tonny Thierry Andersen, head of retail at Danske Bank.

Even so, the startup ethos is changing the way bankers think about their profession. One common refrain among incumbents is that they need to become less product-focused and more customer-focused, which is true but easier said than done. They also note that customers value transparency.

Incumbents are likely to copy, license or buy many of the innovations served up by fintech once they have proved popular. Banks did not invent the ATM but they co-opted it efficiently. Wealth managers will do the same with robo-advisers if they keep attracting new money. For any large financial firm, it would not take more than a few weeks' worth of profits to gobble a fintech star.

Fintech faces many challenges. A lot of startups will fade away when venture capital stops flowing quite so abundantly, as one day it undoubtedly will. Even before that, they will have to prove they can be sustainably profitable, even when credit conditions are less benign. Some services may falter, some may continue to thrive, others will no doubt evolve to work in different conditions.

But for many financial services, the gulf that long isolated banks from competition is being bridged. This is wonderful news for consumers: those who have tested fintech newcomers often gush about the experience, in a way they seldom do after a visit to their local bank branch.

That will prod the incumbents to up their game. Never mind if fintech fails to take over the world, or even the current account: its emergence is changing the face of finance. The all-conquering bluster coming out of places like Level39 is clearly exaggerated. Banks still have a future, but they will have to work harder to make it a profitable one. That is all for the good.

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