The evolution of fintech and incumbent partnerships

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Introduction

The world has become increasingly digital, and customer preferences have evolved as a result. Customers now expect innovation and seamless digital experiences across sectors, from retail to banking, with expectations of these traditional services being influenced by seamless and immersive digital-only user experiences. In response, there has been a proliferation of financial technology (fintech) start-ups over the past decade. These changing preferences and expectations, coupled with the rise of fintechs, require incumbent financial institutions step up their innovation game.

Banking has historically been an insulated industry. Yet, technological advancements, such as peer-to-peer (P2P) networks, application program interfaces (APIs), distributed ledgers and the ubiquity of smartphones have enabled fintech companies to present a serious threat. For example, evolving open banking ecosystems today in jurisdictions such as Australia and England allow customers the power to share their financial data, held by banks, with trusted third parties.

As the Canadian financial sector moves toward a similar open banking framework, today's incumbents will undoubtedly pursue more partnerships with fintechs to augment their respective product and service offerings. Financial institutions that can consistently anticipate and meet the continuously evolving expectations and needs of their customers will have a distinct advantage over those that do not, and fintechs will play a critical role in helping incumbents gain that advantage.

Yet, fintech and incumbent partnerships bring with them a unique set of challenges both parties need to understand and overcome. We set out to investigate these inherent challenges by leveraging our experience as one of Canada's primary advisors to the fintech community, and mid-market and large financial institutions.

Based on our research and discussions with clients, industry stakeholders and academics, we will highlight emerging trends, and provide practical insights and recommendations for both fintechs and banks to build successful partnerships on the road towards collaborative customer-centric digital transformation.

"There will be opportunities for both incumbents and disruptors, but also a reenergized third framework where fintechs will enable incumbents."

- Adam Felesky, CEO, Portag3 Ventures

The evolution of fintechs and incumbent partnerships

While fintechs are often assumed to be a modern innovation, they are by no means a recent phenomenon. Third-party technology ventures and partnerships have long been prevalent in financial services. What has changed is a new partnership model being deployed globally with smaller, more entrepreneurial, fintech start-ups .

As fintechs continue to both emerge and mature, banks will need to adopt a strategic approach to collaboration and third-party relationships. We believe the most successful incumbents will partner with fintechs in several specialty areas and deploy emerging technologies such as advanced data analytics and artificial intelligence to provide their customers with the meaningful experiences they expect and value.

Based on our experience with financial institutions, integrating smaller, more agile start-ups into their core operations presents a challenge. Cultural differences coupled with misalignment in governance, risk and compliance often leads to extended integration timelines, unrealized objectives and the erosion of deal value. To address these challenges, traditional banks must transform their respective cultures, adapt their approaches to governance, risk and compliance and evolve their underlying technology architectures.

The most important consideration for incumbents is how they will prepare for the effective identification and implementation of partnerships with third parties, and, in particular, with smaller start-ups. Adam Felesky, CEO of Portag3 Ventures, a leading Canadian fintech venture capital firm, told MNP that fintech / incumbent partnerships will continue to be a key theme, but this won't be a winner-take-all category.

Impetus behind alliances and partnerships: Symbiotic relationships

Partnerships between fintechs and financial institutions can be viewed as symbiotic relationships. Banks bring their extensive customer reach, rich data, and capital, while fintechs provide innovation, the potential for plug-and-play functionality and augmented customer experiences.

Often, incumbents may lack the internal capabilities to enact digital transformation due to the significant compliance requirements across the enterprise, competing priorities to support the legacy business, and cross-business-line, consensus-based decision making. While these challenges are well understood, we believe the benefits of partnering with fintechs outweigh the challenges and expect fintech / incumbent partnerships to increase as a result.

> *It's important to think of banking as a service, and ultimately what you could do to improve customer service. Integrating fintechs is key in being able to offer better customer experiences and even target specific niches.*
> - Jan Christopher Arp, Founding Managing Partner, Holt Accelerator

Below is an overview discussing the impetus behind these types of alliances for both fintechs and banks.

The motivation to partner: A fintech perspective

Regulatory compliance: Fintechs can depend on incumbents to help navigate highly regulated environments such as retail banking or mortgage lending and facilitate compliance with regulatory requirements.
New customer acquisition channels: Incumbents provide fintechs with a large base of loyal clients as well as direct connectivity to their systems through APIs.
Consumer trust: Partnerships with incumbents can help fintechs improve brand recognition and attract new investors by providing consumer/institutional trust. This is especially true in Canada, as banks and traditional financial institutions are generally viewed quite favourably.
Low cost funding / acquisitions: In many cases, fintech start-ups have been able to access funding through partnerships with financial institutions, and banks may look to acquire promising start-ups, if the partnership is successful.
Learning and development: There is no better place for fintechs to navigate the complex world of regulated financial institutions than within one; gaining insights and perspectives from access to industry experts can help enhance their respective solutions.
Shared services: Fintechs can benefit from the marketing initiatives and reach of incumbents and, in acquisition scenarios, can utilize advanced people management practices and enterprise software platforms.

The motivation to partner: The view from incumbents

Modern brand elevation: Today's consumers demand frictionless digital experiences and value in their online and mobile banking. Incumbents can work with fintech partners to develop marketing strategies that elevate their respective brands by integrating fintechs' capabilities and value propositions into their own.

Innovative technology: Fintechs offer incumbents instant access to the latest and emerging technologies as well as innovative approaches to meeting banks needs without requiring significant proprietary research and development (R&D).

Speed to market: For established financial institutions, partnering with fintechs enables organizations to provide customers with the user experiences they have come to expect and value-added services, in an accelerated timeframe, thereby increasing competitiveness.

Serving new customer segments: By combining their resources and brand power with fintechs, incumbents can develop inroads with new customer segments, such as younger generations, at a lower cost and may even acquire customers in previously unaddressed or challenging market segments.

Access to top talent: Even during times of economic uncertainty, there is a battle for top talent such as engineers, data scientists and software developers. Partnerships provide financial institutions access to top technology talent they may otherwise be unable to attract.

Learning and development: Learning can improve both partners' positioning by addressing each party's respective shortcomings, such as the incumbent's lack of knowledge surrounding evolving digital technologies and agile methodologies, and a fintech's lack of knowledge or experience in regulatory compliance and bank decision-making.

Innovation models

Incumbent financial institutions have adopted several innovation models to develop technology solutions. These include combinations of in-house development through innovation hubs, partnerships, acquisitions and outsourcing.

"[Finanial institutions] need to have a very strategic mission, and then choose between build or buy."

- Elisabeth Laett, Managing Partner, Holt Accelerator

Below is an overview of each model.

Build it in-house

Many banks believe the most effective way to innovate is to address the opportunity internally. Canadian financial institutions have largely adopted this internal model and have launched 'digital factories' and even their own digital banks. Larger banks, in particular, have opted to develop their own proprietary technology such as Scotiabank's eHome platform which digitizes the end-to-end mortgage process for homebuyers or CIBC's Smart Balance Alert that uses advanced analytics to assess funds available against recurring or upcoming payments, and alerts customers when their accounts may hold insufficient funds.

Canadian incumbents, in particular, have also developed in-house accelerator programs and innovation hubs where start-ups can compete for funding and work with the bank, at arm's length, to develop technology solutions. One example is RBC Ventures, which incubates both fintechs and companies operating outside the financial sector.

These types of accelerators help start-ups integrate into the bank in a low-risk and controlled environment. While this strategy has suited incumbents with large innovation budgets, building technology products in-house requires sufficient resources with the right mix of skills. This strategy, however, is not a guarantee of success and presents, even for the largest incumbents, an uncertain return on investment (ROI).

Partner or acquire

While large financial institutions around the world have successfully developed technology solutions in-house, many global banks have also found success collaborating with fintechs to develop innovative products, services and user experiences for their customers. Incumbents may acquire a fintech outright if the results of a partnership are favourable, or if there are strategic advantages in doing so. We spoke with Jan Christopher Arp of the Holt Accelerator, who sees advantages in incumbents partnering with fintechs:

> *"Institutions can enhance their own capabilities by continuing to maintain a focus on what they do well, while integrating what the fintechs do well."*

There is a broad spectrum of partnering models used in the industry. Some of the most common approaches include:

1. **Vendor / client relationship:** In this model, technology solutions are introduced by a third party to be hosted by the bank or as a cloud-based software-as-a-service (SaaS) solution. Irrespective of the hosting model, a significant challenge is integrating the third party's technology with that of the financial institution. This is an age-old issue that is being resolved through the development of APIs and the eventual move toward standardization or an open architecture model. This vendor / client model has traditionally been the most common approach in the sector.

2. **White labelling and managed solutions:** At times, financial institutions may choose to outsource the management of certain products or services to a partner while still presenting the service as its own brand. This 'white labelling' can be advantageous from a customer relationship perspective as the customer's experience with the institution is seamless and the fulfillment of the service by a third party is invisible to the customer. An example might be a mobile small business lending solution funded and advertised by the bank yet managed by a third party.

3. **Mobile applications:** Most banks have focused on a mobile / digital approach to delivering their customer experiences. In this model, a fintech's technology is utilized to enable specific features or functions within a bank's digital ecosystem. Mobile applications are usually connected to online banking platforms or the bank's backend systems, providing the bank with a modern, omnichannel solution.

4. **Full outsourcing:** Areas not within the core competency of the bank may be outsourced to a fintech partner or service provider. In this instance, there is a clear contractual division between the bank and the partner. Regulatory compliance monitoring and reporting are critical in this model.

5. **Application programming interfaces (APIs):** This model can work in both directions. Financial institutions can publish APIs for access by vendors, which allows fintechs to plug into the core IT infrastructure and integrate their technology solution. This plug-and-play functionality is a relatively straightforward partnership model and will become more common as banks continue to implement common integration standards, and as the concepts of open banking / consumer-directed finance evolve in Canada.

6. **Acquire:** Financial institutions often acquire fintech companies, particularly when a fintech introduces a product or service that yields a positive ROI. While being acquired is often considered the end game for many start-ups, fintechs should work to ensure that any acquisition deal is in alignment with their organizational goals, and stakeholder expectations.

Fintech adoption among Canadian incumbents

While partnerships between fintechs and incumbents have been successful in many parts of the world, the evolution in Canada has lagged other financial centers. A recent report revealed that while there are more than 1,000 fintechs operating in Canada, the number of partnerships with financial institutions is significantly lower.[1] The study noted while Canada's big banks may be increasing their engagement with fintechs, the majority of their efforts are still centred on building their own products and digital experiences in-house.

Unlike in other global fintech centers, Canadian banks, with their historical ties to the social fabric of Canada, coupled with the reputation for prudent management and an aversion to risk, are highly trusted by Canadian consumers. The result has been a banking industry with a resilient business model and little pressure to innovate or drastically change.

While larger financial institutions still hold the vast majority of market share in Canada, there is now widespread recognition amongst incumbents that, if they wish to enhance service offerings and achieve their digital innovation goals, they will need to figure out how to work with early-stage and smaller fintechs. Incumbents have recognized the need to improve collaborative relationships. However, most fintechs still find the process of working with them to be cumbersome and potentially disruptive to their business. This highlights an opportunity for banks to enhance their partnering processes and align it to their respective growth and innovation strategies.

1 Geoff Zochodne. "Inside the power struggle between big banks and fintechs to modernize financial services," Financial Post, March 27, 2019. https://financialpost.com/technology/watch-out-big-banks-you-might-wake-up-one-day-and-be-blockbuster (Accessed: June 27, 2021)

Recommendations and steps fintechs can take to successfully navigate partnerships

Despite the clear reasons and benefits, for fintechs and banks to collaborate, there are many challenges that stand in the way of successful partnerships. By analyzing some of our client engagements with both fintechs and incumbents, we have developed a series of recommendations to help address some of the most pressing collaboration challenges, and have outlined a framework for both incumbents and fintechs to improve partnership outcomes.

As a fintech, how can your organization become partnership ready?

1.	Understand the relevant regulations and compliance standards related to your product / solution
2.	Understand how financial institutions make decisions, their internal cultures, and their processes
3.	Find your champion
4.	Assess the alignment of your product / service to the internal processes and needs of incumbent providers
5.	Nail down the use case, and sell the problem
6.	Participate in accelerators and collaboration networks that closely align to your value proposition
7.	Understand incumbents' technology architectures and develop an integration roadmap
8.	Be flexible, but don't overcompensate on your core product offering
9.	Protect yourself contractually and seek advice from external advisors
10.	Set yourself up for success

1. Understand the relevant regulations and compliance standards to your product / solution

An important component in any fintech's go-to-market strategy is an appreciation for the regulatory complexities of the financial services industry. Fintechs must dedicate the time and resources to understanding the complex regulatory requirements of financial institutions and be prepared to address those concerns with potential incumbents.

> *"Many fintechs are excited to partner with us, only to later discover the enormous compliance requirements of a regulated entity. Our partners then need to really lean on us for knowledge related to regulatory compliance, CDIC insurance, fraud and AML."*
>
> *- Neal Oswald, former COO, Concentra Bank*

At MNP, we have seen many of our own fintech clients encounter issues in partnerships because they didn't fully appreciate the magnitude or complexity of regulatory and legal constraints. Savvy fintechs should strive to meet incumbent level compliance requirements and pay close attention to relevant requirements such as OSFI Guideline B-10 on outsourcing, or the relevant provincial credit union regulatory guidance on third party risk management, as examples.

2. Understand how financial institutions make decisions, their internal cultures, and their processes

For partnerships to succeed, fintechs must understand how banks bring new products to market as well as the key priorities relative to their clients and, importantly, with respect to risk.

> *"While the fintech CEO is usually a technologist, the bank CEO is almost always a risk manager".*
>
> *- Graham Seel, industry expert*

The technologist therefore should strive to understand the mindset of the risk manager, who relies on tangible evidence that a technology solution will reduce costs, increase revenue or automate back-office processes while mitigating risks. Many of our fintech clients have benefitted from hiring or engaging ex-bankers and other financial services professionals to help better understand the priorities and decision-making processes within incumbents.

3. Find your champion

Ben Harrison, Head of Partnerships and Policy at Portag3 Ventures, sat down with MNP to discuss fintech / incumbent partnerships among their many portfolio companies. Harrison always advises fintechs to find a champion within the incumbent who can be an advocate, to connect the fintech to the right people and help ensure the partnership is considered an organizational priority. While the champion may help the fintech make inroads within the bank, more often than not, they will not be the ultimate decision-maker.

Harrison recommends fintechs may first seek to align with business leaders within incumbents prior to engaging with their technology leaders. He cites that, in most cases, the business will hold the trump card versus technology. Gaining alignment between the business and technology is an important role of the fintech when contemplating an innovation-based partnership.

> *"…though there's no silver bullet for accelerating the corporate sales cycle, the better the fit between your solution and the corporate pain point and the greater the level of engagement and buy-in from senior business leaders, the quicker the process will move."*
>
> - Ben Harrison, Head of Partnerships and Policy, Portag3 Ventures

4. Assess the alignment of your product / service to the internal processes and needs of incumbent providers

One important observation from our fintech clients is that incumbents have become increasingly demanding when it comes to their investment criteria. Pitching innovative products or services to conservative banks without having translated these into clear use cases, while also checking the boxes from a regulatory, risk and user experience perspective creates delays smaller fintechs can ill-afford. Incumbents demand clear, credible roadmaps based on business needs and quality - not quantity.

To best engage senior leadership, fintechs are encouraged to consolidate their propositions to a one-page visual roadmap, with clear use cases and timelines. According to Portag3 Ventures, focusing on a specific use case provides a clear goal – while demonstrating the value of the partnership. If a fintech is challenged in articulating a use case, it may be championing a solution that's looking for a business problem rather than a business problem that requires a solution. Use cases should clearly define the business benefit, the potential challenges, and what success looks like.

5. Nail down the use case and sell the problem

While fintechs should be clear about their respective product roadmaps, use cases and value proposition, they must also articulate how their solutions solve specific business problems or capitalize on market opportunities. Incumbents want to understand both what they can do with a product or solution and why they should deploy it. Oftentimes, confusion related to use cases and problem definition can reduce the likelihood of partnering. Portag3 Ventures advises their portfolio companies to reframe their pitches from "here is what our product can do" to "this is what you can do with our product."

A complex list of features and functions can often overwhelm an audience but demonstrating the benefits through use cases brings tangibility to those benefits. Portag3 recommends fintechs focus on describing how their solution can help incumbents achieve tangible outcomes such as increasing revenues, acquiring new customers or enhancing productivity as opposed to stating capabilities such as utilizing AI, delivering insights or automating processes.

6. Participate in accelerators and collaboration networks that closely align to your value proposition

The fintech universe is expanding daily and banks are finding it a challenge to remain current on market trends, fintech entrants and the overall partnering ecosystem. This lack of awareness has, in part, been addressed through the proliferation of regional accelerators and collaboration networks. These entities serve an important role in bridging the gaps between fintechs and incumbents and allow fintechs to pitch their solutions and seek out advice from industry experts. Incumbents are relying more frequently on these collaboration networks to familiarize themselves with the global fintech marketplace.

In Canada, The MaRS Center, located in Toronto, supports more than 1,000 start-ups and dozens of fintechs.[2] The MaRS Center connects fintechs with representatives from a wide range of Canadian banks including CIBC, Manulife, Sun Life Financial and Interac. Holt Accelerator, based in Montreal, especially supports fintechs, accelerating their growth and adoption. Some of the prominent fintech accelerators are highlighted in the following table. These networks each bring their own unique approach, focus and capabilities to members and participants:

2 https://www.marsdd.com/our-sectors/fintech/ (Accessed: June 27, 2021)

Accelerator Name	Location
MaRS Center	Toronto
Holt Accelerator	Montreal
North Forge	Winnipeg
Fintech Cadence	Montreal
Station Fintech Montreal	Montreal
Cultivator (by Conexus)	Regina
Co. Labs	Saskatoon
Intuit Prosperity Accelerator w/ Highline Beta	Canada-wide
Plug and Play	Toronto, Silicon Valley, Chicago
Fintech Innovation Lab	New York City
QC Fintech	Charlotte, NC

7. Understand incumbents' technology architectures and develop an integration roadmap

An important aspect for fintechs to consider when readying themselves for partnerships with incumbents is how to integrate into the financial institution's complex technology stacks. While some core systems remain an integration challenge, industry participants are taking steps to allow for easier integrations with third parties. While understanding these types of developments can provide fintechs with critical insights to establish their partnerships, they should also understand the unique cyber security and privacy considerations unique to financial services, and how to mitigate potential integration-related risks.

8. Be flexible, but don't overcompensate on your core product offering

A common trap fintechs should avoid is overpromising on the ability to customize their solutions or committing to unrealistic concessions to incumbent partners. While most partnerships require some level of customization of any solution, a fintech should not redesign its product beyond its strategic vision or strain its resources and capabilities to meet unrealistic commitments. Overpromising product or service capabilities is also a red flag for incumbents, who will generally view a solution being pitched to them as "vapourware" if it requires significant changes to fit the use case or address the problem being solved.

"If you want to evolve and become a successful product, there need to be firm guidelines on what the product is and what it isn't."

- Stephen McDonald, CFO, TickTrade

9. Protect yourself contractually and seek advice from external advisors

Fintechs must ensure they protect themselves contractually and seek professional advice early regarding key aspects of intellectual property protections, conflicts of interest, corporate / deal structuring, and other key success factors. As noted, incumbents appreciate clear roadmaps, well-defined paths to profitability and realistic ROI calculations. Fintechs would be well-served to identify relevant performance metrics, key working objectives, mutually-agreed outcomes and clear accountabilities, capturing these in a contract or statement of work. The selection of advisors, setting of expectations and defining the terms of engagement are critical success factors for any fintech seeking to partner with an incumbent.

10. Set yourself up for success: Lessons from the field

Neal Oswald, former COO of Concentra Bank, explained partnerships need to be executed in a defined period of time with the target outcome of delivering a minimum viable product or MVP. There needs to be clear alignment on the mutual benefits of partnership up front, and management should be encouraged to deliver a fast yes or a fast no.

> *"This is why we have built out a pre-requisite framework for Concentra's prospective partners, and also why we have paid attention to our onboarding capabilities. We need to hear them articulate a strategic view of what they want from the partnership, and we need to be able to articulate that back to them or it simply won't work."*
>
> *- Neal Oswald, former COO, Concentra Bank*

Neal shared with MNP Concentra's five prerequisites for partnership success.

Concentra Bank: Five prerequisites for partnership success

1. Strategic fit assessment / partner due diligence – culture, ethics, strengths and weaknesses, and deal logic
2. Clear communication about mutual objectives, business case and value creation
3. Agreed implementation plan, or sequence of events to get to a plan
4. Agreed governance (standardized metrics and oversight) with defined roles, responsibilities, obligations, expectations, incentives and key performance indicators (KPIs)
5. A mutual understanding of how we work with partners and our relationship expectations

Elisabeth Laett, Managing Partner at Holt Accelerator explained "fintechs need to work with banking institutions very strategically and patiently. Build, at minimum, a three-year vision together of what the new technology will look like when it is integrated and deployed."

Recommendations and steps financial institutions can take to successfully navigate fintech partnerships

While there are several important considerations for fintechs in preparing for partnerships with banks, the accountability to facilitate and execute on partnership success is heavily weighted towards incumbents. As these financial institutions seek to bolster their own technology or customer experience through fintechs, successful integration requires strategic focus and significant effort.

Partnerships with fintechs or start-ups often don't succeed, in part because financial institutions don't prepare themselves adequately for the introduction of novel, and possibly disruptive, technologies and processes. So how can financial institutions increase the probability of partnership success? We believe there are six areas for incumbents to consider in order to facilitate successful partnerships:

1. Prioritize partnering into your organization's strategic plan
2. Establish partnering as a core competency
3. Reassess risk management frameworks, and adjust to incorporate third-party risks
4. Use appropriate performance measurement KPIs
5. Become integration-ready, i.e., assess the development of open APIs and identify potential technology gaps
6. Transform your organization's innovation culture

1. Prioritize partnering into your organization’s strategic plan

Fintech partnerships can be an avenue for success for incumbents seeking to rapidly innovate. The challenge with this option is many banks have not integrated a partnering competency into their formal strategic plans, and generally employ an opportunistic approach to partnerships. According to TD Bank CEO Bharat Masrani, “You can’t just partner your way to relevance – there has to be an internal shift in the culture of the bank.”[3] The fundamental question is, what can be done to change the culture within a financial institution in order to improve partnership outcomes?

> **“You can’t just partner your way to relevance – there has to be an internal shift in the culture of the bank.”**
>
> - Bharat Masrani, CEO, TD Bank

Understand what problems you want solved, and who is best to solve them

Similar to how fintechs must articulate how their product or service solves a problem, financial institutions need to understand the fundamental problems within their organization or their customer proposition that need fixing. This starts with a conversation within the organization regarding those aspects of their business that need help. Once business goals and gaps are outlined, the focus can quickly move to how technology solutions may help, and whether these solutions should remain proprietary versus those that could be delivered by others.

This can be a difficult process for incumbents, particularly given the significant investments already made in developing and extending most organizations’ internal capabilities. The question then becomes whether this is an initiative that should be prioritized for rapid release to the market with help by a third party, or a problem that should be solved internally. Once objectives are understood and assessed, a strategic partnering approach can then be incorporated into strategic planning and a solution roadmap developed incorporating business imperatives, outcomes, technology options and a third-party vendor approach.

Centralize partnership activities to drive consistency

Many financial institutions manage their relationships with third parties, including fintechs, at the line-of-business level. While helpful in fostering business alignment, this approach can introduce additional third-party risk for banks and their partners, and it can translate into added complexity and decreased speed to market. One way of adapting the approach is by designating core teams, and leaders, dedicated to investigating, approving and managing third-party relationships. This centralized function should act as a center of excellence for partnerships to ensure fintechs and other third parties can successfully integrate into the bank.

Jason Hendrichs, CEO of Alloy Labs, an American fintech accelerator for community banks, believes “what will be telling in 2021- is actually developing the muscles and the capabilities in partnering. It’s all about a culture of execution and avoiding the ‘we can’t do this because of risk’ mindset. COVID has proven we can do a lot.”[4] Incumbents should be on the offence, proactively allocating individuals within the organization to assess the needs of its customers, the gaps in its products, and which partners can help them realize their strategy.

3 “The New Partnership Era Ft. Bharat Masrani, Noah Breslow, and Ryan McInerney,” Bank Policy Institute, April 3, 2019. https://www.youtube.com/watch?v=c55bV5gcNHM (Accessed: June 27, 2021)

4 JP Nicols. “Episode 353: Murder Hornets, Firenados, and Your 2021 Strategic Plan,” Provoke.fm, September 4, 2020. https://provoke.fm/episode-353-murder-hornets-firenados-and-your-2021-strategic-plan/ (Accessed: June 27, 2021)

Give the centralized function a leader with authority

A German study of the largest banks in Canada, France, Germany, and the United Kingdom, revealed banks are much more likely to form alliances with fintechs when they employ a chief digital officer (CDO). For example, banks with a CDO initiated 6-10 percent more alliances with fintechs than those that did not.[5] The CDO can coordinate a dedicated third-party collaboration team with broad visibility across the enterprise and with sufficient authority to clear internal roadblocks, resolve interdepartmental conflicts, communicate with senior leadership and maintain a focus on customer outcomes and overall value.

Use the centralized function to research and identify potential fintech partners

Rather than partnering with fintechs on only an ad hoc or opportunistic basis, banks should determine how a partnering strategy may facilitate or accelerate the broader organizational strategy and identify fintechs specializing in the areas of strategic focus. In our experience working with financial institutions, proactive incumbents dedicate sufficient resources to researching the fintech ecosystem for both attractive opportunities and to better understand emerging trends.

Portag3 Ventures Head of Partnerships and Policy, Ben Harrison, believes just staying on top of market developments and engaging with fintechs requires a dedicated focus. "You don't need a whole team, but having one person or a small group whose job it is to engage with fintechs and find partnership opportunities for the organization is really important. Too often we find that this work is being done on the side of someone's desk who has another full-time job." According to Harrison, a great example is Scotiabank, which has found success with their own dedicated partnership group, having decided fintech partnerships are important enough to warrant a focused and dedicated team.

"Having a few people who do this is quite useful, and this is not rocket science. It means having a few simple processes in place to keep track of important industry developments and market players, but also, having a formal way of assessing fintechs and connecting them to the pain points within the business is essential."

- Ben Harrison, Head of Partnerships and Policy, Portag3 Ventures

5 Hornuf, Lars; Klus, Milan F.; Lohwasser, Todor S.; Schwienbacher, Armin. "How Do Banks Interact with Fintechs?" Forms of Alliances and their Impact on Bank Value, CESifo Working Paper, No. 7170, Center for Economic Studies and ifo Institute (CESifo), Munich, July 2018. https://www.econstor.eu/bitstream/10419/185368/1/cesifo1_wp7170.pdf (Accessed: June 27, 2021)

2. Establish partnering as a core competency

It is important to envision and assess how a partnership will impact your infrastructure and identify this early in order to adequately address the issues and set the partnership up for success.

Once the two parties start working together, internal obstacles and a lack of coordination by banks are among the most common barriers cited by fintechs regarding partnerships, largely because many incumbents do not have formalized systems, business processes or a defined path for fintechs to navigate. Financial institutions are often still siloed, with each business unit or department making its own decisions on whether to buy, partner or invest in a fintech.

> *"Serious commitment for change sometimes exists at the top levels and customer-facing levels, but it's important to motivate all the employees in the middle as well. Organizations should give employees a reason to step outside their comfort zone."*
>
> *– Elisabeth Laett, Managing Partner, Holt Accelerator*

A significant source of friction in partnerships arises when incumbents consider fintechs as "just another vendor." Fintechs, especially early-stage companies, are not well-suited to be managed as a traditional vendor by incumbent organizations, who are accustomed to working with larger systems integrators and software providers. Fintechs have unique needs and limitations that should be addressed with an equally unique approach by incumbents. This approach requires flexibility and a higher level of upfront collaboration between the parties.

Helping fintech get 'bank ready'

Incumbents can help fintechs navigate their internal processes and systems and guide them through important considerations such as data security, regulatory compliance, and anti-money laundering requirements. As an example, while banks employ discrete teams tasked with managing regulatory compliance, smaller fintechs often do not possess the necessary resources to actually remain compliant, and may not have personnel within their teams with the skills and knowledge to effectively navigate complex regulatory issues or to understand their impacts.

Above all, incumbents should ensure they are fostering a collaborative culture within their organizations, where employees have sufficient time, resources and skills to work effectively with their fintech counterparts. This translates into providing adequate incentives related to partnership outcomes and encouraging engagement across the business for customer-centric innovation. As mentioned previously, incumbents have helped fintech partners to become 'bank ready' by developing their own internal accelerator programs to support early-stage fintechs at an arm's length. These accelerators help prepare fintechs to present their ideas to bank leaders, while simultaneously addressing important industry issues such as regulatory compliance, cyber security, and integration.

Mitigate protectionism and ditch the traditional vendor relationship model

One of the pain points we frequently hear from fintechs relates to the barriers they have negotiating partnerships with banks, as well as the barriers they face once engaged by incumbents. Most standardized agreements and contracting processes among incumbents are developed with large vendors in mind and can easily overwhelm smaller fintechs, which often do not have in-house legal counsel.

Incumbents should maintain adequate risk and vendor management policies; however, they should also seek to simplify their processes for smaller fintechs, which can become overwhelmed by these policies and processes that, for banks, are standard practice.

The importance of onboarding

Financial institutions should seek to standardize their partnership processes to be well defined, intuitive, and repeatable. This can include improving intake mechanisms and onboarding processes to help fintech partners navigate banks typically complex organizational structures and quickly connect with the right stakeholders. In addition, a culture of disciplined execution and accountability that focuses on deploying high-performing and referenceable fintech solutions can produce favourable outcomes. This requires leveraging technology solutions with the right internal processes and talent to facilitate and support successful delivery.

As an example, Concentra Bank has taken a deliberate and standardized approach to onboarding fintech partners. According to Neal Oswald, Concentra's former COO, "Our goal is to be the fastest Schedule 1 bank to onboard partners so we can become a destination for the best fintechs. We have a 'partnership prerequisites for success guide' that we put partners through to make sure we start off on the right foot. This guide covers important partnership components like KPIs, governance and an implementation plan, and we try and get partners to agree to this beforehand to avoid issues early."

3. Reassess risk management frameworks, and adjust to incorporate third-party risks

Engaging in third-party relationships without appropriate controls for risk can lead to poor outcomes for all stakeholders. Thus, it is critical for banks to understand and manage the risks stemming from fintech partnerships. With respect to risk management, an incumbent should consider where it can, and where it cannot compromise.

Procurement and vendor selection processes have evolved somewhat to accommodate earlier stage companies, however, if these processes are overly complex or burdensome, they could potentially discourage a fintech from pursuing a partnership. A comprehensive third-party risk management framework that includes partnerships with early stage start-ups will address operational, reputational, contractual, regulatory compliance and strategic risks associated with a potential fintech partnership. Other important and salient areas of risk include:

1. Data governance and ownership
2. Cyber security, data encryption and privacy
3. Conduct and customer relationships
4. Skills and competencies
5. Third-party performance management
6. Legal risks

To best address these risks, a formalized process of service level agreement development, execution, monitoring and management should be implemented. This process should be captured within the financial institution's third-party risk management framework with policies and processes that clearly articulate key accountabilities across the lifecycle of the third party relationship, including clearly defined governance, reporting and communications policies.

Balancing risk with innovation

With entrenched cultures of risk aversion, and consensus-based decision making, fintechs face lengthy approvals for their technology solutions when partnering with incumbents. Management and executives within financial institutions might reject a fintech solution if there is too great a perceived impact to risk. The necessary lens of risk can present agile teams from fintechs with bottlenecks. To address these issues, and remove the barriers to innovation, leaders within the business and technology must foster a collaborative approach with third parties. To foster a culture of innovation, while maintaining an appropriate appreciation for risk, banks should:

- Utilize a practical cost-benefit approach to any partnership initiative, culminating in the development of a detailed business case. The business case should include a clear articulation of risks and the potential short to long-term benefits and cost profile.
- Define a clear vision for the future state and what impacts the partnership will have on the organization and its customers, with a focus on outcomes — both intended and unintended.
- Directly link fintech partnerships into the broader goals of the organization, including strategy, key initiatives and the overarching product and service portfolios across the enterprise.

Empathize with fintech by understanding their sales cycle

While risk management is a crucial pillar in any third-party partnership strategy, banks should balance risk mitigation with pragmatism. Incumbents' internal processes, bureaucracies and decision-making processes can often contradict the fast-fail approach common with fintechs and other technology start-ups. Some incumbents have even conceded risk management barriers have killed deals for partnerships with fintechs, which are often operating on short timelines and thin margins. According to TickTrade CFO, Stephen McDonald, "a typical sales cycle with a bank is three to six months, and with security reviews and vendor management programs, the costs of closing a deal are very high."

By imposing longer sales and planning cycles by virtue of their own decision processes and policies, banks can inadvertently derail potentially high value partnerships.

> *"Some partnerships emerge serendipitously, and fintechs come from the world of 'we want to get things going now.' They have the resources and the need to get revenue on the books, while the incumbent has their strategic plan and roadmap that has been put in place through a formal process and is generally inflexible to changes outside of the planning cycle."*
>
> \- Ben Harrison, Head of Partnerships and Policy, Portag3 Ventures

Incumbents should develop their strategies with an understanding risks should always be balanced with the potential rewards of partnership and innovation, such as increased customer satisfaction, calculable ROI and the appreciation of shareholder value. They should also build provisions into their strategic plans and roadmaps that allow flexibility for opportunities that arise on an ad hoc basis.

Finally, if a financial institution does decide to explore a partnership with a fintech, expectations surrounding process, timelines and decision criteria should be set openly and early such that all participants' time and effort can be optimized. It's critical all parties have this information so they can effectively allocate resources and work toward a common understanding of the process and desired outcomes.

4. Use appropriate performance measurement KPIs

One of the more significant issues that can hinder fintech / incumbent partnerships is a lack of appropriate performance metrics. Establishing certainty and ROI of technology investments can be difficult in any industry, and financial institutions can also struggle to establish the quantitative versus qualitative benchmarks related to partnerships.

Both sides should agree, in advance, on appropriate performance metrics, project objectives and key accountabilities. According to industry expert Sam Kilmer, even when all of this is in place, the roadmap still requires a reality check: "Does the fintech have the resources to live up to the commitments it's making? On the flip side, does the financial institution have the resources, and more importantly the capacity to execute and actually implement things?"[6] Ambiguity when answering these questions can paralyze collaboration, investments or acquisition decisions, and further hinder mutually beneficial partnerships.

Recommendations:

While financial institutions tend to prefer quantitative measures of success, our view for incumbents is in addition to hard measures, they should consider a complimentary longer-term, qualitative view of measuring partnership outcomes. Both banks and fintechs should monitor and report on quantitative and qualitative performance metrics to ensure continued alignment on scope and expectations and for clarity on what is required from each party to sustain the partnership for the long-term. While defining quantitative metrics can be difficult, partnerships should adhere to a broad set of agreed-upon performance measures specific to the partnership and aligned to organizational outcomes. Qualitative measures could include such metrics as partner satisfaction, customer satisfaction or net promoter scores and should complement qualitative measures while aligning to the incumbent vision.

6 Steve Cocheo. "Making Fintech Partnerships Work: Tips for Banking Providers," The Financial Brand. https://thefinancialbrand.com/91651/fintech-partnership-digital-innovation-disruption-strategy/ (Accessed: June 27, 2021)

5. Become integration ready

Over time, through mergers, the development and introduction of new products and services and an ever-evolving regulatory landscape, banking systems have become highly complex, and legacy systems continue to limit what incumbents can do from an innovation perspective. Core banking systems, the workhorse of any financial institution, have long been stable and robust systems for banks to securely process millions of daily transactions. These systems, however, present both with costly challenges: Complexity and risk both to the financial institution seeking to innovate and to fintechs accustomed to — or hopeful for — plug-and-play functionality.

> *"Any cloud-based future roadmap comes with a lot of interfaces, and if you don't have an ability to quickly and easily connect interfaces to each other, how are you ever going to take advantage of cloud-native software?"*
>
> – Leonard Hendricks former CTO of Celero Solutions.

While most financial institutions work towards opening up API gateways for third parties, and implementing common integration standards, fintechs still face a fundamentally closed architecture, especially to core banking systems. According to Tick Trade CFO Stephen McDonald, one of the biggest challenges from a contracting point of view with banks is a fundamental lack of understanding around the technology stack. "The software being used in the typical incumbent is very complex, and when you start a project you don't always know all of the details. What can happen is you sign a contract, and then there are 100 change requests because of unexpected integration challenges, which can make things very time consuming, and expensive."

While fintechs seek access to back-end systems and data sets, the inclination to employ shortcuts can be problematic. Incumbents should ensure any third parties being engaged adhere to strict cyber security, privacy and data standards. For example, if a backdoor or weakness exposes a bank to a breach of its customer data — its data crown jewels — the potential costs, both financially and reputationally, of that worst-case scenario would far outweigh any potential benefit of a fintech partnership.

What matters most to fintechs is that banking systems have provisions for collaboration. While integrating with core systems remains a challenge, potential open banking legislation may introduce requirements for banks to expose APIs to qualified third parties and serve as an accelerator for migration to an open architecture approach.

Recommendation

Financial institutions will require foundational investments in making their data easily available to third parties in order to differentiate themselves from intensifying competition. This means developing, testing and maintaining API libraries, so they are available and reusable by qualified third parties. Concentra Bank COO Neal Oswald told MNP that "we spend a lot of time thinking about API library management, and strategic use of APIs. We also try to make sure that our IT systems utilize a microservices architecture that is component and capability-based, so we can assemble the client journey. Fintechs understand this but they are the front end. As a bank, you need to make this happen end-to-end, which means a lot of design and implementation."

Making data available strategically to third-party innovators can help financial institutions accelerate innovation and build the pathway to improved customer experiences — something closed architecture and older legacy systems inhibit.

6. Transform your organization's innovation culture

Canadian financial institutions are evolving, and with the challenges presented by the recent COVID-19 pandemic, they have accelerated change to adapt to a rapidly changing market. They have adopted digital first strategies to better serve their customers and are promoting agile work cultures that foster collaboration amongst teams. Incumbents have largely adopted these strategies out of necessity, responding to changes in consumer behaviours resulting from the pandemic, such as physical distancing and stay-at-home advisories in addition to simply keeping pace with digital trends. But what does this mean for fintech partnerships? To continue transforming both what and how they are serving customers, financial institutions must go further in fostering innovation by implementing what can be defined as an agile execution culture.

Established at their inception, fintechs are inherently agile organizations – naturally embracing the core tenets of agile:

1. **Innovation** – focusing on the unique fit of each solution vs. following rigid processes or standards
2. **Rapid value creation** – bringing iterative solutions to customers at pace
3. **Flexibility** – embracing change as a means to improve
4. **Collaboration** – engaging in frequent and open communication

Incumbents are certainly adopting agile and it is critical to incorporate these principles toward fintech partnering. While most bank leaders understand existing processes, systems, and organizational structures may present obstacles in delivering agile projects, they are less certain of how to effectively instill an agile execution culture into the partnerships and, more broadly, throughout their respective organizations.

> *"A startup culture is one of innovation and being 'customer first,' which can actually be good if embraced by larger organizations from the top and then filtered throughout the organization."*
> \- Jan Christopher Arp, Holt Accelerator

How to foster an agile execution culture

To foster an agile culture and create an environment where fintechs transition from being perceived as vendors to being viewed as integrated team members, the three most important steps are: acknowledging the need; developing the strategy; and adopting best practices.

Incumbents are encouraged to clearly define their vision, identify the internal impediments to adopting agile within their potential partnerships, and create an transformation roadmap to overcome these obstacles. When implementing an agile execution culture, it is advised to start incrementally, either within a line of business, or with a well-defined technology project, and then progressively scale up to other areas of the organization. The fintech / incumbent partnership offers a unique opportunity to integrate these concepts and test against outcomes.

Acknowledge the need - and get stakeholders on board

Incumbents encounter some familiar problems when attempting to deploy agile methodologies across the enterprise. While each institution takes an approach best suited to its context, a lack of a common vision ('why agile?') and what it means to adopt an agile way of working leads to many failing to deliver the business value they anticipated. To address this issue requires incorporating a pragmatic change management strategy, adequately supported by the business with appropriate resources and qualified agile practitioners at the forefront. The organization should utilize a leadership strategy that engages stakeholders, including communicates the vision and benefits of the strategy. For executives, this includes empowering employees, executing frequent touchpoints with teams, and identifying and resolving issues in real time. How employees view the partnership is critical to its success.

Develop the strategy

Implementing agile at scale requires integrating workstreams, and rethinking how technology is developed, tested and released. Incumbents should focus on creating a work culture conducive to facilitating innovation in collaboration with third parties. Friction often manifests when third parties impose an agile approach that conflicts with an organization's existing method of developing and deploying its technology solutions. Large-scale transformations are difficult, and require total leadership commitment, a culture receptive to change, and experienced agile practitioners to effectively lead teams and sustain the newly adopted practices.

Adopt a culture of continuous delivery

A company's technology foundation is also critical to optimizing agile teams. Leading practitioners of agile methodologies adopt software development and IT operations strategies that automatically release new features soon after the team develops them, flipping older and slower software development and IT models. This method of organizing software requirements empowers its proponents to collect timely feedback from customers about new digital products and services. It also serves as an important conduit between the lines of business and IT stakeholders.

Conclusion

Fintech companies will continue to drive financial services modernization and innovation. They will help shape consumer and business expectations and force incumbent financial institutions to adapt to these heightened expectations and the resulting competitive forces. While many industry observers have commented on the perceived “us versus them” mentality between fintechs and incumbents, it is our belief the effective collaboration between both parties can drive accelerated progress and innovation in the sector that will benefit all stakeholders.

To advance collaboration, banks and fintechs must enter the arena with an open mind, understand the drivers of success for both parties and accommodate each other to facilitate, rather than hinder, innovation and transformation. By recognizing the mutual benefits for partnerships, incumbents and fintechs are more likely to thrive in the rapidly evolving financial services ecosystem. With ongoing regulatory reforms in Canada coupled with the changes in customer needs, combined with the rapid evolution of technology, the possibilities for fintech / incumbent partnerships seem endless.

About MNP

MNP is a leading national accounting, tax and business consulting firm in Canada. We proudly serve and respond to the needs of our clients in the public, private and not-for-profit sectors. Through partner-led engagements, we provide a collaborative, cost-effective approach to doing business and personalized strategies to help organizations succeed across the country and around the world.

For a deeper conversation on finding the right partner or making your partnership a success, please contact:

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