Commercial Bank of California

THE FINTECH REVOLUTION IS HERE

HOW WILL YOUR BANK RESPOND?

THE BANKING INDUSTRY IS FACING A FINTECH REVOLUTION.

Fintech (also known as financial technology) is used to describe a broad variety of technological innovations in personal and commercial finance. It includes technologies such as mobile wallets, online financial wellness programs, digital-only banking, blockchain, and others that have not even appeared yet in the market.

Fintech has grown rapidly in recent years because of a convergence of several trends and events. First, the everyday consumer's available computing power (think of the smartphone) has dramatically increased, so that applications that were once available only to businesses or to consumers on desktop computers can now be run literally out of one's pocket. By 2018, over a third of the world's population is projected to own a smartphone, an estimated total of almost 2.53 billion smartphone users in the world.

Second, because of the smartphone, people are accustomed to doing everything with a maximum of efficiency and speed, and that includes managing their financial lives. Travel, real estate, communications, gaming and everything else are all available with the latest mobile technology. Why not banking? A recent PWC survey indicated that 90% of banks expect significant growth in the use of mobile applications in their industry, much higher than any other financial sector.

Third, as more and more Americans reach adulthood without ever knowing a world without mobile applications, the demand for financial applications is increasing. These demographic shifts are helping to create the new market for financial technology. According to a First Data report, 86 percent of millennials aged 25 to 34 use smartphones. Furthermore, according to the report, "Many millennials would never think of ducking into a bank branch to take care of their financial needs, or even writing out a check. More than a fifth of all millennials have never even written a physical check to pay a bill. It's no surprise that 94% of consumers under 35 years old are active users of online banking. Another 27% would consider a branchless digital bank. So, many things that are considered part of a traditional banking relationship, millennials are now doing on their smartphones."

Fourth, the worldwide financial crisis that began almost 10 years ago sapped customers' trust of banks and emboldened new companies, which are now stepping in and looking to take advantage of a changing market while in many cases banks are struggling to satisfy regulators' demands and in some cases merely to survive. According to Forbes, continued trust issues from the financial crisis have reduced consumers' participation in the investment market: "Banks have had a hard time to win back customer trust even if it's been nearly ten years since the rumpus that was the 2008 financial crisis. This is even partly the reason why fintech is able to enter the picture and offer services that poached users away from banks. As banks got stuck firefighting the crisis and dealing with regulation, tech could focus on innovation and launch products and services that became integral to people's lives. Smartphones are arguably more valued by people over their wallets. Enter the fintech firms, who unbundled the services offered by banks and even fused them together to be their verticals, focusing on simplifying the experience for users. It's this expertise in delivering convenience and that makes fintech appealing."

According to PWC 2017 Report, "Funding of fintech startups has increased at a compound annual growth rate of 41% over the last four years, with over $40 billion in cumulative investment." Among these new companies are digital lenders, which are startups that use advanced credit analytic models to make loans to consumers. They are often able to make loans to borrowers who would not qualify under banks' traditional lending standards. Digital lenders' share of the market has increased dramatically in recent years, but they still have only 3 percent of consumer loans and 5 percent of small-business loans.

In addition, digital-only "challenger banks" have sprung up, so far primarily in the United Kingdom, with the intention of unseating banks from their centuries-long dominance.

What should banks do in the face of such a set of emerging and potentially game-changing technologies? Will they suffer the same fate that many brick-and-mortar stores and shopping malls have suffered because of seismic changes in the retail industry sparked by the internet and online shopping? Or that traditional photography companies like Kodak encountered in the wake of digital technology?

In my view, there is no question that banks are in the eye of the storm and must determine how to embrace digital disruption. It is not just necessary to stay in business, but it has the potential to help banks create better, faster and cheaper services that benefit both banks and customers.

In order to do so, bank executives need to abandon any fear or complacency they may still be experiencing. Simply navigating government regulation and waiting for interest rates to rise won't protect them from obsolescence.

Some good ways for a bank to start doing this include embracing openness and collaboration, making smart investments, and taking advantage of the bank's customer base and the intimate knowledge that stems from a personal relationship with its customers.

Smart and sustainable banks know it is the combination of a personalized approach with high technological solutions that will allow the bank and its customers to thrive. There are numerous ways a more traditional bank can start to evolve into a bank that is embracing the disruptive power of fintech.

One possible strategy for a bank that faces disruption from fintech is to embrace collaboration. Banks have traditionally partnered with other participants in their own industry to reduce costs or create new opportunities. In the face of the fintech challenge, banks may need to collaborate with companies in different industries or with different outlooks, such as tech startups or small tech companies with a financial service product.
A second strategy, one that has not always been part of banks' usual approach, is to increase openness. This can mean opening up the bank's intellectual property and expertise to outside innovators to help generate new ideas and change organizational culture.

A third strategy is to emphasize investment. Banks need to imitate venture capital companies and invest their money in new ideas that can keep them ahead of the technological curve.

Fintech companies are not the only tech companies that are having an impact on traditional banks. In fact, some observers say that banks are and perhaps should be more concerned with Facebook and Amazon because these online giants have access to massive amounts of consumer data that banks need in their day-to-day operations. One example is Amazon Data Services, Amazon's data storage product, which most banks rely on, and which a 2017 report from the World Economic Forum says is now "the backbone of the financial services ecosystem."

The future certainly does not include the status quo for the banking industry. The best possible outcome will be solutions that benefit consumers and the banks they choose. While many of the major banks have already started to adapt their business models to include technology products for their customers, the future is less clear for community and local banks who have hoped change doesn't happen too rapidly. I for one feel incredibly fortunate to lead a bank of entrepreneurs who view the fintech revolution as an opportunity to solve the problems of our industry.

About CBC and Ash Patel

Ash and the team at CBC endeavor to build a bank that does not exist today with a focus on offering customers a high touch experience combined with high technology solutions. He has been at the forefront of the critical industry conversations surrounding fintech and how traditional banking organizations need to evolve to embrace new technology.

More information can be found at ***cbcal.com***