

05 May 2023

Opportunities for Banks in Fintech

Image credits: Freepik



www.flagshipadvisorypartners.com

Banks have not become disintermediated utilities as some feared, but fintechs have taken material share in high growth segments.

Where Banks Are Winning

- 1 **Neobanks are highly influential**, but most still **struggle to achieve scale and profitability** due to narrow product sets and lack of credit
- 2 The most **successful neobanks** have pursued **underserved niches** (e.g., cross border transfers, SME)
- 3 **No serious competitors to Visa and MasterCard** have emerged for payments at physical points of sale
- 4 **Open banking** has largely seen much **lower than expected results on the consumer side** in Europe
- 5 **Crypto is not highly usable** for retail payments, even before its latest challenges
- 6 **Alternative consumer lenders have not gained traction** outside of BNPL

Where Fintechs Are Winning

- 7 **E-commerce payments** outside the US (where alternative payment methods are winning over cards with 3DS) **»»» Cross-Border Payments**
- 8 **Short-term consumer lending** (where BNPL is winning over credit cards outside the US) **»»» SME**
- 9 **Younger and underserved consumers** generally **»»» B2B Payments**
- 10 **Payments acceptance** generally (although banks remain a strong distribution channel) **»»» Commercial Cards**
- 11 **Embedded finance** generally (payments and credit embedded into end-user apps and software) **»»» B2B Transactional Lending (B2B BNPL, merchant cash advance, digital factoring, etc.)**

Some of banks' disadvantages vs. fintechs are structural, but banks have many core advantages that they (typically) do not leverage.

Typical Bank Disadvantages

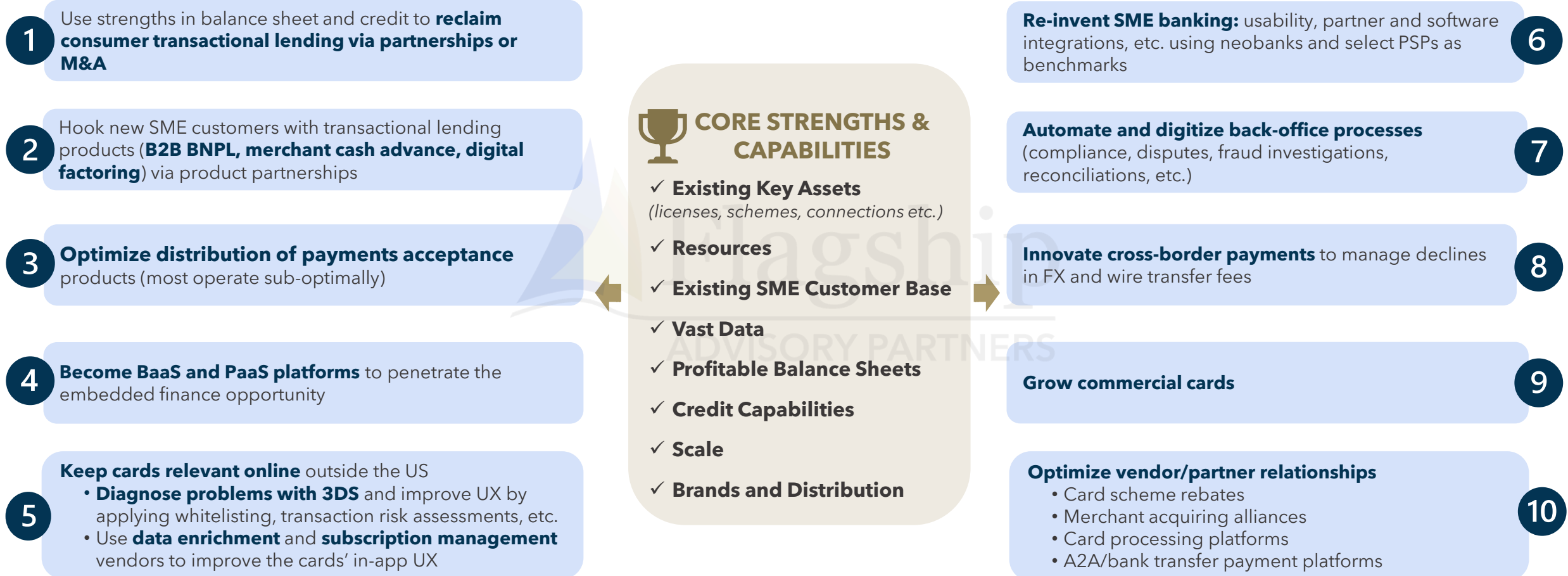
- 1 Must maintain legacy revenue streams.** Unlike fintechs, banks must maintain their legacy revenue streams (e.g., current account fees, per item fees for commercial payments, etc.)
- 2 Greater regulatory compliance burden** than fintechs, oftentimes making it difficult to compete with these less regulated providers
- 3 Higher expectations.** Customers and regulators expect banks to support a broad range of products and functionality, making it more difficult to concentrate resources
- 4 Legacy technical and operational architecture.** Most banks have a patchwork of legacy technical and operational systems that make development slower and more complex than fintechs
- 5 Lack of speed and agility.** The combination of high regulatory compliance burden, less tolerance for operational failures, legacy architecture, and larger organizational size results makes gaining internal consensus on what to do, and then actually going and doing it, significantly harder and slower than fintech competitors
- 6 Short-term thinking.** Many banks are publicly traded, therefore must focus on quarterly/annual earnings, which causes a shorter-term planning mindset, less risk-taking, and tends to discourage innovation relative to privately-owned fintechs
- 7 Lack of "cool factor".** Many younger consumers just don't like banks and getting them to adopt new products is difficult

Typical Bank Advantages

- 1 Already have most key assets.** Unlike fintechs, banks already have most of the core underlying assets needed to grow licenses, scheme connections, products, brand, customer bases, scale, distribution networks, etc. Fintechs must typically build or buy these
- 2 Resources.** Banks typically have substantially more resources than fintechs (although properly mobilizing them can be challenging)
- 3 SME.** B2B and SMEs are a huge growth opportunity, and banks already have these customers
- 4 Data.** Banks have vast stores of data, although many are bad at utilizing it
- 5 Balance sheets.** Banks enjoy very low cost of funding, providing a huge financial advantage vs. fintechs in the lending space, as fintechs must obtain private capital at significantly higher cost
- 6 Credit capabilities.** Many fintechs have no or poor credit underwriting, risk management, or collections capabilities
- 7 Scale.** Banks have large scale, providing a cost and operational efficiency advantage vs. fintechs

Nevertheless, banks do have strong capabilities that can help them compete. Banks have many opportunities to win in payments in fintech.

Key Opportunities For Banks in Payments and Fintech



1 Use strengths in balance sheet and credit to **reclaim consumer transactional lending via partnerships or M&A**

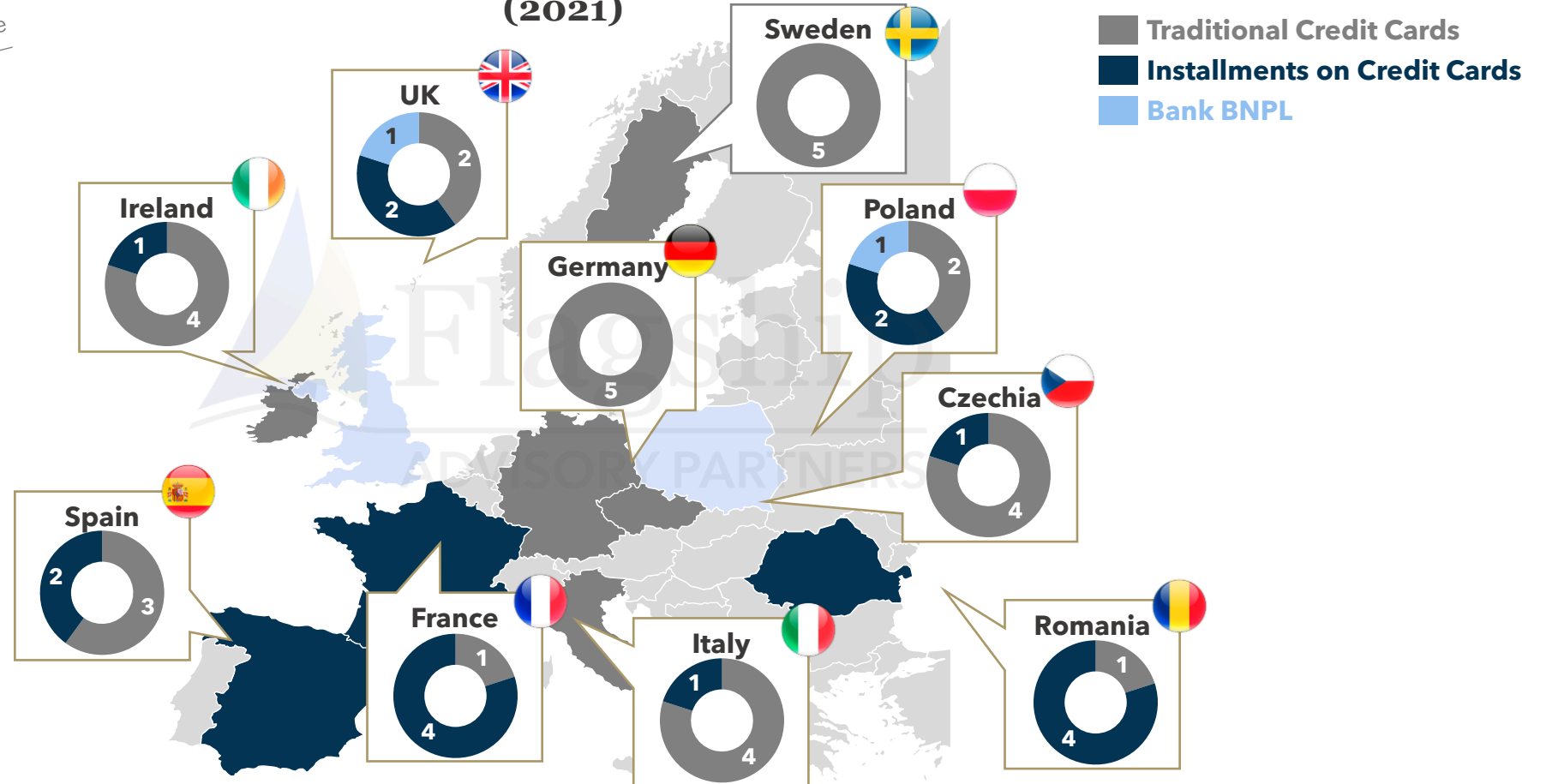
[Link to full article](#)



EU Banks are Missing the Boat on BNPL

Transactional Credit Offerings Marketing by Top 50 Banks (2021)






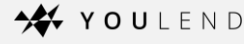










Non-Exhaustive



Source: Flagship Advisory Partners research in 2021
© Flagship Advisory Partners, May 2023

2 Hook new SME customers with transactional lending products (**B2B BNPL, merchant cash advance, digital factoring**) via **product partnerships**

B2B Lending: Prevailing Proposition Models

| | Merchant Cash Advance | Invoice Factoring (B2B BNPL) | Working Capital Lending | OTHER FINANCING: |
|-------------------------|---|---|--|--|
| What is it? | <ul style="list-style-type: none"> Fintechs that effectively offer factoring of card acquiring receivables in exchange for financing at a fee (typically high fees) Fintechs take the risk on behalf of their customers There is typically an interest fee on the financed amount. Balance sheet can be owned or can be offloaded as well | <ul style="list-style-type: none"> A debt financing arrangement where business sell their receivables to third parties (factoring entities) in exchange of receiving upfront financing at a fee Factoring entities are responsible for collecting the payments after purchase of the invoices Balance sheet typically offloaded | <ul style="list-style-type: none"> Provision of short-term loans, mainly for the purpose of working capital financing Could either be a fixed fee upfront or an interest fee for the term of the loan (loan tenures typically 6-12 months) |  COMMERCIAL CREDIT CARDS  DYNAMIC DISCOUNTING  TERM LOANS  CASH ON INVOICING |
| Market Examples: |  Liberis  YOULEND  wayflyer  uncapped |  trevi pay  mondu  HOKODO  KRIYA  two. |  iwoca  PayPal Working Capital  amazon lending | |

3 Optimize distribution of payments acceptance products (most operate sub-optimally)

Reasons for Banks to Market Payments Acceptance

QUANTITATIVE



Attractive **non-interest income** stream



Acquiring merchants have **higher deposits**



Acquiring **increases stickiness** and lowers attrition rate



In combination, customers with acquiring have **higher Life Time Value (LTV)**



Acquiring businesses carry **higher valuation** multiples than banks

QUALITATIVE



Necessary product for a transactional bank and can be used **as an acquisition tool**



Required to defend primacy of current account relationships against competitors



Supports deposits and cash management



Supports digital positioning (as customers need to accept payments via digital channels)



Bundles well with other products



Scales and automates well



Opportunities to cross-sell (e.g., short-term lending, FX and DCC, value-added services)



Transactional data can be monetized

4 Become BaaS and PaaS platforms to penetrate the embedded finance opportunity

[Link to full article](#)

[Peeling Back the Onion of Embedded Finance](#)

[Link to full article](#)

[Banking as a Service \(BaaS\) Fintechs Coming to Age to Fuel Integrated Finance Needs](#)

Embedded Finance Business Models

| BUSINESS MODELS | Examples | Bank Account | Cards | Wallet | A2A Pmt, Open Bkg. | X-Border Pmt & FX | Merch. Accept | Trans Lending | Other Lending |
|----------------------------------|--|--------------|-------|--------|--------------------|-------------------|---------------|---------------|---------------|
| Commerce SW + Merch Pmt | stripe, nuvei, adyen | | | | ✓ | | ✓ | | |
| Pmt as-a-Service (PaaS), A2A | GOCARDLESS, PLAID, Modulr | ✓ | ✓ | | ✓ | | | | |
| Banking-as-a-Service (BaaS) | Solarisbank, Clear.Bank, railsr | ✓ | ✓ | | ✓ | ✓ | | | |
| Issuing-as-a-Service (IaaS) | MARQETA, GPS, galileo | | ✓ | ✓ | | | | | |
| License Sponsors | The Bancorp Bank, cross river, Transact Payments | | ✓ | ✓ | ✓ | | ✓ | | |
| Diversified Processors | fiserv, nexi, WORLDLINE | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | | |
| Open Banking Enablers | TRUELAYER, YAPILY, tink | | | | ✓ | | | | |
| Payout / X-brdr / FX Specialists | Payoneer, Thunes, NIUM | ✓ | ✓ | | ✓ | ✓ | | | |
| A/P and A/R Automation | coupa, tipalti, avidxchange | | ✓ | | ✓ | ✓ | | | |
| Spend Mgmt | Brex, wex, SPENDESK | | ✓ | ✓ | ✓ | | | ✓ | |
| B2B Financing Enablers | trevi pay, C2FO, HOKODO | | | | ✓ | | | ✓ | ✓ |

Examples of UK Banks Investing in BaaS



- Launched BaaS offering in 2018 in the UK
- Starling's BaaS solution services 25 customers including Raisin, Moneybox, Vitesse and others
- In September 2021, announced the plans to expand BaaS offering to European markets like France, Germany, Netherlands and Spain



- Launched BaaS in September 2021 in partnership with Investec bank
- BaaS offering is intended to strengthen Investec's private client transactional banking solution and offer a new business current account offering for private companies
- Monese's BaaS platform claims to be cloud-based, modular and configurable across several jurisdictions



- In October 2022, Natwest partnered with Vodeno to create a new BaaS business in the UK
- Under the partnership agreement, Natwest is to invest £120 mil. into a new BaaS entity and €58 mil. in Vodeno in return for an 18% stake in the new venture
- New BaaS business will be built on Mettle (NatWest's business banking app) with Vodeno's BaaS technology and NatWest's banking technology and licenses

5 Keep cards relevant online; Diagnose problems with 3DS and improve UX by applying whitelisting, transaction risk assessments, etc.

[Link to full article](#)

[Guide for European Card Issuers to Improve UX Challenged 3DS 2.x Processes](#)

Summary of Recommendations for Better 3DS UX

| | Description Of Recommendation | Implementation Difficulty | Impact |
|---|--|---------------------------|--------|
| 1 | Recurring Transactions <ul style="list-style-type: none"> ▪ Flag recurring transactions ▪ Acquirers do not mark these types of transactions very often, resulting in declines, especially in subscription payments. | | |
| 2 | Low-Value Exemption <ul style="list-style-type: none"> ▪ Apply a low-value exemption on as many transactions as possible because the risk of fraud is already low, and it simplifies the authentication process. | | |
| 3 | Trusted Beneficiaries <ul style="list-style-type: none"> ▪ Allow customers to choose trusted merchants, not requiring authentication during ecommerce transactions. | | |
| 4 | Transaction Risk Analysis <ul style="list-style-type: none"> ▪ Exempt a particular transaction from SCA if the issuer determines that the transaction is performed by a specific customer based on their data pattern. | | |
| 5 | Combine Payment and Card Databases for TRA <ul style="list-style-type: none"> ▪ Combine transaction databases to achieve more effective and accurate decision processes for TRA. | | |



Source: Flagship Advisory Partners analysis
© Flagship Advisory Partners, May 2023

6 Re-invent SME banking: usability, partner and software integrations, etc. using Neobanks and select PSPs as benchmarks.

[Link to full article](#)



Top Neobanks in Europe and North America: State of Current Growth, 2022



Product Offering of Top 20 Neobanks



in Europe and North America by #Neobanks (2022)



of Neobanks offering Products & Services
■ >15 ■ 10-14 ■ 5-9 ■ <4

Non-Exhaustive

| | TRANSACTIONAL BANKING | |
|-------------------------|--|---|
| | Consumer  | SME  |
| Debit Card | 16 | 7 |
| Current Account | 15 | 7 |
| Cashback | 9 (+1 vs. 2021) | 4 |
| Round-ups | 12 (+2 vs. 2021) | 3 |
| Spend & Budget Mgmt. | 10 | 7 |
| Virtual Card | 6 | 4 |
| Payment Acceptance | Not applicable | 7 (+1 vs. 2021) |
| Saving Account | 11 (+6 vs. 2021) | 2 (+1 vs. 2021) |
| B2B X-Border Payments | Not applicable | 6 (+1 vs. 2021) |
| Invoicing | Not applicable | 5 |
| Metal Card | 4 | 4 |
| FX on Card Transactions | 4 | 4 |
| Accounting Integration | Not applicable | 4 |
| Other SaaS Integrations | Not applicable | 4* |
| Account Aggregation | 2 | Not applicable |
| Carbon Footprint Offset | 3 | Not applicable |
| Prepaid Card | 1 | 1 |

| | LENDING | |
|---------------------|--|---|
| | Consumer  | SME  |
| Credit Card | 7 | Not offered |
| Personal Loan | 7 | Not applicable |
| Cash Advance* | 4 | 2 (+1 vs. 2021) |
| Mortgage | 3 | Not applicable |
| Overdraft | 4 (+1 vs. 2021) | Not offered |
| BNPL | 2 (+2 vs. 2021) | Not offered |
| SME Working Capital | Not applicable | 5 (+1 vs. 2021) |
| SME Unsecured Loan | Not applicable | 2 |
| Factoring | Not applicable | 1 |

| | INVESTMENTS | |
|----------------|--|---|
| | Consumer  | SME  |
| Stocks, Funds | 6 (+2 vs. 2021) | Not applicable |
| Cryptocurrency | 4 | Not applicable |
| Commodities | 1 | Not applicable |

| | INSURANCE | |
|------------------|--|---|
| | Consumer  | SME  |
| Travel, Device | 5 (+1 vs. 2021) | 1 |
| Life, Auto, Home | 2 | Not applicable |

Notes: *Cash advance is a small value loan typically structured as an unsecured advance on salary
 Sources: Flagship Advisory Partners analysis, company websites
 © Flagship Advisory Partners, May 2023

7 Automate and digitize back-office processes (compliance, disputes, fraud investigations, reconciliations, etc.)

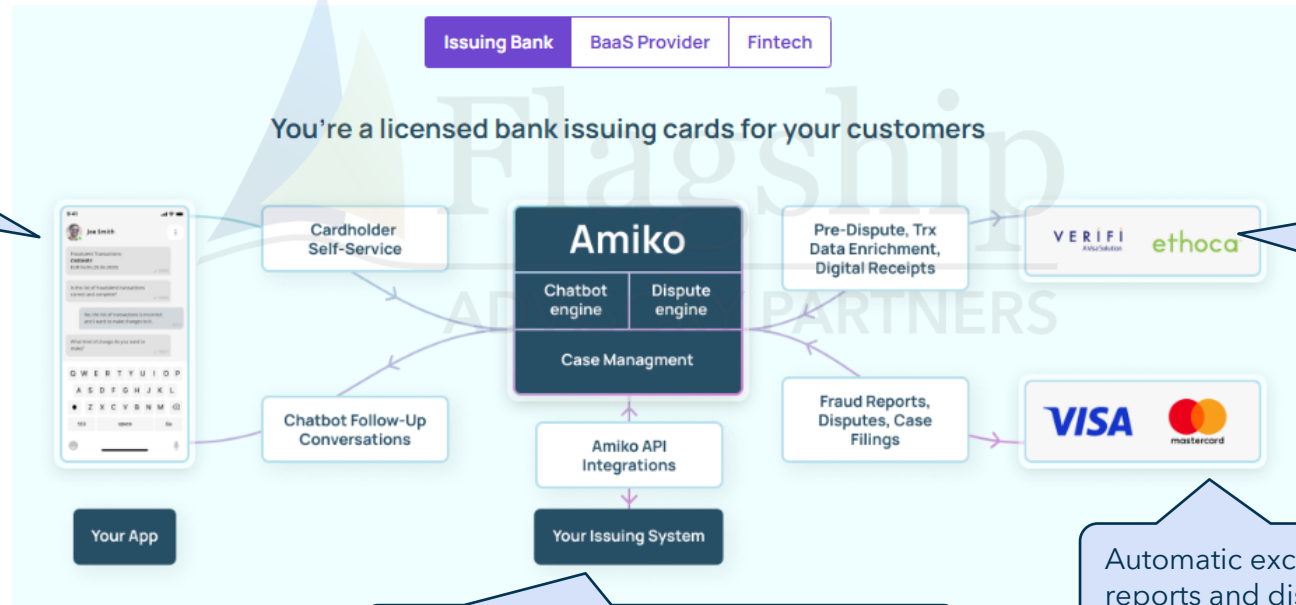
Solution Example

Rivero Amiko: Card Issuing Dispute Process Automation (select screenshots)

Brief Description

- **Amiko is a digital solution that serves issuing banks, BaaS providers, and fintechs, covering the entire dispute process** from cardholder communication over merchant collaboration to Mastercard & VROL dispute and arbitration handling. It integrates directly with Mastercard and Visa networks and is fully certified by both schemes.
- **It uses a self-service chatbot technology that covers potential fraud and all types of dispute conversations** in your app or portal. In addition, it automates multiple levels of processes, increasing its customers' efficiency.

AI Driven chatbot
Implementation via SDK or API



Automatic data exchange with pre-dispute and transaction data enrichment

Automatic exchange of fraud reports and disputes filings

Connection to the Issuing CMS system

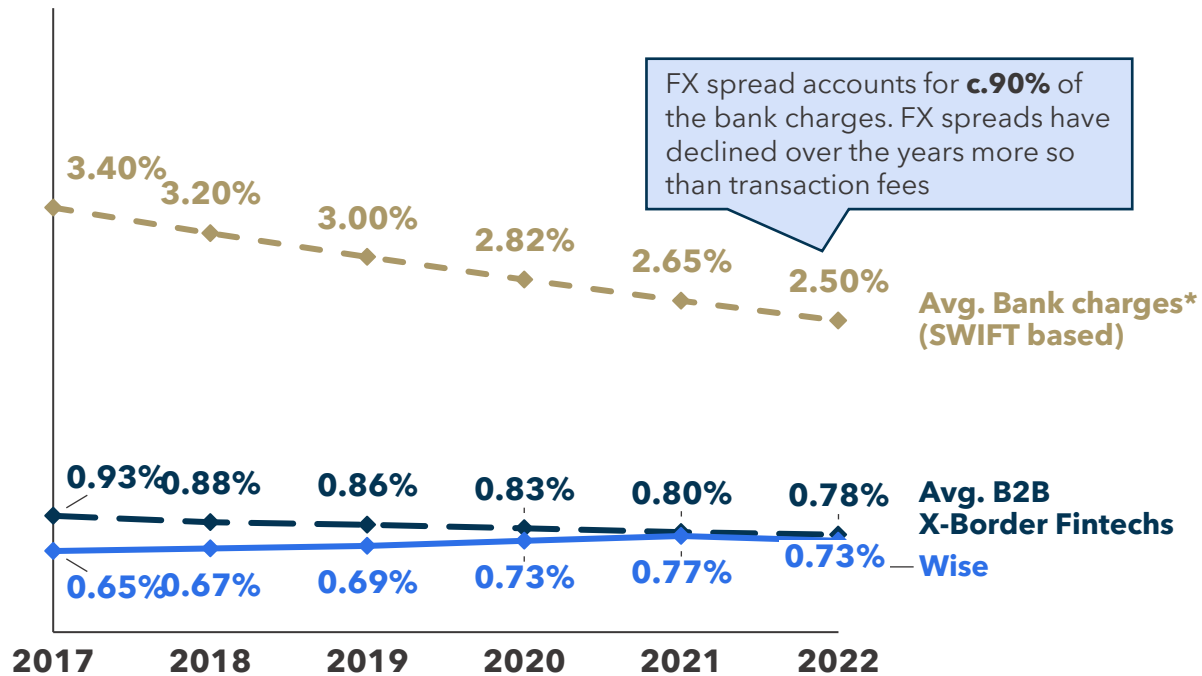
8 Innovate cross-border payments to manage declines in FX and wire transfer fees

[Link to full article](#)

[The Massive B2B X-Border Fintech Opportunity, 2023](#)

Gross Take Rates: B2B X-Border Fintechs vs. Industry Benchmarks

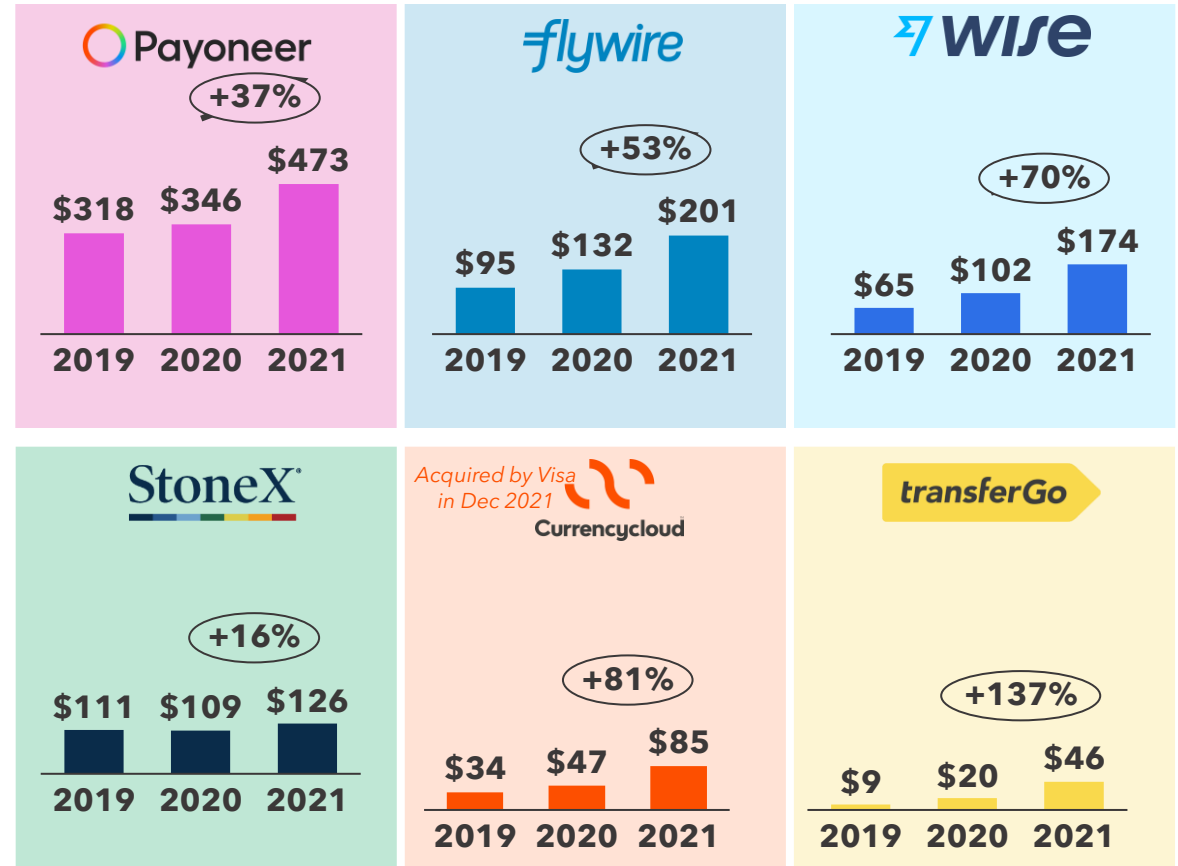
(%, includes FX spread, based on a selected sample)



*Average EU Bank charges for outbound international transfer using internet banking for SMBs and includes FX markup; average ticket size: €4000. Wise's take rate is blended for consumers as well as for SME businesses (includes FX mark-up) and the revenue numbers are B2B only.

Revenue Growth of Select B2B X-Border Fintechs

(USD mil.; growth rate % 2020-2021)



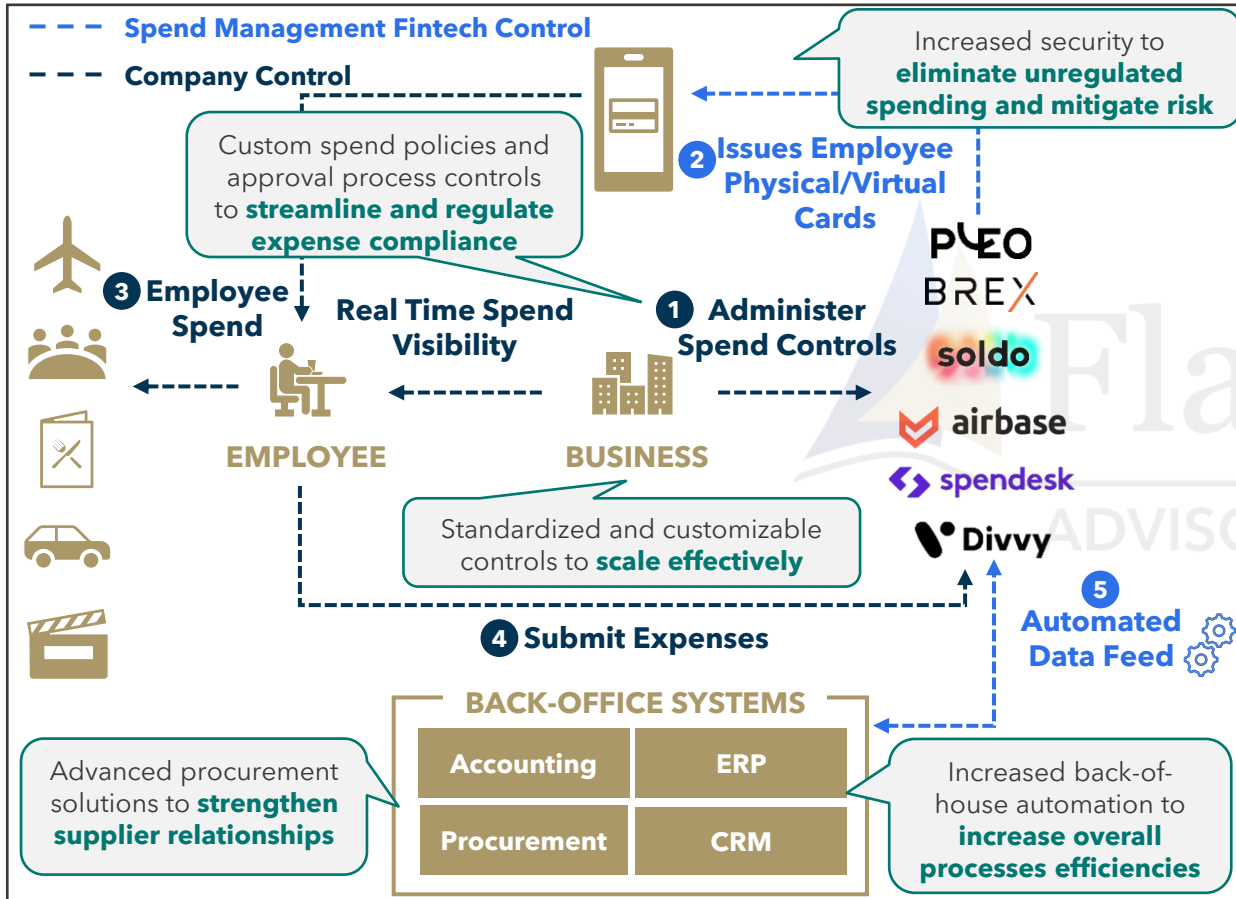
Sources: Public annual reports & investor presentations, Flagship Advisory Partners analysis
© Flagship Advisory Partners, May 2023

9 Grow commercial cards

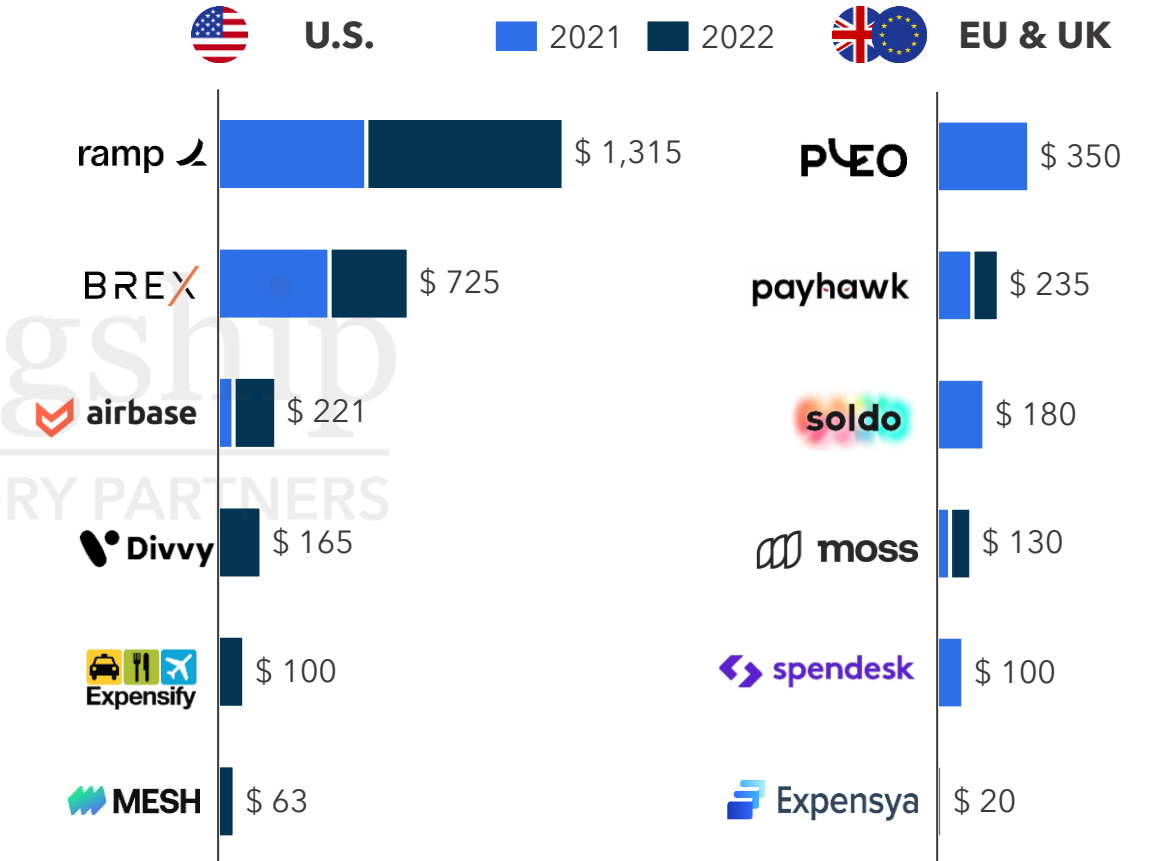
[Link to full article](#)

B2B Spend Management Fintechs: Positioning to Win by Unifying SaaS & Payments

Value Proposition of Spend Management Fintechs



Recent Funding For Spend Management Companies (\$ Mil.; FY '21– Oct '22)



10 Optimize vendor/partner relationships: card scheme rebates, merchant acquiring alliances, card processing platforms, and A2A/bank transfer payment platforms.

[Link to full article](#)

Vendor Future-Proofing is a Priority

Payments Vendor Future-Proofing Framework

| Area | Guiding Question | Items to Assess |
|---------------------|--|--|
| Structure | Are we outsourcing the right activities? | <ul style="list-style-type: none"> Which outsourced/insourced functions still fit with our strategic vision and new market reality? Which outsourced/insourced functions have fulfilled their business case and expectations, and are there better alternative models going forward? Do we need key capabilities that are not being developed internally and haven't been purchased? |
| Selection | Are we using the right vendors? | <ul style="list-style-type: none"> Are our vendors still leaders in their field (in terms of product, servicing, technology, etc.)? Are our vendors ready for the future (e.g., do they have a clear vision and strong roadmaps)? Did our vendors deliver and provide us with the right support during the crisis? |
| Management | Is our management of our vendors ready for the new market reality? | <ul style="list-style-type: none"> Is our management, monitoring, and day-to-day cooperation with vendors ready for remote work, pandemic-level operational disruptions, and other aspects of our current operational reality? Are we sufficiently mitigating risks associated with and preparing contingencies for vendor failures or delays, sub-contractor and geographic risk, and other previously observed difficulties? |
| Contracts | Are our vendor costs and terms optimized? | <ul style="list-style-type: none"> Is our absolute vendor cost level still in line with our revenues? Are our vendor cost structured to mitigate the impacts of future volume or revenue volatility? Are our vendor contractual terms sufficient in times of market volatility and operational difficulties? |
| Future Needs | Is our vendor strategy positioned to effectively adapt and win in the future? | <ul style="list-style-type: none"> Do we have the structural and contractual flexibility needed to change insourcing/outsourcing strategy and add/remove individual vendors as the need arises? Is our organizational infrastructure for vendors sufficiently future-oriented in terms of linking vendor strategy to our roadmap, monitoring vendor roadmaps, planning for volatility and contingencies, etc.? |

Thank You!

For any questions or comments, please do not hesitate to contact the author:



Erik Howell

Erik@FlagshipAP.com



Image credits: Freepik

www.flagshipadvisorypartners.com