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Miklos Dietz, Jared Moon, and Miklos Radnai

Fintechs can help incumbents, not just disrupt them

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While true for other financial services, it's most striking in corporate and investment banking.

Fintechs, the name given to start-ups and more-established companies using technology to make financial services more effective and efficient, have lit up the global banking landscape over the past three to four years. But whereas much market and media commentary has emphasized the threat to established banking models, the opportunities for incumbent organizations to develop new partnerships aimed at better cost control, capital allocation, and customer acquisition are growing.

We estimate that a substantial majority—almost three-fourths—of fintechs focus on retail banking, lending, wealth management, and payment systems for small and medium-size enterprises (SMEs). In many of these areas, start-ups have sought to target the end customer directly, bypassing traditional banks and deepening an impression that they are disrupting a sector ripe for innovation.

However, our most recent analysis suggests that the structure of the fintech industry is changing and that a new spirit of cooperation between fintechs and incumbents is developing. We examined more than 3,000 companies in the McKinsey Panorama FinTech database and found that the share of fintechs with B2B offerings has increased, from 34 percent of those launched in 2011 to 47 percent of last year's start-ups. (These companies may maintain B2C products as well.) B2B fintechs partner with, and provide services to, established banks that continue to own the relationship with the end customer.

Corporate and investment banking is different. The trend toward B2B is most pronounced in corporate and investment banking (CIB), which accounts for 15 percent of all fintech activity across markets. According to our data, as many as two-thirds of CIB fintechs are providing B2B products and services. Only 21 percent are seeking to disintermediate the client relationship, for example, by offering treasury services to corporate-banking clients. And less than 12 percent are truly trying to disrupt existing business models, with sophisticated systems based on blockchain technology, for instance (exhibit).

Assets and relationships matter. It's not surprising that in CIB the nature of the interactions between banks and fintechs should be more cooperative than competitive. This segment

Exhibit

In corporate and investment banking, fewer than 12 percent of fintech solutions are trying to disrupt existing business models.

% of fintech solutions by disruptiveness and technology trends[1]

Cumulative fintech funding, $ million: >$1,000 | $500–$1,000 | $100–$500 | <$100

	Blockchain	Automation	Big data analytics	Biometrics/cybersecurity	Cloud/SaaS[2]	Others[3]	**Total**
Disruptive	6.0	2.7	0.4	0.2	1.8	0.4	11.5
Client disintermediation	0.0	5.3	2.9	2.0	7.3	3.5	21.1
Process improvement	6.4	8.9	19.5	10.2	19.3	3.1	67.4
Total	12.4	16.9	22.8	12.4	28.4	7.1	100.0

[1]Based on sample of more than 390 corporate-and-investment-banking fintech solutions in McKinsey's Panorama FinTech database; might not be representative. Figures may not sum, because of rounding.
[2]Software as a service.
[3]Includes payments, rewards solutions, exchange platforms for corporates, consulting, and others.

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of the banking industry, after all, is heavily regulated.[1] Clients typically are sophisticated and demanding, while the businesses are either relationship and trust based (as is the case in M&A, debt, or equity investment banking), capital intensive (for example, in fixed-income trading), or require highly specialized knowledge (demanded in areas such as structured finance or complex derivatives). Lacking these high-level skills and assets, it's little wonder that most fintechs focus on the retail and SME segments, while those that choose corporate and investment banking enter into partnerships that provide specific solutions with long-standing giants in the sector that own the technology infrastructure and client relationships.

These CIB enablers, as we call them, dedicated to improving one or more elements of the banking value chain, have also been capturing most of the funding. In fact, they accounted for 69 percent of all capital raised by CIB-focused fintechs over the past decade.

Staying ahead. None of this means that CIB players can let their guard down. New areas of fintech innovation are emerging, such as multidealer platforms that target sell-side businesses with lower fees. Fintechs also are making incursions into custody and settlement services and transaction banking. Acting as aggregators, these types of start-ups focus on providing

[1] In Europe, for example, corporate-and-investment-banking institutions must abide by the rules of the Fundamental Review of the Trading Book and the Markets in Financial Instruments Directive.

simplicity and transparency to end customers, similar to the way price-comparison sites work in online retail. Incumbent banks could partner with these players, but the nature of the offerings of such start-ups would likely lead to lower margins and revenues.

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In general, wholesale banks that are willing to adapt can capture a range of new benefits. Fintech innovations can help them in many aspects of their operations, from improved costs and better capital allocation to greater revenue generation. And while the threat to their business models remains real, the core strategic challenge is to choose the right fintech partners. There is a bewildering number of players, and cooperating can be complex (and costly) as CIB players test new concepts and match their in-house technical capabilities with the solutions offered by external providers. Successful incumbents will need to consider many options, including acquisitions, simple partnerships, and more-formal joint ventures. □

Miklos Dietz is a senior partner in McKinsey's Vancouver office; **Jared Moon** is a partner in the London office, where **Miklos Radnai** is a consultant.