INSIGHTS FROM THE BDO FINANCIAL INSTITUTIONS & SPECIALTY FINANCE PRACTICE

WHAT BANKS CAN LEARN FROM FINTECHS

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Fintech companies continue to disrupt financial services as innovations help capture new opportunities. Financial institutions can learn from that disruption to adapt and remain competitive. Assessing the factors that make fintechs tough competitors — and sought-after M&A targets — helps highlight potential areas for advances in strategy, technology capabilities and new product/service offerings. By taking lessons from the success of fintechs, banks can build on their established reputation for reliability and security to capitalize on emerging growth opportunities.

EXAMINING THE SUCCESS OF FINTECHS

The sector's success can be attributed to a few factors. Fintechs have enhanced the customer experience (CX), which has won loyal customers and driven growth. They're also typically more agile than legacy banks and can make changes quickly to meet shifts in consumer behavior.

Recent examples of fintech-led disruption include apps related to impact investing, which address rising consumer interest and help support the move toward environmental, social and governance (ESG) priorities. Fintechs have also led the proliferation of buy now, pay later (BNPL) payment structures, which have reshaped how consumers make retail purchases. BNPL rose in popularity during the pandemic as online shopping boomed, prompting more retailers to offer that option. However, banks can use their existing market share to scale that service and generate revenue. **A study by PYMNTS** indicates that 70% of BNPL users would prefer that option from their bank instead of a third-party fintech platform.

Fintechs will continue to disrupt multiple industries with innovations for banking, asset management, insurance, retail, real estate and more. Rising interest rates could also bolster fintechs' success, as their agility enables rapid response to changing market conditions and consumer needs. The Federal Reserve raised rates in March 2022 — the first increase since December 2018 — and it expects **six additional increases this year**. By emulating the nimble and innovative approach of fintechs, banks can mitigate industry disruption and support strategic growth.

FOCUS ON THE CUSTOMER EXPERIENCE

The pandemic accelerated adoption of digital banking and payment methods among consumers. A commitment to CX in those sectors has aided fintech's recent growth. Fintechs have made financial services more accessible to customers by reducing friction in mobile apps and using omnichannel strategies. Banks recognize that heightened customer expectations require better service and a more intuitive, seamless experience. Customers expect the ability to easily access account information, conduct peer-to-peer (P2P) transactions and execute other banking functions whether they're at home or on the go.

To meet the moment, more banks are digitizing previously in-person services, which improves convenience and accessibility for customers. Banks have increasingly refined their mobile apps to integrate with P2P payment services, as well as perform tasks such as checking balances, viewing investments, automating savings and syncing credit cards on a single platform. Large banks are also using artificial intelligence (AI) technology to offer personalized financial advice delivered by a virtual assistant.

CX-centric capabilities provide banks with ample data for insight into consumer preferences and behavior. Banks collect user data and leverage that to inform further advancements and strategic initiatives. Continued investments in enhancing CX can help traditional financial institutions maintain and gain market share in a changing landscape.

PRIORITIZE ESG

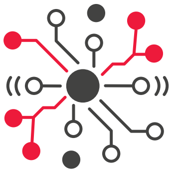
Fintech has helped democratize financial services by broadening customers' access to capital and banking products. Fintech advancements in P2P lending have given small businesses more options for growth funding, while traditional financial institutions may have considered such businesses too high risk. Some fintech startups are dedicated to helping those struggling with student loans to access repayment and refinancing options, while others promote ESG initiatives via impacting investing. Impact investing has become many people's first foray into investment, especially for millennial and Gen Z customers.

ESG has become a necessity rather than a nice-to-have. Increasingly, banks are implementing ESG strategies, which can help reduce exposure to risk and increase shareholder confidence. Some major U.S. banks have reduced or eliminated punitive practices, such as overdraft fees. Many notable financial institutions have made recent commitments to net-zero policies, and the UN has convened an industry-led **Net-Zero Banking Alliance** that spans dozens of countries. ESG initiatives have the support of major institutional investors, and BlackRock CEO Larry Fink's recent **letter to CEOs** underlined the critical need for transitioning to net-zero emissions.

ESG will continue to be an imperative for banks. Boards of directors are under increasing pressure — from shareholders, institutional investors, regulators and others — to show commitments to ESG goals and report on progress accordingly. Customers similarly want banks to focus on ESG and may leave banks that don't prioritize it. Moving forward, banks should consider incorporating robust ESG initiatives into all aspects of business, from loans issuance to internal hiring practices and beyond, in order to support long-term value creation.

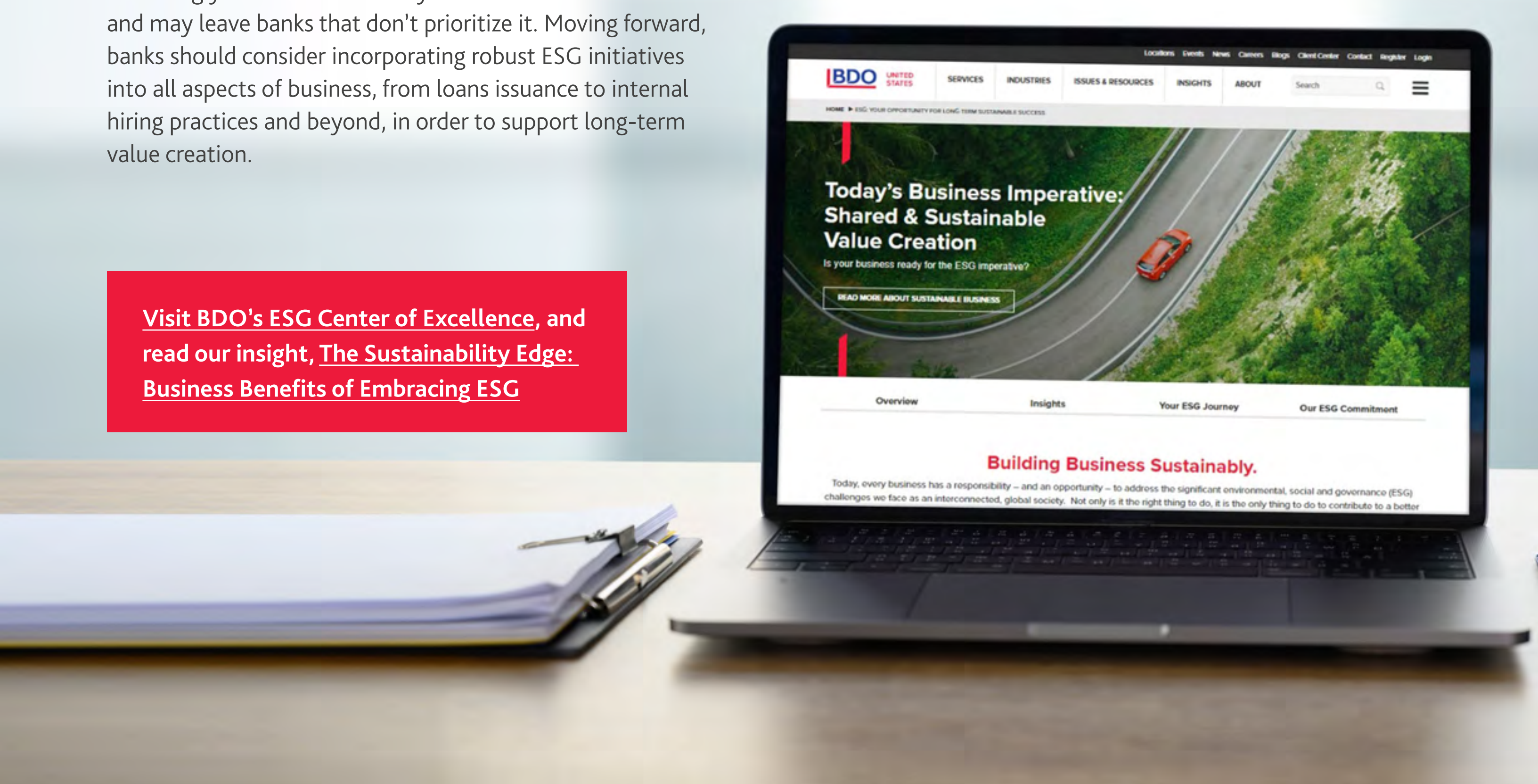
Visit BDO's ESG Center of Excellence, and read our insight, The Sustainability Edge: Business Benefits of Embracing ESG

STAY NIMBLE



Fintechs thrived during the pandemic in part due to an agile approach to product development. Fintechs have been quick to adopt cloud technology, which helps them benefit from real-time data transfer, aggregation and secure storage capabilities. Access to consistent data helps fintechs perform analyses that yield insights about emerging trends and opportunities. Strong data governance practices help fintechs avoid time and labor-intensive processes for information management and decision-making. An openness to collaboration helps fintechs further benefit from lean and agile operations, as they often outsource steps of product development to expedite time to market.

Adopting a nimbler approach can help banks iterate, innovate and stay competitive to stave off disruption. Banks can implement similar strategies to leverage cloud technology and improve their product development processes to maximize efficiency. However, the highly regulated banking environment may pose challenges for financial institutions, especially larger organizations, seeking to benefit from streamlined operations. Banks can consider partnership opportunities to quickly expand offerings or capabilities, in addition to adopting new technology where they can implement it in line with compliance obligations.



LEARNING THE LESSONS OF DISRUPTION

Fintechs have accelerated the pace of innovation in financial services and expanded the availability of those services to more consumers. Their success has been tied to several factors, including improving CX, emphasizing ESG values and adopting an innovative, “fail fast” mindset. Traditional banks can stay competitive and drive growth by adopting some of those strategies that have contributed to the success of fintech companies.

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