EMBEDDED FINTECH:

How Mid-Size Financial Institutions Can Jumpstart New Product Innovation Through Fintech Partnerships

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INSTALLING ESCALATORS ON A HORSE BUGGY

First National Horse and Buggy (FNHB)—a leader in the horse and buggy market—recently announced some exciting customer experience improvements involving:

- **Convenience.** As the population ages, people are finding it increasingly harder to climb the stairs to get into the buggy. So FNHB will be deploying mini-escalators attached to the side of the buggy to make it easier for customers to get in.

- **Security.** Users were reporting that bad actors were stealing buggies at night, using them to go places, then returning them before daybreak. So FNHB is installing combination locks on the buggies' wheels.

With so many people forgetting their passwords to their cryptocurrency accounts, we hope FNHB won't forget the combinations to their buggy locks!

In reality, of course, there is no First National Horse and Buggy (at least, we don't think there is). There's no FNHB because horse buggies are all but extinct (yes, there is one place in the United States where they aren't). And innovating on the user experience for an extinct—or soon to become extinct—product is a waste of time and money, wouldn't you agree?

Yet, this is exactly what banks and credit unions are doing: trying to improve the user experience for products that, while maybe not extinct, are flawed and not worth the effort. At some point, an incremental improvement in the customer experience isn't worth the limited impact it's going to have on customer satisfaction and behavior.

SO WHAT

Improving the user experience of a fundamentally flawed product is like installing an escalator on a horse buggy.

Competing on Product Innovation

The thesis of the book *The Discipline of Market Leaders* states that industry leaders excel in one of three disciplines—product leadership, customer intimacy, or operational excellence—while maintaining competitive positions in the other two.

The book was written before the advent of the "customer experience," so you could make an argument that there is a fourth discipline on which a leader could compete. In any case, a firm aspiring to be a market leader must provide an acceptable level of customer experience.

Strategists must determine, however, if investing in experience improvements really creates an economic return and/or competitive advantage (the latter produces the former). Importantly, they must determine two things: 1) How much will it cost to be the industry leader in customer experience? and 2) What competencies or capabilities will be required to achieve and maintain that leadership position?

SO WHAT

Only the top 25 to 30 banks in the United States truly have the resources—i.e., human and technological—to be among the leaders in digital customer experience. Small and mid-size financial institutions don't have the money to invest, and their reliance on third-party vendors for technology means they probably don't have the capabilities/competencies to be customer experience leaders. As a result, they must pick a different dimension as their basis of competitive differentiation.

Chime's Featurization Strategy

This perspective on customer experience might not jibe with the views of a lot of bank and credit union executives—particularly in light of the growth of the chief experience officer role in financial institutions, or in light of the success that digital banks like Chime have enjoyed over the past couple of years.

According to a recent survey of U.S. consumers by Cornerstone Advisors, 37 million Americans currently have a checking account with a digital bank. Chime has the largest market share with more than 12 million checking accountholders.

Chime has grown to this level by providing a superior digital customer experience, right? Not exactly.

Chime takes more of a "featurization" approach. It certainly has a good user experience and, by touting no fees, attracts consumers in the low- to middle-income brackets. But there are three *product-related features* of the fintech's offering that are key to its success:

1) **Early access to money.** Nearly a quarter of Chime customers said they chose the fintech as their primary bank because it offers two-day early access to their direct-deposited paychecks, as well as because Chime offered early access to government stimulus and tax refund checks.

2) **Spot Me.** This product feature lets Chime customers make debit card purchases that overdraw on their accounts with no overdraft fees. Chime customers with monthly direct deposits of $500 or more are eligible to enroll. According to Chime's website, "limits start at $20 and can be increased up to $100 or more by Chime, based on factors such as account activity and history."

3) Credit-builder credit card. Chime's predominantly low- to middle-income consumers aren't in the crosshairs of the big credit card issuers' marketing efforts. According to Cornerstone's research, 15% of Chime's primary banking customer base either has the card or is on the wait list for the card—all within six months of the card's launch. To get the card, a consumer must have a Chime Spending Account and have set up their direct deposit with the company.

Chime supports it featurization strategy with effective digital marketing tactics that include elements of:

1) Website design. The typical bank website displays a list of products offered. After visitors choose which product category they want (e.g., checking account, savings account), they then choose the product type they want (e.g., "essential," "plus," "platinum," "student," "senior"). Chime's website is different. It has an Accounts menu option, but there are only three choices: Spending Account, Savings Account, Credit Builder. The fintech reinforces its featurization strategy by showing site visitors the features of the products it offers because it knows consumers are choosing the fintech predominantly for one (maybe two) of the product features it offers.

2) Search engine management. Another aspect of Chime's feature-supporting marketing efforts is its search engine tactics. Chime ranks highly on Google searches for its feature keywords. Consumers who search for a term like "free overdrafts" are taken directly to that page on the site—not the home page.

3) Use of artificial intelligence. According to Guy Yalif, CEO of Intellimize, Chime uses AI to create a sophisticated testing approach to determine which marketing tactics to deploy. According to Yalif, "Chime's marketing team was able to test 21 different ideas and 216 different versions of their homepage while improving its performance. Had they used a simpler A/B model to test out these 21 ideas, it would have taken nine years to do what they did in three months." [1]

SO WHAT

Marketing messages like "We have great service!" don't resonate with consumers. Community-based financial institutions need to find and define the "hooks"—like Chime's early access to paychecks and fee-free overdrafts—that consumers want and then associate them with the institution's product offerings.

CONSUMERS WANT NEW PRODUCT INNOVATION

In November 2019, Google announced it was going to launch a checking account that would be integrated into the Google Pay app, which re-launched just before Thanksgiving 2020. The updated Google Pay app has three new or redesigned components:

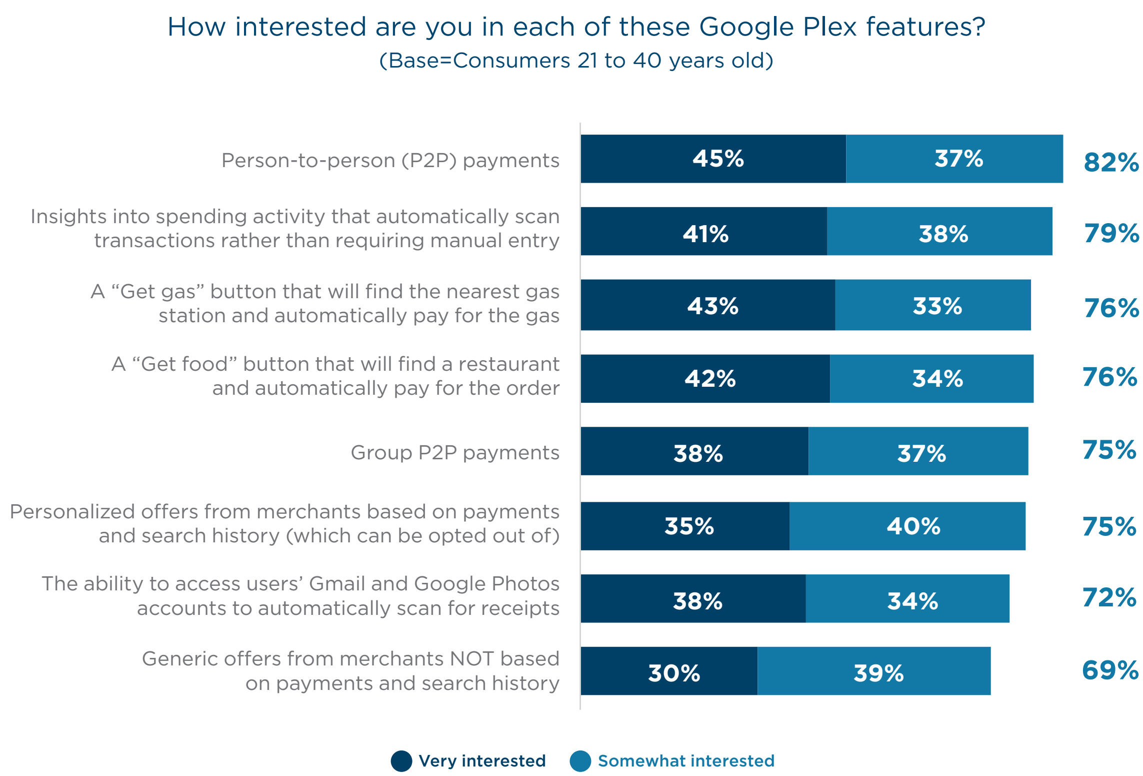
1) **Pay.** The redesigned Pay tab has two pieces: person-to-person (P2P) and retail payments. With the new P2P feature, users will be able to set up group payments, include multiple people in a chat, let them send and request money from each other, and track who has and hasn't paid their share. On the retail side, Google has added two new buttons to the app: "Get gas" and "Order food." Google claims that the food ordering system will work with more than 100,000 restaurants. The company also says users will be able to pay for gas or parking directly from the app in 30,000 locations.

2) **Explore.** This tab is where Google aggregates merchant offers. The default option lets users see generic offers but gives them an option to receive customized offers based on their spending activity. Users can associate an offer with any credit card stored in Google Pay. To redeem the offer, users simply need to use that card. If users redeem a cashback offer, the money goes directly into a Google Pay account. In addition, the new Explore tab has a QR and bar code scanner that enables users to scan a product in a store and use Google Shopping to buy it somewhere else.

3) **Insights.** The Insights tab provides Google's version of personal financial management (PFM) tools available in many banks' digital banking platforms today—with some important differences. Insights scans through transactions rather than requiring users to manually enter and/or categorize them. The redesigned app can access users' Gmail and Google Photos accounts to automatically scan for receipts. With Photos, it uses optical character recognition (OCR) to automatically read receipts and associate them with the correct transaction.

More than seven in 10 Gen Zers and Millennials expressed interest in seven of the eight features Google plans to offer with its new Plex checking account (Figure 1).

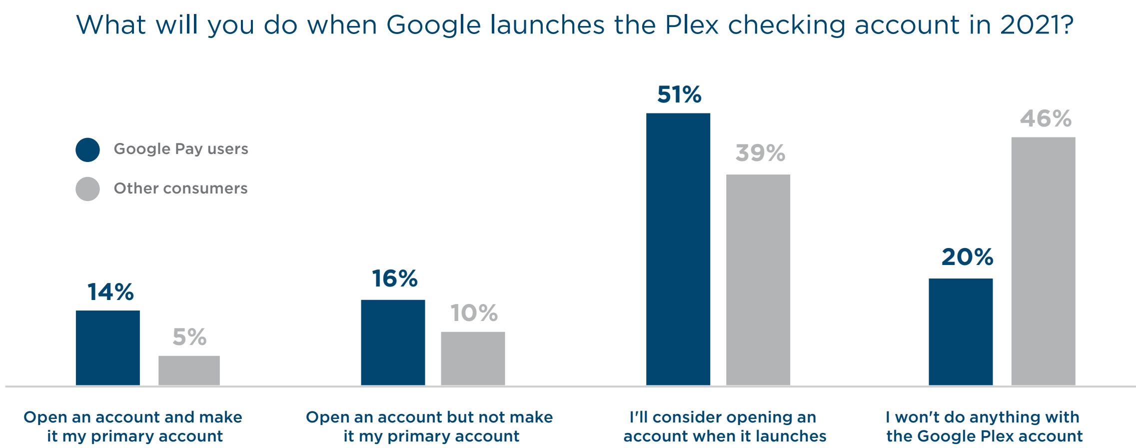
FIGURE 1: Interest in Google Plex Features by Generation



Source: Cornerstone Advisors survey of 3,898 U.S. consumers, Q4 2020

Will Google Plex make a dent in the market? Quite possibly. Existing Google Pay users—who account for one in four smartphone owners—are the most likely candidates for the account. Among Google Pay users, 30% intend to open a Plex account—of which almost half plan to make it their primary account (Figure 2).

FIGURE 2: Choice of Financial Institution with Google Plex



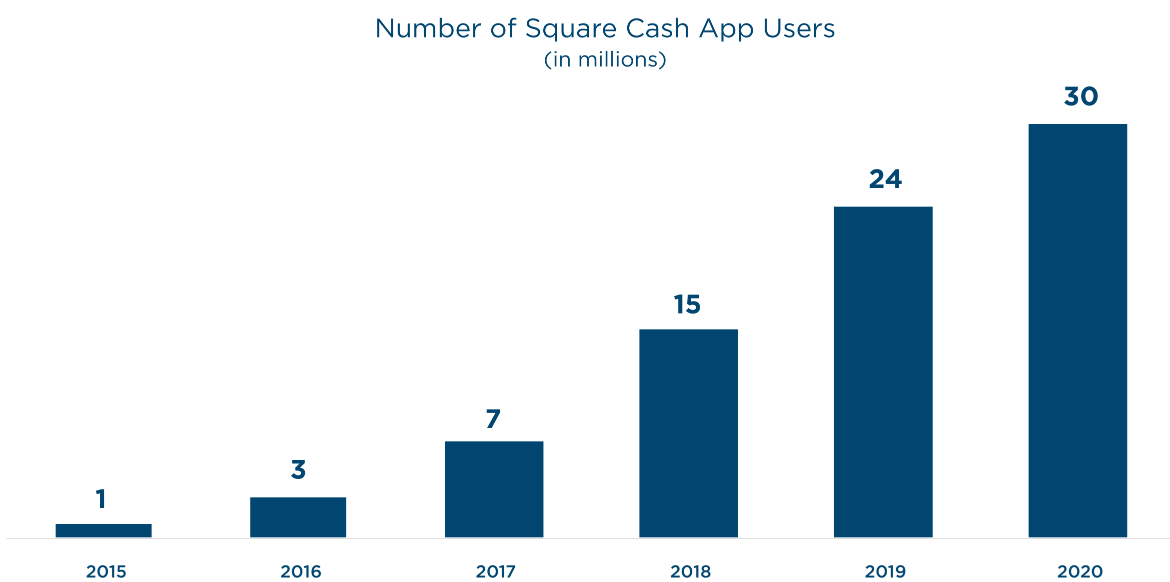
Source: Cornerstone Advisors survey of 3,898 U.S. consumers, Q4 2020

Square Cash App's Product Evolution

Many bankers are familiar with Square's initial product, the dongle that plugged into smartphones allowing small business owners to accept card-based payments. They might not be as familiar with Square's Cash App product—but they should be.

Cash App achieved early traction with low- to middle-income consumers because they could use the service to transfer money fast and for free. The service grew virally—driven primarily by user referrals—with the number of users more than doubling each year between 2015 and 2018 (Figure 3).

FIGURE 3: Number of Cash App Users



Source: Square

Square reported that, between 2017 and 2019, the average cost to acquire a net transacting Cash App customer was $5. Instead of advertising on Facebook or Google, Cash App pursued an influencer marketing strategy leveraging celebrities like Travis Scott, Cardi B, and Kim Kardashian. According to Aika Ussenova, the former head of financial planning and analysis at challenger bank Monzo:

> *“Cash App became so trendy that it is part of hip-hop culture now. There are more than 500 songs on Spotify with Cash App in the lyrics.”* [2]

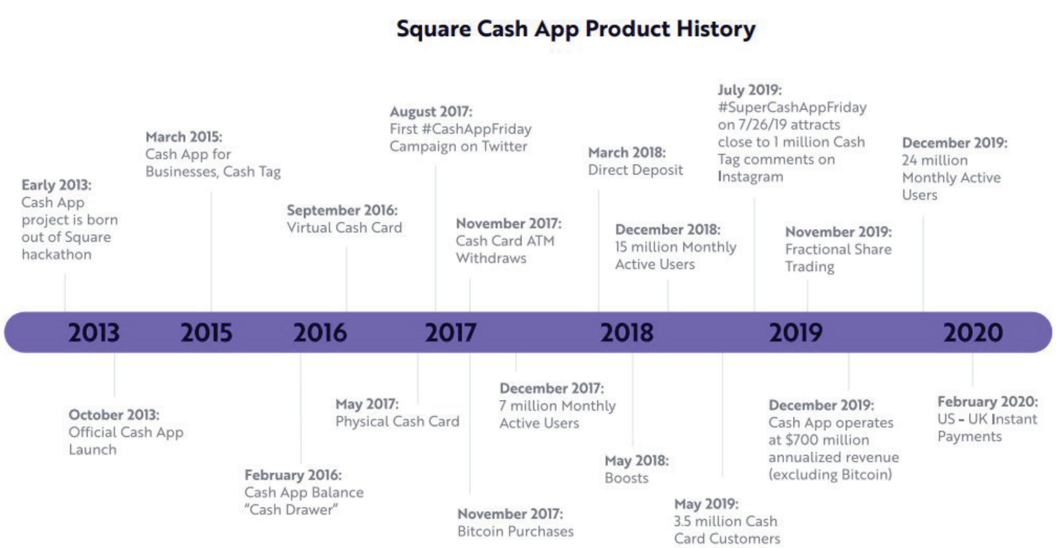
As a result, Cash App has 1.1 million Twitter followers and 1.6 million Instagram followers, orders of magnitude more than that of Venmo, which has 60,000 Twitter followers and 40,000 Instagram followers.

What does this have to do with new product innovation? The distribution Square created allowed Cash App to build products that reinforced the value of its network.

Building on its P2P payments service, Square launched a virtual card, followed by a debit Cash Card. The Cash Card featured “boosts”—discounts and rewards at select merchants. Combined with the ability to directly deposit paychecks and tax credits, Cash Card allowed customers to interact with Cash App fundamentally as a bank. Square then introduced bitcoin investing in 2017 and stock trading in 2020 (Figure 4). According to Seeking Alpha:

> *“Cash App is now used for tax refunds, stimulus deposit, and work paycheck deposit. Also, as retail investing surged during the stay-home period, Cash App has allowed people to buy equities and bitcoin with widely accessible features such as fractional investing and recurring purchases.”* [3]

FIGURE 4: Cash App Product History



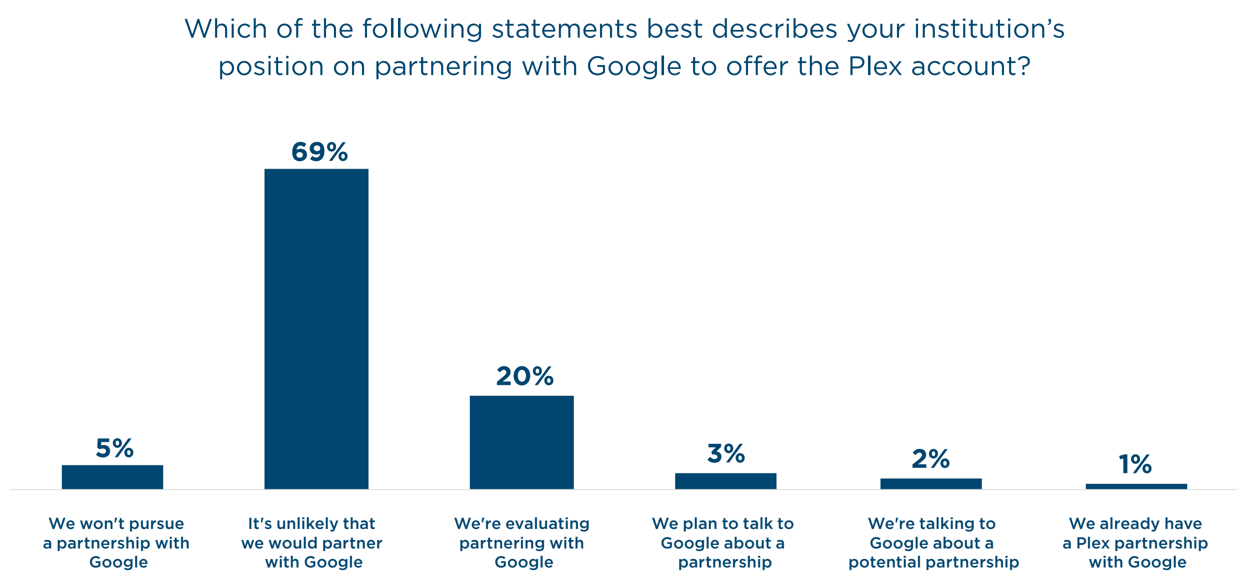
Source: ARK Investment Management, LLC

What’s missing? Lending. But Square is already testing a move to offer up to $200 to some customers. Personal lending is definitely an investment that Cash App is pursuing.

PRODUCT INNOVATION IN BANKING IS BROKEN

Community-based FIs are in no position to replicate what Google is planning to do, but they can partner with the Big Tech firms. Few of them plan to do so, however. Roughly three-quarters said they won't partner with Google on its new Plex account or that they are unlikely to do so (Figure 5).

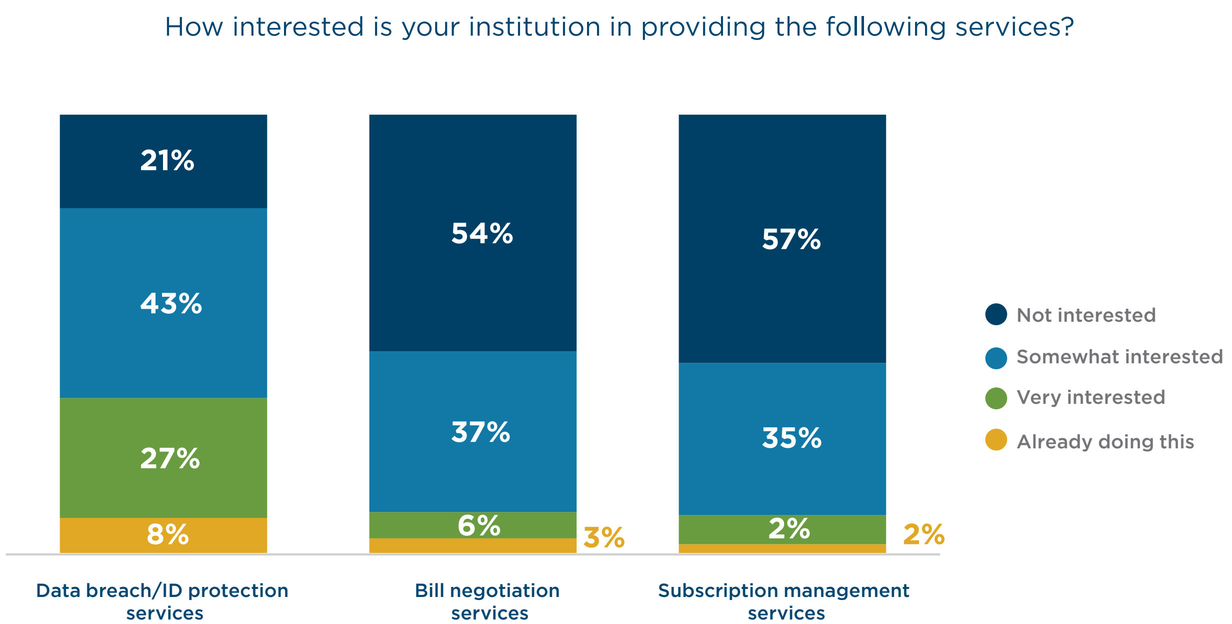
FIGURE 5: Intentions to Partner with Google



Source: Cornerstone Advisors survey 260 financial institution executives, Q4 2020

In addition, despite the relatively strong consumer demand for a variety of products and services, few banks or credit unions are interested in providing them. Less than 10% of banks and credit unions already provide, or say they're very interested in providing, subscription management or bill negotiation services, despite (or unaware of) the demand for them (Figure 6).

FIGURE 6: Interest in Providing Value-Added Services



Source: Cornerstone Advisors survey of 260 financial institution executives, Q4 2020

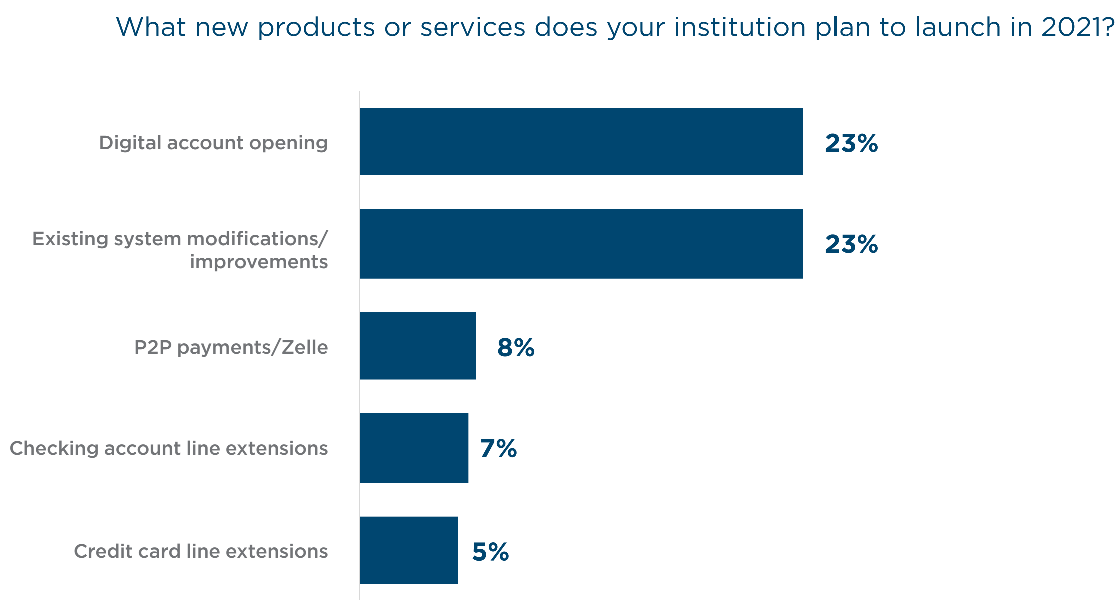
Financial Institutions Have a Funny Definition of 'New Product'

Financial institutions' lack of interest in partnering with Google or offering new digital services may stem from a misunderstanding of what a new product or service is.

In Cornerstone's annual *What's Going On In Banking* study of financial institutions, half of credit unions and 58% of banks said they intend to launch new products or services in 2021—or at least what they *call* new products or services.[4]

Of the financial institutions planning to introduce new products or services, about a quarter of them cited existing system enhancements or digital account opening systems as new product launches (Figure 7).

FIGURE 7: New Product/Service Plans



Source: Cornerstone Advisors survey of 260 community-based financial institution executives, Q4 2020

Just a couple of problems with this, however:

1) How is digital account opening a new product or service? Isn't it just a new way of applying for an *existing* product or service?

2) Making enhancements to existing systems may improve the user experience with existing products, but they don't necessarily produce new features, products, or services.

SO WHAT

Financial institutions are unclear about the distinction between system upgrades and new products or services, and they're out of step regarding consumers' product and service interests.

The Fast Follower Fallacy

Some financial institutions intentionally avoid new product development by hiding behind a "fast follower façade," claiming, "We don't want to be on the bleeding edge of technology—we're fast followers."

According to JP Nicols, managing director at Fintech Forge, which runs the Alloy Labs Alliance, an innovation lab and accelerator for banks:

> *"Banking leaders often describe their approach to innovation as being a 'fast follower.' My typical retort is that they're half-right. Most are definitely followers, but there usually isn't anything fast about their approach."*

When it comes to digital technologies, the rate of adoption among financial institutions is so similar that no one can really claim to have consciously and deliberately pursued and executed a fast-follower strategy.

The reality is that an overwhelming percentage of banks and credit unions deploy digital products and services (e.g., online/mobile banking, online bill pay, eStatements) at the speed with which their vendors offer those services. Or slower.

Even if there was a reason to be a fast-follower, the reality is most mid-size banks and credit unions would be hard-pressed to execute on it. To do it, they would need:

1) A team of people evaluating technological developments in the market, [accurately] assessing the rates of adoptions and the potential economic impact.

2) A team of people to rapidly deploy the technological innovations after a "go" decision was made.

3) An agile, rapid planning process that took in the inputs from the team in point #1 and made the quick decision to fund the team from point #2.

SO WHAT

Being a "fast follower" is a harder—and riskier—strategy than being a product innovator.

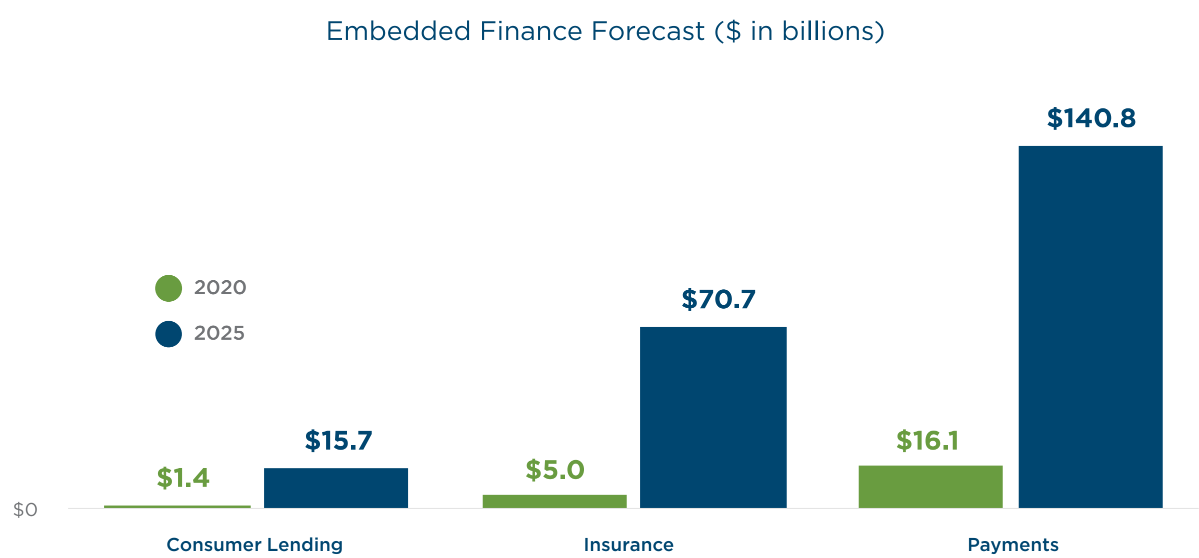
THE RISE OF EMBEDDED FINANCE

A new term has become popular in banking and fintech circles over the past few years: embedded finance (also referred to as embedded banking):

> *"The integration of financial services into non-financial websites, mobile applications, and business processes."*

Across a range of financial services—including wealth management, payments, lending, and insurance—embedded finance is expected to generate $230 billion in revenue by 2025, up from $22.5 billion in 2020 (Figure 8).

FIGURE 8: Embedded Finance Revenue Forecast



Source: Lightyear Capital

Fueling this growth is an interconnected landscape of technology companies that includes:

- **Providers.** Embedded service providers plug offerings into platforms to increase distribution and improve customer retention. Examples of embedded finance service providers include Lemonade, WealthSimple, Raisin, Affirm, and Habito.
- **Enablers.** Enablers are the pipes through which providers and containers exchange information and data. Companies like Green Dot, Railsbank, Marqeta, Plaid, and Finicity provide the data and technology infrastructure and connectivity capabilities via APIs and banking-as-a-service.

- **Containers.** Platforms like Amazon, Gusto, Shopify, SmartRent, and Uber aggregate services across providers to offer a platform or network of interconnected solutions, allowing customers to access best-of-breed solutions through a frictionless experience.

Two recent announcements demonstrate that embedded finance is gaining ground:

- **Shopify announced Affirm as a "Buy Now Pay Later" (BNPL) partner.** BNPL providers have been integrated into merchant websites to offer point-of-sale loans for years. But Shopify was one of the first (if not the first) eCommerce platforms to enable merchants to accept and manage card network payments directly through the platform instead of having to go through a third-party payment gateway. By expanding into embedded lending, Shopify is strengthening the economic advantages it already enjoys from embedding payments.
- **QuickBooks launched a bank account.** Intuit launched QuickBooks Cash, a no-fee business bank account that pays 1% interest when used with QuickBooks software or mobile apps and helps small business owners remove the complexity of managing their finances. The purported benefit isn't anything new. Small business owners have integrated—or tried to integrate—their bank account data with their accounting software for years. What is new is an accounting software provider vertically integrating to add banking services to its software services.

SO WHAT

For consumers, the underlying promise of—and benefit from—embedded finance is reduced friction in the customer experience. Why shop for financial services *after* you buy a home or a car when you can get a loan and insurance as part of the buying process for the product or service itself?

EMBEDDED FINTECH: BANKS' RESPONSE TO EMBEDDED FINANCE

Financial institutions have two strategies to deal with the emergence of embedded finance: 1) capitalize on the opportunities it potentially brings as new distribution channels for banks' products and services, and/or 2) replicate the approach by embedding fintech products into their digital banking platforms.

It's not an either/or choice.

Banks can protect and grow their core products—e.g., payments and loans—by finding new distribution opportunities through embedded finance. That might prove a difficult road, however, for mid-size financial institutions that find themselves shut out of those deals by retail platforms—the containers—that partner exclusively with large banks.

But mid-size banks and credit unions can pursue a different strategy: create new revenue streams from new products and services already created by fintech startups—in other words, embedded fintech.

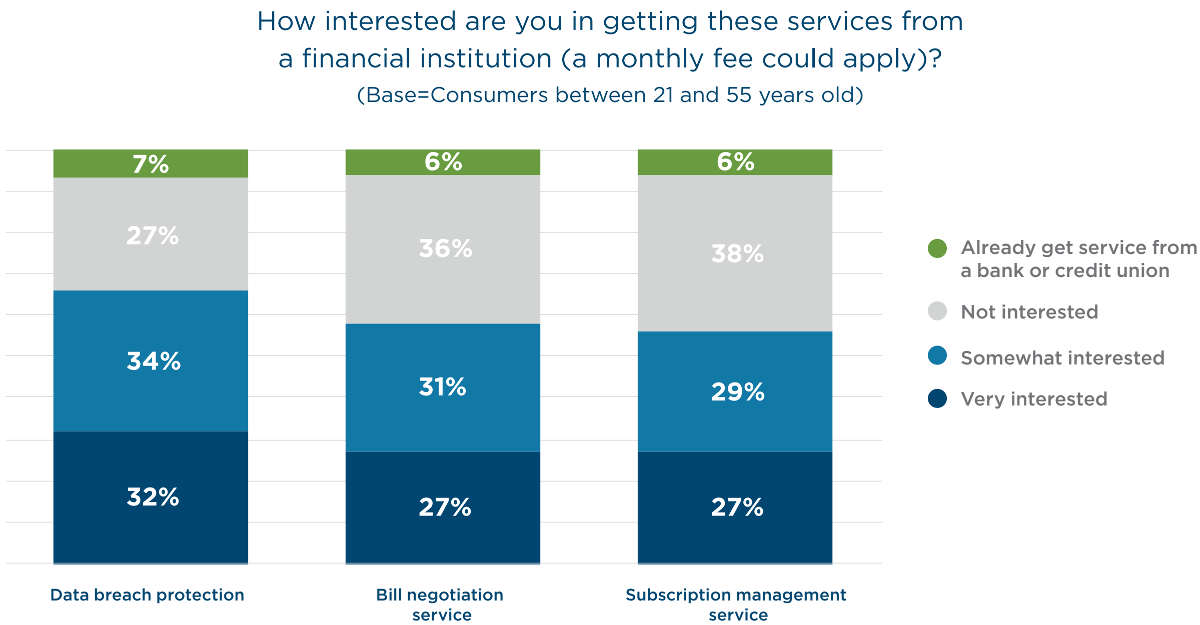
If embedded finance is the integration of financial services into non-financial websites, mobile applications and business processes, then embedded fintech is:

> *"The integration of fintech products and services into financial institutions' product sets, websites, mobile applications, and business processes."*

Consumers Want New Types of Digital Services from Their Banks

Consumers also demonstrate a desire for new types of services—services they're interested in getting from their banks and credit unions. Two-thirds of consumers between the ages of 21 and 55 are somewhat or very interested in getting data breach protection services—for a fee—from a financial institution. In addition, more than half of consumers in the 21 to 55 age range express interest in obtaining bill negotiation and subscription management services from a bank or credit union (Figure 9).

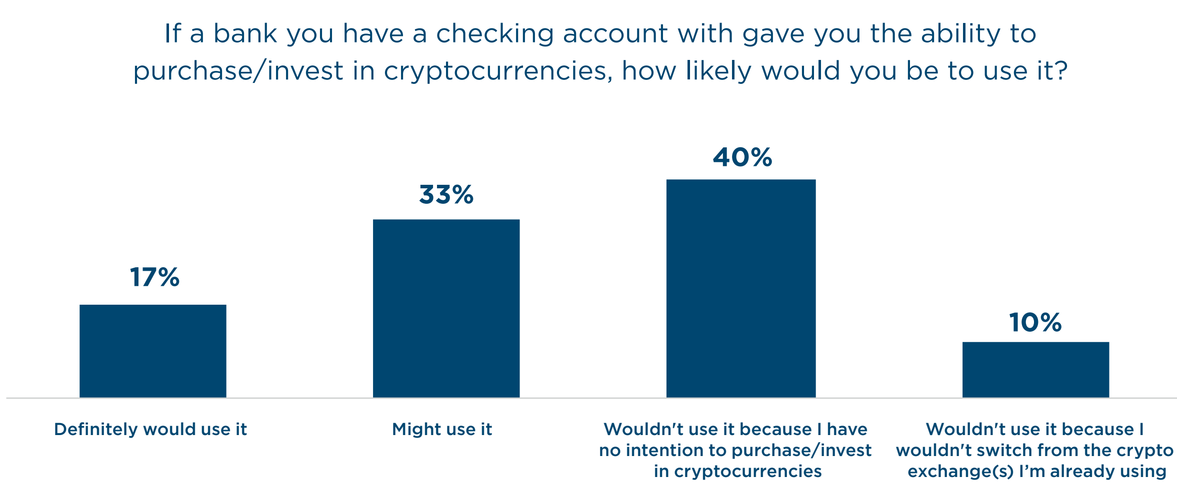
FIGURE 9: Interest in Obtaining Digital Services from a Financial Institution



Source: Cornerstone Advisors survey of 3,898 U.S. consumers, Q4 2020

In addition, half of all consumers demonstrate some degree of interest in using their bank to purchase or invest in cryptocurrencies (Figure 10).

FIGURE 10: Interest in Obtaining Cryptocurrency Services from a Financial Institution



Source: Cornerstone Advisors survey of 3,898 U.S. consumers, Q4 2020

Mid-size banks and credit unions can create new revenue streams through fintech partnerships. Here are five potential opportunities:

1) BILL NEGOTIATION SERVICES

Financial institutions have a bill pay-related problem: few consumers use their bank's or credit union's digital platform to pay their bills, and of those that do, they're predominantly older consumers. It's a problem because when consumers pay bills on their bank's site or mobile app, it provides banks with opportunities to help their customers make smarter decisions about their financial lives, which (theoretically) will drive greater loyalty and relationship growth.

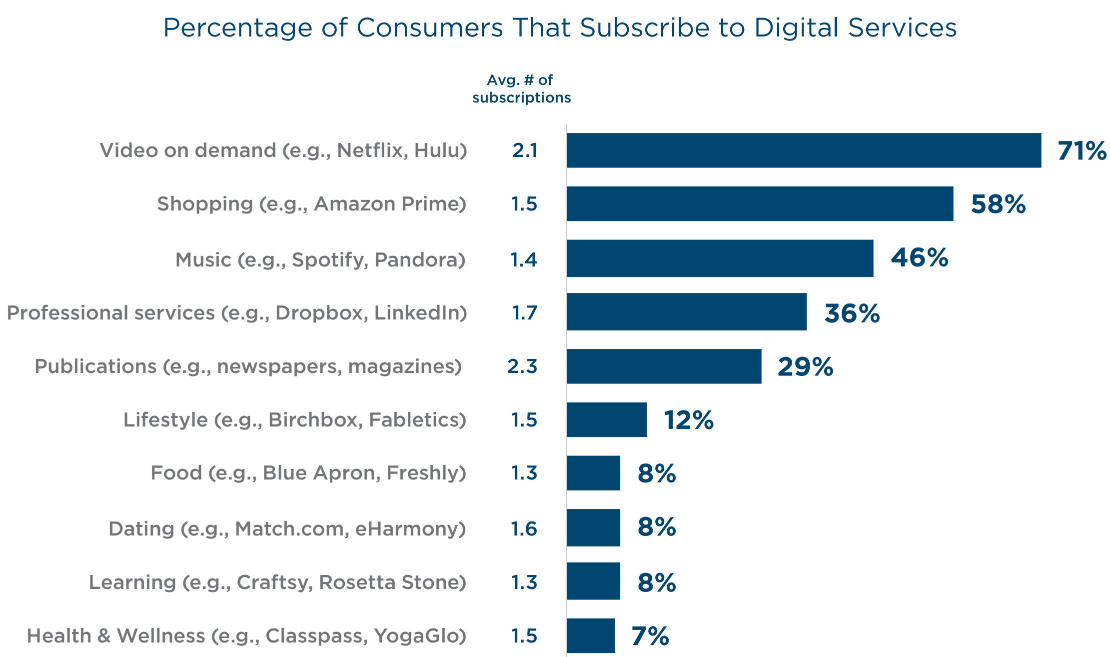
But how can banks provide bill pay recommendations if their customers don't pay bills on their sites and apps? They can't. And for the past few years, they have not succeeded in stemming the tide towards biller direct behavior.

Partnerships with fintechs like Billshark, which negotiates consumers' bills to help them save and shares revenue with the bank—can help drive consumers back to financial institutions' bill pay platforms.

2) SUBSCRIPTION MANAGEMENT

On average, Americans subscribe to roughly 13 services (that's also the median—half have more than 13) (Figure 11).

FIGURE 11: The Subscription Economy



Source: Cornerstone Advisors

It's a pain to keep track of all those subscriptions.

Although there are a number of mobile apps available to track subscriptions, two European fintechs—Subaio and Minna Technologies—and U.S.-based WalletFi do it exclusively with bank partners. Minna Technologies partners with banks like Swedbank and SpareBank to help those banks' customers manage the entire subscription lifecycle including: 1) purchasing new subscriptions, 2) tracking how much is spent, 3) comparing and switching providers, and 4) canceling unwanted subscriptions.

It's easy to envision, however, that some consumers would be willing to pay a one-time fee to avoid the hassle of canceling subscriptions with certain providers (have you ever tried to cancel a SiriusXM subscription?). An added benefit to banks for this kind of partnership is the potential for reductions in customer service-related costs.

One of Minna's bank partners receives tens of thousands of calls each month to block subscriptions or for chargebacks and disputes, and it anticipates $5 million in reduced customer service costs from deploying the subscription management app.

3) DATA BREACH AND IDENTITY PROTECTION SERVICES

We've become numb to data breaches. Many consumers believe that "all of my data is already out there" (which is nonsense—if all of your data was "out there" already, there would be no more data breaches). It's a pain in the neck to track and respond to all the breaches that occur. A new website and service from Breach Clarity makes the process easier and better—for both consumers and banks.

The company analyzes every publicly reported data breach in the United States. Based on more than 1,000 factors, it then computes a score for each breach and provides consumers with recommendations on what they should do about the breach.

There is a challenge, however: consumers aren't likely to check a website every week to see what breaches occurred and what to do about them. The startup has an answer to that: it's integrating its identity protection services into banks' digital banking platforms.

Banks should view data breach and identity protection as a component of financial health and bolster their digital apps and websites with identity safety tools to complement free credit scores and financial calculators.

4) WEALTH TRANSFER MANAGEMENT

According to AARP, "Over the next 25 years, boomers will pass along nearly $48 trillion in assets to their heirs and charities."

Bank executives interpret this in two ways: 1) concern that some portion of the money currently under their management will walk out the door, and 2) optimism that they'll develop relationships with the recipients of the inheritances.

They're right to believe both views, but by focusing on the wealth management implications, they're missing another opportunity: wealth transfer management.

Banks are so focused on getting their hands on the inheritances that they're overlooking the reality that the wealth transfer process is complex, difficult to understand, and that most people don't want to spend thousands of dollars on legal and advisory fees to get the money due them.

Two fintech startups—Atticus and Trust & Will—are poised to capitalize on this opportunity and trend with easy-to-use and affordable digital services for probate, estate settlement, and estate planning. Bank partnerships with fintechs like these two can help generate a new stream of revenue—and maybe still position the bank to be in line to help manage the money when it's passed on.

5) CRYPTOCURRENCY INVESTING

About one in 10 American adults now owns some form of cryptocurrency—and half of them say they've used cryptocurrencies to purchase goods and services. Two recent announcements will help accelerate the growth in cryptocurrency adoption:

- PayPal announced it has been granted a conditional BitLicense by the New York State Department of Financial Services (NYDFS). The license will enable PayPal to launch a new service that will enable its customers to: 1) buy, hold, and sell cryptocurrency (initially Bitcoin, Ethereum, Bitcoin Cash, and Litecoin) directly within the PayPal digital wallet, and 2) use the cryptocurrencies as a funding source for purchases at its 26 million merchants.

- Cryptocurrency exchange Coinbase announced it will launch a Visa debit card in the United States in 2021. The card, which has been available in the United Kingdom and the European Union since April 2019, will be available in all states except Hawaii and will offer rewards based on which cryptocurrency is used for purchases.

Quontic Bank, a New York-based CDFI (Community Development Financial Institution), is already capitalizing on this opportunity. The bank recently launched a Bitcoin Rewards checking account that pays accountholders 1.5% in Bitcoin on purchases made with the account's debit card.

The rewards are held in an account administered by NYDIG, the digital asset subsidiary of Stone Ridge, an alternative asset manager. The NYDIG account doesn't give accountholders the ability to buy more Bitcoin, so they'll have to liquidate and transfer their Bitcoin Rewards if they wish to cash in on the rewards.

Quontic customers don't pay any monthly service fees for their checking accounts although NYDIG charges a 2% fee to execute the sale or liquidation of the accountholder's Bitcoin holdings.

CREATING AN EMBEDDED FINTECH FACTORY

To keep up with changes in consumer attitudes and behaviors and to keep up with or adopt the product innovations hitting the market today, mid-size financial institutions need to create a new core competency: the embedded fintech factory.

The Oxford dictionary defines a factory as a place where "goods are manufactured or assembled chiefly by machine." Financial institutions don't think of product design and development in a factory context—but they should.

Historically, launching a new product has been a multi-year, bet-the-farm proposition for financial institutions. The new imperative, however, is to quickly conceptualize, test, launch, and operationalize a series of smaller products and services targeted at specific segments of the market.

Why haven't banks been able to do this? There have been three barriers:

- **Economics.** The cost of developing, launching, delivering, and marketing new products has forced financial institutions to go for new product "home runs"—products that will bring in millions (if not tens of millions) of dollars in annual revenue. Launching products that only brought in hundreds of thousands of dollars (or less) was simply not economically feasible.
- **Organizational.** Most mid-size financial institutions don't have new product design and development departments. In effect, their technology providers are their *de facto* new product developers.
- **Technical.** Relying on vendor-developed systems, launching new financial products and services is hard for banks and credit unions because of the customization and integration requirements associated with new products.

An embedded fintech factory for financial institutions will overcome these hurdles and will be built on three capabilities: 1) niche identification, 2) organizational accountability, and 3) a digital product platform.

Niche Identification

When a mid-size financial institution designs a new product for the “general public,” it’s essentially going up against large regionals and megabanks—a matchup that’s hard to win. Mid-size institutions must take a more targeted focus to their new product development efforts by identifying the underserved niches in the market they intend to serve.

To explain with an example, consider USAA.

While the company probably wouldn’t describe it like this, the customer segment it serves is like a bull’s eye. In the center of the bull’s eye is the active, deployed military member. USAA designs all of its products, services, and processes around these members—even though they don’t comprise the majority of the firm’s customers.

By serving that segment, with its unique needs, USAA creates sufficient capabilities to serve the next ring of the bull’s eye—active, non-deployed military members, as well at the next ring of the bull’s eye—non-active military members.

The new digital product factory is built on smart segmentation of the market driven by identifying unmet or undermet needs of specific consumer segments.

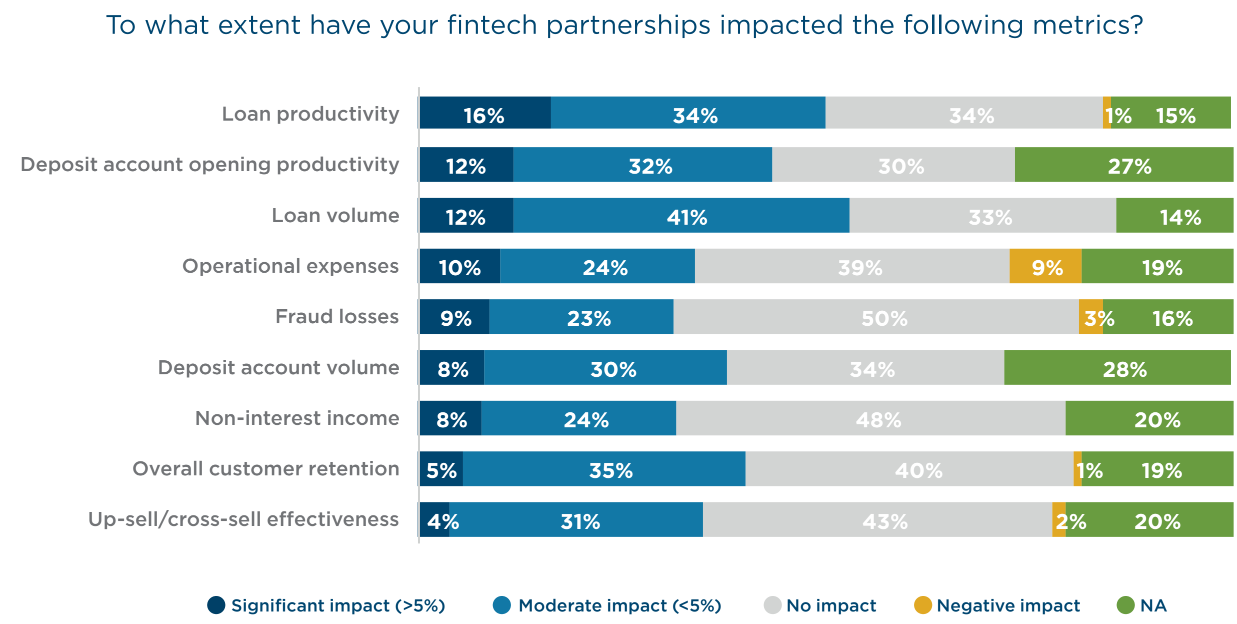
Organizational Accountability

It’s not a huge jump, but the increase in the percentage of financial institutions citing revenue generation as a top priority in Cornerstone’s *What’s Going On In Banking* study—from 17% in 2020 to 28% in 2021—is a sign that banks and credit unions want to grow their way out of tough times, not cut back.

They’re not getting this growth from their fintech partnerships. Roughly half (48%) of banks and about four in 10 (42%) credit unions have partnered with fintech startups over the past three years.

Yet, just 8% of financial institutions that have partnered with fintechs say they’ve seen significant improvements in non-interest income from their partnerships (Figure 12).

FIGURE 12: : Impact of Financial Institutions' Fintech Partnerships



Source: Cornerstone Advisors survey of 260 mid-size financial institution executives, Q4 2020

The root cause of the underperformance: there's no one responsible or accountable for this revenue growth.

One step towards the solution: creating a chief revenue officer position (and organization).

A Google search for "chief revenue officer in banks" results in roughly 161 million hits. In the first three pages of results, however, only three links actually mentioned chief revenue officers in banks (and one we would disqualify because it referred to a "chief revenue/lending officer"—there's more to revenue than just loans, you know).

The time has come for mid-size banks and credit unions to create a chief revenue officer position—someone to 1) create and instill a new product design and development process, 2) focus on creating a sales process for non-lending products and services, and 3) be accountable for non-lending (but not just non-interest) income in the institution.

The chief experience officer is *not* this person.

The chief revenue officer needs to be in charge of fintech partnership efforts. Why is that? Two reasons: 1) lack of focus—fintech partnership efforts are split across so many different objectives and functional areas that revenue generation is often neglected, and 2) lack of resources—on average, roughly 20% of financial institutions have just two full-time equivalents (FTEs) dedicated to finding, vetting, negotiating and deploying fintech partnerships, and 20% have no personnel dedicated to it.

SO WHAT

A newly appointed chief revenue officer should be tasked with running and growing the fintech partnership team and building the embedded fintech factory.

The Digital Product Platform

The third component of the embedded fintech factory is the digital product platform, a technology platform than enables financial institutions to rapidly and cost-effectively design, create—or plug in—and deploy new digital products and services. The digital product platform must be:

- **Component-based.** All components must be self-contained to accommodate continual change. With modern Agile methods, including DevOps and continuous delivery, anything can be changed at any time without affecting other code components.
- **API-first.** Banking components need to be available for consumption throughout the bank and also by third parties. With the right application programming interface (API) architecture, financial institutions can achieve the agility needed to rapidly deploy new products and services regardless of whether they're developed in-house or by third-party providers.
- **Cloud native.** Only cloud computing can offer the computing power and flexibility required to leverage the latest technologies—such as artificial intelligence, machine learning, and advanced analytics—and keep pace with the latest developments in security and regulation.

There are two paths to creating this digital product platform: 1) replace the existing core system with a more modern system, or 2) deploy a core integration layer that sits on top of the existing legacy core.

CONCLUSIONS

The prevailing belief is that fintech startups and the emerging embedded finance trend are unequivocally bad for financial institutions—in particular, mid-size banks and credit unions. The bigger challenge banks and credit unions face is product- (and service-) related.

SO WHAT

Banks and credit unions need to expand and modernize the set of products and services they offer the market (and, in particular, the *segments* of the market they choose to serve).

With limited internal resources to design, develop, and deploy new products and services, mid-size institutions will need to rely on: 1) fintech partnerships for products, and 2) technology providers to provide the capabilities to overcome the technical limitations of existing core and digital platforms.

The answer to countering the threat of embedded finance is through embedded fintech—integrating fintech products and services into financial institutions' core products and services.

ENDNOTES

[1] thefinancialbrand.com/73355/predictive-analytics-digital-banking-website-accounts/

[2] aika.substack.com/p/cashapp-is-king

[3] seekingalpha.com/article/4350623-how-square-is-positioning-to-take-over-retail-banks-sector

[4] hs.crnrstone.com/banking-2021

About the Author

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Ron Shevlin heads up Cornerstone Advisors' fintech research efforts and authors many of the firm's commissioned studies. He has been a management consultant for more than 30 years, working with leading financial services, consumer products, retail, and manufacturing firms worldwide. Prior to Cornerstone, Ron was a researcher and consultant for Aite Group, Forrester Research, and KPMG. Author of the Fintech Snark Tank blog on Forbes, Ron is ranked among the top fintech influencers globally and is a frequent keynote speaker at banking and fintech industry events.

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ABOUT
CORNERSTONE ADVISORS

Cornerstone Advisors delivers consulting services and industry insights aimed at helping banks and credit unions improve their profitability and performance—quickly and efficiently. Backed by 20 years of experience, the philosophy that financial institutions can't improve what they don't measure, and an authoritative database of performance metrics and vendor contract data, Cornerstone shows financial institutions how laser-focused measurement can lead to more competitive business strategies, advantageous vendor contracts, educated technology decisions and purposefully re-engineered processes.

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