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Will the fintech industry really change the way the banking sector operates?

The fintech industry has made a lot of noise and generated a lot of investment, but so far its gains are modest. Citigroup, for instance, found that despite all the hubbub about fintech, only 1% of North American consumer banking revenues had migrated to new, digital models. That despite some $19 billion of investment in fintech firms in 2015.

Such investors are anticipating a disruption of the banking industry on par with others seen recently, like hotels and lodging (via Airbnb), transportation (Uber and Lyft) and music (Spotify). The hope (or fear) is that a startup will enter banking with a mobile-based, intuitive solution that will prompt consumers to abandon traditional banks en masse.

Financial services firms appear to have learned the lessons from other industries though, and are being proactive about integrating fintech into their operations, sometimes launching internal fintech units. Doing so can be tricky for such a highly regulated industry and the agility and flexibility of fintech is a challenge for traditional ways of doing business. Here are some ways to avoid or mitigate risks and streamline the process of integrating the technology.

Decide to buy or create in-house

A quick but expensive way to ramp up in fintech is to buy one of the startups in the space. The risk, however, is that by integrating the startup, a bank will eliminate its innovation and differentiation. A better strategy might be to leave them as stand-alone units.

Developing an internal fintech unit, meanwhile, can be expensive and the payoff can be more elusive. In-house units also face the same problems as innovation labs, namely that they may mimic startups, but they don't have the same existential forces at play. If a startup doesn't get a product out the door in time, that may mean its demise. If an in-house unit fails at the same task, then usually no one loses their jobs. Though there's no proven method of creating in-house units that have the same urgency as a startup, rewards linked to clear goals and consequences for missing goals should be clear. At the same time, the units should foster an atmosphere in which failure and experimentation are encouraged.

Develop a strategy for regulation

One persistent question in the fintech industry is whether regulation will stifle innovation. At the moment, that's not the case. Instead, there's confusion about what type of regulation would emerge. Bloomberg reports that in December 2016, the Office of the Comptroller of the Currency announced plans to regulate fintech like traditional banks, but that plan has faced criticism and it's uncertain what will happen. Regulation is one area in which banks have an edge over startups, particularly ones that lean more toward the "tech" part of fintech. Banks can lean on their in-house regulatory expertise to navigate the space as regulators figure it out. The best strategy would be based on a risk analysis of what regulation is most likely to emerge.

Embrace uncertainty

Banks aren't used to navigating the tech space, where new innovations, disrupters, and consumer use patterns shift fairly quickly. Unlike traditional banking, the returns of fintech aren't predictable. Nor is the trajectory of the technology. Competing in the space then requires a willingness to embrace a certain amount of uncertainty and to move quickly.

Despite the drawbacks of launching full-fledged tech units, financial services companies don't have a choice. Like other sectors, such as TV advertising, banking seems to have a cushion that will give the industry a few years to reorient themselves toward a mobile-based, digital future.

For questions, please **contact your Key Relationship Manager.**