How Bank CIOs Can Make Fintechs Work for Them

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Fintechs offer digital capabilities that can help banks enhance their digital business transformation and address some of their cost optimization challenges. But, bank CIOs must first separate the startup noise from the reality and assess the risks of engaging with or ignoring fintechs.

Key Challenges

- A proliferation of fintech definitions confuses many bank CIOs (and other bank executives) who consequently have unrealistic expectations about the threats and opportunities.
- Fintech startups generally offer either opportunities to help with transformational digital strategies or opportunities for IT cost optimization. Rarely will a fintech be able to address both.
- The nature of fintechs — most of which are startups with limited histories — makes evaluating the risks associated with them extremely challenging but still a mission-critical task for CIOs.

Recommendations

Bank CIOs working to deliver the digital banking experience:

- Clarify the fintech threats to your organization and the potential benefits that might accrue from a successful partnership by conducting an initial workshop for peer executive colleagues.
- Distinguish between fintechs by determining whether the startup drives IT cost optimization or supports digital business transformation, and develop different selection criteria based on that characterization.
- Adapt traditional risk and procurement metrics to assess the value of a fintech to your organization by focusing on the additional benefits that fintechs provide, including increased agility, improved customer experience, new services or brand differentiation.
Strategic Planning Assumption

By YE19, 25% of retail banks will use startup providers to replace legacy online and mobile banking systems.

Introduction

Gartner research consistently shows that digital transformation is one of the most important factors impacting bank CIOs — and the most disruptive one (see "2016 CEO Survey: A New Financial Services Digital Ecosystem Will Redefine the Industry," "2017 CIO Agenda: A Financial Services Perspective" and "The 2017 CIO Agenda: Seize the Digital Ecosystem Opportunity").
Fundamental changes in internal and external demand are driving bank CIOs to seek out emerging digital technologies that both reduce IT costs and deliver needed innovation within tighter time-to-market constraints. However, digital transformation may not be going as well as these CIOs hope and their businesses require. One key problem is that bank IT organizations and incumbent technology vendors are frequently incapable of delivering the transformational digital technologies their business operations require. Increasingly, these technologies are being developed by fintechs, which present both threats and opportunities for banks (see Figure 1).

**Figure 1. Fintech Threats and Opportunities**

![Fintech Threats and Opportunities](source: Gartner (February 2017))

**Consumers Increasingly Use Fintechs for Banking and Payment Services**

Customer demand is one of the most important factors driving the need for digital transformation in banking. Customers continue to change their behaviors and adopt new interaction methods and technologies, finding new ways to use their devices and technologies — often not in the ways their developers intended them to or their financial institutions assumed they would. These new behaviors are impacting, and will continue to impact, banks’ revenue streams. Bank customers are, for example, increasingly using nonbank sites and apps — websites and apps not developed or owned by banks — to help them manage their personal finances or to perform simple banking activities such as paying bills and babysitters, checking balances, and transferring funds between accounts.

The 2015 Gartner Consumer Survey asked respondents whether they had downloaded one or more nonbank apps — apps offered by fintechs — to their mobile devices to make payments, pay bills, check balances or send money to friends using nonbank apps such as those from Starbucks, Mint,
TransferWise and PayPal. Twenty-one percent of all respondents across all 10 countries surveyed reported that they had personally downloaded a nonbank app and used it on their smartphone for banking activities — checking a bank balance, initiating a bank transfer or obtaining the answer to a query — in the past six months. However, in Brazil, China, India, Poland, and the United Arab Emirates (UAE), consumer use of these apps was even higher. In Australia, Canada, France, the U.S., and the U.K., consumer adoption was much lower. The highest consumer adoption of nonbank apps in these developed markets was in Canada (see Figure 2).

Figure 2. Consumer Use of Nonbank Apps on Smartphones for Banking

![Bar chart showing percentage of respondents using nonbank apps for banking across different countries.](source)

Source: Gartner (February 2017)

In the same survey, consumers were asked whether they have personally used a nonbank site to help manage their finances in the past six months and whether they are likely to use such a site in the next 12 months (see Figure 3). Forty-five percent of all respondents reported that they had created an account at a nonbank site to help save money for a specific goal or to reduce debt (e.g., credit card or car loan) in the previous six months or planned to in the next 12 months.
In every country surveyed except the U.K., 30% or more of respondents had created such an account to manage finances (see Figure 3). In China, India, Brazil and the UAE, more than 50% of consumers had created such accounts. As with the question regarding use of nonbank apps for banking, consumers in developed markets and Poland were less likely than consumers in developing markets to have used a nonbank site to help them save money or reduce debt.

These consumer responses indicate that, although mobile banking and insurance apps are still the preferred methods for consumers to conduct banking activities, consumer use of fintechs’ websites and apps is growing. Gartner expects consumer adoption of nonbank apps and sites for both traditional banking activities and financial management tasks to grow.

Fintechs: Threats or Opportunities?

Bank CIOs must be more concerned about the current and near future use of their online banking and mobile banking apps. As Figures 2 and 3 show, consumers in developing markets such as China, India, the UAE and Brazil already use nonbank apps in higher percentages than their counterparts in Australia, the U.S., the U.K., Poland, France and Canada. For this reason, bank CIOs in all geographies must view fintechs as both threats and opportunities (see Figure 1):

- **Threats.** Fintechs threaten the foundational services that banks offer customers — and the revenue streams they represent. To compete on these services alone, banks must improve their existing apps to move from transaction centricity to customer centricity, focusing on addressing

![Figure 3. Consumer Creation of Accounts at Nonbank Sites to Help Save Money or Reduce Debt](image-url)
customer needs and reducing friction. Fintech offerings often focus on simple, easy-to-use apps that charge consumers lower fees — or no fees at all — for transactions. For example, several fintechs (e.g., Simple, Moven and BankMobile) charge lower or no fees for consumer accounts. Although many fintechs do not yet have a clearly identifiable, sustainable revenue model, their apps’ designs and capabilities are forcing banks to change the way they deliver products and services due to interest from customers.

- **Opportunities.** Fintechs offer bank CIOs opportunities to identify emerging digital capabilities and technologies that customers — not just consumers — want and acquire them via a fintech. However, bank CIOs face two significant challenges: identifying those fintechs that may offer opportunities to leverage developing real-world use cases and communicating their value to business leaders. Without clarity around value propositions, it is extremely difficult for CIOs to evaluate the many choices available to them. Banks are increasingly creating and participating in hackathons to facilitate this process of identifying and nurturing the development of fintechs (see “Use Ongoing Hackathons to Accelerate Digital Transformation”).

  Few banking startups and other digital initiatives have yet reached maturity. Even fewer have delivered on the business-critical promise of digital transformation. However, it is clear that fintechs offer bank CIOs an opportunity to deliver the emerging digital technologies their institutions need and their customers demand, and to do so rapidly and cost-effectively, without straining their internal IT resources.

For these reasons, Gartner has developed a set of best practices for CIOs trying to identify the value of fintechs and evaluate the risks involved in working with fintech providers to use them effectively. This research provides bank CIOs with best practices for distinguishing between different types of fintechs and startups, so they can determine which ones are transformational and which ones focus on cost optimization, process improvement and customer experience.

**Analysis**

**Clarify the Fintech Debate by Separating Fintech Noise From Reality**

The ongoing "noise" around fintechs creates confusion for CIOs and other bank business and IT leaders. It presents a significant obstacle to bank CIOs' ability to make well-informed investment decisions about fintech vendors' offerings.

What is the noise around fintechs? It comes from two sources:

1. **Noise from overuse use of the term "fintech."** Definitions of this term have grown to encompass almost every kind of technology provider, including incumbent providers of core systems. This is primarily due to the current hype around this term (a Google search for "fintech" in February 2017 returned more than 19,300,000 results) and the varying and confusing definitions for it. An informal Gartner survey found that the term "fintech" has multiple, and sometimes contradictory, uses and meanings (see Note 1). Virtually every financial services vendor provider uses the term "fintech." Startups, as well as incumbent financial services providers who have long relationships with banks, have also adopted "fintech" to refer
to their new or newly rebranded "digital" solutions. Nonfinancial services startups may also use "fintech" to refer to digital technologies that are not banking-specific but can be used by banks. Sometimes these technologies are positioned as "fintech" for nonfinancial services providers who want to disrupt banking services providers.

2. **Noise from venture capital (VC) funding, accelerator and lab announcements.** These announcements fuel the excitement — and noise — around fintechs. As with any new technology capability, these announcements are not necessarily related to the adoption or success of the technology.

For bank CIOs, the fintech noise becomes a challenge. It fuels demands from the business and others for CIOs to answer questions as to why their banks are not using fintechs, competing more aggressively with fintechs or acquiring fintechs.

**Fintechs Defined**

To quiet the noise and help CIOs determine the real value of fintechs to IT and business organizations, Gartner provides this definition of "fintechs" to include related providers labeled as paytechs, regtechs, wealthtechs, robotechs and investtechs:

Fintechs are startup technology providers that deliver emerging digital technologies that approach financial services in innovative ways or can fundamentally change the way bank products and services are created and distributed, and generate revenue. The term may also refer to the technologies these providers offer.

**Recommendations**

**Bank CIOs working to deliver the digital banking experience:**

- Prepare your team to clarify the fintech debate by clearly articulating the threats and opportunities arising from the fintech marketplace.
- Create a workshop for executive colleagues to define the fintech threat to your organization and the potential benefits that might accrue from a successful partnership with a fintech.
- Document the types of vendor providers the IT organization works with to identify fintechs and distinguish them from other types of providers.
Distinguish Between Fintechs by Determining Whether They Drive IT Cost Optimization or Support Digital Business Transformation

Bank CIOs can use fintechs to address both IT cost optimization needs and demands for initiating digital banking transformation. Therefore, it is critical that CIOs evaluating fintechs can differentiate between those fintechs that focus on solving a specific problem or supporting new products, services and business models, and those that can deliver the transformational change that their internal and external customers are demanding. Fintechs can typically be categorized into two types: those that facilitate IT cost optimization and those that facilitate digital business (see Figure 4).

**Figure 4. Fintechs: IT Cost Optimization or Digital Business?**

![Fintechs: IT Cost Optimization or Digital Business?](image)

Source: Gartner (February 2017)

**Drive IT Cost Optimization**

Fintechs that focus on IT cost optimization offer CIOs the opportunity to improve a customer-facing design or experience, or solve a specific financial-services-related problem. These issues often result in customers turning to branches or contact centers to perform tasks, abandoning account opening applications or simply deleting mobile apps — all of which contribute to higher costs.

To use fintechs that support IT cost optimization, CIOs should purchase access and use APIs to deliver these fintech capabilities through the bank’s mobile app, website or even a third-party app...
or site. This approach is similar to the traditional "white label" solution purchase. The CIO may, for example, want to lower the cost of person-to-person (P2P) payments and incorporate the ability to offer Venmo payment capabilities as part of the bank’s mobile payment offering. Alternatively, business requirements to provide low-cost small business loans might make it attractive for the bank to sell a fintech’s product without the "white label." Alternatively, if the bank has sufficient internal IT skills, the CIO might consider building a similar capability in-house. However, this choice should be used cautiously for IT cost optimization projects as it will likely increase costs and time to market.

Support Digital Business Transformation

Fintechs that facilitate digital business are those that hold the transformative potential to fundamentally change the way bank products and services are created and distributed, and generate revenue. These fintechs support one or all of these aspects of product innovation: the discovery, development and delivery of new products, services and business models.

To use these types of fintechs, CIOs must take a more strategic approach. CIOs should invest in, or partner with, fintechs that have technology or capabilities that appear to have the potential to fundamentally change the way a bank does business or creates/distributes products and services. Partnership with, or investment in, a fintech will enable the bank to develop more expertise around the technology and capabilities to better understand risks and use cases.

Many banks seeking deeper involvement with blockchain technologies have partnered with a fintech developing blockchain solutions. Commonwealth Bank of Australia has, for example, partnered with Ripple, while BBVA Compass has partnered with Wave. This type of partnership will enable the IT organization (and the business) to be deeply involved with development and evolution of blockchain technologies for enterprise-specific business use cases without investing internal R&D resources and acquiring technical staff. Other banks, through corporate VC funds, have invested in Ripple and other fintechs. A partnership may also enable the bank, for example, to start the journey of changing its business model by offering its products indirectly through a student loan refinance startup (e.g., CommonBond or SoFi) to the startup’s customers. Another bank may provide transaction processing or risk management services to a P2P lending platform.

Recommendations

Bank CIOs working to deliver the digital banking experience:

- Differentiate between those fintechs that focus on IT cost optimization and those that hold the transformative potential to fundamentally change the way bank products and services are created and distributed, and generate revenue.

- Identify how your digital architecture will be able to use fintech capabilities as either an opportunity to optimize IT costs or an opportunity to create new digital products, services or business models.
Create collaborative teams that focus on IT optimization problems across channels, lines of business and devices.

Coordinate with corporate VC decision makers to identify fintechs for either IT cost optimization or digital business purposes. Create a senior cross-IT fintech position responsible for liaisons with the bank’s corporate VC organization, as well as with bank accelerators and innovation labs the bank works with, and with senior executives in strategic corporate planning and acquisition. This will enable digital banking strategies and decisions to take advantage of broader corporate strategies.

Adapt Traditional Risk and Procurement Metrics to Assess a Fintech’s Total Value to Your Organization

Finally, CIOs must address the technical and procurement risks involved in working with startups. These risks fall into three basic categories:

- **Viability.** The simple reality is that most startups fail. Estimates range from approximately 58% of fintechs will fail² to 90% of all startups will fail.³ While exact failure rates are impossible to obtain or plan for, it is clear that the overall rates are very high. Consequently, CIOs must have some plan to address this possibility before finalizing any purchase or partnership. By acknowledging that the startups they will work with will fail, CIOs can create a plan for intellectual property (IP) transfer to in-house IT. Doing this will not erase the risk of working with volatile startups, but will mitigate it somewhat.

- **Size.** Startups, by their nature, are small organizations, and their organizational structures are typically much flatter than banks’. They may not have established roles and processes for working with large organizations like banks. Organizational flatness may also mean that the bank procurement officer deals with the CEO one time and a CFO or a cofounder the next. Bank procurement and vendor management organizations will find this flatness challenging when using their standard processes for initiating and managing the relationship with fintech startups. Further, VC or other advisors may participate in contract negotiations and other meetings with the bank during the evaluation or implementation processes. CIOs may find fintechs are not used to their traditional vendor evaluation processes and timelines.

- **Technology.** While they are in the process of adopting new digital technologies and agile development methodologies, banks are used to traditional options for acquiring third-party technology: in-house implementation or outsourcing. They are used to long implementations and difficult (and expensive) integrations required to connect new software to existing systems. However, while banks are increasingly evaluating and adopting software as a service, banks are still making tentative advances toward cloud delivery models. Many fintechs use technologies, methodologies and processing capabilities that appear to be risky for bank IT organizations, including:
  - **Products or services available only via the cloud.** These can be used by other banks via application programming interfaces (APIs), which may introduce security and other risks.
  - **APIs.** Many fintechs require banks and other organizations to use APIs to access their capabilities and integrate with their existing online, mobile or other banking systems.
Enabling this capability on scale will require banks to acquire API gateways or digital platforms (with API gateways) to enable the bank to access and distribute fintech capabilities to their customers at all devices and channels.

- **Scalability.** Traditional banks, and especially large banks, have developed systems to process large volumes of transactions. As fintechs gain momentum and acquire customers, their transaction and processing volumes, and the use of their services, increase. Scale, then, becomes an important issue. The risk for CIOs is the ability of the fintech to maintain ease-of-use and transaction volumes as more bank customers use a certain capability. CIOs must, for example, evaluate the robustness of the fintech’s APIs.

- **Agile development methodologies.** Many, if not most, fintechs are small development organizations that have adopted agile development methodologies. These methodologies are different from traditional waterfall methodologies. On the one hand, CIOs will have to manage internal implementation expectations. On the other hand, working with a fintech may offer CIOs the opportunity to bring agile methodologies into the bank on a limited basis.

CIOs must evaluate their organization's appetite for managing for these risks and adapting to them. For each negative risk such as the failure of a fintech or a fintech’s inability to scale, there are the risks of choosing not to work with fintechs, including:

- Lack of in-house technology skills to develop capabilities that can compete with fintechs
- Time required to develop either the skills or digital capabilities
- Increased cost of IT optimization
- Difficulty of focusing in-house IT organization on both Mode 1 and Mode 2 (bimodal) — IT cost optimization and digital business — at the same time.

**Recommendations**

**Bank CIOs working to deliver the digital banking experience:**

- Assess the bank’s IT and business appetite for managing and adapting to the volatility, size and technology risks of working with fintechs. Address the risks of both working with and not working with fintechs.

- Adapt and adjust IT and procurement risk assessments. The CIO must adapt IT assessments for evaluating fintechs as vendor providers. CIOs must also work with IT procurement management to adjust those risk assessments to better manage risk tolerance of fintech viability, size and technology.

- Create a plan, as part of any relationship with a fintech, for the transfer of IP to in-house IT. Bank CIOs rightly concerned with fintech volatility must plan for the startup’s failure — as well as success.
• Evaluate fintechs for capabilities to be built in-house. CIOs for whom the volatility (and other) risks are too great should evaluate fintechs in terms of capabilities they wish to develop inhouse and avoid the volatility risk altogether. Building new capabilities does not mean IT should avoid new technologies, but instead they should reduce risk by maintaining control of the intellectual property from the start.

Gartner Recommended Reading

Some documents may not be available as part of your current Gartner subscription.

"2016 CIO Agenda: A Financial Services Perspective"

"CEO Briefing: Building Fintech Defenses"

"Digital Disrupters and Customer Demand Force Bank CIOs to Find New Sources of Innovation"

"Digital Initiatives Must Focus on Long-Term Transformation to Avoid Failure"

"Gartner’s 2016 Eye on Innovation Award Winners Demonstrate Leading-Edge Financial Services Capabilities"

"Use the Disruption Index to Evaluate Financial Services Startups"

"Innovation Insight: Technology Startups in the Insurance Industry"

"New Year’s Resolutions for Financial Services CEOs in 2016"

"Predicts 2017: Digital Initiatives Must Focus on Long-Term Transformation to Avoid Failure"

"Predicts 2016: Digital Banking Initiatives Will Fail Without Strategic Investments in Emerging Technologies"

Evidence

1 The 2015 Gartner Banking: Digital Consumer Survey, conducted only in August and September 2015, had 10,212 respondents in the U.S. (n = 1,000), Canada (n = 1,000), the U.K. (n = 1,005), France (n = 1,002), Poland (n = 1,068), the United Arab Emirates (UAE n = 1,024), India (n = 1,011), China (n = 1,003) and Brazil (n = 1,015). Respondents ranged from 18 through 74 years old, with quotas and weights applied within each country for gender, age, region and income (except in the UAE). The results are representative of the respective online populations with respect to age, gender, region and income (except for the UAE). The UAE sample accessed respondents from the three regions: Abu Dhabi, Dubai and Sharjah, and was drawn to be representative of the online population with respect to age, gender and income. Indicative precision level: At full count, sampling error is +/- 3.1% at the 95% confidence level. Levels vary depending on the number being measured as well as the specific data cuts applied.

2 "Here Are the Startup Failure Rates by Industry." Tech.co.
Note 1 Examples of Fintech Definitions

In an informal survey of definitions, Gartner analyzed the term "fintech" and found multiple uses and meanings. The term may be used to refer to any financial services technology provider, whether a startup or a long-established provider, or to new software offerings from traditional providers. Incumbent vendor providers use "fintech" to refer to new versions of their legacy applications. Nonfinancial services startups may also use this term to refer to new versions of their legacy applications. Incumbent vendor providers use "fintech" to refer to new versions of their legacy applications. Nonfinancial services startups may also use this term to refer to new software offerings from traditional providers. Sometimes these nonbanking vendor providers are positioned as "fintech" because they want to disrupt banking technology providers. Few, if any, of these definitions focus on the aspect that Gartner considers most important: the ability of the technology provider and its offerings to deliver truly transformative digital capabilities.
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