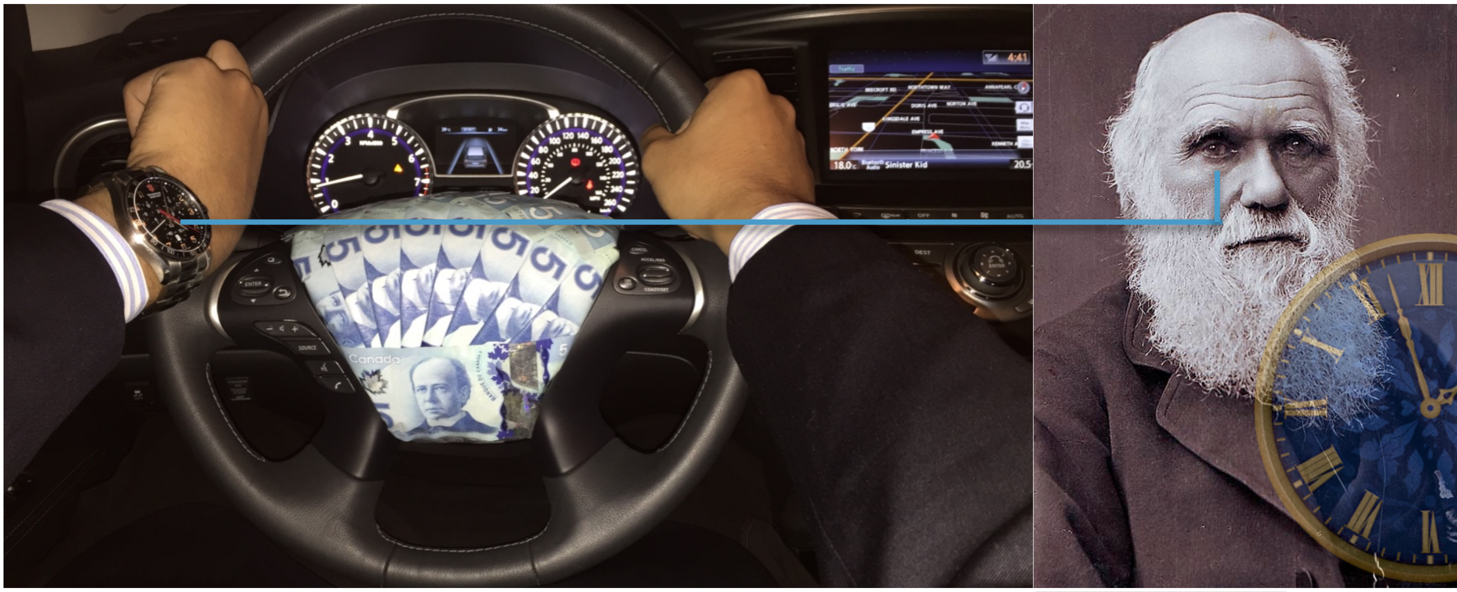
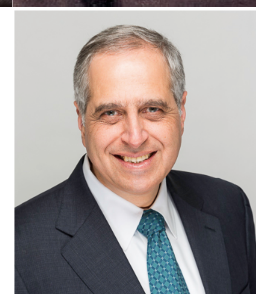


Controlling UberBanking

Time is Running Out for Canadian Banks



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If Darwin were alive, his comment on Mobile Payment in the past five years would be: "No mutation has brought any significant competitive advantage”. I am confident he would also notice more recently that mutations in the Galapagos Islands of FinTech happen tremendously faster than in the biological world he studied. At this speed, with new start-ups and APP’s being born every day, one right “mutation” could bring a ground-breaking advantage tomorrow. The cemetery of payment start-ups holds businesses that gathered decisive advantage but failed to capture capital and market share to turn a disruptive technology into a global competitors, capable of challenging conventional banking in the financial food chain. But some FinTechs “predators” are surviving and reproducing worldwide in hundreds of new startups.

We are witnessing market forces that are challenging the financial establishment to balance a highly regulated and slow-moving business with the capacity to change and adapt itself quickly to new technologies. Some FinTechs are disruptive and threaten traditional banking models. Selecting the best FinTech, targeting the most strategic acquisitions, and acting quickly are critical to Canadian banks. More than adapting to the new competition, banks must embrace some of these “mutations” in their own business model.

Blockchain is Close to Becoming the Uber of Banking.

FinTech services based on the Blockchain interchange concept will undergo exponential growth in 2017 and 2018. Some are already survivors at the evolution game; all are challenging the centralized centuries-old banking models. The survivors have passed successful Proof of Concept phases, and are now migrating to Capital Markets, going through valuations at VCs, providing cryptocurrency brokerage services and occupying precious data space in hundreds of thousands of virtual smart-phone wallets. The value of a Bank as a central trusted intermediary is eroded by the new model of peer-to-peer exchanges. "UberBanking" as a concept, is the predator of the inner core of banking systems. For the first time these systems may become irrelevant. This is a whole new game. Banks are good at integrating and adapting technology to their old legacy systems, but now they have a much harder goal: changing their business model.

Are Regulators Prepared to Accept UberBanking?

The definition of Disruptive Technology (as opposed to a sustained technology) is:

"One that displaces an established technology and shakes up the industry or a ground-breaking product that creates a completely new industry." (1)

Internet Banking in the late 1990's did not disrupt the traditional banking business. Back office could be preserved as well as most of the other business parameters and procedures which essentially came down to being a central business unit with diversified multiple access channels. For the first time after phone banking in the seventies, there was a new way of banking from the customer's computer. Productivity increased, but Internet banking only added an alternative to the typical branch expansion model. A cheap and behaviour-transforming channel, yet preserving the way banking services were provided.

The impact of other disruptive technologies on businesses helps us grasp the difference between disruptive and sustaining innovation in the banking business. Using taxis as an example, the adoption of wireless credit card terminals, convenient as it was to the consumer, did not impact the taxi industry at its core. Uber, on the other hand, brought an extremely disruptive business model that served as an alternative to the taxi industry; an alternative that is earning billions in revenue and threatening the business as we know it.

FinTechs today are close to becoming real alternatives to banking. Regulatory issues are the last barrier, but they can be changed with lobbying and political pressure. Uber knows that and has been good at pushing for these changes in hundreds of regulatory bodies at the city-council level. In the payment industry, regulatory challenges are at the provincial and federal levels. Cryptocurrencies such as Bitcoin are in fact being considered by regulatory bodies. Reviewing what is happening in North Carolina (2) or listening to the recent speech by Mark Carney, Governor of the Bank of England, as this central bank (amongst many others) explores the possibility of using digital currencies (3) can be eye-opening to how close they are to accepting change.

Banks were Technology Magnets, now the consumer drives innovation.

Whenever old IT giants like IBM, HP, and Diebold had a new generation of faster servers, ATMs, teller automation, card technology, fraud detecting solutions, etc., they would first go to the largest banks with their pre-launch beta versions. Integrating new technology into the legacy systems always maintained the continuity of the old banking model. No matter how large technology providers were, they could never take over the strategic value of banking: relationship with customers. So technology providers always submitted to banks.

This reality has changed: some FinTechs are now more concerned with regulators than with competition from banks. This is because they can reach customers directly. By the time they get on the bank's IT radar and on the board room agenda, some of them have built APPs with over a million end-users. All this in a few months. In the past, generations would pass before a bank could boast one million accounts. The number of B2C companies that can actually claim to do what only banks could do years ago has increased immensely in just a few years.

Changing Organizations to Absorb Disruptive Innovation.

It is now imperative for banks to learn to distinguish between disruptive and sustained technology, but unfortunately they often come under the same name: FinTech. When considered, they impose different obstacles to a bank that tries to approach them: sustained innovations require a "shopping" attitude, and later investing to integrate them. FinTechs with disruptive business models need the bank to take a totally different approach from the start: learning from them, adapting their services, creating separate nurseries to develop and apply them regardless of their possible failure. These requirements need a new kind of governance that reacts quickly enough to be able to benefit from them. It's not just joining groups like the R3 Blockchain Consortium or having middle management members reading posts and participating in committees and FinTech clusters.

New Governance Should Drive the Change in Process.

Cultural change in big corporations is very slow, so a new CEO that embraces the need for change will often start with human resources and org charts. Over 50% of the major Canadian banks are changing C-Suite leaders. But the agility required to benefit from joint-ventures and M&A opportunities in FinTech also requires a new kind of governance and decision-making procedures. Aside from culture and people, this is the third key element of change: process. Traditional banking governance, scenario analysis, internal auditing, regulatory issues, and compliancies, prolong the analysis and due diligence process when choosing the right FinTech. To benefit from disruptive innovations, banks must emulate the same path that makes VCs more adapted to control start-ups — the same path nature uses to select winners.

Constrained by their mammoth structures and the need to concentrate on their competition and customers, with executives trained for years in risk avoidance, combine to provoke the opposite of the required entrepreneurial attitude. Most Canadian banks are well adapted in terms of platform and technology expertise but still need more entrepreneurial people at the helm.

Of course the banking industry has had the perception of the evolution on their ecosystem for some time. We have seen the emergence of titles like “VP of Innovation” and Emerging Payment Technologies in a few Canadian banks as first signs of advance. But taking advantage of the next Uber of banking requires adapting much faster. In this game, there are no absolute certainties, yet acting fast is crucial. The first challenge is a change in resources, and this also takes time. Recent job-posts in Toronto, for instance, have included unlikely words like “entrepreneurial attitude” and “start-up background”. A Human Resource officer at a bank who would insert these two Job Description items in a job-post in the late 1990’s would soon be looking for a new job himself.

The path now is more clear: to choose and control the right FinTechs in time, change within the banks is critical today. They must hire the right executives, create independent groups with quick decision making channels reporting directly to the most senior officers. They must seek new solutions and banking models in startups worldwide, not only in Canada. Most importantly they must be ready to shatter old taboos, learn from new concepts, and be ready to experiment with innovation. They should behave as quick and nimble as startups, embrace risk like entrepreneurs and detach from their current governance to avoid the slow route correction of long term navigation charts. The banking industry as we know it will change so significantly that in a few years banking in Canada may not require money or banks. This is the main challenge today at King and Bay.

1: Harvard Business School professor Clayton M. Christensen coined the term *disruptive technology*. In his 1997 best-selling book, "The Innovator's Dilemma,"

2: North Carolina passes bitcoin bill: July 8, 2016. Governor Pat McCrory recently signed into law a new bill that expands the Money Transmitters Act to include virtual currency. The law defines virtual currency as a "medium of exchange," but not as currency, according to a report by Econo Times.

3: Alex Tapscott article in the Globe and Mail further adds: *“ Mr. Carney is not the first central banker to suggest a central-bank digital currency. The Bank of Canada recently announced a digital dollar pilot, and as early as 2013, then-U.S. Federal Reserve chairman Ben Bernanke said that blockchains could “promote a faster, more secure, and more efficient payment system.”*