

Headline	Should banks nurture internal innovation or invest in fintech?		
MediaTitle	Business Mirror		
Date	12 Sep 2016	Color	Black/white
Section	Banking and Finance	Circulation	82,600
Page No	B4	Readership	82,600
Language	English	ArticleSize	420 cm ²



KPMG Perspectives

Should banks nurture internal innovation or invest in fintech?

AS bank CEOs realize the pressing need to introduce next-generation products and refresh their brands to compete for millennial customers, many are turning to financial-technology (fintech) companies for solutions. Although strategies to buy, build, borrow or battle fintech start-ups can be effective, banks should also consider developing their own innovation cultures from within, to create a lasting competitive advantage.

Banks eye fintech innovation

FOR some time, banking leaders have understood that competition is not what it used to be. With product commoditization wearing down their returns, and public trust in the banking system waning, they appreciate that they must inject fresh innovation into their institutions to generate new sources of value, and fortify themselves against a multiplying field of disruptive competitors.

Bank CEOs have urged their boards to make innovation a priority and, rather than simply resisting the fledgling new competitors through regulatory battles and pricing wars, they should instead consider working with, or acquiring, the start-up innovators to improve their competitive footing. This viewpoint was reinforced by a recent KPMG publication, *Fin-Tech 100—Leading Global Fin-Tech Innovators Report*,¹ which observed that venture capital invested is a relevant measure of innovation, which, in turn, fuels enduring competitive advantage.

Different approaches to the fintech challenge

THERE are abundant examples of banks dabbling in the fintech landscape, including investments by Goldman Sachs, Citi Ventures, JPMorgan and Morgan Stanley in Square, a payment solution that ranked in 13th spot in the KPMG report.

Bank activity in fintech sector to date can be grouped into one of four basic approaches:

If you can't beat them, buy them: Many banks have been actively investing in or absorbing start-ups. It will take a few years to know whether this approach works, since slow decision-making in banks and a clash of cultures may impede success.

Become a start-up yourself: A number of banks are examining the methods employed by tech leaders, like Amazon, Spotify, Google and Zappos, to imitate their prowess at innovation, flexibility and speed to market. However, changing employee behaviors is a major challenge.

Start competing with yourself: Advocated by Harvard Prof. Clayton Christensen in his book *The Innovator's Dilemma* this stance suggests that the banks' digital channels can compete directly with branches and independent financial advisors. While many banks chosen this route, while also investing

in fintechs, they may struggle to overcome conservative behavior patterns.

Lobby for tighter regulations: While this may keep the start-ups at bay, it may not guarantee lasting success, and new

regulations could also adversely affect the banks themselves.

Strengthening internal innovation culture

AS an alternative to the fintech strategies above, banks might also consider sparking innovation within their own organizations, and drawing upon the collective wisdom of all employees to help reinvent themselves and improve client relationships. To do so:

- Boards must make innovation a top priority and see new ideas as the seeds of value.

- Foster sweeping cultural and behavioral changes. Make innovation part of your performance indicators and ensure innovation is visible within your organization.

- Spend more time exploring new ideas, with customer involvement to ensure relevance and engagement.

- Establish a balanced social contract between management and employees to enhance the flow of ideas.

- Don't resist every new competitor. Continually scan the horizon for new competitors and fintech players and consider how you may partner with them.

- Contemplate alliances with partners outside the banking industry to help bring fresh innovation inside your organization.

Lately, KPMG member-firms have been working with financial services clients to develop and install innovation in these ways, by involving more people in new idea development, and using technology to better allow the exchange of ideas and

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manage the knowledge generated. These programs, that make use of smart social software to connect people and ideas, have produced an astounding

flow of innovative thinking, and enabled fun, challenging participation among employee populations, to effectively create one global brain.

While fintech companies

may be today's "express route" to help a bank bolt innovation onto its brand, a greater emphasis on revitalizing a bank's internal culture, to empower employee creativity and invention, may produce longer-lasting dividends.

The article was taken from KPMG's publication entitled *Should Banks Nurture Internal Innovation or Invest in FinTech?*

by Mark E. Straub.

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