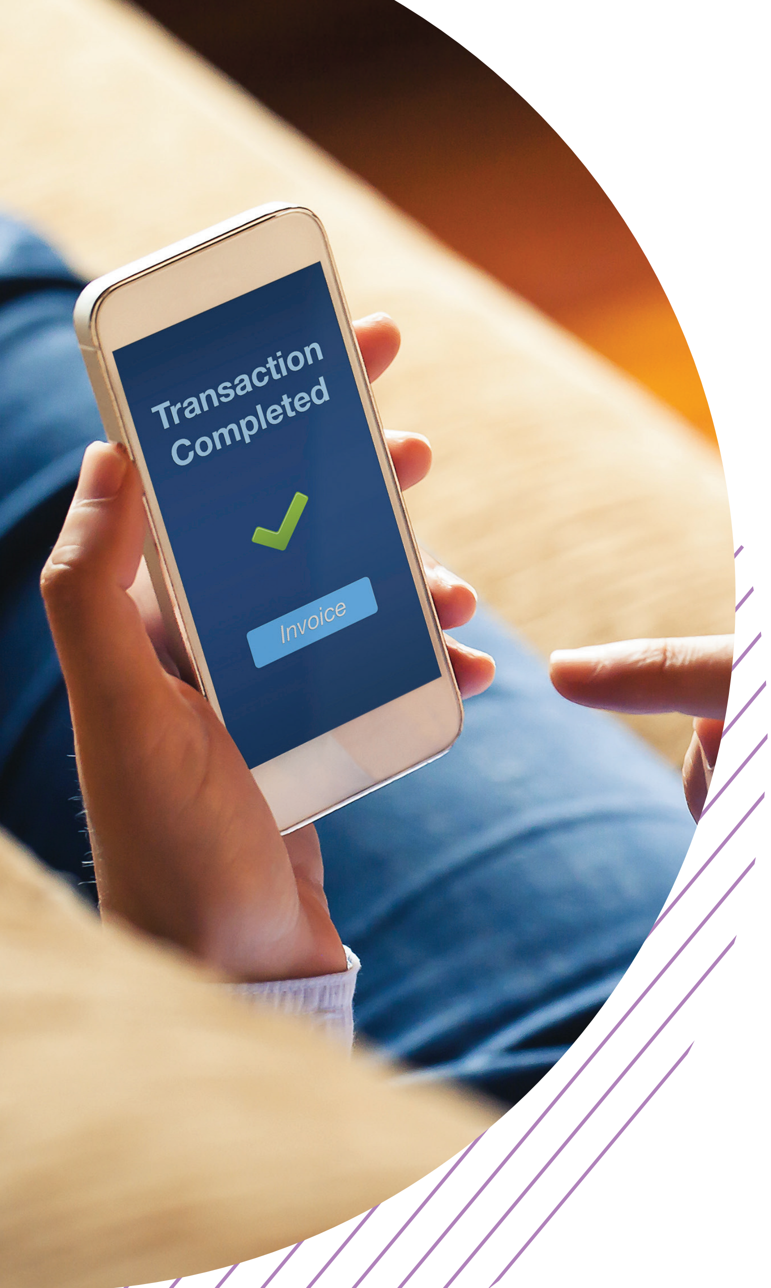
Q2

How to Scale and Monetize Your Fintech App



Introduction

Following the market crash and ensuing recession of 2008, the financial services landscape was changed dramatically. The industry was faced with a loss of consumer trust, increased regulation and compliance, an extreme decrease in bank charters, and burgeoning competition funded by private equity. These factors, and the industry's response, created a new financial environment, complete with new opportunities. Fintech apps are poised to provide basic financial services once limited to chartered finanicial institutions (FIs), but scaling and monetizing these new entrants comes with its own set of challenges.

Context

According to Q2's Rahm McDaniel, the market and industry shift, when looked at holistically, has created a new state in the market today. Key considerations for industry participants include choosing between chartering a new financial entity and partnering with another industry player; removing friction from onboarding; determining ways to monetize deposits; and greatly reducing the unique risks associated with scale and growth.

> **There's pressure on banks. But also, there's new opportunity. Between 2008 and now, you have this huge explosion in social networks. The iPhone comes out in 2006 and the world changes pretty radically. And what private equity started to do was pour funds into fintech starting an innovation race.**
>
> — Rahm McDaniel
> VP of Strategic Solutions, Q2

Key Takeaways

The industry has undergone an intriguing series of changes to bring us to the state of today's market. According to McDaniel, the series of events actually began in 2006, with the advent of the iPhone and the growth of what is now a ubiquitous smart phone culture. By the time the market crashed in 2008, consumers were becoming accustomed to a more connected lifestyle with increasingly higher-quality digital experiences.

In response to the crash and the resulting increase in oversight and regulations, the banking industry itself saw an immense decrease in the number of new banks being chartered even as regulatory compliance became the central focus of their businesses. Simultaneously, the investment community saw an opportunity. While financial institutions (FIs) were sometimes struggling to meet regulations (and find ways to pay for the staffing needed to meet them), fintech apps were growing in popularity as their adoption rates shot skyward.

So what is the state of today's market? Fintechs have created enhanced expectations on the part of consumers, who want more enriching experiences. Clumsier legacy tech often doesn't meet consumer expectations, and while fintechs desire to offer bank services, FIs maintain a clear regulatory and compliance advantage. Ultimately, these dynamics create new opportunities in the financial ecosystem.

> **The number one complaint that I hear, especially in this model, is that onboarding customers is difficult, that online account opening takes too long for banks, and when I talk to fintechs, they don't want to use the account opening mechanisms that banks provide them with because they're too slow.**
>
> — Rahm McDaniel
> VP of Strategic Solutions, Q2

With this in mind, there are four major topics to consider when looking to scale and monetize a fintech app.

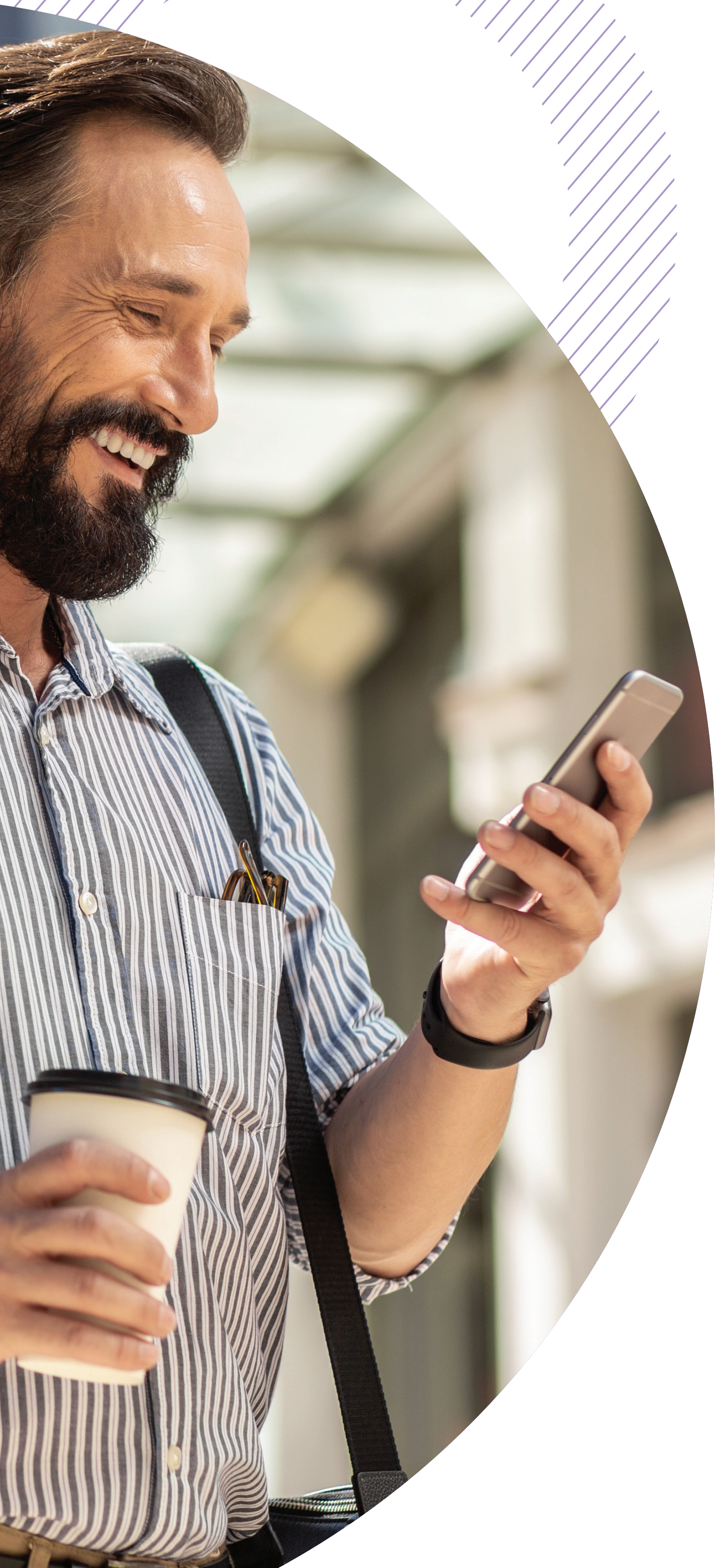
1. Partnership versus chartering

FIs and fintechs both bring strengths and weaknesses to the table—and partnerships can position both to benefit from the other. Thanks to a number of partnership models—including direct, referral, and "White Label"—both entities can leverage the strengths of their partner to maximize an app's quality and features.

FIs are the clear experts on compliance. Fintech companies are often more successful in building the best user experience. By partnering, Fintechs can make use of the FI's banking charter without having to go through the cumbersome chartering process, while FIs benefit from enhanced customer support and marketing. The advantages can be tremendous if both sides are willing to embrace new models of cooperation.

2. Frictionless (or less frictional) onboarding

When it comes to onboarding, faster is better. Yet for many account holders, the account opening mechanisms that FIs provide are too slow. To compound this technological challenge, the need to keep costs low and cultivate relationships creates additional friction for FIs. Many FIs, though, are finding great success mitigating friction by reducing information gathering on initial contact and collecting account holder data as value accrues. This approach often emphasizes the importance of offering products that are easily adopted, such as an FBO account. Then an FI can grow a relationship



using data over time. This can be a much better approach than solely attempting to cross-sell as many products as possible in the initial contact.

3. Monetizing deposits

FI and fintech partnerships are built, in part, around a shared desire to monetize services. Holding money in accounts often doesn't generate needed income, but finding ways to make the process cheaper and to put the money into transactional vehicles can produce more fee income and provide the value both entities are seeking. For example, a partnership that provides a fintech customer with a top-of-wallet card can generate shared interchange income, benefiting both the FI and the fintech.

4. De-risking scale and growth

Working together, FIs and fintechs can create the ability to scale quickly and efficiently. But the reality is, digital banking services can scale too quickly for their sponsoring institution, creating an acceptable level of balance sheet risk. The right partnership, though, can support potential scale while providing a mechanism to spread the liabilities across a network of FIs. Not only can this reduce risk for the partner FI, it can also further monetize deposits by generating interest income for the FI and fintech.

Biography

Rahm McDaniel

VP of Strategic Solutions, Q2

Rahm McDaniel serves as Vice President of Strategic Solutions for Q2. He has spent more than 19 years working in the high-tech industry, with more than 12 years spent serving in various senior roles at Hewlett Packard Enterprise. He also co-founded Ideagility, a digital firm with a focus on marketing, design, advertising, branding, reputation management, and more.

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