



The Platformification of Banking

EXECUTIVE SUMMARY

Over the next 10 years, a new banking business model will emerge: the banking platform.

In this context, a platform is:

“A plug-and-play business model that allows multiple participants (producers and consumers) to connect to it, interact with each other, and create and exchange value.”

Successful platforms attract both producers and consumers, match producers with consumers, and provide seamless integration among participants.

Banking platforms will:

- 1** Give consumers choice, but spare them the additional work of duplicate data entry, integration, and paying multiple providers
- 2** Create new revenue streams for banks, as third-party providers share revenue for using the platform
- 3** Offer opportunities for fintech startups to achieve scale by reducing acquisition costs through platform participation

“ Successful platforms attract both producers and consumers, match producers with consumers, and provide seamless integration among participants. ”

If you've attended a banking conference or read any fintech blogs over the past two or three years, you've probably seen a graphic like the one below (Figure 1).



The premise behind the graphic is that, with the emergence of hundreds (if not thousands) of new fintech startups—all providing a specific product, feature or function that banks provide today—the need for monolithic, multi-product financial institutions (FIs) is waning. Implied, in the chart, is that fintech startups will disrupt and displace today's banks.

CORNERSTONE'S TAKE: Displacement is not what's happening. What is happening is the re-architecting of the banking industry's hierarchy of needs

The term “hierarchy of needs” might ring a bell if you took any psychology classes in school. The term was made famous by Abraham Maslow, who said humans have a hierarchy of needs that starts with food and shelter, and goes up to self-actualization. Modern society has proven Maslow wrong, however, as it has become clear that battery life and access to Wi-Fi is more important than food and shelter.

The banking industry has a hierarchy of needs as well:

- **Security.** Consumers need to know that, when they put their money in the bank on Monday, it will be there on Tuesday. And banks need to ensure that the money in their customers' accounts is secure, and that bad actors can't get access to the accounts.
- **Movement.** Consumers also need to move money. When they swipe a debit or credit card, or when they write a check (if they're actually doing that anymore), they want the money moved from their account to whomever they're transacting or interacting with.
- **Performance.** Consumers and banks have a need to optimize the performance of their financial lives by maximizing returns and minimizing fees. Banks, on the other hand, have a need to earn sufficient profits to remain viable institutions.

“ Consumers and banks have a need to optimize the performance of their financial lives by maximizing returns and minimizing fees. ”

What is happening in the fintech space is that startups are using digital technologies to create new ways to improve security, move money and optimize performance. Nearly every fintech startup we've come across can be slotted into one of the three levels of the hierarchy of needs (Figure 2).

Figure 2 | The Banking Industry Hierarchy of Needs



Source: Cornerstone Advisors

Firms like eStorm, Eyeverify and Trusona bring new capabilities for authentication and password management. Big names like Square, Ripple, Zelle, the big banks' new entry into the person-to-person payments space, are really just new ways of moving money. And neobanks like Moven, fraudulent charges monitors like BillGuard, and automated savings tools like those from Digit, all help consumers optimize the performance of their financial lives.

None of them, however, come anywhere close to unbundling or displacing banks.

THE PARTNERSHIP PARADE

The nature of discussions happening on banking blogs and in banking conferences is changing, however. Today, it's about how banks need to partner with the startups (and vice versa). FIs of all sizes are being urged to “partner” with fintech startups in order to capitalize on their momentum and innovations.

Calls for partnerships are in full force. Recent headlines (with Cornerstone's take on them) include:

- **Big Banks Balance Fintech Startup Partnerships with Internal Innovation.**ⁱ One consultant is quoted as saying: “Banks are smart to work with fintech startups while at the same time searching separately for ways to compete against them. It's a delicate balance and they have to think like a tech company.”

CORNERSTONE'S TAKE: We disagree. The last thing a highly regulated, risk-bearing financial institution needs to do is to “think like a tech company.”

- **Advice to Fintech Firms: How to Partner with Banks.**ⁱⁱ The article states: “Most [fintech] companies will call themselves partners rather than vendors. There may in fact be a case for being a vendor (there is less long-term reward, but also less overhead). Yet, if fintech firms are to be a part of the transformation of banking, they will do so as partners.”

CORNERSTONE'S TAKE: We don't get why there's “less long-term reward and less overhead.”

- **Community Banks Clamor for Fintech Partnerships.**ⁱⁱⁱ According to this article, “smaller traditional firms find themselves struggling against new online regional banks, making partnerships with fintech start-ups crucial.”

CORNERSTONE'S TAKE: New online regional banks? Like who? If you're “online,” why would you be limited to specific regions?

“ The last thing a highly regulated, risk-bearing financial institution needs to do is to ‘think like a tech company.’ ”

PARTNERSHIP DELUSIONS

Interestingly—maybe “surprisingly” is the better word—only the *Wall Street Journal* articleⁱ makes any specific references to bank/fintech partnerships, a partnership between a European bank and a startup.

Not that there aren’t examples. A number of regional and community banks claim that they have “partnered” with Lending Club to boost their loan volume, and Chase says it has “partnered” with OnDeck in the small business lending space.

But are these really partnerships? The author of the Finextra articleⁱⁱ cited above commented:

“Without shared vision, values, and goals, there can be no partnership.”

We agree, and would add “shared risk” to that list of partnership criteria. In this light, then, do the so-called partnerships really qualify? The Lending Club example fails the test, miserably.

Following the lending marketplace’s scandal in 2016, Richard Swart, a Stanford professor and expert in alternative finance, said at a conference that he expected banks to refrain from putting any capital in Lending Club—which turned out to be the case.

CORNERSTONE’S TAKE: Banks aren’t partnering with Lending Club; they’re simply using it as a distribution channel.

Two more realities expose the delusion of bank/fintech partnerships. Many financial institutions:

- **Don’t have the skills or resources to develop true partnerships.** FIs may know how to assess vendors and manage vendor risk, but they don’t necessarily know how to assess potential partners, and negotiate mutually beneficial partnership agreements.

“ Banks aren’t partnering with Lending Club; they’re simply using it as a distribution channel. ”

- **Aren't easy to work with.** The CEO of a successful fintech startup told us: "The biggest barrier to bank/fintech partnerships is banks' procurement departments. They treat us like small IBMs and hammer us with performance and risk clauses that would kill us if we let them."

CORNERSTONE'S TAKE: Partnerships aren't going to produce economic benefit for most FIs, and the discussions around disruption and partnerships ignore a longer-term trend impacting the industry: the "platformification" of banking.

PLATFORMS, NOT PARTNERSHIPS

What is a platform? In a business context, there are many new and divergent definitions. Here's our favorite:

"A platform is a plug-and-play business model that allows multiple participants (producers and consumers) to connect to it, interact with each other and create and exchange value."^{iv}

“ Simply having a lot of producers and consumers is no guarantee of success. ”

There are three important components of this definition:

- 1 Business model.** First and foremost, a platform is a type of business model.
- 2 Plug-and-play.** A platform must enable participants to easily engage—and disengage (which partnerships typically don't).
- 3 Create and exchange value.** One plus one has to equal more than two, or there's no need for the platform.

To successfully execute a platform strategy, a company must:^{vi}

- **Become a magnet.** Without the ability to attract a meaningful number of the "right" participants, a platform cannot succeed. Simply having a lot of producers and consumers is no guarantee of success. The platform must attract the right producers (those with the most desirable products and services) and the right consumers (those with whom the producers in the platform want to do business).
- **Act as a matchmaker.** A platform requires a mechanism for matching consumers to the right producers, and for enabling producers to reach the right consumers who come to the platform. At its most basic level, a search engine can be a matchmaking mechanism.
- **Offer a toolkit.** The toolkit is what enables producers (and consumers) to easily plug-and-play. This is why application program interfaces (APIs) are so critical to firms pursuing platform strategies.

ARE TODAY'S BANKS PLATFORMS?

We've heard bankers tell us that their bank is already a platform. Well, we know platforms, and your bank, sir or madam, is no platform. Here's why:

- **Today's banks are consumer magnets, not producer magnets.** Banks do a fairly good job of attracting consumers. But there is practically no focus on attracting other producers, other than the one-off partnerships that a bank pursues.
- **Today's banks only match consumers to their *own* products or services—if they even do that.** The key to successful matchmaking on a platform is matching a consumer to one (or more) of a number of providers.
- **Today's banks don't have a toolkit.** Banks have a mixed track record of integrating the products and services of the firms with which they develop partnerships with, let alone providing the ability to plug-and-play. A few large institutions, however, have launched developer exchanges or API stores to accelerate the building of a platform-like toolkit ([Table A](#)).

“ We know platforms, and your bank, sir or madam, is no platform. ”

Table A | Bank's Platform Toolkit Development Efforts

BANK	DESCRIPTION
BBVA API Market	<p>Originally launched in Europe, BBVA's U.S. API market currently offers APIs in four categories:</p> <ol style="list-style-type: none"> 1. Customers—create, retrieve and update customer records in the banking core 2. Accounts—access key account data to enhance financial management services 3. Cards—integrate pre-authorized bank card data 4. Payments—allows third party apps to offer money transfer services to pre-authorized users
Citi Global API Developer Hub	<p>Launched in Q4 2016, the developer hub grants developers access to APIs across eight usage categories, including account management, peer-to-peer payments, money transfer to institutions, Citi rewards, investment purchases, and account authorization. Additional categories are expected to be added over time. One month after launch, the Developer Hub offered 49 APIs across the eight categories</p>
Capital One Developer Exchange	<p>Four products offered:</p> <ol style="list-style-type: none"> 1. SwiftIDSM provides two-factor authentication for identity verification 2. Rewards API product enables developers to obtain a list of, and details about, rewards accounts 3. Credit Offers API enables developers to offer Capital One credit products to its customers 4. Bank Account Starter API provides the ability to add an account-opening feature to a developer's website or mobile app

Sources: Cornerstone Advisors, company press releases

THE PLATFORM IMPERATIVE

What's driving the platformification trend? One reason is that technological developments (Internet, mobile, blockchain, artificial intelligence, etc.) have enabled banks to become platforms. But technological change—by itself—is not the only reason. There are two other contributing factors:

- **Consumer demand.** For as important as money is to us, most of us hate managing it. And so we haven't. What's truly different about the younger generation(s) is their involvement with managing their financial lives. This gives rise to interest in, and demand for, a wide range of tools and features to help manage one's financial lives. Tools and features that a single bank would be hard-pressed to develop, launch, support and make profitable.
- **Economics.** Banking's traditional business model is eroding. Interest rates are at a historical low, lending opportunities are being attacked by newcomers, the ability to raise interest rates on credit cards has been regulated away, fewer consumers revolve their card balances anyway, and making money through overdraft fees is hardly a long-term strategy. In short, banks must explore new business models.

As a result of technological, demographic and economic changes, there is a proliferation of new banking capabilities that are being developed to change the way we secure and protect accounts and money, move money, and improve the performance of our accounts and money.

This proliferation of new capabilities—and companies—begs an important question:

Who is going to pull this all together in a coherent, cohesive way for consumers, and perhaps more importantly, for specific consumer segments?

The answer is an organization with a platform-based business model.

Consumers don't know many of today's fintech startups, and they likely don't care to know. Consumers don't want to have to work to find out what companies do, if they're any good, and if they're safe to do business with. They want someone or something to make it all easy for them.

They want a platform.

“ Consumers don't want to have to work to find out what companies do, if they're any good, and if they're safe to do business with. ”

BANKING PLATFORMS: ANOTHER NAME FOR THE AGE-OLD FINANCIAL SUPERMARKET?

The “financial supermarket” concept dates back to the 1980s (maybe earlier), when large banks acquired insurance firms (or vice versa) and brokerages with the idea of becoming a one-stop shop for consumers’ financial needs. Is a platform just the manifestation of this one-stop shop supermarket? No.

The supermarkets of the '80s were created through acquisition. The banking platforms of the 21st century will be created through vendor/merchant agreements and API integration, much like Amazon does with the vendors and merchants that sell through its platform.

On a banking platform, consumers’ choice of services won’t be limited by the product set that the bank provides (through its acquisitions and pre-negotiated partnership), but by the range of providers that use the platform to offer their services.

For example:

- Today, banks select personal financial management tools and services to integrate with their online and mobile banking systems. On a platform, multiple providers would offer their tools and customers would choose which one(s) they wanted to use. So instead of the bank having to evaluate, vet and negotiate partnerships with a savings tool like Acorns or Digit, a banking platform would enable both fintech startups to offer and market their tools.
- Today, a firm like BillGuard markets its purchase tracking services directly to consumers. Consumers who sign up give BillGuard their login credentials to access transaction details and are billed by BillGuard for the service. On a platform, bank customers could choose to use BillGuard’s services without having to give any additional information to BillGuard, and they wouldn’t be billed by BillGuard—they would only see charges from the platform provider.

Banking platforms will take shape over the next 10 years, including those created by existing banks, fintech startups and players outside of financial services, like Amazon.

“ The banking platforms of the 21st century will be created through vendor/merchant agreements and API integration. ”

Three types of platforms will be prevalent:

1 Bank-sponsored platforms. These platforms, created by banks, will integrate add-on tools and services to core banking products and services. Looking somewhat like an Apple or Android apps store, consumers will be able to choose, purchase, and integrate tools and services that link to their payment accounts (i.e., debit or credit cards). Startup banks like Starling Bank in the U.K. and Fidor in Germany are pursuing this strategy (Table B).

2 Fintech-sponsored platforms. Marketplace lenders like Lending Club and Kabbage have already opened their doors to bank participants, not only becoming a distribution channel for banks to source loans, but providing processing and data sourcing services. In this type of platform, banks will be platform participants, not platform sponsors.

3 Non-FI platforms. An Amazon-sponsored banking platform could enable consumers to shop for checking accounts from various financial institutions and facilitate account opening by relying on existing digital account opening vendors and tools.

Table B | Fidor Bank's APIs

BANK	DESCRIPTION
Account	List accounts, view account, create account, update account
Customer	Create customers, update customers, view customer data, view the FIN, update FIN
Card	List/view/order cards, view card data, PIN services, lock/unlock/block/activate a card
Lending	Request/create a short-term loan for an account, show the current short-term loan
Overdraft	List overdrafts for an account, create overdrafts, update overdrafts
Money transfer	Allows customers to make global money transfers via the Currency Cloud service

Sources: Cornerstone Advisors, company press releases

The benefits of a true platform accrue to:

- **Consumers.** Platforms give consumers choice, but spare them the additional work of duplicate data entry, integration, and paying multiple providers.
- **Banks.** Platforms create new revenue streams for banks, as third-party providers share revenue for using the platform.
- **Fintech providers.** Fintech startups—which struggle to achieve scale in a crowded market—reduce acquisition costs through platform participation.

BECOMING A BANKING PLATFORM

Economic realities may be spurring an interest in new business models, but the reality is that:

- **Becoming a platform is hard.** Amazon's history provides a lesson for platformification. It spent the better part of its first 10 years of existence becoming a consumer magnet. In 2006, it launched Amazon Web Services, which really became the basis of its platform "toolkit" and helped solidify its ability to become a producer magnet. All told, Amazon's platform strategy took 20 years to execute.
- **Few FIs have the stomach to transform their business model.** Unless your firm is failing, business model change is unlikely to happen. And even then, it's no guarantee. Too many senior bank executives cling to lifeboats hoping to reach Retirement Island, and the board—well, really now, you weren't looking to the board for business model transformation, were you?
- **Few FIs have the strategic vision.** There's nothing like spending 20, 30, even 40 years in an industry to solidify your view of what drives success in that industry. Platformification is a few steps removed from that view.
- **The regulatory environment is not supportive (or even clear).** The Office of the Comptroller of the Currency recently said: "Making strategic moves to innovate with new technology-based banking involves assuming unfamiliar risks, but banks may face heightened risk if they do not innovate. Banks should have effective risk management to ensure such innovation aligns to their long-term business strategies."

CORNERSTONE'S TAKE: How could a bank with no experience as a platform ensure that it has "effective risk management" to align with that strategy? The agency's discussion of "responsible innovation" leaves much to be desired.

- **Few FIs have the resources to build a platform.** Twenty years ago, when banks and credit unions were told they would need websites and online banking platforms, they said, "We don't have the resources to do that." They were right, but the vendor community filled the gap. As it will with a "bank-as-a-platform" capability.

“ How could a bank with no experience as a platform ensure that it has 'effective risk management' to align with that strategy? ”

THE EMERGING PLATFORM VENDOR SPACE

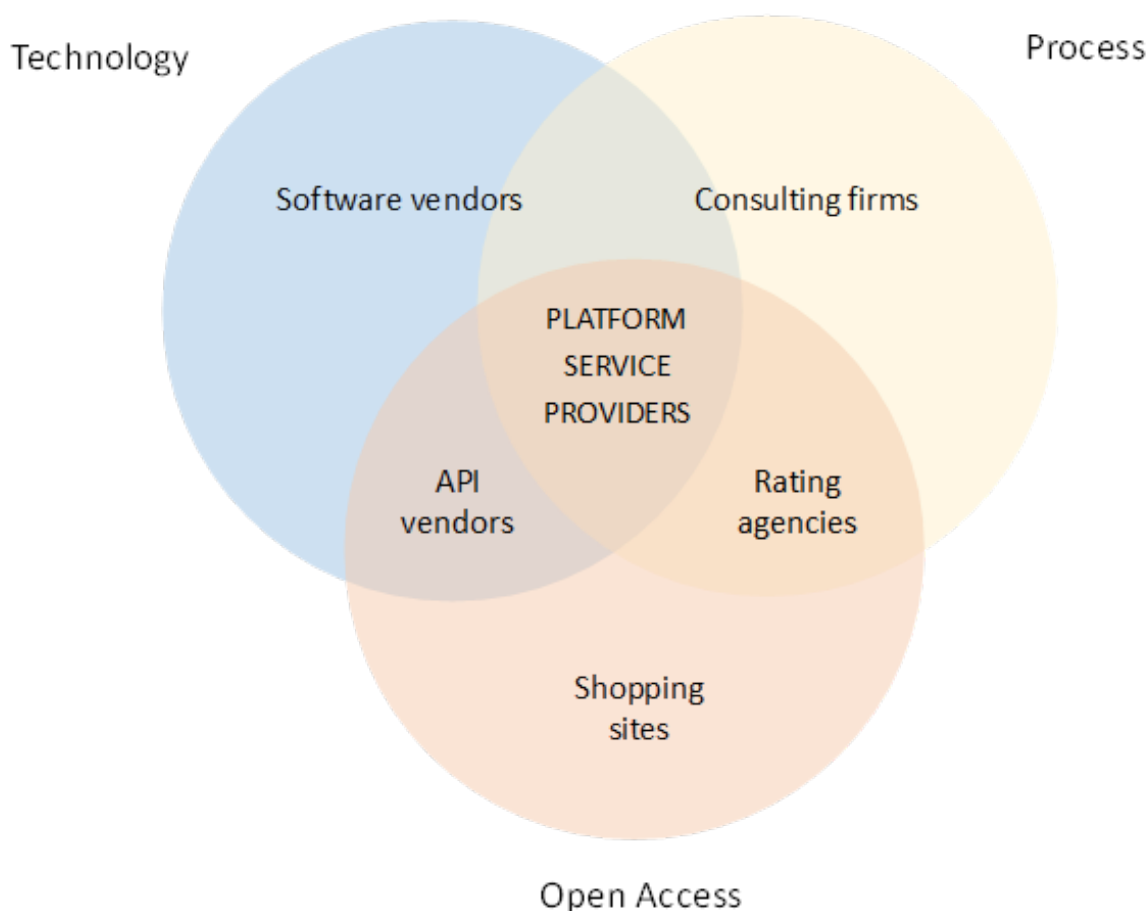
To simplify the situation, creating platform capabilities requires technology, process execution and support, and open access. Existing financial services vendors typically provide one or two of these capabilities (Figure 3):

- **Software vendors.** Traditional financial services technology vendors provide technology to financial institutions (obviously), and over the past 10 to 15 years have added process execution and support capabilities (for example, digital account opening or loan processing. But, for the most part, software vendors don't provide capabilities for third-party product and service providers to plug-in to the technology platforms they provide to clients.
- **Consulting firms.** Traditionally more focused on the process design and execution, consulting firms have expanded their offering to provide software to clients but, like the software vendors, don't deliver on open access.
- **Shopping sites.** Sites like Bankrate for banking products, or even Zillow for home shopping, provide open access to any provider that chooses to participate, but these sites don't provide technology services or process support.
- **API vendors.** Newer firms like Xignite and Plaid have developed APIs for the banking industry, but, to date, they don't provide end-to-end business process execution and support.

CORNERSTONE'S TAKE: Over the next five to 10 years, new vendors will emerge to fill a new space in the vendor market: Platform Service Providers.

“ Software vendors don't provide capabilities for third-party product and service providers to plug-in to the technology platforms they provide to clients. ”

Figure 3 | The Emerging Platform Service Provider Space



Source: Cornerstone Advisors, MIT

A number of platform service providers have already emerged:

- **Akouba.** Akouba provides financial institutions a secure cloud-based platform that reduces the cost and time required to issue a small business loan. Banks retain control over lending decisions, pricing, credit policy, loan dollars, and customer experience. Akouba configures the underwriting of each financial institution's platform based on the bank's credit policy and guidelines. Akouba integrates with core systems including FIS, Fiserv, Jack Henry and D&H, and integrates data from Experian, Transunion, Paynet, and LexisNexis, among others.

- **Kabbage.** Kabbage, a small business lending marketplace, has already begun to re-brand itself as Kabbage Platform, providing a configurable financing engine that reviews thousands of customer data points to inform accurate underwriting and funding on an ongoing basis. The firm's turnkey solution includes data modeling services to help financial institutions construct risk models to achieve their lending objectives. The platform uses real-time data from sources like Amazon, eBay, Shopify and Etsy to assess borrowers' financial health and calculate how much funding should be extended.
- **LendKey.** The company provides demand generation, decisioning, origination, servicing and liquidity management services to banks, credit unions and alternative lenders. In addition, LendKey enables banks to buy loan participations, retain loans on balance sheet, or choose to sell whole or fractional loans. More than \$1 billion in capital has been deployed on LendKey's platform to date, including more than \$400 million in student loans.
- **Avoka.** Unlike the other emerging platform service providers mentioned here that focus on lending, Avoka's platform enables account opening and onboarding. The company's Avoka Exchange™ is a catalog of pre-integrated applications that integrate pre-built connectors for more than 30 services, including fraud detection, identity verification, and digital signatures from companies like FIS, Mitek, Yodlee, Salesforce and eSignLive.

THE FUTURE OF BANKING PLATFORMIFICATION

The strategic shift towards platforms—as a business model, and not just a technology approach—will take years.

CORNERSTONE'S TAKE: The most-likely scenario is that over the next five to 10 years, one or two players will emerge with a banking platform strategy and shake up the strategic viewpoints of other FIs.

With high risk comes high reward, however. An institution that successfully executes on a platform strategy creates new revenue streams, diversification against future downturns in its core businesses, and a new type of relationship with consumers.

ENDNOTES:

ⁱ<http://blogs.wsj.com/cio/2016/03/21/big-banks-balance-fintech-startup-partnerships-with-internal-innovation/>

ⁱⁱ<https://www.finextra.com/blogposting/12403/advice-to-fintech-firms-how-to-partner-with-banks>

ⁱⁱⁱ<http://www.cnbc.com/2016/03/09/community-banks-clamor-for-fintech-partners.html>

^{iv}<https://thefinancialbrand.com/55952/2016-top-banking-trends-predictions-forecast-digital-fintech/>





^v<http://platformed.info/platform-stack/>

^{vi}<https://hbr.org/2013/01/three-elements-of-a-successful-platform>



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