The best way to get your FinTech idea to market – and not go out of business trying

Insights from a 20+ year FinTech veteran, recognized as a global pioneer and industry leader with multiple start-up successes, who shares his views on the arcane complexities of FinTech and how to deal with them.

By Gary Palmer

7 March 2019

FinTech is hot

A Google search for the "definition of FinTech" returns 15,200,000 results. So, before we get started, let's agree on a definition of FinTech:

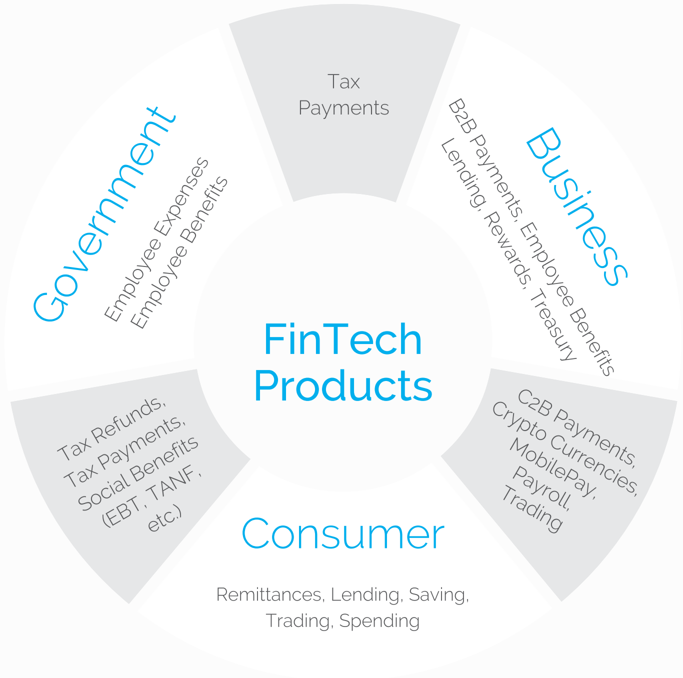
"FinTech firms, those that apply technological innovation to financial functions and systems...."

Patrick T. Harker, *President Philly Fed*

"Philadelphia Fed's Harker: Regulation Is Key to Safeguarding Fintech, Consumers" press release, February 6th 2017

Let's go with this.

I'm drawn to organize my thinking around FinTech by three broad vertical markets or user profiles — Business, Government and Consumer. Within each of these markets there are numerous examples of FinTech products. Some are quite mature, such as Electronic Benefits Transfer (EBT) for the delivery of social benefits by State governments. These began as paper instruments and were replaced by prepaid cards. Mobile apps will eventually coexist with cards. More recent examples include cryptocurrencies, blockchain applications and mobile payments.



Some include businesses that provide information to Consumers, Businesses and Government to aid in decision-making as FinTech. For this paper, I view these as "information services" or "reg-tech" and not FinTech.

Within the vertical markets of Business, Government and Consumer, FinTech applications vary and are supposed to be "better than the status quo" from the perspective of user accessibility, cost, speed, ease of use, control, integration with non-payment applications or safety. These attract investment as managers develop alternatives to how Consumers, Businesses and Governments make or receive payments or facilitate some other financial transaction — such as lending, trading, remittances and more.

It's obvious given the rise of new FinTech companies and the adoption of some FinTech products, there's receptivity to safe, reliable, easy to buy and use alternatives that are substantially better than current offerings.

And capital is pouring in.

Entrepreneurs race to get to market, attract early adopters, refine the value proposition and drive to scale.

Existing payment processors and bank software providers are evolving their businesses in order to support FinTech demand.

But most new FinTech companies fail

Let's be honest, there have been countless FinTech failures over the last 20 years — long before FinTech was its own category. Some failed because products simply didn't solve problems or add better value than existing options. Some were difficult to acquire or complicated to use. Others were caught in the cross-hairs of regulators. And many failed because they ran out of cash before they scaled, when financial sponsors lost faith and stopped writing checks.

Regarding the evaporation of capital, oftentimes entrepreneurs and managers blew their development budgets (by huge sums), failing to get traction, and bled cash for payroll. Bottomline, when adoption and revenues lagged and operators failed to make a dent in their cost base, cash evaporated.

I've carefully listened to numerous passionate arguments from entrepreneurs, CEOs, business leaders and even some investors who asserted they "must build it" and they "must operate it". So, they built, or tried to build, a lot of technology. They hired staffs of 30, 40 or even 60+ people for project management, product management, compliance, fraud/risk, user support, financial settlement and others to support operations.

The result? They simply burned through their precious cash before there was sufficient revenue to cover costs, or at least generate enough sales to prove the product had legs and was backable. This is still happening.

A key objective of this paper is to explain the arcane innards of FinTech. And then, describe an alternative paradigm to "building technology" and "hiring people for operations" as well as working with a "bank partner".

The approach I'll describe will enable FinTech visionaries to minimize cash requirements, dramatically shrink development timelines and even come close to the impossible — **flipping the classic FinTech business model from a high fixed cost to a variable cost model.** Or at least gut the cost-base without compromising information security, safety and soundness, flexibility or quality, and perhaps even improving all of these.

This paper doesn't describe an entirely new construct as other industries, from PC and auto manufacturing, to those pioneering pharmaceutical drug development, have evolved their business models in order to save time and money going from idea, to launch, to scale. Even in the payment and banking industries, elements of this approach have existed for decades.

Pattern Recognition

I'm informed, inspired and cautioned by two-decades of decisions as a founder, big-company operator, investor, board member and advisor, as well as through interactions with countless professionals and entrepreneurs, and observing the outcomes of their decisions. The underbelly of FinTech is a complex world of payment and banking protocols, network rules and government regulations, inflexible processes and procedures, established and even rigid technologies, extreme risks, diverse compliance obligations, as well as other conditions that can't be marginalized. These vary by product and application, by country, and even by region or state within a country. And the possibilities for FinTech are rapidly changing, dynamic and on the cutting edge of technology and regulation. An impossible situation? Absolutely not! But complicated — you bet.

Market expertise, as well as proof that a big problem exists, and users are frustrated and hungry for something better, as well as prior success building tech companies, are powerful forces that improve the odds for new FinTech initiatives.

However, these can also create blind spots (and even hubris), leading to decisions that on the surface appear logical, but result in company threatening (killing) consequences.

The ideas I'll share have been put into practice and are proven to work.

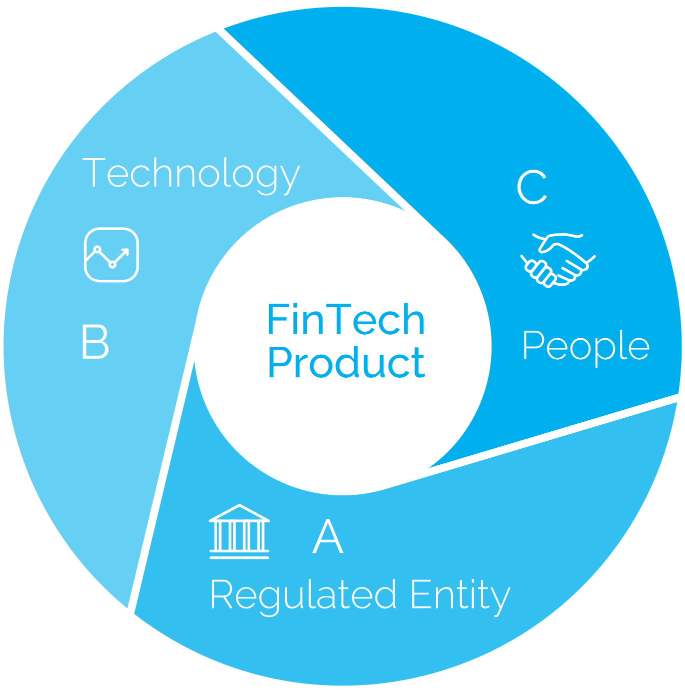
> *"Business pattern recognition aims to understand how elements (activities, events, objects and information) may form new patterns that represent an opportunity for innovation or the threat of disruption to business operations or strategies."*
>
> *Gartner.com*

I won't try to detail the 50+ years of technology development and disruptions, rule-making and compliance, global network building, business norms of banking and payments, nor will I identify the large number of entities and their specialized roles that must be considered. What I will do is simplify the essence of FinTech and describe a new paradigm for accelerating product development and reducing cash requirements by thinking about banks, technology and people in a fundamentally different manner.

> *Electronic payments and banking services are easy and ubiquitous to users. They just work — like getting a dial tone or enjoying light in a room when a switch is flipped. This makes FinTech look easy. And this is a big problem.*

A new paradigm

To consider alternative paradigms, we must first understand what's inside every FinTech product. Then, critically rethink how to execute it in such a way, that the market and the user needs aren't compromised, while simultaneously reducing speed to market, execution risks and cash requirements.



Every FinTech product must have
a Regulated Entity, Technology and People to exist.
I call this the FinTech Triad.

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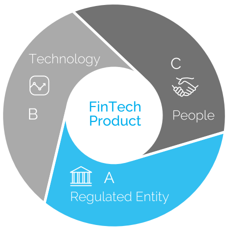

Regulated Entities

Deposit Institutions, Acquirers, Issuers, Consumer Lenders, Commercial Lenders, ACH Operators and more.

The "official name" and service provided by each Regulated Entity varies by jurisdiction. Jurisdictions can vary by country, union of countries, state, canton and numerous other geographic constructs. The official names can be State Banks, Federal Banks, Community Banks and Credit Unions in the US and the EU, but also in the EU, Asia, Latin America and elsewhere non-banks are regulated for specific payment services. Some of these are called Emoney Issuers and Payment Institutions.

This is not a complete list, and the service provided by each can differ widely depending on their charter and regulatory mandate. For example, Emoney Issuers can't accept deposits, make loans or pay interest on accounts — they can only issue electronic money or prepaid cards. Some refer to Emoney Issuers as "non-bank banks" and these entities can be ideal partners given their narrow focus and specific expertise compared to classic, highly diversified (in terms of products) banks.

As an important aside, unless there's internal fraud or gross negligence, given the regulatory requirements to ring-fence user funds or under the new PSD to insure funds, and a prohibition to make loans, Emoney Issuers and similar entities represent no systemic risk to a country's financial system and can aid in driving payment innovations.

While commonplace in the EU for many years, the non-bank banks have worked well and delivered valuable FinTech innovations for Consumers, Businesses and Governments. The US has only recently considered this idea. In a speech, on December 2nd, 2016, at Georgetown University Law Center, Comptroller of the Currency, Thomas Curry announced that the OCC was proceeding with considering applications from FinTech companies to become special purpose national banks. He went on to cite several reasons for this and stated, "First and foremost, we believe doing so is in the public interest… It is clear that FinTech companies hold great potential to expand financial inclusion, empower consumers, and help families and businesses take more control of their financial matters. This is an exciting development, even though the usual suspects have mounted a serious, vocal challenge, rather than thoughtfully developing strategies to leverage this for their benefit.

Let's look at one FinTech business sector (cryptocurrency) and one company (Bitcoin) that depend on Regulated Entities. This is a provocative, yet compelling example. A few years ago, some top execs of the largest US banks were commenting on, or rather lamenting about Bitcoin and citing it as a prime example of FinTech gone bad. The argument was that Bitcoin operates "entirely outside the financial system". After a lengthy dialogue, there was general agreement among bankers about this. When I was asked my opinion, I disagreed and explained the following.

I shared that all funds that flow into Bitcoin come from a "source", and that source is always a bank — either by money transfer or a credit/debit card transaction.

This means that a Regulated Entity — a deposit bank, a credit card issuer, or a debit card issuer, plays an essential role enabling the funding of an account to purchase cryptocurrency. Without Regulated Entities, there would be no Bitcoin. Furthermore, the Regulated Entity completed due diligence on these customers. Also, the Regulated Entity authorized or approved the transaction to fund the account used to buy Bitcoin. And, depending on the specifics of the bank account and other conditions, additional due diligence regarding the source of funds may have taken place when the account was opened and funded.

Also, when Bitcoin is converted to fiat, funds are transferred to an account at a Regulated Entity. This means that the same processes of anti-money laundering and transaction oversight, including in many cases source of funds validation, are utilized by the receiving Regulated Entity. And again, the owner of that account had previously gone through KYC and fraud/risk evaluations when they opened the account.

It's absolutely true that "inside" the Bitcoin ecosystem or blockchain, transactions are outside the financial system. However, it's clear that Regulated Entities are currently essential for Bitcoin to exist. I also asserted that within the closed environment of cryptocurrency transactions there is no impact and no risk to the financial system or regulated markets. This is not to say that those who buy and sell using Bitcoin or any other cryptocurrency are engaged in legal activities. That's a different story.

To be clear, all FinTech products depend on Regulated Entities.

Back to Regulated Entities

In terms of engaging with Regulated Entities, many FinTech operators reach out to someone they know at a bank to help with whatever banking service they need. Working with a friendly banker is often a recipe for disaster. Why? Because in the banker's zeal to help a friend or colleague with a need that's not core to their institution, they put the FinTech company at risk.

When the FinTech operator gets launched with the friendly banker, chances are the service will be less than ideal, if not wholly inflexible since it's not the bank's focus. Also, financial terms can be hit-or-miss, and more importantly, the entire business is on shaky ground given the possibility (and probability) that a higher-up in the Regulated Entity, especially someone from compliance or risk management, will determine the business isn't core, or worth the financial or reputational risk, and the service is stopped. Now the FinTech business is scrambling to find a replacement, or worse — dead.

Consider this alternative and far more effective approach. The FinTech operator engages someone who understands this world and assesses the intersections between the FinTech product and services needed from a Regulated Entity and the needs of the FinTech product. Then, identifies exactly which Regulated Entity is appropriate for the need and describe how they can actually benefit from working with the FinTech company. By the way, in some instances the Regulated Entity may become a sales channel for the FinTech company or in the future a buyer of the business — not a bad scenario.

In the US, a leading prepaid issuer is Meta Bank. For 15+ years, Brad Hanson, CEO of Meta Payment Systems, has built a highly focused, efficient and innovative prepaid business. He powers hundreds of prepaid programs and numerous program managers. This is an example of specialization by a Regulated Entity.

It's beyond the scope of this article to detail every specialty service available from Regulated Entities that may be essential to what the FinTech operator needs — but a few include payment card acquiring, ACH origination, prepaid issuing, core banking services, consumer or business lending or some other regulated activity.

A far better approach is to select a bank based on the specific services needed – such as deposit or cash management services, card acquiring, ACH, prepaid issuing, or some other specific activity that a Regulated Entity provides.

Also, I strongly recommend you respect Regulated Entities and engage them as valuable partners in assessing the business due diligence, individual Know Your Customer (KYC) activities and other compliance, as well as risk mitigation activities. Too often, FinTech operators view their Regulated Entity partner as a "weak link" in their solution. Some even consider them necessary evils. This is not the situation if the correct Regulated Entity is selected!

The engagement with a Regulated Entity should be an open, engaging and constructive process that adds value to the FinTech business by ensuring the existence of a strong (yet progressive) compliance foundation on which to build the business and operate. Of course, not all banks are open to this sort of collaboration. Moreover, some are fundamentally fearful of anything new and they even view compliance requirements as some super scary domain that's used to control or restrict commercial activities. These banks should be avoided, they'll frustrate entrepreneurs to death. But the right bank partner is an invaluable asset.

Working with a Regulated Entity
is a requirement - they're invaluable partners
and are often the "ticket" required to be in FinTech!

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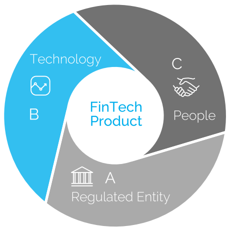


Technology

Core Systems, Acquirer Processors, Issuer Processors, ACH Originators and more.

Most FinTech entrepreneurs I know and have met, love to build systems. I do as well. It's exciting and fulfilling to see products come to life on the back of technology that we designed and built. But what's the real goal of the company? To build technology we think is cool? Or get to market fast with a FinTech product that users embrace, leading to scale, profitability and enterprise value?

> *Peeling back the technology layers on every successful FinTech company reveals few solutions are technically revolutionary or operate significantly independent of existing technology in banking or payments.*

In fact, for many current and previous notable FinTech companies, including PayPal, Square, BillMatrix, Evolution1, Eccount and even WildCard Systems (a prepaid processing company I co-founded) — the technical differentiator that powered their winning propositions was how these businesses enveloped or repurposed existing techology, added their own "special sauce", and how they focused on solving big problems. They then executed with high-performing sales strategies.

TransCard is an example of a technology firm that a FinTech business can "build around" with their "special sauce". While broadly categorized as an issuing processor of network branded prepaid cards, their capabilities are more akin to a specialized corporate disbursements engine that features a robust data processing microservice prior to reaching the prepaid issuing platform. This enables payers of all sorts (from medical or pharmaceutical to entertainment platforms) who require enhanced decisioning to determine if recipients qualify for a payment and how much, based on a set of rules, to utilize the TransCard service rather than build their own.

This powerful nuance gives FinTech companies a choice to a) build additional tools or decisioning themselves and integrate or b) to the extent existing capabilities aren't sufficient, engage TransCard to incrementally extend their decisioning micro service to support a new requirement. Generally, this is much faster, lower cost and more efficient than an external build.

Oftentimes entrepreneurs and investors, unfamiliar with the payment or banking landscape, fail (or refuse) to recognize this reality. A very unpleasant experience is assured. From having products delayed by quarters or years — if ever launched, to founders and early investors getting squeezed as substantial unplanned capital is required and invested — outcomes are bad.

But it doesn't stop with the build. Once systems are constructed, the ongoing care-and-feeding begins. From funding a data center and perpetual PCI-compliance, to ongoing network administration, software support and technical operations, quarterly updates from the likes of Visa and Mastercard — the high-fixed cost nature of this approach sucks cash. Data centers. Hardware. Software. People. A lot of people. It can also consume time and mind share of entrepreneurs and be a distraction from acquiring customers, driving sales and achieving scale.

What's the alternative?

Define exactly "what's needed" to deliver a killer product that delights customers and distinguish between the "special sauce" and what's readily available from others.

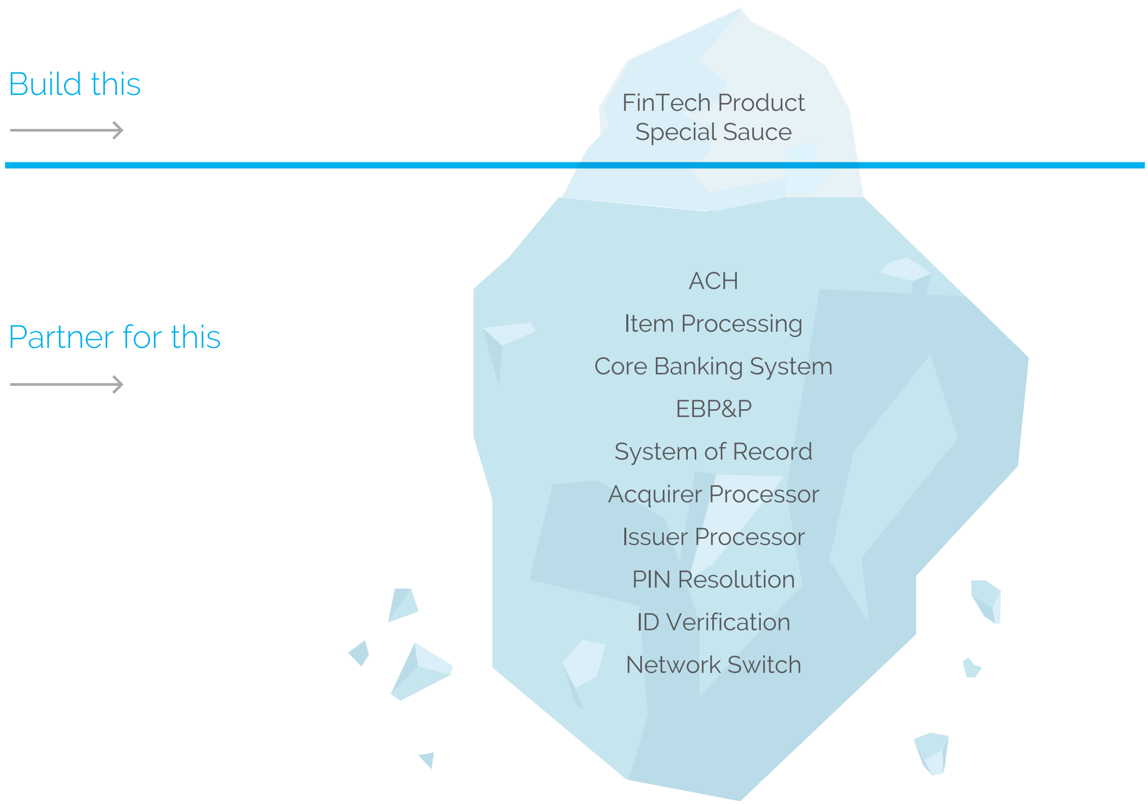
Armed with this information, the capabilities of existing payment technology providers can be assessed and then the FinTech operator can clearly see the "special sauce" they need to develop. Figuring out how to integrate with, or wrap-around, a payment technology provider is much better than building everything from scratch.

There are several very capable processors, software companies and core system providers that can make ideal partners.

In fact, in December 2015 FIS, a Fortune-500 company, with over 20,000 clients in 130 countries, a global leader in financial services technology, partnered with The Venture Center to identify global innovators and accelerate the development and growth of early-stage financial technology ventures and bring FinTech startups and entrepreneurs to Arkansas.

In the announcement of this venture, **Gary Norcross**, president and **CEO of FIS** remarked:
"At FIS we're investing in innovation that keeps our clients competitive in today's environment while also looking at what the global financial services industry will look like in the future".

Although just one example, there are many other quality companies around the world that provide payment and bank technology, illustrating how existing providers are open to, and can be valuable partners for FinTech companies to accelerate their products. In fact, just as with Regulated Entities, the big-payment and banking technology companies can also be sales channels and, eventually, buyers of the FinTech business.



Paying a technology partner a penny per transaction, a modest subscription or license fee, versus spending millions (or tens of millions) of dollars and wasting months or years building readily-available services from others just makes sense.

Over time, with scale, this assessment may change, but not always. In fact, many of the largest issuing and acquiring banks have found partnering with a technology provider produces better products, faster service and even superior financial results versus building, owning and operating technology. Yet countless entrepreneurs think otherwise, with unproven, new products and limited cash.

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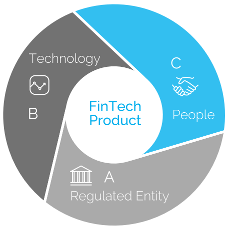

People

Developers, KYC/AML/Compliance Experts, Product Managers, User Support and more

Identifying “People” in this paper as a separate and distinct element of the FinTech Triad is sure to stimulate debate. And for good cause, since many in banking and payments see people as being inseparable from the Regulated Entity or Technology. While it’s true that both have people, sometimes lots of people, it’s imperative to look deeper, and be more circumspect.

Regulated Entities have people that engage in a variety of roles. Nearly every Technology company has teams of professionals that offer services to their clients — be they Regulated Entities, merchants or other businesses. And there are countless third-parties that offer services, usually along clear service areas — like KYC/AML/compliance, account holder support, financial settlement, IT development (mobile, front-end, back-end, switches, etc.) and many other professions.

At a high-level, I’ve dissected People into 3-types: Development, Operations and Sales. To be clear, these are highly-specialized for FinTech, but with the ability to broadly apply financial concepts to new applications.

In terms of the wide range of different FinTech products, the fact is, when we dissect “what people do” or “what people services are needed”, clear repetition, overlap, hand-offs and dependencies emerge. This is the opportunity — efficiently collapse and organize these in order to offer more informed people services, producing better results more quickly, and at a lower cost. This will lead to a better FinTech user experience, while enhancing compliance, KYC, AML, client support, product development and sales.

> *There are countless providers of “back-office” support services for issuers, acquirers, payment processors and others. While most are focused on customer service type activities, what if there was a way to leverage a single company for a wider set of core people functions necessary to support the development of “special sauce” and the entire FinTech people operations?*

Consider the following in terms of People operations.
What happens when a person opens a deposit account?

1. The person applies by providing personally identifiable information (PII) to the Regulated Entity (RE).
2. The RE completes a Know Your Customer (KYC) review of the applicant including OFAC and one or more 3rd party (credit bureaus, ChexSystems, etc.) services.
3. KYC and 3rd party checks are systemically reviewed by the RE.
4. If not auto-approved, a person reviews the information, and may contact the applicant.
5. The applicant is notified of the outcome by mail and perhaps email.
6. If approved, the account is opened on the RE's system.
7. The customer funds the account through some system.
8. Value is recognized in the customer's account on the RE's system.
9. Customer is serviced by email, agent-phone, agent-chat/SMS, IVR, etc.

What happens when a person applies for credit (of any kind)? Basically, the same thing, except that credit is extended and payments are future paid against the credit.

What happens when a person requests a reloadable prepaid card? Very similar process. And a repetitive set of activities occur for various commercial FinTech products as well.

The emergence and expansion of reg-tech companies, along with the countless support service companies and IT shops make it possible for most operations to be outsourced. But this can, and is being taken farther with a few, rare businesses that pitch themselves as "FinTech people platforms".

These companies offer an entire team of professional services that can materially simplify and enhance the highly regulated and complicated development, operational and even some sales realities of FinTech. Moreover, some offer services on a subscription basis. This can replace the typical high fixed payroll cost for a core team with a variable cost structure. This saves cash — not to mention a lot of management calories to identify, recruit, hire, train, manage and keep motivated an oftentimes underutilized and expensive team.

Closing Comments

There's no panacea. By thinking along the dimensions of the FinTech Triad (Regulated Entites, Technology and People), and critically analyzing what is really needed and carefully selecting the right partners- allows you to launch FinTech products faster, cheaper and more easily than the alternative of building everything in-house, hiring, managing and operating staff, and taking the path of least resistance with a known friendly bank.

I'm certain of this. Entrepreneurs, investors, and big company product owners alike would be well-served to consider the FinTech Triad approach analyzed in this paper as an alternative to the status quo.

Author's Disclosures

Capital? Or Capabilities?

I enjoy calls from VCs and entrepreneurs – seeking advice and cash. I've concluded that capabilities are far more valuable than advice alone, and capital. As a result, I'm an investor in TECS and Agile Partners, and co-founder of PayAll. These businesses prove this paper.

TECS: Technology. For nearly two-decades, TECS has delivered highly customized acquiring processing solutions through an omni-channel platform with native-built software from POS or device to switch. In addition to acquiring processing, I've never seen the depth and breadth of payment processing and funds transfer capabilities from a single-company, and certainly not a single-platform. From closed-loop issuing processing to an enterprise-wide AI / machine learning system. Truly unique. www.tecs.at

Agile Partners: People. Agile Partners is a FinTech center-of-excellence for business analysis, due diligence and global compliance, project management, mobile app and front-end development, product management, financial settlement and reconciliation and much more. A complete FinTech people platform. www.agilepartners.eu

PayAll Payment Systems: a FinTech business. PayAll was built and operates on the principles of this paper and offers two primary products - a B2C global payments platform and MyWay2Help, a platform designed to transform the relationship between a non-profit and their supporters. In both cases, special technical sauce has been developed around more traditional payment processors to enable core services. For B2C global payments, this has been supplemented by harmonizing global bank and remittance systems, novel commercial relationships and leveraging non-traditional partners across disparate, country-specific payment paradigms as well as integrating new techniques. The goal? To overcome the messiness and complexity of cross-border payments. To say it simply – PayAll makes global payments easy, fast, less-costly and "as desired" by those who make and receive payments. Regarding MyWay2Help, the goal is to transform the relationships between non-profits and supporters while painlessly funding the mission of the non-profit. PayAll has developed a unique social engagement, business and individual service platform so that non-profits become truly relevant to supporters and businesses. The platform allows non-profits, their supporters as well as those they help, tell their stories. And in doing so, PayAll aims to generate material, near effortless, recurring contributions. www.payallps.com

It's exciting to be a part of high-performing teams, and innovative businesses that solve problems and add value in FinTech. This approach allows me to be on the inside of these businesses and contribute more than capital and ideas. It gives me an opportunity to contribute essential technical and operational capabilities that can be ideal for the entrepreneur, their investors and clients.

Professional Highlights

1996 — Co-founded WildCard Systems
2005 — eFunds acquires WildCard Systems for $262 million USD
2006 — Co-founded Adaptive Payments
2006 — Co-founded WaveCrest Holdings
2007 — FIS acquires eFunds for $1.8 billion USD
2012 — Exit WaveCrest via strategic buyer
2015 — Mastercard acquires Adaptive Payments

Network Branded Prepaid Card Association *former Vice-Chairman and Chairman.*
Center for Financial Services Innovations *10-year director, term limit expired.*

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