

The Wall Street Journal Article by Daniel Huang that ran on November 18, 2015 entitled “Banks and Fintech Firms’ Relationship Status: It’s Complicated” comes as no surprise to us. Investing in fintech companies has required and continues to require a thoughtful and measured approach. We appreciate the enthusiasm and energy that many entrepreneurs and investors have to “disrupt” the incumbent banks along with the rest of the payment processing ecosystem – the industry is running on “rails” laid in some cases, several decades ago. However, entrepreneurs and investors that do not appreciate the regulatory complexities (both federal and state), or dismiss the capital efficiencies for building a fintech business by engaging the established value chain, will find it challenging to build a successful fintech company. Our institutional understanding of the nuances and challenges for building successful fintech companies tells us that companies that will succeed are those that embed financial services into cross-industry applications using modern technologies. Equally important, they will partner with the existing ecosystem to acquire customers and scale in a capital efficient manner.

The evolution and innovation of financial services continues to be developed external to the industry using ubiquitous cross-industry technology (mobile phones, big data, cloud computing, social media, search, and geolocation). Apple is a company that represents this modern approach to fintech. Apple Pay is an integrated payment solution embedded in the operating systems of the iPhone. Consumers’ existing credit cards can be uploaded into the Wallet app on the iPhone and then can be used at POS terminals where Apple Pay is accepted. Cards loaded into the Wallet app can be used for “in app” payments. These “in app” payments can include merchant or retailer apps that allow for “order ahead,” completely displacing the use of a point of sale terminal for offline transactions. By integrating an existing financial services product (a credit card), cross-industry into a mobile device, Apple has created a new attractive product for retailers and consumers.

At the same time, while we see innovation coming from outside the traditional financial services industry, attempts made exclusive of the industry will be challenging. The companies in the Wall Street Journal article attempted to disrupt and displace the existing industry. It is our belief that this is not a capital efficient way to build a large business. When TTV partner Mark Johnson who helped found Checkfree with Pete Kight were scaling Checkfree, they astutely realized that they could continue to acquire customers directly and take a decade to reach a million users. Or, they could partner with banks where their CAC would drop and they could sign up millions of customers in a single year. Further, Apple, with nearly limitless resources, prudently chose to engage with the existing financial services infrastructure rather than attempt to build its own transaction processing rails.

The opportunity for outsized returns moving forward will be investing in companies that provide cross-industry integration of financial services into another vertical. Within our portfolio there are many companies that represent this modern approach to fintech including Cardlytics, Exactuals, MX, PayGo, ShopKeep, and Springbot.

Company	Cross-Industry Integration	Financial Services Partnership
	Payment spend data with advertising	Direct integration into top banks existing systems

	<p>ACH functionality in residuals for the entertainment industry</p>	<p>Direct integration into banks and payroll processors</p>
	<p>Budgeting and personal financial management with online banking</p>	<p>Front end UI/UX for small and medium size banks</p>
	<p>Prepayment functionality embedded into utility billing</p>	<p>Connectivity directly into banks</p>
	<p>Point of Sale and store management software plus payments on iPads</p>	<p>Partnership with existing merchant acquirers</p>
	<p>Marketing robotics integrated into ecommerce shopping carts</p>	<p>Direct partnerships with payment processors and shopping carts</p>