Strange Bedfellows

You know those smart-sounding, fast-moving disruptors that supposedly will disintermediate the banks? Their relationship with the industry isn't entirely adversarial, as Shane Kite reports.

For all the hype around payments industry upstarts like Square and LevelUp, which have successfully drummed up business by enabling smartphone transactions and discounting fees for merchants, the newcomers remain lightweight competitors. Square is used by roughly 3 million consumers, LevelUp by 1 million. JPMorgan Chase, in comparison, has 64 million credit cards in circulation domestically.

But the threat that the upstarts can take market share from banks in certain customer segments, such as small and medium-sized businesses, is real. At the recent PayVest conference in New York City, "disruptive" was a term that panelists used often, alluding to fears that the best tech newbies will siphon off vital bank business like interchange revenue by changing how payments are delivered and lowering price points.

"There is this fear that suddenly Square and others here and globally are going to suddenly come in and completely blow up the pricing world," said John T. Williams, who covers financial technology companies for UBS Investment Research. "You're not really seeing that yet. But in any industry where you have excess profits, you're going to see competition flock there, simply because you can lower your prices and still make a pretty good living."

Unwilling to see the future of their industry controlled by someone else, banks increasingly are funneling investments into promising tech enterprises via their own venture arms. BBVA, Capital One and Citigroup are among the banks that have opened venture offices near technology hubs in cities like San Francisco and Shanghai.

These Silicon Valley-styled units are tasked with helping the banks discover the most interesting business plans early on. Discussions can turn potential competitors into partners, or just inspire the kind of thinking that can spur in-house innovation.

"We're trying to find the next 'Gangnam Style' for the financial industry," said Sergi Herrero, CEO for the U.S. unit of L'Atelier, which focuses on mobile and payments technology for BNP Paribas. Herrero was referencing the hit song that went viral online and became part of mainstream pop culture.

Such casting about is an acknowledgement that much of the innovation in payments is coming from outside the traditional financial sector, often driven by consumer behavior.

"We spend less time looking at peers and more time looking at how people are using technology," said Jaidev Shergill, Capital One's head of digital venture investing.

But incubating saleable widgets from novel concepts is particularly tough for big banks.

"There are a lot of bureaucracies and layers of management that make it very difficult to innovate effectively," said Thomas Whiteaker, executive director at BBVA Ventures. External partnerships are an effective workaround, he added.

BBVA Ventures, a San Francisco-based arm of Spain's BBVA Group, announced in July that it is backing SumUp, which provides smartphone card readers in Europe. The Berlin startup is expanding into Latin America, where the U.S.-focused Square (already backed by Citi Ventures and Visa) has yet to go.

Being forced to keep tabs on the seemingly endless supply of potential game-changers in the payments space has had bankers racking up travel rewards of their own. "Last year, we had 800 meetings with startups," said Chitra Narasimhan, managing director at Citi Ventures, noting that it did so with a staff of less than 20. Citi's venture arm is headquartered in Palo Alto, Calif., and has offices in New York and Shanghai.

PayVest: Innovation Through Strategic Investments and Digital Partnerships

When: July 18

Where: Crowne Plaza Times Square, New York City

For: Payments industry executives, heads of corporate ventures and strategic alliances, bank CIOs, venture capitalists, startup founders and CEOs, industry analysts

Attendees: 130

Key themes:

- Learning from the industry disrupters
- Getting deals done

Host: American Banker, PaymentsSource

In July, Citi Ventures backed a company founded by three Stanford mathematicians, pitching in on a $30.6 million round of funding with Institutional Venture Partners, GE Ventures, Khosla Ventures and Floodgate.

The company, called Ayasdi, uses cluster graphs to depict data relationships, in an effort to better spot money-making opportunities. Unlike the question-based searches of traditional data mining, which can be a shot in the dark, this software starts out by serving up data hotspots pictorially, to enable more informed searches.

It's the large data sets of established tech brands that have some banking incumbents the most worried. Apple's iTunes store has 575 million active customer accounts with card numbers on file; a fingerprint sensor expected on an upcoming iPhone model could be used to secure payments.

"Apple's iDevices could play the role of a terminal or cash register for merchants as Square has shown with traditional card payments," said Brion Bonkowski, managing director at ROI Payments, a tech consulting firm launched by MerchantPlus, a merchant account finder for Wells Fargo.

But not everyone thinks a culture obsessed with seamless design can truly be disruptive in the space. "Payments are messy," said Jed Rice, senior vice president of business development at Paydiant, a mobile wallet provider. "Apple doesn't do messy."

Regardless, throughout the conference there was a palpable "we can all be friends here" attitude among incumbents and new entrants alike.

"Most startups end up changing focus," Day Jimenez, co-founder and president at payments consultant Xtrategies, reminded the crowd. Most would be happy to accept capital and sponsorship from any big bank to grow their business, as much as the banks would be pleased to protect or grow their market share through an acquisition or partnership with a high-potential startup.

PayPerks founder and CEO Arlyn Davich said she was trying to sell a rewards program to payroll directors until she met somebody from MasterCard at a payments conference "who explained to me what a payroll card was." MasterCard is now a partner, using PayPerks' sweepstakes-based rewards to target the underbanked. The program is being promoted as an option in the U.S. Treasury Department's move to get recipients of Social Security and disability benefits to accept direct deposit on prepaid MasterCards.

Given the market dynamics in payments, the next few years should make for "a lot of interesting alliances," said Timothy W. Willi, managing director and senior analyst at Wells Fargo Securities.

That point was underscored by Geoff Iddison, group executive for investments and M&A at MasterCard.

He said the world's second-largest card network is "currently looking at around 120 or 130 businesses" worldwide. □

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Who's Talking...

Sergi Herrero L'Atelier

Timothy W. Willi Wells Fargo Securities

Thomas Whiteaker BBVA Ventures