Transaction Banking by D Sign

Blog

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"Banks Are Sharing Economies Too!"

At a recent, competitive, fintech hackathon, the problem posed to the teams was to create a sharing economy startup. One team's starting point was to provide a payment app on a mobile phone. The team then augmented this app with lots of customer information screens and made it easier for customers to recruit new customers for them. They then added a facility to hold excess cash for customers. They then added an extra function letting customers to lend to one another. When they made their winning pitch for the killer sharing economy startup the judging panel asked, "what do you call this brand new sharing economy company?" "Bank", they answered.

Portions & Pies

Economists study the visible hands of planning, the invisible hands of markets, the translucent hands of decision makers, the helping hands of volunteers, and the grabbing hands of governments – and now the sharing hands of the 'sharing economies'. People are sharing cars (Uber, Lyft, RelayRides), homes (Airbnb, Onefinestay), oddjobs (TaskRabbit, Mechanical Turk), and office space (Liquidspace, ShareDesk). In financial services we have people sharing consumer insurance (Friendsurance, Guevara), consumer lending (Lending Club, Zopa), corporate lending (Funding Circle, ThinCats), and crowdfunding (Kickstarter, IndieGoGo).

The sharing economies are both humdrum and exciting. Humdrum because we've always had them. Sharing economies have many antecedents, many only slightly older such as eBay, so the concepts are simple to grasp. Exciting because they have gone global. It is the potential global scale that makes them exciting. A number of commentators believe that these exciting newcomers will overrun many existing businesses, including banks. I'm not so sure that banks are in danger, but I do believe that banks have much to learn from the simple concepts behind sharing economies. The first lesson is that long-term success of a sharing economy stems from making sure that the pie is fairly shared. Without large numbers of people believing that the commercials deals being struck are fair, the sharing economy fails to develop the trust it needs to thrive.

Rate Sharing

Years ago, when providing strategic advice to a UK building society, I saw first-hand the problem of fairness in setting rates. If the mortgage rate was too favourable, we hurt saving members; if the saving rate was too favourable, we hurt mortgage members. The resolution to this problem for many building societies has been to start from 'market rates' and then adjust for the cost base. A quick inspection shows that this may not be the correct answer. Much depends on the degree of difference between the membership's values and the overall

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market value. Another solution has been to try and make the membership reflect the overall market, which is ethically problematic and somewhat awkward for marketing. The beauty of sharing economy financial sites is the peer-to-peer rates are set at a more granular, transaction level, thus alleviating the rate setting issue. Sharing economy members believe that the rates they strike reflect the community view.

A commercial bank, by contrast, has the ability to leverage. At a leverage rate of 10:1 or so, the market rates become crucial in helping to set rates. A ‘required’ rate of return on equity is so influenced by the leverage rate as to provide little guidance. However, leverage too is why peer-to-peer sharing economies may not overrun some banking services. For example, imagine I set up BikeToBusiness, a peer-to-peer lender focused on connecting investors with entrepreneurs who need bicycles. Imagine too that in the first year I successfully connect 100,000 investors with 10,000 entrepreneurs who want to start businesses and need bicycles. Imagine further that loan repayments are excellent. What have I done? Well, I’ve probably shown traditional banks that there is a market here worth stealing from me. At 10:1 leverage the traditional banks can move in and, in relative terms, run a business the same size as mine with only 10,000 similar investors. By avoiding the need to deal with 90,000 other investors, their costs could be much lower than mine.

Collaborative Economics

For banks, the danger is treating sharing economies as humdrum and missing the opportunity to learn. First, critical mass. Sharing economies should be closely tracked so banks can find the ones who are proving where there is unmet market demand in financial services. Banks need to move once a community begins to take on a life of its own. Sharing economies provide free market research. Second, sharing economies can help indicate where there is a breakeven point such that the value of developing a new service is likely to equal the investment. For many of these sharing economies it may be much higher than straightforward financial products. Third, successful sharing economies can help marketers more clearly understand the values within the community, making successful commercial entry more likely.

However, perhaps the idea of being the second entrant is second rate. Banks might equally consider active collaboration with sharing economies, treating them as strategic customers or partners, providing services such payments, escrow, affinity products, or “provision funds” (see RateSetter for an example) to the sharing economy. One insurer has already identified sharing economies as collaborators to sell the temporary insurance cover necessary for personal cars used as taxis and homes used as hotels.

For transaction banks, it could be difficult to identify a budding corporate-to-corporate sharing economy. Corporates are more heterogenous than consumers. Corporates can be two or three orders of magnitude larger than one another, not quite the case with human beings. While they may be harder to spot, there are a lot of cooperative corporate initiatives that could be proto-sharing-economy sites. Many of them might start from sharing paperwork, e.g. Acord in insurance, or Bolero in shipping. Some might be a natural transition from traditional businesses, e.g. the P&I insurance mutuals providing other mutual insurances outside shipping, or some of the shared corporate jet services. Others might be analogues of the consumer communities, Lending Factory or ParcelPass Vehicle Fleet or Treasury PiePortion.

Sharing economies are shaking things up. For transaction banks this should be much more opportunity than threat. The sharing economies all need financial services operations at the core. Banks are ideally placed to collaborate with sharing economies. I'd hope that any significant transaction bank is already deploying its sharing economy sales and marketing plans. And well-run banks should have lots to teach sharing economies. After all, banks are the original sharing economy.

[1,066 words]

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