**How and why you need to defend your brand against disruptors**

Technology, and being open to opportunities, has preempted transformation in banking. At the top of change are Mint, PayPal and ApplePay; three examples of transformative solutions that are now ubiquitous. On the horizon: Uber and Google, both having recently announced partner based banking services. Further down in the plumbing is Duca Impact Labs, Versabank, and Revolut. This report shows how cost conscious FIs can, not only stay relevant in the face of adversity, but punch well above their weight. All thanks to creative thinking and the ongoing commoditization of technology.

The question is, how can small FIs reinvent themselves on a limited budget, and grow their revenue? The answer, especially with Google and Uber entering into the ring is that small FIs need to be strategic. In fact, in the examples shared below, it can even mean that the fights they will win are the ones with no opponents.

The DUCA Impact Lab, for example, is working on models that show how banking can better deliver services to under-served communities. The lab is a registered charity wholly-owned by DUCA Credit Union and partners with a range of organizations, from bankers, consumers, community organizations, technology companies and policy experts, to academics. As one example, they worked with the School of Social Engineers (SSE) to determine how financial services could assist social entrepreneurs; not a typical market for any financial institution, especially considering that lending to start-ups is largely a high risk activity. Evaluating this opportunity meant partnering with the SSE and conducting interviews with a variety of social entrepreneurs from diverse backgrounds. In this case, it was the precursor to experimentation with a new, much needed financial product, invoice factoring. Invoice factoring solves one of the major unmet needs of entrepreneurs by making cash flows available timely to fund business activities. This has been a territory that traditional financial institutions have tried to tackle by tweaking retail banking HELOCs that entrepreneurs can access.

Another transformative example in Canadian banking is Versabank. This is a transformation that I, along with my partner John Anticoli had a hand in. Versabank's challenge was that it had a high cost of funds and this took a toll on its bottom line. Versabank is a virtual bank that operates through its extensive broker network. Versabank's objective was to reduce its cost of funds but it was forced to compete for funds against many other FIs hungry to secure deposits and willing to pay a premium because they have riskier lending models. As chart 1 below shows, Versabank was paying a premium for deposits prior to 2012. This was the year that the bank struck a deal with Canada's bankruptcy trustees; as you can see by chart 2, the bank was able to transform its net interest margin (NIM) for around 100 basis points to 400 as a result.

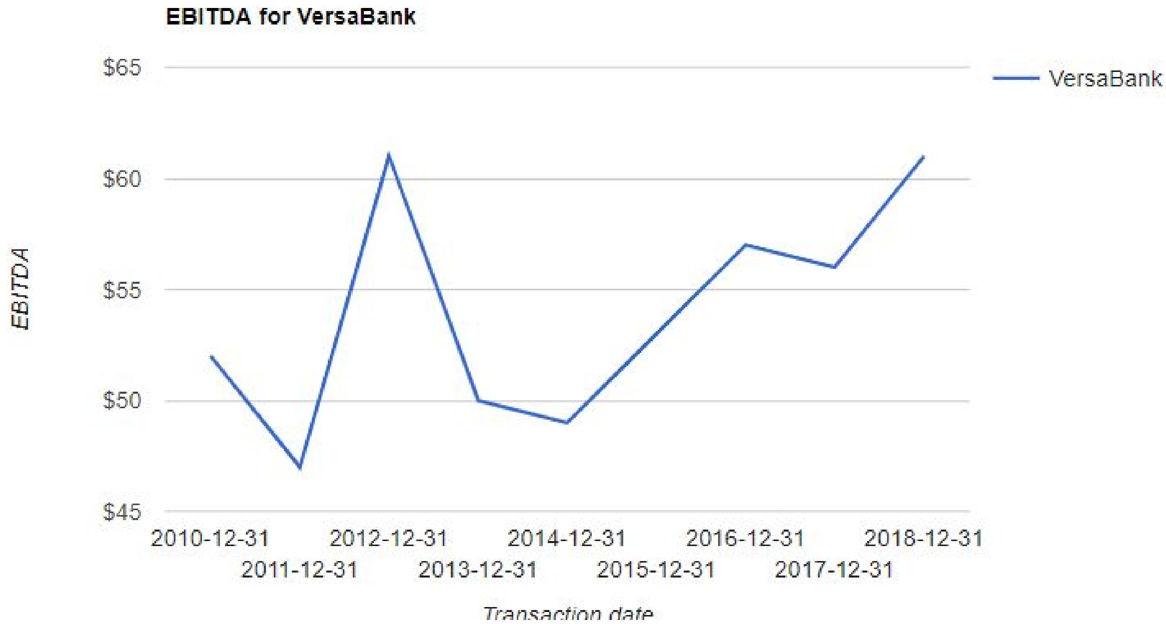


**Chart 3, EBITDA**

Versabank seized a niche opportunity in the bankruptcy industry and this is what precipitated its transformation. Bankruptcy trustees hold billions in trust, but large banks paid then only a pittance for these stable deposits. Consequently, Versabank decided to become known as the go to bank for trustees, the differentiator being that trustees could generate revenue from interest paid on their deposits, and also create efficiencies by streamlining other banking services and integrating these with their software.

To meet the needs of the trustees, the bank adapted its solutions in order to be able to work with the software that the Trustees use to administer estates. Trustee deposits, subsequently became the banks ace-in-the-hole that allowed the bank to pursue commercial vehicle finance and leasing opportunities. What makes this particularly notable is the fact that Versabank conquered both the new deposits and lending segments without having to take on any additional overhead. Hence their efficiency ratio sits at an industry leading level of 51% as of 2018 and, as chart 3 shows, it had an instant impact on the banks revenue.

Duca and Versabank make it clear that some Canadian FIs are willing to invest and take risks in order to create new markets. The fact is that deep pocketed disruptors are going to take away business for existing FIs. Foreign fintech as the perfect example of what lies ahead. For example, UK based Revolut, which just raised $1.5 bn US, has announced plans to set up operations in Canada. Revolut differentiates itself by offering some unique services. Examples of technology enabled innovative services include: freeze and unfreeze credit cards from the mobile app; use $400 per month free at ATMs anywhere in the world; users can transfer money using the interbank exchange rate and a 0.5% fee for anything over $8,000.

Revolut is an example of an innovative FI and also an example of why small FIs need to be willing to adapt. Revolut cut its teeth in a fintech friendly environment that also has access to investor money. Unlike Canada, the UK is widely regarded as one of, if not, the top fintech ecosystem on the planet. In the case of Revolut, its total funding is around $2 billion. Not bad for a firm that got its start in 2015 as a pre-paid card for travellers looking to spend abroad without foreign exchange fees.

Revolut is hoping to Uberize FX, which means it can run at a loss. For example, it has taken on high onboarding costs as the penalty for rapid expansion. This is the exact opposite of incumbent FIs which need to make money and grow revenue. In fact for most incumbent bank models taking a loss would invite scrutiny from OSFI, Canada’s regulator, known to exert authoritarian control over banks.

This is why design thinking is a good strategy; design thinking can be implemented without necessarily incurring substantial expenses. Duca and Versabank demonstrate how this can be done. Partnerships and the commoditization of technology make it possible. Look at banking platforms that are available in the cloud or as a service, even pay-per-use banking platforms exist. What this means is that FIs can test and innovate, without breaking the bank as they say. Even small credit unions can still find ways to grow and out maneuver big, deep pocketed disruptors. Versabank, for example, has had year-on-year revenue growth while large Canadian banks are stalled.