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Community banks and credit unions answer the call of fintechs searching for funding

Article

The news: Fintechs are entering 2023 with little hope for funding from their usual go-tos. Instead, **community banks and credit unions are stepping in to keep fintechs alive while**

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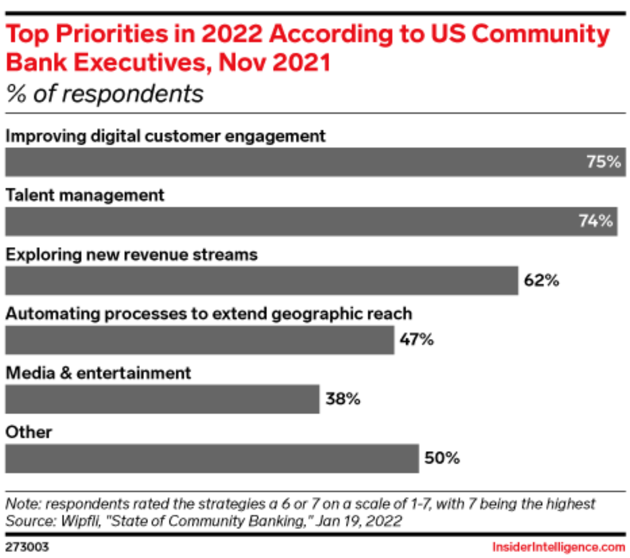
bringing their operations up to speed, per Forbes.

Run the bank: Fintech funding dropped to its lowest level in four years in Q4 2022, coming in at $10.7 billion, according to CB Insights. Though venture capitalists cooled on fintechs last year, some fintech firms benefited from a different source—community banks and credit unions.

- According to Cornerstone Advisors, **more than 500 community banks and credit unions are investing directly in fintechs**.
- In 2022, it's estimated that **roughly $3 million per bank went to fintechs**. That number is expected to rise to $4 million in 2023.
- But these investments aren't aimed at disrupting banking. **Most of their investments are in fintech solutions that "run the bank" rather than "change the bank."** Community banks and credit unions are looking to increase efficiencies in their daily operations and automate more tasks.

While these financial institutions are investing directly with fintechs, they aren't going it alone. Many seek guidance from VC firms and consortiums like **Alloy Labs**, which uses its network to support banks and help them grow. For example, last year Alloy Labs published a fintech playbook to assist banks with navigating bank-fintech partnerships.



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Know your limits: VCs that help banks with their fintech investments outlined a few steps they should take before making this move.

- **Have a focused business strategy:** Banks and credit unions should make sure the fintechs they invest in fit within their long-term strategy. They should define exactly what they're looking for and what they want to get out of the investment.
- **Define the investment budget:** This extends beyond the amount of money the financial institution is willing to invest—it also means banks and credit unions should determine their risk budget, how many fintechs they'd like to invest in, and which segments they will explore.
- **Delegate responsibilities**: Investing in a fintech brings additional risk, so it's vital to define who's making the investment decisions, and what type of due diligence will be completed prior to the investment (a lesson JPMorgan learned a little too late). Someone must also be responsible for ensuring the fintech is delivering what it promised.
- **Take stock of current tech capabilities:** It's important that banks and credit unions be honest about their current tech stack and what it can handle. An investment in a fintech with technology that is too advanced for the financial institution will fail.

US Credit Unions' Deployment of Emerging Technologies, 2018-2022
% of respondents

	2018	2019	2020	2021	2022
APIs	-	-	53%	53%	61%
Cloud computing	-	-	47%	51%	57%
Robotic process automation (RPA)	2%	1%	9%	18%	22%
Chatbots	0%	3%	6%	18%	22%
Machine learning	2%	3%	9%	10%	13%

Note: credit unions deployed technology going into 2018 to 2022
Source: Cornerstone Advisors, "What's Going On in Banking 2022," Jan 25, 2022
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VCs also suggest banks and credit unions consult VC firms on dealmaking, pricing, and due diligence. Though the financial institutions are making a direct investment into a fintech, they aren't always experts in that space.

The bottom line: Community bank and credit union investment in fintechs comes at a crucial time for both parties.

- Fintechs are feeling the pressure from VCs to reach profitability before they will consider additional funding rounds. Focusing on "run the business" operations rather than disruptive

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but sometimes harder-to-implement solutions for community banks and credit unions could be a viable path to the profits they seek.

- Community banks and credit unions often don't have advanced tech capabilities, or the time and resources to develop top-of-the-line digital experiences in-house. Their only options are to tap into technology via fintech investments and partnerships or risk falling behind.

Though it's typically thought of as where the envelope is pushed, the fintech space may, for at least a while—or as long as the economic downturn lasts—do better by accepting a more technologically conservative role and serving as the place where smaller financial institutions turn to weather the storm.

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