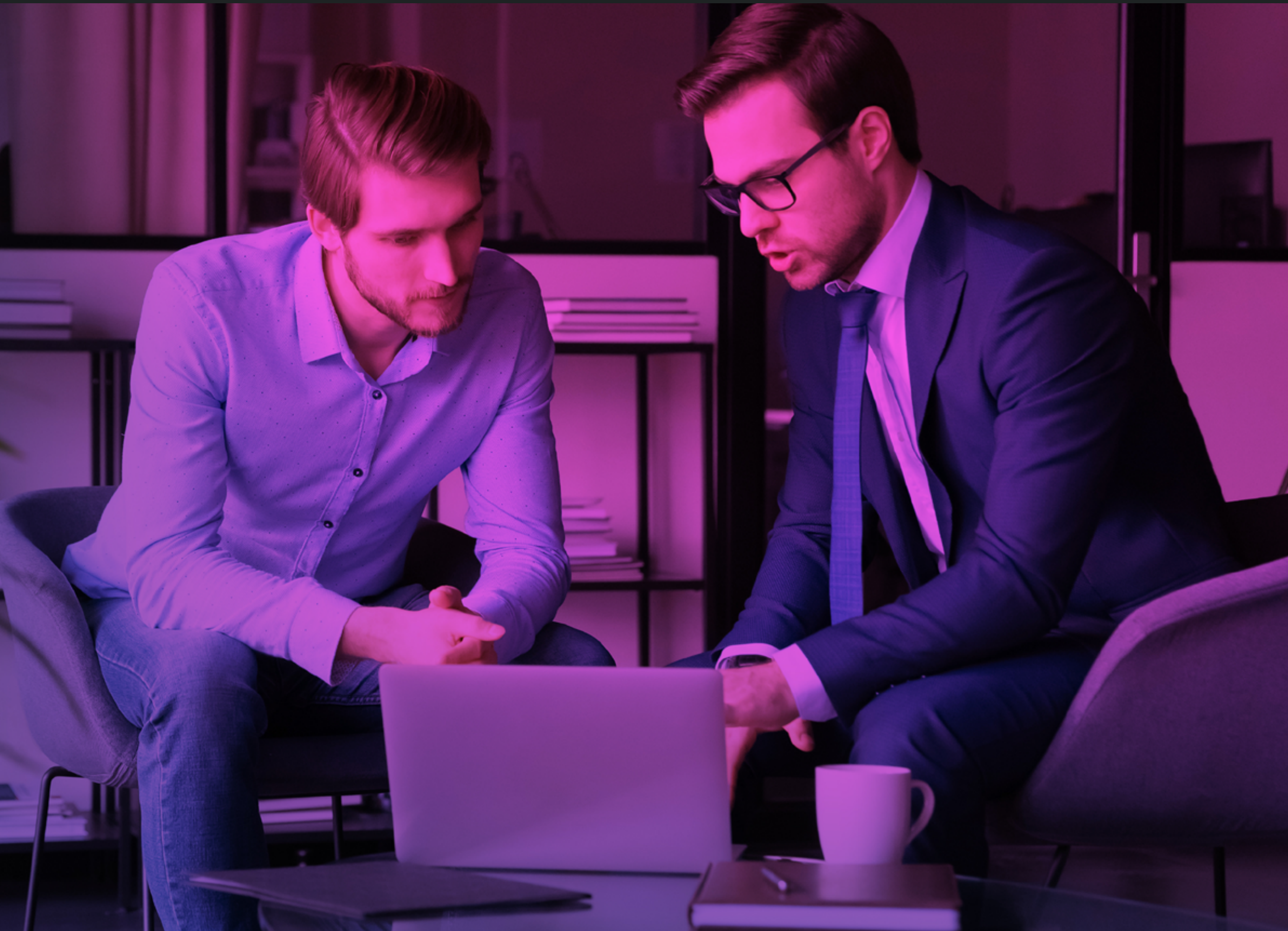
Building on belief

Startup matchmaker: A unique proposition for banks



Abstract

From changing business models to rising competition and regulatory pressures, banks have been facing several challenges over the years. Upon a turbulent business environment came the pandemic, which further pushed banks on a journey towards reinventing themselves. Banks are under constant pressure to retain existing customers while also trying to attract new ones. At the same time, they have to increase profits while minimizing risks. One way to reach their goals is to tap into areas that have not been the focus in the past and integrate various business segments to leverage existing resources and optimize capabilities.

In line with this strategy, banks can look at two different customer segments – startups and high net-worth individuals (HNIs). While one segment is constantly starved for cash, the other is continuously looking for new avenues to invest in. HNIs typically demonstrate an appetite for high risks and higher returns. This white paper explores how cutting-edge technologies, such as artificial intelligence (AI), can be utilized to create a bridge between startups and HNIs. The paper also focuses on how banks, startups, and HNIs can leverage each other's competencies to create a new financing model and drive growth and transformation.

Weathering the storm: Becoming a 'matchmaker'

In these unprecedented times, global banks have done notably well. Despite hiccups, over the last year, they have managed to adopt digital technologies, go virtual, and service customers seamlessly. However, the raging pandemic, waning economic growth around the globe, and fierce competition from new-age fintech firms are some challenges that are forcing banks to revisit their strategies. Looking at new avenues for growth and tapping underserved areas for increased profitability are some options that can turn this crisis into an opportunity for them. The future that banks are aiming for can come from the segment that is known for high growth potential – the startups. While banks welcome high returns, they are generally averse to the risks that come with it. They are justified in their concerns, given the high rate of failure of startups. Among the top reasons for failure is lack of funds, followed only by mismatched market demand for their products or services. Startups are always in need of cash to run existing operations and expand their businesses. Venture capital funding alone won't be enough to sustain their growth.

While banks usually provide finance at the later stages of a firm's growth, they always try to minimize risks by funding partially. However, banks have another segment of customers, in the form of big business houses and high net-worth individuals (HNIs), who are ready to take risks for good returns on investment. This offers banks an opportunity to create a new financing model – they can become a bridge between startups and HNIs and facilitate the flow of funds from HNIs to startups, creating a win-win situation for all the parties involved:

- Banks can reduce risk by partially funding the startups, with HNIs providing the remainder. This model will also help banks increase profits, expand their customer base, and create goodwill among startups and HNIs. They can also build strong relationships with investors and lay the foundation for future business. Additionally, they get the opportunity to tap into the startup ecosystem at minimal risk.

  HNI investors can fund a startup based on their core competence and in line with their vision of diversification, scalability, growth, and transformation. HNIs can save substantial costs and time by relying on the due diligence processes of the bank.

- Startups get quick and timely funding in addition to access to expert business consultancy and an experienced team.

Fostering a three-way partnership

At present, banks, startups, and HNIs work independently without utilizing each other's capabilities. While startups have the growth potential, HNIs wield funding capability, and we believe that banks can act as a conduit between the two. Banks constantly evaluate businesses that seek loans and study various parameters, including credit history and performance. On the other hand, banks are aware of the profiles, funding capability, and risk appetite of their HNI customers. They can hence become facilitators in a three-way partnership by mapping supply with demand. As the model matures, banks can consider building a collaborative digital ecosystem to bring together banks, startups, and HNIs, unlocking exponential value for all the stakeholders.

Banks can play the role of an investor and/or a mediator and can help bring the two customer segments to the table to agree on common terms. The various stages in the process include:

Data collection

Banks must collect the necessary data from startups, including financial metrics, future forecasts, credibility in the market, and the details of the founders by leveraging existing infrastructure and systems. Emerging technologies, especially AI, can help banks augment their data resources. Banks must also regularly track their HNI customers to gauge metrics, including money available for investments, risk appetite, sector preference, and expected return on investments.

Pool creation using AI

Based on the collected information, AI engines can be built to calculate the potential success of startups. The companies can be assigned ratings – high, medium, or low – based on their success potential mapped against risks. To accomplish this, banks will need to track hundreds of parameters for various startups and group them into clusters to trace broad trends. For example, they will have to constantly monitor parameters, including the performance of companies, their reputation, and their competitors' moves and news. Complex clustering techniques have to be deployed to group relevant information together and categorize outcomes. Banks can categorize various parameters based on similarity and correlation and predict the potential success and growth of startups based on broad trends. Banks must use all these inputs to update the risk ratings of startups on a regular basis. This helps protect their investors and enables both the investors and the banks to take the necessary precautionary or investment steps at the right time, depending on the risk exposure.

Matching investors with startups

Once the startups are assigned ratings, marketing teams of banks can approach HNIs with options to invest in startups. HNIs can then decide on the pools of startups or pick individual companies to invest in. Banks can then bring both the players to the table to conclude the deal and realize profits in the form of a percentage in the equity stock or by directly investing along with the investors. Banks can thus act as catalysts in optimally channelizing resources to the benefit of all the parties.

Looking ahead: The evolving role of banks in the financial services industry

Over the decades, banks have continuously evolved from being mere lenders and deposit holders to providers of a wide range of financial services. Moving forward, they have to further differentiate themselves by shifting their focus from managing branches and delivering routine banking services to offering value-added services.

Matching HNIs with startups and facilitating the flow of funds to the right startups can create a new revenue stream for banks. Moreover, banks are uniquely positioned to take advantage of this opportunity given their existing technology, infrastructure, systems, and processes that can be leveraged to define a new business model. Banks stand to gain enormously in the process – they will begin to play the role of startup incubators, facilitating the transition from ideation to actual implementation and launch in the market, in turn fostering economic growth and prosperity.

About the authors

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