THE NEXT

Big Ideas

in

FINANCIAL TECHNOLOGY

Where to Look & What to Look For

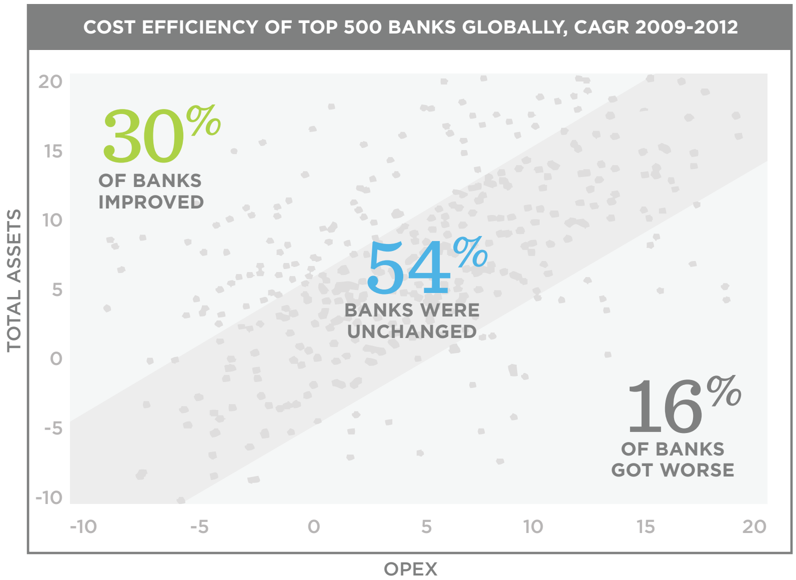
BY CHARLES MOLDOW
General Partner, Foundation Capital

Foundation CAPITAL

When it comes to financial services today, two images tell you everything you need to know.

BANKS ARE INEFFICIENT

McKinsey's latest review of global banking illustrated that just 30 percent of top global banks improved cost efficiency over four years. The remaining 70 percent stayed the same or became less efficient — all despite leaps forward in mobile technology, cloud computing, and web platforms.

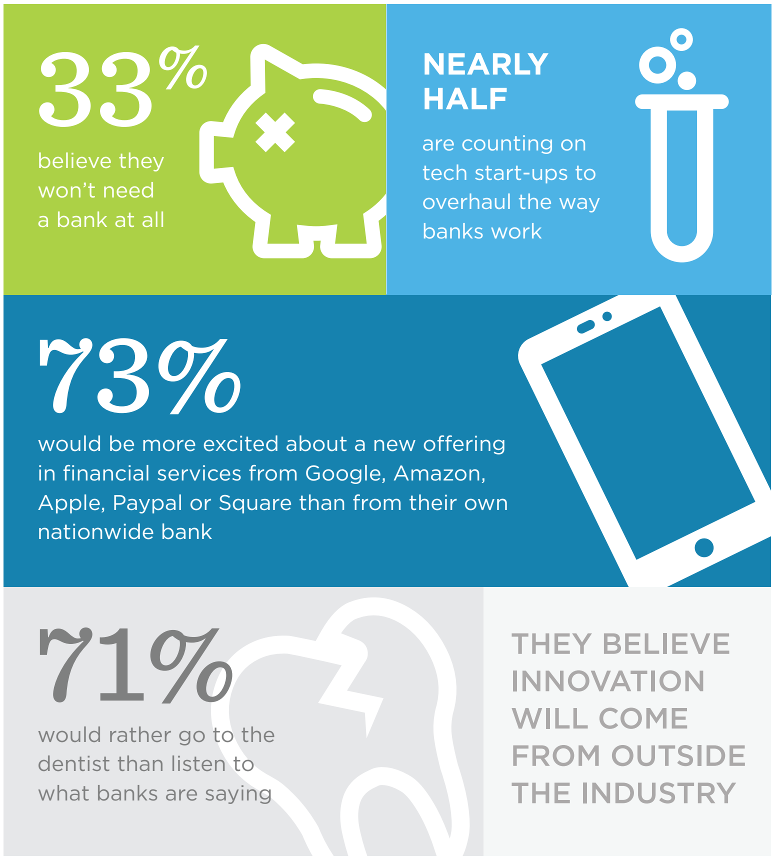


BANKS ARE UNLOVED

A Viacom survey showed that many millennials are ready to give up on banks. More than 70 percent actually prefer a trip to the dentist and nearly half expect (and hope) that tech startups will reinvent banking.

Inefficient and unloved are not generally a recipe for success. Yet in a world where other financial service options simply don't exist, neither are they a recipe for failure.

That is no longer the world we live in today. A new cohort of companies is poised to revolutionize the financial services space across all types of transactions—payments, wealth management, personal investing, loans, and insurance.



Contemporary Bank Profitability is Looking More and More Temporary

Incumbents in the financial services industry have little incentive to innovate when their profit margins continue to grow. And they've grown handsomely.

Between 1994 and 2013, the aggregate value of the S&P 500 expanded from 5.2 trillion to $17 trillion—a $12 trillion gain. Three industries drove much of that growth:

HEALTH CARE

12%

That makes sense, given rising costs and steadily increasing demand.

TECHNOLOGY

17%

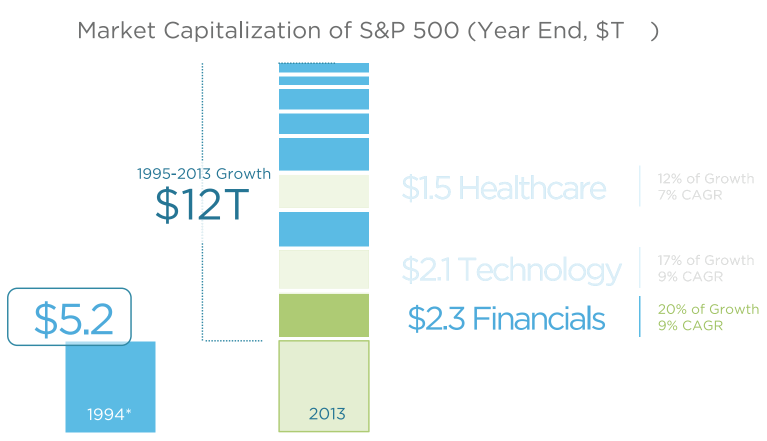
That makes senses, given that large caps like Facebook, Twitter, and LinkedIn didn't exist even 10 years ago.

FINANCIAL SERVICES

20%

That's the largest single industry contribution—more than health care and more than tech—and that makes no sense.

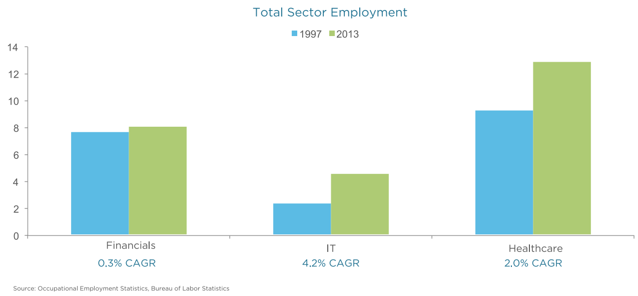
The Financial Sector Grew Even Faster



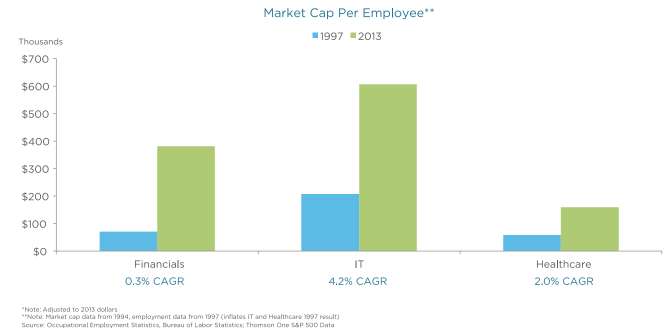
*Adjusted to 1994 dollars
Note: Sectors defined by Industry Classification Benchmark; Financial Administration included within Financials
Source: ThomsonOne

At the same time, the financial sector has generated relatively little employment growth, which means that the market cap value per employee has skyrocketed.

Financials saw essentially no employment growth between 1997 and 2013



Market cap value per employee has sky-rocketed



All told, this is an impressive feat. But does it represent sustainable growth? Or has it merely increased the size of the target at which new players are taking aim?

The Music has Stopped: Find a Chair, or Find Some New Music

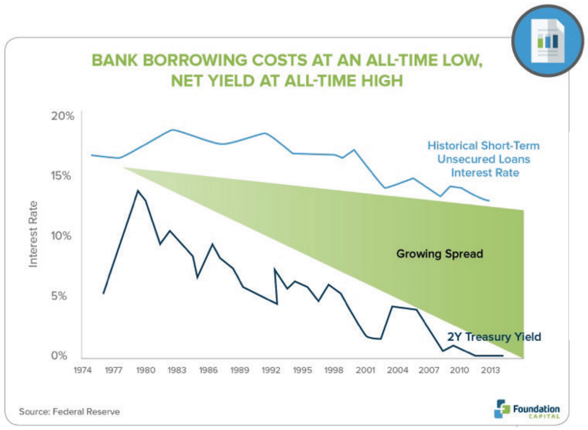
The source of this growth does not seem obvious. As mentioned, we cannot point to cost efficiency. And persistent challenges—like the 2008 correction, historic consumer dissatisfaction, and a dense regulatory environment—make it difficult to credit economic factors.

There are many potential explanations for this growth. From my research, the clearest and most convincing is net interest spread—the difference between the yield banks receive from money they loan and the rate they pay on money they borrow.

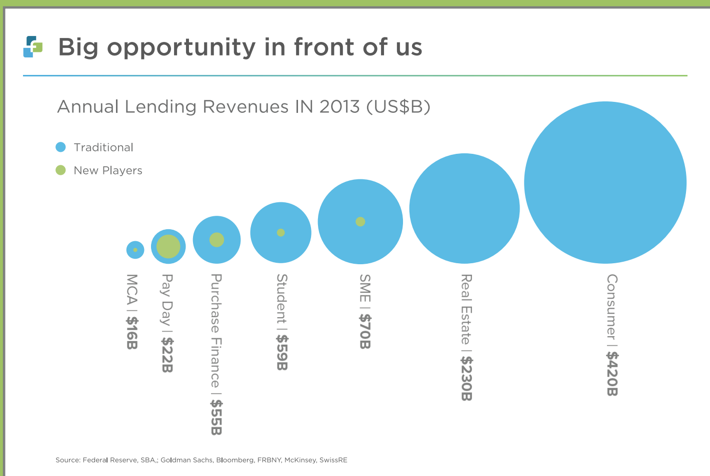
Today, the spread is larger than it's ever been in its history. Banks are borrowing treasury bonds at historically low interest rates—as low as 0.5 percent. They turn around and lend at as much as 10 to 25 percent interest, depending on the borrower's risk profile.

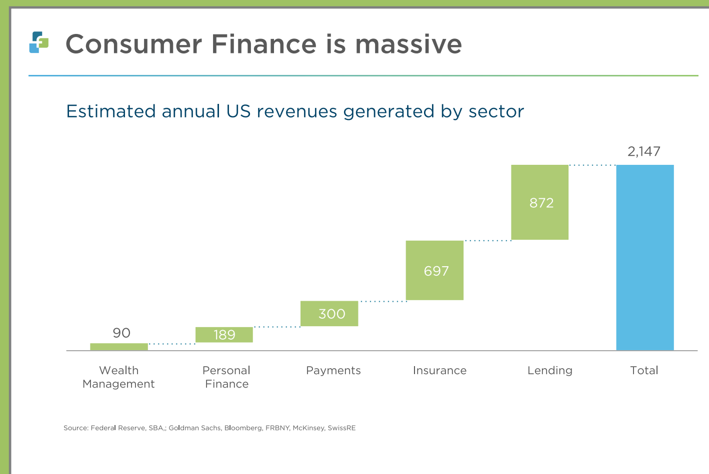
Since the Fed won't lower rates further, this spread will likely narrow, and the party that banks have had for decades will be over. But that incredibly wide spread has opened up an equally wide opportunity for new entrants.

Banks are capturing ever more value

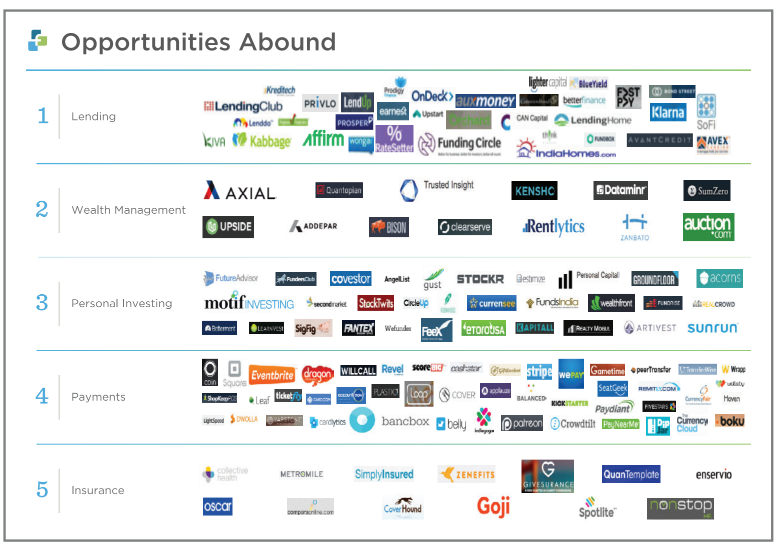


Defining the Opportunity for Emerging FinTech Players





I recently published a paper on the $1 trillion marketplace lending opportunity that exists for companies leveraging new technologies to provide borrowers with better credit options. Significant as it is, that $1 trillion loan volume potential would generate about $50 billion in revenues, just a sliver of a consumer finance industry that generates more than $2 trillion in annual revenue.



To me, this $2 trillion potential market for financial technology startups makes financial services one of today's most exciting areas for innovation and investment. When incumbents seem not only too big to fail but also too slow to react, innovative technology companies are looking at significant opportunities.

Four Maxims for the Future of FinTech

In this new era, the companies best positioned to disrupt or even displace the incumbents will develop against four key consumer trends. These are the four characteristics I look for whenever I'm introduced to a new company.

SIMPLIFICATION

If customers don't find it easy to use, it won't have any customers: Smart companies have made processes so complex they turned off customers into conveniences that are exciting to use. *Sunrun,* a home solar provider, has distilled the complexity of residential solar panel installation and financing into a few simple clicks. Input your address, get a savings estimate in seconds based on your roof's angle and direction, and see how quickly you can get a return on your investment.

TRANSPARENCY

What customers don't know will hurt your business: Companies have every incentive to reveal how the product works. *LendingClub* fully discloses the borrower's costs, offers to answer any question about the platform via email, and allows anyone to download the complete loan book directly from the website—which is the source of this data, which updates in real time, and shows the return every LendingClub investor in history has received.

ANALYTICS

If customers can measure it, they'll want more of it: Consumers are often reluctant to trade stocks because they imagine the intimidating prospect of going up against hedge fund managers.They believe they don't have the tools they might need. That's where *Motif Investing* has created very simple analytics tools—rich historical data and a range of customization options that allow investors to easily add or remove stocks or, with a slider, change their weightings within the portfolio. By giving customers more power, Motif has increased trust and, in turn, increased investor desire to make a transaction.

REDUCE FRICTION

Every wheel gets the grease: Today, cash and checks are becoming relics when I can have my groceries delivered, get my clothes dry cleaned, and catch a ride across town—all without ever physically opening my wallet. And *Bitcoin* is bringing remittance costs down toward zero. It's a powerful way to increase consumers' desire to transact.

FinTech Ideas Crazy Enough to Win Big

With so much opportunity for innovation in financial services, we're going to see hundreds—if not thousands—of new companies ready to capitalize on this new growth potential. Here, I list a few exciting possibilities across a wide range of transaction types.

IF ORIGINATION COSTS FOR LOANS APPROACH ZERO...

borrowers could refinance loans at their convenience. Today, the average bank spends over six thousand dollars to originate a mortgage. We invested in LendingHome, which already originates loans at a fraction of that cost. As this cost drops even further, borrowers could take advantage of changing rates to optimize their debt.

IF CREDITORS ACHIEVED REAL-TIME CREDIT EVALUATION IN UNDERWRITING AND FOR PURCHASES...

interest rates would, likewise, adjust to reflect a borrower's real time credit rating. Instead of "set it and forget it" actuarial calculations, underwriters could instead adjust the rate of outstanding loans based on the decreased or increased risk—whether the customer recently earned a raise or bought a new sports car. It would reward people for de-risking their lifestyle and encourage people to make riskier decisions only when they can afford it.

IF WE REIMAGINED THE BARTER SYSTEM...

your employer could cut out the middleman—like your checking account and multiple payment processors—and directly pay your recurring expenses. That essentially uses pre-tax dollars to cover things like mortgages, car leases, credit card bills, and more.

IF MARKETPLACE PLATFORMS MADE IT POSSIBLE FOR EVERY INDIVIDUAL TO BECOME AN OWNER...

we could have distributed ownership well beyond what AngelList has done for equity and LendingClub has done for loans. It could extend to any number of areas from payments to insurance.

IF WE NO LONGER NEEDED AN AUTOMATED CLEARING HOUSE TO PROCESS TRANSACTIONS...

all payments would approach free and micropayments—even of fractions of a cent—would increase in frequency, resulting in a fluidity of transactions that dwarfs anything out there today. Want to buy a stick of gum with a credit card? No problem. Want Disney to quit spending however many dollars to mail you that dividend check for $0.86? No problem. Want to trade stock and pay $0.00 commission? Robinhood is already making it possible.

IF BUYING INSURANCE WAS AS SIMPLE AS BUYING AN APP...

microinsurance would mean you only need to pay to mitigate the risks you actually take. Insurance, a particularly dense regulatory environment, presents a challenge for innovative tech companies. But Metromile is showing us what's possible. When you buy their per-mile insurance, Metromile sends you a diagnostic device that, once installed under the dash, tracks how many miles you drive—automatically—and figures out what to charge on a minute-to-minute basis.

The Internet is Still Underhyped

Across the board, innovative technology startups have already begun to seize opportunities stodgier institutions have been unable or unwilling to grapple with: reducing cost and complexity, increasing efficiency and effectiveness, and giving consumers the powerful features they are coming to expect.

If you help run a startup that's built on these maxims, let's get in touch. It means you're onto something big, and we want to help you make it bigger.

MEET OUR GENERAL PARTNER CHARLES MOLDOW

Charles is always on the lookout for startups working on the next generation of fintech, martech and consumer tech solutions and services.His current portfolio includes AdRoll, AuxMoney, BancBox, CloudOn, DogVacay, LendingClub, Lending Home, Motif Investing, OnDeck and Refresh.

Charles has made fourteen successful investments since he joined Foundation Capital in 2005. They include PowerSet (acquired by Microsoft), Xoopit (Yahoo!), Adwhirl (Google), Weblistic (Spot Runner), and Therative (Phillips).

Read his full bio on ***FoundationCapital.com*** ›