

# Should Your Bank Invest in Fintech-focused Private Equity?

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**Summary:** Partnerships between CFIs and fintechs are an increasingly important part of any CFI's business model. However popular, it's not a given that fintech-directed private equity is a good fit for every CFI. We provide you with some things to consider before you decide to invest.

When Thomas Edison invented the light bulb, he knew he just couldn't go out and sell millions of them. There also had to be a way for people to literally plug them into some kind of system that would bring electricity to the bulbs. Edison then successfully enticed Pierpont Morgan and the Vanderbilt family to fund the Electric Light Co. (now GE) to manufacture the bulbs — and also the Edison Illuminating Co. (now ConEd) to form one of the country's first electric utility companies.

Just like the ingenuity of Edison to create partnerships that will benefit people, partnerships between community financial institutions (CFIs) and fintech companies are increasingly important to the communities where CFIs reside, as well as their business model. Until now, these partnerships have typically involved apps, websites, and other technology that CFIs need but don't necessarily have the bandwidth to develop. With a recent rule change CFIs can more easily develop technology expertise and build their network. This new rule allows banks to invest as limited partners in venture capital funds that focus on financial technology. This results in CFIs gaining more exposure to new technologies, meeting potential partners and earning a return on investment.

## Global fintech venture capital hit record heights in 2021

Fintech company deals largely drive the global venture capital market. That market hit record levels for both value and number of deals in 2021. In the Q2 2021, funding reached \$36.6B. Last year 21% of all [venture capital investments](#) went to the fintech industry. Some analysts predict that overall global fintech businesses will be valued at \$310B by the end of 2022.

The drivers that fuel this segment's growth are no surprise. More people use fintech to manage their finances, and those finances are increasingly digital and Internet-accessible. By the end of the year, more than 2B people globally will likely use fintech solutions.

## Things to consider before investing in fintech private equity

However popular, it's not a given that fintech-directed private equity is a good fit for every CFI. Before your CFI invests, consider:

- 1) How do you approach fintech overall?** Is fintech a big part of your innovation strategy? Do you have a clear idea of what you need, or would you expect a private equity fund to provide a path for you to follow?
- 2) What problems would you like fintech to solve?** How have you already tried to solve those problems? Do you have the bandwidth to help shape and direct the progress of a solution, or are you primarily interested in plug and play?

Investing in early-stage fintech companies can give CFIs a chance to influence what problems a fintech solves and how that solution approaches those problems. It's good for a fintech to grow alongside a bank too, giving it opportunities to test new technology on bank systems and customers, as well as a chance to learn more about bank culture.

3) **What's your tolerance for risk?** There's no guarantee that your CFI will see a positive return on equity. You could lose time, money—or both.

If you do realize an ROI, the return might not be in dollars and cents. Rather, a CFI that both uses a fintech's technology and invests in that CFI might see technology improvements that make it more productive or effective. That could then have a positive (if indirect) effect on the CFI's bottom line.

Don't forget the opportunity cost of any investment. Whatever money your organization invests in fintech-focused private equity is money that's not invested elsewhere. Remember, too, that this kind of investment will involve both your institution's money and your employees' time and energy. To some CFIs, that's a benefit. To others, it's a bug — and that second group may be better off looking elsewhere for investment opportunities.

For many fintechs, the world is their oyster - and if the opportunity is right for your institution, the sky could also be the limit for you, too!

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## ECONOMY & RATES

Rates As Of: 06/28/2022 05:48AM (GMT-0700)

Treasury	Yields	MTD Chg	YTD Chg
3M	1.79	0.63	1.73
6M	2.56	0.92	2.37
1Y	2.84	0.76	2.46
2Y	3.13	0.57	2.39
5Y	3.29	0.47	2.02
10Y	3.24	0.39	1.73
30Y	3.35	0.30	1.45
FF Market	FF Disc	IOER (Interest on Excess Reserves)	
1.58	1.75	1.65	
SOFR	Prime	OBFR (Overnight Bank Funding Rate)	
1.50	4.75	1.57	

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