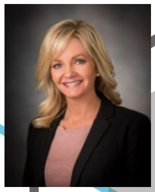
Kentucky Banking Technology Outlook: 2021 Survey Results

Provided in Partnership by:
Banking Program at Eastern Kentucky University
Kentucky Bankers Association



Maggie Abney, CTP
Executive-in-Residence for Banking
Eastern Kentucky University College of Business

Dr. Laura Barthel, CPA
Assistant Professor of Accounting
Eastern Kentucky University College of Business

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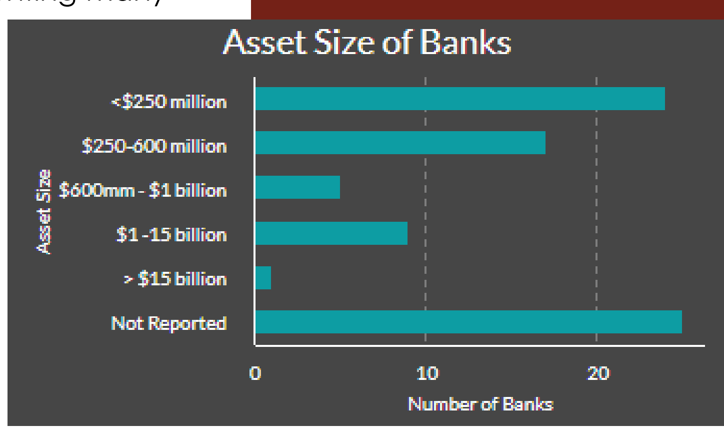
As we navigate the most rapid period of technological innovation in banking history, community banks across the nation are adopting new strategies to modernize the community banking model. Many third-party vendors, including startup companies, are offering cutting edge technology that allows community banks to manage data more effectively, streamline internal processes, increase income opportunities, and enhance the customer experience. However, many of these technologies are not offered by core providers, and due to the differences in culture and business model of a community bank and an early-stage or startup third-party technology provider has made the partnership of the two unlikely in the past. But as regulation evolves and the benefits of technology are undeniable motivators for remaining relevant, community banks across the nation are establishing creative partnerships with startup third-party providers to obtain the technology necessary to achieve their strategic goals.

The Banking Program at Eastern Kentucky University partnered with Kentucky Bankers Association to survey Kentucky bank leaders to gauge perspectives about utilizing technology from third-party providers to achieve strategic goals. We asked banks if they feel prepared to pursue opportunities with technology start-ups, what expectations they have, and if they have the resources to do so. Below we outline the responses from 81 individuals representing bank leadership from 79 banks across Kentucky (participant overview in sidebar). The results show that overall, Kentucky bank leaders are regularly discussing bank technology and how it fits into the strategic plan. However, there are some perceived barriers preventing many banks from pursuing these opportunities.

Who Responded

81 Individual respondents, representing **79 banks**

- 35% Chief Executive Officer
- 19% Operations Management
- 10% Bank/Market President
- 9% IT Management
- 7% Commercial Lending
- 6% Compliance Management
- 5% Other Management
- 3% Board Member



Strategic Alignment

Banks of all sizes indicated that increased operational efficiency and enhanced customer service were the top strategic initiatives for the bank. When asked separately about the expected benefit of partnering with a third-party technology startup provider, nearly half of banks selected increased operational efficiency as the greatest benefit. This shows that there is a strong alignment between the top strategic initiatives of community banks and the belief that third-party technology startup providers can help banks achieve these initiatives.

Top Strategic Initiatives

Increased operational efficiency (38%) #1

Enhanced customer experience (23%)

Increased access to loan customers in new markets (17%) Smaller Banks

Increased Scale (12%)

Expected Benefit from Partnering with Technology Start-up

44%

Increased Operational Efficiency

Barriers with Current Core Providers

Individual community banks have historically had difficulty managing contracts with core providers and implementing new technology offered by the core provider. The most significant barriers reported in implementing new tech offered by core providers are: cost, integration of technology, and implementation time.

Most Significant Barrier

When Implementing Technology Offered by Core Provider

Top Three:

Cost (56%)

Integration of Technology (28%)

Implementation Time (7%)

Desired Technology Solutions

Not Currently Available Through Core Provider

Online account origination/Deposit Gathering (16%)

Lead generation (12%)

Data Analytics (10%)

Small Business Lending (10%)

API (Application Programming Interfaces) (10%)

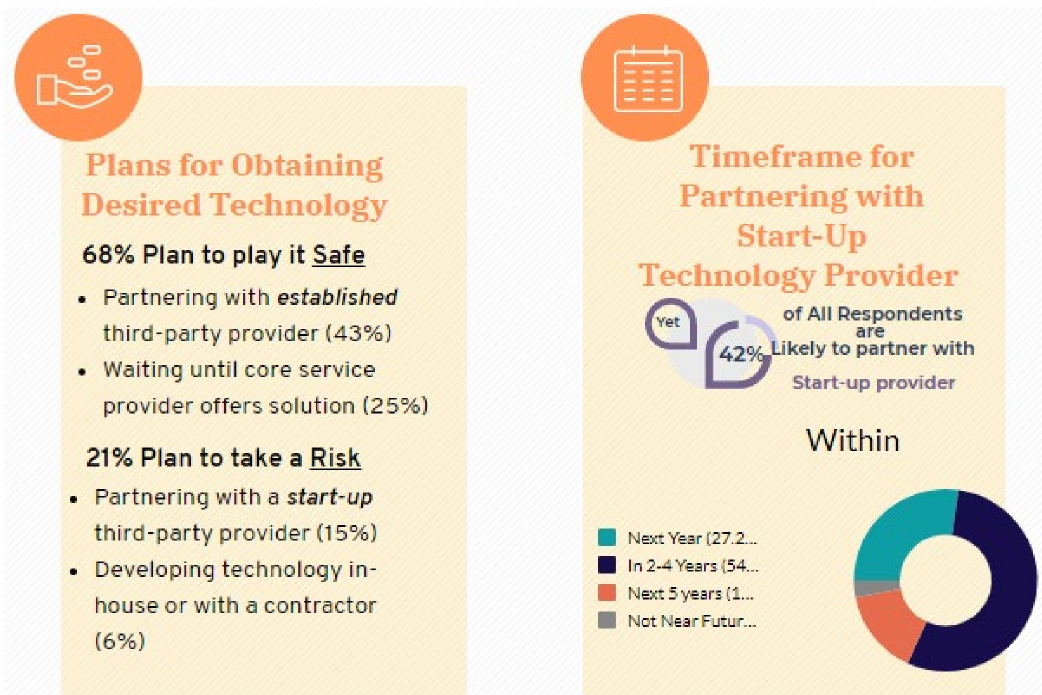
Desired Technology Solutions

KY banks reported that the top five desired technology solutions not currently provided by their core providers are: online account origination, lead generation, data analytics, small business lending, and application programming (API).

Plans for Obtaining Desired Technology Solutions

Banks seem to be making plans to play it safe, yet also seem to understand the likelihood of needing to partner with a third-party technology startup provider within the next five years. When asked if banks plan to partner with a third-party technology startup provider, 68% of banks say they plan to play it safe by working with a third-party provider that is established (not a startup third-party provider), or wait for their core provider to offer the desired solution. Some banks (21%) did indicate that they are making plans to either partner with a third-party technology startup provider or work with a contractor to develop an in-house solution to implement desired technology. The other 11% indicated the desired technology was not a current priority or that they had other plans for achieving.

Even though the majority of the banks indicated they plan to play it safe, 42% of all respondents said they would likely partner with a startup provider at some point over the next five years. This indicates that even though plans are not in place to partners with third-party technology startup providers, it might be a likely route they end up taking due to fast-paced technology changes.



Why More KY Banks Aren't Partnering with Third-Party Technology Providers

The most noted three challenges in partnering with third-party technology startup providers are: IT Integration, reliability, and regulatory compliance. When asked what keeps them from partnering with third-party provider startups, banks cited IT Integration/incompatible with core, risk tolerance, and regulatory compliance.

When diving deeper into the topic of risk, 49% of banks reported that third-party technology startup providers would not be a strategic fit for their bank due to risk, with the most pressing risks ranked as 1) strategic risk, 2) financial risk, and 3) security risk. However, the benefit banks believe third-party startups can provide does match banks strategic goals. But 32% of banks said they are unsure whether partnering with a third-party startup would be a good strategic fit, and 43% said they don't know if partnering with a third-party startup could lead to loss.

In summary, Kentucky bank leaders feel that startup third-party providers offer technology solutions that will help them achieve the top strategic initiatives of the bank. However, they do not feel that startup third-party providers are a strategic fit for the bank due to lack of core compatibility, risk tolerance and regulatory compliance.

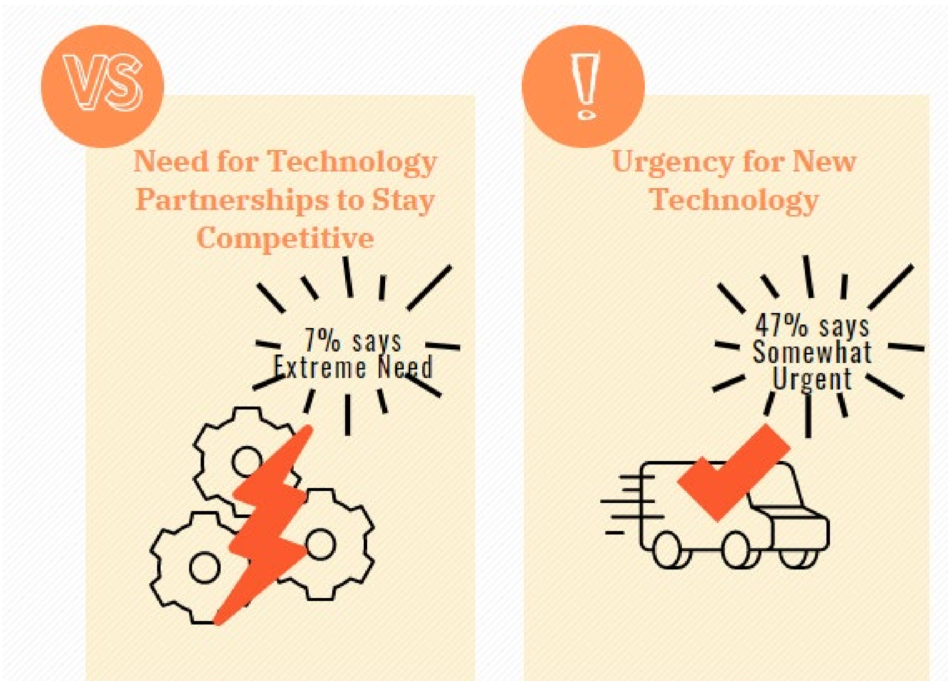
These mixed responses indicate that training could provide some guidance on understanding the risk-benefit analysis of partnering with third-party technology startup providers, as well as understanding these transactions and partnerships altogether.

What Technologies are Worth It

Kentucky banks are more likely to partner with a startup third-party provider if they are providing data analytics, AI/machine learning, marketing, sales and customer channel management, or online account origination/deposit gathering. All of these would drive increased operational efficiencies, which is the top strategic initiative, as well as the expected benefit banks expect to receive from implementing these technology solutions.

Necessity of Technology to Remain Competitive

The survey identified a gap in feeling a necessity for technology partnerships to remain competitive. Only 7% of bank leaders reported an extreme need to partner with third-party startup providers. Yet, only 16% of the responding banks consider their current bank technology plan extremely adequate to remain competitive. Additionally, 89% reported the need for new bank technology is at least slightly urgent. The results translate into an urgent need for new technology, but not a strong desire to partner with startup third-party startup providers.



Incentives for Investing in Third-Party Technology Provider

Oftentimes, state and federal tax incentives exist to help offset the expense and the risk of the investor for investments in startups. In the survey we conducted an experiment to determine if a tax credit incentive for investments made in the technology startups would increase the likelihood of banks to partner with third-party technology startups. Of the 35 respondents that were offered a tax incentive, 77% of them indicated they were likely to invest. Compared to the group without an incentive, only 36% were willing to invest. This is statistically significant and shows that if a tax incentive were offered it would increase the likelihood of banks investing in or partnering with third-party technology startup providers.

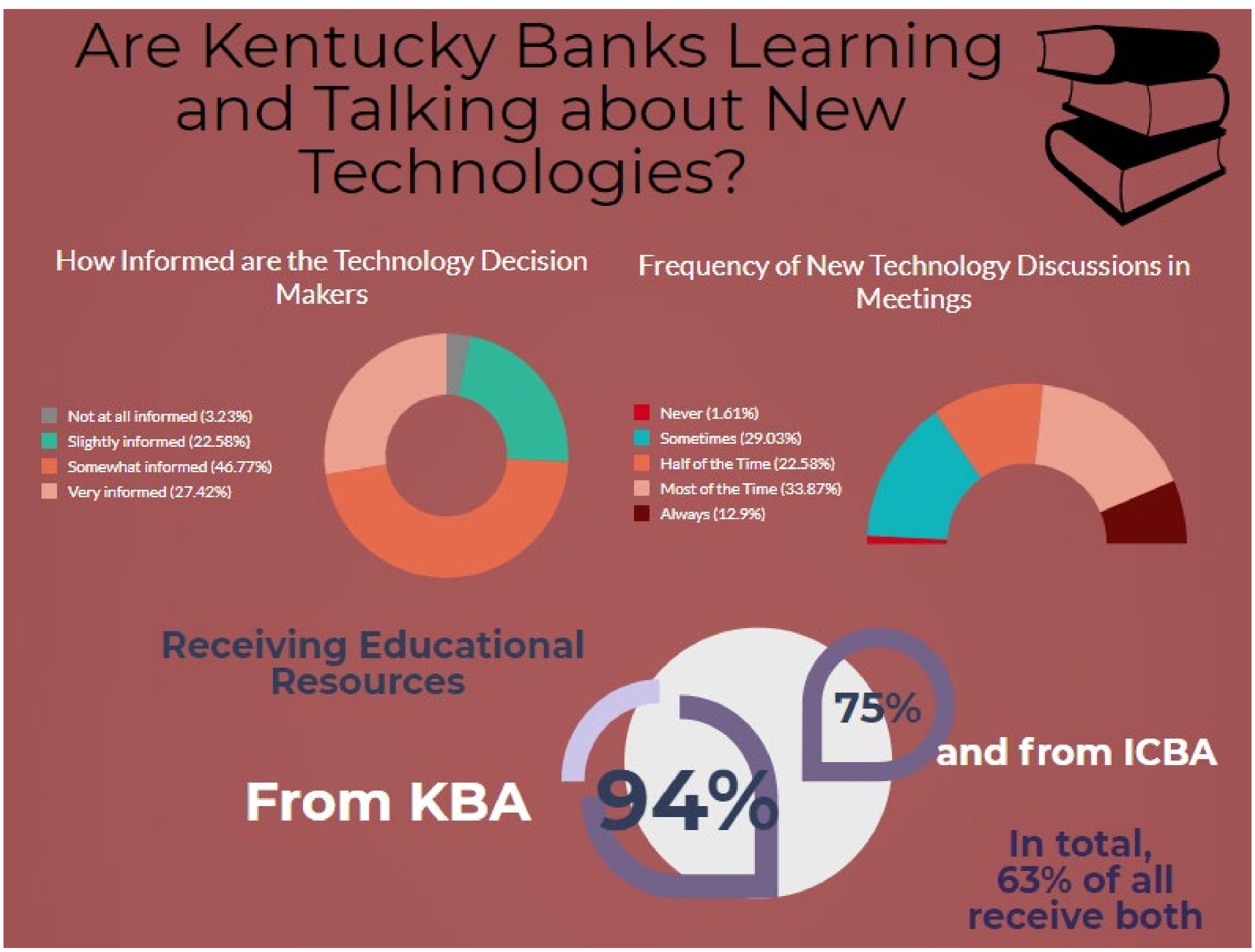
Multiple options exist for banks to partner with third-party technology startup providers. Some community banks are collaborating with peer banks to create investment funds that invest in one or more third-party technology startup providers. In many cases, this allows the banks a seat on the board of the provider/vendor for control over policy decisions and product development, in addition to a return on the investment. Other banks are making equity investments in third-party startup providers on their own.

With the multiple ways to partner with third-party startup providers, banks can determine ways to replace the high sunk cost with an investment opportunity. While also achieving the strategic initiatives they desire, with the benefits they expect technology startups can provide. However, the uncertainty of strategic, financial, and operational risks hinder banks' pursuit of partnerships with third-party startup providers to help them meet strategic initiatives.

Education is Taking Place in Kentucky Banks

Education related to opportunities, approaches to partnership with technology startups, and mitigating potential risks is important for banks to be able to take advantage of opportunities that might exist. To gain this education, it is important for our banks to continue discussions about technology, receive regular updates on regulatory guidance on strategic partnerships to implement new technology, and review case studies of banks that have adopted new technology with success.

We asked bank leaders if they are learning about fintech, and if they are talking about new technology regularly. Over half of banks report that their decision makers are informed or very informed. The frequency of discussions about technology and fintech is 'most of the time' or 'always'. This is the first step in moving toward implementation. We found that 94% of banks are receiving educational resources about technology from KBA, and of those, 75% are receiving education on fintech partnerships from the ICBA.



Opportunity to Learn More

While our banks do have access to resources, there is indication that there is a need for training on how to access the different resources and how to develop and implement fintech strategy (e.g., partnership with third-party technology startup providers).

To address this need, KBA and EKU have partnered to create the first annual *2021 Banking Innovation Conference* to provide our bank leaders and emerging leaders with the knowledge to make informed decisions about technology partnerships. Attendees will hear directly from regulatory experts, community bank fintech strategists, and community banks that have successfully implemented new technology or investment funds in partnership with third-party startup providers. We hope you will join us on October 14th!