FDIC researchers say tech-savvy banks outperformed on PPP loans

By Carter Pape

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Banks that operate more like fintechs outcompete their more traditional competitors on certain financial products, researchers at the Federal Deposit Insurance Corp. found.

The study used a new measure of technology adoption at banks to look at Paycheck Protection Program loan volumes in the second quarter of 2020. Banks in the top 15% for tech adoption made more loans than similarly sized competitors by 9 percentage points — and they gained customers outside their usual markets more often, the data showed.

The findings prove the importance for community banks of adopting technologies fintechs use, such as cloud computing and online loan applications. In responding to the findings, analysts say banks that have not integrated those technologies should devise a strategy for doing so.

The authors, Senior Financial Economist Mark Kutzbach and Jonathan Pogach, chief of the Financial Modeling and Research section at the Center for Financial Research, named their tech adoption measure the Fintech Similarity Score and used a database created by Aberdeen, a marketing intelligence firm headquartered in Massachusetts, to calculate it.

Aberdeen tracks which banks and fintechs are using which tech products — for example, keeping tabs on who uses IBM's latest line of mainframes, Oracle's server operating systems and various virtual private network solutions. The authors considered technology categories rather than specific products — for example, looking at use of digital advertising in general rather than use of Google AdWords in particular.

In their calculations, the authors accounted for factors already known to influence how well a given bank could distribute PPP loans, including number of branches, number of employees, core deposits, number of COVID-19 cases in areas the bank served, and the relative economic impact of the pandemic in counties where the bank had branches. Technology adoption still made a considerable difference.

"We find that these investments in technology-enhanced banks' reach of borrowers, both large and small, and especially to borrowers outside of their branch network," the authors wrote. "This expanded reach does not appear to come at the expense of lending to more proximate borrowers."

The finding builds on previous research that showed expenditures prior to the pandemic on tech adoption correlated with higher PPP loan volumes and higher deposit growth and research into what products fintech leaders tend to prefer.

"Community banks with greater technology investment reported larger increases in loan growth in 2020, driven primarily by participation in the Paycheck Protection Program," a 2021 quarterly report from the FDIC said. “Those banks also reported larger increases in deposit growth in 2020 than did banks with less technology investment.”

Tom Andreesen, managing director in Protiviti’s Technology Consulting practice, said that tech adoption can give community banks a “leverage point” and a “competitive advantage” because it makes them more responsive to customer desires.

“The challenge will be how do these capabilities replace or fit into legacy technology environments, which can be complex,” he said.

Rutger van Faassen, head of product and market strategy for the financial services consulting firm Curinos, said that some technologies create a great customer experience, but only in limited circumstances, and pointed to integration as a primary concern.

Van Faassen identified two key areas where banks could focus new technology investment: Financial planning and points of purchase.

With points of purchase, van Faassen said banks need to look for ways to put their products in front of customers as they need them, such as offering an auto loan to someone as they purchase a car rather than relying on a customer to remember the bank’s ad about auto loans.

With financial planning, van Faassen said, community banks need to ask, “How do I make sure I’m there for a customer when they are planning for financial decisions?” He pointed to tools like Mint and Credit Karma as examples of products that gather information about customers and transform that data into insights that help them plan.

“That fits quite nicely with small and medium-sized banks because that’s usually where they excel — they usually still have those personal relationships because they’re part of the community,” he said.

The authors said they identified 42 product classes used by fintechs. However, the Aberdeen data used in the study is proprietary, and the authors did not cite particular product classes that correlated with greater loan volumes.

As for examples of community banks successfully leveraging technology, van Fassen pointed to the Citizens Bank of Edmond, which partnered with Mark Cuban to build an online application for Paycheck Protection Program loan forgiveness, as the “poster child” of a community bank successfully leveraging tech to reach a broader market.

Some technologies offer banks a more guaranteed return. Andreesen and van Faassen both said cloud computing and storage were highly preferable to on-premise and hosted solutions for community banks. Van Faassen said even “laggards” now acknowledge the superiority of cloud computing to hosted computing.

Kutzbach and Pogach said that they could not assess whether having a stronger tech portfolio caused certain banks to disperse more loans or whether the effect was merely correlation, though they said future research could examine whether banks can “catch up” to industry leaders with tech adoption.

“Although we do not claim causal identification, our results demonstrate an important relationship between pre-existing technology investments and outcomes in the banking industry during the COVID-19 pandemic,” they wrote.