An Eye on the Fish and Another on the Cat: How the Fintechs Dispute Space with the Banks in Times of Low Interest

Um Olho no Peixe e Outro no Gato: Como as Fintechs Disputam Espaço com os Bancos em Época de Juros Baixos

Raul Beal Partyka
Jeferson Lana
Marina Amado Bahia Gama

ABSTRACT

This teaching case contextualizes the evolution and transformation of the Brazilian Financial System, with emphasis on the growth of the fintechs (technology-based financial companies) and the rupture of the moment of "quiet" of the big banks. With the emergence of fintechs, the market share of major banks is threatened. The purpose of this case is to discuss the competitive market strategies of banks and fintechs in the face of possible future scenarios, in particular, to analyze fintech strategies with a focus on corporate political activities in the form of influencing government, regulation and the National Financial System to gain access to the market. The case also allows us to evaluate the integration of market and nonmarket strategies, acting in the face of common interest, between fintechs and large banks. This is a real case within the Brazilian context. It can be used in undergraduate and postgraduate courses in Administration, Accounting, Economics, and Management. It can also be used in complementary courses, short courses or executive education, in subjects such as government relations and institutional relations and nonmarket strategy.
Keywords: Fintechs. Banks. Corporate Political Activity. Strategy.

RESUMO

Este caso de ensino contextualiza a evolução e transformação do Sistema Financeiro brasileiro, com destaque para o crescimento das *fintechs* (empresas financeiras de base tecnológica) e ruptura do momento de "sossego" dos grandes bancos. Com o surgimento das *fintechs*, o *market share* dos grandes bancos passa a ser ameaçado. Com isso, este caso tem por objetivo discutir as estratégias de mercado concorrenciais dos

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Raul Beal Partyka
raul@edu.univali.br
Master in Business Administration - University of Vale do Itajaí
Mestre em Administração pela Universidade do Vale do Itajaí
Universidade do Vale do Itajaí
Biguaçu/SC - Brazil

Jeferson Lana
jlana@univali.br
PhD in Business Administration - FGV/EAESP
Doutor em Administração de Empresas pela FGV/EAESP
Universidade do Vale do Itajaí
Biguaçu/SC - Brazil

Marina Amado Bahia Gama
abgama@gmail.com
PhD in Business Administration - FGV/EAESP
Doutora em Administração de Empresas pela FGV/EAESP
Fundação Getúlio Vargas - Escola de Administração de Empresas de São Paulo
São Paulo/SP - Brazil

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RESUMO

bancos e das *fintechs* frente aos cenários futuros possíveis, sobretudo, analisar as estratégias das *fintechs* com enfoque nas atividades políticas corporativas sob forma de influenciar o governo, a regulação e o Sistema Financeiro Nacional para obter acesso ao mercado. O caso ainda permite avaliar a integração das estratégias de mercado e de não mercado, atuando frente a um interesse em comum, entre as *fintechs* e os grandes bancos. Trata-se de um caso real dentro do contexto brasileiro. Pode ser utilizado em cursos de graduação e de pós-graduação em Administração, Ciências Contábeis, Economia e Gestão. Ainda pode ser utilizado em cursos complementares, de curta duração ou educação executiva, em temáticas tais como Relações Governamentais e Relações Institucionais e Estratégia de Não Mercado.

Palavras-chave: *Fintechs*. Bancos. Atividade Política Corporativa. Estratégia.

Introduction

Since the late 1990s and early 2000s, Brazil has been producing relevant financial inclusion initiatives. Examples are banking correspondents, internet banking and, more recently, mobile banking. Technological advances promote access to solutions and tools made available to the Brazilian consumer, due to the huge investment of banks in this direction over the last years.

Thus, Brazil and the world are experiencing a wave of financial technology growth, which is likely to absorb a market share of traditional banks. Among the main technological innovations are fintechs. These are young financial companies, also called startups in the financial sector, differentiated by their innovations and technologies applied to services. The term joins the word financial with the abbreviation of technology.

In 2015 there were only a few dozen fintechs installed in the country. In April 2016, the number reached 130 (NERY, 2016). A report by Goldman Sachs, a leading New York-based global investment, securities, and investment management firm, estimates that the more than 200 financial technology companies currently operating in Brazil are expected to generate potential revenue of about $ 24 billion in the United States. next ten years (SREEHARSHA, 2017).

Thus, it can be observed that there are changes taking place. Although Brazil's economy is struggling to emerge from recession and political uncertainty grew before the October 2018 elections, Brazilian startups raised record amounts of funds (LEAHY, 2018) this year. Thus, these financial technological changes have been happening in a period of economic stagnation and high political uncertainty in Brazil. On the one hand, there is a consumer market tired of the highest interest rates in the world. On the other, a government seeking ways to encourage consumption and the resumption of growth. Between these two extremes are the big traditional banks and the fintechs, which now compete with each other for the market.

The Government, especially through its National Financial System institutions, bodies, and municipalities, urgently needs to stimulate the economy and promote economic recovery in the face of the recession that began in 2015. Banks, concentrated in five giants, are unable to boost consumption by themselves in the way the government needs. Of these five giants, “four institutions account for 80% of bank transactions” (ARROYO, 2018). In contrast, in the United States, the top five banks hold only about 20 percent of all branches across the country. In India, this figure is slightly over 30%, and in Turkey, it is just under 30%. Mexico and Russia’s financial markets are also less concentrated than Brazil’s (SREEHARSHA, 2017).

Ilan Goldfajn, President of the Central Bank of Brazil from June 2016 to February 2019, emphasizes that: “Instead of discussing whether or not there is concentration, we have to discuss whether or not there is competition in the system. Does more competition help? If so, then let’s move on, stimulate competition so we can lower bank rates faster.” For this, the former Central Bank president lowered the Selic rate to the lowest level in history. But credit remains expensive, and one of the main reasons for this remains the spread. Goldfajn changed regulations, spurred fintechs and took the seats out of the comfort zone. An example of this is the positive registration. “We make this very clear: if the customer wants to use the services of a fintech, the bank cannot make it difficult” (GRADILONE, 2018a).

Brazilian startups are still considered “small fish” compared to their established competitors. In addition, traditional Brazilian banks are also known for their sophisticated financial technology (LEAHY, 2018). However, while efforts to increase Brazil’s financial competitiveness are being implemented with significant advances, fintechs and other competitors continue to experience the difficulties of a complex and limited regulatory environment.

Therefore, in this context, the question is what are the market and nonmarket strategies that banks and fintechs use to influence the government and the national financial system against the low interest scenario. Thus, the dilemma of this case study lies in the efforts that fintechs have been making to grow in the market and to pressure the National Financial System to seek new rules, regulatory stimuli, that allow them to operate in the most diverse financial segments of the country. More specifically, this case study focuses on the market and nonmarket strategies that fintechs have been using and whether they have fulfilled the desired role.

Reduction of interest rates: money available to the population

Why encourage fintechs? Why doesn't the government encourage consumption by itself, printing more money? Well, a government that issues money, by definition, can't break down the same way as a company that relies on revenue. Yes, governments can print money and spend it. But this may, in specific cases, cause inflation (SICSÚ, 2017). Printing money does not accompany an increase in the production of goods and services: with more money in your pocket, people buy too much, the supply of products decreases and they become more expensive.

This is not an assumption; history proves these facts. When Juscelino Kubitschek presided over the country between 1956 and 1961, it was necessary to print more paper money to pay off the debts created by his expansion project. The inflation process that followed this measure was so great that it could be contained only decades later, with the implementation of the Real Plan in 1994. To be aware, in 1993 annual inflation reached 2,477%. Thus, printing money is not a solution to misery: in the end, the poor would remain poor, but with undervalued bills in their pockets (SANT'ANA, 2017).

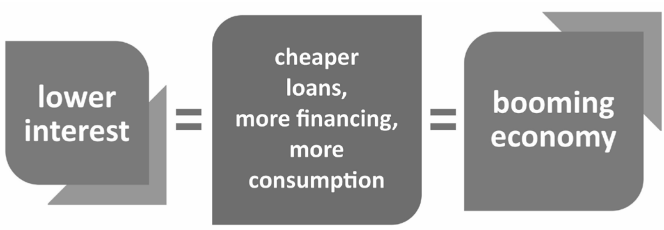
Likewise, the former Central Bank president answered this same question in April 2018 in one of his lectures, stating that printing money to pay off debt has been tried many times, but in the end has only resulted in generation of more inflation: "If there is the impression of more money, having the same amount of goods, there would be more inflation (RIZÉRIO, 2018).

An alternative way of passing money to the population would be to lower interest rates. This would make many families choose to keep their money in circulation rather than invested. In the United States (US), for example, after the 2008 crisis, the Federal Reserve Bank (FED) lowered its basic interest rate to zero.

In this meaning, what is happening in Brazil? There is still a recession, unemployment, companies closing, low consumption, stable prices or falling. On the other hand, the central bank is cutting interest rates, and consumers are less concerned about inflation and more concerned about seeing the economy grow.

Lower interest rates help with this. As shown in Figure 1, lower interest rates also ease the lives of companies, which may even start investing more, which helps the country out of the crisis (ANBIMA, 2017).

Figure 1 Projection of the economy in Brazil.



Source: Anbima (2017).

Without forgetting the large institutions, Goldfajn reported that "Selic rate is just one component of the bank fee. The rest is a lack of guarantees [...]. We will have to deal with all of this over time." (GRADILONE, 2018b). In this meaning, there have also been changes in the treatment of revolving credit card loans, and the Brazilian Federation of Banks (Febraban) has already planned and forwarded the change in overdraft interest rates. These changes alter the traditional way banks operate, and banks deprive themselves of some of the gains. But the big banks are either unable or unwilling to give in and offer cheaper interest rates.

FINTECHS IN BRAZIL

Fintechs installed in Brazil have represented growing hope for the reduction of bank spreads and, consequently, interest rates. "The growth of fintechs in Brazil is directly related to regulation that is attentive to changes in the segment, concerned with fostering new business models" (PERRIN, 2018).

In 2016, the Central Bank and the Securities and Exchange Commission (SEC. In brazil, CVM) created internal cores to monitor fintechs (BRASIL, 2016), while the two institutions were moving to regulate activities that are gaining greater visibility. Overall, entrepreneurs praise the actions of regulators, who have been flexible to avoid compliance with anachronistic rules (ALVES, 2017a). In February 2017, about 250 of these startups were already operating. By November 2017, the number jumped to 332 active fintechs in Brazil. By August 2018, over 400 (see Annex A) were already mapped (FINTECHLAB, 2018a).

Initially, fintechs in Brazil received support from funding institutions for their growth plans. Agencies such as the International Finance Corporation (IFC), a member of the World Bank group, and the Financier of Innovation and Research (in Brazil, Finep), linked to the Ministry of Science and Technology, have supported these platforms by through loans or direct investments. An example of this is fintech GuiaBolso, a personal finance platform that in May 2016 received R$ 60 million (Brazilian real) from IFC-led investors (FINTECHS CRESCEM..., 2017). Sergio Furio, the creator of fintech Creditas, confirms the company's business model based on lending using customer property as collateral. With this, Creditas is able to charge interest of 1.15% per month for vehicle loans and 1.49% for property-backed loans, far below the 6% charged by banks (ALVES, 2017b).

Nubank, one of the most popular fintechs, was born on California Street in Brooklyn's São Paulo neighborhood in May 2013, and remained in that address until January 2015. Today it is headquartered in Pinheiros and has more than 500 employees. Colombian David Vélez, founder of fintech, holds an engineering degree from Stanford University. There he worked for the Capital Sequoia venture fund, which gave Steve Jobs the first million dollars to leverage Apple.

Velez arrived in Brazil in 2011 to find investment opportunities. You didn't find anything interesting. He bumped into the bureaucracy when he needed to open a bank account. Hence the idea, and has since received contributions from even his former employer, Sequoia Capital. "There was a big conventional belief, which I saw in 2012 and 2013, that you couldn't compete with the big banks" (SAMBRANA, 2017).

First, he thought: "We don't have the capital and infrastructure they have, but we have the technology, a very strong culture, we are fast and we think about the customer." On October 24, 2017, Velez announced, in an auditorium filled with customers, partners, and geek guys, the creation of NuConta: a bank account in which the money deposited automatically yielded at a CDI-indexed rate. Queues were formed in the street.

Until then, fintech's activities were restricted to offering credit cards without maintenance costs. For those who think that the dispute is only to take customers from the largest banks, is wrong. The idea is to offer the service to 100% of the population, especially to the 60 million Brazilians who do not have a bank account (SAMBRANA, 2017). Banco do Brasil and Bradesco, for example, created in 2016 the Digio, a credit card technology platform, inspired by the emergence of Nubank (ALVES, 2017a).

Venture capital firms have invested USD $ 179 million from 2013 through April 2018 in Nubank, fintech valued at $ USD 500 million in early 2016 (ALVES, 2018). However, Velez was facing, with few available strategies, the most powerful opponents, the five giants: Itaú Unibanco, Bradesco, Santander, Banco do Brasil and Caixa Econômica. These were creating difficulties for Nubank in contracting the banking services necessary for its business, such as automatic debit, intraday statement, and settlement bank services, as well as restricting essential information such as sender identification (ARROYO, 2018).

In addition, all the clients of Velez's company paid their invoices via slips, which increased costs and the risk of default. Banks submitted to CADE the proposal to charge fees between R$ 6 and R$ 11 (Brazilian real) for authenticated ticket, while data from the Central Bank indicated that the average rate was R$ 3.64. So, Velez needed more strategic resources to take down the giants. Then, following a petition sent by Nubank to the Administrative Council for Economic Defense (in Brazil, CADE), further regulatory changes were approved in mid-March 2018, making the dispute less unequal.

Thus, on March 28, 2018, fintechs gained an ally: the federal government, which, through the National Monetary Council (in Brazil, CMN), approved Resolution No. 4,649 (BRASIL, 2018a). This resolution prohibits banks from creating problems with automatic debit and money transfers, among other examples. The main appeal of startups is that they can, through technology, promote the reduction or even waive the fee charged to customers. Such regulations should be a relief to fintechs (ARROYO, 2018).

A fact that occurred in 2017 also benefited Nubank, when it hired former Central Bank President Gustavo Franco. Also, co-founder of the Rio Bravo manager, where he remains working, the now strategic consultant joined the fintech team. The intention was for the economist to support the young startup in market, nonmarket and macroeconomic strategies. (ZOGBI, 2017).

In January 2018, President Michel Temer authorized Nubank to be a financier, giving fintech more autonomy, known for its purple credit cards. In practice, the decision meant that the startup will no longer need partnerships with banks in the country to set up its fundraising and lending structure. This is because, despite being a Brazilian company, Nubank is controlled by a holding company based in the Cayman Islands and, under that condition, approval would be required. Under Brazilian law, a foreign capital institution depends on a presidential decree to become a financial institution, a process that can take years.

From 2018, then, Nubank was able to form a specific business line, Nu Financeira (ALVES, 2018), and claims to be the largest fintech of customers outside Asia. Accounts are opened online and there are no fees - a revolution for the bureaucratic Brazilian banking industry. “This explains why Nubank was able to grow faster than any other digital bank in the US and Europe, although macroeconomics was much worse,” says Vélez (LEAHY, 2018).

In the same vein, the Original Bank, the first 100% digital bank in Brazil, was created by Henrique Meirelles, former Central Bank President and former Finance Minister. The J&F group owns this already big fintech, which had Meirelles as chairman of the group’s board, and was CEO of Bank of Boston in the 1990s. Often, his name appears on the political scene. (FRIEDLANDER, 2016).

Fintechs are submitted to three regulatory bodies in Brazil: The Private Insurance Superintendence (in Brazil, SUSEP), the Securities and Exchange Commission and the Central Bank (TRINDADE, 2017). As part of the mobilization of fintechs, these financial startups organized to better articulate with regulators. The Brazilian Association of Fintechs (ABFintechs), the Brazilian Digital Credit Association (ABCD), and the Brazilian Equity Crowdfunding Association, established on the eve of the regulation of crowdfunding by the Brazilian Securities and Exchange Commission, were formed in 2016 (NERY, 2016).

In addition, at the hearing on April 26, 2018, at the Senate Economic Affairs Committee (in Brazil, CAE), were present Nubank's director of institutional relations, Bruno Nagrani, and PUC-Rio professor Vinícius Carrasco, fintech executive Stone, representing Brazilian fintechs in defense of positive registration approval. This has as its central objective to debate the high spread levels practiced by the national banks. That is, smaller institutions do not have nearly the same level of access to information as large banks do. To the director of Nubank: "If I don't have this information about each client's risk, I'll assume interest rates will be higher." Thus, with positive registration, credit information to bank consumers can be shared, so competitors of any level can lend with more aggressive offers (FINTECHLAB, 2018b).

Another regulation favorable to fintechs, and also to interested parties, was Decree No. 9,283, of February 7, 2018 (BRASIL, 2018b), which regulated the science and technology incentive policy. The main release is the possibility that public universities, research centers, funding agencies, public companies, and mixed-economy societies can participate as startup partners, either directly or through investment funds (FINTECHLAB, 2018c). The decree makes further provisions and dispenses with certain requirements. This has improved the conditions for advancing the term science of excellence through legislation that enables both parties to gain. With regulation, the science put into practice reaches the top, companies, the market.

However, fintechs do not just take direct action to deal with competition and demand more regulation. They seek to anticipate the market and pursue the development of any innovation that may emerge. In this regard, the digital bank Inter filed an initial public offering for a share in February 2018. Inter and its shareholders may raise up to R$ 815.96 million (Brazilian real) from the Initial Public Offering (IPO). In December 2017, the bank had 380 thousand clients and R$ 3.5 billion (Brazilian real) in assets. (MANDL, 2018). And the claim came to fruition. Banco Inter was the first Brazilian fintech to go public at B3, the brazilian stock exchange.

Also, ContaAzul, a management platform for small businesses, which in 2017 accounted for 23,000 customers, has the strategy of doubling the number of customers using fintech partner accounting offices as sales channels. Still worth mentioning is Thinkseg, fintech that sells insurance through its digital platform and has about 80,000 active clients and 2 million registered clients (FINTECHS CAMINHAM..., 2018).

According to Rodrigo Soeiro, president of the Brazilian Association of Fintechs, these companies are in the process of consolidation, which is already happening internationally and will happen here as a trend (FINTECHS CAMINHAM..., 2018). For Sérgio Furio, president of Creditas, Brazil has a secured loan model that is ahead of developed markets, such as the US. In the view of Fabio Neufeld, president of Kavod Lending, a fintech that works with loans between people, Brazil did not take much longer than the US and Mexico to regulate these startups in the financial sector. Neufeld believes that the legislation created here is better as there is more flexibility (PERRIN, 2018).

In the same vein, the National Bank for Social Development itself (in Brazil, BNDES) created a digital bank. This is fintech BNDES, with the purpose of creating a platform to make the supplier, who is a member of the Brazilian Association of Machinery and Equipment Industry (in Brazil, Abimaq), sell directly to its customer. The goal is to drastically reduce the final spread. Estimates with this new fintech are that annual rates will be less than 12%, depending on customer risk. The president of the institution, Paulo Rabello de Castro, emphasizes that this is one of the segments that BNDES still cannot reach: small, micro and medium companies. (RABELLO:..., 2018).

BNDES's project, also by hiring a fund manager, is to lend money to startups. Called Angel Co-Investment Fund, it will have estimated equity of R$ 100 million (Brazilian real). The bank itself launched an initiative in 2007 called Fundo Criatec, which invests in early stage technology companies. However, with funds from BNDES and Banco do Nordeste do Brasil (BNB), the latter invested in only 36 startups (BNDES, 2017; PAMPLONA, 2017).

In addition, BNDES intends to diversify its network of passers-by to ensure that small and medium enterprises have access to financing. This motivation comes amid the resistance of large banks to offer credit to micro, small and medium enterprises. Today, one of the main focuses of BNDES is that micro, small and medium enterprises have access to financing. Specifically, fintechs are expected to be able to offer even more specialized lines for certain segments such as technology or healthcare. ('FINTECHS' PODEM..., 2017). All of this to make credit more abundant and cheaper and to lift millions of Brazilians, both individuals, and businesses, from the plight of high interest rates on loans. (GRADILONE, 2018b).

Fintech Toro works in the same direction, but with another channel. It launched its brokerage firm in July 2018. The process of approval of the brokerage house by the responsible agencies began in 2016 and in early 2018 Toro obtained the authorizations of the Central Bank and regulators. The brokerage firm will focus on the individual investor, offering both fixed and variable income products and services (LAIER, 2018). It has become one of the only independent non-bank companies in the country to open a brokerage firm in the last 20 years and the first fintech in history to make such a move (RODRIGUES, 2018).

Finally, speaking of giants, Santander's president in Brazil, Sergio Rial, understands that collaboration with fintechs is the way to survive these changes, but entrepreneurship should not only come from outside. For him, banks are not just a bureaucratic form of existence. Rial minimizes the potential conflict between these two actors addressed in this study. More than that, he considers a fruitful partnership already present in this interaction: "I think we have to think about the need to create ecosystems. Within Santander, we have several companies that are not ours, and in some issues partnering with them is fundamental (MIOZZO, 2017).

Thus, large banks are investing heavily in technology and moving fast to bridge the technology gap that separates them from fintechs. In about three or four years, they will be able to stand up to industry startups on a par with speed and innovation (FINTECHS CAMINHAM..., 2018).

THE CHANGES IN SERIES

Against this background, in 2018, the then-president of the Central Bank showed a willingness to encourage competition: "We are making almost all of our regulations and standards based on this and fintechs can also be a new competition vector in this process," he told Fintechlab (2018d). Goldfajn promised to regulate credit fintechs: "Let's make it clear what they can and can't do," he said, with the assurance that banks cannot under any circumstances make it difficult for a customer to decide to use a credit card. from them. Fintechs were at the top of

Goldfajn's agenda, not because of their size, "but because of the innovation factor, the culture change factor, the creation of new disruptive mechanisms." Goldfajn sees these accomplishments with serenity. "The current government has come up with a reform proposal, and we take this window of opportunity," he said in 2018 (GRANDILONE, 2018b).

One of the changes instituted by the BC was the authorization given to fintechs to receive salary accounts credit. The National Monetary Council (in Brazil, CMN) announced in February 2018 a new rule that came into effect on July 1 of the same year: workers will be able to automatically transfer wages, without paying fees, to payroll accounts. not operated by banks, including digital accounts (FINTECHLAB, 2018e). The CMN is responsible for formulating currency and credit policy. Its institutional objective is to ensure currency stability and to promote the economic and social development of the country.

On March 21, 2018, Law No. 13,636 was also published, authorizing fintechs to operate or participate in the National Oriented Productive Microcredit Program (in Brazil, PNMPO), with the objective of supporting and financing entrepreneurial productive activities, in the distribution microcredit (BRASIL, 2018c).

The greatest achievement of fintechs may have come on April 26, 2018. Until then, these financial sector technology companies acted as bank correspondents in offering credit, but on that date, CMN passed resolutions allowing these companies to grant credit without the need for the intermediation of a bank and can act on two fronts: in the form of intercompany loan companies and as direct credit companies. These resolutions also allow companies in this sector to be controlled by Brazilian or foreign investment funds (PRADO; CARNEIRO, 2018).

In addition to these changes, the Central Bank reduced the number of compulsory demand deposits from 40% to 25% and savings accounts from 24.5% to 20% in order to alleviate the problem of reducing capital available to banks. In addition, the CMN approved, on April 26, 2018, a reduction in the transfer of monthly contributions from financial institutions to the Credit Guarantee Fund (FGC) from 0.0125 percent to 0.01 percent. This calculation is applied to the amount of account balances related to guaranteed instruments, such as savings and CDBs (AYRES, 2018).

Figure 2 Changes promoted by the Central Bank between March 2017 and March 2018.

SERIAL CHANGES

Main changes made by the Central Bank in the financial market in the last 12 months

Step	Decision	Date	Goal
Improvement of warranties 1	Electronic registration of warranties	Mar/17	Reduce the cost of loans
Credit card changes	Compulsory migration from revolving to installment	Apr/17	Reduce costs and financial default
Payment flexibility	Simplify oversight for cooperatives and smaller banks	Jun/17	Reduce retail and consumer costs
Bank targeting	Change in BNDES, with the creation of TLP	Jul/17	Reduce banking system costs
Capital market incentive	Guaranteed Real Estate Letter	Aug/17	Stimulate long credit for companies
Improvement of warranties 2	Guaranteed Real Estate Letter	Sep/17	Expand the real estate credit
Reduction of compulsory	Demand deposits: 40% to 25% Savings: 24.5% to 20%	Mar/18	Reduce the cost of credit
Debit card stimulus	Debit card transfer cost limitation	Mar/18	Reduce retail costs
Overdraft changes*	Voluntary migration to another loan to be defined	Apr/18	Reduce cost to customers and financial default
Bank portability	Facility to migrate salary account between banks	May/18 (a)	Reduce cost to customers
Fintechs	Credit fintech regulation	May/18 (a)	Increase competition in the credit market

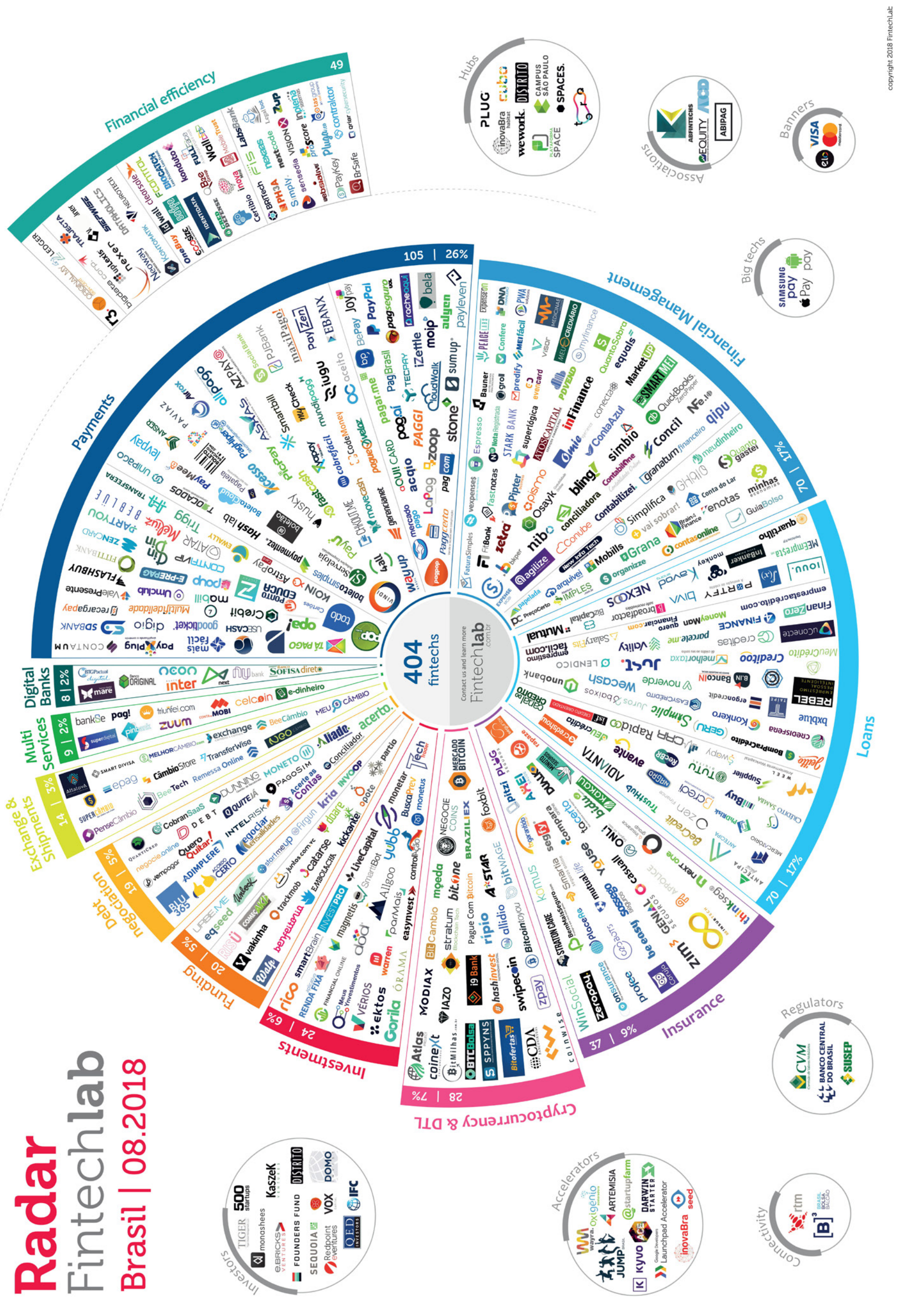
(a) Prediction *Change promoted by the banks themselves.
Source: Gradilone (2018b).

In an interview with Estadão in April 2018, then Central Bank of Brazil President Ilan Goldfajn said he would “attack the spread in the bud”. For him, “there is a lag between the fall of the Selic and the spread, just as when the Selic rate rises, the spread takes longer to rise.” Goldfajn highlighted the electronic guarantees, the reduction in the legal costs with the labor reform and the attempt to apply the positive register to the Brazilian, to reduce costs and thus interest (ZOGBI, 2018). And to do so, favoring the small startups that are emerging seems like a great strategy.

Regulatory changes for credit fintechs were intended to foster innovation within the financial system, increase competition and competition. Above all, new, more technological institutions will help reduce credit costs and bank spreads (CAMPOS, 2018). Lower credit cost attracts demand and promotes greater economic turnover. In the words of the former Central Bank president: “If we can keep this inflation low and interest rates low, the rest, over time, will eventually come. And with the measures we are taking, this fall is likely to come sooner than you think” (GRANDILONE, 2018a).

Finally, it is clear that large banks have historically been privileged, as they face competition only among their peers. On the other hand, there are the financial sector startups, state-of-the-art fintechs, which allow faster and more effective penetration, low interest rates and access by the population. So, what the interest of the government's relationship, in parallel, with banks and fintechs? And from now on, what strategies should fintechs and banks take?

ANNEX A – Fintechs performing in Brazil in 2018



Source: Fintechlab (2018a).

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Teaching Notes

The teaching notes are for instructors only. It has the objective of directing the educational material, methodological strategies and evaluation of the teaching case.

DATA SOURCES

The data sources related to the companies, their origin, historical evolution, and the people involved in the case were obtained through articles from national and international journals, communication websites and websites of companies and institutions. Industry data were obtained from secondary sources, through Central Bank of Brazil regulations, the SEC – Securities and Exchange Commission (in Brazil, CVM), magazine reports (such as: Exame, Época Negócios, Folha de Sao Paulo, Forbes Brasil, G1, Infomoney, Reuters, The New York Times and Valor Econômico), Company Websites, Policies, and Bylaws.

The data collection period took place between April 7 and August 23, 2018. First, all magazines and journalistic articles citing Brazilian fintechs, large banks and the government were digitally cataloged. After this process, we captured from this sample the excerpts that made up the case for teaching. The information collected and transcribed were not adapted or included in the plot. The script and events are real. Still, the case was tested in undergraduate and postgraduate classes at universities in southern and southeastern Brazil. After the tests, the case was improved based on comments, suggestions received from students and perceptions of the application by the instructor.

EDUCATIONAL OBJECTIVES

The case presented was built for discussion in undergraduate and graduate courses in business administration, accounting, economics and management. It can also be used in complementary courses of short duration or executive education, in the themes such as government relations and institutional relations. It was developed with the following objectives, aiming to support the theoretical discussion of the case and to provide, through the discussion, the learning about:

a. analyze the strategies of fintechs focusing on corporate political activities in order to influence the government and the national financial system;
b. contextualize the evolution and transformation of the Brazilian economy, highlighting the growth of fintechs and the break in the moment of "quietness" of the big banks, as well as the performance of both categories in the national scenario;
c. discuss the competitive market strategies of banks and fintechs against possible future scenarios;
d. evaluate the integration of market and nonmarket strategies, acting in an integrative manner in the face of a common interest.

As requirements for the full use of the case, it is suggested: full reading; previous explanation of the core concepts of market and nonmarket strategy; previous understanding of business strategy theories; consult the number of students in class who already use fintech services and have a previous discussion about why they chose them.

With these elements, students will be able to: understand the market and nonmarket strategies used by companies in the competitive environment; besides identifying appropriate moments for the use of market and nonmarket strategies; and the integration of both. Still, as practical contributions: elaborate nonmarket strategies in their future corporate functions, and differentiate nonmarket strategies from market ones.

SUGGESTED QUESTIONS FOR DISCUSSION

The following questions can be used for the educational purpose of discussing the thematic axes, either completely or separately, according to the preference of the case applicator.

Axis 1: Fintechs and Banks Strategy questions

a. Point out the key variables, ways in which fintechs most threaten big banks and enable these startups to grow?
b. What strategies do traditional banks apply in this scenario?

c. What is the subject of the dispute between fintechs and banks with the National Financial System?

Axis 2: Corporate Political Activities (CPA) questions

a. What are the activities and/or corporate political actions that fintechs have used to gain ground in the Brazilian financial market?
b. Identify and justify an individual action and a collective action used by fintechs.
c. What challenges in dealing with the government do banks face? And the fintechs? And how both are responding to the challenges?

TEACHING CASE APPLICATION

In support of the instructor in applying the case in the classroom, two lesson plan suggestions are presented. The first, in script form, separated by the case section. Therefore, it is necessary to read the case carefully before class. If this is not possible, you can allow 20 minutes at the beginning of the session for students to read.

The lesson plan (Chart 1) is based on questions that can be used by the teacher at each time in the main sections of the case.

Chart 1 Routed Lesson Plan.

QUESTIONS	SECTION
Overview of the case, detailing its objectives and dilemma.	Abstract
In this section, it is important to address the demonstrated political and economic con-text, so that students can best situate themselves in understanding the decisions made and then positioning them on the proposed questions. 1. What is the scenario of the national financial system until the early 2000s? 2. Are there new financial players looking for space in the market? 3. Is it possible to identify a structural change in the national financial system?	Introduction
Brazilian economic context, from the inflation and basic interest rate approach. 1. What is the Central Bank's interest rate strategy currently? 2. Can you imagine a favorable scenario for the entry of a new financial actor, supported by the government and the National Financial System?	Reduction of interest rates: money available to the population
Specific approach to financial startups that are transforming the financial environment. 1. Are fintechs vying for market access with some substantial support? Which are? 2. What are the main victories for fintechs in the meaning of regulation? 3. Is support from government, regulatory agencies and SFN visible? In what way?	Fintechs in Brazil
Fintechs have penetrated quickly and effectively and there have been several formalizations for these financial startups to function. But both actors are important. 1. What is the point of the government's relationship, in parallel, with banks and fintechs? 2. What strategies should fintechs and banks take?	The changes in series

Source: Authors.

Also, an alternative lesson plan (Chart 2) is suggested, in the traditional form, which promotes a more comprehensive discussion of the case, taking into account the class profile, the number of students, among other characteristics.

Chart 2 Alternative Lesson Plan.

ESTIMATED TIME	ACTIVITY	MOBILIZED CONCEPTS
10-20min	Overview of the case, detailing the theme and main clashes.	Objectives
30-40min	Discussion about the decisions made by the con-text parties and the actors of the case, and the di-lemma present in the case.	Historical context, clash between actors and mediation of institutions.
90-120min	Two activities are suggested as a lesson plan: 1. Divide the class into two groups: a) one group is responsi-ble for responding as a represen-tative of fintechs, and b) the other group re-presents large banks. 2. More complexly, divide the class into four groups: a) those responsible for the fintechs; b) by large banks; c) by the Government; and d) society as a whole. The questions proposed in this case are presen-ted and dis-cussed, demanding an emphasis on the positioning of each already named party. At the end, we seek a predominant outcome, in which the teacher can direct to the current con-text in the country, the one at the moment of application of the case.	Market strategy Corporate Political Activities Integrated strategy
20-30min	Closing of the class with: a) reflection of the ac-tions performed; b) other possible decision making by the actors of the case; and c) likely future even-ts reflected in the observed regulations and de-cisions. Other hypotheses of decisions already made may also be suggested by the class.	Fintechs and Bank Decisions Based on Government's Goal for Economic Recovery.

Source: Authors.

RESPONSE DIRECTION FOR SUGGESTED QUESTIONS

Axis 1:

a. The global financial crisis has announced a prolonged period of transformation programs. Many fintechs are embracing this cycle. The embrace given by fintechs not only encompasses technology, but includes culture, ways of working, problem-solving, customer engagement, and new leadership ideas. These startups are putting disruption at the center of their strategy (PWC, 2017).

The strategy must be determined before choosing technology, hiring people and cultivating customers (BESANKO et al., 2012). Financial technology startups, or fintechs, have drawn attention in recent years by developing solutions to bottlenecks in traditional financial mechanisms. Advanced analytics platforms are leveraging big data taken from digital trails to drive faster credit ratings. Through digital technologies, these companies are helping to create more robust credit risk profiles and improve understanding of the complex market of micro, small and medium enterprises (MSMEs). Digital automation can streamline underwriting processes as well as organizational decision making, thereby reducing costs for financial institutions.

MSMEs are considered of strategic importance to Latin American and Caribbean (LAC) financial institutions. They can strengthen this supportive environment by reconfiguring strategies for entering new markets in LAC, taking into account not only the region's peculiarities but also the incentives and business motivations of local financial institutions. (HODER et al., 2016).

Fintechs developing innovative applications for the financial markets and many of them have been successful in independently offering numerous services traditionally provided by financial institutions. By leveraging digital technologies, fintechs find innovative ways to improve customer service, raise capital, facilitate electronic payments and analyze large amounts of data. Fintechs are more agile than traditional financial institutions, adapting faster to market needs. Most are startups, currently not yet subject to the same regulatory burden as banks. This affects traditional banks, so they need to recognize their differences from fintechs in order to develop well-informed digital strategies.

Mobile and online banking, combined with transaction lending techniques, enable continuous access to banking over long distances. Increased reliance on difficult and quantifiable information available online and through credit bureaus facilitates artificial intelligence-based decision making (JAKŠIČ; MARINČ, 2018).

b. Banks have largely opted for the segmentation of their products. Companies seeking growth through broadening their industry can better mitigate strategy risks by creating independent units, each with its own brand name and tailor-made activities.

Especially in the large dominant banks of the Brazilian scenario, there is a personal relationship network that generates greater market confidence, in addition to the multiple services offered with certain advanced technology, and human contact still matters to a significant range of customers. Some actions, such as lowering prices and launching similar platforms to compete (even cooperatives are already launching), lead to a competitive strategy, one that has to do with being different. Such actions mean deliberately choosing a different set of activities to deliver a unique value mix (PORTER, 1996).

Financial institutions seek to respond appropriately to innovations and thus empower their clients on a daily basis. Addressing customer retention in the context of the new competition will require traditional banks to focus first on developing intuitive product design, ease of use, and 24/7 accessibility. Financial institutions will also need to disrupt their own operations or processes, which will introduce cultural and mental challenges (PWC, 2017).

Competitive advantage and organizational change tend to converge due to the rapid economic and social changes arising from the evolution of organizational environments. Competitive advantage is an exceptional accident, a temporary imperfection in the functioning of the market. The firm only mechanically applies the rules of economic calculation, which is represented by the transformation of inputs into products. They are two axes: a) as a positioning attribute, external to the organization, and b) superior performance as a phenomenon due to internal characteristics. Porter uses industry as its unit of analysis, not the individual firm. The firm's position within the industrial structure is the main determinant of success or failure.

Competitive advantage is the result of the firm efficiently performing the set of activities necessary to achieve a lower cost than competitors or to generate differentiated value for buyers. The strategy thus has a role in protecting the firm from competitive forces (VASCONCELOS; CYRINO, 2000).

As competitors imitate each other's improvements in quality, cycle times, or supplier partnerships, strategies converge and competition becomes a series of races on identical tracks where there is no winner. Competitive strategy is about being different. New entrants can thrive by occupying a position that a competitor held on another occasion but has given up due to years of imitation and indecision (PORTER, 1996).

c. The dispute between the two main actors in the case is the market. And strategies are the ways in which you will achieve the desired market share.

In 1979, Michael Porter began a revolution in the field of strategy. In the following decades, Porter brought his economic rigor to the study of strategic competition as an alternative for companies.

In essence, the strategist's job is to understand that one must stay and face the competition. Often, managers define competition very narrowly, as if it were only between direct competitors. However, competition for profit goes beyond industry rivals, including four other competitive forces: customers, suppliers, potential entrants, and substitute products/services (Figure 3). Above all, in this case between fintechs and traditional banks, the dispute is due to the force of the threat of new entrants, in this scenario, the fintechs.

Figure 3 Porter's Competitive Five Forces.

Source: Porter (2008).

The threat of entry is related to entry barriers and the result of the interaction of competitors (new or not) with these barriers. Especially in this case of a dispute between fintechs and traditional banks, the associated entry barrier is restrictive government policy. Greater market monitoring and better-quality institutions are associated with higher market concentration and higher growth rates of more efficient banks. And stricter entry restrictions are associated with greater concentration and market share (GONZÁLEZ, 2009).

To open a bank, there is a need for several legal releases and licenses that must be issued. These stringent regulations by government agencies for some sectors are examples of typical entry barriers. It is different from opening a restaurant or a retail trade, some market segments, besides banks, also insurance companies and hospitals need broader supervision to protect society, which makes entering these markets more difficult.

In short, the government, through policy, can directly hinder or assist new entry, as well as amplify (or nullify) the entry barrier. According to its need, the government directly limits or even foresees a closing of entry in certain sectors, with licensing requirements and restrictions on foreign investment. Government policy can also raise other entry barriers through patent rules, which protect proprietary technology from imitation or environmental or safety standards, which increase economies of scale for newcomers (PORTER, 2008).

Strategic use of market actions can allow companies to have a significant influence on policy. Market actions, or just the threat, can be used as leverage to engage policymakers to create or repeal specific rules (FUNK; HIRSCHMAN, 2017). That said, it is reported in Axis 2 how companies protect themselves from unwanted political interference and gain access and support from political actors and institutions, and how they influence government policy or process, especially to gain market access.

Axis 2:

a. The CPA is a subfield of the nonmarket strategy that studies corporate policy actions in the regulatory environment (GETZ, 1997; BODDEWYN, 2007). It is defined by Hillman, Keim and Schuler (2004, p. 837) as "corporate attempts to shape government policy." In the political economy approach, CPA is considered essential to influence economic policies in favor of commercial interests.

The fintechs used the hiring of former politician, in the case of Gustavo Franco. As well as in the development of a new fintech, led by former Finance Minister Henrique Meirelles. Still, they used the association with class entities, through which they were organized to better articulate themselves with the regulatory bodies. In this meaning, the Brazilian Association of Fintechs (in Brazil, ABFintechs), the Brazilian Digital Credit Association (in Brazil, ABCD) were formed, and the Brazilian Equity Crowdfunding Association established on the eve of regulation of crowdfunding by the Securities and Exchange Commission in 2016. (NERY, 2016).

Historically, the regulation was seen as a barrier to entry into the banking industry. The requirements were complex, cumbersome, and difficult for new small organizations to adopt. Now the reverse is observed. Many of the traditional banks are hampered by the complex processes and governance they have created around risk and regulation, and many have also developed a significant degree of risk aversion. This environment is conducive to innovation to influence the financial services industry (PWC, 2017).

Regulators are also looking for ways to leverage new technologies and analytics to better manage systemic risk and large amounts of data (PWC, 2017). Thus, gaps open for the execution of corporate political activities. On the other hand, in addition to protecting companies from external pressure, CPA provides companies with public policy benefits and a form of political insurance that can insulate companies from negative impact, especially when there is a non-cooperative stance on the part of the government. Support comes in the form of resources and political capabilities, which result in actions taken by the government or its agencies to protect companies from unwanted external forces, thus becoming a lucrative activity that helps them "buy in" government favors and therefore reduce your need for effort to external pressures. (HADANI; DOH; SCHNEIDER, 2019).

b. **Individual:** By forming a senior management position in a company, the former politician can facilitate communication between shareholders and regulators. For the government, this link is also important because companies, for example, from regulated sectors, usually belong to key sectors in the economy. In addition, it makes the company more reliable for the market, which understands the appointment of the former politician as something positive for the organization, which will have more support from the regulatory agency.

Dorobantu, Kaul, and Zelner (2017) approve the use of this strategy by ensuring that the choice of companies by political mechanisms has the focus of influencing public power. In the study by Hambrick, Misangyi, and Park (2015), the company's political action that establishes a type of inter-organizational bond between a company and the government is when a senior management team member or board of directors begins to serve in a position. appointed or elected policy. Commonly seen surveys using politically connected advisors (BROWN, 2016a; BROWN, 2016b; KUO; YU, 2017). In contrast, former government officials or someone who has been appointed to a public agency is a research unit of Zhang, Marquis, and Qiao (2016), who corroborate that executives with attained political connections can have a better understanding and more information about the concern of the government, therefore, has an alignment of interests. Above all, the former politician has the role of facilitating the relationship between shareholders and regulators (BOUBAKRI; COSSET; SAFFAR, 2008), put more pressure on regulators to get political support (HOLBURN; VANDEN BERGH, 2008), and the government is also interested in this proximity, since there are important sectors in the national economy (BOUBAKRI; COSSET; SAFFAR, 2008). Still, Lock and Seele (2016) use, as one of the connecting variables of corporate political activity, those managers with participation in a political party. In this case, Gustavo Franco is affiliated with the Party Novo.

Coletiva: For Baron (1999), a nonmarket strategy may involve collective actions taken with market rivals, other industries or interest groups. Companies' individual nonmarket strategies (NMS) reduce the rigidity of regulation, but they are not as effective as NMS, which industry would choose if they were organized as a coalition acting on behalf of its members.

Companies that are already members of a key collective political association are more likely to have an interest in political action. This movement is stronger in less economically developed provinces (JIA, 2014).

Proactive corporate actions are like informing government decision-makers about the impact of possible legislation; actively try to reduce government regulation of the company; work alone or in trade associations to make campaign contributions or otherwise influence legislative and/or regulatory processes (HILLMAN; KEIM; SCHULER, 2004). Corporations can increase their political activities through coordination with trade associations and/or coalitions via lawyers or law firms (MACK, 1997). Trade associations generally represent a broad spectrum of industry members. These types of associations are more likely to be politically active during policy-making when their members have similar concerns about the proposed legislation (MACK, 1997; ROBERTS; DWYER; SWEENEY, 2003).

c. Banks are hoping to return to pre-crisis profitability levels, but political, social, economic, regulatory, competitive and technological challenges continue to put downward pressure on their business development.

With initial regulatory methods to stabilize the economy and banking sector performance, market participants seek to increase market penetration by finding new channels to meet customer needs for financial services, thus spawning fintechs. Precisely, the main area to apply this transformation is the retail banking business, which provides a vital economic function and has a significant impact on consumers and small and medium businesses in the country. This is directly through the provision of transactional banking, savings and loan products, and indirectly through the impact that consumers and small and medium enterprises have on the real economy (SLOBODA; DUNAS; LIMAŃSKI, 2018).

The impulse in the sector follows the improvement of the Brazilian economy, with activity recovery, inflation control and interest rates at record low levels, which stimulates the search for greater returns by investors, with the capital market offering a range of options. The Central Bank is well aware of the tragedy described here and therefore does not print money for anything. If inflation increases, the way to try to control inflation is to raise interest rates and reduce the amount of currency in circulation. There are also more "creative" ways to do this, such as tabulating or freezing prices and confiscating people's income, but they often fail, as in the case description.

As innovators seek to leverage external benefits in seeking collaboration, the pursuit of a collaborative strategy can result in irreversible changes in the systemic characteristics of the innovation process. Therefore, there may be a need for collaboration between banks. The present innovation model is effective and useful. The model not only expands knowledge in the area of financial innovation but also points to the relationship between technological complexities and the strategies used to drive innovation toward a widely used competitive market. Banks can learn the systemic lessons of fintech-based innovations as well as the dynamics of the banking sector to pursue strategies appropriate to market competition (WONGLIMPIYARAT, 2017).

On the other hand, traditional relationship banks may still have an advantage when competing with fintechs. Despite the benefits of the latter, the data is prone to manipulation. The techniques behind the data may also not correctly capture bankers' incentives. It may also lead to increased systemic risk or may disregard the ethical dimensions of lending. Strong relationships still have a competitive advantage in the banking sector. The benefits of a branch network stemming from the geographical and cultural proximity of bank customers still exist, and in lending, human bankers cannot be completely replaced by artificially intelligent computers. Traditional banks need to embrace technology, adjust to changing customer needs, and respond to regulatory demands (JAKŠIČ; MARINČ, 2018).

Finally, it is notorious that technology is radically changing the way the two actors interact with their respective customers. Offerings and relationships will become increasingly integrated with automation, digitization, smart devices, and virtual interaction. Retail banks will be forced to aggressively migrate customers to digital channels in order to compete. The bank-customer relationship will, therefore, a lot most likely be defined along with the dynamics of remote interactions, especially among younger, technology-savvy generations. In addition, the wealth of customer information will enable banks to classify and segment them, as well as observe mere biographical and financial information, including medical and even health-related financial solutions. This will allow banks to provide banking solutions that are not merely reactive but preventive - that is, open and capitalize on opportunities before competitors have access to them (COETZEE, 2018).

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