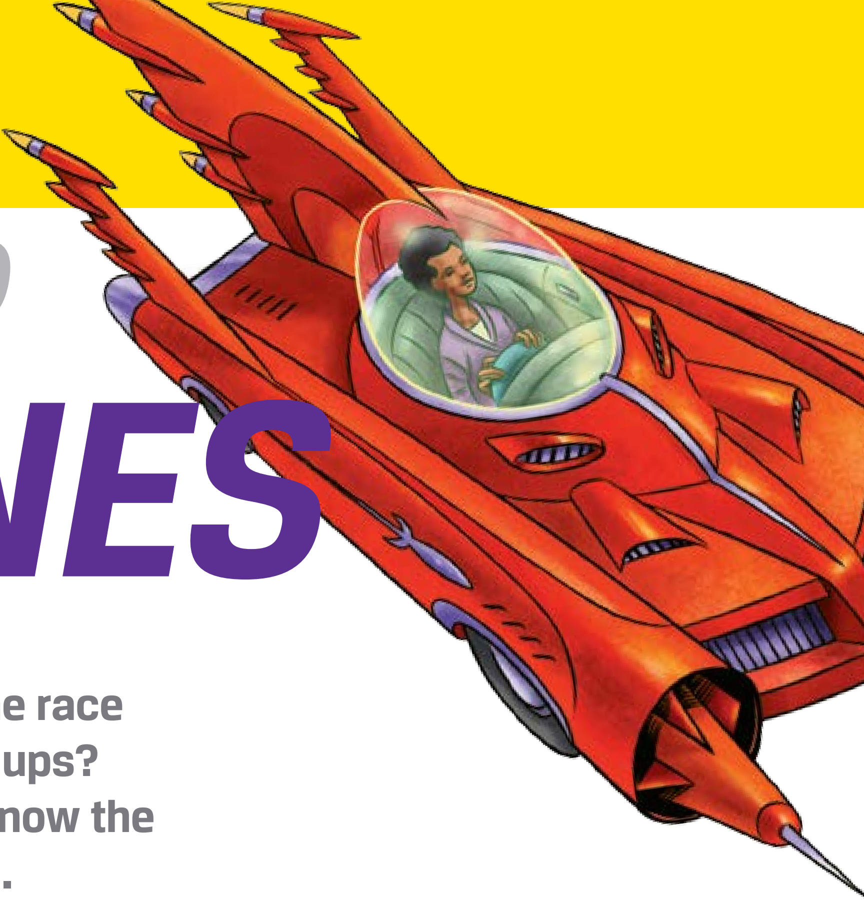
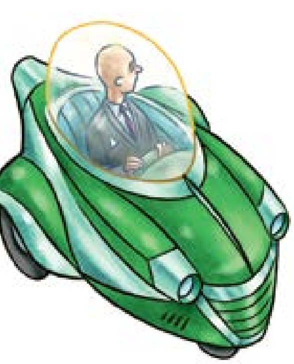
START YOUR FINGINES



Want to get in the race for fintech start-ups? Make sure you know the rules of the road.

By Cynthia Harrington

The finance industry began its long journey toward automation in 1867 with the debut of the first stock ticker, a machine that could report transaction prices over the telegraph wire. At the rapid speed of one character per second, the device soundly beat out the 30–60 seconds it took for a human to write the same information on a chalkboard or deliver a paper note with prices written on it.



Like the development of the ticker, today's fintech companies define the current era of technological disruption. As a result, many finance professionals are looking to put their skills to use working for or becoming fintech entrepreneurs.

THE FIRST STEP CAN BE THE HIGHEST

Many investment professionals may be thinking, "If you can't beat 'em, join 'em." If you are thinking about switching sectors, you need to understand the steps in the path and what additional skills might be needed before announcing your change to the world. The answers differ somewhat depending on whether you choose to start your own venture or look for a job in someone else's.

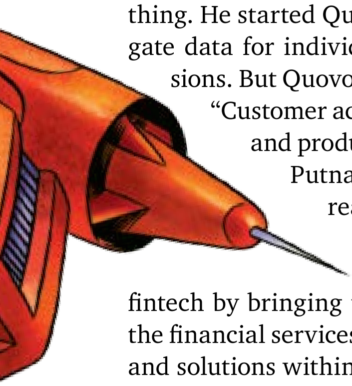
Most start-ups begin with an entrepreneur experiencing a need or pain point in the marketplace. Taking this approach, visionaries have created trading models with far more data than humans can calculate, electronic currencies that outpace slow and expensive credit cards and paper checks, and high-frequency trading systems, to name only a few examples.

Some innovators are pushed into the role of entrepreneur. Layoffs after the Global Financial Crisis of 2008 created a large pool of talent seeking new opportunities. Lowell Putnam was one of those people. Now CEO and co-founder of Quovo, a wealth management data-analytics platform, Putnam was pursuing a traditional investment banking career when the crisis hit. After four years of plying his Harvard degree in literature at Lehman Brothers, events propelled him into a tech career. "I got this amazing education in how big companies in the finance industry work—the needed personal accountability in the workplace," says Putnam. "When I took that job, it felt like the type you don't reject, and it turned out to be dramatic and volatile, not as safe as expected."

Putnam was no stranger to fintech; he had seen inside tech companies through family

Illustration by Kelly Alder

members involved in angel investing. His motivation to step away from finance was the opportunity to build something. He started Quovo in 2010 with a B2C model: aggregate data for individual investors to support better decisions. But Quovo went in a different direction early on. "Customer acquisition costs were exorbitantly high, and products in that space are sold, not bought," Putnam explains. "As the technology is the real asset, we just deployed the product in the wealth management space."



Some people find a path to fintech by bringing technical or scientific knowledge into the financial services business or by developing technology and solutions within the big-company world. Consider the example of serial fintech entrepreneur Amilcar Chavarria. He had an academic degree in biomedical engineering but also earned an MBA from the Wharton School of Business. While at Merrill Lynch earlier in his career, he focused on building the technology behind new products. After a stint at BlackRock as head of portfolio analytics, he co-founded his first of many fintech companies, robo-adviser Bucksprout. "I've been a switcher my entire career," says Chavarria. "By the time I left traditional firms, I had nerded it out on product development enough to do the front office."

Taking that first step to independence came after a process that starts with what Chavarria calls "developing a new habit." This involves allocating a time slot on a regular basis to ideas for the new business. He uses that time in a disciplined manner, starting by defining a problem he sees in the marketplace. What follows is a solution statement with features and customer needs to be addressed by the solution. With that in hand, he experiments with a marketing approach and messages to the target audience. He puts up a website and communicates via social media with potential customers to see who wants to talk about the solution. "From there, a team starts to form," says Chavarria.

Those not yet ready to start their own firm can find opportunities with fast-growth start-ups, which are hungry for talent. But choosing a position to pursue may take more than the usual effort for finance pros because the titles and job descriptions aren't going to fit traditional finance. Plus, fintech companies will have a different set of recruiters, who may not be familiar with applicants from the finance and investment world. And for smaller companies, the jobs are going to be listed on what might be unfamiliar sites, such as AngelList or venture capital or accelerator websites.

The story of Caroline O'Mahony shows how the transition can work. Now vice president of growth at tech-enabled portfolio analysis firm Addepar, she joined the company in 2013 after successfully navigating the path to a new sector. Until that point, O'Mahony's road had led her through positions of increasing responsibility at Merrill Lynch, Värde Partners, and Summit Rock Advisors. At each step, O'Mahony sought entrepreneurial outlets.

Though she was developing key skills in finding value in the capital markets, O'Mahony felt there was a bigger impact she wanted to make. She activated her networks to follow this entrepreneurial urge and was surprised to find herself speaking to founders of Addepar, which was a fast-growing fintech company. Joe Lonsdale founded the firm in 2009; Eric Poirier joined as CEO in 2013, the same year O'Mahony was introduced. "I was connected to Joe and Eric for informal discussions," says O'Mahony. "I wasn't thinking of going into tech, but when I saw the demo of the Addepar product, my eyes opened to how tech can solve the frustrations of so many."

If you love your job in traditional finance (or just love the paycheck), not to worry: There are many ways to participate in active and passive roles with dynamic fintech start-ups. One that can be started immediately is to invest your own capital in fintech. You can find opportunities to be an angel investor on AngelList.com, or you can search for individual companies by attending fintech pitch nights or conferences. You can also access deal flow by networking into the community of incubators and accelerators created to support young companies. Additionally, these incubators and accelerators establish teams of mentors to add to young entrepreneurs' know-how. Given that some fintech entrepreneurs have no finance background, a finance professional's intellectual capital could be in high demand.

VALUATION IS NOT A STRENGTH FOR A FINANCE PERSON IN A START-UP, BECAUSE RATIONALITY HAS NOTHING TO DO WITH THESE VALUATION METHODS.

MAKING THE LEAP

You've got your idea for how to make finance better through technology, you've written the business plan, and you've prepared your spouse for the chaotic times to come. What's next? You need a team around you. The quality and compatibility of your founding team will govern how fast you can grow in the early years.

Your first resource in building a team is your firm and your colleagues who work at other big firms. The number of technology staff employed in traditional firms has grown exponentially over the past decade, and some of these folks are itching to apply their talents to something they own and that can make a direct impact on millions of lives. One approach is to track down the people who developed any internally created products you think work well. That way, you'll find candidates for your founding team whose work you respect. In addition to technology skills, your founding team will need marketing skills and someone who provides the entrepreneurial drive to make things happen.

Professional networks outside of your direct field of employment are another resource. When Putnam went looking for co-founders to build out his data science for wealth management idea, he hit every event he could. He found his first team member at one such event; they had known each other in college and found they had a lot in common. "Then we needed a data expert, someone who was grabbing data for a living now," says Putnam. "We got that introduction through our lawyer when we expressed what we needed."

All these strategies can work well for your first fintech start-up. For your subsequent ones, you'll have identified and probably nurtured relationships with future co-founders. Joe Lonsdale co-founded Addepar with Jason Mirra, a software engineering intern who worked with him at Big Data analysis company Palantir Technologies. When Addepar was ready for an experienced executive, Eric Poirier left his position as director of Palantir and took on the role of CEO at Addepar.

I'M LOOKING FIRST TO INVESTORS AS A START-UP PARTNER. ... I'M LOOKING FOR PEOPLE WHO CAN OPEN DOORS.

Chavarria built his dream team for funding platform FundPaaS (which stands for "Fund Platform as a Service") from an inner circle of connections. FundPaaS is a service that helps a range of businesses raise capital for projects by turning their customers into investors. To complement Chavarria's domain experience in funding and portfolio management, Brian Castro joined as CEO. Castro is an attorney, advocate, and entrepreneur based in Washington, DC, who has held various government positions. The founding FundPaaS CTO, Pablo Rodriguez Bertorello, has been building fintech products for over 5 years and engineering successful software for over 20 years. The founding CCO, Jason Tripp, has been setting up broker–dealer relationships for a self-directed IRA provider and custodian. "Aligning incentives and the equity shares for the founding team is key to making [your way] through the many obstacles in a start-up's path," says Chavarria.

After the team is built, a prototype is created and tested with potential customers. Feedback and suggestions are built into the product as new features. If no one buys, the team pivots and aims the product at a different audience or emphasizes a different message. Once the test product is predicting some success, it is time to raise capital.

Raising investment capital to fund a start-up is radically different from raising capital to invest on behalf of clients. Whereas investing on behalf of clients often puts investment professionals in a fiduciary role, entrepreneurs seeking investors for start-ups should choose investors primarily for their ability to work with the entrepreneur to shepherd the company to success. "I'm looking first to investors as a start-up partner," says Chavarria. "I'm looking for people who can open doors and who are smart money who create syndicates of even smarter money."

"It's one thing to find someone with $2 million–$3 million in assets to manage and another thing entirely to propose investing alongside you to achieve a billion-dollar exit," he adds.

Different investors use a combination of qualitative and quantitative metrics. Common metrics include pedigree and expertise of team, market size, user acquisition milestones, potential revenue run rate, or some combination of these factors. "Size of the total opportunity is perhaps the most important projection for businesses in the start-up phase," says Putnam. "Valuation is not a strength for a finance person in a start-up, because rationality has nothing to do with these valuation methods."

Early stage companies don't have sufficient revenue or cash flow to determine a total value from which to price shares. Many creative approaches exist, and these approaches often differ from investor to investor. Still, there are some common factors. For such B2C business models as peer-to-peer lending or payments applications, the number of users who signed on to use a free version could lead to a valuation. In B2B—used for most blockchain, trading, and data analysis products—a monster market size and a believable path to capturing that market might figure in. Whatever method is used, the quality of the team often figures more prominently on investors' rankings of early stage ventures than any other factor.

Methods also differ by stage of investment. Angel investors want to invest when they can see a prototype, a market validation with successful beta tests, a team on board, and a legally organized and registered entity. Seed-stage investors want to see revenue and a key hire. Series A investors want to see metrics that prove product traction in terms of sales or users (or both); the growth rate, especially relative to comparable enterprises, is the basis for calculating the value of the whole company. The Series A is often the first funding round that actually prices shares purchased. Early rounds are funded through convertible vehicles with conversion price determined in the future; they do not establish an actual valuation of the company because there's no share price to determine.

SKILLS FOR SUCCESS IN THE NEW INDUSTRY

Many skills and honed experiences in the finance world translate directly to a fintech company. The ability to function in an unstructured environment is key to both sectors. The skills of understanding investor needs and the regulations that govern financial service are not only portable but also essential. For companies selling B2B, professionals coming from traditional finance bring experience in how to sell and how to serve clients at the enterprise level. "I sat in the clients' seat before joining Addepar, which gives me perspective on product direction as well as what the client is trying to achieve with the product," says O'Mahony. "I was able to hit the ground running, as were many who also came from the industry."

As a CFA candidate, Chavarria can speak directly to the applicability of skills, knowledge, and expertise of CFA charterholders in fintech. An analyst has the approach of solving problems, using experiments, and analyzing data to develop and prove a thesis. "Plus, every charterholder has proven the kind of persistence and hard work needed by putting in the three years of work," says Chavarria. "Pursuing a gold standard and having a passion for excellence in that way is what gives a start-up an advantage."

Putnam defines the success of his team as being based partly on the quality of their social skills, which financial professionals generally share. "We get along socially and yet have a professional chemistry that trumps any friendship," says Putnam. "Because the partnership comes first, it allows us to be objective in how we work with each other."

Professional flexibility is critical in fintech. Switchover finance professionals need to be ready and able to do a variety of jobs, ones that do not necessarily fit with their title or skillset. For example, before Putnam's team meets a prospect, they "cast" the meeting—deciding who among them will play such roles as "strong silent founder," "technical genius," and "visionary," depending on the specific needs of that prospect. "Being willing to wear different hats depending on what the meeting or the hour needs is key," Putnam says. "No roles can be set in stone."

Additionally, he and his team are constantly learning new things. Putnam even learned to code so he wouldn't need to depend on the developer to troubleshoot. Marketing is another skill he's developed that he never needed in his finance career. "In general, there's a rigidity in finance that's a real liability in tech," he explains. "People in finance have succeeded by doing one thing really well, getting promoted and paid better, and getting better and better at that one thing. That makes them single-faceted."

Learning how to operate in an environment often dominated by a technical mindset also necessitates a new way of thinking for finance professionals. An information flow that comes from customs and the business side has to be communicated and prioritized with the product and engineering team. There are cross-function dependencies to work out. The accelerated growth rate in start-ups means thinking across a lot of different goals at all times and rethinking them often. A single product must be expanded out into a line, and team members must be added or replaced depending on the demands of the new phase. "So many different types of goals hit a company as it moves into new segments, new markets, and new product lines to keep the growth trajectory," says O'Mahony.

One advantage skilled investment professionals have is the ability to analyze business opportunities. Despite all the hype, not all fintech is equal. "Resist the urge [to follow] where everyone else is running at the moment," says Putnam. "Banks are paid to talk about stuff, and that makes it hard to determine the difference between a real opportunity and what is the focus of analysts' reports."

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