PITTSBURGH
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City inching closer to fintech fame

WHILE MANY ELEMENTS ARE IN PLACE, BETTER COORDINATION IS NEEDED

Brian Shanahan, managing partner at PCG Capital, recently started Pineapple Payments, the fifth payment processing company he's launched over 25 years.

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Brian Shanahan was creating and buying "fintech" companies before anyone had coined the term.

He's operated in the sector for 25 years, mostly before the idea of using computer programs and other technology to enable banking and financial services caught fire.

Eleven years ago, when Shanahan launched his fourth company, CardConnect Corp., he was signing brick-and-mortar businesses like restaurants and coffee shops as customers.

"Fintech was in its infancy," said Shanahan, now managing partner at PCG Capital. "Things weren't integrated into people's software systems, they were standalone. You'd swipe your credit card through a reader at the register. Now software integration is the king. Those hardware boxes have been made somewhat virtual and software's been integrated into the point of sales systems, order entry systems, logistic systems. And the fintech space is so robust today, it's growing like gangbusters."

Shanahan's not alone in that thinking.

"This city is ripe to become a fintech-focused city," said Joseph Hipsky, co-founder and chief strategy officer at iraLogix LLC, a Miami-based institutional

record-keeping technology firm that targets financial institutions and advisers. It opened a Pittsburgh office last year.

SteelBridge Labs, an early stage fintech incubator that operates in both cities, serves as iraLogix's technical partner. A big reason was the recruitment potential from universities and existing companies – iraLogix is on track to have at least 30 staffers here by the end of the year.

"Historically, we haven't been a fintech town," Hipsky said. "But there's no reason why we shouldn't be."

Pittsburgh has customers, acquirers, funding – including local venture capitalists who have done deals in the sector – affordable space and at least one company that has secured capital from a major credit card company.

But the region is "just emerging" as a hub, according to Audrey Russo, president and CEO of the Pittsburgh Technology Council.

"We're more like Version 3.0," Russo said. "If you look at where fintech is strong, it's mostly London and New York and Hong Kong, where the financial markets are. We have good pathways and it's always helpful when you have potential customers in your backyard. It's interesting we haven't been on the map. But it's an area Pittsburgh hasn't been aggressive about in a meaningful way, like we've been with life sciences."

In other words, it comes down to coordination, or lack thereof. And, fintech is a very broad category.

"It's like saying, 'I like red wine,'" Hipsky said.

Blurred lines

Fintech is changing how companies, especially retailers and banks, structure payment models and customers pay for goods and services. These companies, typically described as a subset of the software sector, are technology businesses specializing in ways to deliver financial services to businesses and consumers, including crowdfunding, marketplace lending and data-driven loan decisioning. They use the internet, mobile phones and cloud computing to make banking and investing more efficient.

They also can be consumer-facing, meaning they offer digital tools to improve the way individuals borrow and manage money and finance startups, or they can be back office entities that help financial institutions streamline their operations.

But the lines are so blurred about what classifies as fintech that no one, at least at this point, can say just how many of these companies are based in Pittsburgh.

"Dozens and dozens," said Alicia McGinnis, executive director at FortyX80, the standalone nonprofit the Pittsburgh Technology Council launched two years ago to bring outside capital to local startups.

"We're starting to see more fintech companies locally and it's certainly a hot sector nationally," said Richard Lunak, CEO of Innovation Works, an investor in seed-stage companies. "How big it will get remains to be seen. Given the strength of the financial institutions in town, it's a fairly large segment of our corporate community."

What's missing, most agree, is coordination.

"Certainly, an organization that helps make connections to young companies would help us and others," Hipsky said.

McGinnis said she is talking to local foundations about providing funding so FortyX80 can create a database that young companies can register with and be filtered by industry sector.

"We need that," McGinnis said. "It's not that we need a fintech coordinator, but we do need a coordinated database so when investors visit, they can find out who's involved. We have to provide coordination and a solid focal point. IW has a piece of it, we have a piece of it, Carnegie Mellon [University] has a piece of it." FortyX80, she added, already gets inquiries about fintech from potential investors outside Pittsburgh.

"VCs would prefer to see three or four companies working in something rather than one at a time to show there's an economy of scale," she said.

Joel Adams, general partner at Sewickley-based Adams Capital Management, the region's largest VC firm, said he doesn't believe Pittsburgh could have "some important technology and systems" developments that could impact the payments area. To date, ACM has done just one local fintech deal, but it was a huge one.

Eight years ago, ACM staked Dynamics Inc., a developer of battery-powered payment cards that its founder, Jeff Mullen, started in his garage. Dynamics now occupies a 9-acre campus headquarters in Cheswick. It raised $70 million in December 2014 in a financing round led by MasterCard. They also entered into a joint commercial initiative through which MasterCard offered exclusive Dynamics products to its issuers around the world. Other investors include the Canadian Imperial Bank of Commerce and Bain Capital Ventures.

"In Jeff's case, he's building hardware, he's building cards; there are different sets of skills but there's a lot of software in the system he's building," Adams said.

But it's not just Dynamics' capital-raising prowess that's amping up Pittsburgh's credibility as a fintech sector.

"They're important because they stayed here," Hipsky said. "It helps as an anchor. Historically, we've seen a company get a big slug of money and then be moved. Dynamics adds to the technical expertise within the financial services applications. You start building on that and when you have pools of talent, you have better companies forming or getting traction more quickly. And money follows."

The ecosystem

Any city like Pittsburgh with large financial institutions can be a fintech hub, believes Jay Katarincic, managing director at Draper Triangle Ventures, a downtown-based venture capital firm that earlier this month invested in a fintech firm in Detroit.

"We have PNC with all their efforts and BNY Mellon with their Innovation Center downtown," he said.

William Demchak, chairman, CEO and president of PNC Financial Services Group Inc., has often told financial analysts that acquiring financial technology through partnerships or outright acquisition is the way to go.

One example is Zelle, Early Warning Services LLC's faster payments network for consumers and businesses, which will be directly embedded within the mobile banking channels of its network of financial institutions, PNC included.

PNC couldn't give a precise launch date, but it is expected later this year.

"It puts consumers back in our hands," Demchak said during PNC's fourth-quarter 2016 earnings call. "We don't want our customers using third-party applications in what is potentially an insecure fashion and [Zelle] solves that issue. It's not a revenue opportunity out of the gate, but it's another part of the customer relationship that makes it more sticky. I think the U.S. is behind and it's a trend you'll continue to see build. We have applications we're developing on the back of that capability that will be revenue-driven."

PNC also has been investing what Demchak described as "small dollars" in broadly defined fintech firms.

Last April, the Bank of New York Mellon Corp. debuted its Pittsburgh Innovation Center, its sixth such tech-centric facility that aims to align technology with business needs and tap into the region's universities and tech sector.

Although based in New York, BNY Mellon's largest concentration of employees is in Pittsburgh, as are all of its operational and technology units.

BNY Mellon hasn't been as specific about its fintech intentions, but its large presence and commitment of resources opens possibilities.

"Forward-looking enterprises like PNC and BNY Mellon are part of an ecosystem we need for new enterprise companies to grow," Adams said. "I think the Visas and MasterCards and Discover cards of the world have a lot of control over payment systems, and the banks have a lot of control and the interfaces of that growth is where a lot of fintech companies have developed, especially in the processing area. We don't have credit card companies here, but we do have a bunch of people and processes you can build companies around."

A recent Barlow Research study found 70 percent of small businesses would use a cash flow management tool if it were offered by their primary financial institution.

Other potential buyers or customers include investment banks and wealth advisory firms.

Capital Foundry, an investment banking firm launched last year to help underserved small and midsize companies raise capital, is using fintech to set itself apart. Five months ago, it acquired EquityNet, a New York-based business crowdfunding platform, enabling it to find a wider base of investors and solutions for clients' financing needs.

EquityNet's platform is able to standardize and streamline a lot of initial due diligence questions, so Capital Foundry can operate more efficiently and nationally.

Pineapple upside

Shanahan today is off and running with what may be his most ambitious endeavor to date: Pineapple Payments, his fifth payment processing company in 25 years. Consider it a punctuation of the growing local momentum for fintech firms.

He said he intends to invest at least $80 million – $20 million of it his – to acquire local companies and properties as he builds his new venture, aimed at the business-to-business and government markets.

"Pretty much everything I need is here," Shanahan said. "Where I have an edge is, I live in Pittsburgh, I've done private equity deals and have access to private equity firms and can make a compelling case. And I've taken a company public."

Pineapple Payments plans to grow through acquisitions as well as organically. It's a formula he used before with CardConnect, the electronic processor of credit and debit cards for merchants he founded in 2006.

CardConnect merged with FinTech Acquisition Corp. last year in a $438 million transaction, becoming public in the process. Shanahan is its largest individual shareholder and served as chairman until he stepped down to start Pineapple Payments last fall.

But not everyone has Shanahan's connections.

Bradley Roth, founder and chief compliance officer at Kattan Ferretti Financial LP, a fiduciary wealth management firm, developed its own proprietary technology to make investment decisions.

"When we started the firm in 2013, we went out and worked with software engineers to design the financial technology," he said. "A lot of financial technology is housed inside large institutions and given to the wealthiest of the wealthiest. We wanted to design something that was scalable that we could bring to the masses."

But it took time to navigate the local tech landscape to assemble the right team.

"It was serendipitous," Roth said. "We met some [partners] through different contacts and through Duquesne University, where three of us went."

A more organized fintech community would have helped Kattan Ferretti cut to the chase.

"For a company like ours, it's hard to find partners," Roth said. "We're seen as a competitor [rather] than as a means of adding more value. And we're always looking to find people in the space who are local we can work with, but it's challenging to find them with this specific focus."

There's not enough follow-through support for young fintech firms, he believes.

"You have incubators out there, there's shared space and other things, but when it comes to being a center where fintech firms stay and grow, we need to think about how to continue to support these organizations," Roth said.

Russo said a core component to building a successful fintech community is having access to industry veterans.

"You really need mentors in that space, people who have a lot of experience and understand the compliance and security issues right out of the gate," she said. "The likelihood of finding mentors here is pretty high, people who can open the Rolodex for customers, investors and talent."

Sean Sebastian, a partner at Birchmere Ventures, a venture capital firm based in the Strip District, is seeing more local fintech investment opportunities, though "none that we've found compelling yet."

For the sector to continue to evolve, he believes specialized support would be helpful.

"We've got a good base layer of support for software companies in the broadest sense between Innovation Works, AlphaLab and so forth who help them learn the basics, but more specialized support, such as 'how do I know what a financial services vertical will find interesting?' isn't available," Sebastian said. "We could be developing support specific to those types of companies so when they raise money 18 months forward, they'll know what you have to look for in an investor or what a financial services acquirer will be looking for. Those parameters will be different from, say, a life sciences company."

Meanwhile, Adams said he believes better organization would help to build awareness about Pittsburgh's fintech community and its potential.

"One thing about fintech is, it's a very large and growing market worldwide," he said. "It's to some degree a closed system that's slowly being opened up and the players in the system, from what I've seen, are much more open about new technologies and new approaches in the last five or six years, which bodes well for places like Pittsburgh."