Kevin R Jacques of Cota Capital

[00:00:04] This is the Investor Connect podcast program. I'm Hall Martin. I'm the host of the show in which we interview angel investors, venture capital, family offices, private equity, many other investors for early stage and growth companies. I hope you enjoy this episode.

[00:00:23] Well, this is investor perspectives and the host of Investor Call to Martin, where we connect startups and investors for funding.

[00:00:30] Today, we have joining us Kevin Jacques, general partner at Cota Capital. Kevin, thank you for taking time to join us. Glad to be here. All thanks for inviting me. Well, great. Well, tell us more about your work and what you do.

[00:00:43] Well, with my partner, Ben, I helped manage a relatively new early stage, fintech focused venture capital fund on a multi stage, multi asset or multi segment platform called KODE Capital. Our fund is Chota FinTech Ventures, and it is an incredibly exciting time to be investing in FinTech. My partner Ben has been doing it for over 20 years, but to steal some of Ben's language, we've never been more excited about FinTech than we are today. Lots of things going on.

[00:01:16] Well, let's talk about the growth in the fintech segment. What do you see going on there?

[00:01:20] Well, fintech broadly defined in thinking about the subsegments that we focus on in our fund, which is payments, bank tech investing, tech, ensure tech, real estate, tech and financial technology for small businesses is a there's a pretty significant part and growing part of the overall economy in the US. Those segments represent almost 20 percent of GDP and that has roughly doubled over the last 50 years. Financial services employees, over six million Americans and fintech investment has grown at north of 20 percent rates over the last 10 years. It is now pretty consistently about 15 percent of all venture capital deployed in America.

[00:02:04] Wow. And so what you see is the primary trend in this segment.

[00:02:08] Well, the exciting thing, Hall, is that we see four or five different trends converging all at once that are driving significant disruption, but also opportunities across most of the market segments. And we think very good investing opportunities for smart investors with strong domain expertise, people that understand the complexity and the regulation of the fintech ecosystem.

[00:02:31] One of those trends and really one of the more key ones is, is digital disruption. I'm sure any of us with kids notice that our kids spend an increasingly large part of their life living, it seems to be through their smartphones. And the digital disruption that's driving is affecting financial services in some ways, maybe more than other segments. In our view, that trend started as a trickle, let's say, five or six years ago, and it is kind of becoming a flood and all really kind of a funny anecdote. Six years ago when I was still leading the M&A team and into it, I remember coming out of a meeting that had been arranged by Scott Cook, who's into its founder and longtime chairman with a company that was seeking to disrupt paper checks with digital invoicing and payments. And for those of you familiar with B2B payments, digital checks are very stubbornly persistent, still account for the majority of small business payments. And when we left that meeting, one of my younger team members, a digital native, his name was Will. I think he was twenty six years old at the time, said Kevin. I'm having my hard time wrapping my head around this. The difficulty of checks and will. Why is that? And he confessed he didn't own a checkbook. In fact, at twenty six years old, he had never written a check in his life. And I remember being pretty shocked. And I said, Well, how do you pay your landlord? And he told me, Well, easy, I live in San Francisco and my landlord takes both PayPal and Venmo.

[00:04:03] But at that time they were separate companies and. I remember thinking then, will only in Silicon Valley or San Francisco would the landlord take PayPal and Venmo and be fined with no checks. But look, the change that began as a trickle is now a flood. I was looking at some Ernst and Young survey data earlier in January. And according to Ernst and Young, 75 percent of Americans have made or accept payment through a digital at almost half of us have interacted with our insurance company through a digital app. They're similar but less pronounced increases in planning and budgeting, borrowing. But it wasn't in the survey. But I know my former colleagues at that into it would share a similar message about the stunningly high percentage of people that will take on a really complex task financial task like completing your tax return through a mobile app on a digital device. The trickle is now a flood, and that shift to digital consumption of financial services has opened the door for a number of new competitors. And if you recently I looked at some data about Neil Banks and these are digital first or digital only entrance and is the middle of twenty 20. The top seven of those first wave banks had built up an impressive account pace of roughly thirty one million account holders. Significant approaching where? On an aggregate basis, the top 20 bank in America would fit in a stack today and that trend accelerating.

[00:05:37] They're capturing almost 20 percent of new accounts opened in America. Big tech platforms like Google and Apple are embedding financial services very seamlessly into their core offerings. And so those new entrants who are very good at using digital to take mindshare and market share are increasing the level of competition for our financial services dollars overall. And that leads to the second trend that increased level of competition is driving increased investment across the board over the past five or six years. Big banks have invested into technologies that enable new offerings, mostly new digital offerings, with a significantly higher rate of growth, six times the rate of growth versus their their investments into legacy and compliance technologies. And so it kohta. We're very excited about the investment opportunities and the new entrants. We're also very excited in the investment opportunities and some new technology enablers and providers that are benefiting from serving either the new banks or the big banks that have that have dramatically ramped up their rate of investment. And there's a we're seeing a first very valuable wave of fintech enablers achieve exits. Companies like Marchetta Stripe or justify money desktop and we see many more coming. I'd say a third key trend, and this is a big shift, is it? Regulators have shifted from being kind of a rate limiter for innovation and fintech to actively taking steps that are that are accelerating the rate of innovation in fintech. And 15 years ago, when I was a partner at some enterprise focused venture firms, my partners and I, we avoided fintech.

[00:07:18] And the excuse or the comment we'd often make to ourselves is, gosh, banks are terrible customers. Their procurement processes are so long, the sales cycles take forever. Much easier to sell to a typical enterprise, but that's changing. So let me highlight two new steps regulators are taking. The first is open banking. In twenty eighteen, the European Union phased in regulation called to which, among other things, mandated banks share the rich data transaction data in your banking and financial history with your consent to third parties. And if data is the fuel of an AI and machine learning powered revolution, open banking is mandating that. Providing that access and it's spreading globally, it's been happening in the United States on a de facto basis for some time. And what does this enable? What does it mean? Late last year, end of a 20 20. My wife and I refinanced our mortgage. And for me, it was stunning to compare the experience of refinancing to what the experience had been applying for a mortgage. When we first bought the house nine years ago, nine years ago, we had to download and upload months of financial statements so our lender could get the data they need to do the underwriting. I had to use an application called Work Number to verify my employment, and since it was relevant to a project I was working on at the time, I was capturing the screen flows and I think I stopped capturing when I got to twenty seven screen flows simply to provide a key to let the work number verify my lender that I had a job.

[00:08:54] Well, when we refinanced last fall, our mortgage lender used that I was able to give them my login credentials and password to our bank. They could automatically extract all that information from our bank account and gone was the cumbersome process of clicking through twenty five, not very delightful screens. Platt allows the lenders to verify employment by seeing the paychecks at your bank account. And so the onboarding and application experience is greatly streamlined for the consumer that benefits us all. But the lender also benefits. They get fresher and richer data to do their underwriting. The entire ecosystem grows in the end. One of the other key things regulators are doing is globally promoting the adoption of fintech sandboxes and I'll oversimplify a little bit here, but for those that don't know what they are, they're basically programs that allow innovative new companies or even incumbents to launch fintech products and innovations in a limited or capped manner. At the same time, they're obtaining the licensing and regulatory approval they need to eventually scale those offerings into the mass market. So we've gone from serial, obtain the license, launched the product to do it in parallel. It's reduced the time and the cost required to test and prove out that fintech innovation. And those programs are also giving banks a lot more confidence to engage at an earlier stage with enabling technology vendors that are playing by the rules and launching new offerings through the sandboxes final key trend when applied properly.

[00:10:30] A lot of these new digital offerings are increasing inclusion and also dramatically increasing the size of some of the fintech service markets, both in the United States and around the world in the United States. Depending on where we are in the economic cycle, data from the Federal Reserve would tell us that somewhere between thirty five and forty five percent of

Americans are either unbanked or under banked their households that generally live paycheck to paycheck. And sometimes these households struggle to pay bills. They're going to get paid by their employer on Friday. Or the money will hit their bank account on Friday, but they need to pay their phone bill today. And the Neil Banks that are offering embedded earned wage access, allowing you access to that money when they see it coming from your employer as opposed to when it gets into your account, and that's saving some of those households hundreds of dollars a year in late fees, paying their bills. I think the opportunity is even more dramatic globally. I've seen data from the IMF and the World Bank that suggests that there's one point one billion people that own smartphones around the world, outside the United States, but don't yet have a bank account. So the opportunity to provide new forms of digital first or digital only financial services to that population around the world is simply tremendous.

[00:11:51] So what makes for a successful company in this segment? What do you look for?

[00:11:55] Great question. Well, I think a lot of the factors are pretty consistent with things that you look for in a startup management team, in any other segment, a strong leadership team. You want a company and a team that's tackling an important problem. And the benefit or the incremental benefit provided by their solution is significant enough that customers will switch and stay with them. But then there's a couple of things, I think, in FinTech that are a little bit unique as well. One is that management team and the other investors really understanding regulation and compliance. It's very complex and fintech. It varies by segment, often by country. And so working with a management team that understands that is important to its financial services, switch to digital, I think it's very important that they've got some kind of stickiness or moat or aspect of their solution. That's very difficult to copy. If you think about it as a consumer, the more things go digital, actually, the easier it might be to switch providers down the road. So what hooks are they providing you to keep you on their platform and using their solution? Like every other segment, I think finding companies and investment opportunities that have very strong unit economics, great go to market mechanisms and a scalable path to growth is important. That's a huge focus for Chota finally within FinTech in particular.

[00:13:18] I think it's really important to have a clear understanding of the risk and risk in fintech can come from a couple different sources. One is this fraud and fraudsters in digital financial services, there's two kinds of companies, those that are being attacked by fraudsters and those that have been attacked by fraudsters and don't yet know it and are probably losing lots of money. The fact that the services are offered digitally allows hackers from around the world to attack your platform. So having some familiarity coming from payments or banking and understanding what those attacks might look like is important. That's really one of the only ways that a new company is able to prevent and mitigate that fraud. But in fintech, there's other types of risk, there's interest rate risk and underwriting risk, and let me just pick on an interest rate risk over the cycle. There's a history of Wall Street and financial investors really loving non depository lenders, companies like Lending Club and Green Sky until interest rates changed. We got to a different part of the cycle. And boy, they fell out of love with those companies faster than they fell in love with them. And so if you're investing behind business models like that, I think it's important to understand that risk, identify that risk and know where you are in the business cycle.

[00:14:30] Right. So what's your participation in this segment so far?

[00:14:33] Well, while Ben and I are old timers, I think we've got a combined 40 years of overall venture investing experience, 30 years of it in fintech and 50 prior fintech investments. KODE FinTech Ventures is relatively new. Our fund was launched in January and we are on track to hold our first closing in Q2. So today we are in advanced stages of diligence with several companies, but we haven't yet closed. Our first investment will do it on our first close. Chota overall has investments in roughly 20 fintech companies and some of those are fantastic performers and really stars in the existing portfolio. Companies like Trouville and Recertify and now recent investment Amex our money desktop. So what do you look for to invest here with this fund? Many of the things that we identified in what makes a great investment, but for for the Škoda FinTech fund, we're focusing on early stage opportunities in fintech and by early stage a little bit later than see, we want a product in the marketplace and some good early signs of customer traction. And even better, if the companies and revenue we want strong management teams, large market opportunities, as we noted, those differentiated and sticky businesses with a moat. But something that is a real key part of codas culture is to focus on the unit economics and having that scalable go to market and growth path. If you think about it, I think it's more important today where we are in the cycle that it's been in many years. So if you're investing in companies that have virtuous LTV to cash ratios, they're able to earn back the cost of customer acquisition. And under 12 months, those are pretty, potentially pretty capital efficient companies as they grow. And heaven forbid, if valuations come under pressure, I think those companies are going to have more degrees of freedom about how they continue to grow and chart a path forward even as market conditions change.

[00:16:30] Great. So what else do we know about this segment?

[00:16:33] Well, I've talked a lot probably about payments in banking tech, but we firmly believe that this thesis of digital disruption driving increased competition leading to increased investment in innovation. It's one that's playing out across all of the sectors that we're focused on. Right. So payments bank tech and sure, tech, Investec, real estate, tech and financial technology for small business, a really broad set of opportunities that we're excited about today.

[00:17:05] So what changes do you expect to see in the coming 12 months in this space?

[00:17:09] Well, I think we expect to see a continued and sustained increase in both the number and the size of the exits of the first real wave of fintech companies that are now achieving liquidity for investors. There's been some great recent IPO fintech IPOs and companies like a firm there's a very strong near-term pipeline Marchetta has just filed. I think marketers are supposed to expect it to do so very soon. Both of those were visa ventures, investments and even better for the early stage investors. We see a growing number of fintech aspects that are also going to provide an attractive liquidity option for successful and growing fintech companies in addition to to the IPO path.

[00:17:53] Right. Well, in the last few minutes that we have here, what else can we cover that we have in the hall?

[00:17:57] One question that we seem to face at every meeting right now is what do we think about crypto and blocking? Should we be investing and loading up in tokens today? And here's here's how I answer that question. Look, we are all seeing an increased amount of media coverage about Bitcoin and crypto, right? It's it's well over, I think, over fifty thousand dollars at the close today. And some of that media coverage gives evidence or points to signs of more mainstream adoption, which would be a pro. And I'd say things there like Tesla and MicroStrategy placing some of the corporate assets into Bitcoin or Visa and MasterCard opening up slightly their networks to work with more crypto ecosystem players. But at the same time, we see other headlines. And for there, I would say the very significant increase in valuation for Dogecoin since the beginning of the year. And this is a token, if you're not familiar with it, it was literally founded as a joke, those headlines. Tell us that there's still a little bit of speculative energy driving this Nakota, we're really not speculators. Our culture, our DNA is to do our homework, look at fundamentals of an investment opportunity, and then seek out long term investment opportunities.

[00:19:12] So we're less excited about specific tokens, but we're more excited, I'd say, about some of the adjacencies. And I'll cite a couple companies that might benefit from stable coins or central bank digital currencies. We think these potentially do have a bright future. One I'd cite there is Circle Jaromil. There's a new company. They make transactional tools and treasury tools for merchants and enterprise, even banks to take advantage of stable coin. How many more Fortune 500 might be adopting digital currency in addition to Tesla and MicroStrategy, if they can do it in dollars, yen and euro? Another interesting category are secure, scalable, hot, custardy solutions last week being why Melan major bank announced their intention to provide secure crypto custody services to their clients. We think many more financial institutions and banks are potentially likely to make the same choice. There are some interesting companies like Anchorage, a former visa investment Paxos or Bitcoin, that provide these very scalable, secure, hot, custardy solutions. And they stand to benefit, regardless of which token the banks seek to custardy. So those are some of the things that are exciting to us now, right?

[00:20:22] Well, how best for listeners to get back in touch with you.

[00:20:24] For people that are interested in talking about FinTech or learning more about Chota, please feel free to send me an email. My email address is Kevin at Chota Capital Dotcom.

[00:20:35] Great. I want to thank you for joining us today and sharing your perspective and experience and hope to have you back for a follow up soon.

[00:20:42] Thanks all. I've enjoyed it as well.

[00:20:44] Investor Connect helps investors interested in startup funding. In this podcast series, experienced investors share their experience and advice. You can learn more at Investor Connect, Doug.

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