

P E R S P E C T I V E

Banking Innovation: What's Same,
What's Different, in the Developed and
Developing World



YOUR INNOVATION PARTNER

If there wasn't enough focus on it already, the financial crisis has taken innovation to the top of most banks' agendas. In mature as well as emerging markets, banking institutions are differentiating their value proposition from that of their competitors by innovating upon their offerings, benefiting both customers and the organization in the process.

The pursuit of globalization and global standardization by banks has meant that innovations that originate in a particular region make their way quickly across the world, so that banking customers everywhere enjoy a similar, if not the same, usage experience.

That being said, there are many differences in the way that banks from the developed and developing worlds innovate, arising from other fundamental differences in their respective markets. The nature of these factors and their causative impact on innovation differentiation is discussed below:

- **Market Maturity**

A research report presented by The Asian Banker and Finacle from Infosys on the innovation trends and practices in Asia made an interesting observation about how banks go through successive stages of innovation – from Product to Sales to Market Share to Customer Service Innovation – depending on market maturity. Therefore, while banks in Bangladesh, Sri Lanka, Vietnam, and rural China and India, which have large unbanked segments focus on introducing basic products, their counterparts in the competitive Australian, Singapore and Hong Kong Markets are more intent on defending their market share by providing accessibility, convenience and cheaper distribution.

- **Customer Universe**

Given the high penetration of banking services amongst developed nations, a bank operating in those markets can only grow its market share at the cost of another. On the other hand, developing countries house the majority of the 2 billion-strong global unbanked population and hence have more room for growth and relatively less aggressive

competition. Here, banks can grow along with the market by bringing those without financial access into the net of basic banking services.

Although financial inclusion is a much larger priority – and opportunity for innovation – in emerging economies, it does not mean that it has no place in mature markets. In fact, the U.S. alone was estimated to have over 70 million unbanked/underbanked people in 2009. However, the nature of the problem is quite different there. Financial exclusion in the developing world is essentially on account of poor branch penetration in rural or remote areas, whereas in developed countries it is quite often, a voluntary decision or the result of inability to meet KYC norms – the Hispanic immigrants living in the United States are a classic example of this phenomenon, choosing to rely on informal networks or carriers rather than on a bank to send money home.

- **High Net Worth Segment**

In every banking market around the world, High Net Worth Individuals (HNWI) are top-drawer. Because the financial elite come in small stable numbers, (even in 2020, the U.S., which has the most HNWI, will have less than 21 million millionaire households) acquiring such customers in both developing and developed markets is usually a matter of poaching them from rival banks. Also, since the ultra-rich are the same everywhere, having similar needs, wealth managers and private bankers in both the developed and developing world follow a largely similar approach while serving these customers. A key difference however, is that the HNWI segment is growing faster in emerging markets thanks to their rising prosperity as a result of which their mass affluent are turning rich and the already rich are turning richer quicker than their mature market counterparts. This is creating more opportunities for innovation in emerging nations.

- **Telecom and Payments Infrastructure**

The well-established telecommunications and payments infrastructure of the developed world facilitates banking transactions over

multiple channels, such as the phone, ATM, POS terminal, Internet and mobile, and payments through several additional modes including cards, giros and third party payment gateways like PayPal. Unfortunately, such facilities are either missing or very poorly developed in developing countries – infrastructure for financial transactions is still in its infancy and only a limited number of payment options exist.

However, with mobile networks penetrating remote corners of the developing world that still lack basic channels of banking and communication, the mobile phone is emerging as a viable mode of payment and financial transaction. Banking innovation in many emerging economies is focusing on mobile phone-based services, albeit of a basic variety. On the other hand, in the sophisticated mobile markets of the developed world, it's the Smartphones and tablets that are taking banking innovation towards augmented reality, location-based services, contactless payments etc.

The most interesting contrast though, is that while the infrastructure of developed countries has enabled high-end innovation, it has mostly brought incremental change, whereas in the developing world, the absence of infrastructure has forced industry players to look for breakthrough, at times disruptive, solutions. The development and success of M-PESA, a mobile phone-based money transfer service in Kenya is a perfect example of the latter.

- **Customer Need**

In many emerging economies, a sizeable majority of people are first or second generation banking customers and therefore, relatively new to such services. Therefore, the product and service expectations of these customers are quite different – and dare we say, less evolved – than those of mature market customers, which has a strong bearing on innovation.

Branch banking is a classic example of this difference. Bank branches located in emerging markets are mainly concerned with processing a large number of small-ticket

transactions as efficiently as possible. They are interested in innovations that cut cost, improve productivity or ramp up scale at the branch. In contrast, branch banking is on the decline in mature markets, where customers use electronic channels to conduct routine transactions. In these markets, branches are focused on delivering financial advice and high-end services; therefore, their innovation priorities revolve around improving customer experience within the branch.

- **Legacy Burden**

In a 2010 survey of banks in Europe, Middle East and Africa presented jointly by the European Financial Marketing Association and Finacle from Infosys, nearly two out of three respondents from the mature markets of West Europe said that inflexible legacy systems posed a barrier to innovation. Indeed, this is symptomatic of the banking industries of most developed nations, which are struggling to implement new ideas, hindered by their burden of legacy. For instance, in the U.S., the legacy infrastructure supporting card transactions is so widespread that replacing it in order to switch to new robust EMV card technology is both prohibitively expensive and extremely difficult to implement. On the other hand, adopting new technology is much simpler in the developing world, which is unhindered by legacy issues. Not only that, freedom from legacy has also allowed banks in developing countries to come up with unique products that were unheard of in the rest of the world.

- **Cost of Innovation**

It is found that the cost of implementing a completely new system in the developing world is lower than that in the developed one. Often, the developed world has heavy investments in an existing technology and an inventory of infrastructure on which the return is yet to be fully realised. The developing world has no such legacy investment in infrastructure to worry about, and hence innovations are comparatively cost effective.

The tables are turned in the case of incremental innovation, which typically works around existing infrastructure or

investments – available in the developed world, but not in the developing. Therefore, in order to adopt or innovate upon something that isn't totally new, the developing world may first need to make sizeable investment in basic infrastructure.

- **Legal and Compliance Issues**

Compared to emerging economies, mature markets face tougher legal and compliance requirements that could be a constraint while innovating. The former not only have a more permissive regulatory environment, but also less harsh liability norms, making it easier for banks to experiment, and if unsuccessful, withdraw quickly without suffering too much damage. This would not be possible in a country like the U.S., for instance, where there is a high likelihood of severe public backlash should an innovation fail. It is therefore no surprise that many multinational banks including HSBC, Citibank, and Standard Chartered pilot innovations in the developing world before taking them elsewhere.

What is common?

Differences apart, the two worlds do have some things in common. Both encounter similar challenges while trying to establish a culture of innovation, namely resistance to change, misalignment between business and technology teams, and lack of unanimity of purpose. Similarly, all banks in all markets face budgetary constraints, made worse by the financial crisis.

There's another 'peculiar' commonality between developed and developing world banking innovation, which is that some ideas, particularly in the realm of payments, which are well suited to one world are quite irrelevant in the other. For instance, NFC technology, which has made a big impact in Japan – by enabling tap and go mobile payments – and is gathering momentum in many developed countries, is likely to be a slow-starter in emerging economies on account of the infrastructure that it calls for. Likewise, mobile money transfer, a super hit amongst the unbanked classes of Africa and South Asia,

may gain marginal acceptance at best in say, Western Europe or Australia. Ironically, in their respective worlds, these mobile payment innovations are happening at break-neck pace!

Conclusion

While local and cultural variations will continue to create some differences between banking innovation in different countries (even McDonalds has a separate menu for certain countries!) for at least a while, connectivity and globalization will pull in the opposite direction to spread many other innovations from one part of the world to another, sometimes in real time. Therefore, in future it is more likely that an innovation will get picked up, replicated, adapted, improved and transported much faster than before. The consolidation and standardization of systems, processes and products by global banks will further this trend of global relevance. Also, much of the developing world will evolve into a developed state, erasing many of the differences that exist today. That being said, institutions that are rooted locally will continue to practice localized innovation as a way of differentiation.

Reference:

- Innovation in Retail Banking – Asia Pacific, Presented by The Asian Banker and Finacle from Infosys, September 2010
- Innovation in Retail Banking, Presented by EFMA and Finacle from Infosys, September 2010
- The US Wealth Management Market In 2020 – Deloitte, <http://www.wealthbriefing.com/html/article.php?id=36520>
- Identifying the Unbanked Market, <http://www.idology.com/blog?p=344>

Author

Balwant C Surti

Head - Solutions Architecture and Design Group, Finacle
Infosys Limited



YOUR INNOVATION PARTNER

PERSPECTIVE

Universal Banking Solution | System Integration | Consulting | Business Process Outsourcing

Infosys Limited

Plot No. 44, Electronics City, Hosur Road, Bangalore - 560100. India
Tel.: + 91 80 28520261, Fax: + 91 80 28521747, e-mail: finacleweb@infosys.com
www.infosys.com/finacle

Join us on Twitter, LinkedIn and Finacle Whiteboard at www.infosys.com/finacle/networking.asp

*COPYRIGHT NOTICE: Copyright ©2011 Infosys Limited, Bangalore, India. ALL RIGHTS RESERVED.
Finacle logo is a registered trademark of Infosys and Infosys acknowledges the proprietary rights of the trademarks and product names of other companies mentioned in this document. Infosys believes the information in this publication is accurate as of its publication date; such information is subject to change without notice.