PERSPECTIVE

Fintech revolution in banking: Leading the way to digital

Abstract

Fintechs are mostly start-up technology and financial expertise firms, providing domain-specific products and services that are already provided by various traditional financial institutions such as banks, asset management companies, and insurance companies. Fintechs are not confined to start-ups only. A fintech is a vessel of financial technology that can be described as an emerging financial service sector of the 21st century. The term originally applied to technology correlated with the back end of established consumer and trade financial institutions.

The fintech firms have not completely suppressed the traditional banks yet, as these firms are still in the early stages of making a mark. Banks should swiftly adopt this change of growing acceptance for technology in banking by capitalizing on their existing goodwill and by applying good strategies for their betterment.

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Overview

Traditional banks

Traditional banks, for a long time, have enjoyed a monopoly in the financial market across the globe. They are licensed, highly regulated, and compliant bodies of their respective nations — well supported by the ruling national governments to shape the economy.

Banks could raise high capital with the help of government and private financial institutions to develop large infrastructure and increase their network of branches to connect with the customers to offer a wide range of products / services while creating high loyalty, trust, and goodwill. They have heavily invested in acquiring rich talent with relevant skill sets, innovation, and technology.

Globalization in the banking space

After the evolution of globalization, there has been a revolution with tremendous impact on the banking products / services space. Globalization created high competition, wider markets, large customer base, access to sophisticated technology and processes know-how, bridged geographical gaps, and opened the doors of communication for various deals.

After globalization, banks started witnessing cut-throat competition from other banks in providing the customer with a wide range of high-end technology products / services, good customer experience, a good network of bank branches, privileges, promotional services, and so on.

Technology in banking

The technology boom in developed and developing countries has slowly moved from Internet banking to mobile banking and is now taking a new direction toward digital banking. We can see a new revolution evolving with an increase in the usage of mobile gadgets, telecom, and data services at affordable rates, regulated e-commerce platforms assuring security, and the emergence of new market players with growing customer awareness and expectations.

After the technology boom, competition in the banking sector became extensive and included non-banks who provided products / services in the niche areas of banking. These non-banks could be giants in other businesses or could also be start-ups with no business presence. Many such non-banks started identifying and targeting different high-growth areas of the banking business and using their core competencies to demand a share of the banking revenue.

Banks slowly started feeling the pinch of growing customer acceptance of such non-banks or start-ups, threatening them with their competitive high-technology low-cost products / services to keep customers delighted and raise the bar of expectations.

What is fintech?

Fintech is the abbreviation of financial technology. The world of business comprises many companies that use technology as a catalyst to offer various financial services to the end users more efficiently. Normally, such companies are start-ups created to disrupt well-established financial systems and organizations that are not technology savvy or rely less on the specialization of software.

Rise of fintechs

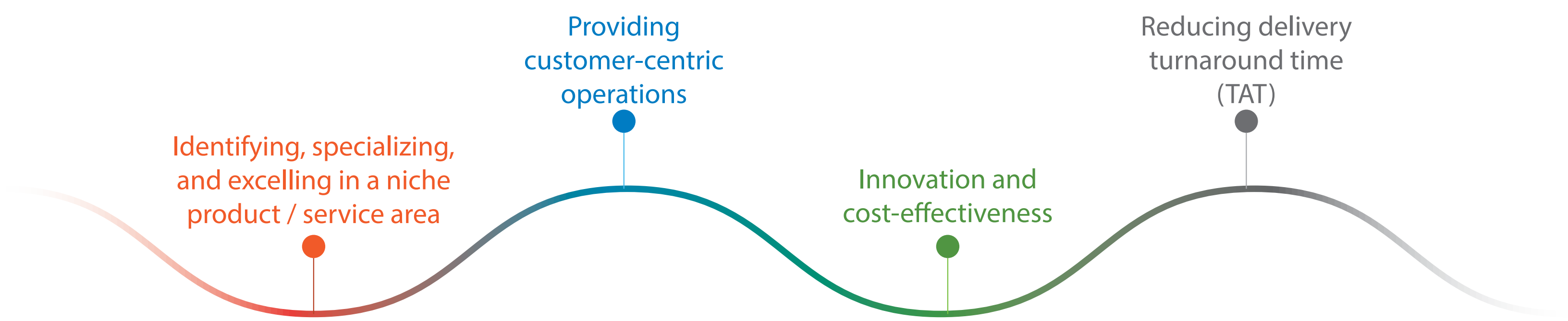
These non-banks and technology-driven start-ups gave rise to the fintech industry during 2008 and have now become the buzzwords in today's financial world.

How do fintechs work?

Fintech firms, in consideration of their market size, capital intensiveness, and market goodwill, work with the concept of creating more value for the end users in a niche area of the business. They aim to generate large business transaction volumes with a small number of transactions rather than relying only on generating a high number of transactions for a decent market share of revenue.

Fintechs believe in achieving this by providing innovative products and services through a partnership of technology-focused start-ups with specialized financial services start-ups. In this way, the targeted niche area slowly expands in coverage and market share.

The fintech firms focus on the following parameters to create more value for the end users:



Challenge ahead for fintech start-ups

The current banking and financial sector has many established players having wide experience, good business know-how, and huge capital. However, this is not the case with fintech start-ups as they are new in the business, small in size, and less capital-intensive.

The banking and financial sector is widely regulated in most countries. Fintech start-ups should plan before venturing into any new assignments, as a breach of any regulation may invariably penalize them and add to the cost of their product or service along with other financial implications. In some cases, there is a high risk of products or services getting banned due to such irregularities.

Another major challenge for fintechs is collaboration. Fintech firms, when small-sized, try to find a collaboration partner for the best outcome. The task of finding a new and right partner for every new venture is very challenging and time-consuming.

Therefore, they should seek to obtain mentorship from various acceleration programs available in the market to continue maintaining their existence without any problem.

Fintech offerings in the banking space

Fintechs in the banking and financial sector normally offer their services in the form of products, applications, business processes, and business models. The major target niche areas for fintechs in this sector are from the consumer and commercial lending and payments space.

Fintechs in the consumer and commercial lending space

One of the core businesses of banks and financial institutions is lending and borrowing money. Traditional banks and financial institutions have provided variants of products and services in this area to their customers over the last several years. The technological evolution in this space has helped the banks to customize and reintroduce some of these products and services for easy customer acceptance. However, it has always been a challenge for new start-ups, small business firms, and a select group of individuals in availing the facility of loans and collaterals granted to them.

Fintechs entered this business to provide the facility of lending and borrowing money online to both individuals and businesses. This was widely accepted by lenders, borrowers, and facilitators across the globe due to the win-win situation created in the area of lending.

Technology-focused start-up fintechs are enhancing these platforms to build innovative business models with advanced security, access, promotional features, and new customer profiling techniques.

The new business model of peer-to-peer lending from fintech firms generates revenue by connecting the lenders to borrowers and vice versa, through fees and charges from all parties of interest without any investment of funds. The acceptance of such innovative products and services is not only from customers but also from the regulators promoting them to ensure secured transactions for the lenders on such online platforms.

Fintechs in the payments space

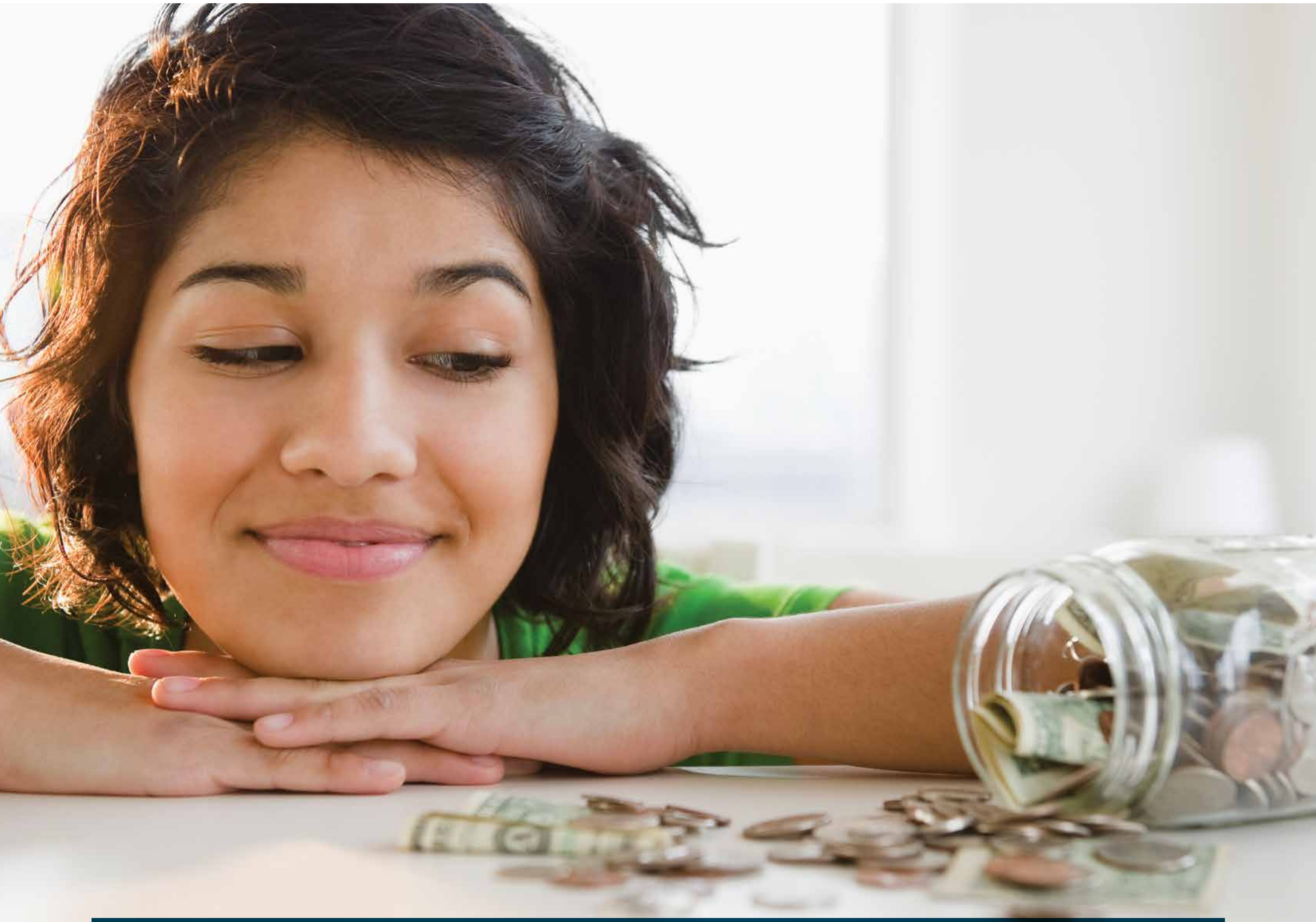
Banks and financial institutions have been enabling their customers to make numerous payment transactions using their products and services for quite some time now. After the technology boom, the area of payments was the most lucrative and disrupted, in comparison to other business areas of banks.

The disruption in payments was mostly due to the availability of advanced mobile gadgets, easy access to various data networks, and a wide range of innovative products and applications introduced in the market by fintechs to draw customer attention away from traditional banking platforms to online platforms.

These applications and products with their advanced integration capabilities allow the consumers to directly partner with merchant vendors and help in removing third-party channels to cut the associated cost for a good customer experience. Many e-wallet providers have collaborated with different industry players of different segments to capture a portion of share in such market revenue.

There were some prominent acquisitions of mobile wallet and online payment providers. The buyers mostly in such acquisitions are e-commerce giants acquiring reputed online payment providers for a good customer payment experience.

Thus, fintech start-ups are taking payments to the next level in terms of speed, convenience, efficiency, and multichannel accessibility. They are driving client behavior and fueling expectations for better, faster, and more innovative solutions across the payments spectrum, and making existing customer relationships with banks a lot more vulnerable than ever before.



Banking issues that led to the fintech revolution

It has become very important now to understand how the traditional banking system has been disrupted and has given rise to a new era of alternative finance.

The traditional banks had the following issues that led to the fintech revolution:

- **Highly regulated** and bound to many rules and compliance norms
- **High operating costs** due to a large network of branches across the globe
- Poor visualization beyond the **traditional business lines** as they are mostly publicly held companies **averting risk propositions**
- **Low involvement** of customers in the **center of operations**
- **Low investment** in value creation from **ideas, innovations, and technology**
- **Low collaboration with progressive minds** to build capabilities and competencies
- Lack of focus on individual profit-making products / services due to the **neutral approach** applied
- Difficulties in deciding changes for upgrading or replacing **legacy core banking infrastructure** built over a long period

Focus areas for banks to overcome competition from fintech firms

Banks should start realizing that, in the present scenario, simply being facilitators of commerce will not be enough to get them through. They need to equip themselves and revamp their business models in order to remain relevant to their fast-evolving and tech-savvy customer base.

- **Investment –** The banking industry, when compared to any other industry, has a large portion of their annual budget allocated to investments in technology and innovation. However, the investment objectives are mostly to resolve any pending proposals and are not targeted at digital transformation. Investments in digital transformation would bring in a fresh perspective to target customers ensuring agile operations and allowing reinvention at every stage to live with the competition.

- **Innovation –** Traditional banks did not ignore innovation in banking, but they were less focused on inculcating the practice of innovation and implementing it in real-time scenarios on a regular basis. Banks should start learning and practicing innovation in every area of banking and gradually change the existing mindset. This is possible through recruitment of the right talent with innovative minds who could help in cutting the operating and resource costs through such constant innovation strategies. In doing this, they should know why, what, and how they are innovating, and keep the digital risk platform protected with a robust growth strategy in place.

- **Customer experience –** Traditional banking customers are not fully satisfied with the existing line of products and services provided to them. They are expecting more upgraded and high-technology products and services for a good experience. Although traditional banks are leaders in providing most of the products and services, they should target the customer demand area with the help of advanced customer relationship management (CRM) tools and customize their offerings to constantly delight the customer.

- **Integrate fintech ideas –** Banks and fintechs have their own unique selling propositions, i.e., fintech sector offers innovation and disruptive technology, while banks can drive customer demand. Banks should leverage on the large customer base and loyalty built over the years. They are also financially strong, which allows them to invest in upcoming trends and ideas that fintechs and start-ups cannot imagine. Therefore, banks should make good use of these concepts and disruptive ideas from fintech and attempt to adopt them in their mode of banking. As one of the strategies, banks could integrate various fintech ideas without collaborating with fintech companies for their advantage.

- **Collaboration –** Banks should work on all the focus areas for having an edge above fintechs. However, they should collaborate with fintechs in areas where they cannot benefit by being alone. They should continue such collaboration until the time they are well equipped to manage alone. Banks should identify the areas with growth prospects and low customer value proposition areas and accordingly select the right fintech partner to fill this service gap and be market-compatible. As another strategy, banks should analyze their core strengths and weaknesses and then decide to collaborate with fintech start-ups for a win-win situation for both.

Revolutionizing conservative banking through a partnership between banks and fintechs

In the world of conservative banking, the banks, consumers, regulators, governments, and all other stakeholders support highly secured investment products and services in the market for transacting safely with decent returns. Whereas, the growth of fintechs strongly supports the need for a shift from consumer banking to digital banking.

Banks and fintechs have their own core competencies for their existence in this financial market. Fintechs or start-ups cannot exist without banks as consumers store their money and important financial information with them, that would be required by any fintech firm to service its customers. On the other hand, fintech firms have cutting-edge technology to their advantage. Therefore, a partnership between banks and fintechs would be more meaningful to usher in a revolution within the conservative banking world.

The collaboration of banks with fintechs can lead to the following fruitful results in the conservative banking world:

- Safe and secured transacting – Banks have the required financial information of the consumers in their database. They could partner with fintech firms to use their cutting-edge technology and still continue to be the transaction authenticating authority, to ensure safety and security in all transactions
- Joint investment – Banks and fintechs partnership could open up gates of joint investment in technology, innovation, and various accelerator programs targeting different areas of banking for their mutual growth.
- Wide range of products and services – Banks in partnership with fintechs can explore providing a wide range of products and services to their customers. This will attract new customers and allow banks to face the cut-throat competition in the market.
- Venture in new alternate businesses – Banks collaborating with fintechs will strengthen confidence in merchants operating in a variety of businesses and be connected under one umbrella to reap the benefits of collaborative business. Consumers will pay a lower price than earlier due to a cut down on business channels and costs associated with it.
- Transacting at ease – The bank consumers will be at an advantage to transact using the latest technology and save on transaction time, efforts, and money. Banks and fintechs will also benefit in terms of high transaction volumes with a low operating cost within a short duration of time.
- Discounts and offers – Due to a low operating cost and high transaction volumes, banks in partnership with fintechs will be in a position to provide their consumers with a variety of offers that can attract new customers and retain the existing customer base.
- Rate of return – It will be a win-win situation for banks and fintechs due to such collaboration and the rate of return on investment will mostly be higher, in the long run, considering high volumes and a low operating cost.
- Change acceptance – Banks and fintechs partnership would mean acceptance of constant changes in the financial markets with respect to investments, products / services, competition, technology, and so on. Consumers' expectations will be met upon the implementation of such changes at regular time intervals.
- Regulatory support and government incentives – Most of the governments and regulators in developed and developing countries are supporting and relaxing the regulations to promote technology in banking and financial markets. Both banks and fintechs can leverage this support and relaxation by collaborating with each other to their mutual advantage.

Summary

The banks and financial services market across the globe is going through a process of revolutionary change in technology by reducing the role of today's banks and giving institutions and individuals an opportunity to create better, faster, and cheaper services that make them an even more essential part of everyday life. The need for open innovation, collaboration, and investment in the right direction will lead traditional banks to the path of digital banking.

Banks should challenge this technological change positively by not being complacent and not just waiting for interest changes from regulators; rather they should work on the key strategies that can redefine banking in this new digital and competitive era. They should find ways and means to collaborate with fintech firms / start-ups / other market players considering all the financial and regulatory implications that will keep them ahead in the race.

References

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About the Author

Anoop Kumar Gnanmote

Senior Consultant, Domain Consulting Group (DCG), Infosys

Anoop is a Senior Consultant with the Domain Consulting Group (DCG) at Infosys. He holds an MBA degree (Distinction) in Finance and Marketing, a Bachelor of Commerce Honors degree (Distinction), and has close to 12 years of experience in the domain areas of retail consumer banking operations, AML, risk management, stock broking operations, and wealth management services.

Prior to joining Infosys, he worked with ICICI Bank Limited and Karvy Stock Broking Limited.