From fintechs to banking as a service: global trends banks cannot ignore

In 2009, in the aftermath of the financial crisis, the late Paul Volcker, former chairman of the U.S. Federal Reserve, quipped that "the only useful innovation in banking for the past 20 years" had been the ATM. He went on to call for banks to think more boldly.

If not banks themselves, soon bold fintech and techfin thinkers appeared, unleashing one of the greatest transformations since… well, the ATM! The decentralisation and quasi-democratisation of financial services, largely at the hands of legions of grassroots players, have forever changed the way money is exchanged. Digital technologies made all of this possible, of course, in the same way as they have disrupted many other industries. But there is more to this story.

This transformation has not just increased efficiency or improved customer experience. It has rewritten the rules of value creation in banking, by relentlessly innovating business models. The transformative tension on banks has just started but some clear business models trends are already shaping the global fintech scene. Let's review them and see how incumbent banks can respond.

Startups: from unbundling to re-bundling

One of the most common disruption strategies across industries is unbundling, or the breaking up of incumbents' business models to focus on one of its element only. Fintech startups epitomise unbundling. For example, while incumbent banks offer numerous services ranging from current accounts to payments and from loans to investments, fintech startups are known to launch only one service. In the U.S. Robinhood offers investment services, Wealthfront offers robo-advisory investments, Credit Karma offers credit scoring and Chime offers current accounts. The same happens elsewhere. British startups Transferwise and Iwoca offer international money transfer and SME loans respectively, China's Lufax offers peer-to-peer lending, India's Paytm and MoneyTap offer payments and loans respectively, France's PayFit offers payroll services, Germany's Bonify offers credit scoring, Italy's Satispay offers payment services and the list goes on.

This trend is now entering its second stage. After perfecting their unbundled offerings, fintechs are expanding their service range, effectively re-bundling the business model. Wealthfront now offers loans, Credit Karma now offers tax preparation services, Lufax offers wealth management and credit rating. The world fintech capitals like China, the US, and the UK are rich in examples, while continental Europe still trails behind in re-bundling. The Anglo-Saxon and the Asian approaches to re-bundling, however, seem headed in different directions.

US-UK: becoming banks

In the US and the UK, fintech startups used their initial services as a beachhead to attract customers and seem poised to become banks. Robinhood now offers checking and savings accounts, Transferwise now offers current accounts, Revolut, Acorns, MoneyLion and others are following suit. To witness how this trend has consolidated, professional services company Deloitte now offers a dedicated service to fintech companies planning to obtain a banking charter.

Asia: AI super-apps

Asian fintechs are championing a different approach, leveraging cross-sectoral customer data to establish AI-powered business models that push the traditional banking borders through platforms referred to as super-apps. For example, Ant Financial operates the payment service Alipay, the online first bank Mybank.cn, credit scoring Sesame, and B2C marketplace Zhao Can Bao. By pooling and matching the massive amounts of orthogonal data from its different financial and trading services, Ant Financial creates new AI-powered services that create enormous efficiencies and ultra-targeted customisation.

For example, it operates an automatic insurance claim system based on image recognition that lets clients file a claim by simply uploading a photo taken with their smartphone. It also improved operational efficiency in asset management by 70 per cent, while reducing costs by 50 per cent, and increasing three-fold the sums invested by returning customers. After learning that young female customers who purchase tight jeans have their smartphone screens replaced more frequently than other demographics, it explored a new screen insurance targeted at them.

China's Tencent, Singapore's Grab, India's GoJek and several other companies are pursuing similar cross-industry growth trajectories through their super-apps. Rather than financial companies, Ant Financial and the others are really AI companies creating and capturing value in financial services, among others.

Techfin: from payments to lending and beyond

While fintech refers to financial companies deploying technology to revolutionise financial services, techfin refers to tech companies offering financial services as add-ons to their existing platforms. Alibaba's Ant Financial above is an example.

The most common trajectory in this case is to start by offering payments to improve customer experience, particularly for merchants. Payments lets techfins start gathering data. Alibaba, Amazon, Apple, Baidu, Google, Tencent… are all offering payments. The second stage is to offer customised loans to merchants, which are made possible by the rich data collected through payments. For example, Alibaba's Ant Financial knows how well merchants are doing, whether their wares are competitively priced, whether their business partners are credit worthy, and leverage such information to disburse small loans in minutes. Amazon offers similar services and it is estimated that, to this day, Amazon has already issued small business loans in excess of $ 5 billion. The further benefit is that these loans are largely invested into inventory that merchants sell via Alibaba or Amazon, therefore resulting in further transaction that generate both additional revenues and data for the platform. Thanks to these synergies, techfins can offer loans at very competitive interest rates, and even subsidise them, because their main monetisation strategy is based on transaction fees.

Banks are responding

Fintechs and techfins chip away at banks' business models by leveraging their unique advantages. As largely legacy-free businesses, they are free to develop novel and customer-centric solutions. They run asset-light operations that are based on the cloud and so can be scaled on demand, and operate in a compliance-light setting (while it lasts).

This is how banks are responding:

Becoming fintechs

Until a few years ago, the consensus was that incumbents would wait and see what fintech posed an actual threat to their business, and then simply acquire them. This corporate venturing trend is now declining and is being sided by a corporate entrepreneurship trend. Large banks are launching their own fintechs. For example, Goldman Sachs launched Marcus in the US, RBS launched its own millennial-friendly mobile bank Bo in the UK, Banca Sella launched HYPE in Italy, in the UAE Emirates NBD launched its consumer digital bank Liv and is now rolling out its SME digital bank E20.

Established corporate culture, risk management, and compliance policies have historically slowed down similar initiatives. Yet, the consensus now seems to be that these are low-risk innovation testbeds that can trickle back to the main bank. For example, after perfecting rapid customer on boarding without face to face meetings in their digital initiatives, banks will bring those best practices back to their existing operations.

Banking-as-a-Service (BaaS)

Small and midcap banks lack the resources to do the same. They do have banking charters, however, which are proving a critical asset for partnering with fintechs. By offering regulated banking services to other companies they make it possible for everyone to become a fintech of sorts. For example, ride-hailing app Uber offers branded debit and credit cards, which Uber would not normally be able to issue, through Green Dot and Barclays respectively.

This latter trend overlaps with the first trend mentioned above, re-bundling. Indeed, Transferwise is not licensed to open bank accounts, but in the US it does so through a partnership with the Community Federal Savings Bank. In the UK it grants access to the Faster Payment Service through a partnership with Raphaels Bank. Even neobanks, or digitally native full-fledged banks, usually partner with chartered banks to operate. Lemonway of France, BBVA of Spain, Solarisbank of Germany, Banca Sella of Italy, Siam Commercial Bank in Thailand, Green Dot in the USA and all major banks in China attest to the global nature of this trend and show how legacy banks can respond to fintechs and in fact offer BaaS to secure access to data and fast track digital transformation.

I told you so

These global fintech trends are both the result of the 'fourth industrial revolution' and drivers for further revolutionary transformation. Technology can be integrated in every facet of life. As this happens, every facet of life is profoundly redefined. If the shape and form of financial transactions is rapidly changing, so will the very meaning of what a payment is, alongside the data attached to it. Even trust, the ultimate facilitator of financial transactions, will soon become a digital protocol, as blockchains have pioneered.

If he were to discuss financial innovation in the aftermath of the pandemic, Mr. Volcker could rightly tell banks, "I told you so." But not all is lost. Banks can still play a pivotal role in the future of finance, if they embrace the right mindset and champion a genuine digital transformation of their business models and industry practices.

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Notes:

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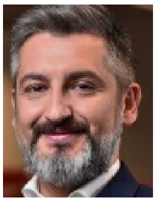

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Date originally posted: 2021-01-19

Permalink: https://blogs.lse.ac.uk/businessreview/2021/01/19/from-fintechs-to-banking-as-a-service-global-trends-banks-cannot-ignore/

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