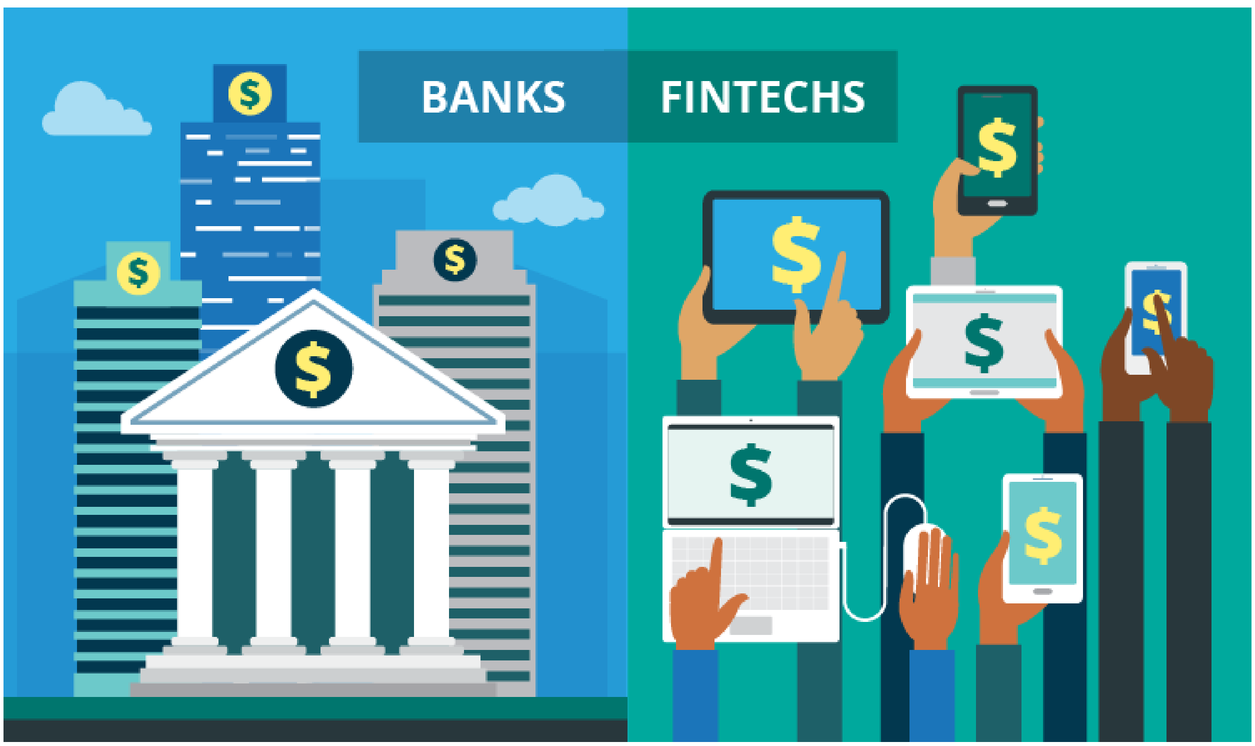
Fintechs & Banks:

Differences & Similarities
Challenges & Benefits



Team 4:

Divyansh Tomar

Sagar Mittal

Priyank Singh

Vatsal Shah

Saswata Rautray

Table of Contents

Introduction

Emerging technologies have played a significant influence in driving innovative advancements into the banking business. 4G internet and chatbots have dramatically changed the banking sector, opening the path for easy customer engagement. At the same time, as the expansion of online businesses was laying the groundwork for non-banking online-payment solutions, FinTech firms took advantage of the opportunity and created a hurdle for the monopoly of these legacy financial institutions. FinTech is now powering some of the most significant innovations in banking.

With the disruptions that FinTechs are causing in the banking sector, the major contrasts and parallels between them and traditional banks is a topic of importance. This report presents the different challenges that incumbent banks are facing as a result of the arrival of Fintech firms, and how banks may benefit from adopting FinTech.

The partnership between FinTech and banks is beneficial because banks supply ready-made infrastructure supported by industry experience, whilst FinTech businesses add innovative use cases of technology and agility. In the last few years, there has been enormous expansion in pan-India payment systems, which has also brought digital wallets to the masses. Finally, the benefits of collaboration and bundling of services is also shed light on.

Key Differences Between Banks and FinTechs

The following characteristics differentiate the new-age market entrants (Fintech firms) from the traditional banks.

Purpose:

The primary distinction between FinTech firms and traditional banks is the purpose for which they were established. Fintech solutions are developed by finding a market gap, whereas traditional institutions such as banks serve a broader audience.

Legacy banks are primarily concerned with risk management, whereas FinTech businesses are concerned with customer experience and satisfaction.

Personalisation:

In terms of personalization or improving user experience, banks are now slowly following the new market entrants - FinTech companies. Banks have typically been laggards, symbolising institutions that are sluggish to adapt and are indifferent about the convenience of their customers.

FinTech is often concerned with mobile functionality, accessibility, agility, cloud computing, and context, personalization and convenience. They respond quickly and adapt to changes in customer preferences for mobile platforms, and different forms of social media.

Communication Pattern:

The application of strong user experience techniques has been one of the key pillars of FinTech businesses. Their focus is on technologies that encourage quicker transactions, permanent access 24x7, and instant consultation, giving much more importance to their interaction with consumers.

It is one aspect where banks have been falling behind and are now slowly waking up by integrating good UX practices so that customers experience a seamless interaction. For example, banks launched interactive chat bots such as Eva by HDFC, iPal by ICICI bank.

Potential Coverage:

Fintech is mostly virtual; you don't need to be physically there to complete a transaction or use a financial service. However, banks used to have physical locations where you could open an account or apply for any other financial service. It is sometimes necessary to be physically present in order for your identification to be verified.

FinTechs' market spread is larger due to increasing adoption of mobile phones in comparison to banks' physical distribution because of their way of doing business. In India, for example, mobile phone penetration is at 80 percent, compared to a bank's distribution of 35 percent, giving FinTech an accessible edge over banks.

Key Functioning:

Banks are more concerned with processes. Their legacy systems and regulatory framework limit their ability to integrate new technology quickly. They are unable to quickly launch new products and services that satisfy customer issues.

FinTech's new-age data native firms, on the other hand, are more customer-oriented and have leaner operational structures. As a result, they are free of legacy system problems. Furthermore, FinTechs have flatter organisational structures with less constraints and bottlenecks for implementing a change. This framework fosters not just innovation, but also the ability to dismantle and rebuild non-performing structures. This enables them to utilise emerging technologies such as cloud and artificial intelligence to provide a more personalised, fast, and relevant client experience.

FinTech also simplifies complicated financial procedures, making them more accessible to the general public. Many data-native firms, such as Google, PayPal, and PhonePe, have launched niche products aimed specifically at the millennial market.

Technology Perspective:

FinTech companies depend heavily on technologies like automation, artificial intelligence, machine learning, and make use of Open APIs and SaaS based analytics solutions which majorly constitutes the *reasons for their faster rate of functioning*.

Key Similarities Between Banks and FinTechs.

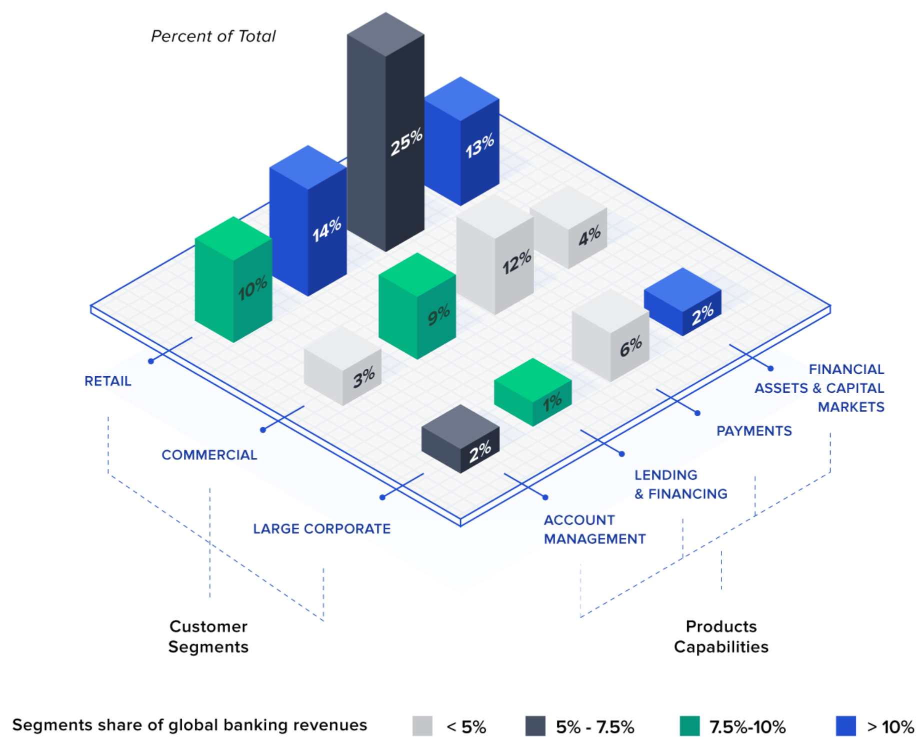
The key similarities between banks and fintechs are the following:

1. **Domain**:-
   Both, the banks and fintechs, aim at providing their customers with seamless financial experience. The banks have traditionally been bestowed with abundance of funds as people have been depositing money for centuries. These funds are thereafter used for loaning, and other services. FinTechs are enabling the faster adoption of cards, payments, and income tax filing, which fell under the area of banks who are staffed to handle them properly.
2. **Market**:-
   They largely have a similar consumer base depending on the services they offer. Since the primary need to carry or transfer funds electronically in our society was done by online banking, the user base is heavily overlapping with the digital-first gentry of people who are using FinTech apps to achieve their desired ends in the financial realm.
3. **Infrastructure and Regulation**:-
   Governance and regulation ensures that payments are conducted with safety, encryption, and transparency. Banks and FinTechs use the same base industry infrastructure (NEFT, RTGS, UPI) for transferring funds electronically.
4. **User-Centric Ecosystem of Social Schemes:-**
   Social welfare schemes like welfare cheques, insurance, public provident funds, etc. are also being operated by banks and FinTechs jointly. These provide collaboration opportunities as banks can leverage the data-native experience of FinTechs, on top of their own infrastructure.

What are the challenges faced by banks due to the arrival of FinTechs?

The challenges faced by banks due to fintechs are several fold, due to various factors such as their history, scale, competition, and the financial regulations they have dealt with, traditional banks now face increased competition from newer technology driven financial companies. It must be noted however, most of this disruption has been for the general public (retail investing) more so than corporate banking. McKinsey analysis of a sample of startup data shows that 62% of startups are tackling the retail banking segment, with only 11% focused on large corporate banking offerings.

Figure 1: Product and Customer Focus for a Sample of 350 Fintech Startups



Source: McKinsey

Digital Customers

Traditional banks are entrenched in their legacy infrastructure and have had little incentive over the years to innovate. However, due to technology disrupting other aspects of customer life, expectations for the ease of use, quality of service, and user experience have changed drastically in the last decade. With the advent of “Uberization”, users, especially younger millennials, expect customer service which is convenient, accessible and on-demand. This is where the legacy systems which banks rely on prevent them from providing the modern tech-based experiences which consumers are used to. Many traditional banks struggle to squeeze their established practices into a mobile format as trying to digitise existing processes isn’t as effective compared to a 'digital-first' approach.

Changing Infrastructure

FinTech startups build products from the ground up to operate in the cloud, this provides a myriad of benefits which are unavailable to traditional banking products. By significantly reducing CAPEX such as branches, physical equipment and legacy processes, these new entrants can operate at different margins enabling newer business models. Furthermore, by being digital only, FinTechs have flexible OPEX which can scale with their user base, reducing the risk they undertake. Through a technologic spine in their businesses, such firms have a far greater efficiency and volume at which customer acquisition takes place, one which traditional banks cannot match. Newer payment systems such as UPI have enabled instantaneous transfer of funds drastically lowering the barrier for users to move their money and further enabling the adoption of newer financial services.

Bundled Regulation

Banks have dealt with increasingly tighter regulations over time spurred by incidents such as the 2008 financial crisis. This problem is further compounded by their approach to be a one-stop shop for financial products. By having such expansive portfolios of products, banks require immense investments into ensuring compliance across the specific regulations governing each type of product. Increased regulatory oversight on banks post-2008 is estimated to cost the six largest US institutions ~$70 billion per year with Citigroup alone employing 30,000 within its compliance division.

Fintechs on the other hand have unbundled such products and focused on providing a better tech-based experience for specific products such as loans or investment options, thus reducing their costs for compliance both by reducing the diversity of their products and by reducing the burden of compliance through automation and digital technologies.

What are the benefits for banks due to the arrival of FinTechs?

According to a survey by FinExtra 95% of banks are willing to work with Fintechs. The benefits of fintech for banks go beyond increasing revenue. Some advantages to banks in collaborating with Fintechs include:

- **Innovation through Open Banking**: Exposing the APIs provided by the banks has made cross-platform payments a reality. RegTechs are able to help banks in keeping up with new regulations.

- **Building up brand reputation**: When one of the collaborating firms has a good reputation, it can extend to the other when the two operate together.

- **Offering additional functions and features to customers:** By collaborating with Fintechs, banks may give more helpful features and functions to customers that they were previously unable to provide, such as personal finance tools or mobile transactions.

- **Increased ease-of-use**: Whenever a bank collaborates closely with a fintech business, the bank can leverage the company's technological know-how and UX expertise.

- **Broadened consumer base**: Banks may increase their market share and attract previously uncontacted consumers by collaborating with Fintechs.

- **Reduced costs**: It is typically more economical for a bank to collaborate with a fintech firm to upgrade the services it provides to clients than it is to try to improve those services by itself.

Most good partnerships need some quid-pro-quo. In the case of fintech and bank collaborations, each firm generally possesses something the other needs. Banking fintech businesses frequently have excellent ideas for fantastic products or services to provide, but conventional banks provide compliance and expertise with financial legislation and rules. A few notable partnerships are:

Banking: Numerous traditional banks have partnered with neobanks, often known as challenger banks, to offer digital savings accounts to individuals and companies. Nonbanks usually provide things that regular banks do not, such as being online-only.

Debit cards: Some collaborations include the issue of debit or prepaid cards. Card programmes frequently reach those who otherwise would be unbanked or who are hesitant to create an account with a regular financial institution.

Consumer and Small business loans: This collaboration enables fintech businesses to benefit from a traditional bank's lending capabilities. Fintechs can give loans to small enterprises as well as individuals who might otherwise be denied or unable to obtain financing from a traditional bank.

References

1. “Decoding the Difference between Traditional Banks and Fintech.” *Blog CashSuvidha: Business & Financial News | Business Tips*, 14 May 2019, blog.cashsuvidha.com/decoding-difference-traditional-banks-fintech/.
2. “FinTech vs Banking: Decoding the Difference between Banks & New Market Entrants.” *Analytics India Magazine*, 19 Dec. 2018, analyticsindiamag.com/fintech-vs-banking-the-difference-between-banks-new-entrants/.
3. “How Bank and Fintech Partnerships Are Redefining the Future of Banking.” Finextra Research, Finextra, 14 Sept. 2020, www.finextra.com/blogposting/19308/how-bank-and-fintech-partnerships-are-redefining-the-future-of-banking.
4. Graham, Alex. “Fintech and Banks: How Can the Banking Industry Respond to the Threat of Disruption?” Toptal Finance Blog, Toptal, 2017, www.toptal.com/finance/investment-banking-freelancer/fintech-and-banks.