BANGOR BUSINESS SCHOOL

Partnership, competition or coopetition?

As FinTech continues to facilitate the digital transformation of financial services, Professor Jonathan Williams explores the evolving ecosystem and relationship between banks, Big Tech and FinTech.

The relationship between technology and finance is not new, but the speed and intensity at which technology is being developed and adapted into financial services are unprecedented. Many perceive FinTech as a game changer with the potential to disrupt and decentralise existing market structures by unbundling traditional financial services, revolutionising how firms create value, and leading to services being delivered in ways that will democratise the industry.

The UK boasts one of the world's leading FinTech centres, with a global market share of 10%. Statistics from the independent *Kalifa Review of UK FinTech* indicate the scale of its success: £11bn of revenue generated; investment of $4.1bn in 2020, exceeding the total of the next five European countries combined; and adoption of FinTech by UK citizens is above the global average, at 71%.

Globally, Findexable's *Global Fintech Index 2020* predicts roughly 60% of global GDP will be digitised by 2022 with growth driven at sector level by digitally-enhanced offerings, operations, and relationships. At the heart of the evolving Fourth Industrial Revolution lies a digitally-enhanced financial services sector being shaped by innovations such as distributed ledger technology, artificial intelligence, machine learning, and cloud computing.

Historical evidence indicates that banks have responded well to new technologies being introduced in the past and incorporated them into their business models, for instance, the ATM. Yet, the technological change literature attests that benefits take time to accrue let alone materialise fully. The Financial Stability Board (FSB), in its *Financial Stability Implications from FinTech* report, perceives that FinTech could facilitate significant changes in financial services due to shifts in technology, customer preferences, and financial regulation. Whereas the FSB believes the core functions of banking are unlikely to fundamentally change, FinTech supporters believe this time will be different, which implies banks could face debilitating competition from tech firms for customer relationships.

Banks enjoy special status because of their position in financial intermediation and payments. As licensed deposit-taking institutions, they access customer deposit markets and safety-net arrangements. The implicit protection inherent in deposit insurance schemes, lender-of-last-resort function, and too-big-to-fail status are sources of competitive advantage that serve to instil trust in banks and the banking system. Technically, banks issue financial claims and transform the size, maturity, and risk characteristics of liabilities as they cross the balance sheet to become assets. Impediments to transformation are called frictions and impair the efficient allocation of capital. Therefore, banks and other financial intermediaries became experts in overcoming frictions relating to information and communication. For instance, banks process large amounts of customer data to assess and manage credit risk by screening loan applicants and monitoring the behaviour of borrowers to ensure compliance with contractual terms. Historically, banks relied upon branch networks to meet customers, acquire information, and resolve communication problems.

Like banks, tech firms collect vast amounts of proprietary data, for example, from existing platforms and/or messaging services. While banks are burdened by legacy infrastructure and IT, tech firms utilise the latest technologies to their competitive advantage. Whereas both banks and tech firms claim to put customers first, Capgemini *World FinTech Report 2020* survey evidence suggests a high level of dissatisfaction exists among bank customers. The abandonment rate of UK banks hit 56% in 2018 from 40% in 2016 despite banks' increasing IT spending by 4% per annum from 2016 to 2019. In contrast, tech firms reportedly offer superior customer experience characterised as seamless, convenient, easy-to-use, and relatively cheaper.

Despite rapid growth, FinTech remains relatively small – and banks are also focused on using new technologies to enhance customer experience. The view that FinTechs are a disruptive influence threatening banks' customer relationships and market share has softened; today banks recognise that collaboration could transform their digital capabilities. Survey evidence shared in Philippon, Rice and Véron's report *Banking Disrupted? Financial Intermediation in an Era of Transformational Technology* provides insights. Market participants (banks and tech firms) accept that competition has affected the provision of banks' primary functions because technological developments have enabled improvements in service quality and fostered a greater appreciation of customer behaviour. Bank respondents suggest technology will affect existing products and services by ushering banks to prioritise digital transformation to enhance efficiency and product quality, reduce product development times, downsize branch networks, and improve risk management processes. Looking towards the medium term, the ecosystem is expected to become more diverse with banks, FinTech, and Big Tech firms competing and partnering at the same time.

Notwithstanding the rationale for partnerships, Capgemini survey evidence identifies specific anomalies which are detrimental to the success of these ventures. Citing the perspective of FinTech firms partnering with banks, the report states partnerships can suffer from differences in organisational culture best illustrated by the contrast between banks' legacy IT and complex processes and the faster pace of FinTech. Banks are perceived to operate in silos, which causes communication difficulties with FinTech partners. FinTech firms often lack funds to scale operations, which constrains commercialisation of products. Therefore, it is imperative that FinTechs identify and liaise with those people in banks who are committed to and interested in a successful partnership.

The emergence of ecosystems, comprising banks, FinTech and Big Tech also affects bilateral partnerships. Big Tech firms have created platforms for non-financial activities that facilitate exchanges between decentralised customers and producers. This could present a comparative advantage for Big Tech if they are able to penetrate financial services more aggressively than at present. Open Banking requires banks to share customer information with third parties subject to consent. Expectations see Open Banking facilitating a marketplace for financial services and enhancing competition and innovation in the financial sector.

At present, banks' comparative advantages include ownership of customer data, financial sector acumen and knowledge of bank regulations, and the loyalty and trust of customers. Yet, banks rely on Big Tech for critical services, such as cloud computing, mobile technology, and biometrics. Indeed, the IT capabilities of Big Tech counterbalance banks' financial know-how and evidence indicates that customers trust Big Tech as much as banks – if not more so. Furthermore, Open Banking could end banks' monopoly on ownership of customer data. With banks and Big Tech seemingly about to lock horns, we should note that full commitment to Open Banking will require substantial investment and that tech firms appear unwilling to cross the regulatory perimeter and apply for full banking licences.

Together these factors heighten the probability that large banks and Big Tech will strike up partnerships leaving FinTechs to capitalise on any unoccupied spaces. While it is too early to draw firm conclusions, an outcome in which either tech firms or banks emerge victoriously is unlikely. Instead, coopetition could emerge with tech firms and banks competing in some market segments while partnering in others. Time will tell. CB