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Beyond Fintech
Disruptive innovation in market infrastructure

Background

A 2017 report from Deloitte and the World Economic Forum, "Beyond Fintech: A pragmatic assessment of disruptive potential in financial services," examines disruptive innovation in financial services.

The report identifies 8 key forces impacting all aspects of financial services:

1. Cost Commoditisation
Financial institutions will accelerate the commoditisation of their cost bases, removing them as points of competition and creating new grounds for differentiation.

2. Profit Redistribution
Technology and new partnerships will enable organisations to bypass traditional value chains, thereby redistributing profit pools.

3. Experience Ownership
Power will transfer to the owner of the customer interface; pure manufacturers must therefore become hyper-scaled or hyper-focused.

4. Data Monetisation
Data will become increasingly important for differentiation, but static data sets will be enriched by flows of data from multiple sources combined and used in real time.

5. Platforms Rising
Platforms that offer the ability to engage with different financial institutions from a single channel will become the dominant model for the delivery of financial services.

6. Bionic Workforce
As the ability of machines to replicate the behaviors of humans continues to evolve, financial institutions will need to manage labor and capital as a single set of capabilities.

7. Financial Regionalisation
Diverging regulatory priorities and customer needs will lead financial services in different regions of the world down distinct paths.

8. Systemically Important Techs
Financial institutions increasingly resemble, and are dependent on, large tech firms to acquire critical infrastructure and differentiating technologies.

Market infrastructure

Trends

	Global	Australia
Where disruption has occurred?	Traditional OTC products continue to digitise prompted by regulation and the promise of improved economies of scale.	Australian authorities have not mandated platform trading obligations for OTC derivatives markets. Nonetheless, reports suggest that dealers have increased use of electronic trading, especially in fixed income markets.
	Scaling electronic trading is complicated by regulatory and political instability in various regions.	Uncertainty due to a regionally fragmented regulatory environment and political instability has been less of an issue in Australia compared to overseas. Authorities have recently emphasised competition and market innovation both federally and state wide. ASIC's regulatory sandbox and various state funding support for fintechs are examples.
	Market infrastructure providers are transforming to stay relevant and earn new revenue.	Since January 2016, the ASX has been examining the use of 'blockchain' as a potential replacement for its post-trade platform (CHESS). Initial findings suggest there are benefits. Disruption has also opened new markets. The ASX introduced its mFund Settlement Service which allows users to digitise and automate previously paper-based and manual processes 43 funds available to investors and has grown to 170 funds (CANSTAR 2017).
Where it hasn't	New market platforms give incumbents opportunities to joint venture and partner, a most successful way to grow.	Given economies of scale and scope, it is unlikely new market platforms challenge incumbents. For example, BRICKX enables investors to trade fractional exposures to real estate assets. In the last 3 months, more than 20,000 units have been transacted by BRICKX. In its first year of operations, BRICKX increased its offerings from four to 14 properties across three capital cities and has nearly 7,000 investors.

Incumbent market infrastructure providers have adopted new technologies to improve their processes and to expand their offerings. Significant scale economies and high switching costs for users have meant that the incumbents remain the key providers of market infrastructure. Nonetheless, new technology platforms have arisen in niche markets and use continues to grow. Partly, these new platforms have been able to expand access to new users, but there has been limited competitive pressure in incumbents' core markets. Any material competition in incumbents' core markets is more likely to come from their traditional rivals.

Open questions

How will incumbent providers' implementation of new technologies be received by users? Will this provide opportunities for incumbents or new providers to offer additional services or delivery of greater efficiency?

How will the 'Comprehensive Right' for consumers to access their data change the competitive dynamic in the sector?

Possible futures

Platform proliferation	New platform capabilities, including pre and post-trade processes, become more common across asset classes.	Additional platforms to facilitate trading will force incumbents to continue to improve, benefiting the buy side.
Data infrastructure collision	As infrastructure and data providers encroach on one another, customers must choose between them.	Customers may have a greater choice of partnerships – leading to lower costs – and will likely work with fewer partners.
New post-trade value chains	As incumbents improve the market infrastructure, providers consolidate and change roles.	Buy-side investors will realise considerable savings as the cost of cash flow and risk management decline.

Key takeaways

Insufficiency of technology alone

New technology will not be enough to create new market infrastructure or change existing infrastructure. As a result, "minimum viable ecosystems" of cooperating stakeholders will become critical. Leading players from both public and private spheres will try to influence these stakeholder groups.

Navigating regulatory uncertainty

Differing regulations around the world will likely lead to regionalisation and uncertainty in the short and medium terms. Financial institutions will have to quickly adapt to major regulatory changes as well as different regulatory treatments of emerging-market infrastructure technologies.

New value chain pressures and opportunities

Regulation and technological advancements are introducing efficiencies, which will force incumbents to consolidate their positions and thus shorten the value chain. Forward-looking firms will look for ways to add value, including expanding into areas that other firms currently occupy.

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