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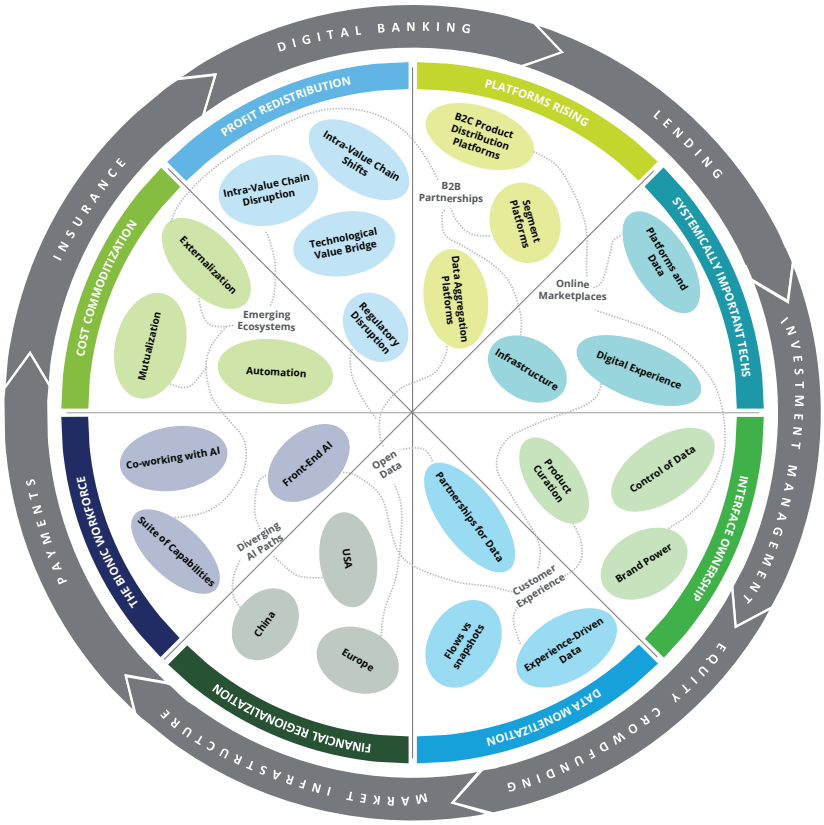
Beyond fintech:
Eight forces that are shifting the competitive landscape

Contents



Source: *Beyond fintech: A pragmatic assessment of disruptive potential in financial services*, World Economic Forum (2017).

Introduction

Dear colleagues,

In 2014, Deloitte Consulting LLP (Deloitte) partnered with the World Economic Forum (the Forum) to study disruptive innovation in financial services. At that time, the industry faced a group of challengers that promised to change the way we structure, provision, and consume financial services. The challengers formed an emerging sector known as fintechs.

This past year, we took a look at what had happened so far. Which innovations made the greatest impact? What do the effects look like? And what does it all mean for the broader financial system? Ten months, ten workshops, and over a hundred conversations later, we have some answers for you.

The first one is this: Fintech companies have not established themselves as dominant industry players. They've struggled to create new infrastructure and have failed to win over the customers of incumbent firms.

But to stop there is to understate the transformative effects fintechs have had on the industry.

In just a few short years, fintech companies have defined the direction, shape, and pace of change across almost every financial services subsector. Customers now expect seamless digital onboarding, rapid loan approvals, and free person-to-person payments—all innovations that fintechs made popular. And while they may not dominate the industry today, fintechs have succeeded as both standalone businesses and vital links in the financial services value chain.

In other words, while fintechs have yet to disrupt the competitive landscape, they've laid the foundation for future disruption.

Fintechs represent a great opportunity for smart incumbents. They provide a chance to see which new offerings show promise. The fintech ecosystem is also a veritable supermarket of capabilities, allowing incumbents to rapidly deploy new offerings via acquisitions and partnerships.

But accelerating change is a serious threat. It means that an incumbent's success is predicated on business model agility and the ability to rapidly deploy partnerships. Neither of these is a mainstay of established financial institutions. What's more, upstart firms can shop the fintech landscape too—and they face significantly lower barriers to entry.

Based on these insights, we've identified eight forces that have the potential to shift the competitive landscape of financial services:

1. Cost commoditization
2. Profit redistribution
3. Experience ownership
4. Platforms rising
5. Data monetization
6. Bionic workforce
7. Systemically important techs
8. Financial regionalization

In the pages that follow, we describe each of these forces and break down the implications for incumbents, fintechs, and regulators. We also offer supporting examples from across seven financial services sectors: payments, insurance, digital banking, lending, investment management, equity crowdfunding, and market infrastructure.

This document summarizes the World Economic Forum report, *Beyond fintech: A pragmatic assessment of disruptive potential in financial services*. If you've been following this initiative of the Forum, welcome back. If you're just joining us, consider downloading the other reports in the series:

The future of financial services: How disruptive innovations are reshaping the way financial services are structured, provisioned and consumed (2015)

The future of financial infrastructure: An ambitious look at how blockchain can reshape financial services (2016

Disruptive innovation in financial services: A blueprint for digital identity (2016)

Together, the reports represent more than three years of research into ways that fintechs can affect the financial services ecosystem. We hope they help to guide your own journey into the future of financial services.

Sincerely,

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Disruptive force #1

Cost commoditization

Operating cost is becoming less of a competitive advantage. Firms are exploring new technologies and working with other organizations—competitors and new entrants alike—to accelerate the commoditization of their cost bases so they can preserve margins and focus on more promising strategies.

One approach is to create a new utility that standardizes processes and avoids duplication of work among the companies it serves. Another is to source out an expanded range of activities (risk management is a recent example). Finally, there's automation. While financial institutions have always embraced enabling technologies, new tools have become available to streamline processes such as loan origination, audit compliance, and account reconciliation.

Between cost-sharing with peers and the use of industry-standard tools, the financial services value chain will flatten. In response, the industry will pay greater attention to partnerships and the overall ecosystem. Security and permissions will be treated independently to minimize the threat from any new external connection. Firms will also step up their protection of user data as they share more information with external organizations.

Incumbent firms have additional work to do. They'll need to find ways to differentiate their customer-facing processes as their middle and back offices become indistinguishable from those of competitors. Regulators will stay busy tracking utilities and business service providers for potential risk.

Examples

Digital banking	Banks are increasingly working in concert with regulators to set up trials of utilities focusing on mission-critical but non-core tasks such as KYC (Know Your Customer) and AML (Anti-Money Laundering).
Lending	Process improvement and middleware remain relatively expensive, causing incumbents to consider partnerships with marketplace lenders for fintech solutions that don't require a full infrastructure overhaul.
Market infrastructure	As profitability in core businesses erodes, market infrastructure providers seek new sources of revenue from their data, which requires extensive industry cooperation between different data providers.

The takeaway

Differentiation of offering. The automation and outsourcing of middle and back offices is commoditizing financial services value propositions, leading firms to create new grounds for differentiation.

Disruptive force #2

Profit redistribution

Technology is shaking up the financial services value chain. Investment firms are using exchange-traded funds (ETFs) to entice customers away from savings deposits. Online sellers are accepting payments via web applications, precluding the need for a traditional merchant bank account. Incumbent institutions are pairing with startups in ways that put them in competition with their traditional partners. And regulators are curtailing financial institutions' control over access to infrastructure. The result of all this activity? An industry-wide redistribution of profits.

Intermediaries will feel the pinch from both sides. As technology reduces the cost of bypassing them to reach the end customer, intermediaries will need to find other opportunities to profitably add value. Meanwhile, fintech companies will gain an expanding pool of potential partners that offer scale and customer reach. The challenge for regulators will be to understand how shifting fortunes are reshaping the value chain, with long-regulated companies giving ground to new ones.

Examples

Payments	Online shopping is growing quickly at the expense of in-person shopping, leading to the dominance of online, cashless solutions for transactions.
Insurance	Insurers and reinsurers increasingly partner with outside organizations (such as insurtech and large technology firms) to acquire expertise and hedge against disruption.
Investment management	Margins are declining as demand shifts to low-cost products and robo-advisors, driving incumbents to search for operational savings.
Market infrastructure	As technological improvements lower the benefit of economies of scale, operating a utility is becoming less profitable.

The takeaway

New value chain pressures. Up-and-coming technologies will encourage both incumbents and fintechs to bypass traditional value chains, creating vigorous competition for both adjacent and new areas of profit.

Disruptive force #3

Experience ownership

Traditionally, many financial institutions distribute the products they create. But with platforms and alternative channels on the rise, prudent incumbents are planning for conditions where distribution is beyond their control. Recognizing that the balance of power swings to those who own the customer experience, dedicated producers of financial offerings are weighing strategies that call for extreme scale or focus.

Current trends offer an early glimpse of this post-integrated world. Customers buy ETFs from a wide range of companies that offer robo-advisory services. They download apps from providers that stringently control which products to display. And when it comes to advisory services, retail businesses are liable to be influenced by benchmarks and recommendations from a distributor with sweeping visibility into comparable retail data.

If trends like these take hold, customers will interact with increasingly fewer distributors as the market consolidates. Large technology firms and incumbent financial institutions have the advantage, the former due to their rich customer data and the latter because of their brand and existing customer base. However, that won't stop other firms from seeking to become distributors, for their own products as well as for others. Fintechs may find niches that help them compete. And if an incumbent firm fails to establish a distributorship, it risks declining profits as its products become commodities.

The regulator's role in all this will be to guard against abuses of the market power that product distributors hold. This will be so especially for open platforms where distributors control the customer shopping experience. Another open question, one with far-reaching consequences, is how distributors and manufacturers will share liability in such an environment.

Examples

Digital banking	To lower costs, incumbent banks are eliminating in-person services and looking to fintech and large technology companies for other ways to engage customers.
Lending	Lenders are targeting non-financial platforms because they provide access to the exact moments when their customers need credit the most, such as during supply chain management or accounts receivables settlement.
Investment management	Stepped-up regulation to protect retail investors has made it more expensive to provide individualized offerings through traditional channels, making robo-advisors a compelling alternative.

The takeaway

Distributors or manufacturers. Market participants may have to choose between focusing on product distribution or product manufacturing, which will affect their business and customer interaction models as well as their competitive landscape.

Disruptive force #4

Platforms rising

Customers are demanding more choices in financial services—and, increasingly, they expect one-stop shopping. Institutions are scrambling to respond, turning to digital platforms that enable them to deliver in multiple geographies, often alongside other providers.

Eventually, these platforms will become the primary means of distributing financial products. Business and retail customers, for example, will be able to purchase credit and asset management services from an online storefront of competing vendors. Buyers and sellers in the capital markets will be matched through platforms that accommodate a wide range of trades.

This development will have several effects on the industry. For firms, product differentiation will become critical. That means putting an end to loss leaders—products will have to stand on their own—and accepting that price shoppers will favor large incumbents who enjoy product economies of scale. Meanwhile, platform owners will have to balance product manufacturer needs against customer demand. Platforms will naturally capture market data from all participants, adding to the market power of the platform owner.

All participants must address the liability of products placed on public platforms, and regulators will have to decide on the responsible party in each market.

Examples

Payments	Thanks to large technology firms, online payments are becoming less visible to the customer, with only a simple login required to enable a transaction.
Digital banking	With the introduction of PSD2 (Revised Payment Service Directive) in Europe, banks are forced to open up their data to any third party, paving the way for platforms offering core banking.
Market infrastructure	Trading platforms collect data to create an aggregated market view, aid discovery of suitable counterparties, and even support analytics that inform all participants.

The takeaway

Fewer, bigger winners. Platforms will offer customers far more choice around what they're buying, significantly increasing the advantage for the best products, which are not unconstrained by their current reach.

Disruptive force #5

Data monetization

Financial institutions know a lot about their customers. But when it comes to monetizing this knowledge—or, more precisely, the data beneath it—technology companies have the lead. The reason? They've moved beyond static datasets to combine rich, differentiated data from multiple sources and use it in real time.

The potential of this approach is not lost on the financial services industry. Facing a future where data is increasingly important, firms are starting to collect it in flows rather than in snapshots—via location data accessed through customer phones rather than transactions, for instance. Firms are also looking to expand their customer datasets. One way is to make the digital experience more engaging to customers, collecting more data in the process. Another is to team up with other companies, offering customers additional value in exchange for their data. In short, institutions are applying a combination of strategies to help them catch up to technology companies and differentiate themselves from other providers.

In the process, however, ownership and control of data will become a key issue for all stakeholders. Data security will be crucial to establishing and maintaining customer trust. New partnerships will be evaluated for the data they can provide. Incumbent institutions will have to decide whether it's worth keeping data in legacy systems as opposed to new systems where it can be easier to maintain. They may turn to fintech companies for help with the management, usage, and security of their data. As for regulators, the concerns will include not only hacking but also the ways banks use the additional data and how well customers understand the implications of sharing it.

Examples

Insurance	Consumers are demanding coverage for specific locations, uses, and timeframes, driving firms to collect additional data that can help them tailor their products.
Payments	Financial institutions are increasingly partnering with non-financial firms, including merchants and data firms, in order to unlock the value of transaction data.
Lending	Incumbent lenders are investing heavily in data transformation, automation, and new analytics to bolster their underwriting models (especially for underbanked customers).

The takeaway

Effective data usage. Data streams will be more valuable where they are granular (e.g., product-level data) and multidimensional (e.g., location data), making data cooperation and partnerships critical to successful monetization.

Disruptive force #6

Bionic workforce

Artificial intelligence (AI) isn't coming. It's already here, upending long-held notions of management as machines become increasingly able to replicate human behaviors. The result is an unfamiliar territory in which talent is both labor and capital, obliging firms to rethink what it means to have a workforce.

At the front end, AI is becoming the public face for financial institutions, similar to the devices that now dominate customer interactions with many technology firms. Internally, people are working alongside AI to boost their efforts, greatly reducing the time and personnel required to complete major projects that involve well-defined, repetitive tasks. Still undetermined is how to treat this mix of humans and AI. Are they colleagues, or a suite of capabilities?

Other developments seem clearer. Going forward, AI risk management will become an industry-wide priority. Technological improvements will likely come in waves, meaning that changes from AI will affect parts of the organization at different rates. Companies will need to manage the balance between natural and synthetic, and train their people to effectively coexist with AI.

Incumbents will have to figure out ways to communicate their culture through customer-facing AI. They'll also need to acquire AI expertise, possibly by working with fintech companies. For regulators, AI will require new strategies, including ones for enforcement and punishment of non-compliant actions.

The intersection of AI and human resources has been the subject of much discussion. But so far, the debate has raised more questions than answers. Beginning in 2017, Deloitte and the Forum will study what lies ahead for this rapidly-developing issue that stands ready to affect every sector of the financial services industry.

Examples

All sectors	The full value of AI can be unlocked only through having employees that can effectively complement the AI's strengths, which will require shifts in both hiring and training.
All sectors	Firms will be uniquely challenged to convey their differentiated values through AI.
All sectors	As AI replaces complex human activities across the front, middle, and back offices, competitive advantages derived from excellence in process execution will deteriorate.

The takeaway

Reoriented expectations. AI will remove friction from front- and back-office processes, sending people into roles that emphasize innovation, engagement, and emotional intelligence.

Disruptive force #7

Systemically important techs

So far, major technology companies have shown little interest in offering financial services. But financial institutions increasingly depend on cloud-based infrastructure and use online utilities for data storage and processing. They're also following technology companies' approach to customers—namely, to make profitable use of their data and remove the friction from their digital experience.

Sounds promising? Yes, but it's also setting the stage for a collision between the two industries. The implication is that financial services faces a balancing act: On one hand, they risk becoming dependent on large techs, but on the other they risk falling behind their competitors. To avoid either outcome, financial institutions will need to find ways to partner with technology companies without losing their core value proposition, and accept some loss of control over their costs and data. They'll also have to compete with large techs for talent, forcing them to redefine their talent model.

Fintech companies will occupy a middle ground. They can help large techs enter financial markets while providing financial institutions with technical talent. At the same time, regulators will have to figure out how to treat large techs under a traditional regulatory framework.

Examples

Insurance	Virtual assistants from large tech companies could become virtual insurance agent for households, but insurers would have to cultivate the right relationships to use those channels effectively.
Digital banking	Customers now demand the same immediate access, seamless experience, and comprehensive service and support from their mobile banking apps as they receive from other leading mobile applications, forcing banks to learn from outside the banking ecosystem.
Investment management	Customers have become used to tech firms' customer-centric offerings and level of service in non-financial settings, and expect the same of wealth management services.

The takeaway

Ecosystem imperatives. Financial institutions will forge more partnerships with one another as well as with fintech and technology companies, developing a proficiency along the way for establishing "win-win," symbiotic relationships.

Disruptive force #8

Financial regionalization

Ten years ago, when the flow of capital across borders reached its peak, financial globalization seemed unstoppable. Now the trend is going the other way, toward financial services models custom-built to local conditions. Diverging regulatory priorities, technological capabilities, and customer conditions are challenging the narrative of increasing globalization, prompting industry players to forge distinct paths in different regions of the world.

In Europe, for instance, regulations to bolster data transparency and consumer protection is driving the development of platform ecosystems and putting pressure on incumbents. In China, the popularity of mobile solutions—combined with an absence of major consumer-focused bank offerings and a largely innovation-friendly regulator—has left significant market share in the hands of large technology companies. And in the United States, unclear regulatory direction plus a mature financial services industry means that any change is likely to be incremental.

Under these conditions, regional fintech hubs could crop up, creating breeding grounds for companies with geographic-specific offerings. This might favor local players at the expense of those seeking expansion abroad. Then again, it could make it easier for multinational firms to test their ideas in one geography before adapting it to other markets. Either way, regionalization of emerging capabilities will likely force different solutions to similar problems. That's an abiding inefficiency that will be hard to ignore.

For incumbent firms, even global ones, financial regionalization will mean cultivating locally competitive advantages and integrating with local economies. Fintech companies may prove eager partners as they seek opportunities to scale and enter new markets. For their part, fintechs will be challenged to establish themselves in multiple jurisdictions, despite the potential of technology to lower barriers to entry. As large incumbents push for global convergence and their smaller rivals campaign for localized regulations, regulators will find themselves in the crosshairs.

Examples

Payments	Countries without modern payments systems have benefited greatly from mobile payment technology, leading to wider adoption in those locations than in others.
Equity crowdfunding	Jurisdictions view equity crowdfunding very differently, and thus treat its risk profile differently, hampering the ability of platforms to expand and operate internationally.
Market infrastructure	As the financial crisis fades into the past, regulatory bodies around the world are starting to revisit regulatory reforms that encouraged the growth of trading platforms.

The takeaway

Regulatory uncertainty. Financial institutions will have to develop an ability to swiftly adapt to large-scale regulatory changes as well as to regionally disparate regulatory treatment of emerging market infrastructure technologies.

Where to go from here

Is the path forward clear? By no means. But three years of turning over rocks, metaphorically speaking, revealed several overarching lessons for incumbent institutions:

- Proactively seek change. This includes finding ways to innovate and create different value, especially as intermediaries lose their customary place in the value chain. A sense of urgency must be present at the top of the organization.
- Prepare to be agile. Regulatory jurisdictions are moving apart, and technology is upending processes in both front and back offices. In some cases, the only way forward may be with a partner, requiring firms to develop skills in managing peer-to-peer business relationships.
- Choose a strategy and pursue it aggressively. Institutions may not be able to own both product manufacturing and product distribution. Rich datasets will be required to stand out either way—and there will be fewer, bigger wins.

Of course, many unknowns remain as well. Among them:

- What is the role of digital identity in financial services, and who should own it?
- How can firms extract the most revenues from their data—and at what cost?
- How will firms mitigate risk when technology races ahead of the ability to understand the consequences?
- How will the transparency of new systems affect their design, profit models, or participant roles?
- Can financial services firms use technology to solve long-running partnership and collaboration issues at the heart of the industry?

The answers to these questions will have at least as much influence as the eight forces we examined. So the journey continues. Stay with us at www.deloitte.com/fsi or contact us personally. We'll continue to check in with industry leaders, innovators, subject matter expert, and regulators—and turn over more rocks along the way.

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