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# Beyond FinTech to digital transformation

Fumio Igarashi

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Nomura Research Institute, Ltd.

**Fumio Igarashi**
*Senior Consultant*
Business Planning & Financial IT Marketing Department

## Executive Summary

*While Japan's regional financial institutions have dived deeply into FinTech over the past couple of years, some are now starting to show signs of FinTech fatigue after reaching key milestones such as API implementation. Nevertheless, financial institutions must undergo true digital transformation and better provide personalized services to capture and retain customers in the digital generation that will sustain their businesses in the future.*

### Current state of FinTech initiatives by Japanese regional financial institutions

Japanese financial institutions' current FinTech initiatives date back to the latter half of 2014. Many regional financial institutions internally formed FinTech development teams in 2015-16 and have since been gathering information on FinTech while working on a wide variety of projects, including partnering with personal budgeting software vendors and/or cloud accounting platforms for businesses, developing APIs (application program interfaces), launching robo-advisors and participating in blockchain research collaborations. Recently, some have even started to deploy artificial intelligence (AI) and robotic process automation (RPA). While megabanks and online financial institutions continue to charge full-speed ahead on the FinTech front, signs of FinTech fatigue have recently emerged among regional financial institutions of all sizes.

Even as regional financial institutions increasingly embrace FinTech, they still derive the bulk of their earnings from customers (including businesses) in pre-digital generations. They accordingly must place priority on serving such customers. Consequently, their strategies for attracting and retaining customers in the low-margin digital generation[1] are currently limited to superficial efforts such as offering apps or other digital tools.

### What European banks are doing

European financial institutions, by contrast, seem to have a sense of urgency to attract digital generation, and expanding their services for digitally savvy customers while continuing to accommodate old-school customers.

In Europe, the digital generation constitutes a low-margin market segment in

NOTE
1) The digital generation, also known as millennials or digital natives, is variously defined. As used herein, "digital generation" refers to the Internet/smartphone-using generation born since 1990.

which banks face intense competition from new entrants and, in turn, severe cost pressures. Banks' traditional in-house business development programs, human sales forces and massive IT infrastructure are costly and ill-suited to serving the digital generation. European bankers have expressed that they must discard their existing business models in favor of new ones that leverage digital technologies. With some members of the digital generation already starting to accumulate wealth, European bankers feel a sense of urgency to move forward with this digital transformation. They fear that if they do not start appealing to the digital generation right away, they might not be able to make up for lost ground later.

In financial services as in virtually all other industries, the key to winning over the digital generation is personalized service. Financial institutions unable to provide such service have little hope of succeeding with a digital generation accustomed to high-added-value services delivered in accord with their (or their businesses') individual preferences. Personalized financial services available in Europe include the following examples.

**Expanding the scope of customer analytics:** To provide personalized service, financial institutions must gather and analyze data, categorize customers into groups based on their attributes, deliver services tailored to each group and follow up on customer satisfaction. Historically, banks have aggregated data collected from different channels and identified customer attributes manually. This process is both costly and time-consuming. Many banks have therefore limited the scope of such analysis to certain subsets of customers like high net-worth individuals. With AI, banks can now analyze more data to quickly classify all of their customers into numerous groups. Banks are consequently now able iteratively develop services targeted at specific customer groups. In Spain, some banks are even rebranding themselves to target customer niches such as farmers, millennials and temporary/part-year residents.

**Treating APIs as a channel:** Nonfinancial companies are increasingly providing financial services via their own apps. Previously, financial institutions placed priority on providing financial services directly to their customers while developing custom apps either independently or collaboratively. Currently, banks are actively embracing APIs to enable customers to access financial services through popular third-party apps. Through APIs, banks can cultivate new customers and roll out new services much faster and less expensively than by developing new apps themselves. Additionally, they can identify the attributes of customers that use their services through specific third-party apps.

A UK bank has implemented an API as a key channel for providing financial products and services via intermediaries. It has set up a department that specializes in identifying potential synergies from partnering with specific companies and formulating strategies for providing services to targeted customer groups through other companies.

**Maximizing customers:** A Spanish financial institution is maintaining its branch network to serve its customers with a combination of human interaction and digital technology, the latter of which enables it to communicate personalized messages such as birthday greetings by whatever means each customer prefers, including in person, by telephone or via text message. Channels through which employees can communicate with customers include mobile tablets in addition to videophone and an online chat app. When outside of the office, bankers can carry the tablets with them to communicate with customers wherever they are, whenever the customer is available. In-branch advisors and call center staff also are thoroughly equipped with digital technologies that enable them to serve more customers and do so in a more personalized manner. Such technologies have allowed the bank to dramatically increase its ratio of customers to employees without sacrificing quality, potentially leading to increased sales productivity and lower sales costs.

The more digitally active that customers are, the more information and data that financial institutions can amass, the more their AIs will learn and the more sophisticated their AI capabilities will become. As a result, they should be able to increase their product offers' hit rates while also reducing marketing expenses.

## Beyond FinTech to digital transformation

Financial institutions have to simultaneously serve both legacy customers and the digital generation. With the former set to decrease in number while the latter grows, catering to the digital generation will become increasingly important going forward. As the population of legacy customers shrinks, financial institutions will see their businesses likewise shrink unless they actively pursue digitalization in collaboration with FinTech companies and other external partners while migrating to new lower-cost, highly productive business models. Instead of transient FinTech fads, financial institutions' management should place priority on transitioning to new business models that support financial services in the digital society of the future.

This holds true for not only major financial institutions but smaller ones also. Financial institutions with limited resources but close ties to their local communities may be better able to digitally transform themselves by proactively collaborating with other companies. In any case, financial institutions able to transform by adapting to digital society will be well positioned to prosper in the future.

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Inquiries to : Business Planning & Financial IT Marketing Department
Nomura Research Institute, Ltd.
Otemachi Financial City Grand Cube,
1-9-2 Otemachi, Chiyoda-ku, Tokyo 100-0004, Japan
E-mail : kyara@nri.co.jp

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