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Why FinTech is hot and how it will change financial services

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Executive Summary



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The daily life of the digital generation that has arisen since the turn of century is changing greatly in the wake of dramatic innovation in IT and networks. Against such a backdrop, FinTech—new IT-enabled financial services tailored to users' needs—is garnering much attention. The time has come for incumbent financial institutions to embrace FinTech.

FinTech, an amalgam of "finance" and "technology", means IT applied to finance. FinTech was originally the domain of major IT vendors that provide services to financial institutions. In recent years, however, relatively small-scale startups (including some individuals yet to formally launch a company) have been increasingly attracting attention with new FinTech service offerings.

Why FinTech is hot

Financial institutions' services have hitherto been mainly mass-market services provided by the financial institutions themselves via their branch offices or websites. However, amid the rapid proliferation of smartphones and cloud computing of recent years, chiefly among the digital generation, users are seeking convenient services that meet their personal needs, offer better user interfaces and are accessible anytime, anywhere.

Such services are available among current FinTech service offerings. They are primarily targeted at the digital generation and designed with specific user demographics in mind, unlike the mass-market services that financial institutions have traditionally favored. Many such services were developed in response to their developers' dissatisfaction with, or ideas about how to improve, existing services. One example is services that enable bank customers to do electronic funds transfers using only a social media ID instead of their bank account number. Additionally, not all such services involve cutting-edge IT. Some combine business outsourcing services to provide a lower-priced, IT-enabled alternative to services currently performed manually. Examples include services that automatically input purchases in household bookkeeping software from photographs of receipts sent by smartphone. In some

cases, services that were previously offered by financial institutions but never gained much traction have become more widely used by virtue of smartphones. A case in point is services that enable users to view their account balances at multiple financial institutions on a single screen. Usage of such services is growing through the use of user-friendly smartphone apps with top-notch graphical designs.

With many such services available as smartphone apps, previously obscure financial services are spontaneously gaining popularity. As such apps' reputations spread via social media, their usership grows further. In the wake of dramatic IT and network innovations, new services can be developed and deployed much more inexpensively than in the past, enabling even relatively small-scale startups to launch hit services.

FinTech services are diverse. The most common include payment services, services for self-employed individuals, personal finance and household bookkeeping services and security-related services. Services that were previously provided by financial institutions or rightfully should have been provided by financial institutions are increasingly being provided by small non-financial companies.

Financial institutions' relationship with FinTech

Usage of such services has grown to the point where they can no longer be dismissed by financial institutions as micro-niche services. Some financial institutions are starting to perceive the services' growth as a threat. In response to the growing prevalence of financial services provided by nonfinancial companies, an executive of a European financial institution remarked that financial institutions' presence is being diluted. The CEO of another foreign bank went as far as to say that banks must aspire to be the software companies in the future.

Major overseas financial institutions are stepping up initiatives targeted at the digital generation, which will continue to grow going forward. To migrate to digital banking models that provide services with a top-flight user-interface tailored to how individual users use the services, overseas financial institutions are all laying the groundwork to adopt new approaches to developing products and services while continuing to serve existing customers. In doing so, financial institutions are researching and embracing external ideas and experimenting with converting such ideas into services, having recognized the limitations of their in-house development staff and the costs and speed constraints of utilizing their existing IT organizations (inclusive of IT vendors). Specific initiatives include setting up specialized organizational units (e.g., innovation centers)

that research and develop services through constant collaboration with outsiders, holding events such as contests or hackathons to solicit external ideas, and providing support programs for FinTech entrepreneurs to commercialize their ideas. Some financial institutions have even acquired promising FinTech companies discovered through such initiatives. In conducting such initiatives, overseas financial institutions often utilize external companies with expertise in discovering and incubating FinTech startups.

In Japan, instances of financial institutions incorporating FinTech companies' ideas into their service offerings are extremely rare, even among financial institutions that have provided venture-capital funding to promising FinTech companies. Until recently, Japanese financial institutions have mostly acquired new technologies through major vendors, but some major banks have finally established organizational units to research and adopt new technologies. At the forefront of this trend is Bank of Tokyo-Mitsubishi UFJ (BTMU), which has long had such a specialized organizational unit and is now independently researching new technologies in the aim of developing service offerings based on innovative ideas. BTMU is holding a contest called FinTech Challenge 2015 to solicit ideas from outsiders. It is currently screening ideas submitted by the contestants.

What lies ahead for financial institutions

NRI is playing a supporting role in running FinTech Challenge 2015. Many ideas for improving financial services were entered in the contest. Having seen a considerable number of these ideas, we are strongly impressed with the breadth and vigor of Japanese FinTech. While a growing number of financial institutions are interested in the FinTech concept, most of them are still approaching FinTech with old mindsets. FinTech today is services customized to meet individual needs. Such services cannot be realized through the traditional financial-service model of delivering mass-market services by simply deploying the latest IT.

Going forward, existing laws will likely be amended to enable banks to acquire strategic equity stakes in IT companies. While taking advantage of such a tailwind, financial institutions will have to develop innovative financial service concepts by utilizing FinTech.

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