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SEIZE THE DISRUPTION

Staying relevant in this digital age

Non-traditional rivals are creating new digital challenges and opportunities for the banking establishment. Take Alibaba for example. The Chinese e-commerce conglomerate is a key challenger to banking incumbents.

After launching its B2B platform in 1999, the group has steadily developed an ecosystem of companies that now includes Alipay (an online payment and escrow service), MYBank (a new online bank focused on loans), and Yu'e Bao (personal wealth fund). Similarly, Tencent and Xiaomi have their own fintech units to offer financial services to their vast clientele.

In the age of digital disruption, many banks are applying modern digital tools, techniques and partnership strategies as they recognise the need to engage disruptive competitors to sustain their competitive advantage. Analysts concur that technology will play a more pervasive role in the banking and securities industry, with many institutions progressively investing in digital solutions and modernising back-end systems, so as to increase reliability and speed .

Yet, heavy compliance requirements, rising cybersecurity risks and anemic revenue growth are among some of the constraining realities at banks' high-margin businesses with innovative customer experience models. What can banks do to protect their profitability and growth - should they disrupt or be disrupted?

THE ONLY CONSTANT IS CHANGE

Even banks at the forefront of new developments or ideas feel outwitted by the speed and scale of disruption caused by non-traditional rivals.

Let us look again at the Alibaba example. Yu'e Bao, which was launched by Alipay in 2013, has quickly gained 554 billion (bn) yuan (US$90bn) worth in assets and become the market leader in less than a year. The scale of disruption can be gauged from the fact that today China has more peer-to-peer lenders than the U.S. and the UK.

These disruptors are beginning to impact the stronghold of traditional

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banks, including personal and small business lending, wealth management, mortgage banking, commercial real estate and student loans. Furthermore, these upstarts are not constrained by regulatory restrictions that banks face domestically and internally. Hence, they are able to pursue opportunities in crowdfunding, peer-to-peer (P2P) lending, robo-adviser investment services, as well as payment network disintermediation, among others.

Some disruptors will be flashes in the pan, while there will be others that will gain critical mass and truly threaten meaningful portions of the banking and financial services industry. In the immediate future, the forces of disruption will introduce looming challenges for banks, especially when considered in the context of the current regulatory environment. However, in the long run, these two factors - disruptive competitors and increasing regulations - may very well converge in ways that create new opportunities for banks.

DISRUPT OR BE DISRUPTED

Over time, the incursions of disruptors into banking markets could reach a critical mass that exposes them to the crosshairs of regulators. This is the critical juncture where disruptors will discover the complexity of banking.

It is imperative for institutions to have a strong balance sheet, the expertise and resources to operate within a regulatory compliance framework. These know-hows are designed to protect the money and wealth of consumers, as well as the well-being of the economy.

When it comes to entrusting one's life savings to an institution, banks cannot be supplanted as rapidly as how Netflix displaced Blockbuster. The larger the share of loans that P2P lending platforms capture, the likelier it is that regulators will promptly descend.

Unlike the western economies, there is a huge mass of unbanked population and numerous small businesses, who have very little access to bank credit. The online or mobile channel is the best way to engage and provide cost-effective banking solutions to the under-banked.

STAY IN THE GAME

Before regulators disrupt the disruptors, banks can take the following steps to capitalise on the inevitable changes in the financial landscape.

1. Acknowledge that disruption is fundamental. Even if it does not appear to be a direct threat to everything that the bank does, it has the ability to erode higher-margin business.
2. Start initiating some of the disruptors' concepts into your business model and service offerings, even if they cannot be exactly replicated. Then, explore whether to compete head-on with disruptors to protect high-margin business, or to find ways to collaborate with them. For example, bankers can take steps to explore investment opportunities in financial technologies, such as Westpac's VC fund investing AUD$5 million in Australia's first active peer-to-peer lending platform, SocietyOne.
3. Offer value to the disruptors. To help upstarts scale their offerings, banks can construct value clusters based on their core platforms, disclosing APIs, as well as providing resources. By leveraging their strengths, banks are able to protect their client base and simultaneously furnish an ecosystem for innovators while taking a cut in the process. For example, in South Korea, Woori Bank has made an 'agreement of joint duties' for cooperation with five fintech companies. The agreement is on joint duties for R&D, business model introduction and commercialisation.
4. In the light of regulatory pressures, as many international banks downsize or withdraw from Asia, there are tremendous opportunities for local and regional banks to expand their presence and importance.

Banks recognise that they are confronted with uncertainties today and need to react accordingly. In order to seize the high ground, banks need to think like disruptors.

IF YOU CAN'T BEAT THEM, JOIN THEM

Bankers have long traveled the regulatory road, constructing compliance systems, engaging with relevant authorities, as well as continually adapting to new mandates and expectations.

However, disruptors that feel right at home in an innovation lab might be far less comfortable navigating and dealing with regulatory strictures. Therefore, some guidance from the veterans will always be welcome.

Banks recognise that they are confronted with uncertainties today and need to react accordingly. In order to seize the high ground, banks need to think like disruptors. They need to accept inevitable change, keep pace with innovation, and capitalise on their inherent and hard-earned strengths. Only then will they have a fighting chance to stay relevant in the game. BT