

Трансформация банковской системы: перспективы и риски

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Аннотация

В данной статье проанализировано текущее состояние банковской сферы и рассмотрено такое явление, как необанки. Отражены положительные стороны цифровизации для различных участников рынка, а также связанные с новыми технологиями перспективы и риски в глобальной экономике и в отдельно рассмотренной ситуации на Российском рынке.

Ключевые слова: банковская деятельность, банковский сектор, традиционные банки, нео-банки, финансовые технологии, цифровизация, инновационные технологии.

Transformation of the banking system: prospects and risks

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Abstract

The article touches upon the issue of the current state of the banking sector and examines the phenomenon of neobanks. It also reflects the positive aspects of digitalization for various market participants, as well as the prospects and risks associated with new technologies in the global economy and in the separately considered situation in the Russian market.

Keywords: banking, banking sector, traditional banks, neobanks, transformation of banks, new generation banks, digitalization, digital banking, financial technologies, FinTech, innovative technologies.

Introduction

Nowadays penetration of information technologies into all spheres of life has become an objective necessity. One of the areas where their importance cannot be overestimated is the financial sector, including banking activities. In the nearest future this sector will be dominated by the tendency to increase the quality and reliability of offered products and services, increased speed of conducting settlement operations, implementation of electronic access of clients to banking products. This is primarily due to desire of banks to achieve competitive advantage in the financial markets.

Outside of technological industry itself, the banking and securities sector is the biggest spender on external AI services and has fast growth. According to Citi GPS «Global Perspectives & Solutions» report, in 2016 investments amounted to 1900 million dollars, the estimated amount in 2019 is \$7500 mln. [9]

In recent years, a substantial number of new generation banks have appeared in the world. A bank of a new type, or neobank is a fully online bank without the branch network – that is a completely digital structure that heavily relies on remote interaction with clients. They either obtain a license to carry out their own activities or are based on one of the existing banks. [2]

Transformation of the banking sector

The list of the most widespread services provided by digital banks does not vary from the traditional:

- keeping accounts and making operations with them;
- providing loans;
- capital and investment management;
- deposit-taking;
- expenses analytics (users can instantly check expenses by time, retailer).

Currently neobanks embark on using new formats, such as:

- P2P-lending (peer-to-peer lending is the practice of lending money through online services that match lenders with borrowers);
- crowdfunding platforms;
- financial robots-consultants;
- accounts in crypto-currencies. [1]

At first, traditional financial market players treated them with skepticism and did not consider as serious competitors. This idea seemed to be an experiment that will not result in success. However, digital banks almost immediately became profitable and are still actively expanding in all segments of the financial market. The best world practices are shown by British banks: Monzo, Atom,

Revolut and Starling. These names are not well-known in Russia, but they are already well-established brands with a high degree of recognition abroad. Opening a small business account at a major U.K. “high street” bank can take over a month, because it is built on “Stone Age” technology and is combined with bureaucratic and organizational structures and regulatory burdens. While at a U.K. neobank, the same process can take minutes. [12]

Traditional banks are struggling to adapt because they have built an expensive infrastructure of local branches and have become increasingly reliant on revenue from fees. Surveys have shown that a wide array of fees, for everything from A.T.M. use to checking account maintenance, have been steadily rising in recent years.

“We need banking. We don’t need banks anymore” said Bill Gates in 1997 year. Nowadays traditional bank branches are “following” this quotation and closing all over the world. Global trend is the following: over the past 5 years, more than 1,800 offices have been closed in the US and will furthermore be reduced by a third, in the Scandinavian countries – every second branch will be closed. In Russia in 6 years their number may decrease by 40%. The reason is that digital technologies are changing incumbent traditional business models. Another cause for the large-scale reduction in the number of branches is a change in customer behavior – reluctance of customers to visit banks as often as it was before. [12]

Key features of new business models:

- Development of innovative services focused primarily on customer satisfaction, creation and implementation of the best, fully digital customer experience, not limited by the capabilities of outdated mindsets.
- Use of modern solutions that provide rapid development, integration, testing and implementation of processes, as well as collection and analysis of feedback from customers in real time.
- Use of ready-made third-party services instead of self-development and integration of all components, which can significantly accelerate launch of a new business and build it on the basis of the best digital solutions available on the market. Examples of such solutions are cloud automated banking systems, KYC procedures (“know your customer”) that combats money laundering through identification and verification of the client and his documents, tracking suspicious transactions.
- Active analysis of customer data, including both information available to the parent company and data on customer behavior received by the new digital business.

At the same time there is still high need for brick-and-mortar branches. Currently customers prefer a hybrid model. It is convenient to use basic services in digital format, day-to-day operations go into apps. More than 90% of payments are made via mobile bank. However, more complex

operations related to consulting on investment products, asset management, mortgage issues are carried out in physical infrastructure offices. That is why, it is needed to maintain at least a minimum number of branches for advisory purposes and to offer sophisticated financial instruments. [2]

Advantages of online servicing for banks

+ Significant cost reduction takes place due to digitalization and online-banking models: absence of offices, insignificant paper workflow, less personnel. For instance, Singaporean banks earn 2 times more from “digital” clients, than leading business in a traditional way. The costs for attracting new customers are 5 times lower: 30\$ against 150\$.

+ The sum, which is required for the creation of a neobank as an add-on of an existing bank, is significantly lower than operating as a full-fledged bank structure.

+ Neobanks can be seen as a tool for banks to carry out experiments, as they are able to conduct it faster than traditional banks. Without burden in the form of outdated infrastructure, new players have more opportunities to create modern banking products. [4]

Advantages of neobanks for clients

+ The most substantial benefit that customers note is a 30-35% reduction in costs after switching to digital banking (according to Oliver Wyman). [12]

+ Convenience that include: an interface that is easy to use on mobile devices, first-class support services, which do not require a physical visit to the bank branch on the other side of the city, easy registration and verification (usually it is needed just to download the app and send a scan an ID). Customers can ask a question in any form, with any words in a messenger or via video, as if communicating with a friend, and they will be answered immediately. All that leads to time-saving.

+ New opportunities are created for customers. This is due to the reduction of costs (about 30%) among banks in the process of transition to the digital operating. In addition to new offers, there is improvement of the current conditions: loyalty programs, better rates. Hence, the lower the cost of customer service, the more the bank can give to the customer to ensure loyalty and create more interesting conditions.

+ One of the reasons for the emergence of neobanks like Monzo is that one traditional bank is not able to satisfy all the requests of different micro-audiences (students, elderly, migrants, etc.) Neobanks are perfectly fitting into the customization trend by creating special conditions for a variety of specific audiences. Often developments in the field of fintech are focused on the needs of Millennials. Banks and payment systems release mobile applications and online platforms for advanced users who want to pay bills directly from their smartphone or quickly transfer money to friends. But a number of companies are trying to implement technology to help older people (instructions via video calls). [7]

+ As a rule, neobanks offer higher interest rates for deposits, lower commissions (or even the absence of such) for transactions and the higher level of service and support. [2]

Risks for neobanks

1. Instability of the business model of neobanks in the long term.

Traditional banks have two main sources of income: commissions and net interest income (the difference between interest received on loans and interest paid on deposits). However, the effectiveness of these sources in the long-term perspective may be doubted.

Considering the net interest income and the connected beneficial flexible underwriting policy of neobanks, it may occur that the policy is to become a disadvantage in specific cases. On the one hand, it allows to gain a much faster client base, but simultaneously it significantly increases the risk of a loan portfolio. This raises a question of whether such a model would still make profit in the case of a significant deterioration in the quality of the loan portfolio and an increase in arrears and non-payment of loans.

Commissions' source of income is also contradictory. It is one of the most important income sources for the banks, however its long-term stability is also doubtful.

Firstly, the size of the interbank commission is in the process of reduction under the pressure from regulators, and it will continue to go down (in Russia and also in the US, EU, Canada and other regions). As a response to the negative trend, large financial groups are trying to minimize these losses through vertical integration, for example, by merging banks with processing companies. This strategy allows to claim most of the commission, as well as to improve the accuracy of scoring models through the use of transaction data that pass through the processing centers, which in turn increases profitability.

Secondly, those neobanks that do not have their own banking license have to share their interchange fee (which in most cases does not exceed 1.8-2.0% of transaction) with that bank, whose license they are using.

Thirdly, in absolute terms, only fee and commission income itself may not be sufficient for business growth and for reaching the break-even point. For instance, Brazilian Nubank showed a loss of \$36 million in 2016, despite reaching 1 million open accounts.

A number of neobanks is trying to introduce new models of monetization and began to charge a fixed subscription fee from users, following the example of popular media platforms, such as Netflix and Spotify. For example, in the case of the Dutch Knab, this fee is from €5 to €7.5 per month. However, it is still unknown whether such a model will take root in neo-banking. [3]

2. The risk of easy and quick coping among neo- and traditional banks.

The members of the banking market are used to fast adoption of innovations and new efficient features. This leads to healthy competition and advancement of the whole financial environment. Nonetheless, it is the main obstacle for neobanks being pioneers of innovations, because traditional banks copy and adopt their strategies of experience and modern features, leading to low differentiation in mobile apps and similar functionality.

However, it is not always a danger to the uniqueness of neobanks. Firstly, the new solutions are built in the mobile-first paradigm, not branch-first — it's a completely different customer experience. Secondly, they are focused on the new customers of the market, which greatly affects their brand positioning, language of communication with customers and perception. Moreover, these customers don't usually have a previous experience in traditional banking service — either because of age or because they are from emerging markets, where there is low penetration of banking services. [7]

3. The risk of conflicts with supervisory entities.

The ease of transactions, their simplicity and speed may face disagreement from the side of the governmental authorities, which are known for the desire to control all operations and for the requirements to the banks to have a deep understanding of the client's business and the economic sense of each transaction. [4]

4. Finally, the risk connected to online technologies and remote services.

Digitalization of banking services inevitably leads to appearance of the risk of cyber-crime due to cyber security imperfection. It also requires the calculation of algorithms of artificial intelligence, which is the work demanding accuracy and reliable security, along with great financial resources. If the customers would not be assured in the reliability of these online services, there would be little success in the whole system of neobanking. [4]

The case of Russia

According to Oliver Wyman, 40% of retail customers in the Russian market are dissatisfied with the level of services provided by their banks, and 25% are ready to change the bank within one year. [12]

The Russian market is characterized by a high level of use of digital channels: 75% of customers prefer them for day-to-day basic operations, and 35% - for all operations. At the same time, the offer of remote service is rather limited. According to the estimates, the potential market for new business models – digital banks – can reach 40-50 million customers. Also, according to the Bloomchain study "FinTech in Russia-2018: searching for a new market", that are banks that remain the main drivers of the fintech industry in the country: both traditional and neo-banks. [9]

Despite the relatively low competition among neobanks in the Russian market and their high attractiveness for users, implementation of such projects may encounter the following obstacles:

1) in case of launching a digital bank as a digital addition to the existing financial institution, they will have to share income;

2) in order to start a bank as an independent unit, it is required to pass the process of obtaining a banking license (the minimum authorized capital for banks with a basic license — 300 million rubles, with universal — 1 billion rubles).

Fintech perspectives in the Russian market

Can it be said that Russian market and Russian infrastructure are ready for changes? Is there a platform for new technologies?

On the one hand, according to Deloitte, Russia is included into the first cohort of digital banking maturity [10]. It means that Russian digital banking is currently on a very high level of development. Also, according to the latest Visa payment forum, held in Dubai – Russia is almost the leader in contactless payments (thus, being ahead of many countries on digitalization) [8]. One more serious advantage is the belated IT-transformation that led to more recent technological solutions in the financial institutions. If business finds effective tools for R&D financing and innovation system development, then the future of digital Russian banks is more promising than in Europe or in the United States.

On the other hand, last year world number of venture capital deals in fintech was a record investment of about 40 billion dollars. At the same time, in Russia the entire venture capital market (data for 2018) is approximately \$400 million, with fintech market being about \$50 million [5]. Thus, it can be said that in the global sense, Russian fintech is still very imperfect [6]. What is more, overall fintech adoption rates in Russia appear to be relatively low, since, for instance, Internet and smartphones penetration is covering only approximately the half of the population.

To support fintech growth in the Russian market, in February 2017 the Bank of Russia created a regulatory sandbox along with a Russian fintech consortium – in order to accelerate innovation boost and create a fertile platform for the improvements and development of new financial service technologies. Among other initiatives with an aim of fintech environment support were a phased transition to an open API (application programming interface), blockchain technology pilot projects implementation and the provision of a single digital identification environment. Consequently, all of these projects and programs are pursuing the aim of contribution to the Russian fintech development. [9]

So, it can be concluded that in Russia there are prerequisites for digitalization of banking processes, but not of the level of developed countries.

Global perspectives for neobanks

In the current circumstances there can be foreseen several outcomes of development of neobanks in the near future.

The first is that they can be absorbed by the traditional players for the development of electronic channels. New players may be of a high interest due to bringing technologically savvy customer base, allowing to make a technological leap in the field of electronic channels. And this can be a way for banks to update electronic financial services.

The second case is that more and more traditional banks can create their own neobanks under the new brand. In digital banks there are no secret algorithms, intellectual property and other know-how, so many banks are more than able to create something similar. In fact, there are already many examples when such services were created, such as UBank that operates as a division of National Australia Bank (NAB), BankDirect owned by Commonwealth Bank of Australia or HelloBank owned by BNP Paribas S.A. (a French international banking group). By launching new brands, traditional banks are testing the e-business model.

It is also possible for neobanks to disappear, after giving push for banks to develop electronic services. Now some new-wave banks rely on deposits in traditional banks, which makes them just prepaid card services with some added features. This imposes restrictions on them, they cannot be much better than the banks they rely on, and this can be a factor preventing them from attracting customers, and ultimately questioning their survival.

Conclusion

After the conducted analysis, it can be concluded that neobanks are to continue its development and will even be able to crowd out the traditional bank players. Digital banks possess a strong advantage – their convenience for clients. In addition, as they are considered to be fintech companies, their future is estimated to be rather perspective and successful, at least in Europe and the United States. The industry has become so popular that the world's financial centers, such as London and New York, are ready to fight for the title of a global fintech capital and are attracting startups and neobanks in order to gain that position.

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