

The Fintech Advantage

Harnessing digital technology,
keeping the customer in focus



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KEY FINDINGS

1. Fintech is emerging from the gaps into the mainstream of the Australian financial services ecosystem
2. A key enabler of Fintech success is catering to unmet customer needs by quickly and creatively harnessing emerging digital technologies
3. Insurtech has been slow to launch in Australia but is now poised to disrupt the local and global insurance industry
4. Fintech companies have harnessed digital technologies to offer customers value in key areas of price, convenience, access, choice, and community, but incumbents retain the advantage on trust
5. Strategic partnerships offer advantages to both Fintechs and incumbents but collaboration needs to carefully consider the complexities of partnering, and the challenges of merging cultures, in order to deliver value by keeping the customer in focus

Executive Summary

Australia's Fintech industry is thriving. Fintech start-ups are enjoying investments from both venture capitalists and traditional financial institutions who recognise the importance of digital ways of doing business.

Incumbents are realising that existing and emerging enabling technologies – most notably mobile and cloud – are significantly changing customer expectations about what constitutes convenient, high quality service. This awareness does not however automatically translate into action, as it can be difficult for incumbents to adapt legacy systems to cater to emerging customer needs.

As a result, Fintechs are not merely taking advantage of the gaps left by traditional players, but are setting up new and innovative services that are changing what customers expect over time.

Initially operating only in transactional offerings, such as payments, the Fintech sector is increasingly emerging as a competitor in more expertise-based areas of the financial services ecosystem, including loans and investments.

Traditional firms that were at times wary of these new players are now looking to maximise their return on innovation investment by buying proven Fintech solutions. Combined with growing attention from government, it would seem that Fintech companies are now well placed to make the most of their increasingly favourable regulatory environment.

In this report, we take stock of the Australian B2C Fintech landscape by first providing an overview of the existing financial services ecosystem. We explain how Fintech has been successful in harnessing digital technology to cater to customer needs.

We've identified 5 key areas where Fintechs offer value to their customers by harnessing digital technologies: price, convenience, access, choice, and community. Incumbents however retain the advantage on trust – which we define as the perception of stability, security and safety.

This perception helps incumbents compete in long-term financial activities such as mortgages, because longevity is something that Fintech companies have yet to prove. As a result, gaining customer trust can be a key motivator that drives Fintechs to collaborate with incumbents.

Finally, we offer practical suggestions for how Fintech and incumbents can develop a partnership, throughout the innovation process and effectively work together to gain a combined advantage. Although these partnerships seem full of promise, we recognise the challenges that incumbents face when partnering with start-ups and offer advice on how to evolve culture.

Ultimately, this report looks at how incumbents can work with Fintechs to harness digital technology, always keeping the customer in focus, to differentiate themselves in the digital age.





Overview of the Australian B2C Fintech Landscape

Australian Fintech: Approaching the Mainstream

Australian Fintech has followed a similar trajectory to the global market, though local economic and market conditions have factored in the eco-system's evolution. The Australian Fintech sector is predicted to grow exponentially over the next 3 years, to AUD\$4.2billion by 2020 (Frost & Sullivan, 2016).

Australia has one of the healthiest Fintech eco-systems in the world – investment is flowing, including from the big banks. The emerging Fintech ecosystem is growing thanks to both venture capital but also significant corporate backing for innovation initiatives such as the independent Fintech hub *Stone and Chalk*.

Emerging enabling technology

Driving the need for change in the financial services sector is the development and diffusion of enabling technologies such as mobile and data analytics, combined with changing customer expectations. These developments go hand in hand.

Australia is globally the second most penetrated market in terms of smartphone technology, which supports the growth of Fintech offerings. Financial services such as investment, financial advice, and product comparison are being automated, greatly reducing expense and barriers to entry for customers.

Incumbent business models that rely on exclusivity and high touch interactions with customers are now challenged by inexpensive services that draw on collective intelligence of the crowd through sophisticated data analytics.

While banks and other traditional institutions are making inroads in adapting their services to cater to customers in new ways, it is the smaller Fintech firms that have the advantage in quickly

capitalising on emerging technologies to deliver value to their customers. However, traditional firms' market share is not yet greatly affected.

The Fintech advantage

The regulatory framework in Australia is now changing to encourage innovation in Fintech. The Australian government is reconsidering regulations that impede crowdfunding and investment activity, and a 'regulatory sandbox' has been proposed to allow for greater experimentation by Fintech companies.

Fintech companies are well placed to make the most of this increasingly favourable regulatory environment. Due to their size and youth, Fintech offerings are responsive, able to serve and adapt to emerging customer needs. It would thus seem that Fintech currently has the advantage in the Australian financial services market.

Driven by the narrative of digital disruption, traditional firms initially saw Fintech as a threat, even though there was uncertainty about the future of the industry. But recent Fintech successes (the P2P lending platform SocietyOne is a notable Australian example) are driving banks to look for opportunities to partner with or to leverage the Fintech advantage and ecosystem to bridge gaps in their own customer experience and service models. Traditional firms are increasingly looking to maximise their return on innovation investment by buying proven Fintech solutions.

This report aims to first provide an overview of the existing Fintech ecosystem and explains how they've been successful by catering to unmet customer needs. We then consider how the combination of traditional players with future Fintech firms can provide both with mutual benefit.

Key enablers of Fintech

Customer Demand

Customers are getting more accustomed to services that are:

- digital
- mobile
- interactive
- personalised

Barriers to Entry

Traditional financial firms have difficulties quickly responding to evolving customer needs, because of:

- inflexible legacy systems
- risk-averse budgeting and decision processes
- siloed channels

Technological Evolution

New technological developments provide nimble Fintech firms with multiple opportunities to meet customer expectations using the latest technology.

VC Funding

Increasing VC funding:

- drives Fintech innovation
- gives entrepreneurs a platform to challenge incumbents

The perfect storm

Alignment of a combination of drivers - such as the maturing of digital capabilities and increased venture capital funding – has led to a perfect storm in the financial services market. Disruption has been furthered by higher customer expectations around convenience and ease of use.

Originally, “Fintech” was used to refer to back-end transformations of financial services. Fintech now points to an industry of smaller players who are using digital technology to deliver value to customers. Increasingly, these Fintech companies are looking to capitalise on the lucrative financial services market.

Activity and interest in Fintech is growing but the market is still in its infancy. Fintech firms initially focused on informational customer oriented services, but increasingly they are moving into the lucrative transactions, investments, and loans markets.

We find that Fintech companies have opened up new niche offerings in Australia, by attracting formerly disengaged groups to participate in financial services, for example millennials and tech-savvy customers who are more willing to embrace new offerings that deliver financial services more cheaply and conveniently.

Competition is heating up

Although Fintech companies have successfully managed to bring to the market offerings centred on service efficiency and better value for money, traditional firms still hold an advantage in the area of trust, specifically the perception of stability, security, and safety. In part, it is the strict regulatory framework in Australia that has so far protected incumbents from disruption.

But the advantage held by traditional firms is gradually being diminished by changing regulations, globally and domestically, that encourage and support Fintech development and investment.

A further threat to incumbents comes from the market entry of both globally successful “pure digital players” and “BigTech” firms such as Apple, Amazon and Google. These well-respected companies have built extensive relationships and trust with customers across the world. Their market penetration and embeddedness in customers’ daily lives, through mobile technology use in particular, makes them powerful competitors in what has traditionally been the arena of large banks.

Many global companies are incorporating financial services to enhance their current offerings and to increase loyalty to their core products. Examples include Uber, who made payments for rides seamless, and WeChat, where payments are just one of a multitude of functions offered on the rapidly expanding platform. These companies typically develop their solutions around customer needs and emerging technologies, to deliver a comprehensive and seamless customer experience by combining different services into one platform.

Incumbents are already collaborating with other potential disruptors. For example, 39 Australian banks have already partnered with Apple to launch Apple Pay while Woolworths’ credit cards are currently backed by Macquarie Bank. Yet, while we recognise the looming “BigTech” entry onto the financial services scene, in this report we focus on how Fintech firms in Australia are already starting to challenge conventional financial institutions.

This challenge manifests in the choices particularly of younger, tech-savvy and affluent customers in the Australian financial services market. As the figure below shows the majority of such customers have already gained practical experience with non-traditional firms. It is data such as this that makes engagement with the status-quo of the Australian Fintech sector a timely exercise.

Younger, tech-savvy, and affluent customers in Australia are much more likely to avail financial services from non-traditional firms

Customers’ Usage of Non-Traditional Firms, by Customer Segment (%), Australia, 2016



With Gen Y and tech-savvy customers expected to become increasingly prominent over time, the pool of customers turning to non-traditional firms is likely to grow.

Note: The percentage on the chart indicates the customers who use traditional and/or non-traditional firms (remaining non-respondent)
Question: Please indicate if you use the following products and the nature of firm you interact with for each product. Products: Banking, Payments and Transfers, Investment Management, and Insurance. Nature of Firm: Only traditional firms, Only non-traditional firms, Both traditional and non-traditional firms
Source: Capgemini Financial Services Analysis, 2016; Capgemini and LinkedIn WFTR Voice of Customer Survey, 2016

The B2C Financial Services Ecosystem

From the start, Fintech offerings recognised that technology creates opportunities to better serve the customer. OFX for example made it easier and cheaper for Australians to send money overseas – a common need given our international population.

How has this Fintech firm created value for their customer? The service is convenient, using simple web layouts and integrated systems. Low-cost communication channels minimise upfront investment in marketing, while limited need for physical infrastructure reduces overheads. This value is passed on to the customer as lower cost.

On top of leveraging traditional business models (e.g. transaction fees on payments), Fintech firms have been able to create alternative sources of revenue. These alternative approaches often leverage existing business models from the IT industry (e.g. licensing and data monetisation).

Embracing technology such as cloud solutions allows Fintech firms to remain agile while seeking scalability. Straightforward end-to-end processes maintain a firm's capacity to trial and

adjust its offerings in response to customer preferences and feedback, creating a level of responsiveness that can make Fintech firms strong and resilient competitors.

Making use of emerging enabling technologies, Fintech firms have gradually expanded their offerings, creating differentiated, simplified, and secure services in all areas of the financial services ecosystem.

Beginning with simple information offerings Fintech firms have gradually developed and now provide alternatives to traditional transactional services. Further moving towards expertise-driven products and offerings, Fintechs today cover the full spectrum of the market, including banking services such as loans and investments.

In the following we provide an overview of the Fintech landscape with its various levels of service offerings. In doing so, we will outline how Fintechs harness the capabilities of a variety of enabling technologies.

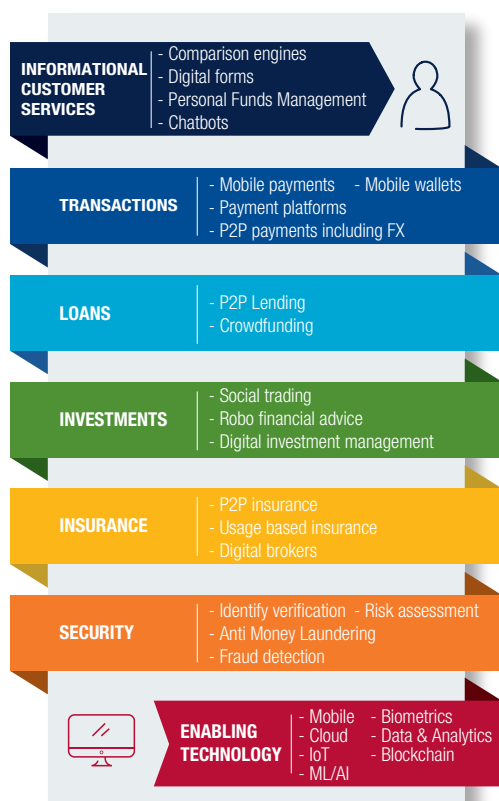
Enabling Technologies underpin most innovations in financial service delivery. While the industry has been quick to adopt technology since the early days of computing, Fintech start-ups have been particularly good at taking advantage of enabling technologies as a starting point for innovation in financial services and to inspire value creation.

Security is a significant driver of technologically enabled innovation across financial services. A number of Fintech start-ups utilise Artificial Intelligence, Machine Learning and Big Data Analytics, including video, image and voice processing to battle fraud and improve cybersecurity. Use cases include analysis of payments history and funds flow to discover credit and trade fraud; voice and face recognition to validate users; and use of machine learning and deep learning to advance traditional analytics methods.

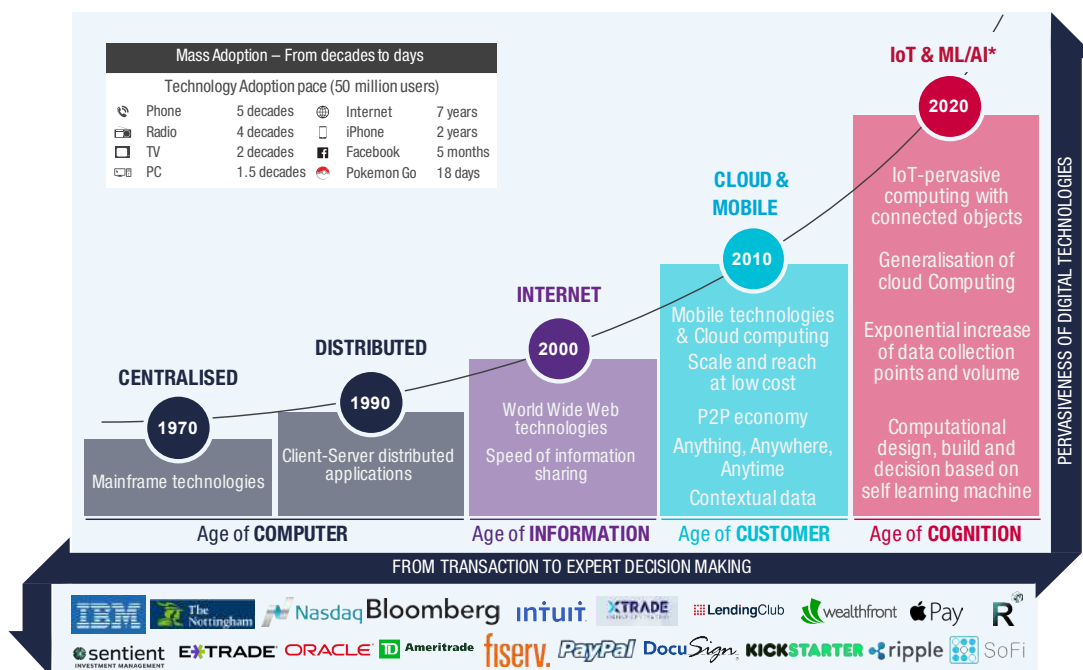
Insurance in Australia is yet to be significantly disrupted by Fintech offerings, but internationally Insurtech is making inroads. Currently, Decision Support Systems help Australian consumers compare and choose financial services. These platforms often take a referral fee as their revenue model. A potential new service is peer-to-peer insurance – already emerging in the U.S.. Members are pooled into groups, where part of each member's premium is deposited into a fund which backs potential claims. IoT (the Internet of Things) is poised to redefine cost-intensive distributed activities such as insurance assessment. See pages 10-11 to find out more about Insurtech in Australia.

Investments and Loans have more recently begun to be transformed through digital technology applications. Fintech firms are increasingly using social technologies to pool information and resources to create new forms of shared

Overview of Fintech landscape



The acceleration of technology pervasiveness



* Internet of Things, Machine Learning/Artificial Intelligence

investments and returns, for example using crowdfunding platforms. Peer-to-peer lending platforms connect investors and borrowers, opening up new markets such as access to the large “unbanked” customer segment (2 billion people world-wide in 2014).

Algorithms and machine learning are hallmarks of the ‘Age of Cognition’. These technologies draw on multiple data points to offer advice to both consumers and businesses. Through harnessing the power of algorithms, new players promise straight-forward investment advice, so-called robo-advice, most recently in the superannuation space.

Transactions present as the most developed part of the Fintech landscape. Mobile phones with Near Field Communication (NFC) technology are driving the evolution of mobile payments and e-wallets. These services provide more contextual products and services, such as barcode scanning and personalised offers.

Augmented Reality applications are gradually adding to this context-rich customer experience. Blockchain technology provides a traceable way of transacting without involvement of mainstream intermediaries and infrastructures.

In enabling cryptocurrencies, Blockchain technology makes cross-border transactions simple and inexpensive. The full potential of these technologies is not yet known, however investment and development is rife. Bitcoin wallets for example are accessible without bank involvement, potentially leading to future disintermediation. Alternative revenue models such as advertising can help cover costs of mobile wallets.

Informational Customer Services provide a value-adding link between the end consumer and the financial services ecosystem. The actors on this layer capitalise on their data and information management capabilities to provide aggregation, integration and comparison services. Comparison engines aggregate data and make comparisons simpler and more transparent for customers, guiding informed purchasing decisions that can lead to greater market competition.

Digital forms and portals interface between the customer and back-end legacy systems of financial institutions, making it possible to cheaply streamline the customer experience while maintaining established infrastructures. Personal Funds Management services integrate digitally with everyday banking to provide budgeting services such as monitoring and budget advice.

Insurtech - Next in Line

Recognising opportunity

Traditional under-investment in technology has led to serious inefficiencies in the insurance ecosystem prompting a new generation of players to cater to those inefficiencies.

Insurers have always been laggards when it comes to adopting technology even though they were the first ones to start using it. Over the years the aversion to technological innovation has led to a delay in innovation in the insurance operating model compared to other industries.

To compound the problem, digital transformation has enabled other industries, such as retail, banking and technology organisations, to venture into the traditional domain of insurers, thus forcing insurers to step up their innovation game.

However the pace of innovation amongst incumbents has been slow, and this has given rise to a new generation of players (also known as Insurtech) that foray into different areas of the insurance value chain, through the use of enabling technology.

Insurtech investment

Investment in Insurtech has leapfrogged from 800mn USD in 2014 to more than 2.6bn USD in 2015 and is beginning to outpace investment in Fintech. The pace of investment in these new generation technology companies aiming to disrupt the insurance value chain has multiplied several times in the last 12-18 months, as investors begin to see a strong potential for Insurtech firms to challenge the traditional insurance industry.



Changing the game

Key areas where Insurtech players are changing the game are P2P insurance, insurance aggregation, usage-based insurance, claims management, and seamless coverage.

P2P insurance: This is the most basic form of insurance where peer groups come together to create a pool to underwrite any risk event. With the use of social media and a connected ecosystem, P2P insurers like “friendsurance” are trying to move away from the traditional method of risk pooling to create a more homogenous risk pool and also to create a better customer experience that is more affordable.

Aggregation: Traditional brokers are being challenged by insurtech aggregators who offer price transparency and empowerment of the customer through availability of information.

Usage based insurance: The world is moving towards full connectivity where a combination of wearables, smart cities, driverless cars and IoT will mean that every activity is trackable and thus can be analysed for risk assessment. Insurtech players like Metromile are making use of this connected technology to change the way insurance is being provided, where customers will pay premiums only when they use their insured assets. This contrasts with traditional insurers that will underwrite any asset for the entire time irrespective of whether it is at risk or not.

Claims management: The traditional claims management process is lengthy, cumbersome and expensive. Insurtech players use newer technology such as drones for claim inspection, connected technology to react to risk events, predictive analytics to prevent claims events as well as other technologies like video streaming, or robotics, to assess and manage the claims process.

Seamless coverage: Newer technologies like Blockchain and analytics are used by Insurtech firms to innovate insurance products. For example, Insurtech firms work to make the entire insurance process from policy issuance to claims payout seamless, for products such as cruise insurance or weather insurance.

Insurtech advantage drivers

The key drivers used by Insurtech players to compete with traditional insurers are:

Data advantage: Insurance business is fundamentally driven by data. Yet, unfortunately traditional insurers have been “data rich but information poor”. Insurtech players are starting to gain an advantage through their use of technology in collecting and analysing data, and using the insights to rewrite the insurance value chain.

Lack of regulatory restrictions: Insurtech players have still not been fully regulated thus making the entry barrier lower.

Deeper customer insight: Insurtech players have been using technology to collect customer data in real time and are using that to create customer insight to be able to engage with customers more meaningfully and on a realtime basis.

Agility and technology expertise: Insurtech firms can invest early in agile infrastructures and human capital with expertise in technological service delivery. Many Insurtech companies are thus able to compete with traditional insurers through homegrown technology platforms.

Venture capital: Increased investor interest is fuelling new entries into the emerging Insurtech sector, driving growth, competition and innovation.

Consequently, traditional insurers have started realising that Insurtech players represent genuine competition. They are reacting to the threat by either acquiring Insurtech players to bring the competitive advantage inhouse or partnering with them, through strategic investment or formal partnerships. Suncorp investment in Trov and Generali’s acquisition of MyDrive are just some examples.





The Fintech Digital Advantage: Australian Examples

We've seen the Australian market flourish with smaller Fintech players who are taking advantage of gaps left by larger players. In the following cases, Fintech firms have gained an advantage by harnessing digital technologies to deliver value to customers on 5 key differentiating factors:

- 1. Price**
- 2. Convenience**
- 3. Access**
- 4. Choice**
- 5. Community**

However, traditional institutions retain the advantage on:

- 6. Trust**

Harnessing digital technology to deliver on **price**

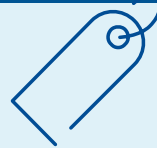


Australian Case: Acorns

<https://www.acornsau.com.au/>

- Acorns is an automated investment app, where transactions made with a linked credit or debit card are rounded up to the nearest dollar and the difference is invested into one of 5 diversified portfolios constructed using ETFs quoted on the Australian Securities Exchange.
- The platform targets new investors by offering “no account minimums, no commissions, and fractional investing” (Acorns, 2017).
- The app is free to download, with fees of AUD1.25 per month for a portfolio worth less than AUD5,000 or 0.275% per year for larger amounts.

LOCAL ROBOADVISORS



- *Value for money*
- *Transparency*
- *Incentives and rewards*

What's the Fintech digital advantage?

- Advice and risk assessment automation reduces the need for human intervention, lowering costs and reducing barriers to entry.
- Single and targeted offerings rationalise the cost of maintaining and servicing multiple systems and legacy contracts.
- Collective intelligence distilled through data analytics offers customers insight without the cost of high-touch activities.
- Dashboards offer users real-time feedback on investment activity and performance.

GLOBAL ROBOADVISORS



Harnessing digital technology to deliver on **convenience**

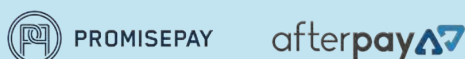


Australian Case: zipMoney

<https://zipmoney.com.au/>

- zipMoney is an Australian company that offers ‘buy now, pay later’ finance to its customers, for purchases made with partnered online retailers.
- zipMoney lends from AUD1,000 to AUD10,000 to fund online retail purchases with up to a 6 month interest-free period. Customers can set and change their repayment amounts and periods using their online account.
- The company uses big data analytics to reduce the time it takes to get credit approval to as little as 3 minutes. zipMoney claims to currently have approximately 200,000 customers in its client base.

LOCAL PAYMENT INTEGRATION SERVICES



- *Simple, quick, intuitive processes*
- *Relevant information is visible*
- *Continuity between channels*

What's the Fintech digital advantage?

- Fintechs utilize big data analytics to offer quick, paperless credit checks that can draw on numerous sources including social media to assess credit applicants online.
- User-friendly online tools allow users to configure their repayment amounts and repayment schedule based on their capacity and needs.

GLOBAL PAYMENT INTEGRATION SERVICES



Harnessing digital technology to deliver on **access**

Pozible

Australian Case: Pozible

<https://pozible.com/>

- Crowdfunding site Pozible digitally links investors to people with an idea or initiative that is seeking funding. Fintech start-ups can also be the beneficiaries of crowdfunded investment.
- Pozible projects have a 57% success rate of achieving funding goals.
- Pozible's service fees range from 3-5%, depending on the size of the project, and transaction fees are applied to payments.
- Over AUD50million has been raised in pledges and over 12,000 projects have been launched.



- *Connecting customer segments*
- *Creating opportunities for excluded groups to participate*

What's the Fintech digital advantage?

- Demographics locked out of high-barrier investment activities can gain access to capital and investment opportunities.
- Pooling resources allows shared investment and returns, and donations and subscriptions are easy to manage for investors and entrepreneurs.
- Integrating systems and investment activities with social media means projects are visible to others, shareable, and easy to access.

LOCAL CROWDFUNDING PLATFORMS

VENTURE
CROWD

EQUITISE



GLOBAL CROWDFUNDING PLATFORMS

indiegogo

KICKSTARTER

crowdfunder

Harnessing digital technology to deliver on **choice**

iSelect
.com.au

Australian Case: iSelect

<http://www.iselect.com.au>

- iSelect is an online comparison service with a presence in health, electricity and gas, car insurance, broadband, life insurance, home loans, and home and contents insurance.
- The business positions itself as taking care of important but "boring" life decisions, particularly in relation to insurance policies and plans.
- The group's strategy is to become "Australia's life admin store", offering decision support services across a range of industries with which customers are likely to interface.



- *Numerous options*
- *Clear comparison points*
- *Low switching costs*

What's the Fintech digital advantage?

- Decision support systems automate comparison, making product features visible and comparable in relation to the customer's needs.
- Referral fees can be lucrative and comparison business models can be easily adapted to new markets.
- Integration with other platforms further personalises comparison services.

LOCAL COMPARISON SITES

mozo
australia's life admin store

InfoChoice
.com.au

GLOBAL COMPARISON SITES

CompareAsia
Group

**Money
Super
Market** com

Harnessing digital technology to deliver on **community**

SelfWealth.

Australian Case: SelfWealth

<https://www.selfwealth.com.au/>

- SelfWealth was established in 2012 and is owned and operated in Australia.
- The company calls itself an “online community for investors, partnering to achieve the common purpose of better results”.
- “Top investors” make their investment activities visible so that other users can follow or mimic their decisions, reinforcing the status of top performers in the community.
- Access to the SelfWealth brokerage service costs AUD9.50 per trade, regardless of the size of the trade.

LOCAL SOCIAL TRADING PLATFORMS

livewire



- *Interaction drives engagement*
- *Opportunities to gain status*
- *Value from shared knowledge*

What's the Fintech digital advantage?

- Networked communities generate engagement through gamification mechanisms that emphasise recognition for contributions and performance (e.g. status, rewards, follower metrics, leaderboards).
- Community-run platforms enable low-cost services that attract a wide range of users.
- Word-of-mouth from active communities works to attract new users.

GLOBAL SOCIAL TRADING PLATFORMS



Traditional institutions retain the advantage on **trust**

Australian Example: Mortgages

- Mortgages are not currently catered to by Fintech offerings in Australia, perhaps because of the risk associated with a long-term financial commitment of approximately 30 years.
- This lack of activity is significant because the mortgage market is currently worth \$1.5 trillion.
- Fintechs are already starting to play a role in mortgage brokering in Australia, for example HashChing offers customers free home loan information and comparison services.
- San Francisco-based Fintech firm SoFi recently advertised on LinkedIn for a Sydney based “manager of mortgage operations”, sparking speculation that the Australian mortgage market will soon be targeted by Fintech (Financial Review, 2017).



- *Appearance of stability*
- *Reputation for security*
- *Perception of safety*

Trust in Traditional Financial Institutions

When customers trust a financial services institution, we mean that they perceive the company to be stable, secure and safe:

Stable: The company will be here tomorrow and is unlikely to fail.

Secure: My information and assets are protected from theft.

Safe: I am familiar with the business' brand, products, and processes.

Trust is an important differentiator in financial services, and for now, incumbents retain the advantage.



What is the traditional advantage, and will it last?

Trust in traditional financial institutions has been declining over time, but for now customers still have the expectation that the large banks and other large bricks-and-mortar financial institutions are stable, secure, and safe.

This trust that is associated with banks and other traditional financial institutions is not guaranteed going forward. Generational differences already exist – for example, in North America Gen Y customers are far less trusting of their primary bank compared with other age groups (Capgemini World Retail Banking Report, 2016).

Gen Y represents a significant market, and their digital savviness and high expectations around customer

experience mean they are more likely to embrace Fintech platforms once they begin to prove their stability over time.

Trust is also significantly effected by customer experience. The 2016 Capgemini World Retail Banking Report found that customers who had positive experiences with their primary bank had high levels of trust (71%) while those who had negative experiences scored much lower (32%).

This points to the need for traditional financial institutions to keep up with evolving customer expectations if they want to retain the advantage on trust in the long term.

Pursuing a Combined Advantage

Synergies in Financial Services

Traditional firms have deployed a range of strategies in response to Fintech competition. These strategies initially focused on investing in in-house capabilities but now over 76% of financial services executives globally believe that Fintechs present an opportunity for collaborative partnerships (Capgemini World Fintech Report, 2017).

Although the benefit of such collaboration may seem obvious to traditional firms wanting to develop their internal innovation capabilities, Fintech start-ups also need this investment, in order to drive their growth and enhance the quality of their services.

Mutual benefits of collaboration

Fintech firms can help accelerate the incumbent's digital delivery and foster innovation by bringing in the missing capabilities from a technology and people perspective. Indeed, Fintechs offer incumbents new skills, languages, API, and digital solutions in line with customer expectations, combined with agile delivery models that are adapted to the digital age and are not weighed down by legacy systems.

Fintech start-ups that have previously considered themselves as competitors with a differentiating value proposition to poorly served customers are now considering partnerships to overcome existing barriers around customer acquisition costs, capital access, solutions scalability, and compliance with existing regulations.

The native segment for Fintechs has been B2C, where they have targeted digitally savvy individuals. Collaborating with banks offers Fintechs the opportunity to reach a wider and more diverse customer base in both B2C and B2B segments. This expanded reach can lead to accelerated growth.

Importantly, Fintechs have the potential to capitalise on the existing retail footprint of incumbents in order to improve their service quality and visibility. Customers' daily interactions with services are increasingly digital, meaning that human contact enabled through a physical business footprint could become a key differentiator in the near future.

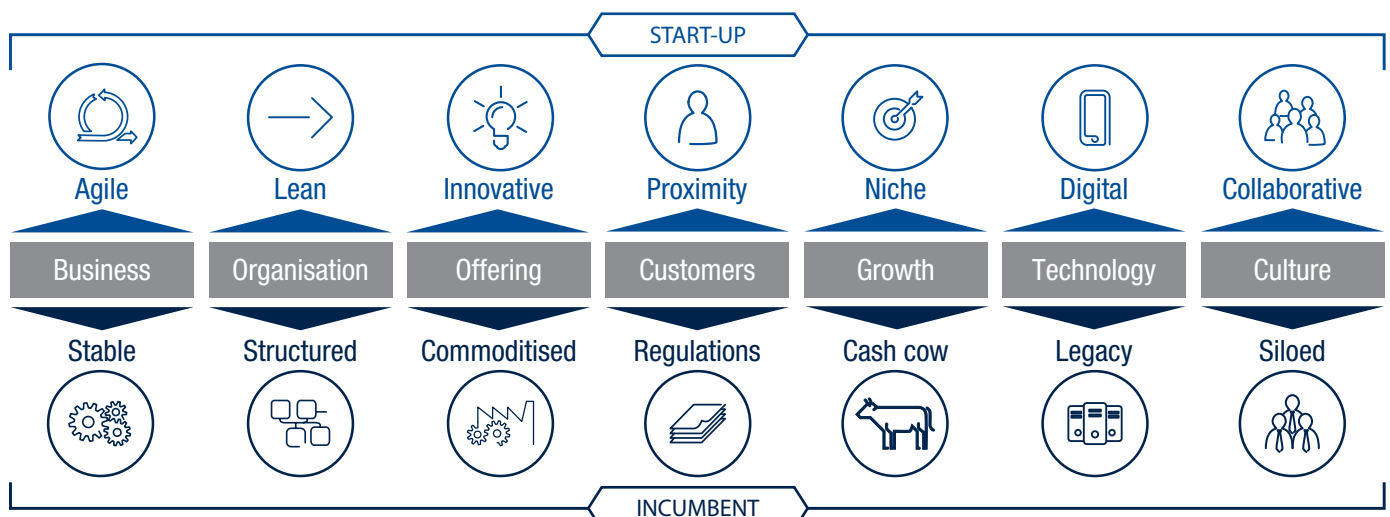
In the pursuit of differentiation and cost reduction in a highly commoditised market, banks are increasing the amount of capital allocated to digitally enabled innovation. Fintechs have an opportunity to gain access to these funds by proposing white-labelled solutions that can help banks to rapidly achieve their objectives. Because of this opportunity, Fintech firms could pivot away from being competitors to solution-providers.

Younger Fintech firms can also learn from more robust and proven business processes that incumbents have refined over time to scale-up and implement their solutions for the long-haul.

Finally, being backed by the big banks can also foster the much-needed trust and long-term customer confidence that Fintech firms currently still lack. Today, Australia has a Fintech customer adoption rate of 61.2%, but the level of trust towards these firms is only 24.8% among the same customer base (Capgemini World Retail Banking Report, 2016).

In essence, the legacy infrastructures and customer data that can act as a liability for incumbents can become an asset for Fintechs looking to scale-up their services while remaining in compliance with regulations. Fintechs in turn offer incumbents new skills, innovative ways of working and exploiting new technologies, in line with customer and/or banks' expectations. There are clearly benefits to working together, but how effective collaboration can be achieved requires consideration.

Complementing organisational capabilities and values



How Fintech and incumbents can work together

Although strategic collaboration seems mutually beneficial and is high on banks' agenda for 2017, before partnering, incumbents have to decide on their objectives, so that the organisation can structure the partnership appropriately.

The lack of clarity around the sustainability and return on investment of Fintechs, on top of the lack of a natural cultural fit, is driving banks to consider collaboration rather than acquisitions.

The following three types of collaboration can be considered in response to three distinct objectives, each requiring a different level of capital investment.

Divergent Thinking: feed the ideation process and generate new concepts

If the incumbent is aiming to develop new ideas or concepts to prototype and test, occasional, punctuated engagement based on specific requirements might be enough. For example, BOQ ran a hackathon in association with River Labs to generate ideas and validate business concepts. Although such collaboration requires minimum capital investment, incumbents need to maintain a clear and current overview of the existing Fintech ecosystem, with a focus on how start-ups are using new technologies to provide solutions. Appropriate contractual agreements need to be on-hand to enable the quick mobilisation of collaboration in order to take advantage of opportunities as they arise.

Problem Solving: accelerate specific solutions development

If the goal is to solve a specific issue, challenge or problem, it might be worth putting in place a structured innovation environment with a dedicated, time-limited program to nurture concepts and ideas. For example, traditional financial institutions are investing in incubation and accelerator programs run by the Fintech Hub *Stone and Chalk*. This approach requires a longer-term structure where the appropriate level of program and project management are in place and supported over time.

Symbiosis: team-up with a start-up to develop brand new products and services

If the aim is to fully leverage an existing and proven technology, product, or solution to improve customer experience and complement existing offerings, incumbents can enter into a partnership with Fintech(s) - ranging from a simple cross-referral model, to a more elaborated joint venture. For example, several Australian banks have partnered with the Blockchain technology

firm R3 Consortium, to experiment with Blockchain solutions for intra-bank transfers and back-office processing. Similarly, the Australian insurer Suncorp has partnered with the start-up Trov to grow their market share among tech-savvy millennials. This is the most intensive option, as a joint partnership requires more investment in contractual agreements and systems integration.

Keeping the customer in focus

Fintechs have flourished by maintaining a deep understanding of the customer. They have grown by relentlessly developing innovative customer centric solutions with a strong differentiating value proposition whilst traditional firms have lost this proximity.

To put the customer back at the centre of everything they do, incumbents have heavily invested in customer experience programs. This includes the deployment of the usual tracking mechanisms such as Net Promoter Score (NPS) to continuously ensure customer satisfaction and advocacy is high.

Unfortunately, despite such efforts, it remains rare for incumbents to actually investigate the root cause of customer frustrations behind low scores. And when scores are deemed acceptable, few challenge the status quo by proactively seeking out unarticulated needs that constitute opportunities for developing innovative and differentiated services and/or products.

Fintechs on the other hand draw on their deep customer understanding to continually improve services and offerings. This customer focus is paramount and constitutes the basis upon which incumbents should define the challenge to be addressed, fuel innovation, and select the appropriate partner.

Making collaboration meaningful

Focusing on the customer problem that needs solving is critical in partnering with the right Fintech and delivering actual value rather than just appearing fashionable. Accessing the right start-ups, in addition to embedding the best functional support from incumbents, is the only way to enable effective synergy that can lead to the development of innovative opportunities in the market.

The complexity of these collaborations shouldn't be underestimated. Although working with start-ups can be reinvigorating, adjustments are required from a cultural and operating model perspective. For example, a start-up may lack structured ways of scaling up their ideas, whilst most traditional firms likely struggle to select valuable solutions that have not been built out of a clear and endorsed business case.

Why partner for innovation now?

Given the maturity of digital technology in the Australian market; the flourishing number of initiatives led by local players (e.g. CBA collaborating with Ondeck); the level of funds promised to start-up investments (e.g. Westpac AUD\$100m; finder.com.au, 2017); the increasing market share of digital banks such as ING Direct; and the evolution of regulations (e.g. authorisation of the use of robo advisors for superannuation management), we can expect interesting times ahead.

New players of a larger organisational calibre, with high frequency customer transactions, such as “BigTech” (e.g. Google, Apple, Facebook, Alibaba, WeChat) and large retailers (e.g. Woolworths and Coles) are poised to further disrupt the financial services landscape. These developments are further fuelled by regulatory changes (such as the Revised Payment Service Directive “PSD2” in Europe).

Incumbents are encouraged to take a more active role in building a strong digital ecosystem in which they can play a leading role in innovation, rather than potentially becoming the ‘backbone’ provider for other suppliers, who own the customer relationship. To encourage such innovation and ease technology integration

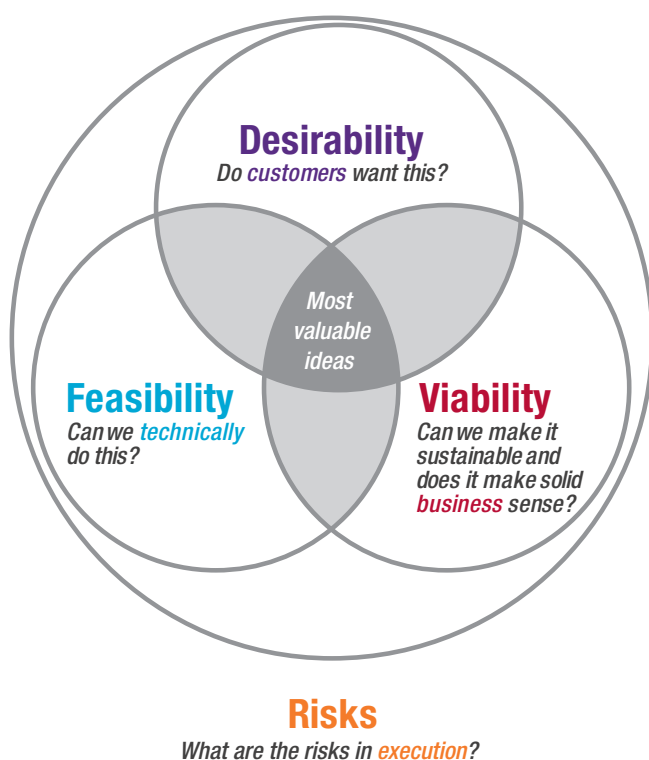
with legacy systems, incumbents can consider securely opening their API to enable Fintechs to build and test their prototypes. Being open will proactively foster meaningful future partnership opportunities that can later generate real value for customers.

The innovation process

Innovation in Financial Services is not easy, in part due to the complexity of product and service offerings and also because of high levels of regulation. Many organisations struggle to transition from the ideation to the ‘prototyping’ phase, as there is often doubt about either the viability of a new idea or its potential to be a game changer. Even if the value has been demonstrated, organisations find themselves struggling to scale the solution.

“BigTech” firms such as Facebook and Apple became truly successful only after iterating on their original ideas. Experience shows that innovation comes from persistence in testing, learning, implementing, and iterating, in order to deliver desirable solutions that are technically feasible, economically viable and that have a manageable level of risks. Rather than building a traditional business case, desirability, feasibility, viability and risks, as well as opportunities to pivot, need to be assessed when considering ideas for innovation.

DFVR Assessment Framework for Innovation



Examples of criteria to assess:

Desirability

- Meets customers' expectations
- Addresses unmet needs or pain points
- Offers customers moment of truth
- Improves customer value across price, convenience, etc

Feasibility

- Maturity of enabling technology
- Technology gap (internal)
- People and/or skills capability gap
- Impact on existing operating model

Viability

- Revenue increase from new business model
- Differentiated value proposition
- Efficiency improvements
- Accelerate speed of innovation foster customer focus

Risks

- IT/Business collaboration required
- Multiple Business Unit involvement
- Duration, financial investment required
- Vulnerability to external factors (e.g. legal, brand)
- Competing with existing initiative portfolio
- Decreased risk aversion

Applying the DFVR Framework

Sample DFVR Assessment: Mobile Payments

To illustrate how an organisation could use the DFVR framework, we offer a hypothetical example of an incumbent that is looking to target tech-savvy customers by proposing new mobile payment features within their existing banking apps:

Desirable

Feasible

Viable

Risk

The technology required to facilitate mobile payments is already well developed, which makes the solution feasible. And the necessary investment, and thus risk involved, are moderate. Paying with a mobile device offers little added value for customers over other contactless payment solutions, which impedes desirability. This lack of differentiation combined with intense competition make it difficult and costly to drive adoption, compromising viability. If successful however, transactional data generated from payments could be used for targeted marketing. Following this assessment, a mobile payments feature might not be immediately valuable, unless mobile wallets and data collection are the end game.

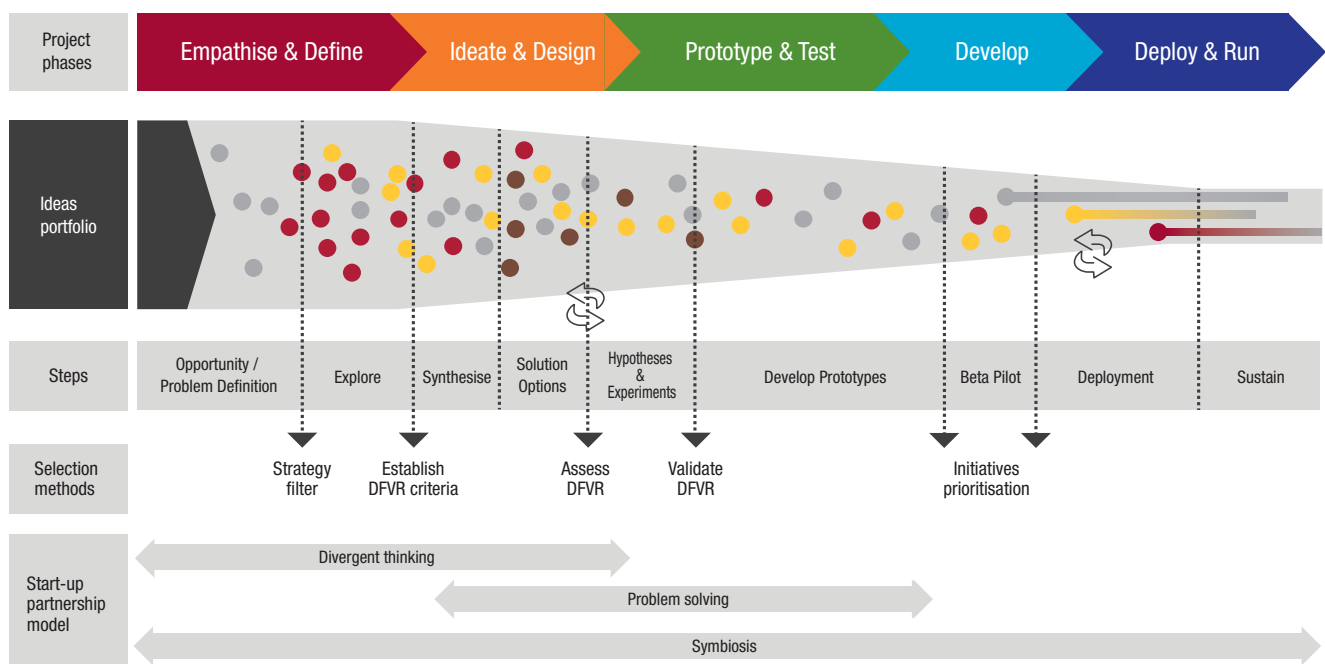
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A structured approach to assessing ideas

In our view, proposed innovations shouldn't be assessed just once at the outset of an innovation process. Ideas and initiatives should instead be assessed regularly throughout. In this way, the DFVR framework can be used to guide innovation. Unlike traditional methods for assessing ideas, this framework allows organisations to take into consideration their existing capabilities when assessing how an innovation will be incorporated and sustained in the context of their business. The graph below shows how and when the DFVR framework can be used in the innovation process.

A structured approach to innovation: focusing on ideas that have the potential to deliver value



Legend:

Ideas originated from

- Organisation early ideas/concepts
- Customer interviews and observation
- Leading practices
- Ideation sessions

The Challenge of Scaling-Up

Offering value to end customers by governing for impact

New financial technologies and business models are still maturing, so it is currently difficult to gauge the extent of the impact Fintech will ultimately have on the Financial Services landscape. For now, incumbents are expected to remain as the cornerstone of the financial services sector. Fintechs will however remain central players in the competition to service a greater share of customer's financial needs.

End customers will only truly experience the disruptive value of these start-ups once they find their way past the next hurdle to innovation – scale-up. Experience suggest that over 95% of Fintech companies fail when they reach the scale-up phase. The ability to grow and retain an active customer base with the necessary available funding pipeline often dictates success and failure for Fintechs. This is where incumbents can make a difference in Fintechs' fight for survival.

For banks, the challenge is to not let traditional risk management methods hinder the development of innovation. In order to harness the full value of innovation, incumbents need to establish supportive governance structures to embed and scale Fintech offerings into the core business. Incumbents often attempt to embrace Fintechs by setting up separate businesses, or adapting a multi-speed approach, where governance and decision making are based in different sets of criteria to the normal ways of working in order to accelerate the delivery of innovation outcomes.

This approach helps to validate the technological concept and marketability with end customers, however to achieve sustained ROI incumbents need to consider how to scale and embed Fintech solutions across the enterprise, so that they can become an integral part of the core value proposition. A good place to start is from the enterprise operating model, to make adaptive changes to people and processes, not just technology.

Challenge		Example
Harness value	Longevity of partnership	What if the Fintech founders decide to cash out?
	Risk exposure	How do incumbents make sure the security, data privacy and compliance of their core business are fully protected?
	Dependency on niche skillsets	What can be done to minimise reliance on niche assets and skillsets such as proprietary machine learning algorithms?
	Leverage front-end capabilities	Should branch staff offer Fintech products to customers?
	Scope of applicability	Is there a use case in other geographical locations with different regulatory conditions?
Governing for impact	Speed to test and iterate	Traditional methods of procurement, commercial and legal constructs can slow down the pace of innovation.
	Metrics to define success	The way ROI is measured by business units may not align with the innovation agenda.
	Time to monetisation	Business Units' priorities may not align with innovative ideas, e.g. in terms of time to market, maturity of technology, costs, or infrastructures.

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From Compliance to Innovation

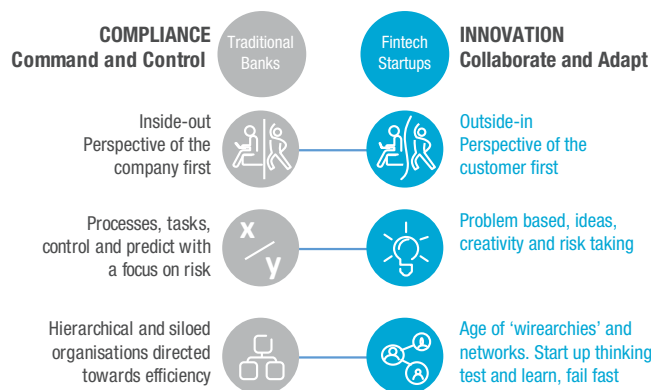
In the world of disruption, will transforming your culture mean thinking outside of the boss?

Elon Musk, who was behind the success of Paypal, didn't have any financial services experience. Zappos promotes the end of hierarchies, and Netflix has no vacation policy. Start-ups promote failure as a principle to grow. Most Fintech CEOs don't have a background in financial services, but instead are focused on better customer experiences; are not afraid to experiment and fail; and are open to taking risks. Incumbents now face a dilemma: how to drive innovation and agility, without disrupting our DNA, legacy, and established trust? Is having ping-pong tables, onsite baristas and colourful offices enough?

Executive buy-in, and shift in cultural mindset to be agile and innovative are recognised as the top two success factors for Fintech Strategy.

Capgemini and LinkedIn WFTR Executive Survey 2016

For a long time, the financial services paradigm has been one of compliance. While a risk-averse mindset has acted as a protective mechanism for incumbents, the attitudes and leadership that have come with it can be a hurdle to the kind of innovative, agile thinking that is needed to thrive in the digital age.



Facing the elephant in the room

'To what extent can we rebuild an elephant so it's half an elephant and half a panther?'

J. Kotter, Accelerate

Conventional collaboration models have been driven by risk mitigation. New initiatives are often kept separate from the mainstream organisation. True transformation however requires being open to failure and experimentation and staying open to cultural cross-pollination between incumbents and start-ups.

Incumbents have the potential to reform traditional approaches to business by learning from Fintech organisations native to the

digital age. Rather than just buying in new talent and capabilities, incumbents can learn from the leadership, mindset, and culture of Fintech start-ups, in order to begin an internal evolution.

Disrupting the status quo and co-creating the culture shift

'Failure is an option here. If things are not failing, you are not innovating enough.'

Elon Musk

Fintech startup DNA is often interdisciplinary, made up of diverse backgrounds and expertise. Fintechs work closely with customers and are quick to respond to unmet needs. They are comfortable with failure and embrace it to innovate. Their way of working can and should disrupt the established status quo. Being open to disrupting your ways of operating by collaborating with these organisations presents an opportunity to evolve your company's culture.

To embrace this journey, it is important to:

- **Start with purpose and mindset:** what does this journey mean for your organization and its leaders? Root your journey in empathy and challenge the elephant in the room.
- **Co-create the new culture:** culture needs to be co-created with team members not just HR; it should be experiential and drive collaboration within and outside with the ecosystem.
- **Think outside of the boss:** bring a diversity of thought - go beyond hierarchies by empowering employees; experiment, fail and learn from it. Trust is the currency for intrapreneurship and ultimately innovation.

By focusing on deep cultural change, collaboration between Fintechs and incumbents can make both parties more resilient and able to thrive in the digital age.

Traditional organisations can learn to answer the bigger question – how can we be more innovative and agile? – while Fintechs can learn valuable lessons in generating stability and trust. Together they can work on 'expanding the size of the pie' instead of just competing for the biggest part.

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CONCLUSION

Fintechs are effectively harnessing digital technologies to cater to unmet customer needs, altering customer expectations in the process. Fintech firms are beginning to reach beyond niche offerings to evolve into significant competition for incumbents in mainstream parts of the financial services ecosystem.

Incumbents will increasingly respond by partnering and collaborating with Fintech firms, in the hope of capitalising on their innovative ideas and sought-after digital and people capabilities.

Collaboration with incumbents also benefits Fintech firms who are in need of investment, access to existing customer bases, scalable processes, and importantly the perception of stability, safety and security that large financial institutions in Australia still benefit from.

Collaborating to achieve combined advantage makes a great deal of sense for both Fintechs and incumbents. However, the task is complex as it requires two very different cultures to come together and learn from one another. We stress that strategic collaboration needs to be thoughtfully planned and executed in order for the endeavour to reach beyond initial hype and excitement.

Always at the forefront of collaborative endeavours should be the central question - how can the customer best be served? Our DFVR Assessment Framework can assist incumbents working through this process.

Fintechs, like all start-ups, face the enormous hurdle of scaling up. Partnering with incumbents is an attractive response to this challenge. For incumbents to truly benefit from such partnerships however, processes and people, not just technology, require attention. Both banks and Fintechs need to dedicate thought and resources towards addressing operational and cultural aspects of their partnership. If approached with a willingness to learn from one another, such partnerships can provide a catalyst for meaningful organisational evolution.

It is important to note that Fintech is not the only disruptive force brought on by advances in digital technology. The fast-approaching threat on the international horizon is “BigTech” – companies such as Apple, Amazon and Google who have not traditionally been involved in the financial services market but own the resources to do so.

These firms are poised to become major players. With access to customer data, established consumer infrastructure such as mobile phones and payment systems, as well as strong brand reputations, both Fintech and incumbents would be wise to consider what the entry of “BigTech” into the financial services market in Australia will mean for current and planned partnerships and service offerings.

Staying ahead in the key areas of price, convenience, access, choice, community, and trust requires harnessing digital technology and capabilities by keeping the customer at the centre. Strategic partnerships, built with appropriate structures and timelines in mind, can help both incumbents and Fintechs to continue to evolve and respond to a rapidly changing financial services landscape in Australia and beyond.



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Australian Digital Transformation Lab

“Co-Creating Digital Advantage”

The Australian Digital Transformation Lab (ADTL) is a joint venture between The University of Sydney Business School and Capgemini Australia. It combines the established academic research skills and knowledge of the Business School's Digital Disruption Research Group (DDRG) with Capgemini's expertise, leadership, and applied innovation acumen in business transformation and organisational change.

The Lab engages in a range of applied research activities and produces insights in the following two key areas, with a distinct Australian focus:

1. Digital transformation of business and customer interaction: Digital technologies are transforming established business models and modes of interactions between customers and business partners. Often narrowly viewed as disruptive threats, the lab highlights and explores the innovation opportunities of digital technologies for rethinking value creation and customer interaction.

2. Digital transformation of work and organisation: Digital technologies enable new forms of work, organisation and culture. The Lab targets the organisational impact of new digital technologies with a particular focus on the paradox and challenges of managing the bottom-up adoption of transformative digital technologies.

As an applied research lab the ADTL combines Capgemini's proven Applied Innovation Exchange, a digital lab and methodology for engaging in customer-centric design, rapid prototyping and digital experimentation, with the academically-minded network and thought-leadership of the Business School's Digital Disruption Research Group.

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