Disruptions in Financial Services

The financial services industry is one of the most fast paced industries and technology is not new to this sector. However, today, a new set of technology trends is disrupting this sector and creating a huge opportunity for fin-tech startups. These disruptions are bound to create some impact on the entire BFSI sector, be it banking, insurance, non-banking finance companies (NBFCs), payments or asset management companies. Let us examine the impact in each of these areas.

Payments

India is on a journey to become a digital superpower and the government is focused on the vision of Digital India, with its various initiatives including demonetization, incentivizing digital payments, and ban on cash transactions above a certain limit.

A number of payments innovations have emerged in the past few years, leveraging mobile and connectivity to make payments simpler and add value. Innovations are making payments more cashless and invisible. New consumer functionalities are being built on existing payment systems and are resulting in meaningful changes in customer behavior.

The recently introduced payments methods such as Unified Payments Interface (UPI), BHIM, Aadhaar Enabled Payment System (AEPS), etc. are some examples of such innovations. Out of the in-principle holders of payments bank licenses, three have already started operations, with some others to follow suit soon. The proposed creation of a Payments Regulatory Board (PRB) within RBI is a great start as it will allow for more representation from payments industry experts in policymaking for digital payments while driving a level-playing field for players across the sector.

Digitisation of payments presents a large opportunity in the Indian context. It is estimated that the total payments conducted via digital payment instruments will be in the range of USD 500 billion by 2020, which is approximately 10 times the current levels.

Technology trends in the form of smartphone penetration, ubiquitous connectivity, biometrics, tokenization, cloud computing and the Internet of Things (IoT) will shape the way consumers transact in the future.

All these will have some implications on the payments sector.

Payments will provide access to customer transaction data, which will enable payment service providers (PSPs) to offer relevant deals, offers and coupons to consumers and influence their consumption decisions.

Using Aadhaar for online authentication and confirmation of KYC data will boost growth of digital payment systems.

The big push for digital payments in India will come from merchant payments. The ability of financial institutions and PSPs to partner with merchants will become a critical component of strategies to drive merchant-specific usage, enable merchant-issued credits, or become a preferred card on merchant platforms. Margins on the current payment and settlement transactions will need to be restructured as competitive pressure grows from alternative methods. As more efficient alternative payment methods are adopted, the role of traditional intermediaries as trusted parties may diminish.

Due to the tight economic model of payments businesses and the preference of customers to use fewer solutions, PSPs will need to extensively partner to lower customer acquisition costs, offer a broad spectrum of solutions and get access to a large distribution network.

Financial institutions may face a new set of risks, such as reputation, security, and regulatory issues as they adopt new payment channels.

Banking and NBFC

Alternative lending platforms are creating competitive pressures on the banking and NBFC industries to become more transparent and customer friendly. P2P lending is one such business model that has gathered momentum globally and is taking shape in India. The RBI has finalized norms for peer to peer lending platforms and is expected to release final guidelines in July. This will have some implications on the banking and NBFC industries.

As savers leverage alternative lending platforms as short and medium-term investment vehicles, erosion may occur among traditional deposits and investment products, such as money market funds offered by traditional institutions, leading to some balance sheet shrinkage. Customers' savings and credit portfolios could become distributed over a large number of alternative platforms with varying reporting standards, making it difficult for financial institutions to measure each customer’s creditworthiness on a consistent basis. This intensified competition may narrow spread between deposits and loans, decreasing financial institutions’ profitability. Financial products and services may increasingly be offered on a stand-alone basis, limiting incumbent institutions’ ability to cross-subsidise.

Financial institutions will have to work with non-traditional players to create new distribution channels, provide competitive product offerings and enable non-traditional services.

With access to more diverse funding options, new companies will be able to grow at a quicker pace and the average time between funding stages will be shortened.

Insurance

Financial disruptions have percolated through the insurance sector as well. These disruptions have impacted almost all the segments of the insurance business, although at varying levelsOpening up and growth of the insurance sector led insurance firms to innovate by either emulating their international strategies for growth in the Indian markets or introducing innovations as per Indian markets. The focus lies on how the current set of innovations has impacted the sector and what lies ahead for it.

The disruptions can be broadly categorized to have occurred in two different forms: The current insurance players innovating their processes and evolution of parallel support organizations that are either disruptive or supportive in nature for the current players, across different components of the insurance value-chain; Manufacturing, distribution, underwriting, claims management and risk management and capital and investment management.

Additionally, several technology-based start-ups such as online web-aggregators have the potential to disrupt the distribution chain to an extent of separating insurers from customer ownership. Also, evolution of insurable entities such as self-driving vehicles could set tough challenges for companies to price their products.

As a better ecosystem for the insurance sector evolves, companies shall have to remain focused and invest in their core-competencies to maintain a competitive stance. The success of the ecosystem shall also depend on the evolution and adaptability of both customers and regulators.

Asset-management companies

Asset-management, in India, by far, remains a conservative sector. The growth in Indian economy, has fueled surplus income and hence, domestic household savings. The gradual shift of the customer segment from xennials to millennials, has increased the demand for greater agility in investment returns and shifted the focus from fixed-income products and thereby, increased the demand for wealth managers.

The sector continues to encounter disruptions on customer-servicing, product innovations and risk management on the operational front. Automated wealth management services may pose as a potential competition for the traditional wealth management services. This may commoditize the wealth management practice and reduce the value delivered by the traditional wealth managers, thereby creating disruptions for efficient pricing of services. Increase in investor education and awareness about investments has further created a healthy competition for the wealth managers in India.

With the growth in outsourcing of key capabilities, technology and processes, larger financial institutions may be expected to lose the negotiation power and may become excessively dependent on third party services.

The key implications could then be, a creation of a wealth management services market without any entry-barriers due to more automation and less personalization of services that used to distinguish the players earlier. This would in turn, reduce the burden on the regulator, as the regulatory models may be expected to shift from interpretation-based approach to more measurable black-and-white approach, reducing the room for interpretation of regulations.

As we understand, the discussed innovations are creating and expected to create several disruptions in the financial sector. What needs to be gauged, is the impact of these disruptions, along with their longevity. The way forward for financial institutions lies in assessing and harnessing their key strengths, and collaboration and co-existence while being adaptable.