Traditional Banks are the New FinTech

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For the past decade, the future outlook has looked rather grim for traditional banks.

Start-up banks that could run at a lower cost and offered more customer-friendly services kept popping up to take away market share. Low interest rates in the last eight years have only rubbed salt into the wound by making funding cheap for the new entrants, which was essential to their success as many of them had to pay high prices to acquire new customers and grow. Cheap capital also jacked up valuations, thereby attracting more investors to put in larger and larger sums. At the same time, negative deposit rates and low interest rates have squeezed the profit margins of banks as they could no longer make money from investing the cash held. Depressed profitability has also left these banks with little of the much needed capital to spend on technologies to catch up with the challenger banks.

Challenger banks are not the only newly appeared rivals. E-commerce companies and tech giants have long shown an interest in offering financial services traditionally supplied by banks. Amazon has for years helped businesses with working capital. Rakuten, a Japanese online retailer, has expanded into banking in Europe since 2016. Uber has offered credit cards in the US. Apple recently launched its own “buy-now-pay-later” (BNPL) product by lending out the cash on its own balance sheet. This is a new addition to the range of financial services offered by the company, which also markets its own branded credit cards by partnering with the retailing banking arm of Goldman Sachs. Regulations have also made life hard for traditional banks. Incumbent banks are often subjected to far more regulatory scrutiny than newcomers.

One obstacle for incumbents to overcome is undoubtedly their legacy IT setup. Compared to their new and more technology-enabled counterparts, the existing digital infrastructure that banks have got often holds them back, affecting their ability to catch up. It is not for the lack of trying: traditional banks have been updating and expanding IT capacities. Yet, decades old IT stacks have made it difficult for traditional banks to compete with new entrants in terms of personalisation, customer experience and innovation. This prompted some of them to try to build completely new challenger banks as side bets. Not all of these initiatives were met with success: UK’s Royal Bank of Scotland created Bó, which lasted only seven months before it was shut down for good.

New economic and business developments create a favourable setting for banks

Against this background, it was expected that incumbent banks would only be able to stay in a defensive position against fintech companies. Lately, however, the wheel of fortune is turning in favour of the traditional banks. To start with, interest rates are most likely to be on a continuous rise, making banks more profitable. This in turn helps them to expand and invest in their lending businesses and build a strong defence against the fintech companies. Simultaneously, less funding is now available to fintech start-ups. The second quarter of 2022 saw a drop of 33 percent in global fintech funding compared to the first quarter, which was already lower than the three quarters prior.[1]

To maintain their appeal, many fintech companies have taken the approach to growth as resorting to offering an ever-widening range of products – from access to airport lounges to share and cryptocurrency trading and sizeable referral fees. Yet, these are very expensive means of growth that are set to become even more so, cheap financing comes to an end.

In contrast, traditional banks have all got large customer bases, making it cheaper for them to cross-sell and easier to move these to new digital banking platforms. In the emerging economic environment, characterised by high interest rates, incumbent banks will most likely to be able to generate far more revenue on a per customer basis than challenger banks.

Indeed, the rise and rise of fintech in the past years has often left us over-estimating their market power.

For instance, in spite of their enthusiasm towards challenger banks, a majority of retail fintech customers (still) do not use them as their primary account to, say, receive their salary or savings. In 2020, the average monthly customer deposit was only £396 for Revolut[2] and, in 2021, £793 for Monzo. Even for Starling, which has been marketing itself as a proper banking institution, this was only £2,180[3] in 2021. After a couple of years of being regarded as the hot growth area in fintech, BNPL may have to confront economic realities. A recent report has shown that a third of the millennials who have used BNPL services have been charged late-payment fees.[4] In an attempt to ensure its economic survival, Klarna, a leader in BNPL, laid off 10 percent of its workforce in May 2022. In fact, companies like Klarna are gearing up for upcoming regulatory crackdowns such as "stronger credit checks".[5] Crackdowns or not, fintech companies, as they mature, will in all likelihood come under the regulatory spotlight. The changing market horizon is now seemingly handing advantages to the traditional banks.

Even though the general environment is turning in favour of the incumbent banks, they must still come up with initiatives fast to fend off new entrants, be they fintech, e-commerce companies or tech giants.

1 https://research-assets.cbinsights.com/2022/07/15100139/quarterly-fintech-funding-Q222.png
2 https://www.businessofapps.com/data/revolut-statistics/
3 https://www.businessofapps.com/data/starling-bank-statistics/
4 https://www.ft.com/content/cf93cd47-21cb-4de3-b201-41f150f5a0e0
5 https://www.ft.com/content/89fc33b7-4029-4ca4-82c1-04065d84fe31

Using technologies that can really work with legacy IT infrastructure

A vital step to enhance competitiveness is to push past legacy solutions. Since banks are organisationally large and complex, it makes good economic sense to focus on improving processes. Despite of the countless number of technology solution vendors, very few are able to offer full solutions that can help incumbent banks automate processes and scale up quickly and without hiccup when integrating with the existing IT infrastructure.

IMMEDIATE BENEFITS: PROCESS AUTOMATION

At Nexus FrontierTech, we help traditional banks transform into new fintech organisations. We believe that there are three critical elements upon which every traditional bank would have to focus when expanding their digital capabilities:

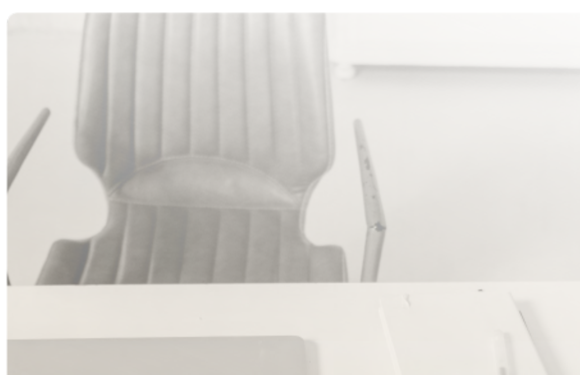
- Technology innovation;
- Risk mitigation; and
- Regulatory compliance.

Our AI technology solutions and continuous supports enable banks to connect and excel in all of these three areas, adding value as a result.

Take automating corporate lending decisions as an illustration. Traditionally, they require manually reading and processing pages and pages of documents provided by a single borrower. In addition, to complying with regulations, the process to reach the loan decision has to be documented properly and to be traceable. To complete all of these adequately means going through labour-intensive and time-consuming processes – some 4 to 6 hours is normal, and in the meantime the borrowers wait for the loans to be made available.

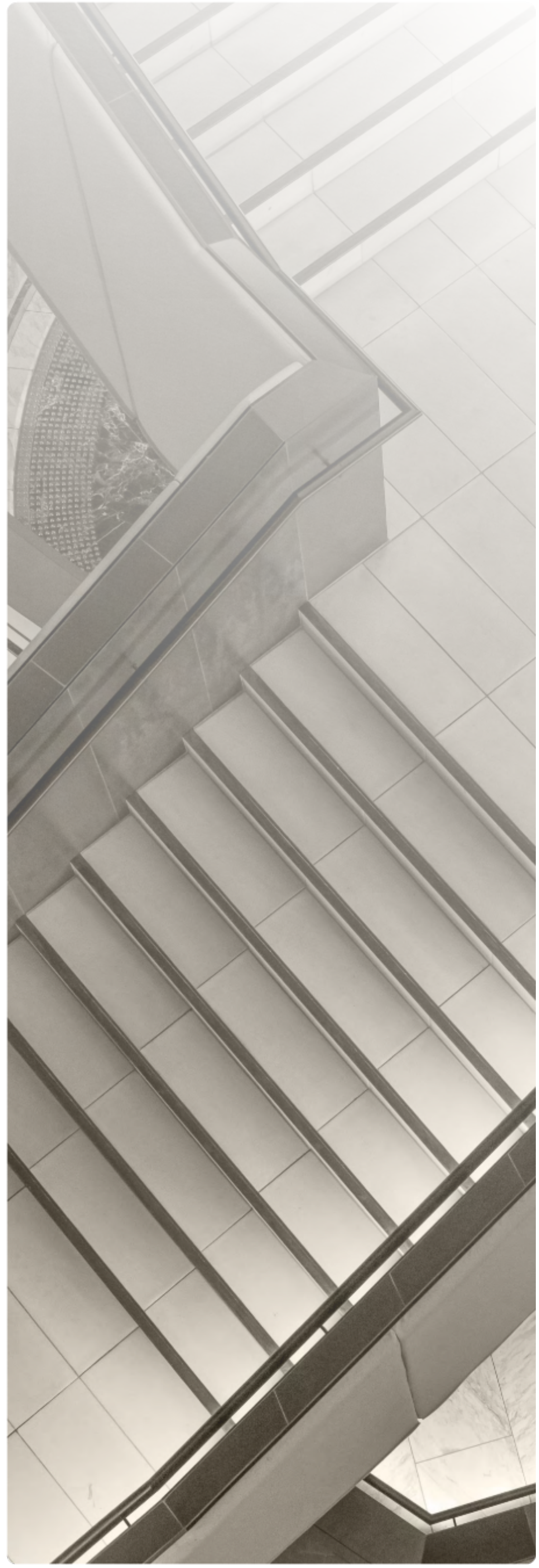
To enable our clients to automate this process end-to-end, we have developed algorithmic models that can extract the required data from the lengthy and extensive documents, all in a matter of minutes and pushing 100% accuracy. This data extraction is conducted with risk and compliance issues in mind. Our systems are configured to allow for full traceability and transparency on the credit decisions. Our development team tailors the AI models to make sure they will work on clients' legacy systems. We understand that technology-driven value can only be reaped over time. Hence, our engineering team works closely with banks' IT team to provide the continuous support that is necessary to maintain and upkeep the effectiveness of the newly improved capabilities.

All in all, our services have helped several clients reduce costs, increase speed and make better use of the data collected, all of which will bring direct positive impact to their bottom lines. These are particularly important considerations at a time when inflation is high and the labour-market tight.



FURTHER VALUE-ADDED: NEW PRODUCT OFFERINGS

From our experience, banks should look beyond gains just from process automation. This is because further benefits can stem from scaling up and extending the same process to other products, for instance, to SME lending. As an illustration, it is not unrealistic to imagine that banks can offer a self-served – i.e. minimal human intervention – loan application process to SMEs and reach a credit decision within an hour after submission. This is neither hypothetical nor farfetched. This, and other new possibilities, can only be opened up if incumbent banks act now to take advantage of the evolving competitive landscape.



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About Nexus FrontierTech

Nexus FrontierTech accelerates decision-making processes by enabling modular automation solutions on our proprietary AI engine. We bring visibility, traceability and usability to enterprise data in real-time, empowering the financial services industry to efficiently develop structured processes for compliance, risk management, and innovation purposes.