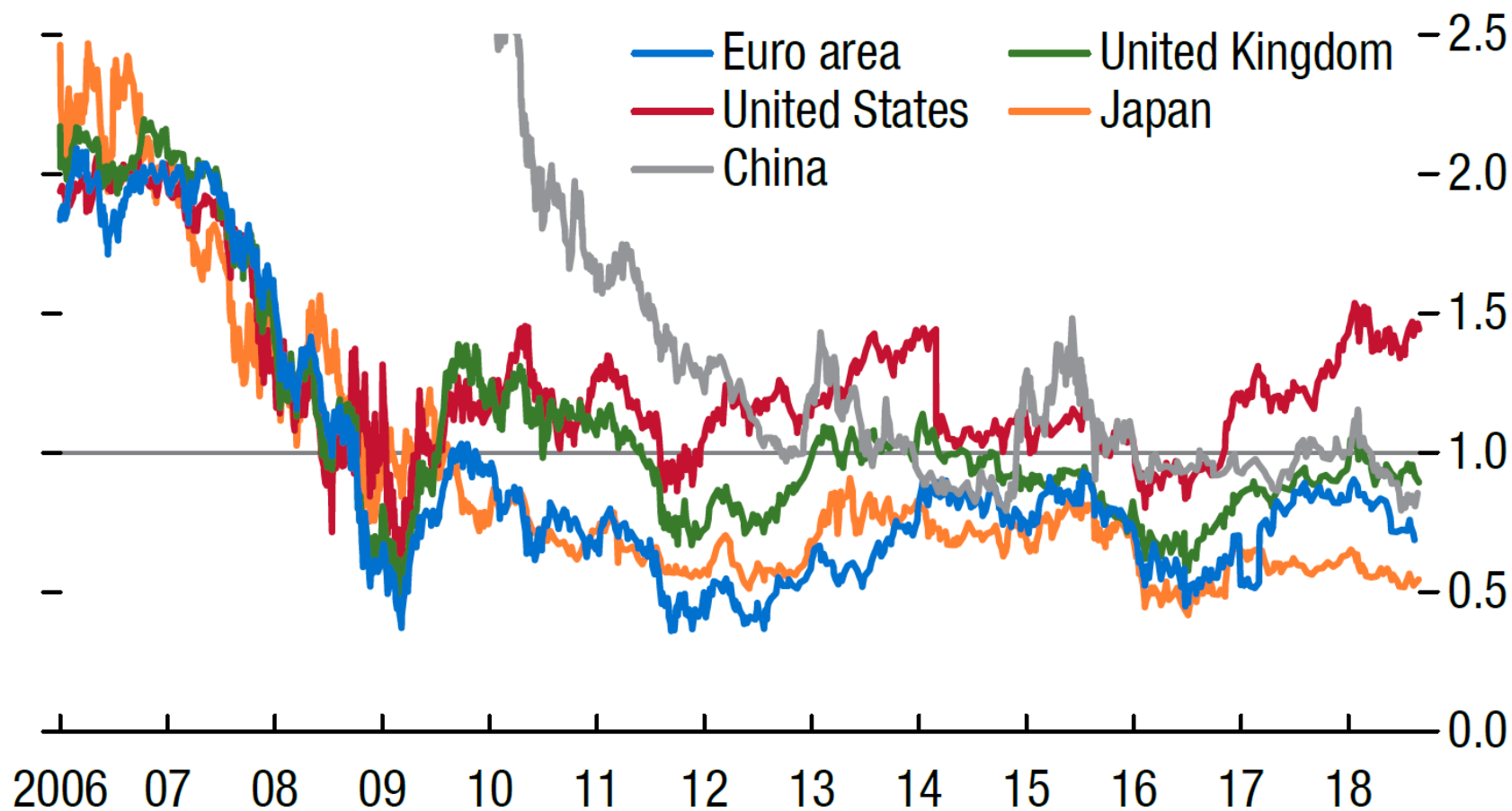


Digital Disruption in Banking

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Bank price-to-book ratios



Source: IMF, Global Financial Stability Report, October 2018

Impact of digital disruption

- Moves the sector to be customer-centered with an upgraded customer experience.
- Leaves incumbents with obsolete technologies (e.g. rigid mainframes) and an overextended branch network while new generations want to bank with the mobile phone.
- The industry is facing a deep restructuring.

FinTech advantages & disadvantages

Advantage	Disadvantage
Superior technology free of legacy systems; leaner operation	Absence of an installed, loyal customer base
Friendly consumer interface and new standard of consumer experience	Limited access to soft information
Focus on activities/business segments with higher ROEs	Lack of reputation and brand recognition
More equity funding	High cost of capital
Able to attract best talent	

BigTech platforms have the advantages of fintechs with none of the drawbacks (plus superior data, technology, deep pocket)→ potential more severe disruption for the traditional banking business.

Strategies: incumbents and fintechs

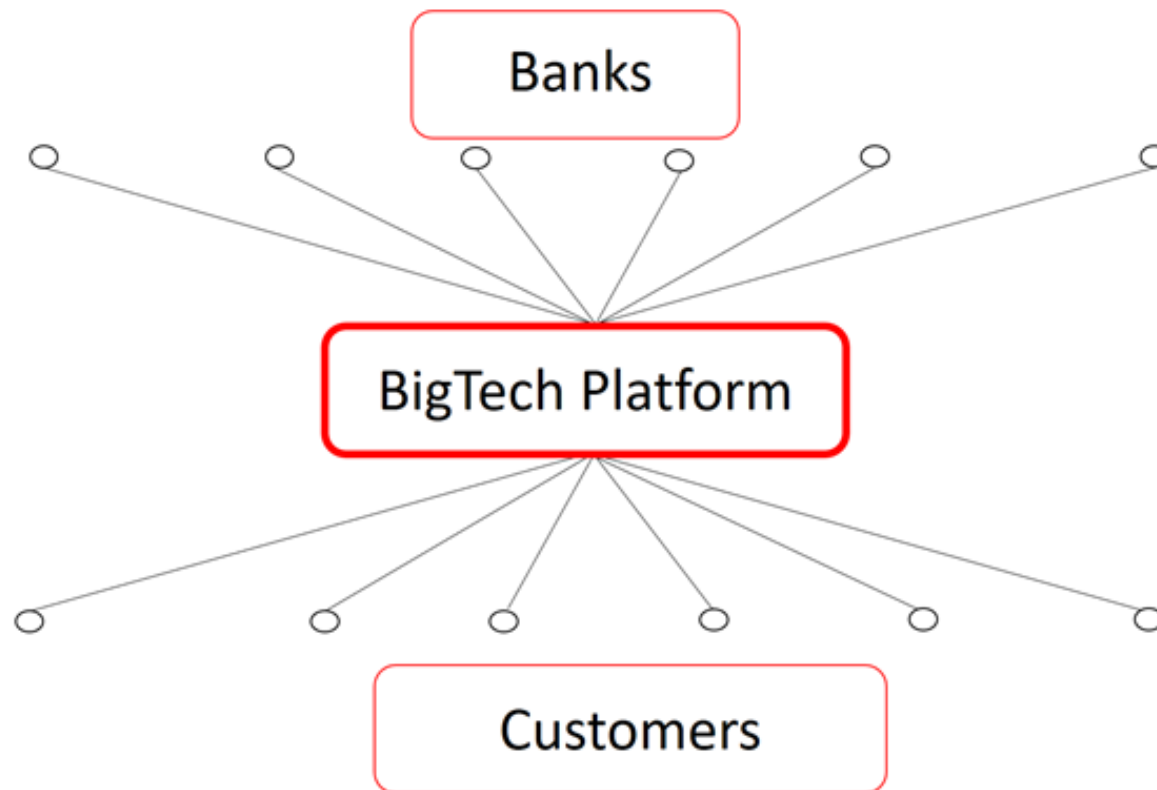
Incumbents strategies (Discriminate by segment)	Fintech strategies
<p>Accommodate ('fat-cat')</p> <ul style="list-style-type: none"> • In the presence of high switching costs • To gain interchange fees paid to them by new service operators 	<p>Commit to remain small ('puppy-dog ploy')</p> <ul style="list-style-type: none"> • No banking license • E.g. with P2P lending that serves unbanked segments of population <p>→ Form partnership</p>
<p>Fight, prevent entry ('top dog')</p> <ul style="list-style-type: none"> • Shutdown/degrade access to infrastructure 	<p>Entry as a (licensed) digital bank</p> <ul style="list-style-type: none"> • Less likely given the high compliance costs involved. <p>→ Consolidate or sell to incumbents</p>
Launch their own fully online banks	

- Advantage of partnership
 - Incumbents benefit from IT knowledge and regulatory arbitrage.
 - Entrants experience lighter regulation, or reach new customers, benefit from established brand, economies of scale and distribution channels of incumbents.

Strategies: incumbents and bigtechs

Incumbents	Bigtechs
<p>Accommodate</p> <ul style="list-style-type: none"> • Cooperate with partnerships • Provide specialized unique banking products and services 	<p>Accommodate</p> <ul style="list-style-type: none"> • Partnerships
<p>Fight/Compete head-to-head by becoming platform/marketplace</p> <ul style="list-style-type: none"> • Profit from superior trust (?) from customers and data security • Better regulatory navigation skills • Cannot match bigtechs' bundling/cross-subsidization strategy with complementary financial and non-financial products/services 	<p>Compete head-to-head</p> <ul style="list-style-type: none"> • Become banks/intermediaries bundling their offerings and exploiting economies of scope <ul style="list-style-type: none"> • Opt not to accept deposits to avoid regulation • Multi-sided platform (marketplace) <ul style="list-style-type: none"> • Platform envelopment • Gatekeeper: Monopolize interface with customers

The future?



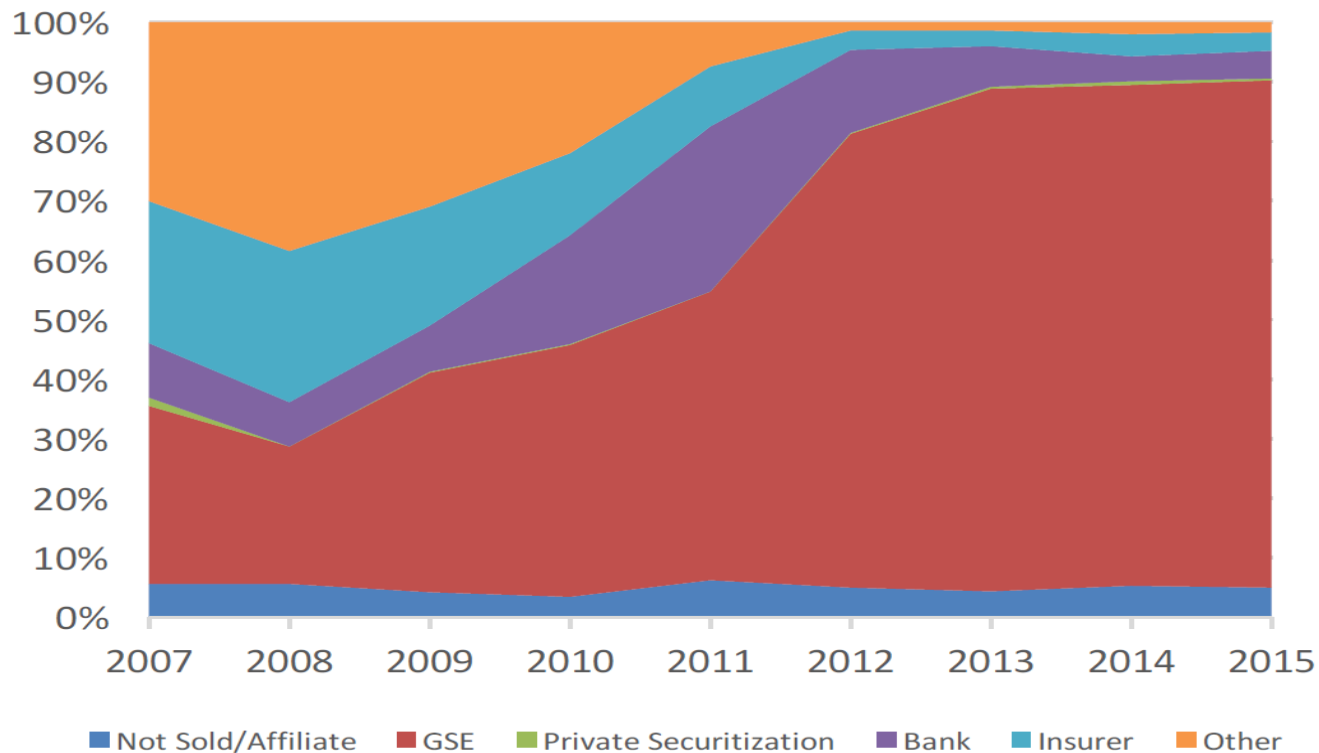
Scenarios

- First impact of digital disruption will
 - increase competition;
 - erode incumbents margins; and
 - increase competitive pressure and contestability.
- Incumbents will have to restructure:
 - The current overcapacity together with the need to invest heavily in information technology in a low profitability environment will lead to consolidation.
- Long run impact will depend on
 - extent of entry of BigTech (modulo regulation) and
 - whether a few bigtechs (perhaps including some platform-transformed incumbents) manage to monopolize the interface with customers and appropriate the rents in the business.

Regulation and financial stability (1)

- Level playing field?
 - EBA consultation: more than 30% of fintechs reported to be unregulated
 - “Open banking”: asymmetry in information sharing requirements between PSD2 and GDPR.
 - Data ownership, portability, and interoperability are key.
 - Market fragmentation and impediment of international operations caused by cross-border asymmetries in data protection regimes.
 - Different compliance burden for dominant players and small entrants (UK)?
 - Regulate activities but entities are those that fail:
 - Tradeoff between regulating by activity, which fosters a level playing field, and protecting against systemic risk of failed entities.
- Heightened regulatory pressure fosters shadow (fintech) banking
 - e.g. US with GSE guarantee.

Disposition of mortgage loans of shadow banks



Source: Fig. 4 in Buchak et al. (2017)

Regulation and financial stability (2)

- Increased competitive pressure decrease profits of incumbents and increases risk-taking.
- New sources of systemic risk:
 - Contamination of bank and non-bank activities in platforms.
 - Interconnectedness /“step-in” risk arising from ownership, partnership or sponsorship.
 - Failure of third-party providers and cyberattacks.
- Consumer protection
 - Data privacy.
 - Integrity of process, traceability of transactions (liability if breach?).
 - Price discrimination. Transparency and behavioral biases.



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COMPETITION AND STABILITY IN BANKING

THE ROLE OF REGULATION AND
COMPETITION POLICY



XAVIER VIVES

A question of balance



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- <http://blog.iese.edu/xvives/>