



Panel of Experts on FinTech Start-ups

# Creation of Innovative Businesses by Financial Institutions

Material for discussion

October 5, 2016

**Provisional Translation  
by the Secretariat**  
Please refer to the original  
material in Japanese

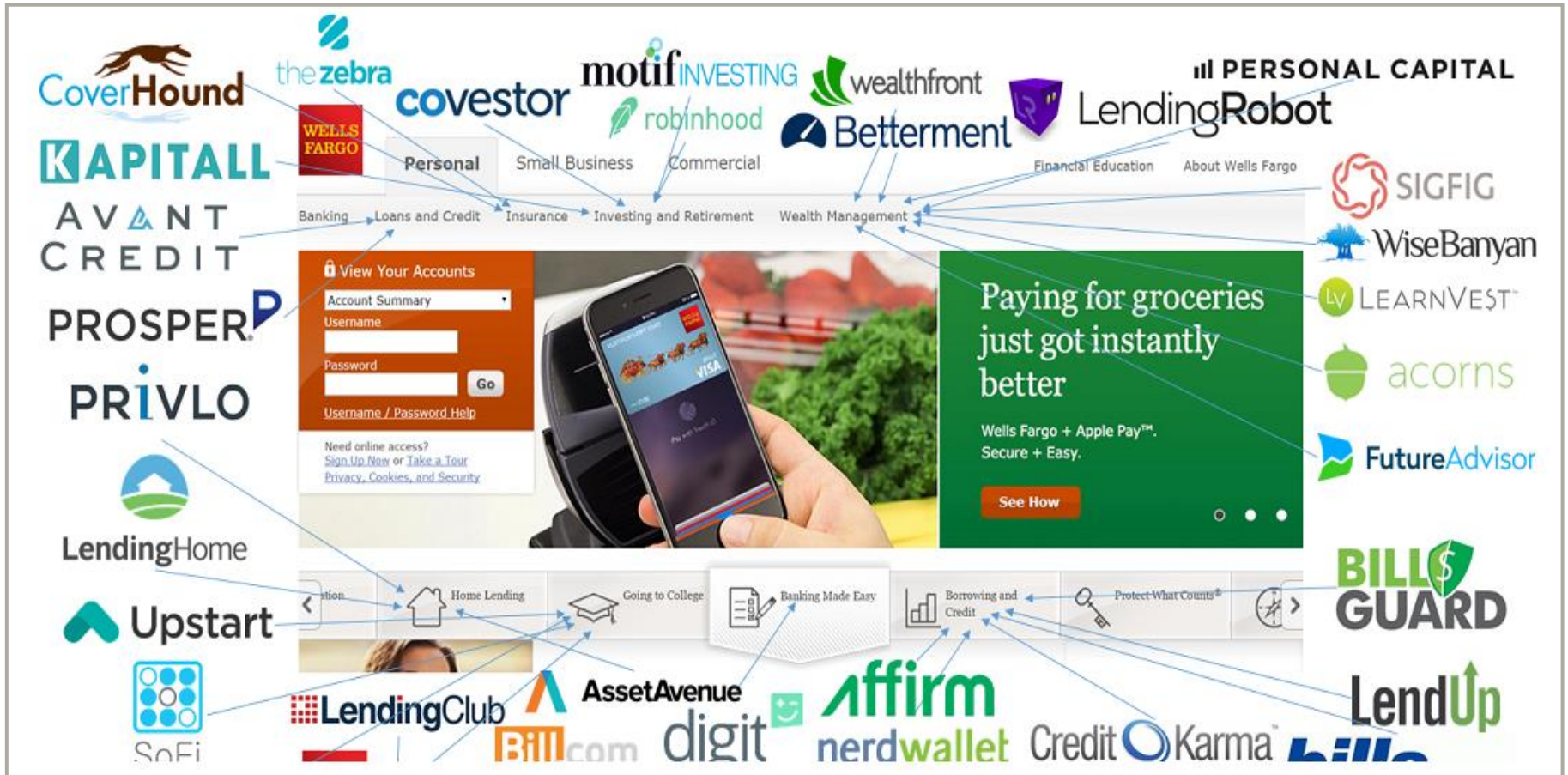
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## Summary

- **In order to create FinTech ecosystems in Japan, it is necessary to build a mechanism to support the foundation and development of FinTech itself, but existing financial institutions, which are to participate in ecosystems, also need to make voluntary efforts to create innovative businesses.**
  - It is a worldwide trend that innovative proposals concerning financial businesses are no longer made by financial institutions themselves but by non-traditional external players.
  - Under such circumstances, existing financial institutions have been seeking the reason for their existence and striving to fulfil socially required financial functions. However, many of them have yet to go so far as to reform their organization or corporate culture, which is indispensable for creating innovative businesses.
- **Therefore, existing financial institutions must first endeavor to create means to provide new value from the viewpoint of clients and develop business infrastructure to enable required collaboration with external partners, instead of only rushing to purchase new technologies from outside.**
  - For example, measures to strengthen contacts with clients focusing on their significant events will also be effective in differentiating a bank from other competitors.
  - It is also necessary to develop new business infrastructure, such as a system under which improvements can be made continuously on a real-time basis.
- **Additionally, it is required to develop a mechanism to allow existing financial institutions to take risks and make challenges in creating innovative businesses in new markets under a new competitive environment. For achieving this, financial institutions need to make requests to the administrative side more actively and the financial authorities need to take prompt measures to alleviate burdens on financial institutions.**
  - In particular, the need to take measures for regulations and give due consideration to safety and reliability creates a significant financial burden. How much can such burden be alleviated?
  - If it is difficult to change an existing organization or corporate culture, is it possible to spin off the relevant organization itself?

Almost all services of retail banks can already be replaced with FinTech...

Separation of banking functions - Scope of banking functions targeting individual clients



FinTech is now prevailing also among businesses targeting SMEs.

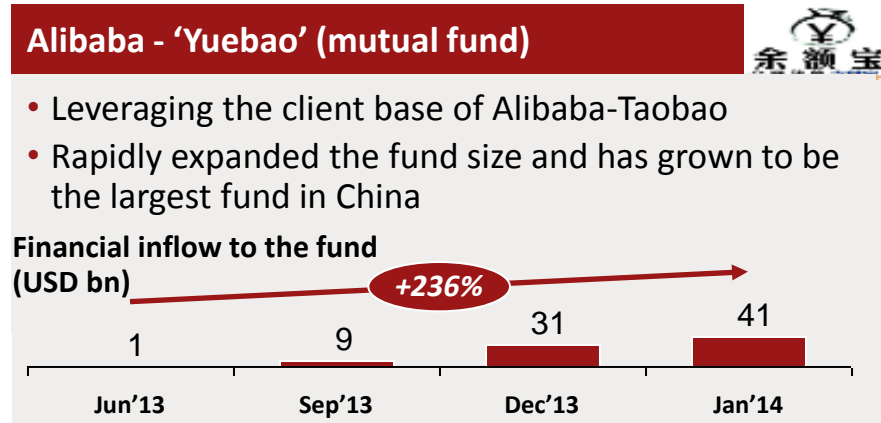
Separation of banking functions - Scope of banking functions targeting SMEs

The image shows a screenshot of the HSBC Business Banking website. The main heading reads "Every business has its own story" with the subtext "We create different business bank accounts to suit different needs". Below this, there is a section titled "Discover products and services for your banking needs" with a grid of service categories: Community account, Other accounts, Finance & borrowing, Credit cards & debit cards, Payment services, Business insurance policies, Business savings & investments, Ways to Bank, International business, and Pensions. To the right, there is a "Get in touch" section with contact information and a "Retrieve application" link. The website header includes the HSBC logo, "the currency cloud" logo, and navigation tabs for Personal and Business. A search bar and "LOG ON" button are also visible. Numerous fintech logos are overlaid on the image with yellow arrows pointing to specific services on the website: Wonga, Spotcap, Funding Circle, FINEXKAP, fleximize, iwoca, capiota, HOLVI, Trade River, Ebury, Lydia, jusp, ensygnio, payleven, Klarna, adyen, sum up, iZettle, BILLPAY, and GOCARDLESS. The "Payment services" category in the grid is the primary target for these fintech logos.



In China, innovative players, FinTech companies, are reforming the structure of the banking industry.

Online Asset Management Services



Microcredit



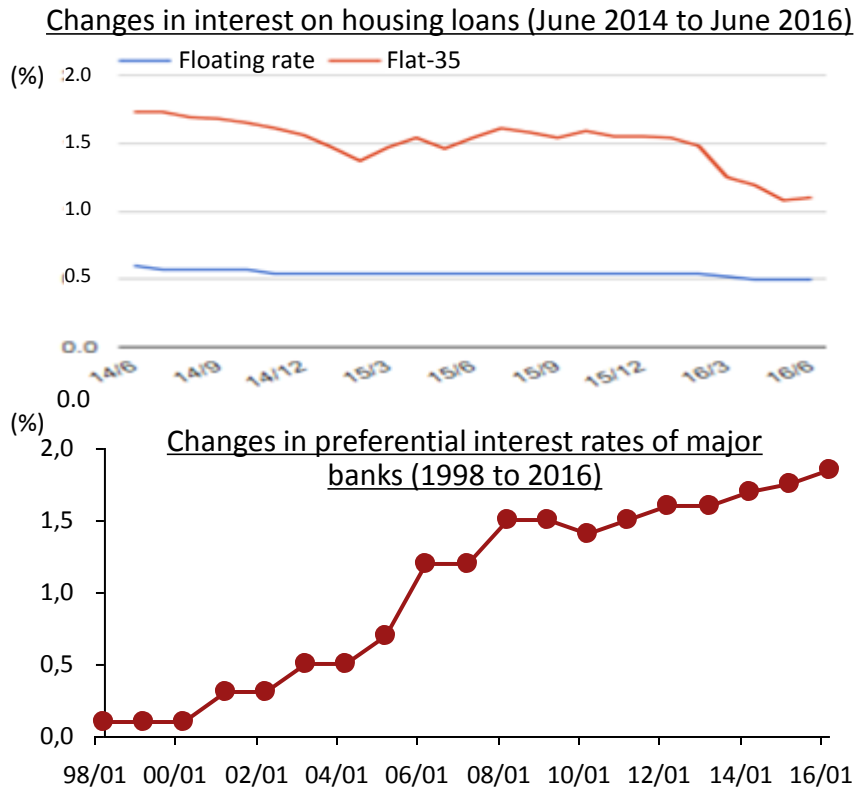
P2P Lending



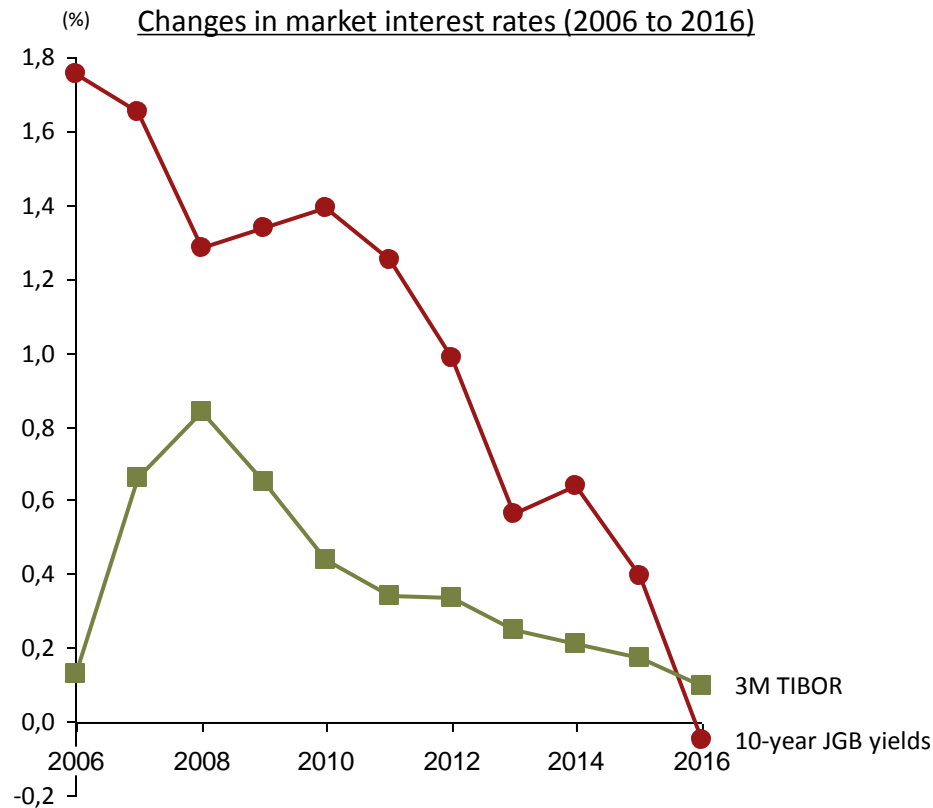
1. Alibaba: 2010 - Jun. 2013; HC360.com: Jan. 2013 - Jun. 2013; JD.com: Oct. 2012 - Jun. 2013  
Source: Web sources, A.T. Kearney

Services of retail banks, where FinTech and entries of other types of businesses have not prevailed, will become less profitable due to changes in the competitive environment and external environment.

**Housing loan business: Interests on loans are at record-low levels partly due to expansion of preferential interest rates.**

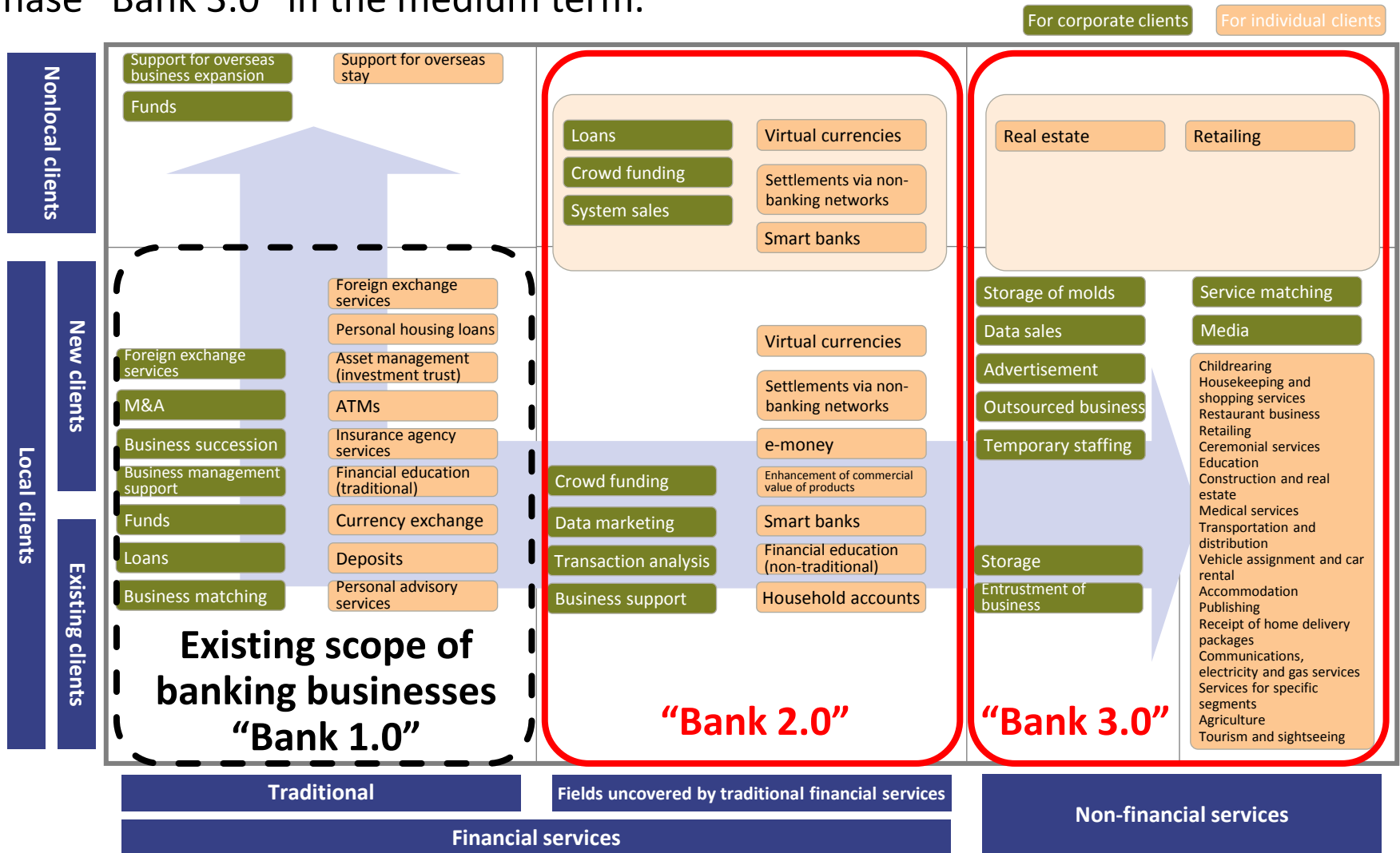


**Designated financial institution business of local banks: Accumulation of deposits may be risky under the negative-interest policy.**



**Under such circumstances, banks are facing the need to take new measures, such as strengthening of corporate capacity and enhancement of efficiency through reorganization, creation of new business models, or entries into new types of businesses.**

Banks need to expand the scope of businesses. They have to utilize digital technology and be prepared for the possible need to expand the business scope to Phase “Bank 3.0” in the medium term.



[Example: Bank 3.0] Nedbank (South Africa) analyses clients' personal data to strengthen services it provides and also promote its business to support other companies' marketing.

NedBank's Market Edge (marketing support services)

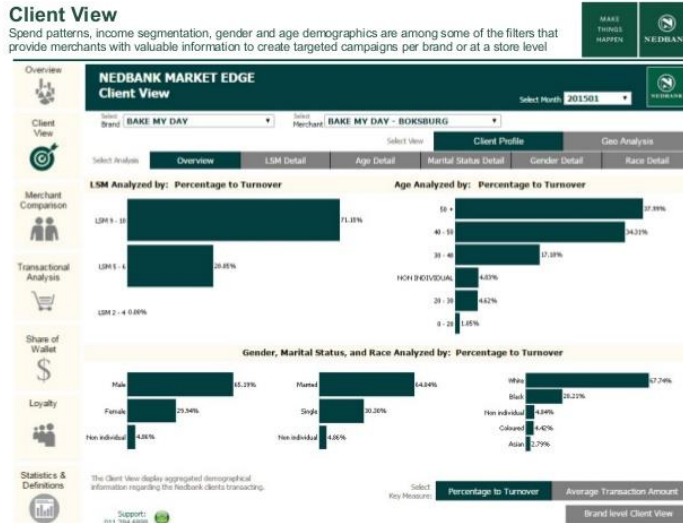
Outline of Nedbank

(Example 1) Tabulate purchase records by client attributes

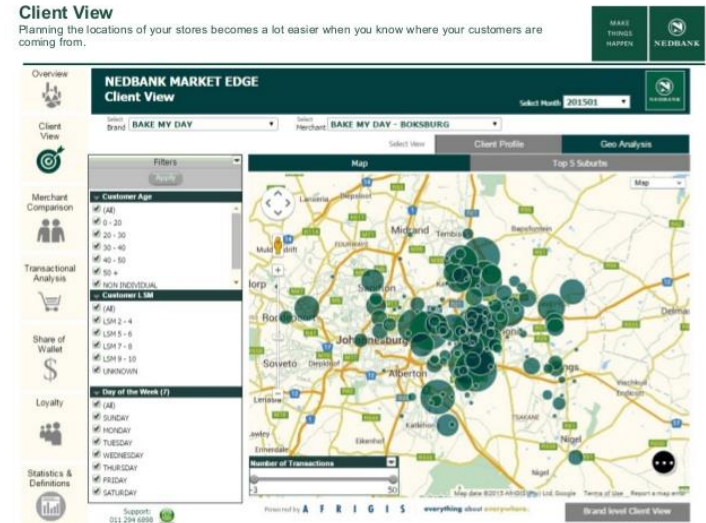
(Example 2) Make visible the regional distribution of clients for companies it supports



- Split off from the parent company in 1951
- From Dutch Bank and Credit Union for South Africa (established in 1888)
- The largest bank in South Africa
- Total assets: 866.5 billion ZAR (approx. 6.3 trillion yen)
- 30,000 or more employees
- Providing marketing support services called "Market Edge" to other companies



- **Data of purchase records tabulated by client attributes are used in establishing brands and formulating campaign strategies for each shop.**
  - Spending patterns, income, gender, age, race, etc.



- **This service to make their clients' regional distribution visible helps supported companies decide where to open new shops.**



In the meantime, four erroneous beliefs have delayed banks' digitalization in the FinTech revolution.

**Beliefs**

**i Banks: "We are already innovative..."**

**ii Concerning digital banking: "New technologies are not safe..."**

**iii Concerning digital banking: "We will add digital banking as a part of our omni-channel strategies..."**

**iv Concerning FinTech: "This is only a temporary fad and will be regulated sooner or later..."**

**Reality**

- Banks have invested several billion yen in creating digital platforms but have failed to reduce costs as expected by consumers and have failed to satisfy them.
- It is quite natural that banks have such worries, but they should look for solutions to ensure safety instead of rejecting new technologies. Are there any effective solutions already in the market?
- Such approach to consider digital banking as an additional service will increase complexity and rigidities, and will eventually increase the cost. Innovation must be commenced from the core business.
- So far, the regulatory authorities are allowing the expansion of FinTech and the momentum of innovators in this field.

# Even if banks commence initiatives, their actions for creating innovative businesses end up in failures in many cases.

## Frequently observed initiatives concerning new businesses

## Results

### Establishment of a promotion team

- The top management directs the promotion team to discuss possible new businesses as it is the trend.
- It is not clear what level of achievement should be sought and by when.
- The team consists of only staff of the bank.

- There are gaps in expectations between the top management and the sales department. The team is pressured to show results and is apt to seek short-term achievement.
- Breakthrough ideas seldom come from the conservative staff of the bank.

### Formulation of a business concept

- From the need to achieve some results in a short term, the bank is apt to devote itself to discovering and acquiring technologies with high potential.
- The bank rushes to make investments to monopolize technologies or establish an independent laboratory in order to exclusively own technologies without having good judgment.
- The bank considers what can be achieved with such technologies after acquiring them.

- The involvement of the bank's corporate culture triggers outflow of excellent personnel who would lead the FinTech initiatives (as in the case of the purchase of Simple by BBVA).
- The emergence of new FinTech ventures caused technologies held by companies that the bank had acquired to be outdated.
- The laboratory fails to attract top level technologies as the holders of such technologies do not want them to be monopolized.

### Materialization of the concept, implementation and improvement of initiatives

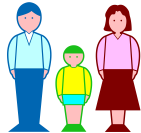
- Fearing failure, the bank completely materializes the concept before commencing the initiatives.
- The bank carefully considers how to synergize new businesses so as to avoid them from infringing on existing businesses.
- The bank considers how to link new businesses to existing IT infrastructure.

- When the bank finally finishes preparations for starting a new business, competitors have already gone far ahead.
- The bank strives to maintain existing businesses and high-cost infrastructure and the created business model may end up to be destructive.

Furthermore, there is a structure that hinders challenges of financial institutions in Japan.

**Negative Triangle that Generates Mismatch in Supply and Demand for Financial Institutions**

**Clients (consumers)**

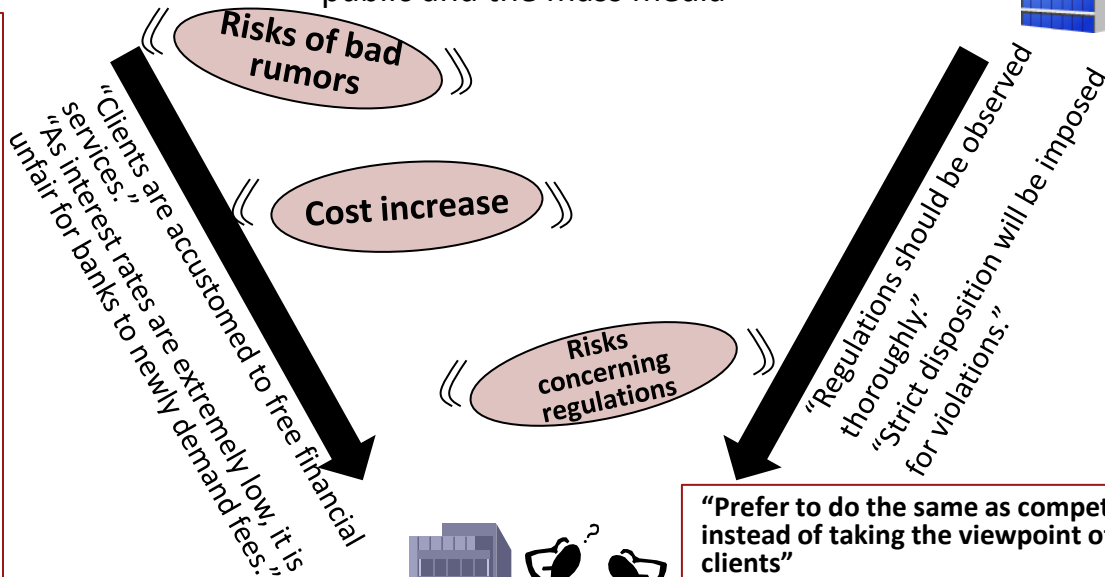


**“Financial services are free of charge.”**

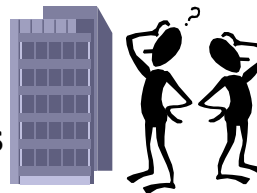
- Clients have long received the free services of banks for currency exchange and deposits over the counter and visits of bank staff for collecting money, etc.
- They take such services as granted and generally consider that financial institutions should not demand fees therefor.
- As interest rates are extremely low, clients are more unwilling to pay fees.

Politics sensitive to criticism by the general public and the mass media

**Administration**



**Financial institutions in Japan**



**“Prefer to do the same as competitors instead of taking the viewpoint of clients”**

- They seem to consider it more profitable in the end to do the same as competitors than to start something new by searching for new needs from the viewpoint of clients. (Stay-the-course approach)

Lack of competition in the area?

Lack of pressure from shareholders?

Apt to seek short-term performance due to short tenure of the top management?

**However, due to entries of different types of business and the emergence of FinTech, financial institutions in Japan can no longer delay their challenges for innovation.**

# Factors for Success for Banks in Creating Innovative Businesses as Suggested by A.T. Kearney

## **1 Clarify the mission and roles of innovation promotion teams/organizations and authorities given thereto for promoting the initiatives**

- Clarify matters to be achieved and deadlines therefor, as well as the authority system, personnel requirements and evaluation items for promoting the initiatives
- Have the top management and the sales department share basic principles so as to avoid creating pressure to achieve prompt results

## **2 Create means to provide new value from the viewpoint of clients**

- Instead of rushing to purchase technologies from the outside, first define clients to be targeted and value to be provided and create an ecosystem together with appropriate external partners (collaboration model based on a partnership)
- Provide new client experience through such measures as strengthening contacts with clients focusing on their significant events

## **3 Develop business infrastructure on the premise of digitalization**

- It is necessary to conduct an objective evaluation of and take measures for the entire business infrastructure of the bank on the premise of digitalization.
- Build a system and corporate culture under which improvements can be made continuously on a real-time basis



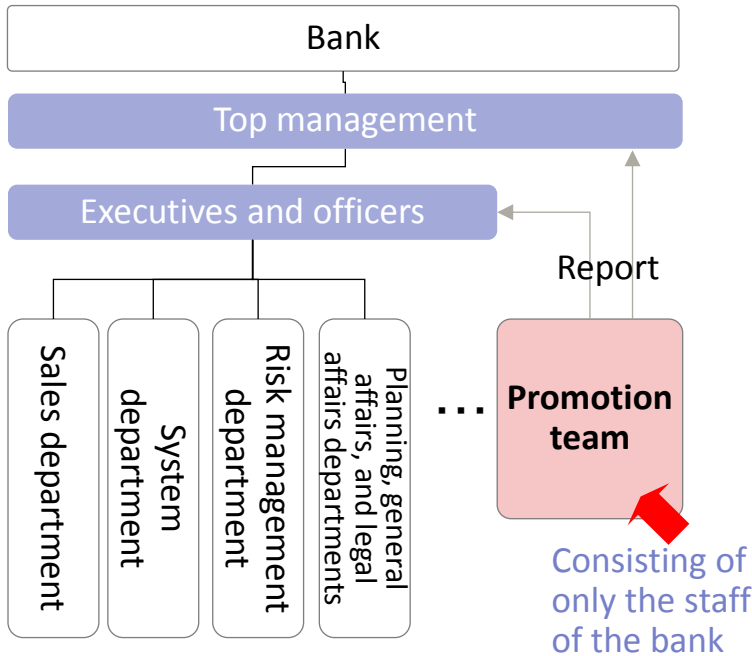


# Innovation promotion teams/organizations should be granted authorities to conduct trials under direct control of the top management.

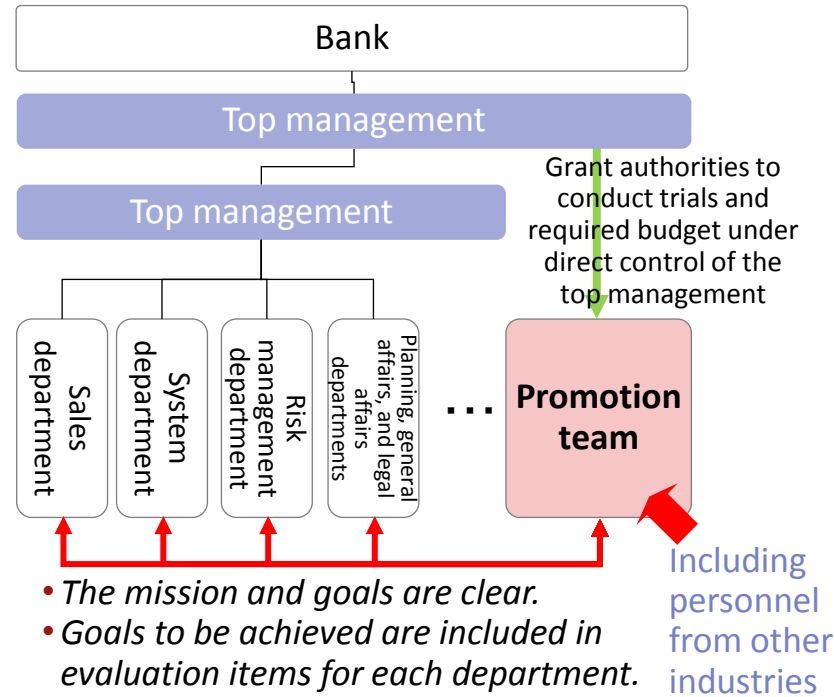
Positioning within the organization



Frequently observed cases



Preferable direction to be aimed at

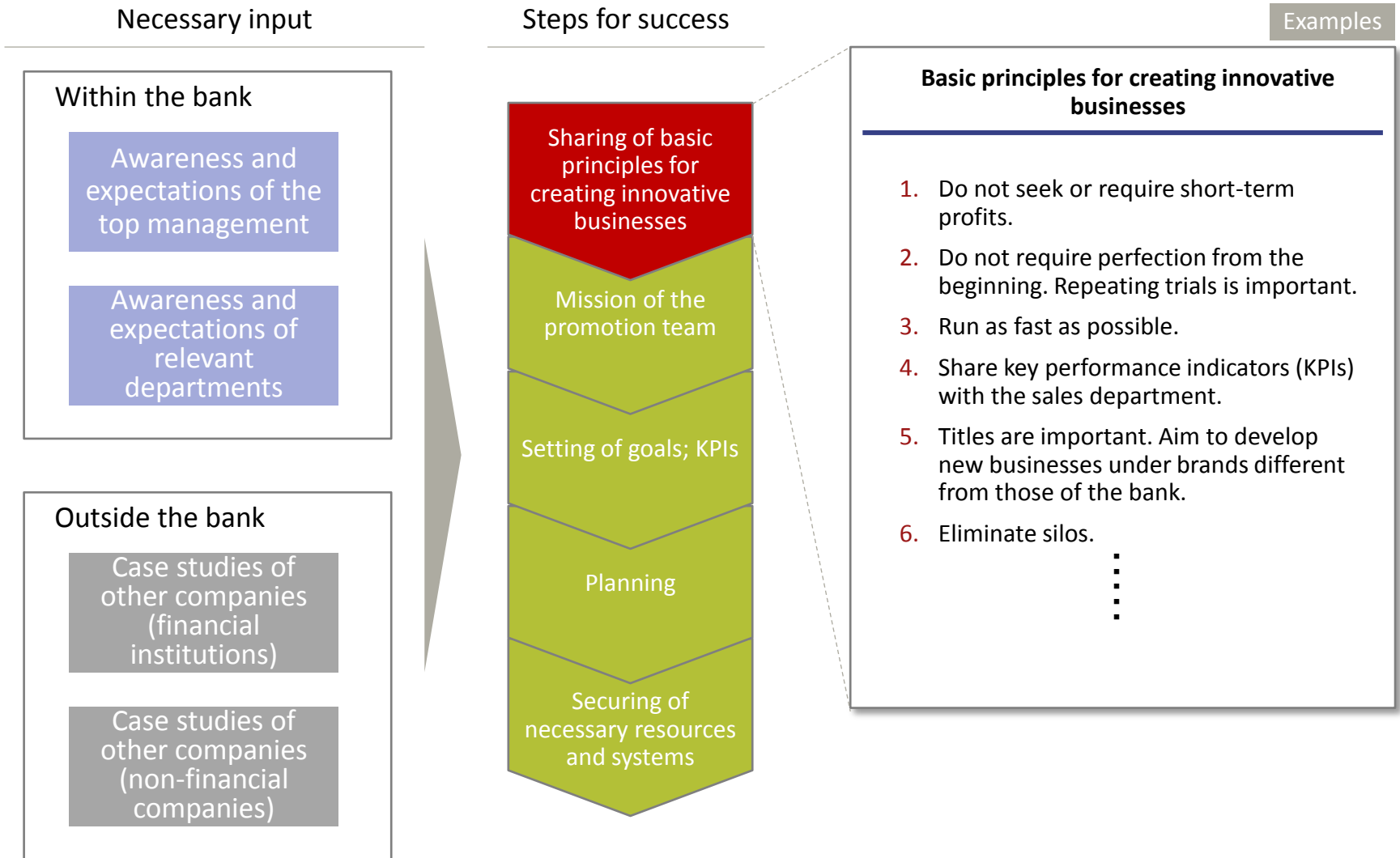


What can occur

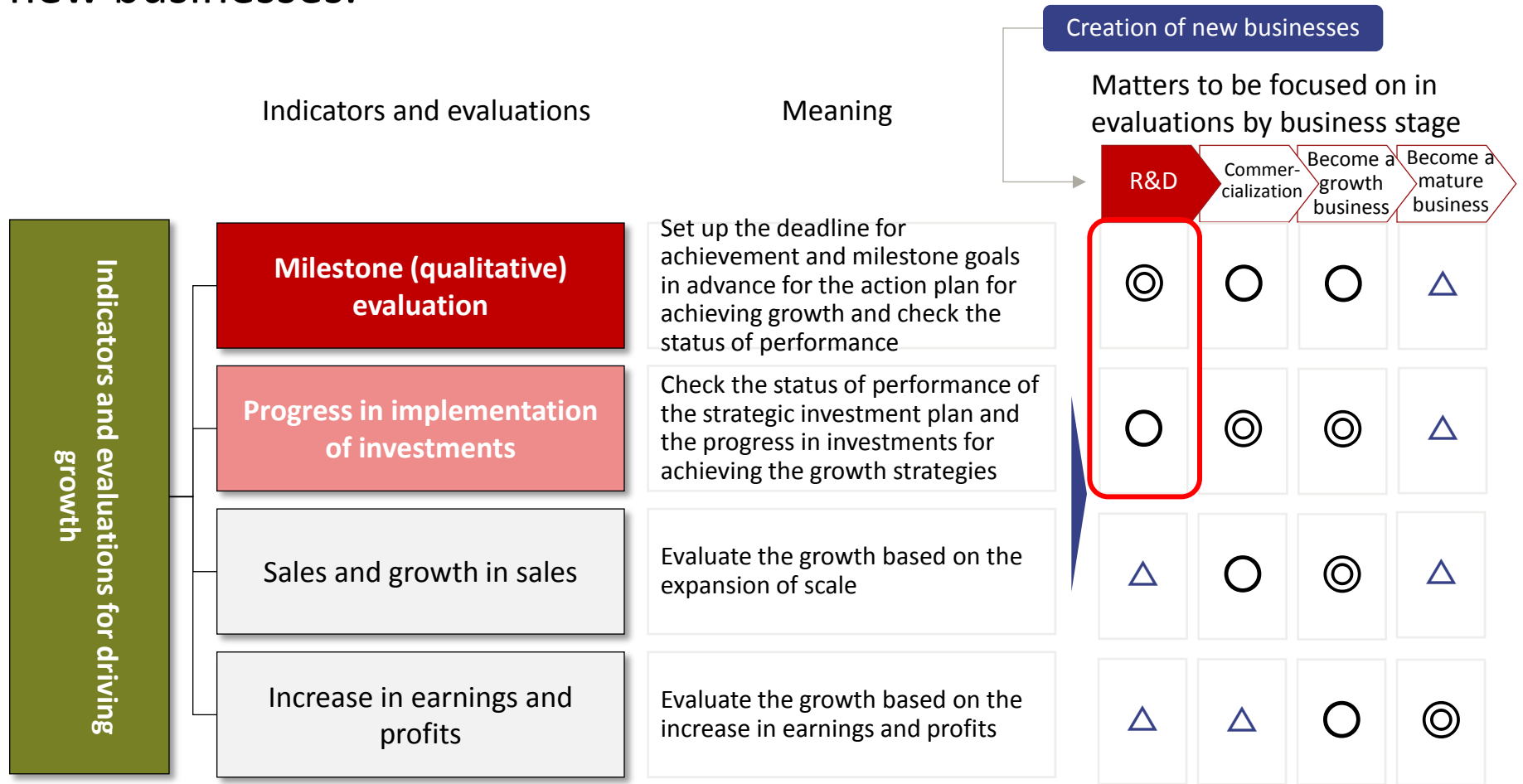
- Promotion team members do not actually understand what they should do.
- Officers and field staff require the team to contribute to increasing profits.
- The team seeks some new ideas or technologies that would generate profits in a short term without having been given clear mission and goals.

- The mission and goals are shared.
- The team is not required to contribute to increasing profits in a short term.
- In collaboration with the sales department, experiments and trials of new businesses are facilitated.

Basic principles for promoting the initiatives should be shared among the organization to increase the certainty of success.



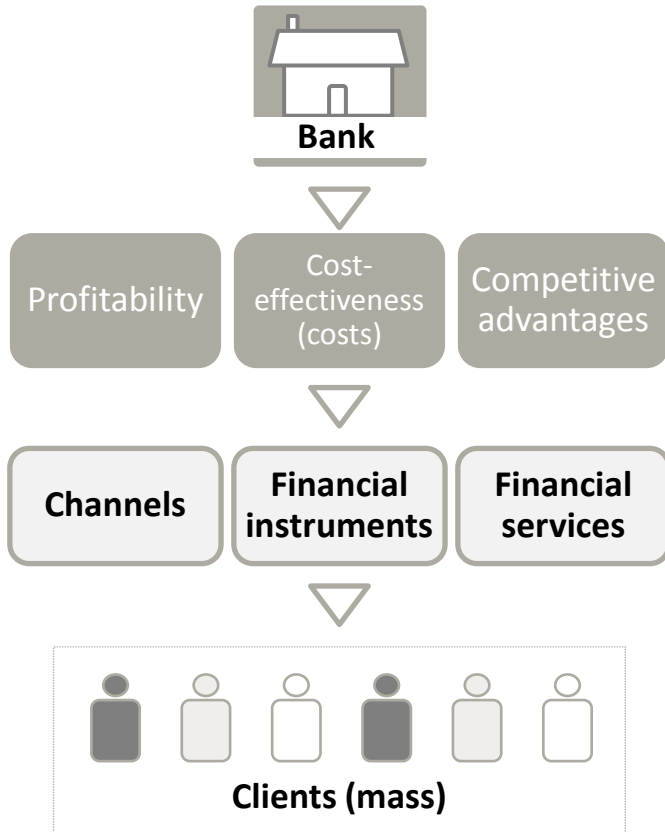
# Set proper key performance indicators (KPIs) suited to the creation of new businesses.



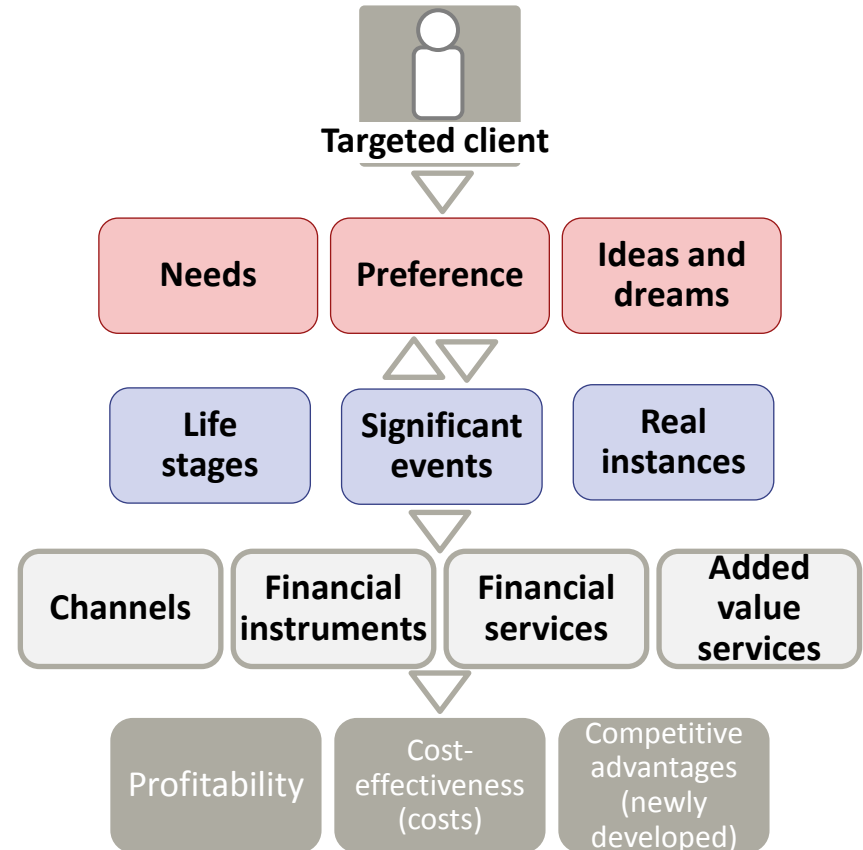
**Milestone (qualitative) evaluation and evaluation of the progress in implementation of investments are the bases.**

What is required when considering services is the perspective of what the bank can achieve for clients rather than the perspective of what the bank wants to provide.

### Up until today: Centered on the bank



### From now on: Centered on clients



**Reform going so far as to change banks' conventional corporate culture is indispensable.**



# Designing services focusing on clients' significant events in their life stages is effective in differentiating a bank from other competitors.

## ✘ Not a significant event

From a client: "I need ..."



- "I want my lost credit card reissued."
- "Please arrange a housing loan program."
- "Please set a credit line."
- "Please consolidate my debts."

From a bank: "You need ..."



- "We can offer you attractive convertible bonds."
- "Let me check the credibility of your business for the next year."
- "Your credit line can be expanded by one million yen."

The focus is on the characteristics of financial instruments.

## ✓ Significant events

- "I lost my wallet."
- "I am thinking of purchasing a house for the first time."
- "I would like to expand my business."
- "I lost my job." "I got divorced."

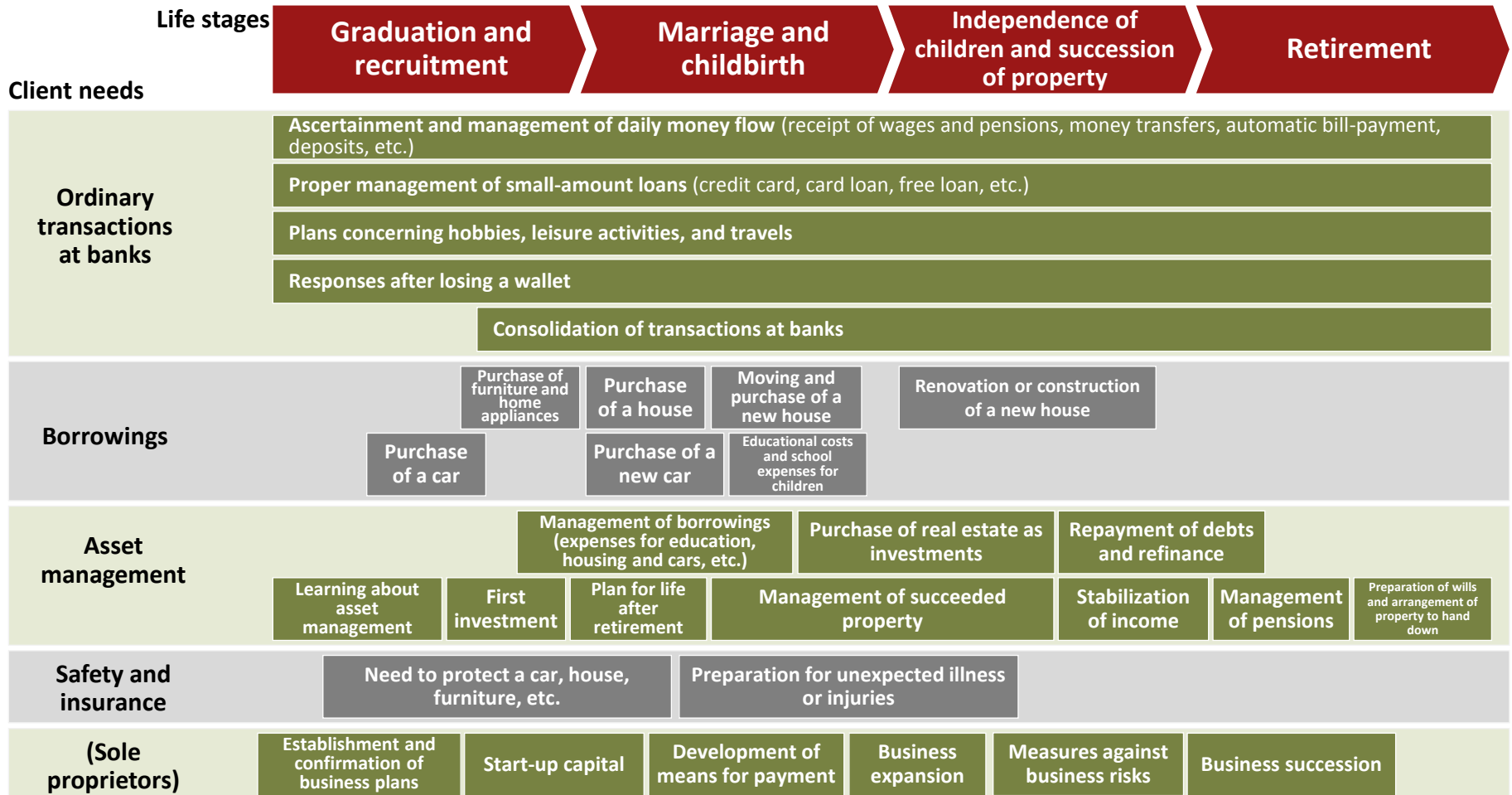
- "Let us consider how to plan your income level after retirement."
- "Let us seek means to achieve further success in your business toward the next year."
- "We can help you increase your earnings by two million yen."

The focus is on client needs.



Analysis of situations where clients utilize financial services reveals clients' significant events in their life stages that will give financial institutions opportunities to provide services.

### Clients' significant events that give hints for designing services



If any service that covers clients' significant events in full or in part is developed, this may create new value that is significant and helpful for both banks and clients.

### Example: What can be proposed upon a client's first home purchase

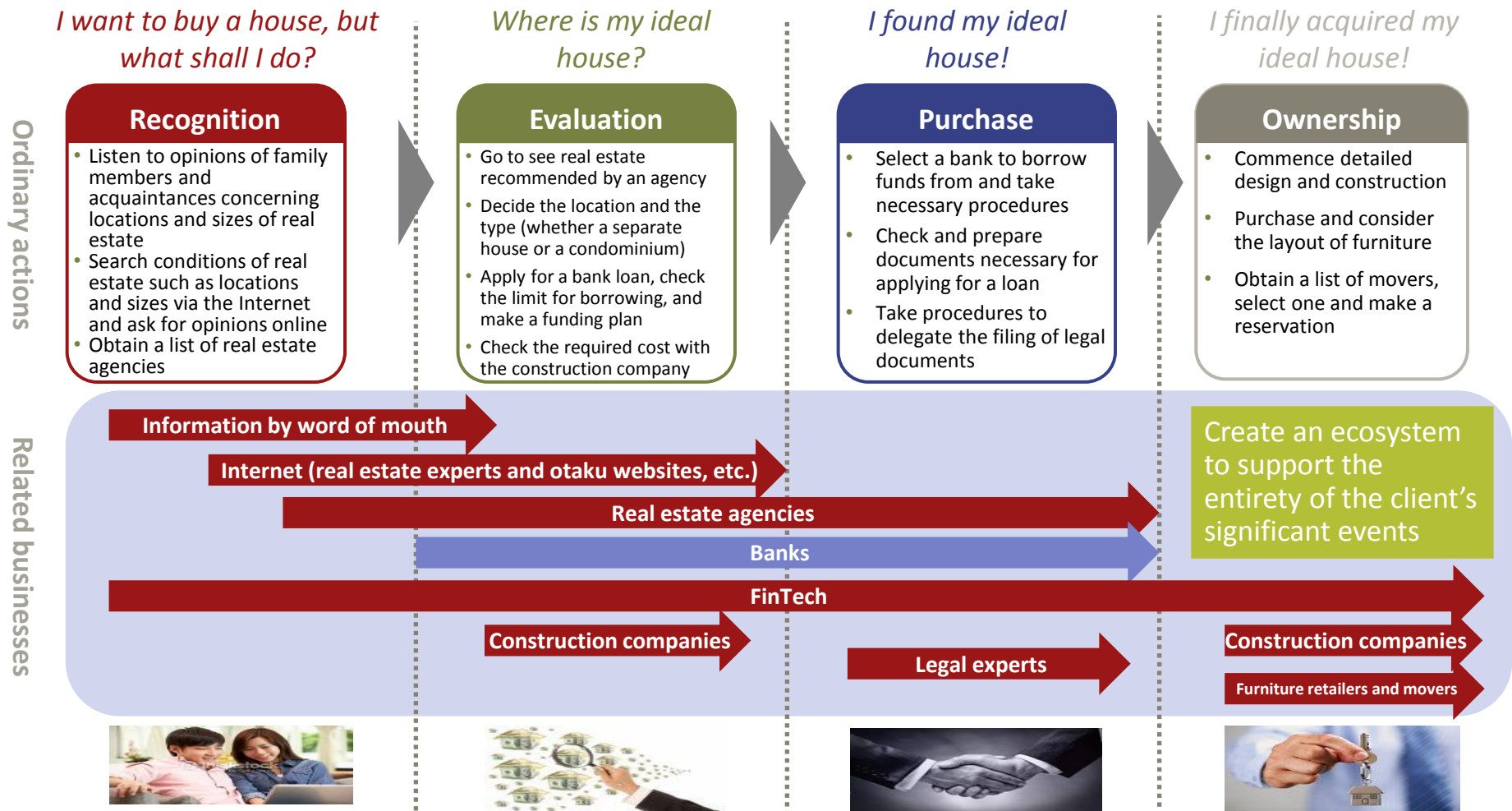
Example

	What a bank provides (example)	Value for a client	Economic efficiency for a bank
Savings	<ul style="list-style-type: none"> <li>Set conditions in advance in such a manner as "If you continue transactions of ordinary or cumulative deposits for two years, we offer you a service to automatically accept your application for the first housing loan up to XX yen. We will issue a written provisional acceptance of loan application for prior examination to be submitted to the seller of the real estate."</li> </ul>	High	High
Selection of real estate	<ul style="list-style-type: none"> <li>An original database compiling price histories</li> <li>A database compiling various lists and information on developers of real estate for pre-sales</li> </ul>	High	High
Purchase	<ul style="list-style-type: none"> <li>Information on a reliable support service provider who helps price negotiations as a third party</li> <li>Agency service to file applications for various subsidies</li> </ul>	High	Medium level
Renovation	<ul style="list-style-type: none"> <li>Information on a network of reliable renovators (negotiation to make loan interest and other conditions more advantageous to the relevant client)</li> </ul>	Medium level	Medium level
Furniture	<ul style="list-style-type: none"> <li>Dealing with a major department store (negotiation to enable the relevant client to purchase furniture, etc. at a discount)</li> <li>Automatic raising of the upper limit of credit cards or personal loans</li> </ul>	Medium level	High
Security	<ul style="list-style-type: none"> <li>Life insurance customized for the relevant client</li> <li>Home insurance and furniture insurance customized for the relevant client</li> </ul>	Medium level	High
Moving in	<ul style="list-style-type: none"> <li>Information on a network of reliable movers that provide transport and unpacking services</li> </ul>	Medium level	Medium level
Miscellaneous notifications	<ul style="list-style-type: none"> <li>A checklist of things to be done before and after moving and various notification forms that may be filled in and submitted easily (address change notices, etc. to be submitted to a water supplier, gas company, post office and banks, etc.)</li> </ul>	High	High

When providing services, banks should create a mechanism (ecosystem) in collaboration with external organizations to support the entirety of clients' significant events.

**Example of an ecosystem concerning a client's first home purchase**

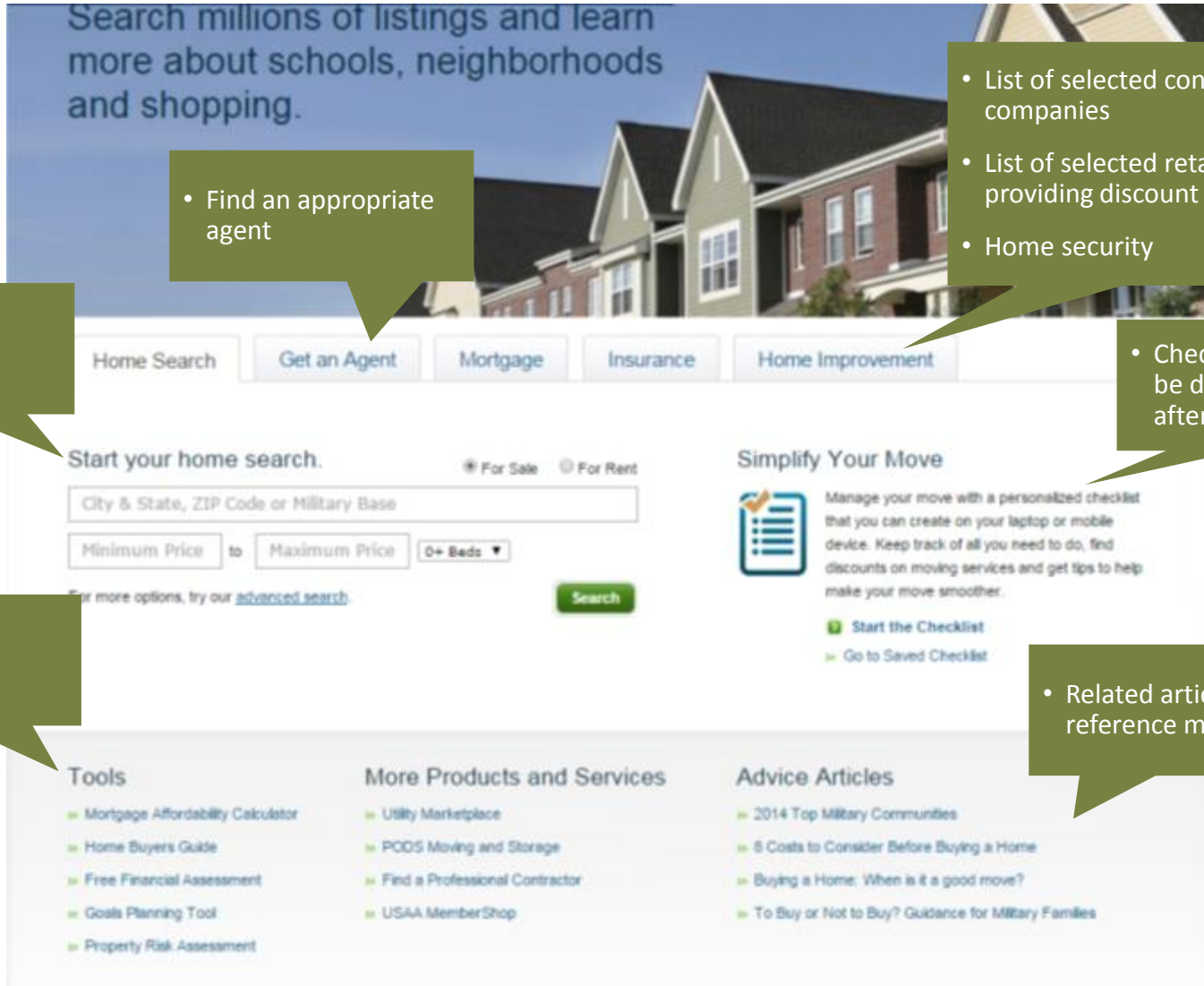
Example





# [Example] USAA's Service to Support Home Purchase

USAA (United Services Automobile Association) is a company located in San Antonio, Texas, which is specialized in financial business and insurance business targeting American soldiers and civilians employed by the military, as well as their families.



• Find an appropriate agent

• Home search

• List of selected construction companies  
• List of selected retailers providing discount  
• Home security

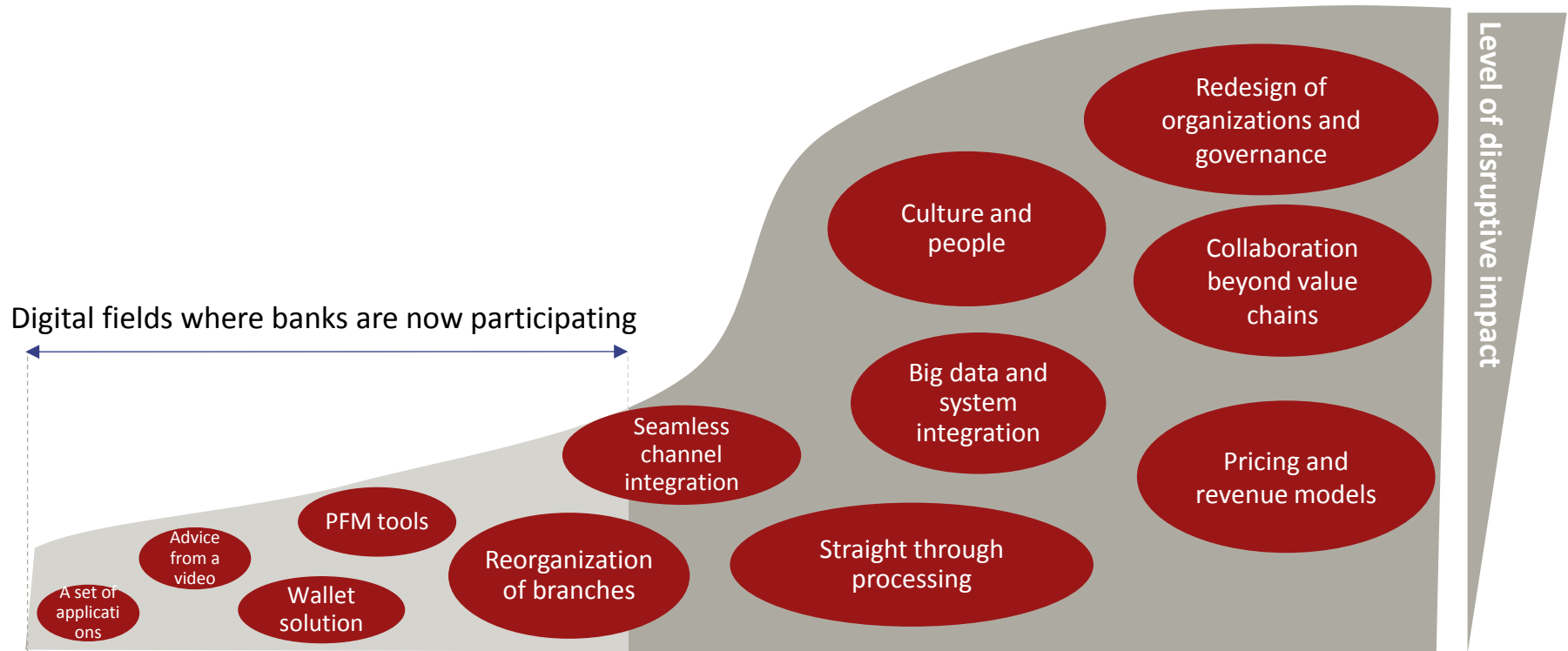
• Checklist of things to be done before and after moving

• Financial tools

• Related articles and reference materials

When building new business infrastructure, it should be noted that effective factors for digitalization have yet to be fully developed.

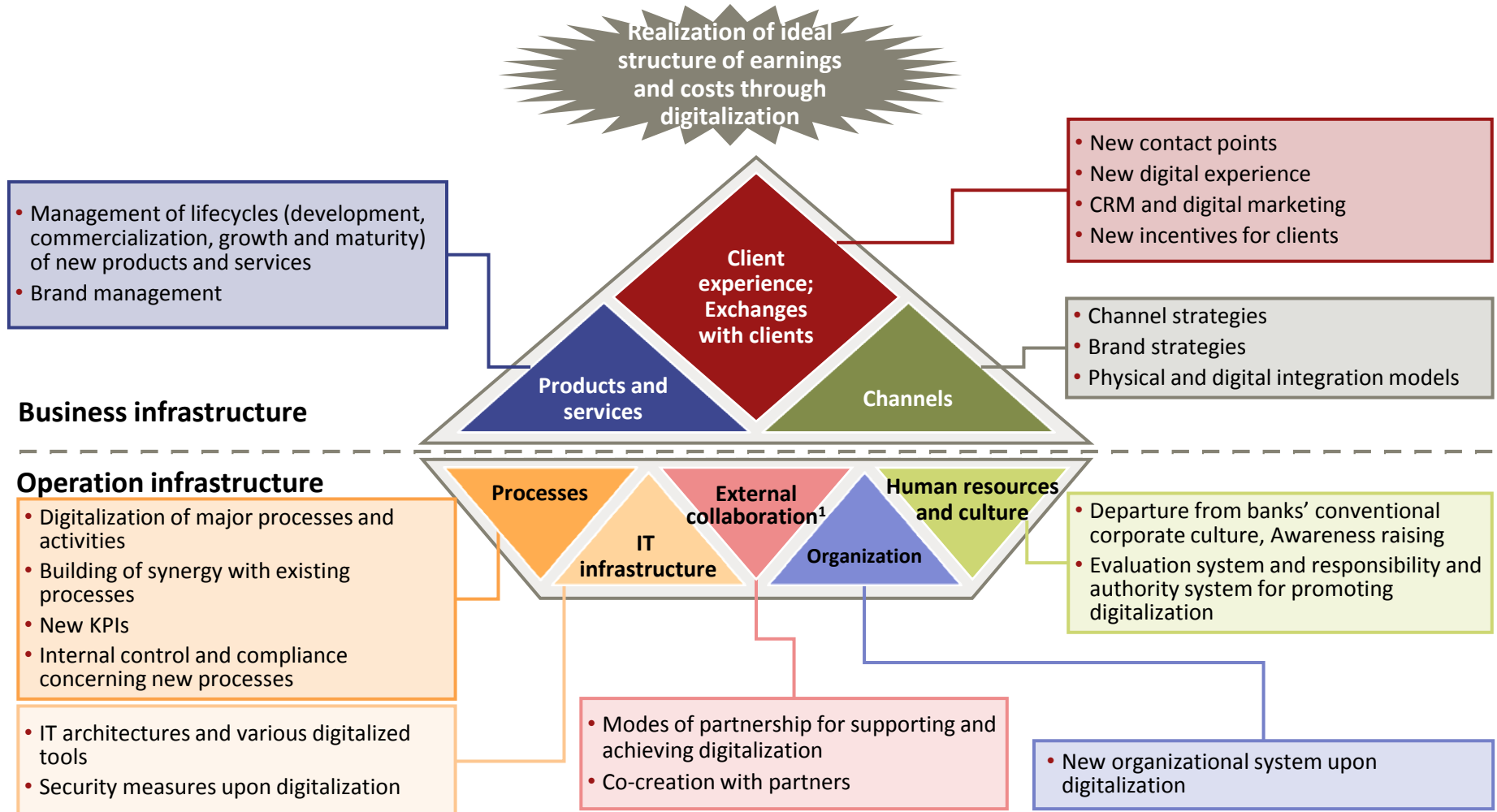
## Major problems in digitalization



**In order for banks to maintain their competitiveness amid such environmental change, only making moderate investments in digital banking will become insufficient sooner or later.**

When making preparations for problems that may be brought about by FinTech, banks need to evaluate their business infrastructure on the premise of digitalization.

## Components of banks' business infrastructure on the premise of digitalization



1. External collaboration is also applicable to the aspect of business infrastructure (e.g. joint development of products and services, etc.)

First, it is necessary to properly respond to significant questions ahead of digitalization.

## Questions to respond to

### Digital maturity evaluation

*Where are we now and which direction are we heading?*

- Do we have clear visions shared among the company concerning digital functions and initiatives that we are going to achieve?
- Do we have skills to have digital thinking take root and lead the digital initiative? What skills do we need to acquire?
- Have we introduced technologies to support the digital initiative?
- What position do we want to acquire in the future?
- Are there any ongoing initiatives that can be utilized for the digital initiative?

### Formulation of digital strategies

*How should we reach our objectives?*

- What approach should we take for digitalization? Should we be a digital innovator, digital adaptor, or digital laggard?
- What strategic initiatives should we launch? How should we set priorities among them?
- What are the key factors for achieving success?
- What are the strategic action plans for the coming five to ten years?
- What roadmap should we formulate for innovative changes?

### Implementation of a digital innovation program

*What should we do to reach this objective?*

- What approach is the most suited to our organization?
- How should we make a detailed design of the initiatives?
- What is required for the organization and personnel and what form of governance is preferable? How will these factors change?
- How can we pursue the progress of the strategic initiatives and achieve success?
- What effect will the initiatives bring about on sales and profits?
- How should we ensure continuation of improvements?

Prompt and ongoing approach for adaptation through trial and error is the key to succeed in creating innovative businesses.

## Related lessons learned from startups of ventures



***Start a business where one can be the top instead of targeting all fields.***

- To be a leader in offering support for a client's first home purchase, etc.



***A good name is the start of a great company.***

- A simple name that is easy to remember (Apple, Squirrel, etc.)



***Take prompt actions instead of seeking perfection.***

- Start challenges promptly and repeat tests and improvements, instead of trying to complete a perfect design after a long lead time



***The top management must directly understand their clients in order to achieve success.***

- They should get deeply involved in interviews with clients.



***Run as fast as possible while accelerating speed.***

- The company can feel safe only when it has acquired a 30% market share or twice as large a share as the runner-up.



***The company must build its own culture.***

- The company should build a craftsmanship-like culture and should carefully maintain it.

**If it is difficult to change an existing organization or corporate culture, one option is to spin off the relevant organization as a different organization.**

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