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Indian Accounting Association (IAA) Sponsored a
Two Day International Conference on

HARMONY IN DIGITAL FINANCE: LEGAL PERSPECTIVES

Editors

Dr. S. Thangamayan
Prof. Dr. Asha Sundaram

22nd & 23rd
MARCH 2024

In association with

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CONTENTS

EMERGING FINANCIAL TECHNOLOGY (FINTECH) IN THE BANKING INDUSTRY: THREATS AND OPPORTUNITIES

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Abstract

The way financial services are accessed and provided has been completely transformed by financial technology, or FinTech, which has become a disruptive force in the financial industry. Financial technology, or FinTech, has become incredibly popular in recent years. The term "financial technology" (FinTech) refers to a broad category of financial services that use rapid advancements in technology. These services include clearing, settlement, and payments, followed by credit, deposit, and capital-raising services. The purpose of this study is to create a thorough understanding of the opportunities and threats associated with financial technology, or FinTech, for the banking industry. The researcher identifies the opportunities and threats related to financial technology in the banking industry by analyzing the existing literature, empirical data, and theoretical concepts of national and international researchers that represent different approaches to financial technology. Financial technology presents several advantages for the banking industry, chief among them being lower costs and more comfortable service delivery when compared to traditional methods. Among the benefits of financial technology are its increased accessibility and increased competitiveness. Financial losses and a reduction in public confidence in the financial system pose the biggest risks to financial technology. Because of service consumers' low level of financial literacy, which causes them to undervalue risks and make poor financial decisions, it was found that these challenges had emerged. This study focused on financial technology (FinTech) in the banking industry to provide a conceptual identification of FinTech and its positive and negative effects on the industry. For this, published articles examined the development of financial technology.

Keywords: *Financial Technology, Banking Industry, Financial Services, Financial Decisions*

Introduction

New value chains are created and conventional business models are altered by information and communication technology. FinTech startups offer appealing alternatives to traditional banks and have the potential to turn them into outdated commodities. However, banks are afraid of losing business in competition, thus they are unable to adjust to the changing circumstances due to numerous limits and constraining factors. Both good and negative effects have been felt by the banking sector, posing possibilities and risks to the banks (Chen et al., 2021). Many nations have employed traditional financial tools over the years, including borrowing money, looking for investors, purchasing stock, and carrying out numerous other financial transactions. These methods required a lot of paperwork and time, and in the end, the other side profited. FinTech makes it easier for everyone involved in the financial system to borrow and use money. The financial sector had not been affected much until recently. With the development of businesses using technology to provide a range of financial services, including payments, banking, and personal finance management, this has altered. These companies were once known as FinTech companies. FinTech companies seek to draw clients by offering automated, transparent, efficient, and user-friendly products and services compared to those that are already on the market (Dorfleitner, Hornuf, Schmitt, & Weber, 2017).

Through FinTech, new players in the financial sector pose a challenge to established banks because they compete with them in their primary market credit. These widely used electronic platforms operate on a global scale and are a formidable opponent to traditional banks when it comes to lending, particularly to individuals and households. These newcomers have an advantage over the established banking system in many ways. Today's financial services providers who successfully target underserved markets (like peer-to-peer lending, crowdfunding, and lending clubs) have the potential to be powerful due to the variety of financing options available to them; these options are regarded as flexible, affordable, less regulated, and timesaving. Such innovations, according to Pierrakis and Collins (2013), have the power to upend established industry structures, blur industry lines, enable strategic disintermediation, and completely transform the way that businesses produce and deliver goods and services. They can also open up new avenues for entrepreneurship and democratize access to financial services, but they also pose serious privacy, regulatory, and law enforcement risks. As a result, this study used a literature analysis to examine the opportunities and threats that financial technology may present to the banking sector.

Problem Statement

Globally, the banking sector is currently undergoing unheard-of transformation. New technologies are pushing established banks out of the market and giving rise to massive high-tech enterprises and startups. FinTech businesses are a relatively recent phenomenon that offers alternative banking solutions and business strategies that have the potential to turn traditional bank services into commodities. By meeting the needs of the consumer, banks and the economy today have a rare opportunity to reinvent the business model and develop a new way to approach the customer. The institution that can undertake a more thorough examination of these shifts, gauge shifts in consumer demand, and evaluate the potential dangers and opportunities for the business through a transformation of its strategy and culture would be able to seize the forefront of the banking industry. Many studies worldwide have focused on the relationship between FinTech and the banking sector. FinTech is becoming increasingly important in the banking sector, but only a small number of published publications have identified the opportunities and threats it poses to the sector. Thus, in the current context, conceptual research on FinTech in the banking sector has emerged as a highly prominent research subject. Consequently, this topic gained attention, and the research challenge under it is as follows: "Identifying the opportunities and threats of FinTech in the banking industry."

Objectives of the Study

- To study the threats of FinTech in the banking industry.
- To explore the opportunities of FinTech in the banking industry.

Literature Review

One of the many fronts on which FinTech companies are believed to be a genuine threat to the established banking system is efficiency. According to KPMG (2016) and Lines (2016), the primary reason for the efficiency gains in FinTech companies may be attributed to the personalization of loans and the disintermediation of processes by doing away with middlemen, resulting in reduced transaction costs for customers.

The efficiency of new technologies like "Blockchain" has also increased (Peters & Panayi, 2016; Wood, 2015).

As per Philippon (2015), there is a counterargument to the claim that FinTech advancements have not resulted in lower intermediation costs.

Buchak, Matvos, Piskorski, and Seru (2017) claim that interest rates from FinTech lenders are greater than those from non-FinTech lenders.

The impact of digital financial services, or FinTech, on bank performance was studied by Misati et al. (2017). The findings suggested the need to develop strategies to prevent low-income earners from becoming even more financially excluded because they might not be able to afford smartphones, may not have internet access, or may not be familiar with their features.

Isibor et al.'s (2018) research examined how electronic banking technology affects customer happiness and economic expansion. The findings demonstrated that FinTech-based banking solutions have raised customer satisfaction and sparked economic expansion in Nigeria.

Kemunto and Kagiri (2018) investigated how the application of FinTech strategies affected the competitiveness of Kenya's banking sector. They discovered that increased use of e-banking, mobile banking, agency banking, and process automation would boost the sector's competitiveness in commercial banks.

Security risk, financial risk, legal risk, and operational risk are the four aspects of perceived risk factor that Ryu (2018) discovered and which may influence customers' intention to adopt FinTech.

Kammoun et al. (2020) studied the impact of digital finance on financial inclusion and system stability in the context of political unrest in MENA zone countries. The study found that lending activities by FinTech contribute to inflation and found empirical evidence supporting FinTech's role as an engine of economic growth.

Phan et al. (2020) discovered that bank performance is adversely affected by the expansion of FinTech companies.

Chen et al.'s (2021) study sought to determine how China's commercial banks performed to FinTech offerings. The results showed that the perceived usefulness (PU) of

FTPs has positive and significant impacts on client satisfaction, low expectations of bank employee assistance, bank's service quality, and employee work efficiency, This is the first study that helps commercial banks in China understand the perception of FTPs from both client and employee perspectives.

Methodology

The study approach used by the authors aims to give a thorough assessment of the opportunities and threats of FinTech in the banking sector. They have used a methodical literature review approach to achieve this. Motivated by the previously indicated research goals, the authors incorporated papers that examined the impact of FinTech on the banking sector. Using the Boolean operators "OR" and "AND," several focused keywords about the banking industry and financial technologies were added to the search string based on the focus. Using the following keyword search technique, the evaluation was carried out ("Financial Technology" OR "FinTech") AND ("banking industry" OR "banking sector" OR "banking services"). After refining the initial research findings, the authors searched for full-text, peer-reviewed English-language papers published between 2010 and 2023 using the search algorithm on all search engines, including Base, Google Scholar, Research Gate, Semantic Scholar, SCOPUS, and others. 85 of the 100 publications that were downloaded might be eliminated because 15 of them were judged irrelevant, as the research entails conceptual literature review analysis. According to the screened papers, the authors give considerable thought to each of the 85 and summarize the opportunities and threats faced by FinTech in the banking sector. FinTech, an acronym for financial technology, is used in this research article.

Discussions and Findings

Opportunities

In addition to coordination and cooperation to prevent duplication of work and reap synergies from the various efforts at the international level, various studies and specialized reports discussed the suggested opportunities and benefits of FinTech for the financial industry from different perspectives. These opportunities related to consumer and investor protection, market integrity, competition, and financial inclusion (Financial Stability Board, 2017).

Muneera et al. (2023) identified Financial inclusion, emerging industries with high development potential, open banking and collaboration, providing highly customized and custom-made financial administrations, an abundance of board space through robo-warning administrations, cross-border payments, sustainable finance, and collaborations and partnerships are among the opportunities.

One of the main benefits of digitalizing financial services for customers is that the service is provided more quickly and comfortably than with traditional servicing. Among the benefits of the financial industry's digitalization are the intensifying competition and increased accessibility of financial services, which benefit both consumers and regulators. Reducing operating costs without running the risk of losing clients is advantageous for companies offering digital financial services (Galina Tcvetova, 2021).

The BCBS, B. (2018) stated that the following opportunities have been identified for banks and the banking system: financial inclusion; better and more individualized banking services; reduced transaction costs and faster banking services; enhanced and more effective banking procedures; creative use of data for marketing and risk management; possible positive effect on financial stability as a result of increased competition; and RegTech.

The following are the main opportunities, per international specialized reports and studies (BCBS, 2017; Financial Stability Board, 2017; IOSCO, 2017; Peters & Panayi, 2016): cost advantage, increased capital access, better and more customized banking services, potential improved competition that will lead to financial stability, improved security, financial inclusion, and regulation technology (RegTech).

It is crucial to remember that consumer protection safety and soundness should never be sacrificed for the obvious benefits of FinTech. The same degree of risk management, control requirements, and safeguards must be upheld by banks and bank supervisors for the new, emergent delivery channels and services that financial institutions are introducing through FinTech. The high standards for safety and soundness and consumer protection objectives required in the banking industry need to be maintained, but banking standards and expectations should be sufficiently flexible to accommodate innovations within the appropriate statutory authorities of jurisdictions (BCBS, 2017).

Threats

FinTech, like any new invention, has advantages and opportunities, but it also comes with a wide range of risks that span across industries and frequently include strategic and tactical risk factors. Concerns regarding operational risk, compliance, liquidity, and volatility of bank funding sources, as well as intense competition, are the key sources of FinTech risks and threats.

The following risks are connected to FinTech, especially concerning the banking sector (BCBS, 2017; IOSCO, 2017; Financial Stability Board, 2017; Peters & Panayi, 2016) Risks associated with the platform include the possibility of it collapsing, fraud or malpractice by the platform or some of its users, competitive risk related to market share, high operational risk with an idiosyncratic dimension, liquidity risk and bank funding source volatility, increased challenges in meeting compliance requirements, compliance risk regarding data privacy, and cyber-risk.

The risks identified by Muneera et al. (2023) include uncertainty and compliance with regulations, cybersecurity, and data privacy issues, incumbent technology disruption, economic and market volatility, consumer adoption and trust issues, operational and scalability challenges, competition and market saturation, economic and regulatory protectionism, and technological obsolescence.

The primary risks associated with the digitalization of financial services, according to Galina Tcvetova (2021), are the unfavorable experiences brought on by financial losses, the erosion of public confidence in the financial system, and the exclusion of some vulnerable social groups from the target market.

The BCBS, B. (2018) stated that the following risks have been identified for banks and the banking system: cyber-risk, increased interconnectedness between financial parties, data privacy, and security, discontinuity of banking services, inappropriate marketing practices, cyber-risk, high operational risk - systemic, high operational risk - idiosyncratic, compliance risk - including failure to protect consumers and data protection regulations, money laundering - terrorism financing risk, liquidity risk, and volatility of bank funding sources.

Conclusion and Future Research Direction

The risks and opportunities presented by financial technology (FinTech) to the banking sector have been thoroughly examined in this article. The prospects that have been found, including enhanced service delivery, reduced costs, and heightened competition, highlight FinTech's disruptive potential. On the other hand, the risks and difficulties connected with this quickly changing sector are brought to light by the threats that have been highlighted, which include bad experiences brought on by monetary losses and a deterioration in trust. The impact of different FinTech platforms on banking has been examined in the literature review, which has provided insights into efficiency benefits, divergent viewpoints on cost reduction, and geographical variances. The utilization of a systematic literature review methodology has guaranteed an exhaustive examination of pertinent papers within a designated time limit.

Future studies could improve our comprehension of the FinTech banking interaction by delving further into customer behavior and financial literacy, exploring regional influences in detail, and emphasizing the development of regulatory frameworks. Furthermore, a more comprehensive understanding of this intricate and dynamic ecosystem would benefit from an exploration of future technologies and their implications for FinTech, as well as a longitudinal study of how banking models change in response to FinTech trends. All things considered, this study establishes the foundation for additional investigation to traverse the complexities of FinTech's influence on the direction of the banking sector.

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