

## Talking point

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### Operation “Digital transformation of the financial sector” (Fintech #1)

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July 3, 2015

**The digital strategies currently unveiled by traditional banks do not go far enough and often deliver only fragmented silo solutions. With each division “doing its own thing” and adopting the silo principle that stifles innovation, many (digital) financial innovations are primarily experienced at the client front-end and are also warmly welcomed. However, the banks will not achieve resounding success using such methods.**

Traditional banks would be well advised to transform themselves into an open digital financial platform in a timely fashion. Otherwise they will not establish themselves as leading contenders in the market for smart financial products and services over the medium to long term. Market players are already subjected to dog-eat-dog competition, with many new algorithm-based financial solutions already coming from the non-banking sector. In particular blockchain technology, the decentralised peer-to-peer (P2P) instrument, is gaining prominence with arguments raging about whether it is “the next big thing”.

It is especially the technology-driven market players from the non-bank sector that are deploying self-learning algorithms and cognitive systems to successfully position themselves in the market and shake up one sector after another at different speeds but with similar levels of intensity. At the same time various new technologies and potential business models are constantly being tweaked on an experimental basis. These developments combined with the high rate of innovation in the digital age are resulting in internationally sector-overarching, flexible, platform-based company architectures becoming established that are frequently referred to in the relevant literature as “digital ecosystems”. The platforms are well known for their so-called “walled garden strategies”. In a nutshell, their recipe for success is: the longer consumers remain on a single platform and can have their requirements satisfied, the more efficiently the various monetarisation strategies can be translated into lucrative profits. This is proved by, for example, the adaptive recommendation algorithms and P2P ratings on the online giant Amazon's platform.

These strategies are also deployed by the Alibabas, Ubers, Apples, Airbnbs, Googles and Facebooks of this world. On the respective digital platforms we customers are conveniently and intuitively apprised of the latest innovations with impressive alacrity. Behind the scenes of the big digital ecosystems the cogs of implemented hardware and software mesh together harmoniously. Via the optimum synchronisation and utilisation of compatible and interoperable standards and strategic programming interfaces (application programming interfaces, APIs) we – the platform-spoiled consumers – are courted with attractive products and services conveniently, globally and above all from a single source.



The success of many internet platforms with dominant market positions cannot be ignored. Their business models are often accompanied by strong sales and earnings growth and thus enable them to speed up the process of developing many innovations, projects and investments to market readiness. The liquid funds at their disposal are so vast in some cases that some internet giants are extending their antennae into other sectors and investing billions of euros also outside their hitherto core activities. The pipeline with innovative projects or business models appears to be well filled given the impressive innovation rate for new services and products. At the same time digital structural change is being driven aggressively in part, but above all equipped with ample financial resources.

In addition to their other challenges traditional banks are feeling the pressure from technological advances at ever shorter intervals. Implementing a fundamental reform attuned to the digital age will provide the opportunity for traditional banks to recognise and adopt the strengths and particularly the proven monetisation strategies of the successful digital ecosystems. So the main task for traditional banks now is to comprehensively rework many of their established business models, distribution and communication channels, products, services and processes, which means also including the back-end. The use of cognitive systems needs to be stepped up in particular. In this respect rethinking how to utilise existing and new data is just as important as using advanced algorithms for data analysis.

Another major contribution (not only) to banking of the future looks set to be made by deploying decentralised P2P mechanisms. So-called blockchain technology, which enables technical trading using the bitcoin cryptocurrency for example, will put pressure not only on the banking sector over the medium to long term. Not only an ever-increasing number of fintech start-ups, but also major players, are experimenting with P2P technology in order to achieve the market readiness of business models that are as lucrative as possible.

Blockchain technology (chain of transaction blocks) enables different transactions to be organised relatively inexpensively using a decentralised system, that is via numerous servers. These can be not only payments in close to real-time, but also securities transactions or the documentation and settlement of contractual details (current debate about smart contracts). First and foremost this technology cuts transaction costs considerably, because the decentralised logic of the blockchain database means that no intermediaries need to be included.

Of course the debate about blockchain and the technology is still in its infancy. There are (still) no answers to the question of whether the regulatory framework of existing legislation can handle this technological potential in the first place. Regulation will therefore have to be adapted here and there to the digital age – not least because many regulations still date back to the analogue era. In principle, however, the decentralised blockchain technology can be deployed in a variety of ways by adapting and/or rewriting software also outside the realm of cryptocurrencies.

Established financial institutions are transforming themselves into a digital platform-based banking ecosystem and performing timely implementation of modern internet technologies along their entire value chain. This enables them to compete forcefully with the aid of modern products, services and processes so they can stand up to the new market players from the technology-driven, non-bank sector with their own strategies. The outcome for customers is a digital, easy-to-use, secure financial platform with up-to-date personalised services, also provided by third-party vendors.

Further commentaries from the Fintech series may be found here:

[Fintech #4](#)

[Fintech #3](#)

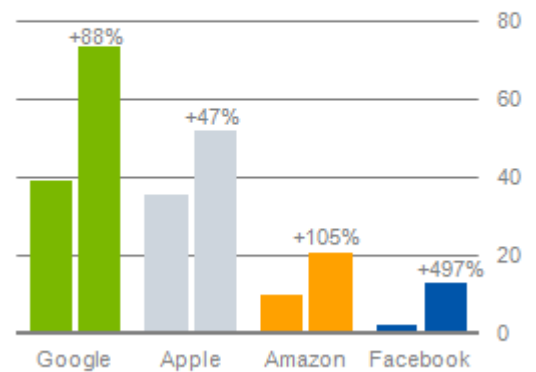
[Fintech #2](#)

[Click here to find out what the Fintech movement holds](#)

[Here you can discover why traditional banks should transform themselves into a digital platform \(Fintech\)](#)

## Digital ecosystems have sufficient liquid funds

USD bn. (chart legend: Difference between 2010 and 2014, %)



Sources: Annual Reports, Deutsche Bank Research

reloaded).

Details about the opportunities and risks of “Big Data” can be found here.

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