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Digital transformation in financial sector

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ABSTRACT

Digital transformation is a necessity for banks. Changes in consumer needs, along with the need to reduce costs and increase efficiency, leave banks with no other option but to change and use modern technologies. But these changes carry risks with them. Banks need to have sustainable business models to be ready for them.

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Digital transformation is a necessity for banks. Changes in consumer needs, along with the need to reduce costs and increase efficiency, leave banks with no other option but to change and use modern technologies. But these changes carry risks with them. Banks need to have sustainable business models to be ready for them.

The coronavirus pandemic has had a significant impact on digital transformation, creating an immediate need for banks to communicate with their customers through digital channels such as platforms and applications. The number of digital users has increased by 23% since the beginning of the pandemic [1].

But this technological development cannot be considered as something new. Bank customers have been switching from traditional branch banking to online and mobile alternatives for several years [2].

Customers have become more adapted to using online products. This has opened up the market to new entrants, such as fintech firms and large technology platforms that are able to develop attractive and easy-to-use client interfaces for their services. As a result, services are offered to customers more efficiently and with a wider choice of services themselves, which increases customer engagement in the process.

The efficiency gained from providing exclusively online services can be seen on the example of the Chinese organization WeBank. Launched in 2014, it currently serves more than 200 million private customers and 1.2 million small and medium-sized companies. However, it does not have a single branch, and it employs only 2,000 people. Thus, his fixed expenses are less, while his income from clients is one-thirtieth of the average for banks, and he can achieve a return on equity of 30%. Another example is the Brazilian company Nubank, which provides credit cards and personal loans to 50 million customers. Most of these customers were unable to get a loan from traditional banks due to a lack of credit history. Most of these customers were unable to get a loan from traditional banks due to a lack of credit history. But Nubank uses data on customer behavior and its own algorithms to conduct its assessment [3]. You can also give an example of the Russian Tinkoff Bank. In 2021, the number of customers is 18.5 million, and the return on capital reached 42.6%.[4]

Giant technology companies such as Google, Apple and Amazon have also been able to start offering financial services. They quickly entered the financial sector using their networks, user data and available technologies to focus on specific financial services related to their other services and products. Traditionally, banks have been the custodians of relevant customer data, in particular data needed to assess the creditworthiness of customers. But large tech firms can now also make a similar assessment using their user data. And now the traditional role of banks in data storage is being questioned.

Usability is at the heart of the success of these new market players. In other words, customers value the ability to access all their financial services online or via mobile devices. The easier it is to use the service, the better. In addition, customers can choose from more customized options, including non-financial services that meet their specific needs more fully. Such options are based on extensive data on the daily behavior of customers.

As the example with Nubank shows, the use of user data and analytics allows companies to offer services to customers who do not have a good credit history. Other innovations, like Apple pay, also help to increase the availability of financial services.

Another factor contributing to usability is the new layer that has appeared between banks and customers. For example, some platforms allow customers to compare offers from several banks, and then choose the best one. Banks are forced to allow the use of these platforms because they attract more customers, while abandoning them may mean their loss. But it is the platform that collects customer data, not the bank. Therefore, such a development of events may lead to banks becoming "factories" of services and products that are sold to customers through platforms and applications.

At the same time, convenient offers based on new technologies do not guarantee instant profit. The German organization N26 is an example of a fintech firm that has not yet achieved success: despite 7 million customers in 24 countries, it had to stop offering its services in the United States and the United Kingdom. However, its estimated high market value indicates expectations of future profitability.

Risks and opportunities for banks.

New technological developments are putting competitive pressure on banks. Banks will need to respond to changes in the behavior of their customers that require more efficient and convenient online services.

There are also new risks associated with the development of technology. Wider use of technology and more active involvement of third parties, for example, through outsourcing and cloud computing, will make banks more dependent on the availability of IT services and more vulnerable to cyber risks.

At the same time, these risks are not completely new territory for banks, since banking supervision authorities require reducing all kinds of risks, including those related to technological innovations.

And banks do have extensive experience in the field of regulation and compliance, having already overcome key regulatory obstacles that new market participants are now facing. In addition, many fintech firms and large technology platforms offer their financial services in close cooperation with banks. Therefore, it is not yet clear whether large technology firms will want to enter the financial market themselves with all the requirements that follow from this.

In general, banks are aware of the need to adapt to digital transformations. Investments are already being allocated for this, a large number of online services and applications are appearing, which are used by many customers.

The coronavirus pandemic has shown to some extent that banks' digital investments have borne fruit – at least in terms of ensuring operational sustainability. Banks had to face serious problems, and their IT infrastructures proved to be on top - the continuity of service was provided smoothly and reliably. Most banks are currently accelerating their technological innovations.

Conclusion.

Currently, there is a digital transformation of all kinds of spheres, including banking. It will give banks the opportunity to provide their customers with more efficient and customized services and products.

Competition from new market participants and customer needs will encourage banks to continue investing in digital development in the future.

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