BANKING ON DISRUPTION:

Digitization, FinTech and the future of retail banking

BY SUBHAJIT DAS

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FOREWORD

Society has made significant progress owing to technology. The steam engine helped to transform manufacturing and transportation thereby heralding the Industrial Age. Electricity brought lighting and power to nearly every facet of life. Computing and internet transformed the exchange of information. All of these technologies have enabled innovations that have solved an array of problems people face and dramatically improved our quality of life.

Now, we are in the midst of a large scale shift from the internet economy to a Digital Consumer Economy. This economy is distinguished by connections between consumers, consumers and machines, and between machines themselves. Further, it is characterized by business models that ease the exchange of goods and services. In the near future, innovations created through the combination of emerging technologies (such as big data and analytics, cloud, mobility & pervasive computing, social media, AI and robotics) promise to transform many industries including banking, healthcare, energy, retail, government, and security. We believe these innovations will have three broad areas of impact. First, they will lead to changes in organizations' business models. Second, they will lead to the rise of new firms. Finally, and most importantly, they will have a direct impact on society, as people will have access to solutions that were unthinkable even a few years ago.

In this context, Tata Consultancy Services, a leading IT services, consulting and business solutions organisation and the Clayton Christensen Institute have collaborated to produce a series of articles and whitepapers that explore the future of industries through the lenses of a set of fundamental theories developed by Harvard Business School Professor Clayton Christensen. The theories offer if-then statements for how the world works—so executives and leaders who find themselves in different situations can leverage their knowledge of these theories to predict what actions will yield what results, in each circumstance. These theories include Disruption Theory, the Theory of Jobs to Be Done, and Modularity Theory. In the current era of technological change, the objective is to apply these theories in order to solve problems facing businesses and societies.

In the first of a four-part series on disruption in retail banking, this whitepaper analyzes some of the overall trends that are affecting the banking industry. Using the Theories of Disruptive Innovation, we examine the competitive landscape and implications for FinTech entrants and incumbent banks in retail banking.

Rajesh Gopinathan

CEO & Managing Director

Tata Consultancy Services

Clayton Christensen

Professor

Harvard Business School

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EXECUTIVE SUMMARY

Retail banking has long been a tech-intensive industry. However, the recent digitization of products and services coupled with the the emergence of tech-savvy millennials has created the context for unprecedented innovation and transformation in retail banking. This changing environment has enabled a new group of competitors who bear few similarities to traditional banks. Often dubbed "FinTech," these financial service providers are attacking virtually every product category in retail banking, from payments, to wealth management, to lending.

The phenomenon has been widely assessed as "disruptive" by industry analysts, however, the underivative concept of disruption is far more discerning and powerfully prescriptive. The Theory of Disruptive Innovation explains the process by which technology enables new entrants to provide goods and services that are less expensive and more accessible, and eventually replace—or disrupt—well-established competitors. Through this lens, it is clear that true disruption is not as widespread in banking as some might believe.

In the first in a four-part series on disruption in banking, *Digitization, FinTech, and the future of retail banking* uses the Theories of Disruptive Innovation to assess the impact of FinTech on established organizations with a specific focus on three segments: payments, wealth management, and lending. Our analysis shows that in each product category, entrants do indeed pose a competitive threat to banks—but the conditions are not always ripe for disruption. Instead, many FinTech innovations are being launched to sustain or improve existing products, making them attractive for both new entrants and existing banks. So long as incumbent banks are incentivized to adopt these solutions rather than ignore them, disruption will be difficult for entrants.

But this does not mean disruption is impossible. The strategies of those entrants with maximum chances of success appear to be coalescing around two themes: 1) targeting an underserved market and moving upmarket into other products and services, and 2) focusing efforts around the contemporary marketing strategy of Jobs to Be Done, which aims to better understand the progress that individuals are trying to make in their daily lives.

Laterally, our analysis reveals that banks have two clear choices for market maintenance: 1) employ a sustaining strategy by adopting the innovations that are launched by entrants, so long as they build on existing performance, and 2) in the event that their business models cannot profitably support new innovations, build an independent business unit with fundamentally different DNA from which to launch new products or services.

As it stands today, disruption is indeed lurking. Whether FinTech entrants or incumbent banks, individual organizations must make a careful assessment of the disruptive and sustaining potential of innovations in their respective industries. Doing this will enable them to stay ahead of their immediate competition and thrive in this period of change.

INTRODUCTION

Over the course of the last century, retail banking has undergone several changes. In the United States, it has evolved from a state-centric business to one that spans across states and is more centralized. ATMs, ACH, Core Banking, credit cards and debit cards have been the technological enablers of this evolution. Now, it appears that the industry is again on the cusp of a significant change. The multi-decade progress in digitization of products and services and the emergence of tech-savvy millennials has enabled the creation of a new kind of financial services provider—one that does not appear to look or act like a bank. The likes of Square and Stripe in payments, Lending Club and Prosper in lending, and Wealthfront and Betterment in wealth management have captured the attention and dollars of customers and investors. These new organizations and others like them are collectively branded as FinTech. In the last five years, about $50B has been invested in FinTech firms in the U.S. alone.[1]

Since the early days of the FinTech phenomenon, many analysts and experts have held the view that such entrants will disrupt retail banking. This is partially due to a misunderstanding of disruption—often, the term is mischaracterized to describe widespread change in an industry brought about by new entrants. However, true Disruptive Innovation is not as prevalent as one might think. Now that FinTech entrants have been in existence for a few years and we have a better understanding of their performance in the market, this is a suitable time to reassess their potential impact on the future of retail banking. In part one of a four-part series on disruption in banking, we use the Theories of Disruptive Innovation to understand how the competitive dynamic between incumbents and entrants will shape the industry in the future.

DISRUPTIVE INNOVATION: THE IMPORTANCE OF A BUSINESS MODEL

Disruptive Innovation denotes the process by which technology enables entrants to launch less expensive and more accessible products and services that gradually replace those of well-established competitors. The outcomes of Disruptive Innovations are typically products that initially perform poorly with respect to existing options and are positioned toward unserved or less attractive segments of the market that are ignored by other businesses. These consumers are happy to purchase the lower quality product because they have no adequate alternatives.

For example, in its early days, cloud computing appeared to be a poorly performing solution for enterprises with respect to their existing internal IT infrastructure. There were concerns associated with reliability, availability, security, and even privacy. As such, the early customers of cloud computing solutions were not well established enterprises, but rather startups and small businesses. Unlike enterprises, such firms often struggled with the high-capital expenditure associated with conventional IT infrastructure. Thus, they were willing to adopt the emerging, seemingly poor performing solution. Over time, however, cloud computing gained traction with large enterprises since it offers a means to reduce the cost of IT infrastructure.[2]

A technology-enabled product is only one aspect of a Disruptive Innovation; an innovative business model is equally important. For Amazon's cloud computing product Amazon Web Services (AWS), the e-commerce giant complemented its focus on startups with a suitable business model that made it easy for developers to access and release computing infrastructure when required. At the time, established providers of IT infrastructure were focused on targeting enterprises and selling them expensive hardware that required customers to invest large amounts of capital into their IT infrastructure. Today, these companies are playing catch up to Amazon. This example illustrates how a potential disruptor must not only have an appropriate product that targets nonconsumers or low-end consumers, but also a business model that is suitable for such customers at the low-end of the market.

It is important to note that while not all innovations are disruptive, they can still be successful and even transform their respective industries. *Sustaining innovations* improve products along dimensions of performance that are important for average consumers—they make existing products better, faster, or more luxurious. In most situations, these innovations promise higher profitability as consumers are willing to pay for such improvements. Naturally, such innovations are attractive for incumbent businesses especially when they can be created without major alterations to the processes and profit model. For example, new product categories in the

Disruptive Innovation denotes the process by which technology enables entrants to launch less expensive and more accessible solutions that gradually replace those of well-established competitors.

auto industry, such as minivans and hybrids, have not caused disruption but instead are sustaining innovations built on top of an unchanged system of manufacturing cars in large volumes. Similarly, the minivan launched by Chrysler was not disruptive relative to other competitors because there was no change to the model of manufacturing and selling cars.

> Sustaining innovations improve products along dimensions of performance that are important for average consumers—they make existing products better, faster, or more luxurious.

Evaluating the disruptive potential of FinTech

As it stands today, virtually every product category in retail banking is under attack from a host of entrants. From payments, to wealth management, to personal loans and mortgages, it is clear that entrants are establishing positions in the market, even if such positions seem minute compared to larger banks. **Figure 1** captures a sample of the FinTech competition faced by banks.

Where does the industry go from here? Will entrants continue to focus on individual product categories and gradually steal market share? Or, will some of them diversify and emerge as large competitors to banks? Do all entrants in all product categories have the potential to disrupt incumbents? What is it that banks can do to respond? Before we draw conclusions about the disruptive potential of entrants and the strategic response alternatives for banks, let us begin by evaluating the competitive landscape within a few product categories, each of which will be explored in greater detail in the subsequent papers.

Payments

There are three categories of entrants in the payments space: those who offer solutions specifically for consumers, those who offer solutions specifically for merchants, and those who target both consumers and merchants. Examples include Venmo, Square, Stripe, Apple Pay and Android Pay.

The principal competitive challenge for entrants is that any innovation they develop must rely on established organizations who control the infrastructure and the value network of payments. Consider Square, which enables merchants to swipe credit cards using its proprietary magstripe reader. Square's merchant solutions would be useless without compatibility with credit cards and other payment instruments used by individuals. Such instruments are predominantly offered by banks in partnership with card networks. Due to this, FinTech entrants like Square must part with a large portion of the fees collected from merchants.[3] Because entrants' solutions rely on the incumbent-controlled infrastructure, any success that entrants have effectively keeps incumbents in business as well. As such, disruption in payments is difficult.

The multi-faceted nature of the market also poses an additional challenge to disruption. There are two customers of the payments infrastructure—the individual who makes the payment, and the merchant that accepts it. Since merchants pay directly for each transaction, their preference for payment type is not aligned with that of individual consumers. Merchants want to reduce transaction costs while consumers are interested in other benefits such as rewards offered by cards. Due to this misalignment, banks and card networks can counter solutions offered to merchants by creating new payment products for consumers thereby compelling the entrant to retain compatibility with such products.

Still, this does not mean that there are no threats for established organizations. Companies including Apple, Google, Facebook and Amazon have the capability of leveraging their respective products and platforms for

Figure 1. FinTech competition faced by banks

Transaction Banking	Wealth Management	Mortgages	Small Business	Student Loans	Personal Loans	Payments
SIMPLE	wealthfront	LendingHome	FUNDATION	CommonBond	OPORTUN	stripe
Moven	SIGFIG	MONEY360	OnDeck	SoFi	LendingClub	venmo
	Betterment	GROUNDFLOOR	lighter capital	Upstart	PROSPER	Square
		REALTY MOGUL	Kabbage			

consumers and pushing them onto merchants and banks. Should they gain sufficient adoption amongst merchants, they can pose a serious challenge to banks and card networks. In addition, unlike startups, these large companies have the resources to sustain expensive battles with banks and card networks. We expand on this idea further in the upcoming paper, *Banking on disruption: The hype and reality of disruption in consumer payments.*

Wealth management

Over the past decade, robo-advisors have emerged as an alternative to human financial advisors. Robo-advisors are software-enabled financial-advisory services that help to manage wealth with minimal human intervention. Previously, wealth management software was sold to financial advisors and not to end users.[4] With the help of robo-advisors, however, users may invest without ever talking to a human financial advisor. Wealthfront and Betterment are just a couple of examples of entrants who have appeared as an alternative to traditional providers of wealth management services.

Considering the function they provide, robo-advisors are more sustaining than disruptive. The process of investing has not changed; the current crop of robo-advisory solutions are built as an enabling interface on top of the existing methods of investing. All they have done is automated the process of onboarding to make it easier for individuals to avail wealth management services. In short, robo-advisors have improved upon existing performance and are useful for any individual that is comfortable with technology, making them suitable for customers of entrants and banks.

Because incumbents are motivated to adopt robo-advisor technology, entrants are facing steep competition. As with all sustaining innovations, the incumbent response has been aided by the fact that they do not need to throw out their business models in order to launch their own robo-advisor services. While the process to onboard customers may have changed, the process used for placing trades and generating returns has not. Thus, we see a fierce response from incumbents including Charles Schwab, Vanguard and Blackrock who appear to have made significant gains against FinTech startups in terms of assets under management (AUM). **Table 1** provides a comparison of various robo-advisors by AUM.

Table 1. Robo-advisors by assets under management

Name	AUM (Mar 2017)	Type
Betterment	$7 billion	Entrant
Wealthfront	$5 billion	Entrant
Personal Capital	$3.9 billion	Entrant
Wisebanyan	$100 million	Entrant
Hedgeable	$44 million	Entrant
Vanguard Personal Advisor	$51 billion	Existing firm
Charles Schwab Intelligent Portfolios	$10 billion	Existing firm
Future Advisor (Blackrock)	Not available	Existing firm
Tradeking (Acquired by Ally Bank)	Not available	Existing firm
TD Ameritrade Essential Portfolios	Not available	Existing firm
Etrade Adaptive Portfolio	Not available	Existing firm

Lending

Whereas incumbents appear to have a competitive advantage in both payments and wealth management, lending presents a different picture. As with other products and services, digitization is making it easier for entrant lenders to reach customers without spending time and money in creating fresh distribution infrastructure. However, it is marketplace lending, which enables people to lend directly to one another, and the presence of investors looking for yields, that are creating a situation with enormous implications for incumbent lending institutions. Many segments of the lending market are under attack from entrants such as Sofi, Lighter Capital, and OnDeck, and several aspects of lending are likely to change in ways that are unfavorable to incumbents. The sale of business and commercial loans is likely to move away from a relationship-based model to a marketplace model that is more transactional in nature, thereby increasing competition for customers. Should peer-to-peer lending gain significant adoption amongst borrowers and retail investors, it could serve as an alternative to bank-led lending in many situations, thereby reducing banks' power to set interest rates.

In addition, many entrants are adopting a disruptive strategy. Using capital from different sources, many are attempting to create an alternative value network. Additionally, they are implementing new credit models and using new kinds of data on potential borrowers—including reviews on Yelp—to extend financing to segments of the market that are unattractive to existing institutions, such as small businesses and individuals struggling with a shortage of credit. Now, some of them are moving upmarket into other market segments as well. Although Lending Club started out by offering personal loans to consolidate credit card debt, it now offers auto refinancing, business loans, and healthcare financing. There is no doubt that current offerings by FinTech entrants will be useful for customers. However, it is the business model FinTech lenders are using—targeting the low-end of the market, then building on that success to move upmarket—that makes these developments a disruptive threat to existing lenders.

Table 2 includes a list of FinTech lenders that are competing with banks.

Table 2. FinTech entrants in lending

Company	Area	Notes
Lending Club	Consumer lending	$24 billion in loans issued
Prosper	Consumer lending	$8 billion in funded loans
Oportun	Consumer lending	$3.3 billionn in loans Has raised $265 million in funding Offers small dollar loans (from $300 upto $7000)
LendUP	Payday lending	Originated $1 billion in loans Total equity and debt financing of upto $325 million
Avant	Payday lending	$3.5 billion borrowed by customers Has raised $1.8 billion in funding till date 500,000 customers
Lending Club	Purchase finance	$24 billion in loans issued
Upgrade USA	Purchase finance	Technology leasing for small businesses, startups and schools
Lending Club	Education financing	$24 billion in loans issued
Sofi	Education financing	$16 billion in loans funded
CommonBond	Education financing	Raised $300 million in July 2016
Upstart	Education financing	Has extended more than $600 million in financing
LendingHome	Real estate	$1 billion in origination $100 million in venture funding
Money360	Real estate	Marketplace lending for commercial real estate
Groundfloor	Real estate	Offered for non-accredited investors
Realty Mogul	Real estate	REIT offered for non-accredited investors
C2FO	Merchant cash advance	Working capital marketplace
FastPay	Merchant cash advance	Provides working capital to digital media companies Has provided $1.5 billion in loans
Lighter Capital	Merchant cash advance	Revenue based financing for small technology companies $100 million credit facility
MarketInvoice	Merchant cash advance	$1 billion in financing extended to small businesses
OnDeck	Small business financing	$6 billion loaned to small businesses globally
Kabbage	Small business financing	$2 billion in financing extended Has extended its platform to financial services customers
Fundation	Small business financing	Works with community banks, B2B companies and consultants to extend lending to small businesses

FINTECH DISRUPTION: WHO WILL SUCCEED AND HOW?

A careful assessment of the competitive landscape in retail banking leads to the realization that not all product categories provide an equally viable foothold for entrants to pursue a disruptive strategy against incumbents. It becomes clear that any innovation effort that improves customer experience without changing the underlying business model—what we call sustaining innovations—is bound to face direct competition from existing institutions. However, this does not mean that entrants cannot succeed. Two types of FinTech entrants appear to be well positioned to emerge as a competitive threat to retail banks.

1. The upmarket entrant

Entrants in this category can gain scale by establishing themselves in a market segment that offers a viable foothold against incumbents before moving upmarket into other products and services. As discussed, lending appears to provide a disruptive foothold from which entrants can attack other segments of retail banking. Sofi is following this strategy. The personal finance company started out by offering student loan refinancing funded by alumni of different universities. Since major banks do not offer competing products, this strategy has allowed Sofi to establish a foothold without competition.

Sofi appears to be building an interdependent customer interface by providing services such as career development advice. It may also be using data to uniquely customize its products and services. As its customers progress in life—get a job, buy a car, apply for a mortgage—Sofi has positioned itself to offer more products and services to meet those needs, such that it can develop more refined data models that will enable it to offer solutions that are better than those offered by the competition. Thus, customers will be incentivized to come back to them every time they are in need of a new product. In this way, Sofi is moving along an upmarket trajectory of growth.

If history is any indication, technology giants such as Apple and Google may soon employ a similar directional strategy. They are attempting to gain a foothold in payments and could use that positioning to move into other products and services. While adoption of mobile payments has not been rapid, it is likely to go up over the next few years.[5] If technology companies are able to capture a large number of consumers and merchants with their solutions, they could gradually attempt to become distributors of different kinds of financial products such as credit at point-of-purchase. By doing this they will be able to tap a new revenue stream where they earn a cut from each transaction between the customer and a provider. However, it remains to be seen whether they will entirely follow the strategy of focused FinTech entities such as Sofi considering the onerous regulatory requirements that must be fulfilled by a financial institution.

Entrants can gain scale by establishing themselves in a market segment that offers a viable footold against incumbents before moving upmarket into other products and services.

2. The "Job to Be Done" entrant

The second type of entrant that can succeed within this competitive landscape is the "Job to Be Done" entrant. Everyday consumers have different jobs that they want to accomplish as they seek to make progress within a specific circumstance. For companies, developing products that help consumers accomplish a given job can be a successful strategy for growth. However, it is important to note that every job has a social, emotional, and functional component, thus products must be designed with each taken into consideration.

Take, for example, Ikea, the Swedish superstore. Most people go to Ikea when they have the job of furnishing their homes quickly.[6] With that in mind, Ikea has designed itself in such a way that it lends itself entirely to addressing the social, emotional and functional issues associated with furnishing a house. At Ikea, a customer may choose from wide choice of furniture in one single store, may visualize how the furniture will appear, and can relax at the restaurant with a companion after a long day of shopping. Compared to shopping for furniture at a department or a discount store, it is likely a more productive, more pleasant, and less stressful experience. By addressing this specific job, Ikea has created a business that can easily withstand competition from other providers of furnishing whether they are low-cost or luxury providers.

Rather than wage an expensive war with incumbents, developing products and services that address an unfulfilled job can be a more sustainable strategy for entrants. For instance, startups that provide lending to small businesses and payments solutions to merchants could emerge as non-banks that address the job of running a small business. As discussed in our analysis of payments, it is impossible for an entrant to offer payments solutions to merchants without relying on the infrastructure owned by established organizations. This makes it difficult to establish a viable business model since the entrant has to forfeit most of the fees made on each transaction. For this reason, entrants such as Square and Stripe have shifted their focus towards providing solutions associated with setting up, running and growing a small business. By following such a strategy, they are building an integrated solution for their customers and going after all firms that provide partial solutions for starting a small business. The added benefit is that this reduces their competitive exposure to card networks and banks who are in strong competitive positions considering their ownership of the payments infrastructure.

INCUMBENT RESPONSE: WHO IS EVOLVING AND HOW?

Many factors determine why and how incumbents will or in some cases will not respond to threats from entrants. Asymmetric motivation, for instance, denotes the situation in which existing companies are not incentivized to respond to competition from entrants because they cannot profitably target the same customer segment. Accordingly, entrants are able to build their businesses without direct threats from organizations with more resources at their disposal.

In retail banking, many entrants are targeting millennials, a large population segment that is comfortable with technology-enabled products and services. Thus, in many situations, there is little asymmetric motivation at play because incumbent banks are motivated to fight for the same customer segment. Already, we have seen that in specific product categories, such as wealth management, established institutions are taking demonstrable steps in responding to entrants. As they invest and acclimatize to this period of change, successful banks have two clear choices ahead of them: remain a sustainer bank, or develop an independent bank.

1. The sustainer bank

One approach that banks have chosen to employ is redesigning themselves around evolving customer behavior and technology while retaining the core of their current business model. In this way, they are able to focus on an improved customer experience by adopting the very technologies that have contributed to the rise of entrants. None of the technologies that are being utilized by entrants—such as the internet, mobile phones and advanced analytical tools—are inherently disruptive. They are equally useful for a bank that seeks to deploy them to create improved products and services for their customers.

Capital One, for instance, employs a mobile banking application that is highly rated by customers and experts. It has also launched Auto Navigator, an online tool that eases the process of buying and financing a car. Another organization, SunTrust Bank, has launched an online lending platform called LightStream that simplifies the process of getting a personal loan for customers with high credit scores. The bank has originated $2 billion in loans using the platform. All of these are sustaining innovations that improve performance in ways that are important for customers—but they do not fundamentally alter the function of banking.

None of the technologies that are being utilized by entrants—such as the internet, mobile phones and advanced analytical tools—are inherently disruptive.

Within this model, sustainer banks are able to rethink their focus areas as far as customers and products are concerned. For instance, a particular bank may choose to be a full-service provider and therefore establish the means to deliver value across the life of the customer. This is not a new idea. But thanks to sustaining innovations such as mobile phones and data analytics, the bank can now offer customized products and services closer to the point of purchase than was previously possible.

Another option is to focus on maximizing value in a particular context. Financial management is a difficult task for many people since they are unable to devote adequate time and energy to it. A sustainer bank can choose to position itself around this struggle by reducing the information overload associated with managing finances. Then, it can create products and services that ease financial management, and utilize its available infrastructure such as branches to deliver financial awareness in a social setting rather than merely sell products.

2. The independent bank

The capabilities of a mature organization reside in its processes and priorities, which are extremely difficult to change. Processes denote both concrete functions such as capital management as well as relatively abstract ones like decision making and communication. Priorities denote the objectives of an organization around growth and profitability. If an innovation effort is incompatible with the processes and priorities of the organization, it is unlikely to succeed. As an example, if a particular innovation promises lower profitability, the processes and priorities of the organization are likely to starve it of the necessary resources despite the best intentions of the organization's leadership. This is because the hierarchy of management that controls resource allocation is bound by the existing processes and priorities and will find it easier to route resources to other initiatives that promise to retain profitability such as ones that reduce cost.

When a new business model is required due to conflicting processes and priorities, banks must create an organization that is completely independent from their current one. This organization, then, competes with FinTech entrants directly utilizing its own combination of dedicated resources and processes. Early Warning, an independent bank-owned company that offers solutions for payments, provides an example. To compete with Venmo, it recently launched a peer-to-peer payments solution called Zelle. Since it was designed to offer its peer-to-peer payments solution as an independent entity, the Theory of Disruptive Innovation indicates that it has a higher chance of success than if it were to build its own solution using its previous business model.

When a new business model is required, banks must create an organization that is completely independent from their current one.

This type of banking model can also help smaller banks scale by pooling innovation initiatives in an independent organization. For example, a small lending platform that is exclusive to a set of smaller banks may be created. Such a platform can deliver consistent customer experience from a single distribution infrastructure while enabling the banks to utilize a common pool of data to create differentiated products and services. In order to succeed, such an effort from an existing bank will need attention from the top management of the organization so that it is not deprived of resources in its competitive skirmishes with entrants.

CONCLUSION

Across industries, the term disruption has been mischaracterized to describe widespread change caused by entrants in a given market. With that understanding, then yes—we are seeing disruption in retail banking, as there is no denying that banks are under attack from a multitude of independent entities. However, with a more precise understanding of the Theory of Disruptive Innovation, it is clear that the phenomenon is less pervasive than some might expect.

In fact, within retail banking, innovations created by many entrants are *not* disruptive but rather sustaining from a consumer perspective—they improve products and services on dimensions of performance that are valuable for many customers. For established organizations, the technological cores of such innovations are useful as well. Mobile applications, distribution over the internet and advanced data analytics are hardly poorly performing technologies that incumbents want to ignore. Thus, in many situations, we have observed adoption of these innovations from established organizations.

Which entrants, then, will succeed? What heavily determines the disruptive potential of entrants is their business model and choice of customers with respect to their immediate competition. As successful FinTech entrants seek to achieve comparable scale to banks, they will either 1) attempt to move upmarket after establishing themselves in a viable foothold or 2) focus on a specific Job to Be Done.

In an effort to maintain market share, many banks are redesigning themselves to align with evolving customer behavior. Looking forward, incumbent banks have two clear choices ahead of them. The first is to follow a path of sustaining innovation and improve products to align with customer expectations. As demonstrated by Capital One and LightStream, many banks are already doing this.

However, when an organization's business model cannot profitably compete with entrants because its processes and priorities do not support a given innovation, the leadership should not hesitate to take the second approach and follow the path of Disruptive Innovation. This involves creating an independent business unit with fundamentally different DNA whose resources, processes and priorities are designed to compete with both banks *and* FinTech entrants.

Banking has always been a technologically intensive industry. And the future of retail banking is going to be more tech-intensive than it has ever been before. FinTech entrants deserve credit for being the early movers in capturing the opportunity created by technological and demographic change. Irrespective of how their skirmishes with banks turn out, customers can expect to see simpler, better and more accessible products and services from both banks and entrants that establish themselves in the market.

NOTES

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About the Institute

The Clayton Christensen Institute for Disruptive Innovation is a nonprofit, nonpartisan think tank dedicated to improving the world through Disruptive Innovation. Founded on the theories of Harvard professor Clayton M. Christensen, the Institute offers a unique framework for understanding many of society's most pressing problems. Its mission is ambitious but clear: work to shape and elevate the conversation surrounding these issues through rigorous research and public outreach.

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About the author

Subhajit Das is a Visiting Research Fellow at the Christensen Institute from Tata Consultancy Services. Subhajit's research applies the Theory of Disruption to the future of the banking industry and progress of new technologies. Since 2010, Subhajit has worked as a business analyst focusing on business process management and technology solutions for sales, marketing, and after-sales functions of consumer-oriented industries.

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