STRATEGIC TRANSFORMATION THROUGH INNOVATIVE DISRUPTERS: COLLABORATION IN BANKING TOWARDS TOMORROW

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Abstract

There may be no better time than now for banks to reimagine transformation and pursue strategic change to their traditional business models. In the present business environment, the 'disruption' caused in the traditional banking industry by non-banking service firms/FinTechs is quite obvious. Disruption is a process whereby a smaller company with fewer resources is able to successfully challenge the established market-leaders or businesses. Disruptive innovations are innovations that create a new market and finally disrupting a traditional existing market and value network, displacing established market-leaders, products and alliances. Disruptive change in the banking industry is mainly due to new trends with digital transformation through fast-developing innovative technology. Digital disruption is transforming the global banking industry, with the introduction of innovative digital products and services. This article presents the disruptive change or revolution caused by non-banking service companies/FinTech firms in the banking industry. Researchers recommend strategic transformation for traditional banks through non-banking financial service firms such as FinTechs. This article discusses transformation strategies for banks through unleashing the potential of disruptive innovators/FinTechs, highlighting the strengths of banking ecosystems. Based on recent global banking surveys, it recommends measurers for traditional banks, for effective collaboration with non-financial services companies/FinTech firms. Embedding non-financial services companies /FinTechs in to the banking ecosystem, is suggested towards strategic transformation of traditional banks. Based on the reputed global surveys, this article conveys a strong message to traditional banks: "Collaborate with non-financial services companies/FinTechs effectively towards strategic transformation or Perish. "The objective of this article is to discuss in detail the strategic transformation of traditional banks through collaboration with innovative disrupters/FinTechs towards the future. The article presents valuable insights and managerial implications for traditional banks, for strategic transformation through effective collaboration with non-banking financial service companies.

Key Words: Disruptive change, Innovative disrupters, FinTechs, Banks, Strategic transformation, Collaboration, Future banking

Introduction

"Everything changes, nothing remains without change" – Lord Buddha

Change in the banking industry is inevitable, hence no exception to the above noble truth. Change continues to redesign the future of banks, globally and locally. A decade after the last financial crisis, the global banking industry is on a firmer ground and growing fast. Research and management consultants argue that this is mainly due to digital transformation through fast-developing, new technologies with innovative trends. Deloitte, a reputed global management research/consulting company had stated in their report 'Reimagining Transformation in the Banking Industry: 2019 Banking Industry Outlook' that there may be no better time than now for banks to reimagine transformation and pursue strategic change. Further recommended, in the need for strategic transformation in 2019, the banks should prioritize in four key areas: regulatory compliance, technology, risk management and talent, while focusing on seven strategic business segments, such as retail banking, corporate banking, investment banking, transaction banking, payments, wealth management and market infrastructure. Based on recent research by reputed research companies in the global banking context, this article will highlight how global and local banks could continue their strategic transformation in a disruptive digital environment, by collaborating with innovative disruptors.

Disruptive Change

First, it is important to recap what is 'disruption' and how a 'disruptive change' occurs in a market. Scholars (Christensen et al., 2015) have identified that 'disruption is a process, where by a smaller company with fewer resources is able to successfully challenge established market-leaders/incumbent businesses'. Established market-leaders focus on developing products and services for their most demanding and profitable customer segments. Sometimes, by doing so they exceed the needs of those high-end customers, while ignoring the needs of other less-demanding and less profitable customers. 'Disruption' begins when an innovative disruptor/new entrant with innovative solutions, successfully target those overlooked customers and establish a footing in the market. They enter the market by providing more-suitable products and services to the low-end customers at a lower price, compared to the prices of established companies. Generally, the established market-leaders/incumbents who focus on profitability in the high-end customer segments, do not respond quickly at this point. The new entrants/innovative disrupters then gradually move upmarket with novel and better products and services, challenging the established market-leaders/incumbent businesses. They gradually deliver the performance that the established leaders' most-demanding, profitable customers require, while protecting the advantage at low-end customers that drove their early success. In other words, innovative disrupters initiate by appealing to low-end or unserved customers in a market. Then they gradually migrate to the mainstream or upmarket customer segments, delivering the performance they require. The 'disruptive change' truly occur in an industry when the established market-leaders' mainstream customers start accepting the new entrant's offerings in volumes. The global and local banks are no exception to such disruptive change by innovative new entrants, hence facing

great new challenges. How geared are the banks to face such challenges? Prior to addressing this issue, it is pertinent to understand how disruptive-innovations originate in a market.

Disruptive Innovations

'Disruption' is a process whereby a smaller company with fewer resources is able to successfully challenge established market-leaders or incumbent businesses. In business theory, a 'disruptive innovation' is defined as 'an innovation that creates a new market and value network, and finally disrupting an existing market and value network, displacing established market-leaders, products and alliances.' The Disruptive Innovation Model (Christensen et al., 2015) indicates how a 'disruptive innovation' occurs in a business environment. A disruptive innovation, by definition, originates from one of two types of footholds in a market, where the established market-leaders or incumbent businesses that overlook. The two types of footholds in a market: (i) Low-end footholds and (ii) New-market footholds.

(i) Low-end footholds exist as a result of established market-leaders typically trying to serve their most profitable and high-demanding customers with ever- improving products and services, while ignoring or paying less attention to the low-demanding, less profitable customers. Very often, the market-leaders' offerings exceed the performance needs of the less-demanding, low-end customers. This gives an opportunity to a disruptive innovator/new entrant (as their initial step) to focus on those low-profile customers who were ignored by the market-leaders. They offer them with a standard or 'good-enough' product/service at a reasonably low cost, to meet their expected needs.

(ii) New-market footholds exist when innovative disrupters/new entrants create a market where none existed, or when they find a way to turn non-consumers into consumers in the market. The case study of Xerox photocopier is a good example of a disruptive innovation that occurred due to a new-market foothold. In the early days, Xerox targeted large corporations and charged high prices to provide the services these companies required. This resulted in small customers, such as school librarians, small organizations and education institutions being dropped out of the photocopier market. They found their own, low cost ways of meeting their needs. Later, new entrants to the market introduced personal copiers, offering a reasonable solution to individuals and small business organizations, creating a new market foothold. The personal photocopier makers getting hold of the new-market from a relatively modest beginning, gradually established a major position in the mainstream photocopier market, which the market-leader, Xerox, established earlier. The new market foothold created by the new entrants disrupted the existing photocopier industry.

Types of Innovations

According to the Disruption Theory, there are two types of innovations in a market: disruptive innovations and sustaining innovations. It is important to differentiate 'disruptive innovations' from 'sustaining innovations', in order to understand how banks should develop

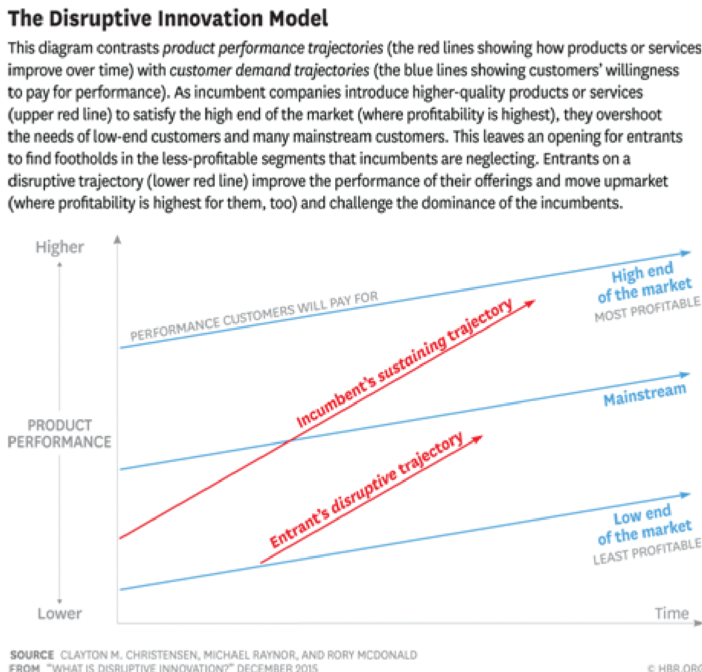
measures to face challenges by innovative disrupters. The Disruption Theory differentiates disruptive innovations from sustaining innovations as follows:

(i) Sustaining Innovations: Sustaining innovations of a company make good products better in the eyes of the company's existing customers, such as the clearer TV picture, better mobile phone reception, fast internet access etc. These improvements may be twofold: incremental advances or major breakthroughs. But, both improvements enable firms to sell more products to their most profitable customers.

(ii) Disruptive Innovations: In contrast to sustaining innovations, disruptive innovations are initially considered as low-standard or inferior by most of the customers. Usually, customers are not willing to switch to new products/services merely because it is less expensive. Sometimes, customers do not accept the product/service at the beginning due to its inferior quality. Instead, they wait until the quality improves enough to satisfy them. Once the quality is up to the expected standard, customers willingly accept the new product/service at its lower price. Hence, disruption drives prices down in a market.

The 'Disruptive Innovation Model' shown in **Figure 1** displays how the above two types of innovations: Sustaining Innovations and Disruptive Innovations occur in a market.

Figure 1: Disruptive Innovation Model



Source: Christensen et al., 2015

Transformation in Banking Through Innovative Disrupters

Fast-developing new technology is already transforming the global and local banking industry. The traditional banking landscape is rapidly changing, with the introduction of many new digital features, offering customers more friendly and better customer experiences. For example, remote banking applications such as online banking, telephone banking, transactions through ATMs, mobile apps etc. offer more convenience to customers in doing banking transactions than ever before. In the modern digital banking environment, customers need not visit a brick-and-mortar bank branch physically, to fulfil their basic payment and deposit transactions. For instance, now it is not necessary for customers to take their cheques/cash to a bank branch to deposit them. They have the convenience of making their deposits through the bank's mobile App or at the ATM. Modern technology has revolutionized the global banking industry by making transactions more unified, thus making cash almost obsolete. Most customers use their credit or debit cards to effect their payments at retail stores or online. Further, modern electronic safety features, such as advanced cryptography and biometrics through new technology ensure protection against bank frauds. For example, major global banks use such advanced new technology to identify their customers at ATMs.

Disruption in banking through Innovative non-banking service firms/FinTechs

Research companies, such as Ernst & Young (EY) and Pricewaterhouse Coopers (PWC), have predicted how global banks and the financial services industry would transform in the future, due to fast-growing digital banking technologies and innovative non-banking companies. Proliferation of non-banking firms, such as FinTech companies in the banking industry has challenged the traditional banks in the market. Rapid development of digital banking technologies has facilitated banks to deliver faster and transparent payment experiences to consumers with enhanced facilities, such as accuracy, efficiency and security, demanded by customers. Banks have been dominating in this area for many decades. However, innovative disrupters who are non-banking entities have now started to occupy the market, offering new reliable products/services, comparatively at a lower cost. Traditional banks spend a major portion of their resources towards security, compliance and other industry-specific requirements. In contrast, non-banking firms or FinTech firms who are not controlled by banking industry regulators, benefit from this situation. Hence, they could allocate a large percentage of their resources to develop innovative better financial solutions to demanding customers, much faster and at a lower cost than the traditional banks. This would attract tech-savvy, demanding customers to non-banking service providers, extending a great challenge to traditional banks. Specialized payment agencies such as PayPal, Amazon, mobile phone companies and supermarket chains are few such examples of disruptive non-banking facilitators in the payment market, once dominated by traditional banks.

Hence, banks are constantly challenged by the entrance of innovative disrupters, disturbing the status-quo and changing the ecosystem that banks operate in. As a result, a range of risks and challenges to banks and the banking industry are inevitable in the present business context. The advancement of fast-developing technologies, ever-increasing complexities of national and international financial regulations, rapidly changing consumer demand and behaviour, talent management and retention of quality employees in banks etc. add to these challenges. Transformational issues created by Financial Technology (FinTech) companies are evident, re-designing the global and local financial services industry future. For example, technology-driven innovation has increased rapidly over the past ten years, introducing new business opportunities, as well as rising threats and challenges to the banking industry. The fast-growing technological advancements have fundamentally changed the customer expectations, or the way they expect to be served and interact with banks. In this disruptive business context, customers demand to be served through multiple channels, having a series of expectations. For example, they expect better and unique customer experiences; secure and faster transactions; more flexibility in operations/transactions and better control over the privacy of their data and assets, in order to prevent frauds in the complex environment.

Further, rapid developments in telecommunications, big data, artificial intelligence and machine learning, blockchain technology etc., appear to have a strong effect on the future of banks and the banking industry. For instance, blockchain technology will be a major disrupter in the future digital banking environment. The blockchain technology distributes financial management from a central authority to a widespread network of computers. In this technology, financial transactions are broken down into encrypted packets, or 'blocks', which are then added to the 'chain' of computer code and encrypted for enhanced cybersecurity. The blockchain technology has the potential to upgrade numerous faces of banking and it is the basis for many other banking technology trends, such as 'bitcoin'. According to Wharton School of the University of Pennsylvania, USA, it is no longer a question of 'if blockchain will change the banking industry'. But the question is 'when will it happen?' Hence, Blockchain technology is anticipated to transform the banking and financial services industry in the near future.

Transformation Strategies for Banks in a digitally disruptive environment

What transformation strategies should banks adopt, to proactively address the impact of innovative disrupters on their traditional business models? According to researchers in the global banking context, 'out-of-the box' thinking and well-crafted approaches are important for strategic transformation of banks in 2020 and beyond. As recommended by reputed research companies, the focus should be on addressing four key areas such as regulatory compliance, technology, risk management and talent, in particular. Banks need to approach problems in a new way, conceptualizing the issues differently. Traditional banks should understand their position in relation to any particular disruptive innovator in the market, in a way they had never thought before. In such a situation, creating unique experiences for ever-demanding customers,

meeting regulatory compliance, maintaining accountability, transparency, data protection, good governance, and talent management/retention are great challenges for banks. Thinking differently/out-of-the-box is vital for traditional banks for a strategic transformation in the present digitally disrupted banking context.

Banking ecosystems

Researchers have recognized that in a fast-growing digital banking environment, banks are interested in working in 'banking ecosystems'. A banking ecosystem is 'an inter-connected set of financial services where customers could fulfil a variety of needs in a single integrated experience'. It focuses on bridging transactions in order to make the customer's daily life easier. In an ecosystem, customers demand better unique experiences from banks. In a fast-developing modern digital banking environment, it is possible for banks to offer integration of products and services from a variety of providers. This is in contrast to offering customers only a few traditional core banking products/services from a single provider. The integration of products and services from a variety of providers will focus on effective and efficient banking solutions to customers. It will help to simplify their daily life and offer superior, different customer experiences. This is identified as the 'core' of digital banking.

However, it is important to note that in a banking ecosystem, where customers demand improved unique experiences, the banks are faced with great challenges in delivering such perfect customer solutions. This is due to many obvious reasons: complying with strict expensive regulatory requirements, managing various forms of risks to banks, managing talent at work etc. being in the forefront. About challenges faced by banks in complying with changing regulatory requirements, over the past five years in Sri Lanka many new regulatory requirements have been imposed on banks. The objective of such requirements was to ensure a strong sustainable banking industry, mainly to guard against risks in capital requirements and provisioning for irregular and bad debts. The Basel III regulation commenced from 1st July 2017 which imposed on Sri Lankan banks (Central Bank of Sri Lanka, 2017), a requirement to maintain minimum capital ratios and buffers in respect of total risk weighted assets, had led to more stringent regulations in capital, liquidity and leverage. An established credit rating agency, Fitch Ratings Inc., had stated in the article 'Basel III raises capital pressure for Sri Lankan banks' (economynext, 2019) that 'Sri Lankan banks are likely to come under increased capital pressure from Basel III-related requirements that take full effect at the start of 2019'. Hence, in contrast to innovative non-banking companies operating in the financial services industry, banks face a great challenge in delivering perfect customer solutions, in a disruptively changing banking environment.

Further, in such a fast-developing environment, banks are strongly engaged in strict competition with each other for their survival and growth. Researchers argue that by doing so banks harm themselves and also damage the banking industry, as a whole. Instead, banks should be aware of threats being posed by non-banking firms such as FinTechs, invading into their space. Banks need to work in collaboration with non-banking firms being strong and proactive, in order to face such challenges/threats successfully. In addition, technological developments such as a combination of advanced data analytics, open banking APIs and conversational Artificial

Intelligence (AI) could create a unique customer experience. This could increase customer satisfaction, customer loyalty and life-time value, generate revenue for the provider etc. The challenge is that the provider of this advanced banking ecosystem does not necessarily have to be a traditional bank. Hence, in this fast-developing challenging environment, banks need to redesign their road maps, collaborating with existing competitors and new entrants/innovative disruptors such as the FinTech companies etc., in the financial services industry.

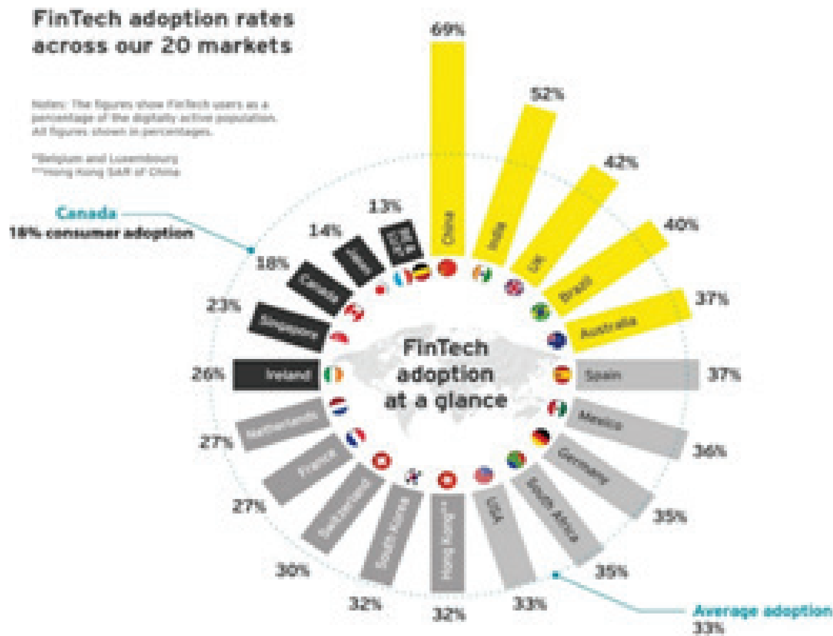
Unleashing the Potential of Disruptive Innovators

Disruption-driven change in the banking industry is inevitable, driven by a combination of innovative disrupters such as major technology players being in the fore front, including Financial Technology (FinTech) companies. Researchers argue that 'disruptive innovation' has proved to be a strong way of thinking about innovation-led growth, introducing affordability and convenience to customers in a variety of business industries. In this context, the technological revolution has already begun in the banking industry, disrupting the traditional banking models. Today, the younger customer segment, especially the millennials, no longer appreciate the banking system that was customarily designed for about two generations prior to them. They demand faster, smarter and cost-effective banking solutions. Hence, the conventional banking system is now challenged by fast-developing innovative models, introduced by disruptive innovators such as financial technology (FinTech) companies. Innovative market disruptors in the financial services industry offer customers better solutions to pay, send, borrow and invest money in their day-to-day financial transactions, without physically visiting a bank or bank branch. These options have made the customers' lives easier, with better and unique experiences. Many large technological companies are now functioning as 'big banks' in this context, disturbing the traditional banking system. They offer banking services to customers in a smarter way than the traditional market-leaders or incumbent retail banks. The Apple Pay, Google Pay and PayPal are few examples of such alternative services provided by FinTechs. Disruptive-innovation led change is now evident in the banking industry, globally and locally.

The global FinTech industry is developing fast, due to innovative start-ups and major technology companies. A global survey conducted by Ernst & Young in 2017, 'EY FinTech Adoption Index 2017' (EY, 2017) across 20 markets revealed important insights and future trends. The study was based on more than 22,000 online interviews with digitally active consumers (i.e., internet users) across 20 markets: Australia, Canada, Hong Kong, Singapore, the UK, the US, Mainland China, India, South Africa, Brazil, Mexico, France, Spain, Switzerland, Germany, Ireland, Japan, Netherlands, South Korea and Belgium/ Luxembourg (considered as one market for this analysis). In this study, a regular FinTech user was defined as 'an individual who has used two or more FinTech services in the last six months.'

FinTech adoption rates across above 20 markets are given in **Figure 2**. It indicates that in 2017 the average adoption rate of FinTecs was 33% (EY, 2017). The highest FinTech adoption rates were reported from China (69%) and India (52%). The lowest adoption rate was reported from Japan (14%) and Belgium/Luxembourg (13%).

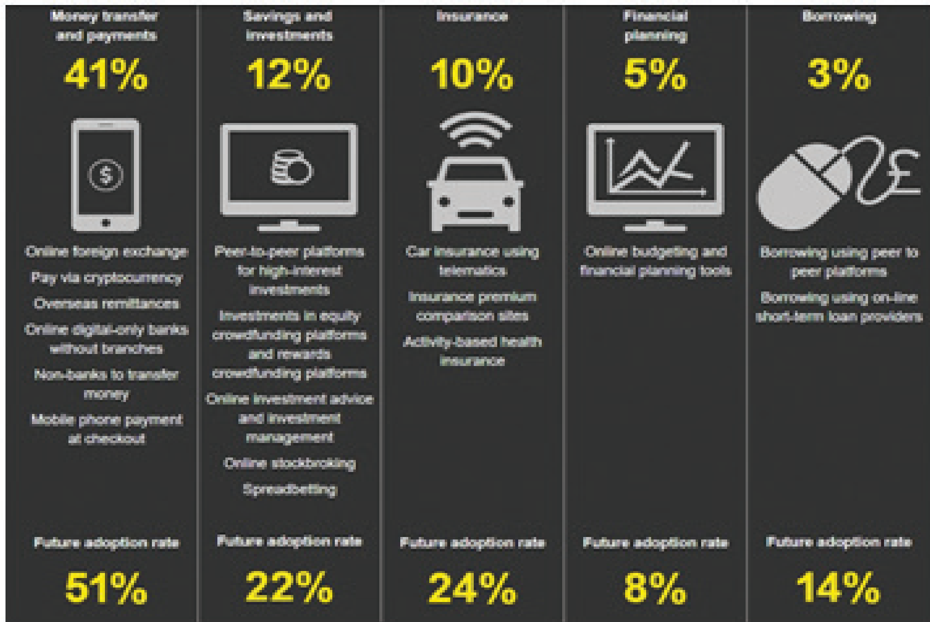
Figure 2: FinTech adoption rates across 20 markets



Source: Ernst & Young, 2017

The survey revealed that in the above 20 global markets, customers preferred FinTech products and services in a number of key areas, over their traditional banks. **Figure 3** gives a glimpse of the FinTech adoption rate in 2017 and predicted future adoption rates in the given key areas (EY, 2017). Customers have indicated the highest FinTech adoption rate of 41% in the 'money transfer and payments' area, predicting a future adoption rate of 51% in this area. The lowest FinTech adoption rate of 3% was recorded in the 'borrowing' area, with a future adoption rate of 14%. This indicated customers still value the traditional banking services when it comes for borrowing.

Figure 3: Present and future trends in adopting FinTechs in 20 global markets

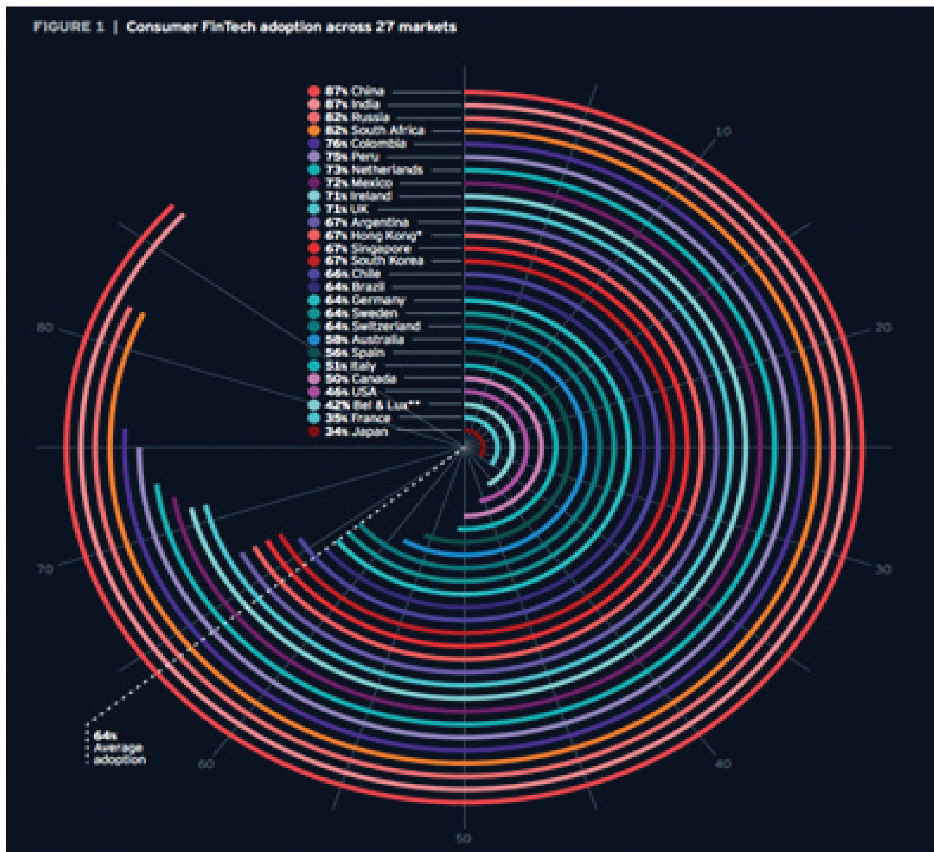


Source: Ernst & Young, 2017

According to a global banking survey by Ernst & Young in 2019 (EY, 2019a), FinTechs have developed significantly, since the EY's first report on 'EY FinTech Adoption Index 2015'. They reported that the FinTech trend in 2015 was 'clearly more than just hype' and the average global consumer adoption rate was only 16% in the selected markets. EY's next survey report in 2017, 'EY FinTech Adoption Index in 2017', revealed that the FinTech firms have grown rapidly over the past two years and have achieved an average adoption rate of 33% across the said 20 global markets in 2017. The latest survey in 2019 'Global FinTech adoption Index 2019' (EY, 2019a), conducted in 27 global markets interviewing 27,000 consumers, revealed that the average global consumer adoption rate of FinTech companies in 2019 had increased up 64% in the past two years **(Figure 4)**. The 'Global EY FinTech Adoption Index in 2019' exposed, how FinTech firms have advanced and expanded their products and services across the globe, and how they have effected a disruptive change across the entire global financial services industry. The success behind the FinTech firms' expansion is due to their attempt to make financial services more accessible for both consumers and businesses. Further, through the connection of consumers to a digital world, FinTech companies enhance their experiences, making them more efficient, economical and flexible in the respective markets. According to the latest survey of Ernst & Young (EY, 2019a), 'FinTechs are organizations that combine innovative business models and technology to enable, enhance and disrupt financial services'.

Figure 4 shows the individual FinTech adoption rates of the given 27 markets. It revealed that China and India had the highest FinTech adoption rate of 87%. Next highest adoption rate was Russia and South Africa at 82%. Japan and France indicated the lowest FinTech adoption rates of 34% and 35%, respectively.

Figure 4: FinTech Consumer Adoption accoss 27 Markets



Source: Global EY FinTech Adoption Index in 2019' (EY, 2019a)

Key Findings of the report: 'Global FinTech Adoption Index 2019'

- Global FinTech adoption has reached 64% and has become mainstream in all the surveyed markets. The top reasons to use a FinTech firm over a traditional bank were reported as 'attractive rates and fees.'

- About 96% of the global consumers are aware of at least one money transfer and payment by FinTechs. Only 4% of global consumers are not aware of money transfer and payment by FinTech firms.

- Three out of four consumers, or 75% of the global consumers, have used a money transfer and payments by FinTech service.

- FinTech adopters prefer online and app-based financial products despite concerns about personal data security.

- Attractive rates and fees has overtaken the ease of setting up an account as the primary reason adopters cite for choosing a FinTech challenger.

- While consumers' trust in their main bank or insurer remains high, 33% of FinTech adopters say they would first turn to another organization when considering a new financial services product.

- 68% of consumers are willing to consider a financial services product offered by a non-financial services company.

- 46% of FinTech adopters are willing to share their bank data with other organizations in exchange for better offers.

- FinTech adopters are much more willing than non-adopters to consider financial products offered by non-financial services companies. However, even 30% of non-adopters are willing to consider a digital-only bank account from a non-financial services company.

- There is a 'trust gap' that can create opportunities for both incumbent financial institutions and FinTech challengers. It was revealed, even though non-financial services companies have led the way in deploying new technologies to deliver innovative services and have raised the bar on consumer expectations, they do not yet have the full confidence of consumers when it comes to providing financial services on their own.

Further, the above survey (EY, 2019a) revealed that almost half (47%) of the FinTech adopters would be happy to use those services if the non-financial services company was working in collaboration with a traditional bank/financial company, 27% said they would be happy to use the services if the non-financial services company partnered with a FinTech challenger, and just 18% said they would be happy to use the services if the non-financial services company offered them on its own. This highlights the prominent role of traditional banks/incumbents, as the primary bearers of consumer trust and their main point of contact, in driving the development of FinTech ecosystems. It indicated the importance of effective collaboration of banks with non-financial services companies/FinTech companies in the financial services industry.

Effective collaboration between banks and non-financial services companies / FinTechs

Based on recent surveys by reputed research companies in global banks, this article will next discuss how banks could better collaborate with Innovative non-financial services companies/ FinTech firms, to enjoy benefits of modern technology towards strategic transformation.

A recent global survey by Ernst & Young (EY, 2019b), using data from 45 major banks over the past three years, on 'Unleashing the potential of FinTech in banking' revealed that banks remain mainly focused on applications of FinTechs in payments (EY, 2019b). However, banks are increasingly looking at using FinTechs across their entire value chain, without limiting to only payments. For example, banks are interested in using FinTechs for compliance training to surveillance software that could identify employees who pose the greatest organizational risk. Further, global banks are interested in using Artificial Intelligence (AI) to improve customer service, in order to drive greater workforce productivity. The global FinTech industry is developing rapidly. Banks that are interested in benefiting from this potential must act fast to find new ways to engage with these innovative firms to achieve value-creating collaborations. Research had recognized that banks and FinTech firms benefit by collaboration or working together, acquiring the full benefits of innovation. However, success in collaboration with FinTechs and benefits will depend on the strength of banks' innovative culture. For a bank that has a weak innovation culture, selecting the right FinTech firm to collaborate with, and successfully implementing new technologies would be a challenge.

In addition, the survey report on 'Unleashing the potential of FinTech in banking' by Ernst & Young, (EY, 2019b) revealed that the major threat to most global banks comes from traditional competitors better leveraging the innovative non-financial services companies/FinTecs, and not from FinTechs directly. Unless banks and FinTech companies work together in collaboration, neither will secure the full benefits of innovations. If banks need to leverage its potential, they need to act fast and find ways to engage with FinTecs, to achieve value-creating collaboration. Hence, according to EY (2019b), 'banks must partner with FinTechs, or they may perish.' However, this study exposed that out of the 45 major global banks that participated in the survey, only about 25% were largely engaged with FinTechs. This was due to barriers to collaborate with

such non-financial services companies. Effective partnering of banks and FinTech companies addressing such barriers, would reap the benefits of collaboration through new technology.

Collaborate or perish: Suggestions for banks

Globally, both traditional banks and FinTechs are challenged and pressurized to develop simpler, more transparent customer-centric financial services/products. This would help them to survive and stay strong in the fast-developing digital financial services industry. Researchers have identified, in such a situation the 'competitive' mindset of both, banks and FinTech firms, now turning into a 'desire to collaborate' mindset. For example, Ron Stokes (2017), EY Canada's FinTech leader, stated that "when it comes to banks and FinTecs, we're seeing what used to be a competitive mindset turn into a desire to collaborate. It's becoming clear that working for mutual benefit rather than competing with each other, will result in more meaningful innovations, faster." Considering the strategic importance of collaboration with non-financial services companies, today large global banks are using a number of approaches to partnering or engaging with disruptive innovators/FinTechs. According to researchers, reducing long-term costs while protecting their market share has been recognized as a key approach by banks. Banks' will attempt to achieve this objective by introducing innovative banking products/services for their customers, probably through collaboration with FinTechs in the future.

However, it has been recognized that the success or the outcome of collaboration is mixed. Despite banks having many new ground-breaking ideas, the challenge is to approve the best idea, pursue it actively and integrate with the technology. Banks very often fail in facing this challenge effectively, due to the complexity of the situation, scale, security, nature of banks etc. According to researchers, in order to deliver truly transformational value through collaboration with FinTecs, banks need to focus on few key areas: Banks need to be clear about the innovation model, the scope and mandate for innovation, procurement and retained technology functions. Further, it is essential that banks determine how best to partner with FinTechs, given the diverse contrasting sizes and cultures of their respective organizations.

The report on 'Unleashing the potential of FinTech in banking' by Ernst & Young (2019b) recommend four steps for banks, to successfully collaborate with non-financial services firms/ FinTecs and transform their organizations, strategically. This article will briefly discuss the four steps as follows.

Step 1: Develop a FinTech framework that rewards innovation

Mostly, innovation opportunities of banks address the challenge of structural costs protecting its market share, with benefits enjoyed over long-term. In contrast, performance measurement and compensation cycles of banks are usually short. In a disruptive economic context, there is some hesitation about accepting the additional risk of these investment costs that come with innovation opportunities. This would be a hindrance to banks for effective collaboration with non-financial services companies. According to Ernst & Young (2019b),

banks need to resolve this inherent conflict, before developing a suitable FinTech framework. Further, banks need to define guidelines within a FinTech strategy, and this process must be driven from the top to bottom. Banks need to encourage new ideas within the organization, and build lessons learnt into the process. New suggestions for innovation should be welcomed via internal social media/intranet across the banks. In this context, an innovation-led FinTech framework is necessary to support originality in the organization. Further, clear accountabilities, decision-making outlines and criteria for success need to be specified clearly. Ernst & Young (2019b) recommend that banks define their innovation framework and process clearly, then share relevant aspects with the firms they seek to engage with. This final stage includes sources of external and internal influence, the end-to-end process, decision-makers and acceptance criteria, and the enablers to support the framework.

Step 2: Choose an innovation operating model that connects new ideas to business needs

Ernst & Young (EY, 2019b) identified, out of many innovation operating models used in the present context, banks typically employ one of three types: (i) centralized, (ii) decentralized or (iii) hybrid.

Centralized Innovation Model: In a centralized model, a chief digital officer is in charge of a central innovation team who develop business solutions. The salient feature of a centralized model is that it identifies the specific need for innovation and exposes the company to innovative ideas and concepts. This model enables better coordination among the chief digital officer, procurement and dealer risk management activities. However, few disadvantages of a centralized model have been identified: A perception that the central team is too distant from the business units to fully understand their needs; decision cycles may take longer, spending more time before a prospective business promoter is found. However, in a collaboration when the centralized model works well, its structure supports and benefits the non-financial services firms/FinTech companies.

Decentralized Innovation Model: The decentralized model is much dominant in small and regional banks. Each independent business unit runs its own governance processes. It enables those familiar with the business to identify real problems, and innovators with real solutions, much faster. FinTech companies that have strong relationships with banks could engage much faster with their business partners. However, with the lack of support and direction of a central team, others find it difficult to connect with each other. The other disadvantages noted by researchers in a decentralized innovation model: a duplication of effort; proliferation of local processes and lack of consistency in the process.

Hybrid Innovation Model: According to Ernst & Young (2019b), Hybrid Innovation Model is the ideal solution to connect innovative ideas to business needs, to successfully collaborate with non-financial firms/FinTecs. Researchers believed, defined, distinct innovation team would help to create the right setting and message, guided by a clear leadership to support in the

process. For efficiency in the hybrid model, distance between innovating teams and business units needs to be reduced as much as possible. Further, recommend transparency around the end-to-end innovation adoption process, as the bank's innovation teams prefer to know how this process works. Hence, researchers have recommended the Hybrid Innovation Model, for effective collaboration with non-financial firms/FinTech companies.

Step 3: Assess the pros and cons of your FinTech engagement strategies

In order to successfully collaborate with non-financial firms/FinTecs and transform their organizations strategically, banks need to assess the pros and cons of their FinTech engagement strategies. Global banking surveys have identified that banks turn to FinTech firms to support drive innovation in their organizations. A collaborative engagement strategy enables a network of banks to jointly develop new technology standards that can be adopted in the future. However, researchers argued that there is no single right answer as to how to collaborate with non-financial services firms/FinTechs. Banks look to FinTechs to help initiate innovation. However, whatever path they select to engage, implementing modern, innovative technology is a challenge to banks. Banks should be efficient in embracing innovation faster at all levels of the organization, to witness faster sustainable change in the organizations. Hence, researchers argued, in collaboration with FinTechs, "banks should carefully evaluate the pros and cons of various engagement models and choose a mix that supports their innovation model and long-term growth strategy (EY, 2019b, p. 10)."

The following **Table 1** indicates the pros and cons of FinTech collaboration strategies of 45 global banks in the above survey.

Table 1: Pros and Cons of FinTech Collaboration Strategies of banks

Model of Engagement	FinTech Collaboration Strategies	Pros	Cons
Collaboration	Banks entered into various types of arrangements with FinTech companies: • Utilizing products or platforms developed by FinTechs (e.g., a bank teaming up with a robo-advice. FinTech to offer investment management services) • Collaborating as a network to develop and test new technologies and solutions • Referral arrangements, primarily in the p-to-p (P2P) lending space, where a bank might refer a small business that falls outside the bank's risk appetite to a P2P FinTech. • Joint ventures or co-created services (e.g., a bank partnering with a FinTech firm to launch a digital marketplace)	•Benefits from cutting-edge projects such as blockchain • Addresses lack of in-house talent and innovative culture	Finding a compatible partner • Monetization of partnership • Data security and privacy •Potential culture clashes • Not always an exclusive relationship

Source: Ernst and Young (2019b, p.11)

Step 4: Carefully manage talent and architectural change

As the fourth step in this process Ernst & Young (2019b) recommend, banks need to manage talent and architectural change prudently, to successfully collaborate with FinTecs and transform their organizations strategically. Transformational architectural change requires a long-term commitment. Possibly, it may deviate from a long-term strategic vision. Irrespective of the process that is used to formulate the strategy, the application, technical and data design of the future is expected to appear very different, compared to the present looks.

In addition, the structure of talent pool need to be changed. In the process of collaboration with FinTechs, new talent/capabilities will be required, and the existing talent/skill sets need to be transformed in the future. Hence, banks require change in talent acquisition strategies at all levels of the organization. Advanced technology and automation of routine processes will release human beings to perform more productive/value-added tasks in the new structure. Further, there may be some migration of talent from banks to non-banking technology firms/FinTech companies. The above ideas for transformational change could be viewed as threatening, as well as challenging, to banks. The study report (EY, 2019b, p. 13) recommend, "regular communication and participation in innovation will foster and drive collaboration. Silence and a "us vs. them" mentality will result in a demotivated workplace and will make it difficult to retain top talent."

Embedding non-financial services firms / FinTech in the banking ecosystem

Researchers have predicted that the most successful banks in the future will be those that improve efficiency and reduce structural costs, through collaboration with non-banking technology firms or FinTech companies. In the process, they bring various components together to build the strongest ecosystem. The transformed banks will be stronger, enlarged through external collaboration with non-banking financial services/firms/FinTech firms. The banks' component-based architecture, resembling a set of interoperable building blocks, will drive innovation and next-generation efficiency. Their technology structure will be modular, interoperable and ultimately much simpler. The new culture will be a mixture of the two cultures as a result of collaboration, and not protectionism. Hence, researchers argued that success for banks will be based on building a better ecosystem with non-banking financial services firms/ FinTech firms, and not building a bigger bank. But, scholars argued, to achieve this future status, banks will need to unleash the potential of FinTech in their own organizations/industry.

Conclusion

Change in the banking industry is inevitable, and it continues to redesign the future of banks, globally and locally. Based on few recent surveys in the global banking industry by reputed research companies, this article discussed in detail, on strategic transformation of traditional banks towards tomorrow, through collaboration with innovative disrupters/non-banking financial service companies. First, disruption caused by disruptive innovations by non-banking service firms/FinTecs in the banking industry was discussed. Disruption is a process, whereby a smaller company with fewer resources is able to successfully challenge established market-leaders/incumbent businesses. Disruptive innovations are innovations that create a new market and value network, and finally disrupting an existing market and value network, displacing established market-leaders, products and alliances. With this understanding, the article discussed the disruption caused in the banking industry by innovative disrupters or non-banking service firms, such as FinTecs firms. Rapidly developing new technology is transforming the global banking industry, disruptively changing the landscape of traditional banking with the introduction of innovative digital products and services. Researchers recommend strategic transformation for traditional banks through innovative disrupters or non-banking financial service firms such as FinTechs. Transformation strategies for banks in a digitally disruptive environment is discussed, highlighting the strengths of banking ecosystems and unleashing the potential of disruptive innovators.

Finally, based on a recent global banking survey by Ernst & Young (2019b), the article recommended four steps for banks, for effective collaboration with non-financial services companies/FinTechs, towards strategic transformation of traditional banks: (i) to develop a FinTech framework that rewards innovation; (ii) to choose an innovation operating model that connects new ideas to business needs; (iii) to assess the pros and cons of bank's FinTech engagement strategies and (iv) to carefully manage talent and architectural change of the organizations. Based on the above global survey, the Ernst & Young researchers recommended embedding non-financial services companies/FinTechs in the banking ecosystem. This article lastly discussed the strong message given to the traditional banks through the above survey: "Collaborate or Perish."

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