INNOSIGHT
STRATEGY AND INNOVATION AT HURON

Disruption Ahead:
Financial Services In Asia

Leadership Strategies in an Era of Market Transformation

Spring 2015

EXECUTIVE SUMMARY

OVER THE PAST FIVE YEARS, the economy in Asia has been growing steadily and the largest banks have enjoyed double-digit growth in return on equity,[1] staying well ahead of their European and American counterparts who are still recovering from the credit crisis. Today, the Asian financial sector accounts for close to 40% of the world's banking and insurance market capitalization, more than double what it was a decade ago.[2]

While banks in Asia have solid balance sheets, they are by no means immune to disruptive threats. A host of non-bank players have entered the industry to make banking simpler, cheaper and more accessible. Of course, not all of these new entrants will succeed, and success in one country may not be transferrable to another given the region's diversity. Through the lens of disruptive innovation theory as well as Innosight's own framework for strategic transformation, our analysis shows where and how established players can grow by harnessing disruption and discovering new market opportunities across both emerging and developed markets in Asia.

While banks in Asia have solid balance sheets, they are by no means immune to disruptive threats.

Findings and insights include:

Disruptive new entrants are gaining ground in Asia's financial service sector
Across Asia, the financial services industry is now awash with new business models promising to redefine how transactions are brokered and how customers are served. Tech giants, telecom operators, retailers and FinTech startups are all rushing in to get a slice of the pie. These new entrants typically started small in underserved segments, but they have already started to advance upmarket and further disrupt the industry. For example, online payment provider Alipay started by enabling e-commerce payments but subsequently launched a money market fund that quickly captured one-third of the China's 1.46 trillion-yuan market.

Knowing where and how disruptions occur will help banks formulate an effective response
The success of these new competitors in Asia should sound the alarm that broader industry transformation is on the horizon, but exactly which disruptive threats will materialize and which will fizzle out is difficult to pinpoint, especially given the diversity of the region's economies. With bank account penetration ranging from 20% in Indonesia to 99% in Australia, market needs vary so widely that what is disruptive in one country may not work at all in another.

The patterns of disruptive innovations reveal three types of strong new entrants in Asia
Leveraging the theory of disruptive innovation, devised by Innosight's co-founder and Harvard Business School professor Clayton Christensen, we have developed a set of patterns and indicators for assessing a new entrant's potential to kick-start and sustain industry disruption. Successful entrants typically offer a unique solution for a niche segment that has strong unmet needs but where it is unprofitable for incumbents to compete. And once a foothold is established, entrants who can overcome performance gaps while maintaining a competitive edge will have a good chance of expanding into adjacencies and causing further industry disruption.

After screening a long list of new business models in financial services using the disruption patterns, we have identified three particularly strong archetypes of new entrants across different markets in Asia, based on bank account penetration.

- **In early-stage emerging markets** such as Philippines and Indonesia (bank account penetration <40%), telecom operators have started to disrupt the financial services sector by creating **mobile money services** that initially target remittance, a prevalent pain point among the unbanked, and they could eventually offer a full range of mobile banking services.
- **In late-stage emerging markets** such as China and Thailand (bank account penetration at 40%-80%), **online payment providers** have built a disruptive foothold by enabling fast and secure e-commerce payments among small merchants and consumers without credit cards, and they are expanding into other digital markets.
- **In developed markets** such as Japan and Australia (bank account penetration over 80%), we have seen the emergence of **peer-to-peer (P2P) lenders** offering attractive interest rates to both lenders and investors by cutting out banks as the middleman. They started by offering small unsecured loans to those that are unable to borrow from a bank and could grow further by targeting larger, secured loans.

To sustain growth, banks will need to disrupt their own business model before someone else does.

Banks can counter disruptive threats using the "dual transformation" approach

To sustain growth, banks will need to disrupt their own business model before someone else does. Pursuing such a large-scale transformation is complex and risky, and we believe that "dual transformation" is an effective framework for governing a long-term innovation strategy. This approach involves launching two parallel but distinct efforts, one focused on repositioning the core and the other on launching new businesses. For banks, this means revamping or getting rid of legacy assets that do not contribute to competitive advantage, while at the same time creating separate businesses that could become the engine of future growth.

Banks should start the process of strategic transformation while their market position is still strong

Banks in Asia are in relatively good financial and market positions and may not see the urgency to change. However, the best time to innovate is when the core business is still strong enough to finance new growth. By the time crisis strikes, the organization will be in such mayhem that any transformation effort will be substantially more difficult to execute. Although many banks are assuming a wait-and-see approach, transformation plans will have to start soon for banks to survive and thrive in the face of disruption.

PART 1

PART 1: WHERE DISRUPTION BEGINS AND HOW IT WILL PROGRESS

According to Christensen's research, disruption typically begins when new entrants spot and fill a gap in niche markets where customers are underserved or when those niches are neglected by incumbents because they are deemed unattractive. By building a foothold among these highly frustrated customers who have no good options, new entrants can gain traction quickly and cheaply even when their initial "good enough" offering is inferior in key dimensions. As they continue to hone their business model at the foothold, some of these entrants will raise their performance enough to target more demanding, more profitable customers in the mainstream while keeping their business model advantage, thereby posing a more direct threat to incumbents.

Based on how disruptive innovations typically occur, we have summarized five key patterns and relevant indicators for the purpose of assessing the disruptive potential of new entrants in financial services (see Figure 1). The presence of all five patterns indicates that a new entrant has a high chance of causing industry-wide disruption.

Where entrants have gained footholds in Asia and how they will progress

Applying the disruptive patterns to a long list of new business models (see Appendix) confirms that at least a handful of non-bank players have the potential to jump-start and sustain disruption in Asia's financial service industry. To understand how disruptive threats may manifest themselves differently depending on a market's stage of development, we have categorized Asian countries into early-stage emerging, late-stage emerging and developed markets based on bank account penetration and potential growth paths (see Figures 2 and 3).

For each of these three market archetypes, we profile new entrants that align strongly with the patterns of disruptive innovation and discuss how they may profoundly disrupt financial services by first capturing a foothold and then pursuing adjacent growth paths in order to seize a greater share of the industry.

1. Mobile money providers in early-stage emerging markets

In early-stage emerging markets like Vietnam, Indonesia and Philippines, the vast majority (over 60%) of consumers do not have a bank account due to the lack of funds, access to bank branches or identity documentations. While the unbanked represents a huge untapped opportunity, they are costly and risky for banks to serve with their current business model. This creates a market space for **telecom operators** to introduce **mobile money services,** which leverage mobile data platforms and extensive third-party agency networks to enable low-cost, accessible transactions for the unbanked.

At least a handful of non-bank players have the potential to jump-start and sustain disruption in Asia's financial service industry.

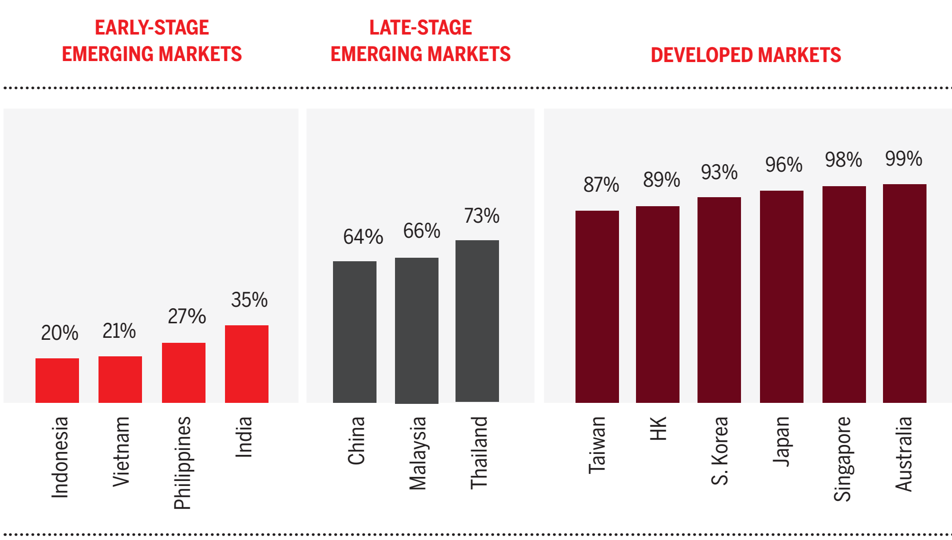
Figure 1: Five patterns of industry disruption

PATTERNS OF DISRUPTION	INDICATORS FOR ASSESSING IF A PATTERN EXISTS
New entrant targets a "pain point" problem of foothold customers **EXAMPLE:** Before the arrival of M-Pesa, migrant workers in Kenya had no good way to send money back home. Money transfer operators (e.g. Western Union) are expensive while using bus drivers to deliver cash is risky. Remittance was not done as frequently as it could have been as a result.	**For the foothold customers, does the target problem...** • Take too much time, effort or money to solve? • Sometimes require workarounds designed for another purpose? • Often get delayed and neglected, leading to under-consumption?
New entrant offers a clearly superior solution with a unique business model **EXAMPLE:** Peer-to-Peer online models directly match parties who want to transact (e.g. buyers and sellers, borrowers and investors), therefore reducing transaction costs and the need for banks to act as the middleman.	**Does the new entrant's business model...** • Have a very different cost structure? • Leverage emerging technologies in a different way? • Cause significant changes to the ecosystem?
New entrant's foothold has little impact on incumbents' profitability **EXAMPLE:** Low cost airlines like AirAsia and Ryan Air steered away from lucrative routes for established airlines to prevent retaliation. Instead they flew routes that compete with trains and buses.	**For the incumbents, are these foothold customers...** • Relatively small in number? • Highly price sensitive? • Costly or risky to serve?
Current business model offers unique advantages in addressing adjacent customers or problems **EXAMPLE:** Skype's voice-over-IP (VoIP) technology enables them to offer cheaper international calls than telcos, and this advantage applies to consumers (Skype's foothold market) as well as businesses (a potential adjacency).	**Does the new entrant's business model have a unique advantage in...** • Solving the same problem for different customers? • Solving other problems for the foothold customer?
Performance gap(s) hindering adoption are expected to narrow over time **EXAMPLE:** Skype's voice quality was not good enough for business communications at the onset, but this performance gap is vanishing as internet speed increases.	**Can the performance gap(s) be narrowed by...** • Natural evolution in the business model's underlying technology? • Adding capabilities that could be acquired easily? • Improving processes through greater operational experience?

Market foothold: remittance for the unbanked

Mobile money players entered early-stage emerging markets over a decade ago, starting with the Philippines. Early movers Smart Communications launched Smart Money with Banco De Oro (BDO) in 2001 and Globe Telecom launched GCash in 2004. Both GCash and Smart Money built a foothold by enabling remittance, given that it is a strong, prevalent pain point in the Philippines — a country where remittance accounts for over a tenth of its GDP.[4] By enabling users to send money via SMS wherever they are and conduct cash-in cash-out transactions at a wide network of merchant partners, mobile money players give consumers easy access to remittance services at a fee of less than 3%, significantly lower than the 8% average remittance fees at traditional channels.

Figure 2: Penetration of formal bank accounts in selected markets across Asia[3]



Besides the Philippines, we are also seeing the emergence of mobile remittance services in Indonesia, Vietnam and India. As a source of nearly 60 million migrant workers who sent almost USD 260 billion to their families in 2012,[5] Asia has a huge and growing remittance market that could soon be overtaken by non--bank entrants.

Disruptive growth paths: extending payment services and becoming a mobile bank

Mobile money providers have also established an edge over banks in converting other payments into cashless transactions. For instance, GCash and Smart Money have successfully moved into bill payments, e-commerce payments, in-store payments and payroll in the Philippines. While facilitating business payments (e.g. e-commerce, payroll) would require a higher level of security and service reliability than consumer-to-consumer transactions, mobile money providers should be able to close this performance gap relatively easily by leveraging new cyber-security technologies and by streamlining operations. As a result, we expect mobile money providers who have built a stronghold in remittance to be able to disrupt the wider payment market.

Mobile money providers can cause an even greater competitive threat to banks by becoming pure-play mobile banks themselves, offering a range of basic financial products to the unbanked, including savings and loans. Even though the customer demand is there, this is a relatively challenging growth path for mobile money players since their third-party agent network will need to be upgraded to handle more complex transactions. In addition, new capabilities in liquidity, interest rate and credit risks management will need to be built, and new operating licenses and compliance polices will need to be put in place.

Becoming a mobile bank is a challenging proposition, but those with a strong market position and access to resources still have a good chance of winning by taking advantage of new technologies, such as credit rating algorithms, air time top up, and partnerships. In particular, partnering is a very viable option. Given that each market is typically dominated by one or two mobile money operators, they have relatively strong negotiation power and should be able to form partnerships with banks under favorable terms. For example, Globe Telecom has successfully partnered with Bank of the Philippines Island (BPI) to form BanKo, a pure-play mobile bank. On the other hand, banks who do not manage to secure a partnership with mobile money providers may find themselves losing out on a huge growth segment as today's unbanked become the middle class of tomorrow.

Figure 3: The new entrant's foothold and potential growth paths

MARKET ARCHETYPE:	EARLY-STAGE EMERGING	LATE-STAGE EMERGING	DEVELOPED
NEW ENTRANT	Mobile money providers	Online payment providers	P2P lenders
FOOTHOLD MARKET	Remittance for the unbanked	E-commerce payments for SMEs and consumers	Small unsecured loans for "high risk" individuals and small businesses
POTENTIAL GROWTH PATHS	Extend payment services Become a mobile bank	Extend payment services Become an online financial service provider	Move upmarket into large, low risk loans Apply P2P model to other financial services

2. Online payment providers in late-stage emerging markets

In late-stage emerging markets like China, Thailand and Malaysia, where the unbanked population is a dwindling minority (less than 40%), we found that disruptions occur at a very different place in the market. Basic banking needs have been largely satisfied, yet the burgeoning middle class and the rapid rise in internet penetration are driving up demand for e-commerce. As credit card adoption remains low, a new breed of **technology companies** has emerged to facilitate secure **e-commerce payments.** The early movers among them not only are expanding into other types of payments, but they have started offering online financial products like savings and loans. If they manage to become pure-play online financial service providers, they could take away a significant share of the small and medium enterprise (SME) and middle-class consumer business away from banks.

Market foothold: e-commerce payments for small and medium enterprises & consumers

With a stronghold in e-commerce and over USD 7.9 billion cash on hand,[7] China's e-commerce conglomerate Alibaba is by far the biggest adversary of banks in Asia today. Alibaba launched its online payment platform Alipay alongside its e-commerce marketplace, Taobao, back in 2003. At that time, there were just 3 million credit cards in use in a 1.3 billion population,[8] making payment a major barrier of e-commerce adoption. While the majority of online shoppers could pay via bank transfer, many worried that sellers would not hold up their end of the deal after receiving payments. To give buyers and sellers the peace of mind they needed, Alipay introduced a unique escrow model that takes funds from the buyer's bank account and only releases it to the supplier after the buyer confirms order delivery. This helped fuel the growth of e-commerce from about USD 200 million in the mid 2000's to USD 120 billion today.[9]

Disruptive growth paths: extend payment services and become an online financial service provider

Leveraging low-cost e-commerce payment platforms, technology companies can enable other forms of payment and disrupt the broader payment market. The success of Alipay (China), iPay88 (Malaysia) and Paysbuy (Thailand) in providing in-store payments, bill payments and mobile payments demonstrate that this growth path is highly viable.

Taking it one step further, technology companies can offer other financial services, like investments and loans, to their SME and consumer base using their online platform. Given their understanding of online user behaviors, fast development cycles, and solid data analytics expertise, technology companies could differentiate themselves from

Spotlight 1: Improvements in cybersecurity and risk models through emerging technologies

A range of new technologies are emerging in the area of cybersecurity and risk management. Bitcoin and Big Data look particularly promising.

Bitcoin has lost a lot of friends lately. In 2014, the well-publicized collapse of the Mt. Gox exchange based in Tokyo unnerved many traders and investment bankers. In a recent report, Goldman Sachs said "Bitcoin likely can't work as a currency," although it added that "the ledger-based technology that underlies it could hold promise." We agree with this view that Bitcoin as a currency faces a multitude of challenges that would deter adoption. But blockchain—the public ledger of all Bitcoin transactions that have ever been executed—has many potential applications that could revolutionize financial services.

One of the most powerful applications is digital identity management. *With its decentralized ledger system and cryptography, blockchain could act as a "smart contract" for claiming ownership of physical as well as virtual assets. In e-commerce, blockchain could be used to track and validate current and past transactions, check the identity of buyers and sellers, and transfer ownership of purchases including expansive assets like properties and vehicles. In peer-to-peer lending, blockchain could be used to validate past credit history of borrowers as well as their asset ownership.*

Big Data could also dramatically improve online security and risk management. *Dozens of startups (e.g., Cignifi, Affirm, Klarna and Paidy) are racing to launch alternative credit rating algorithms using non-traditional data such as airtime top-up patterns to boost credibility in social networks. This has enabled mobile payment providers like WePay in China to roll out mobile lending products to their existing users. WePay's next move could be introducing credit cards that threaten the lucrative interchange revenues that banks currently enjoy.*

banks by delivering a superior user experience. On the negative side, these players may not be seen as secure enough to hold one's life savings. Moving into higher value, more mission-critical financial products will therefore require technology companies to ramp up their security measures without letting the bureaucracy defeat their original competitive advantage.

Closing the performance gap in security is challenging but not impossible, as new technologies in cybersecurity evolve *(See Spotlight 1)* and consumers get increasingly comfortable letting non-banks handle their finances beyond payments. The success of Alipay in expanding to SME loans (Aliloans) and money market funds (Yu'e Bao) goes to show that large technology companies with ample resources can improve performance enough to compete neck-and-neck with banks. In particular, Yu'e Bao, which was launched by Alipay in 2013, quickly gained 554 billion yuan (USD 90 billion) worth in assets and became the market leader in less than a year.[10] As a result, there is a strong possibility that technology players can leverage their user-friendly online and mobile financial tools to place themselves at the front end of customer transactions. This could potentially relegate banks to providing back-end administrative services (e.g. holding cash) and force them to compete on the basis of cost efficiency.

3. Peer-to-peer lenders in developed markets

In developed markets like Singapore, Australia and Japan, virtually everyone has a bank account (>85% penetration), yet there are pockets of unmet needs that are ripe for disruption. Specifically, we have seen the emergence of **FinTech startups** that use a **peer-to-peer (P2P) model** to offer small unsecured loans to individuals and small businesses that would otherwise be rejected by banks due to poor credit ratings.

Since small, unsecured loans fit well with the disruptive patterns, we expect to see more P2P lenders springing up across the region.

Market foothold: Unsecured loans for "high-risk" individuals & small enterprises

The P2P lending model was first pioneered in the US and UK around 2005 by Prosper (US) and Zopa (UK) respectively. It matches borrowers directly with lenders by making credit risks and interest rates transparent. This gives borrowers without a sound credit record the chance to secure a loan at a rate that reflects their risk level, rather than getting rejected outright by banks. Also, by cutting out banks as the middleman and using only online channels, P2P lending platforms offer more attractive rates than banks to both borrowers and lenders.

P2P lenders have also emerged in Asia including Japan (e.g. maneo, AQUSH), Australia (e.g. SocietyOne, Lending Hub, iGrin), and Hong Kong (e.g. WeLab). Since small, unsecured loans fit well with the disruptive patterns, we expect to see more P2P lenders springing up across the region to capture this segment.

Disruptive growth paths: Moving upmarket to apply the P2P model to other financial services

P2P lenders' online marketplace model enables them to offer attractive interest rates since, unlike banks, they do not need to invest significantly on liquidity, compliance and branch networks. Leveraging this cost advantage, P2P lenders can move upmarket and compete with banks on large, secured loans. For example, AQUSH in Japan started by providing loans to individuals, eventually targeted small businesses and then large businesses including solar energy power plant operators.

Spotlight 2: Near Field Communications-enabled mobile wallets are unlikely to cause major industry disruption.

NFC-enabled mobile wallets, like Apple Pay and Google Wallet, promise consumers greater convenience. A deeper analysis, however, reveals that their disruptive potential is not strong.

Firstly, existing in-store payment methods like cash, debit/credit cards and NFC prepaid cards are largely "good enough" even for small transactions. This makes the improvements offered by NFC mobile wallets more incremental than revolutionary. Also, storing physical credit cards in the wallet also doesn't appear to be a major pain point, and in fact, branded credit cards serve as a status symbol for many Asians.

Increasing payment speed is not a strong enough selling point for merchants either, as evidenced by the refusal of retail giants like Walmart and CVS to accept Apple Pay in the U.S. What merchants really are frustrated about is the card transactions fee, which goes up to 3%, a heavy burden considering large retailers' razor-thin margins.

Given that the NFC-enabled mobile wallet does not fit well with the disruption patterns, slow adoption by consumers and merchants could be expected and a significant marketing push would be necessary to drive adoption.

Even though lending has been the most prevalent application of the P2P model, other types of P2P financial services are emerging. These include P2P investment (i.e. crowdfunding), P2P insurance, and P2P foreign currency transfer. There are a handful of cases where P2P lenders managed to move into other P2P financial services. This includes Shacom, a P2P lender which was set up in Taiwan in 2000 and introduced a P2P insurance platform a decade later.

PART 2

PART 2: HOW BANKS SHOULD RESPOND

Transforming the core while building the new

While it is important to know what types of disruptive threats are in the horizon, it doesn't guarantee that incumbents can respond to these threats effectively. As Clayton Christensen explained in his best-selling book, ***The Innovator's Dilemma**,* large organizations can do everything "right" and still lose the battle against industry challengers. The very structures, processes and norms that made large organizations successful also make them resistant to change in the face of new market realities.

This is especially true in financial services, where regulatory compliance and a high cost-base from legacy IT systems and branch networks prevent banks from transforming their business model radically. There is an overwhelming amount of work to be done in order for banks to fend off disruptive new entrants, so revamping the entire business model in one fell swoop is going to be challenging. Instead, bank executives may find it much more manageable to treat the transformation as two distinct innovation efforts, or what we call "dual transformation."

The concept of dual transformation was first introduced by Innosight in the Harvard Business Review article ***Two Routes to Resilience*** in 2012. "Transformation A" is about repositioning the core business, adapting its current business model to new market realities. This requires finding and strengthening the business's competitive advantage, while cutting resources devoted to low-priority areas. "Transformation B" is about creating a separate, disruptive business that could become the engine of future growth. Dividing the effort in two allows leaders to sustain and prolong the revenue potential of the core, while giving the new venture the required time and space to grow.

Transformation A: strengthening competitive advantage

As branch networks become redundant, customers increasingly trust non-banks with their finances. And as the Internet enables consumers to easily deal with multiple financial providers at once, banks' traditional sources of competitive advantage are slowing fading away. To remain indispensable in the customer's financial universe, banks will need to find new ways to differentiate. For most banks, transformation A is therefore about deepening and broadening customer relationships by improving their core business model. This necessitates adding new channels and services that create customer value, like adding new mobile and online payment functions which many banks are working on. Transformation A also involves repositioning legacy assets like the branch infrastructure and compliance policies so that they do not become liabilities in the future. This transformation is not dissimilar to what many brick-and-mortar

The very structures, processes and norms that made large organizations successful also make them resistant to change in the face of new market realities.

Spotlight 3: Lesson from retailers on how to improve the in-branch experience

Shorten waiting time

Predictive analytics *– The supermarket chain Kroger in the U.S. uses cameras and people-counting technology to detect shoppers entering the store, predict when they will finish shopping, and determine the number of lanes that need to be open*

Pre-ordering *– Starbucks is introducing pre-ordering so that your drink will be ready and waiting for you when you enter the store. Starbucks knows shorter wait times will make customers happier*

Remote queuing *– The NoWait app lets you make a reservation, check wait times at nearby restaurants and remotely add your name to the wait list. Then, when your table is ready, you will be sent a text by the hostess*

Engage and reward customers

Gamification with loyalty rewards *– In Singapore, Coca-Cola set up a Hug Machine –a vending machine inviting the consumer to "hug" it, after which the consumer would be given a free Coke*

iPad stations *– The recently refitted Delta terminal in New York City's LaGuardia airport has 2,500 iPad stations set up throughout the terminal, allowing you to do everything from reading news to ordering food*

Personalized loyalty rewards *– Leveraging customer insights, supermarket holding company Ahold USA sent out unique personalized coupons delivered electronically to customers' loyalty cards*

retailers have gone through in face of disruption by e-commerce, and there are plenty of lessons that banks could learn from retailers in improving branch performance (see Spotlight 3).

Ultimately, success in transformation A depends on banks having a clear vision and knowing what capabilities are core to achieving that vision. Everything else that is not aligned with the vision should be eliminated or outsourced to save costs. As banks work towards transforming their core business, there are a couple of risks to be mindful of:

Outsourcing of core competencies: In the spirit of cutting costs while improving speed to market, banks could end up outsourcing parts of the business that are critical for long-term differentiation. For instance, while it may be easier to link up with an established mobile payment platform rather than building one internally, not owning the technology, the customer interaction and data in-house could take away a source of future competitive edge.

Overshooting on low-value dimensions: Banks could run into the trap of continuous, incremental improvements that eventually overshoot what customers are willing to pay for. For instance, as banks fight against each other for the business of high net-worth individuals, they are progressively pushing up service quality as well as cost. But not all wealthy customers see the value of the red-carpet treatment, and this may open up a market for "robo-advisors" like LearnVest and WealthFront to provide low-fee portfolio management services for passive investors.

Transformation B: building the new growth engine

If a new venture fits poorly with, or worse yet, competes with the incumbent's core business, chances are it will not get the resources and focus it needs to succeed. That is why some innovations, especially those with the potential to disrupt the industry, should be nurtured outside of the core through transformation B.

There are, generally speaking, three types of innovation that should be treated as transformation B. Low-cost innovations with a slimmer profit margin than the core business is the most obvious one. For example, when the Danish Bank Lan & Spar set up a purely direct bank

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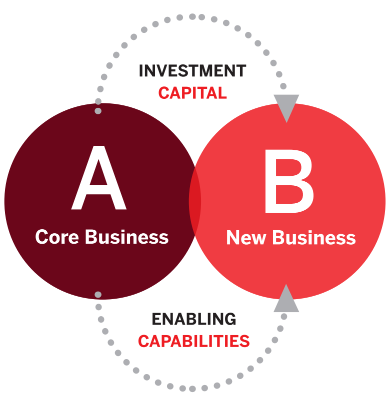
alongside its branch network, they kept the two concepts separate for three years to avoid cannibalization. Interest margin at the branch was 10% a year whereas at the direct bank it was only 3% a year.[11] The potential profit loss if customers switch to the direct bank en masse would have been unacceptable to the core branch banking business. Keeping the new direct bank as an independent operation was essential in protecting it from potential sabotage by the core.

Innovations that create new conflicts of interest in the ecosystem also belong in transformation B. For example, when Admiral Group, a UK-based motor insurance company, acquired insurance price comparison website Confused.com, they had to keep it as a completely independent business to avoid conflict of interests. Fair and transparent insurance price comparison is crucial for both users and insurance companies advertising on the site. Keeping the Admiral and Confused.com separate prevented any perception that the price comparison site may favor Admiral.



Lastly, ventures that target non-customers could benefit from transformation B, since they are likely to require a completely different go-to-market approach and delivery model. Separation will enable the venture to focus on building in the right solution without feeling pressured to make use of the incumbent's core infrastructure. For example, State Bank of India and Bank of Philippines Island (BPI) moved into pure-play mobile banking by setting up an independent joint venture with telco partners so that they could develop solutions and backend systems based on market needs rather than based on their legacy systems.

Building and scaling up a new business through transformation B takes time and careful orchestration. Many things could go wrong in this transformation process, and in particular, large organizations and their independent new ventures should watch out for the risks below.

Share resources carefully: While maintaining strategic independence is important, transformation B should not be done in isolation. The venture should leverage capabilities of the core, whenever appropriate, to gain a competitive edge over other startups. For example, when Globe Telecom, BPI and Ayala Group set up BanKo, a mobile-based banking service that targets the Philippines' unbanked population, they strategically excluded BPI bank branches or Globe Telecom business centers from the BanKo customer service network. Instead, customers can cash-in or cash-out at the 7,000 Globe GCash partner outlets, which are cheaper to operate.

It will be up to the top management to set out a clear vision of how the new venture and the core business will co-exist in the future.

Avoid getting drowned in ideas: Many banks have dabbled in FinTech startups through accelerator programs and innovation labs. While these mechanisms are great for building connections with entrepreneurs and keeping abreast of the latest technologies, they could be a distraction if banks do not have established processes to filter top solutions and integrate them with their operations.

Don't shy away from ecosystem misfits: Banks are naturally reluctant to embrace disruptive startups like P2P lenders and crypto-currency providers that aim to displace them. For instance, it took a decade for a major bank, Australia's Westpac, to invest in a P2P lending venture, which first appeared in 2005. But because disruptive new entrants have the potential to transform the entire banking ecosystem, these are precisely the types of businesses banks need to invest in.

Set vision and boundaries: Providing the new venture with sufficient funding and resources to grow in the early years is likely to be an uphill battle, especially when the incumbent's core business itself is shrinking and undergoing cost-cutting. It will be up to the top management to set out a clear vision of how the new venture and the core business will co-exist in the future—carefully policing the boundaries so that each of the two transformation efforts gets what it needs and is protected from interference by the other.

FOOTNOTES

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CONCLUSION

While the future of banking is still a big unknown, we believe that **established banks will not be completely eliminated by new industry entrants,** in the same way that e-commerce did not lead to an end of high-street retail and online advertising did not kill off all TV broadcasters. Having said that, those who survived disruption saw their business model transformed, both in terms of how they make money and how they operate. Similarly, while banks will continue to play a role in the financial system for decades to come, that role is likely to look very different from today.

In early-stage emerging markets in Asia, **the biggest disruptive risk is that non-bank entrants completely seize today's unbanked population and their future financial needs** as they gradually move up to the middle and upper-middle class, leaving banks to serve niche segments at the fringe. If banks continue to lose sight of consumer-facing transaction activities, they could eventually be relegated to back-end administrative and infrastructure services and be forced to compete with each other on the basis of cost efficiency. In developed markets, banks in Asia could see chunks of their retail and business banking business being eaten away by the P2P model, starting from unsecured personal and SME loans, and eventually in areas like mortgages, foreign currency and insurance.

Banks in Asia have an advantage in their modern IT infrastructure. Yet there is really no room for complacency. While many banks in Asia are still taking a wait-and-see approach, while placing small bets here and there and making changes that are low-hanging fruit, **more radical organizational transformation will have to start soon if banks want to survive and thrive in the face of disruption.**

More radical organizational transformation will have to start soon if banks want to survive and thrive in the face of disruption.

Appendix: A High-Level Screening of Disruptive Business Models in Financial Services across Asia

NEW BUSINESS MODEL	HOW IT WORKS	CURRENT STATUS IN ASIA	DISRUPTIVE POTENTIAL
Payment			
P2P international transfer (e.g. TransferWise)	Instead of transferring the sender's money directly to the recipient, this model finds and re-directs equivalent transfers going in the opposite direction to avoid costly currency conversion. It essentially is a marketplace that matches senders and receivers to create foreign currency swaps.	Not launched	●●●○ Strong foothold in remittance but large performance gap for moving upmarket into the enterprise segment and applying P2P model to other types of financial swaps
Bitcoin-based international transfer (e.g coins.ph, Bitspark)	The use of Bitcoin as a means of international currency transfer drastically reduces costs associated with tracking and validating transactions. This is enabled through its public, decentralized ledger system and cryptography. Hence, overall transaction costs which are typically high for international transfers can be avoided.	Early-stage startups across emerging and developed markets	●●●○ Strong foothold in remittance but high real transaction cost (3-4% mining cost + cash out fees) makes further growth difficult. Large performance gap for moving upmarket into the enterprise segment due to security concerns
Mobile money (e.g. GCash, Smart Money)	Mobile money enables individuals to have a virtual wallet in their mobile phone in which they can deposit, send, receive or withdraw money – leveraging a physical agent network and mobile technology to conduct transactions. This gives increased security as compared to holding cash, especially when amounts are large.	Service expansion in early-stage emerging markets	●●●● Successfully penetrated the unbanked as a foothold. Evidence of service expansion by early movers
NFC-enabled mobile wallet (e.g. Google Wallet, Apple Pay, SingTel/Standard Chartered's Dash)	NFC-enabled mobile wallets allow customers to aggregate their credit cards on a virtual wallet in their mobile phones. With NFC terminals deployed at retail stores, customers can make payments quickly and securely using their cards by simply placing their phones in close proximity to the terminal.	Launched in developed markets with variable success	●○○○ Incremental convenience for point-of-sale purchases with no change to the current debit/credit card ecosystem. Limited application potential in other forms of payments
Online payment platform (e.g. Alipay, Paysbuy)	Online payment platforms are the backbone behind e-commerce, enabling customers to make payments via their bank accounts or credit/debit cards, while ensuring security in the payment and overall purchasing process.	Service expansion in late-stage emerging markets	●●●● Offers a safer and easier way to make e-commerce payments than alternatives. Early evidence of successful expansion into other online financial services
Mobile credit card processor (e.g. Square, Flint, Soft Space)	Mobile credit card processors can be attached to a smartphone to enable businesses to take credit card payments securely through the device. It offers mobility to the business owner and eliminates the need for other POS payment equipment.	Early-stage startups in late-stage emerging and developed markets	●●●○ Makes it easier for small merchants to accept credit cards without changing current payment ecosystem. Does not address consumer adoption barriers for credit cards

● = MOST DISRUPTIVE ○ = LEAST DISRUPTIVE

NEW BUSINESS MODEL	HOW IT WORKS	CURRENT STATUS IN ASIA	DISRUPTIVE POTENTIAL	
Other Banking Services				
P2P lending (e.g. Maneo, SocietyOne, WeLend)	The P2P lending platform is a marketplace to match individual borrowers and lenders, at lower overheads and with less compliance measures than banks because of its online model. P2P loans often have lower requirements for credit-worthiness of borrowers, lower repayment rates, and higher returns for lenders.	Service expansion in developed markets	●●●●	Target a strong pain point among SMEs and individuals with low credit ratings. Cost advantage can be extended to large secured loans
Microfinance (e.g. Kiva, lendwithcare.org)	Microfinance institutions (MFIs) offer microloans to support poor entrepreneurs in emerging markets, through tapping lenders globally to pitch their money for part of or the whole loan amount. The online platform gives access to a greater pool of lenders (than traditional MFIs), increasing supply of funds at a low cost.	Service expansion in emerging markets	●●●○	Strong foothold in loans for the poor but limited business model advantages for moving into larger loans or other types of financial services
Crowdfunding (e.g. Kickstarter, indiegogo, Crowdonomic)	On a crowdfunding site, entrepreneurs can raise a target amount for their business idea from the contributions of many members of the public (rather than one or a few investors). This model enables funders to limit the value-at-risk in investing (should the business idea fail to progress) and entrepreneurs to increase the success of reaching their target sum.	Early-stage startups in developed markets	●●●○	Strong foothold in early-stage startups funding but significant performance gap exists for moving upmarket into large VC investments due to strict due diligence and complex legal/accounting requirements
Mobile banking (e.g. BanKo, Novopay)	Deposit services are made accessible to the rural unbanked through a channel of agents (including mom-and-pop stores or vendors) who help in setting up accounts, depositing, transferring and withdrawing cash. Using the mobile network, customers can make non-cash-out/in transactions on their mobile phones.	Early-stage startups in emerging markets	●●●○	Some demand for mobile savings/loans among the unbanked but it is not the easiest foothold comparing to mobile payments given stricter legal requirements and higher consumer demand for security and trust
Robo-advisor (e.g. LearnVest, Wealthfront, Betterment Institutional)	Robo-advisor firms rely on algorithmic templates to provide portfolio management services with minimal human intervention. This allows investors to maximize their gains with passive investing, also cutting out on commission fees.	Not launched	●○○○	Does not offer clear advantages over other passive investment products such as ETFs
P2P insurance (e.g. Shacom, Friendsurance, Bought By Many)	In the P2P insurance model, a group of individuals can team together to purchase insurance, with terms agreed upon by the group. Premiums paid are split between a group fund and the insurer. Minor damages are paid out of the group fund (if agreed upon by all members) and larger ones exceeding a limit are paid out by the insurer. This gives greater transparency with regard to terms of the policy, and also a lower overall premium with reduced administration fees and overheads.	Early-stage startups in developed markets	●●●○	Strong foothold among the elderly and the disabled who are subjected to high insurance premium under the current system. But limited adjacencies for growth as other segments are well served by insurers

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ABOUT INNOSIGHT

Innosight is a strategy and innovation consulting firm that helps organizations navigate disruptive change and transform for the future. We work with enterprise leaders to identify new growth opportunities, accelerate innovation initiatives, and build capabilities. Innosight is based in Lexington, MA, with offices in Singapore and Lausanne, Switzerland.
www.innosight.com

About the Authors

Jenny Chung is a Manager based in Innosight's Asia-Pacific office in Singapore. Her experience includes more than a decade helping organizations across Europe, North America and Asia uncover emerging market opportunities, develop innovative products and services, and embed innovation capabilities.

Annabel Tio is an Analyst at Innosight, where she has helped clients develop new business models beyond their core businesses and industries. She comes from a background in strategy consulting where she worked in the telecom, media and financial services sectors, serving clients across China and Southeast Asia.

Scott D. Anthony is the Managing Partner of Innosight. Based in the firm's Singapore offices since 2010, he has led Innosight's expansion into the Asia-Pacific region. He has extensive experience in emerging markets, particularly in India, China, and the Philippines. He is co-author most recently of the Harvard Business Review article "Build an Innovation Engine in 90 Days" as well as author of *The First Mile: A Launch Manual for Getting Great Ideas Into the Market.*

Innosight has worked with some of the companies mentioned herein but prepared this report based on publicly available material.

INNOSIGHT
STRATEGY AND INNOVATION AT HURON

Company Headquarters
92 Hayden Avenue
Lexington, MA 02421
United States

PHONE: +1-781-652-7200
EMAIL: inquiries@innosight.com
WEB: www.innosight.com

Innosight Asia-Pacific
Eu Tong Sen Street
#15-89, The Central
Singapore 059818

PHONE: +65-6884-9375
EMAIL: info-sg@innosight.com

Innosight Europe
Ateliers de la Ville de Renens
Avenue du 24 Janvier 11
1020 Renens/Lausanne
Switzerland

PHONE: +41-21-632-7831
EMAIL: inquiries@innosight.com