

Convergence of banking and telecoms

Will digitalization encourage cooperation?



Telecom operators and retail banks have been converging for years. As remaining barriers vanish and extrinsic factors push further convergence, banks will see increasing competition from telecom operators, which will aggressively enter into financial services, especially in transactional lines of business. In this Viewpoint, we explore the opportunities for competition or co-opetition between these industries that are ready for cross-fertilization.

Retail banks have been eager to push digital channels, such as fixed and mobile, as an important part of their operations, since Wells Fargo started offering services to its clients through the web almost 20 years ago. Today, all banks are facing the digital age with a broad set of solutions, from pure channel adaptation to radical changes in their business models. In parallel, telecom companies have been adapting their customer relationships or converging communication and media offerings. But once telecom companies become client oriented, why stop there? With such an ambition they've been offering a full array of additional services to their clients, including financial services such as money transfer¹, payment or ticketing. However, this integration of financial services into the portfolio of telecom companies has been slower and less successful than expected.

Part of this non-dynamic convergence has been due to the barriers to entry to the banking industry, especially considering the deposit insurance system and regulation, control over flows of capital (payments) and capillarity of the branch networks. However, these barriers are vanishing for retail banks, as:

- Lack of clear regulation for small cash accounts, facility of client usage and value-added services (Personal Finance Managers) support the development of mobile wallets, which enables telecom operators to offer a more convenient deposit solution than retail banks

- Traditional payments are being threatened by either P2P solutions or a myriad of mobile payment alternatives
- Branches are decreasing in importance due to the adoption of digital channels – over 85% of customer transactions are now done via digital channels (ATM, computer or mobile) in developed countries – with smartphones gaining relevance as a key channel for banking customer interaction

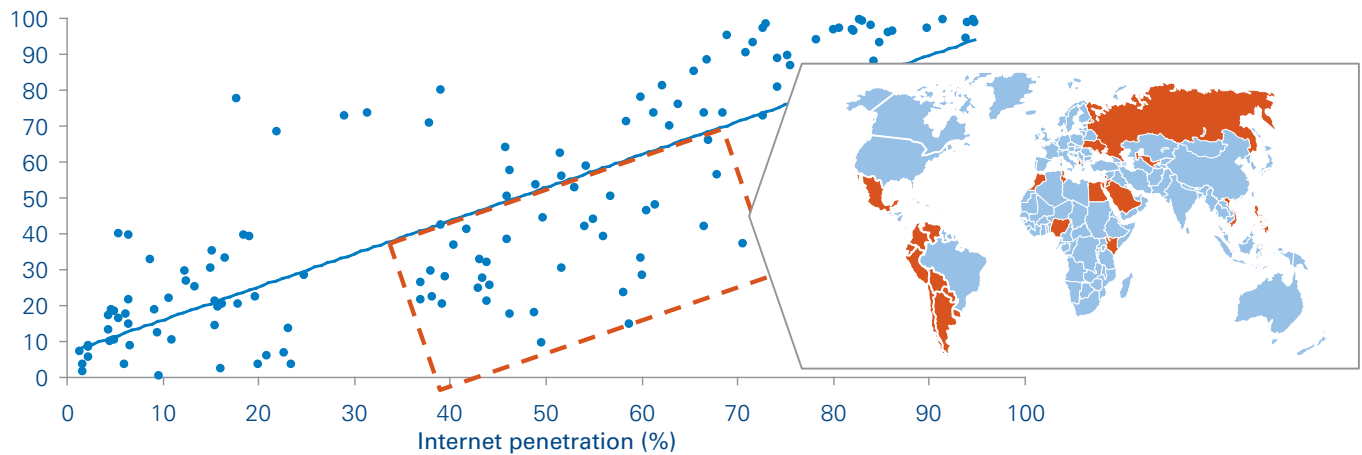
Furthermore, consumers are eager to break the status quo of banks as the main provider of financial services; according to Scratch, an in-house unit of Viacom, 33% of millennials believe they will not need a bank in the future, and 73% would likely prefer to get financial services from digital start-ups. In this context, telecommunication companies can be a formidable contender in offering financial products to their clients, considering:

1. They have stronger client concentration and bases – on average, clients have relationships with one telecom provider, but almost three financial institutions. Furthermore, telecom providers generally have larger customer bases than retail banks
2. They have broader client appeal due to their stronger and more mature marketing skills, resulting in advanced client management, bundled products and communication capabilities
3. In emerging economies, internet and mobile penetration are considerably higher than banking penetration, which provide telecoms with an edge for marketing financial products to their clients through greater reach (see first figure overleaf).

¹ Money transfer or mobile wallets have been successful, especially in developing countries, e.g. with M-pesa

Internet penetration vs banking penetration 2013

Banking penetration (%)



Source: Worldbank and Arthur D. Little analysis

Countries representing a great opportunity

4. Telecom operators do not suffer from the poor image of banking crafted after 2008-2009, leaving space to attract customers in younger segments with an image of “banking without banks”

As a result, the convergence between banking and telecommunication will become increasingly more dynamic.

Joint commercialization of banking product and service offerings

Telecom companies have entered the financial services arena with transactional activities, such as payments or wallets, but do not yet have an offering that covers the full financing or savings

needs of their clients. However, more digital-native clients have been adopting myriad apps and services from “non-bank banks” that threaten many of the traditional banking lines of business (see figure below).

Thus, a range of opportunities has arisen for joint commercialization. For instance, in countries with lower banking penetration, a joint solution for transactional activity to the un-banked is feasible. There are multiple examples of strong collaboration between telecoms and financial service companies to jointly commercialize their products:

- **Stronger integration with banks beyond transactional lines of business:** Poland is the global test bed for this

Retail banks competitors – Telecom and non-telecom related

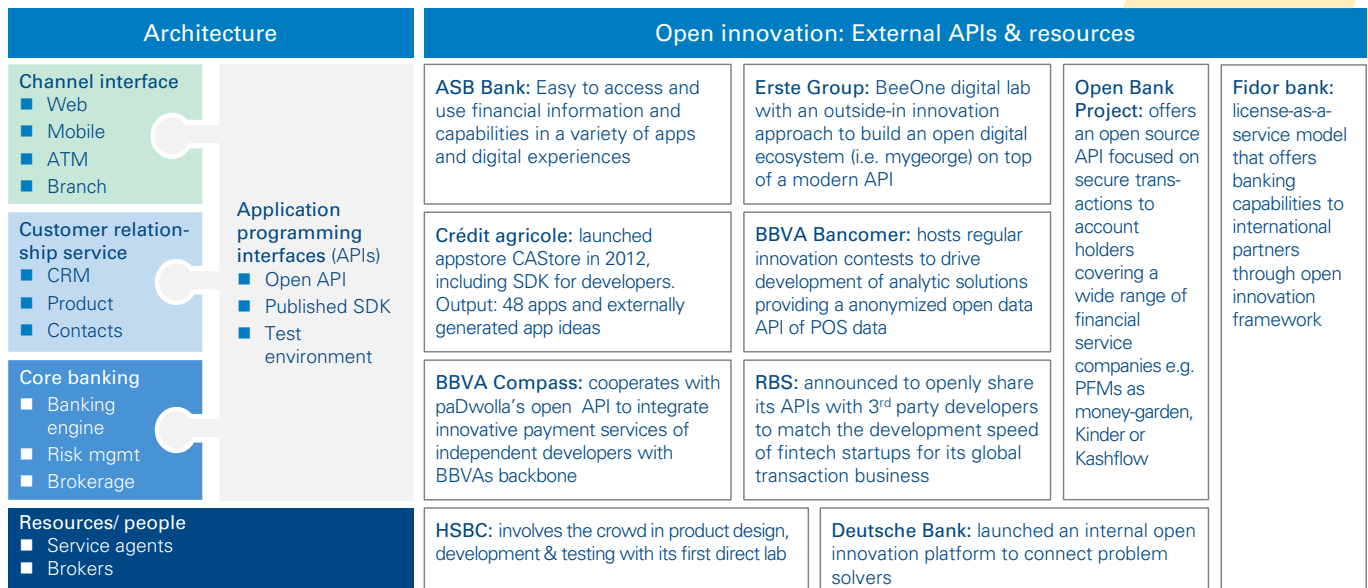
Not Exhaustive

		Non-telecom related		Telecom related	
Degree of threat from non-banking business	+	Transactional competitors	Payments		
	Credit cards				
	PFM or simple cash accounts (i.e. wallet)				
	Financing competitors	Consumer loans			
		Cash advancements			
Start-up & small company loans & mortgages					
Trading platforms					
-					

Source: Arthur D. Little analysis

Examples of Open Innovation in Application Programming Interfaces

Examples



Source: Arthur D. Little analysis

co-competition. Three out of four major Polish mobile telecom operators recently launched banking activities either through JVs with banks or by developing their own banking platforms²

- **Beyond transactions or financing into savings:** Telcos entering financial services – China Unicom and China Telecom started selling monetary fund products to their customers through various financial platforms

Development of new joint business models

Banks are interested in leveraging clients' mobility needs as a source of advantage. As such, retail banks could either partner with telecoms or enter the mobile market as MVNOs in order to exploit some of these new, convergent opportunities:

- **Benefiting commercially from customers' transactional information** considering the sizable amount of information that banks can control, analyze (big data/smart analytics) and input into geo-localization capabilities of smartphones to spur new business opportunities
- **Financing the increased device cost for consumers** as a result of combined multi-screen communications and reduced product life cycles³. Thus, banks acting as MVNOs could offer financing and insurance to for mobile devices
- **Integrating into direct carrier billing**, covering commercial and financing charges, which would facilitate client comprehension and value-added services (e.g. PFM, fraction payment)

Value creation from convergence to Telecom Operator and Retail Banks

	Telecom Operators	Retail Banks
Competition	<ul style="list-style-type: none"> ■ Growth areas from new lines of business – strong positioning on transactional and weaker in financing – to increase ARPU ■ Increased need for data services and usage of smartphones (integrated device usage) ■ Integrated direct carrier billing – telco & banking – with financing capabilities for purchases 	<ul style="list-style-type: none"> ■ Stronger positioning for related telecom products such as device or balance financing and insurance ■ Improve integration of the mobile channel as the reference channel for customer management
Partnership	<ul style="list-style-type: none"> ■ Increase the potential customer base (especially for banks) and facilitate customer acquisition with a focus on youth segments based on image and usage of telecom operators information ■ Exploit opportunities derived from conversion – e.g. build online community of merchants and customers seeking offers, discounts and promotions – promoted by geo-localization capabilities and advanced analytics ■ Increased digital relationship and product integration – e.g. bundled offer with crossed discounts depending on usage – to help reduce churn and improve customer satisfaction ■ Improved value proposition to protect Lines of Business from “non-bank banks” 	

Source: Arthur D. Little analysis

2 <https://bankinghub.de/innovation-digital/innovations-CEE-banking-emergence-telecom-banks-poland>

3 Equipment companies reduced their launching mobile model cycle from 382 to 265 days in 2010 and 2013, respectively, according to Datawrapper

- **Controlling the mobile digital channel experience** as the main method of interaction – mobile phones will progressively substitute ATM and POS usage. Thus, controlling the customer experience (live chat) and integrated secure banking in semi-managed devices will be key differentiators for banking services

Development of customer interfaces with API architectures that allow open, third party innovation models

Retail banks need to continue building customer-centric organizations that engage clients in social ecosystems with open Application Programming Interfaces (APIs) and consumer-based retail (branches, telephone service and digital channels) offering an omni-channel experience. Retail banks in countries where branch capacity is smaller are leveraging technology, such as real-time communications networks, and increasingly delegating “last-mile” cash management and customer service functions to third-party retail outlets. Thus, there is a need for an open innovation model with third parties, which implies that the transformation retail banks require is analogous with that telecoms achieved by partnering with third parties to remain innovative. Currently, much innovation in the telecom industry is now introduced via OTT and partners.

To achieve this transformation, banks will modify their technical ecosystems with open APIs, allowing third-party integration. It is crucial for successful integration that partners can easily be integrated and products can be developed through teaming-up efforts, while at the same time assuring customer and financial data confidentiality as well as technical IT security (see figure on top of page 3). This means that the bank’s IT architecture needs to be able to encapsulate all the relevant data exchange in a very controlled way, with enhanced authorization and authentication as well as data interchange-controlling and -monitoring elements.

Within these industries’ convergence, different approaches exist depending on the degree of partnership/competition and drivers for value creation (see figure at the bottom of page 3). Even though the generation of financial products – assumption of risk, capital management and regulation – has remained the core responsibility of banks, telecom companies could play a disruptive role, especially for transactional activities, following their simpler product/service philosophy. For further development into the financial world and broadening their offering, telecom operators will need to enter the banking space by acquiring bank licenses or small digital banks. For banks, they could launch MVNOs to leverage opportunities for customer mobility and channel control.

However, considering synergies derived from partnership and the common threat from alternative solutions or disintermediation providers, telecom operators and banks should be seeking opportunities to partner and fully exploit these areas of convergence. It is time for cross-fertilization!

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Arthur D. Little

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