E. European Impact

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ESCP Impact Paper No. 2022-24-EN

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Abstract

Recent major regulatory reforms within the context of Open Banking have triggered the rise of technology-driven firms in the financial services sector. Consequently, they have encouraged banks to rethink their value creation models. Banks may shift from pipeline and vertically integrated value creation models towards platform ones. However, in highly uncertain environments, when radical innovation resets the counter to zero, incumbents cannot just do business as usual. They need to reinvent the way of doing business and thereby redefine the foundations of legitimacy. This article explores towards which platform value creation model banks are currently moving and examines what underpins banks’ choices. Using hand-collected data covering the largest French banks, we investigate how banks strategically use external growth operations to chart the course towards new value creation models. We shed light on key salient features in the choices made by banks toward these new platform models. We particularly notice that, when “dancing in the dark”, the incumbents facing radical uncertainty tend to develop mimical actions in order to maintain their space of legitimacy– what we call a herding effect.

Mots clés (keywords): platforms; value creation models; retail banking; open banking; incumbents; external growth operations

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Introduction

In recent years, advances in technologies have enabled the rise of digital platforms that address a wide range of activities in most sectors and challenge incumbent firms (Parker & al., 2016). The banking sector, which seemed to be spared because of high barriers to entry, is nowadays facing this rise of technology-driven innovations as well as the emergence of new players benefiting from new regulations (e.g., Fintechs, start-ups). While traditional retail banking models are weakening, generating less profit, and facing increasing competition from new players, banks are searching for new value creation models. In this context, banks are moving towards platform-based business models that are more customer-oriented and offer seamless and user-friendly services. These models enable the unlocking of new sources of supply and value creation and remove ineffective control processes which tend to make incumbents more complex, reducing their capacity to innovate (Parker & al., 2016). The platformization movement we observe in most sectors refers to a "*shift from individual products/services to platforms as intermediaries for transactions and for organizing value creation processes*" (Nambisan & al., 2018:355). In platform ecosystems, the platform owner acts as market intermediaries between multiple groups of users. It aims at fostering the formation of ecosystems of complementary firms that offer their products and services within the platform, thus creating value for both its users and the platform owner (Nambisan & al., 2018).

Adapted to the banking sector, this move towards novel banking models implies the opening up of banking core technological infrastructure, the integration of new services and the building of a platform to offer such services. We observe the emergence of two distinct platform banking models: Banking-as-a-Platform and Banking-as-a-Service. Banking-as-a-Platform for a bank consists of integrating offering new services provided by third parties, that cover both financial and extra-financial products. As for Banking-as-a-Service, it depicts a model in which a financial institution (generally an incumbent bank) makes its core technologies and infrastructure available to unlicensed players on a white label basis via APIs. While both models correspond to platform-based banking models, they differ in terms of value creation and structure. For incumbent banks, the development of such business models requires open service infrastructures enabling this intermediation, which is challenging in terms of their IT legacy and organizational complexity (Hornuf & al., 2020). Moreover, the extension of products and services offered by incumbent banks raises the question of banks' legitimacy to deviate from their core activities. Following this logic, banks are more inclined to develop interactions with external firms, including the very start-ups and Fintechs that threaten them.

But, in times of technological disruption and competitive uncertainties, the incumbents cannot benefit anymore from traditional landmarks to make decisions and have no choice other than reinventing a way towards new value propositions. As a reaction to the ongoing changes that threaten traditional models, banks respond by using external growth operations (partnerships, equity investments, and acquisitions) to foster the transformation process. In this paper, we investigate how banks use partnerships and external growth operations to find out which value creation model (Banking-as-a-Platform or Banking-as-a-Service) banks are moving towards.

Digital transformation of the banking world

Multiform developments lead to a high uncertainty in the banking sector

Technological innovation and digitalization have created new challenges for incumbent banks by creating new market standards and modifying their competitive landscape. Digitalization is changing consumers' expectations and uses. Banking customers have developed novel expectations: they are now looking more for tailor-made solutions adapted to their specific needs instead of standardized banking products. Moreover, users want to manage their finances wherever they are, without any delay or friction. Baranov (2019) summarises the new expectations of banking customers with the acronym TIPS: transparency, immediacy, personalization, and simplicity.

In Europe, the recent regulations implemented by the Competition Market Authority in the UK and the Payment Systems Directive (PSD2) in the EU have opened the banking sector to new players (Fintechs and start-ups) by shifting the intellectual property on data from banks to their clients. Since when, banks must provide authorized third parties access to customer and payment account information. These third parties can now use the data made available by banks to define new value propositions. These changes have paved the way to a new model, called ‘Open Banking’, that is a reconfiguration of the competitive structure with new players offering new value propositions based on innovative value creation models. Open Banking is a banking system in which retail and business customers allow their banks or financial service providers to use their financial data using APIs (application programming interfaces). Open APIs enable third parties (developers) to access and exploit financial data to create new services and financial solutions. The underlying idea is to guarantee better financial transparency for account holders (Wewege & al., 2019), in order to promote competition in the retail banking sector and to enhance clients' experience.

Together with regulatory evolutions and technological changes, the emergence of value creation models represents significant changes in values and practices corresponding to a paradigm shift in the retail banking sector (Omarini, 2018). In short, banks in the European Union must comply with PSD2 directives which force them to open their data to third parties. They could either choose to drag their feet regarding the application of these rules or try to take advantage of them. In the latter case, opening its data and partnering with the third parties would be a means to diversify banks' revenue streams, adapt their value propositions to changing demand and improve their technological abilities.

Legitimacy challenges arising in the banking sector

In addition to the regulatory and technological evolutions, as well as the changes in demand, banks currently face legitimacy challenges. Banks' legitimacy depends very much on stakeholders' confidence in their ability to properly act as an intermediary between economic agents to finance economic operations. It is based on their ability to serve customers' interests, to guarantee the security of their funds and the return on their savings, and to optimize the use of their money. Historically, banks were seen as actors behaving positively for the economy, enabling firms and individuals' transactions, ensuring their proper economic development.

However, the rapid rise of new entrants (e.g., neo-banks and Fintechs) who are developing novel value propositions, is evidence of changes within audiences' perceptions of how banks should behave and what they should be offering their customers. For instance, the rise of neo-banks offering cheaper banking fees in exchange for no-direct access to advisors, proves that the ability of banks to guide investment decisions through advisors is no longer a determinant of their legitimacy. The multiple economic crises since the 1980s, and especially that of the 2008 crisis that shook the global economy, demonstrated banks' weaknesses in ensuring economic stability and in satisfying common interests. The legitimacy of these banks has therefore been altered, resulting in lower customer loyalty and a decrease of confidence within audiences. Nonetheless, banks remain an unavoidable key player in the financing of the economy.

In addition, perception by customers of a certain inertia in incumbent banks is affecting their legitimacy to transform their business models by investigating new fields of activity and proposing innovative value propositions (Benner, 2007). Therefore, banks are facing a dilemma: trying to regain some of the legitimacy they have lost, while retaining their existing legitimacy in their core business. By extending their activities to customers' renewed needs, banks tend to put customers back at the heart of their strategies, and in order to regain a market legitimacy that they seem to have lost through past crises. However, this differentiation could be perceived as illegitimate regarding the expectations of audiences towards banking activities. This is what we call the strategic challenge of "dancing in the dark".

Experimenting with a new value creation model using external growth operations

External growth operations deployed by banks take the form of partnerships, product co-developments, joint ventures, equity investments and acquisitions. From the perspective of developing novel business models, these operations enable firms to develop novel competitive advantages while protecting their core business (Hagedoorn & Duysters, 2002), and to facilitate the adaptation process (Cozzolino & al., 2018). Specifically, in the case of platform models development, external growth operations are frequently used to build the technological capabilities and the foundations of the platform ecosystem. These past few years, incumbent banks have increased their external growth operations with new players, especially Fintechs and start-ups. Banks perceive Fintechs as a solution "*to create value at the core of the bank's financial-innovation activities through agile digital transformation"* (Wewege & al., 2020: 29). This type of collaboration enables banks to achieve cost and scope savings by exploiting similarities and complementarities with Fintechs. Second, banks form external growth operations with start-ups and with more established firms that are developing activities in multiple non-financial segments. This is an opportunity for banks to develop new sources of value in extra-banking segments and to meet their customers' renewed expectations, by offering integrated and comprehensive solutions rather than a portfolio of individual services.

Focusing on the the fifth largest French banking groups (Société Générale, BPCE, Crédit Mutuel Arkéa, Crédit Agricole, and BNP Paribas), which represent 76% of total assets in the French banking sector,we hand-collected extensive data of external growth operations conducted by thanks banks and their subsidiaries. We focused on external growth operations carried out between 2015 and 2021. Our sample consisted of 188 external growth operations conducted by five banks and their subsidiaries. We observe a steady and continuous increase in the operations conducted by our sample banks since 2013. From 2019 onwards a clear acceleration for these active banks has been noticed.

Key salient features of recent operations

Salient feature 1 – the rush towards Banking-as-a-Platform model

As mentioned by a banker during our interview, "*banks have been designed in a closed ecosystem, and therefore, they are the opposite of Open Banking*" (verbatim). The transformation towards a platform-based business model is particularly challenging for banks. This explains why banks develop their new platform models gradually, following an iterative approach based on test-and-learn. Indeed, there is no clear and explicit strategy communicated by banks regarding Open Banking. Banking-as-a-Platform operations are numerous compared to other strategies : the share of external growth operations corresponding to a Banking-as-a-Platform strategy is 72%, while 9% correspond to a hybrid strategy.

Banking-as-a-Service strategy represents less than 9% of the total number of operations. Banking-as-a-Service is the most difficult to characterize as this model has not yet reached its final form. With the notable exception of Société Générale which claimed its willingness to be a Banking-as-a-Service pioneer, other French banks are relatively more cautious. Banking-as-a-Service models constitute a lever to capitalize on banks' core IT by monetizing its infrastructure and its services. However, the development of such models is complex for several reasons. As evoked by an interviewee, the deployment of Banking-as-a-Service model could be technically challenging: "*you might have the best product,but if your Information Systems are not able to be easily visible or interconnected, you can't do anything. That is the tragedy of some banks, they don't have Information Systems that were designed to be open*" (verbatim).

Salient feature 2 – A strongly diversified exploration in new universes

Through their Banking-as-a-Platform operations, banks expand in multiple universes of needs. This trend is relatively stable from one bank to another, which reveals banks' preference for a cross-universe Banking-as-a-Platform strategy.

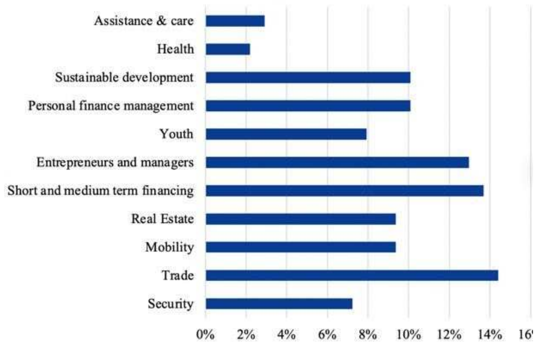

Figure 1 - Distribution of Banking-as-a-Platform operations by Universe of needs

A greater number of operations relates to universes close to core banking services (e.g., trade, short- and medium-term financing, services to entrepreneurs and managers) compared to universes far removed from banking traditional activities (e.g., real estate, mobility, youth). This raises the question of banks' legitimacy to explore market segments far from their traditional activities. Offering a plethora of extra-banking services to their clients might increase the added value banks bring to their clients. However, going beyond their field of banking expertise can damage their legitimacy. A bank's field of expertise is limited, and extending a platform strategy that is too far from its initial competencies can make it be seen as an illegitimate player investing in this economic field. The first Banking-as-a-Platform strategies can therefore be seen as a way of experimenting a banks' legitimacy to be present in certain market segments. The number of banking operations in universes far from their core business [1] has accelerated since 2019 : 47% have been conducted between 2019 and 2022.

Most banks have conducted operations in universes close to their core business, as well as in trade, health, and security. However, we found that these banks made different choices when it comes to exploring universes far from their core business. For instance, Crédit Agricole has carried out the most operations identified in the sustainable development universe. Operations related to youth were mostly realized by Société Générale; the bank has created a platform dedicated to 18–24-year-olds and develops partnerships, enhancing the portfolio of extra-banking services offered. As for mobility, this universe has raised banks' interest in recent years. Société Générale has been a pioneer in the universe, closely followed since 2019 by the other banks.

Meanwhile, in mutualist banks, the parent company conduct significantly less operations than its subsidiaries. For instance, the operations of Crédit Mutuel Arkéa are carried out mainly by their subsidiaries, which are federations with a strong regional footprint. In contrast, the two largest capitalist banks – BNP Paribas and Société Générale – develop their operations mostly through their parent company according to group strategy.

Salient feature 3 – Ally rather than buy!

Banking-as-a-Platform operations are mostly deployed through partnerships, which are more flexible than equity investments and acquisitions, and require a low level of integration. Banks widening their range of activities are likely to prefer partnerships with external partners, especially when they explore value propositions far from their core activities: "*If it is too strategic to do it with an external partner, we do it internally. But this happens in rare cases and even less so when you are outside the banking business*." (verbatim)

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[1] i.e., « Security » « Trade », « Mobility », « Real Estate », « Entrepreneurs and managers », « Youth », « Sustainable development », « Assistance & Care », « Health »

When banks aim at internalizing new technologies and capabilities, their operations naturally take the form of incubation or investments, be they minor equity investment or full acquisition. Hence, banks can often obtain representation in the target's board, enabling them to drive the target's strategy towards its future interests and have full control over the resources of the target.

Salient feature 4 – Banking-as-a-Platform exploration through strategic partnership; equity investment for the others

We found a relationship of dependence between the strategy pursued by a bank for a given operation and the nature of this operation. There are more Banking-as-a-Platform operations using strategic partnerships than would be expected if there were no association between the strategy corresponding to the operation and the nature of the very operation. Our results also show that Banking-as-a-Platform operation corresponds to a market-driven approach. These operations enable banks to enter new markets by developing interactions with non-financial firms and thus enriching their offers. Indeed, banks could benefit from the existence of a nascent ecosystem around banking services that could renew customers' experience, enhance their value propositions, and generate more profit since the bank positions itself as the central actor of the platform.

Salient feature 5 – Banks' strategic choices: a herding effect

Since there is no guarantee about the profitability and long-term viability of the two platform models – Banking-as-a-Platform and Banking-as-a-Service -- banks are navigating in a highly uncertain environment. The herding effect describes a social dynamic in decision-making in which actors follow the actions of their peers (Bikhchandani & al., 1998). In the absence of rationality and sufficient information, it becomes rational for managers to imitate the decisions of other managers. Banks can easily track the ongoing operations led by other banks through banks' official releases and public announcements. We use cumulative number of operations per universe as a measure of herding. This measure reflects banks' collective assessment of a certain universe of needs. We argue that banks as a whole exhibit herding behaviour if the cumulative number of aforementioned banks positively impacts the decision of other behaviour. We found concrete proof for the existence of herding behaviour in banks' decisions of collaborating with external partners and Fintechs. For instance, Société Générale collaborated early on with mobility actors, and after 2019, this universe was also being investigated by other banks.

Conclusion

Using a hand-collected dataset of 188 operations carried out among the five largest French banks, we found that banks have mostly opted for the Banking-as-a-Platform model. Our findings show that this strategy generally aims at expanding into new market segments, while the motivations underlying Banking-as-a-Service operations are less clear.

Banks are facing paradoxical pressures between conformity to their core activities in which they are perceived as legitimate, and differentiation that could help them renew their competitive advantage. This dilemma, referring to the "optimal distinctiveness" paradox, constrains incumbents in their transformation projects (Zhao & al., 2017). Developing partnerships appears to be a solution to overcome this dilemma in this very context. We also provided evidence of the existence of salient features in the development of incumbent banks' platform models. We can interpret this result regarding the high level of uncertainty characterizing the Open Banking context, as inducing herding effects among incumbent banks.

In highly uncertain environments, when radical innovation resets the counter to zero incumbents cannot just carry on business as usual. They need to reinvent the way of doing business and consequently their foundations of legitimacy. But it can be like dancing in the dark near a precipice. So, what do you do in such a case? You dance as the others do, hoping that where you are all dancing is the dance floor – what we call the herding effect.

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