Big tech won’t eat the banks’ lunch in the foreseeable future

“Banking is necessary, banks are not”. Bill Gates’s statement announcing the dawn of internet finance is now a quarter-century old, yet banks remain very much in the saddle. They continue to dominate financial intermediation in Europe’s economies, even if decentralising financial technologies are increasingly threatening traditional business models.

Neither fintechs nor big tech names like Google, Amazon, Facebook, or Apple (GAFA) are about to tip the established banks overboard. Not now nor in the foreseeable future.

The most successful fintechs may in fact end up being acquired by large banking groups that embrace transformational digital change: co-opting rather than just competing. Unlike China or other regions of the world, the European fintech sector is inherently dynamic but remains relatively fragmented, with a more marginal market positioning.

As for big tech, Facebook’s recent Libra cryptocurrency announcement revived old fears of European banks one day having to surrender to GAFA. There are several reasons why these fears may be misplaced, however, which centre on the banking sector’s entrenched market position, big tech’s changing brand image (not for the better), and not least Europe’s evolving regulatory and public-policy dynamics.

Europe’s banks have a more unassailable domestic market position compared to China and the US

Examples from the rest of the world – China and others in East Asia, East Africa, or Latin America – are not relevant for Europe. The degree of financial penetration (mostly by banks) is very high, at 94%-99% in Western Europe (where the large banking groups are). It is lower, sometimes much lower, in emerging markets.

This will make the task of an e-commerce or social-media platform interested in taking market share in European financial services from the large banks much more difficult. It is not about empowering a meaningful unbanked segment of the population (like in emerging markets), which helped businesses like Alibaba, Tencent, M-pesa, or Mercado Libre. It is about the much taller challenge of scooping out a significant share of financial products from the banks.

China has not had the same embedded banking culture as Europe: much of the post-war decades have been characterised by a centrally-planned economy where banks had only a token role. This may partially explain why the diversification of e-commerce platforms into financial services – payments, investments, loans, etc. – was less challenged by the country’s banking industry and ended up being so successful. The fact that, since last year, Chinese big

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techs are required to clear payments through state-owned clearing houses does not make this business model easy or attractive to replicate.

European banks may also be in a better competitive shape than US banks regarding the defence against big techs. In the US, the intermediation role played by banks has been decreasing since the early 1980s, softened by the growth of deregulated markets, and there is now much more specialisation (e.g. investment banks, asset managers, etc.). At roughly 94%, the degree of financial penetration is in line with Western Europe's, but a much larger share of it is held away from the banks. Therefore, an ambitious big tech (e.g. Amazon) could find better openings in the US market than in mainstream European markets.

In general terms, the 'big-tech-winning-in-financial-services' business model may be most successful in emerging markets, which are seeing fast growth in the middle-class. East European countries would fit this model, but West European banks filled the space decades ago by acquiring domestic banks, creating new ones, and growing the local financial services markets. Kenya's M-pesa tried a few years ago to build a franchise in Romania, but the venture fizzled out.

Big tech's public image is taking a turn for the worse

A few years ago, the brand image of GAFA was stellar, especially among millennials. Growing concerns about privacy rules, improper use of personal data, business practices, or related to specific socio-political angles, have, however, taken the glow away from this image. This applies mainly to Facebook or Amazon, which are defined less as pure techs than Apple or Microsoft (with Google being somewhere in-between).

In this evolving situation, it is unclear how successful a bank displacement strategy would work for any of these US big techs across Europe, even among millennials. Growing negative vibes coming from European regulators and politicians are not helping.

As for the large Chinese e-commerce platforms, they would be even less welcome if they considered expanding in European financial services (which they currently do not).

Regulatory and policymaking hurdles to US big techs are rising

There are several layers of these hurdles coming from European regulators and policymakers. The first concerns general growing uneasiness about the rising share of shadow banks – big techs or not – in the financial market. The fear is of lack of proper regulation, both prudential and conduct, for these activities at a time when the regulatory architecture for the banking system itself has been tightened considerably.

Indeed, it is quite likely that, should a future financial crisis emerge in Europe, it will not be triggered from within the banking system, as was the case last time around. There is a clear element of procyclicality in the way non-banks extend credit – both to SMEs and individuals. This is not non-existent, but less threatening in the case of regulated banks, with their capital buffers and loan-loss provisioning policies.

The second layer of regulatory uneasiness is the threat of re-positioning financial-services not only outside of regulated banks, but also lumped within large providers of financial tech infrastructures like cloud or blockchain. The tail risk for financial stability could go up.

The third layer of consideration is that of largely non-regulated tech platforms built and grown in the US chipping away business from European regulated financial institutions. There is a clear element of goodwill among EU policymakers to encourage the successful growth of local fintechs, regtechs, insurtechs, etc. Rather than chasing them away from the market on account of insufficient regulation (e.g., on misconduct), they are trying to integrate them into the existing regulatory framework. It is not likely that such goodwill would be readily extended to US big techs due to political, fiscal, competitive and cultural considerations.

This would be so for Facebook's Libra project, despite the Libra Association anchoring itself in Geneva. The prospect in retail and wholesale markets of a private-sector cryptocurrency, fuzzily regulated and backed by bank deposits and government securities (thus being able to influence monetary policy), is not likely to hit a home run with policymakers.

The scenario, potentially favoured by European policymakers and regulators, of a local fintech being acquired by a bank with deeper pockets, would not be applicable in the case of big techs from outside Europe. On the other hand, it is also doubtful that a US big tech would be that eager to build financial services activities in Europe which would entail it being regulated and supervised as a financial institution.

Threats for the established banks are nonetheless growing

The fact that regulatory, political and cultural barriers will likely prevent big techs from making material inroads into banking services (and the big techs themselves may not wish it at this time) does not mean that existential threats are not growing for the established banks. This would be true especially for those institutions which are slow, hesitant, or ill-equipped and ill-financed to embark proactively on the digital path.

For example, a bank contemplating a transformational M&A with another institution, especially cross-border (where cost reductions are less convincing), could instead use the financing and the management effort allocated to that transaction for building or solidifying a scalable forward-looking digital offering. Such a move could perhaps be less effective for tomorrow morning's stock price (assuming the deal is welcome by analysts) but probably better for future-proofing its business and competitive position.

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