THE ROLE OF CUSTOMER EXPERIENCE IN RETAIL BANKING AND THE RISE OF FINTECHS

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Abstract

We are part of historic changes in terms of profoundness and velocity in all industries and in customers' expectations. The aim of this paper is to create an overview of a new age in customer experience generated by a banking environment disturbed by the raising of Financial Technology. Firstly, the article is reviewing the customer experience concept from academic and practitioner perspective. It is making a literature review and additionally is bringing into attention the common elements of customer satisfaction and service quality which are considered an antecedent of customer experience. Furthermore, it is reminded that the latest developments in communications and information technology are intensely changing customers' demands and expectations resulting a total transformation in the way that customers are interfering with the service providers. Secondly, is debating the subject of how financial service industry should balance customer experience expectations, considering that the banks are activating in an environment disrupted by the raise of distributed ledger technology, machine learning, big data analytics, roboadvice and other technology/digitalization proliferated by the FinTechs. Lastly it is analyzed how European regulatory bodies are seeing and managing the new technologies and FinTechs, how agile should be in an ecosystem that is very dynamic and governed by a customer with a lot of choices, good or bad, risky or non-risky, in front of his decision.

Keywords: *Customer Experience, Customer Journey, Banking Profitability, FinTechs*

Classification JEL: G20, G21

1. Introduction

For the first time the term of Experience Economy was brought into attention in 1998 by B. Joseph Pine II and James H. Gilmor. They are seeing the Experience Economy as the next step that should be created by the seller for the buyer to maximize sales in the era of new economy, based on technology and a change of customer behavior, "goods and services are no longer enough" (1999, p.11)[17]. In addition, according to same authors "in the emerging Experience Economy, companies must realize that they make memories, not goods, and create the stage for generating greater economic value, not deliver services"(1999, p.100)[17].

Moreover, the latest developments in communications and information technology are changing customers' demands and expectations regarding the way how interferes with the service providers and, therefore, may influence customers' perceptions of the service experience.(Froehle and Roth, 2004)[8]. In shaping their present and future products/business models, banks should include both the technology and behavioral psychology by generating a choice architecture with a high visibility for them (Thaler and Sunstein, 2009)[20]. Furthermore, customers that are living digital experiences provided by the leaders like Alibaba, Amazon, Airbnb, Booking, Google and many others, will expect the same kind of service from other players and industries. In fact, the so called "fourth industrial revolution" is creating the "world of now" which is generating pressure on the traditional financial services provider (Schwab, 2017)[18]. On the other hand, the penetration of the technology in financial services industry can create additional risks for the customers (i.e. fraud risk, money laundering risk). In this context „any attempt to extrapolate timelines and probable scenarios for the development of truly disruptive technologies is always fraught with risk" (Trautman, 2016)[21].

The aim of this paper is to go further in debating how banks should balance customer experience expectations, considering that the banks are activating in an environment disrupted by the raise of cryptocurrency and technology/digitalization proliferated by the FinTech.

2. Customer Experience, Customer Journey and Technology

Customer experience concept has a more deeply involvement in a company success and in this context, it is more than necessary to have a critical assessment of the terminology both from academic point of view and from practitioner.

In the article Customer experience management: a critical review of an emerging idea the author Adrian Palmer (2010)[15] is bringing a strong contribution in clarifying the research limitations/implications:" Academic coverage of the subject of customer experience remains fragmented. Approaches to its measurement are suggested and their limitations noted. The multi-dimensional, situation-specific nature of customer experience favors qualitative rather than quantitative".(2010, p.196)[15].This conclusion raised by author A. Palmer shows that the term/ concept Customer Experience is relatively new as academic approach, and this shows us the importance of the subject in the beginning of the fourth industrial revolution especially in the financial services industry.

Going further in our assessment and looking into the definitions of customer experience we found a large range of definitions in the literature, we focus on the major accepted definition. The same author, Adrian Palmer (2010)[15], acknowledge us in the same article that "The range of definitions...began with experience being essentially about the accumulation of knowledge and wisdom, such that an individual could be expected to respond to stimuli with a learned response. However, the later definitions emphasise experience as a unique event, and therefore, by implication learning from previous experience is of little value in attempts to understand consumers' response (cognitive, affective or behavioural)" (2010, p.197)[15]. Indeed, customer experience is raising more and more interest on behalf of firms taking into consideration that the customers have more visibility in expressing if they are pleased or unpleased regarding a product, a service or a company. Recent business practice also defined customer experience as being the integrated perception of customer as a result of the interactions in various occasion and moments like purchase, use, service, after sales service, advertising, packaging, accessibility, convenience. Customer perception takes different form of expression like, word-of-mouth recommendations or criticisms, reviews in online, news reports, and so forth. "Customer experience is the internal and subjective response customers have to any direct or indirect contact with a company" (Meyer and Schwager, 2007)[13].

By the other hand there is a large amount of data in the literature regarding on service quality and customer satisfaction which are more customer- focused concepts, than customer experience which is relatively broad. To have a better view it is helpful to see how customer experience is related customer satisfaction and service quality. Lemon and Verhoef (2016) [11] in their recent article suggests that "Customer satisfaction could be one of the components of customer experience, focusing on the customer's cognitive evaluation of the experience. One could even argue that customer experience is broadening the concept of customer satisfaction, leading to a richer view".In line with earlier researcher Mittal, Kumar, and Tsiros (1999 cited in Lemon and Verhoef, 2016, p.74)[11] " service quality (and its constituent elements) would be consider an antecedent of customer experience". Additionally, researchers Sharma, Tiwari and Chaubey (2016)[19] suggest that " customer experience is driven by 14 factors: convenience, customer interaction, servicescape[1], employee's attitude, online functional elements, presence of other customers, online hedonic elements, customization, core service, value addition, speed, marketing mix, service process and online aesthetics" Assuming these points of view we can consider that the customer experience is similar to a "journey" through company touch points and meeting with 14 factors.When an organization is thinking to the customer experience it should focus also on customer's journey, from the prepurchase stage to purchase and postpurchase(Lemon and Verhoef, 2016)[11]. Additionally, according to one of the largest consulting company McKensey and Company (2016, p.5)[12] that in a report on customer experience stated that, "Customer journeys are the framework that allows a company to organize itself and mobilize employees to deliver value to customers consistently, in line with its purpose to achieve a superior customer experience ".

3. Regulatory Bodies, Banks and Services provided by FinTech.

The cost cutting, competition from other banks and from FinTechs are guiding financial services to adopt more and more alternative touch points to create new bridges to the customers. Conversely ," new technologies, increased digitization, and connectivity have increased the number of touch points for customers, ensuring new experiences but have also increased banks' vulnerability to attacks" (Capgemini, 2017, p.10)[2]. Still, the banks have a good reputation based on a strong amount of knowledge and the all known appetite for security and risk control. This is the heritage on which the traditional financial industry should build on, their present and future strategy. Above all, in the same market is raising a new trend, FinTechs, which are disrupting the banks (see Figure 1), by providing to customers new experiences characterized by designing an intuitive and friendly interfaces and journey with simple onboarding, easy to understand product constructs, with no penalties or additional responsibilities (Gulamhuseinwala, Bull and Lewis, 2015, p.20)[9]. Going further and looking to the Figure 1, which is an analysis of how a European Bank is unbundling by FinTechs offers for the same services that the traditional bank has. Figure 1 shows how banks are under attack and "the attack" is by individual products or service.

Figure 1- Unbundling of a European Bank
Source: CB Insights Research(2015)[3]

In this part of the article we will perform a critical review about the status of how these technologies are seen by the involved parties, and how much they are penetrating the financial service market.

One of the technology that is highly propagated in the online environment it is the so called Blockchain or Distributed Ledger Technology (DLT). On the topic of DLT, Professors Peters and Panayi (2015, p.1)[16] have stated that: "blockchain technology has the potential to disrupt the world of banking through facilitating global money remittance, smart contracts, automated banking ledgers and digital assets." In addition, the same authors (2015, p.1)[16]"Blockchain…may find applications in areas as varied as transaction processing, government cash management, commercial bank ledger administration and clearing and settlement of financial assets."

Furthermore, in the late 2015, major nine global banks together with financial tech firm R3 announced a partnerships in order to create a basis for using blockchain technology in the markets .(Barclay's, BBVA, Commonwealth Bank of Australia,Credit Suisse, Goldman Sachs, JP Morgan, Royal Bank of Scotland, StateStreet, and UBS) (Kelly, 2015)[10] .

On the regulatory side, for example The Bank of England have launched in June 2016 the Accelerator. The role of the Accelerator is to identify innovative technologies that are covering Bank's assignments and operations. Some of the technologies that raised interest are the Distributed Ledger Technology, machine learning, data sharing capabilities and many others. The

Bank together with FinTech companies are looking to develop new approaches, to understand these technologies and to support development of the sector. The role of the Accelerator community is to work for: share all the new developments, trends and insights found in the financial sector ; ensure a continuous contact between the Bank and FinTech firms from across the sector; and create networking across firms that are acting in the sector (BoE, 2017)[1].

By the other hand on 23 March 2017, the European Commission launched a public consultation entitled "FinTech: a more competitive and innovative European financial sector".
The objectives of this public consultation are:

- improved access for consumers and businesses to financial services
- improve operational costs and a beter efficiency for the industry
- a more competitive single market, easy to access, transparency with data security and protection needs.

In the meantime, European Banking Authority (EBA) launched a public hearing to support the consultation process as a bridge between all the parties involved. According to Slavka Eley (2017b)[5], Head of Supervisory Convergence Unit, "for the first time at the EU level, in spring of 2017, EBA conducted a mapping exercise to gain a better insight into financial services offered and innovations applied by FinTech firms in the EU, and their regulatory treatment. The results suggest that there are over 1500 firms established in the EU that meet the definition of 'FinTech firm' while more detailed information has been analyzed on a sample of 282 of these FinTech firms".

The EBA mapping exercise, European Union public hearing, Bank of England exploration through Accelerator are showing us that the FinTech disturbance of the banking sector has lot of facets. The increase digitalization of financial sectors, but also possibility to have an easier access to services or products could also raise risks, due that the FinTech sector is not subject to uniform regulation. Moreover, through alternative channels growth, banks are no longer the only defender of customer monies (Mitic, 2017)[14]. On the other hand, starting to examine the usual journey of a customer in a" brick and mortar" branch we will see that usually is starting by waiting to a cue, finding an employee of the bank pressed by a lot of internal regulations and procedures, working with too many applications, maybe new in the field and who, sometimes, look bored. Indeed, to be part of a regulated sector implies additional costs which are transfer in final costs and extra time spent by the customer. Furthermore, banks need good trained staff to provide a friendly and pleasant journey for the customer. Examining the findings of all regulatory bodies we also observe a gap between market advance and regulatory control which has different cause.

For example, the mapping exercise performed by EBA shows that across Europe there is not a common practice or treatment regarding FinTechs status (Figure 2). Besides, the high percentage of firms, that are not subject to any regulatory regime could, recommend a further analysis of such firms. Above all, many of the firms, considered as FinTechs, which are subject of national authorization or registration management are providing services such as credit, deposits, capital raising, payments, clearing, settlement services, investment services, other financial-related services, in fact same as traditional banks are providing, confirming the findings from the CB Insights Research, exemplified in Figure 1. From the same mapping exercise emerge the conclusion that 67% of the FinTech firms reported that are using DLT are not subject to any regulatory regime, also this could raise additional attention.

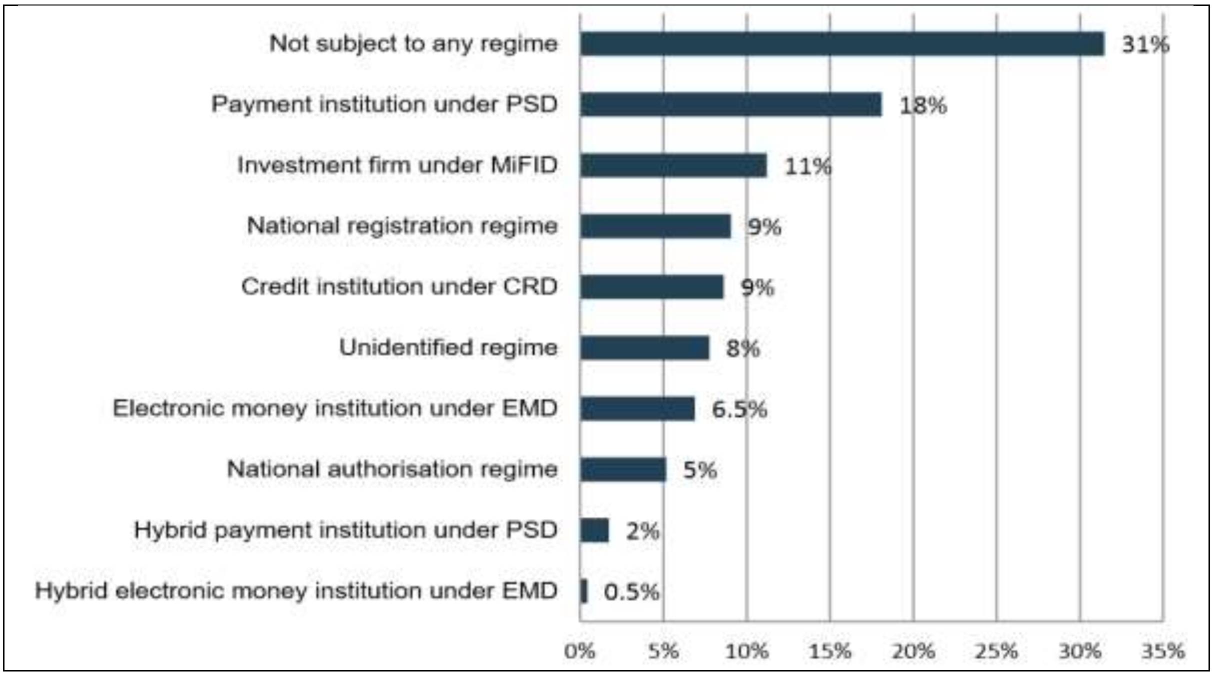


Figure 2- Regulatory status of FinTech – (282 FinTechs Sample)

Source: Discussion Paper on the EBA's approach to financial technology (*FinTech*) Public hearing, 4 October 2017 Overview *FinTech* DP;(2017a) [4]

Advances have been made also in RegTech, cloud computing, Virtual Currency, biometric technology and data aggregation services and as can be seen in Figure 3, the FinTech firms that are applying these technologies are not subject of regulatory regime.

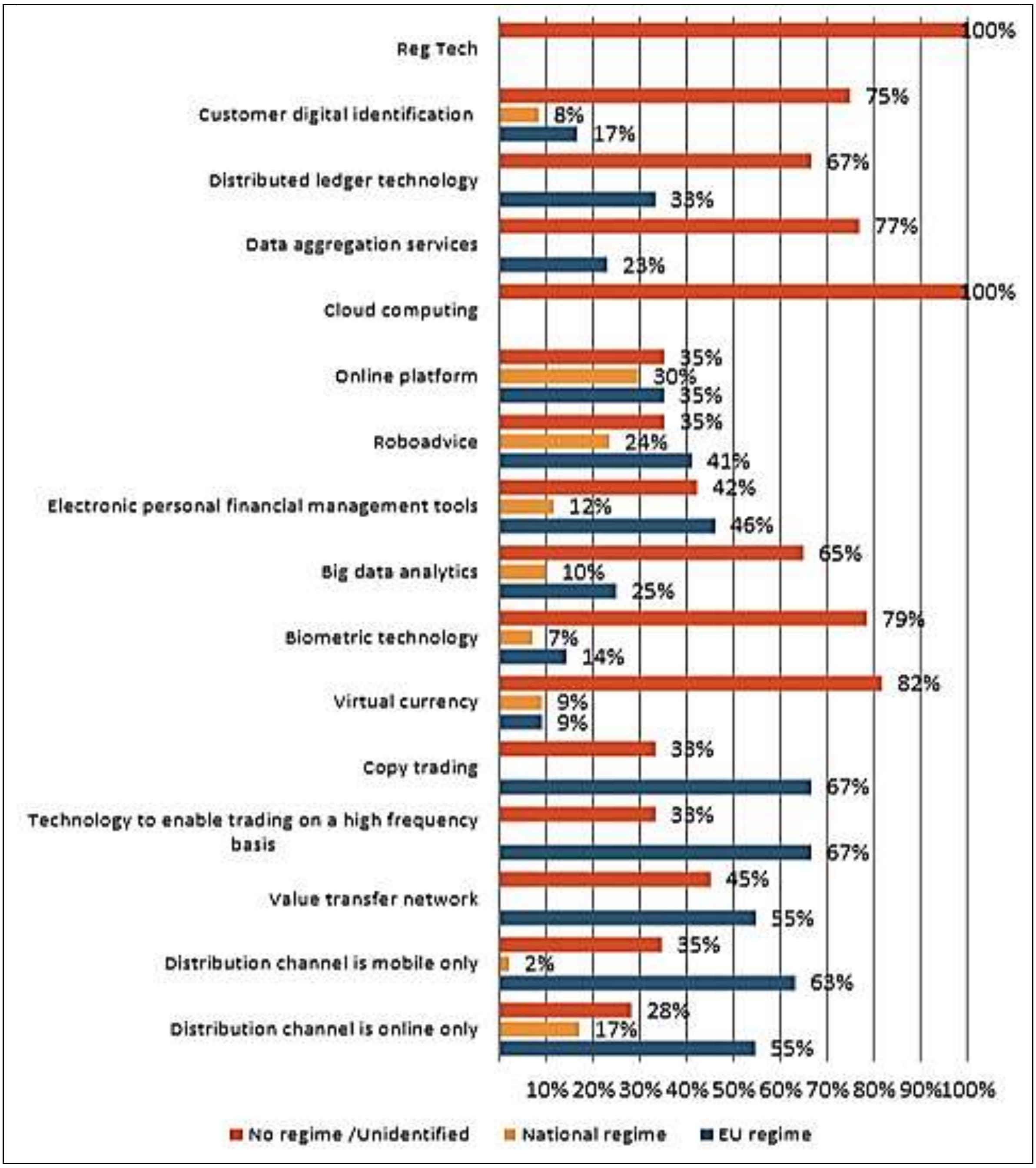
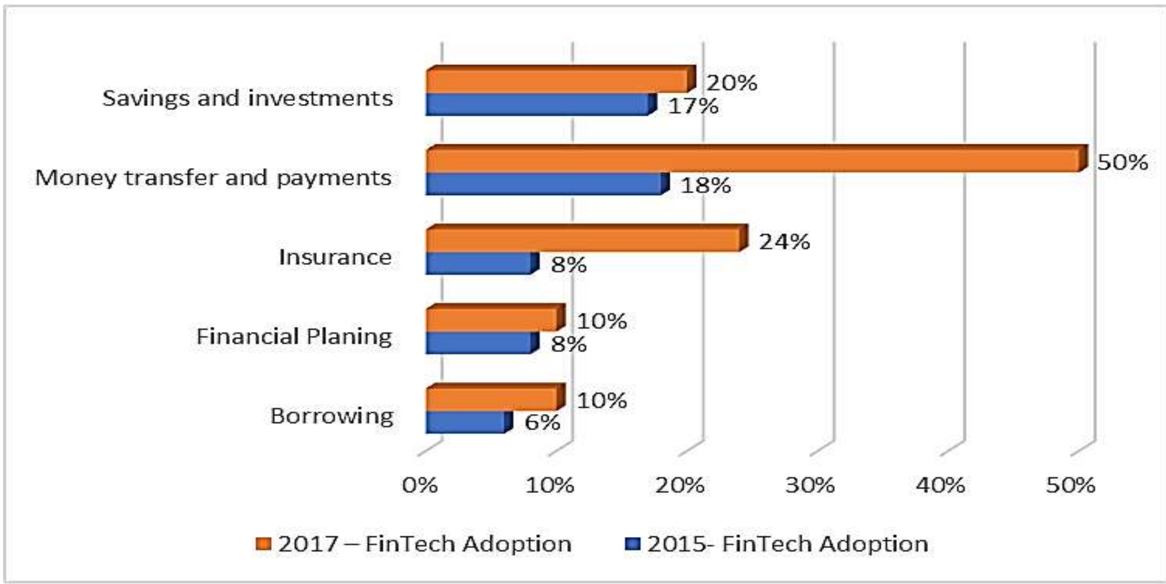


Figure 3 -FinTech (282 FinTechs Sample): Breakdown of financial innovations by regulatory status of FinTech firms applying each innovation;

Source**:** Discussion Paper on the EBA's approach to financial technology (*FinTech*) Public hearing, 4 October 2017 Overview *FinTech* DP;(2017a)[4]

One additional point of view should be taking into consideration, are FinTechs accepted or adopted by the consumers? Not surprisingly the numbers and evolution of FinTech adoption are showed in the Figure 4, 2017 services adoption rate in comparison with 2015.



Notes: The figures show the average percentage of respondents who reported using one or more FinTech services in that category. Data for 2015 differs from that originally published in order to align to the 2017 categorization and averaging methodology.

Figure 4- FinTechs Adoption – Comparison 2017 with 2015 services used by the consumers
Source: EY FinTech Adoption Index (2017)[7]

Data from the Figure 4 are showing an accelerating adoption of FinTechs services and products. Money transfer and payments have raised considerably and also borrowing, financial planning, savings and investments.

The changing nature of the banking ecosystem conducted by the shift from brick and mortar branches to online or remote banking, furthermore the entry of the FinTech that are more agile in the online environment than the banks are the challenge for the banks. How could be created memorable experience to maintain customers loyalty?

The answer it will be a highly visible choice architecture should be created by banks and FinTech companies only together. From this collaboration banks will be able to focuse in delivering new added value for their core services with improved time to market, better costs, and enhanced return on investments and so to concentrate the efforts in their core area of expertise. By the other side, delivering a superior customer experience takes more than developing an application it requires significant investments in employees training and collaboration across customer channels and business function, from distribution to operations and compliance departments
Similarly, the adaptation to the dynamic environment of the regulatory authorities is on time to protect customers from fraudulent and other risky constructions?

Summarizing regulatory preliminary views, we can see, that distributed ledger technology, big data analytics, artificial intelligence and cloud computing needs more attention and some legislative initiative will be necessary. Cybersecurity and prevention of Money laundering are the most important part of the ecosystem. Neutrality, proportionality and integrity of technology should be the principle for guiding the EU regulatory framework.(EUROPEAN COMMISSION, 2017)[6]

Both EU and EBA approaches or based on public consultation and a mapping exercise for the FinTechs ecosystem in comparison Bank of England approach which was closer to the real-world through Proof of Concept methods. The last methods are giving a practical view about the studied issues for all the parties involved. Andrew Hauser (BoE, 2017)[1]reflected on what the Bank of England has learned through the proof of concepts applied:"Our work on DLT has helped us start to think through how the financial networks of the future may be able to operate in safer and more efficient ways", moreover the results from the Accelerator approach showed that many technologies are in a beginning stage and can create added value in a secure environment only with a continuous collaboration between the Fintechs, banks and regulatory

Moreover, regulatory bodies and banks as a choice architects are the guardian of the customer experience in an environment of innovation that also implies risks. "A choice architect has responsibility for organizing the context in which people make decisions" (Thaler and Sunstein, 2009, p.3)[20].

4. Conclusions

As long as innovation arise in the pursuit of genuine business objectives, such as revenue generation, cost reduction widening of customer choice and convenience, regulatory bodies should be also agile in creating the framework for governance and to be the guardians of the customer experience.

Collaborations between banks, FinTechs and regulatory bodies is the choice for a good working framework and protective environment with good customer experience.

FinTechs and their adoption by the consumers are the key and the alarm for the change of the traditional banking system, stuck in the past.

Also, the regulatory body should find the balance between stopping the innovation by regulating proactively the environment and making aware the consumer/customer about the risks and advantages of the new technology.

Customer should look for convenience, but also for security both in banking systems and FinTechs in order to protect their money and positive experience.

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[1] Servicescape is a model developed by Booms and Bitner to emphasize the impact of the physical environment in which a service process takes place.

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