A Study on Influences of Internet Finance on China’s Commercial Banks

Yong ZHANG\(^1,a\), Jian-Jun WANG\(^2,b,\ast\)

\(^1\)Department of Corporate Management Consulting, State Grid Energy Research Institute, Beijing, China
\(^2\)Policy Research Department, China Banking Regulatory Commission, Beijing, China

\(^a\)zhangyong@sgeri.sgcc.com.cn, \(^b\)asterwjj@163.com

Keywords: Internet finance, Commercial bank, Relative strategies.

Abstract. The year 2013 is widely regarded as the Internet financial year in which internet technologies and internet ways of thinking profoundly affected and changed the pattern of traditional financial business. Internet companies, the electricity supplier giants raced to get involved in the financial sector, financial innovation protagonists are no longer limited to banks, insurance companies, securities companies and fund companies. The convenience and high-return products offered by internet finance brought forward unprecedented challenge to the banking industry. How could the banking industry face the challenges in the Internet finance era, and how to make good use of these opportunities to transform and develop the banks has become an important issue. This article describes the challenges banking institutions are confronted with in internet financial tide, and the strategies to deal with the challenges.

Introduction

In recent years, with the development of a new generation of high-tech, such as cloud computing, big data, search engines, financial innovation business including mobile payment, online banking, mobile banking, cloud finance have developed rapidly as the representative of Internet finance. The third-party payment and mobile payment grew rapidly, the Internet wealth management became very popular, and network lending expanded in a rush and the crowd funding quietly rose. Internet finance provides useful supplement to traditional financial services, while at the same time also brings great impact on financial institutions, especially commercial banks.

The Characteristics of Internet Finance

The internet financial characteristics this article analyses mainly refer to the characteristics of internet companies penetrating in the financial sector, these features are born with the Internet companies, they brought these advantages into the financial sector and caused changes in the financial sector.

Convenience of Transactions

Alipay is a platform for the third-party payment, an intermediary transaction will bring precipitation funds. One of the ways to use these deposit funds is to buy the Yu’ebao, a popular online fund offering, who is directly connected with TianHong Money Market Fund. So Taobao users can make real-time transfer of funds from the balance of Yu’ebao to Alipay account to pay when buying goods online. Just because of this convenience, Alipay could bring together a large amount of money in a very short time.

Efficient and Low-Cost Information Processing Capacity

Ali micro credit is one of the representatives of small loans. By analyzing Taobao business data flow of each merchant, including cash flow, trading volume, reputation in Taobao business, customer satisfaction and other information of the businesses, Ali evaluated the merchants to determine the loan amount for each of them. As long as proper credit models were developed, the marginal cost of
each new Taobao credit demand is as low as only 2 yuan, far below the 20 yuan of traditional commercial banks.

**Resource Allocation Function**

On P2P net loan platform, all loans were secured by guarantors. P2P companies make advantage of the data mining and information processing capabilities of internet companies to establish risk control model to control credit risks. And with the expansion of business, big data mining of loan data shows a snowball effect so that the company can take advantage of the learning curve to reduce costs continuously, making the marginal cost of each loan lower and lower.

**Strong Social Viscidity of Internet Products**

Recently, the number of Tencent Wechat users has exceeded 600 million, and more than 450 million of them are domestic users. Social viscosity of Wechat has slowly become obvious as Wechat gradually replaced QQ to be the main tool for everyday communication. Wechat now has the function of payment, as long as the owner's bank card is bounded to the account, payments can easily be done when a certain two-dimensional code is scanned. With these functions, user viscosity of Wechat has been continuously enhanced, thus forms the foundation for a financial platform.

**Problems and Challenges of Traditional Commercial Banks in Internet Finance Era**

With the rapid development of internet finance for everyday life and strong penetration of internet technology, internet finance developing very fast launched a fierce attack at traditional commercial banks with cost and time advantages. Especially in recent years, internet finance has slowly begun to erode the bank's traditional core business, and brought fairly great pressure to commercial banks.

**Influences of Internet Finance on Traditional Commercial Banks**

Internet technology reduces the information and transaction costs, and could meet financial intermediary service demands which were traditionally met by commercial banks. In a financing process, a major obstacle is the supply and demand sides of funds cannot timely and effectively obtain supply and demand information. As the most important financial intermediaries in economic life, commercial banks have acted as information aggregation center of money supply and demand, and have formed the scale effect of information gathering and processing. With the development of Internet technology, especially social communication networks such as Wechat, microblog etc. have changed the mode and channel of information transfer, and accumulated a large information database, so some internet companies also obtain the ability to provide financial services. Therefore, commercial banks are faced with the risk of weakening role of financial intermediaries.

Internet technology has changed the pay channels and impacted the commercial banks’ role of payment intermediary. As payment service intermediary, commercial banks mainly dependent on the separation of people and the mismatch of time and space in credit and debt liquidation activities to make a profit. The development of internet technology breaks the constraints of time and space, and to some extent impacts the payment intermediary position of commercial banks.

Network lending affects the income of interest margin of commercial banks. Although the online lending has developed for only a short period, it is developing rapidly for it can raise money for those individuals or businesses that have no access to formal financial institutions, and so is welcomed by the grass roots. In the future, online lending will compete with banks in the field of small and micro enterprises loans and personal loans. And with the further development of internet technology, large companies may also be more dependent on the network, and the new model of network lending will also be designed for big companies, which will bring about fundamental challenge for banks.

Internet wealth management products disperse deposits of commercial banks. Deposits from non-financial enterprises and savings deposits of residents are the lowest-cost source of bank funding. Enterprises and residents keep the money in order to meet consumption demand of daily life and
production, to prepare for the monthly repayment of principal and interest of all kinds of loans, and to meet possible future unintended payments. Internet wealth management has a payment convenience of "T+0", the consumption demand, repayment demand and expected demand of deposits can be replaced to some extent. This substitution effect makes bank deposits continuously decrease. According to the estimation of Bank of China, under the full calibration of residents and enterprises, when the costs of other deposits are at 3.5%, if 10% of demand deposits were lost, commercial bank deposits cost will increase 6.871 bps, and the funds cost for financial institutions will also rise more than 5 bps.

**Problems of Commercial Banks Facing Internet Finance**

The way to offer service needs to be changed. First, some commercial banks failed to integrate equality, inclusiveness spirit of the internet and ignored the financial demands of low-net-worth customers. Over the years, most commercial banks regarded low-net-worth clients as a burden, which eventually caused loss of customers. Whereas internet finance offers financial services to those who were neglected by many traditional financial institutions and therefore obtains rapid growth of the size and influence. Second, commercial banks pay much attention to achieve basic functions while ignore the customer experience, so some of them failed to provide customers with personalized, one-stop financial services. The Internet finance timely and accurately grasp the customer psychology, combines fundamental functions of banks such as payment and settlement with social communication, wealth management, business and other functions, to provide users with good experience of integrated service platform.

There are deficiencies in commercial banks’ data applications. Although in commercial banks the construction of electronic banking has made rapid development in recent years, compared to internet financial enterprises, there are still gaps in its big data applications and other aspects of data mining. First, internet financial enterprises put large data, customer information at the core, while banks are still stuck to the channel-centric architecture. With service channel of business support system isolated from each other, customer information is separated from each channel. Thus hinders a comprehensive analysis of customer behavior, making cross-selling and differentiated services difficult to implement. Second, the absence of depth data application leads to insufficient bank customer viscidity. As the core of commercial bank's e-channel, network banking failed to transform a trading platform which offers fundamental financial services to integrated financial marketing platform, failed to fully tap the customer transaction behavior data to provide retail clients comprehensive assets management services, thus made the bank merely an intermediary for basic financial transactions, and loss of customer is inevitable.

**Strategies to Deal with the Challenge of Internet Finance**

Internet finance brings tremendous challenges to traditional commercial banks. Some people think that the rapid development of the internet finance will bring great impact on the banking sector, and may even threaten their survival. From the current situation, such a concern is more or less exaggerated. The small amount, fragmented nature of internet finance and limitations of the existing policy determine that the scope of its application is significantly different from traditional banking sector. Domestic banks have mature management philosophy and sound risk control advantages, and internet finance will not change commercial banks’ traditional business model and profit obtaining style fundamentally in the short term. There is much cooperation rather than competition between internet finance and commercial banks. But in the long term, the characteristics of high efficiency and low cost of the internet finance is in line with financial reform to ease financial repression and improve financial efficiency. Rapid penetration of internet finance will accelerate China's financial reform, and the trend of transformation of traditional financial is irreversible, so traditional commercial banks should fully learn from the internet financial model and make faster adjustments in response to the profound changes in the financial system to get new development.
Construction of Internet Thinking, Rethinking Development Strategies

The development of internet financial has had a profound impact on commercial banks’ corporate development strategy. For commercial banks, the internet finance has changed the traditional way of thinking and mode of development. It is urgent for banks to take advantage of internet thinking, deepen electronic banking innovation and improve the user experience. Banking should review the impact of the Internet finance from a strategic point of view and further increase the pace of change and innovation. First, banks should abandon the sense of superiority in financial system, and change the profit model that spread is the bank's main source of income. Second, banks should change their service model, sales model, management model and remodel business processes, integrate multiple channels of financial products, value-added services and professional information, and provide customers one-stop financial services.

Strengthening the Existing Advantages, Maintaining and Absorbing More Customers

Banks should learn good experiences and practices from internet companies. At the same time, banks should also see the inherent advantages and strengths of their own, and make full use of their advantages to increase their ability to deal with market competition. First, paying more attention to the risk management and control advantages, and continue to enhance the capacities of controlling risk, it will help to improve the public confidence in banks. Second, taking advantage of product diversification, professionalization to develop a chain of financial products to enhance customer loyalty. Thirdly, banks should further enhance the management ability on the public and large business, where internet companies are still at a disadvantage.

Focus on the Customer Experience, Accelerating Product Innovation

The convenience and popularity make internet banking become the first choice for financial management for more people, and its features enable customers to experience a new financial service. Commercial banks should attach great importance to the customer experience and build customer-centric business model. Only by these improvements will customers have a sense of participation and motivation. Banks should strengthen independent product innovation based on customer demand. With the development of internet finance, in the future all standardized financial products are likely to be sold through the internet banking platform channel. The bank's commission income will also be greatly compressed. Therefore, to strengthen the bank's own product design capability is also an important measure to cope with future financial development of the internet.

Strengthening the Industry and Cross-Industry Cooperation to Seek Win-Win

First, strengthen cross-border cooperation. Banks should strengthen collaboration with internet companies, on the one hand, using its powerful data resources and platforms channels, through micro blog, Wechat etc. to enhance the inlet flow and get a wider range of customer data. On the other hand, banks can take advantage of electronic business platform which combine the information flow, capital flow and logistics together to provide customers with a set of chain service experience which includes business, financial, payment and other aspects. Customer business will be gradually moved to a closed environment, and customer resources will be consolidated. Second is to strengthen cooperation with industry. Banks should follow the "complementary advantages, resource sharing and common development" principle, and actively cooperate with other banks, fund companies, securities, insurance, trust and other financial institutions. Banks should improve financial services, explore design class MMF financial products and other financial products with high liquidity to extend the product chain and stabilize customer resources.

Focus on the Training of Internet-Related Personnel

Commercial banks should focus on training of internet-related professionals. On the one hand, banks should pay much attention to the recruitment of complex talents. On the other hand, banks should also strengthen the impartment of scientific and technological knowledge to the existing staff, and the
instructing of financial business knowledge to technology professionals. Banks should own a variety of internet banking complex talent who are proficient in the use of financial business knowledge, network information technology and the internet tools.

**Strengthening the Analysis and Application of Big Data**

Data Analysts grasp the real operational data through the detailed order information of Taobao and Tmall stores. They analyze and process the data, and filter out the stores qualified for loaning. This credit approval process and risk control is different from traditional banking, and is sufficiently reliable. For banks, the most direct relevance is that to successfully control the micro-enterprise credit risks, meanwhile loan officers can also save labor costs. In the process of banks providing financial services to customers, banks are accumulating a large number of customers’ financial behavior data. The information contained in the data is an important future source of revenue and profits of banks. Banks should build the client-related behavior database, and tap the customer's trading and consumer information through professional data analysis, grasp the customer's spending habits, and accurately predict customer behavior. Through the analysis on different types of customer transactions, banks can grasp customers’ real needs, provide more systematic support to customers, and finally maintain the core competitiveness of commercial banks.

**Summary**

Internet finance has brought many challenges to commercial banks of China. However, banks have mature management philosophy, sound risk control advantages and more customers, so there is still much can be done by the banks to meet these challenges. Banks should establish the internet thinking way and rethink their development strategies and focus on the customer experience, change their service model, sales model, management model, cooperate with other banks and financial institutions and accelerate product innovation.

**References**

[1] Xie Ping, Internet financial model to meet the opportunities and challenges, 21 Century Economic Report, 2012-09-03.