The Effects of Fintech Prepaid Services on Competition and Stability in Banking

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— Abstract —

This paper theoretically examines the impacts of the asymmetric expansion of the Fintech-based prepaid services (e.g., Alipay, Cashbee, Payco) on competition and stability in the banking sector. Specifically, Fintech prepaid services can substitute bank deposits in retail payments service but is less likely to penetrate into loan service. Our model focuses on such asymmetric competition pressure from the entry of Fintech firms on the banks’ operations. We find that if the expansion of Fintech prepaid services concentrate on the deposit market but not on the loan provision, then banks are likely to take more risky loans. Our finding is interesting because our result in the risky loan is the same as what Allen and Gale (2000) finds, even though our model is based on Boyd and De Nicolo (2006) which has the opposite finding. The reason is due to the introduction of asymmetric competition environment into Boyd and De Nicolo (2006). On the contrary, if the competition becomes symmetric in both deposit and loan market by allowing equally enhanced competition into the loan market, the Fintech’s entry will possibly enhance financial stability by making banks taking less risky loan. The supervisory authorities need to take this point into account when they make their policies.

Keywords: Fintech, Competition in Banking, Financial Stability

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I. Introduction

"Fintech" means information and communication technology applied to financial services. According to Accenture (2014), fintech companies are those that provide services across the financial sector, from banking to investment, data analysis, payment and settlement services. The fintech firms are expected to spur innovations and increase competition in the banking industry by applying information and communication technology (ICT) to financial services.

Fintech firms are described as “the combination of T-shirt-wearing whizz-kids and venture capital” by the Economist (2015). There are a great number of startups with ideas and money working on various alternatives to traditional banking. Although these many newcomers will certainly increase competition in banking, the new competitive landscape will be different from the past.

Traditionally, the business of banking is bundling of various services.1) The defining characteristics of a bank is that they engage in distinct activities, especially deposit-taking and lending. There have been many studies to answer the question of why it is important that one institution perform the two services under the same roof. For example, Kashyap, Rajan, and Stein (2002) provides a logic as follows.

… since banks often lend via commitments, their lending and deposit-taking may be two manifestations of one primitive function: the provision of liquidity on demand. There will be synergies between the two activities to the extent that both require banks to hold large balances of liquid assets: If deposit withdrawals and commitment takedowns are imperfectly correlated, the two activities can share the costs of the liquid-asset stockpile.

Since traditional banking is a kind of bundling of a wide range of services, entry of a new bank meant increased competition in most of the areas of banking services. On the contrary, fintech startups are not interested in providing bundled financial services, but in laying claim to a small piece of banking. Small firms are much better when it comes

1) A non-exhaustive list is the following: payment guarantees, bill underwriting, factoring, safekeeping, underwriting and sales of securities, making of arrangements for the sale and offering of securities, securities transactions under repurchase agreements, and collective investment, investment advice, investment transactions, investment brokerages, trusts, bancassurance, credit cards, and so on.