FinTAF

FinTech and Artificial Intelligence in Finance (FINTAF)
Issue 2

Bridging the Gap: The Impact of Open Banking on Traditional Banking and FinTech Collaboration

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Submitted : July 31, 2024
Accepted: **07/03/2025**
Published 07/03/2025

"Everybody's working very hard on it, and it seems it's going to change the world; I think it's going to be the biggest change in banking and payments in our lifetime; I'm genuinely convinced of that. It's a jump from the Nokia to the smartphone; it's basically allowing third-party creativity on a platform."

Industry Expert (2020 Q1)

Abstract

The banking sector has undergone rapid digitalization and technological advances, shifting from the traditional closed banking model to open banking. Open banking is a more innovative and open structure that has gained significance. This article delves into the transformative effects of open banking on the traditional banking landscape and its synergistic relationship with FinTech companies. This paper explores the transformative effects of open banking on the financial services landscape. As regulatory frameworks evolve, open banking is disrupting traditional banking models by promoting transparency, data sharing, and customer-centric services. This study examines the burgeoning partnerships between traditional banks and FinTech companies, highlighting how collaboration enhances innovation, agility, and customer experience. By analyzing current trends and future implications, this paper illustrates how open banking is reshaping the financial ecosystem, fostering a new era of collaboration that ultimately benefits consumers and drives industry advancement.

Keywords: Digital Transformation, FinTech, Open Banking, API, Interoperability

Introduction

The necessity of digital transformation arises from the heightened customer expectations regarding seamless and convenient banking experiences. In an era marked by technological advancement across industries, the banking sector must embrace digitalization to uphold its competitive edge and relevance.

The financial industry has experienced significant changes in recent years. One of these changes is the rise of financial technology, "FinTech companies", which are transforming the industry and posing a substantial challenge to traditional commercial banks. [1] (Horváth, Kerényi, and Szabó 2022) The banking sector has been subject to fundamental changes as digitalization enables novel technology-driven banking services and creates new customer demands. While banks face sluggish

[1] Horváth, D., Kerényi, Á., & Szabó, R. Z. (2022). Intended benefits and challenges of cooperation between FinTechs and commercial banks. Acta Oeconomica, 72(3), 289–308. https://doi.org/10.1556/032.2022.00023

innovation processes, fintech's use the digital era to deliver customer-centric solutions. Although banks have realized that cooperation with Fintechs is a crucial approach to fostering innovation, they need help to address the associated challenges. [2] Drasch et al. 2018

Digital technology platforms have enabled the emergence of new business models, rendering traditional product and service creation obsolete. Institutions are formulating operational strategies through digital transformation to compete and adapt to the evolving work environment effectively.

Customers can access financial products and services through various channels, such as automated teller machines, internet banking, and mobile banking. Recent economic and financial geographic literature pertaining to Fintech has prompted inquiries into the ways in which digital technologies are reshaping the operational and business frameworks of financial incumbents. Corporate banking, an essential component of the Advanced Producer Service (APS), assumes a critical role in facilitating firms' operational and international endeavors and is currently undergoing transformative changes. This paper contributes to the geographical literature on Fintech and digital transformation in the banking sector by introducing a new cultural economy approach to digital transformation.

Literature Review

The literature background identified several advantages of cooperation between banks and FinTech companies. The findings have shown that banks can significantly increase their competitiveness and effectively renew their product and service portfolios through collaboration with FinTechs. A large variety of banking IT innovations has emerged. It illustrates that traditional banks are expected to have less power to impede competition at the customer interface and, consequently, need to re-position themselves3 (Alt and Puschmann 2012)

[2] Drasch, B. J., Schweizer, A., & Urbach, N. (2018). Integrating the 'Troublemakers': A taxonomy for cooperation between banks and fintechs. Journal of Economics and Business, 100, 26–42. https://doi.org/10.1016/j.jeconbus.2018.04.002

[3] Alt, R., & Puschmann, T. (2012). The rise of customer-oriented banking - electronic markets are paving the way for change in the financial industry. *EM*, *22*(4), 203–215. https://doi.org/10.1007/s12525-012-0106-2

The digital evolution within the banking sector yields dual ramifications. Firstly, it impacts the customer base by introducing novel products, facilitating immediate transactions, and providing round-the-clock banking services, thereby extending financial access to areas lacking physical bank branches. Secondly, it significantly influences the human resources of banks. While the advantages to the customer base are evident in empirical studies on the adoption of new technologies such as e-banking and m-banking, academic research pertaining to the impact on bank staff remains limited. Contemporary analyses of this subject predominantly feature in financial investigations and forums.

The concept of digital transformation involves using digital technology and strategies to fundamentally change how an organization operates and delivers value to its customers. This change can have a significant impact on various aspects of the organization, including its business model, operational processes, corporate culture, customer relationships, and customer satisfaction.

The article "Conceptualising 'Value for the Customer': An Attributional, Structural, and Dispositional Analysis" by Tony Woodall, published in the Academy of Marketing Science Review in January 2003, explores the concept of 'Value for the Customer' (VC)

The document defines 'Value for the Customer' (VC) as a demand-side, personal perception of advantage that arises from a customer's association with an organization's offering. This perception can manifest in several ways, including a reduction in sacrifice, the presence of benefit (perceived as either attributes or outcomes), a weighted combination of sacrifice and benefit determined and expressed either rationally or intuitively, or an aggregation over time of any or all of these elements. Value for the customer (VC) is any demand-side, personal perception of advantage arising out of a customer’s association with an organization’s offering and can occur as a reduction in sacrifice; the presence of benefit (perceived as either attributes or outcomes); the resultant of any weighted combination of sacrifice and benefit (determined and expressed either rationally or intuitively); or an aggregation, over time, of any or all of these.[4]

4 Woodall, T. (2003). Conceptualising “value for the customer”: an attributional, structural and dispositional analysis. Academy of Marketing Science. https://is.muni.cz/el/1456/jaro2013/MPH_MVPS/39278324/value_Woodall.pdf

Banks adopting the technology:

The Basel Committee on Banking Supervision (BCBS) has released a consultative document examining the implications of fintech developments for banks and banking supervisors. Fintech, or financial technology, has seen significant investment from banks and venture capital funds, indicating potential for substantial change in the banking industry. The document acknowledges the uncertainty of fintech's impact on banks' business models but suggests that technological change and customer expectations could challenge banks' current operating models.5

Banks are adopting technology to improve their services, products, and operations. They are pressured to enhance cost efficiency and customer relationships, leveraging their market knowledge and investment capacities. Key technologies mentioned in the provided document include cloud computing, big data, artificial intelligence (AI), machine learning (ML), advanced data analytics, distributed ledger technology (DLT), and application programming interfaces (APIs). Banks are using these technologies to develop new value propositions that cannot be effectively provided with their current infrastructure. For instance, they are implementing biometry, video, chatbots, and AI to create sophisticated remote customer relationship capabilities, secure transactions, and mitigate fraud and anti-money laundering (AML) / combating the financing of terrorism (CFT) risks. They are also exploring using robo-advisor

5 Basel Committee on Banking Supervision Sound Practices: Implications of Fintech Developments for Banks and Bank Supervisors, Issued for comment by 31 October 2017. August 2017, Bank For International Settlements.

services and digital wealth management tools to maintain a competitive edge in the retail banking market.

Additionally, banks are considering adopting mobile wallets developed by third-party technology companies, which is an example of the "distributed bank" scenario. Some banks have developed mobile wallets, while others offer third-party wallets due to widespread customer adoption. This shows that banks are open to collaborating with or integrating services from fintech and big tech companies to provide a better customer experience.

The modern, ever-changing technological environment compels all economic entities to transform digitally. Digital transformation serves a dual purpose for banking organizations: it enables them to introduce new service channels through electronic platforms (such as e-banking and virtual banking) and service points (like e-branch stores and POS) while also reducing operating costs by cutting down on physical stores and staff. This is why the banking industry worldwide invests three times more in IT than any other industry. Business models in the banking sector are being reevaluated due to digitalization, disruptive innovation, and new technologies, which are altering traditional processes and models. Therefore, banks need to adapt their business models to revamp customer interactions, streamline middle and back-office operations, stay competitive, and prepare for the future.

A considerable volume of banking transactions is now conducted via individuals' personal computers or mobile devices. The array of available options, combined with the time and cost savings and the user-friendly interfaces of these applications, consistently compel a portion of the business away from traditional banking channels, such as physical bank branches. Through these applications, customers can access real-time information regarding the valuation of their investment products, the banks' reward programs, and the expenses incurred through digital media, which can result in more favorable tax treatment. These attributes render mobile banking increasingly appealing not only to younger demographics but to all smartphone owners. Consequently, the term "digital natives" is employed to characterize individuals born after 1980 with a heightened familiarity with and acceptance of new electronic technologies.

What is Open Banking

Open banking is a financial practice in which banks provide third-party providers with access to their data and services. Open banking allows third-party developers to access bank data through application programming interfaces (APIs). This approach enables consumers to securely share their financial information with authorized third-party providers, such as FinTech companies, to access a range of new and innovative services.
Information and communication technologies (ICT) enable the digital transformation of financial services and the associated growth of Fintech.(2)

Open banking refers to a system that allows for unprecedented openness of financial data of all users, aiming to simplify financial transactions and enhance communication between clients and financial service providers. The concept of open banking serves to advance competition within the banking sector, foster the development of digital banking, and promote collaboration with fintech entities. Moreover, it places significant emphasis on ensuring the security of data. Despite apprehensions concerning the potential for personal data breaches and misuse, open banking offers tools aimed at enhancing financial conditions and addressing intricate financial metrics. The shift to open banking is a substantial consideration for governments seeking to modernize their banking systems, with many nations having already incorporated this paradigm.

The Need for Digitalization in Banks

Digital transformation plays a crucial role in establishing and maintaining a competitive advantage in today's evolving corporate landscape. The banking industry has undergone substantial transformation due to the digitalization processes. The efficacy of intermediaries' digital banking strategies hinges on customers' proficiency in adopting new products, services, and technologies. Conversely, the deficiency in digital skills among the populace may impede the effectiveness of

the banking digitization strategy (Sun et al., 2020)[6]. Additionally, exogenous occurrences such as the Covid-19 pandemic have underscored the importance of enhancing knowledge and competencies in utilizing digital banking tools.

As a result, the familiar concept of financial literacy (FL) has evolved into digital financial literacy (DFL), which refers to people's ability to use digital devices and tools to conduct safe and sound e-banking transactions.[7]

The increasing expectations of customers for seamless and convenient banking experiences have led to the need for digital transformation. In today's technology-driven era, the banking sector must adopt digitalization to remain competitive and relevant. Digital transformation in banking is important as it enhances operational efficiency, reduces costs, and streamlines processes. Automated transactions, online banking, and digital payment solutions not only make banking services more accessible, but also significantly improve the speed and accuracy of financial transactions.

Research method:

The study will employ a comprehensive methodology including literature reviews, source selection, surveys, and interviews to evaluate the impact of open banking on traditional banking practices and its implications for FinTech collaboration. By analyzing the data obtained, the study aims to provide insights into how open banking is reshaping the financial ecosystem and driving innovation in the industry. Ultimately, this research seeks to bridge the gap between traditional banking and FinTech, highlighting the opportunities and challenges that lie ahead in this rapidly evolving sector.

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[6] Sun, H., Yuen, D. C., Zhang, J., & Zhang, X. (2020). Is knowledge powerful? Evidence from financial education and earnings quality. Research in International Business and Finance, 52, 101179. https://doi.org/10.1016/j.ribaf.2019.101179

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Conclusions

It is indisputable that the increasing digitalization of the economy, along with the rise of new players such as fintech, has significantly altered the operations of the banking industry. Rodrigues et al 2023. The banking sector has undergone significant changes due to digital technology, resulting in a major impact. One of the most noticeable effects is the improved customer experience, which includes digital onboarding, automatization, enhanced security, open access, and speed of response. Banks are going through a significant digital transformation due to the emergence of new financial technologies (FinTech). These technologies offer innovative services that are capturing the attention of both customers and investors. Fintech startups are mainly focused on breaking down banks' services into individual products or services. These specialized companies have separated financial services, enabling consumers to choose and combine their preferred products, primarily by enhancing the customer-facing aspects of financial services. Rodrigues et al. 2023

Digital transformation has given customers easy access to banking services through mobile apps and online platforms. Another evident impact is on operational efficiency. Automation of routine transactions and processes has significantly reduced manual workload and operational costs for banks. In today's era of digital transformation, the banking system's development is closely linked to the advancement of digital technology in order to stay competitive and foster financial ecosystems.

Digital transformation has streamlined internal operations, leading to faster decision-making processes, improved resource utilization, and more secure transactions through blockchain technology. Banks can implement these improvements not only by implementing the technology but also by collaborating with specialized FinTech companies.

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