'New Finance' Redefines What's Possible

Paul Breloff and Robert Schiff

Digital technology is changing financial services. The signs are everywhere: Apple Pay, eBay splitting off PayPal, the fixation with bitcoin. However, we're still at the start of what's possible, with attention on first-generation innovations in payments and e-commerce. What we've seen so far is only a preview of what's to come — part of a broader set of forces at work that we call "New Finance."

New Finance combines the digital savvy and let's-disrupt-something attitude of startups, the social mission of microfinance and financial inclusion, and insights from behavioral economics and human-centered design. These strands are increasingly combining in ways that point toward a reshaping of the financial services landscape. New Finance means new opportunities and threats for financial service providers, and it promises radically different and better products tailored to individual needs, characterized by higher quality, lower cost, and unheard-of convenience.

Imagine a world where all small businesses get the loans they need at the same cost as big companies, provided they have the ability to repay. Imagine these firms getting that money immediately, with the push of a button, and without long applications. Imagine new bundled insurance products that account for health crises, unemployment, and macroeconomic shocks. And imagine savings tools that make it easier to invest in a stock portfolio than it is to buy a cup of coffee.

Examples of New Finance include: online lenders that use nontraditional data for credit scoring, such as OnDeck; investment platforms that make modern portfolio theory available to us all, such as Wealthfront; low-cost bank account substitutes that have the benefits of banks without branches or fees, such as Simple and Bluebird; and digitally enabled financial management tools, such as RevolutionCredit, which has courses on how to use credit in exchange for waived fees and other benefits.

The rise of "Big Data" is increasing providers' ability to market and manage risk efficiently. The growing number of fintech startups and venture capital funds focused on financial services mean an orders-of-magnitude increase in the amount of digitally enabled experimentation.

Providers' relationships with their customers are also changing. Consumers expect iPhone-like banking experiences, including simpler products and enjoyable interfaces. They are savvier shoppers, using online comparison and real-time feedback through social networks. At the same time, providers better understand how people think about money, building on advances in behavioral economics. Understanding seemingly irrational behaviors lets us nudge each other toward better financial decisions, such as defaulting some of each paycheck into retirement accounts.

Meanwhile, post-crisis, governments, policymakers, and financial institutions are emphasizing financial services' role in society more, including the importance of financial inclusion for long-term prosperity and growth. This is increasing regulators' openness to experimenting with new models. And banks are evolving from purely vertically integrated financial providers to also serving as utilities, providing the backbone for startups offering deposits and lending services.

New Finance is an opportunity for incumbent financial institutions to innovate because the growing use of digital technology lowers costs and makes it possible to serve a broader range of customers. For example, better
analytics means lower credit losses.

New Finance is also a challenge. Innovations are largely being driven by nonbanks — from tech players to retailers to telecoms to startups. Through 2008, Kenyan banks only reached 10% of the population; now almost 90% of adults there have access to payments via the country's mobile operators. Realizing the promise of New Finance will require more creativity in how providers harness these forces and different kinds of collaborations between banks and nonbanks, as well as the social and public sectors. Our biggest constraint is our imagination. That's an exciting place to be.

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