How Fintech can reduce information asymmetry
by Mritunjay (Munjay) Singh, Executive Director & President, Services unit, Persistent Systems

In the emerging Fintech world, the longstanding information asymmetry is being reduced. A good example is a transfer of money from one currency to another, perhaps dollar to euro. Today, most banks will take the interbank interest rate charged on short-term loans between banks, and charge the customer a four or five percent rate, in addition to the current interbank rate. This method has typically worked well since most customers simply ask for a quotation and accept it.

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How will Fintech impact how we live and work every day as the banking industry as we now know it changes? After all, arbitrage and information asymmetry have long stood as pillars of the business model of the financial services industry. Purchasing and selling assets to profit from price differences -- at rates determined by the banks -- is how financial institutions have historically made money.

As consumers, we do not know the actual cost of the services that the banks provide since this information is not symmetrical. Financial institutions have traditionally calculated and priced interest rates based on risk and operational cost. Again, the risk is part of the financial information asymmetry because it is the bank that knows and manages it.

In practicality, a consumer making a deposit in their savings account at the bank may see an interest rate of one percent. If the consumer wants to then borrow money, the bank may lend funds at rates from four to five percent or higher, depending on a credit score, with the spread and profit determined by the bank. This information asymmetry is accrued for the majority of customers and it’s here where Fintech can have an impact.

Fintech is challenging the traditional financial model in ways that I believe will ultimately benefit us all - the consumer and the financial ecosystem.

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What new age Fintech companies have figured out is that when many people transfer
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small amounts of money, such as US$400 or less, contrary to common belief, they are not in a hurry to withdraw this money. However, amounts over US$400 are withdrawn. As a result, some banks have changed their financial model. Customers transferring less than US$400 are charged the current interbank rate. However if the amount is greater than US$400, the bank may charge the interbank rate, plus two percent arbitrage -- which is still less than other banks will charge.

The result? Now, there is a market for small value transactions, such as dollar to euro or other currencies, and that money provides liquidity that Fintech companies use to earn interest. It’s an innovative and different way of earning money on small amounts being collected within the system. And because it is online and is in real time, it is easy for the banking system to aggregate and make money.

Fintech is purely technology-driven. This is a classic case where financial information asymmetry is reduced and new, previously unavailable data can be leveraged with less personnel and resources required. Consequently, the cost of extending operations is lower and volume can more easily rise, along with profitability.

Better consumer profiles mean better customer service

The telecom world – with its early digital adopters -- has provided the Fintech companies with valuable real world lessons. Telecom companies have long discovered they need to aid the consumer by profiling them and adopting product offerings according to the wants and needs of the individual consumer.

For example, telecom companies found themselves with angry customers who were unhappy when they were charged if they inadvertently went over their data limits. Customers wanted their provider to monitor their data usage and either warn them before they incurred additional charges or offer them plans tailored to their individual usage patterns.

The same principal can apply to services offered by Fintech financial institutions. Banks can proactively evaluate a customer’s profile and offer corresponding investment opportunities to maximize the customer’s assets, rather than simply offer a generic product.

Ultimately, what Fintech technology is doing is freeing up time and resources for the consumers and the financial institutions. We will find that as information asymmetry is compressed, the capability of individualized price points and products that better serve customers will grow. Fintech is giving rise to a completely new world of banking – one that I believe we will all appreciate!