

Innovation in Financial Services: Disrupting Traditional Banking with Fintech

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Abstract

Fintech's explosive expansion has drastically changed the global financial scene, especially by upending established banking structures. The paper addresses the primary forces driving the emergence of fintech, how it is changing traditional banking procedures, and the tactics used by well-established financial institutions to stay competitive. Fintech innovations are growing in popularity among consumers because of their user-friendly, easily available, and effective financial services. The findings reflect that fintech technologies, including robo-advisors, peer-to-peer lending, digital wallets, and rapid payments, are revolutionizing the banking business. Fintech's growth is being driven by advances in digital technology, changing client demands, and regulatory support. Traditional banks are investing in digital technologies, establishing innovation centers, and incorporating cutting-edge technology into their offerings. They are also stepping up cybersecurity and advocating for regulatory changes to equalize the playing field with fintech disruptors.

Keywords: Fintech, banking, innovations, technology, transformation

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Introduction

The global financial services industry is witnessing a seismic shift as fintech threaten and disrupt traditional banking structures. To maintain competitiveness and satisfy changing customer demands, digitalization is fostering new heights of creativity and revolution. The rapid expansion of the fintech sector in the past few years has fundamentally changed how we engage with financial items and offerings. Cryptocurrency, roboadvisors and mobile banking applications are few examples of how advancements in fintech are evolving traditional banking procedures and providing customers with more efficient, accessible, and user-friendly financial services, avoiding a large number of the constraints that conventional banks face. Changes in customer expectations, advances in digital technologies, and the rapid emergence of alternative financial solutions aimed at both retail consumers and companies are driving this disruption.

Fintech is a wave of revolutionary technology and business concepts rather than a single invention. This disruption has resulted in a shift in the competitive dynamics of the financial sector. Traditional banks are being pushed to reconsider their strategies as they experience additional stress from fintech innovators. Financial institutions across the globe face different kinds of opportunities and difficulties due to the

ongoing trends that are blurring the boundaries between fintech and traditional banking. This paper will explore the various ways in which fintech is challenging traditional banking, with a focus on breakthroughs, customer behavior shifts, changes in law, and incumbent financial institutions' responses. By examining these changes, we can obtain insight into the future of banking and the long-term implications of fintech for the global financial ecosystem.

Literature Review

The emergence of fintech companies, or financial technology firms, has caused a substantial change in the financial services industry by redefining traditional banking processes. Utilizing digital technologies to enhance and automate the provision and consumption of financial services is known as fintech (*Gomber, Kauffman, Parker, & Weber, 2018*). The shift in customer expectations towards flawless and instantaneous digital experiences is making it difficult for conventional banks to compete with these customer-focused, nimble entrepreneurs. Blockchain, Artificial Intelligence (AI) and Machine Learning (ML), are among the latest innovations that are propelling fintech's ascent and changing the way financial institution function.

The emergence of fintech has been attributed to a variety of factors. Technology has made it possible to provide banking services faster, less expensive, and more effective. This has allowed fintech companies to offer customized solutions which weren't feasible for traditional banks. For example, the introduction of blockchain technology has enabled to provide decentralized financial services, also known as decentralized finance, or DeFi, which are quicker, safer, and more transparent than traditional banking procedures (*Zhang, Xue, & Huang, 2020*). Fintech businesses may now provide individualized financial services like robo-advisory, identification of fraud, and credit scoring based on alternative data sources thanks to advances in artificial intelligence (AI) and machine learning (*Bussmann, 2017*).

Through the introduction of innovative business models and customer-focused solutions, fintech is upending the established banking industry. Peer-to-peer lending, digital wallets, crowdfunding websites, and cryptocurrency exchanges are a few examples of innovations that have transformed financial services (*Puschmann, 2017*). One of the primary areas impacted by disruption is payments. Fintech businesses like PayPal, Square, and Venmo, which provide lower costs and quicker transaction processing, have lessened the dependency on traditional banks payment systems due to the growth of digital wallets and mobile banking (*Arner, Barberis, & Buckley, 2016*).

Traditional banks have started pursuing digital transformation initiatives in an effort to counter the challenge posed by fintech. Many individuals are investing in joint ventures or buying fintech businesses to incorporate cutting-edge ideas into their own products. Similar to this, large banks have established innovation hubs and fintech incubators to encourage cutting-edge ideas and technology within. Traditional banks are also investing heavily in cybersecurity to manage the increase in digital transactions. The rise of online banking has made sophisticated encryption techniques, biometric authentication, and fraud detection crucial for preserving client confidence (*Leong, Tan, Xiao, & Tan, 2020*). Additionally, banks are collaborating with authorities to guarantee that rivals in the fintech industry function on a fair playing field by advocating for reforms to the legislation governing these companies.

Fintech is often perceived as a disruptive technology, however a hybrid approach in which fintech

companies and conventional banks coexist and interact may hold the crucial element for the future of financial service sector. As fintech businesses grow, they are working together more often with conventional banks to offer comprehensive financial assistance that bring together the security and size of well-established financial organizations with the creativity and agility of fintech (*Philippon, 2016*). A more customer-focused financial services ecosystem that benefits both incumbents and innovators may result from this mutually beneficial partnership.

Research Methodology

This study uses a qualitative research approach to investigate how advancements in fintech have affected conventional banking systems. It does this by thoroughly reviewing the body of current literature, case studies, and industry reports. Understanding the factors driving fintech growth, the shifts in banking practices, and the adaptation tactics used by financial institutions are all accomplished through the use of secondary data sources, such as scholarly journals, market research publications, and policy documents. Furthermore, speaking with professionals and industry experts offers insights into the real-world applications of financial innovations. The data is subjected to thematic analysis to detect trends, patterns, and obstacles within the dynamic financial ecosystem. A thorough analysis of fintech's contribution to changing the global financial scene is ensured by this methodology.

Scope

The goal of the study is to understand the manner in which fintech is transforming traditional banking systems, with a focus on innovations like digital wallets, peer-to-peer lending, robo-advisors, and real-time payment systems. It examines the fundamental forces behind the growth of fintech, such as changes in consumer preferences, regulatory frameworks, and technology breakthroughs, and it examines how well-established financial institutions have responded to maintain a competitive edge. The geographic coverage mostly covers developed and emerging nations, offering a worldwide viewpoint on fintech's contribution to improving operational effectiveness and financial accessibility. The results are intended to provide stakeholders, financial institutions, and policymakers with useful information for navigating the quickly evolving financial landscape.

Objectives

- To identify the key drivers behind the rapid growth and adoption of fintech solutions.
- To assess how fintech is disrupting traditional banking practices.
- To evaluate the strategies used by traditional financial institutions to adjust to the evolving fintech landscape.

The Fintech Revolution

The term "fintech" describes the creative application of technology to deliver financial services. To enhance client experiences and optimize workflows, fintech companies frequently make application of data analytics, blockchain, and artificial intelligence (AI), and other cutting-edge technologies (*Das & Das, 2024*). Fintech businesses integrate technological innovations into their offerings and span from major

financial institutions to startups and disruptors. Innovation and technical advancements over the past decade have accelerated the fintech industry from the periphery to the forefront of financial services. And the rise has been rapid and intensive because of the banking industry's rapid expansion, rapid digitization, changing consumer tastes, and rising support from investors and regulators. Fintech have significantly changed some segments of the financial services sector throughout the previous decade with their creative, unique, and customer-focused value propositions, cooperative business structures, and flexible, cross-functional teams. Financial technology businesses, or fintech, have grown at an exponential rate over the past ten years, drawing in over \$200 billion in investment in 2021 alone. Fintech are flourishing because of several reasons, including the acceleration of consumer adoption of digital finance, the expansion of open-banking frameworks by regulators in the US and EU, and the ease with which new software and financial infrastructure can be launched. Andreessen Horowitz general partner Angela Strange predicts that "every company will be a fintech company" eventually. According to Global Payments, software channels account for 60%–70% of new customer acquisition. By 2025, the firm is projected to generate \$230 billion in additional revenue, a 922% growth from 2020. There is a \$7 trillion potential (*"The Rise of Fintech and Embedded Payments," 2023*).

Drivers of Fintech Growth

After the US and China, with 22,290 and 8,870 Fintech, respectively, India now has the third-largest Fintech market throughout the world with 7,460 Fintech companies. Having \$29 billion in funding across 2,084 agreements to date, with 14% of global capital, the Indian fintech market is the second-largest deal volume. Moreover, the fintech sector in India grew at an increased CAGR of 20% than in the US, UK, and China, where growth rates were 16%, 15%, and 10%, respectively. Fintech has significantly boosted the Indian economy with its cutting-edge products and inclusive strategy to serve all Indians, generating over \$800 billion in yearly payments transaction value (*Future Fintech Growth Drivers - Niyogin Fintech, n.d.*). Several favorable, legislative, and economic considerations indicate that India's fintech industry has a promising future.

The main forces behind FinTech companies are modern technologies such as blockchain, artificial intelligence, machine learning, Internet of Things, and cloud computing. These days, people make purchases and handle their finances using these technologies. FinTech is seen by traditional banking and financial services businesses as a disruptor of their sector. By concentrating on the primary goal of simplifying and improving money management, FinTech companies are currently at the forefront of the sector. Consumers today have higher expectations regarding faster, more easily accessible, and highly tailored financial services. Fintech businesses have benefited from this shift by providing user-friendly channels that enable users to do banking operations, invest, or receive loans with minimal friction. Fintech solutions frequently meet consumer expectations for seamless digital interactions that are more effective as compared to conventional banks. Instant payments, digital wallets, and peer-to-peer lending are just a handful of the services that have made financial transactions more accessible and efficient. The financial and payment habits of Generations X, Y, and Z have changed in tandem with societal shifts, and millennials have demonstrated an early adoption rate. There will undoubtedly be many more innovations in the near future because the sector is seeing healthy and rapid growth in investment. Worldwide use of e-wallets as well as additional electronic payment methods has been spurred by e-commerce. Fintech companies are being trusted by both individuals and companies using their private information for online purchases, financial

transfers, and e-wallet usage (*Kumar, 2022*). FinTech is developing at a rapid pace, so we have only just begun to scrape the surface of what is anticipated to occur over the next several years.

Disruption of Traditional Banking

Innovative services and technologies are transforming the banking sector for both huge IT corporations and fintech startups. They are bringing about major changes in loans, payments, investment management, and personal finance by utilizing social media, mobile communications, and advanced data analytics. It's imperative for traditional banks to change or else they could lose market share to these adaptable, emerging rivals.

In the financial services sector, digital transformation is significant trend. Financial organizations such as banks are investing heavily in digital technology to enhance client satisfaction, curtail expenses, and maintain their competitiveness. Banks are utilizing chatbots and smartphone apps, for instance, to offer their customers with more convenient and individualized services. Digital-only banks, such as Varo and Chime, provide an entirely online banking interaction without experiencing any physical branches (*Ferdinand, 2024*).

Neobanks are another invention that threatens traditional banking. Neobanks differentiate themselves from traditional banks with their cutting-edge features and client-focused philosophy. These digitally native financial institutions provide smooth, intuitive user interfaces and give users mobile app access to their accounts in real time. Furthermore, neobanks frequently use cutting-edge technology, such as machine learning and artificial intelligence, to provide individualized financial advice and insights (*Fintechly, 2024*). Different industries have seen a paradigm shift since the advent of artificial intelligence (AI) and machine learning (ML). Large-scale data analysis and pattern recognition competencies that were previously unreachable for humans are provided by AI-powered algorithms. This allows businesses to make data-driven decisions, automate processes, and enhance customer experiences. Future business trends, innovation, and industry revolutions are anticipated to be further shaped by the development of AI and ML.

Enterprises now have enormous potential due to big data and analytics. Businesses now possess unmatched insights into market trends and customer behavior, and operational efficiency because to the capacity to gather, handle, and analyze enormous amounts of data. Businesses may optimize supply chains, improve product development, and provide individualized experiences by utilizing big data and analytics. In addition, organizations can maintain flexibility and responsiveness to evolving market conditions through data-driven decision making (*Riordan, 2023*).

Traditional company paradigms are still being disrupted by technology, which presents both opportunities and challenges. Businesses may set themselves up for long-term success by grasping the idea of digital disruption, embracing developing technology, and being flexible. Through constant innovation and technology utilization, businesses may secure their future and prosper in the ever-changing business environment.

Traditional Banks' Response to Fintech Disruption

The rapid growth of fintech generated a tsunami that traditional banking structures have never seen, triggering responses from established financial institutions as a matter of relevance. Aid has always existed among the strains of established institutions, and solutions have been developed, however slowly, in response to shifting market conditions. In the past, the development of the financial services sector required fixed assets, which made it difficult for newcomers to enter. Owing to technological advancements, start-ups may now carry out intricate tasks virtually. For instance, neobanks are totally dependent on technology infrastructure to operate. Despite not having a live customer-facing feature, Revolut, which was founded in the UK, has 1.5 million users, 350,000 of whom use the service every day (*Talent Network Experts, n.d.*).

Traditional banks are putting cybersecurity first to keep their customers' trust as digital transactions increase. To oppose fintech companies, where digital trust is a crucial differentiation, they are investing in fraud detection systems, biometric identification, and advanced encryption technologies to assure data protection and avoid cyberattacks. To encourage internal technology innovation, numerous traditional banks have established innovation hubs and startup incubators. The goal of banks' establishment of fintech labs, like ING's innovation labs and Barclays' Rise, is to leverage disruptive technology to develop new financial solutions that rival fintech solutions. Traditional banks are rethinking the customer journey to compete with fintech firms that place a greater emphasis on the user experience. Banks are striving to fulfill the higher expectations of today's digitally aware customers by enhancing digital interfaces, implementing chatbots driven by AI, and providing individualized financial advice using data analytics. Banks are implementing omnichannel solutions to ensure consistent consumer experiences across online, mobile, and in-person channels. Standard financial institutions are pushing for reforms to regulations that level the playing field because fintech challengers frequently operate in less regulated regions. Banks and regulators are collaborating closely to implement new frameworks that support innovation while upholding compliance at the same time. For example, regulatory sandboxes let banks test fintech ideas in a regulated environment, without needing to instantly comply with all regulations.

In response to the threats posed by fintech, traditional banks are embracing digital transformation, forming strategic alliances, and utilizing innovation. They are trying to maintain their competitiveness in a financial ecosystem that is changing quickly by combining external cooperation with internal innovation. As fintech develops further, the banking industry will probably implement a hybrid model wherein fintech businesses and traditional financial institutions work together to create financial services that are more technologically advanced and customer-focused.

Findings and Discussion

A number of significant factors, such as improvements in digital technology, shifting customer preferences, and regulatory support, were shown to be important contributors to the quick uptake and expansion of fintech solutions. Because they offer services that are easier to access, tailor, and quick in response to modern customer demands, fintech companies have upended the established banking industry. A handful of the innovations that are transforming the business include robo-advisors, peer-to-peer lending, digital wallets, and quick payments.

Furthermore, promising regulatory environments and financial backing have fueled the fintech industry's expansion, especially in developing nations like India. As a disruptive force, fintech is forcing more specialized financial services, partnerships, and digital transformation initiatives from long-standing financial institutions to stay competitive.

The disruption caused by fintech has prompted traditional banks to take many actions. They are investing heavily in digital technologies to improve customer experiences and modernize procedures. Additionally, numerous banks have established innovation centers and fintech laboratories to utilize cutting-edge technology. Through strategic alliances and fintech company acquisitions, they can include cutting-edge technologies into their service offerings. Conventional banks are also strengthening their cybersecurity defenses and pushing for regulatory adjustments that would put fintech disruptors on an even playing field.

Conclusion

The financial services industry has witnessed a rapid transformation thanks to fintech, which has put traditional banking institutions under pressure to innovate and change with the times. Fintech companies have stepped in to bridge the gap created by consumers' growing desire for faster, more efficient, and tailored services through emerging technology. As a result, traditional banks have begun their own journeys toward digital transformation in order to stay relevant., utilizing internal innovations, collaborations, and regulatory cooperation. It is probable that the financial services industry will adopt a hybrid model in which traditional banks and fintech startups coexist and work together to provide technologically sophisticated and customer-focused financial solutions.

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