Fintech and Korea's Financial Investment Industry

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Fintech, meaning the convergence between finance and technology, is a buzzword for 2015. Mobile technology makes it easier for startups to run a business than at any time in history, driving a shift towards the Fintech era where IT makes use of finance. There is no exception to this megatrend, in particular in the global financial investment industries. Fintech increases its presence in every corner of financial markets, even in those regarded as the traditional businesses such as wealth management, brokerage, investment advising, the secondary market, clearing and settlement, etc. Korea is a little bit behind this global trend but now is keeping pace in seeking for opportunities to push Fintech innovation forward.

Fintech, referring to the convergence of finance and technology, emerged as a buzzword for 2015. The financial sector is busy keeping up with this latest trend. Many financial firms are eager to see if Fintech could expand the demand for and supply of financial products and services. Financial authorities are also backing up this Fintech trend to trigger financial innovation and create a new growth driver for Korea's financial sector.

What's Fintech?

Harvard Business School Professor Clayton Christensen distinguished innovation into two categories: "sustaining innovation" to seek for gradual improvements on existing businesses, and "disruptive innovation" to transform the existing paradigm into a new one.[1] From this

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1) See "Sustaining Innovation and Destructive Innovation" (2007) in FSB Review (renamed to Shinhan Review) published by Shinhan Bank in April 2007, and "Landscaping UK Fintech"(2014) published by Ernst&Young.

perspective of innovation, Fintech also falls into two types: "sustaining Fintech" where existing financial firms use IT to sustain their business, and "disruptive Fintech" where new players adopt IT to challenge the arena of traditional financial firms. In the same vein, Mr Je-yoon Shin, Chairman of the Financial Services Commission, in his new year's address mentioned, "In the past, IT was just a tool for the financial sector. Now, however, IT is starting to take over the financial sector's share." The latter is close to the concept of Fintech currently discussed worldwide. Thanks to fast development in mobile technology, a startup can be easily established than at any time in history, which adds more value to the economy by running a business based on disruptive Fintech.

Two main reasons explain the advent of Fintech firms. First, Fintech can fill a niche demand for financial services not satisfied by traditional financial firms. For example, Jack Dorsey, Twitter co-founder, developed and launched Square, a payment card reader that is plugged into smartphones and tablets in 2009. This is a niche function that allows street vendors to service clients who want to use payment cards such as debit or credit cards. In 2014 alone, over KRW 30 trillion was paid through Square, pushing up the company's value to about KRW 5 trillion.

Second, Fintech can introduce new venues for product sales based on new technologies. For example, MarketInvoice in the UK launched an online trading platform in 2011 where SMEs can sell outstanding invoices to finance their working capital.[2] Currently, MarketInvoice trades around €10 million worth of invoices on average per month, and provides SMEs loans with the €50 billion worth of fund granted by the UK government.

Global trends and features

Fintech innovation is widely used in the financial sector, including the financial investment industry. A simple example is the online asset management company.[3] The US provides wide-ranging investment management services where algorithms and software diagnose investor appetite, accordingly allocate assets, automatically rebalance portfolios, report investment performance, and even provide investment advising. A company that provides services without human intervention is often referred to as an algorithmic asset management company or robo

2) Tesorio is the US counterpart for similar services.

3) See "Online Wealth Management Industry: Global Trends and Implications" (2014) released by the Korea Financial Investment Association.

advisor. Any entity that wants to run such a business must register with the Securities Exchange Commission (SEC) as an investment advisor.

Wealthfront and Betterment established in 2008 are two leading robo advisors in the US. As of January 5, 2015, Wealthfront based in California manages over $1 billion of client assets, and Betterment based in New York manages almost $840 million. The two robo advisors are rapidly absorbing the demand of retail investors for investment activities in the US by using a strategy of lowering entrance barriers: Wealthfront sets $5,000 for the minimum investment requirement while Betterment does not require any minimum investment.

Existing investment firms also started to provide similar services. In the US, Merrill Lynch launched Merrill Edge, an online investment management service for targeting self-oriented clients, in June 2010. It provides wide-ranging financial products, managed portfolios tailored to individual needs, and 24-hour financial advice every day. Its product diversity is particularly noticeable, ranging from investment products such as equity, bonds, ETFs, options, and retirement plans all the way to bank products such as CDs and short-term deposits. Vanguard, the largest mutual fund company in the US, also started its online wealth management service through Vanguard Personal Advisor Services in 2013, on top of its existing business lines of fund distribution and brokerage.

Also notable is Motif Investing, an online broker that is converged from brokerage with Fintech. Since 2010, it offers thematic investing consisting of up to 30 equities or bonds. Investors are allowed to adjust the weight of individual stocks or bonds in their thematic investing portfolios, and to invest with opening either cash or margin accounts.[4] The minimum investment should be at least $250 for cash, and $2,000 for margin accounts. The major shareholders in Motif Investing are Balderton Capital, Foundation Capital, Goldman Sachs, Ignition Partners, JPMorgan, Norwest Venture Partners, and Wicklow Capital, which implies that existing financial firms and investors are keen on Fintech startups.

Another example of Fintech is crowdfunding platforms that intermediate financing for small to medium startups. Seedrs in the UK, established in November 2008 and began operations in July 2012, is one of the leading platforms for equity crowdfunding. Startups in need of capital can register on Seedrs to attract investments from €10 to €150,000. In the US, Fundersclub

4) Use of margin means borrowing money or securities from Motif Investing using securities or cash as collateral for the loan at terms defined by the firm.

helped 104 startups to raise $26 million as of January 2015.

SecondMarket is another case of Fintech in the US. It adopted Fintech to facilitate over-the-counter transactions between investors. Since its establishment in 2004, SecondMarket plays a significant role of arranging transactions of unlisted stocks, limited partnership interests, bonds, MBS, CDO, warrants, restricted stocks, etc. It is an alternative trading system registered with the SEC and a broker-dealer with the Financial Industry Regulatory Authority (FINRA).

Markit in the UK is a success story in financial data analytics using Fintech. It analyzes and processes financial big data which are generated from financial transactions and combined with social network information. Markit that started in 2003 to provide credit default swap pricing services and has expanded its business lines to providing independent database, processing transactions for derivatives and loans, and building technology platforms and managing them according to clients' need. It is now providing its products and services to banks, hedge funds, insurers, asset management companies, central banks, supervisory authorities, and accounting firms.

Online banking is also the case that securities companies apply Fintech to their business. Charles Schwab Bank and E*Trade Bank, both of which is one of the US's online banks, are subsidiaries of each different mother company which has grown fast since the late 1990s as an online broker. They want to provide their investors with a broader access to financial activities including payment services. It is notable that the wave to start online banks in the US was actually led by non-bank financial institutions such as brokers and insurers.[5)]

In general, Fintech has four common factors to make its business different and successful. First, they provide better access. Most of them offer smartphone-based platforms which make retail investors access anytime anywhere. They also lower the entry barrier such as the minimum investment requirement so that new clients who have never got involved in investing enter the market. Second, they utilize big data. For example, algorithmic asset managers such as Wealthfront proactively collect relevant investor information through social networks to better catch investor appetite, rather than rely solely on investor profiles provided by investors themselves. Motif Investing also analyzes big data when selecting their social, political, economic themes, e.g., cyber security, 3D printing, oil prices, interest rate changes, etc. Third, there is no

5) See "Global Online Banking Trends and Korea's Issues" (2014) published in KB Knowledge Vitamin (14-73) by KB Financial Group's Research Institute.

human intervention. Motif Investing minimizes the need of human intervention by automating many processes if possible and necessary. For example, it does not require investors to show up for opening an account. Instead, investors only have to provide personal information online (e.g., U.S. Permanent Residential address; date of birth; social security number or tax ID number; employer name & address; and for an IRA, each beneficiary's name, address and social security number). Fourth, information is provided to clients in a transparent and timely manner. It helps investors to check their portfolio performance in real time. Also fees are transparent and simple for clients to easily understand them and calculate their transaction costs.

Going forward with Fintech, Korea

What is the current state of Korea's financial investment industry? Compared to other industries in Korea's financial sector, the financial investment industry is a leader in the Fintech trend in that it has been a pioneer successfully combining IT with the businesses. For example, it opened the first online brokerage in January 2000.[6] Also, it has led the dramatic growth in online securities trading, which surged 47 times to about 85% in 2014 from only 1.8% in 1998.

Moreover, Korea launched FreeBoard in July 2005 to help unlisted SMEs and ventures access direct financing. Recently, FreeBoard was upgraded to the K-OTC, a marketplace for unlisted stocks. Earlier in July 2013, KONEX was launched as an SME-only marketplace. In 2013, a fund supermarket, Fund Online Korea, commenced its online sales platform for public-offered funds. In line with this, Korea's asset management companies started their own online wealth management services to help investors manage their financial investment assets more efficiently and inexpensively.

It is said that Fintech firms are not most likely to emerge under the Korean financial circumstances compared with other countries. Behind this are two primary reasons. First, online financial services are already comprehensively covered by traditional financial firms. Second, Korea's current regulatory barriers (e.g., the regulation mandating at least one face-to-face transaction) are believed to undermine easy access, one of the Fintech's core benefits.

However, Korea's financial investment industry, in contrast with other financial industries,

6) In Korea, E*Trade and Kiwoon Securities acquired the securities business license from the Financial Service Commission (formerly Financial Supervisory Commission) and began its business as an online-only brokerage. In the insurance industry, online-only car insurance services were launched; Daum Direct co-invested by LG Insurance and Daum Communications in December 2013, and Hyundai Hicar Direct 100% owned by Hyundai Marine & Fire Insurance in March 2006. But Korea still has no online-only bank so far.

is most likely to see Fintech startups emerge. The better Korea's overall financial environment improves in a direction that promotes Fintech innovation, the more Fintech startups will emerge and challenge the traditional financial investment industry.

What do we need to prepare for Fintech that can bring a structural shift in financial industries? The banking industry is already faced with this question. This is because banks worry about the widely-held view that Fintech will gain market share in the areas once regarded as traditional banks' roles, for example, wire transfers, payment and settlement, and credit loans.

It is time that Korea's financial investment industry capitalizes on Fintech as an opportunity to take a leap forward. As long as it pursues destructive innovation proactively for a paradigm shift and makes the best use of it, this may alter the challenges posed by Fintech into a new opportunity to extend revenue bases.