

The Changing Landscape of the Financial Services

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Abstract—The last global crisis, the worst economic and financial crisis since the 1930s that erupted in 2007-2008, was a groundbreaking time for the financial services sector. Banking continues to go through tremendous changes influenced by the aftermath of the economic crisis, the development of new regulations and the challenges and opportunities resulting from advances in technology. The financial crisis also had an impact on the behaviour of customers. Customers demand complex solutions through more understandable and secure products and services that match their individual needs. Their profitability is decreasing as they distribute their assets across multiple banks and even punish financial institutions through their lethargic passivity.

This article reviews the current challenges in financial services to financial institutions. The purposes of this article are twofold. The first purpose is to provide a theoretical discussion of the most influencing changes. And, secondly, to review the main practical impacts on banks and their customers. The article highlights a number of important areas that should be kept in mind to achieve effective and efficient organisation for facing these challenges.

Index Terms—Financial services, financial regulation, management, technical advances.

I. INTRODUCTION

Money, banking and financial services have been in the world and around us for centuries. Their content, form and functions have become increasingly diverse and complex. Nonetheless, they are rapidly changing. One of the biggest forces in this process is the development of the economy and society.

Banking is the management of risks, and financial crises are part of the financial world. In 2007-2008 the global crisis erupted, the worst economic and financial crisis since the 1930s. After the global financial crisis, banking is now facing many new challenges, namely: an increasing number of regulations and legislative acts that will have a strong influence on banks' everyday activities; competition from non-banks enabled by improvements in technology (notably electronics); evolving customer demands; and loss of customer confidence towards the financial sector.

This article focuses on the changing landscape of financial services. The old-fashioned customer-bank face-to-face communication is disappearing fast and being replaced with multichannel solutions based on technology. Simultaneously, a difficult economic environment and rising regulatory pressures have led to an increased focus on costs. All these changes comprise a significant challenge to the strategic management of financial services.

II. THE ROLES OF BANKS IN SOCIETY

A well-organized and efficient financial system is the central nervous system of every market economy. It is particularly important in reallocating capital for providing the basis for the continuous restructuring of the economy that is needed to support growth. The financial system has two main components: financial markets (money markets, bond markets and equity markets) in which claims are exchanged and financial intermediaries (such as banks) that are an indirect linkage between savers and borrowers. They act as principals in assuming liabilities and acquiring claims.

The general opinion is that the optimal financial system, in combination with a well-developed legal system, incorporates elements of both direct, market-based and indirect, bank-based finance to improve the efficiency of financing decisions, favouring a better allocation of resources and thereby economic growth.

Looking closer at financial intermediaries and particularly at the banking sector it can be said that banks play important and critical roles in every financial system and in every economy. However, understanding the roles that banks play in the financial system is one of the bases for this study. Different authors [1], [2] have identified the roles of banks primarily related to liquidity transformation, information production, delegated monitoring, and risk sharing.

Banks perform an important role in terms of liquidity transformation. They collect funds in the shape of deposits from surplus agents (depositors) and raise funds in the short-term capital markets and transform them into medium- and long-term credits. Usually, these credits can be characterized as large size with medium or high risk and with a low degree of liquidity. This transformation can occur because banks can attract small-size and low-risk deposits and have access to a large mass of depositors as well as the scale of the economy. So banks create liquidity that individual surplus agents cannot.

The second role of the banks is information production. In the resource allocation process the surplus agents can bear substantial costs to find potential partners on their own. Banks have the necessary know-how and expertise because of the experience earned over time in relationships with deficit agents. As banks collect and process information regarding deficit agents on behalf of depositors, their transaction costs for information gathering are lower than surplus agents would be if they tried to gather information on a pool borrowers. The intermediary's profits from lending compensate for investments in information.

Because the monitoring of the credit risk determined by the debtors' inability to pay or bad faith is costly and difficult to observe, it is more efficient to delegate this monitoring activity to specialized entities such as banks. Delegated monitoring allows various informational problems to be solved. A bank is an entity that matches, analyses and verifies

borrowers. Banks carry out monitoring and control functions to ensure that firms use the financial funds allocated to them effectively. They have the necessary expertise because of the large-scale economy in the processing of information regarding debtor risk, and it can be beneficial for them.

Additionally, one of the most important functions of banks is to provide some form of insurance against several sources of risk by diversifying and smoothing fluctuations over time. Banks must select and control the risk inherent to the management activity of deposits, credit portfolio and balance-sheet operations and have invested in different risk management systems to analyse, limit and cover the risks they are exposed to. It has even been argued that the bank's main role has shifted from providing information and transformation liquidity to the management and control of risks or from credit intermediation to risk intermediation. For example, banks have the possibility to minimize individual credit risk by diversifying the investment portfolio, covering risks and evaluating and monitoring debtors. The diversification of credits and monitoring activity helps to deal with information asymmetry in the relationship with debtors and to eliminate the effects of moral hazard [3].

III. CURRENT CHALLENGES IN FINANCIAL REGULATIONS

In 2007-2008 the global crisis erupted. The modern crisis created considerable "brand damage" for the financial sector and raised different questions about the trustworthiness of banks and the whole financial sector.

The supervisory authorities are convinced about increasing the readiness of banks for possible unexpected events in the future. On the one hand, it means increased requirements for capital and reserves. On the other hand, there will be limits in offering cost-effective, but perhaps riskier, services.

It can be said that a comprehensive regulatory reform will affect every aspect of banks' business model, operations and infrastructure. Despite low revenues from daily economic activities, banks are facing high costs related to the implementation of various legislative acts. But it is not only financial costs. As banks do not have unlimited resources, they need to be able to plan time, resources and capital. Additionally, regulations are not free: some of the rules imposed on banks are seen as burdensome; however, they impose real costs in the form of prices on money, inefficiencies, reduced competition and innovation [4].

In order to understand the extent of the changes, some examples of the implementation activities are given. In particular, it is necessary to set up an effective governance model to ensure compliance with the regulations, align and harmonize financial and risk management, establish more stringent operational risk management principles and examine the existing crisis management plans. Additional attention is needed for upgrading the customer data collection and Know Your Customer and anti-money laundering processes. These measures also require extended reporting structures and the renewal of strategic plans and operations.

All these regulations not only create a tightening effect but become quite complicated and require management's close attention, not to mention lots of time, resources and capital. This is the "new normal" for the banking industry as size, growth and future business models of financial institutions

are to be dominated by regulatory and supervisory changes.

The ultimate objectives of the banking regulation should be to provide a safe-and-sound banking industry that will protect depositors, to reduce the likelihood of bank failures and to lower the very large macroeconomic and social costs of those failures that occur [5]. Regulations must cover the whole range of banking risks, but should also retain its flexibility and innovative character and should not penalize the supply of useful banking services.

Regulations should be simple and understandable without too many detailed and overlapping regulatory prescriptions. Every new or changed regulation needs a true cost-benefit analysis because, as we see, the implementation of regulatory changes is costly: new competent people, technology and processes. All these costs can be transformed to customers in the form of higher prices or reduced availability of banking products and services.

Consequently, regulations should be based on clear economic and policy principles addressed to real-world vulnerabilities. Accordingly, the implementation of broad-ranging regulatory reform should be balanced and limited so that:

- Financial development and financial stability will be used in order to ensure economic growth. The aim of risk management of the financial system is to ensure strong, stable and sustainable growth, by reducing the probability and severity of bad events. A sound banking system is one of the key ingredients for sustainable growth, but regulations are not just about preventing crises. It is also about cultivating financial systems that provide growth-promoting services. Regulations that impede sound financial innovation could slow technological innovations and sustained improvements in living standards. Other important aspect of the development of the financial sector is the flexibility of regulations, i.e. how quickly the legal system is able to adapt to changing conditions in order to meet the needs of financial sector. But sometimes vital to focus more on the possible sources of the next crisis rather than correcting all mistakes of the last crisis. The banking sector must be efficient with providing critical services at low costs and to be resilient to real economic shocks.
- A more timely and intensive supervision by testing and monitoring of risk analysis and management systems of banks leads to earlier intervention and clearly-defined resolution arrangements. The authorities should have knowledge, experiences and power to take action to forestall threats to financial stability.
- Competition in financial services stays strong compared to different business limitations to ensure high-quality services with reasonable prices and adequate scope. Financial regulations attempt to improve stability but may also shape the quality of financial services available to an economy and influence competitive outcomes. New stringent regulations tend to favour the non-banking financial institutions or the less-regulated financial service providers entering the market and win customers with more innovative business models and financial solutions.

Different authors [6] have argued, whether such strict and overwhelming regulations in banking sector is necessary

solely because they provide loans to businesses and individuals. Maybe banks are simple businesses with only a few special features, that should be regulated. In the European Union similar small loans are provided by many other non-bank organisations, for example businesses generally (such as telecommunication companies, which finance purchases of goods), peer-to-peer (P2P) loan companies (such as Bondora (by IsePankur)) or SMS-loan providers. None of these companies are regulated as strictly as banks. However, the regulation is based on the fact that banks finance their loans with deposits.

- Financial firms can deal with financial innovation to ensure new services to meet public demands. Financial innovation is necessary for fostering technological innovations and sustaining economic growth, but regulations often lag behind technological innovation. It can even be said that the financial institutions are constantly innovating around existing rules. They take advantages of gaps, ambiguities or inefficiencies of the regulatory framework and will try to find new innovations that will help to go around the new rules. The solution is not to prohibit the innovation, but to find principle-based rules, that help to prevent utilizing new financial innovations to achieve an undesired outcome. Appropriately employed innovations can improve the allocation of resources and boost economic prosperity.
- The right balance between the private (and public) costs and the public (and private) benefits is found. On the one hand reforming the regulations should provide large benefits to society. On the other hand the need is for better, not more regulation as every new regulation or regulatory change can raise on financial services institutions. These can be in form of new costs in the form of direct expenditures on compliance, development of internal technical and reporting system, increased reporting or inefficient procedures that can influence the profit earnings (for example banks cannot choose the least cost options to distribute financial services) etc. All this can have undesirable side-effects – rise in the prices of financial services which are paid ultimately by customers.

For example Santos and Elliott [7] have shown in their study that reforming the regulation of financial institutions should provide large benefits to society, but financial reforms will likely result in modest increase in banking lending rates. On some occasions these regulations implementations costs can be absorbed by lowering returns to shareholders, reducing expenses or restructuring the business, but usually it will lead to increase to financial institutions operating costs, than in turn affects directly bank customers, employees and investors.

The banking sector must be efficient with providing critical services at low costs and to be resilient to real economic shocks. Costs of a less efficient financial system have to be less than the expected costs of financial instability. So every new or modified policy requires a true cost-benefit analysis. If the costs are too high the regulations should be reassessed to improve the cost-benefit ratio, because usually additional costs and inefficiencies will be passed on to the final consumers.

A new survival model is about creating the right culture, appropriate governance, and oversight of all regulations/limitations and taking steps to ensure compliance and improvements. Implementation of separate individual regulations in the short term it is not enough. Rather these actions should be aligned with the bank's strategic and tactical plans. The regulatory environment has become the primary driver in determining banks' long-term strategy. Some individual steps according to the implementation of regulatory changes may be inefficient and wasted investments over the medium and long term. The world's high-performing banks are looking at possibilities, not just to be compliant with new regulations, but to use these investments to make changes in existing products, services, processes and business models to achieve a new level in a new environment.

IV. TECHNOLOGY ADVANCES IN THE FINANCIAL SERVICES SECTOR

Innovations in technology have always influenced and changed the functionality of society and its various components. Banking by nature is a very technology intensive sector and so in the financial services sector technological progress has resulted in improved quality and variety of banking services. Information, communication and technological innovations do not just provide the creation of high-level finance (for example) derivatives and the emergence of new financial markets and trading systems (for example derivatives), but allow cheaper and better financial services for households and companies without a close presence (on-line).

However, the banks have eagerly taken advantage and have been excellent users of new technology innovations, and new information technology is becoming a continuously important factor in the future development of the financial services industry, influencing banks' marketing and business strategies. For example, the unprecedented development of electronic devices has strongly affected the development of online-banking. It can even be said that technological advantages will cause radical changes in traditional banking through, on the one hand, the creation of successful customer-facing products and services. On the other hand, technology has introduced new entrants (telecommunications companies, supermarkets, e-brokers, etc.) in the financial services sector, who are ready to rapidly create, adjust to user preferences and deliver innovative solutions.

However, banks have always invested in expanding and improving IT systems: the technological innovation in the banking sector reflect the internal structure of banks as being determined by a combination of changes in banks' external environments and advances in information technology [8]. For example, the consistent process of meeting regulatory risk and compliance requirements continue to dictate the main IT initiatives. As a result, banks have limited budgets and resources to focus on developing new capabilities for operational excellence and innovation and a more seamless and digital customer experience. Nevertheless, the needs and preferences of customers are changing. Traditionally, retail banks have used branches, ATMs, call centres, and the Internet bank to interact with customers. But changes in

customer behaviour leveraged by growing technological innovations, has led to an increased popularity and adoption of new, recently emerged direct channels such as mobile banking, tablet banking and social media.

So it can be said that one of the most overwhelming trends in banking technology is the development of electronic channels. On the one hand, people are looking for online possibilities to be connected with their bank and perceive banks as leaders in technology implementation and therefore, the banks enjoy a better brand image. On the other hand, quantitative evidence [9]-[10] suggests that high digital usage correlates closely with customers' profitability and loyalty. Customers who use more channels become more loyal, buy more products and are more satisfied. For example, mobile bank users give a higher Net Promoter Score (NPS) than people who do not use mobile devices. Not only they recommend the bank to other people, but they also stay longer with their bank and buy more products.

Innovations around better and faster delivery of the right products to a customer will help banks provide a differentiated customer experience and therefore to lower customer retention costs in a situation where markets are highly saturated, volatile and uncertain and product and price no longer provide a clear competitive edge. Leading customers from higher-cost traditional bank branches to lower-cost online channels can help to reduce overall cost-to-serve while improving return on investments.

Financial regulations and technological development have and will influence the development of the banking industry, but not only that. On the one hand, simultaneously with regulatory requirements and selective technology innovation, customers' rising expectations and the improvement of customer experience cannot be forgotten. On the other hand, historical experience [11] has shown that new technologies cannot be implemented without an acceptance of social institutions and structures. It must be closely interconnected with the fundamental social and cultural changes influencing the customer awareness and behaviour.

V. CHANGES IN CUSTOMER BEHAVIOR

The third and equally relevant banking market driving force is changes in customer behaviour. Shifts in demographics, attitudes and behaviour, in addition to ubiquitous information, are giving customers the power to require much more [12]. Continuously, customers are demanding that banks consistently deliver on the basics, presenting a full set of services at reasonable and fair prices. But it can be said that banking customers are becoming more experienced and savvy at using technology-based banking services. If at the beginning of the e-channels era it was something "strange and dangerous", then nowadays it is mandatory for financial institutions to provide the right service at the right time and place to the customer.

One of the influencing socio-cultural factors is the emergence of the next generation of consumers. Younger consumers (so called GenY and Millennials) do not depict their world without the aid of the Internet or their social and working life without smart devices, and therefore they are increasingly less engaged with the physical distribution of financial services. So they expect services providers not only

to provide the service but like to be "self-directed" and highly adapted to the online world.

But it must also be noted that today customers of all ages are active customers of the Internet and electronic devices designed to bring instant gratification to any task. Almost every activity (communication, music-listening, travelling) can now be accomplished within seconds at any time, from any location. The same expectations accorded to fast service delivery are also extended towards providers of financial services. Financial services should be simple, convenient and engaging, by creating a seamless ("anything, anywhere and around-the-clock") integration of all channels for an omnichannel experience across in-branch, assisted and digital interactions, differentiated customer experience and digital interactions as "wow" experiences that exceed their expectations. Customer-centricity should be the mantra because some of the alternative providers can already offer good online services, low fees and personalized service.

VI. "NEW NORMAL"

As already mentioned, the banking sector is changing rapidly. Market forces, due to regulatory and customer behaviour changes supported by technological advances, have led to large changes in financial systems and will affect almost every aspect of financial institutions' activities. The effects range across the organisational structure and culture, risk governance, product development, investment strategies and even customer service and marketing. Subsequently, some examples of top impacts are given.

A. Business Model

The changing environment will force radical changes in banks' business strategies, organisational structures, business models and core operations.

Firstly, supervisors are looking for radical changes in banking behaviour. So the new regulations increase demand towards organisational culture to make sure that financial institutions treat customers fairly and minimise risk of moral hazard and conflicts of interest. All these regulatory demands are so extensive that changes in the "conduct of business" are not enough. It should be a significant change in organisational culture to achieve the awareness and personal commitment of every employee. It is a dramatic shift in culture that needs additional time and resources for strengthening the role of risk management and compliance functions and changing the existing values, thoughts, and behaviour of all stakeholders – employees, senior executives, customers, partners and shareholders.

Secondly, traditional operating models should be replaced by new strategies to rethink the usual levers around enabling new or increased revenue streams and cost reduction but also a wider economic and social role. It will need the establishment of more customer-focused business and operating models, both internally and externally, that is driving business from customer demands and will realise greater value from deeper relationships. It will impact virtually all parts of organisations – with profound implications across strategy, leadership, organisational culture, the commercial value proposition or employees' skills from front-end commercial activities to back-end

technology and operations must be focused on continuous innovation and incremental development. People in frontline positions should develop more general and interpersonal skills to create and retain long-term customer relationships, give high-quality product advice, generate sales and earn revenues. On the back end the activities should be rationalized and streamlined to deliver value and achieve business results. Development positions will demand fewer administrative skills and stronger ability for innovation – incentives to offer and test new ideas, readiness to experiment and failure. It will require laser focus and the commitment to rebuilding internal and external business models around consumer priorities. Customers should benefit from a customer-centric attitude, understandable products and user-friendly distribution channels.

B. Technological Platform

The changing environment will force radical changes in banks' business strategies, organisational structures, business models and core operations. The main goal of any company is to maximize profits for its owners, and banks are no exception. Electronic channels provide the perfect opportunity for minimizing costs for banks and their customers. It helps customers to use less cash, and if the amount of cash in circulation decreases, the efficiency of the banking sector will increase as the costs, both the customer's and the bank's, will decrease through diminishing costs (for example cash storage, cash fees or processing costs). The main benefit from the bank customers' point of view is comfort, time savings and quick and continuous access to information as transactions can be made around the clock, without requiring physical interaction with the bank.

So electronic channels management is being transformed from simply an operational function to a tactical tool as part of the larger business and customer management strategy. In order to support the achievement of the bank's key performance indicators through the development of electronic channels, there should be an advised activity plan for how to achieve channel excellence across key customer touch points and to discover what the possibilities are to move customers from high-cost contact centres and branch operations to the lower-cost channel to optimize satisfaction and profits.

The other important trend is digital banking – an essential competitive edge in today's banking landscape. It can be even said that it is a critical factor to the more agile and innovative operating model. The aim of digital banking is twofold. Firstly, experiences have shown that the customer will adopt digital banking propositions breathtakingly quickly and the bank will enjoy a better brand image. Secondly, digital banking can be a cost-saving opportunity for financial institutions and create new sources of value and revenue. A full digital transformation can realize 40 to 90 percent of the bank cost base by automation of internal servicing and fulfilment processes [13]. But it does not mean mimicking digitally current operations and capabilities. It can be achieved by transforming existing IT platforms or rigid legacy technology in the back office.

Accordingly, the current economic challenges are forcing banks to take a longer view of technology investments to ensure strategic value of investments. Banks' legacy systems are complex, and the upgrade is a challenging and expensive

task. These investments shouldn't just fulfil today's functional needs but should also support the achievement of the organization's broader strategic goals around cost reduction and right-channelling. Transformation from traditional banking to omnichannel and digital banking means for many banks overcoming some key challenges and a multiyear roadmap of changes to systems and infrastructure. Banks face challenges around their existing legacy applications, systems and processes. All this requires a combination of IT systems and human skills and proficiency that is substantially different from systems designed for so-called traditional banking. As it is expensive and hard to deliver, a few banks have chosen to replace their core systems at once. Others are mitigating risks, staging the transition and exploring opportunities to achieve their IT goals at a lower cost level. Funding these changes in the terms of decreasing revenues is a major challenge to management of financial institutions.

C. Communication

Digital usage through electronic channels (internet bank, mobile and tablet banking) will increase over the next few years, but branches will not disappear. Although it could be argued that gone are the days when branches represented a slow and inflexible one-size-fits-all solution for all demographics and services, branches will remain a major channel for customer acquisition and the customers' preferred channel for face-to-face advice about complex products. Branches will be the cornerstone of a social interchange, a place to build valuable customer relationships and a unique opportunity to reach success in cross-selling; the key challenge is to justify the high operating costs by better and more cost-effective client service. Banks will increasingly focus on matching the level of service provided with the profitability of the individual customer. Only the most profitable customers will have their own relationship manager.

Although the branch remains the bedrock for many customer relationships and a major barrier to entry for many potential new competitors, the role of the branch and the associated branch processes need a rethink and change in areas such as format and design, roles, sales and services. Some leading banks have begun to combine digital and physical assets. It can be a radically new approach to distribution – a combination of simpler branch offering with the continuous innovation of seamless digital services. Branch formats will vary according to a range of services provided, the complexity of advice provided and customer intimacy achieved. For example, branches will be the salesrooms for complex products and venues for providing expert advice, which will be supported by modern design and different technology zones – a self-service banking zone (ATM, Internet Bank), a product zone for different demonstrations on devices, remote personal advisors' zone for providing face-to-face advice via video-conferencing, etc. Secondly, branches can also be physical extensions of online or mobile banking and part of a digital bank by employing advanced digital tools and technologies, such as video-conferencing, online document sharing, digital signatures and card readers.

New possibilities for enhanced communication with their clients can be created through social media. On the one hand,

the data provided by social media can help better understand customers' motivations, behaviour, sentiments and needs. For example, banks can start blogs or forums to discuss new products and services with their clients, or participate in social networks to increase transparency and foster customer loyalty. LinkedIn provides information about job changes and Facebook distributes information on new homes and new babies, which can influence cross-sale opportunities, credit decisions, relationship pricing or loan-collection.

On the other hand, customers already expect their banks to replace one-way communication methods and open the dialogue by offering high-level personal interaction and financial advice through social media and allow them to provide feedback about bank services and products. Using social media as one of the communication channels can create active experiences, which create emotions, which in turn encourage the buying of products. So it should be integrated into the marketing strategy – social networks can enhance the recognition and perception of the brand and further build the bank's credibility and reputation.

VII. CONCLUSION

As mentioned in previous sections there are some significant strategic challenges for the banking sector. Financial institutions have to adapt to a very different and rapidly changing economic, regulatory and business environment. The key drivers of the financial services sector are meeting the rising expectation of customers, heightened and costly regulatory changes and burdens, searches for operational efficiency through technology innovation and competition from low-cost digital-only entrants who are responding to customers' needs and banking behaviours. So financial institutions urgently need new and a lower-cost business model that can generate sustainable and predictable revenues.

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