



November 8, 2016

Bank of Japan

Creation of value added through open innovation

Remarks at the 2nd FinTech Forum

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(English translation based on the Japanese original)

Introduction

It is a great pleasure to welcome you all today to the second meeting of the FinTech Forum. Today, I would like to share the Bank of Japan's view on open innovation in the financial industry.

I. Importance of innovation

Dr. Schumpeter, one of the most influential economists of the early 20th century, regarded long-term equilibrium as a state of stagnancy devoid of innovation. He insisted that innovation disturbs equilibrium and is the main driver of economic development. He believed, in other words, that an economy can only be sustainable with ongoing innovation.

Turning to the current situation with the development of technology and deepening globalization, the competitive environment surrounding companies has become increasingly severe. Companies, meanwhile, are compelled to provide more exact added value as the perceptions of value and types of beneficiaries grow ever more diverse and fragmented. And given our growing dependence on the Internet in daily life with today's explosive growth in the use of smartphones, these trends are expected to accelerate.

To ensure the sustainable growth of the Japanese economy, industries must urgently address the demands of today's competitive environment with the greatest possible speed and flexibility. The essence of the "fourth industrial revolution," a pillar of Japan's growth strategy, is to drive innovation driven by technologies such as IoT (internet of things) and AI (Artificial Intelligence).

The financial industry is no exception here. Improved customer service incorporating new information technology is imperative. Financial institutions need to respond to change with freshly innovated business models, to decisively take on new frontiers, and to enhance value added.

II. Significance of open innovation

Speed and effectiveness are crucial in promoting innovation. We cannot achieve

sustainable growth without responding to today's diversifying sense of values quickly and accurately. Yet as we remember from the way things were done before, a company that relies on innovation solely with its own resources or based on the "principle of self-sufficiency" will run into limits.

Here we can see the significance of "open innovation." A company can provide new value-added and further increase customer satisfaction by leveraging the resources and knowledge of other companies. And in the areas where the company has its own strengths, it can provide much higher value-added by selecting and leveraging suitable know-how from outside.

The importance of open innovation can be found from the case of modern industrial development. The Paris Convention, signed in 1883, was an international treaty concluded to protect industrial property rights such as patents and utility models. Beyond its original purpose of ensuring that the innovator holds exclusive rights to developer profits, the patent system dispels the fear of imitation, which allows the innovator to share tips on new innovation by publishing industrial technology and know-how. The Paris Convention has been credited for sparking the explosive development of science and technology globally. In short, open access to information is very effective in promoting innovation.

Likening these trends of the past to the present situation, we can cite an example of that, in the predawn of personal computers in the early 1980s, rapid development of software and peripheral devices was promoted by disclosing technical details of operating systems. Another example is that development of mobile phones and smart phones has been accelerated by universal platform with open sourcing in 2000s. These are good examples which show the evidence of that innovations have been promoted with the rise of information-sharing.

III. Open innovation in the financial industry

FinTech has recently attracted a great attention in the financial industry. Both traditional financial institutions and FinTech companies continue to launch new services by introducing ideas more flexible and more diverse than we have ever seen. This trend has the potential to significantly change the business models of the financial industry. It is therefore necessary, even in this transition stage, to respond quickly and appropriately to today's diversifying sense of value and diversifying needs. Promoting open

innovation is more important than ever.

On the other hand, we must be aware of the various risks and issues to closely watch when we promote open innovation in the financial industry.

First, we need to pay close attention to information security. Financial institutions form the basis of the economy's system for smooth financial transactions and settlements. We should also thoroughly note that as financial networks open, the potential target points for cyber-attacks tend to increase. In addition to securing the consent of their customers, service providers must also control the increased cyber risk inherent to more opened networks. This is important not only for the development of the financial sector through open innovation, but also the protection of customers and their interests.

Second, the enhancements in customer convenience from the value-added of services should provide sure benefits not just for the customer, but for all parties – the customer, the financial institution, and FinTech companies alike. The relationship is “win-win-win,” a win for all three parties. FinTech companies are sometimes seen as "Disruptors". To the contrary, they should be seen as "Stimulators" who enhance the value-added of the financial industry. This switch in perspective is key for positive outcomes. The financial industry should promote a Japanese style of open innovation by designing a mechanism that will enhance customer satisfaction through cooperation between financial institutions and FinTech companies in parallel with appropriate competition.

Third, when financial institutions and FinTech companies cooperate together, we should note the big differences between them in corporate cultures. Common sense for one could be preposterous to the other. Yet the goal, the development of the financial sector, is something they can share. To achieve the goal, they must deepen mutual understanding and overcome the differences.

IV. Conclusion

Traditionally, Japanese companies tend to adhere to a "principle of self-sufficiency" not only on the technology side, but also in the human resources that support the technology. We need to fully recognize the turning point where we now stand. Coupled with today's rapid advances in hardware processing speeds and baud rates, a number of innovative technologies and internet-based services will change the structure of the industry

significantly. Now is the time to change our way of thinking and see our position as a good opportunity to promote open innovation.

I would like to close my remarks by expressing my hope that today's FinTech Forum will be a fruitful opportunity to gain new knowledge and perspective for all of us.

Thank you for your attention.