The Future of Korea's Banking Industry and Its Implications

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As global economic conditions change rapidly, business conditions in the banking sector have been deteriorating. Korean banks as well are facing greater uncertainty about whether the relatively strong performances recorded until now can be continued as they struggle to improve profitability.

First, the digital transformation taking place in the global economy and the expansion of electronic commerce have caused big-tech and fintech companies, which have grown on the back of these industries, to emerge as new competitors to the incumbent banks. Moreover, demographic changes such as the acceleration of population aging and the rise of the millennial generation are creating a wide range of financial demands to which the banking sector must respond. The persistent low-interest and low-growth environment has led to a narrower net interest margin and a decline in loan demand, creating concerns over deteriorating profitability for banks. Meanwhile, fintech businesses are subject to increasingly laxer regulations thanks to regulatory reform. Against this background, banking industries around the world are expected to undergo structural changes and, as a result, are likely to take one of the following three forms, depending on the level of information technology development, the market share of incumbent banks and the level of regulations: i) an industry centering on incumbent banks; ii) a co-existence of incumbent banks and fintech companies, competing against big-tech companies (internet-only banks, etc.); or iii) a new financial ecosystem centering on big-tech companies.

This paper looks into the conditions surrounding domestic banks as they respond to the changing economic environment at home and abroad. While major global banks are making strenuous efforts and large investments toward digitization, the domestic banking industry has seen little progress in this area due to cost, human-resource, and governance constraints. Korean banks are seen as lacking sufficient incentives to innovate so as to satisfy various financial demands, because their assets consist largely of guaranteed loans due to the oligopolistic structure of the Korean banking system. In addition, domestic banks are facing difficulties in enhancing profitability in the low-interest, low-growth environment, as their profit model is centered around interest income.

In order for domestic banks to enhance competitiveness and thereby increase profits and ensure stability under these circumstances, multifaceted efforts are needed in addition to industrial restructuring. Considering the stability of the financial system, the level of entry regulations to the banking industry, and the minimization of necessary costs to enhance competitiveness, it seems desirable that the domestic banking industry take the form of co-existence and cooperation between incumbent banks and fintech companies, while competing against internet-only banks. In response to the expansion of the digital economy, digital platforms for various financial transactions should be built, while working towards offering customized financial products designed to meet the needs of individuals based on big data. In order to respond to demographic changes, financial products designed specifically for the elderly and millenials should be developed, while creating an environment that enables convenient use of digital devices. Also, for the banking sector to step out of the relatively small domestic market and go global, banks need to have localized business models tailored to each market by, for example, focusing on mobile platforms or mobile application services. In order for these efforts to materialize, digital transformation must be undertaken in a swift and efficient manner, making greater use of existing digital infrastructure and recruiting and nurturing specialized staff. In addition, banks need to closely cooperate and enter into partnerships with fintech companies while ensuring a stable governance structure so that these efforts can be consistently carried forward.

In order for domestic banks to effectively respond to the changing economic environment at home and abroad, appropriate regulations and policies must be put in place. The vitality of the banking industry can be maintained by promoting competition through easing regulations regarding entry and business operations. At the same time, financial stability must be ensured by devoting efforts to identify and respond to potential risks such as deteriorating business soundness, worsening procyclicality and escalating credit risks. Lastly, worker re-education and training systems need to be established so that staff restructuring, which is inevitable in the process of digitization, does not result in the loss of high-quality workers.

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