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Law, Business and Recapturing Innovations

Arvind Ashta*

CEREN EA 7477, Burgundy School of Business, Université Bourgogne Franche-Comté, Dijon, France

Abstract

For some time now, I have been studying law and business development. I have noted that, by and large, the relationship between regulation and business development has been conservative. First, businesses do not like rapid changes in laws till they can study the effect that the new law would have on their business. Second, an absence of legislation permits experimentation but can be risky. Third, a lack of appropriate legislation can also act as brakes to the diffusion of innovation since entrepreneurs are wary of regulatory voids. Fourth, if an innovation creates adverse social changes and stress. Defensive regulation may create or destroy industries. For the businessman caught unaware, this is like a black swan or a high-impact low-probability event. Fifth, rather than wait for the legislator to take such drastic action, it is in the interest of business to create an image of fairness and transparency. Therefore, by and large, the firms and policy-makers are conservative.

Keywords

Law • Business development • Transparency

About the Study

At the same time, policy-makers would like innovations and experimentations that are good for a nation's competitive advantage [1]. Since the risk of experimenting is high, innovations often occur in start-ups rather than in large firms because the founders of start-ups have high-powered incentives to reap benefits when acquired and are therefore willing to take high risks [2-4]. The question then comes on how big businesses can recapture these innovations. This discussion on recapturing innovations is based on recent research on neobanking [5]. This research involves a case study of a French neobank, Nickel, that is offering financial inclusion through a payments product.

The theoretical basis of recapturing innovation is situated within the field of radical innovations rather than incremental innovations [6]. Within radical innovations, some authors examine innovations by the incumbents, the established players. These are called sustaining innovations, and they serve to create barriers to entry. The other radical innovations are those done by possible new entrants and are called disruptive innovations [7-9]. The success of an innovation is based on factors such as perceived usefulness, and perceived ease of use, perceived risk or security, social norms, and education [10]. However, both incumbents and challengers can benefit from such factors and they do not explain why innovations are done by incumbents or challengers. However, regulation may create a difference on who innovates: for example, for mobile banking innovation, the two competing models were bank-led or telecom-led modes, and the model adopted in a country depended on the regulations adopted [11]. Very often, disruptive innovations start with niche markets [12]. It is not in incumbent's interest to spend a lot of time trying to protect niche markets, so they permit minor disruptions [13]. However, if small disruptors attack too many niche markets, the incumbents begin to worry [14,15]. Therefore, they need to recapture many of these innovations, as illustrated in Figure 1.

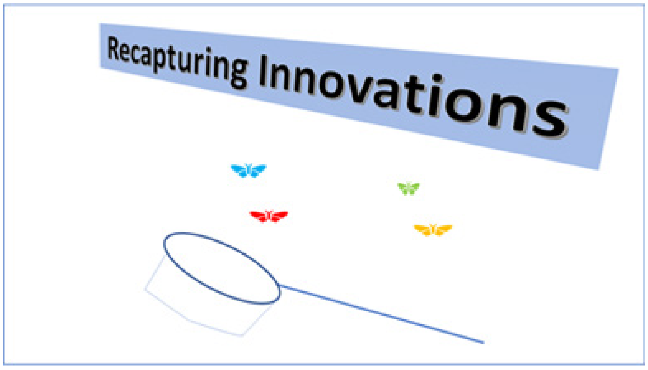

Figure 1. Incumbents need to recapture small disruptive innovations that are flying away with their customers.

Since there is very little research done on how this recapturing happens, we take the case of Nickel. Nickel is a neobank that was bought-out by a prominent French bank called BNP. On learning about Nickel's success, I interviewed the CEO, Mr. Thomas Courtois, and last year [16]. I then triangulated the information by reading books, the annual reports banks are worried that the fintechs are taking away too much of their business [17-20]. These fintechs include crowdfunding, mobile banking, credit scoring, wealthtech and many others. One particular kind of fintech, neobanks, offer prepaid cards or apps and target young people, dissatisfied customers, people who travel, or cost-conscious customers. The reason why neobanks can enter the market is that banks cannot implement innovations quickly because the banking regulator has to approve every change. In contrast, neobanks can offer something new and take the approval later.

Innovations respond to problems. One social issue that confronts France is that banks are reducing branches and people are feeling excluded. A second problem is that many people are over-indebted, and if they cannot pay and if their cheque bounces, the banks withdraw the checkbook and sometimes close the account. The root of the problem is that some people cannot monitor their bank accounts because they don't know how much money they have. When they do pay, they get debited interest on the overdraft if there is not enough balance [21].

To resolve this problem, an innovative idea came from a person who was not a banker. He came from a middle-income background. He used to watch his parents manage their budget, trying not to get into overdraft [22]. As a result, he decided to create an instrument that allows them to transact without possibly get into overdraft. He used a radically new form of distribution to market his invention [23]. Instead of going to the banks, people would go to a tobacco shop. The tobacconist would help them get the kit on the app onto their phone. In five minutes at the shop, you register, and the tobacconist gets you immediately activated. After that, you can pay and withdraw cash anywhere. You can manage everything online, but you

***Address for Correspondence:** Arvind Ashta, Department of Finance and Control, Bourgogne Franche-Comté University, Dijon, France, E-mail: arvind.ashta@bsb-education.com*

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do not have an overdraft facility. You see your debit immediately: You pay, and in one second, you see the debit and how much balance is left. This instantaneous debiting is very different from banks that will debit you after a few days. It is unique and valuable because you do not need to mentally calculate how many payments you have made that are not yet debited and your position: how close to zero [24].

What can this case study illustrate in the theory of relationship between regulation and business: Usually, conservative actors, aided by regulation, block innovation. Indeed, in the early stages, Nickel could not get off the ground because the financial authorities wanted a bank to house the money collected from depositors [25]. No bank was willing to collaborate. Finally, they found a cooperative bank subsidiary in a faraway department that encouraged innovation and agreed to keep their money. That took a long time. Therefore, one theoretical advance is that new entrants need a partnership with a small niche conservative player and build on that [24].

Discussion

The success of Nickel led to its being acquired by a major French bank, BNP. The original funders and the entrepreneurs made huge profits, as expected. Moreover, the entrepreneurs no longer have to frantically look for financiers to add money at the last minute [26]. Instead, their energies can be used to develop the product and experiment on a larger base of clients: the bank's customers. They also get a bigger budget from the bank rather than operating on a shoe-string budget. For BNP, the acquirer, it was a bit of catching up on banking 2.0. It was low-risk since Nickel had already broken even and shown its proof of concept. There were other synergies. Nickel gives them a new product with a different business model. They recaptured their clients in the rural areas, as well as their data which is very valuable. The banks can also use the nickel model to simplify their identity check systems [27]. BNP immediately got the whole organizational learning experience that interests them most. Second, their managers will be exposed to entrepreneurs.

Conclusion

My previous research showed that if a social innovation succeeds, owing to regulatory advantages provided for doing well to an impoverished section of society, gradually, established businesses will recapture the innovation after lobbying for a change in laws. However, this case study shows that if a social innovation succeeds without the regulator assisting it, the incumbents do not need legislative support to take it over.

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