KAREN FOLEY: The Online Business Exchange was a two-day live event presented by the Business School at the Open University. During the event, there was live chat and forum discussions. The live chat is now closed, but we hope you enjoy the video that follows.

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KAREN FOLEY: Hi, and welcome back to the Online Business Exchange. In this session, I'm joined by Devendra Kodwani who was in our previous session, and also Alan Shipman is also joining us who is from the Economics Department and has written "Capital Without-- Capitalism Without Capital." I always get this the wrong way around. I'm very sorry.

So this'll be a very interesting discussion because what we're going to focus on now is what's happening in terms of finance in the digital economy. And obviously very relevant in times of, you know, cashless societies, et cetera. So, Alan, could I start by asking you about some of the key things from an economic perspective that you think are most relevant in times of finance in a digital economy right now?

ALAN SHIPMAN: Well, I'm paid to worry about the financial sector, and that leaves me in the rather unpopular situation of worrying about the condition of banks, especially the high street banks that we've traditionally regarded as sort of solid and profitable and always there to provide finance for industry.

Devendra was mentioning in the earlier session you don't necessarily need to go to a bank anymore. There is peer-to-peer lending, there's crowdfunding, there are other ways in which savers can connect to borrowers and businesses can get funding, and that's one of many things troubling banks at the moment. Where do they fit in? Because they traditionally were the only people you could go to for credit.

There are a number of other problems that banks are up against. The aftermath of that financial crisis, which almost brought some of them down, the extra regulation they have to deal with as a result of that, the capital requirements that have been upped substantially, and, of course, continued problems in the economy that they're dealing with, which are an aftermath of that financial crisis and a product of other troubling events that have happened since.

So in this situation, although it's very exciting to look at the new opportunities for new entrants in the financial sector and for borrowers and for savers, one also has to look at this big legacy of the banks we've got. And the message that economists bring is that you can't get rid of banks. They do something special. That banking licence they've got literally is a licence to create money.

And if they're not able to operate in the traditional way, there might be a drainage of demand from the economy. There might be a seizing up of some of the wheels of commerce, which do depend on banks' unique ability to lend out money which is created as distinct from just taking savers money and sending it over to lenders. So that's my concern. Lot of exciting things happening in the digital economy, but it may make life for traditional banks more difficult, and we might suddenly realise they were doing something important that we'd forgotten about.

KAREN FOLEY: So your take, really, on this digital economy is this cashless transactions in terms of how banks are shifting money around?

ALAN SHIPMAN: Yes. Financial technology, all this innovation is really building on the basic products that banks do-- current accounts, the traditional payment system they operate, and this active lending and the very special way in which banks lend money that they don't have as distinct from money they've collected from others in the economy. It's great to be building all these things on that infrastructure. We have to look at whether the infrastructure is viable and whether the sinking profitability of banks is actually going to be a problem in the future.

KAREN FOLEY: OK, interesting. So really this is all about banks. Devendra, what would you say in response to this?

DEVENDRA KODWANI: I agree with Alan that banks are facing a challenge, and this shows the power-- disruptive power-- of technology if it takes on. So I think it is-- if one goes back, it's probably similar to what the way energy was. Once who had a steam engine, what happened to the people which were, you know, who were providing energy through manual force.

So I think we are in for a shakeup in the way the finance is floated and moves around in the economy. And banks, traditionally, have played a very dominant and important role, and I agree with Alan that they do have some value-adding.

Even the kind of example that we were discussing with crowdfunding or a cashless society, cashless society may appear on the outside it is cashless, but behind the scene, what you and

I as consumers would not see, somebody is processing, making sure that payments are going through, that contracts are being honoured, and customers and suppliers are getting the money when they should be getting and so on. So there is behind cashless society is a infrastructure which is reliable, and, you know, there's integrity of that system to work for the economy so that people are getting what they should be getting through the transaction.

So obviously there is this need for banks to survive because they are the backbone-- behind the scene backbone-- of operations, flow of money in the society. And also they create the velocity, what Alan was alluding to, is a cycle of credit. The lending. And then that can be a kind of a negative consequence of, for example, crowdfunding. So if I and you do not go to banks and deposit our money and directly invest with small investors, small business size, small-size business or medium-sized business because there is hardly any intermediary, then it takes out the role of intermediary who creates credit lending.

And, of course, when they go overboard, they end up creating subprime kind of a crisis. But if they do it judiciously, diligently, that is a useful function.

KAREN FOLEY: So if we were to look then-- we're looking at the future in terms of ways of funding things and also some of the implications, but if we were to look at some of the past issues as well in terms of how the banks have been operating and how the, you know, economy was managed in that time of inflation and lending, et cetera, what would some of the learnings that we could be-- you know, what are some of the learnings from that? And then what are some of the implications in terms of how we're looking at the future? What are some of the issues that we need to take from that?

ALAN SHIPMAN: It's always tempting to look back at the crisis of 2007, 2008, and the re-regulation of the banking sector that followed and think that was really when things went wrong, but I think we have to look at why did things go wrong at that point. And what we saw was effectively an earlier stage of banks losing some of their core business and having to do newer, riskier things in order to stay profitable.

A number of factors fed into that crisis, but one of them was that high street banks had lost a lot of their bigger business opportunities to investment banks. Sometimes part of the same group, but sometimes standalone. They were doing the big business lending, and the commercial banks, the high street banks, were really left looking at small businesses or households, and the big thing that they could do with households was lend to people to buy houses.

So they moved into a mortgage lending area, which really commercial banks hadn't been involved in initially. That was a province of building societies, other specialist lenders. Banks marched in, apparently, very successfully, especially when they found that new way of making loans to customers, bundling those loans up, selling them off into a wholesale market, and apparently moving that risk off their books and therefore making riskier loans than they had before. Profitable loans, if they were paid back. Apparently low risk, if they had sold the risk on appropriately.

That arithmetic just fell apart. They found that they got a lot of bad lending. They needed state-subsidized rescue because of the extent of that bad lending. They're still recovering from that.

But it was really a symptom of banks looking for a role, because they'd lost some of their traditional business to other parts of the financial sector. And this is happening all over again now with financial technology, these innovations in payment systems, innovations in systems of lending. Banks are left with a certain amount of business providing ordinary current accounts, providing their legacy payment system, which isn't necessarily going to be profitable for them.

And so they have a choice, really, of do they move into these new areas and try and compete with the new providers? Or do they find some sort of accommodation with them? And we're seeing elements of both of that at the moment, including banks moving into the making of loans via peer-to-peer lending, which is an interesting development. They're trying to co-op something which ostensibly is competing with them.

But it's very difficult, and it's still left them in a situation where they're being cherry-picked, essentially, by new providers which can take their more profitable customers, depositors, and lenders, leave them with the rest. And banks end up looking a bit like a social service. They're expected to provide basic accounting facilities to everyone. A lot of those are not profitable customers, but they're left with them.

And they are also under very heavy regulation as a result of their past indiscretions.

KAREN FOLEY: Now, this is a very interesting point, and it's something that's come up in the chat actually. Starlen Atton has raised this question about these smaller banks and saying are they mostly--

you know, the new providers-- are they mostly for businesses or consumers? And very interesting question, are they good?

ALAN SHIPMAN: We're still waiting to find out. Encouraged by government there has been a lot of entry into the banking system. Challenger banks and also new forms of financial institution which are not banks in the sense that they create credit. They don't have banking licences, but they are doing the intermediation, linking savers and borrowers, which banks also traditionally did.

So a lot of new providers have moved in, and we're waiting to see, firstly, do they become anything more than niche providers? Because the big banks are still doing most of the borrowing and lending in the economy. And secondly, do they-- even if they remain small-- do they create a problem for the existing banks? Or do they create a way forward and actually in the end may the whole system viable for banks and better for customers?

It's really too early to judge that. And I would also bring in a major caveat that we've seen very rapid growth of these new providers, including crowdfunding, which is causing a lot of excitement. But it's all happened in a very unusual environment of zero interest rates. Interest rates globally have been pushed down to historically very low levels as a way of dealing with the financial crisis, and there's no sign of those interest rates rising much above zero, the base lending rate set by central banks.

This is historically unique, and it means there is a lot of very cheap capital floating around in ways that we've never seen before. At some point, probably, interest rates will start rising back towards where they used to be, which is much higher. And at that point, I think we might see a shakeout of an already crowded space.

There's going to be a shakeout anyway, because when something new comes in, a lot of providers go in, only a few will survive. But the extra dangerous element is one day that cost of borrowing is going to rise, and it's going to be a very difficult adjustment after a very long time when interest rates were close to zero. So that's the second thing we have to watch, and it's really unknown territory. We haven't been in this--

KAREN FOLEY: No.

ALAN SHIPMAN: --situation of actually interest rates possibly having to go negative in some regions in the near future because of the very delicate stage to the global economy still.

KAREN FOLEY: Have they ever been negative before?

ALAN SHIPMAN: In real terms, yes. I mean, there have often been times when the inflation rate-- prices rising-- is higher than the interest rates. And so in real terms interest rates can go negative, and that can be good for the economy.

The problem we have now-- it never used to be a problem, but it is now-- is zero inflation, mildly falling prices, negative inflation in some areas like the eurozone. And that means that the central banks' traditional weapon, which is rescuing the economy by pushing lending rates down, has really been exhausted. We got them down to zero, but if prices are falling, that's still a positive real interest rate.

And central banks are starting to experiment with that negative interest rate where you would actually be charging people for depositing their funds rather than paying them interest for depositing funds.

KAREN FOLEY: Would we be the only ones then if there was to be a situation where there were those negative rates?

ALAN SHIPMAN: Japan is having to look at this. The European Central Bank is having to look at this. In the aftermath of Brexit, the Bank of England may have to look at this.

Essentially we want inflation back because that's good for borrowers, less good for lenders. But to get the economy growing again convincingly, we need conditions to be better for borrowers, and that means inflation rates which hold down that real cost of borrowing. We haven't got that at the moment.

KAREN FOLEY: Dev, what's you take on all of this from a more practical perspective?

DEVENDRA KODWANI: I think from a practical perspective, if you look at it from small and medium-sized business owner, they will have, on one side, capital available at low cost, but at the same time, if the demand is not boosted, as Alan is saying that we are seeing a fairly fragile economy at the moment for most consumer and industrial goods, then it's a problem of even if you had capital, how do you grow your business? You know, so that's a challenge.

At the same time, it is creating some different-- if I go back to the micro level of financing from the crowdfunding, we are finding in the crowdfunding is not just the commercial projects that are being funded, it's a different type of product. Social enterprises are being funded.

Now, they might be a small portion of the total economic value that we have, but they are funding projects which are small entrepreneur. An artist wants to create an album, music album, doesn't find any buyers from the major music companies, and then he goes out and pitches to millions of interested people. Only a few would support, so maybe he would get backing from 500 people and he would just create, or she, would create 500 DVDs and send it to only the backers. So it is creating all kinds of innovative ideas.

Some social enterprises that are being funded would have found no funding from the traditional banks because the rates of return on those, the risks will be high. Even venture capitalists won't go to them because the projects that they are thinking about are not necessarily commercially viable. So I think crowdfunding is, in that sense, creating opportunities for those people who do need funding, but not necessarily for making huge profits. And this is where it is becoming quite innovative, I find.

One of the platforms that I looked up claims that they have enabled mobilisation of $2.4 billion for over a hundred thousand small projects to medium projects, and it ranges from $1,000 to $2, $3 million project. And one that excited me was funding of production of a social robot, which is exciting.

KAREN FOLEY: Yeah, and a huge change for ordinary people to have that concept of engaging and investing with business.

DEVENDRA KODWANI: Yes. I think this further brings-- I mean, it's not a new thing that ordinary small investors are interested in the, you know, financial markets. We have historically-- Britain has led the world in terms of creating millions and millions of investors. But this is going way beyond it and really capturing the attention of people who are just interested in backing ideas. They think they want to take risk, and it's going down to investing $50, 50 pounds, to 50 euros kind of amounts we are talking here, which is a very, very exciting. Yes.

KAREN FOLEY: What about this idea of crowdfunding, then?

DEVENDRA KODWANI: It is not-- in a way it is not new. If you look the way traditionally we have raised funds, they have come either from banks are directly from the stock markets. Companies had gone out and made pitch to potential investors who buy shares. So in a way issuing millions of shares to thousands of investors is a kind of a crowdfunding.

I think what's new is that it is outside the remit of formal regulation. And this is where the risks might lie, and this is where some important functions of regulations might be important.

KAREN FOLEY: And their terms are very rigorous, aren't they?

DEVENDRA KODWANI: Yes.

KAREN FOLEY: In terms of ensuring that people deliver--

DEVENDRA KODWANI: Yes--

KAREN FOLEY: --on those investments.

DEVENDRA KODWANI: --on investments.

KAREN FOLEY: Yeah.

DEVENDRA KODWANI: So the prospectors of a regular offer from a company would be very, very different document than a pitch which might be a YouTube pitch from an entrepreneur that, this is the product I want. It's like "Dragons' Den" programme on BBC where you have four potential, you know, entrepreneurs sitting with pockets of money saying that I would invest in this project.

Instead of "Dragons' Den," you have millions of "Dragons' Den--"

KAREN FOLEY: Well, I was--

DEVENDRA KODWANI: --entrepeneurs.

KAREN FOLEY: --that later.

DEVENDRA KODWANI: Yes. And then everybody is willing to listen to your pitch and then back it up. So in a way democratises the risk sharing, the participation and risk, giving shares and so on.

KAREN FOLEY: OK, excellent. But there are some things to be wary of. And, Alan, I know that you were saying that, you know, in terms of some of the technologies, there are some things that as businesses-- you know, people in business-- we should be mindful of. I wonder if you can tell us a little bit about some of the financial technologies and some of the issues around some of that.

ALAN SHIPMAN: Financial technology, it's become a bit of a buzz word and it's meant different things at different times. But essentially there's a lot of friction and a lot of inefficiency and ignorance still in the financial system. People, if they've made overseas payments or tried to recently, they probably found it's expensive, there are delays, there's a lot of bureaucracy. It should be easier than it is to transfer money from one place to another, even if it has to go from one currency into another at the same time.

And there is a tremendous suspicion that banks are holding back on the efficiency improvement that they could make because essentially they used to charge a lot for this service. It's much lower cost to them. But if they can keep those charges out to the customer, they just make more profit.

That's the red light-- the green light, even-- for new entrants to come in and set up payment systems which just get rid of that friction using the new electronic technology, charge less, and take the business away from the banks. Or force the banks to go into alliance with them so that they can deliver this lower cost transfer payment method.

There's a huge amount of innovation. I can't reel off names of companies, but there are many, many startups looking at more efficient ways off transferring money, that very simple but very important basis to every transaction. We've got companies that have been around for a while, like PayPal, which were doing this as these new electronic technologies first came in.

But there are now companies moving on from that realising there are even more efficient, quicker, cheaper ways of doing it. And they would say this is taking the friction out of the system, because the technology now allows us to do this.

The problem I was alluding to earlier is it does take, potentially, a big source of profits away from the banks. And if they are not the ones using these new technologies, if that's gone to new entrants, that leaves the banks struggling to make good that profit stream in another way.

There are other hazards as well, and traditionally there have been a lot of checks and balances within the financial transfer process for a very obvious reason that there can be fraud, there can be theft, all sorts of things can go wrong. So there's a need for a sort of a cumbersome verification process very often. And as that becomes electronic, the hazards rise. We hear about hacking, we hear about identity theft, all sorts of ways in which, if they're not seeing each other, if they're just transacting at a distance, people might be tricked or perpetrating tricks.

And so there is necessarily a sort of bureaucratic checking element. But it may be harder to do that when it's gone electronic than it was in the traditional way when you actually had to go in and talk to people in banks and fill forms in and have signatures verified and so on.

KAREN FOLEY: Yeah. So, Dev, how are businesses then dealing with some of these issues of theft and, you know, managing that whole process?

DEVENDRA KODWANI: Yes. I think one of the things most businesses would need to pick up as a kind of core competence, which'll become a basic service function in most businesses, the cybersecurity. Because whether we like it or not, every part of the business transaction, the whole supply chain, the functions that business performs, is electronically managed or interfaced; therefore, all the risks that Allen has just now listed are real genuine risks.

And I think we as a society, as an economy, will need to gear up in terms of making sure that the cost and the time required for high-quality security servers, the knowledge that people need to have using the technology, you know, it's an important aspect of business function now. So risk management, particularly on the technology side, will be an important aspect that businesses will need to look at.

And, again, this is where learning can come in, because I know that one of the most popular MOOCs that Open University put out was on cybersecurity. And millions of people have benefited from that thing. So, again, it's, moving with time, what are the new functions that you need to add to your business portfolio? And I think cybersecurity and electronic security is one of the keys things that--

KAREN FOLEY: Even on an individual level--

DEVENDRA KODWANI: Absolutely.

KAREN FOLEY: --that matters.

DEVENDRA KODWANI: And we need to be mindful of it. On one side it is exciting. So as a parent now I have a separate on parentpay.com which manages only payments between schools and parents. So there'll be niche kind of platforms and payment processing systems and so on.

So it does complicate life, because I need to now know what's the quality of security on my servers at home. You would need to worry about your laptop is secure or not. And to be able to pick up those cues and signals. So, again, it goes back to that in a digital economy, it's not just as a consumer that you need to be careful, but also as just a living person interacting with--

KAREN FOLEY: There's even pocket money systems now--

DEVENDRA KODWANI: Absolutely.

KAREN FOLEY: --where you can pay your children electronically.

DEVENDRA KODWANI: Yes, you can. You can have that thing. And then you don't know what they're doing. So if you just paid them in the form of plastic card or a digital account, you don't know where it went. It's difficult to, you know, find what's going on with all kinds of games and people out there on the internet, how they are using that money.

So it poses real challenges for parents, for businesspeople, for us. And in a university, it will-- we are facing a similar type of challenge that how do we know people are submitting their own work, for example, electronically.

KAREN FOLEY: Excellent. Well, Alan Shipman and Devendra Kodwani, thank you. That has been a really interesting discussion, and just the start of a discussion as well because we'll be picking up some of these themes. We do hope that you can engage on the chat.

I'm just going to see how that widget is looking because we asked how you were feeling right now. And I'm very pleased to see that there were a lot of very positive emotions. People were saying they're feeling positive, calm, engaged, ready to learn, intrigued, curious, joyful-- I like that-- and somebody was feeling frustrated. Let us know if that's to do with the economy, finance, or something that you're experiencing with this event, because we are manning that inbox. So do let us know if you've got any questions or concerns that we can help you with.

Please do chat as well. I know that a lot of you are watching in the Watch Only option. It really will limit your experience of the event. And so if you can come into the Watch and Engage, by reengaging with the website, selecting Watch and Engage and then using the normal login details that you would use if you were a student.

Or, if you're not a student, you can get an Open University Visitor Account, which is really simple and easy to do, and there is a link there on the Frequently Asked Questions section of the website. There's also a short video about the interface so you can see what will happen when you join. But it's a great way to see what other people are talking about.

But I'd like to know now what you thought. What are your thoughts on this session? We've raised a lot of issues. And a lot of those, you know, many people are saying that they're in full-time employment, how does this impact on you as an employee? Maybe as an individual? Maybe as a parent? In all these various roles, financial aspects of the digital economy are having, you know, a huge impact on the way that we're operating in society.

So let us know your thoughts on how that's impacting. And we can continue that discussion also later on Yammer today. But just type those in the chat box and that'll be really interesting.

We're going to have a short break now, and we're going to have the chat open for about a quarter of an hour or so and then Devendra will come back and we're going to talk about corporate society and corporate governance and the impact that that has in a financial context in this digital economy. So have that short break on chat, let us know what you thought of that last session, and are there any interesting aspects, if you're in a large enterprise, where corporate governance is an issue for you.

Let us know the questions and Dev'll be talking about those in a few moments with us. But we'll leave the chat open, we'll see you back in about 15 minutes, and I hope you're enjoying the programme so far.

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