The future of FinTech and financial services

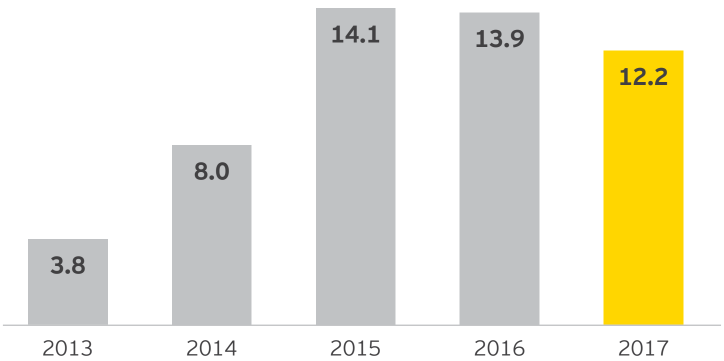
What's the next big bet?

Building a better working world

In this roundtable, held as part of the investment summit — “Deal Day” powered by EY in November — we hosted 22 senior financial services executives, investors and FinTech founders to talk about the evolving trends around FinTech innovations and investment in the next 12 months.

Some common themes that were discussed are on the promising FinTech innovations, their impact on the investment and consumer landscape, and foreseeable future with increasing industry convergence.

Global FinTech VC investments (US$b)



Source: "Annual global financing trend to VC-backed fintech companies", The Global FinTech Report Q3 2017", as at September 2017 via CB Insights, Tracxn

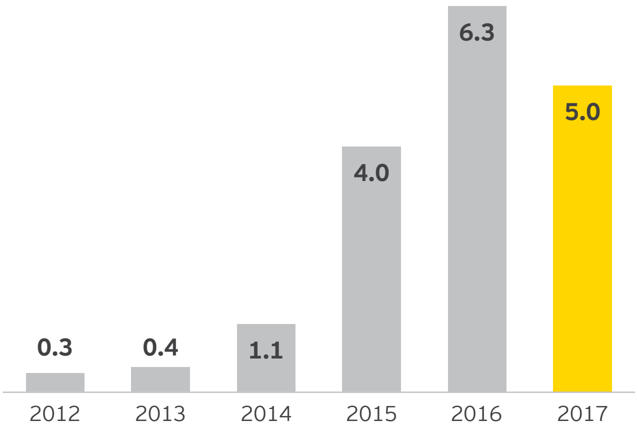
Current investment landscape globally and in Asia

Global FinTech funding has a compound annual growth rate (CAGR) of 44% from 2013 to 2017. Fintech investment increased in 2017 with US$12.2b via 818 deals made in the first three quarters as compared with US$11.7b via 762 deals made in the first three quarters of 2016.1

The average deal size so far in 2017 is US$14.8m as compared with US$14.1m in 2016.1 Artificial intelligence (AI) is the hot new investment sector in FinTech, with expected direct investment growth CAGR (2016–22) of 63%.2

Investments in cryptocurrency and blockchain market are expected to grow at a CAGR (2016–22) of 35%.[3]

Asia Fintech VC funding (US$b)[4]



Source: "Asia annual global financing trend to VC-backed fintech companies", The Global FinTech Report Q3 2017", as at September 2017 via CB Insights, Tracxn

Asia clocked in 203 FinTech deals since the start of 2017 and the average deal size has been increasing as the FinTech sector matures.[4]

In terms of countries that have contributed to the most FinTech deals from the last five years, China is the undisputed leader contributing 80% of FinTech investments in Asia, while India comes up with 12%.[5]

Among that, alternative lending leads the FinTech charge in Asia for the last five years, capturing 40% of total Asian FinTech funding.[4] Consumer finance is the second most popular sector in Asia, capturing 26% of the Asian FinTech funding.[4] Regulation technology (RegTech) is set to grow in the coming years due to increase in regulation, with China taking the lead in anti-money laundering and digital identity management.

Similarly, in the Deal Day matchmaking exercise that EY conducted, the top subsectors of interest from investors are data analytics (70%), blockchain (65%), lending applications (64%), payment solutions (61%) and RegTech (56%).

Comparatively, the top subsectors of FinTech focuses are payment solutions (20%), lending applications (14%), robo-advisors and personal financial management (PFM) (14%), trading and fund management (12%), and RegTech (10%), which some might say are low-hanging fruits.

FinTechs with blockchain focus make up just 8% of total population for Deal Day, while FinTechs with data analytics focus make up only 11% of the total population, another key subsector of investor interest.

This leads us to the discussion on why supply doesn't always meet demand in this case, and what some of the other big bets are that investors are looking into for the next 12 months.

Is demand really driving supply or are there other inhibitors in play?

Big bets on game-changing technologies

Most attendees named technologies in blockchain, AI and crypto to be the moneymakers in the next 12 months. Some, however, like Dr. Julian Hosp, Co-founder and President of TenX, see many cryptocurrency companies already gaining traction.

To them, the key to successful investment into FinTechs is a willingness to take the chance and a genuine belief in their offerings for the betterment of their end customers and their own bottom line at the end of the day.

Frederic Legault, Element AI, said, "To be successful, you have to look at the bottom line regardless of the regulations. It is always about the profits."

Alex Kong, Group CEO, TNG Wallet, further attests, "That's the Asian mentality. Investors always worry about profit. Investors will only invest in companies when they (FinTechs) can still grow when they start charging."

Ultimately, the success of these FinTechs is dependent on the appetite and demand of the consumers, especially in areas where regulations remain fairly open.

As Gary Hwa, EY Global FS Markets Executive Chair and EY Asia-Pacific Regional Managing Partner Financial Services, says, "It's not just about focusing on where the money is, but who their target group is and how they are targeting them as customers. For example, millennials care about different things than we did in our generation. Our kids are less interested in a Porsche or a Ferrari. They are less brand-conscious. They are far more interested in the purpose and value these services provide. Also, their behaviors are very different in the way they digest and retain information. Remember, they grew up in the video game age and some are still playing games at age 29, so you need to cater to them differently."

"Baby boomers grew up during different times and value wealth creation, resulting in the largest amount of generational wealth. To this end, the transfer of this wealth may very well result in a behavioral change for those who inherit it. FinTechs can be an intermediary for that. That's a huge opportunity waiting to be monetized."

If FinTechs can harness spending habits, consumer lifestyle or pain points using big data, it would be very powerful.

An example is a differentiated credit scoring or underwriting process that allows for the underwriting of loans to borrowers with limited financial history by leveraging data gathered from the borrowers' daily activities or actions taken that are not directly reflected in their banking transactions.

Another example is the integration of health or medical data, which enables companies to make predictions of how long an individual could live and what kind of diseases they might have later on in life. This technology is something that insurance companies are looking into currently for their policy and premium-pricing strategies.

Consumers continue to drive demand and shape supply

In terms of the investment landscape, opportunities will continue to remain strong in emerging markets where there is a large population of unbanked or underserved consumers, underpinned by automation and connectivity across platforms. These consumers are also supported by the opportunity to leverage data and analytics to reveal in-depth insights about them, and what is lacking in terms of services or products. This, in turn, will help create more business opportunities for the FinTechs to develop more innovative solutions targeted at the underserved.

In a lot of the unbanked areas, for example in China, hard cash is getting less popular and many find it cumbersome to have to get to a bank teller to withdraw cash for Lunar New Year red packets for their relatives, especially those who are living far away from them. Recognizing the opportunity to provide a differentiated service for these customers, ecommerce merchants, such as AliPay and Tencent, have enabled electronic red packets, which have seen high adoption rates among consumers in China.

In addition, with the digitalization of investment platforms, information is more accessible than before and consumers are similarly empowered to make their own decisions. Investment in straightforward products, such as exchange-traded funds (ETFs), can be done in a matter of minutes from account setup to portfolio selection, cutting off the middle man and making the process more transparent.

Most attendees remain positive on technologies related to data analytics, AI and, to a certain extent, RegTech, depending on how regulations play out.

A key enabler for such technologies is the openness of the customer to divulge his or her personal data in order to enjoy the benefits they bring. Depending on the age and social upbringing of the customers, some are also more open to new technologies and less concerned with data privacy than others, which impacts the adoption rate of such technologies.

As Alex commented, "In Hong Kong, the more educated you are, the less likely you are to use FinTech. They worry too much about their data."

On RegTech, most opined that while it is promising and will be a popular investment for financial institutions, there is still a level of risk that no one is willing to undertake if something goes wrong with the compliance process. The common observation is that the government is taking a back seat for now and leaving it to the RegTech firms to ensure compliance through their technology.

A case in point as mentioned by a senior private banking attendee, "Switzerland just announced their aim to introduce an e-identity, which will be provided by a third party."

Most also think that Singapore would be an ideal market to roll this out quickly, given the government's inclusive and progressive stance around such emerging financial technologies.

Industry convergence and collaboration

Janet Young, MD and Head, Group Channels and Digitalization, UOB, anticipates the trend of alliances between service providers and payment gateways to continue to evolve alongside the changing needs and demands of customers.

In terms of collaboration, some of the attendees remain skeptical about the sincerity of banks in wanting to collaborate with FinTechs.

As Peter S. Klein, Technology Director, Finlync, commented, "Banks are smart, with their own substantial IT teams. They like to welcome you (FinTech) in, to listen and learn, but tend toward proprietary solutions, marketed as their own. I don't see FinTechs being acquired by banks, but rather [by] mutual collaboration."

Alex further added, "[Some] banks are not sincere in cooperating with FinTechs. The bigger the bank, the less serious they are to acquire. The more resources they have, the better they copy. They need to manage their risks. There's a lot of risk for banks to introduce anything. It will dilute their branding. Hong Kong is giving out free FinTech licenses to banks, but only three banks took it up."

Some, like Frederic, remain optimistic, "There are a lot of things FinTechs can do but banks cannot due to sheer size of the banks. I'm optimistic in M&A in FinTech. There are a lot of people that are unbanked and companies, like e-wallet, present huge opportunities for these people."

On industry convergence, Varun Mittal, EY ASEAN FinTech Leader, added that a lot of services are coming together and it is time for coexistence of "rebuilding" of financial services by internet companies who have large user base. They are often larger than incumbent financial services players and "unbundling" at traditional financial institutions, which are collaborating with FinTech start-ups to be competitive in niche areas instead of trying to develop everything in-house.

"The future of financial services may be where there is a layer below and everything is built on top. A major player might own the layer below and everybody has to work with them."

Managing Partner for EY ASEAN Markets Liew Nam Soon is of the view that both collaboration and convergence are key to building a well-rounded ecosystem, "In our experience working with both banks and FinTechs, we have observed some initial uncertainty between both sides in terms of how best to work together, given both are quite different in their setup and processes."

"What has proven to be helpful is having a third party to help them bridge the gap and address concerns in an independent manner so they can remain focused on their end goal, which is to provide more value to the end consumer in a sustainable manner".

Frederic offered a similar view, "Consolidation will happen to a certain extent. Not one company will monopolize everything. Competition will weed out the bad companies and the few good ones will survive and dominate the market."

EY ASEAN Transaction Advisory Services Leader for Financial Services Patrick Hanna says, "Financial services firms will need to cooperate with FinTech — rather than compete against — in order to grow. In fact, many incumbents are looking toward FinTech to drive their growth through faster, cheaper and broader distribution of their services as opposed to the traditional, more costly and riskier M&A."

It seems that collaboration and convergence are the anticipated trends going forward and no single model will prevail.

As Seah Kian Wee, MD and CEO of UOB Venture Management, UOB, shared, "We have a tie-up with a private bank. We manage a fund, investing in the largest education tech company in Indonesia. They have a lot of people working in the firm to create content to lower the cost of education for students. Now, the company we invested in Indonesia is one of the largest there."

Be it collaboration or convergence between banks and FinTechs, other banks or on-demand service providers, the end goal is to establish an inclusive ecosystem where everybody understands the part they play. All parties must continuously innovate to improve in accordance to market needs and demands so as to create a positive outcome for the end consumer. This is then the truly sustainable model that can prevail.

Looking ahead

As smartphone becomes the primary mode of consumption, a large segment of the economy will become digitalized, creating a massive "new economy" opportunity where services can be provided in a real-time, location-based and decentralized manner.

We believe that in such an environment, customers would seek simplification of offerings and transparency in pricing, with new emerging loyalties that transcend traditional customer segment and asset classes.

As traditional financial institutions continue to compete for customer attention and loyalty, which today is disrupted by a handful of internet conglomerates from US and China, they will see a giant leap of evolution in terms of customer engagement and servicing as industry convergences become unavoidable.

They will then need to think about sustainability of their business models in the current state and look beyond just FinTech collaboration. Against a backdrop of digitalization and hyper-connectivity, disruption creates convergence nodes between previously separate industries.

Traditional institutions, be it financial services or otherwise, will need to start evaluating collaboration with multiple tech innovations that are disrupting the various industry verticals, including new telecommunications, media, healthcare, GovTech and retail, just to name a few.

Source:

1. "The Global Fintech Report Q3 2017," *cbinsights*, www.cbinsights.com/research/report/fintech-trends-q3-2017/, accessed 5 March 2018.
2. "Artificial Intelligence Market by Offering (Hardware, Software, Services), Technology (Machine Learning, Natural Language Processing, Context-Aware Computing, Computer Vision), End-User Industry, and Geography - Global Forecast to 2025," *marketsandmarkets*, www.marketsandmarkets.com/Market-Reports/artificial-intelligence-market-74851580.html, accessed 5 March 2018.
3. "Cryptocurrency and Blockchain Technology Market to Grow at a CAGR of 35.2% During the Forecast Period 2016-2022 to Aggregate $42.16 Billion by 2022," *newswire*, www.newswire.com/news/cryptocurrency-and-blockchain-technology-market-to-grow-at-a-cagr-of-19214018, accessed 5 March 2018.
4. "Asia annual global financing trend to VC-backed fintech companies", The Global FinTech Report Q3 2017", as at September 2017, *CB Insights*

> "A lot of services are coming together and it is time for coexistence of "rebuilding" of financial services by internet companies who have large user base. The future of financial services may be where there is a layer below and everything is built on top. A major player might own the layer below and everybody has to work with them."
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> **Varun Mittal** | EY ASEAN FinTech Leader

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