

# THE VALUE IN FINTECH

## *Technology*

*To offer real value to investors, clients and partners, fintech companies need to balance opportunity, solution maturity and a sustainable business model, writes Dan Barnes.*

**FOR INCUMBENT BANKS AND INVESTORS LOOKING TO PARTNER WITH – OR MAKE A RETURN FROM – THE MANY FINANCIAL TECHNOLOGY (FINTECH) START-UPS IN THE MARKET,** it is easy to get swept away with the hype. A lot of the ideas being discussed are completely new and innovative, and for many long-standing businesses the process of digitisation is compelling new ways of working.

Fintechs are a key part of the new landscape and are seen both as rivals and partners to existing financial service providers, with some offering a completely new service altogether. Their technological element should add value to the service and in some way disrupt the existing business model. As Philippe Gelis, chief executive at foreign exchange and payment fintech specialist Kantox, explains: “Without an element of disruption, we are talking about financial services with a technology component, not fintech.”

At a high level, disruptive innovation can have two main impacts within finance, says Matt Hatch, Americas fintech leader at EY. “The first is providing financial services to the unbanked or under-banked,” he says. “There are 2.5 billion people globally who don’t have access to financial services, either in its entirety or partially, but 1 billion of those now have smartphones, which can act as a gateway [for financial services]. The second impact is felt through the provision of cheaper, more accessible and more value-added services for those who already have access to financial product and services.”

### IDENTIFYING THE OPPORTUNITY

Digging a little deeper, the ‘financial’ part of ‘fintech’ may span many different businesses, across the capital markets, retail banking, wealth management and insurance. Fintechs are looking to provide specific componentised services in these spaces, or even a full service such as retail banking. Whatever idea the firm may have



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at its core, the disruptive element has to be embedded within its intellectual property if it is to be viable in the long run.

“Is a company just using the internet to create an agency model, or is it actually building sustainable advantage via analytics?” asks Giles Andrews, CEO of direct lending platform Zopa, a fintech that launched in 2005.

Mr Gelis adds: “I think it will become harder for fintech firms that are market-driven and are basically disruptive by just being cheaper; the long-term value resides in a firm that has technology that adds value both for the user and the industry.”

The competitiveness of the field, the size of the opportunity and customer demand are different in each sector and affect the capacity to disrupt. To illustrate, 17.6% had used fintech services for payments, 16.7% for investment and saving, and just 7.7% for insurance, according to EY’s Fintech Adoption Index, which surveyed 10,000 digitally active people globally.

Imran Gulamhuseinwala, global fintech leader at EY, says: “Trying to engage with and entice a customer through traditional financial services products is tricky. For example, I have yet to see anyone dropping into a bank branch because they get a kick out of refinancing their mortgage.”

### DISRUPTIVE REGULATION

Regulation presents an opportunity to plough a new furrow in an existing business, either to help overcome a compliance challenge or to fill a new service role. Retail banking is being actively disrupted by regulators who, via the EU’s Payment Services Directive 2 (PSD2) and the UK’s Open Banking initiative, are forcing the incumbent firms to open their application programming interfaces to third parties. Fintechs will be able to gain permissioned access to client account and transactional data, and can then offer services directly to bank customers, including services that compete directly with the banks, such as payments.

“PSD2 is a game changer for me,” says Mr Gelis. “Banks will have to share all of their customer data, creating a viable basis on which firms can offer new services that have not existed before. Payment providers may be given permission to initiate transactions on behalf of banks’ clients. This means that banks are losing the client relationship, which is where the money is.”

In addition to the UK and EU, China is also seeing a revolution in the payments space. In the second quarter of 2016, the

People's Bank of China reported that a greater volume of electronic payments in China were transmitted by non-banks than by incumbents, according to James Lloyd, Asia-Pacific fintech leader at EY.

"[In China] banks continue to dominate in terms of high-value payments, but non-banks are disintermediating person-to-person and retail payments," he says.

### STRUCTURING AND TIMING

Having spotted an opportunity and a viable solution, the right team and structure will be essential for a fintech to grow its business and be successful. In addition, tapping industry experience can be useful when establishing a business model. While early entrants were able to capture first-mover advantage, many of these entrepreneurs – and their backers – lacked finance services-specific expertise, says Mr Gulamhuseinwala, leading to problems in modelling the cost of customer acquisition.

"They frequently modelled [customer acquisition] at about \$15 to \$20. It's fair to say that they were in for a shock when they found these costs often to be 10 times that amount," he says. "Many fintechs still haven't worked out how to cost-effectively connect with the public. They are now reaching out to the financial institutions that have those relationships and hence end up working with banks."

However, while a larger partner on board can be highly advantageous in getting access to an existing customer base, those sorts of relationships are only viable once the start-up has proven its idea can stand up, according to Mr Andrews.

"You can't launch a fintech business solely based on a partnership, as you haven't proven your capabilities," he says. "When fintech businesses launch, often they define themselves by what they aren't – mainly because the market understands the alternative. For example, Zopa wasn't a bank. As a fintech develops proven capabilities, then it can start to define itself by what it is and begin to look for partnership opportunities."

### PATIENT APPROACH

Having patience when maturing the start-up has other advantages. Entering a field where mistakes have already been made, and can be learned from, will allow the start-up to keep its feet when early in the process of building the business and establishing its sustainability. It can also help if one is not trying to engage with a concept for the first time, notes Mr Andrews.

"In some cases it's helpful not to be the

first because one of the things that most businesses like ours are trying to do is change people's fundamental behaviour and that's hard, involves building quite a lot of trust and takes time," he says.

### SUSTAINABILITY AND DISRUPTION

Once a fintech has tapped a rich vein with a robust disruptive solution, it will still need to ensure it can sustain momentum. That will require a support network of partners, investors and advisors to help it grow. Those firms wishing to work with fintechs will need to exhibit an understanding of the model that allows these innovators to grow, and not force them into an existing corporate model.

That also means supporting start-ups when they can deliver better value for the customer, instead of pushing customers toward traditional models outside their chosen platform. "If you look at the massive success of the Chinese fintechs, you'll see that it's not a good idea to have your customers go 'off ramp' and then come back on again," says Mr Gulamhuseinwala. "It is much better to embed the transaction within your offering from the outset and retain control of the relationship."

China has provided some innovative examples of fintech models, in part because the banks remained almost exclusively focused on servicing state-owned enterprises and corporates, while the majority of consumers and small businesses were unable to access basic credit and investment products. EY's Mr Lloyd says: "There was a vacuum into which some of these technology players moved with solutions that were an order of magnitude better than those that previously existed."

Some of these models, such as the collaboration between digital retail giant Alibaba and Tianhong Asset Management, whose products are distributed by Alibaba, have shown that fintech is not solely about start-ups, but can be about disruptive business models developed by existing companies taking a digital-first approach.

Mr Gulamhuseinwala says, "We monitor more than 20,000-plus fintechs through our proprietary database to help traditional players navigate the space and identify opportunities to invest and partner. We think that the number of new entrants will continue to increase substantially, but that the second wave is more likely to be established through non-financial services companies looking to attack the financial services activity chain to support their core business." <sup>TB</sup>



IS A COMPANY JUST USING THE INTERNET TO CREATE AN AGENCY MODEL, OR IS IT ACTUALLY BUILDING SUSTAINABLE ADVANTAGE VIA ANALYTICS? *Giles Andrews*