The State of Fintech 2019

Kene . Partners

Executive Summary

2018 saw fintech continue to deliver significant benefits to consumers, firms within financial services and investors.

Consumers have enjoyed a broader financial product offering, easier access to banking services through digitization and greater financial inclusion. Established firms are investing more and more into exploring emerging technologies such as blockchain, big data and analytics and AI, as well as collaborating with disruptive new entrants. Investors, meanwhile, continued to break records in terms of number of deals as well as total funding for fintech firms.

Kene Partners are enormously excited by the ongoing technological revolution permeating financial services. The UK has established itself as the global leader in fintech, and there is no doubt that this will play a huge part in maintaining our reputation as a global technology and innovation hub. We look forward with great anticipation to seeing what the future holds in the world of fintech.

Adam Kene, Managing Director of Kene Partners

2018 in Summary

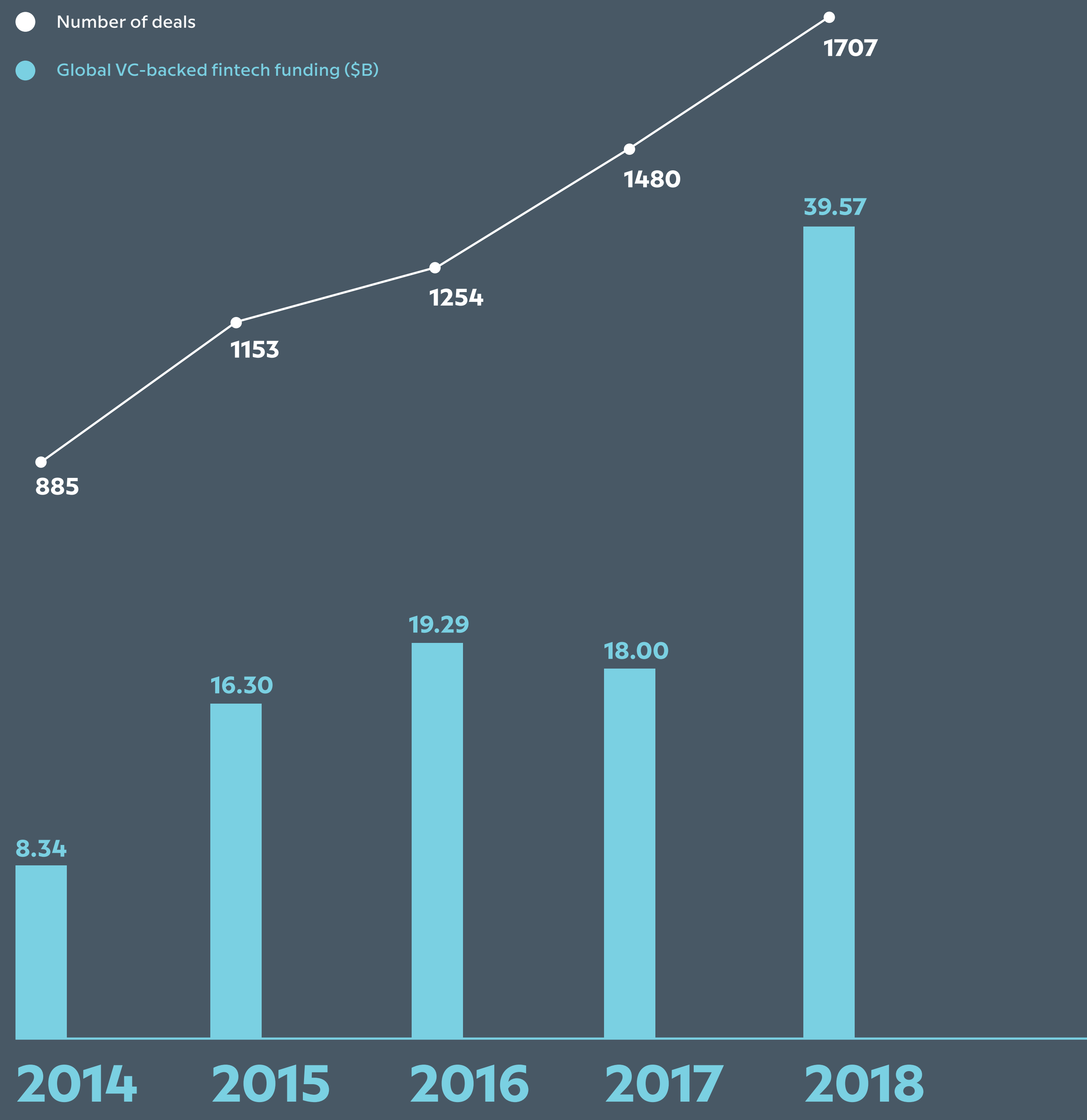
2018 was a record-breaking year on multiple levels in fintech investment. Global investment in fintech companies across VC, M&A and PE more than doubled to $111.8B with 2,196 deals.

VC-backed fintechs raised just shy of $40B, up from $18B in 2017. These figures were, however, skewed somewhat by Ant Financial's $14B investment, which accounted for 35% of that figure. Perhaps a more accurate representation of the growth in this area is the increase in the number of VC-backed deals by 15% to 1,707, including 52 rounds over $100M.

Investors were seemingly more conservative with their bets in 2018. While Seed and Series A fintech deals grew 5% annually, they were down as a percentage of total deals at 57%. While this suggests a more risk-averse approach from investors, as the fintech industry matures and more unicorns emerge, perhaps this subtle shift is not surprising. In fact, this figure has been in steady decline since 2014 (67%).

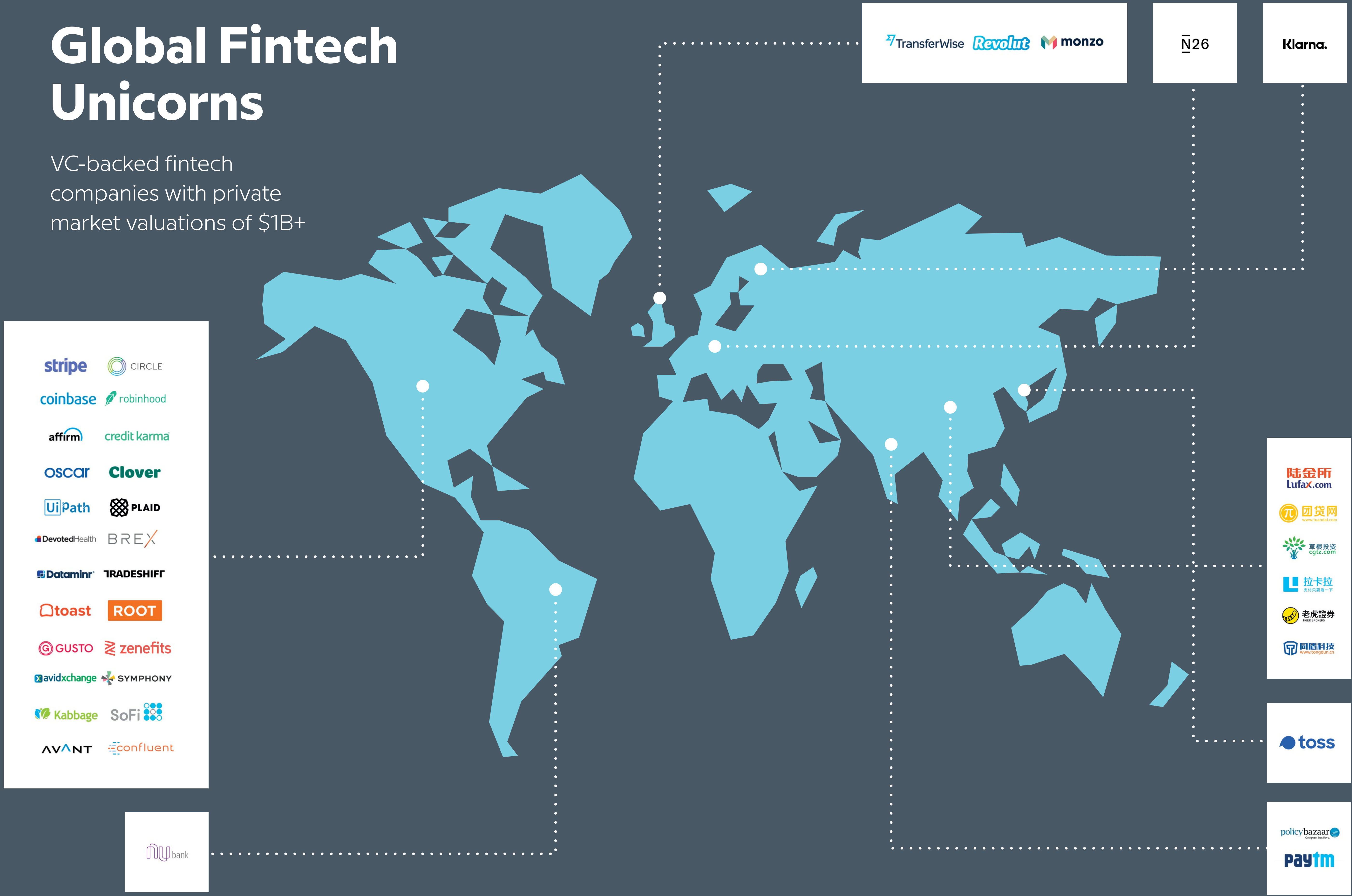
Fintech unicorns continue to emerge at an impressive rate. As of Q1'19, there are now 39 VC-backed fintech unicorns. This figure is higher than any other industry vertical in the Unicorn Club and the 39 fintech unicorns to date are worth a combined $147.37B. Since the start of Q4'18, seven new fintech unicorns have emerged: Plaid, Brex, Monzo, DevotedHealth, Toss, N26 and Confluent.

VC-backed Fintech Funding



Global Fintech Unicorns

VC-backed fintech companies with private market valuations of $1B+



2019 Fintech Trends

A summary of the most popular fintech predictions for 2019

1. Increased focus on regulatory compliance

Increased international collaboration by regulators is driving the proliferation of innovation in regulation globally. Over the last five years, regulators have generally been willing to support new entrant challengers in the name of boosting competition within financial services, choosing to focus on the benefits of disruption. However, regulation has since evolved as worries have arisen about risk, cyber-security, data privacy, consumer protection and money-laundering. As a result, regulators are beginning to step up their scrutiny on high-profile challengers. An example of this in action came in December 2018, when stock-trading app Robinhood announced plans to launch a checking and savings account with no fees attached. After widespread criticism, the company appeared to backtrack, offering "to work closely with regulators" ahead of its launch. The onus remains on firms to be proactive about emerging risks and evolving regulation. Fintechs will need to be more mindful of regulation than ever and establishing internal compliance teams will be essential to avoiding getting left behind and caught out.

2. Paychecks disrupted

Fintech firms are disrupting the paycheck with the mission statement of tackling predatory debt. The argument is that the very simple principle of capitalism that employees should be paid for the work they have completed is being violated by employers using the traditional bi-weekly or even monthly payday. With the massive advancement in the digitization of banking and accounting services in the 21st century, there no longer seems sufficient justification for this delay of payment. Gusto, valued at $2B, is an HRIS platform providing HR, benefits administration, and payroll automation software. In 2018 it introduced Flexible Pay, a new feature allowing employees to choose when they receive payment for work they have completed. Similarly, Earnin is an app that enables workers to access their earned income in advance of their scheduled payday.

Both of these firms raised $125M+ in the second half of 2018, and appear to reflect a wider trend towards greater flexibility in how and when workers receive payment for work they have completed.

3. Blockchain accelerates

Blockchain, the underlying technology behind Bitcoin, has garnered significant and sustained interest from banks since arriving on the scene, unlike the cryptocurrency itself. Consensus on blockchain and Bitcoin moved in opposite directions in 2018. As fintechs dreamt up numerous possible applications for the emerging technology in areas such as trading, payments and loans, Bitcoin's price plummeted from almost $20k at the end of 2017 to just over $3k a year later. If 2018 was a year of exploration and experimentation for blockchain, 2019 should be the year when discussions become more sophisticated and we begin to see substantial investment. Over the last year, most financial services companies have been eager to be seen to be engaging with blockchain. This year, however, will bring more solid commitments to the technology as firms increase their levels of investment and begin to build feasible, scalable products and solutions based on blockchain.

4. Impact fintech rising

In a recent survey conducted by Deloitte, millennial workers were asked what the primary purpose of businesses should be. 63% more people answered 'improving society' than 'generating profit.' Blackrock CEO Larry Fink agrees – insisting that all companies must 'make a positive contribution to society.' It shouldn't come as a surprise, then, that impact investing and ESG (environmental, social and governance) are rapidly emerging trends in fintech. Financial services are seeing a demographic shift as millennials account for a more significant portion of the global workforce. In areas such as wealth management, firms are increasingly encountering millennial customers looking for alignment between their investment portfolios and their values. It is important not to misunderstand this habit as romantic idealism, rather a firm belief that any successful company of the future will be sustainable and socially responsible. Fintechs such as Clarity AI are already providing platforms that automatically optimize the social impact of investment portfolios.

5. Democratization of investing

Roboadvisers like Acorns, Betterment and WealthFront have, for some time, been using technology effectively to open up new modes of basic investing and lowering the barriers for first-time investors. Equity crowdfunding platforms such as Crowdcube have granted thousands of investors ease and accessibility to invest in SMEs, while Robinhood enables individuals to invest in public companies and exchange-traded funds listed on U.S. stock exchanges – charging no commission. Now, the next generation of investors are being given the opportunity to invest in new, alternative asset classes with innovative new investment models. For example, Royalty Exchange is an online platform where investors can buy the royalties of musicians in auctions. Otis Masterworks, meanwhile, allows anyone to purchase and trade shares in iconic artwork. 2019 will see the continued democratization of investing and emergence of increasingly alternative asset classes, such as blockchain-backed crypto assets.

6. Fintechs continue to avoid IPOs

2018 saw three fintech IPOs yield mixed results. Dutch payments processor Adyen was a resounding success, with shares soaring 98% on its first day of trading. Day one was moderate for online lender GreenSky, ending the day with a share price 1.5% higher than that set the night before. Funding Circle, however, suffered as they ended their first day 21% down from their initial flotation price.At a time when the sector seems to be breaking investment records every year, and when all emphasis is on the quality of the new, innovative financial products they are offering, it is no wonder fintechs are continuing to shy away from IPOs. With so much financial backing, fintechs are enjoying the opportunity to focus on optimizing their core offering rather than delivering profits. That said, if anyone does decide to take the plunge, Credit Karma and Robinhood are looking the most likely.

7. Consolidation of the market

M&A in fintech was surprisingly quiet in 2018, although not for a lack of proactivity by banks in scoping potential acquisition targets. Very few actually pulled the trigger last year as banks took in the lay of the land and optimized processes for fintech engagement and onboarding. There were just three fintechs bought by banks over the course of the year – digital bank Azlo (BBVA), personal finance app Clarity Money (Goldman Sachs) and AI startup Layer6 (TD Bank). The longer buyers wait, though, the more they risk the most exciting prospects growing too large for acquisition. The pace of growth in this sector is evidenced by the fact that fintech unicorns such as Credit Karma and Stripe (neither more than 12 years old) are becoming more active in M&A than established incumbents. The initial response from banks to disruptive new entrants was to try and create their own digital products. However, there seemed to be a paradigm shift in 2018 in which the realisation dawned that, owing to the pace at which they are required to innovate, developing a slick onboarding process and then purchasing ready-made solutions is a better option than trying to develop in-house.

8. Big tech vs. big finance

App and data-centric tech giants like Microsoft, Apple and Google in the West and Alibaba, Tencent and Baidu in the East are beginning to encroach on financial services. Starting with payments, these companies have been expanding into areas such as insurance, provision of credit and wealth management, either directly or indirectly through partnerships. Tech firms have a fantastic starting-point for entering the financial services. Excellent customer engagement, user experience and their vast pools of data are hugely advantageous. However, their biggest challenges will be around trust and data privacy. Established banks have pre-existing reputations of trust to safely and securely look after their customers' money. Tech companies on the other hand, particularly in the West, are facing increasing scrutiny and scepticism from politicians and the general public. It is possible then, that in 2019 it may not be a case of Big Tech vs. Big Finance, rather tech organisations and financial organisations collaborating to deliver integrated financial platforms. It remains to be seen whether this will diversify the financial services or produce new and perhaps more threatening forms of concentration in the eyes of regulators and legislators.

9. Insurtech, regtech and real estate join the party

In Insurance, the industry often described as being largely unchanged for more than 300 years, the technology revolution is beginning to gather momentum. Whether it's blockchain, wearables, drones or AI, insurers are starting to get the message that it's time to innovate. The greatest challenge for them will be trying to organise and decipher their huge banks of data spread out across legacy systems and even handwritten documents. Regtech investment more than tripled from $1.2B in 2017 to $3.7B in 2018. Regulation is evolving at a much faster rate than ever before, and fintech startups are looking at ways of helping incumbents reduce the continued cost of complying with increasingly complex and rigorous regulation. Technology permeating the real estate industry has so far been focussed on new digital platforms and tech-led portfolio diversification and optimization. 2019 will see this fusion of technology spread to mortgages, alternative lending platforms, home equity, title insurance and the integration of home insurance into the property-buying process.

10. Open Banking

2018 was the year of Open Banking. Or at least that's what everyone predicted. The government-backed initiative geared towards fairer and more transparent banking requires banks to open their APIs and grant data access to approved third-party providers (with the customer's permission). It's safe to say it had something of a false start. Caution from customers about sharing data with third-party companies they've never heard of has been the major stumbling block and is entirely understandable. It will be up to the banks to communicate the benefits effectively, which they have so far failed to do. Huge excitement remains about its future, though. The idea behind it is to boost competition and innovation and give customers access to a wider range of financial products. Banks and fintechs will need to continue to refine and enhance their methods of collaboration before customers commit to it, though. Once they can convince customers of real benefits, saving them money and time, widespread adoption will follow. Open Banking may have been slow off the mark, but it's certainly a game-changer.

About Kene Partners

We are a team of specialist R&D Incentive advisors. We help innovative companies access millions of pounds of Government money set aside to encourage innovation.

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