Is Fintech Here to Stay?

By Serguei Netessine , The Timken Chaired Professor of Global Technology and Innovation at INSEAD

2015 was the best year for venture investment in US Fintech start-ups since 2000, with $21.6 billion invested, but the number of deals fell for the first time since 2009.

There are more than **5000 financial technology (fintech) startups** in the world now. Many unicorns are emerging among them. There are now about 50 fintech unicorns (tech firms valued at more than $1 billion) on the loose. Along with many established players becoming larger, new startups are launched monthly, **if not weekly**. This staggering growth is a reflection of the hype around fintech, where a plethora of start-ups are using technology to compete against or collaborate with established financial players. The result is a dramatic increase in company valuations as investors look to get in on the ground floor of the next big thing.

While disrupting transport and other sectors, tech start-ups have **set their sights on traditional financial services**. As shown in the latest **Money of the Future** report, by Singapore-based fintech venture capital firm, **Life.SREDA**, and INSEAD, a new wave of start-ups are engaged in an array of financial services, from payments and lending to wealth management, aiming to grab a slice of revenues that Goldman Sachs estimates is worth

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$4.7 trillion. According to a September report by McKinsey & Co., tech companies could wipe out as much as 60 percent of profits on banks' financial products. Like other disrupters from Silicon Valley, fintech firms are growing fast by questioning the status quo of a very traditional and highly regulated industry.

Fintech firms are set to alter the financial landscape by cutting costs, improving quality and connecting borrowers and lenders in the same way Uber connects those with a car to those without. But there are still challenges on the horizon.

Incumbents fight back

The banks are getting in on the act. Major banks, such as BBVA, Santander, HSBC have set up venture-capital. Others, including DBS in Singapore, run their own start-up mentoring programmes, exchanging cash and staff time for a small stake in a budding enterprise. Barclays, Wells Fargo, and Bank of America are hosting or sponsoring finance-tech accelerators, awarding cash and guidance in exchange for a small stake in the companies and an ongoing relationship.

Despite their contempt for their incumbent rivals, partnerships and acquisitions are an important way for fintech start-ups to gain a foothold. The same ideas are advanced in the recent report that I co-authored with **500 Startups.**

The start-up ethos is also changing the way bankers think about their profession. One common refrain among incumbents is that they need to become less product-focused and more customer-focused, which is true but easier said than done.

Will they grow?

Whether fintech makes a significant dent in global finance or not will depend on what happens in 2016, which will be a **pivotal year for the future of the sector**. Over the next 12 to 15 months, as exits take place, we’ll likely get a clearer picture of which firms are overvalued and set to peter out and which are here to stay.

The initial public offering market has been unwelcoming lately. Elevate Credit Inc., an online subprime consumer lender, delayed an IPO scheduled

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for this week, citing difficult market conditions. That follows an indefinite postponement of an IPO by online mortgage and consumer lender LoanDepot Inc. late last year.

The future of fintech

Nevertheless, investors, analysts and banks still see financial innovation as the future.
Autonomous Research estimates digital lenders will have roughly $100 billion out in loans globally by 2020, roughly 10 percent all small business and consumer loans. The report also noted that there were more than 2,000 firms globally now competing in digital lending.

Looking at the global picture, while North America continues to account for the bulk of funding to VC-backed fintech companies, investments in Asia Pacific grew to $3.5 billion in the first 9 months of 2015, from $880 million in 2014, according to a recent **Accenture report**.

Asia is also emerging at outstanding speed as an innovation hub. China, India, Singapore and Hong Kong are fuelling Asian fintech and emerging as significant competitors globally. As one more interesting trend, Fintech startups also have **attracted investment from a variety of corporations** globally. Of the 72 corporate deals since 2012, the US has accounted for the biggest share, with just under half. China and Japan follow second and third respectively. Besides the usual U.S. suspects like GV and American Express Ventures, Chinese internet heavyweights such as Renren, Alibaba, and Tencent also had a strong presence.

The struggle with Series B

But fintech enthusiast, Max Levchin, is doubtful. Speaking to Inc magazine, he reckons raising money for series B will be harder in 2016 than it was in 2015.

According to a report by **CB Insights,** on a cohort of tech companies that raised seed funding in 2009-2010, just under half of companies that raised a Seed or Seed VC round in 2009-2010 raised a second round of funding. 22 percent of companies that raised a Seed in 2009-2010 exited through M&A or IPO within six rounds of funding. Nine companies (0.9 percent) that raised a Seed round in 2009-2010 reached a value of $1 billion (either via exit or funding round). As companies move into the later stages, the proportion that

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manage to raise follow on financing decreases.

For the time being though, finance is now riding an entrepreneurial wave. Demand for upstarts' services is strong, driven by widespread frustration with big banks. Many big banks are embracing technology to reduce costs and attract new kinds of customers. Banks must reinvent their business models or other players will do it for them.

Fintech’s new entrants are **spread across many sectors**. Around one third are in lending, one third in payments and the rest in real estate, insurance and investing.

Low interest rates have made capital, cheap and plentiful. You may get your next business loan from Lending Club, OnDeck, or Kabbage, instead of an it-takes-forever bank. You can now look to Kickstarter, Indie-gogo, or CircleUp to raise financing. Your company's transactions could be processed with fewer headaches by Square, Stripe, or WePay. And you can manage your money automatically at Betterment or Wealthfront and not pay for investment advice that may or may not outperform the market. You can even start replacing money itself using Coinbase, Circle, and other digital-currency options. The future of financial industry is here and it’s here to stay.

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This article is an edited version of Serguei’s introductory chapter in the ***Money of the Future*** *report.*

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