Fintech’s Golden Age

As fintechs move from competition to collaboration, Wall Street has a unique opportunity to advance.
Introduction

Over the past half-decade, the word “fintech” has evolved from an apparent spelling error to a word that is on everyone’s tongue. Globally, investment in financial technology ventures climbed to $22.3 billion in 2015, up from $1.8 billion in 2010 and $12.6 billion in 2014.

As deal volume has increased, there has been a shift in the types of fintech companies that are getting the most attention (and having the most success). Initially, many startups were looking to compete with the traditional financial services sector. Now, there has been a move toward collaboration as tech-savvy startups partner with, or are acquired by, established financial institutions.

“We are now in a golden age of fintech,” says Robert Gach, Capital Markets managing director for Accenture Strategy. “Technologies like robotics, cloud computing and data analytics are accomplishing things that six years ago would have been unthinkable.”

But there’s still vast room for growth and development. Banks and insurers need to do more than just invest in fintech that solves a single problem. They need to transform themselves into companies that can seamlessly adopt new fintech. When they do, the combined effect of multiple technologies will be incredibly powerful. Instead of just solving one problem at a time, the technologies will work together and build upon one another to improve efficiency and profitability.

For example, combining cloud technology with blockchain creates an environment that allows companies to collaborate easily and securely, which is critical to advancing use cases for blockchain. If you combine mobile with machine learning, you create an even more powerful platform that enables significant innovation.
New York Is Booming

In the United States and globally, New York is quickly becoming the center of fintech innovation. In the first quarter of 2016, New York received more fintech financing than Silicon Valley for the first time ever: $690 million in deals compared to $511 million.

For the full year 2015, fintech investment in New York tripled from the previous year to $2.3 billion, and accounted for roughly 10 percent of all global fintech investment.

“For fintech entrepreneurs, New York provides advantages no other city can match,” says Maria Gotsch, President and CEO of the Partnership Fund for New York City. “It offers close access to potential customers and a deep pool of talent. With each passing year, New York City’s fintech industry becomes more established and a larger force in the city’s entrepreneurial and financial services ecosystem.”

The industry is learning to work more closely with startups, companies that embrace rapid iterations to test and learn, and a fail-fast mentality, to quickly find the best path forward. Through innovation labs and accelerators, banks are establishing “greenfield” sites where their people can operate in a different environment that allows the startup mindset to take over, enabling more rapid testing and experimentation.

For example, the New York FinTech Innovation Lab, co-founded by Accenture and the Partnership Fund for New York City, is in its sixth year helping early- and growth-stage fintech companies accelerate product and business development by introducing entrepreneurs to top bank and venture capital executives through a 12-week program. The Lab pairs startup businesses with mentors, giving them a fast track to access bank customers and win business. So far, the Lab’s 31 alumni companies have raised a total of $296 million in financing after participating in the program.

New York Fintech Financing Activity

<table>
<thead>
<tr>
<th>Year</th>
<th>Investment Value ($M)</th>
<th>Deal volume (#)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010</td>
<td>$216</td>
<td>34</td>
</tr>
<tr>
<td>2011</td>
<td>$202</td>
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<td>90</td>
</tr>
<tr>
<td>2015</td>
<td>$2,312</td>
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</tr>
</tbody>
</table>

Source: Accenture, Partnership Fund analysis of CB Insights data
A Changing Mix

Globally, the balance between investments in fintech companies looking to compete against the financial services industry versus those hoping to collaborate with financial institutions has remained steady over the past five years (with 62 percent of deals going to competitive companies).

But in New York, there has been a dramatic shift toward collaboration. In 2010, only 37 percent of investment in New York went to collaborative fintechs. By 2015, that number had climbed to 83 percent.

Companies like OnDeck have gone from a seemingly disruptive position to a more collaborative approach. Founded in 2011, the company filled a gap with software that was able to underwrite small loans at a lower cost in a market from which banks were retreating. OnDeck went public in 2014 and is now partnering with several large global retail banks, enabling them to offer small business borrowers the speed of an alternative lender.

Some New York startups have been collaborative from the beginning. Digital Asset Holdings, founded in 2014, uses blockchain, the technology that underlies Bitcoin, to help banks speed compliance time. Thanks to its close relationship with Wall Street, in February Digital Asset was able to raise $60 million in a round that included nearly a dozen Wall Street veteran firms, like Citigroup, JPMorgan and DTCC.

But even in New York, not every company has set out to collaborate with Wall Street. Betterment, launched in 2010 as a low-fee, digital alternative to traditional investing, quickly became a venture capital darling, raising $205 million in its first six investment rounds. It has continued to grow in clout and financing and, with $4 billion in assets under management, is valued at $700 million. It offers white-label products to financial advisers and institutional investors and helps companies manage 401k investments. “We want to be our customers’ central financial relationship,” the company’s CEO recently told Fortune.

Companies like Betterment offer a traditional banking product that is more attuned to today’s customers needs. And while that competition might sting in the short term, in the long term, it’s forcing traditional financial institutions to “up their game,” which will be a good thing for banks, insurers and their customers.

Still, overall U.S. fintech investment favors collaborative ventures more than investment in other regions. In Europe, between 2010 and 2015, investment in collaborative fintech actually shrunk from 38 percent of deals to 14 percent of deals. Meanwhile, in the U.S., even Silicon Valley saw a rise in investment in collaborative technologies, with volume climbing from 21 percent in 2010 to 35 percent in 2015.

This can partially be attributed to Europe’s regulatory environment, which encourages startup competition for banks and insurers. The European Union’s Payments Services Directive (PSD2), for example, makes it easier to establish new payment services. Regulations around interchange fees encourage banks to offer alternatives to card payments.

But in the U.S., the regulatory environment for tech startups looking to become full-fledged financial institutions is much more challenging. And some regulatory bodies are signaling that it may become even more difficult for new entrants, citing concerns about cyber security and the staying power of new financial companies.
Collaborative Versus Competitive Fintech Investments ($M)

Europe
- 2010: $92, Collaborative 38%, Competitive 62%
- 2015: $2,897, Collaborative 14%, Competitive 86%

North America
- 2010: $1,118, Collaborative 40%, Competitive 60%
- 2015: $11,387, Collaborative 60%, Competitive 40%

APAC
- 2010: $43, Collaborative 7%, Competitive 93%
- 2015: $3,781, Collaborative 16%, Competitive 84%

Source: Accenture analysis of CB Insights data

Collaborative Versus Competitive Fintech Investments (# of Deals)

New York
- 2010: 27, Collaborative 67%, Competitive 33%
- 2015: 94, Collaborative 56%, Competitive 44%

Silicon Valley
- 2010: 38, Collaborative 71%, Competitive 29%
- 2015: 127, Collaborative 63%, Competitive 37%

Collaborative
- 2010: $174, Collaborative 63%
- 2015: $2,209, Collaborative 83%

Competitive
- 2010: $271, Competitive 17%
- 2015: $4,343, Competitive 17%

Source: Accenture and Partnership Fund analysis of CB Insights data
Golden Age

The reality of the U.S. regulatory landscape—combined with surging demand for digital innovation—makes the fintech venture investment boom a golden age for banks.

In 2015, banks participated in less than 10 percent of all reported fintech venture deals, totaling less than $5 billion. At the same time, banks spent $50 billion on investments in new technology. Most of that money is going to updating decades-old mainframe and information technology infrastructures.

It is challenging for banks to jump into adopting technologies like robo-advice and cloud-based software with aging infrastructure. And for the past eight years, banks have diverted much of their capital to compliance measures. During this time, it has been venture capital that has fueled many of the new innovations that banks can now adopt for themselves.

As the changing regulatory environment makes it difficult for fintechs—particularly in the U.S.—to grow and scale on their own, many financial institutions are now structurally ready to adopt new technologies that could, in the long run, save banks time and money and rebuild profit margins.

Financial institutions are starting to embrace this idea. Barclays, for example, has taken its 250-question procurement form and developed a special “lite” version for smaller vendors, which may have as few as 10 questions. Such institutions recognize that they need to streamline their processes in order to be more startup friendly and, in return, startups are lining up to work with them.

“Collaboration puts you on the bench, but it doesn’t necessarily mean you get to play in the game,” says Gach. “With friction easing and cooperation growing between traditional financial institutions, fintech startups, regulators and consumers, financial services firms need to take the next step.”

Global Banks’ IT Investment by Type, 2015

- Bank IT spending for new investments
  ~ $50Bn

- Fintech Investments
  ~ $22Bn

- Value of Fintech deals with banks as investors
  ~ $5Bn

Source:
1. IT Spending in Banking. A Global Perspective, Celent, February 2015
2. Digital Disruption: How FinTech is forcing Banking to a tipping point, Citi, March 2016
3. Accenture analysis of CB Insights data
Conclusion

The shift from competition to collaboration will continue. Collaboration, and eventually real adoption, has the potential to fundamentally change the banking ecosystem.

For example, blockchain technology could take time and expense out of things like post-trade processing and payments. Cloud computing could make banks and insurers more nimble and able to modernize their software with simple updates. And data analysis could help financial institutions find ways to save money while providing better customer service and building new sources of revenue.

“It’s when these technologies are no longer solving one problem at a time but being put together and building upon each other that fintech will go the final mile,” says Gach.

Financial institutions need to continue to open up to startups and bake venture-funded innovations into their business plans. Innovation and fintech shouldn’t just be something that takes place in a far-away incubator, it should be part of the fabric of every financial institution.

“We are starting to see this shift. When we launched the FinTech Innovation Lab in 2010, 10 banks participated; this year nearly three times as many institutions, including insurance companies, hedge funds and payment companies, are working as mentors. We’ll know we’ve succeeded when onboarding innovation is second nature to financial institutions,” concluded Gotsch.
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Sources
3 http://fortune.com/2016/03/29/betterment-funding/

About the FinTech Innovation Lab
Founded in 2010 by Accenture and the Partnership Fund for New York City, the FinTech Innovation Lab is a mentorship and accelerator program for leading financial technology ventures. Accenture launched additional labs in London in 2012, and in Hong Kong and Dublin in 2013. The program is supported by 33 of the world’s leading financial institutions. Nearly 100 ventures have participated in the Labs, raising more than $335 million in financing after the program.

About Accenture
Accenture is a leading global professional services company, providing a broad range of services and solutions in strategy, consulting, digital, technology and operations. Combining unmatched experience and specialized skills across more than 40 industries and all business functions—underpinned by the world’s largest delivery network—Accenture works at the intersection of business and technology to help clients improve their performance and create sustainable value for their stakeholders. With approximately 373,000 people serving clients in more than 120 countries, Accenture drives innovation to improve the way the world works and lives. Visit us at www.accenture.com.

About the Partnership Fund for New York City
The Partnership Fund for New York City is the $115 million investment arm of the Partnership for New York City, New York’s leading business organization. The Fund’s mission is to engage the City’s business leaders to identify and support promising NYC-based entrepreneurs in both the for-profit and non-profit sectors to create jobs, spur new business and expand opportunities for New Yorkers to participate in the City’s economy. The Fund is governed by a Board of Directors co-chaired by Charles “Chip” Kaye, co-chief executive officer of Warburg Pincus, and Tarek Sherif, Chairman and CEO of Medidata. Maria Gotsch serves as President and CEO of the Fund. More information about the Fund can be found at www.pfnycc.org.