TO BEAT THEM, JOIN THEM

M&A is reshaping the fintech landscape as the sector matures and key players – established and emergent – realise their limitations, explains Grant Murgatroyd

Deal and investment activity in the fintech sector globally slowed sharply in 2016. KPMG reported that 1,076 companies received $25bn of investment last year, down from 1,255 receiving $47bn in 2015.

"For the majority of fintechs it is now about growth," says Warren Mead, London-based global co-head of fintech at professional services firm KPMG. "Many raised significant financing in 2015 and 2016 and they now need to prove the business model. For those competing against the big incumbents, the biggest challenge is distribution. Getting new clients in financial services is notoriously difficult because customer inertia is a powerful force."

For many early-stage investors, the fintech story is yet to have a happy ending. "You could argue that a lot of these guys would become significant scale businesses very quickly," says Atul Monga, director in Grant Thornton's technology, media and telecommunications M&A team in London. "The reality is that it is not so straightforward. It takes a hell of a long time to grow these businesses and it doesn't take long for others to replicate that model. There is often very little by way of intellectual property, so the disrupters get disrupted relatively quickly. The key thing is to sustain your advantage and build on it quickly. Capital is very important."

SPECIALIST OR GENERALIST?

Institutional investors sit somewhere on a range from embedded specialists to generalists. LTP, a US news service for fintechs, identified 61 venture capital firms with specific fintech expertise. That's on top of the global private equity heavyweights who have been building expertise and experience in the sector. Advent International, for example, counts Worldpay, which commanded a £4.8bn valuation when it listed on the London Stock Exchange in October 2015, as one of its investments.

"Pretty much everyone will look at fintech," says Monga. "The ones that tend to get it are the likes of Summit, Carlisle and HgCapital, who make significant investments in that space. A lot of the others aspire to do it, but struggle with valuations, because at this point in time fintech businesses tend to get valued quite highly. Either they are disrupters and get funky valuations or they are enabling the monolithic financial services houses to offer services and products more nimbly."

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1,076

FINTECH FIRMS RECEIVED $25BN OF INVESTMENT IN 2016 GLOBALLY

1,255

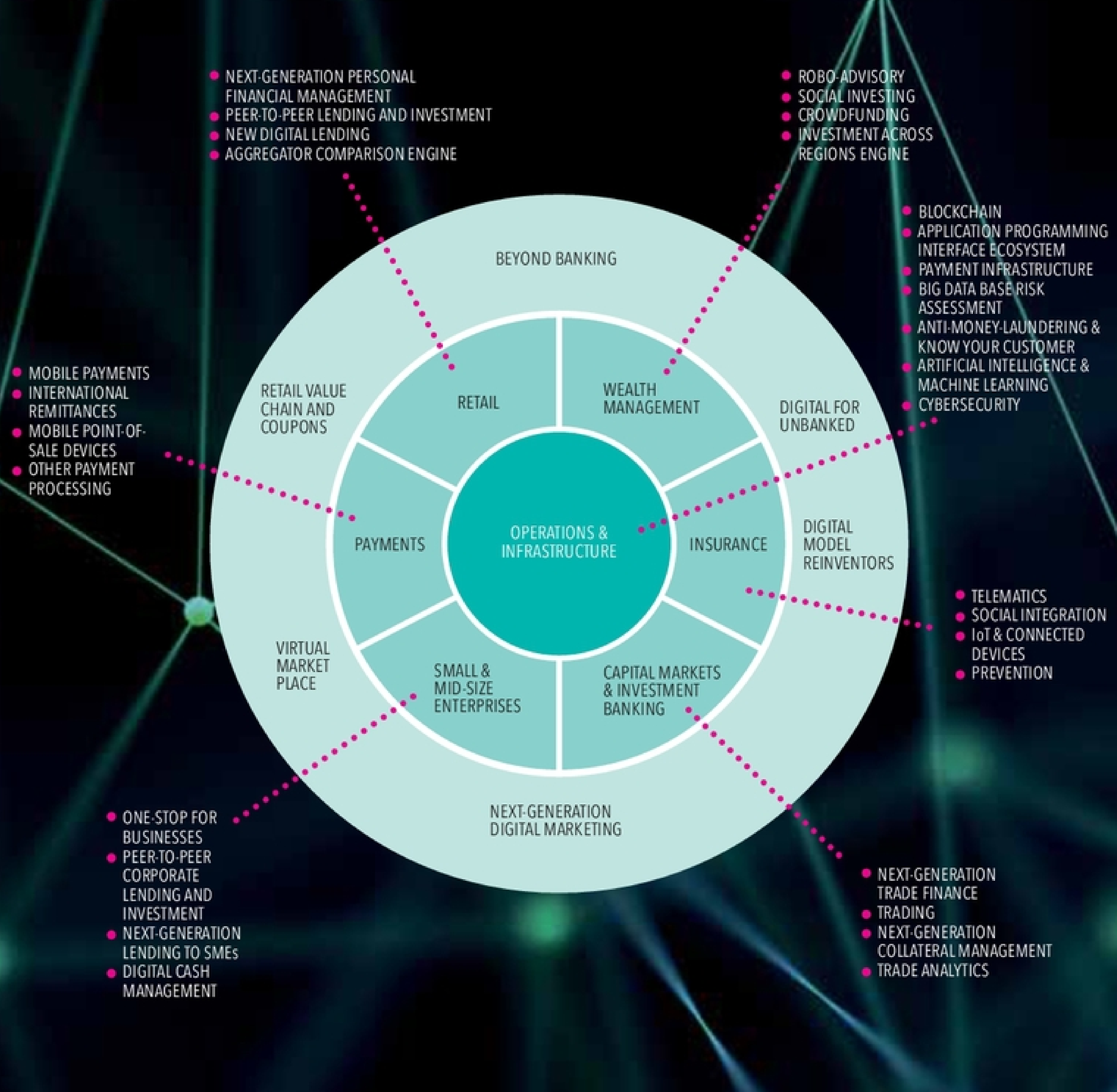
FINTECH FIRMS RECEIVED $47BN OF INVESTMENT IN 2015

FINTECH TRENDS TO LOOK OUT FOR

According to consultants McKinsey, there are seven imminent trends facing the fintech sector:

1. expanding scope;
2. increased diversity;
3. improved collaboration;
4. consolidation;
5. normalised valuations;
6. shifting regulations; and
7. emerging ecosystems.

KEY EMERGING AREAS OF FINTECH IN BANKING



SOURCE: PANORAMA BY MCKINSEY

TRESPASSERS BE AWARE

Established financial services companies will not, of course, give up an $11trn market without a fight. Corporate venturing arms have played an increasing role in development capital deals over recent years. In 2012, corporate venturers invested $600m, accounting for 9% of the total. But by 2016 the amounts had surged to $8.5bn and 17%.

As with technology companies during the dotcom era, corporate venture capitalists (VCs) are not always clear about their objectives, which include making a return, accessing and acquiring new technologies and taking out future competitors.

"Entrepreneurs have to make a big call as to whether to just purely go to institutional investors or go to corporates," says Eddie Harding, a partner at boutique ICON Corporate Finance, which has been advising fintechs for 15 years. "You are deciding whether to dance with the devil early on. It can be a good decision because it can give you significant risk mitigation. While a lot of them say that they're arm's length, they are really there

"ENTREPRENEURS HAVE TO MAKE A BIG CALL AS TO WHETHER TO JUST PURELY GO TO INSTITUTIONAL INVESTORS OR GO TO CORPORATES"

Eddie Harding,
partner, ICON Corporate Finance

LONDON: STAYING IN FRONT

The Department for International Trade's predecessor, UKTI, valued the UK's fintech market as being worth £20bn in annual revenue. 'Traditional' fintech such as InfoSys, SunGard and FirstData accounted for 82%, with emergent fintechs taking the remaining 18%. The government wants to maintain the UK's market leadership position, a tricky task post-Brexit.

"One of the most important reasons why fintechs locate in the UK is the proximity to a huge customer base," says Warren Mead of KPMG. "The UK has global banks, insurers and wealth managers on a scale not seen anywhere else in Europe. The future of the fintech industry in the UK is therefore closely aligned with the overall wellbeing of our financial services sector."

A financial centre's success is determined by its business environment, infrastructure, financial sector development, human capital and reputational factors. According to the *Global Financial Services Index 20*, published in September 2016 by consultancy Z/Yen, and based on pre-referendum data, London was leading the world, ahead of New York, Hong Kong, Tokyo and Singapore.

But professor Michael Mainelli of Z/Yen is cautious: "Since the beginning of 2017, the global trade and political outlook has become increasingly uncertain, leading to significant concerns over the future of global financial centres, particularly New York and London."

because they want a commercial benefit or a strategic benefit at some point down the line. It's not a case of putting golden handcuffs on straight away, but it does have a significant impact on your independence or at least people's impression of your independence."

A SEISMIC SHIFT

One of the most active corporate VCs, BBVA Ventures, last year handed management of its $100m venture fund to Propel Venture Partners, an independent VC with offices in London and San Francisco. The move was seen as an indication of the difficulties facing corporate venturers, rather than a withdrawal from the market.

As well as encountering a reticence from some entrepreneurs to take corporate money, BBVA Ventures was limited by its terms to investing no more than 5% of its fund in a single round. BBVA's $67m investment in Atom, a mobile-only bank in the UK, in 2015 was structured as a corporate equity investment, not a VC fund investment.

After some seismic shifts over the past few years, the fintech landscape is settling down. Investment has dropped off, and companies and their shareholders are focused on growing businesses, turning a profit and securing an exit

At that time, Teppo Paavola, BBVA's chief development officer, who is now also general manager of new digital businesses, said: "In an increasingly competitive fintech venture capital environment, we believe that our increased capital, Propel's independence and a presence in London can enable us to invest in the best fintech start-ups and better support BBVA's vision of using technology to change financial services for the benefit of the customer." A subsequent £29.4m investment was made by BBVA directly, not via Propel, in March 2017.

After some seismic shifts over the past couple of years, the fintech landscape is settling down. Investment has dropped off, and companies and their shareholders are focused on growing businesses, turning a profit and securing an exit.

"The key difference in five years' time will be that the business models of the new entrants will either be proven, or they will not," predicts Mead. "There will be some incredible success stories with multi-billion valuations, but there will also be a huge number of failures between now and 2022." ●

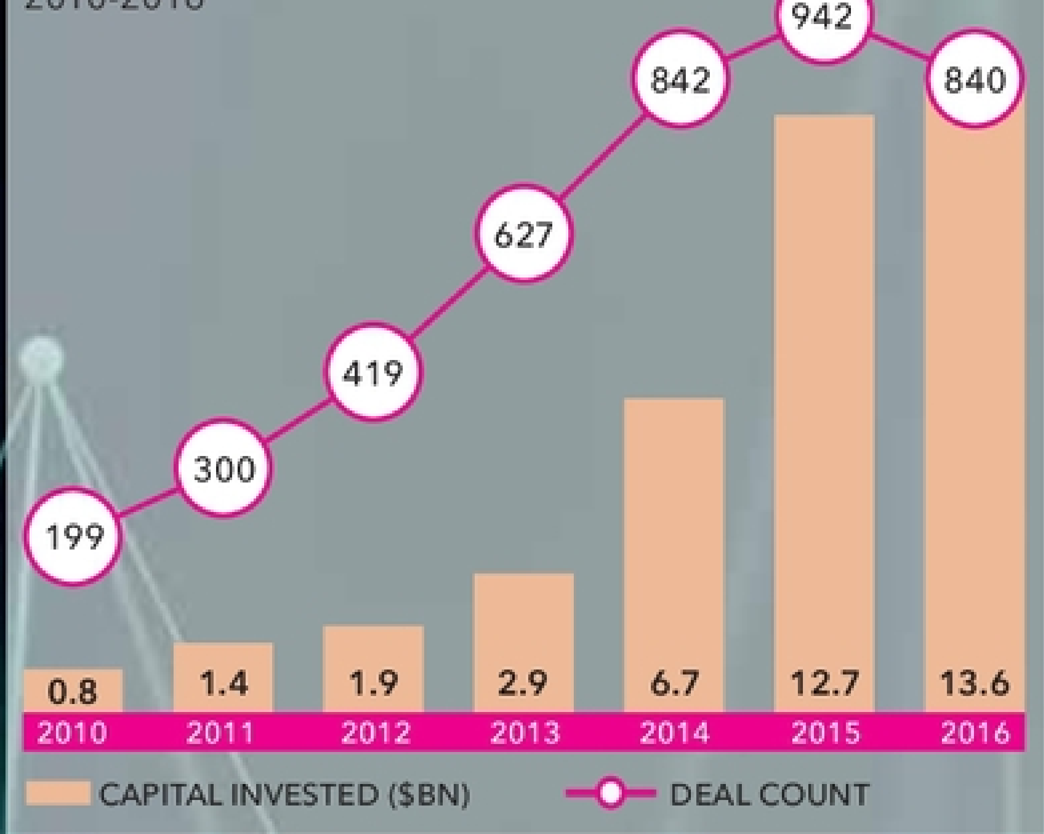
$67M

BBVA'S INITIAL INVESTMENT IN UK APP-ONLY BANK ATOM

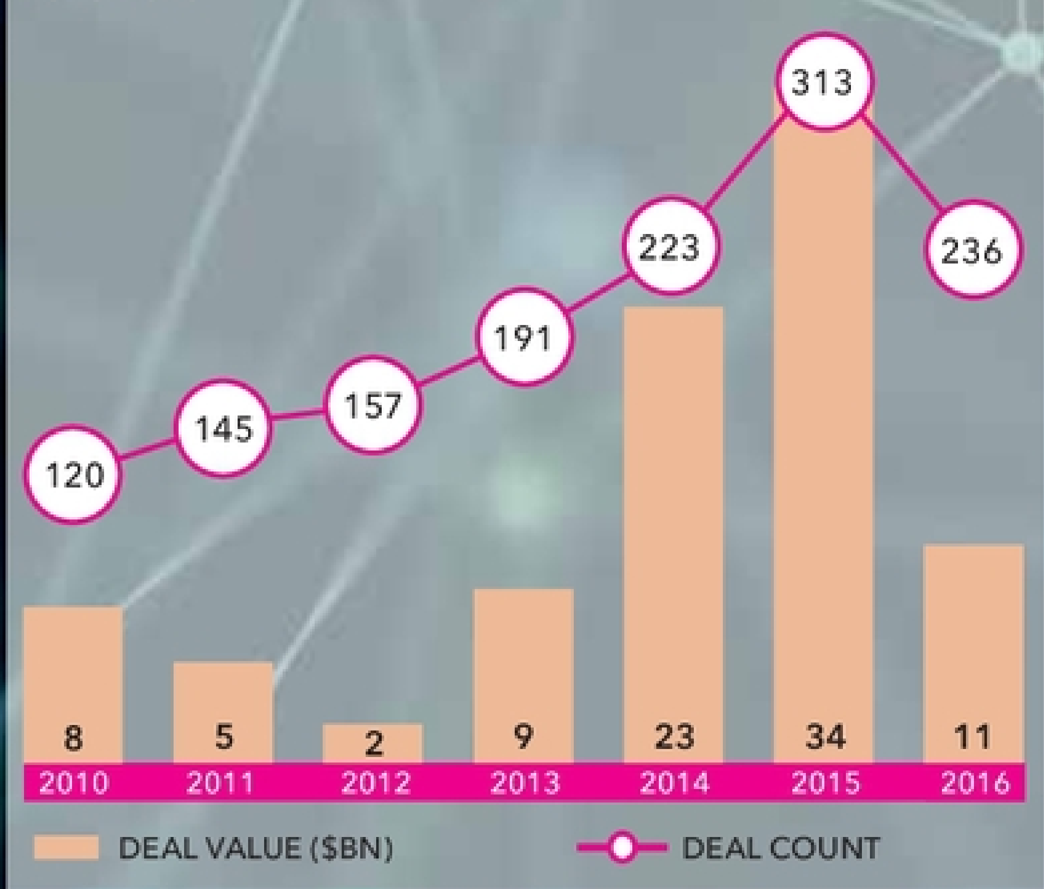
£29.4M

BBVA'S LATEST INVESTMENT IN UK APP-ONLY BANK ATOM

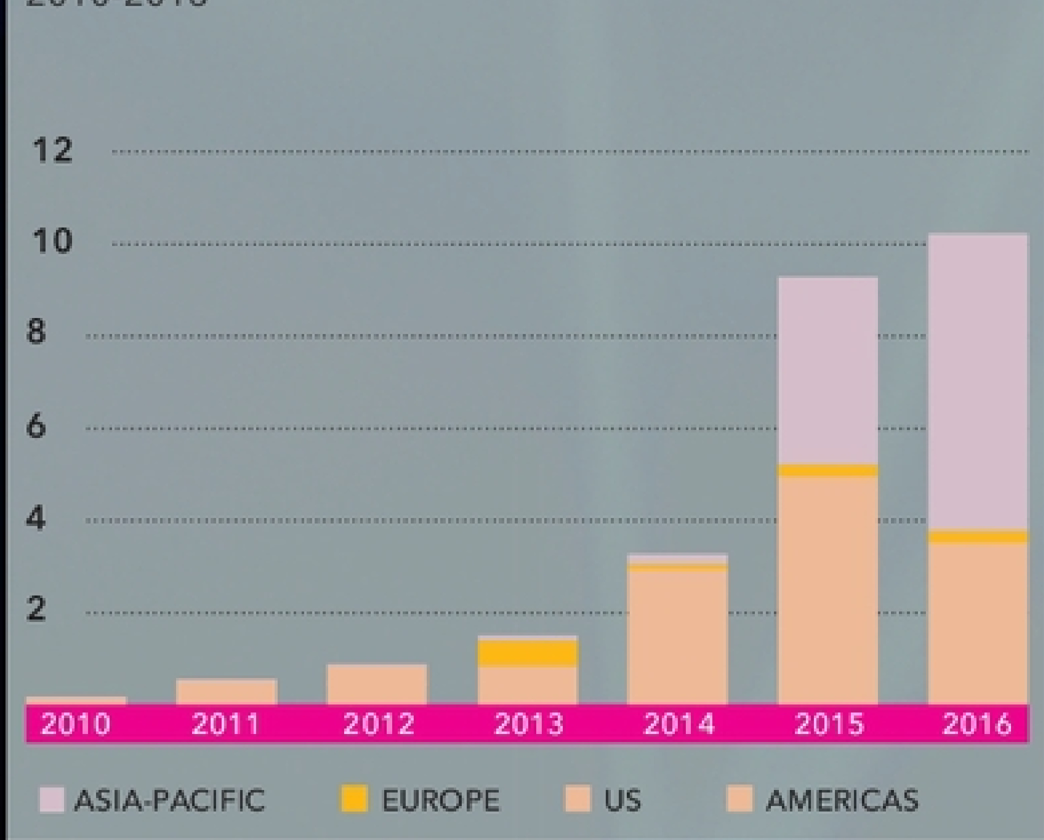
GLOBAL VENTURE INVESTMENT IN FINTECH COMPANIES
2010-2016



GLOBAL M&A ACTIVITY IN FINTECH
2010-2016



VENTURE INVESTMENT ($BN) IN FINTECH COMPANIES WITH CORPORATE VC PARTICIPATION
2010-2016



SOURCE FOR ABOVE GRAPHS: *THE PULSE OF FINTECH Q4 2016 – GLOBAL ANALYSIS OF INVESTMENT IN FINTECH*, KPMG