

# The Future of Fintech and Banking:

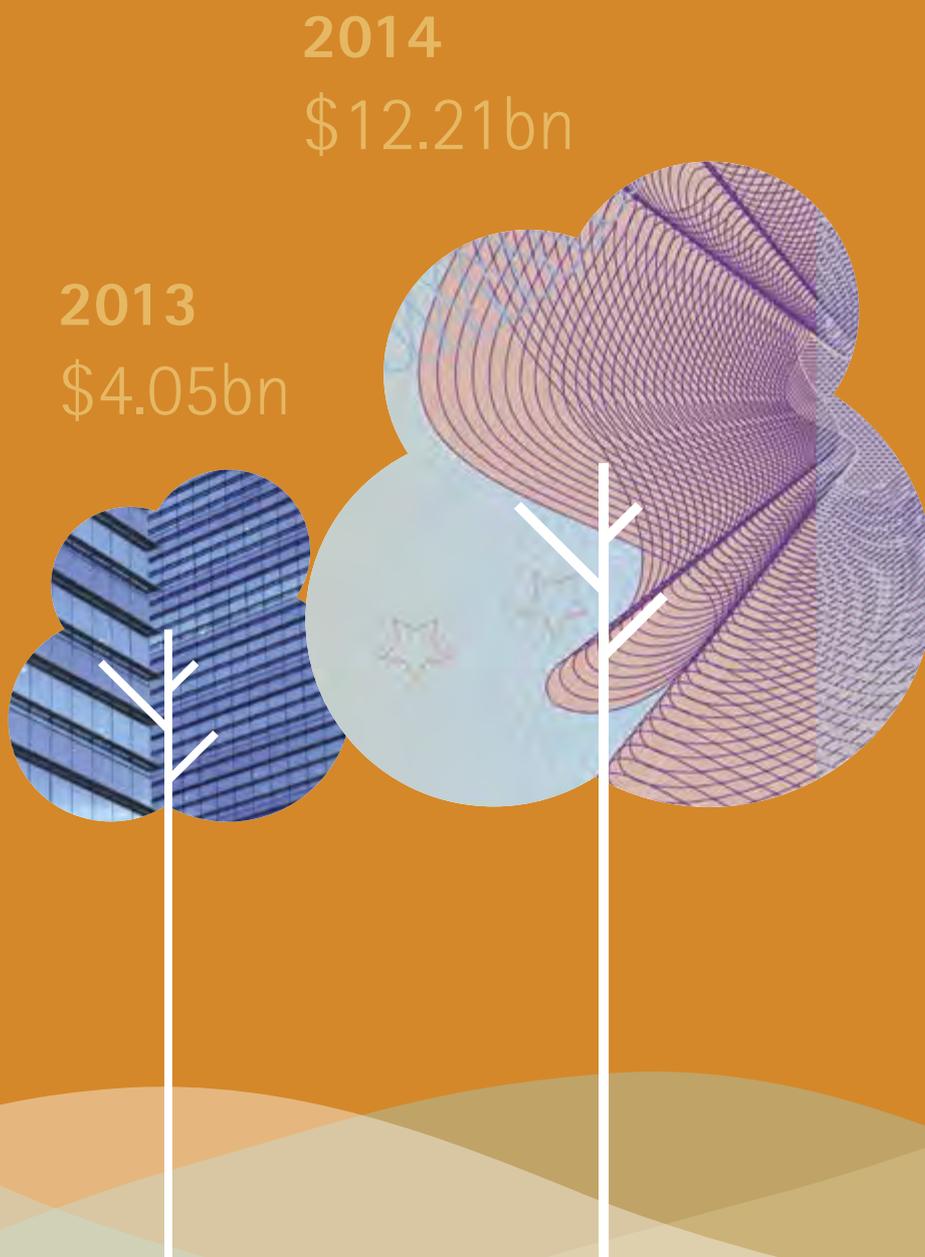
Digitally disrupted  
or reimaged?

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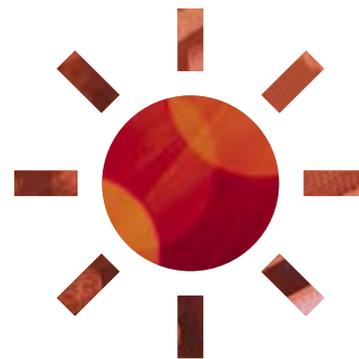




# Global investment in fintech ventures tripled to \$12.21 billion in 2014



# Executive Summary



Investment in financial-technology (fintech) companies grew by 201% globally in 2014, compared to 63% growth in overall venture-capital investments, confirming this sector as a hot ticket. Expectations for new digital start-ups in the industry continue to swell, with the amount of money flowing into first round investments alone growing by 48%<sup>1</sup>.

It is clear that the digital revolution in financial services is under way, but the impact on current banking players is not as well defined. Digital disruption has the potential to shrink the role and relevance of today's banks, and simultaneously help them create better, faster, cheaper services that make them an even more essential part of everyday life for institutions and individuals. To make the impact positive, banks are acknowledging that they need to shake themselves out of institutional complacency and

recognise that merely navigating waves of regulation and waiting for interest rates to rise won't protect them from obsolescence.

This Accenture report brings together the views of 25 influential financial services executives involved in innovation, and maps out the activities that established players have identified as necessary to allow them to disrupt their own business model rather than watch challenger models disintermediate them.

Openness, Collaboration and Investment are the critical themes that emerge for existing banking players if they are to benefit from growth driven by new services and productivity. Banks also recognise two other fundamental steps to ensuring that they are net winners from digital disruption: successfully dealing with the issue

of legacy technology and managing a large infusion of new talent.

Embracing these themes and creating the right foundations creates challenges to the rate of change and approach to risk that are hard-wired into the way banks currently adapt to innovation. This hands an advantage to challengers who only hit regulators' radar once their new business models have found ways to cherry-pick services and customers. Banks are anticipating this by creating new businesses within their existing structures that adapt and collaborate to meet these challenges and make better use, faster, of their enduring source of competitive advantage – customer insight.

Existing banks will know they are winning in digital when bank valuations start to factor in the future value of proven innovation, in addition to protecting the core franchise.



# Introduction

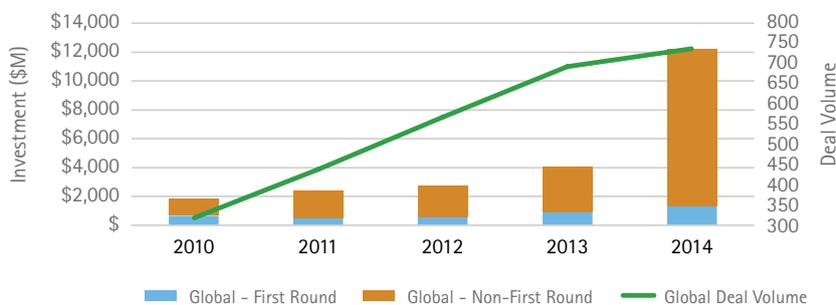
Global investment in fintech ventures tripled to \$12.21 billion in 2014, clearly signifying that the digital revolution has arrived in the financial services sector. It is still unclear whether this presents more of a challenge or an opportunity for the incumbents in the industry. But established financial services players are starting to take bold steps to engage with emerging innovations.

The fintech sector is often characterised as a battle between the old and the new. But it's worth noting that the flood of new money going into the space is distributed across both parts – in fact, with a slight bias towards investments in more established companies.

Two of the biggest successes of 2014 perfectly characterise this diversity in the market. On one hand, First Data, a provider of payment processing services founded in 1971, raised \$3.5 billion<sup>2</sup> in private equity led by KKR. On the other hand we have a true 'new wave fintech' poster child, Lending Club, the peer-to-peer lending platform founded in 2006 that raised \$865 million on the New York Stock Exchange, valuing its business at \$8.5 billion and hitting the record for the biggest US tech IPO of 2014.

Lending Club's successful IPO shows that a new wave of financial technology is building momentum, and will have a significant impact on the future of financial services. In fact, two-fifths of all the fintech venture-capital deals done in 2014 were first round investments in early-stage companies.

Figure 1: Global FinTech Financing Activity



Source: Accenture and CB Insights

By value, this only represents 11% (\$1.38 billion) of total investments in the space, but growth is an impressive 48% year-on-year.

The concern is that established financial services players are not doing enough to keep up to speed with this surge in new innovation investment. Accenture's survey of senior industry executives involved in the FinTech Innovation Lab (see page 7) reveals that 72% feel their bank has only a fragmented or opportunistic strategy to dealing within digital innovation (see figure 1).

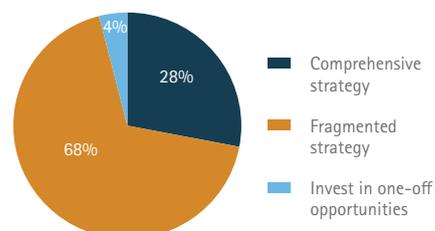
Legacy technology and the difficulty of deploying new technology fast is a big part of this issue. All of the respondents felt that legacy technology presented an issue to their organisation, but only just over half said their bank had a strategic approach to decommissioning this old technology (see figure 2).

More worrying is the speed at which these banks implement new technology. The overwhelming majority agreed that, in the future,

new technology deployment cycles will be much quicker. However, 40% of respondents felt that the current time taken for their organisation to deploy new technology was either negatively impacting its value, or providing no net benefit at all.

Skills and culture also present a challenge. Four out of five respondents felt that when it came to culture and talent, they were only "somewhat" or "minimally" equipped for the digital age. Meanwhile, only half felt that their procurement processes and technology were up to scratch.

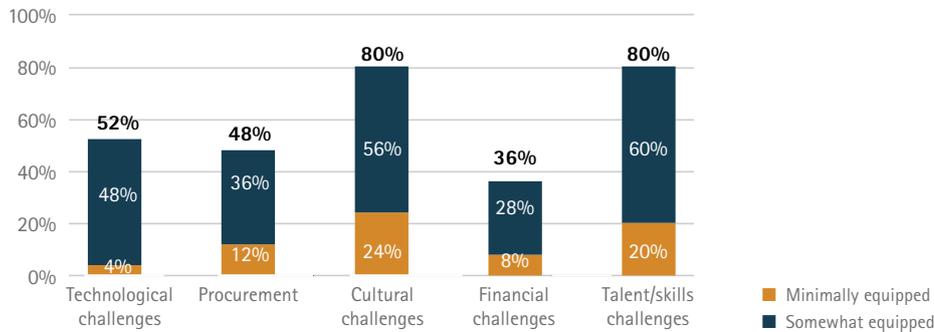
Figure 2: Strategy in place for digital and innovation



Number of respondents = 25



**Figure 3:** How equipped do banks feel to address the challenges associated with the next wave of digital innovations



Number of respondents = 25

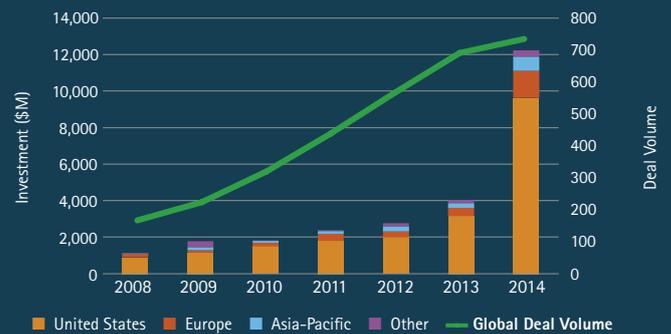
## Regional Investment Data

Of the \$12.21 billion invested in 2014, the US makes up the lion's share, but Europe experienced the highest level of growth, with an increase of 215% (year-on-year). Fintech investment growth in the UK and Ireland was slightly slower (up 136% to \$623 million) although the region accounted for 42% of European investment.

Following a relatively slow 2013, fintech investment in Silicon Valley more than doubled (117%), pushing the start-up hotspot over the \$2 billion mark, more than the total investment in Europe (\$1.48 billion).

Whilst the UK and Ireland dominate Europe's fintech investment, the rest of Europe is showing promise: the value of fintech investment in the region grew more than twice as fast as the UK and Ireland in 2014; the most significant levels of investments were in the Nordic countries (\$345 million), the Netherlands (\$306 million) and Germany (\$82 million).

**Figure 4:** Global FinTech Financing Activity



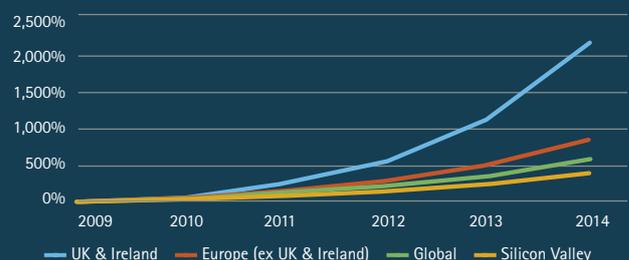
Source: Accenture and CB Insights

**Figure 5:** Top 5 European Regions for Fintech Investment Activity, 2014



Source: Accenture and CB Insights

**Figure 6:** Five-year Growth in Fintech Investment (\$M)



Source: Accenture and CB Insights



## The future state

Despite these complications which the incumbent players in the industry are facing, three-fifths of respondents to the survey felt that established financial services players would survive and thrive in the digital future – either because new and existing banks would find ways to grow and enrich the market overall, or because the established banks would simply acquire the new players (see figure 3).

Yet it's notable that the remaining two-fifths (a significant minority) felt the future was much more bleak. One fifth felt that the industry would become disaggregated, while the remaining fifth felt that traditional banks would lose market share, revenue, scale – and importantly, that margins would fall or banking services would be added incrementally to non-financial services offerings (see figure 7).

These two camps represent the two broad scenarios for the future of financial services in the fintech age.

How this digital revolution will impact the established financial services industry is uncertain, but the following two scenarios provide a structure for how things may play out. It is important to recognise that there is no reason to believe either scenario will apply to all banks – banks can still control their own destiny:

### Scenario 1: Digitally Disrupted

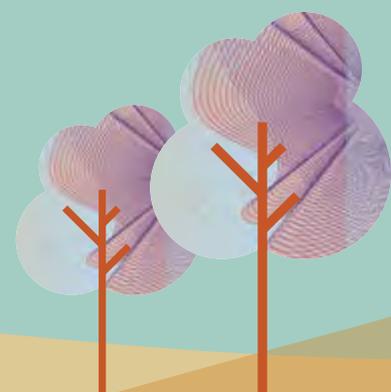
Caught in the headlights of regulation and cost reduction, the bank loses out to new players that provide more effective financial products and services attuned to the digital age. The bank continues with a product-based sales approach rather than improving the customer experience and as a result lacks the motivation to deal with legacy applications. Banks in this scenario compete for a diminishing share of wallet as their brands are relegated in customers' eyes to that of commodity utilities. They continue to believe in the impregnable nature of their business model and that fast-following strategies will remain the most successful.

### Scenario 2: Digitally Reimagined

Innovations are embraced at the business model level. The focus is on making a customer's life easier not on asset monopolies, and sources of revenue change over time as customer insight grows and the bank learns how to use collaboration with adjacent business models to surprise and delight customers. Banks in this category see themselves as having short term advantages in infrastructure and customer data, but no long term right to exist without converting this into services that solve emerging digital consumer frustrations.

When Accenture started its journey with the FinTech Innovation Lab in NYC in 2010, no bank we spoke with believed Scenario 1 could happen to them. The overriding belief was that providing sustainable banking services or sub-services was too complex, risky and regulated for new players to threaten the existing players. Few banks now feel that the outcome of digital is so clear.

Figure 7: Hypothetical banking future



## The FinTech Innovation Lab

The FinTech Innovation Lab is an annual mentorship programme for entrepreneurs and early-stage companies that are developing cutting-edge technologies for the financial services sector.

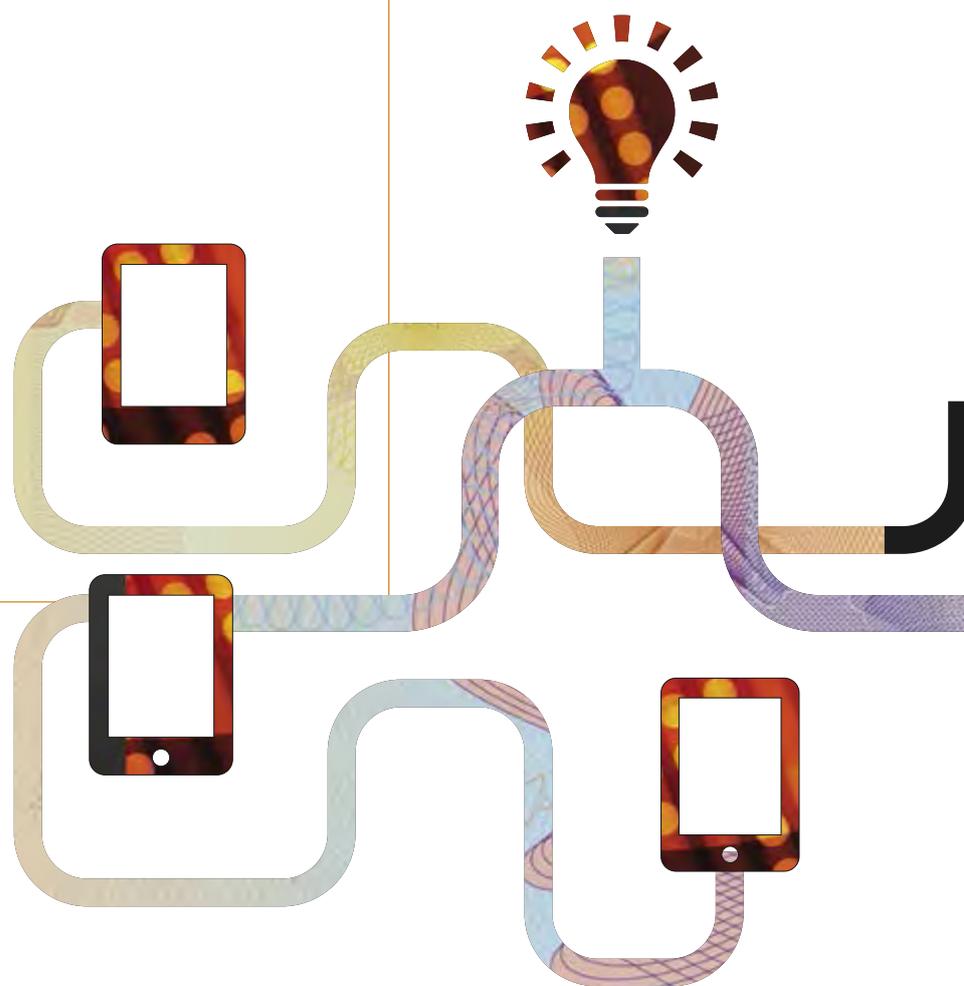
The lab brings Chief Information Officers and senior IT decision makers from the world's leading financial services firms together to mentor a handful of aspiring entrepreneurs, and to refine and test their propositions over a three-month period.

The FinTech Innovation Lab began in New York in 2010, founded by the Partnership Fund for New York City and Accenture. In 2012, Accenture launched the programme in London, and then Hong Kong and Ireland in 2014.

In London, senior executives from 15 major global and domestic banks participate, including Bank of America, Barclays, Citi, Credit Suisse, Deutsche Bank, Goldman

Sachs, HSBC, Intesa Sanpaolo, JP Morgan, Lloyds Banking Group, Morgan Stanley, Nationwide, RBS, Santander and UBS.

Graduates of the programme enjoy a number of successes. On average, London start-ups grew staff numbers by 55% and increased revenues by 170% since graduating from the programme. The Lab also sets them up well to raise significant levels of capital. To date, the 14 London graduates have raised more than \$35 million.



# Three behaviours enabling banks to be digital winners

Our interviews and analysis point to three behaviours in relation to fintech that banks believe could allow them to reimagine themselves digitally:

## Act Open

Open innovation is at the heart of the digital revolution, exemplified by the open source movement that has supported so much of the new technology development in recent years. For large organisations this translates as a process of engaging with external technology solutions, knowledge capital and resources early on in an innovation process. Often it involves opening up the organisation's own intellectual property (IP), assets and expertise to outside innovators to help generate new ideas, change organisational culture, identify and attract new skills, and discover new areas for growth.

The open concept is embedded in many of the new fintech companies' approaches. For example, Germany's Fidor Bank has established FidorOS<sup>3</sup>, a middleware with an open Application Programming Interface (API) that can connect to existing core banking platforms to offer a range of modern services including lending money to friends, sending money via Twitter and arranging an emergency 24-hour loan.

Their open API also allows third parties to access all areas of the bank

system, unbundle relevant services, and build new services based upon the bank's platform facilitating considerable innovation. The bank has also moved into partnership with foreign exchange specialist Currency Cloud<sup>4</sup> to offer a current account product that can be viewed in seven currencies and offers foreign exchange transactions.

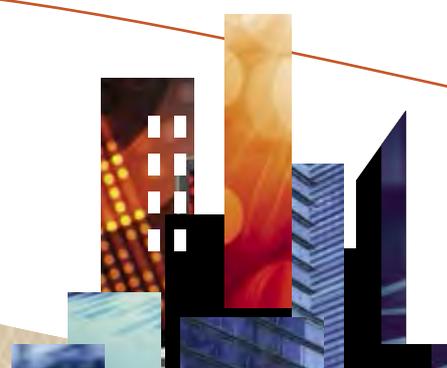
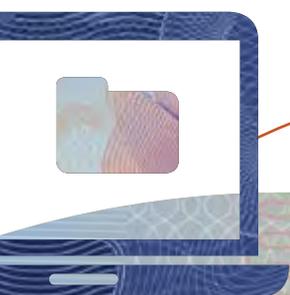
Similarly, two former senior staff at Simple, the online bank acquired by Spain's BBVA in 2014, have launched a new business bank in the US called SEED which has a customisable interface<sup>5</sup> to better allow small businesses to develop their own tools and services. Firms have to apply for membership of the bank, at which point they can use the bank's API to build their own banking tools.

Established banks have also been getting in on the act, and the open approach to innovation is gaining significant popularity amongst the survey respondents. Forty percent of the banks we surveyed already have some open technical innovation activities, while another 56% will set one up in the next two years.

A great example in the capital markets field is Goldman Sachs' placement of its proprietary source code on the online collaboration tool GitHub<sup>6</sup>. This allows external coders to try and optimise it, fostering competition amongst erstwhile Goldman Sachs programmers and while potentially seeing improvements from their efforts.

In the retail banking space, French bank Credit Agricole launched an open API as early as 2012, enabling developers to build apps on top of its services, and now has a range of apps providing expense management, social payment and finance analysis tools to customers<sup>7</sup>. Not far behind, BBVA launched the Innova Challenge<sup>8</sup>, a competition that involves software developers building new platforms and apps based on anonymised client data from the bank.

Possibly the biggest opportunity from taking an open approach to innovation is in the area of the Blockchain, the protocol that underpins the distributed architecture of the Bitcoin cryptocurrency. It is early days for cryptocurrencies, and it is unclear what the long-term effects of their adoption will be on the financial services industry. However, it is clear that if established players are going to benefit from this revolutionary approach to finance, they will have to engage with a much wider range of technical specialists and developers outside their own organisations.



## Collaborate

The concepts of collaboration – or “co-innovation” – are becoming more important within the financial services and technology industries. This is confirmed by the survey, which reveals that three-fifths of respondents support the “Digitally Reimagined” scenario for the future, where the addressable market for financial service grows through complementary alliances between different players.

Traditionally, financial services incumbents have been comfortable partnering with others in their own industry – especially where there is an opportunity to share processes or services that are considered “non-core”, and which help all collaborators either reduce their costs or create a new market opportunity.

There are many examples of these partnerships in capital markets and retail banking, but the most commonly known examples are in the payments space. For instance, MasterCard was founded by a consortium of banks to support interbank card payments for consumers in 1966, having realised the potential it had for customer service and spending. Another is SWIFT, the interbank payments network founded in 1973, which functions as a shared utility owned by banks, a communication standards authority and connectivity systems provider<sup>9</sup>.

## The big challenge for established players is their organisational culture's ability to adopt a collaborative approach with new innovators and start-ups.

Yet collaboration will need to go a step further in future. In order to maintain and grow value in these times of change, established players should look to collaborate more closely with those in different industries and with different outlooks to identify new ways to generate value.

Collaborative engagement with start-ups has already become particularly popular. Take the FinTech Innovation Lab model, which brings together multiple banks to collaborate and provide mentorship to start-ups that could potentially help their businesses. And the FinTech Innovation Lab is not alone in this approach. In February 2015, Australian banks helped to set up a AUS\$2million not-for-profit start-up centre in Sydney to support new fintech firms<sup>10</sup>.

Cross-industry collaboration is also crucial for future value generation. Digital technologies thrive by enabling interesting products

and services to be created when combining the assets of two industries. For instance, mBank, part of Commerzbank Group and Poland's fourth largest by capital<sup>11</sup>, partnered with telco Orange Polska in 2014 to begin offering a joint (white-labelled) banking service for phones and tablets. mBank is seeking to enhance mobile banking through an app that allows full online banking functionality using a smartphone and a PIN code.

The big challenge for established players is their organisational culture's ability to adopt a collaborative approach with new innovators and start-ups. Over half of the respondents to the survey believe they should collaborate “fully” or “extensively” with other industries, while 80% believe the value in working with start-ups is bringing new ideas to their business. Yet 56% claim that organisational culture is the biggest area of their business that needs to change in order to work effectively with start-ups.



## Invest

Venture investing has always been at the heart of the start-up innovation model. But now more than ever, established financial services firms are taking this route to try and generate innovation for their business. Corporate venture arms are used by one-third of the surveyed bankers and further third expect to launch one in the next two years.

American Express, BBVA, HSBC, Santander and Sberbank have all developed corporate investment vehicles over the last four years, each with at least US\$100 million to invest. In February 2015 AXA, the insurance and investment management firm, launched a €200 million fund to act as "an accelerating force for start-up companies" in its areas of business.

As with all investments, however, the value can go up as well as down – and with venture investment the risks are significantly higher than when investing in established businesses. Yet there is a further complication for a corporate venture arm, because the return on investment can be measured in two ways: either as a traditional direct return on

capital invested through their equity stake, or as a measure of the value generated for the parent business.

While the former measure of ROI is well understood, an investment return here does not necessarily result in an innovation for the parent business. In fact, the two businesses may never collaborate, yet still an ROI on paper is achieved. But, for the latter approach, measuring the innovation value for the parent business, there is still no consensus amongst corporate venture arms about how an equity stake can be translated into improvements in innovation culture, technology or processes. There is also the risk that a strategic investment will constrain the bank's ability to adopt new technology as it develops.

The fact remains that innovative start-ups have a high innovation quotient, but need capital, and established financial services firms have lots of capital, but need to increase their ability to innovate. In such a situation it is inevitable that we are now seeing so much interest in financing fintech companies – and we do not see this ending any time soon. What has yet to be proved is how the innovation flows back to those that are funding it.

## A Desire to Reimagine

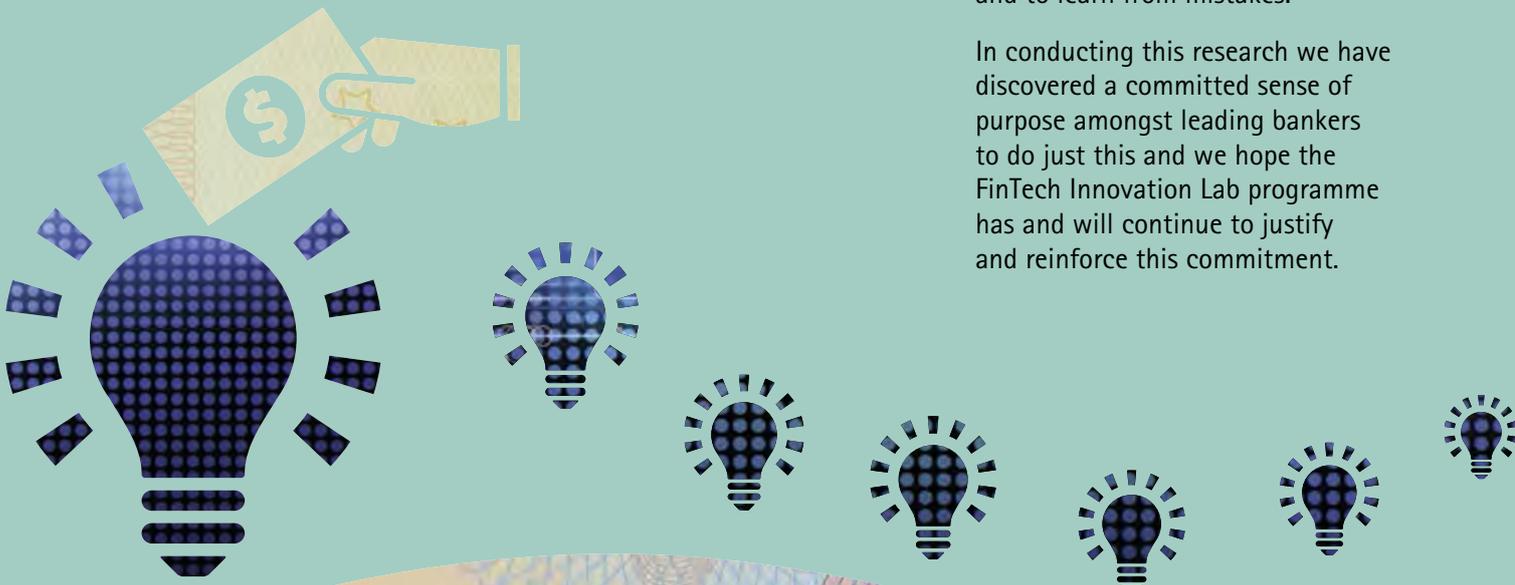
Accenture believes that banks have recognised the threat posed by digital and that they are avidly exploring the opportunities. They have recognised that, as John F. Kennedy once said, "Those who make peaceful revolution impossible will make violent revolution inevitable."

Most have also concluded that we are only beginning to understand the full impact of digital technologies on society, let alone in the financial services space, and that for the most part early-stage fintech innovators need the support of large established banks as much as those large organisations need the start-ups' new ideas and energy.

Furthermore, three-fifths of respondents said they were "somewhat" or "extensively" open to sacrificing revenue in order to move to new business models. And a further quarter were comfortable with this revenue sacrifice to a "minimal" degree.

Re-imagining a business model is exhilarating and exhausting. Many battles must be fought and won to get momentum, to fail fast and to learn from mistakes.

In conducting this research we have discovered a committed sense of purpose amongst leading bankers to do just this and we hope the FinTech Innovation Lab programme has and will continue to justify and reinforce this commitment.



## Methodology

This report used investment data from CB Insights, a global venture finance-data and analytics firm. The analysis included global financing activity from venture capital and private equity firms, corporations and corporate venture-capital divisions, hedge funds, accelerators, and government-backed funds.

The research also includes global exit activities of fintech companies – including M&A and IPOs – and a number of regional tracking dimensions. Fintech companies are defined as those that offer technologies for banking and corporate finance, capital markets, financial data analytics, payments and personal financial management.

The list of deals included are dynamic and constantly changing, as new companies are added to the database; all publicly known fund raises for a company, which can include earlier rounds, are back filled into the database.

In addition to this data, Accenture conducted a survey of 25 innovation-focused senior banking executives from across the banks that participate in the FinTech Innovation Lab London and Dublin. The banks involved represent 40% of the top 10 global banks by market capitalisation including two of the world's top five banks; however, these survey responses do not represent a statistically significant sample size, and should be used only as an indicative guide.

## Acknowledgements

This report and the research would not have been possible without the generous participation of many people from the financial services industry and beyond.

<sup>1</sup> CB Insights

<sup>2</sup> First Data Holdings, company announcement 'First Data Announces \$3.5 Billion Private Placement Led By KKR', 19 June 2014

<sup>3</sup> Fidortecs.com 'fidorOS - the fast and flexible middle ware'

<sup>4</sup> www.currencycloud.com/case-study/fidor-bank

<sup>5</sup> 'API Banking With SEED' <http://docs.seed.co/v1.0/docs/getting-started>

<sup>6</sup> <https://github.com/goldmansachs>

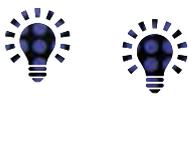
<sup>7</sup> <https://www.creditagricolestore.fr/>

<sup>8</sup> <http://www.centrodeinnovacionbbva.com/en/innovachallenge/home>

<sup>9</sup> [http://www.swift.com/about\\_swift/index](http://www.swift.com/about_swift/index)

<sup>10</sup> 'New Knowledge Hub to strengthen Sydney's position as a global financial centre', <http://www.trade.nsw.gov.au/>, 3 March 2015

<sup>11</sup> The Banker magazine, 2014



## About Accenture

Accenture is a global management consulting, technology services and outsourcing company, with approximately 319,000 people serving clients in more than 120 countries. Combining unparalleled experience, comprehensive capabilities across all industries and business functions, and extensive research on the world's most successful companies, Accenture collaborates with clients to help them become high-performance businesses and governments. The company generated net revenues of US\$30.0 billion for the fiscal year ended Aug. 31, 2014. Its home page is [www.accenture.com](http://www.accenture.com).

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