

Miklos Dietz,  
Vinayak HV,  
and Gillian Lee

# Bracing for seven critical changes as fintech matures

Financial Services November 2016

The fintech sector is being shaped by shifting market conditions, new regulations, and changes in consumer demands and behaviors.

**For the past decade,** fintech companies—technology firms that focus on financial products and services—have moved quickly, forcing incumbents to rethink their core business models and embrace digital innovations. But now, the fintech industry is itself maturing and entering a period of rapid change. Companies wondering how they will fit into this new era must first understand the forces that are pushing the changes.

While the industry will undoubtedly continue to expand as its customer base grows and investor appetite remains unsated, changes are imminent. Indeed, the very concept of what comprises fintech will shift. As the industry evolves, it will play a role well beyond financial products and services, individual companies will vie to become undisputed leaders by size and breadth, and ecosystems will develop that have a tight grip on customer loyalty.

This new fintech era is being shaped by changes in market conditions, new regulations, and shifts in consumer demands and behaviors. As a result, the industry, generally, is becoming more cautious, even as it becomes more diverse across technologies and products. McKinsey research and work with fintechs in many markets suggest seven critical aspects of this new environment that must be understood to thrive in the shifting market.

## Expanding scope

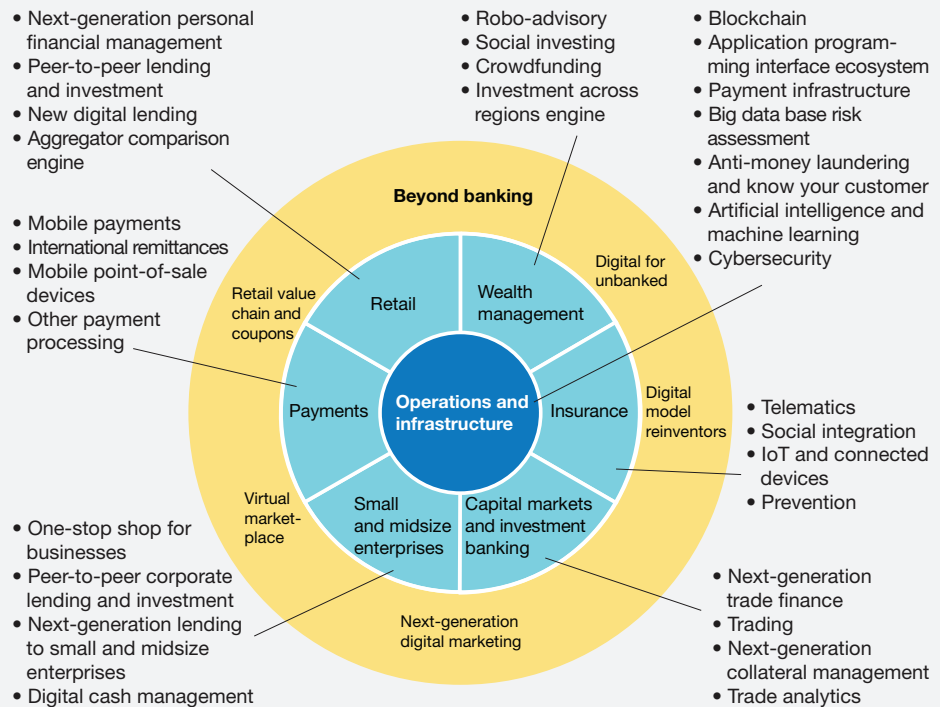
The scope of products and services offered by fintechs is expanding rapidly. Where once companies focused on payment applications, lending, and money transfers, the industry's reach has extended into more than 30 areas (exhibit). The shift brings fintechs away from a focus on frontline activities to a broad engagement throughout the value chain. The new offerings cut across a wide swath of financial services: retail, wealth management, small- and midsize enterprises (SMEs), corporate and investment banking, and insurance.

Various fintechs using a variety of technologies are active in each of these areas. Some, for example robo-advisory systems that provide automated recommendations with little human input, use tested technologies to meet customer needs, while others pursue more experimental technologies, such as blockchain systems that track and store an expanding series of transactions to help reduce infrastructure costs and improve efficiency.

## Exhibit

We see more than 30 areas emerging as new norms in banking.

### Key fintech trends



McKinsey&Company | Source: Panorama by McKinsey

In addition, fintechs are moving beyond addressing a customer's financial needs to offering a wider range of services, blurring the industry's boundaries. For example, Social Finance, known generally as SoFi, began by offering financial products to students and young professionals and has since expanded to provide career coaching and networking services. Holvi Payment Services, a Finnish start-up acquired by Spanish financial group Banco Bilbao Vizcaya Argentaria (BBVA) in 2016, began by offering banking services to SMEs and expanded to provide complementary offerings, such as an online sales platform, bookkeeping services, expense-claims systems, and a cash-flow tracker.

### Increasing diversity

The fintech industry is also becoming more diversified, with a wide variety of business models seen across geographies, segments, and technologies. One common model would be a start-up backed by venture-capital funding emerging to address a specific customer need.

For example, the US-based Stripe, one of the largest fintech players, was founded in 2011 to offer an improved online payment system and has attracted more than \$300 million from venture-capital funds, including Founders Fund, Khosla Ventures, and Sequoia Capital.<sup>1</sup> Stripe was one of the first fintechs to dramatically accelerate and improve the process merchants followed to accept payments online. While legacy payments companies needed five to seven days to set up a new merchant, Stripe gave merchants the chance to launch a website and start accepting payments within minutes.<sup>2</sup> Another model would be a large technology company expanding into financial services. China's Alibaba, one of the best-known examples of this model, started as a major e-commerce site and has moved into financial products, with its Alipay subsidiary boasting more than 800 million registered users in 2016. Another emerging model would be an established financial company creating its own fintech unit. For example, Ping An Insurance (Group) Company of China, China's largest insurer by assets, launched a peer-to-peer service, Lufax, in 2012, and by 2016 the unit was valued at almost \$19 billion.<sup>3</sup>

<sup>1</sup> Leena Rao, "Stripe's new funding makes it a \$5 billion company," *Fortune*, July 28, 2015, fortune.com.

<sup>2</sup> TechCrunch blog, "The story behind payment disruptor Stripe.com and its founder Patrick Collison," blog entry by Derek Andersen, May 20, 2012, techcrunch.com.

<sup>3</sup> Gabriel Wildau, "Chinese P2P lender Lufax valued at \$19bn in latest funding round," *Financial Times*, January 18, 2016, ft.com.

<sup>4</sup> Mashable business blog, "PayPal mobile app lets you order ahead at restaurants," blog entry by Todd Wasserman, September 5, 2013, mashable.com.

<sup>5</sup> Q3 16 Earnings Supplemental Financials, IHS Markit, September 27, 2016, phx.corporate-ir.net.

<sup>6</sup> Westpac New Zealand REDnews business blog, "Westpac enters exclusive New Zealand partnership with financial services start-up Moven," August 25, 2014, Westpac.co.nz.

Fintech pioneers, such as PayPal, are also adjusting their business models to encompass a wider range of services. PayPal, launched in the 1990s to provide a payment system for online purchases, then a new phenomena, has since expanded to provide instant lines of credit and mobile applications that locate nearby stores and restaurants that accept payment by PayPal.<sup>4</sup>

Along with diversified models, performance has also become highly variable among fintechs. Certain players have seen share prices fall more than 50 percent. At the other extreme, fintechs that retain the confidence of investors and customers have continued to see strong performance as reflected by share price and business growth. Among the examples, share price for IHS Markit, a financial information and data provider, rose by more than 20 percent over the 12 months ending October 2016. IHS Markit had shown consistently strong financial performance, with, for instance, adjusted third quarter 2016 revenue up 5 percent from a year earlier and its full-year margin forecast at about 36 percent.<sup>5</sup>

### Improving collaboration

Collaborative partnerships will become increasingly important as fintechs seek scale and traditional financial institutions seek digital expertise. While fintechs have developed applications that create improved customer experiences, many lack skills in customer acquisition and other fields needed to grow quickly. Incumbent banks, on the other hand, already have hard-won capabilities in these areas, but they will have to work harder to create a true digital enterprise.

Examples of such partnerships are already emerging. For example, in 2014 New York-based Moven and Australia's Westpac announced an agreement to integrate Moven's mobile financial-management tools with Westpac's Internet-banking platform in New Zealand. Westpac hoped to use the tools to become the largest bank in the market, while Moven sought to expand into new markets.<sup>6</sup>

Spain's BBVA offers an example of an incumbent bank moving aggressively across several areas. BBVA joined data-analytics start-up Destacame to extend credit to the underbanked

using Destacame credit scores built from utility-bill-payment histories.<sup>7</sup> It is also working with FutureAdvisor, which focuses on robo-advisory services, to offer low-cost, enhanced financial-advisory services to help customers with portfolio optimization.<sup>8</sup> In addition, BBVA and Dwolla, a payments company, have joined to offer BBVA customers accelerated payment services with low fees.

### Impending consolidation

As the industry continues to mature, fintechs will likely enter a period of consolidation, with larger players turning to mergers and acquisitions to satisfy their expansion goals. For example, in 2015 PayPal announced the acquisition of Xoom, an international fund-transfer service, for \$890 million. The acquisition was expected to allow PayPal to broaden its services into digital money transfer and management.<sup>9</sup>

In another recent example, in 2015 peer-to-peer lender Prosper Marketplace spent \$30 million to acquire BillGuard, later renamed Prosper Daily, an app that allows users to track their spending and credit. The move added personal-financial-management services to Prosper's core refinancing and credit-rehabilitation offerings and provided a new channel for engaging with customers.<sup>10</sup>

Consolidation, which complements the collaboration trend, may force other changes in the market as well. For instance, banks may have to move quickly to identify acquisition targets before the most attractive are taken by competitors. They will also have to reconcile differences in corporate culture that can limit the upside from such mergers. The trend also offers fintech start-ups an alternative to initial public offerings for exit options.

### Normalizing valuations

Valuations of fintechs are also normalizing as investors become more cautious and start favoring companies with proven track records. Examining 44 fintechs with valuations of more than \$1 billion, McKinsey found that valuation growth has slowed considerably. Between 2014 and 2015, valuations for these companies grew on average by 77 percent, and then slowed to 9 percent from 2015 to 2016. Companies in the study cut across geographies and segments.

In the United States, where more than half the companies in the study were based, the shift was even more dramatic. While valuations for large US fintechs grew on average by 54 percent from 2014 to 2015, they not only did not grow but dropped by 7 percent from 2015 and 2016.

The shift toward normalized valuations was also noticeable in investment trends. One study looked at the 30 largest fintech investments by venture-capital funds in 2016 through August and found that more than half were later-stage funding deals.<sup>11</sup> The data suggest investors are more interested in companies with proven business models.

### Shifting regulations

Not surprising for a new industry, the regulatory regimes affecting fintechs are also evolving swiftly and will significantly influence how the industry develops. In many markets, regulators

<sup>7</sup> Next billion blog, "The Power of partnerships: Why they can be the key to reaching the unbanked," blog entry by Hannah Sherman, July 27, 2016, nextbillion.net.

<sup>8</sup> Forbes tech blog, "BBVA Compass teams up with Robo FutureAdvisor," blog entry by Tom Groenfeldt, January 12, 2016, forbes.com.

<sup>9</sup> Wall Street Journal Moneybeat blog, "PayPal-Xoom deal shakes up the payments world," blog entry by Maureen Farrell, July 6, 2015, blogs.wsj.com.

<sup>10</sup> TechCrunch blog, "Prosper Marketplace relaunches its BillGuard app under the Prosper brand," blog entry by Jonathan Shieber, March 10, 2016, techcrunch.com.

<sup>11</sup> The pulse of fintech, Q2 2016: Global analysis of fintech venture funding, CB Insights and KPMG, August 17, 2016, kpmg.com.

are playing a more proactive role in overseeing the industry, often encouraging its development, for instance by following a sandbox—or test and learn—approach that allows fintechs to experiment without impacting the entire financial system.

In the United Kingdom, for example, the country's Financial Conduct Authority has launched Project Innovate, a program that guides technology start-ups through regulatory processes and pushes for speedy responses to applications and questions. Regulators are also increasingly involved in nurturing fintech clusters, organizing large educational and community-building events in many markets.

As regulators increasingly shape the evolution and growth of the fintech industry, it remains unclear how the costs of regulations will impact players, particularly early-stage start-ups. However, while regulators work toward balancing the risks to the financial-services sector, they are also eager to encourage innovation, and many have taken steps toward this goal.

### Emerging ecosystems

As digital offerings become more mature and interconnected, vast ecosystems will develop that span multiple industries. In many instances, fintechs will become submerged in these ecosystems, representing, like many others, a component of a much broader digital network.

Ecosystems will likely develop to follow customer needs, rather than conform to traditional industry lines. Leaders in these ecosystems will need strong data-analytic capabilities to develop useful insights from the torrent of customer information available, and they will likely use fintechs and others to develop the system and extract maximum value. While data and analytic capabilities are crucial to leading an ecosystem, companies will also need demonstrated prowess in cybersecurity to credibly safeguard the huge amounts of potentially sensitive client data available in the system.

Already, ecosystem orchestrators are building advantageous data-analytic capabilities. For example, China's Ping An established a big data-analytics platform in 2013 to improve cross-selling and customer migration. The platform is a critical component in reaching the company's stated goal of "one customer, one account, multiple services, and multiple products." Ping An is already benefiting from the use of this platform, with more than half of Ping An's 109 million core finance customers successfully migrated and also using its online services as of 2016. Across all its platforms, the company has an Internet user base of 298 million people as of June 2016, presenting powerful opportunities for customer acquisition and channel migration.<sup>12</sup>

Other examples of early ecosystems include Commonwealth Bank of Australia (CBA), which is building relationships with a broad customer base across different channels, using technology like MyWealth, a portfolio-management app; DailyIQ, a data-analytic app for SMEs; and Albert, a point-of-sale device for business owners.<sup>13</sup> Combined, these efforts can provide CBA access to rich data on customer-spending patterns, allowing it to build an ecosystem around these insights and customer relationships.

<sup>12</sup> *Interim report 2016*, Ping An Insurance (Group) Company of China, June 2016, [pingan.com](http://pingan.com).

<sup>13</sup> Commonwealth Bank of Australia blog, "Albert- Our next generation EFTPOS tablet," February 19, 2016, [commbank.com.au](http://commbank.com.au).


Outside the financial sector, China's Tencent, a leader in gaming and social networking, has launched WeChat, a messaging platform that, among other features, can provide instant loans without collateral of up to \$30,000. The service combines credit-bureau data from the People's Bank of China with that gleaned from Tencent's customer base of 800 million active users to analyze and respond to credit applications.<sup>14</sup> Fintech services have become an integral component in the company's ecosystem.

The development of ecosystems will differ broadly across markets for various reasons, such as consumer behavior and competitive landscape. In the United States, for example, they could be slower to develop because of market fragmentation, with strong companies already providing compelling solutions backed by advanced technologies. Greater consolidation and scale are likely needed to create conditions suitable for viable ecosystems. In emerging markets, however, digital ecosystems could advance more quickly as companies bypass intermediary technologies and go straight to the most advanced solutions. Platform players that are already deeply entrenched in the lives of consumers, like Tencent, could leverage their solid customer base to form the core needed for an ecosystem's development.



Fintechs have matured rapidly in recent years, and the industry is entering a new phase of development. With no signs of the industry's growth abating, its reach is likely to broaden quickly to embrace even newer technologies and offerings, blurring the boundaries now delineating financial services. As the momentum continues, some aspects of fintech are likely to reach into a broad swath of the global economy, much like how digital technologies have become a necessity, rather than an option, for every industry. Understanding the seven features that characterize this new era will allow companies to stake out the most valuable plots in the new landscape.

#### *Additional insights*

To provide additional perspectives on how fintech has evolved and its impact on various customer segments, and to provide a broader view on its core underlying technologies, we have assembled an anthology of articles published by McKinsey. This body of work draws substantially from articles authored by McKinsey experts around the globe and includes reflections from several business leaders. 

<sup>14</sup> Juro Osawa, "Tencent's WeChat app to offer personal loans in minutes," *Wall Street Journal*, September 11, 2015, [wsj.com](http://wsj.com).

**Miklos Dietz** is a senior partner in McKinsey's Vancouver office; **Vinayak HV** is a partner in McKinsey's Singapore office, where **Gillian Lee** is a consultant.

The authors wish to thank Balazs Kenez, Miklos Radnai, Kausik Rajgopal, and Joydeep Sengupta for their contributions to this article.