

# FinTech

The Financial Technology (FinTech) industry in the UK has grown significantly in the past five years despite uncertainty caused by the EU referendum.

Despite the challenging outlook on the economy because of the UK's impending departure from the EU, FinTech revenue in 2019 is expected to have risen to £9.9 billion, a 7.5% increase on 2018. This trend is expected to continue over the next five years with IBISworld predicting revenue to increase at a compound annual growth rate of almost 7.1%, reaching £14 billion in 2025.



## Overview

**Growth in the FinTech sector is powered by strong demand conditions, such as the increasing prevalence of smartphones and growing consumer expectations around levels of service; this is fuelled through increasing levels of investment, with the industry relying on funding from both private and public sources.** Furthermore, the UK government has highlighted the FinTech industry as an important area for future economic growth, committing more than £500 million to the sector through the British Business Bank (BBB) programmes as at June 2019. This is likely to counteract the 'Brexit effect' to some extent. Private sources of investment are also essential to industry growth, with UK FinTech companies benefitting from increasing investment activity from seed capital to high profile M&A deals.

FinTech can be categorised by two main types of products: **'disruptive'** and **'inventive'** services. 'Disruptive' services refer to those previously offered by traditional financial institutions, with the adoption of technology enabling firms to deliver enhanced services for lower prices or fees. To compete with these new technologies and firms, incumbents in traditional banking have had to increase their own investment in FinTech. 'Inventive' services are those that didn't previously exist, redefining the products available to businesses and consumers. The industry's growth has been driven by the success of digitalised payments, peer-to-peer financing and fund transfers led by companies such as Funding Circle, Transferwise and Revolut.

## Industry trends

The development of the FinTech industry has been facilitated by the UK's progressive regulatory and policy framework alongside strong access to skilled workers and external financing.

One of the principal challenges highlighted by those in the sector has been the regulatory burden that firms faced. The Financial Conduct Authorities (FCA) aimed to address this challenge with the launch of two flagship programmes, the Innovation Hub and the Regulatory Sandbox. Since 2013, the FCA's innovation hub has provided support in regulatory compliance to over 500 businesses, and since 2016, almost 100 firms have tested products in the FCA Sandbox. These have been widely credited with supporting FinTech businesses to meet the challenging regulatory compliance requirements. The introduction of the Innovative Finance ISA by the UK government has also stimulated FinTech investment, allowing investors to receive interest and capital gains tax-free when lending funds using FCA regulated peer-to-peer lending platforms.

Recruitment into the FinTech industry has been essential in generating growth. The industry is heavily reliant on highly skilled workers in order to provide high quality and innovative services. As one of the world's leading financial centres, the UK has proved attractive for FinTech firms, granting access to employees with experience in both financial services and regulations. Whilst the number of jobs created in the sector is still smaller than banking, the rate of growth remains significant with over 61% more jobs created in 2018 when compared to 2017, making it London's fastest growing sector. With businesses therefore choosing

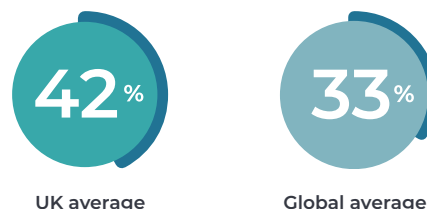
to base their headquarters in London, higher levels of investment have been generated in the region.

The development of FinTech has been highly reliant on access to external investment. EY's UK FinTech Consensus 2017 revealed that FinTech companies had received an average of £15 million of investment. The attractiveness of FinTech firms to investors has therefore been essential for the sector to grow. The industry also benefits from public investment, with the UK government launching the UK Innovation Investment Fund with the BBB. This fund aims to co-invest with private investors into technology-based businesses such as FinTech companies, providing over £2.5 million of public money with the aim to generate private investment of £7.5 million.

Undoubtedly, one of the significant drivers behind the growth of FinTech is the need to match experience with the expectations of younger users. The UK has one of

the highest adoption rates, with 42% of adults active on at least one FinTech product, compared to the global average of 33%.

### Adults using at least one FinTech product



The increasing reliance on smart phones, smart watches and tablets has altered the way consumers interact with banks, retailers and other businesses, which, in turn, has driven firms to innovate to compete through digital transformation and improved operational efficiency.

### Recent M&A Activity

Company Name	Deal Size	Deal Type	Lead Investor	Date
Zopa	£140m	Venture Funding	IAG Capital	03/12/2019
Limeglass	Undisclosed	Acquisition	J.P. Morgan	12/11/2019
Ebury	£350m	Acquisition	Banco Santander	04/11/2019
TotallyMoney	£5m	Private Equity	Silicon Valley Bank	30/10/2019
StatPro Group	£161.1m	Acquisition	Confluence Technologies	29/10/2019
Starling	£30m	Venture Funding	Merian Chrysalis	23/10/2019
Starling	£75m	Venture Funding	Merian Global Investors	13/02/2019
Starling	£110m	Grant	Banking Competition Remedies	01/02/2019
Sonovate	£110m	Venture Funding	Dawn Capital	09/09/2019
LenDinvest	£229m	Debt financing	National Australia Bank	12/07/2019
Acuris	£1.38bn	LBO	ION Group	01/07/2019
Monzo	£113m	Venture Funding	Y Combinator	25/06/2019
WorldRemit	£113m	Venture Funding	Leap Frog Investments	03/06/2019
Transferwise	£241m	Venture Funding	Lead Edge Capital	22/05/2019
Checkout.com	\$230m	Venture Funding	Insight Partners and DST Global	01/05/2019
Evolution Funding	£110m	Development Capital	LDC	19/02/2019
Iwoca	£150m	Venture Funding	Augmentum (London) and Prime Ventures	18/02/2019
World First UK	\$717m	Acquisition	Ant Financial	14/02/2019
Oaknorth	\$440m	Venture Funding	SoftBank Investment Advisers and The Clermont Group	07/02/2019
Bud	\$20m	Venture Funding	The Goldman Sachs Group and HSBC Innovation Investments	03/02/2019
Notion	£10.8m	Venture Funding	HSBC Innovation Investments, Development Bank of Wales, Santander, Royal Bank of Scotland	01/10/2018



### M&A activity

Globally, M&A activity in the FinTech sector has been declining, with both the volume and value of activity falling. However, the UK has continued to boom despite this global trend, with investments spanning from start-ups to established FinTech companies rethinking their strategies, and traditional institutions looking to expand and adapt their offerings to meet consumer demands.

FinTech presents an attractive investment opportunity, with growing acceptance and utilisation of digital banking, payments and financial data services across businesses and consumers. The adoption of FinTech presents an opportunity for businesses to streamline operations, improve customer experience and cut costs. In particular, we have seen a trend towards a demand for FinTech investment by traditional financial institutions, looking to adapt to changing consumer expectations and acquire the necessary technology to compete with these new entrants.

In the UK, investment in the first six months of 2019 almost doubled to £2.15 billion when compared to the first half of 2018. The number of deals in this six-month period also increased by 25% to reach 263. These deals were primarily VC led, with significant international investment at 54% in the first eight months of 2019 alone. Outlined on the page above are the highlights of M&A activity within the FinTech industry in recent times.

### Market structure

The market consists of moderate barriers to entry, with high costs related to hiring specialised staff often meaning that businesses are constrained by the need to secure large amounts of external funding.

However, the industry remains fragmented, with strong competition and a wide variety of products offered within the sector.

In 2019 the Department for International Trade estimated that there are over 1,600 FinTech firms operating in the UK, with this number expected to more than double by 2030. Very few companies are therefore able to dominate the market, with the four largest FinTech companies estimated to have a combined market share of only 5% in 2019-20.

### Fintech unicorns

According to a June 2019 London Tech Week Update report prepared by Tech Nation and Dealroom.co, London is now a world leader in FinTech unicorns, housing a total of 18 companies with a valuation of more than \$1 billion, making it home to more FinTech unicorns than previous leader, San Francisco, with 15.

The UK also continues to be at the forefront of European technology growth. For example, UK based firm Revolut received a \$5 billion valuation in January 2020 ahead of an upcoming funding round looking to raise \$1.2 billion, making it Europe's most valuable tech firm, and further raises – at even higher valuations – are already being mooted. This figure significantly surpasses other London based unicorns, Transferwise, OakNorth and Monzo, with valuations of \$3.5 billion, \$2.8 billion and \$2 billion respectively. This clearly provides a measure of the strength of Britain's FinTech industry with the economy generating a number of high-value companies, presenting an exciting backdrop for investors looking to capitalise on this dynamic tech sector.



## Products and services

The FinTech industry encompasses a broad range of products and services, the main five of which generate almost 75% of industry revenue and include: payments and digital banking, investment platforms and management, credit and lending, RegTech and distributed ledger technology.

The largest sector within the FinTech industry is payments and digital banking, accounting for 23.8% of total industry revenue. A key driver of growth in this segment has been the expansion of the digital economy and the UK banking initiative, 'Faster Payment Service', launched in 2008. This growth trend is expected to continue, with large flows of Venture Capital investment predicted, in particular from incumbents such as banks as mobile payments and ecommerce continue to expand.

The second largest performing segment of the FinTech industry is investment platforms and management, generating approximately 18.5% of industry revenue. Rather than focusing on budgeting and saving, the younger generations are placing more importance on investing, presenting an opportunity for FinTech companies to attract new customers who expect digital solutions to manage their assets.

Credit and lending are expected to be the third largest performing sector of the FinTech industry, contributing an estimated 17.1% of revenue in 2019, and mainly dominated by peer-to-peer lending businesses. Whilst most peer-to-peer firms have grown consistently over

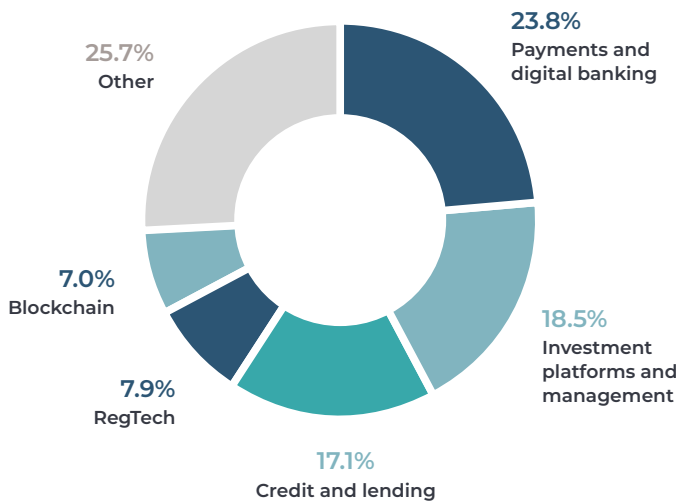
the past five years, investor enthusiasm for marketplace lending has fallen overall. Worldwide investments in 2019 reduced and there were several high-profile scandals, such as the collapse of the peer-to-peer lending site Lendy in May 2019. However, this segment is still expected to continue to grow in importance, and whilst there is a push for increased regulatory scrutiny after several highly publicised lending firms collapsed, UK Government support for the tax-efficient Innovative Finance ISA is expected to drive industry growth.

RegTech, the use of innovative technology to address regulatory changes in the financial services sector, is estimated to account for 7.9% of industry revenue in 2019. Given the constant regulatory burden facing financial institutions, demand for these products is expected to be sustained and continue to grow as companies look to automate compliance functions and cut costs via reduced labour and decreased regulatory fines.

An estimated 7% of 2019 FinTech industry revenue was driven by distributed ledger technology, known as a blockchain, which is a synchronized and decentralized digital database software system designed to store a record which cannot be changed and can be verified. Distributed ledger technology enables faster, safer and more economical transactions when compared to conventional transaction systems. This segment faces rising demand due to increased adoption worldwide thanks to a variety of commercial applications, such as payment verification, smart contracts, land registration and digital currencies.



## Top FinTech Products & Services by Revenue



54% of FinTech investment in the first eight months of 2019 originating from outside the UK, the ongoing uncertainty around the deal may have significant implications on the availability of these external finances. This could be an additional factor in reducing the UK's attractiveness for new FinTech start-ups.

One of the challenges faced by the industry is increasing regulation. This introduces higher costs and impedes scalability for many FinTech firms. Many start-ups are looking to partner with incumbents who already have compliance and regulatory procedures in place. This is increasingly the case with pressure placed on regulatory authorities due to a number of high profile collapses, including Lendy in the UK and Funding Secure, one of the leading European peer-to-peer lenders. This has the potential to limit growth across the landscape in the future.

## Threats

One of the main threats faced by the UK FinTech industry is the impact of the UK's exit from the EU. Companies with offices in London are able to benefit from access to highly skilled workers. However, according to data provided by WPI Economics, almost 30% of workers in UK FinTech are from overseas. The UK's exit from the EU may affect this supply of specialist employees and compromise the industry's success, inflating UK wage costs, and placing downward pressure on profit margins. FinTech firms therefore require further clarity from the Government to ensure the sector remains open to recruiting overseas talent post Brexit negotiations. Uncertainty over the contents of a Brexit deal could potentially deter FinTech start-ups from locating their headquarters in the UK.

The UK FinTech industry is heavily reliant on external sourcing, with start-ups often requiring significant investment in order to achieve success. With over

## Outlook

The FinTech industry is expected to continue to grow rapidly, with industry revenue expected to reach £14 billion over the five years through to 2025, at a 7.1% compound annual growth rate.

The uncertainty surrounding the agreement that will be negotiated for UK's exit from the EU has the potential to constrain the growth of the industry in the future, inflating wages, depleting the pool from which skilled workers can be recruited and reducing external financing activities. However, the future funding commitments of the UK government and the British Business Bank programme is expected to offset this to an extent, with the size of the overall impact on the industry dependent on the Brexit deal, which is expected to be agreed by the end of 2020.





Over the next few years the industry is forecast to benefit from sustained consumer demand. As technological awareness and adoption increases among both businesses and consumers, demand is expected to increase significantly. The entrance of more traditional financial institutions is also likely to increase competition within the market, with their ability to access significant financial resources expected to increase efficiency and increase consumer offering. Overall the number and the quality of products offered to consumers is expected to grow significantly.

The industry is performing relatively well with consistently high levels of growth against a backdrop of uncertainty and continuing pressures on cost and financing demands. There are exciting opportunities

for investors that are able to recognise and capitalise on innovative, modern brands.

### Gerald Edelman services

We have significant experience in and deliver a range of services to those in the FinTech sector, including:

- ▶ Business development and strategy
- ▶ M&A and deal advisory
- ▶ Asset finance and leasing solutions
- ▶ HR advisory
- ▶ Fundraising



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