

FinTech: Transforming Financial Services in the UK

INNOVATE
FINANCE

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The UK is viewed as a leading location for FinTech thanks to its position as both a top financial services jurisdiction and one of the highest ranked global technology hubs. It cannot rest on these laurels, as there is competition from Asia, the US and increasingly from Europe. How does the U.K. strengthen this position; expand the ecosystem; and use FinTech to remain a leading financial centre in the future?

The FinTech sector contributes over £6bn (1) to the UK economy annually. It, however, has a much wider impact in supporting the innovation and export of the UK's wider Financial Services industry, which contributed over £132bn (GVA) to the economy and supported a £44bn trade surplus in 2018 (2). FinTech represents the Financial Service industry's drive to digitise and improve productivity. Like the Financial Services industry, the UK FinTech sector is under significant external and internal pressure from the growth of competitor jurisdictions in Asia and the US (3). So how can the UK keep up with or accelerate away from the competition?

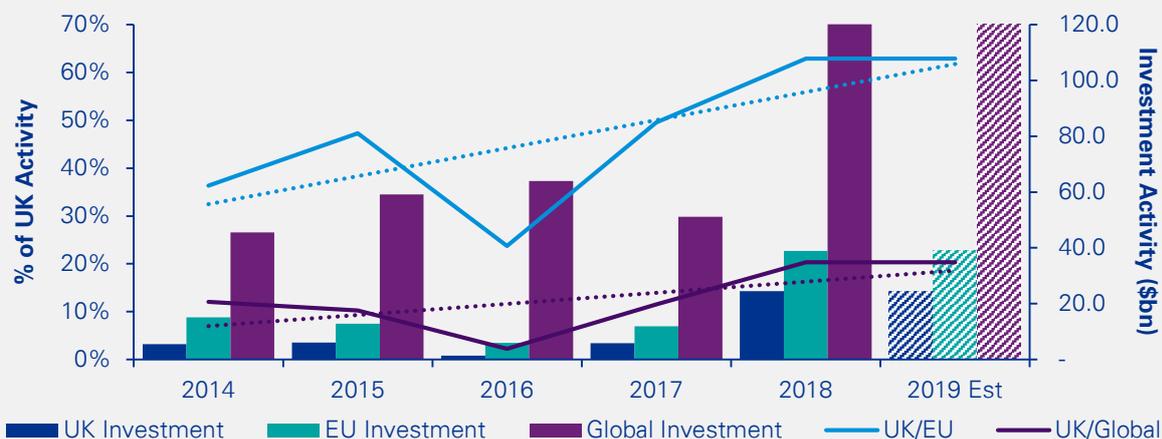
A rapidly evolving sector

The FinTech sector is fast moving and supports increasingly diverse products, customers, and sources of capital. Since 2017, annual investment activity has doubled (4);

56% of incumbent financial institutions now have disruption at the heart of their strategy (1); and the FinTech workforce is set to grow by one third by 2030 (1).

Despite the growth, there are increasing headwinds challenging the Sector. The UK's Financial Services industry is under pressure with a 12% reduction in overall economic output since its height in 2008 (2) and it has recently lost its top spot in the global rankings of Financial Services centres to New York (5). The UK's Tech sector is still growing: with growth in both recruitment and business activity since 2013, although the level of growth is on a downward trend (6). With this and the changing political, social and economic environment, Government and the wider industry should look to identify how they can foster and encourage this vital area of the Financial Services industry.

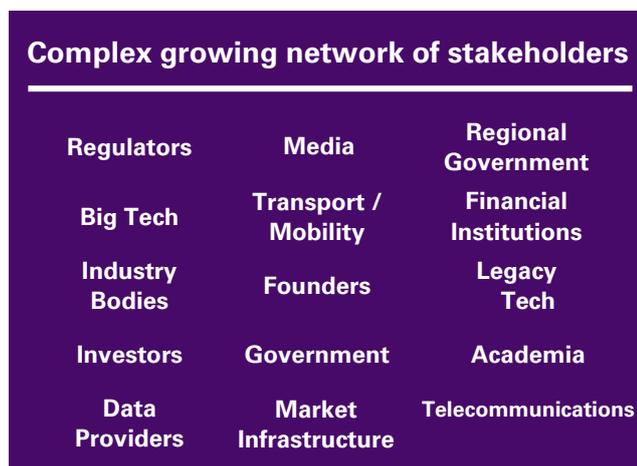
UK vs Global and EU FinTech Investment Activity



Source: KPMG International, Pulse of Fintech H1 2019

A growing ecosystem

The FinTech ecosystem in the UK has developed to encompass a diverse range of stakeholders with varying and evolving interconnectivity and co-reliance. It has expanded beyond traditional Financial Services: pulling in technology from other industries such as media and telecommunications, as well as transferring expertise to emerging fields such as 'LawTech' and 'SecurTech' – further building on the UK's reputation in these industries.



The distribution of the UK's academic and technology centres around the Country combined with the cost of London operations has resulted in a number of Financial Services businesses setting up or moving outside of London, for example: Monzo in Cardiff; Starling in Southampton; or some incumbent banks moving large operations to Birmingham or Edinburgh. This development and growth of the ecosystem beyond the traditional hub of London has further increased the number of stakeholders, but importantly, also the pool of talent and opportunities for businesses operating or looking to enter the Sector.

A new wave

A new wave of FinTech businesses is evolving out of the development of 'at-scale' analytics; cloud computing; integration of artificial intelligence; and an 'open finance' ecosystem. This is alongside the rise of the 'Gig Economy'; new ways of working; and an evolving set of customer and employee expectations. These developments have also brought the 'BigTech' players squarely into the Financial Services industry. Familiar to a US Silicon Valley environment, they are driving an alternative view of Financial Services and its interaction with society, significantly influencing the evolution of 'Service 4.0' and 'Financial Services 4.0'.

Scaling: seeking growth and going global

Capital

Globally FinTech investment activity has increased by an average of 31% year on year over the past 5 years, with the UK increasing an average of 113% (7). This has been fuelled by an increasing number of larger Private Equity ("PE") / M&A deals; an overall increase in the average size of each transaction (4); and a fourfold increase in the amount of corporate venture ("CVC") investment (8), as the first and second wave of FinTech businesses, established between 2008 and 2014, reach maturity. This must continue to be supported, but there is a need to focus on the 'new wave' through early stage Venture Capital ("VC") investment.

VC and PE investment into UK FinTechs has increased on average by 50% per year since 2015 (7). By comparison, investment in the US and Asia Pacific has grown by an average of 27% and 63% per year (7), respectively. Whilst growth in the UK is strong overall, growth in early stage VC investment underperforms: only achieving 29% average growth per year compared to 35% globally (7). In comparison the US early stage VC investment has achieved 46% growth on average per year since 2015 – almost double the US average growth rate (7).

'Patient' capital is essential for many FinTech business models which often require significant capital or scale in order to become profitable. Investors and Founders have differing views on the issues when matching capital to investments, including: tax incentives; investment approach; and differing attitudes between US tech-led investors compared to UK business/sector-led investors. Understanding the quantitative and qualitative factors supporting the growth of each source of capital; monitoring how these develop; and how capital is matched to FinTechs will be a key success factor for the UK FinTech sector.

Talent

With over 30% of jobs in Financial Services being at risk from automation (9), equivalent to over 300,000 jobs in the UK, encouraging an innovation culture; providing the skills to achieve this automation; as well as retraining the existing workforce is essential. Both science, technology, engineering and maths ("STEM") and creative skills are predicted to be needed for the Services 4.0 economy (10) replacing administrative and basic management skills (11). FinTech has the opportunity to lead this evolution of talent: using the UK's world-leading universities and established tertiary education institutions which have strength in both STEM and creative disciplines. Innovation and intrapreneurship also has a significant role in re-skilling the workforce.

Yet only 52% of UK CEOs say that they need to improve how they innovate, which is one of the lowest rates globally (12).

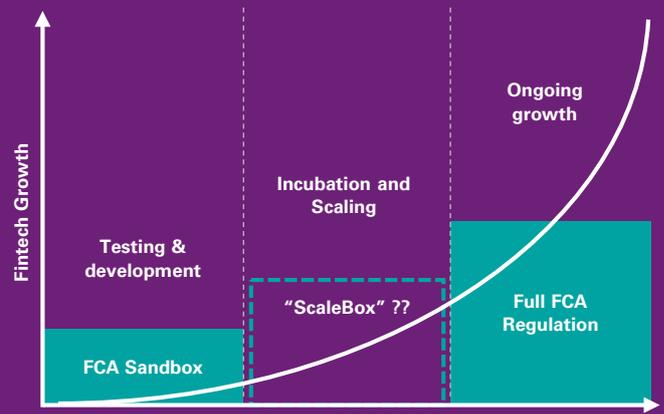
Workforce mobility and an available source of talent will also drive future growth: the FinTech workforce is currently constituted of 42% non-UK nationals and 86% of firms are considering re-locating outside of the UK if the immigration system becomes more stringent. This would translate to a direct loss to the UK FinTech sector of £361m (13). Brexit and the UK's future policies on immigration, funding and education are likely to have significant impact on the Sector.

Regulation

The UK has led global innovation in Financial Services regulation. The role of the regulator in facilitating development is key: with over 110 firms entering the Financial Conduct Authority's ("FCA") Regulatory Sandbox since its inception and our leading position in the Global Financial Innovation Network ("GFIN"). However, competition for innovation is coming from Asia and competing with a, usually, less restrictive regulatory

environment has created two streams of global FinTech businesses with the likes of AliPay's and WeChat Pay's innovation and growth far outstripping anything in the West. ASPAC's FinTech sector CAGR is 43% compared to the global average of 22.17% (14).

Despite the success of the Sandbox, FinTech businesses still appear to struggle to scale and move from the unregulated space to full FCA regulation, with only 39% of businesses entering the Sandbox receiving further investment (15). There is an opportunity to consider proportionate oversight/regulation in a scaling environment which bridges the gap between the Sandbox and full FCA regulation, akin to 'EU SME Growth market' concept which has brought proportionate regulation to SMEs for Capital Markets in the EU. The 'ScaleBox' could also be used to address asynchronous regulation from inbound FinTechs to drive innovation in existing UK Financial Services businesses.

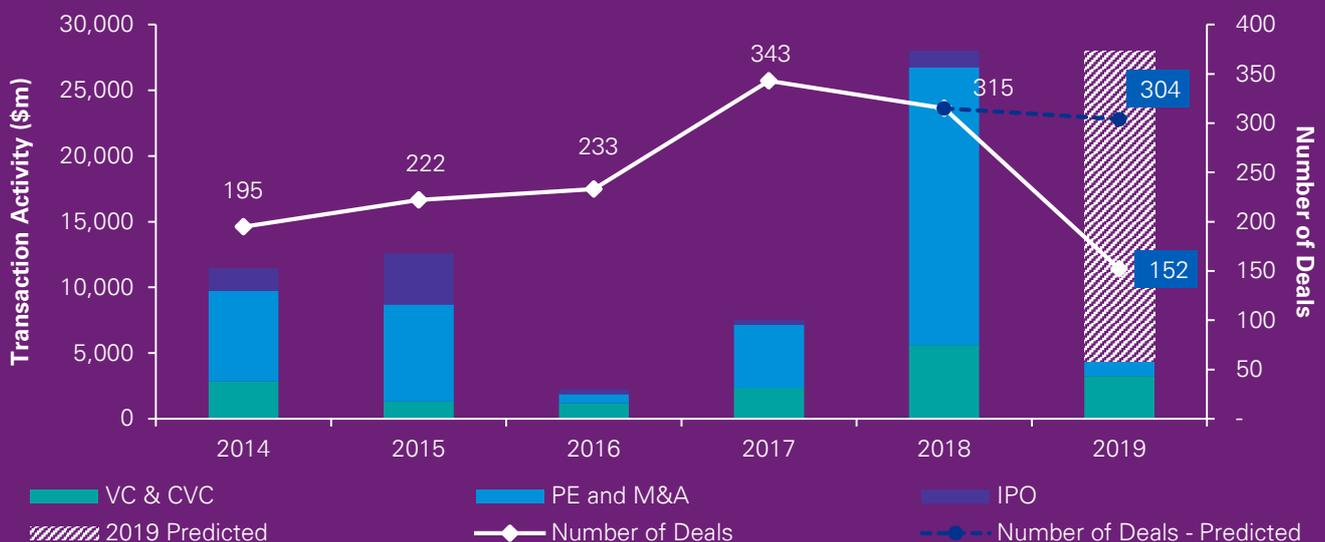


Expanding overseas

Global expansion is essential for scale and profitability of FinTech businesses. The global FinTech market is set to be worth approximately \$305.7bn by 2023, expanding at a CAGR of 22.17% between now and 2023 (14). The expected impact of technological change on overall UK trade with the rest of the world has the potential to triple by 2050 (16). Much of this addressable market will be led by businesses incubated in leading FinTech hubs and Financial Services jurisdictions – this is the UK's opportunity.

Increasingly this expansion is being facilitated by cross-border investment activity. Globally over 50% of investment in 2018 was sourced outside FinTechs' home country, compared to 30% and 25% in 2017 and 2016 respectively (4). Maintaining and expanding inward flows of capital across all sources of investment and the subsequent outward flow of trade, accessing the above addressable market, therefore has the ability to support significant GDP growth for the UK.

UK FinTech Investment Activity



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KPMG FinTech professionals include partners and staff in over 50 FinTech hubs around the world, working closely with financial institutions and FinTech companies to help them understand the signals of change; identify the growth opportunities; and to develop and execute on their strategic plans.

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