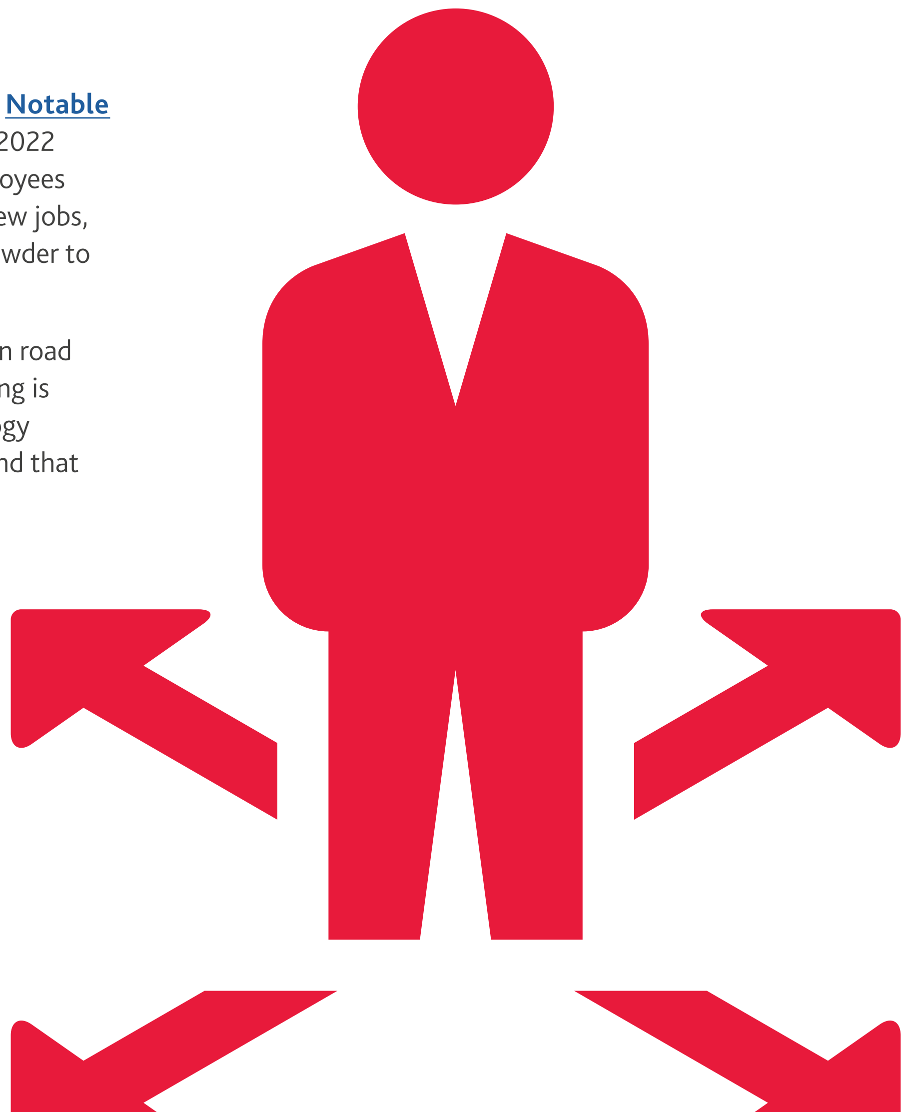
2023 Fintech Predictions

Today's talent cuts are tomorrow's growth opportunities.

As the economic downturn pressures fintechs, the industry can expect a continued flurry of headlines about fintech layoffs. While layoffs and hiring freezes are likely to continue in 2023 – at both large and small companies – there may be an upside to come.

At the start of 2023, many talented fintech professionals find themselves looking for work. **Notable fintechs announced layoffs** in November of 2022 ranging from 10-18% of their employees. Employees who were recently laid off will be looking for new jobs, presenting opportunity for fintechs with dry powder to hire top-tier talent currently in limbo.

While the fintech market still faces an uncertain road ahead after a difficult 2022, we believe one thing is for sure – talent is the backbone of all technology companies, regardless of shifting economics, and that will become more valuable in 2023.



Embedded finance to see a major uptick in industry appetite.

In 2023, we predict that the industry will almost certainly see increased interest in embedded finance, otherwise known as banking-as-a-service (BaaS). The search term "embedded finance" saw **488% growth** over the last five years while BaaS saw a 176% increase.

As fintechs look to improve the customer experience and build customer loyalty, BaaS offers a means to meet heightening demand. More financial services are being integrated – or embedded – into the products of non-banking companies through application programming interfaces (APIs). By licensing the financial institutions' offerings, fintechs can gain access to new capabilities that may have proved cumbersome to build out in-house and provide a more seamless experience for the end-user.

By 2030, the BaaS space is projected to reach $74.5 billion. Because this dynamic inherently blurs the lines between traditional banks and fintech companies, the Office of the Comptroller of the Currency (OCC) has **suggested** that more regulation is likely incoming – fintechs, take note.

Fintechs will be indispensable for banking's Sustainability and ESG journey.

With mounting ESG compliance checklists, we predict that banks and financial institutions will be increasingly open to working with fintech partners to develop ESG programming.

The success of banks' ESG programs will largely depend on data quality, analysis and integration in the lending and investment process. Banks and other financial institutions are grappling with complex and evolving ESG lending and investment disclosure and reporting mandates. According to **Nasdaq**, fintechs will take the helm of bank and asset manager ESG initiatives, due to the intricacy of data analysis requirements, to help them leverage data in a meaningful way. Regulators, stakeholders and customers alike will apply greater pressure to ensure that companies integrate ESG criteria into capital management "frameworks," pricing and/or risk models, making it imperative that banks and fintechs work together.

All of this creates an opportunity for fintechs, especially those with deep data management capabilities, to offer support to banks' ESG programs. This will, of course, require those interested fintechs to be able to pivot and apply their data analytics tools to the aforementioned ESG purposes (i.e., integrating ESG criteria into pricing and/or risk models).

Fintechs with the technology to support ESG profiling, climate risk analysis, unstructured data process, and/or custom regulatory reporting will be well positioned to capture market share.

In 2023, more banks will look to leverage digital tools or fintechs partnerships to meet the moment.

It's no surprise that startups positioned between climate impact and finance are becoming industry darlings, **according to Sifted**. Fintechs in this sub-sector **raised $1.8 billion in global dollars** in the first half of 2022, which was 1.5x the total raised in 2021. It's a near certainty that venture capitalists will be watching these fintechs this year in the pursuit of new ESG-friendly investments.

Venture capitalists are pumping their brakes and will prioritize profitability.

Like we saw in many industries last year, venture capital funding in fintech saw a drop off, and VCs continue to signal electivity during recessionary times.

Though VCs eased off the accelerator, fintech executives have reason to be optimistic. "Many investors predict the funding environment will remain tricky this year but they're still super upbeat about the sector," according to a January 2023 **Forbes article**. This should be welcome optimism for fintechs after a harsh 2022. Globally, fintech funding dropped 46% in 2022 compared to the prior year. If we zoom in further, we can see that in the fourth quarter of 2022, the U.S. **captured $3.9 billion** in venture funding – more than any other region but still down from 2021.

Despite the flurry of negative headlines the industry saw last year, funding activity in 2022 still **surpassed pre-pandemic levels**. So what's next?

As fintechs try to attract more investor dollars, we predict that 2023 will be a year where they must strategically manage their spend – this is especially true for late-stage startups. This is because high growth is likely to remain a critical performance indicator for early-stage startups, though they too should keep an eye on how much cash they're burning. But for those late-stage companies looking to exit, IPO or receive a higher valuation, demonstrating profitability will be key. Why? Investors seek stability during a market downturn. Fintechs that can achieve steady growth with positive net cashflow, instead of pursuing a "growth-at-all-costs-mentality" will be prime VC targets.

Increasingly, investors are looking for fintechs to focus on cash flow, particularly amid a turbulent economic environment where inconsistent revenue and shrinking reserves can challenge a fintech's ability to operate between funding rounds. A **focus on improving profitability**, managing expansion plans and slashing fixed costs can help fintechs attract funding or position themselves as attractive acquisition targets. This can lead to a brighter 2023 compared to 2022.

While many in the VC community are still excited to back disruptors, investors looking for slightly less risk will seek companies that can tie cash infusions to actionable business goals. Beyond this, investors have noted they'll also be looking for "safer business models" in 2023, such as fintechs selling their software to banks, according to Fortune. This underlines that VCs, while always willing to take on risk, are looking for a bit less of it. Fintech firms should use their time wisely, while the market is not in a dealmaking frenzy, to assess efficiencies, improve cost optimization and prove fiscal responsibility.

Latin American bright spot: serving untapped markets in 2023.

While a global slowdown is impacting fintech companies, different maturity cycles reveal different narratives. One region that has attracted a lot of investor attention is Latin America. In Latin America, the fintech market is still emerging and fintech companies often play different roles than similar markets in North America, Europe and much of Asia.

Latin America was the fasting growing region for market-wide venture capital funding in 2021, with $16.3 billion worth of investments going into startups – 39% of which was dedicated to fintechs and financial services. Fast forward to 2022 and startup funding into LatAm tumbled. 2022 started out steady, but did not end on the same high note – market-wide venture **funding decreased** to roughly $8.3 billion, according to CrunchBase. While that number is representative of all startups, and not just fintechs, it is safe to say the fintech sector took a hit.

2023 is expected to bring slowed momentum, but we think we'll see continued interest from investors for the LatAm fintech market due to the potential for delivering service to the unbanked and the opportunity to convert existing cash-based systems to digital transactions.

Unlike more developed markets, Latin America's relative lack of digital infrastructure and high level of bureaucracy have created an opportunity for local fintechs to reach the region's growing middle class. Traditional Latin Americans banks often ignore middle class consumers, who are subject to **poor customer service and high loan rejection rates**. Non-bank lenders operating in areas such as Buy Now, Pay Later, have witnessed strong consumer appetite from the middle class, thanks to more lenient credit requirements and their ability to fully service customers online with innovative digital tools.

A regional lack of accessibility to traditional financial institutions is a real opportunity for digital-first banks and non-bank lenders.

It will be important for emerging fintechs to consider one major factor: cash. In Latin America, cash accounted for 85% of retail spending, according to PYMNTS Global Index, indicating that consumers in this region still prefer to pay with cash rather than payment tech, credit cards, or other non-cash-based transaction methods. Capturing wallet share will look much different than it does in the U.S.

Europe's fintech sector is on the rebound.

When discussing fintech trends, it's important to compare and contrast to other regions, too, such as Europe. Like the North American market, European fintechs were and still are feeling the impact of recessionary pressures and inflation, but somewhat surprisingly, fintech funding in Europe soared in 2022. The European fintech sector raised **$22.2 billion** from investors in 2022, as of December 19. While this is still lower than fintech funding in 2021, $22.2 billion raised was more than any other European sector, according to Sifted.

The question is: will this momentum last? It's hard to say at this point. Some say no and that the European fintech sector will cool in 2023. On the other hand, we could see a "soft landing," since there was still $28 billion in dry powder reserved for fintechs, as of October 2022, **according to Forbes**.

This has led to a shift among fintechs, many of which are now reassessing their models and offerings. Increasingly, we're seeing a move away from innovative finance vehicles to **more traditional, bank-like approaches to business**. We expect this will continue this year.

This has led fintechs to explore new tactics and products, including offering interest-bearing services, new services for mortgage loans and outsourcing to save on costs. For example, some European Buy Now, Pay Later (BNPL) companies have begun using their infrastructure to provide business loans, sometimes in partnership with existing small business lenders. Others are simply exploring exits.

Eventually, we think, fintech markets both in the EU and U.S. will return to healthy funding levels.

Similarly to the U.S., fintechs in the U.K. – especially late-stage companies – that focus on stable growth instead of rapid growth, as well as profitability, will likely be the most attractive to potential investors and buyers. The bottom line: investors want to attach themselves to fintechs that can withstand a variety of market conditions without always needing to reinvent themselves.

Buy Now, Pay Later: brace for the regulatory microscope.

Buy Now, Pay Later firms have seen explosive growth by offering consumers the option to spread out the cost of their purchases, usually into four payments. BNPL companies do not check consumer credit before offering financing. While this is helpful to many, it makes it easy for consumers to take on unsustainable levels of BNPL debt. This is partially why the U.S. Consumer Financial Protection Bureau (CFPB) is **considering new regulations for the BNPL industry**.

This year, we could see additional regulatory guidance issued for BNPL fintechs. With increased interest providing more safeguards for BNPL users, the Consumer Financial Protection Bureau –may develop reporting regulations for BNPL to ensure that these firms are being effectively monitored. Chief concerns include the fact that delinquencies are increasing at an alarming rate, and even BNPL late fees are on the rise – 10.5% of customers incurred a late fee in 2021 compared to 7.8% the year prior.

Given BNPL's ability to make consumers feel like they're spending less money by spreading out payments, regulators are also concerned that BNPL will cause consumers to go deeper into debt during this period of high inflation.

Regulators are also putting data privacy under the microscope regarding how BNPL fintechs leverage data, particularly the way these companies use consumers' BNPL purchases to help advertisers market their products.

Rates and fees may also become the target of regulators in 2023. When consumers cannot pay their BNPL debts, they can be hit with high-interest late fees and have their credit scores reduced.

Unlike credit cards, regularly paying BNPL debt cannot help consumers improve or maintain their credit score, yet BNPL delinquency will negatively impact credit. Despite these issues, consumers are keen to keep using BNPL, which will continue to generate demand.

Regardless of the outcome, we predict that BNPL firms will see rule changes and guidance updates in 2023. If regulators see BNPL as predatory lending and a troubling source of debt growth in the marketplace, they are likely to introduce additional rules. This could negatively impact the profitability outlook of the BNPL model and scare investors.

Proposed legislation in the United Kingdom, **which would require BNPL providers** to "carry out affordability checks before approving loans," may serve as a model for U.S. regulation. However, one of the reasons BNPL is so attractive is its speed to execution – instituting credit and affordability checks could compromise this model. Retailers love BNPL because it naturally leads to fewer abandoned carts and consumers enjoy the convenience. But throw in a loan application process and the prospect of credit rejection, and BNPL could lose some of its appeal.

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