INSIGHTS FROM THE BDO FINTECH PRACTICE

HOW INNOVATION IS TRANSFORMING FINTECH VERTICALS

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The fintech marketplace has evolved rapidly and new innovative trends continue to transform the industry's future. Digital adoption rates have increased significantly in recent years, especially since the start of the pandemic. Customer expectations have elevated, and payment processing, wealth tech and neobanks are rising to meet them, offering convenience, security and a better customer experience.

PAYMENT PROCESSING

The scope of innovation in payment processing encompasses emerging trends in student loan payments, retail payments and person-to-person (P2P) payments, as well as in credit and debit card transaction processing and settlement.

Student loan payments

Millennials are known for two things: their comfort with technology and being the generation with the highest student loan debt (14.8 million owe money for education). Fintech has taken notice, with several startups offering this demographic novel, convenient and affordable repayment and refinancing options. Some set rates based on more traditional credit rating systems, whereas others evaluate credit worthiness through new algorithms that consider factors like education level. No matter the criteria of the user, the technology is designed for optimal convenience for all customers, allowing an interface with information that is accessible through online dashboards and mobile apps.

Retail payments

Innovations in payment processing are not only helping customers absolve student loan debt at a pace that works for them, but also helping them make purchases from the comfort of home. Insider Intelligence estimates that the pandemic accelerated the industry's digitalization by two to three years. Restrictions on in-door shopping and health-conscious consumers' varying comfort levels with face-to-face interactions in a brick-and-mortar establishment caused online retail to surge to $794.50 billion, a record-breaking 14.4% of total U.S. retail in 2020.

Credit and debit card transaction processing

In-store purchases made with cash are quickly becoming outdated. Debit cards remain the most popular payment method in the U.S., closely followed by credit cards with cash lagging behind. However, digital payment methods are growing in ubiquity with digital wallets accounting for 29.8% of e-commerce transactions, a 23.7% increase from 2019. The global digital payments industry is projected to reach a $6.6 trillion value in 2021, which is a 40% uptick in the past two years. A Mordor Intelligence report points to the cashless payment market experiencing a CAGR of 22.6% between 2021 and 2026.

P2P Payments

Of the four subcategories, P2P is arguably experiencing the most dramatic shift. PayPal subsidiary Venmo is the most popular, but Apple, Facebook and Google have recently entered the P2P arena. The rise of P2P is convenient for consumers and revolutionary for small business. In some instances, small businesses can be considered high risk for banks and other financial institutions, making P2P a viable solution for small businesses to procure growth funding.

The above trends indicate that companies should fold payments into their digital experiences and prioritize payment processing as a key component of growth. Companies are increasingly integrating new payment methods, adopting machine learning (ML) technology to improve authorization rates, and harnessing application programming interfaces (APIs) and user experience (UX) designs to streamline checkout flow. This trend also promises to impact M&A. With software as a service (SaaS) platforms and marketplaces fast becoming mission-critical entities to align with and reach small and midsize businesses, payment processors can position themselves as attractive partners.

In addition to new payment processing methods, companies should consider emerging methods of payment structure. Buy Now Pay Later (BNPL) is a short-term lending option that allows customers to pay the balance of a purchase in interest-free installments over a set period of time instead of the full cost upfront. According to an Amex Trendex survey, 39% of customers have opted for BNPL in the past year. 19% of companies plan to adopt BNPL in the next 12 months and an additional 28% are considering it. Over half of merchants offering or considering offering BNPL cite attracting new customers, increasing overall sales and providing customers with flexible payment options as BNPL's appeal. A successful rollout of a pending alliance between Apple and Goldman Sachs would likely convert merchants on the fence about offering BNPL. Apple Pay Later will allow consumers to buy goods and services via Apple Pay online or in-store and pay for them through either bi-weekly or monthly installments.

WEALTH TECH

More widespread use of cloud computing and the emergence of blockchain technology are some of the trends transforming wealth tech.

Increasing adoption of the cloud

Wealth management firms are migrating their data to the cloud and reaping the benefits. The cloud offers firms a scalable environment conducive to today's selection of data-intensive analytics apps. It also streamlines data sharing within the organization, giving more employees access to relevant information. Thus, firms that embrace the cloud can perform more accurate data analysis and draw from artificial intelligence-backed insights. Cloud adoption also helps them save money in the long-term, as legacy systems are expensive to maintain and leave data vulnerable to potentially costly breaches.

Emergence of blockchain

Blockchain eliminates the middleman by establishing peer-to-peer networks for fast and transparent transactions and enables bankless fiscal management, providing users a sense of ownership. Blockchain also fits seamlessly into the increasingly interconnected world by supporting borderless transactions.

As cloud migration climbs the list of priorities, wealth managers will likely shift to a remote advisory model, which allows them to offer more personalized services. The shift from a linear, industrial financial services value chain towards modular backends, open platforms and embedded financial services will erode the line between the originators and distributors of financial products. Traditional institutions recognize the urgent need to tackle their transformation efforts to generate new net revenue growth. In another example of how Goldman Sachs is keeping a close eye on fintech, the multinational investment bank has built a portfolio of new business lines in recent years. This includes Marcus, an independent, exclusively digital challenger bank boasting account capabilities, a $40,000 lending maximum and personal finance management features. Goldman Sachs has also introduced a cloud-hosted, API-based Banking-as-a-Service (BaaS) platform that allows the bank to conduct financial services across numerous jurisdictions.

CHALLENGER AND NEOBANKS

Challenger, or neobanks, are pouncing on opportunities to reach vulnerable or underserved customer segments to emerge as formidable competition for their traditional counterparts. According to Payments Cards and Mobile, 144 new neobanks opened between 2019 and 2020. They are setting sights on national markets and expanding services, from account opening to travel credit card sales. As traditional banks are just embracing digitalization, neobanks remain a few steps ahead. For example, some neobanks are leveraging technology that enables customers to manage their accounts and cards from their preferred messaging service, instead of installing a banking app. Innovation pays off—in 2020, neobanks attracted more than $2 billion in venture capital worldwide.

Traditional banks will likely expand the criteria for approving loans and opening bank accounts to compete with neobanks. Analysts project that the number of users of neobank applications in North America and Europe will reach 145 million by 2024. Neobanks will start to differentiate themselves from competitors by entering niche markets, like brokerages.

Neobanks will also look more intensely towards the B2B sector which will have a significant impact on banking as a whole. Some neobanks expanded their clientele to B2B but a newer cohort of neobanks has entered the market, catering exclusively to the B2B sector. Neobanks appeal to the growing number of businesses helmed by digital natives by offering user-friendly apps and 24/7 availability. "Digital natives" includes Millennials and Generation Z, expanding neobanks' potential customer base.

Fintech has touched many sectors. The current state of payment processing, wealth tech and neobanks point to the progression of its evolution, and the future looks bright. In the coming years, retail will likely refine payment processing and rethink payment structures. The benefits of payment structure improvements will extend to the millions struggling to repay student loans. Wealth tech will become more personalized and stiff competition will close the gap between traditional and neobanks, providing a larger segment of individuals and business owners more options and opportunities.

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