

The Covid-19 impact on fintech: now is the time to boost investment



While the coronavirus pandemic sweeps the entire world, governments' response to the international health crisis has led the global economy to a standstill. Extensive lockdowns and social distancing measures are leading to massive unemployment spikes and numerous businesses are already seeing dramatic loss of revenue and struggling to maintain their operations.

In the US, unemployment rates rose to 4.4% in March and there are projections that it will reach 32% before the crisis is over. Similar figures are also estimated for most European countries including strong economies such as Germany, UK, and France. Small and medium enterprises (SMEs) in several industries are particularly vulnerable as they lack the capital to support their operations and salaries during this period, which is expected to last months.

Fintech start-ups and scale-ups are no exception. As VCs and investors liquidate their assets, fintechs will need to tighten their finances and cut costs to survive the drop. In line with this, Monzo CEO announced that he will forgo his salary for 12 months and one fifth of the company's employees will need to take voluntary unpaid leave of absence for the business to cope. As expected, better capitalised and profitable fintechs that recently received funding will have an advantage, but early-stage companies will suffer more as funding becomes scarcer and competition for cash intensifies.

Before the Covid-19 crisis, only a limited number of fintechs were breaking even, or profitable, and most firms were focusing on year-on-year growth operating on investor money. It has already been documented that fintech deals decreased sharply during Q1 of 2020 and the drop is expected to deepen in the next few months (CBInsights, 2020).

While it makes economic sense that many businesses will contract and decline in the context of the emerging financial crisis, the question is whether, in an environment that forces consumers to switch to online channels, digital financial services will thrive and fintechs will be seen as the natural remedy. After all, the fintech revolution did emerge partially from the ashes of the previous global financial crisis, so fintechs are used to being agile, flexible and faster in responding to uncertainty. The answer to this question is 'Yes' and 'No'.

While the fintech ecosystem has proved to be transformative for the sector, the demand for fintech services is dependent on the economic activity across the globe. Research from McKinsey suggests that transactional services and revenues from payments will decline as spending decreases. This will affect the business model of many fintechs who relied on scaling up their customer base and making small profit margins from money transfer and payment services. In particular, fintechs that rely on cross-border transactions, e.g. from travel spending or international payments, will be more affected as travel is banned and commercial restrictions on international trade imposed. Combined with lack of funding, this may mean that several fintechs will fail or be acquired on a discount as fintech valuations decline. This kind of speculation may have knock-on effects as consumers will be less likely to hold their investments or savings with smaller institutions that are more likely to go bust leading to a “fintech run”.

In order to avoid companies defaulting and people going bankrupt, governments are rushing to inject cash in the economy and capitalise businesses and the self-employed through financial aid. Fintechs can certainly benefit from that. However, the circulation of large amounts of cash, e.g., through the Coronavirus Business Interruption Loan Scheme (CBILS) in the UK, in such a short amount of time, is a difficult exercise that requires a solid financial infrastructure and supply chain. In that respect, fintechs can be uniquely positioned to step in and facilitate credit requests from businesses and monetary aid to individuals.

Technologies such as machine learning algorithms can put fintechs – from P2P lending platforms such as Funding Circle to digital banks that provide lending to SMEs, such as OakNorth and Iwoca – at an advantage as they are called to assess the credit worthiness of businesses and distribute loans rapidly by automating the due diligence process.

In addition, fintechs may be able to serve customers that are usually excluded by the traditional banks, for instance, due to lack of collateral. Bigger and older financial institutions that operate with legacy technologies and models can potentially struggle to work at this pace and be more reluctant to offer lending to businesses using alternative data for their credit assessment. Considering that most SMEs have limited liquidity, time here is of the essence. Being digitally native, fintechs will also be better equipped for remote working, and will potentially be more prepared to respond to such calls and service businesses remotely.

It's difficult to assess whether the impact of the COVID-19 crisis will be positive or negative in the aggregate. As mentioned above, payments businesses may struggle – VISA has already reported a sharp slowdown of cross-border activity. On the other hand, demand for digital financial services (e.g. such as credit) will be on the rise and this may be the point where certain fintech businesses can grow their customer base. For example, Greensill Capital, a trade finance platform, suggested that demand tripled in March as many businesses experienced cash-flow constraints but hesitated to approach large banks for credit. Digital banks may also be able to attract more customers who seek a better banking experience that relies exclusively on digital channels.

In addition, the fintech community has been a force for good in this crisis. Several fintechs stepped in quickly to help people during this time of need. Members from the UK fintech community, led by Credit Kudos, Fronted and 11:FS, came together to create a digital solution for the self-employed to prove a loss of income via open banking, and apply for fiscal support from the government. The solution named “Covid Credit” was developed over a weekend. In addition, Greensill Capital provided their salary finance platform at no cost to allow NHS workers to be paid sooner.

In the US, Kabbage introduced helpsmallbusiness.com, a website that allows consumers to purchase gift certificates from SMEs that need support during the pandemic. A similar move in the UK is “Save My Local” by fintechs such as Curl, where people can buy advance vouchers for services in an attempt to help their local businesses.

Having studied the impact of fintech firms and digital disruption on the banking sector (see more on [open banking](#) and [digital banking](#)), our position is that now is that time to boost fintech investment and bring several of these services to the forefront of the sector. Results from our research show that growing their customer base has been the main challenge (mainly due to lack of customer trust in new players in a data-sensitive industry such as finance).

If fintech solutions are incorporated into formal government schemes such as CBILS and become the only option for some people during the financial crisis, the psychological hurdle to try these services can be overcome faster, which will also boost the digitalisation of the financial services sector. As high-street banks reduce the number of their branches, customers will increasingly have to rely on digital solutions. This means that now is the time for many types of fintechs to prove their value, utilising their advanced algorithms for the benefit of customers who need better money management, access to credit, benefits, digital identity services, quick fund transfers, etc.

Flipping the coin, this also means that despite the economic hardship expected to follow the Covid-19 crisis, now is the time for investors to support fintechs whose services can increase customers' financial wellbeing. The incoming financial crisis (even before it starts!) has already proven that digital financial services will be the future and are more necessary than ever in an increasingly digitised world.



Notes:

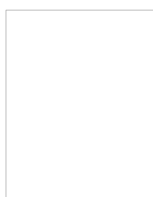
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