Bloomberg Law

Professional Perspective

Covid-19 & the Future of Fintech

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In the last number of years, the global fintech industry has experienced a period of exponential growth. Investors have scrambled to plunge money into the sector, and fintech valuations have soared. In 2019, there were 66 VC-backed fintech unicorns worth a combined $243.6 billion, with 24 new unicorns born in 2019 alone.

The beginning of 2020 saw the fintech sector continuing to ride on the crest of the wave, with the announcement of a number of high-profile acquisitions. January saw the acquisition by Visa of fintech darling, Plaid, for $5.3 billion, in what was one of the biggest fintech acquisitions of all time. This was followed shortly after by Intuit's announcement of it its intention to buy Credit Karma for $7.1 billion.

With a number of mega-deals already in the bag before the end of February, and public fintechs outperforming both the S&P 500 and NASDAQ in the first two months of the year, many were predicting that 2020 could be the fintech sector's best year yet.

But then a global pandemic struck, and suddenly everything changed.

Covid-19 Crisis

In April 2020, with Covid-19 spreading quickly and aggressively across the world, the global economic outlook shifted monumentally. Furloughs and mass layoffs have been being implemented across all sectors, with a record 22 million people filing for unemployment in the U.S. between mid-March and mid-April. The tech sector has seen significant valuation adjustments, with a number of high profile unicorns already losing their horns.

With the global pandemic taking a massive toll on the economy at large, it is unsurprising that the fintech sector has also begun to suffer. By late February, digital payment giants Mastercard and PayPal had already warned investors that Covid-19 would hurt revenue, citing the impact it would have on cross-border travel and cross-border e-commerce growth.

With the situation escalating quickly in March, NYSE-listed Square saw a 37.1% drop in its share price throughout that month, leading the global payment processor (which primarily serves small- to medium-sized businesses, including many now-closed restaurants and retailers) to pull its full-year forecast.

Meanwhile in private markets, experts anticipated significant declines in valuations, as well as down-rounds. In a report published in March by brokerage firm RosenBlatt Securities, it predicted that the current fintech unicorn class could expect to see their valuations decline by an average of 15% and predicted tough times ahead for the sector—in particular, for challenger banks, marketplace lenders, and robo-advisers. Throughout March and April, several high profile fintech unicorns responded to the downturn with the announcement of significant layoffs.

Winners & Losers

While there is no doubt that there are tough times ahead for the fintech sector, there are some early signs that the industry may be well-positioned to emerge from the crisis relatively unscathed overall.

Certainly, it would seem that the investment community has faith in the sector's ability to successfully navigate through the crisis. Throughout March and April, a number of high profile fintechs completed mega funding rounds, including U.K. challenger bank Revolut (which completed a $500 million funding round in late February), San Francisco-based challenger bank Chime (completing a $700 million funding round in early March), and the global payment processor Stripe (raising $600 million in April, at a massive $36 billion valuation). Early April also saw the announcement of another fintech mega-deal, with SoFi announcing its acquisition of the banking and payments platform Galileo for $1.2 billion.

As with every crisis, some market players may find that the evolving coronavirus economy presents new opportunities and even drives business growth. This has happened, —for example, for Zoom in the telecommunications space and Peloton in the home fitness space, and for Netflix and others in the online video streaming sector. For the fintech sector, the shift to virtual will put pressure on financial institutions, who continue to rely largely on bricks and mortar branches and traditional paper-based processes, to rapidly automate and digitalize legacy processes around customer onboarding, know-your-client or KYC requirements, etc. The unanticipated need to move quickly to digital could see more financial institutions, as well as their customers, turning to fintechs to leverage their existing suite of technologies and solutions. This may drive opportunities for fintech enablers, as well as regtech businesses.

With the uptick in digital adoption, coupled with a growing "anti-germ" economy, a further movement away from cash in favor of digital and contactless transactions is likely. In Europe, for example, the European Banking Authority has issued a statement urging the European payments industry to increase contactless transaction limits to €50 to help with curbing the spread of the virus and several European countries have already taken action to increase national thresholds. This move away from cash is likely to drive opportunities for the digital payments sector.

Cash Is King

Ultimately, many fintech businesses may experience a seesaw effect as a result of the coronavirus crisis, with some aspects of their business experiencing an uptick, and other aspects experiencing a downturn. For example, while the move to digital should have a positive impact for payments processors in terms of new customer acquisition; decreased consumer and business spending may mean an overall decrease in revenues. Similarly, while marketplace lenders may see an increase in demand for their products, as businesses and consumers seek to avail of alternative financing options; they are also likely to see an uptick in loan defaults, leading to significant devaluations in their loan books.

For businesses experiencing this type of seesaw effect on their business, their ability to successfully weather the Covid-19 storm may depend on their overall cash flow position. Fintechs with plenty of fresh funding in the bank, like Revolut, Chime, and Stripe, as well as the many others that raised significant funding in the period prior to the Covid-19 crisis, should have plenty of runway to make it through the crisis.

As access to new funding becomes more restricted as a result of the crisis, capital-intensive businesses that have burned through prior funding rounds may find themselves more exposed.

Embracing New Challenges

The ability of fintech businesses to successfully navigate difficult times may also depend on how quickly and successfully they can pivot in response to the unique new challenges the coronavirus crisis presents. Again, early signs would indicate that the sector may be well-positioned in that regard.

The U.K. fintech community demonstrated the sector's incredible ability to quickly mobilize and innovate in the face of new challenge, with the launch of the Covid Credit project. This project was launched by members of the U.K. fintech sector following the announcement by the U.K. government on March 20th of an emergency financial support package for furloughed employed workers. The idea behind the Covid Credit project was to develop a digital solution that would enable self-employed workers (who are excluded from the current government scheme) to provide reliable evidence of loss of earnings in order to allow them to qualify for a similar government scheme in the future. Over the course of a weekend, the U.K. fintech community rallied and, within only 48 hours, had created a working prototype that leverages open banking to enable self-employed individuals to provide the relevant financial data through a self-certification process.

This is just one example of fintech businesses collaborating and innovating to take on the challenges of the new coronavirus economy. In the U.S., similar efforts have been launched by the fintech community in connection with the distribution of government financial supports, with a number of fintechs quickly mobilizing to ensure that they have the approvals and technologies in place to facilitate the rapid disbursement of government loan checks under the Paycheck Protection Program.

Fintech businesses have also stepped up to assist with some of the non-financial challenges posed by the Covid-19 crisis. For example, the U.K.-headquartered digital identity fintech, Onfido, is reportedly in talks with the U.S. and other governments in relation to the development of a digital coronavirus "immunity passport" for the identification of those who have already recovered from Covid-19 and tested positive for antibodies. Similarly, the global blockchain community has also been rallying to come up with creative solutions to tackle coronavirus-related challenges around contact tracing, immunity tracking, and screening, as well as supply chain authentication issues, using blockchain technology.

Thus, the initial signs indicate that the industry is well-armed and ready to innovate as needed to tackle the challenges that lie ahead.

Looking Ahead

The deep and sudden economic shock of the Covid-19 pandemic has left businesses reeling. While the full impact of the pandemic on the global fintech sector is uncertain at this point (and may be uncertain for several years), it is clear that tough times lie ahead, both in the U.S. and internationally. However, as with every crisis, there will be opportunities, and when we get to the other side, there will be winners and losers.

For the fintech sector, which already largely operates and exists online, businesses should be relatively well- placed to adapt to the new "virtual reality" and to help find innovative solutions to the unique challenges the world at large now faces.

This innovative spirit, along with the capacity to adapt and mobilize rapidly, will no doubt serve the sector well in the challenging times that lie ahead. Where this innovation is also supported by appropriate legal and regulatory compliance strategies, together with robust business continuity planning and cashflow management, at both the domestic and international level, hopefully more international fintech businesses will emerge on the winning side of the crisis.

Many say that the fintech sector rose from the ashes of the 2008 financial crisis. Perhaps out of the ashes of the coronavirus crisis, we will see the rise of Fintech 2.0.

