EMERGING PAYMENTS ASSOCIATION

Investments in PayTech

A study of investments in payment technology companies

From the EPA, in association with The Bancorp,
with research from Accourt

The Bancorp

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#PayTech

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Introduction from The Bancorp

I am sure anyone currently operating or looking to operate in the FinTech space – specifically in PayTech – will enjoy the key findings of this EPA Whitepaper, "Investment in PayTech: A study of investments in payment technology companies." For European Senior Executives, the study contains some great insight into the challenges and opportunities involved with funding, an analysis of the investment trends currently being witnessed, as well as an assessment of the business and investor lifecycles currently anticipated in this exciting and accelerating sector.

As one who has been involved in financial services for nearly 20 years, it's clear to me that we are currently witnessing a speed of evolution in payments that is unprecedented. This is truly a fantastic opportunity for the companies and individuals who have compelling use cases and solutions that businesses and end-user consumers can adopt.

The Bancorp is pleased to have taken a leadership role in the development of this EPA Whitepaper as we believe that the PayTech market will continue to witness significant growth, particularly in the two key markets of our involvement – the US and the UK. With PayTech companies now representing more than 40% (and growing) of the space in FinTech, it clearly is THE sector of the moment, further evidenced by the increasing rate of investor interest.

It is our pleasure to support the Emerging Payments Association and their ongoing commitment to PayTech. Dedicated to setting a new standard in financial services innovation, The Bancorp is proud to support the EPA and the PayTech industry in their continuing efforts to create disruptive, customised finance solutions for partners, ranging from entrepreneurial start-ups to those on recognised global indices.

Kriya Patel
European Managing Director, The Bancorp

An advisory board member of the Emerging Payments Association, Kriya Patel has served as European Managing Director for The Bancorp since 2010. Prior to joining The Bancorp, Kriya was Chief Operating Officer for Newcastle Card Solutions from 2008 to 2010, founding the very successful Newcastle Building Society prepaid cards subsidiary, which became the largest prepaid Issuer of MasterCard prepaid in Europe and fifth largest globally. He also served previously as Managing Director for Newcastle Mortgage Services and Newton Facilities Management Ltd, in addition to IT and project management roles for Newcastle Strategic Solutions Ltd.

Kriya holds a diploma in Management Development from Northumbria University and a BSc in Business Information Systems from Sheffield Hallam University, as well as qualifications in ITIL, Business Systems Analysis, and Software Testing.

Background to the study

In 2016, investments in financial technology (FinTech) companies have double compared with the same period last year[1]. So it is not surprising that the UK seems to be awash with FinTech companies – 2,000 today compared with 800 in April 2015 – receiving investments of £524m last year in a sector that employs 61,000[2] people and generates revenues of £6.6bn.[3]

But the FinTech market is still young. There are only a few examples of FinTech 'Unicorns', young companies with market valuations above $1bn. And not many FinTech businesses are listed on the stock market. So few FinTech companies can report meteoric success. But the longer-term financial performance of such companies, and the return on investments by angels, trade investors, Venture Capital firms and Private Equity, is yet to be proven. And sometimes, FinTech business fail spectacularly[4].

Payments represent a significant proportion of the FinTech sector. Of the 350 leading FinTech companies in the four segments[5] surveyed by McKinsey & Co in early 2016, 43% were in payments. This part of the FinTech sector, increasingly referred to as 'PayTech', is developing fast, with the increased use of smart devices, new digital applications, alternative processing networks, wearable technologies and new payments processes. PayTech companies are positioning themselves to benefit from the 28% of today's consumer banking and payments business that are said to be threatened by tomorrow's FinTech businesses by 2020, and investors in PayTech are hoping they have tapped into a profitable, growing marketplace.

But what are we able to say about investments in PayTech companies? What has been the most popular place to set up such a company? What happens to the funds invested in them and what is their most likely route to exit, if any? And what does this say about the future of PayTech and the money invested in it?

The Emerging Payments Association (EPA) supports over 80 PayTech members, helping them grow their businesses faster, at lower cost and risk. It sets out to make the UK the global hotspot for innovation in payments, and in doing so, to shed light on important topics that help its members to differentiate themselves in a competitive marketplace. So with the support of our Benefactor, The Bancorp, the EPA commissioned the specialist payments consultancy, Accourt, to conduct research into the lifecycle of PayTech companies launched in the last five years.

The research covered when the company was launched, the category it largely operated in (mobile payments, security, etc.), its location and the funding it received at launch and in total. It reviewed what happened to that investment, whether the company is still trading, exited (either IPO or M&A) or failed/disappeared. If the company exited, we determined at what valuation and, in the case of M&A, the acquirer/merger was also identified.

This survey set out to identify the average lifecycle for an emerging payments company, the average level of seed funding, the average level of growth funding and the percentage that exited, failed or continue to trade. It also identified the most common type of exit and the most common type of acquirer.

We hope this White Paper provides our members and the wider FinTech community with insights about the nature of PayTech investment. Thank you to The Bancorp for providing the resources to allow us to produce this report; to the crew at Accourt for undertaking the original research and analysis; and to our members, without whom none of this insight would be available.

[1] Source: Finovate blog - Fintech Fundings: 36 Companies Raise $480 Million Week Ending March 18

[2] Source: Ernst & Young, UK FinTech On the cutting edge, 2016

[3] £6.6bn revenues for non-traditional, high growth FinTechs only – see fn.2, above

[4] Source: BBC Online, Powa: The start-up that fell to earth, March 2016

[5] Account Management, Lending and Financing, Payments and Financial Assets and Capital Markets

[6] Source: Cutting through the noise around financial technology, McKinsey & Co, 2016 – 350 companies, not necessarily representative

[7] Source: Blurred Lines: How FinTech is Shaping Financial Services, PwC, March 2016

Top level findings

From the data we have found that:

01. The U.S. and UK dominate payments in western markets

- 90% of PayTech start-ups originate in the US or the UK

02. The UK is the second most attractive place globally to set up a payments business after the US. While the proportion of UK PayTech start-ups appears to have doubled between 2010 and 2014 while the US remained fairly stable, the US still accounts, however, for twice as many PayTech start-ups as the UK. In our study of published source material, we found that:

- In 2010, 58% of PayTech start-ups were in the US. and 12.5% were in the UK
- In 2014, 61% of PayTech start-ups were in the US. and 28% were in the UK

03. Investor interest in UK payment businesses has increased, with seed funding more than doubling between 2010 and 2014.

- In 2010 and 2011, UK seed funding averaged at $0.84m and grew to $1.8m in 2014

04. The UK is now on a par with the US when it comes to seed funding:

- In 2014 US seed funding averaged $1.9m compared with $1.8m in the UK

05. Of the payments companies we studied, those in the UK have remained independently active for longer than US players

- 43% of the US PayTech companies which were established in 2010 have either closed or been acquired
- 100% of the UK PayTech companies included in this survey are still independently active

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Commentary

The headline indications from the analysis of this research is that the UK is an extremely attractive place in which to set up a payments business. The US and UK dominate payments in western markets. The US has a population of 320m, five times greater than the UK. In proportion to its population, however, the UK supports 2.5 times as many payments businesses. The rate of growth from 2010 – 2014 is also comparably faster in the UK than the US. The percentage of PayTech start-ups basing themselves in the UK has almost doubled. And the lifecycle of UK PayTech companies also exceeds anywhere that of PayTech start-ups elsewhere.

2010 PayTech start-ups	58% US	12.5% UK	29.5% other
2014	61% of PayTech start-ups were US	28% of PayTech start-ups were UK	11% of PayTech start-ups were other

The FinTech context

FinTech is booming globally, with investment pouring in from around the world. The number of start-ups and deals are growing at a fast pace: in 2014 alone the total value invested globally in the FinTech sector was $13.7bn and from 2010 the growth of funding has been growing at a rate of 45%.[8]

The UK FinTech sector in particular is currently thriving due to unique drivers such as the effect of digital connectivity, customer dissatisfaction with banks, and a lack of innovation and investment by incumbent providers. Also, regulatory changes and the requirement for fraud and identity protection are creating demand for a range of new and innovative solutions.

By the end of 2014, the UK and Ireland were the fastest-growing region for FinTech investment. Deal volumes here have been growing at 74% a year since 2008, compared with 27% globally and 13% in Silicon Valley. From 2008 to 2013, the value of UK FinTech investment increased nearly eightfold, to US$265 million in 2013 – a rate of 51% a year, nearly twice the global average (26%), and more than twice that of Silicon Valley (23%).[9] Within Europe, London is the capital of the tech start-ups where 1,009 start-ups were launched between 2005 and 2014. It is followed by Paris with just 281 firms, Dublin with 162 and Madrid with 139 start-ups.[10]

[8] Source: CB Insights

[9] Source: UK Government

[10] Source: Accourt research

According to various sources, the FinTech sector is driving a record hike in venture capital invested in UK start-ups, mainly based in London. London and Partners, a public-private partnership created with backing from the Mayor of London and designed to promote the Capital outside the UK, announced in July 2015 that of the $1.47bn (£940m) VC funding raised during the first half of the year 2015, $1.18bn (£750m) was invested into London businesses and of that, 40% was being directly invested into local FinTech - that is an investment of $465m (£300m) in this particular sector.

FinTech businesses based in London, including Funding Circle, Azimo, WorldRemit and Currency Cloud, raised $472m (£302m) between January and July 2015. Tech companies in general raised 80% of total funding and 70% of deals. Out of all the venture capital investment going to tech firms in the UK, London receives 80%. VC funding has increased tenfold since 2010.[11]

Nowadays FinTech companies have greater longevity than before; in the past start-ups were created with the long-term aim of fitting into a big company – in short, to be acquired. Now many FinTech start-ups are created to satisfy demand in a niche and succeed in their own right rather than by being bought by a competitor.

During the past few years, new companies have been keen to take advantage of the momentum, holding on to IPO, and receive more private funding due to the booming investment atmosphere within FinTech. However the growth in FinTech funding and innovation will generate a new cohort of companies big enough to start acquiring others – or with the scale to make them meaningful bolt-ons to existing large players.

IPO activity, however, is expected to be patchy. The booming payments sector has already seen deals and is expected to see more. But less mature sectors such as peer-to-peer lending may need more time before consolidation takes off. “There is no doubt it is going to be a bigger market, and we expect to see more M&A. These businesses are growing rapidly, so it clearly will be a bigger portion of the overall market,” said Markus Boser, head of technology, media & telecoms banking for Europe, the Middle East and Africa at JP Morgan.[12]

The UK scores highly as an attractive location for global FinTech. The size of the market opportunity in the UK is significant due to a large domestic and technologically sophisticated customer base, and in London’s position as a world leading centre for institutional financial services. The UK financial services sector, which accounts for approximately 9.4% of UK GDP (£140bn), is one of the largest globally, and more active than those of the UK’s continental European peers.[13] The UK also scores highly due to the availability of capital, although there are gaps at the IPO stage where we have not seen much activity over the last three years.

UK investment in PayTech and FinTech

Investor interest in the UK PayTech sector has been increasing for the last five years. On average PayTech companies founded five years ago have received $80m each from investors so far.

According to a study by London & Partners, the official promotional body for the capital, London attracted 62% of the money invested in UK tech companies by venture capital firms, underlining its dominance of the fast-growing sector. The FinTech sector accounted for close to a quarter of the total raised. The San Francisco-based company Index Ventures, was the most active investor in London technology firms, ploughing $345.6 million into 12 companies in 2015 including peer-to-peer money transfer firm Transferwise.

According to this research, the UK PayTech sector average initial funding is lower than that of the US in absolute figures throughout the five year period. However, due to the relative size of the countries, average initial funding received by the UK PayTech sector would be higher, with investor interest now on a par.

[11] Source: Accourt research

[12] Source: FT Partners

[13] Source: UK Government 2015

While we are not able to offer a meaningful comparison between PayTech and FinTech companies, it is worth noting the global pace of FinTech investment, which is running at double its pace of 2015 - $6.1bn in the first three months of 2016 compared to $3bn in the same months of 2015. In one week alone, a record 36 companies raised $480M in equity and debt[14]. And with PayTech being the biggest part of FinTech, it is reasonable to assume that a decent share of the investment will be heading into payments technology firms.

PayTech acquisitions

The most common destination for these businesses is to be acquired by another company. Most of such acquisitions, or trade sales, were for companies based in the US. Acquirers tend to be large or global companies looking to enhance their payments offerings or to provide additional value added services to their portfolios. Some have been particularly interested in a niche market, payments capability, knowledge or talent.

There are many examples. Samsung, for example, acquired the US-based LoopPay, a mobile payments-based company as part of Samsung's strategy to power its mobile payment transactions. Recently Samsung Pay has become an active member of the Emerging Payments Association. Coinbase, a Bitcoin wallet and merchant processing company acquired the also US-based Blockr, a company that keeps track of Bitcoin transactions. According to Coinbase's CEO, the acquisition has been driven more to acquire the talent within the company rather than the product. Other acquiring companies include Workingpoint, Google, PayPal, Funding Circle, Capital One, Heartland Payments, Twitter, LifeLock, Braintree, Square, Capital One, Bankrate, Inmar and First Data.

The line between an acquisition and a merger can be very fine, when it's the brand and leadership on the table as well as money. Mobile payments start-ups SumUp and Payleven announced their merger at the end of April 2016, after this study was carried out. CEO of SumUp, Daniel Klein, will become CEO of the merged company, which will keep the SumUp brand. SumUp launched in 2011 and Payleven in 2012, alongside numerous other PayTech companies looking to capitalise on the opening market for mobile payments. To date they have raised investment of nearly $45m and just over $25m respectively.

So why have they merged and why are others not doing the same? The fit between these two companies includes their shared vision and complementary strengths, and these are clear benefits from the merger which will support global growth while enabling economies of scale. Perhaps the reason we have not seen more mergers to date is, as Klein points out, that payments card adoption has taken longer in Europe than expected. In addition, it is quite possible that the flood of investment capital finding its way into these PayTech companies has given them the luxury to remain independent without the need to go through the challenging process of merging – yet.

Longevity of PayTech start-ups

The research indicates that UK payments companies remain independently active for longer than US players. 29% of US PayTech companies which originated in 2010 have either closed or been acquired, while 100% of the UK PayTech companies reviewed are still independently active. The research undertaken showed many active PayTech companies in the UK, although it is likely that a share of these will be acquired by another company in the coming years. Particular niches where the top VC firms seem interested include Bitcoin/blockchain, crowd funding and peer-to-peer lending, international payments, personal finance management, mobile payments and mobile banking.

While the media focuses on high-profile failures, such as Powa Technologies in 2016, the percentage of PayTech businesses that fail is very low. Where businesses on this list have failed, the most common reasons cited are insufficient funding, poor proposition, an unappealing product or the timing of the launch.

[14] Finovate blog - Fintech Fundings: 36 Companies Raise $480 Million Week Ending March 18

Future of PayTech investment

Right now the UK is anxious about the implications of a potential "Brexit" from Europe. With London wishing to maintain its reputation as a top global location for FinTech – and this applies to PayTech too – there is concern that FinTech businesses might relocate to elsewhere in Europe, although others cite back to similar concerns over the decision not to adopt the Euro. Whatever the decision in the referendum on 23rd June, some factors will continue to stand in favour of the UK for PayTech businesses, such as London's strong international position in foreign exchange, for example and the health of the UK's asset finance and investment industry.

UK PayTech start-ups may also benefit from some of the general conditions to support innovation where the UK is recognised as performing well. These include competition conditions, as measured by new start-up rates and business churn, entrepreneurship[15] and its flexible approach to regulating new businesses.[16]

In its recent evaluation of the international FinTech sector, Ernst and Young ranked the UK as the leading global FinTech ecosystem, presenting itself as a good all-rounder in the attributes of capital, talent, policy and demand. The report cites its well-rounded FinTech ecosystem with an effective network of FinTech hubs, proximity to global financial hub offering a wealth of talent and expertise and particular competitive advantage in its government and regulatory policy.[17]

A unique assets of the UK's PayTech sector is the existence of the world's only Payments Systems Regulator (PSR). Its focus on promoting competition and innovation while protecting user interests and its approach to engaging with the whole payments ecosystem has created an unexpected benefit: the payments community is taking responsibility for driving its own change in a customer-centric, commercially attractive and innovative way.

Other factors also suggest a positive future for PayTech in the UK. These include reduced trust in the traditional banking system and the spread and capability of smartphones and wearable technologies as payment devices. On top of this the increasing demand from consumers for personalised, seamless and on-demand payment services, which is unlikely to diminish and, with many established businesses lacking the ability to provide this, the opportunity for disintermediation is considerable.

Conclusion

We conclude that the UK is punching well above its weight when it comes to attracting investment in PayTech; that UK companies are more likely to remain independent than US companies; and that if you want to launch a company in the most popular hub for PayTech companies, you should come to the UK.

[15] Source: NESTA report, The wider conditions for innovation in the UK - How the UK compares to leading innovation nations, 2009

[16] Source: www.citie.org

[17] Source: Ernst & Young, UK FinTech On the cutting edge, 2016

Assessment of findings

Year	Average life cycle (Years)	Average level of seed funding	Average level of growth funding	% that fail, exit or continue
2010	5.1	$0.75m	7000%	Active: 75% Acquired: 20.8% Out of business: 4.2%
2011	3.6	$1.14m	1600%	Active: 67.8 % Acquired: 25.0% Out of business: 7.2%
2012	3.1	$2.0	2600%	Active: 75.0% Acquired: 25.0% Out of business: 0.0%
2013	2.3	$0.5m	553%	Active: 89.5% Acquired: 10.5% Out of business: 0.0%
2014	1.5	$2.96m	139%	Active: 99.99% Acquired: 0.0% Out of business: 0.0%

About the survey

The scope of the project was to look at financial technology companies in payments in the UK, US and FIGS and chart their evolution and exit over a 5 year period up to 2015. In addition we included some companies that operate in these markets although are domiciled elsewhere; iZettle based in Sweden being such an example. The sample size of PayTech companies was 23 on average and the selection criteria used was that the firm was performing any activity related to payments and/or payments and technology.

About The Bancorp

Founded in 2000, The Bancorp creates customized banks for our hundreds of affinity partners, setting a new standard in financial services innovation. Today, The Bancorp remains one of the few financial service companies in the world dedicated to providing private-label banking and technology solutions for non-bank companies ranging from entrepreneurial start-ups to those on the Fortune 500.

With operations in the US and Europe (e-money issuer), The Bancorp is dedicated to serving the unique needs of non-bank financial service companies, ranging from entrepreneurial start-ups to those on the Fortune 500. The Payment Solutions team at The Bancorp is dedicated to locating and accelerating innovators. Our payments team has been the guiding force propelling the creation, execution and service of countless leading prepaid card and emerging payment solutions. The company's chief financial institution, The Bancorp Bank (Member FDIC, Equal Housing Lender), has been repeatedly recognized in the payments industry as the Top Issuer of Prepaid Cards (US), a top merchant sponsor bank, and a top ACH originator. The Bancorp is a Founding Member of the Network Branded Prepaid Card Association (NBPCA), a Direct Financial Institution Member of NACHA, a member (with Advisory Board representation) of the Emerging Payments Association, and an active participant in the Electronic Transactions Association. The company maintains memberships with the E-Money Association, the Gibraltar E-Money Association, as well as with numerous payment networks including Visa® and Mastercard®. **thebancorp.com.**

About Accourt

Accourt is a leading provider of strategic and operational consultancy and research services to the payments industry worldwide. Our clients include banks, the card schemes and financial services institutions, payments and technology providers, telecom operators, corporates, merchants, and government organisations.

Our team are all experienced practitioners with front line P&L experience, combining unrivalled strategic expertise with operational know-how. From defining and setting strategy, to implementing deployment, through to final delivery, Accourt is dedicated to minimising operational risk and ensuring a successful and profitable outcome for our clients. We have a passion for delivering real and lasting value and we bring focused, world-class expertise to complement client teams.

Accourt specialises in addressing issues affecting the payments community. Our unique blend of experienced industry specialists and local market intimacy has positioned us as the advisor of choice for market leaders across the industry.

We aim to make a powerful, positive difference to our clients' futures.

About the Emerging Payments Association

Established in 2004, the EPA is a thriving community of over 80 progressive payments companies. The EPA helps member organisations connect with prospects, partners, educators and suppliers; removes barriers to innovation; and helps its members to speak with a common voice to promote them, emerging payments and their community.

The EPA's goal is to establish the UK as the global hotspot for payments innovation. As it sets out to be the most influential trade association in emerging payments, the EPA's mission to advance payments innovation has the potential to improve lives everywhere.

By attracting investment capital and creating a hospitable regulatory environment and payment system for innovators, new entrants and disruptors, the UK can make a material contribution to the world around us. So we bring together companies across the emerging payments spectrum to help shape the future while rewarding them with commercial and personal benefits derived from connecting with the right people in the right places.

The EPA's objectives

01. To develop a growing and thriving community where people can meet, learn, help each other and do more business

02. To create a way for non-settlement bank players to gain direct access to settlement at a fair price

03. To make buying new financial services products easier and cheaper

04. To support early stage PayTech companies by providing them with access to mentoring, advice, workspace and commercial partners

05. To coordinate members' views so they speak with a common voice with regulators, the government, the central bank and other stakeholders

06. To encourage retailers and other users of payments systems to adopt emerging payments innovation

07. To provide a source of education and professional development for people working in payments

More information

For more information on this White Paper, or to talk over how you could become a part of the EPA innovation community, please contact

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