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Developing a FinTech ecosystem in the GCC

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Executive summary

In the U.S. and Europe, financial technology (FinTech) "ecosystems" have stimulated technological innovation, made financial markets and systems more efficient, and improved the overall customer experience. These ecosystems — composed of governments, financial institutions, and entrepreneurs — have also shown that they can energize the broader local economy by attracting talented, ambitious people and becoming a locus of creative thinking and business activity. Until now, the Gulf Cooperation Council (GCC) countries[1] have not established particularly deep FinTech ecosystems. However, that could soon change because the four key design elements necessary for FinTech ecosystems are present in the GCC. These are: the business environment/access to markets, government/regulatory support, access to capital, and financial expertise.

Moreover, a consensus is emerging among governments and financial institutions that nurturing these ecosystems is important and beneficial for the region. Indeed, there are already some success stories in the GCC, particularly in the United Arab Emirates (UAE) where incubators, enterprise development funds and programs, and innovation hubs are supporting the creation and growth of local entrepreneurs. Given the benefits of FinTech ecosystems and their viability in the GCC, we recommend several immediate steps, ideally done in coordination with one another, for governments and financial institutions to nurture these ecosystems.

The elements of a FinTech ecosystem

FinTech ecosystems are critical to nurturing the kind of technological innovation necessary to make financial markets and systems more efficient and improve the overall customer experience. Moreover, given the scope of financial technology, a vibrant FinTech ecosystem can stimulate the broader local economy by attracting talented, ambitious people and becoming a locus of creative thinking and business activity. FinTech ecosystems enable growth opportunities for many sectors, including software, data analytics, payments, platforms (e.g., peer-to-peer lending and trading), mobile banking, and algorithmic asset management systems.

A sign of just how significant FinTech has become, global investment in this sector jumped three-fold between 2008 and 2014, reaching US$3 billion. By some estimates, that investment will at least double again by 2018, and may even hit $8 billion.[2]

Although most FinTech investment is currently in the U.S., which captures about 80 percent of this spending, meaningful innovation is also occurring in the European Union, particularly in the U.K. Although relatively little FinTech investment has occurred in the GCC to date, that could and should change. Many of the necessary elements exist in the GCC to develop FinTech ecosystems. There are good reasons to believe the region has the collective will to give rise to these ecosystems and reap their broader economic benefits.

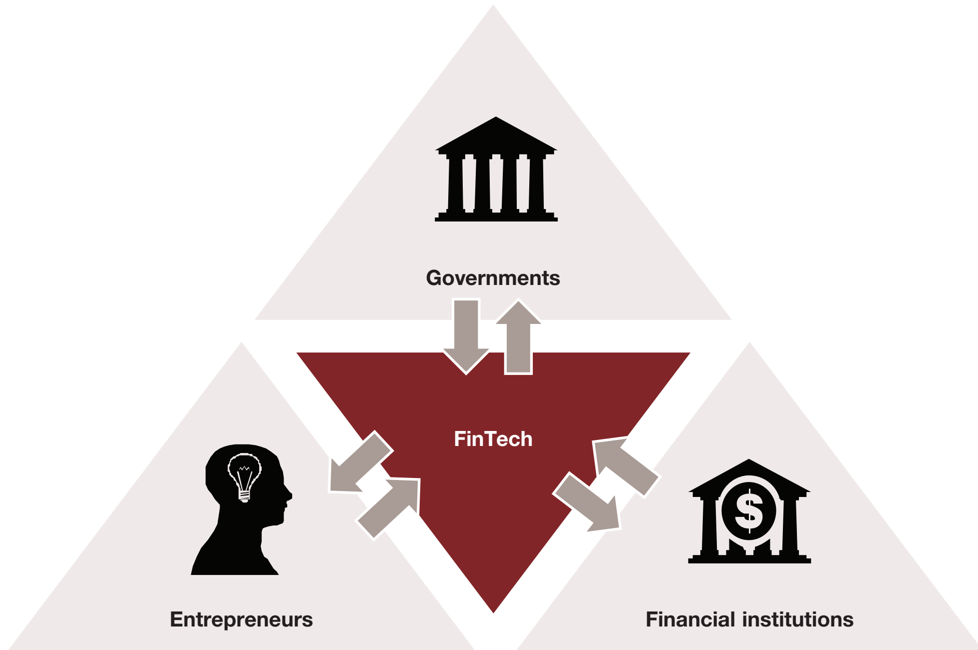
Many of the necessary elements exist in the GCC to develop FinTech ecosystems.

The participants in a FinTech ecosystem

Establishing and nurturing a FinTech ecosystem is difficult given the level of sustained collaboration that is necessary among governments, financial institutions, and entrepreneurs. For a FinTech ecosystem to function, it is imperative that each participant clearly understands its role, as well as the benefits it stands to gain from involvement (*see Exhibit 1*).

Governments must implement and enforce policies and a regulatory environment that will ease the development of the FinTech ecosystem. Doing so encourages entrepreneurial activity and hiring by financial services and technology firms. It also improves the country's overall competitiveness.

Exhibit 1
Major participants in the FinTech ecosystem



Source: Strategy&

Financial institutions, including global and local banks, private equity shops, and venture capital funds could contribute deep content and market expertise to the ecosystem. Also, many of these financial institutions can stimulate their own innovation by establishing partnerships with FinTech startups. These partnerships can strengthen the competitive position of financial institutions, for example, by shortening the time it takes for new products and services to reach the market.

Entrepreneurs contribute innovative and often disruptive technology solutions to the FinTech ecosystem. In return, entrepreneurs benefit from greater access to financing and market expertise, as well as a receptive market for their innovations.

The design of a FinTech ecosystem

There are four critical design elements that support the development of a FinTech ecosystem (*see Exhibit 2*):

- Business environment/access to markets
- Government/regulatory support
- Access to capital
- Financial expertise

Business environment/access to markets

FinTech ecosystems must create an overall cost advantage to working in a country or region if they are to flourish. This means, for example, that facilities (such as land and real estate), equipment, technologies, and utilities must all be available and affordable.

Another factor is the degree of integration and synergies among the players. Technology clusters (or hubs), where entrepreneurs have similar business objectives and are integrated, make it easier for the ecosystem to flourish. These clusters promote the availability of skilled labor and know-how (such as banking analysts, IT developers, sales force, and management staff).

Exhibit 2

FinTech ecosystem development framework

1. Business environment/access to markets
- Cost advantages
- Labor availability and know-how
- Degree of clustering & integration
- Infrastructure quality & access

2. Government/regulatory support
- Policy setting
- Land ownership & development
- Ease of doing business
- Taxes & work permits

3. Access to capital
- Governmental funding
- Bank funding
- PE/VC funding
- Incubators / accelerators

4. Financial expertise
- Funding strategies
- "Know your customer" & regulatory requirements
- Deals structuring
- Due diligence

Source: Strategy&

Finally, the quality of infrastructure is critically important. This includes the state of physical infrastructure (e.g., roads and ports), the ecosystem's connections (e.g., distance to existing business hubs and ease of access), the utilities (power, water, telecommunication, etc.), and the overall quality of real estate and facilities.

Government/regulatory support
Governments can influence many aspects of the ecosystem, including easing business regulations (such as copyright, product registration, initial public offering [IPO] requirements) and keeping taxes and fees low. However, the extent of the government's involvement can vary. In relatively mature FinTech ecosystems such as in the U.K. and the U.S., the private sector dominates the service provider landscape. In these countries, the government's role is limited to policy setting, regulations, and property development. In less-mature FinTech environments, such as Jordan and Saudi Arabia, the government should be involved across the entire ecosystem (*see Exhibit 3*).

Exhibit 3
Government roles and responsibilities in the FinTech ecosystem

Role	Responsibilities
Regulator	- Sets rules and regulations for the ecosystem - Administers government services (e.g., residencies) - Sets licensing requirements - Implements the regulations
Policy setting	- Sets the economic objectives and overall policies for the ecosystem (typically a government entity handling the overall economic or sector development/planning)
Landowner	- Owns the land of the ecosystem - Assigns land development rights to developers - Invests in infrastructure/services to support property development
Developer	- Defines business accelerators and offerings - Sets service standards/promotes the ecosystem - Sets the operating model and contracts operators - Installs, manages, and maintains infrastructure - Invests in services to support the fulfilment of the business accelerators
Operator	- Handles part, or all, of real estate and services management responsibilities for developers - Operates a one-stop-shop service for the tenants

Service provider	- Supplies specific services, which can be divided into three categories:
	  - Superstructure: offices, warehouses, and supplier units
	  - Utilities: power, gas, water, sewage, water treatment, telecom
	  - Value add services: logistics, housing, labor recruitment, labor training, export support, customs clearance, legal/business advice, financing support

Source: Strategy&

Access to capital
FinTech ecosystems are typically funded through four main sources.

Governments may fund the construction of the FinTech hub, by providing seed funds, interest-free grants, or even through provision of subsidized office and co-working spaces. This can be done with *banks* in a consortium. The government may also provide initial financial support to venture capital or private equity funds, banks, and incubators to encourage investment in small businesses.

Venture capital funds and private equity shops are traditional investors in FinTech startups. Funds' involvement will typically increase as these business models gain momentum and reach critical mass.

Incubators and accelerators prepare businesses for venture capital fundraising and provide grants and investments. By offering financial and due diligence services to entrepreneurs, they become a one-stop shop for buyers and sellers in the ecosystem.

Financial expertise
Broad financial expertise and know-how is necessary to structure the ownership of a FinTech ecosystem, provide advisory services to entrepreneurs from the early stages of idea generation through commercialization, and lastly provide legal and regulatory counseling to ensure adherence to local law and tax regulations.

These experts can also be instrumental in lobbying for financial or regulatory measures (e.g., relaxation of IPO requirements, reduced taxation, and financial participation of governments) to ease the conception and acquisition of startups. In addition, by promoting reduced business regulations (e.g., copyrights, product registration) these experts support entrepreneurs and financial services players and increase the attractiveness of the overall ecosystem.

Case study: FinTech in the U.S.

The U.S. has been the most successful at fostering the FinTech industry, receiving the lion's share of global FinTech investments. Companies such as Mint.com (personal finance), Kickstarter (crowd funding), and OnDeck (business peer-to-peer lending) have been FinTech-funded. Financiers include Goldman Sachs, Barclays, Bank of America, and Wells Fargo (*see Exhibit 4*).

FinTech growth in the U.S. is driven in part by the efforts of institutions such as the New York FinTech Innovation Lab. The lab is a mentoring program, designed to help FinTech entrepreneurs engage with finance leaders. Companies coming out of the lab have raised tens of millions of dollars in financing, with some companies achieving substantial valuations.

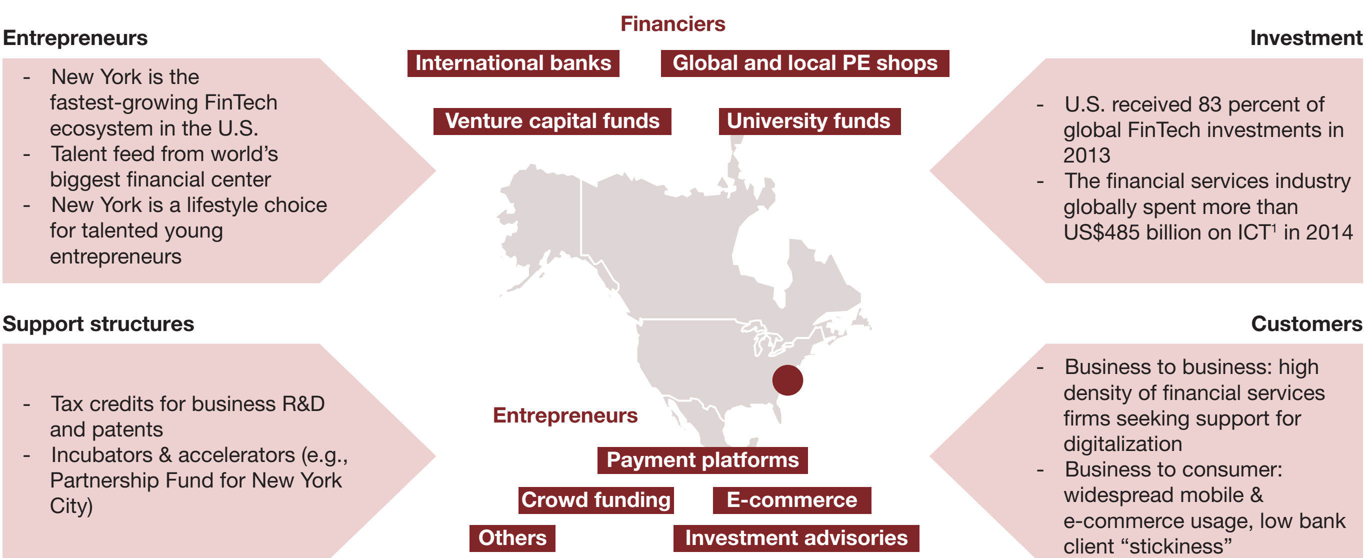
The lab has helped tech startups understand the consumer issues of foremost concern to large financial institutions, thus turning their innovations into the products and services that participating banks need the most. This has helped to reduce the typical startup sales cycle from 18 months to 12 weeks. Moreover, the lab has strengthened the competitive position of financial institutions by cutting the time to develop and launch new products.

The key success factors for FinTech in the U.S. include:

- the country's position as a leading global financial center
- its proximity to a large potential customer base of financial institutions
- banks, capital markets firms, and insurers that increasingly understand the benefits of having a FinTech cluster close to home
- a vast, existing financial technology workforce
- a burgeoning venture capital ecosystem

Exhibit 4

The U.S. FinTech landscape



[1] Information and communications technology

Source: Accenture, Partnership Fund for New York City, FinTech Innovation Lab, "Fintech New York: Partnerships, Platforms and Open Innovation," 2015; Gartner, IT Key Metrics Data 2014 Strategy& analysis

The potential for FinTech in the GCC

Today, FinTech ecosystems are not well established in the GCC and still face obstacles to development. For example, GCC governments have been promoting financial e-services and digitized financial interactions. However, many of these initiatives have stalled, and few private-sector companies with digital experience have joined the effort.

Meanwhile, traditional financial services players are coping with several problems. They may have outdated or non-integrated technology and dissatisfied customers suffering many pain points (such as administrative burdens, a lack of personalization, and difficult account access). They may also face a competitive threat from entrepreneurs stepping up to address customer pain points with innovative digital offerings that could disrupt the financial services industry. Finally, although the region is starting to entice some entrepreneurs, government regulation in much of the GCC and the lack of financing possibilities hamper significant growth of entrepreneurial activity.

The future is more promising. Despite these difficulties, the critical design elements for FinTech ecosystems exist in the GCC. As important, a consensus is emerging that nurturing these ecosystems is important and beneficial for the region. Indeed, there are already some success stories in the GCC, particularly in the UAE where incubators, enterprise development funds/programs, and innovation hubs are supporting the creation and growth of local digital enterprises.

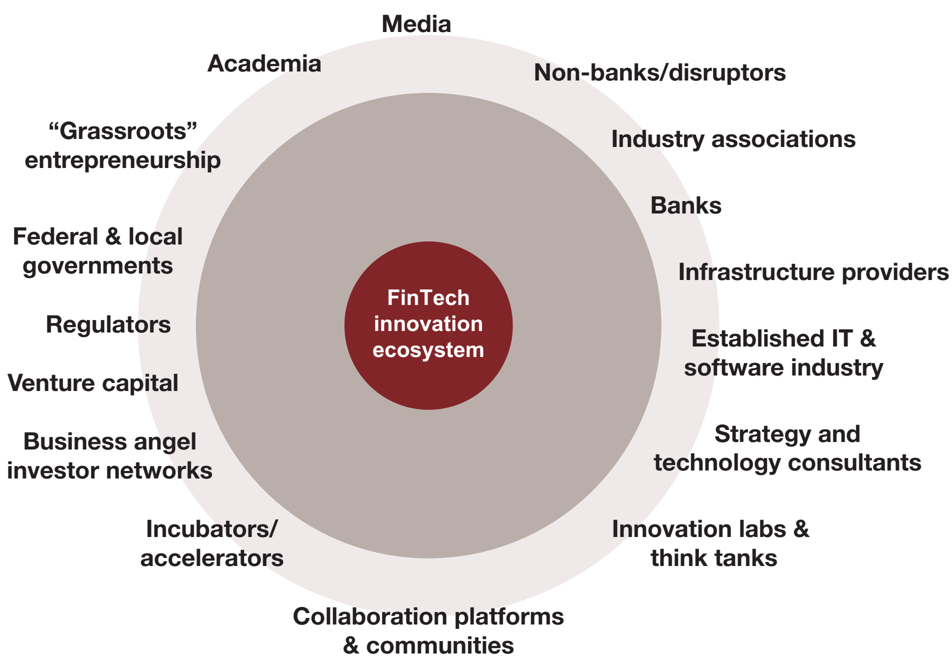
For example, the UAE Academy aims to stimulate enterprise in the country by increasing awareness of entrepreneurship. The UAE Academy's Business Start-up and Innovation Park (BSIP) includes a startup boot camp that imparts a basic understanding of entrepreneurship. It also conducts "ideation" workshops in which participants formulate and develop concrete business ideas.

The BSIP provides a way to test a business idea in a virtual/simulated environment over a period of 12 weeks. Once a business proposal is ready for implementation, the academy disburses a "scholarship" from a fund financed by private-sector donors to help start the business. Each business is incubated within the BSIP for one year and receives mentoring from an industry specialist and/or a successful Emirati or non-Emirati.

In a complementary endeavor, the UAE Academy's SME One-Stop Center conducts grassroots-level awareness campaigns to encourage and inspire young inventors and entrepreneurs. It targets schools, universities, and corporate entities when headhunting talent and potential, while identifying a broad network of interested investors. This approach is important as it recognizes how wide the broader landscape of FinTech actually is. A FinTech ecosystem is about more than matching promising ideas to financing. It is about generating innovative ideas through the interplay of the four design elements of the FinTech ecosystem and the involvement of multiple stakeholders, including the media, disruptive non-bank players, universities, software and infrastructure providers, and venture capitalists (*see Exhibit 5*).

Exhibit 5

The FinTech innovation ecosystem



Source: Strategy&

GCC governments, particularly the UAE's, can build on these advances to encourage a region-wide FinTech ecosystem by connecting a multitude of different stakeholders to support innovation. Indeed, we believe that other GCC members are well positioned to develop FinTech ecosystems given the presence of all four critical design factors (*see Exhibit 6, page 12*).

Also worth noting is that the GCC has a large retail customer base receptive to new and disruptive financial technologies. For example, e-commerce sites such as Groupon, Dubizzle, and MarkaVIP have enjoyed significant success. The region also has a robust financial services industry that wants to quickly leverage proven local and Western FinTech developments.

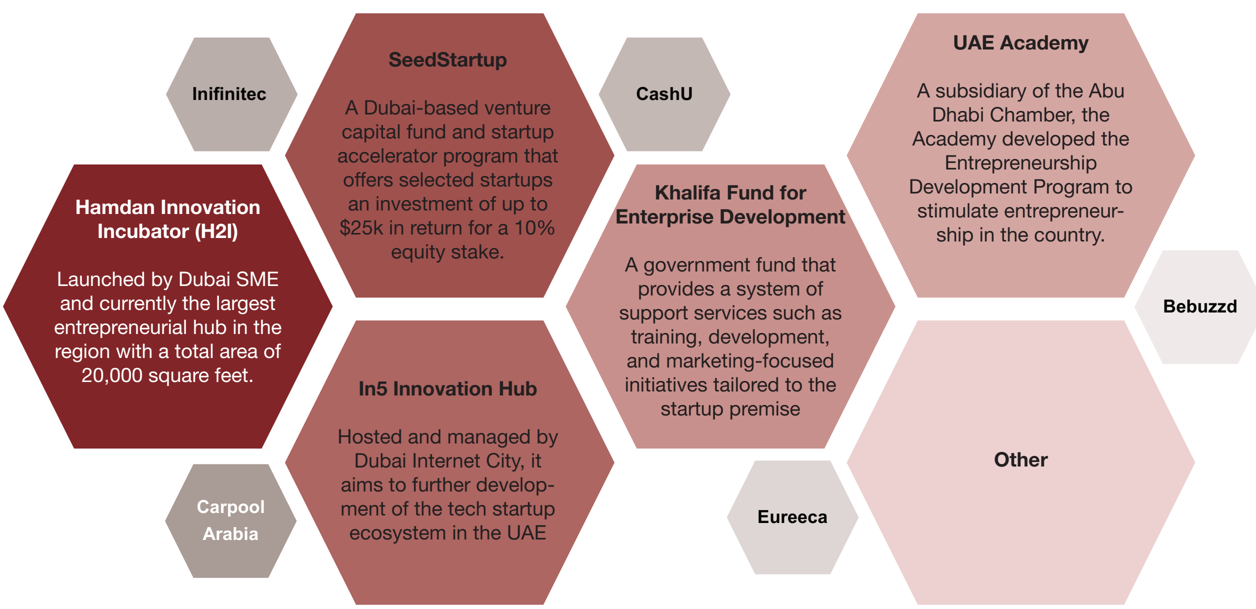
Exhibit 6
FinTech ecosystem success factors in the GCC

Government/ Regulatory support	- The strong position and influence of the government in the economic development of the GCC eases the setup and organization of the FinTech ecosystems at an early stage - Continuous regulatory support ensures continuous development of the ecosystem
Business environment/ Access to markets	- A dynamic technology startup community works on cutting-edge digital developments that are “tailored” to the Middle East (e.g., Arabic needs, culture, and language) - Thanks to its cosmopolitan nature, in regards to both its talent pool and presence of international enterprises, the GCC is very attractive to regional and international talent
Access to capital	- Government-driven funding programs (e.g., Hamdan Innovation Incubator, SeedStartup, In5), venture capitalists, and local financial services players can provide early-stage funding for FinTech startups
Financial expertise	- In line with access to capital, various government bodies and international and local financial institutions can provide the needed advisory, due diligence, and lobbying services to seed ecosystem setup.

Source: Strategy&

Indeed, there is already evidence of the impact that developing the elements of a FinTech ecosystem can have in such a favorable environment. FinTech start-ups, government backing, and support programs are creating pockets of innovation in the UAE (*see Exhibit 7*).

Exhibit 7
UAE FinTech entrepreneurs



Source: Company and government websites; Strategy& analysis

Next steps for GCC governments and the financial sector

To capitalize on this potential and nurture a FinTech ecosystem, governments and financial institutions should take 10 immediate steps, ideally done in coordination with one another. The measures are equally divided between GCC governments and the financial sector.

GCC governments should:

- estimate the financial benefits of establishing such an ecosystem
- develop their strategy for setting up a FinTech ecosystem
- develop the ecosystem's operating model and governance structure
- select financial institutions to partner with, and prioritize the type of startups the government wants to encourage and support
- if the government is setting aside a zone of development for an innovation hub, establish a set of criteria to guide the best use of the space

Financial services players should:

- develop a FinTech business case and understand the financial risks and opportunities
- if an innovation hub is being created, define the financial structure of the hub and the role of stakeholders
- identify the business needs of those in the hub and coordinate with the government
- create a screening and selection process for entrepreneurial tenants of the hub
- prioritize financial startups for potential mergers, acquisitions, and joint ventures

Conclusion

In the GCC, where FinTech ecosystems have yet to take root, governments will have to play a more significant role than in established markets. However, the GCC does have an advantage over other emerging markets: All four critical elements for a FinTech ecosystem are already in place. The challenge is to achieve the necessary level of coordination to make the ecosystem work. If the region can rise to this challenge, the rewards for the financial industry and the broader regional economy could be significant.

Endnotes

[1] The GCC consists of Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates.

[2] Philippe Gelis and Timothy Woods, "The Rise of Fintech in Finance: How fintech is reshaping the finance sector and how you handle your money," Kantox, 2014 (http://cdn2.hubspot.net/hub/310641/file-1445626583-pdf/Rise_of_Fintech_in_Finance/Fintech_DEF.pdf?t=1413451665739).

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