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Fintech in the Middle East

Building on the momentum

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Mehdi Djikhy also contributed to this report.

EXECUTIVE SUMMARY

The Middle East and North Africa (MENA) region is steadily building its financial technology (fintech) sector. Fintech hubs have emerged across the region and are channeling significant funds to dynamic, small companies. MENA region startups received more than US$2.5 billion in funding in 2021 alone.[1] Trends in the first half of 2022 indicate this year will surpass that, given the $1.73 billion that has been raised to date.[2] A growing number of these companies are having successful initial public offerings (IPOs). In particular, the Gulf Cooperation Council (GCC)[3] countries have moved decisively into fintech. Some of the GCC fintech hubs are now so large that they are on the global fintech map.[4]

The challenge for the GCC countries is to build on this momentum so the fintech sector becomes stronger and more sustainable. That will have an impact beyond financial services as it will increase these countries' economic diversification and further their goal of becoming more innovative.

Strengthening fintech requires more private-sector involvement and greater efforts to fill gaps in the fintech ecosystem. Scaling up is essential and difficult, given the fragmented regional market. There needs to be easier access to capital, including through increased venture capital (VC) funding. GCC fintech players need more liquidity, which the favorable macroeconomic context can provide.

One of the largest gaps in the fintech ecosystem is that of talent. The sector must attract experienced professionals who can improve the sophistication and delivery of systems and of support.

BUILDING FINTECH: A GCC SUCCESS STORY

Back in 2015, we published a Viewpoint on the potential for the GCC to develop a fintech ecosystem, subtitled "Let's get ready for take off."[5] Seven years later, GCC fintech has more than taken off. It has soared:

- The number of fintech hubs in the GCC has risen from just one in 2018 to four in 2022: the Abu Dhabi Global Market (ADGM), Bahrain FinTech Bay, Fintech Saudi, and the FinTech Hive at the Dubai International Financial Centre (DIFC). The growth in GCC fintech hubs mirrors the expansion in the MENA region (*see Exhibit 1*).

- As the ecosystem has grown, so has the transaction volume. The amount of fintech investment in the MENA region reached $448 million in 2021, with 108 transactions involving fintechs.[6] There were also four fintech "exits," the highest for a single year.[7] A fintech exit includes IPOs, special purpose acquisition companies (SPACs), mergers, and acquisitions.

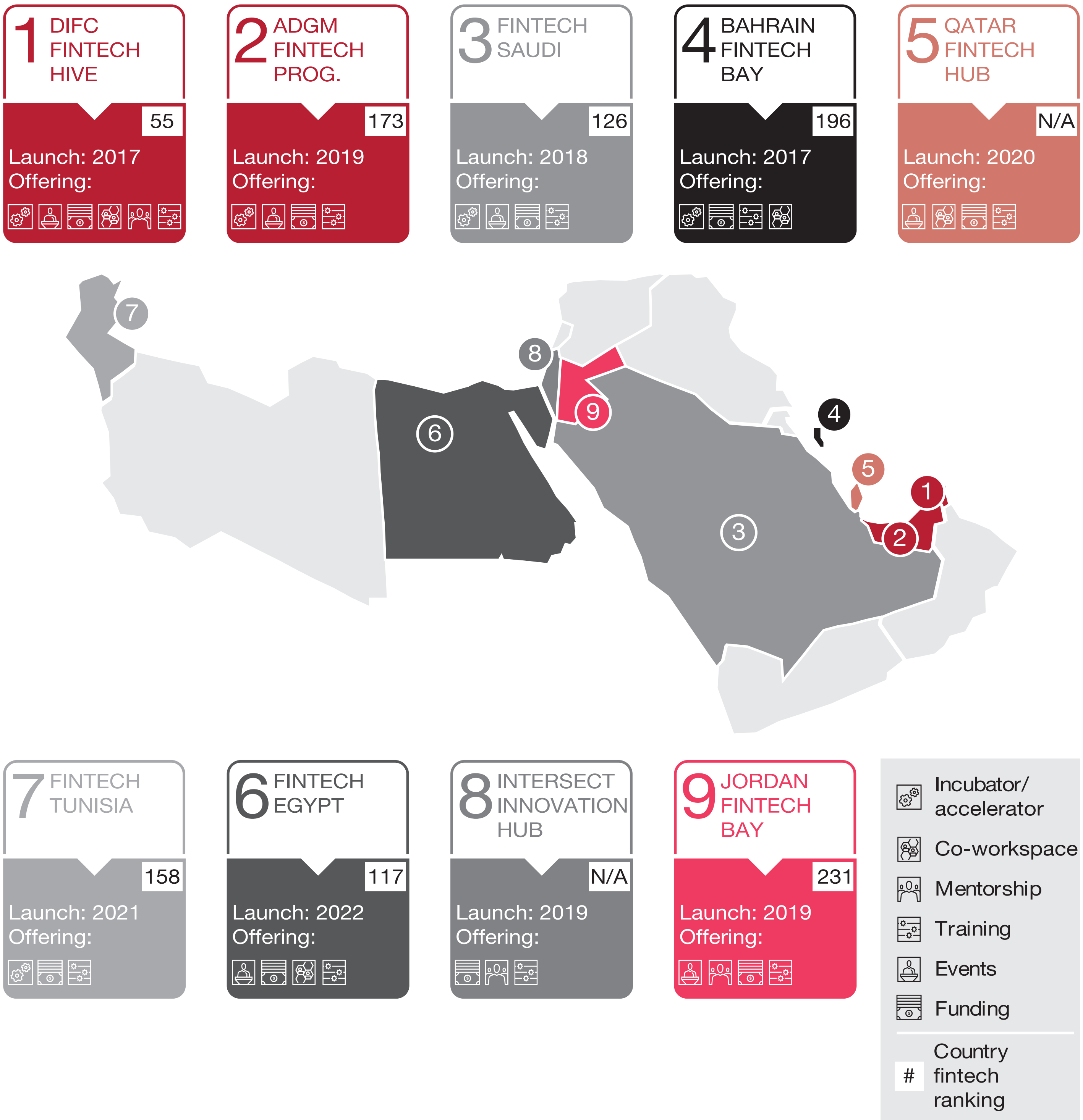
- Although the global economic and geopolitical climate changed in 2022, the outlook remains buoyant. The region boasted its first fintech unicorn in August 2020, when Egypt's Fawry, a digital transformation and e-payment platform, exceeded a $1 billion valuation.[8] Since then, other high-profile companies such as stc pay have reached "unicorn" status, with many more across the region fast approaching this milestone.

- Some of the recent major developments have been in Saudi Arabia, encouraged by the recent National Fintech Strategy 2030, which aims to position the country as one of the top 10 global fintech hubs, with 500 active fintechs by 2030.[9]

This growth is being fueled by a range of factors, supportive regulation in particular. Bahrain, Qatar, Saudi Arabia, and the UAE have each designed a national fintech strategy and set up government-sponsored accelerators and incubators. Regulatory "sandboxes" have allowed room for experimentation and growth.[10]

EXHIBIT 1

Fintech hubs have spread in the Middle East and North Africa

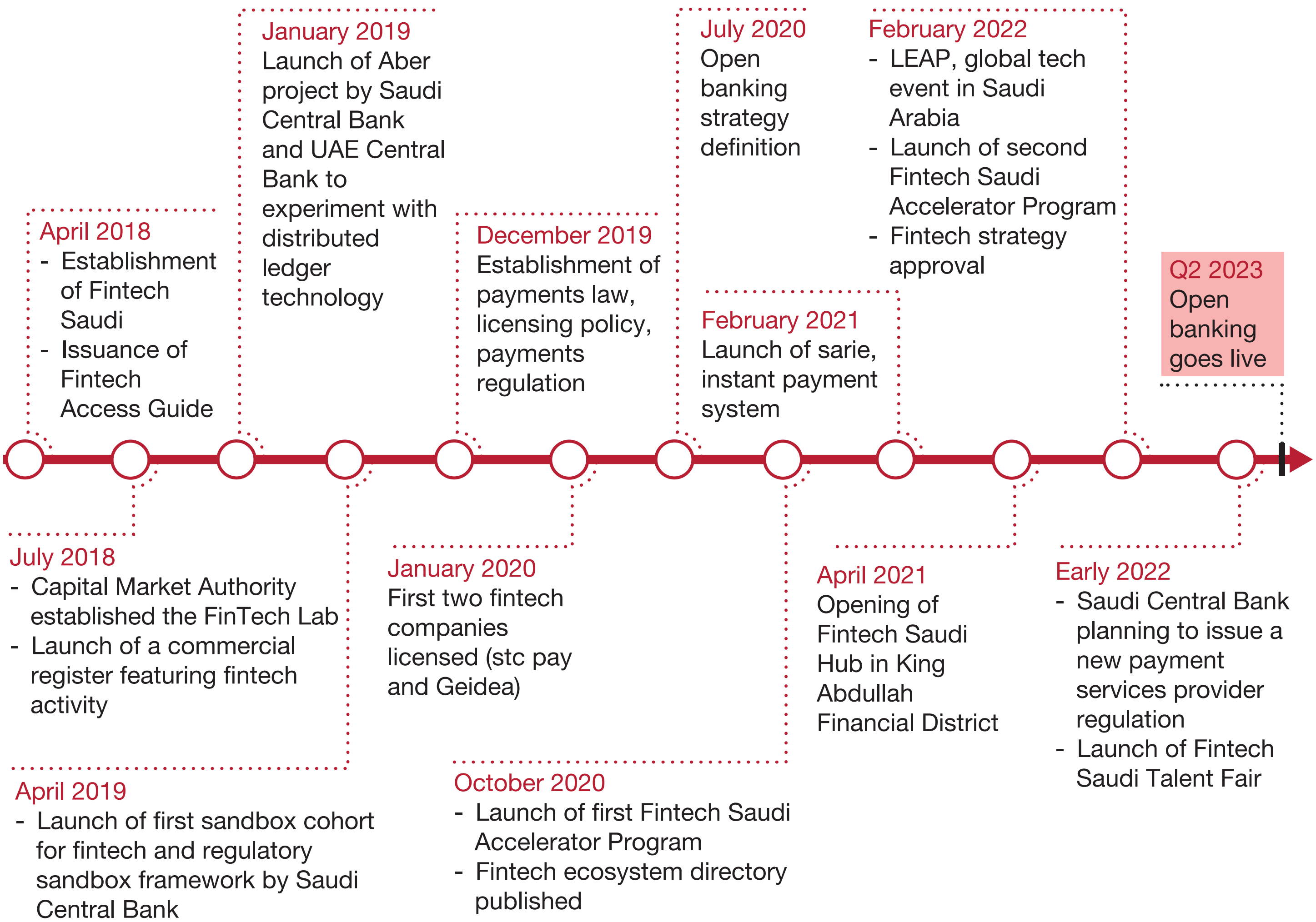


Source: Richie Santosdiaz, "Overview of Key Fintech Hubs Across the Middle East and Africa," *The Fintech Times*, October 30, 2021 (https://thefintechtimes.com/overview-of-key-fintech-hubs-across-the-middle-east-and-africa/); Findexable 2021 Fintech hub rankings (https://findexable.com/wp-content/uploads/2021/06/Global-Fintech-Rankings-2021-v1.2_30_June.pdf)

The Saudi fintech story is characteristic of the supportive policy environment in GCC countries (*see Exhibit 2*). Fintech Saudi was established in April 2018.[11] Within 20 months, a regulatory sandbox framework had been established, along with payments laws, licensing policy, and a new commercial register that featured fintech activity. In July 2018, the authorities licensed the first two fintech companies.[12] Further measures followed, including the first Saudi fintech accelerator program, the launch of an instant payments system, and development of a strategy for open banking, which is scheduled to go live in the second quarter of 2023.[13] The number of active fintechs in Saudi Arabia continues to grow; between 2020 and 2021, the number increased 37 percent. The medium-term trajectory is also significant. There were 82 licensed fintechs in 2021, compared with 10 in 2018.[14]

EXHIBIT 2

Saudi fintech has progressed through enabling regulation



Source: Strategy& analysis

Beyond these enabling policies, GCC countries, in common with others in the MENA region, have some competitive advantages in fintech. These include the availability of government funding and good infrastructure, such as widespread access to broadband. Smartphone penetration is comparatively high, which means that a substantial proportion of the population can access digital fintech services, including cardless payments.[15] For example, in the UAE alone, noncash payments (a category that includes cardless payments) are expected to account for 73 percent of the total transaction volume by 2023 (compared with 39 percent in 2018). These noncash payments are growing across all payment types, including business-to-business, business-to-consumer, and business-to-government.[16]

GCC countries, in common with others in the MENA region, also have a demographic advantage in their young, growing, educated population. Around 30 percent of the MENA region's population, or some 110 million people, are between 15 and 29 years old—the largest number to transition to adulthood in the region's history. Moreover, these young people are educated. About 70 percent have achieved a secondary level of education, and primary schooling is nearly universal.[17]

The region is capitalizing on these advantages. There has been particularly strong growth in fintech payments systems. For example, currently, 30 payment fintechs are operating in Saudi Arabia.[18] The value of point-of-sale (POS) transactions in Saudi Arabia doubled between 2018 and 2022—and is likely to double again by 2026, to reach almost SAR 1 trillion ($266 billion). The number of POS devices in Saudi Arabia is expected to almost triple, to 1.5 million, by 2025.[19] The COVID-19 pandemic has been responsible for only part of that growth. Market trends and favorable regulation also have had a significant impact. The e-commerce penetration rate by user in Saudi Arabia increased to 60.6 percent in 2021, and it is expected to reach 70.9 percent by 2024.[20] Online "buy now, pay later" offerings, too, are becoming more popular, especially with younger consumers. These payment methods offer consumers the option to split a specific purchase into installments, and can be offered more effectively by fintech.

THREE CRITICAL AREAS FOR DEVELOPMENT

When viewing the progress that fintech has made in the GCC, it is important to consider the global context. Fintech has become fiercely competitive. Financial centers around the world are jostling for position as they seek to build their competence, improve the regulatory framework, and attract financing and talent. Various organizations publish rankings of fintech hubs or indices of performance. It is noticeable that despite this competitive environment, GCC centers, especially those from the UAE, tend to feature significantly in these rankings. The Lucerne University of Applied Sciences and Arts' ranking, for example, puts Dubai just behind Paris and Madrid and ahead of Tel Aviv, Vilnius, Shanghai, and Beijing.[21]

For all the progress of the past seven years, however, much remains to be done to make the recent successes sustainable and ensure that GCC fintech hubs stay competitive. Even with favorable regulation, market fragmentation can make scaling up difficult. Technological challenges include the level of cloud computing maturity and data sovereignty, such as requirements for the location of servers. From a financial perspective, a lack of exit opportunities can prevent growth.

Overall, there are three priority areas. Regional fintech must improve access to capital and liquidity, create more exit opportunities, and attract talent for tech systems and broader fintech support.

Access to capital and liquidity

Given the GCC region's prosperity, VC funding is less than it should be, even with the recent fintech growth. For example, the Saudi share of global VC funding is just 0.08 percent, whereas the country accounts for 0.9 percent of global GDP.[22] Key players include sovereign wealth funds, which have broad mandates to invest, but can do more in terms of fintech.[23] A variety of fintech categories are gaining traction in the region. Payments systems are attracting the most financing interest, while areas such as regulatory technology are less well funded.[24] Until now, governments in the region have been the main sources of funding. In the future, the private sector will need to play a larger role by helping to create deeper markets that enable scale and so ensure sustainable growth. Organizations such as the Middle East Venture Capital Association, launched in 2018, can consolidate private VC activity, but more needs to be done.[25]

Exit opportunities

The IPO market in most GCC countries is not very dynamic. Consequently, founders have relatively few opportunities to bring in other investors and to exit their initial investment. That can limit the opportunities for innovation and the growth of VC investment. In many instances, the only viable route is to sell to established players. This trend has not abated. Even though the MENA region had the most international and cross-market M&A plays across a group of emerging markets that included Pakistan and Türkiye (previously known as Turkey), only 21 exits across all sectors were announced during the first half of 2022.[26] This trend illustrates the opportunity to further develop the IPO market.

Talent

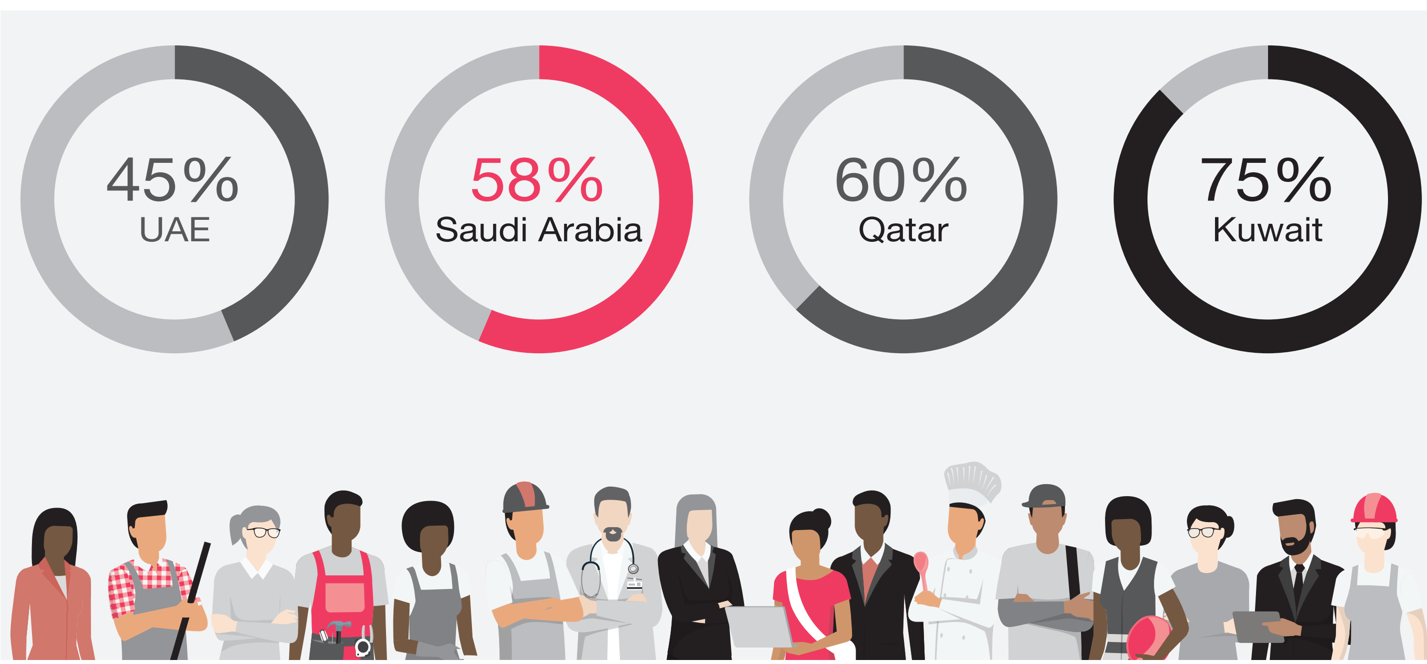
One of the main challenges for GCC fintech is finding people with the right skill sets. This challenge is exacerbated by the rising demand for these skills throughout the economy. According to a recent Strategy& report, if the GCC region reaches the level of the most advanced digital economies, it could create an additional 600,000 technology jobs. That would, without the sustained development of in-country talent, rapidly drain the currently shallow pool of talent.[27]

However, there are indications that employers are taking this shortage seriously. A recent PwC survey found that 75 percent of the employees who responded in Kuwait, 60 percent in Qatar, 58 percent in Saudi Arabia, and 46 percent in the UAE believed their country had a shortage of people with specialized skills. Interestingly, GCC respondents were more confident than the global survey average that their employers were making skills improvement a priority (*see Exhibit 3*).[28]

EXHIBIT 3

Concern is widespread about the availability of talent

Respondents who believe their country has a shortage of people with specialized skills



Source: PwC, "What 1,565 people in the region think about work today: PwC Middle East Workforce Hopes and Fears Survey 2022," June 21, 2022 (https://www.pwc.com/me/hopes-and-fears)

We estimate that at present, just 6 percent of the workforce in the GCC is engaged in technology-related jobs.[29] The talent shortage is clear from research and anecdotal evidence.[30] It is difficult, though, to measure the shortfall without accurate regional or country statistics. That also makes it a challenge to design meaningful programs to fill the talent gap at a national level. The Fintech Saudi survey has, however, revealed some specific fintech-related areas that need attention.[31] The greatest needs are for tech experts who can build fintech infrastructure. For example, the region needs more people specialized in cloud computing, application programming interfaces, and blockchain technologies. There is also considerable demand for app developers who can improve the customer experience, as well as risk management specialists, including those focused on cybersecurity.

Beyond these technology roles is a need for professionals in a range of support services, such as accounting, payroll, legal, growth marketing, and sales support. Of course, nurturing domestic talent will do more than assist the fintech sector. Domestic talent is a crucial element in a broad range of policies that could help the GCC countries grow what Strategy& terms "tech champions," which could increase regional GDP by a cumulative 5 percent by 2030.[32]

> The future market size for GCC fintech will depend primarily on how successfully the region can overcome regulatory and operational issues.

HOW PUBLIC-SECTOR AND PRIVATE-SECTOR STAKEHOLDERS CAN MAKE GCC FINTECH GROW

As noted above, governments have played an instrumental role in enabling the growth of GCC fintech. Private-sector players have become increasingly involved as the market has developed. Both government and business must now do even more to ensure that GCC fintech grows stronger and more sustainable, and is globally competitive. Key actions include efforts to overcome market fragmentation and achieve scale, strengthen capital markets, and attract more talent.

The future market size for GCC fintech will depend primarily on how successfully the region can overcome regulatory and operational issues.

For now, regulation is largely nationally focused and sometimes creates obstacles for cross-border providers. Data storage is one area in which national restrictions, such as data sovereignty, can impede greater cross-border activity. Another example is the lack of preferential regulatory treatment for companies that are licensed and regulated in some GCC countries but not others. For example, if a bank in Saudi Arabia wants to open a subsidiary in the UAE, it must follow the same process as institutions from outside the region, which is a considerable regulatory burden.

Public-sector and private-sector stakeholders should alleviate such difficulties by aligning on key aspects of market growth to allow easier provision of cross-border services. For example, so-called passporting agreements between regulators in different jurisdictions could enable startups to expand geographically without regulatory impediments. Passporting would allow companies in one GCC country to operate in other GCC countries while following their home-country rules. Establishing a passporting system would require some regulatory harmonization and, most importantly, a mindset that regional growth benefits all and is vital in allowing fintechs to build scale.

There are already some signs that this might happen. In early 2022, the Digital Cooperation Organization (DCO) announced that Bahrain, Nigeria, and Saudi Arabia would provide a "startup passport" that allows entrepreneurs in one DCO member country to avoid excessive red tape when entering the markets of other DCO member countries.[33] Similarly, Qatar has announced an initiative that seeks to create an economic corridor including India, Kuwait, Oman, Pakistan, and Türkiye and that will develop trade finance.[34] Even if regulators do not allow passporting, they could recognize similar regulatory regimes and have simplified provisions for companies overseen by recognized GCC regulators.

Encouraging capital market growth requires a multipronged effort lasting years. A starting point is to develop a stronger savings culture in these countries, for example, by devising investment vehicles that are attractive to domestic savers. Regulatory changes can remove impediments to investment funds. Governments can create public campaigns to raise awareness about investment opportunities. The region also needs attractive and innovative asset management solutions, which can come from private-sector players. IPOs have been blossoming, but public- and private-sector players can do more to encourage them. Such efforts could include simplifying the listing process for small companies that do not possess the infrastructure to comply with requirements that were designed for larger organizations. More early-stage investment would strengthen the funding environment, as would an emphasis on the need for "patient capital," which does not seek quick returns.

Resolving the talent shortage is a long-term undertaking. At home, governments, fintech providers, and others can work with universities and educational institutions to deepen the talent pool so that fintechs can access the requisite skills for technology and support services. Countries have already launched some initiatives to address these issues. These include Saudi Arabia's $1.2 billion investment to improve the digital skills of 100,000 Saudi youngsters by 2030, with a focus on cybersecurity, programming, artificial intelligence, and gaming.[35] In the UAE, the National Program for Coders aims to develop homegrown talent.[36]

These countries also need to attract international talent, which requires incentives and recruiting campaigns, while nurturing national talent. The UAE is taking a step in this direction by having the National Program for Coders make available 100,000 "Golden Visas" for coders.[37] Similarly, the UAE government recently announced the "NextGenFDI," which aims to attract to the country more than 300 players in technology fields, including global firms, software developers, data scientists, and coders. NextGenFDI is offering measures including fast incorporation processes to speed up licensing, bulk visa issuance, banking facilitation, and commercial and residential lease incentives.[38] GCC countries also need to examine their national labor policies to ensure that they are easier places to work in. The same applies to the region as a whole.

CONCLUSION

The critical challenge for MENA fintech, and the GCC in particular, is to remain competitive in a fast-developing sector. Some of the forces that will shape the future of fintech in the GCC may be beyond regional control. Still, GCC stakeholders can make adjustments and improvements that will keep the sector moving forward. By focusing on the long-term imperatives of greater fintech scale, deeper capital markets, and talent development, GCC countries can become vibrant players in global fintech.

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