FUTURE OF FINTECH

INVESTMENT

Winter is coming: British fintech gets to grips with its big freeze on funding

Investments in the sector have plummeted in the past six months, but industry insiders are largely optimistic that its fundamentals remain strong enough to regain the confidence of potential backers

Daniel Thomas

The UK fintech sector has been a glittering success in recent years, as London's status as a global financial hub made the country a magnet for dynamic startups. Digital challenger banks such as Starling, money-transfer services such as Wise and investment apps such as Nutmeg have attracted billions of pounds in investment.

But, with the economic outlook deteriorating both at home and abroad, the market's shine has faded fast this year. The prospect of stagflation over the coming months is hitting investor confidence in hi-tech industries particularly hard.

The combined equity investment raised by British fintech companies plummeted from £2.13bn during Q2 2022 to £491m in Q3, according to research published by Beauhurst and Deloitte.

The number of fintech investment deals also fell off a cliff during that period, notes Beauhurst's head of research and consultancy, Henry Whorwood,

"Investors have dramatically changed their behaviour in the face of the worsening economic outlook," he reports. "Many newcomers to this asset class have cut activity as rapidly as they started it."

Could the decline in sentiment accelerate and plunge fintech activity into a deep freeze this winter? Business valuations have been slashed as startups struggle to attract investment, while there have already been reports of firms in financial difficulty. Even Klarna, the phenomenally successful Swedish provider of buy-now-pay-later (BNPL) finance, was trying to raise fresh capital in June at less than half of its peak valuation.

Praetura Ventures is a Manchester-based venture capital provider that invests in young, high-growth businesses around the UK. It's backed about 30 firms since 2019.

> We have to consider fintech investment against the backdrop of the global economic slowdown and other external factors, such as the war in Ukraine

Praetura's co-founder and MD, David Foreman, says: "Attracting investment entails demonstrating capital efficiency and a clear path to profitability, but this is difficult for fast-growing fintech startups. That's because their cost of entry into these markets is steep and their business models tend to start making sense only once a critical mass of customers has been acquired. This critical mass is proving harder and costlier to reach than it was last year."

While fintech is facing headwinds globally, the sector's UK-based players have had some extra problems to contend with. Brexit has hindered their efforts to attract the best talent from overseas, while the recent economic instability caused by the ill-fated Truss administration has shaken the confidence of foreign investors. Despite all this, most insiders see the funding drought as a natural adjustment after the unprecedented boom that tech firms enjoyed during the early months of the pandemic.

Steve Round is co-founder of SaaScada, a British startup that has developed a cloud-native platform for digital banking services. He believes that "the severity of the downturn is undoubtedly connected to international events. We have to consider fintech investment against the backdrop of the global economic slowdown and other external factors, such as the war in Ukraine, which are making investors more cautious."

The road will inevitably be rockier for British fintech, as GDP growth falters and the rapid increase in interest rates to fight inflation brings a 13-year era of ultra-cheap money to an end.

Some in the sector believe that young British companies, many of which remain loss-making concerns, will need to adopt a more traditional model of being what venture capitalists call default alive – that is, on track to achieve profitability without needing any further injections of capital.

"The advice they'll undoubtedly be getting from their existing investors is quite simple," says Sabrina Del Prete, founder and CEO of Kore Labs, a specialist in digital product governance. "That will be: reduce your cost base to essentials only; narrow your focus to reduce the time it will take to achieve run-rate break-even; stay close to your investors and use their goodwill to access equity investment to protect the near term; don't take on debt; and, lastly, remain resilient with your business plan and have informed confidence in what you set out to do."

It's a certainty that some firms will fail or be bought out in the next couple of years. But the fundamentals of fintech remain strong, so it's unlikely that investment in the sector will dry up permanently. So says Rich Bayer, executive vice-president and head of sales in the UK and the EU at Clearpay, a BNPL platform that has raised almost £85m since it was founded in 2017.

He points out that BNPL is the nation's fastest-growing online payment method, proving particularly popular with consumers from generations Y and Z. Last year, the segment accounted for nearly £13bn of ecommerce expenditure. This total is expected to double by 2025.

"The dip in investment the fintech sector is seeing this year in comparison with 2021's exorbitant success shouldn't distract us from this overall picture," Bayer argues.

Other insiders note that the traditional high-street banks, faced with stiff competition from online challengers, will look to fintech for help in meeting consumers' changing expectations. Large incumbents are therefore likely to continue backing or acquiring innovative digital solutions.

The downturn may even encourage innovation, pushing certain sub-sectors of fintech to the fore, according to Round. Products designed to help banks to manage consumer and commercial credit risk should flourish, for instance.

"Those that harness data effectively are the ones to watch," he says. "The future is all about data – the ability it grants you to track and predict changing customer needs and identify areas of trapped value. Such factors will enable users to gain a greater share of wallet, even as recession looms."

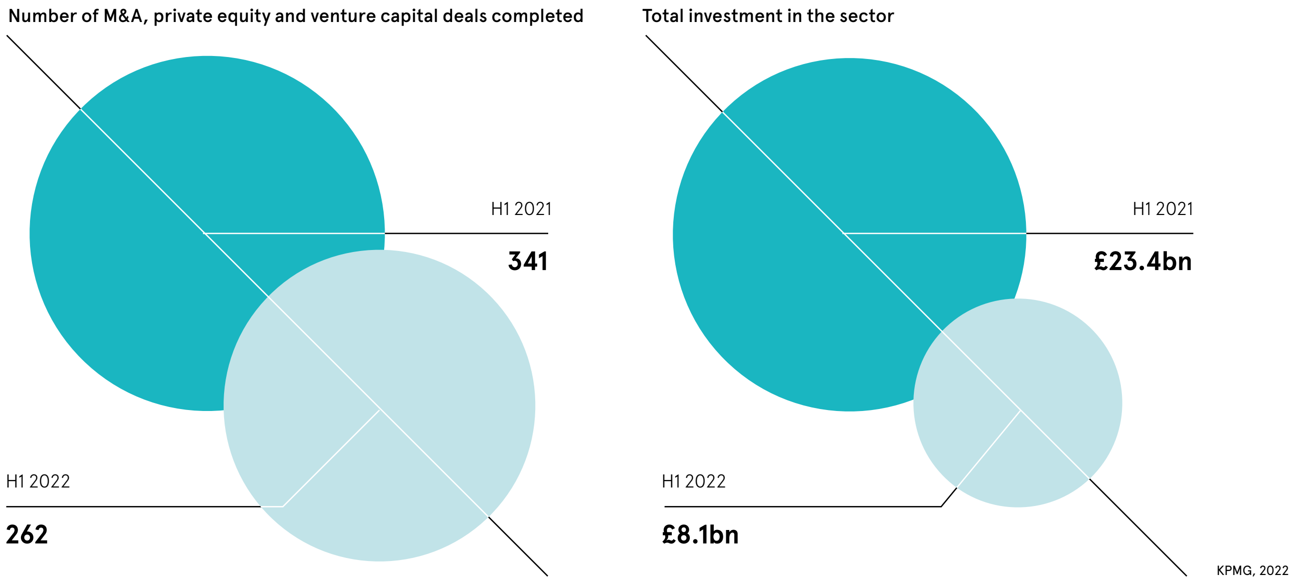
No one knows what the future holds, but it seems unlikely that the UK fintech will become a story of boom and bust. If anything, the downturn will prompt a shake-out of weaker players and encourage those with true potential to step up and demonstrate their value. As the economy enters a potentially dangerous new phase, that would be no bad thing.

DEALS IN DECLINE

Key figures for UK fintech investment in H1 2021 and H1 2022

Number of M&A, private equity and venture capital deals completed

Total investment in the sector



KPMG, 2022

2,548

The number of fintech investment deals funded by venture capital worldwide in H1 2022

KPMG, 2022

26,346

The number of fintech startups in existence worldwide last year

Boston Consulting Group, 2021

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THE RISE OF THE ROBOS

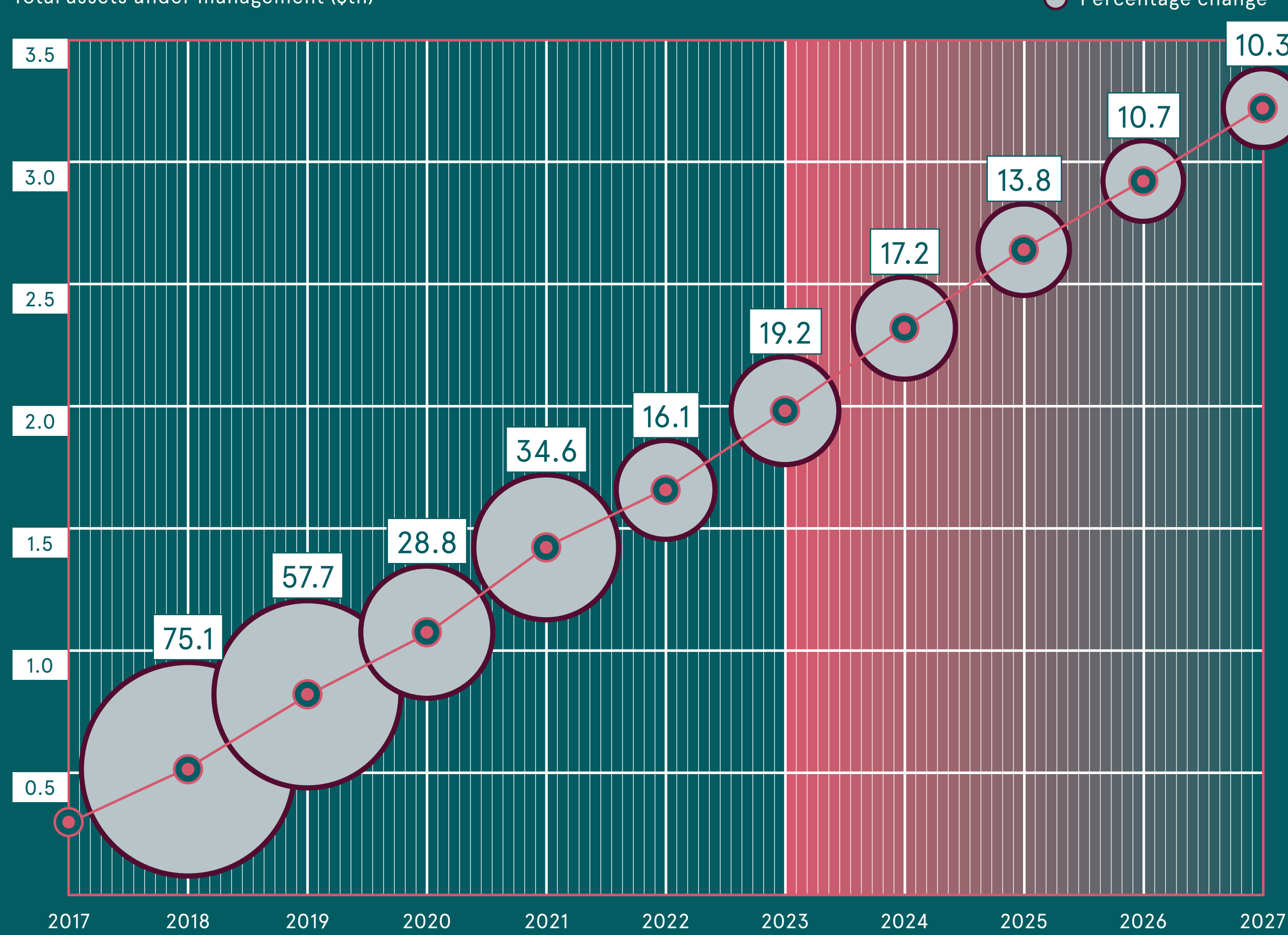
Robo-advisers have been tirelessly attracting new users and hoovering up assets in recent years. They're an effective way for banks and investment firms to service mass-market investors by intelligently allocating capital to diversified baskets of index funds on the basis of each investor's risk tolerance (usually determined by a questionnaire rather than a financial plan). But, given the development costs involved, they must operate at considerable scale to offer good value for money. And, crucially, question marks still hang over how they're likely to perform during a significant downturn. Will investors keep faith with the algorithms, or will a faltering market prompt them to seek human intuition?

THE GLOBAL VALUE OF ASSETS MANAGED BY ROBO-ADVISERS IS FORECAST TO GROW BY AN AVERAGE ANNUAL RATE OF 14.2% TO 2027

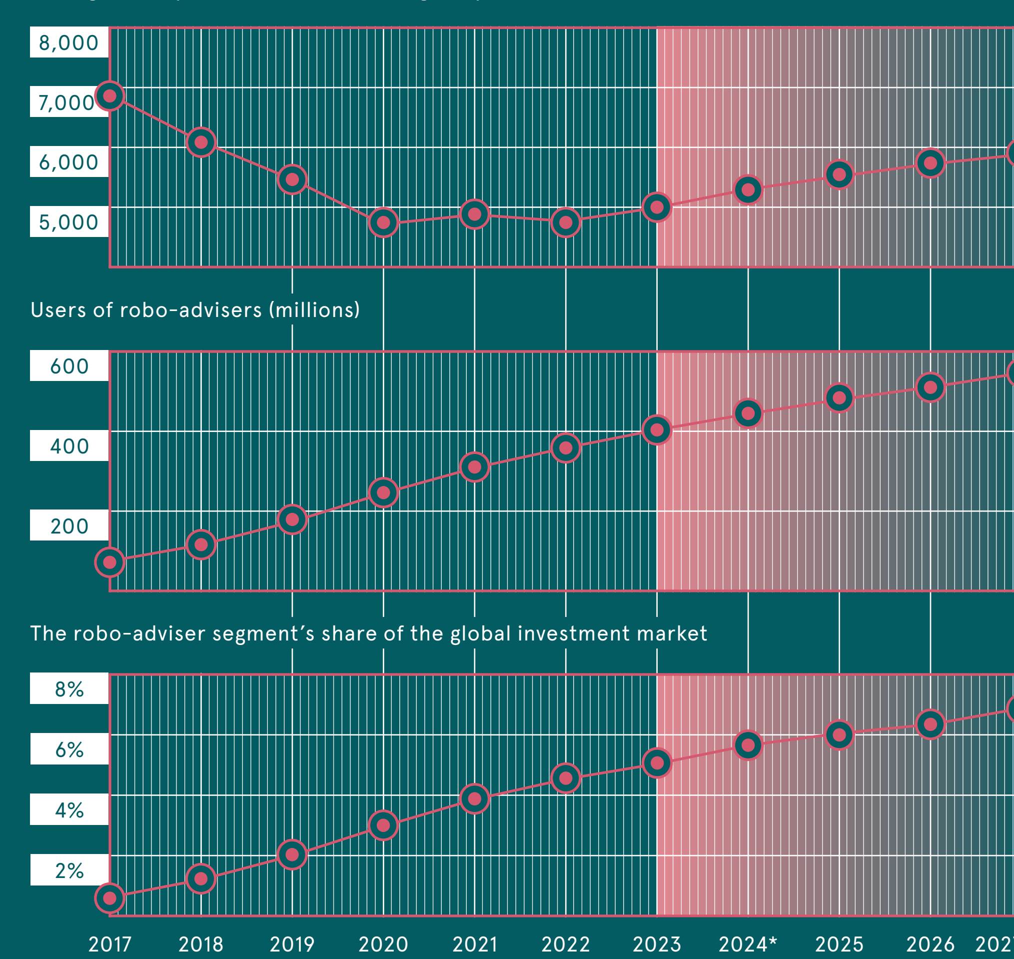
Forecast

Total assets under management ($tn)

Percentage change



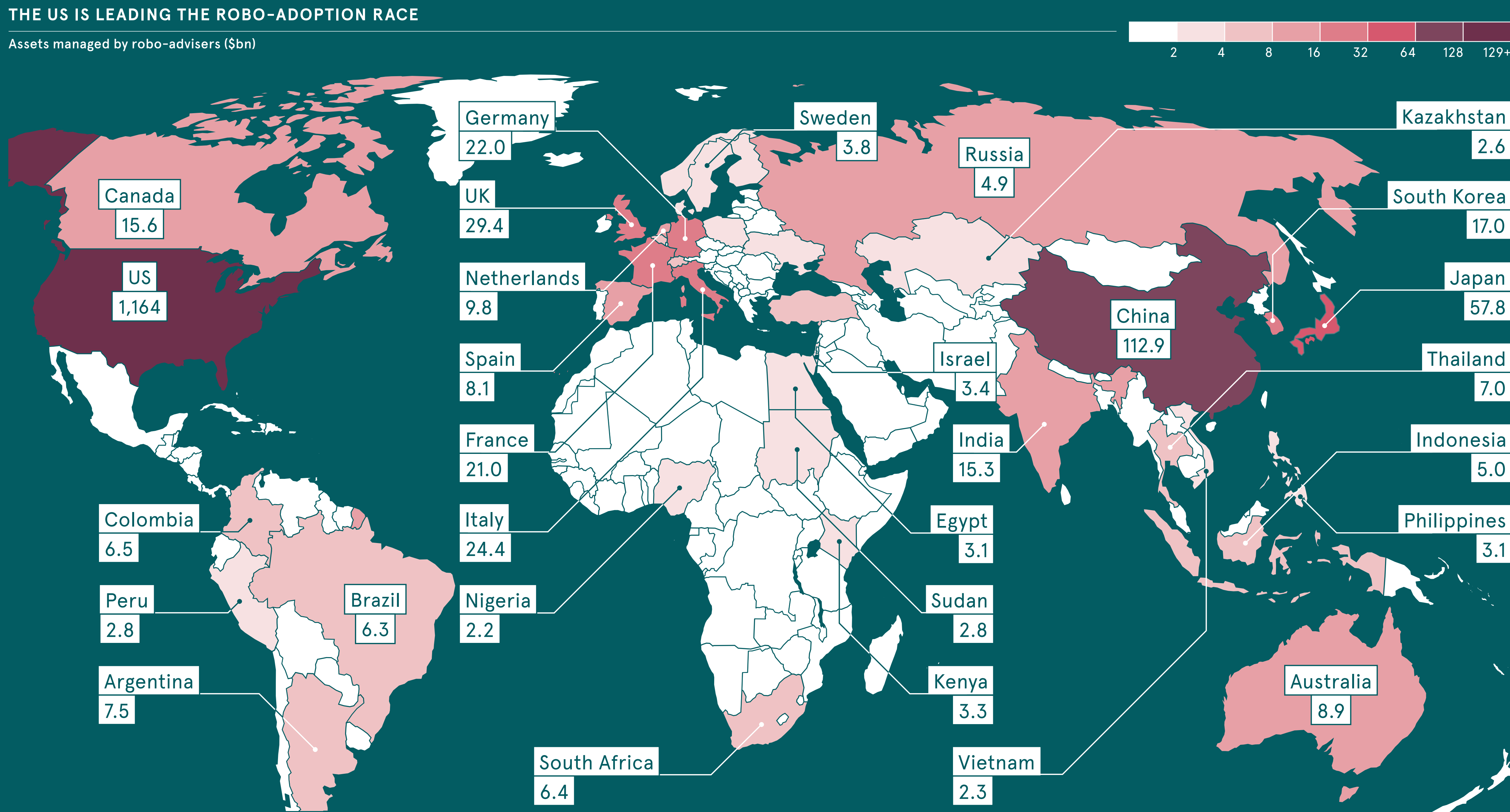
Average value per user of assets managed by robo-advisers ($)



Statista, 2022

THE US IS LEADING THE ROBO-ADOPTION RACE

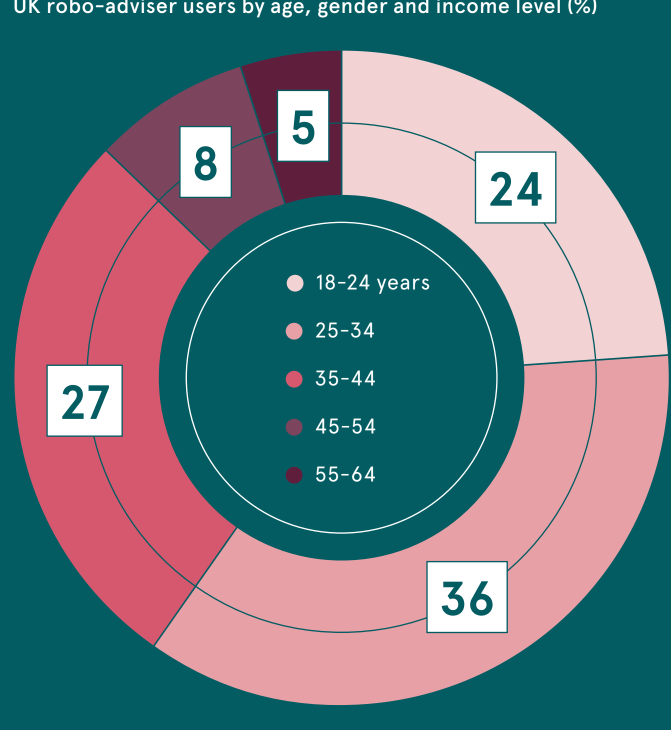
Assets managed by robo-advisers ($bn)

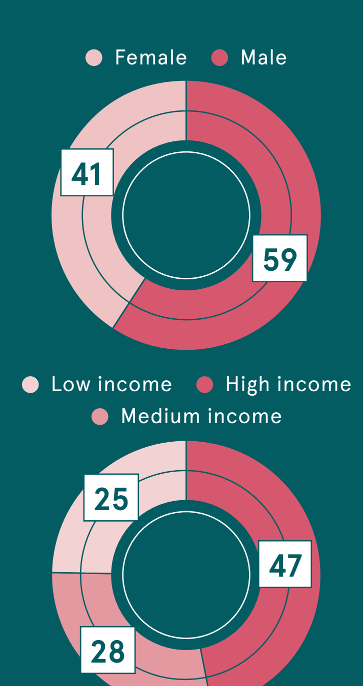


Statista, 2022

WEALTHY YOUNG MEN ARE MOST LIKELY TO USE A ROBO-ADVISER

UK robo-adviser users by age, gender and income level (%)

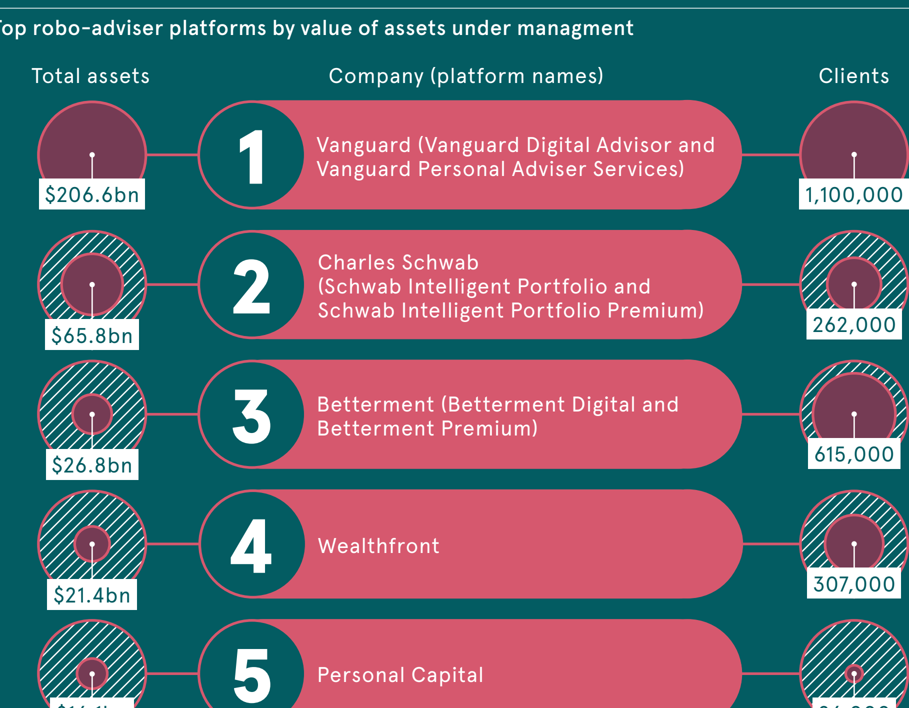




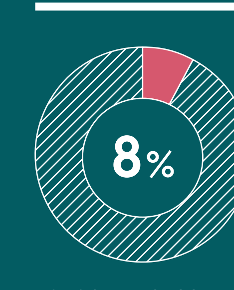
Statista, 2021

A HANDFUL OF PLAYERS DOMINATE THE MARKET

Top robo-adviser platforms by value of assets under managment



Forbes, 2022



of US households have a robo-adviser account

A further

aren't sure whether they have one or not

Kitces.com, Hearts & Wallets, 2020

Embedded financial services: seizing the opportunities

SMBs are recognising the significant benefits to be gained from accessing financial services via the platform they currently use to run their business operations, a new study reveals

For too long small-and medium-sized businesses (SMBs) have suffered from sluggish financial processes and have often been overlooked by business banking services. This is because they're not perceived to present the same scope of opportunity as enterprise businesses. And yet, SMBs, which number over five million, had a combined turnover of around £2.3bn last year, according to government figures, representing a huge potential market.

As a result, these businesses, which are often digital-savvy, if not digital-first, are currently underserved, and are therefore failing to make the contribution to the UK economy that they could, partly because of inadequate access to financial services. But a rapidly emerging technology promises to meet this challenge. Embedded finance enables platforms and marketplaces to integrate an array of financial services into their suite of solutions and deliver them directly to SMB users via their everyday workflow.

It's a logical progression for the platform-user relationship, since the platform that many SMBs' have chosen forms the digital foundation of their business – it's their flagship store, inventory, back office, mission control – and now it can be their bank, too. Adyen, the global financial technology partner of choice for leading businesses recently created a report alongside Boston Consulting Group (BCG) which identifies three key areas in which platforms could unlock a potential revenue uplift of up to 70%. These are: lending which can be offered and approved on the spot; bank accounts to streamline finance management; and card issuing to speed up settlement and pay-outs.

The increasing cost of living is hitting SMBs hard and optimised cashflow is more important than ever. Embedded finance can help both by streamlining the payments process; enabling SMBs to increase conversions and get paid faster, and unlocking access to pre-approved capital. This is made possible since the financing, payments, and treasury services are embedded into the platform on which the SMBs do business day-to-day. This gives platforms access to data, which makes it simple for them to quickly authorise loans for instance.

It should come as no surprise then, that Adyen's research found that nearly two thirds (64%) of SMBs are interested in financial services being embedded within a platform. Payments is also seen as the bedrock on which platforms will grow embedded financial services. Nearly a third (30%) of responding platforms already offer embedded payments services and nearly three quarters (74%) of SMBs are interested in embedded payments.

Adyen recently announced its expansion beyond payments to build embedded financial products. "By building our banking infrastructure, as a part of the single platform, from the ground up, we remove the limitations of legacy financial systems, enabling Adyen to deliver the power of a bank combined with the adaptability of a fintech," says Thom Ruiter, VP of banking and financial products at Adyen. "This unique approach means we can offer our platform customers unparalleled flexibility to meet the evolving needs of their user base without the barriers of regulatory complexity, lengthy product development, or sponsor bank restrictions."

> The [embedded finance] opportunity is simply too big, and too synergetic with their core business, for platforms to ignore

With an addressable market across the UK and Europe of some £46bn, according to Adyen's BCG report, SMB demand has opened up an exciting opportunity for platforms and marketplaces to better serve their users, grow loyalty and drive revenue. But the time for platforms to act is now.

Adyen research identifies three strengths and three products that platforms should build upon for a higher share of SMB banking and payment revenue pools. It also reveals the importance of leveraging the right partnership model to ensure effective go-to-market and long-term success.

The first is the capability for integrated services. According to the Adyen report, nearly seven in 10 (69%) of SMBs say they would change their payment processor if the solution were more integrated into their business process. The key differentiator of embedded finance will be its ability to become part of an SMB's usual workflow, enabling features such as pre-approved capital, one-click provisioning, and dynamic repayments at the point of need. The central premise of embedded finance – a single interface without referrals to other pages, fast resolution, and a simple user journey – will be crucial to realising its full potential.

Second is detailed, timely data. From real-time payment flows and cash positions to inventory levels and point of sale activity, platforms have access to a broad range of relevant user data, at a higher level of granularity than traditional financial institutions. Centralised, accessible data sets will ensure that platforms can deliver a superior financial service offering. This includes greater accuracy of underwriting and risk models to make rapid financing available to SMBs.

The third factor is the development of in-depth user relationships. Platforms have built trust through consistently strong performance and a deep understanding of their SMB users' specific industry, challenges, and needs. This is evidenced by the fact that around 85% of those SMBs surveyed were satisfied with their platform. Platforms can now leverage these strong relationships in order to differentiate themselves from traditional banking players. They can also use this good will to develop highly tailored solutions for users.

Adyen's report cites three products that will drive embedded finance adoption. The first is cash advances. Liquidity has never been more important for SMBs and it's hardly surprising that a whopping 94% of them states that pre-approved cash advances are a product they would benefit from. The second product is similar – there's an opportunity for platforms to provide SMBs with accounts offering unique features such as accelerated settlement, a single and integrated interface and ultra-fast opening. Moreover, SMBs are also showing interest in services such as treasury management or cross-border payments with FX, providing a basis for further cross-sell. Third is card issuing. Platforms can complete their payments offering by enabling their SMB users to spend their funds on platform-issued debit or credit cards. This presents a compelling revenue opportunity for platforms to not only monetise incoming payments but outgoing payments as well by receiving a share of the interchange revenue from each transaction completed on a platform-issued card.

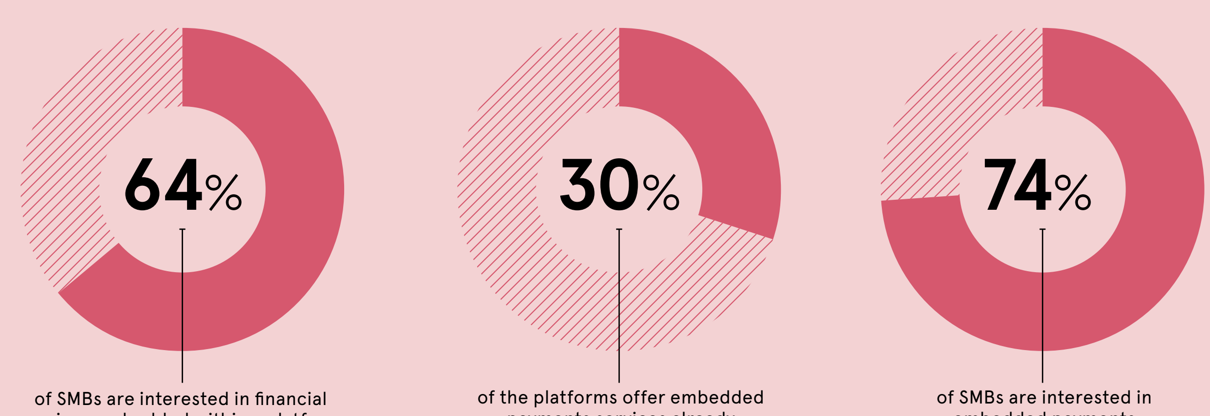
Their close relationships with SMBs, thanks to their integration into day-to-day operations and their deep market penetration, will enable platforms to build on their unique capabilities and transition into banking services. These might include real-time data that can improve risk processes, and vertical-specific knowledge for more tailored services.

The market for SMB embedded finance is still at an early stage of development, with less than 5% of penetration – but it's now poised to develop rapidly. "The opportunity is simply too big, and too synergetic with their core business, for platforms to ignore," says Ruiter. "Frontrunners are already building positions, supported by agile partners bringing together payments, account, lending and card issuance capabilities."

The SMB banking revolution has already begun, with platforms leading the charge. For those businesses looking to seize the opportunity of embedded finance, now is the time to take action and realise the full potential of their platforms.

> Platforms have built trust through consistently strong performance and a deep understanding of their SMB users' specific industry, challenges and needs

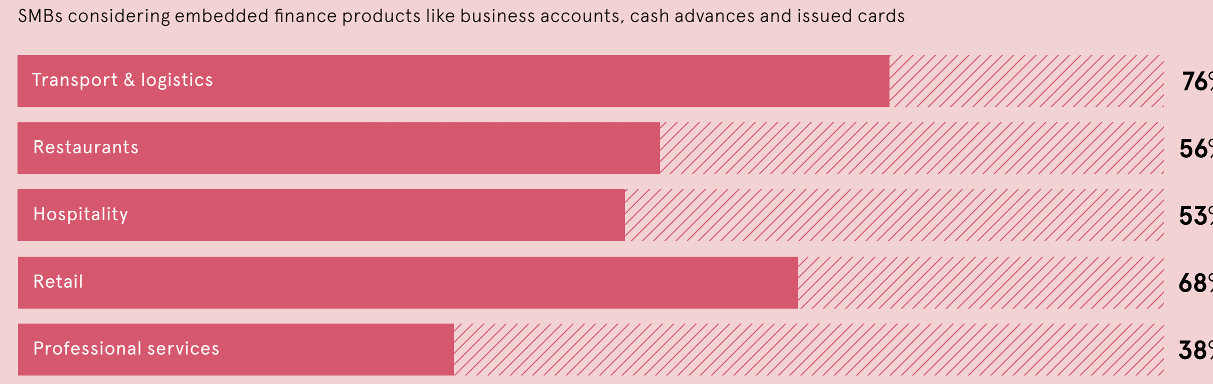
THE OPPORTUNITY FOR EMBEDDED FINANCE IS RIPE



Adyen, 2022

INTEREST IN EMBEDDED FINANCE IS GROWING ACROSS DIFFERENT INDUSTRIES

SMBs considering embedded finance products like business accounts, cash advances and issued cards



Adyen, 2022

The opportunity for rapid growth

Hundreds of thousands of SMBs rely on platforms such as software as a service (SaaS) providers or ecommerce platforms to run their businesses. These niche boutiques and businesses run from kitchen tables can find themselves on an equal footing with long established household names.

"Our customers tend to do anywhere from a hundred thousand to ten million in annual turnover" says Nathan Gill, chief product officer of Epos Now, cloud-based software provider, specialising in the design and manufacture of electronic point of sale. "So it's important we provide a lot of flexibility because no two businesses are alike. We need to make sure that the corner cafe, which is different from the bike shop, which is different from a multi-location franchise, has the tools it needs to efficiently run its business."

Epos Now powers businesses in the retail and hospitality sectors. "We're a point-of-sale software solution that allows companies to manage their customers, their supply chain and their product deliveries as well as marketing the financial aspects of the business," says Gill. "It's essentially everything that they need to operate day-to-day."

The ubiquity of the service puts Epos Now in a strong position to expand into new financial offerings, as Nathan explains:

"Our software is really the operating system that these merchants use to run their business. We already know a lot about their businesses and we can make much more informed credit decisions than a traditional financial institution can."

Looking to the future, Gill says the sector will see consolidation among providers. "There will be fewer players but competition will still be intense, as demand grows and SMBs look for a full banking solution from their platforms," he says. "Cloud technology will drive innovation and platforms will have to invest heavily to ensure that they're offering their SMB clients the kind of services that they need not just today but for tomorrow and beyond."

For more information, please visit adyen.com

INTERVIEW

‘If there’s a problem, I’m not going to stop until I solve it’

Tavonia Evans is a self-described ‘mompreneur’ who has established four businesses and created a cryptocurrency. She explains why guapcoin will empower Black people and the businesses they own

Francesca Cassidy

Even from a young age, Tavonia Evans knew that she wanted to change the world, but her early passions didn’t hold many clues as to how her career might progress.

First, the New Yorker thought she might become a scientist or perhaps an attorney. And then “I was going to study history and travel the world”, she says.

Evans did indeed take history at North Carolina Agricultural and Technical State University, but there she became interested in computer-aided design and desktop publishing. Her love affair with IT began, born of a desire to solve problems.

“I started out by fixing broken code, which helped me to learn,” she recalls. “I’m a very good problem-solver. I can solve any problem – I don’t care what field it’s in. If there’s a problem, I’m not going to stop until I solve it.”

Evans drew on this tenacity when she started working to fix glitches on open-source ecommerce platforms. Then she began to write her own code.

“Every time I had the opportunity to learn something, I would take it,” she says. “That’s just my love of tech in general.”

Evans deepened her technical knowledge by completing a further course at Central Georgia Technical College. She then landed her first tech job as a network troubleshooter at the University of Georgia – work that she found “super-fun”.

Evans went on to serve various government departments and telecoms giant AT&T as a software engineer before launching peer-to-peer verification platform Safe2Meet in 2014. It was at about this time that her interest in cryptocurrencies began to develop.

Evans admits that she was dismissive of the technology initially. She recalls being unimpressed when a colleague introduced her to bitcoin in its early days.

“Back then, the wallet was big, clunky, desktop hardware that took all day to sync. It just wasn’t that sexy to me,” she says. “Fast-forward to 2014 and I started to see how it was being adopted in more ecosystems. Then it clicked with me.”

> **My job is split between providing greater access to cryptocurrency and educating consumers, evangelising about the power it offers common people**

What changed her view was a realisation that may sound straightforward but often gets passed over in people’s confusion about cryptocurrencies. “Crypto is money. New money, but the kind of money I feel that we’re going to be engaging with every day on a normal basis in the coming years,” Evans explains.

She points out that much of her role as a crypto founder centres on helping the public to understand just that. “My job is split between providing greater access to cryptocurrency and educating consumers, evangelising about the power it offers common people.”

In her view, people often get caught up in the technical intricacies of how a cryptocurrency operates. Such distractions, she suggests, can hinder them from using it to improve their lives.

“The funny thing is that people don’t know a lot about traditional money either – and they use that every day,” Evans says. “The main advantage of cryptocurrency is that it can empower regular people by removing the power structures, giving them more direct access to be able to do business with one another. Initially, we need to get more comfortable with crypto as money. Then we can get more into the technological aspects.”

She launched her own cryptocurrency, guapcoin, in 2017. It is the first crypto of its kind that has been designed specifically to address the financial concerns of Africa’s diaspora community. In five years, it has attracted more than 10,000 wallet-holders.

This important mission is what keeps Evans motivated. She describes how she was driven to help a community that has been chronically under-served by the financial establishment: “I have a bit of a superwoman complex – I want to save the world! So I like the fact that I can potentially have a positive impact on the lives of many people. I wanted to appeal to the Black community because we’ve always been last to the party and now we have a chance to be first. My vision is for guapcoin to become a global cryptocurrency for the people in general – the 99% versus the 1%.”

> **Cryptocurrency can empower regular people by removing the power structures, giving them more direct access to be able to do business with one another**

The ability to explain cryptocurrency in a straightforward way and get others excited about its potential is one of the core skills required of a crypto founder, according to Evans.

“When I talk to people, they understand. “They tell me: ‘I’ve been around crypto for two or three years, yet my 30 minutes with you have demystified so many things,’” she says, adding that effective communication is a rare commodity in the hi-tech sector. Leaders in this space may have great technical minds “when what they really need is people skills. They have to understand how consumers are going to use whatever they build. They need to be relatable.”

This was the secret of Steve Jobs’ success, she argues. “He took Apple to a place that was much more people-orientated than Microsoft, so even to this day you get people who are die-hard Apple fans.”

As if a mission to change the world were not enough, Evans is also a mother of eight. She has brought up her children while completing her education and founding four businesses.

“With that many children, you’re actually heading a corporation,” she laughs. “I find running a company so similar to managing a bunch of kids.”

While she has no aspirations to build a business dynasty, her 18-year-old son seems to be following in her footsteps, running his own game development company.

A new tech-savvy generation, brought up using a cryptocurrency with the power to bring financial security to the masses? The future looks bright. ●

9,310

The number of cryptocurrencies in existence as of November 2022

Investing.com, 2022

85m

The number of unique bitcoin wallets created on Blockchain.com as of November 2022

Blockchain.com, 2022

INSIGHT

‘We must embrace fintech’s ability to build a better future’

Fintech emerged in response to the global financial crisis of 2007-08, as several new players stepped in to rebuild resilience and trust in a struggling financial services sector and put the consumer back at the heart of the industry.

Since then, fintech has continued to have a positive impact on the sector and on society, leading the way in providing more democratic, more transparent and more inclusive financial services solutions for everyone.

Fintech companies are more than mere alternative providers; they have become integral to the financial ecosystem. British fintech enterprises secured more than $11.6bn (9.8bn) of investment last year and $9.1bn of investment in the first half of 2022 alone. Four in five adults in the UK use fintech tools regularly – scanning your phone to pay for your bus journey rather than carrying around several bank cards in a physical wallet is just one solution that many of us take advantage of every day.

A key part of so many fintech companies’ propositions and success has been to make financial services more accessible for consumers. Small businesses have also benefited: more than 65% of all SME lending in this country is being delivered by alternative lenders and challenger banks.

The fintech industry has demonstrated a unique ability to harness innovation and technology to transform financial services and provide consumers and businesses with better solutions. In doing so, it is also helping businesses, consumers and societies overcome the challenges of our age.

The cost-of-living crisis

The UK is enduring the worst cost-of-living crisis since records began nearly seven decades ago. About 26 million people in this country have had to make lifestyle changes this year as a result of soaring inflation, including spending less on non-essentials.

Fintech offers new, and often cheaper and more user-friendly, solutions to help people better manage their income and outgoings; prepare for scenarios such as further price increases and interest-rate fluctuations; build a credit rating; and access finance. This is perhaps more important now than ever before.

Climate and sustainability

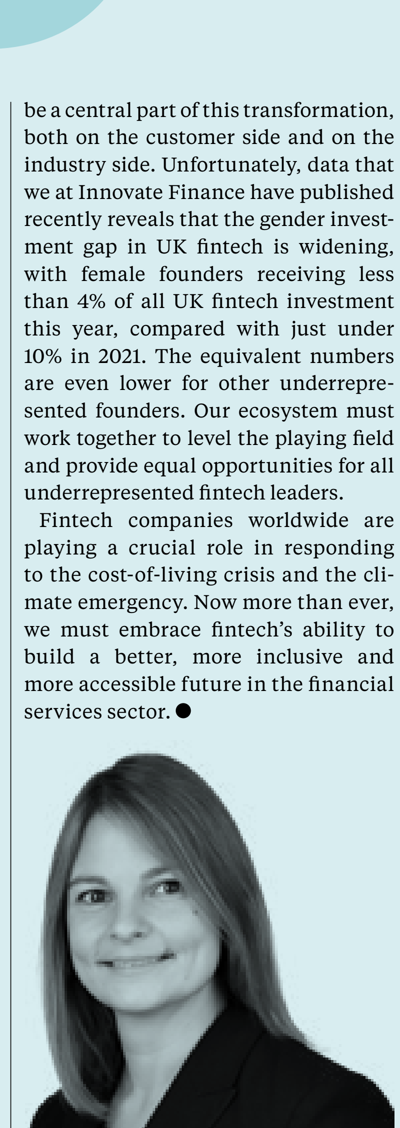
Fintech is also providing important solutions to battle the environmental crisis, with technology playing a key role in creating a more sustainable financial services sector.

Averting a climate catastrophe depends upon rewiring our financial systems to direct capital to net-zero solutions. This goal will be achieved through data and technology – and data and technology are what fintech does best. Firms are already helping consumers and businesses to measure their environmental impact. As the UK is a world leader in fintech, the opportunity exists for us to build on this same expertise to cement the UK as a world leader in green finance.

Diversity and inclusion

Many fintech founders are driven by a desire to create a fairer, more democratic and more inclusive financial services sector. Diversity and equality must be a central part of this transformation, both on the customer side and on the industry side. Unfortunately, data that we at Innovate Finance have published recently reveals that the gender investment gap in UK fintech is widening, with female founders receiving less than 4% of all UK fintech investment this year, compared with just under 10% in 2021. The equivalent numbers are even lower for other underrepresented founders. Our ecosystem must work together to level the playing field and provide equal opportunities for all underrepresented fintech leaders.

Fintech companies worldwide are playing a crucial role in responding to the cost-of-living crisis and the climate emergency. Now more than ever, we must embrace fintech’s ability to build a better, more inclusive and more accessible future in the financial services sector. ●



Janine Hirt
Chief executive,
Innovate Finance

REGULATION

Third-party insurance

The ever-increasing dependence of UK banks on a few cloud service providers presents a significant risk to the nation's financial stability. What protective measures are the sector's watchdogs considering?

Ouida Taaffe

During the 1950s, lengthy power cuts weren't unusual in the UK, but people were able to shrug them off because most homes and services hadn't come to rely on electricity. If the grid were to fail completely tomorrow, it would bring down the nation's telecoms systems and force most of us to buy bottled drinking water – if we could find the cash to pay for it and shops still open to sell it – in a matter of days, according to the Energy Research Partnership.

But electricity is not the only critical service. Seven decades ago, banks could have functioned by candlelight. Today, they rely on cloud computing. Providers of cloud services have become what the government calls critical third parties, which "could affect financial stability and cause harm to consumers if they fail or are disrupted". The financial services and markets (FSM) bill, which has had its second reading in the Commons, aims to grant the industry's regulators oversight of those critical third parties.

Monica Sasso is chief technologist for the EMEA financial services industry at Red Hat, a subsidiary of IBM. She observes that the sector has made dramatic changes to the hardware and software it uses in recent years, including the widespread adoption of public cloud services.

"In many places this move has evolved, rather than being part of a strategic plan. Meanwhile, fintech firms have been able to scale up quickly because they haven't needed to maintain hardware or decide where the software is run," Sasso says. "But at what point does the hardware – that is, the servers in the cloud – become part of their business processes?"

There are good reasons for banks to enter the cloud. It can reduce their costs, increase their resilience and give them access to the latest technological innovations. But most public cloud services are provided by a small number of so-called hyperscalers – particularly Google Cloud, Microsoft Azure and Amazon Web Services (AWS) – which gives rise to concentration risk.

What measures, then, could regulators have in mind to manage that risk?

Simon Crown is a partner specialising in financial regulation at magic-circle law firm Clifford Chance. With the FSM bill at committee stage in the Commons, he believes "it's unlikely that the Treasury will tie its own hands, or allow regulators to do so, by giving the term 'critical third party' a narrow and tightly worded definition".

Crown expects the Financial Conduct Authority (FCA) and the Bank of England's Prudential Regulation Authority (PRA) to issue guidance in light of responses to *Operational Resilience: critical third parties to the UK financial sector*, the discussion paper they published jointly in July.

"That may give more colour to the quantitative criteria that will be considered," he says.

Sasso hopes that this process will stimulate "a conversation about what 'state of the art' means – for instance, when it comes to security and the software supply chain". Her concern is that, below the container platform layer where the applications are managed, there are several pieces of software and hardware that banks can lose control of when outsourcing.

"That comes with benefits and challenges," she says. "It's a bit of a dance to get the oversight right."

It's not that banks aren't careful when outsourcing such critical infrastructure, stresses Nitesh Palana, director of risk and compliance at Thought Machine, a provider of core banking software.

"They don't just flip over to us. There's a whole process that they go through," he says, adding that this can take months.

Are banks at risk of getting tied to a particular cloud provider? "Moving from one cloud to another is always a challenge, but there are strategies to manage it," says Daniel Blander, Thought Machine's director of security. "The reason we use [application management system] Kubernetes is that it's ubiquitous across platforms. It enables us to run services in parallel on different clouds."

Kubernetes is designed to manage applications that work using small units of software known as containers, which can run on a wide range of hardware. The flexible functionality offered by Kubernetes and containers is one reason why the forthcoming legislation won't need to apply to pure banking software providers such as Thought Machine.

Hardware providers, by contrast, will be covered. Could that be a burden? Michael Jefferson, head of UK financial services public policy at AWS, views the bill more as an opportunity for his company to shape the industry's development.

"We look forward to working with the Bank of England, PRA and FCA to support a future framework that accelerates the digitalisation and modernisation of the financial sector," he wrote in a post on the AWS Blog in July.

Will the watchdogs need oversight of the opaque algorithms used by the machine-learning tech that's becoming increasingly prevalent in financial services?

> It's unlikely that the Treasury will tie its own hands, or allow regulators to do so, by giving the term 'critical third party' a narrow and tightly worded definition

Daniel Schwarz, a senior associate with Clifford Chance and a legal fellow at the Cambridge Centre for Finance, Technology & Regulation, believes it's "important that regulators have an understanding of these algorithms, so that they can monitor risk. This area is becoming ever more important as the volume and the velocity of data increase. It will come under greater scrutiny."

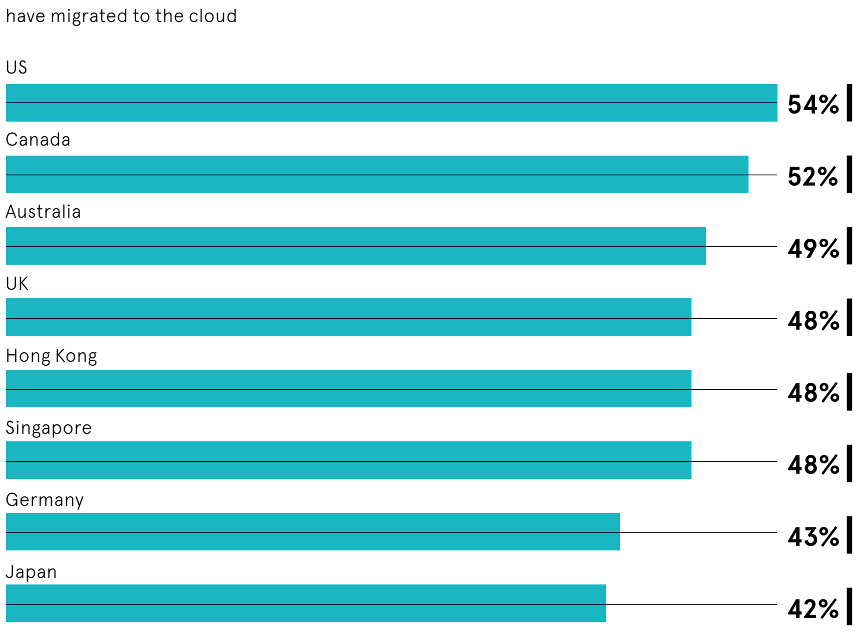
Sasso cites another likely topic of interest for regulators: the use of fintech firms by non-banking businesses to offer their customers banking as a service (BaaS).

"The new risk is that a BaaS provider may not have control over who the fintech firm is onboarding as a customer, yet it needs to manage the risk this presents in terms of the anti-money-laundering and know-your-customer requirements," she says, adding that this calls for the traditional three lines of defence – front office, compliance and internal audit – to adopt a more joined-up approach.

Despite the sector's enthusiasm for the cloud, many players are still using at least some legacy IT. Banks in the US are facing regulatory pressure to ditch their old in-house tech. The FCA stresses that it is focused on outcomes and doesn't prescribe which hardware and software to use. It's unlikely to need to, given that the Bank of England noted in its response to the 2019 van Steenis review of the future of finance that moving to the cloud could cut a bank's tech infrastructure costs by as much as half. There is only one direction of travel – for both banks and their regulators.

CLOUD COVERAGE

Average shares of total workload that financial services providers in selected territories have migrated to the cloud



Harris Poll, Google, 2021

Q&A

Digital infrastructure will unleash the power of private capital

Unleashing the power of private capital globally is dependent on the right infrastructure, explains **Martijn de Wever**, CEO and founder of Floww

Q What's been happening with the private capital markets?

A Over the past decade we have seen the private capital markets grow exponentially to an all-time high of $10tn. They are among the highest-returning asset classes in the past few years and have increasingly become an attractive alternative to the public markets. This explosive growth, coupled with a lack of transparency, has driven the regulators to act and professionalise the market. The need for a more structured approach, where both investors and companies are protected, has been amplified by a bleaker economic backdrop. Now it is clear that the industry faces greater scrutiny around trust, efficiency and liquidity. There is a lack of all three. For the industry to really flourish, these aspects need to change. But what I find exciting is the significant opportunity to unlock this market to a larger range of investors.

Q What causes these issues and what are the consequences?

A The infrastructure in private markets has failed to keep up with valuations and technological advances. In fact, there is very little structure compared to the public markets, hence the lack of liquidity. The word 'private' is key here. Private companies are by nature 'private', many are unknown. Information is sparse and often unverified, leaving investors to use their research skills or leverage their own networks to make up for the deficit in trust.

Without a structure, private markets have remained fragmented, with players from venture capitalists to banks, and other market participants creating their own mini-ecosystems – often without the use of technology. This means that both companies and investors only have access to the networks that they are part of and many have to rely on referrals to participate. Moreover, as private markets have not benefited from technological innovation, economies of scale have yet to reach their potential.

Finally, the existing regulatory and legal framework adds a layer of complexity, making it difficult, time consuming and expensive to transact with private companies. This results in a large variety of investors avoiding the market entirely and another opportunity lost.

> There are two types of companies. Those that challenge current market players and those that empower current market players

Q How can these challenges be addressed?

A What the private markets need is the ability to exchange information in a way that respects the nature of unlisted assets, where sensitive information is shared with the right people, at the right time. The best way to do this is through technology. Whether a private company shares information to individual investors, venture capitalists or other intermediaries, such as a fund or a bank, privacy and pin-point control is key to creating trust. Investors, at the same time, need trustworthy data to make investment decisions. By creating the technology to manage each piece of information shared through a funding journey – whether it is company or investor information – we can increase both parties' willingness to share more information in exchange for access. Fundamentally, this provides companies with access to a larger pool of investors, and enables investors to access more opportunities, solving fragmentation for all, while respecting privacy. This is not easy, but for the first time in history, we can achieve this with the right infrastructure, regulatory innovation and technology. This is Floww's bread and butter.

197% Global private assets forecasted growth to 2027

McKinsey, 2022

Q Why do private markets need better infrastructure?

A Right now, we need better routes to capitalisation to support the contribution private markets make to our economy. In everything from renewable energy to mobility, we need to support the widest range of companies globally through their funding lifecycle. We also must help them with investments from diversified sources of funding. In fact, every industry player needs access. International founders across the globe should be able to find capital from investors in London, New York or Silicon Valley. If a green-hydrogen project in Africa needs investment, it should be able to access private finance from, say, New Zealand. This can only be achieved if we build trust in a global infrastructure that underpins private markets. This involves access to reliable data and reporting tools, as well as a worldwide network. This is the infrastructure challenge we face and one we are aiming to overcome. When we build the world's first, truly global, tradeable private market ecosystem, we will be able to fast-track some of the most promising startups, solving some of the biggest issues of our time.

Q Why invest in private-market infrastructure and not just focus on getting to IPO faster?

A This is the exciting bit. Companies should have a rainbow of capitalisation options wherever they are on the investment curve. Companies stay private longer. For some, staying private is the best option and for others listing on an exchange better serves their goals. Access to both options is key here. That's why we teamed up with London Stock Exchange Group. We are making it easier for companies to raise money at any stage of the funding cycle, from early stage all the way through to listing on an exchange. By building the bridge between private and public markets we can offer the full spectrum of opportunities. Particularly in a downturn, where there's more pressure for companies to gather the right data and supply better reporting to raise capital. Making it simpler to give visibility will create stronger investor relationships and attract more money into this space. Combining full access with high-quality data on a beautiful governance system, we have created an experience that never feels complex but packs a punch when you need it.

> Companies should have a rainbow of capitalisation options wherever they are on the investment curve. Companies stay private longer. For some, staying private is the best option and for others listing on an exchange better serves their goals. Access to both options are key here

Q So, what does the future hold?

A There are two types of companies. Those that challenge current market players and those that empower current market players. I believe in empowerment. By empowering players to connect on a platform that prioritises trustworthy data and regulatory safeguards, we can allow a broader range of investors access to private-market returns and increase access to capital for early-stage companies – driving both innovation and economic growth. Every day, we burn the midnight oil at Floww to reach our goal of unlocking capital to innovation and with a global infrastructure that now hosts a 10,000 strong network, we are well on our way.

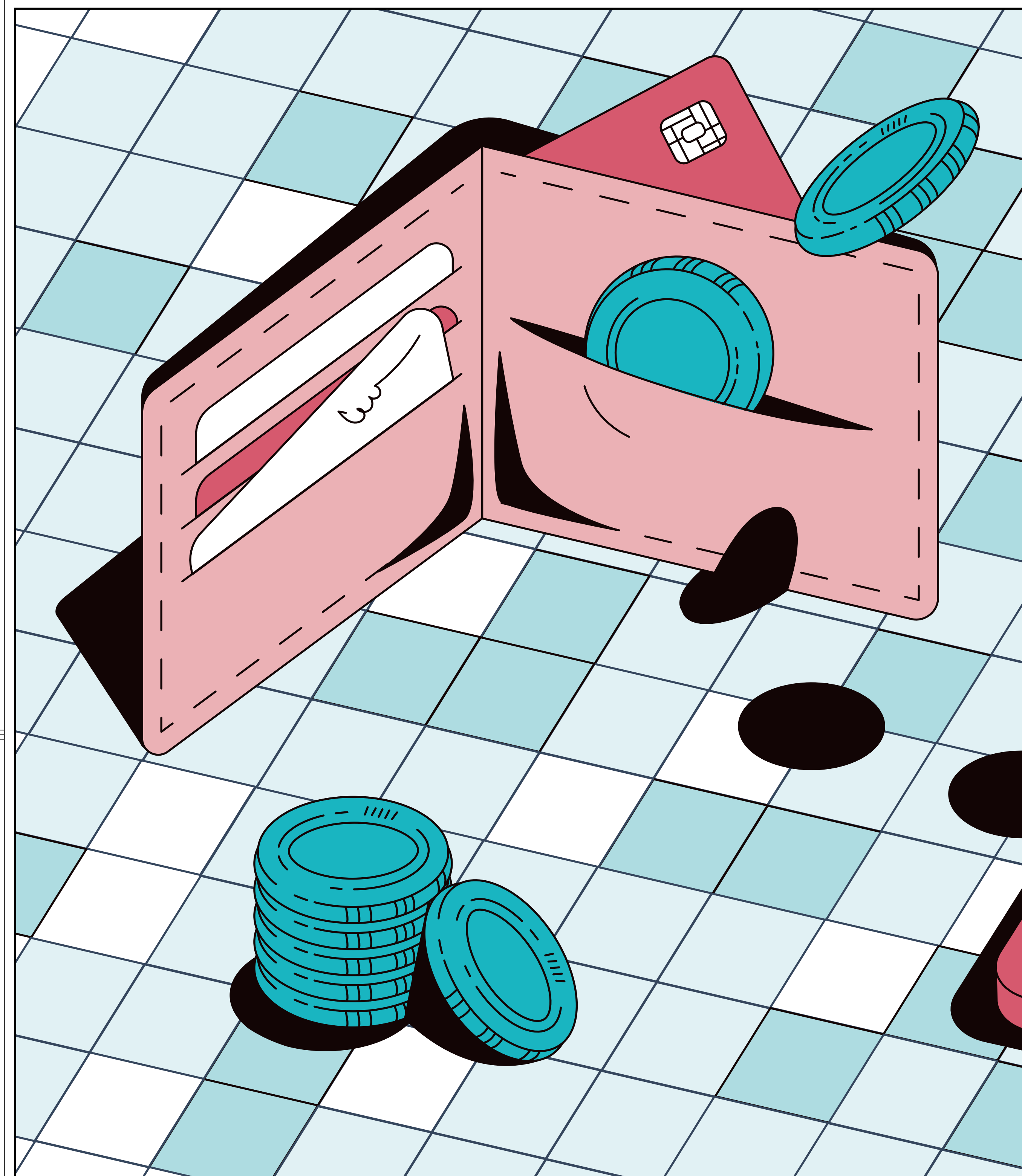
Find out how we can help unlock private capital flows at floww.io

Floww

INNOVATION

All hail the auto-savers

Banks are responding to the cost-of-living crisis with advanced tools that are offering cash-strapped customers a range of innovative ways to make their money go a little further



Andy Jones

Do you remember the time when a bank customer in financial difficulty could hold a face-to-face conversation with a fellow human to seek the help they needed? They could walk into their local branch and state their case to the manager, who would then decide on the most appropriate solutions to offer. If so, you could be forgiven for thinking that the banks' enthusiastic embrace of advanced digital tech – preferring AI-powered online chatbots to branches, never mind branch managers, for instance – might have hindered their provision of such support.

Far from fostering a 'computer says no' mentality, the technology is closer to the angel on a consumer's shoulder, providing wise counsel in a crisis. Many banks have applied fintech to give struggling customers proactive assistance such as budgeting tools before they fall too deeply into debt.

Back-of-the-net gain

BNP Paribas is one of a growing number of banks to have provided apps that use behavioural science and gamification to help customers – particularly younger ones – manage their money. The cost-of-living crisis has been especially tough on young adults, who are also one of the hardest demographic groups to reach with financial advice. More than 70% of low-income households containing at least one member aged 18 to 24 in the UK have been in arrears with at least one household bill this year, according to research published in June by the Joseph Rowntree Foundation. The study also found that more than 80% of 18- to 34-year-olds have had to go without essentials such as food and heating.

To reach this target user base, the BNP Paribas app includes features such as The Thief, which 'steals' an agreed sum each week from your salary account and puts it into your savings pot, and Save Goal, which automatically saves a set amount each time your nominated sports team scores. Such processes and the incremental amounts they deal in help users to save without missing the cash.

For group saving – useful for couples buying a first home together, for instance – the app's Copy Cat feature automatically matches the user's saving to whatever amount their saving partner has managed to put aside.

"Through our understanding of human behavioural psychology, we have been able to build an emotional connection with digital banking customers and empower them to make changes," says Jean-Marc Chaudoreille, head of daily and sustainable banking at BNP Paribas.

The app's developer, Dreams Technology, based its product on eight years of research, including collaborations with Harvard University, Stockholm School of Economics, the University of Toronto and the University of California, Los Angeles. This work created a template for saving based on the theory proposed by eminent social scientist B J Fogg that human behaviour is driven by three connected factors. First, we must want to take the recommended action. Second, we must have both the ability and the confidence to do so. Third, it must be easy for us to initiate and sustain the necessary new behaviour.

To aid this process, the app breaks down each key savings goal into weekly amounts that look more achievable and help users to understand the cumulative impact of several small changes of habit. For example, if you were to save £3 every weekday by no longer buying a coffee on your morning commute, that would add up to more than £600 in a year.

"The Thief's approach is based on 'intermittent reinforcement', the concept that receiving a reward or positive feedback when you don't expect it is more powerful than when it follows a pattern," explains Dreams Technology's head of product science, Stina Söderqvist. "Users feel more confident in their ability to save money when they see they've managed to put by a larger sum than they had anticipated. By providing instant positive feedback to saving actions, we help banks to engage and motivate their customers, while making the process more enjoyable for users."

Numbers of the beast

Taking out a high-interest payday loan can be a deal with the devil that many workers make simply to survive until their next salary payment enters their account. But what if, instead of making such a Faustian pact, they could easily obtain an advance on their salary, with no extra costs and no awkward discussions with their employer?

> **By providing instant positive feedback to saving actions, we help banks to engage and motivate their customers, while making the process more enjoyable for users**

The Borofree app allows you to take £300-worth of vouchers – accepted by big retailers including Amazon, Primark, Sainsbury's, Tesco, Uber Eats and Waitrose – early from your forthcoming pay packet. There are no interest charges or fees to pay and you don't need permission from your employer to use it, says Darshan Patel, CFO of the app's developer, Karma.

He cites the recent case of a woman whose fridge broke down irreparably just when she had no money left to buy a new one or even replace the spoiled food. "But with the vouchers she was able to shop at John Lewis and Currys for a £250 fridge and buy £50-worth of food from one of the many participating supermarkets."

Organisations that have realised that some employees may be struggling financially as the cost-of-living crisis wears on are invited to partner with the Borofree scheme. Karma has signed up dozens of big enterprises and is also in discussions with several NHS trusts. It doesn't charge employers either, deriving its profits purely

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Commercial feature

Small business finance made simple

For years, the many complexities of small businesses have made securing loans a lengthy process. Now, thanks to automation and AI-based credit models, SMEs can access the long- and short-term finance they need to thrive amid fast-changing conditions

It is no secret that since the global financial crisis of 2008, smaller businesses have faced an uphill battle trying to access essential finance to steady their cash flows, weather difficult times and invest for growth. Bank lenders can take months to approve finance for small firms, with lending criteria now tightening further in the face of recessionary risks.

Emerging fintechs with models based on the latest analytics and AI are changing small businesses' access to finance. The use of these powerful systems can enable a rapid and accurate understanding of the individual attributes of businesses, unlocking the ability for finance to be provided quickly, affordably and prudently.

"When you think that small businesses are really the engine of our economy, representing more than 50% of private sector turnover and 60% of private sector employment, it's vital they have the finance they need to function as effectively as larger competitors," explains Lisa Jacobs, chief executive at the small business lending platform Funding Circle.

The UK-headquartered fintech has a unique model, bringing in institutional investors and routing their capital as finance to businesses employing on average seven employees with around £1.4m of annual turnover. Loans are also issued to larger SMEs with up to £30m in revenues. Funding Circle's distinctive approach has enabled it to provide over £14.5bn in loans to 130,000 small businesses globally since 2010.

Speed and good decision-making have been fundamental to providing finance so quickly. "Technology is absolutely critical here," Jacobs explains. "We have a data lake with around 2 billion information points, including publicly available information on 28 million businesses, financial data from their loan applications to us and behavioural data on when and how they draw down credit."

At Funding Circle, analytics and AI are being harnessed to quickly understand individual cases and make rapid decisions on loan applications, which usually take SME leaders less than six minutes to complete. In 70% of cases, UK businesses applying to Funding Circle receive a near-instant decision, with successful applicants receiving money in their accounts within a day. Only in more complex situations are manual assessments required.

> **When you think that small businesses are really the engine of our economy, it's vital they have the finance they need to function as effectively as larger competitors**

"We focus on providing straightforward and rapid access to credit, coupled with a human touch, because it's important for small businesses to not only survive but to grow," Jacobs says. "It's also a powerful driver for economic growth: every £1m lent to small businesses in the UK contributes £1.8m in GDP and supports 26 jobs, while delivering £500,000 in tax revenue."

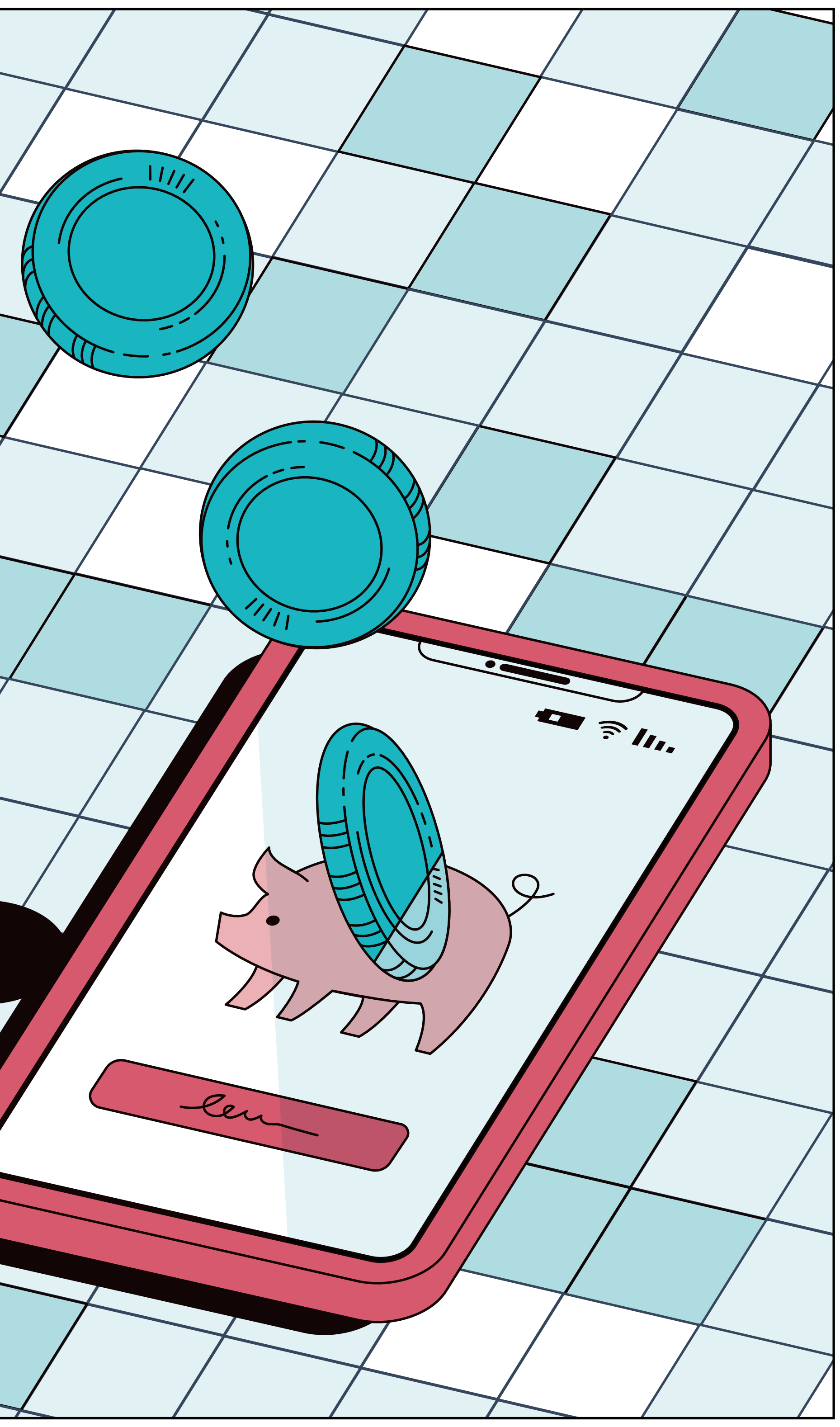
Small businesses across many sectors already rely on Funding Circle to provide loans for up to six years, supporting their business plans. They include The Foundry, a training gym that borrowed to fund its recent expansion, and the homeware brand Att Pynta that took on a government-backed Covid recovery loan via Funding Circle to pay suppliers and smooth cash flow.

The lender has also introduced a short-term finance product known as FlexiPay. "It's well-documented that the lengthy payment times small businesses deal with can create serious cash flow problems. Companies are using FlexiPay to quickly access credit to pay suppliers and meet other commitments, spreading payments over three-month periods," Jacobs explains. At the end of the year, a FlexiPay Card is set to be introduced to enable SMEs to cover everyday expenses whenever needed.

Looking ahead, Jacobs expects technology to become ever more important in connecting small businesses to the finance they need. Partner firms are now able to tap into Funding Circle's technology for the benefit of their customers - a newly created application programming interface enables them to natively embed Funding Circle into their websites, seamlessly acting as brokers to their customers. As finance is made ever more accessible and simple, now is the time for managers of small businesses to apply for the credit they need, supporting cash flow and catalysing growth.

To find out about rapid, simple access to small business finance, visit fundingcircle.com

Funding Circle



from buying huge numbers of vouchers at a bulk discount.

The Borofree method takes away any stigma a user might feel about seeking an advance, according to Patel.

"You don't need to speak to your boss, the HR department or the bank. There is no human intervention whatsoever," he says. "Given the cost-of-living crisis, we don't believe it's right to charge employees to access their own money. This approach doesn't give people enough to put them into difficulties further down the line, but it does provide enough to cover emergency purchases. You won't have to choose between eating and heating, because at least the eating should be covered."

Some people are even using the app as a basic budgeting tool, Patel adds. "For example, one user withdrew a £25 Amazon voucher every month to pay for Christmas presents. Others who spend a lot on takeaways can get hold of £100 in Uber Eats vouchers to last the month – and when they're gone, they're gone."

Virtually Martin Lewis

Although knowledge is definitely power in the cost-of-living crisis, the services of a personal financial adviser are beyond the reach of most people. But Nous promises to be a digital accountant for the most vulnerable members of society, offering users a free personalised report that explains how inflation will increase their outgoings and advises them on how to adapt to this.

People on universal credit and struggling to pay their bills probably wouldn't have heard much this year from their broadband providers about getting a better deal, but Nous has been setting them straight, reports its co-founder and chief commercial officer, Jon Rudoe.

> "Legacy banks have been slow to meet the evolving needs of flexible workers, who often require more sophisticated services than those offered by retail bank accounts"

"Major providers are required by the regulator to provide discounted rates to customers receiving universal credit, but they don't tend to publicise these," he says. "Only about 1% of eligible households had accessed these tariffs when we first took up the fight, yet millions are eligible. Now the number of households taking advantage of them is rising rapidly."

For too long, the banking industry has been focused on the mechanics of money – moving it, storing it and profiting from it – rather than giving customers information that enables them to make better choices, Rudoe argues. But fintech is changing that. For instance, the free dashboard provided by Nous enables users to understand what the cost-of-living crisis means for them, forecasting how major bills are likely to increase over the next 12 months. Its offering includes a mortgage refix calculator and more general money-saving advice.

Digital challenger Starling Bank has been investing heavily in customer education of late. In June, for instance, it updated its Spending Insights tool in response to the worsening cost-of-living crisis. The bank added 36 new categories, including "essential spending", "rent" and "takeaways", to give customers a clearer view of their spending patterns and so help them to budget more effectively.

Its features include Bills Manager, which helps you to keep money aside for essential outgoings, and Round Up, which offers an incremental, automated saving method that makes use of your digital purchases. If you were to use your debit card to spend £2.70 on a sandwich for lunch, for example, the total taken from your current account would be rounded up to £3 and the 30p difference would be sent to your linked savings account. And, designed to enhance the financial literacy of even the hardest-to-reach consumers, the Kite Card helps users to educate their children in money management as soon as they can start spending.

Crucially, Starling uses the data it receives from these tools to identify at the earliest possible stage any users running a particularly high risk of financial hardship. The bank says that it has "measures in place to ensure that customers who are in difficulty are identified – and that they can access the support and tools they need to help them get back on track".

A fiscal Swiss army knife

Established in the UK by Russian-born Nikolay Storonsky and Ukrainian Vlad Yatsenko in 2015, Revolut offers a one-stop app-based platform giving users access to a wide range of financial services. Today, it has 20 million customers, who are using it to trade stocks and cryptocurrencies, send money abroad, budget for bill payments, obtain advances on their salaries and even send personalised gift cards.

Its Revolut Reader device enables businesses and sole traders to take contactless payments. Free smart bookkeeping tech reduces the amount of manual work that users have to do, reading receipts and automatically attaching them to the matching expenses. Businesses will receive notifications with reminders to submit receipts after each transaction.

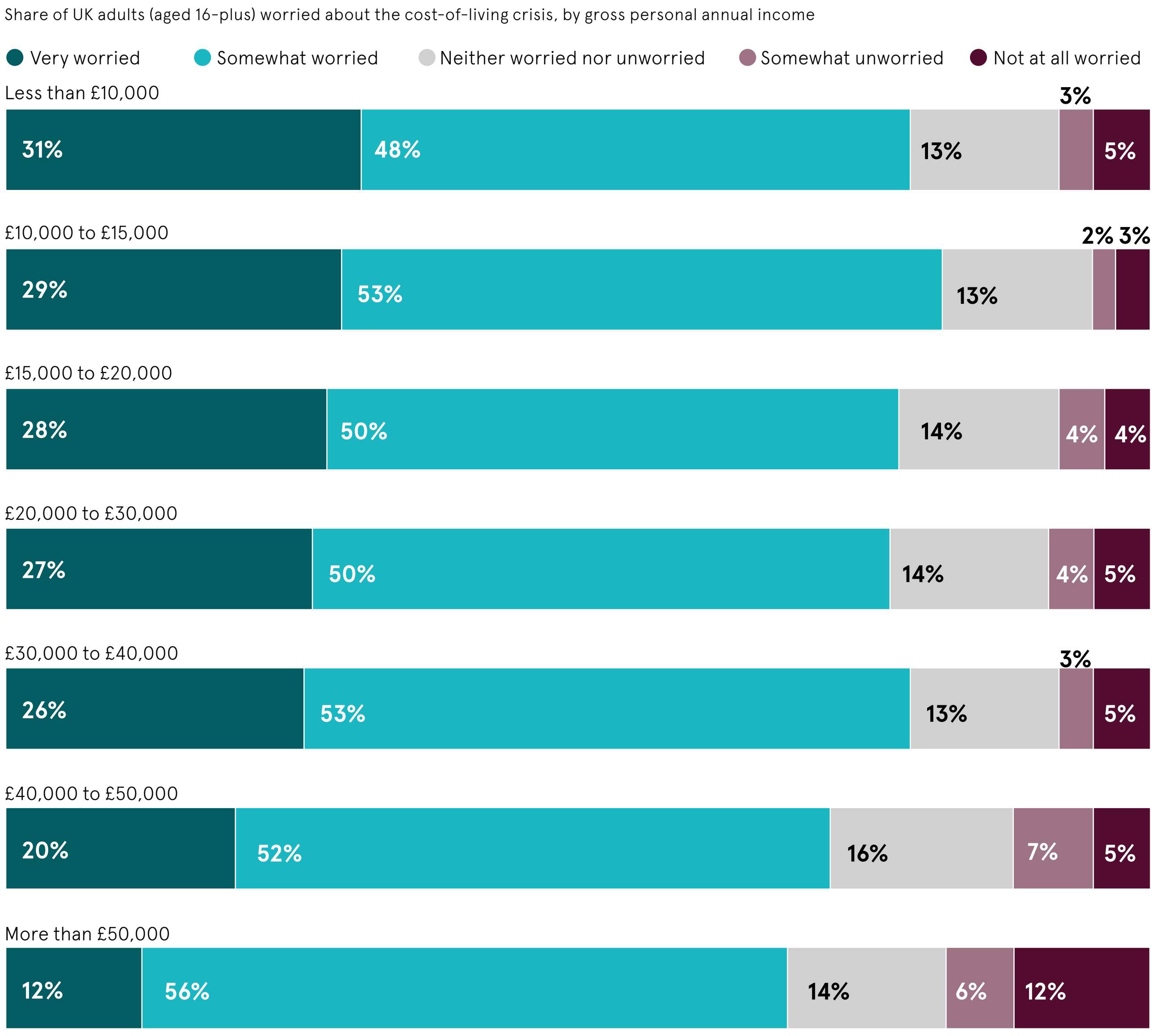
When filing tax returns, a user can apply Revolut's default categories and rates to see their dues or use custom settings if that's their accountant's preference, says James Gibson, head of products at Revolut Business. He adds: "This tool can reduce the hours that accountants and finance managers have to spend on bookkeeping. Files can be exported in CSV format to use on any external accounting platform. Xero users can easily connect their profile to a Revolut Business account, allowing them to better manage their finances."

The firm has also launched an account called Revolut Pro, which is aimed at people working in the gig economy. Maria Marti Garcia, senior product owner at Revolut, explains: "Legacy banks have been slow to develop services to meet the evolving needs of flexible workers. These customers often require more sophisticated services than those offered by retail bank accounts but cannot afford, or do not need the complexity of, a full business account."

During the depths of the Covid crisis in 2020, just under one-third of the 5 million people who reported income from self-employment to HMRC found themselves ineligible to receive a subsistence grant via the government's self-employment income support scheme. The financial services industry too has tended to leave a lot of self-employed people, from microbusiness owners to freelance contractors, outside the tent over the years. But at least some players have started using fintech to offer them the tailored support that many will require if they're to make it through this latest crisis unscathed.

WHO'S LOSING SLEEP ABOUT MAKING ENDS MEET?

Share of UK adults (aged 16-plus) worried about the cost-of-living crisis, by gross personal annual income



Office for National Statistics, 2022

SME manufacturer Glazing Vision needed funds for international expansion

Serving the established SMEs snubbed by banks and fintechs

Businesses with 10 to 250 employees are often ill-served or ignored entirely by big banks and their app-based challengers. Yet providing the loans, accounts and relationship banking they need can unlock their success and drive the UK's prosperity

Established SMEs, which account for almost a third of UK economic activity and jobs, are finding themselves routinely neglected by banks and other mainstream financial services providers. For some, this threatens competitiveness – and worse still, many experience a clear risk to their viability.

Fintech neobanks largely ignore these companies, preferring instead to focus on consumer markets and the UK's many microbusinesses, whose needs are relatively easily met through banking apps. The complex legal entities, ownership structures and financial product requirements of established SMEs are perceived as too difficult to address through the automated apps these companies are built around.

Meanwhile, high street banks have been cutting back sharply on the branches and relationship managers that used to service these established SMEs, instead pursuing mass consumer and microbusiness areas, in addition to lucrative incomes from corporate clients.

"It's alarming that half a million established SMEs face so many challenges getting a decent bank account and accessing essential funding," says Conrad Ford, chief product officer at Allica Bank, the fast-growing fintech challenger bank. "When they do manage to open accounts, they often find themselves ripped off by punitive fees and poor savings rates. That's aside from the lack of human support."

The dearth of lending has become an infamous problem for established SMEs, given the importance of credit for supporting both immediate working capital and long-term growth. "A hotel might have a lot of cash at the end of the summer season, but very little at the end of the winter, so getting a loan can be critical. Or a manufacturer might urgently need to invest in equipment to meet incoming sales demand," Ford explains.

Established SMEs have long relied on relationship banking, but widespread high street bank closures have severed connections. "Banks are making decisions without getting to know them," Ford says. "They write off entire industries, instead of understanding the individuality of each enterprise, many of which are doing well even if their sector might appear less desirable."

Given neobanks' focus on apps, and the big banks' removal of relationship managers, established SMEs are finding themselves between a rock and a hard place. This leads to a dire impact on the overall economy, which has established businesses at its centre. Ford notes: "To put it straight, if we don't all sort this out, the government's levelling up agenda and its attempts to bounce back from Covid are at risk of being just soundbites rather than reality. These businesses are vital to local communities given the activity they generate, who they serve and who they employ."

A small number of fintech challenger banks are seeking to better serve established SMEs. Having the right technologies, expertise and operating models is crucial to meeting these firms' complex needs and structures, and their often variable cash flows.

Allica Bank is exclusively focused on the established SME segment. Since its inception in 2019, it has lent over £1bn to such businesses, across all sectors and regions of the UK, and the expansion of its innovative, dedicated model has been critical in the bank already reaching monthly profitability.

Thousands of SMEs rely on Allica Bank's tailored and local expertise, and smart technology, to provide accessible lending for their premises, factories and shops, as well as financing for machinery and equipment. "A lot of these companies had hit real challenges accessing finance or a fair bank account. It's been an unfair reality, in spite of the great business they are doing and their strong future prospects," Ford adds.

> "If we don't all sort this out, the levelling up agenda and attempts to bounce back from Covid are at risk of being just soundbites"

Among them is the luxury glass rooflight maker Glazing Vision, which employs over 100 people. At the height of the pandemic, it had sought to remortgage its premises in order to fund its international expansion, only to find the major banks ultimately unwilling to provide credit. Its executives approached Allica Bank, whose relationship managers met with them, spent time assessing the business, and agreed to a £1.9m remortgage essential to the company's rapid growth plans.

Other established businesses often encounter problems when seeking finance for additional premises or critical equipment. In the retail or logistics space, for example, a company might find the perfect warehouse to purchase, and the executives apply to the bank for a mortgage. "Often, they are either rejected, or even more frequently they're not given a straight answer at all, and the opportunity passes them by," Ford says. Equally, leisure and entertainment companies seeking support during a seasonal dip in business are frequently unable to access the necessary credit in time.

Allica Bank focuses on offering valuable current account services, and its managers meet customers however they prefer, meaning a return to the relationship banking SMEs had previously relied upon. "Imagine if your bank manager met you at your premises or your favourite coffee shop," Ford says, "instead of expecting you to meet in a branch that's miles away, or asking you to speak to a faceless voice in a call centre."

In addition, Allica Bank's savings rates are highly positive for businesses, who are increasingly mindful of poor returns on their cash balances. "This is becoming particularly important, as inflation bites. Moving money held in current accounts to interest-bearing savings accounts is one way to counter the diminishing value of cash holdings," he says.

As the economic challenges continue to intensify, Ford predicts that established SMEs will face greater obstacles to accessing appropriate and affordable banking services. "Certainly for the next couple of years, it's very conceivable that major high street banks will tighten their lending further. Meanwhile, neobanks won't want the complexity of the established SME segment, and non-bank lenders may struggle to get enough investors on board."

Given established SMEs' nuanced needs and the tightening economic conditions, now is the time for these companies to look beyond the big banks and their app-based rivals. Moving to a bank that understands their needs and strengths can provide the critical basis for them to survive and thrive.

SUSTAINABILITY

The unlikely rehabilitation of crypto as a green force

Putting their energy and emissions excesses behind them, can cryptocurrencies emerge as change agents for net zero, harnessing the potential of blockchain tech and Web3?

Jim McClelland

In its early days, crypto had a bad reputation for its carbon footprint – and rightly so. The energy demands and emissions associated with mining blockchain-based currencies were making the wrong kinds of headlines and earning the wrath of climate campaigners. But this is becoming old news as the technology advances. So says Conor Svensson, founder and CEO of Web3 Labs and author of *The Blockchain Innovator's Handbook*.

"The high power consumption of the bitcoin network, which is 0.47 of global electricity usage, has portrayed cryptocurrencies and blockchain technology negatively in the past," he says. "But bitcoin is in the minority in this respect. All other major crypto networks, including ethereum, have trivial power requirements compared with those of big tech."

The latest generation of blockchains are changing for the better, as illustrated by ethereum's recent network upgrade, which could cut its energy consumption by 99.9%.

Crypto is cleaning up its climate act too. Take philanthropic initiative Giving to Services, for instance. It offers a crypto token and staking platform that's designed to give back to public sector workers. Concerned about its climate impact, it switched to the XRP Ledger, the first major blockchain certified as carbon-neutral. It also signed up to the Crypto Climate Accord, a private sector initiative inspired by the UN's Paris climate agreement.

In a world where environmental, social and governance (ESG) criteria are key, the newfound ability of crypto to meet the rising expectations of responsible investment, climate finance and green banking can be seen as a sign of a maturing market.

Can cryptocurrencies continue their rehabilitation and become part of the solution to the climate crisis – and even help the UN achieve its sustainable development goals (SDGs) – rather than part of the problem?

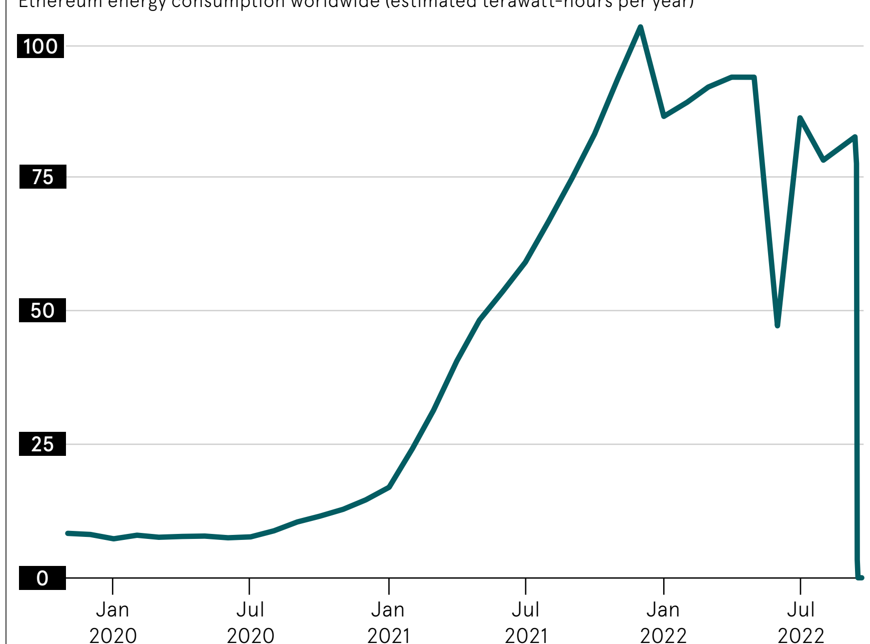
The establishment seems to think so, judging by the positive signs from global institutions. The World Economic Forum recently formed a crypto sustainability coalition to investigate the potential of Web3 technologies in tackling climate change. And the World Bank has announced its backing for a carbon credit blockchain registry to attract crypto investors and direct the craze for non-fungible tokens towards projects that help to reduce greenhouse gas emissions and make the markets for carbon offsets more transparent.

The question is becoming less about whether crypto can help and more about how much. Markets can see the benefits of blockchain to authenticate transactions, identities and sources, so the technology is proving its worth by fuelling the global energy transition in a fully accountable way. That's the view of Benjamin Dunkel, vice-president of ecosystem growth at Alkimi, a decentralised ad exchange.

"The potential of blockchain to aid global decarbonisation is not just theoretical; this is already happening," he argues. "For example, projects such as Energy Web are using decentralised ledgers to help grids incorporate green assets in a fully transparent and traceable way."

ETHEREUM MOVED TO A MORE ECO-FRIENDLY PROOF-OF-STAKE MECHANISM FOR VERIFYING TRANSACTIONS IN SEPTEMBER 2022

Ethereum energy consumption worldwide (estimated terawatt-hours per year)



Digiconomist, 2022

The integration of blockchain technology into the global financial system serves to advance its ESG credentials. One area of potential benefit lies in the carbon market, suggests Alisa DiCaprio, chief economist at R3, a specialist in blockchain software.

"Markets are struggling to handle the demand for voluntary carbon offsets, which is predicted to increase from $1bn (£890m) in 2021 to $50bn by 2030," she says. "As a result, offsets are commonly misused, misreported and undervalued."

Blockchains can help here, as DiCaprio explains: "Decentralisation reduces complexity in how carbon credits are registered, traded and managed, leading to an increase in quota utilisation. It also addresses opacity by making markets more reliable and open. This has a positive impact on problems such as fraud, illegal trading, lost quotas and repeated transactions."

Only time will tell whether crypto will support or distort the market, observes Claude Brown, partner at international law firm Reed Smith. "If crypto fractionalises carbon credits and offsets, it has the potential to democratise the voluntary carbon markets. But it's equally possible for crypto to distort the market by favouring older vintage allowances and creating functionality gaps between the tokens and the credits and offsets that underpin them," he warns.

Fintech clearly has the potential to aid progress towards the UN's SDGs and net zero. It can be a powerful enabler of social change programmes involving regenerative and decentralised finance (DeFi). This is a significant play for sustainability, with the global DeFi market valued at $11.8bn in 2021 and set to grow apace. But Brown points out the need to distinguish between the role played by decentralisation and that of tokenisation. The system and the coin are not one and the same, he stresses.

> The potential of blockchain to aid global decarbonisation is not just theoretical; this is already happening

"Decentralisation has the potential to provide a robust core infrastructure for measuring, verifying and policing progress. Tokens can help, but they are not essential and risk adding a layer of complexity and wizardry that can discourage investment," Brown explains.

Nonetheless, tokens remain prized by consumers. In the DeFi ecosystem, crucial opportunities remain to engage the public in climate action by way of collectively owned structures such as decentralised autonomous organisations (DAOs). These can connect digital rewards to real-world decarbonisation, notes Svensson.

"Web3 technologies such as DAOs could be used to form new communities that are passionate about climate initiatives. One is KlimaDAO, which rewards users with tokens backed by carbon offsets to increase the liquidity of carbon assets," he says.

Taking gamification several steps further – literally – is the lifestyle Web3 application Stepn. This move-to-earn smartphone app rewards users with crypto for walking, jogging or running outside and has made a monthly commitment of $100,000 towards carbon removal. By using a percentage of its profits to buy carbon removal credits on the Nori marketplace, Stepn expects to fund the extraction of nearly 70,000 tonnes of carbon from the atmosphere a year.

All this is a long way from stories about bitcoin using more energy than Argentina. The narrative, like the tech, is changing. Crypto *can* become a tool for climate action – and it's not just desirable; it's doable.

Commercial feature

Q&A

Seamless money movement is key to surviving business-cost crisis

A challenging economic environment requires a rethink on how businesses move money, says **Ian Strafford-Taylor**, CEO and co-founder of Equals Group (LON:EQLS)

Q What's going on right now with British businesses?

A The cost-of-living crisis is evolving into a cost-of-doing-business crisis. We've got rocketing inflation, spiralling energy costs, falling consumer spending and a recession looming. The situation is unpredictable. We conducted a survey among 1,000 business leaders and one in five said they may have to close due to financial challenges and economic turbulence. Nine out of 10 struggle with cash flow. A similar proportion said they will have to significantly change the way they operate. This is a crucial time for cost controls and managing cash flow effectively.

Q How are money issues playing out in the current climate?

A Businesses need to focus on what they're good at, rather than get bogged down in managing company money. Right now, money movement is harder than it needs to be. Working capital is vital for firms, a lack of it is why businesses fail. If money is moving more quickly and isn't caught up in archaic payment networks and financial plumbing for days it can be used more effectively. Money needs to move seamlessly whether it's by transfer or card, in any currency and from one platform. As a challenger fintech that's what we're trying to achieve, making it easier for working capital to move to where it's needed the most and for reconciliations to be instant.

Q Are there challenges corporations are seeing?

A The bane of business is uncertainty – this is also reflected in the currency markets where there's tremendous volatility, which is difficult to navigate if you're importing or exporting. Many SMEs don't realise they can fix exchange rates in advance. Most have never been sold the concept of buying a forward FX contract, yet you can lock in rates and save money with a small deposit, offering hedging and short-term insulation from this issue. In this process, businesses also need just one account, one platform, supporting all currencies making it simpler. This is what we do best.

Q How can businesses manage other costs?

A Managing expenses in real time is a hot topic. Corporate cards used by executives where CFOs don't know what costs are being racked up until six weeks later when the bill comes in is an issue. Prepaid cards with approved spending limits and alerts sent to decision-makers when more is needed makes sense. Money can then be released through an app. This is the pinnacle of cost control. More of these services need to be made available to all businesses. Right now, we're laser-focused on creating an 'enabling environment' – where the utilisation of money for all enterprises should be frictionless, seamless and easy to use.

Q Is an enabling environment easy to achieve?

A In essence, no, as we're still sitting on payment networks that are decades old. As a fintech with 17 years' experience we're still trying to disrupt the status quo, not just by providing a great user experience, but by investing in the underlying infrastructure and connectivity – plugging into payment networks directly, while concurrently investing in technology to knit these disparate networks together. The aim is to offer the most efficient and flexible movement of money possible, whatever the payment rails are. Trust is also key, that's why we offer bank-grade connections, are regulated by the FCA and have clearance accounts at the Bank of England. We were also admitted to the SEPA network, ahead of many UK institutional banks.

Q What does the future hold?

A The advent of crypto and digital currencies, as well as the blockchain technology that underpins them, has served as a wake-up call for the broader payments industry – the current settlement system is not fit for purpose in a digital economy. Moving money should take seconds, not days, and modern technology can enable this. As businesses increasingly transform digitally, they legitimately expect that payments should do the same. We see Equals Money as an enabling force in accelerating the development of that environment.

A platform for seamless money movement
equalsmoney.com
equalsplc.com

EQUALS Group