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PACESETTERS

Financial Services

Contents

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Foreword

Europe's fastest-growing financial services businesses are setting the pace for the rest of their industry. Despite facing challenges ranging from regulatory upheaval to the uncertainties of Brexit, they have been able to power ahead, exploiting their competitive edge to leave their rivals trailing.

This research sets out to understand how these businesses are achieving superior performance. It forms part of Pinsent Masons' *Pacesetters* research, published in association with Mergermarket. Based on 100 interviews with senior executives of some of the fastest-growing financial services businesses across Western Europe, it aims to identify the qualities, skills and characteristics that set these companies apart.

For while these financial services firms are based in different geographies and operate in a diverse range of sub-sectors, it is striking that they share certain characteristics.

In particular, these are businesses that understand the potential for technology and innovation to power growth. Not all of them would be considered financial technology (Fintech) businesses, though some such firms do feature in the fastest-growing firms in Europe, but most are highly focused on how digital transformation and investment in technology can take their growth to the next level.

Similarly, fast-growing financial services businesses share an openness to collaboration and partnership. Many have embraced mergers & acquisitions (M&A) as part of their growth to date and intend to do more deals. But they also see the potential for a broad range of alliances, from minority stakes to joint ventures, to create valuable new opportunities.

There are challenges ahead. Most notably, 82% of the fast-growing financial services firms in this research believe Brexit will have a negative effect on their growth (not one foresees a positive impact). Nevertheless, they remain optimistic. *Pacesetters* sets out the basis for this upbeat sentiment – and provides a roadmap for other businesses keen to secure similar rates of growth.

Alexis Roberts
Sector Head, Financial Services
Pinsent Masons

Hannah Brader
Partner
Pinsent Masons

Key findings

74%
feel that Fintech/Insurtech will be among the top two growth sectors over the next three years in Western Europe

47%
consider digital transformation will be one of the two factors driving most growth over the next three years

83%
feel that investing and utilising technology effectively will be most important for their business in the next three years

84%
expect increased partnership with Fintech/Insurtech companies

52%
expect changing customer expectations to drive most growth in the next three years

72%
believe that cybersecurity regulations will be among the two most challenging areas of regulation over the next three years

82%
expect Brexit to have a negative impact on growth

28%
believe that M&A will be among the most important factors in their growth in the next three years

88%
of financial services companies have acquired a minority stake in a company in the past three years

80%
of respondents anticipate buying a blockchain product or service over the next three years

70%
believe acquiring IP or tech will be one of the main objectives of M&A and alliances over the next three years (up from 58% over the past three years)

33%
feel that alternative lending will see the most growth in Western Europe in the next three years

Methodology

The companies chosen to take part in the survey were drawn from a list of the fastest-growing Western European-based financial services companies

The list was produced by Mergermarket from a variety of public sources of information and company databases. Growth rates were calculated based on turnover reported in accounts for the past three years and, to be eligible for inclusion, companies had to have shown growth in each of the previous two years. There was a minimum turnover threshold for inclusion of €50 million based on the most recent set of accounts.

The survey of fast-growing financial services companies is part of a larger 400-respondent survey of fast-growing companies. 100 respondents in each of the following three sectors were also surveyed: Advanced Manufacturing & Technology, Energy and Infrastructure. Overall results of the survey are available in the *Pacesetters* overview report. For more information, visit https://pacesetters.pinsentmasons.com.

Company breakdown

	Number of companies
France	20
Germany	20
Spain	20
UK & Ireland	20
Other Western Europe	20
Total	**100**

Chapter 1:
The rise of the machines

The rise of the machines

Our exclusive survey of 100 fast-growing European financial services companies found that technology is driving the sector. And firms acknowledge that mastering disruptive technology is fundamental to their survival and growth

Europe's fastest-growing financial services companies believe that technology holds the key to their success in the months and years ahead, providing a means to further outperform their peers. Their commitment to innovation reflects the widely held view that digital transformation and the exploitation of new technologies can drive further growth throughout the marketplace.

As such, many fast-growing financial services businesses are pursuing ambitious plans for acquiring new capabilities, from investment in new technology to M&A activity or strategic alliances that will secure access to innovation. Many firms are excited about the potential of these capabilities to help them sharpen their focus on the customer.

However, transformation will be challenging, with difficult choices to be made at each step of the journey. Many businesses in the sector are acutely aware of the dangers posed by technology renewal; and they are determined to manage these risks.

Technology to drive growth

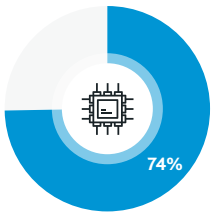
Almost three-quarters of fast-growing financial services businesses (74%) see Fintech or Insurtech firms as being the two fastest-growing sectors of their industry in Western Europe over the next three years. They also regard Western Europe as leading the way – only 18% see Fintech/Insurtech as a top-two growth sector on a global basis.

This view is backed by the CFO of a UK financial services company. "Western Europe will ride the wave of Fintech and Insurtech over the next three years," she says. "Places like Amsterdam and London are brimming with Insurtech start-ups and these are hubs for Fintech."

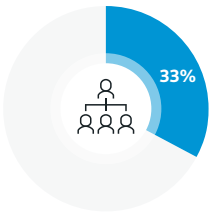
The idea that growth will be far stronger in Western Europe may be surprising, given the strength of technology-driven financial services firms in many parts of the world, with North America and particularly China now boasting many well-established Fintech businesses, for example. Nevertheless, London's well-established reputation as a global Fintech centre[1], supported by strongly performing hubs across Europe, leaves the continent particularly well-placed to pursue growth in this area.

1 London keeps hold of global fintech lead (City A.M., April 2017) [http://www.cityam.com/262644/london-keeps-hold-global-fintech-lead-but-these-global]

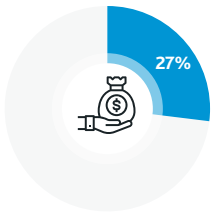
Which two areas do you consider will see the most growth over the next three years in Western Europe?



Fintech/Insurtech

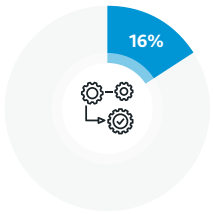


Alternative lending

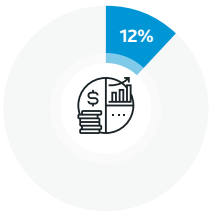


Venture capital/ private equity

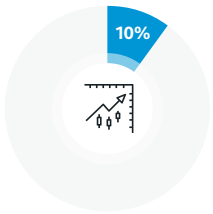
Insurance



Asset management/ wealth management



Investment banking



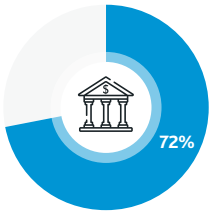
Investment broking

Retail/commercial banking

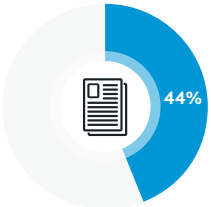
> Western Europe will ride the wave of Fintech and Insurtech over the next three years.
>
> **CFO of a UK financial services company**

The future of Fintechs is clearly exciting, but their growth is also driving the technology endeavours of traditional businesses. "These companies are all acutely conscious of the need to use technology to keep up with – and to keep ahead of if they can – the disruptors in the market," says Pinsent Masons' Partner Yvonne Dunn. "This is a market that is being highly disrupted at the moment and financial services businesses are going to have to invest to enhance and develop the experience their customers want and the way those customers engage with them."

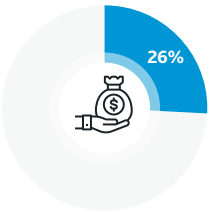
Within the financial services sector, which two areas do you consider will see the most growth over the next three years globally?



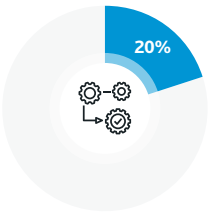
Retail/commercial banking



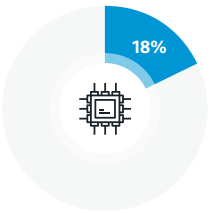
Insurance



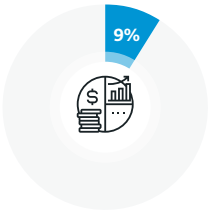
Venture capital/ private equity



Asset management/ wealth management

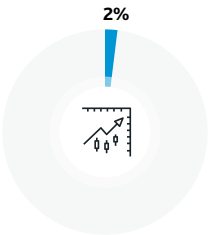


Fintech/Insurtech



Investment banking

Alternative lending



Investment broking

The rise of the machines

Investing for change

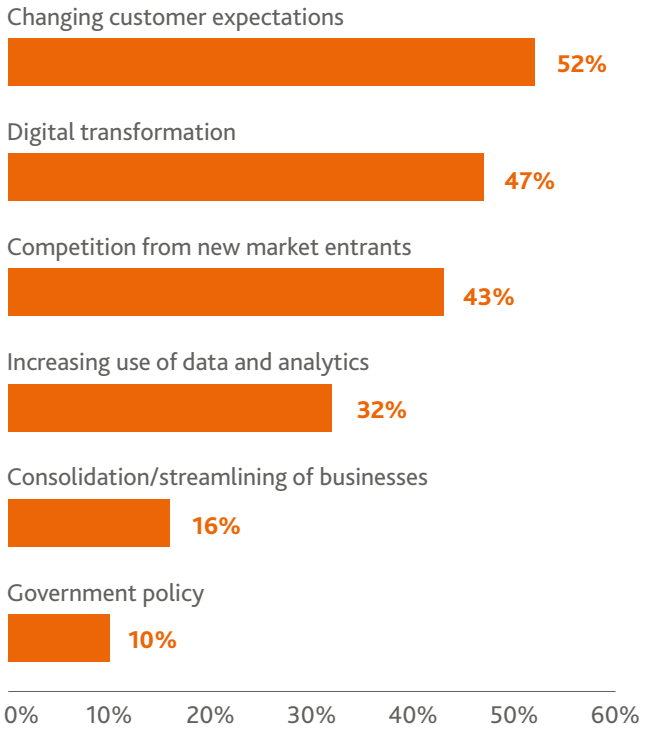
Part of the challenge will be to harness the power of new technologies to drive change, with financial services companies switching to new business models, introducing new products and services and working more closely with a broader range of stakeholders, including their customers.

And fast-growing companies clearly recognise that imperative. Almost half (47%) now see digital transformation as one of the two factors most likely to drive growth in financial services over the next three years. Along with a determination to adapt to the changing expectations of their customers, this will clearly be a vital component of the future growth story of the fastest-growing companies in this industry.

Achieving that transformation is likely to require investment in new technology and tools. Many financial services businesses have already made significant investments, with more than half reporting that their investment in new technology and subsequent use of it has been an important growth driver over the past three years.

Now, however, these fast-growing companies plan to redouble their efforts. As the financial services marketplace continues to evolve ever more rapidly, 83% of these firms believe making further investments, and then putting this new technology to good use, will be important in sustaining the fast growth already achieved over the last three years, particularly as new entrants eye the sector. "Insurance is becoming more competitive," warns the CEO of a French financial services business. "Technology means there are now competitors who have limited experience in this line of business."

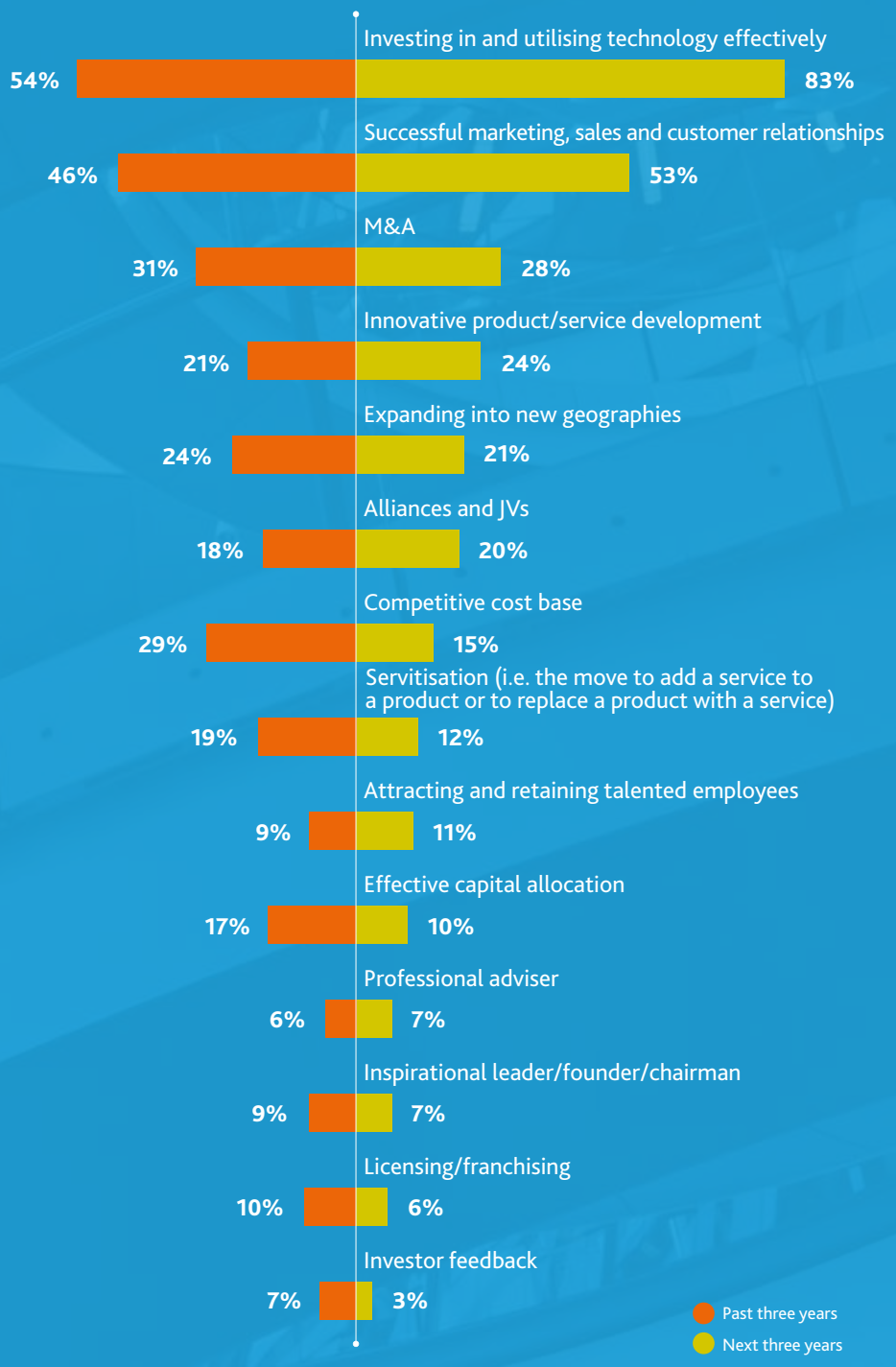
Within your industry sector, which two factors do you consider will drive the most growth over the next three years? (Respondents selected top two)

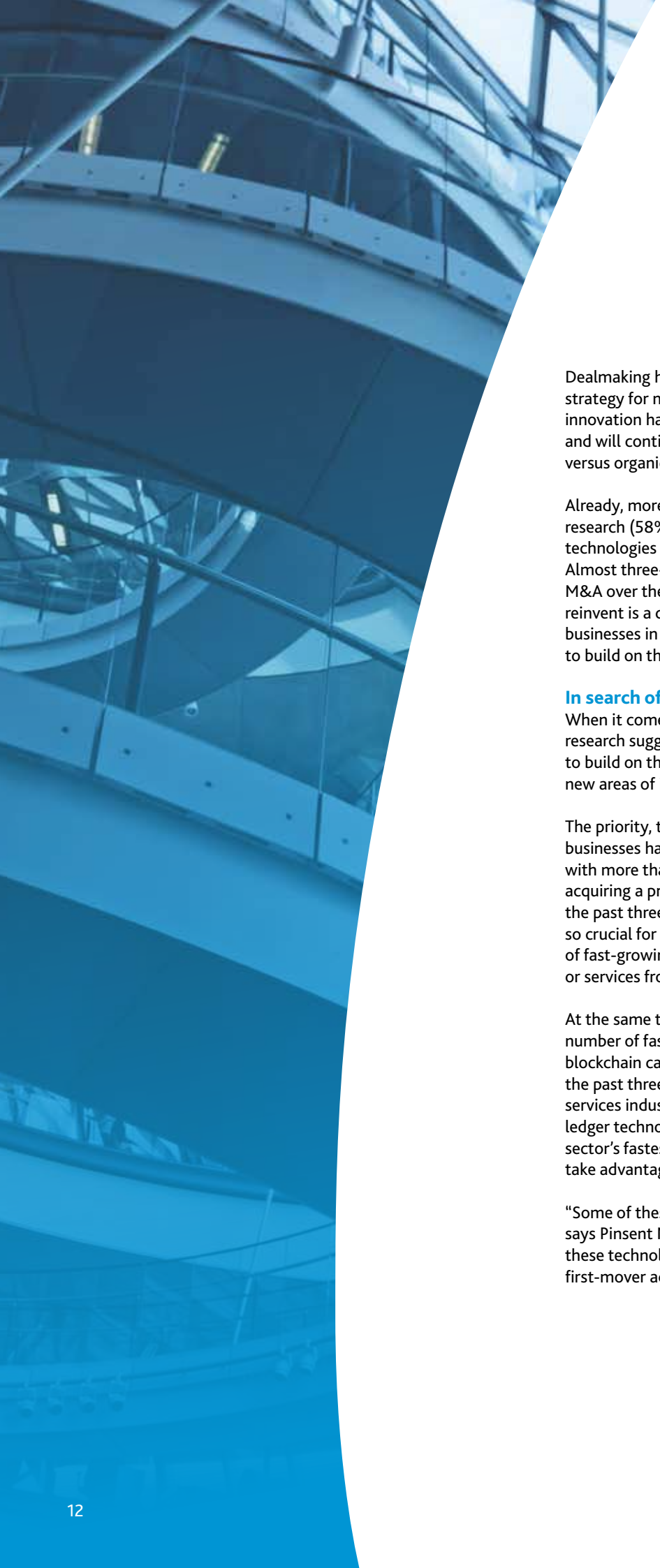


> This is a market that is being highly disrupted at the moment and financial services businesses are going to have to invest to enhance and develop the experience their customers want and the way those customers engage with them.

Yvonne Dunn, Partner, Pinsent Masons

Which factors have been most important for the growth of your business over the past three years? Which factors will be most important to your growth over the next three years? (Respondents selected top three)





Dealmaking has been an important element of this investment strategy for many fast-growing companies. While in-house innovation has been an objective for businesses in the sector – and will continue to be so – the transformational benefits of M&A versus organic growth are attractive, and becoming more so.

Already, more than half the fast-growing companies in this research (58%) report that the acquisition of IP or new technologies has been a key growth driver in their M&A activity. Almost three-quarters (70%) expect to realise such benefits from M&A over the next three years. If the ability to innovate and reinvent is a crucial distinguishing characteristic of fast-growing businesses in the financial services sector, M&A provides a means to build on that ability – and thus deliver further growth.

In search of new capabilities

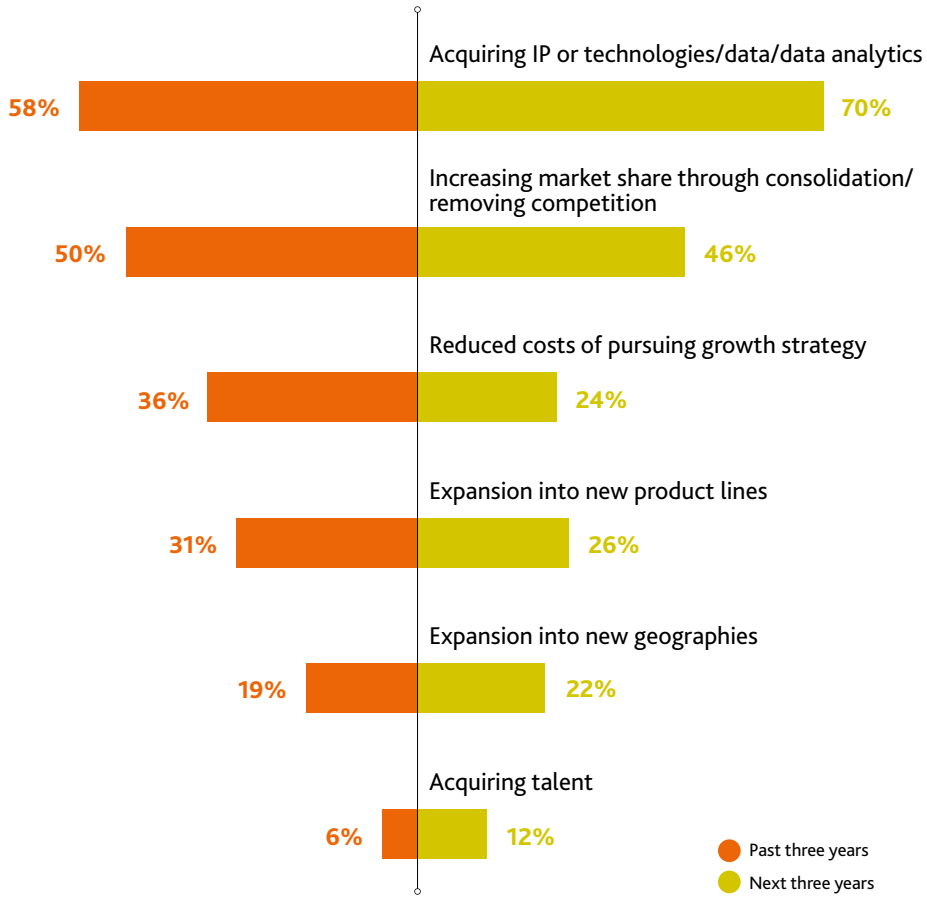
When it comes to specific technology areas in which to invest, our research suggests companies in the sector recognise both the need to build on their existing capabilities and to move into exciting new areas of innovation.

The priority, to date, for significant numbers of financial services businesses has been to boost their data and analytics capabilities, with more than three-quarters of fast-growing companies (77%) acquiring a product or service from a Fintech firm in this area over the past three years. Clearly, the data agenda, which has become so crucial for financial services companies, is not going away: 73% of fast-growing companies expect to buy data analytics products or services from a Fintech company over the next three years.

At the same time, new priorities are emerging. In particular, the number of fast-growth financial services businesses acquiring blockchain capabilities is set to more than treble, from 26% over the past three years to 80% looking forward. As the financial services industry ponders emerging use cases for distributed ledger technologies, from settlement to disintermediation, the sector's fastest-growing businesses want to be in a position to take advantage.

"Some of these businesses are now amassing blockchain patents," says Pinsent Masons' Yvonne Dunn. "They're securing rights over these technologies so they're in a position to be able to secure first-mover advantage when the use cases do fully emerge."

What have been the most important ways that M&A and alliances with other companies have contributed to your growth over the past three years? What will the most important objectives of your M&A and alliances with other companies be over the next three years? (Respondents selected top two)

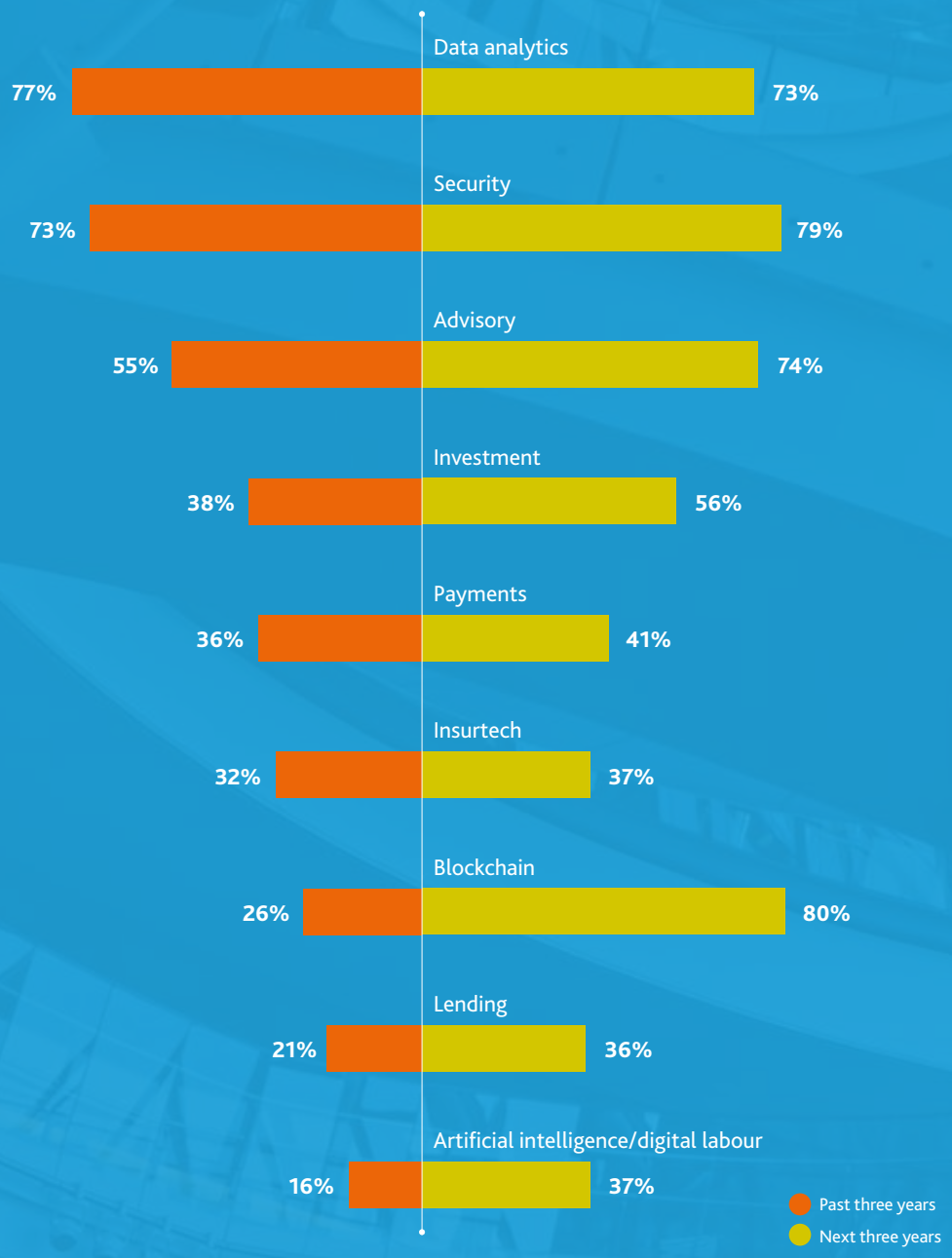


> Insurance is becoming more competitive. Technology means there are now competitors who have limited experience in this line of business.

CEO of a French financial services business

The rise of the machines

Which types of Fintech/Insurtech companies has your firm bought a product or service from over the past three years? And which types do you anticipate buying a product or service from over the next three years? (Respondents selected all that apply for each)



The CEO of a French insurance company is well aware that first-mover advantage is crucial in the blockchain arena: "If we successfully integrate blockchain technology, we will be on a higher level than most of the businesses in our industry."

Investment in artificial intelligence (AI) technologies is also set for a dramatic increase. While just 16% of fast-growing financial services businesses have bought a product or service in this area over the past three years, 37% now expect do so.

Some imperatives are unchanged, however. For example, concern about security continues to be front and centre for very significant numbers of fast-growing companies. With the World Economic Forum now recognising that cyberattacks are among the most significant risks faced by all organisations[2], the fastest-growing financial services businesses are determined to invest in their capabilities in this area. They recognise the value of strong security in protecting their customers, managing their own risk profile, and ultimately ensuring their ability to continue growing rapidly is not compromised.

"Cyber security is now our prime focus," says the Head of Finance at a Spanish financial services business. "We have to create different strategic layers that will protect the business from any attack."

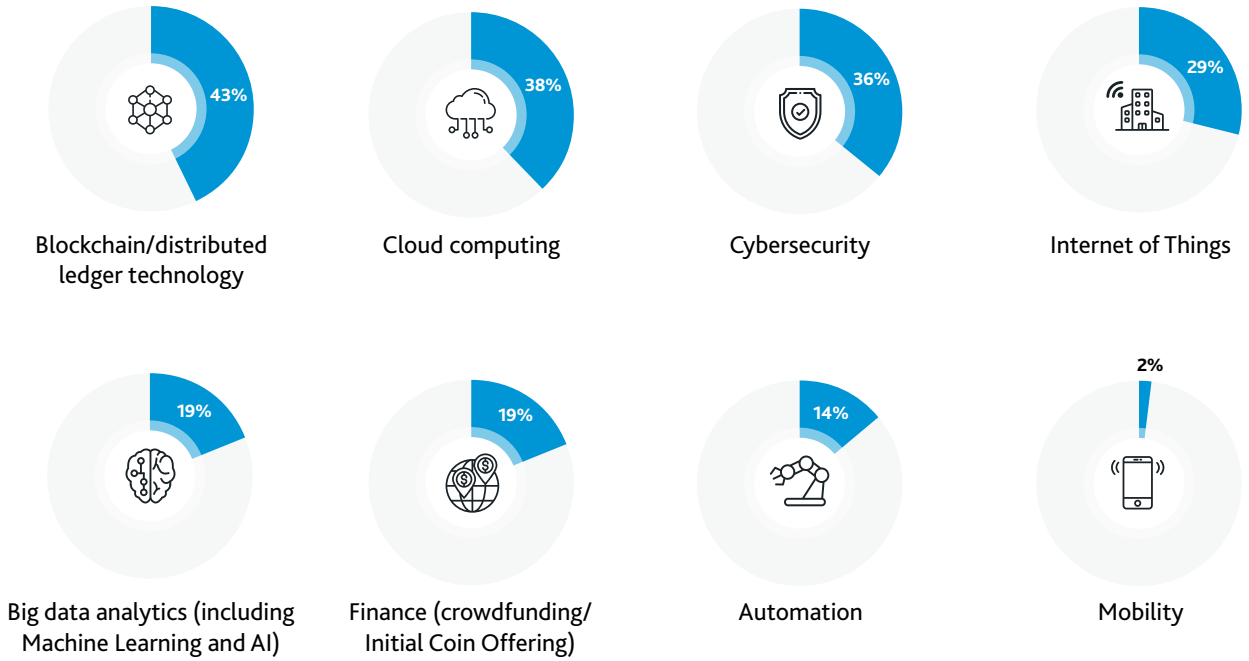
These sentiments are reflected in the priorities that fast-growing financial services companies are now setting themselves for technology investment over the next three years. Cyber security will continue to be a pressing need, with more than a third (36%) of businesses citing this at the top of their list.

"Cyber security is a big concern at the moment," says the CFO of an Italian firm. "There are regular attacks which cripple systems and overall businesses. Creating multiple back-ups on the cloud will provide us with security and consistency. This is what we are working on at the moment."

With that in mind, cloud computing, which allows fast-growing businesses to scale with agility and speed, often making use of as-a-service provision, is another key area of focus – 38% of firms say they are making plans in this area. And, according to Yvonne Dunn,

2 Global Risks Report, World Economic Forum 2018 [https://www.weforum.org/reports/the-global-risks-report-2018]

Which technologies are you prioritising for investment in the next three years? (Respondents selected top two)



The rise of the machines

Cloud is being seen by financial services businesses as a better way to counteract cyber threats than legacy technology. "Cloud service providers are in the business of infrastructure and so more likely to have the means to invest in what's needed to keep up with cyber threat," she says.

Blockchain, cited by 43% of fast-growing financial services businesses, tops the priority list, as companies rush to ensure they do not lose competitive advantage by being slow to adopt this emerging technology.

More broadly, fast-growing financial services companies are keen to explore every possible avenue to improve their product and service mix, invest in their technology and innovate for growth. Collaboration will come to the fore: some 84% of firms anticipate increasing their partnership activities with Fintech and Insurtech businesses over the next three years.

The customer is always right

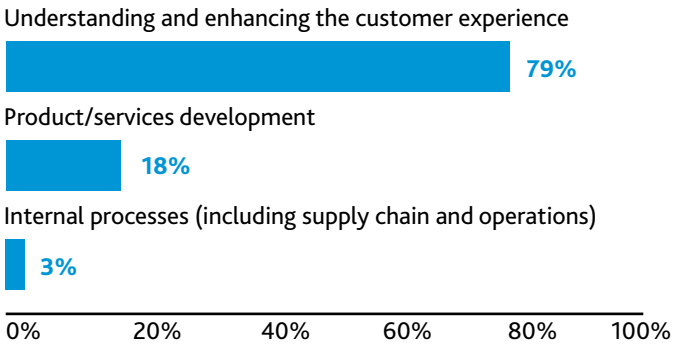
With more than half of the financial services sector's fastest-growing businesses considering the changing expectations of their customers as a key driver of further growth in the years ahead (see page 10), many firms are focused on the question of how technology can give them a better understanding of both existing and new customers.

In fact, more than three-quarters of the fast-growing companies in this research (79%) say this is the area where new technology has had the greatest impact on their business in recent times. Their ability to use tools such as big data and analytics functionality has given them a much clearer picture of the desires of their customers – and, potentially even more crucially, an insight into how better to meet those needs.

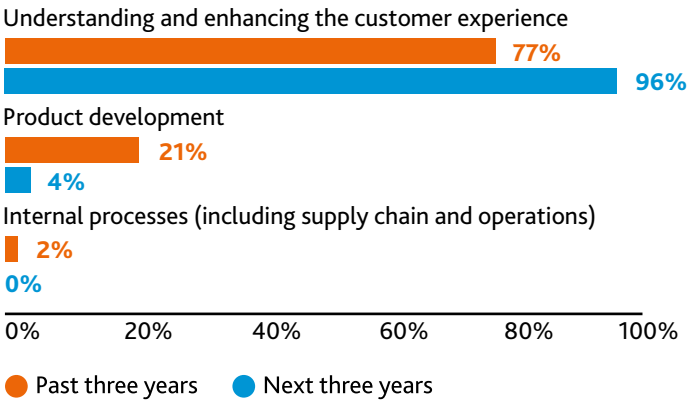
"These businesses have to respond to what customers are looking for," says Pinsent Masons' Yvonne Dunn. "People have more accounts and more investment products than before. They don't necessarily just have a single bank with a deposit account and a current account. They've got multiple savings, investment and pension accounts, as well as protection products and other services. They're interested in products that can aggregate those products into a user-friendly dashboard that gives them a snapshot of how they're doing financially, with the data being delivered to the dashboard securely. Technology is the key to that."

This is not to suggest technology does not have an important role to play elsewhere in the business. Some 18% of firms cite their use of technology to develop new products and services. Ultimately, however, it is firms' customer understanding and responsiveness that is driving their elevated levels of growth.

In which of the following areas has new technology had the greatest impact over the past three years in your market? (Respondents selected most important)



Over the past three years, in which of the following areas have you prioritised investment in technology? How will you prioritise investment over the next three years? (Respondents selected top priority area)



Operations ignored

In this context, it is understandable that such large numbers of fast-growing financial services companies say that investing in technology to help further understand and enhance the customer experience will be a priority. The overwhelming majority of firms (96%) now make the case for this focus over the next three years.

However, while no one would dispute the value of customer centricity, fast-growing businesses must be careful not to under-resource other areas of technology renewal. In particular, it is significant that none of the respondents to this survey see investment in internal processes as a priority for the next three years. The very public travails of financial services companies caught out by technology failures highlight the dangers of underplaying such needs.

In the most serious cases, businesses' emphasis on greater customer centricity has been undermined by failures that have inconvenienced and disappointed customers. The experiences of TSB Bank, for example, have been widely reported and it is still trying to recover from the fall-out of its failed systems migration earlier this year[3]. In a regulated industry, moreover, such problems may also have implications for compliance.

"We know the customer wants to have this seamless experience and that the better the experience is, the more the customer is engaged," says Emma Steeley, Commercial Director of financial analytics firm AccountScore. "But if the back-end isn't working as expected, that can create a massive backlash – so the internal systems have to be maintained too."

> The better the experience is, the more the customer is engaged. But if the back-end isn't working as expected, that can create a massive backlash – so the internal systems have to be maintained too.
>
> **Emma Steeley, Commercial Director, AccountScore**

3 TSB offers interest rate sweetener as IT issues continue at the bank (Computer Weekly, May 2018) [https://www.computerweekly.com/news/252440695/TSB-offers-interest-rate-sweetener-as-IT-issues-continue-at-the-bank]

The rise of the machines

Avoiding the pitfalls

While fast-growing businesses in financial services recognise the potential of new technology to provide a further fillip to their performance, they are also conscious of the potential risks of innovation. And although fast growth often goes hand-in-hand with agility and flexibility, the challenges of managing rapid change and implementing new technologies are numerous – the danger is that mis-steps get in the way of day-to-day operational performance.

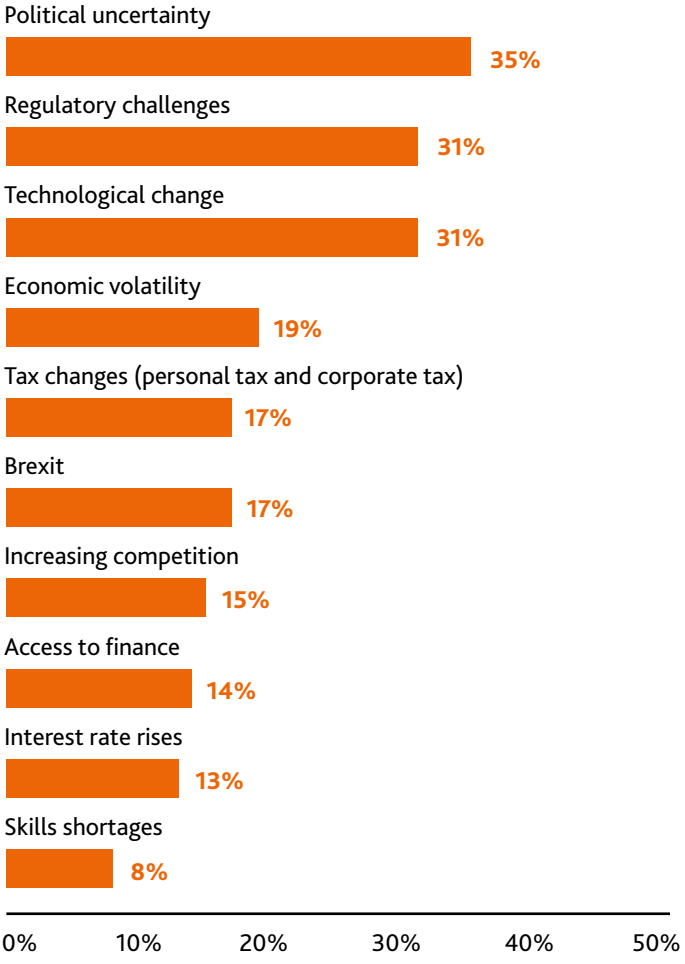
Our survey reveals that 42% of fast-growing financial services companies believe that the difficulty and cost of digital transformation threatens to be the most significant drag on their performance – well ahead of conventional risks such as economic uncertainty.

It is also significant that the same percentage of businesses cite recruitment and shaping the workforce as a potential drag on their ability to grow. This is likely to be directly linked to the issue of transformation: as the business changes, so too will the skills and capabilities required, but these are in short supply across the sector. Lack of talent may prevent businesses capitalising on the potential of new technology.

Similarly, almost a third of fast-growing financial services companies (31%) warn that technological change is one of the two biggest threats to their ability to continue expanding at a rapid pace. In part, this may reflect a fear of disruption, with new technology enabling rivals, including disruptive new entrants to the sector, to take market share from established businesses.

Within your industry sector, which two factors do you consider will be the biggest drag on growth over the next three years?

Which of the following risks do you see as the biggest threat to your growth? (Respondents selected top two)



"Innovation in Fintech has hindered our growth," says the Head of Finance at an Irish business in the sector. "These technologies are targeting millennials, who are the next generation of customers, and they are choosing these Fintech products over us."

Still, execution risk is part of the equation too, with firms nervous about their ability to secure the returns on technology investment for which they hope.

The fact that technological change is regarded as just as big a threat to growth as regulatory challenges by fast-growth companies in financial services underlines the scale of the threat. Only political uncertainty is regarded as a more significant potential problem.

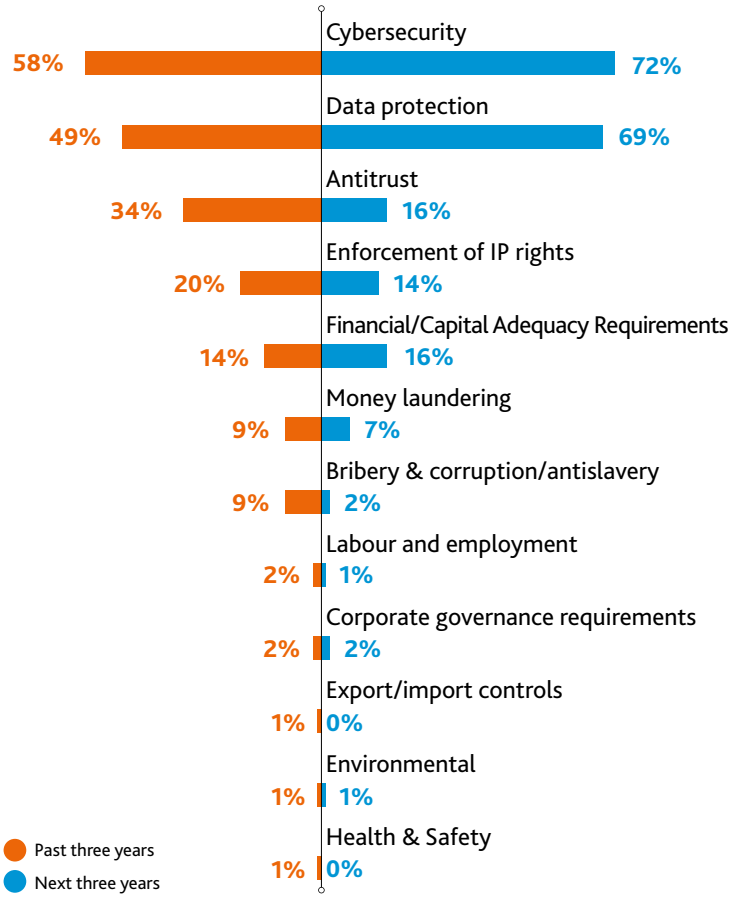
Cyber risk hits home

Moreover, even when fast-growing financial services companies do focus specifically on regulatory or legal risk, they are inclined to emphasise the dangers to which technology exposes them.

Almost three-quarters of businesses (72%) regard cybersecurity issues as the most likely of these regulatory issues to have a negative impact on their growth over the next three years; 58% say this has been one of their top two most difficult challenges over the period just gone.

Similarly, data protection is rising up the agenda – in part, no doubt, because of the impact of the General Data Protection Regulation (GDPR) in May, which requires all organisations to meet exacting new requirements. For financial services companies, which increasingly regard data as a potential source of competitive advantage – hence the heavy investment in analytics – GDPR will be a particularly pressing concern. While 49% of businesses in this research say data protection issues have been one of the most challenging issues over the past three years, 69% see it this way looking forward.

Which legal/regulatory matters have you found most challenging over the past three years? Which regulatory burdens or challenges do you see as most likely to impact your firm's growth over the next three years? (Respondents selected top two)



Snapshot: Brexit blues

Our exclusive survey reveals that respondents feel that Brexit is going to have a huge impact on the sector – and not in a good way

The financial services sector is deeply concerned about the potential negative impact of Brexit on its growth. The fear is felt by both businesses in the UK and those in the rest of the EU, amid worries about access to markets, regulatory uncertainty and arbitrage, liquidity problems and skills shortages.

More than four-fifths of fast-growing financial services companies (82%) expect Brexit to have a negative impact on their growth. Not a single business in this research expected the impact to be positive.

"There is potential for a double whammy," warns Alexis Roberts, Head of Financial Services at Pinsent Masons. "Financial services is diverse, but many of these businesses are operating in jurisdictions across Europe and want to ensure they will continue to have access to them, both to serve customers and to recruit talent; then there's the indirect effect – the economic impact of Brexit threatens to reduce demand for financial products and services."

The Head of Technology at a UK-based financial services company frames the problem this way: "The regulations are going to change and Europe, which was our biggest market, will shift its focus away from UK companies."

Meanwhile, a CEO from Ireland feels that Brexit is hampering their investment and dealmaking ability. "The economic and political scenario in and around Ireland has been unpredictable – particularly concerning the effect of Brexit and the ongoing UK negotiations with the EU," he says. "This hugely affected our decision-making process for M&A activities, bringing us to a standstill in certain deals."

Flying south

Many UK companies are now in the process of setting up subsidiaries in other EU nations as they seek to retain access to the marketplace there. EU businesses are doing the same in the UK. Companies throughout the industry are increasingly worried about agreeing trades and investments for which there may be no legal force if the UK exits the EU without some form of deal.

Perhaps the biggest problem of all for many fast-growing businesses is that, with so little time to go until the UK leaves the EU, they do not feel able to make plans for the post-Brexit environment. The absence of clarity in the shape of the UK's departure has made it difficult for many businesses to progress their planning beyond the early stages.

Indeed, just a quarter of the fast-growing financial services businesses in this research say they are now in advanced stages of planning for Brexit, while 59% are in the early stages. Nearly one in six businesses (16%) have done no planning at all, which seems remarkable given that the UK is scheduled to leave the EU on 29 March 2019.

Pinsent Masons' Alexis Roberts says this is now beginning to change. "Regulation is so crucial to the way these firms do business that many are now putting in place the structures that will allow them to continue operating in both the UK and the EU, even if there is no Brexit deal agreed."

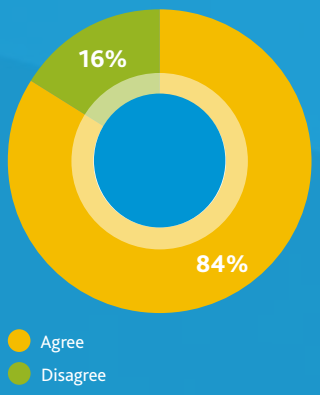
In fact, financial services businesses remain optimistic that a reasonable deal for their sector can be reached. Some 84% predict that UK firms will retain passporting rights following Brexit, which would enable the country's industry to get simple access to EU markets.

In the absence of passporting, 82% think regulatory equivalence, which would still underpin access, should be agreed. Nevertheless, fast-growing businesses expect the fall-out from Brexit to be considerable: more than half (53%) think London is set to lose its status as the financial capital of Europe.

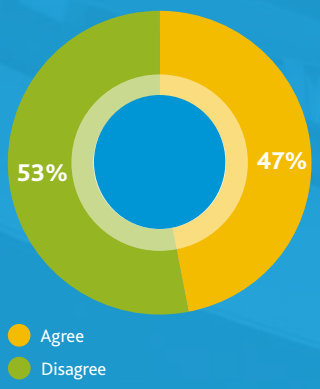
More broadly, the perception that Brexit is just one element of a new wave of political volatility that is engulfing many marketplaces will be an ongoing worry for fast-growing financial services companies. In an era of rising protectionism and nationalism, the stability that the industry could once rely upon looks increasingly fragile. This may even alter their strategic priorities.

"Countries are facing a number of political issues and these issues have affected business too," warns the CFO of a British financial services firm. "Businesses such as ours are rethinking strategies of investments and acquisitions in certain countries because of political concerns there."

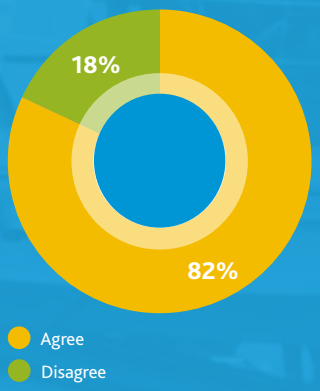
UK firms are likely to retain passporting rights after Brexit.



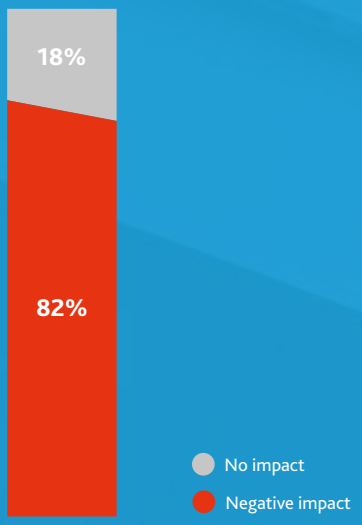
London will remain the financial capital of Europe regardless of whether passporting rights continue after Brexit.



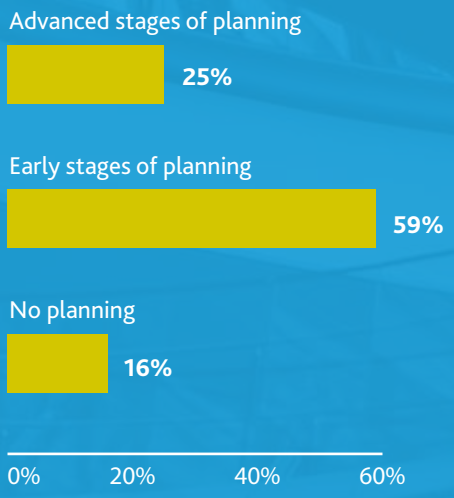
If UK firms lose passporting rights, regulatory equivalence of financial services between the UK and EU after Brexit should be maintained.



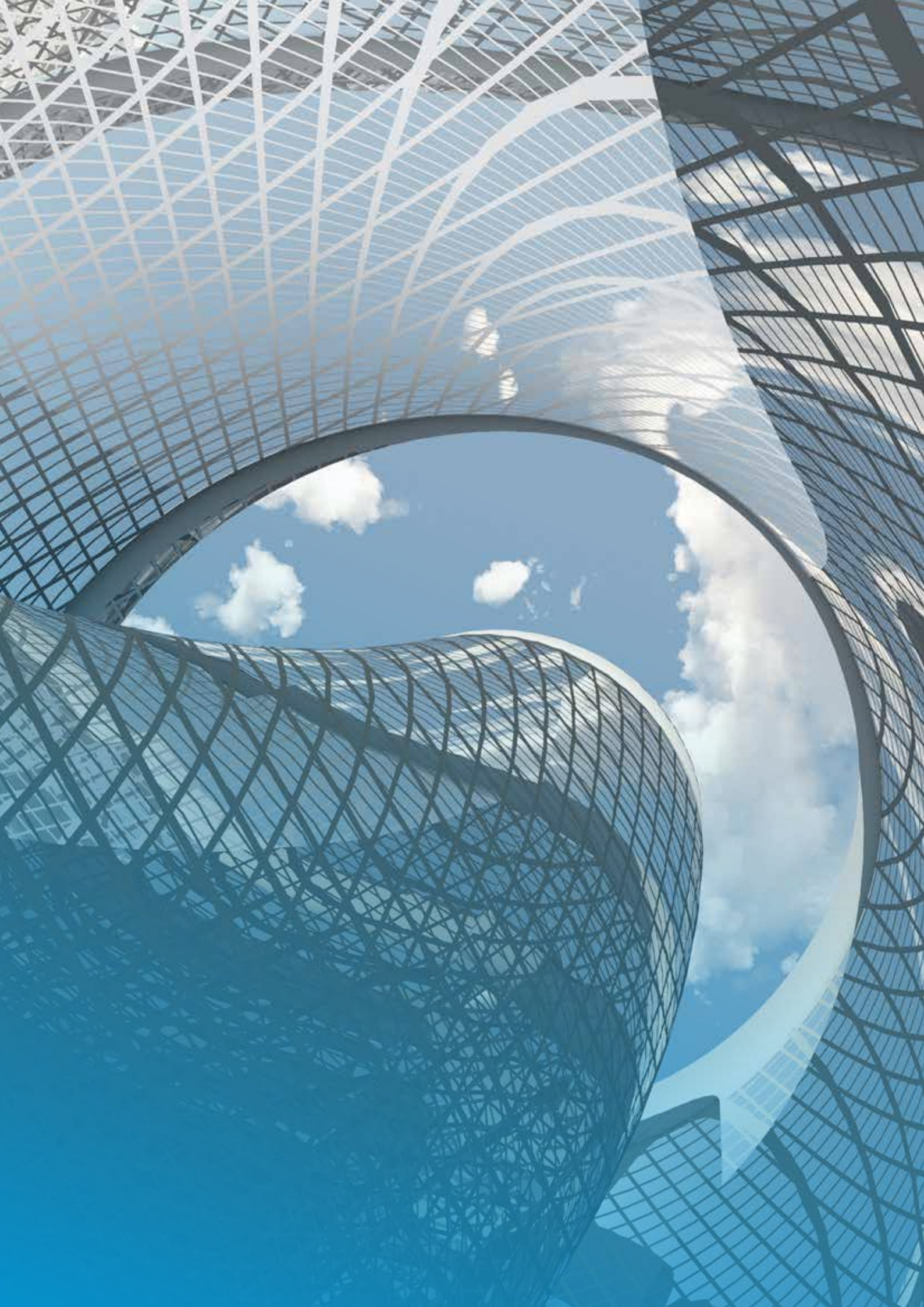
Do you expect Brexit to have an impact on your growth?



Have you put in place plans to deal with the impact of Brexit?



Chapter 2:
United we stand – collaborating through M&A and alliances



United we stand – collaborating through M&A and alliances

Our exclusive survey reveals that M&A and alliances are vital strategies for growth. In this chapter, we explore the drivers of and deterrents to dealmaking, the assets on offer and the regional picture

Fast-growing companies in the financial services sector believe in the power of collaboration. They are determined to work with a broad range of partners in order to harness new technologies, pursue their strategic goals and sustain or accelerate the high rates of growth they have achieved so far.

Moreover, these businesses are often agnostic about the form their collaborations should take, pursuing both M&A and less formal alliances according to what works best for the task at hand. Dealmaking plays an important part in the strategic plans of many companies in the sector, but so too do other forms of collaboration.

M&A on the rise

Significant numbers of fast-growing financial services companies cite M&A activity as having been one of the most important factors in driving the growth they have achieved so far. Almost a third of the respondents in this research (31%) pick out M&A as a vital driver of growth, behind only technology investment and successful marketing, sales and customer relationships.

This looks set to continue, with 28% of fast-growing businesses expecting M&A to continue to be a central plank of their growth strategy. "M&A offers opportunities for financial services businesses to grow and achieve their strategic objectives much more quickly," says Hannah Brader, a Partner at Pinsent Masons. "There are a number of headwinds in the sector right now, from more burdensome regulation to disruptive competitors, which mean that some businesses are having to look beyond organic growth."

Businesses are making acquisitions for a variety of reasons, but very often focus on the need to acquire new IP, including new talent and technology, or market share.

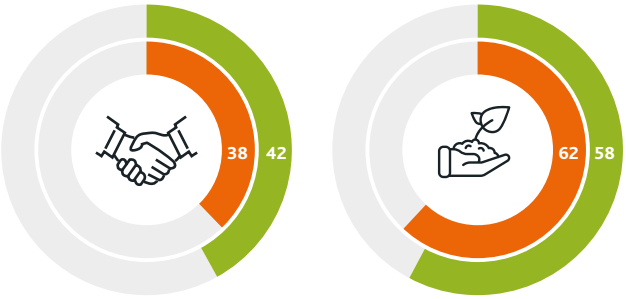
"The acquisition of technology to provide us with greater operational benefits and increasing market share are our greatest considerations," says the Head of Finance at a French financial services company. "We need to invest in the best targets that will assist us in our strategy."

In Italy, the CFO of another firm adds: "We are pursuing M&A deals with the intention of acquiring talent and IP that is unique and beneficial to us."

Importantly, many fast-growing businesses see M&A as having the potential to transform their growth prospects. In the past three years alone, M&A has accounted for an average of 38% of the revenue growth achieved by the fast-growing companies in this research; these businesses expect that figure to increase to 42% over the next three years.

It is for this reason that many businesses are now increasing the proportion of capital they allocate to dealmaking. The average firm in this sample has allocated 39% of capital to

What proportion of your firm's revenue growth over the past three years is attributable to organic growth/non-M&A activity and what proportion to M&A activity? What do you anticipate for the next three years?

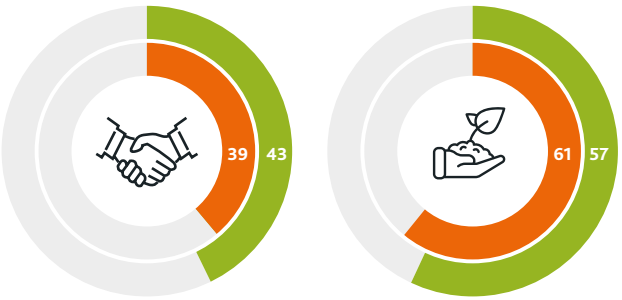


M&A (%)

Organic growth/ non-M&A activity (%)

Past three years Next three years

How has your capital been allocated between organic growth and M&A over the past three years? How will your capital be allocated between organic growth and M&A over the next three years?



M&A (%)

Organic growth/non M&A activity (%)

Past three years Next three years

M&A over the past three years, but this is now set to rise to 43% in the coming three years.

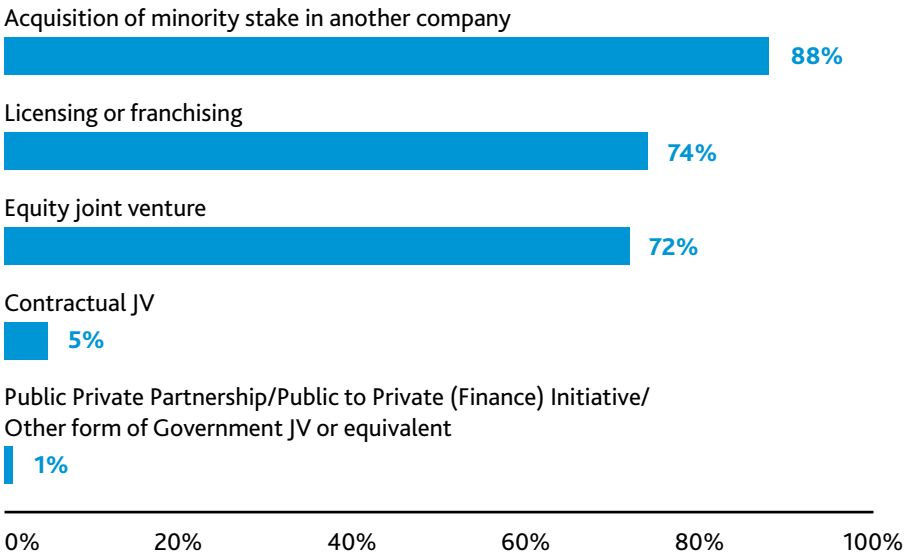
This recognition of the transformational role that acquisitions can play in strategic growth is likely to increase as organic growth becomes harder to come by. As the fast-growing businesses in this research scale up, M&A activity may represent their best chance of sustaining their current rates of expansion.

Reliance on alliance

Collaborations falling short of outright M&A are on the increase as fast-growing businesses seek more flexible and agile working relationships with their partners. Sometimes these alliances may lead to a deal, as the businesses naturally move closer together. In other cases, however, businesses may be collaborating in one specific area, but otherwise seeking to maintain their independence.

Almost nine in 10 fast-growing financial services companies have taken a minority stake in another company, potentially giving them greater access to the business' talent, technology and markets without a full-blown acquisition. Such alliances may give rise to issues of control and governance, which need careful management, but nonetheless represent an important opportunity for many businesses to pursue collaboration.

Which of the following types of alliance arrangements have you entered into over the past three years? (Respondents selected all that apply)



Other types of alliance are in vogue too. For example, almost three-quarters (74%) of these businesses have entered into licensing or franchising agreements, while similar numbers (72%) have engaged in equity-based joint ventures.

"These arrangements carry risks, such as lack of control for the investor, but also offer advantages for both parties," says Pinsent Masons' Hannah Brader. "They can be a way to harness the innovative and entrepreneurial spirit of a smaller company whilst allowing it to retain its independence, or to access a specific tool or technology whilst leaving the business free to continue developing it."

It is also notable that the vast majority of fast-growing financial services businesses (84%) expect to see more partnerships with Fintech and Insurtech firms over the next three years.

Some of the businesses in this research are Fintechs themselves, but as we have seen, almost all recognise the power of innovation and technology to drive future growth. For businesses able to harness the innovative and entrepreneurial spirit of Fintechs, the value of such alliances can be immense.

Deal drivers

In practice, fast-growing financial services businesses have a range of objectives in mind as they pursue M&A and alliances; moreover, very often a deal may be predicated on several of those objectives simultaneously.

However, certain themes dominate. More than half of the businesses in this research (58%) have agreed deals and alliances over the past three years in order to acquire IP or technology. And as the imperative for digital transformation becomes ever stronger, this is now set to increase: more than two-thirds (70%) of firms expect to do deals for this reason over the next three years. A further 12% are looking to acquire talent, twice as many as in the recent past – which itself could well be linked to the acquisition of technology and the skills needed to make the most of it.

Within your industry sector, do you anticipate that there will be increased partnering with Fintech/Insurtech companies over the next three years?

Expansion will also remain a prime objective. Almost half of these businesses (46%) look forward to transactions that will increase their market share, while 26% and 22% respectively cite a desire to move into new product lines or new geographies.

Deal deterrents

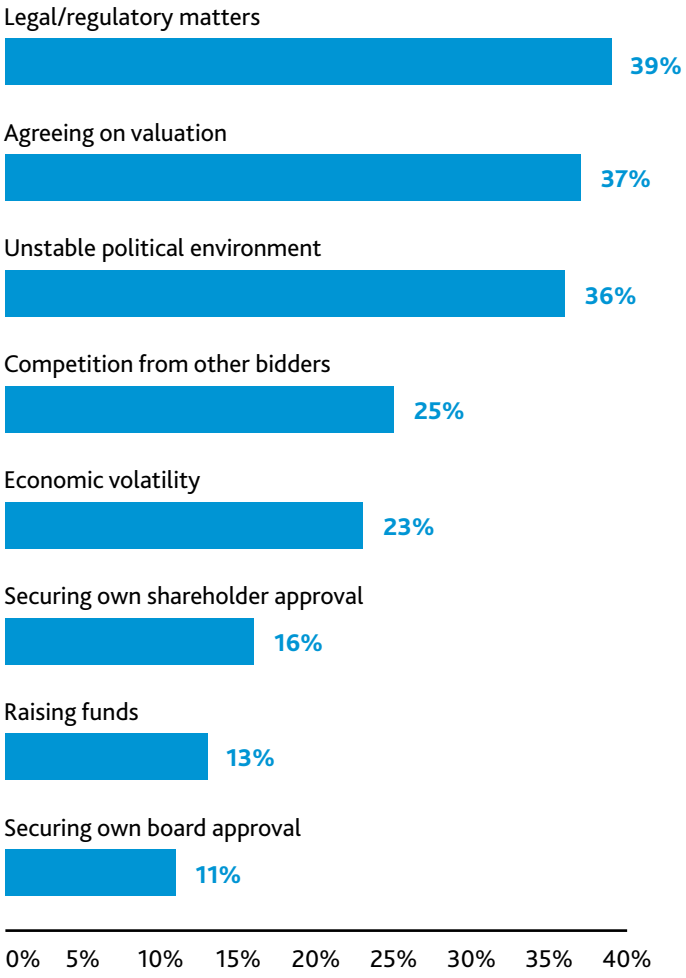
This is not to say, however, that such agreements are always straightforward – either to complete in the first place or to execute and manage successfully thereafter.

Fast-growing financial services businesses face some familiar challenges in this regard, with legal or regulatory barriers getting in the way of M&A for 39% of respondents. Meanwhile, 37% cite the difficulty of agreeing on a valuation. External factors are potentially problematic too, with 36% of fast-growing companies in financial services worrying about the unstable political environment and 23% citing economic volatility.

Moreover, points out Hannah Brader, the theme of consolidation can only go so far. "Some of these deals may give rise to merger clearance considerations," she warns. "That obviously won't always be an issue, but where you've got larger entities looking at consolidation to drive economies of scale, deals may need to go through the competition authorities."

Overcoming these hurdles is just part of the challenge for strategic M&A. Ultimately, the issue of whether the deal creates or destroys value will depend on how successfully new acquisitions are integrated. Many businesses may need to do more work on integration planning – and at an earlier stage – to give deals the best possible chance of success.

What have been the most important strategic barriers to M&A activity over the past three years? (Respondents selected top two)



> Some of these deals may give rise to merger clearance considerations. That obviously won't always be an issue, but where you've got larger entities looking at consolidation to drive economies of scale, deals may need to go through the competition authorities.

Hannah Brader, Partner, Pinsent Masons

United we stand – collaborating through M&A and alliances

The global opportunity

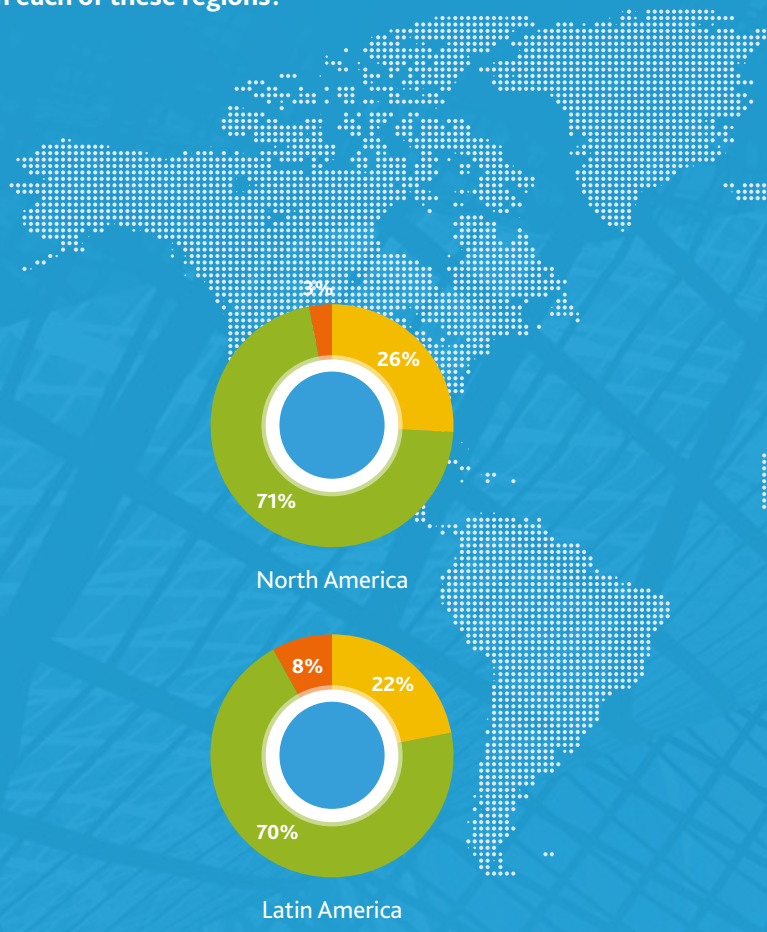
Europe's fast-growing financial services companies are increasingly global in their outlook, recognising the potential of new markets to drive their growth, particularly in regions such as Asia, where the number of middle-class citizens with the means and appetite to buy financial services is now growing rapidly.

Europe itself will continue to be a crucial market for these businesses. Almost three-quarters (71%) of fast-growing firms expect to target another Western European business over the next three years. However, this is down on the 80% seen over the past three years, with other regions picking up accordingly. Some 12% of firms look forward to targeting companies in Asia, a third up on the past three years.

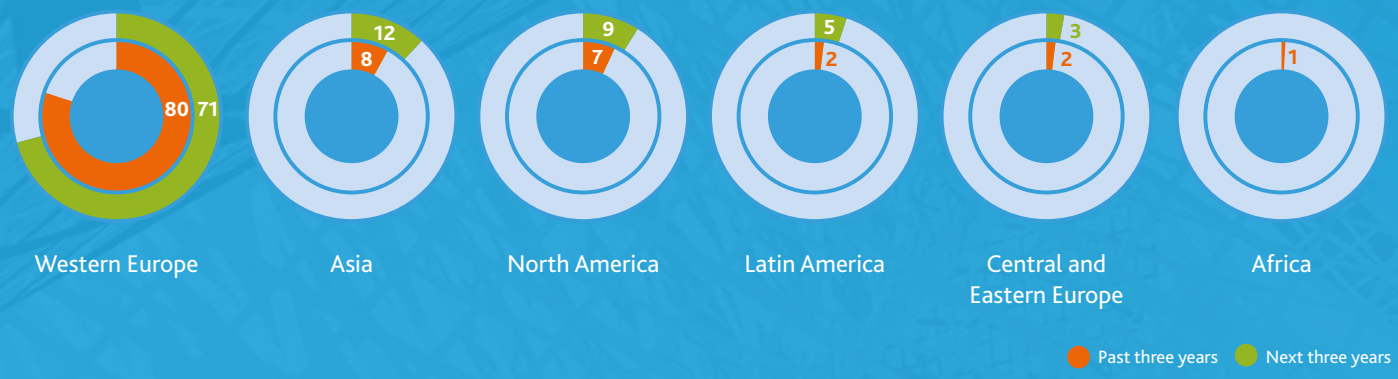
And fast-growing financial services businesses have high hopes for these new marketplaces. Some 47% expect the market for their products and services to increase greatly in Asia; 33% say the same of the African market. By contrast, in more mature markets, fewer respondents expect demand to increase greatly, with Western Europe (27%) and North America (26%) offering less enticing growth prospects.

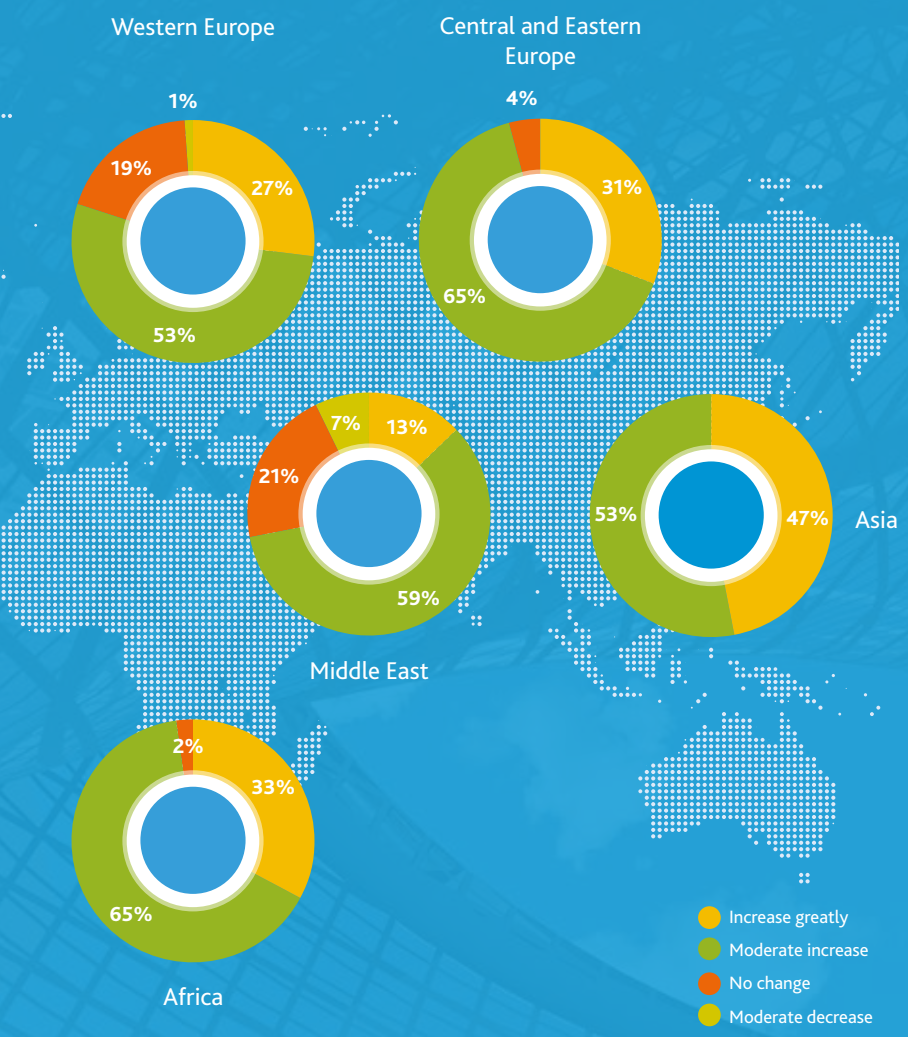
"The largest financial services businesses will already have a global presence, but smaller fast-growing companies will very often have begun by concentrating on their home markets," says Pinsent Masons' Hannah Brader. "That will likely change over time given the growth potential of emerging economies, with their rapidly growing middle classes and the extra demand for financial services they bring."

What are your expectations for the market for products and/or services in your sector over the next 12 months in each of these regions?



In which regions have you targeted companies in the past three years? In which regions will you target companies over the next three years? (Respondents selected most important)




Western Europe
1%
19%
27%
53%
Central and Eastern Europe
4%
31%
65%
7%
13%
21%
59%
Middle East
53%
47%
Asia
2%
33%
65%
Africa
Increase greatly
Moderate increase
No change
Moderate decrease

Snapshot: Alternative lending

Alternative lending: a definition
Alternative lending is a type of non-bank digital financial service for consumer and business customers. There are many different types of consumer and business alternative lending examples including invoice trading, equity-based crowdfunding, debt-based securities and peer-to-peer (P2P) lending.

Our survey reveals that a sizable proportion of fast-growing financial services businesses believe that alternative lending will thrive in the next three years in Western Europe

A third of the fast-growing financial services companies in this research (33%) see alternative lending as one of the two areas of the industry most likely to see rapid growth in Western Europe over the next three years. This is second only to Fintech/Insurtech in terms of perceived growth sectors.

The alternative lending sector has the potential to play a key role in the continued expansion of many fast-growing financial services companies for two different and quite separate reasons. First, some of the fastest-growing firms are facilitators of alternative lending, building platforms that disintermediate traditional bank lenders by directly connecting those with capital to lend and those looking to borrow it. Second, alternative lending represents an important new source of capital for fast-growing businesses in need of funding to underpin further growth.

Certainly, this is a sector that has already grown rapidly in recent years. "What started out as a small, niche market with crowdfunding and P2P finance has changed over time," says Pinsent Masons' Partner Tony Andersen. "You're now seeing more participation by financial institutions and private equity, which wasn't the intention at all at the outset."

Pick up the pace

By 2016, the most recent period for which data is available, the total alternative finance market across Europe was worth €7.7bn, according to the Cambridge Centre for Alternative Finance. That was a 41% annual increase. The UK leads the way with an alternative finance marketplace that is worth €5.6bn, with France (€444m), Germany (€322m) and the Netherlands (€194m) following behind.

Indeed, outside the UK, P2P consumer and business lending accounts for some 51% of the total European alternative finance market.

In recent years, new forms of finance have come to the fore, including balance sheet business lending, debt-based securities, mini bonds and several real estate-linked variations on the theme.

Moreover, many leading players in alternative finance are now innovating at pace. In the equity crowdfunding space, for example, this year has seen several platforms launching secondary markets, improving liquidity and hopefully widening the pool of potential investors as a result.

> I think you're going to see more collaboration potentially between traditional lenders and Fintechs in this space. Banks understand they will need to change their behaviour to participate in these fast-growing new markets and alternative lending is one example of where they are beginning to do so.

Tony Anderson, Partner, Pinsent Masons

In the lending segment, secondary markets are already well-established, a series of collective funds are now offering managed exposure to debt finance for both businesses and consumers, and many platforms are focusing on benefits such as streamlined payment processing and customer verification.

A new dawn?

Pinsent Masons' Tony Anderson suggests the next leap forward for the sector could be to piggyback on the UK's open-banking revolution, which requires banks to offer access to customer data to authorised third parties. "When you think about the financial reporting that borrowers typically have to provide to lenders on a quarterly or monthly basis, such as balance sheets and various financial covenants, open banking will give those lenders the ability to look at the financial data of borrowers at any time," he says. "The regular reporting cycle is going to be circumvented by this new relationship between the lenders and borrowers; that could give lenders the comfort they need to operate with less security, for example."

The bottom line is that the growth of the alternative lending market across much of Europe is powered by its mutual benefit. For the businesses behind alternative finance platforms, the sector is a prime example of how digital disintermediation can provide good profitability while still offering margin to share with customers without taking on the risk of lending.

For lenders, meanwhile, the attraction is good levels of yield at a time when income is in short supply, gleaned from a diversified pool of assets. Finally, for borrowers, alternative lending has stepped into the gap left by traditional bank lenders now constrained by much more demanding capital requirements, particularly in areas such as lending to small and medium-sized enterprises.

Given this virtuous cycle and the growing maturity of the market, Pinsent Masons' Tony Anderson suggests the market may now come full circle. "I think you're going to see more collaboration potentially between traditional lenders and Fintechs in this space," he says. "Banks understand they will need to change their behaviour to participate in these fast-growing new markets and alternative lending is one example of where they are beginning to do so."

Taking account

Emma Steeley, Commercial Director of AccountScore, a fast-growing company which provides bank transaction details for companies, discusses the factors that contribute to fast growth in the financial services sector

Emma Steeley, Commercial Director of AccountScore

Digital transformation is a big theme for fast-growing companies in the financial services segment. What do you think this means for companies in the sector?
Emma Steeley (ES): In terms of digital transformation, growth is driven by optimising the processes, creating greater efficiencies within the business and then being able to deliver greater revenue.

Open banking is obviously a big part of that for us. A good example is where a bank is now provided visibility on a new-to-bank customer and they're able to use third parties to deliver the data in such a way they enable them to make informed, real-time lending decisions on data that was previously unavailable.

There are many parts to the puzzle. First, accessing the data, then analysis. Then being able to ingest the data and incorporate it into lending scorecards that provide richer user experiences, and larger choices to the financial services provider for the consumer.

How much progress do you think the big financial services companies are making with digital transformation?
ES: It will take some time because there are very complex legacy systems in place, which can be difficult to change quickly.

The customer is expecting a seamless experience, and often the customer-facing changes are easiest for a corporate but these have to go hand-in-hand with the backend changes. And we've got to give them the time to be able to do that.

One thing that really comes out of the survey is that for fast-growing companies, collaboration is key. Do you see a lot of collaboration in practice?
ES: I completely agree. All companies have got to think openly when it comes to alliances. A one-size-fits-all approach is highly unlikely to succeed.

In our experience, Fintechs have got the ability to drive new business models within the bank, but the bank still maintains the public-facing brands that are able to maintain the customer's trust.

What kind of arrangement works best between Fintechs and the bigger financial institutions?
ES: One of the keys to successful collaboration is that the big financial services firms understand the requirements and capabilities of Fintechs. You know, a lot of that sits around the information security, the regulation piece, the legal and compliance, because the Fintechs often don't have a large team to be able to deal with that.

The most successful collaborations that I've worked with have been where there has been a complete understanding and mutual engagement with the projects on both sides.

There needs to be a constant conversation. But there also has to be a cultural shift – one partner does not fit all needs. There will need to be a variety of partners collaborating with the firm to make everything work. The bigger firms need to bring these partners together and really make it work.

While I still think bigger firms will continue to take equity stakes in Fintech firms, I feel that could restrict the Fintech organisation. The smaller firm may end up getting swallowed up, as opposed to doing what they initially set out to do. As soon as the Fintech loses its ability to be nimble and adapt, then that's when the original promise is unlikely to be delivered.

Our survey found that, from a digital spend point of view, the customer experience was paramount. But in your experience, is the behind-the-scenes stuff getting the attention that it should?
ES: Absolutely not, 100% no doubt about it. We know that the customer wants to have this seamless experience and the better the experience, the more the customer is engaged. But if the backend is not working as expected, then it creates a massive backlash. So the internal systems have to be maintained, otherwise you're in a whole world of trouble.

Right across the board from the smallest Fintech to the largest banking corporation, they've got to be investing and ensuring that everything is working as it should be.

What are the biggest challenges to successful digital transformation?
ES: The main issues that I've encountered are employee pushback, lack of expertise to lead a digitisation initiative, a lack of overall digitisation strategy, and a limited budget.

If you have a cohesive plan that sets out the objectives within a business that is well communicated to an organisation, that's what tends to lead to the success of a digital transformation.

How can companies keep up with the pace of change?
ES: Firms need to be more intelligent when it comes to understanding customer needs. That's something that is very important. The ability to act on real-time intelligence is impacting the industry as a whole and it will drive revenue and profitability now and in the future.

I think that financial services are starting to interact differently now with their customers. It's moving towards the context of exchange, which I personally think has never been more vital when it comes to acquiring new customers and providing the very best service and experience for existing customers.

Investing in excellence

Timothy Karpoff, Group Head of Strategy and Corporate Development at Barclays, talks about the characteristics that the bank looks for when investing in new businesses

Timothy Karpoff, Group Head of Strategy and Corporate Development at Barclays

As a large, mature company, when you invest in fast-growth companies, what characteristics are you looking for?
Tim Karpoff (TK): I think the most important thing is going to be strategic adjacency. That is to say that the company one is looking at providing something that is going to advance the underlying strategy of Barclays – something that fits with the broader set of services we already provide, or something that our customers or clients are definitely going to need.

The next point is exploring whether the partnership is going to deliver something better than a bespoke solution that we could create internally.

Our survey found that the fast-growing companies were very collaborative. Is this a factor that you look for when you are investing?
TK: Absolutely. When you're going to partner with someone, you want to make sure that there's not only the strategic fit, but that cultures are complementary as well. We're obviously a fairly large institution, but there are ways of working that we value. And the manner in which a fast-growing company or start-up conducts itself, and how it gets things done, is important when you're considering whether that's somebody with whom you want to establish what you hope to be a longer-term partnership.

The companies we interviewed were very much focused on technology. What do you see as the major transformations that are going to occur in the industry over the coming years?
TK: I think that you will see differences between what the customer experience is, and then what the middle and back office of financial services looks like. So, on the front end, I think that the march towards digital as the primary interface that customers and clients use will continue and will only accelerate.

At Barclays, our mobile app is an extremely effective channel for engaging with our customers. And I think that this phenomenon will only get turbo-charged as open banking gets more and more ingrained into the culture, such that individuals are going to want their entire financial position available through one portal.

And this requires an integrated application that can aggregate all of that information into a digestible format for the customer and client. So I think that that will be, from the customer's perspective, the biggest trend that we'll see here in the UK. The back and middle office is going to be less immediately apparent to the customer, but no less important over the long term.

And from my perspective, the march towards automation in the back and middle office will continue. And that not only will mean cost reduction and lower cost to serve for the biggest institutions, but it will also mean a delivery of improved products and services for customers and clients. This is due to the fact that propositions will be based on larger, more accessible data sets, which are then powered with 21st-century analytics such as artificial intelligence, and machine learning. This should allow companies to deliver better-priced propositions and also to deliver propositions, at moments that otherwise wouldn't be the first interaction between a financial services provider and a customer. For example, companies will have the predictive capability to understand when a customer is going to need a car loan, before the customer goes shopping for an automobile. I don't think it will be immediately apparent to the customer, but over time people will just take it as normal.

How do you effectively integrate fast-growing companies?
TK: Often you're looking at a stake rather than full integration but you will still be working with that company, and taking its service, so understanding how best to integrate that service into your offering is critical.

I feel the most important thing is setting out the rules of the road and establishing clear principles on how you are going to work together that serves to align the incentives between partners. And a well-designed partnership agreement upfront – which, quite frankly, can be challenging to negotiate – serves everybody better in the long run. Punting these types of issues only leads to pain later.

What are the challenges of allying with or investing in a fast-growing company?
TK: If their business strategy and our needs over the foreseeable future are not well aligned, then that sends up a red flag. For example, if the company is really focused on sales and market share in the very near future, and we're really focused on continued development of the product, that's a red flag. Because their priorities and our priorities are different, you will eventually get to a divergence which is going to be difficult to reconcile.

And what are the major risks facing fast-growing businesses in the financial services sector at the moment?
TK: In the last few years, the macro environment has been quite conducive to the development of start-ups and fast-growing companies. Money's been cheap and life has been relatively calm.

But we're entering a time where it's possible that the macro environment will become more volatile. The cost of funds will rise and that is a different operating environment. And I think that will be challenging, both from a funding perspective and from the risk appetite perspective of potential clients and customers of start-ups and fast-growing companies.

Pace, people and process put fast-growing companies ahead of the pack

Aviva Ventures' Ben Luckett discusses the role of agility, leadership and risk when investing in a fast-growing financial services company

Ben Luckett, Managing, Director of Aviva Ventures

Our research suggests that three particular attributes characterise fast-growing companies in particular: their spirit of collaboration, their focus on technology and their sense of collective purpose. Have you seen those attributes in practice?

Ben Luckett (BL): It's really the first and the third attributes that stand out for me, because the ability to collaborate and that sense of purpose are really linked to being able to execute at pace – that's what fast growth requires.

How do these companies execute at pace?

BL: You need a certain amount of process that means things don't and can't get in the way. You need the right people who understand what moving at pace actually means and how to do that because part of it is people's ability to get others to do work at the same pace. The classic thing on process is the massive change that we've seen over the last few years around agile working and moving from a more traditional sort of waterfall approach to a much more agile process.

Within financial services, the environment needs to be conducive to moving at pace particularly from a regulatory standpoint, which is why we've seen the Financial Conduct Authority (FCA) developing the sandbox because it recognised that one of the things that defines moving at pace is the ability to test and learn rapidly and deploy things iteratively rather than once every six months.

What dangers do investors need to be wary of with fast-growing companies?

BL: The question I always look at is whether the business has the right balance of people to sustain its growth – do they have the right leadership team in place, bearing in mind that the founding team may not have the right capabilities to grow the business to the next stage, and can they recruit the best people?

What are the big risks facing fast-growing companies in Europe right now?

BL: Some of the risks are going to be sector-specific but one challenge we see is with raising later-stage growth capital. There's a great deal of tax support for early-stage investors, but that isn't necessarily the case later on and that means the appetite can sometimes be lessened.

Talent is also a challenge. In the financial services sector, you need to ask whether there will be mismatch between the level of talent required – particularly in some of the new and emerging technology fields such as machine learning. Are companies getting the right balance? And that's quite a significant risk as things grow and go forward – the gap between talent, capability and need.

What about Brexit?

BL: I do think it's becoming more challenging, though one quality of many fast-growing companies is that they are able to manage ambiguity. Still, I spoke to one fast-growing financial services company from Germany recently that had been poised to expand into the UK but their thinking had changed on the back of Brexit uncertainty.

I also believe it depends on your business model, on your market and, for really fast-growing companies, I think one of the reasons they're successful is probably their ability to manage uncertainty. Maybe it's more of a threat for those who can't handle that kind of volatility and, by their nature, aren't as fast growing.

The majority of companies have funded their growth through debt and intend to continue to do so. Are you wary of companies taking on too much debt?

BL: We sometimes come across companies that are too leveraged, but we do support debt funding when it's the right thing to do for the business – for working capital and cash flow, for example. It needs to be a balance.

At what point does an IPO make sense? Our research suggests relatively few fast-growing companies have initiated IPOs in the past three years, but those that have gone public say it has boosted their growth.

BL: I guess it really depends on strategy and why you're looking to raise capital. There is also a question of losing some control once you put yourself at the mercy of other factors. When you have a wider and broader shareholder base, then obviously it's a different investor conversation.

I also think there's a certain level of maturity and stability needed before you go through that process. It's a time-consuming and tricky process which you don't go into lightly.

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