The FinTech Industry's Outsourcing Needs

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Introduction

Following the 2008 financial crisis, when FinTech startups began to emerge, naysayers dismissed them as yet another tech fad, a blip in the global financial market. And yet, they persisted and gained popularity among consumers due to their unique Customer Experience Management (CXM)-focused value propositions with innovative solutions and multiple touchpoints.

In the intervening years, the FinTech industry has registered significant growth. In recent years, however, while the number, diversity, and scale of the new players in the market have grown significantly, they have run into challenges related to operating efficiently at lower cost.

In this report, we explore the FinTech industry's outsourcing needs, focusing on the following key questions:

- What does the FinTech industry landscape look like?
- What parameters are needed to map FinTech on a maturity lifecycle model?
- What key challenges do FinTech operations face, and what are their associated sourcing needs?
- How can FinTechs best address their operational challenges?

This report will enable FinTechs to determine their operational sourcing strategies.

Overview and rise of FinTechs

FinTechs are transforming the global financial services landscape. In 2021, FinTechs raised US$138.8 billion – a 180% year-over-year increase in investments. Driven by consumer adoption, FinTechs of all types are well positioned to continue to outpace the broader financial services market and its traditional players.

What is a FinTech?

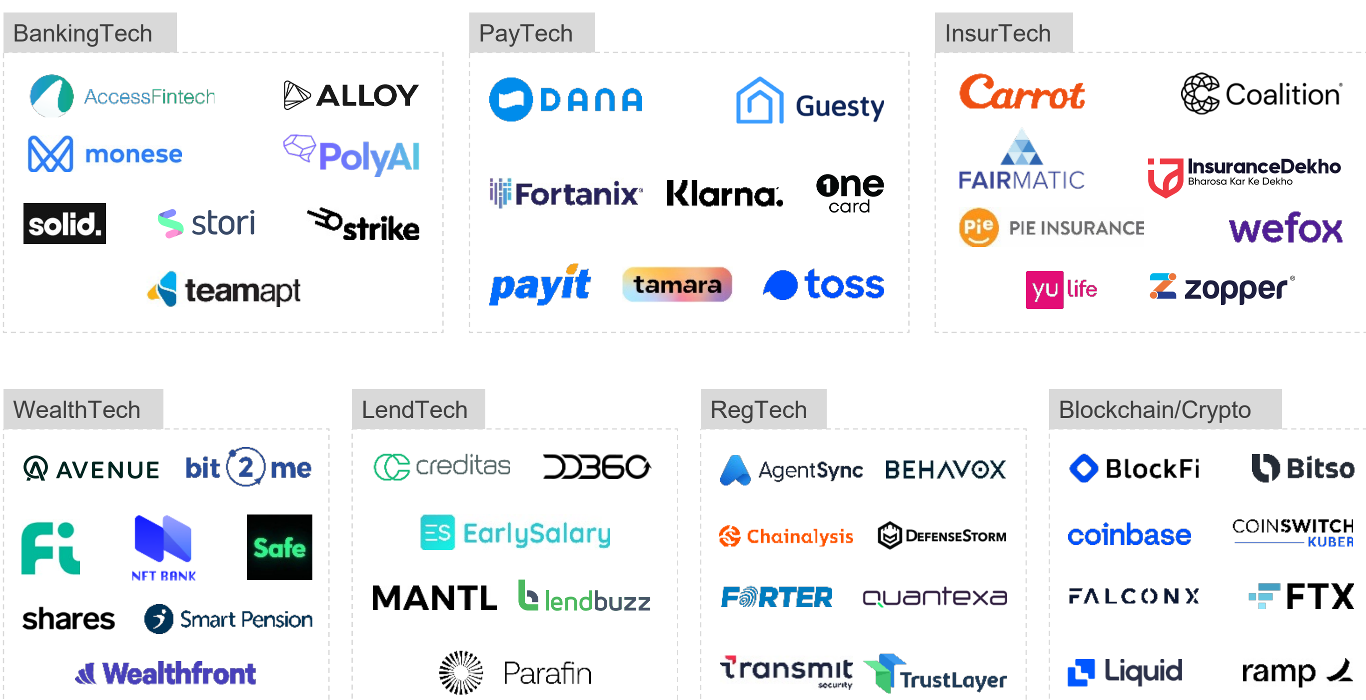
A FinTech is an institution or company that provides specific financial services but that is not affiliated with a conventional financial services firm such as a bank or a credit union. While FinTechs offer financial services such as banking, payments, and insurance, among others, incorporating the use of the latest technologies, they are not considered conventional financial services institutions.

Exhibit 1 depicts the various Lines of Business (LoBs) across the FinTech landscape.

EXHIBIT 1

FinTech industry segment map

Source: Everest Group (2023)



Current state of the FinTech market

In the first half of 2022, multiple factors, including geopolitical tensions, turbulent financial markets, ongoing supply chain disruptions, the global talent crisis, and rising inflation and interest rates, affected the global FinTech industry's growth trajectory.

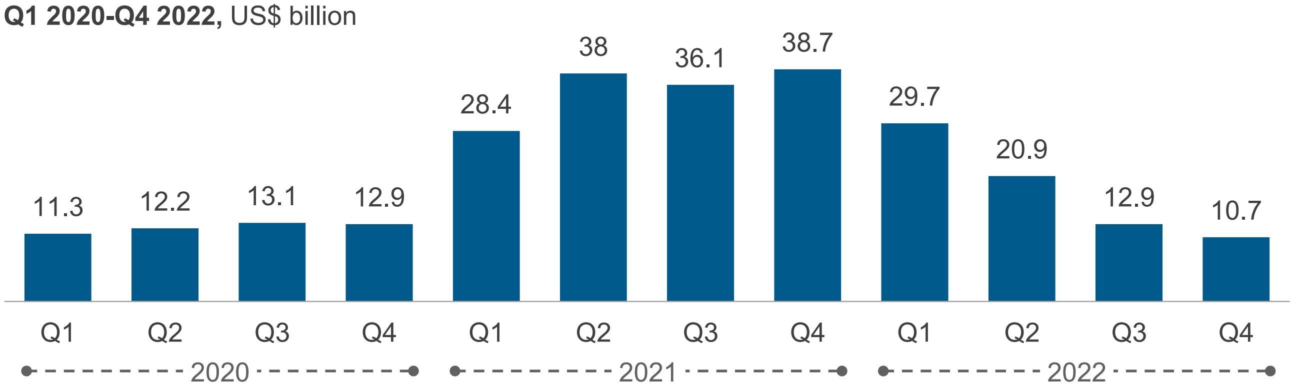
With no near-term relief from market volatility and the fear of a recession looming FinTech investments in 2022 saw a significant year-on-year decline, as Exhibit 2 indicates. However, instead of seeing this as an investment decline, we believe it is accurately characterized as a recalibration of the global FinTech market to pre-COVID levels.

EXHIBIT 2

Quarterly global VC-backed FinTech financing

Source: Everest Group Estimates, CB Insights

Q1 2020-Q4 2022, US$ billion



Over the last few years, FinTechs have cornered significant financial services industry market share as a result of rising digital adoption, as indicated in Exhibit 3.

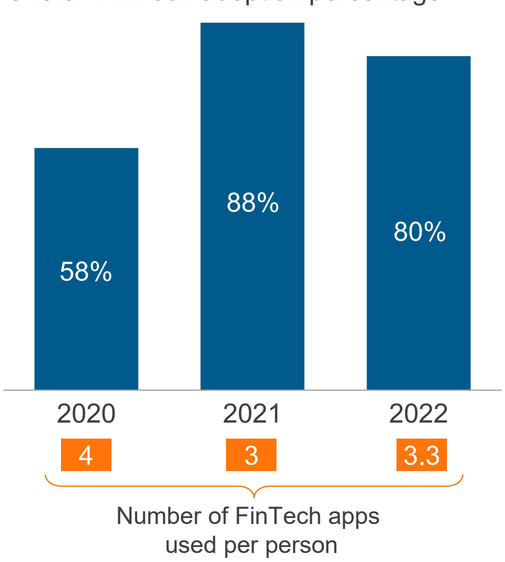
EXHIBIT 3

Rising FinTech adoption

Source: The FinTech Effect 2022—Plaid's Research;
Finserv Quarterly Consumer Trends Research, November 2021 and The Harris Poll

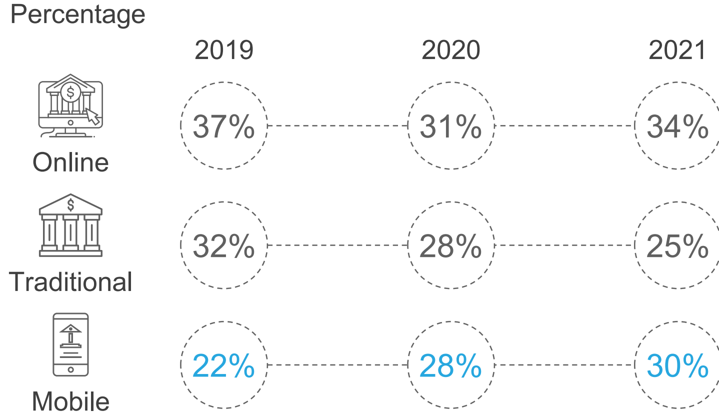
Number of FinTech apps per user rose while overall adoption remained high

Overall FinTech adoption percentage



Preferred methods of interaction with primary financial organization

Percentage



For the first time, **mobile has overtaken traditional branches** as the preferred method of interaction by users.

Online mode of interaction remains the top choice.

FinTech industry trends

Recent major market trends and sentiments have impacted the global FinTech industry in a variety of ways:

- During the past 18 months, there have been market corrections due to an impending recession, market volatility, and COVID-19 pandemic-induced overconfidence, which is evident from the drop in FinTech VC funding and fewer new FinTech unicorns
- FinTechs are increasingly relying on B2B solutions and shifting focus to embedded and data-driven solutions across banking, payments, and insurance, among others
- Operational efficiency is becoming an imperative, without compromising on FinTechs' innovative capabilities of Blockchain/cryptocurrency FinTechs have slowed, while RegTechs have grown
- There has been a push for a common regulatory framework for cryptocurrencies and blockchain/cryptocurrency-based FinTechs
- There is a rising need for FinTechs to focus more on building personalized customer connects and offering consistent user experience (UX)
- FinTechs need to explore more innovative models and go-to-market strategies to engage with other market players
- Banks are adopting the FinTech model to become more innovative and nimble with their offerings, with FinTechs hoping to become banks in order to offer better financial solutions and build complex lending products better suited to their growing customer bases

The FinTech maturity lifecycle model

As FinTechs grow and scale their operations, they progress through multiple maturity stages that can be broadly classified as: validation, scale up, and mature, depending on various parameters that we discuss in this section. Moreover, for FinTechs to scale and grow without compromising on their agility and innovation, they need to pay attention to their maturity stage to address their unique operational challenges efficiently.

Relevant parameters needed to map a FinTech on the maturity lifecycle model

It is important to identify an organization's maturity stage, as business priorities vary based on the FinTech's stage. In the validation stage the focus is on market validation, funding and surviving. In the scale-up stage it is largely about entering new markets, expanding and hiring. The mature stage focuses on scaling operations with lower margins and addressing competition, while there is limited scope for innovation/diversification. Understanding the stage is vital to being able to prioritize operational challenges; FinTechs need to map themselves accurately on the maturity lifecycle model in order to understand their unique operational challenges and identify the optimal operational solution mix.

When defining their maturity lifecycle stage, FinTechs need to consider multiple parameters including:

- **Funding stage:** As a FinTechs moves up in the maturity lifecycle, the financing stages also evolves accordingly staring from a seed/series A funding, then moving on to series B, series C, series D and further rounds

- **Annual revenue:** Revenue growth is considered a definite indicator for any FinTech's maturity level, in large part because as the FinTechs mature, its market share will grow proportionately. Further, this additional revenue could be needed to reinvest to continue the business growth journey
- **Product maturity:** FinTech products will evolve from minimum viable offerings to market standard; it is vital to understand where products are along this life cycle
- **Market penetration:** As FinTechs mature, solutions focus moves from pilot/market discovery to customer segment-specific focus and then evolving toward market saturation
- **Operational maturity:** Operational maturity can be classified into three broad categories: inception, growth, and expansion. While a FinTech needs to design its operational processes from scratch in the early stage, as it matures its emphasis shift toward automation and analytics, and ultimately to scalability and operational adaptability

FinTechs can use the combination of parameters depicted in Exhibit 5 to map themselves on the maturity lifecycle model, an exercise that forms the basis the analysis that follows.

EXHIBIT 4

FinTech maturity lifecycle model

Source: Everest Group (2023)

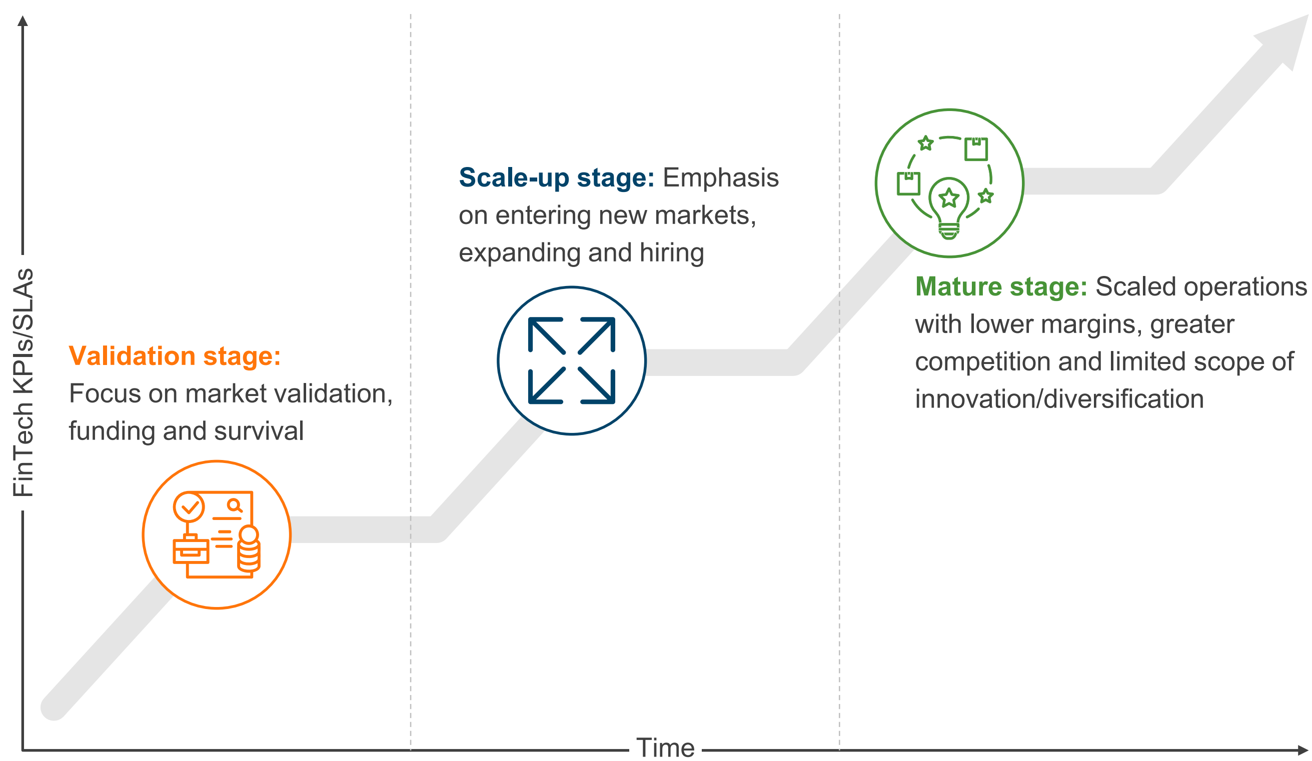


EXHIBIT 5

Key decision-making parameters needed to map FinTech on maturity lifecycle model

Source: Everest Group (2023)

	Validation stage	Scale-up stage	Maturity stage
Funding stage	Seed ($ 0-4m) / Series A ($ 4-15m)	Series B ($ 15-40m) / Series C ($ 40-100m)	Series D ($100-250m) / $ 250m+
Annual Revenue	Up to US$ 300,000	US$ 300,000-1,000,000	More than US$ 1,000,000
Product maturity	Minimum viable product or first-generation product	Product replication or product market fit	Established product
Market penetration	Market discovery/Pilots	Customer segment focus	Market saturation
Operational maturity	Inception stage: Designing new processes, mapping regulatory requirements, and establishing risk management	Growth stage: Operational transformation through automation, analytics, and performance management measures	Expansion stage: Conformance to new regulations, operational adaptability and scalability

Key challenges for FinTech operations and associated sourcing needs

FinTech-offered services differ from those of conventional financial services firms; comprehending this difference is key to understanding their distinct sourcing priorities. Furthermore, a FinTech's sourcing requirements will vary depending on its maturity stage.

Why are FinTech sourcing needs different?

When compared to other conventional market players, FinTechs operate in a more dynamic environment. Their operational needs change overnight owing to the ever-evolving regulatory landscape or a change in their overall strategy driven by market or investor sentiments.

FinTechs' value propositions are distinct from BigTechs' and traditional financial services firms', with unique sourcing implications in areas such as:

- Charges/Value of money
- Extent of personalization
- Consistency of end-user experience
- Breadth of product portfolio
- Degree of digital adoption
- Regulatory oversight

EXHIBIT 6

Major differences between conventional financial services firms, BigTechs, and FinTechs

Source: Everest Group (2023)

Low ○○○○○ High

	Conventional financial services firms	BigTech	FinTech
Value for money	●●●○○	●●●●○	●●●●●
Extent of personalization	●●●○○	●●●●○	●●●●●
Consistent End User Experience	●●●○○	●●●●●	●●●●○
Product portfolio breadth	●●●●●	●●●●○	●●●○○
Degree of digital adoption	●●●○○	●●●●○	●●●●●
Regulatory oversight	●●●●●	●●●●○	●●●○○

The sourcing implications for FinTechs based on these differences include:

- Most FinTechs offer high personalization, impacting their sourcing priorities, so they need to partner with firms that deliver services with high customer experience
- Given their high degree of digital adoption, FinTechs often partner with technology solution providers for building robust tech capabilities. This would essentially require staff augmentation with talent transformation as a major value add, and empowers the FinTechs to deliver end-to-end services
- FinTechs offer fewer products and often also lack scale to deploy some services, making their sourcing needs specialized in nature and smaller in scale. This feature also makes them more receptive to end-to-end offerings
- FinTechs have less regulatory oversight than traditional banks and are, therefore, less mature in regulatory processes and reporting. They often look for consulting support with process outsourcing
- While FinTechs have established tech capabilities, there are inconsistencies in their operational models that drives up their costs, and in order to relegate this, operational support from third parties is needed
- FinTechs' operational requirements may evolve overnight either due to the changing regulations or some other market forces and sentiments. Hence, FinTechs need sourcing partners who are nimble and can support their dynamic requirements on the fly at all fronts – be it scaling up/down on human resources deployed or agile project implementation
- In order to deliver consistent high quality customer experiences, FinTechs need to leverage data around customer behavior and other operational metrices via the use of proactive and predictive analytical models, and use these insights to evolve their products and offerings
- FinTechs are predominantly based on a niche technology or cutting-edge digital breakthrough. As a result, FinTechs often lack domain depth and visibility around the overall industry. Hence, while looking for an ideal sourcing partner, FinTechs should make sure that in addition to providing the basic sourcing needs, the partner also brings in deep domain expertise, industry knowledge and advisory support capabilities

FinTech operational trends

The key operational trends and major challenges the FinTech industry faces include:

- **Regulatory and compliance challenges:** As FinTechs are growing, they are drawing increasing attention from regulators worldwide. With the changing regulatory climate, more checks, screenings, and continuous process updates and staff training are necessary to remain compliant. The risks of non-compliance are huge – heavy penalties, sanctions, and reputational damage, among others
- **Rising fraud, data security breaches, and the need for cybersecurity:** As FinTech customers increase, fraud is on the rise, particularly targeting first-time FinTech customers (and their data). On top of that, the increasing sophistication of the frauds poses a challenge for FinTechs in fighting cybersecurity threats
- **High cost of operations / need for end-to-end operations capability:** The global recession, a global talent shortage leading to high labor costs, and high interest rates have limited FinTechs' ability to increase revenues, resulting in increasing pressure to reduce costs. To be more profitable, FinTechs need to increase operational efficiency

- **Lack of geographical diversification:** With the recent geopolitical tensions and heavily impacted global supply chains, FinTechs need to geographically diversify their operations to reduce the concentration risk and benefit from low-cost location
- **Competition with BigTech:** BigTech players such as Google, Meta, and Apple, among others, are not only creating competition, but also disrupting the financial services industry at scale. With their limited resources, FinTechs often find it difficult to compete with the BigTechs
- **Delivery assurance is key:** As FinTech offerings become increasingly complex, they need to retain and regain customer trust. Services delivery assurance and the resultant customer experience will be critical for FinTechs to continue to grow and offer more complex products and services

Varying operational challenges depending on the FinTech's maturity lifecycle stage

Operational challenges depend largely on the FinTech's stage on the maturity lifecycle model.

For a validation-stage FinTech, trying to focus on market validation and building trust and credibility among customers, data privacy and cybersecurity pose the most important operational challenges as they usually require highly qualified talent – generally a limitation for a validation-stage FinTech. Challenges like regulatory and compliance, competition with BigTechs, and geographical concentration risks are not given priority as the volume at this stage of maturity is not high enough.

However, as soon as a FinTech moves to the scale-up stage, consistent service delivery assurance becomes the highest priority, as the emphasis shifts to entering new markets and expanding and retaining the customer base, followed closely by regulatory and compliance challenges.

And finally, for a mature-stage FinTech which, by now, has likely implemented some operational frameworks to lower the cost of operations or to mitigate data security breaches, the relevance of regulatory and compliance increases as it joins the "too big to fail" club. At this stage of maturity, competition with BigTechs also becomes a major challenge.

EXHIBIT 7

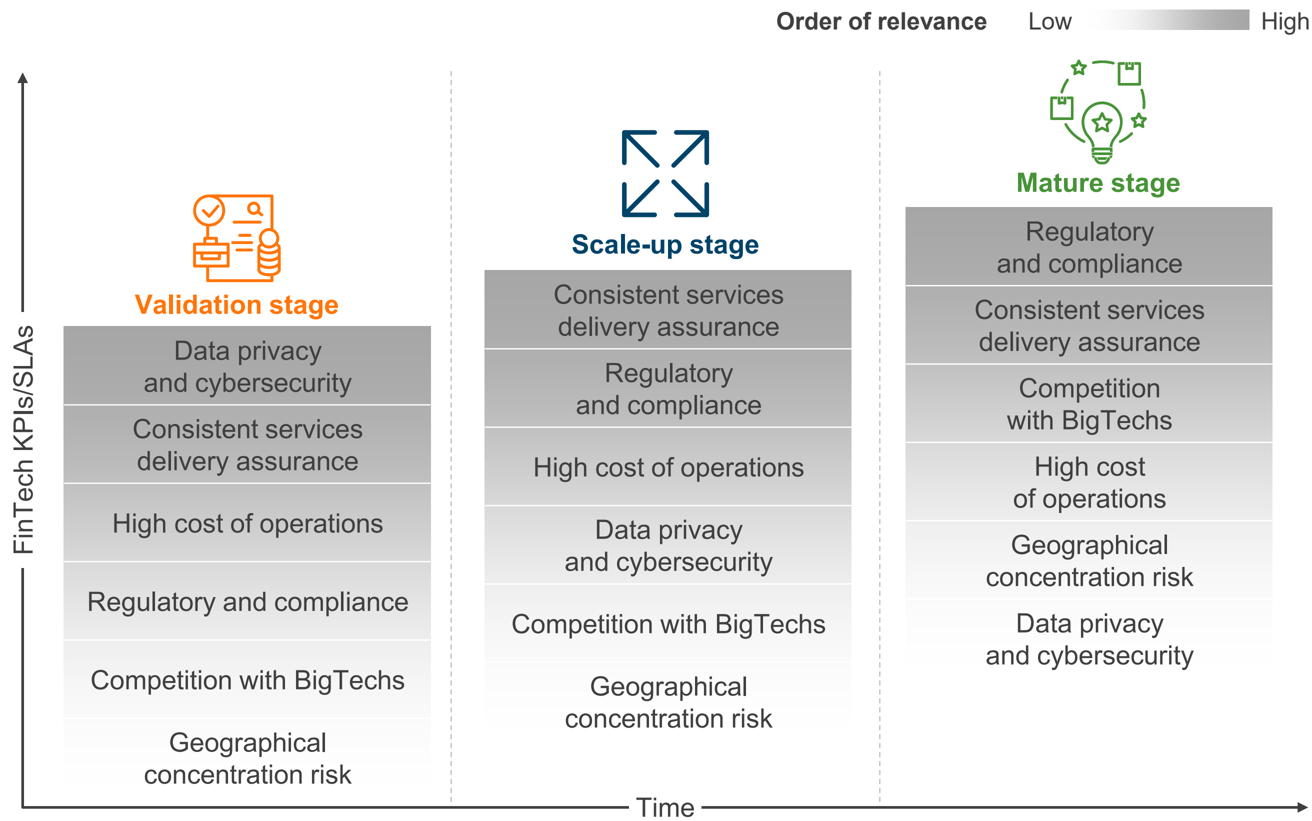
Major operational challenges FinTechs face

Source: Everest Group (2023)

EXHIBIT 8

Operational challenges by maturity stage

Source: Everest Group (2023)



How the FinTech industry can best address operational challenges

Operational challenges and their solutions

The most important operational solutions FinTechs should consider as they try to move up the maturity lifecycle include:

- **Rethinking the customer onboarding experience (KYC/AML and sanctions screening):** Like traditional financial services firms, FinTechs must implement Know Your Customer (KYC) and Customer Due Diligence (CDD) procedures during the customer onboarding process. While FinTechs use digital onboarding, they can leverage outsourcing solutions to lower their operational expenditure, reduce the time needed to onboard new customers, and gain real-time risk management capabilities such Anti-Money Laundering (AML), Politically Exposed People (PEP), and adverse media data for AML and sanctions screening
- **Proactive fraud screening:** As FinTechs had high growth rates in digital transactions, the burden of fraud screening also rose. As they scale operations, they should look for support in predictive fraud screening to reduce costs
- **Regulatory reporting support:** While most countries already have regulations for FinTechs, new regulations are being enacted regularly. FinTechs need help to meet regulatory and compliance requirements

- **Collections:** The high degree of effort committed to collections poses a serious challenge for FinTech lenders trying to grow their portfolios organically. FinTechs can leverage analytics-driven collections services along with custom treatment strategies to provide their customer with an empathetic collections experience, backed by Robotic Process Automation (RPA) and continuous quality monitoring
- **Loan originations:** As loan origination volumes for FinTechs are increasing, FinTechs are looking to augment their operations without proportionately increasing their fixed costs. Automated solutions can help FinTechs control costs while adhering to stringent regulatory controls as cycle time declines and loan origination rates improve
- **Loan servicing:** FinTechs can leverage outsourcing solutions for loan servicing activities such as sending monthly payment statements, collecting monthly payments, and maintaining records of payments and balances, among others
- **RPA, Artificial Intelligence (AI) and Machine Learning (ML) capabilities:** RPA, AI, and ML can help FinTechs address their business imperatives of operational control and governance, cost optimization, positive customer experience, regulatory compliance, and digital transformation
- **Payment operations:** At a time when digital payment is the norm, payments processing and operations support outsourcing can be a quick way for FinTechs to reduce their processing costs and scale business without increasing headcount
- **Loan underwriting:** By automating the loan underwriting process, FinTechs can significantly reduce the time taken for the loan application and approval process. Use cases such as digital underwriting that leverage existing data pools and emerging technologies such as AI/ML models, analytics, and IoT, could ultimately help increase FinTechs' underwriting capacity and can also help them in serving customers with low credit scores
- **True omni-channel customer experience:** Interactive Voice Response (IVR), chatbots, multi-lingual sales and servicing, and UX support are interesting use cases that can help FinTechs provide reliable and consistent end-user experiences
- **Proactive and predictive analytical models:** By utilizing customer and operational data to generate intelligent insights via proactive and predictive analytical models, FinTechs can not only deliver high quality CX, but can also keep a tab on how customer behavior is changing and how their products and services need to evolve to stay relevant

How can FinTechs leverage third-party service providers?

FinTechs need to concentrate and focus resources on their core competencies, market differentiation and innovation. Leveraging the expertise of third-party service providers can help them to achieve service delivery assurance and drive customer experience in the front, middle, and back offices.

FinTechs can leverage outsourcing partners in multiple ways. The right engagement model can be beneficial for both parties and ensure long-term positive relationships.

There are several potential engagement models, as described below:

The FinTech manages technology solutions while leveraging service providers only for operations. Mature-stage FinTechs could leverage service providers to run operations. The third party can provide the operations support on regulatory compliance, risk management, and more, and help the FinTech with capabilities and expertise in diverse financial services lines of business.

On the other hand, mature-stage FinTechs can own their technology platforms given their strong technology resources, data analytics capabilities and digital ecosystem support. As a result, by using a service provider's complementary strengths, FinTechs at this stage of maturity can leverage their agility, customer-centric approach, and innovative mindset to maintain their competitive positions in the market.

Service providers run operations for the FinTech while also providing technology platforms or development support. Validation and scale-up stage FinTechs could leverage service providers to run operations as well as technology/platform solutions or leverage technology support from service providers to improve current technology. This model would effectively make FinTechs and service providers technology partners, and FinTechs in the scale-up/validation stage of maturity can continue to focus on business growth, market validation, and other strategic priorities.

The FinTech and service providers partner and leverage the FinTech's technology to deliver services to conventional financial services firms. Technology-focused FinTechs with innovative products, irrespective of their stage of maturity, can partner with service providers to co-innovate and offer solutions to conventional financial firms in specialized regions and sectors.

In this engagement model, the FinTech would use its technology expertise to serve the needs of conventional financial services firms, while the service providers act as a trusted intermediary between the two.

- FinTechs can benefit from the collaboration by gaining access to conventional financial firms and scale of operations
- Third-party service providers can provide services to both conventional financial firms and FinTechs, leveraging their expertise in implementing technology solutions and providing operations support for financial firms
- Going forward, service providers can bundle their services with the FinTech technology
- Service providers can leverage their strengths – access to resources, banks' trust, and expertise in core banking and financial services
- These strengths, combined with the FinTech's innovative offerings, can help them address the threat of disruption in the industry

Drivers of service provider and FinTech partnerships include:

- **The threat from BigTechs:** BigTechs are not only creating competition, but also disrupting the industry at scale, and FinTechs often find it difficult to compete with their limited resources
- **Increasing customer reach:** Limited market preference often limits FinTechs' ability to realize the full potential of their innovative solutions. Partnering with service providers ensures increased transparency, more accurate pricing, better modeling, and increased understanding of customer needs
- **Overcoming cultural differences:** FinTechs and conventional financial firms often fail to collaborate due to cultural and operational style differences. Service providers with a history of collaboration and understanding of financial services operations help in bridging this gap
- **Risk:** Financial firms are concerned with issues such as technology and data risk when collaborating with FinTechs. Service providers, which have years of experience in managing such risk, can ease partnership with FinTechs

Deciding parameters when choosing the optimal solution mix

The outsourcing solutions a FinTech should consider depend on its maturity lifecycle stage. As discussed in earlier sections, a FinTech's operational challenges change as it transitions through the maturity lifecycle; therefore, the optimal time to implement business process outsourcing support varies as well.

For instance, while solutions such as loan servicing, KYC/AML and RPA, AI, ML could be implemented even with small volumes (their incremental gains will, in fact, be more apparent when they are implemented at an early stage of maturity), solutions such as loan underwriting and fraud screening are core operations for FinTechs, and it is better to outsource them once the volumes are considerable.

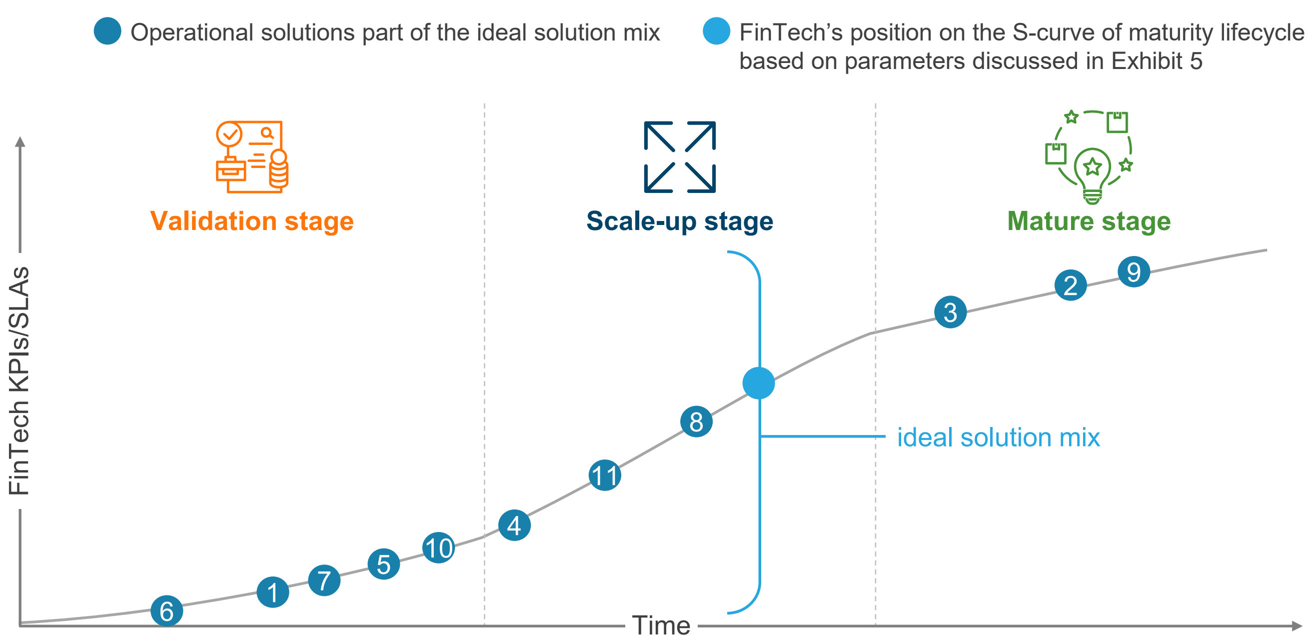
As a FinTech moves up the maturity lifecycle curve, the volumes of day-to-day, non-essential operations increase proportionately. Therefore, as FinTechs scale up, the need for operational support arises.

Exhibit 9 summarizes this concept and provides a basic framework to identify the ideal solution mix that a FinTech in its growth journey should try to adopt. After identifying where the FinTech is mapped on the S-curve of the maturity lifecycle, the solutions mentioned on the left side of the FinTech's position comprises of the ideal solution mix.

EXHIBIT 9

Framework to determine a FinTech's ideal solution mix*

Source: Everest Group (2023)



1. KYC/AML
2. Fraud screening
3. Regulatory support
4. Collections
5. Loan origination
6. Loan servicing
7. RPA, AI, ML
8. Payment operations
9. Loan underwriting
10. CX services
11. Proactive and predictive analytical models

* While this framework helps in identifying the mix of operational solutions a FinTech, in general, should consider outsourcing based on where it is mapped on the maturity lifecycle, there could be FinTechs for which the business case is such that they must outsource certain solutions at earlier or later maturity stages

Conclusion

While FinTechs have established themselves as major market players in the banking and financial services industry, given their unique value propositions, extent of personalization, and high degree of digital adoption, they now need to analyze their operational challenges as they attempt to scale without compromising on their agility and innovation.

It is imperative for FinTechs to concentrate and focus resources on their core competencies and build market-differentiating offerings rather than on managing their day-to-day operations. This shift would benefit FinTechs through increased operational efficiency, enhanced customer experience, optimized risk management, increased scalability and flexibility, data security, and regulatory and compliance support.

We have presented a framework to help FinTechs address their operational challenges. FinTechs can map themselves depending on their maturity level on this framework to identify the optimum solution mix, based on the most relevant operational challenges at each stage. Finally, we have defined a methodology to choose the ideal engagement model depending on a FinTech's capabilities and maturity stage.

With funding levels declining and market sentiment shifting to a wait-and-see mode, especially against the backdrop of an impending recession, the best way for FinTechs to gain traction is to look beyond internal capabilities to support their back-office operations. This report offers a starting point with which FinTechs can map themselves on the maturity lifecycle model, look closely at their key operational challenges and priorities, choose the ideal engagement model, and decide on the optimal solution mix for which they would need third-party support.

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