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Financial Services Practice

Fintechs: A new paradigm of growth

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After decades of hypergrowth, fintechs have entered a new era of value creation, where the focus is on sustainable, profitable growth. This report examines how fintechs can win in these disruptive times.

This report is a collaborative effort by Lindsay Anan, Diego Castellanos Isaza, Fernando Figueiredo, Max Flötotto, André Jerenz, Alexis Krivkovich, Marie-Claude Nadeau, Tunde Olanrewaju, Zaccaria Orlando, and Alessia Vassallo, representing views from McKinsey's Financial Services Practice.

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Executive summary

Over the past decade, technological progress and innovation have catapulted the fintech sector from the fringes to the forefront of financial services. And the growth has been fast and furious, buoyed by the robust growth of the banking sector, rapid digitization, changing customer preferences, and increasing support of investors and regulators. During this decade, fintechs have profoundly reshaped certain areas of financial services with their innovative, differentiated, and customer-centric value propositions, collaborative business models, and cross-skilled and agile teams.

As of July 2023, publicly traded fintechs represented a market capitalization of $550 billion, a two-times increase versus 2019.[1] In addition, as of the same period, there were more than 272 fintech unicorns, with a combined valuation of $936 billion, a sevenfold increase from 39 firms valued at $1 billion or more five years ago.[2]

In 2022, a market correction triggered a slowdown in this explosive growth momentum. The impact continues to be felt today. Funding and deal activity have declined across the board, and there are fewer IPOs and SPAC (special purpose acquisition company) listings, as well as a decline in new unicorn creation. The macro environment also remains challenging and uncertain. In such a scenario, fintechs are entering a new era of value creation. The last era was all about firms being experimental—taking risks and pursuing growth at all costs. In the new era, a challenged funding environment means fintechs can no longer afford to sprint. To remain competitive, they must run at a slower and steadier pace.

In this report, we examine how fintechs can continue to grow in strength and relevance for customers, the overall financial ecosystem, and the world economy, even in disruptive times. Based on research and interviews with more than 100 founders, fintech and banking executives, investors, and senior ecosystem stakeholders, we have identified key themes shaping the future of fintechs. To help fintechs capitalize on these themes, we also provide a framework for sustainable growth, based on an analysis of the strategies used by long-established public companies that have weathered previous economic cycles.

1 F-Prime Fintech Index.
2 Dealroom.co; McKinsey analysis.

Chapter 1: Fintech growth then and now

The fintech industry raised record capital in the second half of the last decade. Venture capital (VC) funding grew from $19.4 billion in 2015 to $33.3 billion in 2020, a 17 percent year-over-year increase (see sidebar "What are fintechs?"). Deal activity increased in tandem, with the number of deals growing 1.2 times over this period.

The industry fared even better in 2021, thriving on the backs of the pandemic-triggered acceleration in digitization and a financial system awash with liquidity. Funding increased by 177 percent year over year to $92.3 billion, and the number of deals grew by 19 percent.

The funding surge proved to be a one-off event. Funding levels in 2022 returned to long-term trend levels as inflated growth expectations from the 2021 extraordinary results were reanchored to business-as-usual levels, and as deteriorating macroeconomic conditions and geopolitical shocks destabilized the business environment. The correction caused fintech valuations to plummet. Many private firms faced down rounds, and publicly traded fintechs lost billions of dollars in market capitalization. VC funding was hit hard globally and across sectors, dropping to $459.6 billion in 2022 from $683.1 billion in 2021. Fintech funding faced a 40 percent year-over-year funding decline, down from $92 billion to $55 billion. Yet, when analyzed over a five-year period, fintech funding as a proportion of total VC funding remained fairly stable at 12 percent, registering only a 0.5 percentage point decline in 2022.

Looking ahead, the fintech industry continues to face a challenging future, but there are several opportunities yet to be unlocked. Investors are adapting to a new financial paradigm with higher interest rates and inflation, which has altered their assessment of risk and reward. At the same time, the once-in-a-generation technology revolution under way is generating more value creation opportunities. Our research shows that revenues in the fintech industry are expected to grow almost three times faster than those in the traditional banking sector between 2022 and 2028. Compared with the 6 percent annual revenue growth for traditional banking, fintechs could post annual revenue growth of 15 percent over the next five years.

These trends are also coinciding with—and in many ways catalyzing—the maturation of the fintech industry. Based on our research and interviews, three themes will shape the next chapter of fintech growth. First, fintechs will continue to benefit from the radical transformation of the banking industry, rapid digital adoption, and e-commerce growth around the world, particularly in developing economies. Second, despite short-term pressures, fintechs still have room to achieve further growth in an expanding financial-services ecosystem. And finally, not all fintechs are being hit equally hard during the market correction: fintechs in certain verticals and at particular stages of growth are more resilient than their peers.

What are fintechs?

We define fintech players as start-ups and growth companies that rely primarily on technology to conduct fundamental functions provided by financial services, thereby affecting how users store, save, borrow, invest, move, pay, and protect money. For the analysis of this report, we included the following fintech sectors: daily banking; lending; wealth management; payments; investment banking and capital markets; small and medium-size enterprise (SME) and corporate services; operations; and infrastructure (including embedded finance, and banking as a service). The analysis excluded cryptocurrency, decentralized finance, and insurtech.

McKinsey's research shows that revenues in the fintech industry are expected to grow almost three times faster than those in the traditional banking sector between 2023 and 2028.

Radical transformation of the banking industry

Banking is facing a future marked by fundamental restructuring. As our colleagues wrote recently, banks and nonbanks are competing to fulfill distinct customer needs in five cross-industry arenas in this new era: everyday banking, investment advisory, complex financing, mass wholesale intermediation, and banking as a service (BaaS).[3]

At the same time, macro tailwinds are powering the growth of fintechs and the broader financial-services ecosystem. Digital adoption is no longer a question but a reality: around 73 percent of the world's interactions with banks now take place through digital channels.

Moreover, retail consumers globally now have the same level of satisfaction and trust in fintechs as they have with incumbent banks.[4] In fact, 41 percent of retail consumers surveyed by McKinsey in 2021 said they planned to increase their fintech product exposure. The demand—and need—for fintech products is higher across developing economies. In 2022, for example, Africa had almost 800 million mobile accounts, almost half of the whole world's total.[5]

B2B firms' demand for fintech solutions also is growing. In 2022, 35 percent of the small and medium-size enterprises (SMEs) in the United States considered using fintechs for lending, better pricing, and integration with their existing platforms. And in Asia, 20 percent of SMEs leveraged fintechs for payments and lending.[6]

To capitalize on this demand, fintechs will need to keep up with fast-evolving regulations and ensure they have adequate resources and capacity to comply. Some European Union member states, such as Ireland, are bringing buy-now-pay-later providers under the scope of financial regulation.[7] Meanwhile, the US Consumer Financial Protection Bureau aims to issue a proposed rule around open banking this year that would require financial institutions to share consumer data upon consumers' requests.[8] This would make it necessary for fintechs to ensure they have the available resources and capacity to respond to these requests.

A nascent industry in an expanding ecosystem

The banking industry generated more than $6.5 trillion in revenues in 2022, with year-over-year growth in volume and revenue margins.[9] Given the fintech market dynamics, this suggests there is still plenty of room for further growth in both public and private markets.

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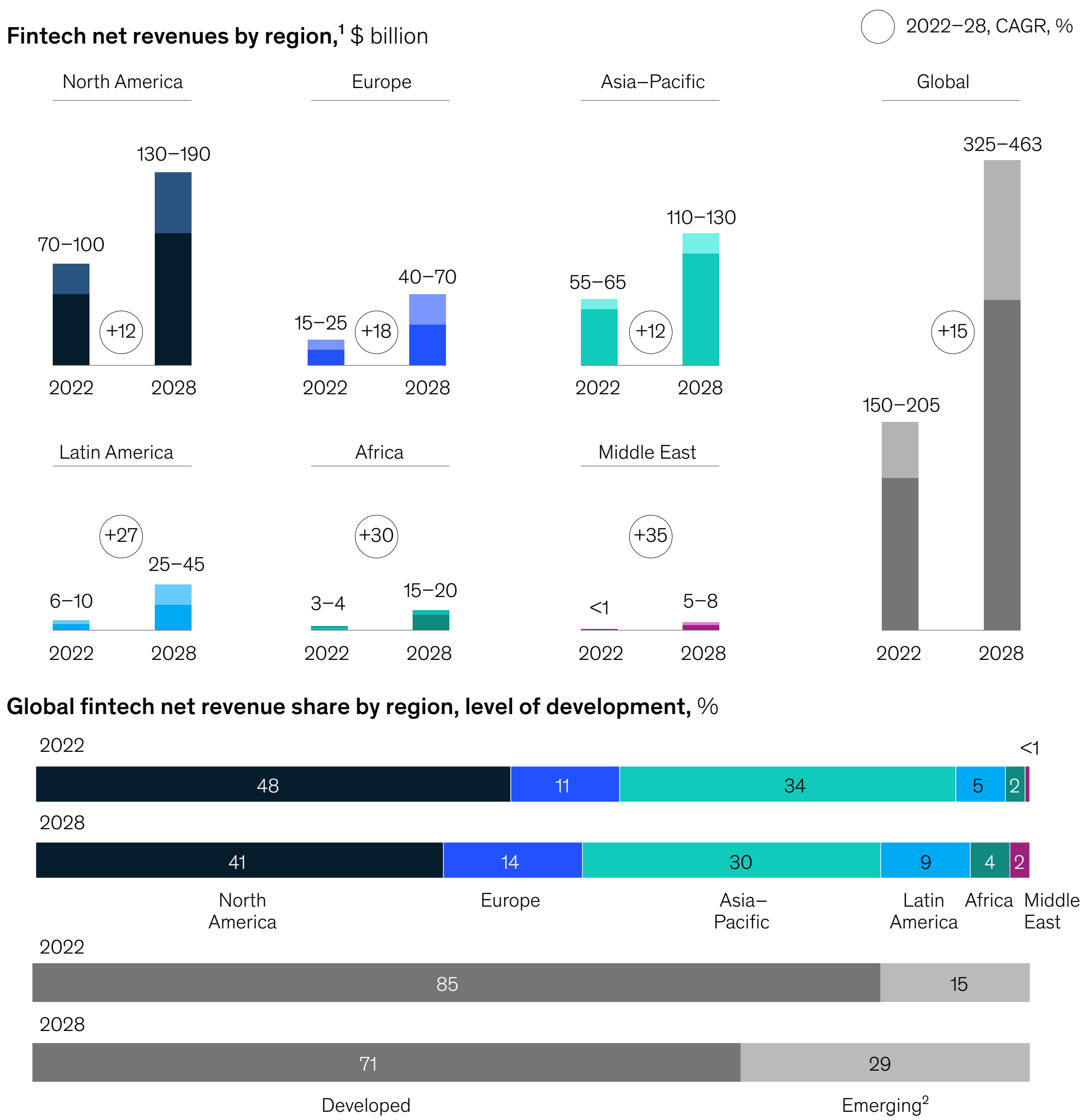
3 Balázs Czímer, Miklós Dietz, Valéria László, and Joydeep Sengupta, "The future of banks: A $20 trillion breakup opportunity," *McKinsey Quarterly*, December 20, 2022.
4 McKinsey Retail Banking Consumer Survey, 2021.
5 *The state of the industry report on mobile money*, GSM Association, April 2023.
6 McKinsey 2022 US SMB Banking Survey, 2022 (n = 955).
7 Miroslav Đurić and Verena Ritter-Döring, "Regulation of buy-now-pay-later in the EU: New regime on the horizon," Law Business Research, February 8, 2023.
8 Farouk Ferchichi, "The US is one step closer to making open banking a reality," Finextra, January 19, 2023.
9 "McKinsey's Global Banking Annual Review," McKinsey, December 1, 2022.

In 2022, fintechs accounted for 5 percent (or $150 billion to $205 billion) of the global banking sector's net revenue,[10] according to our analysis. We estimate this share could increase to more than $400 billion by 2028,[11] representing a 15 percent annual growth rate of fintech revenue between 2022 and 2028, three times the overall banking industry's growth rate of roughly 6 percent (Exhibit 1).

Emerging markets will fuel much of this revenue growth. Fintech revenues in Africa, Asia–Pacific (excluding China), Latin America, and the Middle East represented 15 percent of fintech's global

Exhibit 1

Emerging markets are expected to play a growing role in fintech revenue growth.



[1]Net revenue is defined as revenue after risk minus direct costs.
[2]Latin America, Africa, Middle East, and Asia, excluding China.
Source: Dealroom.co; McKinsey analysis

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[10] Net revenue equals revenue after risk minus direct costs.
[11] Estimate based on historical growth at regional level and expert inputs from regional leaders in the banking industry (for example, forecast of roughly 80 percent 2021–22 revenue increase in Latin America).

revenues last year. We estimate that they will increase to 29 percent in aggregate by 2028. On the other hand, North America, currently accounting for 48 percent of worldwide fintech revenues, is expected to decrease its share to 41 percent by 2028.

While fintech penetration in emerging markets is already the highest in the world, its growth potential is underscored by a few trends. Many of these economies lack access to traditional banking services and have a high share of underbanked population. Fintechs have had some success in addressing these unmet needs. In Brazil, for example, 46 percent of the adult population is said to be using Nubank, a fintech bank in Latin America—double the share two years ago.[12]

Moreover, while the market cap of private fintech companies has increased substantially over the past decade, the sector's penetration of the public market remains small.[13] In the eight years leading up to October 2022, 44 modern fintechs (those that were founded in 1999 or later and went public after 2014) did an IPO, creating a combined market cap of $0.3 trillion. In contrast, during the same period, there were more than 2,500 legacy public financial-services companies (whose average year of founding was 1926) with a combined market cap of $11.1 trillion.[14]

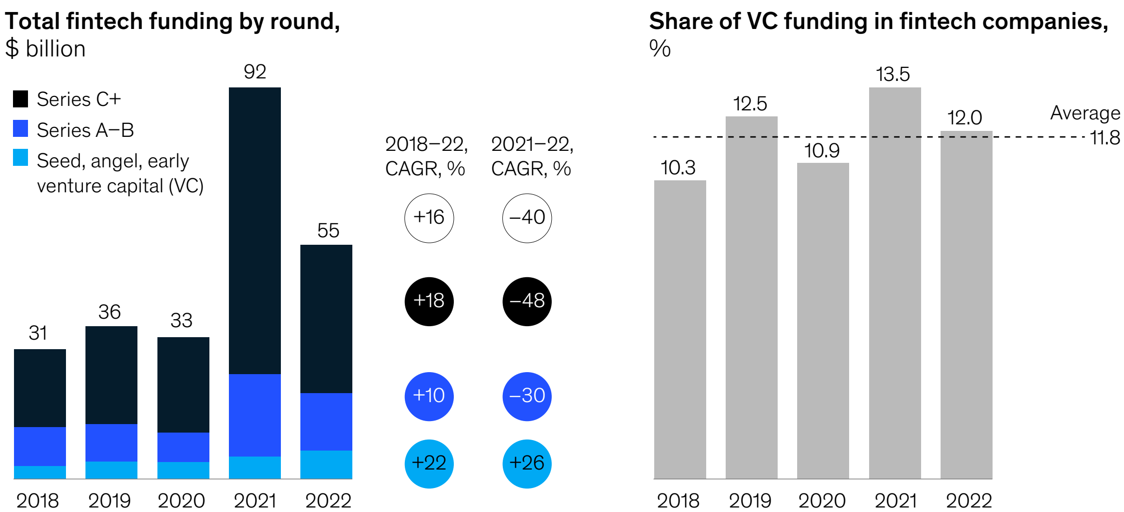
Not all fintech businesses are created (or funded) equal

Last year was turbulent for fintechs, but there were differences in the fundraising performance of firms based on maturity and segments.

Maturity stage
Companies in the growth stage (series C and beyond) showed the highest sensitivity to last year's funding downturn, with a sharp year-over-year funding decline of 50 percent. Meanwhile, fintechs in the early seed and pre-seed stages were more resilient and increased funding by 26 percent year over year (Exhibit 2). This funding outperformance of firms in the early and pre-seed stages was a

Exhibit 2

Fintechs in seed, angel, and early venture capital stages posted funding growth in 2022.



Source: Dealroom.com; McKinsey analysis

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[12] Oliver Smith, "Nubank turns $141m profit in Q1 as Brazilian market share nears 50%," AltFi, May 16, 2023.
[13] Michael Gilroy, Chase Packard, and Leslie Wang, *Fintech and the pursuit of the prize: Who stands to win over the next decade?*, Coatue, October 24, 2022.
[14] Ibid.

consequence of the longer time to maturity, which gives start-ups more time to get through periods of economic uncertainty and recover any losses before an eventual sale.

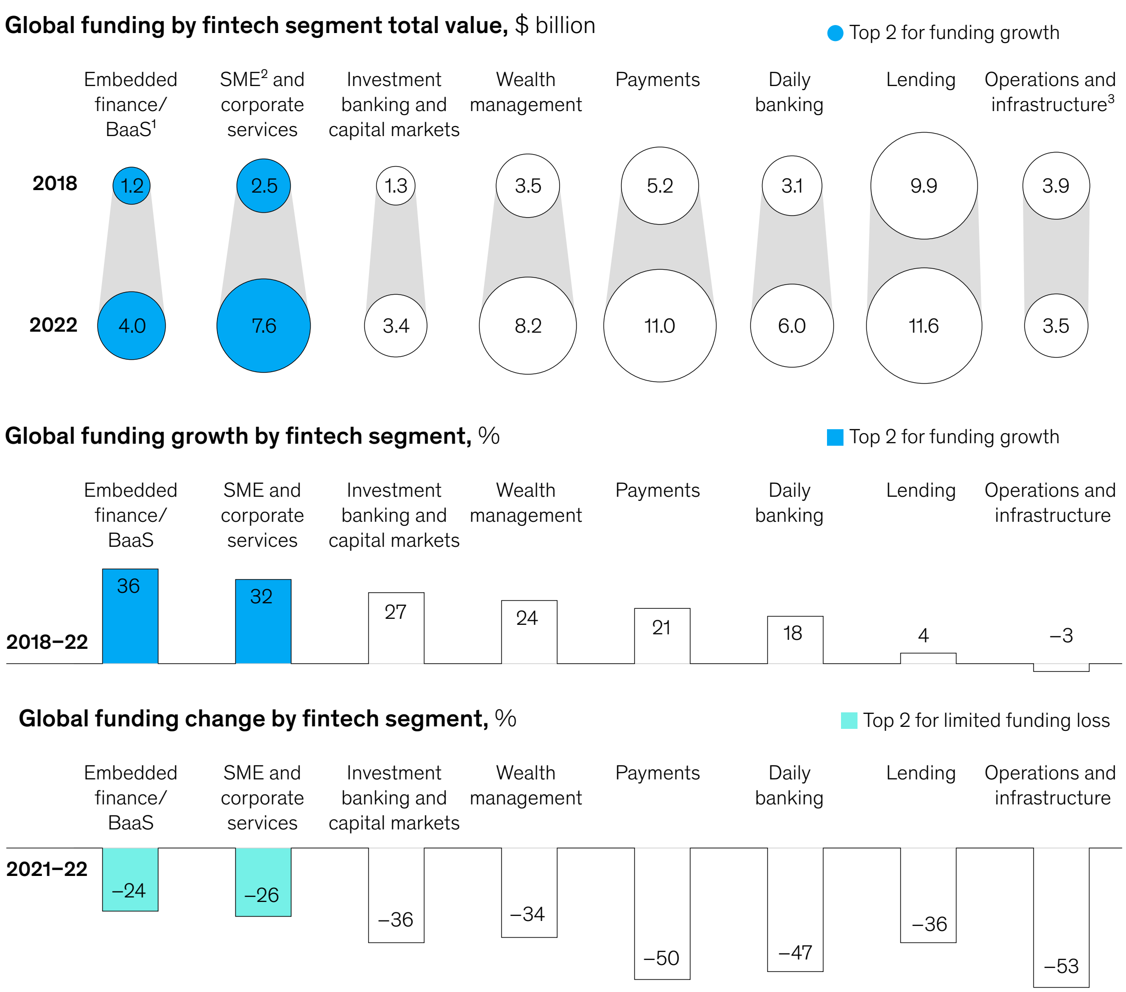
Verticals

Funding for B2B fintech segments last year was more resilient than for those in B2C, with smaller funding declines (Exhibit 3). The two B2B verticals that were least affected were (1) BaaS and embedded finance and (2) SME and corporate value-added services. These two verticals recorded year-over-year funding declines of 24 and 26 percent, respectively. In contrast, funding for payments-focused fintechs dropped 50 percent. Even then, payments and lending received the largest shares of total fintech funding.

Funding for B2B segments grew at more than 25 percent annually between 2018 and 2022, driven by an increasing number of businesses adopting off-the-shelf solutions provided by digital-native firms (including payments, open banking, and core banking technology) to address challenges arising from using legacy banking infrastructure—for example, limited flexibility, slower speed, and high costs.

Exhibit 3

Business-to-business segments recorded smaller funding declines from 2021 to 2022 than did business-to-consumer-focused fintechs.



[1]Banking as a service.
[2]Small and medium-size enterprises.
[3]Includes core banking technology, regtech, and open banking.
Source: Dealroom.co, 2023

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Many businesses continue to rely on legacy banking infrastructure that limits flexibility and speed and can often be more costly. To address these challenges, businesses are benefiting from using off-the-shelf solutions provided by digital natives for services such as payments, open banking, and core banking technology.

For BaaS and embedded finance, demand is led by customer-facing businesses looking to control their users' end-to-end experience. Meanwhile, SMEs have been underserved by traditional financial-services providers, despite the fact they represent about 90 percent of businesses and more than 50 percent of employment worldwide.[15] And in developing countries, the finance gap for micro, small, and medium-size enterprises (MSME) is estimated to be approximately $5 trillion, or 1.3 times the current level of MSME lending.[16] Fintech firms have successfully addressed some of SMEs' needs worldwide, especially in developing countries.

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15 "Small and medium enterprises (SMEs) finance," The World Bank, accessed October 10, 2023.
16 "MSME finance gap," IFC, accessed October 10, 2023.

Chapter 2: The path to sustainable growth

The current churn in the markets makes it prudent for fintechs to define their next move carefully. After all, they are operating in a much different environment than in years past. In their hypergrowth stage, fintechs had access to capital that allowed them to be bold in their business strategy. They could make revenue generation their foremost objective; profits were expected to follow.

The narrative has shifted since last year. The time between funding rounds for fintechs increased by more than five months from the first to the fourth quarter of 2022. The average value of funding rounds decreased by 50 percent over the same period.[17] These changes are forcing fintechs to find newer ways to extend runways and adjust their operating models to make decreasing amounts of cash last longer.

The days of growth at any cost are behind the industry, for now at least. In a liquidity-constrained environment, fintechs and their investors are emphasizing profitability, not just growth in customer adoption numbers or total revenues. “In the past, the reward went to fintechs that showed growth at all costs, which led to healthy valuations,” said one Africa-based growth equity investor. “Now it is about the sustainability of the business, the addressable market, and profitability.”

So how can fintechs get on a path of sustainable, profitable growth?

In 2019, McKinsey conducted an in-depth study of the growth patterns and performance of the world’s 5,000 largest public companies over the preceding 15 years. The researchers’ analysis identified ten rules for value-creating growth.[18] According to the research, companies that set growth strategies addressing all available pathways to growth were 97 percent more likely to achieve above-peer profitable growth.[19]

This set of rules adopted by public companies that have lived through economic cycles and periods of uncertainty can also be useful for fintechs as they transition to a sustainable growth model. Based on our analysis of these rules and interviews with more than 40 fintech industry leaders, we expect four pathways to deliver the most impact for fintechs.

In a liquidity-constrained environment, fintechs and their investors are emphasizing profitability, not just growth in customer adoption numbers or total revenues.

17 “SVB’s challenges will accelerate valuation down rounds, startup mortality, and layoffs,” CB Information Services, March 15, 2023.
18 Chris Bradley, Rebecca Doherty, Nicholas Northcote, and Tido Röder, “The ten rules of growth,” McKinsey, August 12, 2022.
19 “Choosing to grow: The leader’s blueprint,” McKinsey, July 7, 2022.

Cost discipline

When fintechs had access to abundant cash and funding was easy, they placed more emphasis on growing rapidly than on managing costs. Targeted cost savings have become a bigger priority today, as fintechs seek ways to lower expenses and achieve profitability while maintaining customer satisfaction and pursuing customer growth and acquisition. Our research has found that 50 percent of public fintechs (following their IPO) were profitable in 2022. And the key differentiator between profitable and nonprofitable fintechs was cost management, not revenue growth (Exhibit 4). While both categories recorded year-over-year revenue growth of 13 percent, profitable fintechs posted a median 3 percent decrease in costs. Nonprofitable fintechs, in contrast, saw costs rise by 27 percent, which affected their profit margins.

Successful implementation of cost management efforts is the key for fintechs in their next phase of evolution. Several leaders are already making moves: 60 percent of our survey respondents said their firms are significantly managing costs. An executive at an African mobile payments firm said they are now negotiating every cost and making sure the firm is thinking for the long run.

Consider the example of the Indian fintech company Paytm, which specializes in digital payments and financial services. The firm had had a target of achieving breakeven by September 2023 but was able to achieve this six months ahead of schedule. It did so through disciplined cost management, revenue growth across businesses, and a business model with strong operating leverage.[20]

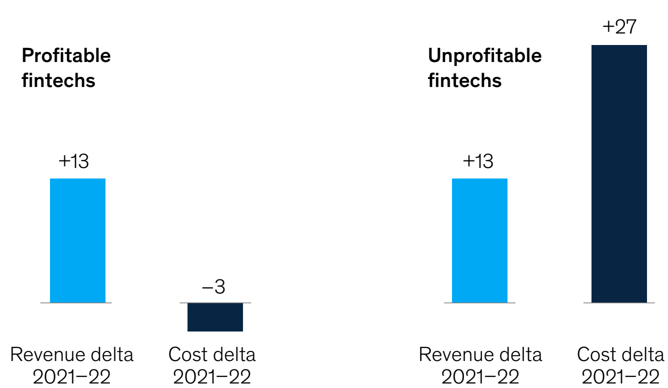
While fintechs establish a clear focus on costs, they should also consider adjusting how they operate, thereby creating a more agile and flexible organization that can deal with the current environment. Around 80 percent of the interviewed fintechs report that they are currently making changes to their operating models. Of these, 66 percent cite a focus on profitability and a sustainable cost structure as being among their top three reasons. Such adjustments to the operating model are most sustainable when institutions also reinforce the control functions to protect customers and stay on top of regulatory changes.

A shift from hypergrowth to sustainable growth would also result in a greater focus on strong unit economics. To do this, fintechs ensure that the profitability view is embedded across the business. For example, assessment of the value of adding new customers would evolve from efficiency-only metrics such as the customer acquisition cost (CAC) to a more holistic approach. In this example, one

Exhibit 4

Strict cost management, not revenue growth, is the key differentiator for fintech profitability.

Profitable and unprofitable fintechs in 2022, %



Source: McKinsey analysis, based on a sample of 120+ public fintechs around the world

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[20] "Our discipline in cost management sustains and grows profitability," Paytm, February 20, 2023.

way to embed profitability into acquisition investment and decision making is to compare the CAC with the projected lifetime value (LTV) of a customer, using the LTV/CAC ratio to assess the marginal return on investment for acquiring every new customer. In Latin America, for example, 68 percent of fintechs self-reported an LTV/CAC greater than five, which indicates a potential for fintechs to increase spending and further fuel growth without sacrificing profitability.

Measured growth

As leaders develop growth strategies, an important question is where growth should come from. Fintechs can grow sustainably by taking three steps: building a strong core, expanding into adjacent industries and geographies, and shrinking to grow. Identifying which steps will be most accretive to growth will depend on the unique circumstances of each fintech; some might find value in pursuing all three steps, while others could choose to focus on one. Regardless of the circumstances, this decision will have greater longer-term consequences in the current environment, compared with the earlier high-funding phase.

Focus on building a strong core as a precursor for expansion
The first step in cracking the growth code involves focusing on the local market and developing a healthy core business. According to our research, companies that focus on their core business and have a strong home market are 1.6 times more likely to generate peer-beating returns.[21]

For fintechs, the key will be to relentlessly focus on growth in their core business. As a North American fintech executive told us: “It’s a bit of back to basics. On a core product or offering, 18 to 24 months ago, you would have built additional pieces on it to upsell and cross-sell. Now, we’re looking to double down on the core business and make sure it’s a stable, viable operation.”

To do this, fintechs must tailor their value propositions to their focus markets. Let’s take the example of B2C fintechs. Our recent research (McKinsey’s Retail Banking Consumer Survey and Global Banking Pools) quantified the potential drivers for growth at B2C fintechs. Cross-selling will likely drive growth for fintechs in emerging economies, while those in developed countries will likely see greater growth from capturing new customers. Around 72 percent of revenue growth for companies in Brazil, for example, is expected to come from cross-selling, in contrast with 25 percent and 30 percent for the United Kingdom and the United States, respectively, with the remaining growth coming from new customers (Exhibit 5). There is arguably less potential for new-customer development in developing economies, given their high fintech penetration.

Across the competitive landscape, as markets are highly heterogenous, a dedicated strategy for each region is recommended. For example, our analysis found that in the United Kingdom and the United States, fintech revenue share is split almost equally between incumbent digital banks and pure fintech players. In contrast, digital incumbents in Germany and pure fintech players in Brazil could dominate banking’s revenue share in their respective markets.

Expand into adjacent segments and geographies
After building a strong core, fintechs can consider expanding into other segments and geographies as a second source of growth. According to our previously published research, companies that do so are 1.2 to 1.3 times more likely to generate sizable returns than peers that focus solely on their core.[22]

Today, however, expansion is no longer a must-do strategy. It may be most advantageous for companies that have strong footholds in their core markets and can use some competitive or ownership advantage to expand elsewhere. The key is to pursue measured, value-creating growth. A case in point is OPay, which started as a mobile money platform in Nigeria and has since expanded across financial-services verticals. OPay now offers peer-to-peer payments and merchant and card services.

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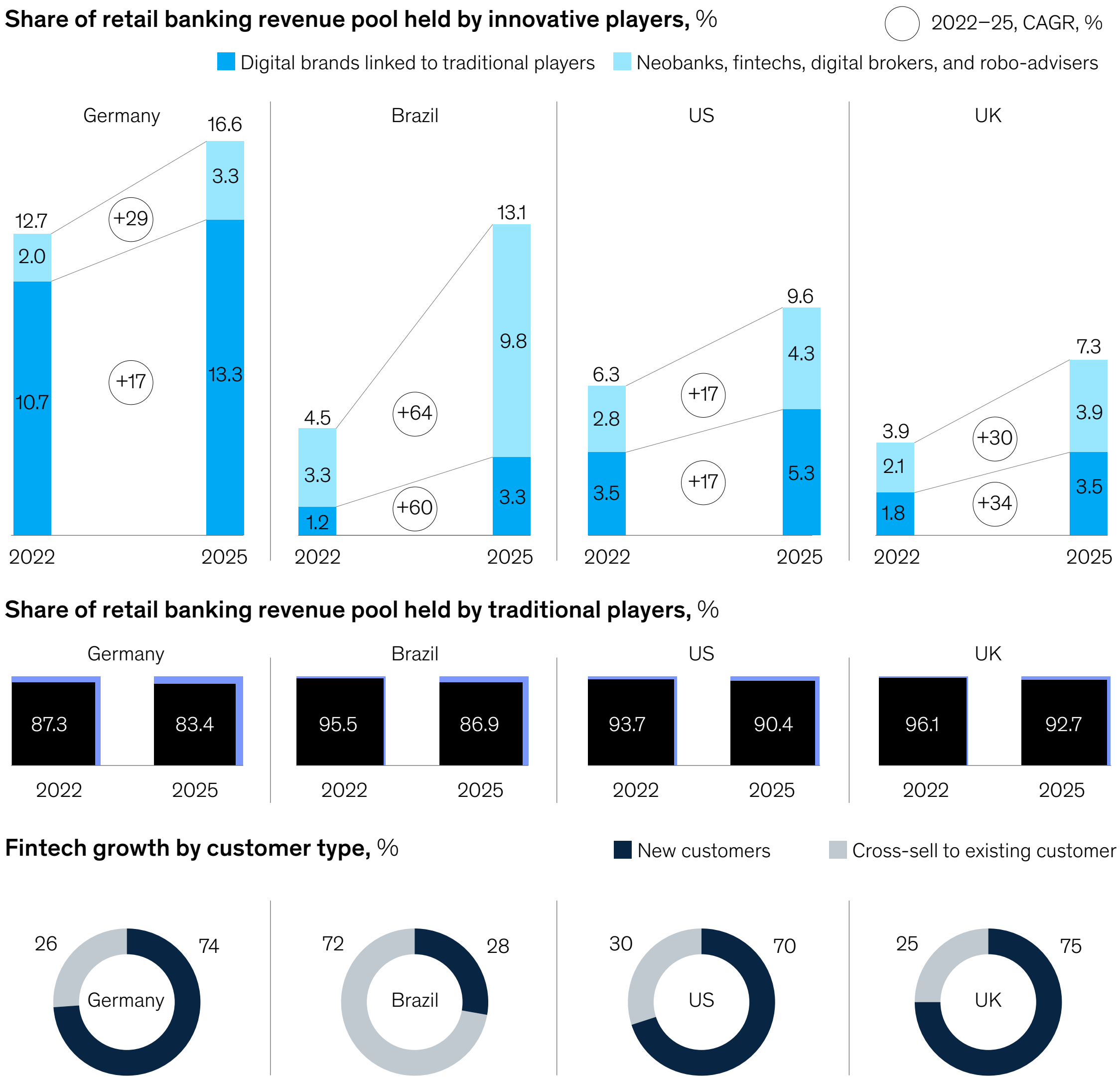
[21] Chris Bradley, Rebecca Doherty, Tido Röder, and Jill Zucker, “Growth rules: Which matter most?,” McKinsey, March 6, 2023.
[22] Ibid.

Exhibit 5

Fintech's value proposition should be tailored to the specifics of the local market.



Source: Based on McKinsey's Retail Banking Consumer Survey, 2021

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Shrink to grow

Fintechs are moving from hypergrowth to sustainable growth, but that growth may not necessarily be consistent across all parts of the business. If fintechs divest from underperforming parts of their portfolios and scale back from regions recording limited growth, they can reinvest that capital into high-performing segments—a strategy we call "shrinking to grow." In our research, companies that use this approach are 1.4 times more likely to outperform their peers.

"In the past, many fintechs expanded geographically, even if it didn't make much sense," an executive at a Latin American fintech told us. "Now they will have to focus on their profitable segment and geography and stop expanding where they are not."

Some fintechs have been deliberate about using a shrink-to-grow strategy, changing track if an expansion strategy did not materialize as expected or the local market had more potential for growth. German robo-adviser Scalable Capital, for example, announced plans to discontinue its Swiss operations as of 2020 to focus on other markets because the implementation of the Financial Services Act in Switzerland would have required the company to manage two regulatory frameworks simultaneously. Meanwhile, Wealthsimple, a Canadian online investment platform, exited from the United Kingdom and the United States in 2021 to concentrate on its local retail market and expand its product portfolio into new financial-services areas. Similarly, in late 2020, San Francisco–based fintech LendingClub shut down its retail peer-to-peer platform called Notes to focus on other products.

Programmatic M&A

Many companies will conclude they can achieve the steps outlined in this report—launching new features, building new capabilities, and pivoting toward new revenue streams and segments—more swiftly through thoughtful acquisitions and partnerships than by relying on pure organic development. Fintech firm Block, for example, completed its acquisition of the buy-now-pay-later platform Afterpay in January 2022 to accelerate its strategic priorities for its seller and cash app ecosystems.[23] Nearly 60 percent of fintech executives in our survey told us they are considering an acquisition in the next 18 months.

Moreover, with IPO and SPAC (special purpose acquisition company) activity slowing considerably since last year, many fintechs that might otherwise go public are turning to private markets for funding. Take the example of the British fintech Zopa, which intended to list by 2022 but eventually decided to put IPO plans on hold in response to challenging market conditions. In the interim, the firm has been raising capital from its shareholders, including $92 million in February.[24]

M&A transactions increase significantly during periods of economic uncertainty, when they also tend to deliver higher returns. During the global financial crisis, around 45 percent of banking M&A deals showed positive excess two-year total shareholder returns (TSR) between 2007 and 2009.[25] In comparison, less than 30 percent of banking deals posted positive excess two-year TSR between 2010 and 2020.[26] Across industries, companies actively making acquisitions worth 10 percent or more of their market cap in total had an average TSR of 6.4 percent between January 2007 and January 2008, compared with –3.4 percent for the less active companies.[27]

However, not all M&As are successful. Many fail to create value due to contrasting values and cultures, mismatched product–market fit, and inflated revenue forecasts in the pursuit of customer engagement and growth at all costs.

Keeping the culture alive

What has made fintechs so disruptive over the years? The answer lies largely in their ability to innovate and differentiate. Since fintechs are not as encumbered by legacy systems and processes, they can be more agile in using emerging technologies to anticipate and solve customer needs. Typically, they also have a customer-centric and collaborative approach to deliver innovation with cross-skilled teams.

Innovations have happened across fintech verticals. Neobanks like Chime and Monzo, designed around a simple and intuitive user experience, have changed assumptions about the role of branches in traditional retail banking. In the United Kingdom, for example, the total number of bank and building society branches fell by 40 percent between 2012 and 2022.[28] Robo-advisers such as Wealthfront and Nutmeg disrupted the traditional wealth management industry by offering low-cost, accessible alternatives to individuals lacking access to personalized financial advice. Funding Circle introduced the peer-to-peer lending concept to the financial sector, bypassing traditional banks (which had owned this relationship) and enabling direct lending between parties.

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[23] "Block, Inc. completes acquisition of Afterpay," Block, January 31, 2022.
[24] "Zopa raises £75 million," Zopa Bank Limited, February 1, 2023.
[25] As of the year of the deal's announcement.
[26] McKinsey Fintech Quarterly Radar, Q1 2023.
[27] Brian Salsberg, "The case for M&A in a downturn," *Harvard Business Review*, May 2020.
[28] Lorna Booth, *Statistics on access to cash, bank branches and ATMs*, House of Commons, September 1, 2023.

Incumbents are fast catching up with these innovations by ramping up investments in new technologies. Around 94 percent of banks in a recent survey said they plan to invest more in modern payments technology to support end user demand for better payment capabilities over the next two to three years. Of these, 65 percent said they intend to make significant or moderate levels of investment.[29] Many incumbents are also partnering with BaaS platforms to overhaul their digital capabilities. Examples include Fifth Third Bank's acquisition of Rize Money in May 2023 and NatWest Group's partnership with Vodeno Group in October 2022 to create a BaaS business in the United Kingdom.

To retain their competitive advantage, fintechs must continue to innovate. The next big disruptor is always around the corner. Technologies like generative AI are predicted to revolutionize the competitive landscape of finance over the next decade (see sidebar "Generative AI and the future of banking"). WeBank's CFO Arthur Wang is one executive who appreciates the urgency. He told us, "Even though our bank has been around for almost eight years, we consider ourselves a start-up. We're always exploring better fintech technology. WeBank's strategy is to provide better, more

[29] "94% of banks eyeing investment in modern payment tech, to keep pace with fintech innovation," Finastra press release, March 8, 2023.

Generative AI and the future of banking

Artificial intelligence (AI) technologies are increasingly integral to the world we live in, and investors are taking notice. Generative AI is among the advanced technologies for which investments are accelerating, thanks to its potential to transform business. According to McKinsey research published in June 2023, generative AI could add the equivalent of $2.6 trillion to $4.4 trillion annually across as many as 63 use cases.

Generative AI's impact on the banking industry will be significant, delivering benefits beyond existing applications of AI in areas such as marketing. As our colleagues have written, this technology could generate an additional $200 billion to $340 billion annually in value, arising from around 2.8 to 4.7 percent increase in the productivity of banking's annual revenues—if the use cases are fully implemented.[1] For fintech, we expect a commensurate impact, if not more, given the already high exposure to tech.

Generative AI's impact—and resulting reinvention—will span three broad categories:

1. *Automation.* Half of today's work activities could be automated between 2030 and 2060, according to McKinsey estimates.[2] Fintech firm Intuit, for example, has introduced a generative AI operating system on its platform. Its custom-trained large language financial models specialize in solving tax, accounting, cash flow, and personal finance challenges, among others.[3]

2. *Augmenting and enhancing productivity to do work more effectively.* Generative AI could enable labor productivity growth of 0.1 to 0.6 percent annually through 2040, depending on the rate of technology adoption and redeployment of workers' time to other activities. Morgan Stanley is building an AI assistant using GPT-4 to help the organization's wealth managers quickly find and synthesize answers from a massive internal knowledge base.[4]

3. *Acceleration.* Organizations can use generative AI to extract and index knowledge to shorten innovation cycles, thereby enabling continuous innovation.

To capture these opportunities, fintechs need an ecosystem of capabilities and partners that will allow them to move fast. First movers will accrue competitive advantage as they build their capabilities and mobilize with a focus on value, rather than rushing to deliver pilots. To do this, fintechs should consider investing more in people and change management, given generative AI's unique potential to influence the future of work. Fintechs could think about developing a medium- to longer-term talent strategy and find ways to emphasize change management and adoption. Fintechs that delay building their capabilities risk becoming the disrupted instead of the disruptors.

[1] "The economic potential of generative AI: The next productivity frontier," McKinsey, June 14, 2023.
[2] Ibid.
[3] "Intuit introduces generative AI operating system with custom trained financial large language models," Intuit press release, June 6, 2023.
[4] "Morgan Stanley Wealth Management announces key milestone in innovation journey with OpenAI," Morgan Stanley press release, March 14, 2023.

inclusive financial services—to the mass population as well as small and medium-size enterprises—with leading technology. We do business 100 percent online, so we rely on technology."[30]

A tight labor market has also made it more challenging for fintechs to attract and hire tech talent. Our survey uncovered a shift in the perception of fintechs as riskier employers. As a Europe-based fintech executive told us: "Fintechs are less attractive now because it is clearer that it is a 'high risk' job compared with established institutions. On the other hand, large fintechs are laying off, which can create a new pool of talents to attract."

In such an environment, fintechs must work toward strengthening their culture and mission and, consequently, their hiring strategy. One European payments fintech, for example, has differentiated strategies based on the profile of open roles. An executive at the firm says it has been easier to recruit people for junior roles, since these workers are more eager to join a growing organization. "It is a different story with experienced profiles—for example, management team or 35-plus years—where recruiting is more difficult and retention is crucial," he said. To attract such people, the firm offers stock options and other incentive packages. Meanwhile, an Africa-based payments and remittances fintech casts a more global net: "We hire globally, regardless of location, gender, or race," an executive told us. "We have no quotas and try to just find the best person for each role."

The fintech industry is undergoing a sea change, so players will have to evolve to survive. Approaches will vary, depending on each fintech's maturity level and its vertical and geographic focus. The framework for sustainable growth, described in this report, provides a strong foundation:

1. *Measured growth based on a stable core.* Ensure there is a strong and stable core business with a targeted and proven market fit before expanding, rather than trying to grow while strengthening the core.

2. *Programmatic M&A.* Pursue M&A strategically and establish mutually beneficial partnerships based on a programmatic strategy rooted in value sharing (with incumbents and other fintechs), as opposed to pursuing M&A only as a response to a low-valuation environment.

3. *Cost discipline.* Control costs to withstand the new funding environment while remaining flexible, nimble, and compliant.

4. *Keep the culture alive.* Maintain the agility, innovation, and culture that have been the bedrock of disruption so far.

Decisions taken today will likely set the pace for fintechs over the mid to long term. The present conditions therefore call for a careful evaluation and focused implementation.

Lindsay Anan is an alumna of McKinsey's San Francisco office, where **Alexis Krivkovich** and **Marie-Claude Nadeau** are senior partners; **Diego Castellanos Isaza** is a consultant in the London office, where **Fernando Figueiredo** is a partner and **Tunde Olanrewaju** is a senior partner; **Max Flötotto** is a senior partner in the Munich office; **André Jerenz** is a partner in the Hamburg office; and **Zaccaria Orlando** and **Alessia Vassallo** are associate partners in the Milan office.

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[30] See "Making financial services available to the masses through AI," McKinsey, August 9, 2022.