FinTech: From Buzzword to New Reality

Financial technology has been a hot topic in Hong Kong ever since it crept onto the scene some two years ago, disrupting the nature of business as we know it. More than just a buzzword, "FinTech" has grown into a reality that is here to stay. At AmCham's 2016 FinTech Forum in early September, Hong Kong government officials, business leaders and other industry experts gathered to discuss the role of FinTech in Hong Kong, and the city's larger role in the global FinTech space

By **Jennifer Khoo**

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Whenever the word "FinTech" was mentioned in 2014, it was rarely outside of the tech start-up sphere. Short for financial technology, FinTech refers to the application of technology within the financial services industry to improve the efficiency of business transactions and processes such as payments, investments, financing and banking infrastructure.

Back then, what was considered as little more than a niche industry is today igniting a global revolution, forcing governments and business institutions alike to adapt and innovate, or else run the risk of becoming irrelevant.

While there is evidence of technological progress in the growing number of technology-enabled payment transaction platforms like PayPal and crowdfunding websites like Kickstarter, the global financial services industry as we know it is still largely in need of an overhaul – both in its practices and its mindset. Nowhere is this more the case than in Hong Kong.

The fourth industrial revolution

FinTech is just one aspect of the technological movement described frequently as the "fourth industrial revolution," which encompasses other cyber-systems such as the Internet of Things (IoT) and cloud computing, and already has a significant and irreversible impact on our everyday lives.

It is a sentiment Steve Lackey, Asia-Pacific Chairman of financial giant BNY Mellon and Vice Chairman of AmCham Hong Kong echoes, saying that even in today's business world, it has become difficult *not* to talk about FinTech, a term now synonymous with innovation in his line of work.

The evidence is in the numbers. Global investment in FinTech in the first half of 2016 reached nearly US$10 billion in the APAC region alone – almost double the amount invested in APAC for the whole of 2015 – according to the latest report by global professional services firm Accenture. Of that figure, investment in China and Hong Kong accounted for 90 percent, an amount valued at US$8.75 billion.

While Hong Kong still has a long way to go in the global FinTech space, the city is fortunate to have an environment conducive to development in the local context, thanks to its world-renowned success as a financial services hub and, more recently, active support from the local government.

Changing attitudes

Since the appearance of FinTech in 2014, James McKeough, Partner at KPMG China, has witnessed a gradual shift in the financial services industry's attitude as a whole, from one of indifference into a willingness to collaborate with FinTech startups.

This shift was born out of necessity, as banks soon realized that if they didn't innovate, it would only be a matter of time before they lost customers to FinTech ventures that could meet their needs more effectively than the banks could.

McKeough says that this transition will undoubtedly take some time, as most financial institutions (FIs) are still reluctant to commit extensive time and resources towards new, unfamiliar FinTech projects at the expense of disrupting other projects. FIs might also be dissuaded by their lack of technological infrastructure perceived as necessary for immediate success on a global scale.

But, on the contrary, the issue of scale isn't an immediate priority in the FinTech world. Rather, continuous experimentation to ensure that the final product is something that meets customer needs is key, even if that means making mistakes. The sooner FIs adopt this mindset, the sooner they can start being innovative.

Government support

Less than a year ago, the Hong Kong government formed the Innovation and Technology Bureau, a landmark response driven by its recognition of FinTech's role in the city's future.

Special guest speaker Nicholas Yang, Secretary for Innovation and Technology of the Government of the Hong Kong Special Administrative Region (HKSAR), shared his insights on local FinTech development. From his perspective, Hong Kong already has a vibrant local FinTech sector, thanks to government funding and facilitation of innovation and technology ventures over the years.

Cyberport in Pokfulam is just one of the many examples of this, says Yang. A 700-strong, government-managed community of digital and technology startups, Cyberport was built to boost Hong Kong's visibility as a hub for entrepreneurship, innovation and technology.

The initiative has been a success, attracting not just local startups but also global players to establish a presence within its premises. In 2014, Accenture collaborated with Cyberport to establish its first Fintech Innovation Lab in APAC, and its third in the world after New York and London.

In March this year, Cyberport also announced that it would increase its existing FinTech co-working space facility by over 50 percent, and is rolling out a designated program to provide support to around 150 FinTech startups over the next five years. In addition, the government has recently launched a HK$200 million Cyberport Macro Fund for investment in its ICT startups, which Yang believes will help to attract additional funding from other investors as well.

From left: Steve Lackey, Asia-Pacific Chairman, BNY Mellon and AmCham Vice Chairman; Nicholas W Yang, JP, Secretary for Innovation and Technology (HKSAR); James McKeogh, Partner and Head of Fintech, KPMG China; and Steven Xavier Chan, Managing Director & Regional Head of Regulatory, Industry and Government Affairs, Asia Pacific, State Street Asia Ltd

Elsewhere, approval has been secured for the establishment of a HK$2 billion Innovation and Technology Venture Fund, through which the government will co-invest with private venture capital funds in local startups on a matching basis. Yang hopes that this initiative will bring in the expertise and business networks of venture capitalists, which will also help to improve the startup ecosystem in Hong Kong.

Trust factor

In addition to government funding and support, Yang believes that Hong Kong has a conducive investment environment, especially due to the stringent regulatory and independent legal environment, which gives the city its high level of trustworthiness in the global market.

In Hong Kong, the stock exchange is modelled after all the other stock exchanges around the world, i.e. it uses the B2B (business-to-business) model, in which the stock exchange deals with members, and members deal with consumers in turn. But in Mainland China, says Yang, the stock exchange operates on a B2C model, because customers do not trust Chinese intermediaries with their investments.

Specifically where FinTech is concerned, financial investment is secondary; trust is the most important factor. Blockchain, for example, the data structure that forms the backbone of all FinTech transactions, is essentially a digital ledger of transactions which is effective only on a premise of trust, as it operates on the sharing of extremely sensitive user information.

Other conditions that make Hong Kong attractive to outside investment include its free flow of information, its world class ICT infrastructure, and its pro-business environment.

Macro challenges

While those impatient with governmental efforts to nurture FinTech in Hong Kong may be tempted to look to Singapore as a shining example of what could be done better, Yang argues that there are many fundamental differences between the Lion City and Hong Kong.

But perhaps most crucially is that Hong Kong is not a sovereignty, and therefore has no defense budget like Singapore does. As so much of modern-day warfare relies on technology, more government money is spent on improving and innovating technology within a country's military. This inevitably influences a national mindset that technological development is crucial elsewhere also, and that funding to do so must be accessible and sufficient.

In Hong Kong currently, there is only one source of funding for innovation and technology related projects – the Innovation and Technology Commission of the HKSAR Government – and competition among startup talent is tough.

From a governmental perspective, however, the biggest hurdle to accelerated FinTech growth in Hong Kong has more to do with the city's overachieving culture than anything. Yang believes that it will take some time before local would-be entrepreneurs and their families are convinced that failure is okay.

He attributes the success of Silicon Valley in the United States to two key elements: firstly, to the never-ending stream of hopeful entrepreneurs who travel to the home of Apple, Facebook and Google to try their hand at start-up success, and secondly, to the ability of said entrepreneurs to regenerate from failure and maintain the will to keep trying.

"Success comes from the ability to accept failure and the resilience to keep trying until something hits," says Yang.

The Hong Kong — US FinTech link

While Hong Kong still has a long journey ahead on the road to FinTech leadership, it could improve its pace significantly by learning from a country that started the journey much earlier – the United States.

The US, more specifically Silicon Valley in the San Francisco Bay Area, is home to many of the world's largest technology companies and promising startups, attracting billions of dollars of venture capital each year.

Using the success of Silicon Valley as a point of comparison, the questions to be addressed are: what are the market opportunities in Hong Kong for offshore FinTech ventures, and what could the city be doing to improve its attractiveness as a destination for direct investment in FinTech?

Market opportunities for offshore companies in Hong Kong

Tim Hwang, Founder and CEO of legal and regulatory analytics company FiscalNote, believes that Hong Kong is an attractive FinTech investment destination for several reasons.

Firstly, Hong Kong is similar to Silicon Valley in that it has a large pool of technical talent, and an abundance of capital available for entrepreneurs who want to find Chinese partners quickly.

Secondly, many foreign companies view Hong Kong as a launch pad to the rest of the Asia-Pacific region, leveraging the similarities in languages and cultures for business expansion. For this purpose, Hong Kong's political situation remains critical for its prospects in FinTech, i.e. maintaining open channels with the US and the rest of the world.

Finally, Hwang thinks that Hong Kong has real potential to become a market leader in areas that companies in Silicon Valley haven't mastered yet, i.e. the RegTech (regulatory technology) and Legal Tech (legal technology) industries.

Hwang believes that this presents a major opportunity for technology ventures in Hong Kong to fill the gap, by working with regulators in the international context to build software which would enable FIs and other institutions to navigate the increasingly regulated global business environment.

Benedicte Nolens, Head of Risk and Strategy at the Hong Kong Securities and Futures Commission (HKSFC) concurs, saying that FIs in Hong Kong (and elsewhere) have an enormous need for streamlining in their back offices, particularly in departments like regulatory and compliance, which could benefit greatly from an integrated RegTech service.

Speaking from a regulator's perspective, Nolens encourages more offshore startup firms to come to Hong Kong and Asia, and to view it as an opportunity of ideas exchange with regards to business models.

Mismatched supply and demand

Aspiring FinTech entrepreneurs looking to break into the local market will be glad – if not somewhat surprised – to hear that FI demand for tech innovations and solutions is greater in Asia than in the US, despite a greater prevalence of FinTech ventures in the latter.

Henri Arslanian, Adjunct Assistant Professor at Hong Kong University who teaches graduate courses on FinTech and Entrepreneurship, believes that the reason for this is because customers in Asia are much more demanding than those in the US. They are accustomed to greater technological accessibility and convenience of services, and will simply go elsewhere if their needs aren't met.

WeChat, for instance, is being used increasingly as a mobile banking platform by customers in China. As a result, a growing number of FIs and wealth managers have started to adopt the popular Chinese mobile messaging app within the last year as a modern means of communication with their Chinese clients. Those that have yet to adapt are learning to do so the hard way.

Despite greater demand for FinTech solutions in Asia than in the US, the quality of FinTech startups in Asia compared to those in Silicon Valley is not what it could be, resulting in a "mismatch" of supply and demand in both regions, says Arslanian.

This presents an opportunity for FinTech firms and entrepreneurs in the States to target the Asian markets, something all parties stand to benefit from. Consulting firms in particular, are in the perfect position to capitalize on bridging the gap between the two markets, says Arslanian.

Harnessing private investment

While all panelists agreed that the greatest opportunities for FinTech in Asia lie in the region's B2B (business-to-business) market, Nolens believes that there are also prospects in Hong Kong's B2C market, linked specifically to raising of startup capital.

In addition to utilizing government funding and venture capital funding, Nolens feels that the FinTech industry should be harnessing Hong Kong's abundance of private investment (PI) to expand, but not before a FinTech company creates the technology to make such a thing possible.

Currently, no technology exists in the city that facilitates the automated pairing of PI money with the needs of local startups, presenting another gap in the market ready to be filled.

"Raising PI is a huge business, especially in Hong Kong," says Nolens. "There is a lot of PI money in Hong Kong which can be tech-enabled, to carry investment not just locally but globally."

Practical challenges for offshore companies

For all the opportunities that Hong Kong presents for FinTech ventures, there are an equal number of practical challenges.

Melissa Guzy, Founder and Managing Partner of venture capital firm Arbor Ventures, believes that one of Hong Kong's biggest deterrents for offshore startups is a problem shared by many of the city's inhabitants – the cost of real estate.

"With space in Cyberport costing more than in Silicon Valley, it is just not feasible for offshore startups [especially] to have their headquarters in Hong Kong," says Guzy.

Other practical challenges include Hong Kong's "PR problem," including the city's underwhelming efforts to market itself globally as a FinTech destination, compared with other Asian cities like Singapore, for example.

But perhaps even more crucially is the difficulty in hiring local talent, due to the cultural attitude towards failure nearly everywhere in Asia, compared with the United States. As the nature of FinTech in these early stages is still largely experimental, failure is part and parcel of the industry.

"Failure is a badge of honor in Silicon Valley. It means you're more backable today than you were the day before," says Guzy.

Guzy believes that attitudes across the region will shift gradually. This is already evident among many millennials in Hong Kong who are willing to explore less traditional career paths, to the initial dismay of their families.

From a venture capitalist's perspective, Guzy's first consideration is investment cost versus likelihood of success in the market. This involves asking questions like whether a VC-backed company will have a better chance of success in Asia than a global giant like PayPal did.

Despite having nearly 200 million active users globally, PayPal has less than 10 percent market share in every single Asian market, having found it difficult to compete with "national champions" like Alipay, Tencent and WeChat.

Statistics like this give offshore ventures and VCs alike a more balanced perspective on the likelihood of FinTech success in Asia.

Thinking about the future

Perhaps if FinTech innovation was viewed as a matter of survival for Hong Kong's financial industry, the challenges associated with its adoption wouldn't be so deciding.

Nolens predicts that the brick-and-mortar financial institutions of today are at risk of being replaced by FinTech companies like PayPal and WeChat – those that can provide customers with direct, individual, mobile access to banking functions, i.e. borrowing, lending and saving, without the need for a traditional bank account.

In reality, however, the likelihood of this occurring will depend on whether FIs welcome collaboration with FinTech startups in the coming years, or whether they continue to resist.

As Guzy says, "Our world will be changed by technology, tomorrow will be different. We just have to adopt it now or we'll be left behind."

From left: Henri Arslanian, Adjunct Assistant Professor, Hong Kong University; Benedicte Nolens, Senior Director, Head of Risk and Strategy, Hong Kong Securities and Futures Commission; Melissa Guzy, Founder and Managing Partner, Arbor Ventures; and Jyoti Vazirani, Partner, KPMG China

A Homegrown FinTech Industry

Before Hong Kong can accommodate the arrival of offshore FinTech ventures, the city has to first assess the readiness of its own ecosystem and consider the practical challenges of cultivating a homegrown FinTech industry.

Opportunities for local B2C players

Renu Bhatia, Founding Partner of Hong Kong-based FinTech accelerator program Super-Charger, has observed a lot of B2B and B2C local startup talent in Hong Kong looking for opportunities. However, she feels it is much more difficult for B2C players as there isn't a large enough local market, and those that start in Hong Kong typically have plans to expand regionally.

But even regional expansion from Hong Kong to other Asian countries like Singapore or Malaysia isn't as simple as it sounds, Bhatia points out. With over 20 different regulatory regimes within the Asia region, startups need to bear in mind that they aren't dealing with a single market.

Particularly for early-stage B2C startups expanding out of Hong Kong, compared with those expanding out of China or other countries like Indonesia and India where the B2C market is more developed, access to talent and capital is crucial if they are to have any chance at survival, let alone success, says Bhatia.

And unfortunately in Hong Kong's FinTech industry, talent and capital aren't that readily available.

Talent and 'tiger moms'

Hugh Madden, Chief Technology Officer at FinTech company ANX International, says that where talent is concerned, people in Hong Kong generally prefer to work for larger organizations, and it can be difficult to find experienced people who have the "risk appetite" to work for a smaller organization, let alone a startup.

Though this may be the case, a shortage of tech-skilled talent will never be an issue for local FinTech startups, due to the growing number of native Chinese-speaking, strongly skilled tech professionals and engineers just across the border in Mainland China.

As Benedicte Nolens, a panelist of the forum, puts it, "If the tech-minded offspring of Hong Kong's 'tiger moms' do not get the chance to work in FinTech startups, there will always be others willing and able to take their opportunities instead. The transience of this city means that there will always be a healthy supply of skilled professionals from around the world who would love to spend at least some part of their careers in Hong Kong."

If Hong Kong people's entrenched mindset towards risk doesn't change, the city could lose its chance of becoming a hub for homegrown FinTech talent.

But Bhatia feels optimistic, having observed that local students and young adults with some startup internship exposure "fight harder" to be part of one in the future, and are less enticed by a more traditional career path going forward.

A question of capital

Securing capital for high-risk startups is likewise no easy task in Hong Kong. Most FIs require a lengthy process of around 18 months to draw up a loan contract, a timeframe which most startups don't have the luxury of sparing.

Local VCs, on the other hand, focus heavily on cash flows and bank balance, rather than on a holistic

From left: Renu Bhatia, Founding Partner, SuperCharger; Serina Wong, Regional Sector Leader of Asset Management, APAC, and Global Sector Leader of Wealth Management, Korn Ferry International; Hugh Madden, CTO, ANX International; Gavin Leo-Rhynie, Regional Head of Technology, Asia-Pacific, Goldman Sachs; and Fangfang Chen, Senior Vice President for Strategy, Asia-Pacific, State Street Asia Ltd

consideration of all factors such as IP valuation and NPV (net present value), says Madden. While this approach can sometimes provide a healthy "push" for new startups, most of the time it is what makes the difference between survival and early-stage failure.

The solution?

"What Hong Kong needs is a homegrown success story which will provide the necessary psychological push on the funding front, the human capital front, and in schools," says Madden.

But perhaps more crucially, is the need for large financial institutions to instigate change on a greater scale.

Role of the financial services industry

A couple of years back when the FinTech ecosystem was in its infancy, startups had somewhat of a "fear" relationship with banks and regulators, who back then were only concerned with how secure a product was, and not about user experience, says Henri Arslanian, also a panelist of the forum.

Today, regulators along with the wider ecosystem are encouraging FIs to engage with startups, as they too have begun to appreciate Hong Kong's growing role in the global FinTech movement.

But a shift in industry actions has to start with a shift in industry mindset. On a societal level, this requires greater cross-fertilization between sectors, and the creation of more opportunities for large institutions to work with startups.

On an organizational level, this requires instilling the values of innovation across the entire company, rather than confining them to specific departments like R&D or technology, as may have been the case previously.

Serina Wong, Global Sector Leader at executive search firm Korn Ferry International, says that internal compensation structures which reward actions driven by creativity and innovation can help to create an associated work culture.

Signs of change

Signs of change are already apparent in Hong Kong's financial services industry, from internal work culture to hiring policy.

Gavin Leo-Rhynie, Regional Head of Technology at Goldman Sachs Asia-Pacific, has witnessed the benefits of some of the changes at his firm, and urges the wider industry not to lose momentum in the pursuit of technological progression.

"Three or four years ago, GS was reluctant to speak to the press about what it was doing from an engineering perspective, even though there were some incredibly well-respected engineers on staff. This really hurt them in terms of attracting new talent," says Leo-Rhynie.

Since then, the firm has undergone a remarkable internal cultural change to attract more engineers and tech-minded individuals.

Company initiatives like internal hackathons and greater participation in tech conferences have helped GS to push out the message that experimentation, a risk-taking mindset, and a willingness to fail are factors crucial for the advancement of the financial services industry.

In practical terms, it is about "giving people time to work on things that might fail, and the opportunity to innovate on different ways of meeting the deadline," says Leo-Rhynie.

"Many engineers in financial institutions spend their time doing very repetitive work, so by pushing these institutions to automate internally, engineers can use more of their time to innovate," he adds.

Finally, Leo-Rhynie advises organizations to accept the reality that investment for the sake of long-term innovation might bring about underwhelming results in the short-term.

The next generation

Looking ahead, the biggest challenge that Hong Kong's ecosystem faces is about fostering the next generation, so that they are well equipped with the skills necessary for survival and success in the technologically advanced society of tomorrow.

Where the financial services industry is concerned, the global FinTech movement will undoubtedly result in a change of the nature of bankers as well, for these "new banks" may no longer require MBA graduates but instead designers, creative thinkers, and computer programmers.

Leo-Rhynie suggests more collaboration among educational institutions, the government, and the private sector to nurture the city's existing tech talent.

Starting today, financial education courses should include compulsory programming, design and creative thinking classes, while schools should promote and encourage technological literacy among children – boys *and* girls – from an early age, according to the panel.

The FinTech world is still so predominantly male, due perhaps to fewer numbers of girls taking STEM (Science, Technology, Engineering, Mathematics) subjects in schools. This is certainly one area in which Hong Kong's government can directly help out, by introducing compulsory programming or coding classes into the educational curriculum, for example.

While a complete technological paradigm shift is unlikely to happen anytime soon, it certainly isn't too far off. Leo-Rhynie hazards a guess that sometime in the next 15-20 years, whether or not we are ready for it, "coding will become the new literacy."