THE FUTURE OF FINTECH IN THE MIDDLE EAST: TRENDS THAT ARE HERE TO STAY

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Ten years ago, could you ever imagine that one day you could trade fractions of stocks and virtual currencies while sitting at a bus stop, all from your cellphone? Have you ever wondered what the future of finance will look like five years from today? Imagine going to the grocery store for a seamless shopping experience: You walk in, grab a carton of milk, and walk right out while cameras recognize the items in your basket and your face to enable a secured payment. The financial world has made tremendous advances in the last 10 years due to the arrival of FinTech, and the sector is only getting bigger.

The FinTech sector in the Middle East is growing rapidly with a compounded annual growth rate (CAGR) of 30%. By 2022, it's predicted that 800+ FinTech companies from sub-segments including payments, open banking, RegTech and compliance, smart lending, InsurTech, blockchain, and cybersecurity solutions for the financial industry (such as anti-money-laundering, anti-fraud, identity theft, identity management, and others) will raise over $2 billion in venture capital funding. Since 2017, when only 30 regional FinTechs raised less than $80 million, the Middle East has seen significant growth as a FinTech hub both for investors and tech-savvy innovators. As almost half of the 400 million people in the region are under the age of 25 years, we believe the push for digital-first solutions across sectors like payments, banking, and lending will continue to surge. In this article, we want to highlight the FinTech verticals that show the most promise for rapid development in the next five years.

Digital currency

According to the Bank for International Settlements, 80% of central banks are engaging with central bank digital currency (CBDC) work in some way, with 50% already in the experimental or pilot phase.

In the Middle East, countries such as Israel, the UAE, and Saudi Arabia have displayed public interest in this trend. By creating a CBDC as a new means of payment, they can keep up with an expanding digital economy while maintaining regulatory control.

The meteoric rise of Bitcoin through this spring — from $7,000 in April 2020 to $63,000 in April 2021 — has highlighted the increased interest and institutional adoption of major cryptocurrencies. FinTech players such as social trading platform eToro and global cryptocurrency exchange Binance of course excel in this area, but central banks have also been catching on.

According to the Central Bank of Israel (CBoI), the benefits of adopting a digital version of the shekel, the local currency, include reducing the use of cash in the "shadow economy," creating a more efficient and cheaper cross-border payment infrastructure, and ensuring a backup for the payment system in case of a sudden breakdown. The CBoI established a panel led by its deputy governor to study the feasibility of a CBDC and issued a public call for responses through July. Their desire to collaborate with the professional community supports the idea of a CBDC serving the general public. In addition, the timeliness of the request emphasizes the magnitude of the rapid developments in payments and the digital economy.

Meanwhile, in February 2021, the central banks of the UAE and China joined the second phase of a joint CBDC project initiated by the Hong Kong Monetary Authority along with the Bank of Thailand. The project, known as the "Multiple CBDC

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Bridge," serves as a prototype to assess the feasibility of cross-border fund transfers, international trade settlement, and capital market transactions.

Banking as a Service

While the race for a useful digital currency managed by central banks continues, businesses outside of the financial industry are also looking to capitalize on digital trends. Embedded finance, sometimes referred to as Banking as a Service (BaaS), allows businesses outside of the financial industry to offer additional value to their customers through digital banking services. According to research by FinTech TV, the embedded finance sector is expected to grow up to 10 times by 2025, from a current valuation of $22.5 billion to over $250 billion. Using embedded finance, a company that does not possess a banking license can integrate products such as checking accounts, consumer micro-loans, and identity verification solutions directly into their business while leaning on the regulatory permissions of another financial institution.

Companies are already taking advantage of BaaS platforms to establish deeper connections with their users and build brand loyalty. One example is white-labeled debit cards, which increase the number of touch-points between a consumer and their favorite brand while providing greater insights into the consumer's spending habits. Before the explosion of FinTech in the Middle East, seeking regulatory approvals and building the proper IT infrastructure to offer financial services was extremely costly and timely. Now, and at an increasing rate, businesses are leveraging their existing relationships with customers to offer these services at a fraction of the cost.

While embedded finance and other FinTech trends continue to grow, it is important to mention that traditional banks are here to stay. Embedded finance relies on the existing infrastructure of banks' licenses. In addition, these banks benefit from embedded finance due to the aggregated data they collect, which makes lending and insurance-writing more efficient. While they will not be completely displaced, we expect to see a rise of mobile-first approaches in banking apps as well as decentralized finance. This demand for mobile solutions is driven by the low financial inclusion rates across the region. For example, 43% of the adult population in the Arab world do not have access to bank accounts.

Challenges to growth

Despite all the advancements, the FinTech ecosystem in the Middle East still faces obstacles limiting its growth. While the ecosystem is developing rapidly in terms of tech-focused solutions, it needs additional financing from overseas to boost its impact. In addition, while many banks in the Middle East are engaging with FinTechs in exploratory projects and intense discussions, so far there have been few strategic partnerships.

In a Deloitte study of the relationship between digital leaders and FinTechs in the Middle East, only 5% of banks partnered to win while 15% partnered to differentiate. This means that banks in the Middle East are engaging with FinTechs in exploratory projects and intense discussions, but limited strategic partnerships. Whereas more banks want to offer FinTech features that enhance the customer experience and set them apart from competition, fewer banks are willing to invest in an ecosystem of partnerships built around the value propositions offered by these FinTechs and remain reluctant to integrate them into their organization's strategy. For example, instead of proactively navigating upcoming regulatory changes, banks might prefer to opt for a "wait and see" approach.

To enable the Middle East FinTech ecosystem to reach its full potential, we need to see an increased integration of FinTechs into banking strategies. Financial institutions can meet customer expectations for digital-first solutions by creating long-standing partnerships with FinTechs and jointly defining value propositions that have a tangible impact on customer experience. In addition, governments and regulators need to pursue regulatory harmonization on the national level, with the goal of building harmonized regulation across several Middle East countries. By doing so, financial institutions will feel more comfortable onboarding FinTechs and FinTechs will have more room to grow so that we, as end clients, can enjoy a seamless and much safer shopping experience on all levels.

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