WORLD / AMERICAS / CANADA

Canada’s co-operative approach to fintech

Joy Macknight | 2/10/2017 9:00 am

Canada’s fintech ecosystem is flourishing due to the backing of banks, academic institutions and government. Together they are also taking steps to capitalise on the country’s leading position in artificial intelligence research, as Joy Macknight reports.

Canada fared relatively well during the 2007-08 global financial crisis, mainly due to the conservative approach favoured by its institutions. As a result, it was touted around the world as a safe place for banking and viewed as a gold standard in managing systemic risk.

However, without such a shock to the system, Canada’s banking industry has been slow to respond to fintech innovation. “In one respect, [being insulated from a crisis] is great, but it doesn’t spur on real innovation,” says Jay Ferst, managing partner at Ferst Capital Partners, a Montreal-based fintech venture capital (VC) firm.

He adds that the industry’s attitude changed in 2014, however. The

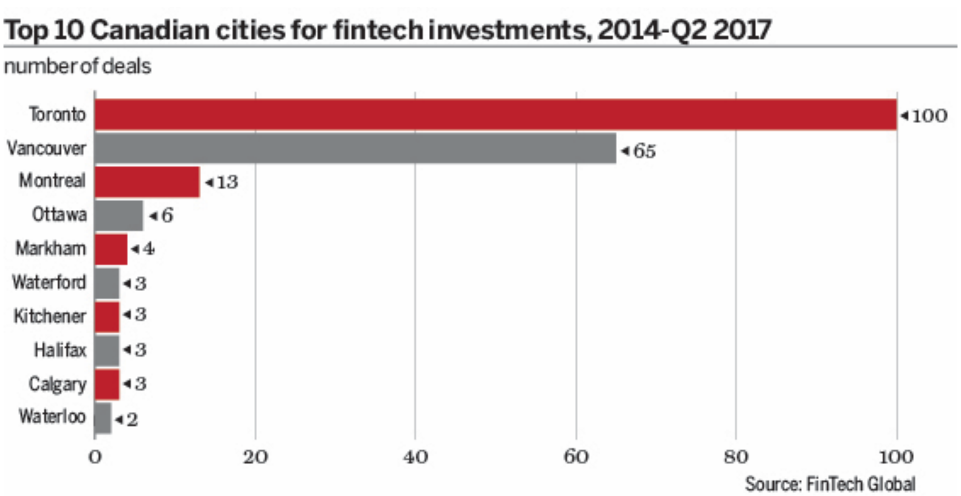
Big Five banks – Royal Bank of Canada (RBC), Toronto Dominion Bank, Scotiabank, Bank of Montreal and CIBC – together with central bank, the Bank of Canada, and both federal and provincial government, increased their efforts to provide greater support for the fintech community. "We have seen a rapid acceleration during the past three years. And, from the investment side, we see great promise," adds Mr Ferst.

Despite this activity, Canada still lags other countries in terms of VC investment in fintech. According to Innovate Finance's H1 2017 Venture Capital Fintech Investment Landscape report, based on data provided by PitchBook, Canada ranks seventh among the top 10 countries by deal value with $123m-worth of investments, compared to the first placed US, with $3.3bn and second placed China, with $1bn. Canada ranks sixth by deal volume, with just 22 deals versus the US's 357 and China's 102.

Bridging the gap

Many point to the fact that VCs in Canada are very risk averse. This cautious approach has produced funding issues for many start-ups, not just fintechs. While capital is available for very early stage start-ups and once they reach series C or pre-initial public offering, there is a gaping hole in the middle.

"Many fintechs pass the minimum viable product stage and start to scale, only to hit this dead zone," says Mr Ferst. To address this, federal and provincial governments have launched several programmes, and corporates such as Power Financial Corporation have stepped in to help.



Examples of federal government initiatives include the Scientific

Research and Experimental Development Programme, the Industrial Research Assistance Programme and Build in Canada Innovation Programme, which give tax breaks or grants to offset research and development costs.

"Although the [funding] environment has been slow to change, the Canadian government is putting a lot of investment into making that change happen and we are seeing the effects," says Guy Halford-Thompson, CEO at BTL Group, a Vancouver-based blockchain start-up.

However, financing is still lagging innovation and technology, which he believes is compounded by the lack of VC activity in Canada. He also highlights the conservative nature of Canadian investors and VCs.

Going public

BTL took a different approach to capital raising. Within a year of launch, in November 2015, the start-up went public as TSXV:BTL on the TSX Venture Exchange under the exchange's capital pool company (CPC) programme. "The CPC programme is designed to enable early-stage companies to list without going through a huge expense or stringent requirements," says Mr Halford-Thompson.

The company has raised $6.5m more cheaply than tapping the VC community, he says, and he encourages other companies to take the same route. "Most think listing is expensive, heavily regulated and with lots of overhead – and it can be if it isn't structured properly. But going public opens the doors to a wider investor community, especially given the lack of VCs in Canada," he adds.

When looking at the geographical spread of investment, unsurprisingly it is Toronto – Canada's largest city and premier financial centre – that pulls in the greatest amount of fintech dollars. According to FinTech Global, out of a total $997.8m invested in the top three Canadian cities between 2014 and the second quarter of 2017, Toronto received $596.8m, Vancouver attracted $201.4m and Montreal saw $199.6m of investment.

According to Toronto Financial Services Alliance's February 2017 report, Toronto's growing reputation as a global fintech hub is built on "a strong core of financial institutions, top-tier research facilities at local academic institutions, a strong talent base and relatively low business operating costs compared with other global fintech ecosystems".

The fintech ecosystem also benefits from the development of the Toronto-Kitchener-Waterloo corridor, which links several notable universities as well as large innovation hubs, such as MaRS Discovery District in Toronto and Communitech in Kitchener-Waterloo.

MaRS, for example, is home to more than 200 companies, from fintech start-ups such as League and Zafin, to banks including CIBC and RBC, and large tech companies such as IBM and Airbnb. According to Salim Teja, president, venture services, at MaRS, the aim is to attract a concentrated pool of high-quality talent to the Toronto and Kitchener-Waterloo area, not just technologists but executives, operations experts, board members and advisers.

Canada-wide innovation

But fintech innovation is not limited to Toronto, as evidenced by the FinTech Global investment statistics. According to Will Cornelissen, a partner at Deloitte Canada: "Vancouver and Montreal have different competitive environments, which can foster different mentalities and out-of-the-box thinking."

BTL's chief innovation officer, Hugh Halford-Thompson, admits it is hard to argue with the bank proximity in Toronto, but points to many successful fintech companies based in other cities. "In Toronto, the banks are across the street, making it easier to meet with senior people, but the downside is that it limits a start-up's scope and ambition. Toronto start-ups are well known in Canada but not globally because it is difficult to break out of that scene," he says. "On the other hand, companies built in Montreal or Vancouver may have to put in more effort at the beginning but right away they are pitching to European and US banks."

He emphasises that fintechs have access to the same level and quality of talent in Vancouver as in Toronto. "Many come to Vancouver because of the lifestyle, city and the company culture – it has a disproportionate amount of high-quality developers in the fintech space," he says. "The large tech companies in Silicon Valley look to Vancouver because it is in the same time zone, and if they want to access Canadian talent then it makes more sense than Toronto."

Ian Chan, partner, exponentials and innovation leader, at Deloitte Canada, says: "While it is nice to be based at MaRS or Communitech because of clientele proximity, as soon as a fintech gets one or two banks on board, they will want exclusivity. It also plays havoc with long-term cash flows because many VCs ask about the third client. I usually query Canadian start-ups about their rest-of-the-world strategy."

AI expertise

Artificial intelligence (AI), specifically deep learning, is an area where Canada is recognised as a world leader. In 2012, research teams at University of Toronto, McGill University and University of Alberta made a significant breakthrough, led by Geoffrey Hinton (now chief scientific adviser at the MaRS-based Vector Institute). To remain in front, the Canadian government has invested $125m in AI research, which led to creation of three institutes: Vector, Montreal Institute for Learning Algorithms and Alberta Machine Intelligence Institute.

RBC, Canada's largest bank by Tier 1 capital, has also set up an AI research institute at MaRS that focuses on both fundamental and applied research. The bank recognised its responsibility in creating a place where PhD students can continue to do world-class research in Canada after their degree, according to Foteini Agrafioti, RBC's chief science officer.

"It is very rare to find leadership that truly understands this – the responsibility to the country and investing in research, not just innovation. It is easy to spin-up labs, hack things together and create prototypes but it is much harder to do research. The unknowns, the risk associated, the long timelines – you need a vision to be able to execute on such things," she says.

The RBC Research Institute is also exploring wider social issues, such as healthcare and global warming. "RBC is putting research dollars into areas other than financial services," says Ms Agrafioti. "The research team is also encouraged to publish its research and participate in academic conferences."

In this way, life inside the bank is an extension of academic life, which helps recruitment. "That openness is a key ingredient in attracting the right talent, because academic freedom is a core value for researchers," she says. "I can't emphasise enough how important it is to be able to publish research because that moves us away from a world of industrial trade secrets. I hope other industries follow suit."

More stories from this section

- RBC CEO Dave McKay looks to stay ahead of technology
- Nafta or not: Mexico’s economy in the balance
- Canadian banks hit by low oil and gas prices
- TPP to benefit a third of global economy
- Scotiabank CEO sticking to growth plan
- Building a global mid-market challenger

https://o-tracking-builder.ft.com/v1/banker?source=banker