Fintech investors say the Wirecard scandal will put increased regulatory pressure on payments companies and stymie growth for startups

By Dan DeFrancesco and Shannen Balogh

Fintech investors are bracing for the possibility of stricter regulations for the payments space in light of the Wirecard scandal, and some say there could be knock-on effects to the red-hot industry.

As the dust settles on the accounting fraud uncovered at German payments giant Wirecard, which filed for insolvency after revealing it couldn't account for $2 billion in cash reserves on its balance sheet, industry insiders have begun to assess what impact the high-profile scandal will have on the wider payments industry.

And while nearly all fintech investors we spoke to said that Wirecard represents an outlier as opposed to an example of wider issues that exist among payments companies, they also expect that nearly everyone will take a closer look at companies in the space.

"While the payments industry may not be more susceptible to fraud in a 'post-Wirecard' world, investors and regulators will prudently operate under the assumption that it is," Ashley Paston, an investor at Bain Capital Ventures, told Business Insider via email. "On the investor front, we will certainly see extra due diligence prior to investing."

Much of the additional attention stems from the criticism Germany's Federal Financial Supervisory Authority, also known at BaFin, has received. The regulator had previously banned short selling of Wirecard's stock despite reports of its financial misconduct. As a result, many expect a tougher stance from regulators across Europe, and potentially globally.

"On the regulator side, we will see a strong overcorrection, especially in light of how poorly BaFin comes out of this looking, after they chose to prevent short-selling of Wirecard stock rather than investigate allegations against the company back in January 2019," Paston added.

New regulations could have a significant impact on upstarts

Likely the biggest, and most obvious, change that will occur as a result of the Wirecard scandal are additional regulations.

Payments, like the rest of financial services, is already a highly-regulated space. Startups and incumbents alike have to keep a close eye on everything from fraud and anti-money laundering to compliance across borders.

But Yusuf Özdalga, a London-based partner for QED Investors, told Business Insider non-bank payment companies, in general, will be looked at more closely and face more compliance requirements thanks to the Wirecard scandal.

Additional scrutiny is likely to impact early-stage companies the most, Özdalga said, as more rules require additional capital, which can be tricky for a startup.

"They may effectively need a bit more capital/resources as they look to launch from the ground up," he said. "I don't think this will be a big impediment in the long run. But in the short- to medium-term, if you're starting such a business you'll sort of have to count on a bit more regulation and allocate more resources to deal with that."

Fintechs have made their name in the payments space in recent years. From unicorns like $36 billion Stripe to smaller players like Finix, investors have been pouring money into payments-focused startups. And this has only accelerated as the coronavirus pandemic has shifted spending largely online.

On one hand, more rules could create an opportunity for upstarts. Being able to smoothly navigate compliance and governance issues could represent a way to differentiate themselves in what has become a crowded space. There are already startups out there specializing in managing fraud and compliance, selling their software to fellow non-bank tech firms who process payments.

However, for the most part, stricter compliance requirements will likely accelerate the consolidation that is already beginning to take place in the space. The startups with the backing to deal with higher requirements will be fine, while those who have yet to attract big-money rounds will fall further behind, Özdalga said.

"For fintechs, the future now holds more red tape and compliance, which could ultimately stifle growth of newcomers," Paston added.

Additional regulation could come in the form of new certifications, according to one industry expert. Ralph Dangelmaier, CEO of payments fintech BlueSnap, told Business Insider that he thinks the US could even consider requiring a license to process payments, similar to Europe.

In the US, to offer banking services like checking accounts, for example, you need a bank charter. Non-bank fintechs tend to partner with banks to roll out their financial products. That's not the case with payments, Dangelmaier said.

"I'm completely convinced this is happening with others. Maybe not the banks, but potentially with these platforms that are now selling payments," Dangelmaier said.

Customers might look to work with more traditional players

Additional scrutiny won't just be from rule makers, insiders said. One fintech investor told Business Insider that companies in need of payment services will become more selective about who they work with. As a result, startups, which have less of a track record than established players, could have a tough time.

The irony of that trend, the investor said, is the fact Wirecard was in fact a major player in the space. Still, that won't stop some from choosing to go with the more well-known names in the industry.

Özdalga echoed similar sentiments.

"This will favor more secure, incumbent players. If you're using payment service providers or other payment institutions, you're definitely going to be looking at the ones that are best-funded and have the best policies," he said.

"That will drive volumes towards more established and more secure players," Özdalga added.

The venture-capital community won't be spared from scrutiny either, Özdalga said. While Wirecard was a well-established, publicly-traded company, he still believes more pressure will be put on investors of private companies to perform better due diligence.

While much of the focus will remain on private equity and growth-stage funds that invest in more mature companies, Özdalga believes eventually those concerns will trickle down to even early-stage investors.

It's a theme that has already seen traction in the wake of some of the issues high-profile startups faced in 2019, most notably WeWork.

"I think there will be a call for funds taking more responsibility, doing better diligence, crossing their T's and dotting their I's better," he said.

"I think LPs, as they think about where to invest, they will — and they should — scrutinize very carefully the [due diligence] practices of funds they invest in. I think that will be one outcome as well," Özdalga added.