Fintech Companies in Emerging Markets

State of Play, Financial Inclusion Potential, And Your Role

Gayatri Murthy
Financial Sector Specialist, CGAP
The Enabling Environment For Fintech
Fintech continues to explode globally, and in emerging markets.

Many services appear as do ecosystems of incubators, accelerators, etc. But things shift fast!
The solutions and their scale is dependent on enabling regulation

Enabling Regulation
CGAP Research Shows 4 Enablers are crucial:
- Non-bank e-money issuance
- Use of agents
- Risk-based customer due diligence
- Customer protection

Mexico Fintech Law

P2P legislation in India and Indonesia

M-Pesa enabled by Kenyan E-money issuance
Robust financial and physical infrastructure is also key to fintech development

Robust financial and physical infrastructure:
• Mobile phone
• Mobile internet connections
• Reliable electricity
• Digital ID system
• Real-time, interoperable payments
• Data sharing regimes (rare)

Account Holders (Findex)

<table>
<thead>
<tr>
<th>Country</th>
<th>2011</th>
<th>2018</th>
</tr>
</thead>
<tbody>
<tr>
<td>Indonesia</td>
<td>20%</td>
<td>49%</td>
</tr>
<tr>
<td>India</td>
<td>35%</td>
<td>80%</td>
</tr>
<tr>
<td>Kenya</td>
<td>42%</td>
<td>82%</td>
</tr>
</tbody>
</table>

Mobile Internet Penetration (GSMA)

<table>
<thead>
<tr>
<th>Country</th>
<th>2014</th>
<th>2018</th>
</tr>
</thead>
<tbody>
<tr>
<td>Indonesia</td>
<td>21%</td>
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<tr>
<td>Kenya</td>
<td>16%</td>
<td>24%</td>
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</table>
These two factors also determine whether these solutions can reach BOP or not

Enabling Regulation

Robust financial and physical infrastructure:

Reach BOP or not:
- Example: Nigeria’s BVN number
- Example: Most agents, merchants and drivers focused in rural areas
Guideline: Understand and support external factors that are crucial

- Fintech can diversify the market if allowed to compete
- Fintech goes mass market where rails exist
- Enabling regulation
- Financial and physical infrastructure
The Nature of Solutions and Services
Proliferation so far is uneven, and understandably has focused on payments and credit.

- **Payments**
  - Wallets
  - Domestic remittances
  - POS devices
  - Payment processing for merchants

- **Insurance**

- **Service Marketplaces**

- **B2B Payment Solutions**

- **Platforms**
  - e.g: GoJek, Mercado Libre

- **Credit**
  - P2P versus balance sheet
  - Individual, MSMEs, Agri
  - Factoring, crowdsourcing

- **Digital Banks**
A wide range of products are grouped under the fintech umbrella.

Many ways to slice and dice

**B2B**
(Serving banks, MFI)
- Payment distribution, agent management,
- BaaS, SaaS, chatbots

**B2C**
(Serving End customer)
- Payments - wallets, remittances, POS machines, payment processors
- Digital credit for SMEs, individuals, agri, P2P, factoring, asset finance
- Micro-saving apps, social savings
- P2P insurance, voucher insurance, automated claims,

**Inclusive or not**

The fintech explosion is varied and uneven

Focus is on classifying services and creating taxonomies

Many good taxonomies exist - World Bank, the Mix and the Cambridge Center

**Pay**
- Payment distribution, agent management,

**Borrow**
- Credit scoring, data analytics, KYC checks

**Save**
- Literacy tools

**Protect**
- Regtech, Suptech
- Cyber-security tools

**Digital**
- Cyber-security tools
- Security tools

**BaaS, SaaS, chatbots**

**Digital Banks**

**Marketplaces**

**Platforms**
Variations within product groups are also important to understand.

- **Segment**
  - Individual
  - MSME
  - Agriculture
  - Asset finance

- **Business Model**
  - P2P
  - Balance sheet lending

- **Frontier/early-stage**
  - Invoice Discounting
  - Crowdfunding
  - Digital ROSCA

This level of detail is key to understanding viability, innovation and inclusivity.
Important to connect products with business innovation and with value

<table>
<thead>
<tr>
<th>Product</th>
<th>Innovation</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Payments</td>
<td>QR Codes</td>
<td>Allows many to pay easily; merchants to digitize; creates digital footprints</td>
</tr>
<tr>
<td>Credit</td>
<td>P2P lenders connect funds with borrowers; take on risk.</td>
<td>Reduces risk to lend; connects unused funds with lenders</td>
</tr>
</tbody>
</table>

**Payments**
- QR Codes
- Easy-to-use apps
- POS

**Credit**
- Alternate credit scoring using phone data and bank transactions to assess people and firms
- Creates creditworthiness where it didn’t exist before
Maturity of products is a key factor in determining impact in markets.

<table>
<thead>
<tr>
<th>Replicability</th>
<th>Early Stage</th>
<th>Growth Stage</th>
<th>Mature Stage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Model validation</td>
<td>Customer use &amp; behavior</td>
<td>Financial inclusion effects</td>
<td></td>
</tr>
<tr>
<td>Customer risks</td>
<td>Scalability and market effects</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Funding</td>
<td>Seed</td>
<td>Series A-C</td>
<td>Series D+</td>
</tr>
</tbody>
</table>

Large variations in capital availability.

Large variations in models and their maturity by market.
Funding Flows & Gaps
The funder community sees benefit in engaging with fintechs

Fintech could improve access for the underserved

FOR EMERGING AND DEVELOPING MARKETS

- Better infrastructure (financial)
- Greater competition & choice
- Use cases for payments accounts

FOR THE UNDERSERVED, LOW-INCOME CUSTOMER

- Cost
- Access
- Fit
- Experience
According to the latest data from CGAP Funder Survey, “Digital Finance” was the third most funded project theme globally with a total of $1.59 bn commitments in 2018.

“Micro and Small Enterprises”, and “Women” were the two project themes that received more funding than “Digital Finance”, in that order.
Public Funding for Digital Finance: The Big Picture--2018

212 PROJECTS

$1.59bn COMMITMENTS

18 ACTIVE FUNDERS
But lack of data on funding flows, that combine public, private and venture funding

So hard to assess gaps in market-making when full picture is not evident
Africa is often excluded from global funding numbers

- Total African venture investments reached a record high in 2019: USD 1,340 Bn in investments through 427 deals in equity and debt financing and a total of 203 investors.

- Funding is uneven within the continent. More than 75% of the deals were concentrated in Nigeria, Kenya and South Africa creating a funding gap in francophone. In 2018, only 1% of the $1.16 billion raised in equity by African Tech Startup in 2018 was allocated to francophone Africa.

- Fintech retained its top position as the sector with most funding: USD 678.73 Mn, a 138.48% increase compared to the previous year.
Stable fintech products attract more funding

Over the past years, a handful of sectors and products (e.g. payments and credit) attracted more funding than other sectors.

**Example:** Payment and Credit in India

Funders are now beginning to invest emerging models like Insuretech, but in select markets.
There is lack of early-stage funding

Quarterly Deal Share by Stage to Global VC-Banked Fintech Companies

Source: CB Insights Q3'19 Report
In emerging markets, lack of early-stage financing leads to inefficient innovation.

**Developed markets**

- **Seed** (prototype, founding team)
  - Broad source of funding available: angel investors, friends/family, own funds

- **Venture** (Pilot, iterate, marketing, sales)
  - Constant pipeline for VC maintained
  - Scarce funding: Little to no angel investing. Small grants are very competitive
  - Small set makes it this far. Focus is mostly on proven models like credit and payments

- **Growth** (sales, impact)
  - Active pipeline: Large valuations, follow-on equity rounds, debt capital accessible
  - Constrained pipeline: Few larger follow-on equity rounds, focus on demonstrated models, little debt financing available

**Emerging markets**

- **Valley of death**

**Market disruption, influencing incumbents, M&A activity**

- **Mature companies** (expand, diversify)
  - Little or no pathways to scale and exit for ventures (acquisitions by incumbents are rare)
We haven’t yet connected capital with evidence

At all levels of maturity, we are not sure of our effects. Insight buried within firms, investors and few actors. No one sees the whole picture.

**Mature Stage**

- Low Public-Funder Participation
  - Big payment wallets: Paytm, GO Pay, Paga, MobiKwik, OXXO, GCash
- Medium Public-Funder Participation
  - E.g.: Digital credit in E.Africa
  - Copycats: TALA, branch
  - New variations: P2P, investree, MSME, Lulalend, fenix intl

**Growth Stage**

- Experiments at the frontier
  - New models: savings, pension, etc that don’t break even early.
  - Harder-to-reach segments like agritech

**Early Stage**

- High Public-Funder Participation

• **Do maturing** products see cost reductions and secondary effects among the poor?
• **What is the viability and risks in growing** models?
• **What innovations in early** models can work and scale?
Fintech’s Effects on the Underserved
We assessed fintech activity against four key inclusion criteria

**Cost**
- Makes services more affordable
- Lowers operating costs
- Lowers end user fees
- Offers more flexible payments
- Reduces the need for expensive devices
- Requires less or cheaper connectivity
- Reduces the need for collateral

**Access**
- Makes financial services more accessible:
  - Expands eligibility through innovative means of CDD
  - Expands eligibility through innovative means of risk assessment
  - Requires less interaction at physical transaction points
  - Expands or improves the distribution of physical transaction points

**Fit**
- Makes financial services better suited to the needs and wants of underserved customers:
  - Addresses a customer need not served by typical products
  - Aligns better with the needs and wants of underserved customers
  - Allows greater customization to different contexts, user needs and preferences
  - Has a higher degree of suitability for target customers
  - Enjoys higher general trust and satisfaction from users

**Experience**
- Offers an improved user experience:
  - Has product features that are easier to access, understand and compare
  - Has an interface easier for most customers to understand and use
  - Delivers clearer value to users
  - Helps users identify, understand and resolve problems
  - Gives users control over data
  - Stronger technical security
Access to basic services has expanded where right conditions exist

<table>
<thead>
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<th>Type of access</th>
<th>Experience</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cheap, real-time payments</td>
<td>• Existing rails and long-term equity investments (despite being pre-revenue) offset costs and low price.</td>
</tr>
<tr>
<td></td>
<td>• This gives the companies time and space to generate vast amounts of observable data, gain market share and offer bundled services.</td>
</tr>
<tr>
<td>Digital individual credit</td>
<td>• Leverages comfort and trust with mobile money.</td>
</tr>
<tr>
<td></td>
<td>• Using alternate data such as mobile payments behavior and mobile use to offer tiny, non-collateralized loans</td>
</tr>
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Access for excluded groups and for long-term finance is harder

<table>
<thead>
<tr>
<th>Access</th>
<th>Fit</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>For excluded groups:</strong></td>
<td><strong>Agritech supply chain</strong></td>
</tr>
<tr>
<td></td>
<td>informal domestic workers</td>
</tr>
<tr>
<td><strong>For long-term finance:</strong></td>
<td><strong>Micro-insurance with flexible premiums</strong></td>
</tr>
<tr>
<td></td>
<td><strong>Micro-savings with bite-sized contributions</strong></td>
</tr>
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- Generally early-stage.
- Need patient capital to develop scores, creditworthiness.
- Products are new and complex; require capital to ascertain viability.
- Don’t give returns for a long time.
Costs rise for riskier or specialized segments

- If basic digital credit (Branch, Tala, Mshwari, etc) is extended to agriculture and SME loans, and are higher ticket, then the fully digital model does not work as well.
- Costs go up as partnerships, additional checks and deep context are needed on the ground if loans involve input financing for farmers or invoice factoring for SMEs.
Experience is enhanced, but largely on the smartphone

Policybazaar makes insurance easy to pick

Paytm’s money manager

GoPay’s platform expands use cases

Choose a plan as per your needs

5 Steps to Manage your Money Better in 2019
Access and Experience is not always virtual, not all apps

Especially for complex products and for excluded groups, fintechs and their customers need to meet physically.

MSME lenders in India assess firms bank transactions but also needs to “see” businesses and build sector expertise. Growth is restricted to few geographies as expertise develops.

Shared network of roaming agent throughout the territory that can perform in person visits to people at their homes. provides a physical front to a range of services that are natively digital.

Few companies have figured out how to do this at scale.
Considerations for Funding

• Funding for “large” companies going downstream, e.g.: Paytm, Policybazaar, etc

• Funding “difficult” products aimed at: excluded groups (developing scores for farmers, MSMEs, etc)
  • Models that combine tech and touch
    E.g.: Kobra, Aye

• Funding riskier models such as long-term finance—(insurance for gig workers, bite-sized savings)—where returns slow or not guaranteed.
Questions for you

• Does this “state of play” for fintech resonate with you?
• What factors that you have noticed are missing?
• Are you satisfied with what you know about fintech? What are other knowledge gaps?
• How do you measure market effects?
For further reading

Main paper summary lessons

Case studies showcasing pilots with 18 fintechs

http://cgap.org/fintech