Africa – The Fintech Fulcrum Between East and West

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With 20 years of experience in investment banking, Edmund Higenbottam, Managing Director of Verdant Capital (IMAP South Africa), the largest advisor to the Fintech sector in Africa, talks to Creating Value about Fintech in Africa and why the continent's flourishing tech landscape is so attractive to investors.

Africa is currently home to just under 500 Fintech firms[1], with South Africa, Nigeria, and Kenya at the forefront of startup activity. So, what makes the continent so attractive? The African Fintech market is not only potentially very large, it is highly unpenetrated. Of the 1.1 billion people in sub-Sahara Africa, two-thirds of them are unbanked. Therefore, there is enormous scope for Fintechs to onboard these demographics into the financial sector. Furthermore, customers with access to credit is only a fraction of the proportion of the population with a bank account, so for innovative credit businesses, this is a huge opportunity to come to market and provide credit products to individuals and enterprises for the first time.

Ideal Testing Ground for Technology Solutions

In the past, and indeed still today, technology and business models from the West have been applied in Africa, e.g. the merchant cash advance business model from the US, which is being employed in South Africa – the pioneer and largest operator in South Africa being Retail Capital.

[1] https://disrupt-africa.com/finnovating-for-africa/

However, we are now also seeing a real sense of two-way technology transfer, by means of an interesting flow of efficient solutions for bottom-of-pyramid income groups in the first world – take the number of people on food stamps in the US and it would be the 10th largest country in Africa.

Customer identification technology for example is a growing segment as most countries still don't have ID cards or digital ID schemes, and systems such as Aadhar, the nationwide biometric identification system in India, are simply not available in most African countries. This means the private sector must provide its own solution.

The African landscape, with its physically dispersed population; a population density of 45 per km^2 versus 460 per km^2 in India, in conjunction with a poor physical infrastructure, means that technology is key in reaching customers efficiently. Though delivering solutions to end consumers is obviously a big challenge, the good news is that the technology does exist.

African Fintechs have the ideal testing ground to trial new bottom-of-pyramid solutions, before applying them in other low-income markets, as well as upper to middle income countries. Essentially, allowing other countries to leapfrog opportunities and far more advanced technology.

If we also look at the cost base, Africa boasts a well-trained pool of software engineers, that has the added benefit of being significantly cheaper than in Europe or the US. Low cost customization is particularly important in the B2B segment (e.g. insuretech and platforms), and many successful South African operators have export-driven models, such as Kalibre Life.

Composition of Income

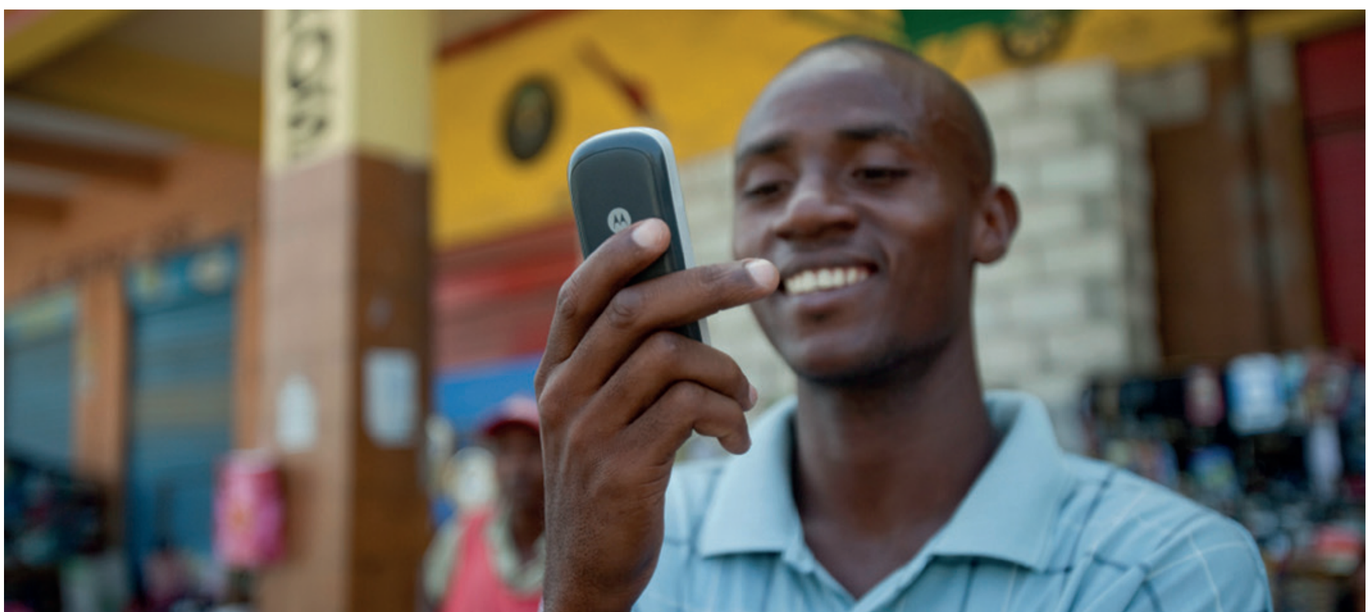
In many markets, remittances provide a large share of income and Africa is no different. In fact, they are the 2nd largest contributor to the country's GDP. Therefore, the digital termination of remittances is not only a key business model, but also a "launch pad" for broader mobile financial services products. A great example of this business model is Zeepay in Ghana.

Another large contributor to the GDP in Africa, is the micro-entrepreneur. Lack of formal state benefits in most African countries is a key spur to micro-entrepreneurship. A number of Fintech business models have disrupted the traditional microfinance business model with new ways of originating, underwriting, dispersing and collecting credit to micro-entrepreneurs. In most African markets providing credit, as opposed to collecting credit, is not subject to regulation.

COVID-19 Fallout – Getting Over the Technological Hump

The COVID crisis and lockdown situation has in fact been a coup in terms of the adoption of digital payments. People simply don't want to leave their homes, meaning an increase in demand for digital banking services and online payment platforms. Kenya, now the biggest mobile money country in Africa, was the first to adopt mobile money, but why are they arguably so far ahead in the game?

Most analysis now points to the post-election violence in 2007 - when the USSD payment technology was pioneered – which left people scared to leave their homes, hence people quickly got over the adoption hump and were more willing to embrace new technologies. Of course, it does help that the complicated issue of data privacy simply isn't an issue in Africa and is seen as a first world problem.



COVID also means that we are expecting to see a ramp up in the activity of development banks, which is extremely important as they are increasing capital levels which makes its way in to the bricks and mortar financial sector.

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Global Players Looking for Market Share and Synergies

There isn't the same conveyor belt of funding available in Africa, hence companies find themselves forced to be profitable and mature sooner. Luckily, with lower operating costs, it's easier for companies to break even earlier. If we look at a Series A company, that has an 8-year operating history, a proven model and is profitable, yet it hasn't scaled, this company is actually as mature as a Series B company in many other countries. It's not surprising therefore, that in Africa it is often said, that you get *"Series B maturity in a Series A raise"*.

In terms of the most active players, there is a wealth of global Fintech investors, including VCs, PE and strategic investors. We have a lot of experience in this sector, executing transactions in 20 African countries, and have built up a strong relationship with around 30 key investors, and we have contacts with many more. It seems that at the moment, VC funds on the West Coast are very keen to do at least one Fintech deal in Africa, driving an increase in the level of interest in African Fintech firms and technology.

We are currently seeing high levels of cross border M&A opportunities. Though the traditional credit card business model utilized across the rest of the world has been slow to take off in Africa, global payments groups are increasingly seeking to buy up market share, looking for synergistic businesses, as well as other payment channels, such as mobile wallet, VSR codes, mobile money, remittances, etc. Large Chinese players for example, continue to buy-up the technology value chain, essentially expanding where they are most strong. Another driving factor is consolidation.

Dealmaking in the Current Environment

When it comes to exit, Africa, along with perhaps LatAm, is a fulcrum between East and West, thus the high number of acquisitions and investments. Leading US payments businesses such as VISA, Mastercard and Paypal are actively acquiring investments/ businesses, competing with leading Chinese tech giants such as Ant Financial, Tencent and Transsient.

If we look at where we are today, compared to a year ago, COVID has had a significant impact, with valuations now sitting at roughly half of what they were.

At the end of the day, people are still happy to do deals. Even though processes, such as due diligences may perhaps take longer now, we have the technology available to help facilitate a "virtual process". We have even undertaken virtual site visits, in fact, you could say it's almost easier to buy a company without physically seeing it, than perhaps buy a house.

In terms of general advice to our clients, simply put, 24 is the new 12. By this I mean that we would generally advise clients looking to sandbag their business plans to ensure they have 12 months of funds available. However, with things how they are, our new recommendation would be to up this to 24 months. ■