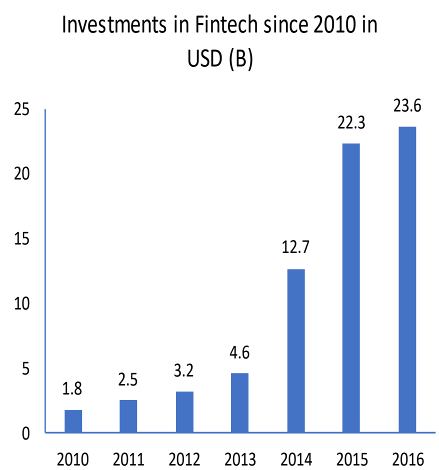
Financial Technology (Fintech)

“A Different Ball Game”

What is Fintech?

Fintech is the intense transformation that technology is bringing to finance. There are several players of fintech ranging from fintech startups (new companies trying to create new services and compete with existing banks) to e-commerce companies, asset managers, hedge funds and also banks who are trying to remain relevant in this space. Fintech has led the revolution of change in finance and has brought about innovation and efficiency for consumers and businesses. Moreover, increased penetration and usage of smart phones across the globe has seen fintech investments diversify from the original investment destinations of the developed nations.

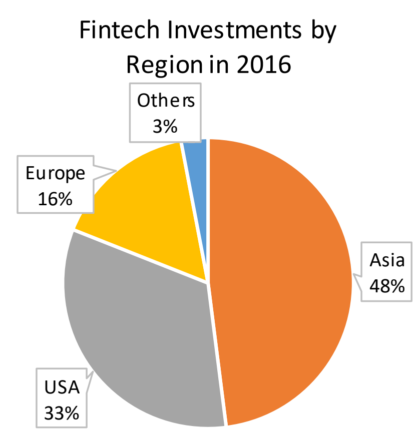


Source: Accenture and CB insights

Reasons That Gave Birth to Fintech

I. **Aftermath of the financial crisis of 2008:** after the global financial crisis of 2008, people’s trust in banks weakened significantly. This paved way for fintech as it created a more positive social impact in the financial space and gained traction with the penetration of mobile finance.

II. **Technology:** rapidly advancing technology with new and developed avenues of resolving financial problems have driven the development and uptake of fintech. In addition, yield seeking investors in the space have provided capital as they try to eat into profits previously enjoyed by banks. On the other hand, banks, in their quest to protect margins have further supported investment in the space.



Source: Accenture and CB insights

Revolutionary Changes in the Finance Space

We have seen disruption in the financial space over the past few years. The advertising industry has been disrupted by the likes of Facebook and Google, which are inexpensive and provide a global reach for businesses. On the other hand, we have also witnessed disruption in the travel industry with online booking platforms such as booking.com and Expedia who are now dominant in the space and are slowly phasing out travel agencies. In addition, smartphones have rendered digital cameras and Mp3 players among other devices obsolete.

However, finance has been the last to transform- so why is it transforming today? This is because of two things; demand and supply. On the demand side, there is greater demand from consumers and businesses. The following explain the changes

Research Analyst

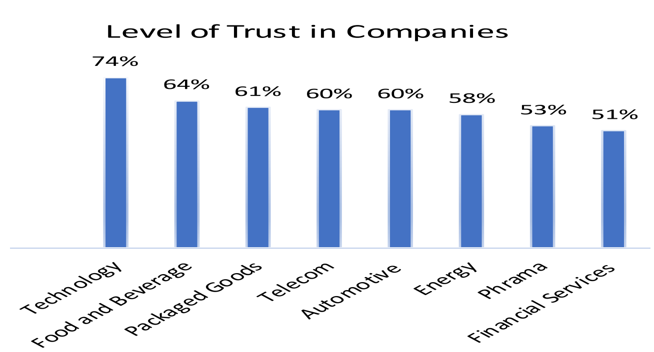
Shaniza Kassam
skassam@apexafrica.com
+254 20 7602533

in **demand;**

Consumers' perception of banks has changed: 20 years ago, banks were some of the most trusted organizations for consumers. After the financial crisis of 2008, consumers level of trust in large financial institutions deteriorated significantly (from 90% in 1983 to 19% today, source: British Social Attitudes Survey). Consumers now trust technology more as they spend most of their time on smartphones and social media platforms.

Age pyramid: 10 years ago, very few people were born with the internet and a few started their work life with the internet. Today, the situation is totally different- people are very familiar with the internet, most people own a smartphone and as such most people have totally different behaviors in terms of what they expect of technology.

Consumer behaviour: In finance, trust is key and nowadays, consumers place more trust in tech companies as compared to financial institutions. 10 years ago, people would have been reluctant to put their credit card numbers on the internet while today we have a situation where new companies like Wealthfront, after just 6 months in existence, received USD 500,000 from consumers who just wired their money into its account.



Source: Edelman Trust Barometer, 2017 Survey

On the other hand, **supply** is growing at the same pace to cater for consumers and businesses ever-growing demand;

Smartphone: many new companies can offer financial services today without having to spend enormous amounts of money to build branches and to hire people, but they can access millions of consumers directly on their smartphones.

Technology has become cheaper: for example, Amazon Web Services offers inexpensive cloud computing services. These web services can be accessed by anyone for the cost of USD 100 per month. 5 or 10 years ago it would have been impossible to get the same kind of technology. For that price, you would need to have atleast USD 10M in terms of machines, computers and software. Therefore, new cheap infrastructure is becoming easily accessible and is leading the transformation in finance.

Regulators are supporting fintech: In October 2014, Martin Wheatley the ex-chief executive of the Financial Services Authority (FCA) in the UK, stated that competition will come from enhanced innovation which will be facilitated by smaller companies. Thereafter, regulators started supporting smaller companies and have continued to do so.

Fintech is not only gaining traction from smaller companies but also from large digital companies such as Alibaba, Amazon and Tencent. This is because finance has been very slow in its transition into the digital space, thus presenting opportunities for well-established digital companies to curve a niche for themselves in finance.

With Finance sitting at the heart of commerce, most companies may eventually have to adopt fintech in their day-to-day operations.

Fintech Innovation

Types of fintech innovation;

I. Better, cheaper, faster

The notion of better, cheaper and faster is brought about by the unbundling of finance. Unbundling of finance is breaking down the core services an organization offers and with each core service, encouraging new companies to specialize on that particular core service. Consequently, more choices, cheaper choices and more products are great for consumers and organizations. Although for traditional companies, more competitors would lead to margin compression and new entrants would face high customer acquisition costs whilst fight on margins, leading to low revenues. When starting out, Amazon had very tight margins, required high capital but at the end became very successful. Amazon also started unbundling and competing on a specific segment, which was books but went ahead and re-bundled, so today on Amazon you can buy much more than just books such as electronics and groceries.

Applications;

i. **FX payments:** companies like WorldRemit now offer the same service as a bank but at a fraction of the cost through an online platform, without having to visit a branch.

ii. **Prepaid debit card:** when you visit a foreign country, opening a bank account is very difficult and impractical if you're going on vacation. That is why Loot in the UK, together with other companies created an instant prepaid card that you can use in any currency.

iii. **Challenger banks** are small, recently created retail banks that compete with the longer-established banks in the country but offer cheaper services such as Monzo in Europe

iv. **Payment:** Safaricom in Kenya started as a telco and then went ahead and launched a mobile money payment platform dubbed M-Pesa while WeChat in China started as a messenger service and then introduced a payment platform.

II. Different

Fintech innovation that is different, is complex and less natural but can have a greater impact such as disruptive innovation. Data in general will have a huge disruptive impact in finance. For example, Sesame Credit (created by Alibaba) in China undertakes credit scoring by taking an entire range of social information and create a credit score of an individual but ofcourse this poses several questions on privacy and ethics but could totally disrupt finance.

Applications;

i. **Peer-to-peer lending** removed intermediaries like banks and connected people who can lend directly to each other. For e.g. Lending Club in the U.S.

ii. **Crowdfunding** is the practice of funding a project or venture by raising many small amounts of money from a large number of people, typically via the Internet. Platforms like CrowdCube are pretty much the democratization of venture capital- so anybody can investment a small amount into small companies and experience what if feels like to be a venture capitalist. This was not possible a few years ago and was only limited to large organizations who could invest into other companies.

iii. **Cryptocurrencies:** are digital assets designed to work as a medium of exchange that uses cryptography to secure its transactions, to control the creation of additional units, and to verify the transfer of assets. The future of cryptocurrencies is unclear but could phase out paper-money in the future.

How NSE Listed Companies Can Survive and Thrive in the Fintech Space.

Engage: firms should engage in trending fintech technologies such as blockchain technology. A block is the 'current' part of a blockchain which records the recent transactions. Once it is verified, it becomes a permanent part of the growing blockchain. Blockchain technology is vital today because it is secure and reduces transaction times. For example, bank-to-bank transactions may take days to settle especially outside the ordinary working hours but with blockchain technology these would be reduced to minutes.

Embrace: companies can either create fintech solutions in-house or acquire/partner with start-ups. Not only will this allow them to retain talent and culture that will thrive tech business but will also allow them to enjoy a share of profits.

Evolve: organizations should envision how the world would be like in the next 5-10 years. We picture a lifestyle that will be fully digital. Therefore, firms will have to kick-out all manual processes and adopt the latest technologies to keep up with this digitally dependent world.

Let us look at fintech applications that could well-position NSE listed companies in various sectors:

Banking;

i. Adopt credit scoring systems for loans: For instance, a mortgage proposal usually needs a few weeks to be processed and returned to customers before returning response. However, if a bank invests in credit scoring systems or data analytics then a mortgage proposal can be processed within minutes. This strategy would attract customers and increase the bank's top line.

Live remote tellers: banks should adopt innovative ATM-based technology that lets people talk to a live remote teller and gives the teller remote access to the machine to help customers make transactions. NIC Bank, is the first listed bank in East Africa to install the NCR Interactive Teller, which will digitize transactions and enhance the banking experience for its customers. This is also expected to ease its operating expenses going forward.

Investment;

i. Software robots: software robots offer customers advice on how much money to invest and where to invest based on them answering a few questions. In the long run, this will eliminate the need for human financial advisors for people investing small amounts.

Commercial;

i. **Cloud computing services:** can save time and money for firms by outsourcing cloud hosting services to a local provider. These services include data storage, security I.T functions without the hassle of setting up and managing the infrastructure.

Insurance;

i. Claims processing with blockchain technology: using satellite information and sensor data can improve efficiency throughout the claims processing funnel. If insurers can be informed of a car accident instantaneously, they can begin the claims procedure right away.

In Summary…

Millennials are coming, data is the new oil and network effects & blockchain-based ecosystems might dominate the economy of the future. Therefore, a principle-based approach might be a good way for businesses to survive our faster future.

Disclaimer

ApexAfrica and its parent company AXYS Group seek to do business with companies covered in their research reports. Consequently, a conflict of interest may arise that could affect the objectivity of this report. This document should only be considered a single factor used by investors in making their investment decisions. The reader should independently evaluate the investment risks and is solely responsible for their investment decisions. The opinions and information portrayed in this report may change without prior notice to investors.

This publication may not be distributed to the public media or quoted or used by the public media without prior and express written consent of ApexAfrica or AXYS Group.

This document does not constitute an offer, or the solicitation of an offer, for the sale or purchase of any security. Whilst every care has been taken in preparing this document, no representation, warranty or undertaking (express or implied) is given and no responsibility or liability is accepted by Apex Africa or any of its employees as to the accuracy of the information contained and opinions expressed in this report.

ApexAfrica Capital Ltd
A The Riverfront, 1st Floor, Prof. David Wasawo Drive, Off Riverside Drive | P.O. Box 43676-00100 | Nairobi | Kenya |
T: +254-20-2226440 | Fax: +254-20-2319092 | Cell: +254-723-420204|
W : www.apexafrica.com
Part of AXYS Group
W : www.axys-group.com