African fintech is trending

By Ashlin Perumall

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The African fintech ecosystem continues to expand, despite global economic challenges. As an investment segment, the fintech industry made up more than 25% of all venture capital rounds in the last few years, with South Africa joining other regional leaders, such as Egypt, Nigeria and Kenya. Out of the nine notable tech unicorns in Africa, seven are fintech companies.

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A recent study by Mastercard noted that African fintech startups increased in number from 311 in 2019 to 564 by 2021. The study also noted that of the $2.7bn in venture capital funding that was deployed in Africa in 2021, 61% of that was in fintech startups. The study found that sub-Saharan Africa region had one of the highest year-on-year growth rates globally, with fintech startups recording 894% year-on-year growth in funding in 2021. With the right targeted solutions, the potential for rapid growth is significant.

In the last few years, the region also saw the majority of fintech investment capital coming from various offshore money markets, including west-coast United States, the United Kingdom and China. African fintech startups are also able to do more with dollar-based capital raises if they have locally based operations.

Mobile money leads the way

> *Mobile money and third-party payment systems in particular, are segment leaders in the African fintech space, with more than half of the world's mobile money customers nowbased in Africa.*

A low proportion of Africa's population currently has adequate access to financial products and the potential for digital deployment of solutions took off alongside the rise in mobile and internet access. For example, due to a lack of interconnectedness in the cross-border banking infrastructure and a huge migrant labour workforce, there was a clear need for ways to transmit money across regions safely. Servicing the underbanked and migrant workforce has also created opportunities for innovative financial solutions in Africa and user markets are huge.

Kenya's fintech industry was originally focused on mobile money transfer services and has ridden the wave of exponential market adoption since 2007. Building on technology akin to GSM text messaging, major players in the market were able to expand its offering to users who did not have internet or data connection, but had access to cellular phone towers and basic mobile devices. In that same period, financial inclusion went from 26% in 2006 to 83% of the total population today. That activity created a market that many other fintech entrants were able to diversify within and as a result, a large portion of GDP flowed through such services. This makes the regulators similarly fintech-friendly and interested in being cooperative towards innovation.

Nigeria's unicorns winning the race

Three of the largest African unicorns come from Nigeria, and the country is dominant in Africa in respect of fintech venture capital investments. The Mastercard study found that Nigeria's fintechs accounted for a third of all venture capital funding deployed into fintech in 2021. The country has also benefitted from a highly entrepreneurial technology sector and deep issues in respect of financial inclusion.

> *About 38 million adults in Nigeria are completely financially excluded, particularly when it comes to credit access. This created the perfect conditions for dynamic fintechs to emerge with a massive potential market if successful.*

Senegal's Wave, the first unicorn from the Francophone African region, recently saw a $200m capital raise in a Series A round of fundraising. This was largest Series A to come out of that region to-date. Examples such as this demonstrate that there are still a lot more African regions yet to take off in the African fintech push.

SA focus on fintech fine print

South Africa benefits from a robust financial and banking industry, but one that has been slow in terms of adoption of new technologies and modernising of legacy banking tech. This has led to the country seeing additional trends in open banking fintechs that are operating on top of current bank infrastructure but providing more nimble payment channels. There have been several recent regulatory developments as the country prepares to fully adopt fintech and its various sub-segments. South Africa also has specific compliance and due diligence issues that must be addressed before and during fintech transactions.

The country has taken a coordinated approach to fintech across its regulators, first creating the Intergovernmental Fintech Working Group or IFWG, a consortium of the key financial regulators. This consortium includes the South African Reserve Bank (SARB), which also doubles up as the prudential authority and monetary systems regulator, the Financial Sector Conduct Authority (FSCA), the Financial Intelligence Centre and the country's credit regulator. This group has engaged in public-private participatory discussions and the production of position papers to settle on the policies to advise the drafting of regulations.

Much of the focus of the IFWG has been the regulation of crypto assets, with anti-money laundering and South African exchange control being the primary focus areas. In October 2022, the FSCA declared that crypto assets would not be included under the definition of 'financial products' in terms of the Financial Advisory and Intermediary Services (FAIS) Act. The effect of the Declaration is that any person who provides advice or renders intermediary services in relation to crypto assets must be authorised under the FAIS Act as a financial services provider, and must comply with the requirements of the Act.

Rise of real-time and rapid payment systems

In the wider fintech arena, South African regulators have focused on the payments regulation environment, given the size of this sub-segment and because it has been due for a significant overhaul for some time as part of the central bank's Vision 2025 programme.

> *The SARB has been working on a new Rapid Payments Programme (RPP) aimed at modernising real-time payments, such as immediate credit push, pay-by-proxy and request-to-pay functionality in the national payment system.*

In late October 2022, it was announced the RPP would implement its first service, PayShap, in 2023. PayShap, a real-time interbank digital payments service, will be offered by Absa, FNB, Nedbank and Standard Bank first, before being extended to other banks.

Treading carefully around IP issues, stagflation

The most prominent issue still encountered during fintech deals in South Africa is the housing of the intellectual property (IP) in South African corporate startups. South Africa is subject to an exchange control regime, whereby any transfer of intellectual property offshore from residents requires Reserve Bank approval. As a result, many fintechs have either structured around this with IP sitting in offshore vehicles, or have not, which then separately raises concerns with many VC investors on global expansion. Either way, IP presents a specific deal structuring and diligence issue which must be looked at carefully in the South African context.

The biggest challenge fintech faces globally is stagflation and that investors are going to be more careful in their investment choices and risk-taking. However, the African fintech space has shown incredible resilience to global market turmoil and there is still a lot more room for growth in segments such as such as alternative lending, digital investment and neo-banking.

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