Driving the fintech and regulation success story

By Lee Naik

8 Nov 2019

Tell me if you've heard this one before. Somewhere in Africa, some savvy entrepreneurs come up with a potentially disruptive solution to a longstanding infrastructural challenge. They found their own fintech, win an innovation prize or two, and manage to raise enough venture capital to grow into a viable company. However, they are hampered by a stringent regulatory environment that just doesn't understand their business.

Lee Naik, CEO of TransUnion Africa

The story of the plucky start-up going up against red tape and backwards-thinking bureaucrats is a pretty compelling one, especially if you're the plucky start-up. And there's certainly an element of truth to it - in most places, existing regulations are written in a way that's currently oriented towards traditional credit and finance.

But it's only half the story. No-one likes to hear about the other half, where our fintech is about to fold.

For all the growth we're seeing in the African fintech market, it's a stark reality that most of these companies will not survive past the first few years. You've heard the stats before - an estimated nine out of 10 start-ups fail. Even if you do manage to get past the funding stage and establish yourself as a high growth business, there's no guarantee that you have a sustainable profit model on your hands.

There's a happy ending to this story - maybe even involving rainbows and (tech) unicorns. But you won't get these by casting regulation as the bad guy.

Risky business

The tricky thing about digital leapfrogging is that you don't always know what's swimming in the water below you. Fintech companies doing business in the developing world face greater uncertainties than those in the US or Europe, especially if their goal is to improve financial inclusion.

These fintechs work in lower income spaces, where indebtedness and delinquency levels are prevalent. They must somehow build a profitable growth-focused business while operating in a high-risk market.

Look at how risky micro-transactions can get versus traditional lending. Many consumers use micro-lenders to fund low ticket items but turn to traditional lenders when they need to fund larger purchases - say a house or car. And if that consumer finds themselves in financial distress, they naturally focus on paying back the big ticket debt rather than the smaller loans.

Without the safety net of regulatory oversight, it's extremely difficult for companies to price for this risk within their business model. One report shows that nearly half of all mobile loan borrowers in Kenya and Tanzania have missed their mobile payments at some point. No surprise then that fintechs tend to have a short shelf life. Many simply can't sustain themselves for more than a few months because of losses or fraud.

This isn't just a problem that's limited to small-time players. Even well-funded fintechs sometimes fall prey to myopic thinking around regulation. Sure, they know there's high risk involved in what they're doing, but they think they've cracked the code through some very clever algorithms.

What often happens is that these guys get so caught up in the moment of celebrating initial success that they ignore the larger environment around them. Add in the fact that many fintechs are foreign-owned and don't have a full understanding of the formal lending environments they're entering, and you have a recipe for a blindside.

Don't count out tradition

Let's venture outside of the fintech bubble for a second. In India, the number of people who are part of the formal financial sector has more than doubled since 2011, outpacing the growth of digital payments. Even in nations where financial inclusion is a challenge, a lot of customer information still sits in traditional financial spaces.

Regulatory bodies and traditional credit bureaus have access to much of this data and can give insights into the formal debt environment. Shut them out and you're cutting yourself off from a major source of key data about your consumers.

No man is an island and no fintech, no matter how innovative, is either. Yes, you can understand every grain of sand and seashell on a deserted beach, but what about the ocean around you. The most complete picture of your customers will come from leveraging both alternative data sets evolving, and expanding upon available data sets.

Every market is different. What works in Kenya won't work in Rwanda or South Africa or India. It's important to approach each market holistically, investing in the right partnerships and collaborations to build a full understanding of your customers.

Sure, you may have perfected your pitch and put together a brilliant data science team. Sure, you may have solid funding behind you. But are you working with regulators to understand how to create success for your business or your industry? Are you leveraging existing players who have been in the market for years for advice and insights you might otherwise not have access to?

So what if different regulations aren't quite there yet when it comes to fintech? There's a real opportunity to engage with regulatory bodies and help shape new frameworks. Time to toss out the story of an underdog start-up doing it all on its own and start working together to create a healthy, sustainable and inclusive financial ecosystem.

ABOUT LEE NAIK

Lee Naik is the CEO of TransUnion Africa.

- Driving the fintech and regulation success story - 8 Nov 2019

View my profile and articles...