Development Funders and Inclusive Fintechs

Analyzing one decade of funding flows

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I. Introduction

Funders can help fintechs to solve complex problems for the poor and advance financial inclusion by providing capital, capacity, and incentives

Previous CGAP research shows that fintechs have the potential to address common barriers for reaching low-income populations, but they do not always have the resources, capacity and incentives to do so. Funders, and especially development funders, can fill these gaps through a variety of instruments, such as funding, capacity building, research and advocacy.

Funders can support fintechs directly, through capital and technical assistance, to target low-income and underserved customers:

- Funders can support fintechs from a very early stage to address financial inclusion challenges, e.g., by reducing product and service cost, improving access, improving product fit, or improving customer experience.
- Funders can work with more mature fintechs, that may not have targeted underserved populations so far, to scale their services or add new services to reach the underserved population.
- Funders can support fintechs indirectly by providing funding, technical assistance or advocacy to address barriers in the market ecosystem that hinder fintechs to enter new markets, introduce new products, grow sustainably and reach the lower income, underserved population. For example, funders can support regulatory reform processes, infrastructural development, capital market development and market research that allow the fintech sector to grow and target low-income populations.

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But are development funders providing support that is catalytic and that helps build inclusive fintech markets?

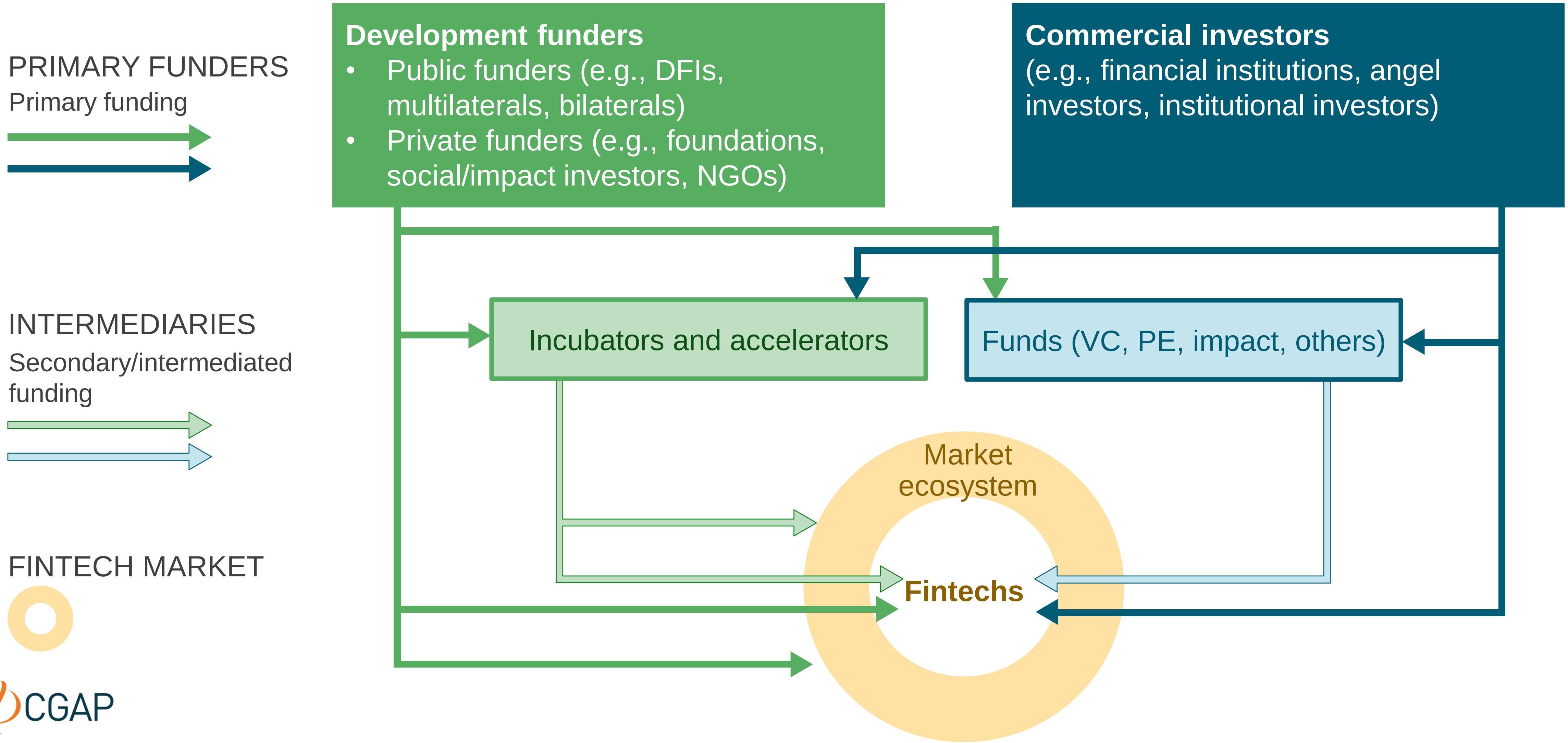
Over the past decade, funders – commercial and development funders – have been investing increasingly in the fintech market in developing economies. While commercial funders target this sector primarily for its growth potential, development funders also care about fintech's potential to have a development impact.

Research shows that fintech investments have become more popular over recent years. However, there is very little data on the source of funding and where development funding flows relative to commercial funding. It is not known whether development funding (i) complements commercial funding, (ii) builds an environment that crowds in other sources of funding, and (iii) enables fintech to reach low-income populations.

This analysis uses available data to paint a picture of fintech investments by development funders – relative to commercial funders – and understand whether development funders are adding value by supporting markets and companies that do not receive/qualify for commercial funding or that have an opportunity to provide solutions that can enable low-income populations build resilience and capture opportunities.

II. Funding flows and research methodology

There are different ways how funding flows to fintechs and to the fintech market ecosystem



This analysis combines data from development funders and inclusive fintechs

This analysis compares insights from two different data sources: data from public and private funders (investments *made by* funders) and data from fintechs (investments *received by* fintechs). By bringing together these two types of data sources, this analysis addresses some of the data gaps in each data set. The result is a more comprehensive picture of fintech funding flows; though limitations to this approach are outlined later in this presentation.

Data from both sources is triangulated based on:

- Types of funders
- Funding instruments
- Direct funding vs. indirect funding via intermediaries
- Funding stages
- Geographic location of fintechs

Comparison of data sources

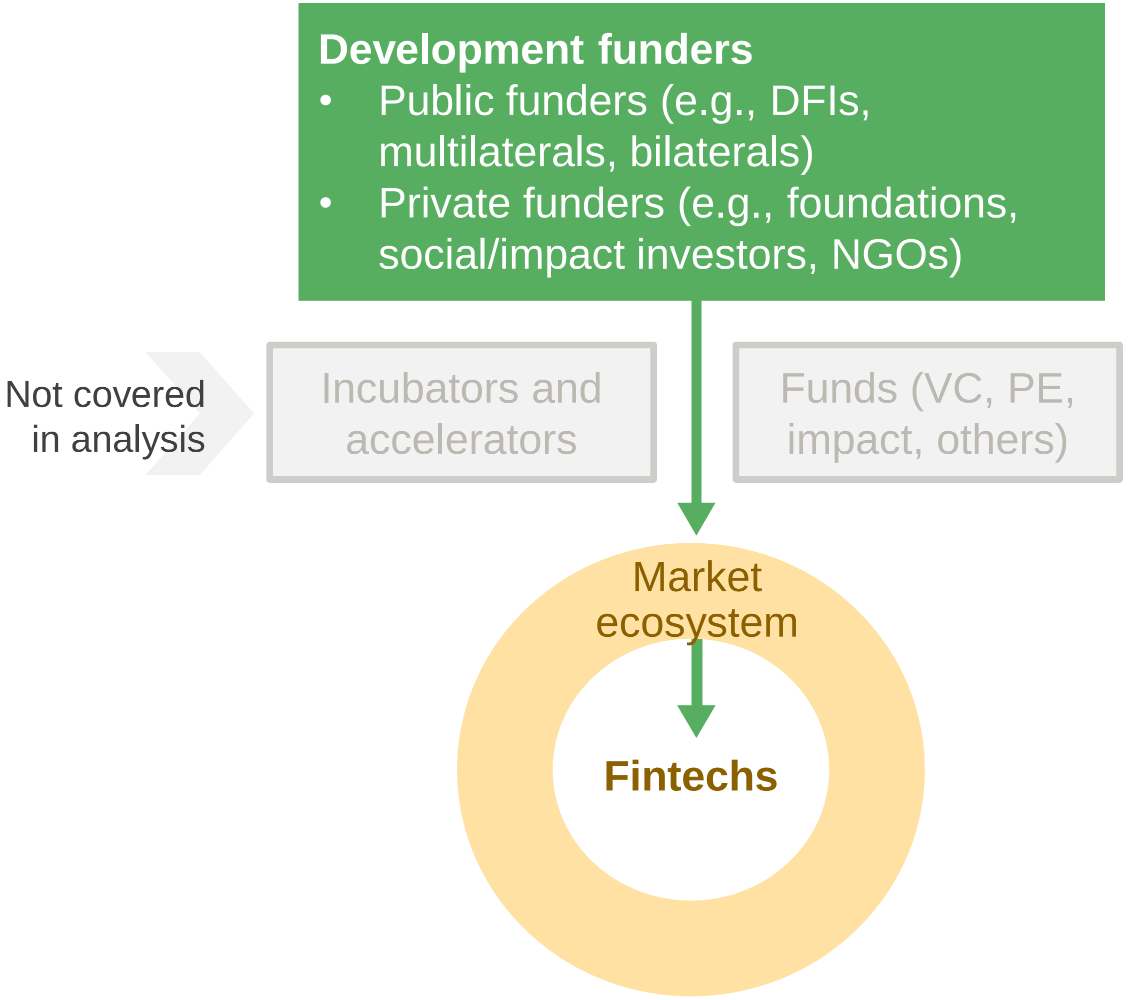
	INVESTMENTS MADE BY FUNDERS	INVESTMENTS RECEIVED BY FINTECHS	OVERLAPS
Types of funders	Public and private development funders	Public and private development funders, commercial investors	Public and private development funders
Funding instruments	TA, grant, equity, debt	Grant, equity, debt	Grant, equity, debt
Direct vs. indirect funding	Direct and indirect	Direct and indirect	Direct and indirect
Funding stages	Series A, B, C, D	Seed, Series A, B	Series A, B
Product types	Credit, Payments, Savings, Insurance, Infrastructure	Credit, Payments, Savings, Insurance, Infrastructure	Credit, Payments, Savings, Insurance, Infrastructure
Geographies	Developing countries	Developed and developing countries	Developing countries

First dataset covers investments made by development funders between 2008 and 2019

Investments made by funders data accumulates investments reported by funders in the CGAP Funder Survey between 2008-2019, complemented with data from the IATI registry and Crunchbase.

Investments made by funders fintech data snapshot:

- USD1.7 billion total funding
- 168 investments
- 90 fintechs, 46 funds, 14 ecosystem investments

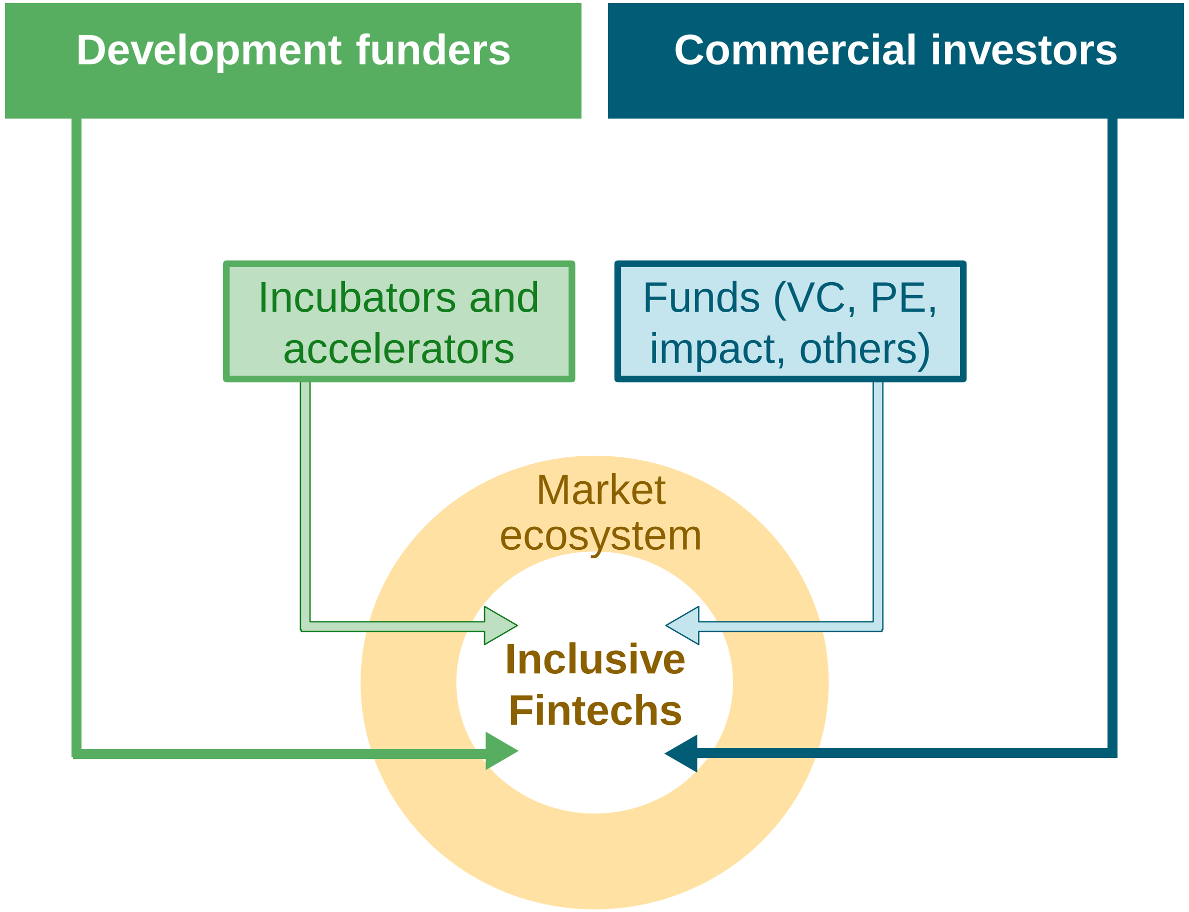


Second dataset covers investments received by a selected set of inclusive fintechs between 2008 and 2019

Data from investments received by fintechs accumulates those that applied to the 2019 Inclusive Fintech 50 competition (an initiative run by the Center for Financial Inclusion) up to and including 2019, and is complemented with data from Crunchbase.

Investments received by fintechs snapshot:

- USD931 million total funding
- 660 investments
- 359 fintechs (early stage and 'inclusive')



This analysis provides a glimpse of how funders invest in fintech, but limited reporting makes it difficult to paint a full picture

This analysis provides a unique view on the inclusive fintech environment by bringing together insights from two previously unexplored data sets. However, both data sets have limitations due to limited and inconsistent reporting.

Limitations of first dataset (investments made by funders)

- Limited reporting by development funders, especially by private foundations. (Some gaps filled from other sources where available, e.g., CrunchBase, IATI, funder websites.)
- Limited data on how much of intermediated funding reaches fintechs (e.g., DFI funding to impact investor or fund, which may then invest in fintechs); analysis only captures flow from funder to intermediary fund.
- Limited data on ecosystem investments due to limited granularity of data.
- Limited assurance how ‘inclusive’ fintech solutions really are; business models are vetted based on funder investment criteria.

Limitations of second dataset (data from Inclusive Finance 50)

- Limited data on investors and investments. Only data from 55% of Inclusive Finance 50 fintechs could be used for this analysis.
- Little data on larger and more mature fintechs. Inclusive Finance 50 targets early-stage fintechs (median of 3 years).
- No time series available. Data is as of March 2019 and supplemented with additional data from Crunchbase.
- Limited assurance how ‘inclusive’ fintech solutions really are; business models are vetted based on self-reported information.

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III. Funding flow analysis

Key takeaway #1

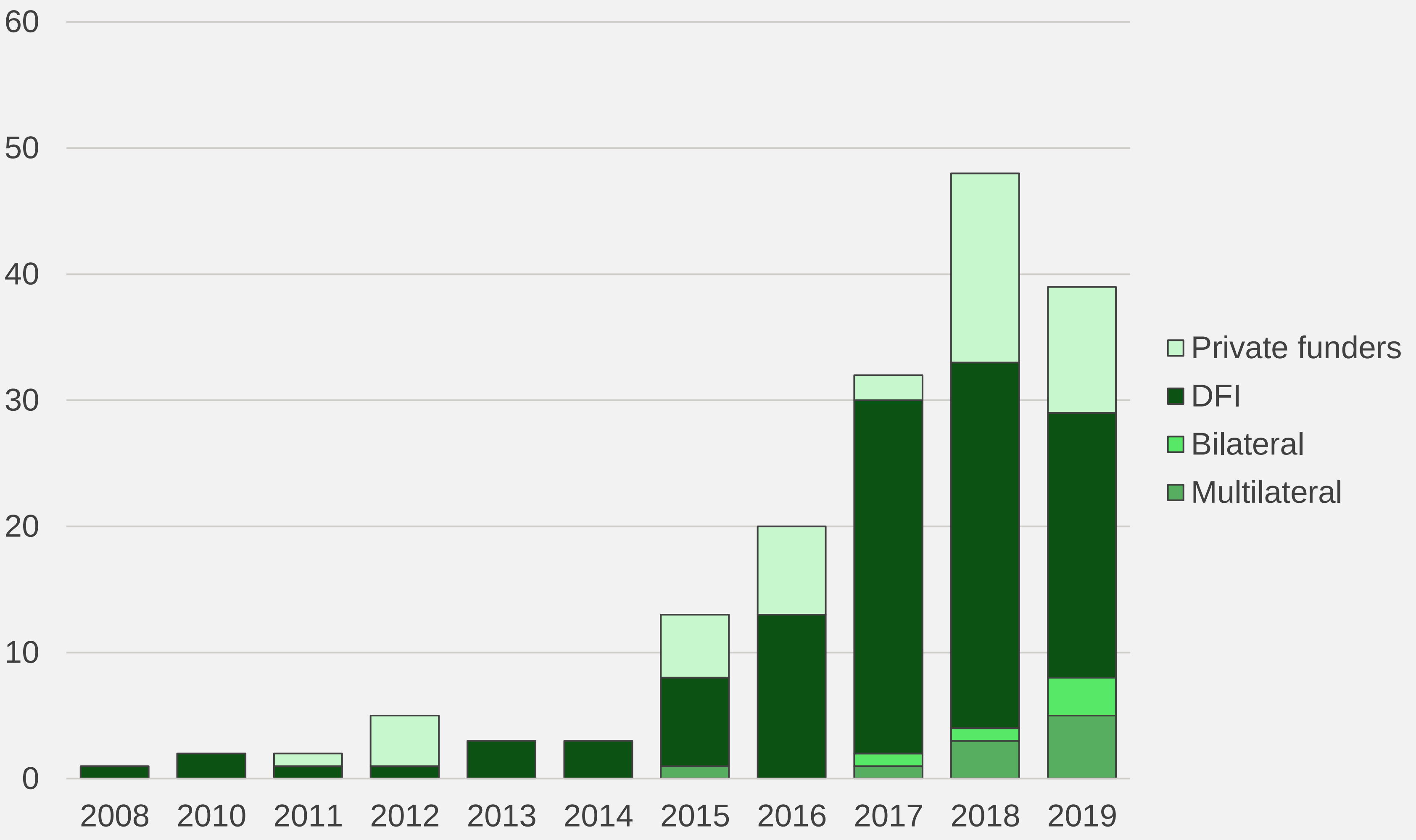
Development funders are growing their fintech portfolios, but it is not clear if their funding reaches fintechs and markets that lack access to capital from commercial investors. Early stage, inclusive fintechs receive capital from many sources and development funders play a relatively small role.

Development funders are increasing the number of fintech projects...

Since 2008, development funders have funded a total of 168 projects that target fintech development.

DFIs are the most active development funders in the fintech market, followed by private funders. Yet, multilaterals are slowly increasing their fintech projects.

Number of fintech projects by development funders between 2008 and 2019 (N=168 projects)



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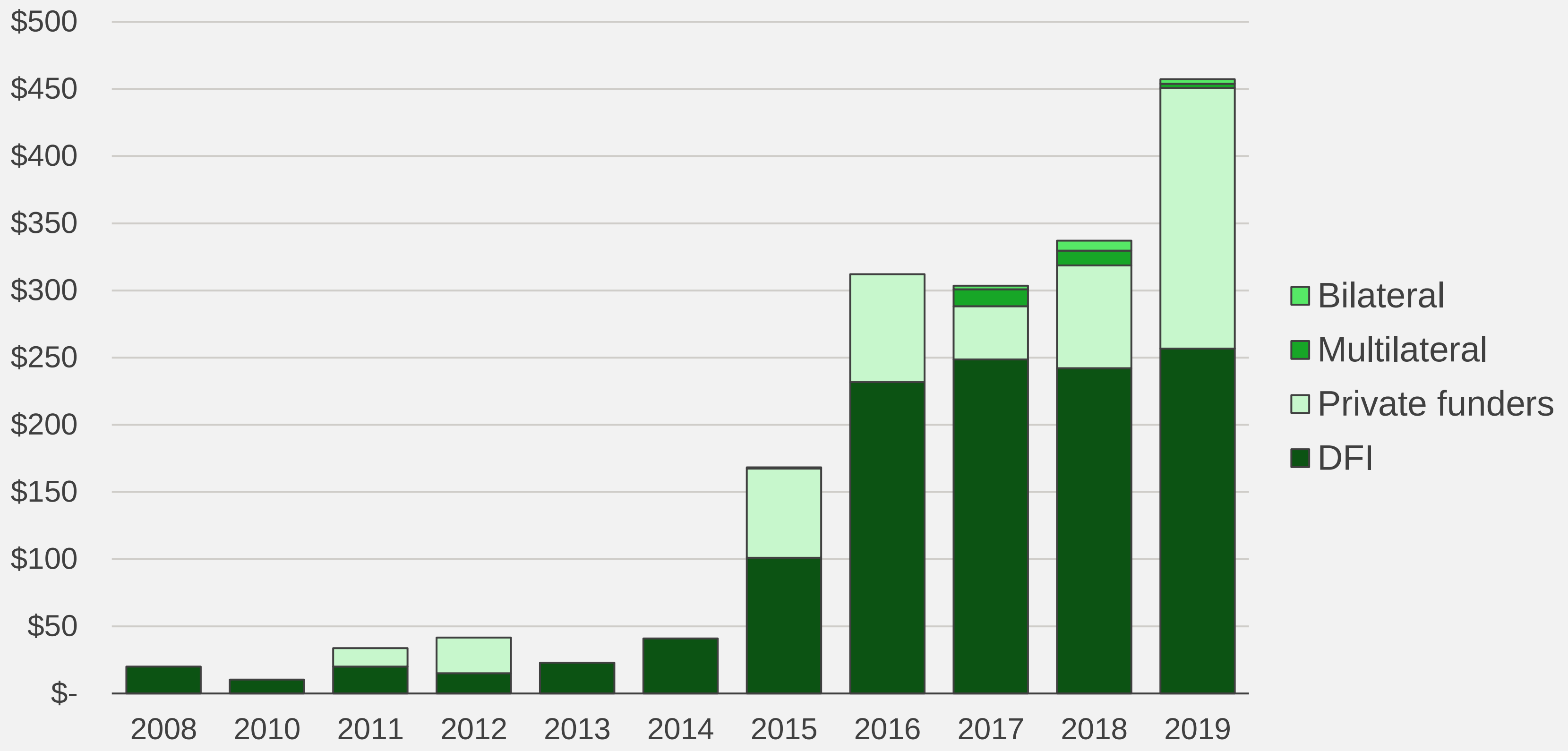
…and are increasing their funding to fintech related activities

Cumulatively, development funders have allocated over USD1.75 billion to support the development of fintechs since 2008.

DFIs are the largest investors in terms of USD volume. Private funders are experiencing the fasted growth in terms of volume.

Volume of funding for fintech projects by development funders between 2008 and 2019 (in USD millions) (N=168 projects)



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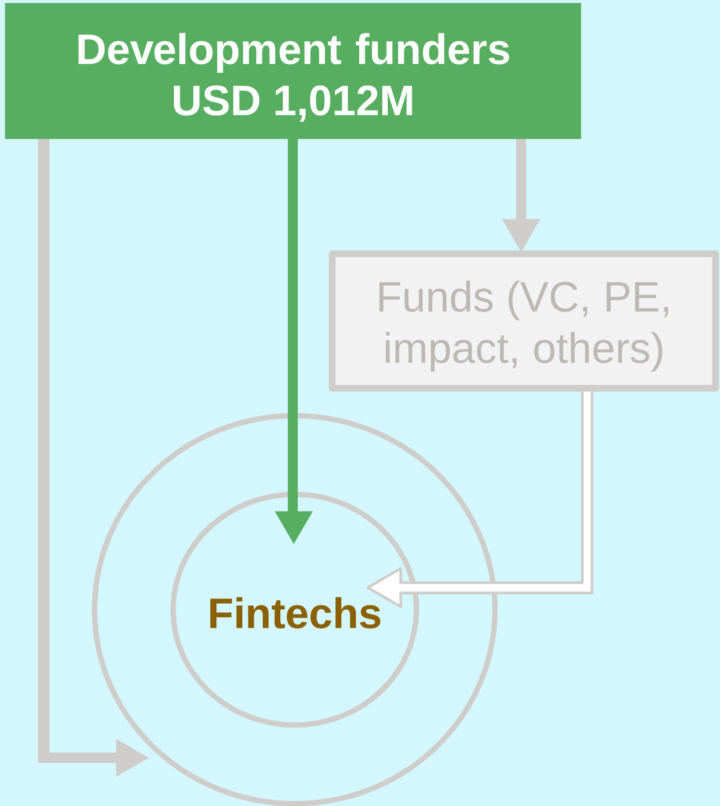
Most of development funding goes to directly support fintechs

60% OR **USD 1B**

Percentage and value of the total volume of fintech related investments made by development funders between 2008 and 2019 which were direct investments in fintech companies



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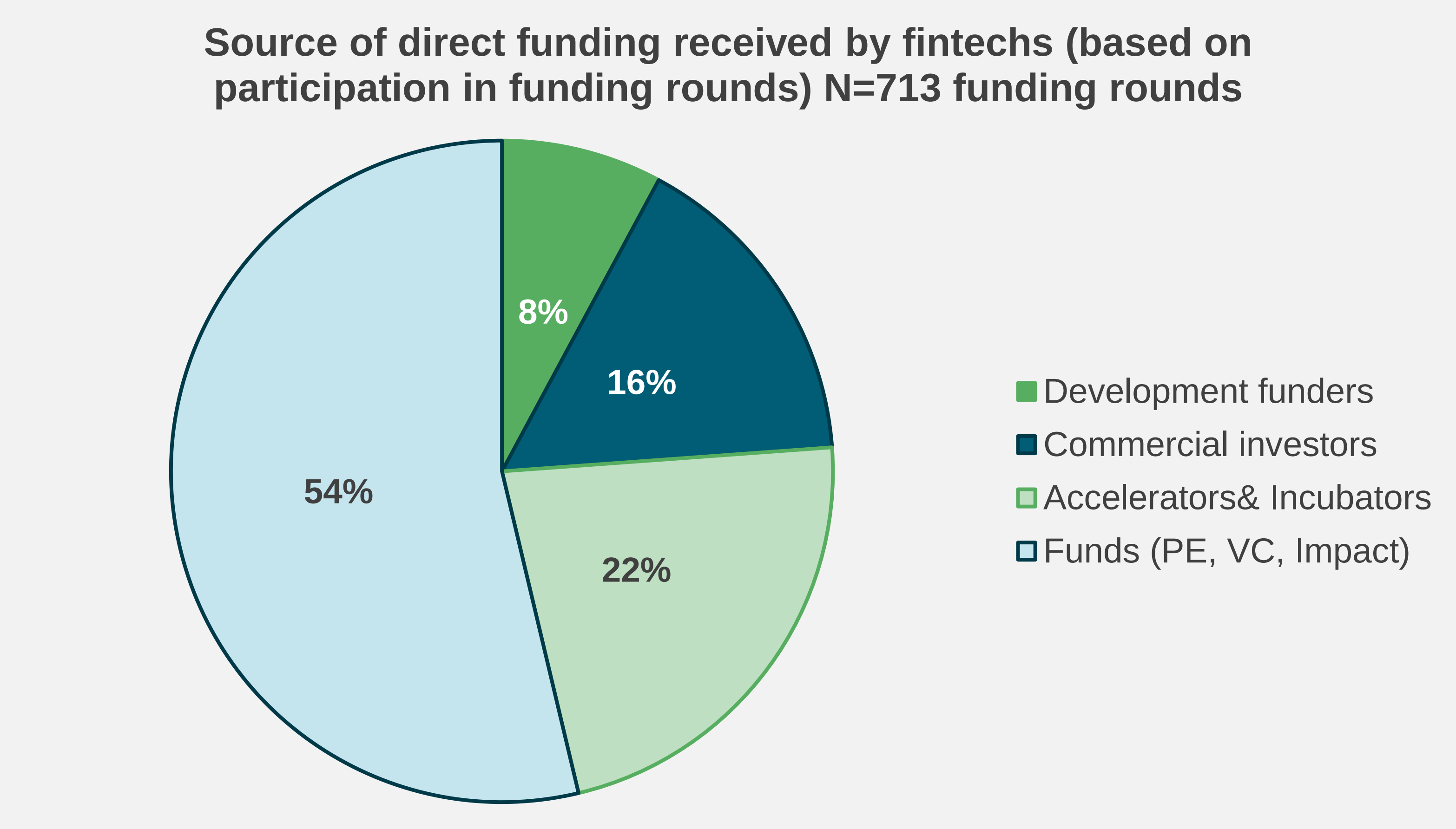
Compared to other funding sources, however, development funders play a relatively small role as a source of direct funding

Investment funds have been the most important funding source for early stage fintechs. Of all funding rounds for early stage fintech identified by Inclusive Finance 50 from 2008-2019, development funders participated in 8%.



Key takeaway #2

As development funders are growing their fintech portfolios, there is a need for more transparency on how much of their indirect investments (through intermediaries like funds, accelerators and incubators) reach fintechs and how much of these support solutions that can solve problems for underserved populations.

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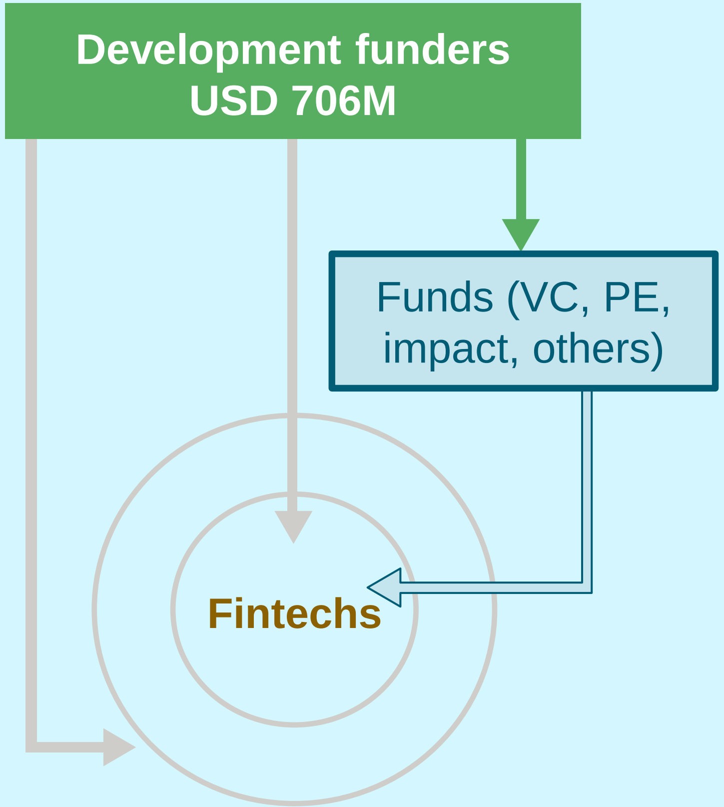
In addition to direct funding, development funders also invest in funds that may or may not fund (inclusive) fintech solutions

40% OR USD 706M

Close to 40% of their funding is channeled through funds that may invest in fintechs but may also invest in other financial service providers or tech start-ups. It is unknown how much of this intermediated funding is passed on to fintechs; and how much to 'inclusive' fintech solutions.



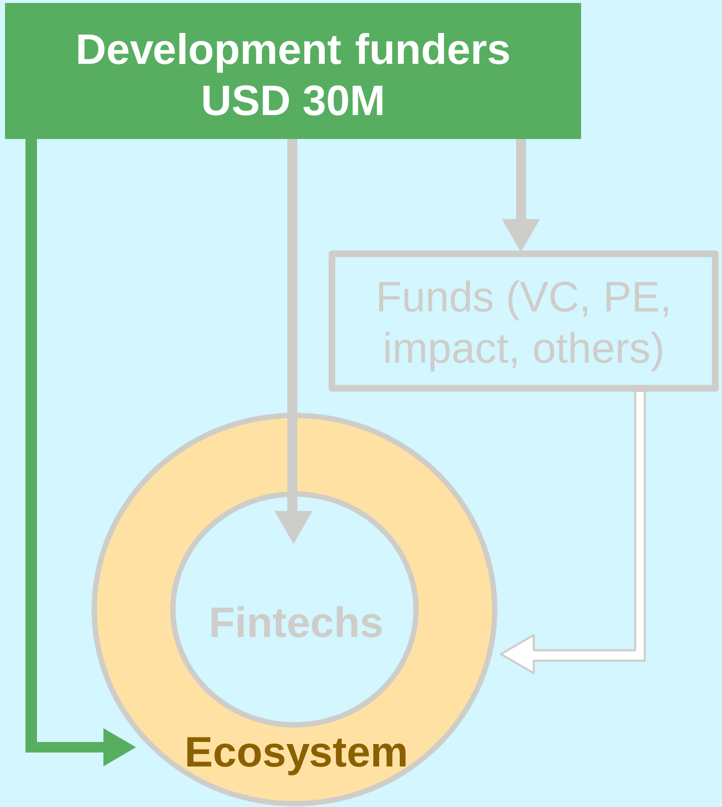
Key takeaway #3

There is an important role for development funders to influence and build an enabling environment for fintechs to develop innovative solutions for underserved segments. Since 2015, development funders have been reporting projects that support market actors in the fintech ecosystem (other than fintechs themselves). However, it is not known whether these projects address barriers that hinder fintechs to target lower income populations and grow at scale.

Development funders play an important role in helping create market conditions that allow fintechs to thrive

USD 30M

Development funders also support fintech through funding, technical assistance or advocacy to address barriers in the market ecosystem that hinder fintechs to enter new markets, introduce new products, grow sustainably and reach underserved populations. E.g., funders may support regulatory reform, payment infrastructure, identification systems and market research, or provide funding to incubators and accelerators who then provide technical assistance and market access to fintechs. Market ecosystem investments represent 2% of the total volume of fintech related projects made by development funders between 2008 and 2019.



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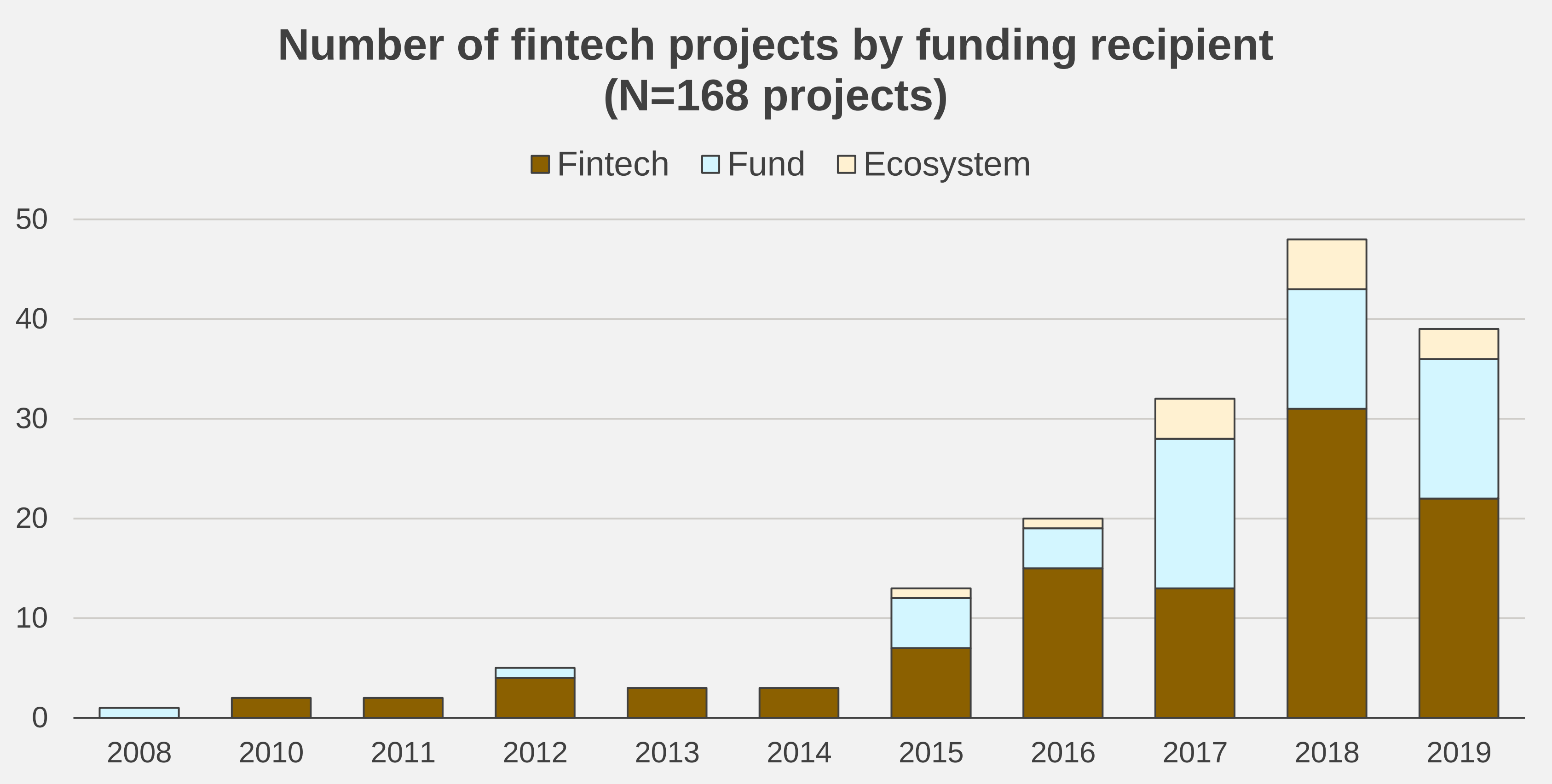
In recent years, development funders have increased their support for projects that have the potential to create conditions for fintechs to thrive

Since 2015, development funders have been reporting projects related to fintech ecosystem development. Since then, the number of projects has slowly increased. The average project size is USD 2.3 million.

While the number of reported projects has increased over the past years, it is not known how exactly funds are used and contributing to the fintech market ecosystem.



Key takeaway #4

It is not clear if development funding supports fintechs in generating impact. Development funders' direct investments go more frequently to fintechs in their growth stage. These investments can have impact if they are used to help fintechs take their products to financially excluded or underserved populations. Early stage fintechs receive less frequently direct funding from development funders but could benefit from capital that helps them develop solutions for underserved segments and take them to market.

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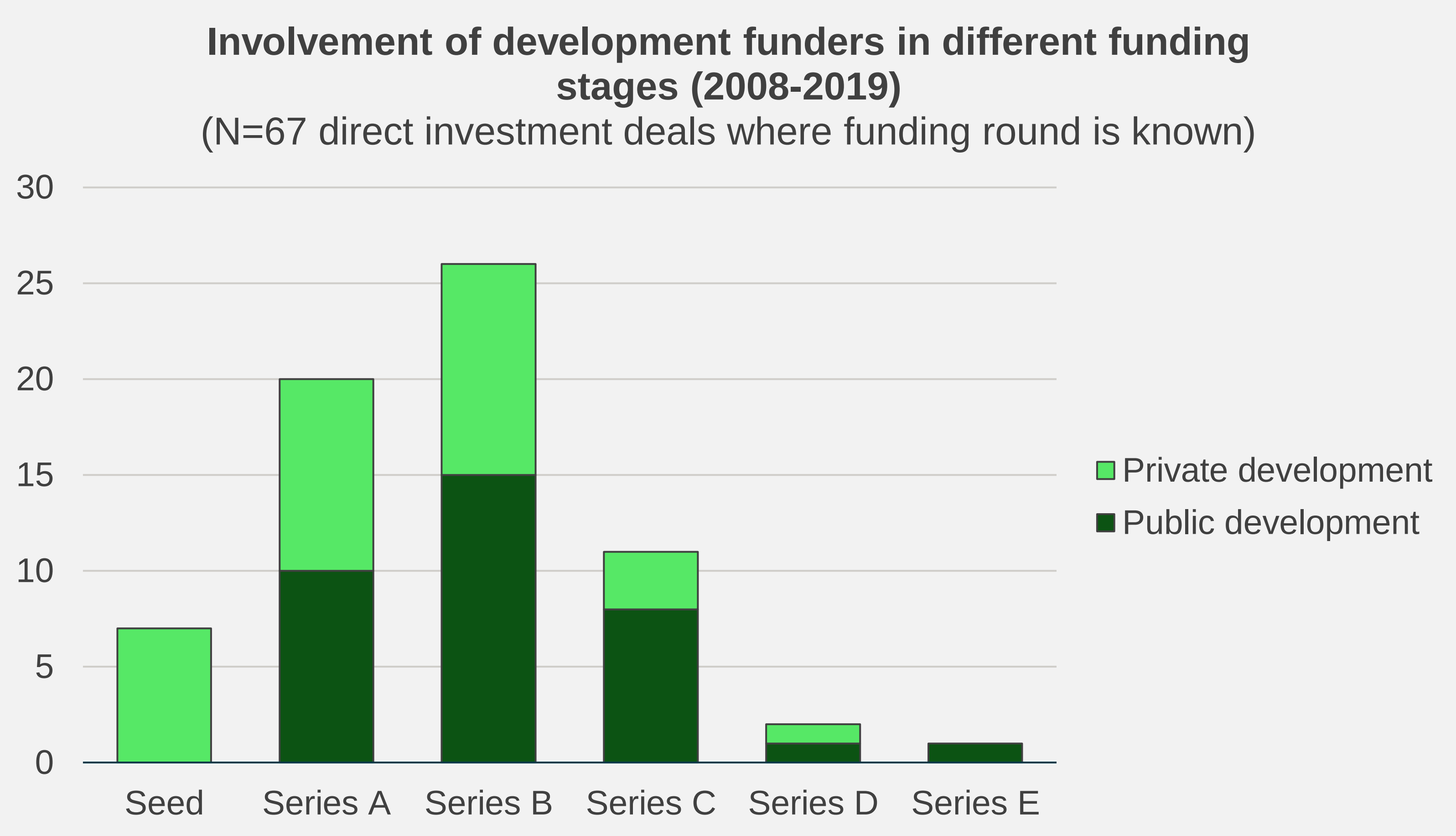
In terms of fintech maturity, development funders are more likely to provide funding to more mature fintechs

Over half (55%) of development funders' direct investment deals are Series B and C funding, 30% are Series A funding and 10% are seed funding. Public development funders didn't report any direct investments into seed stage fintechs.

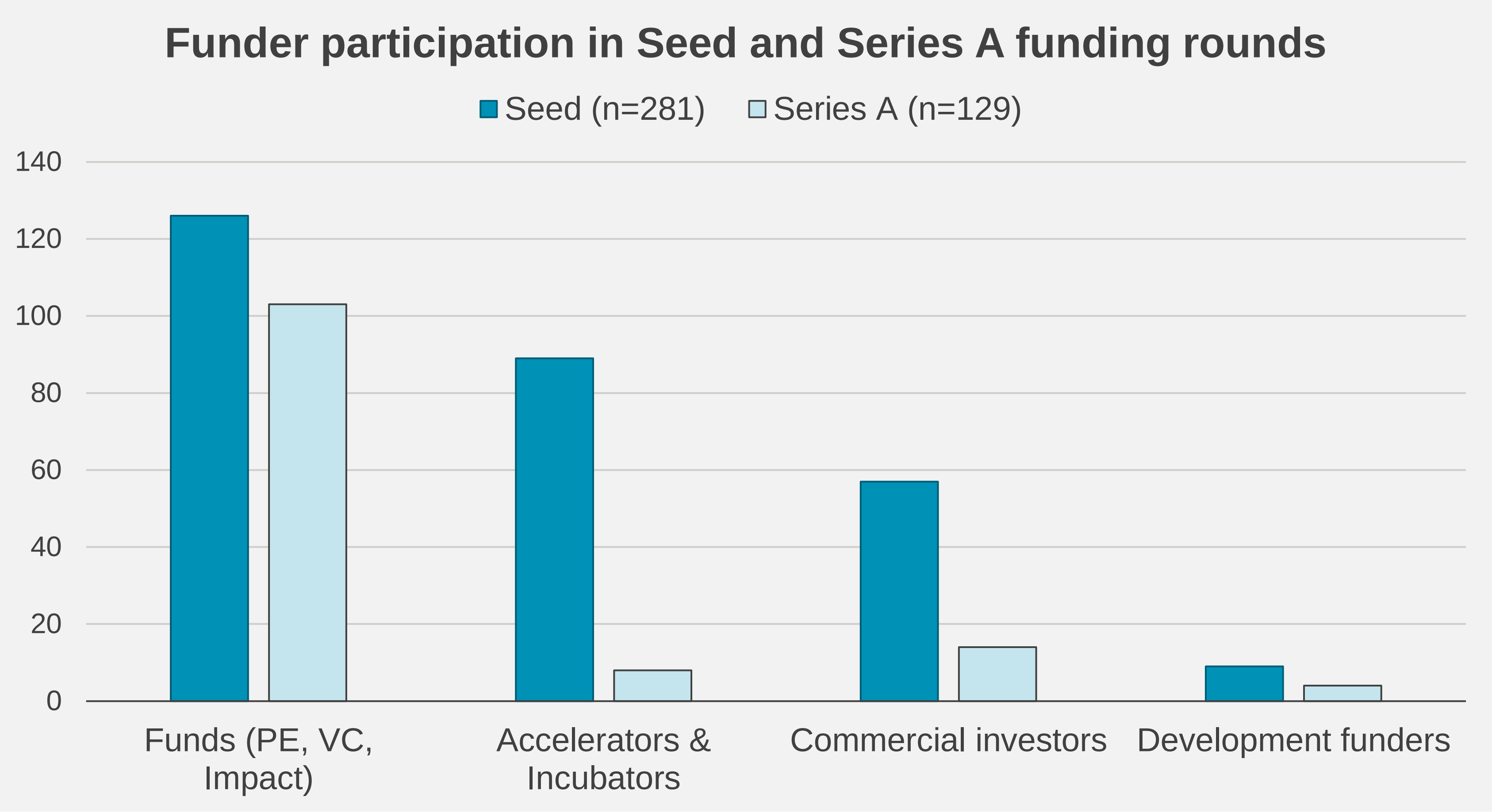
Generally, fintechs occupy one of three stages – early, growing and mature.

- Early stage: Fintechs attracting Seed and Series A funding
- Growth stage: Fintechs attracting Series B and Series C
- Mature stage: Fintechs attracting Series D and higher



Data confirms that development funders play a small role in early stage funding rounds. Intermediaries (funds, accelerators and incubators) are more active in early stage funding.

Fintechs in seed stage receive 32% of their funding from accelerators and incubators, which may receive some primary funding from development funders (though data is not clear). VC funds are the most active funders across all stages, particularly in Series A and B funding rounds, where they tend to be represented in over 70% of all deals



Key takeaway #5

Development funders may add value by providing financing to those types of **fintech solutions that receive little attention from commercial investors**, such as insurance and savings products.

They may also consider using **different funding instruments for different types of fintechs.** Less proven business models, such as for inclusive insurance and savings products, may benefit from grants to experiment and pilot. More mature fintechs, and credit fintechs in particular, may benefit from higher stake and longer-term investments that allow funders to influence their business practices, e.g., responsible lending.

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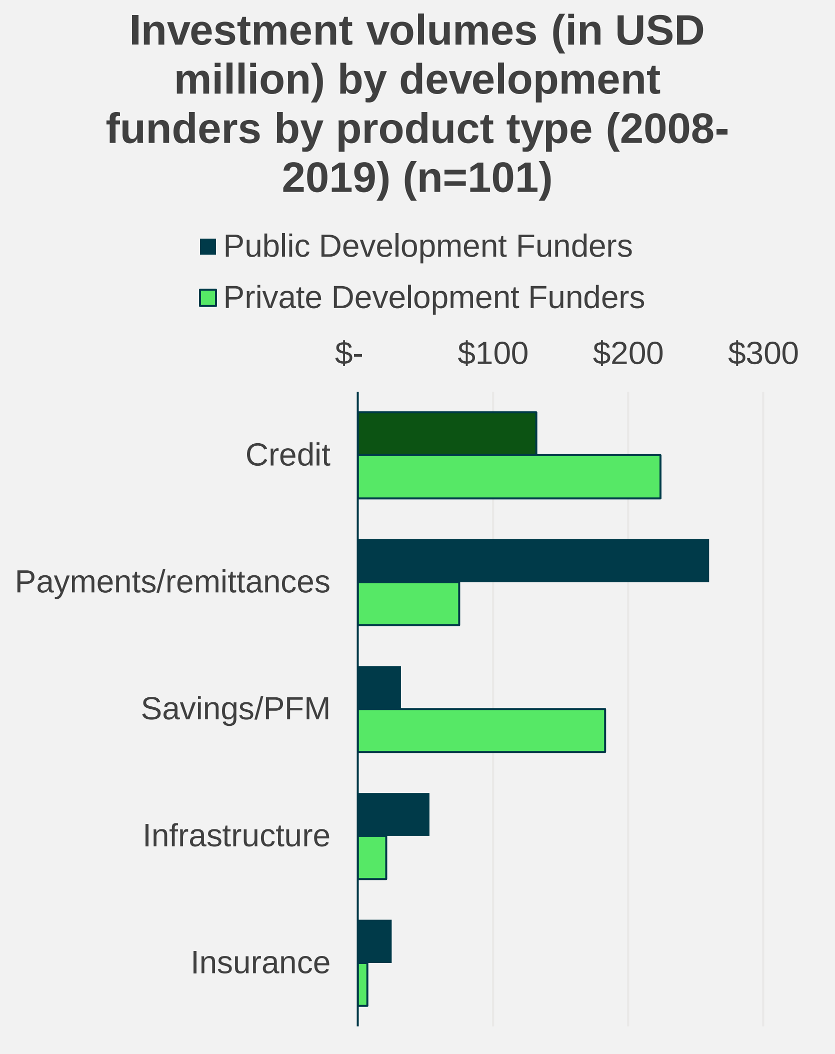
Investments made by funders

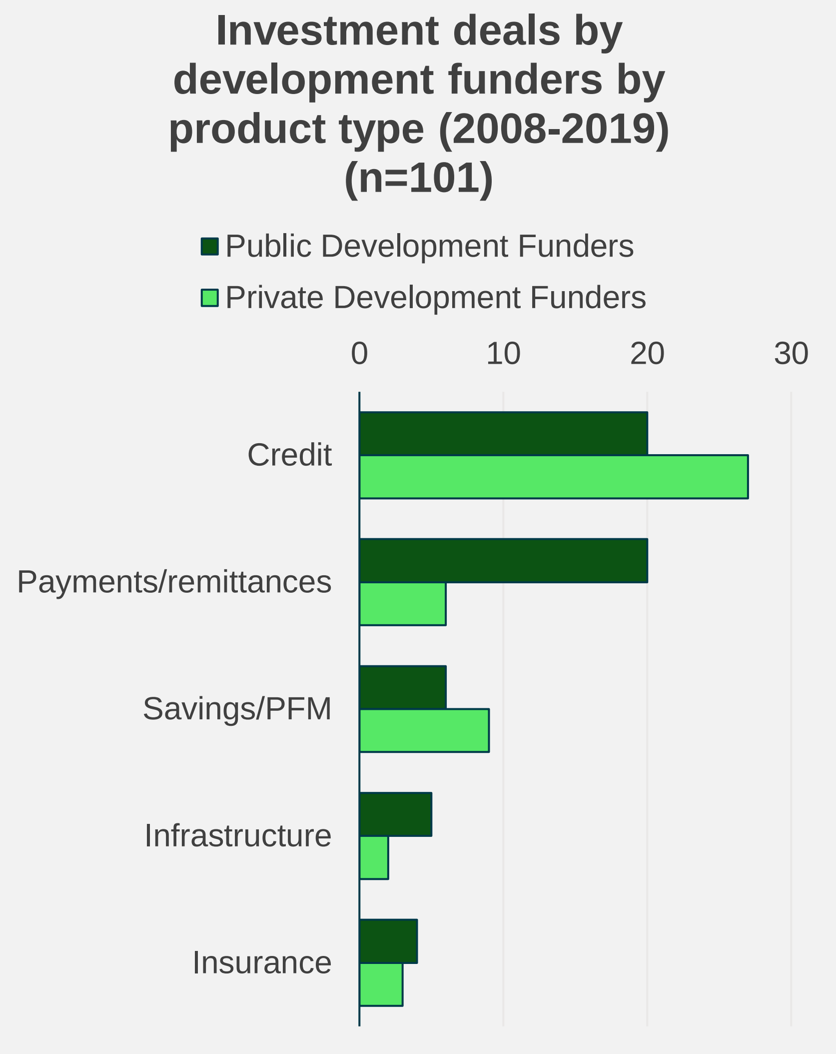
Investments received by fintechs

In terms of product type, development funders have been more likely to invest in credit and payments fintechs

Over two thirds (68%) of development funding went to credit and payments fintechs. Insurance and infrastructure fintechs attracted only 3% and 7% respectively, of the total funding volume. This focus is also true in terms of number of direct investment deals, with 73% of deals to credit and payments fintechs.

PFM = Personal Financial Management





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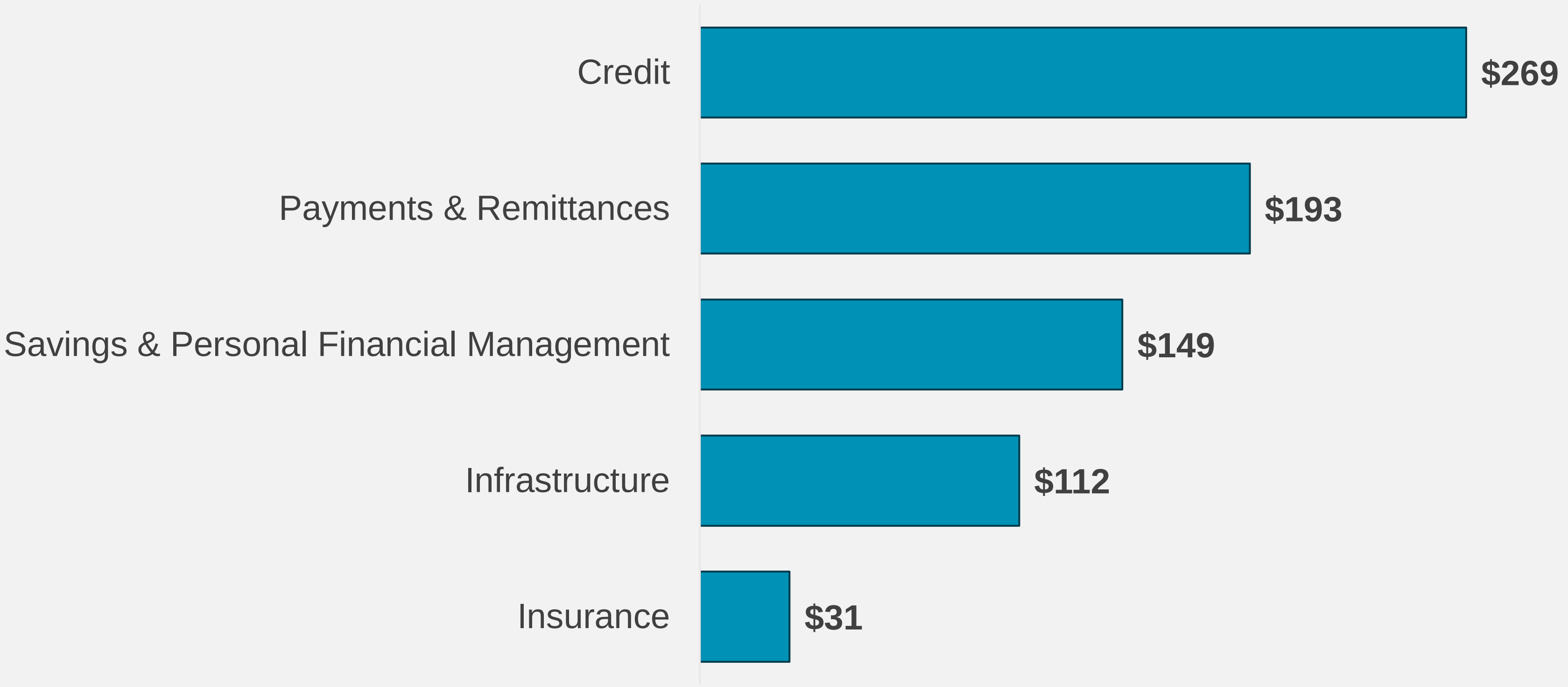
This reflects an overall trend: credit and payments fintechs attract larger amounts of funding by all types of funders

Over 60% of the total funding received by Inclusive Finance 50 fintechs went to credit and payments fintechs (which account for 54% of fintechs in the sample). Relatively little went to savings & personal financial management (PFM) and insurance fintechs.

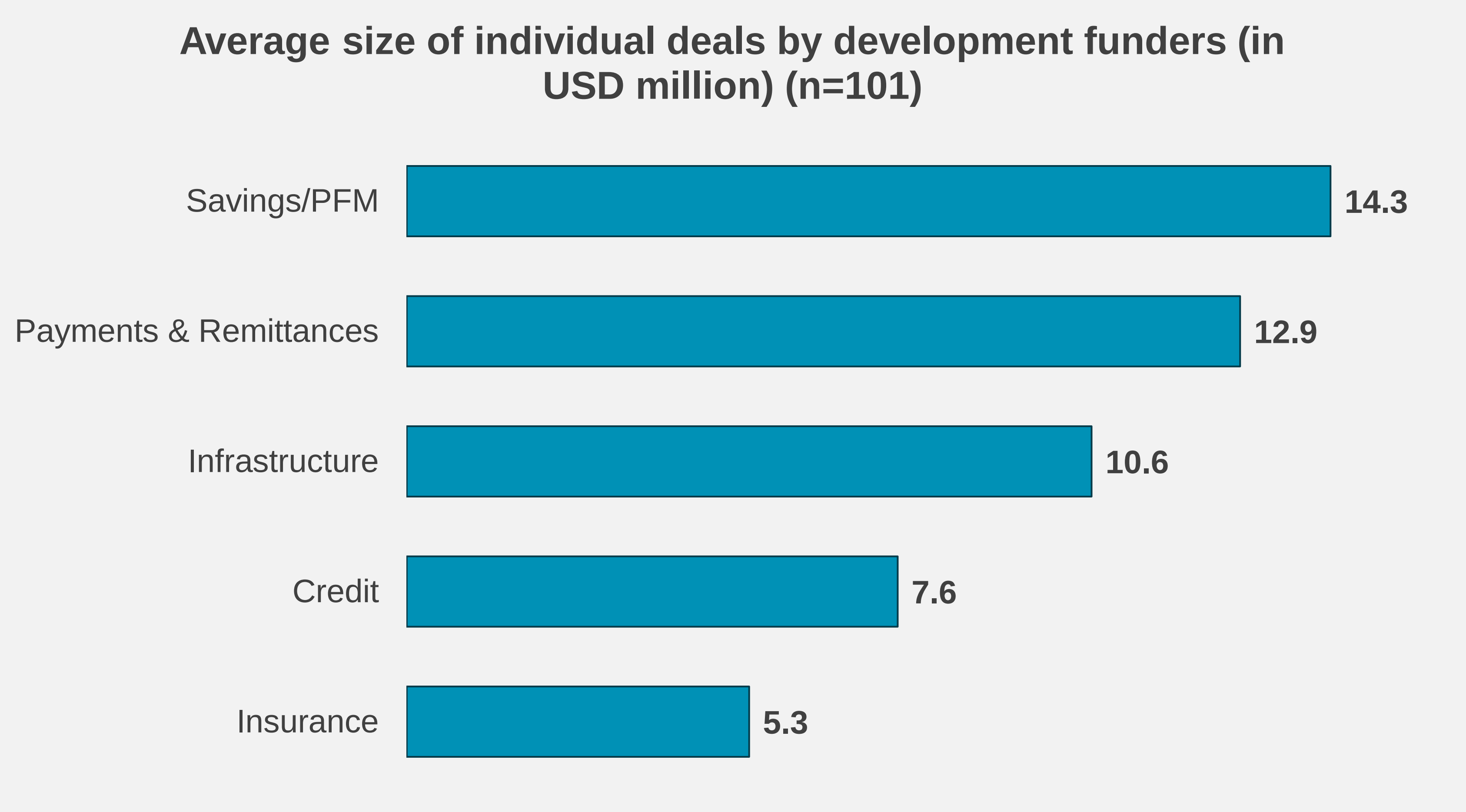
Money raised by different types of fintechs (in USD million) (N=359 fintechs)



At the same time, development funders make the highest investments in savings and infrastructure fintechs

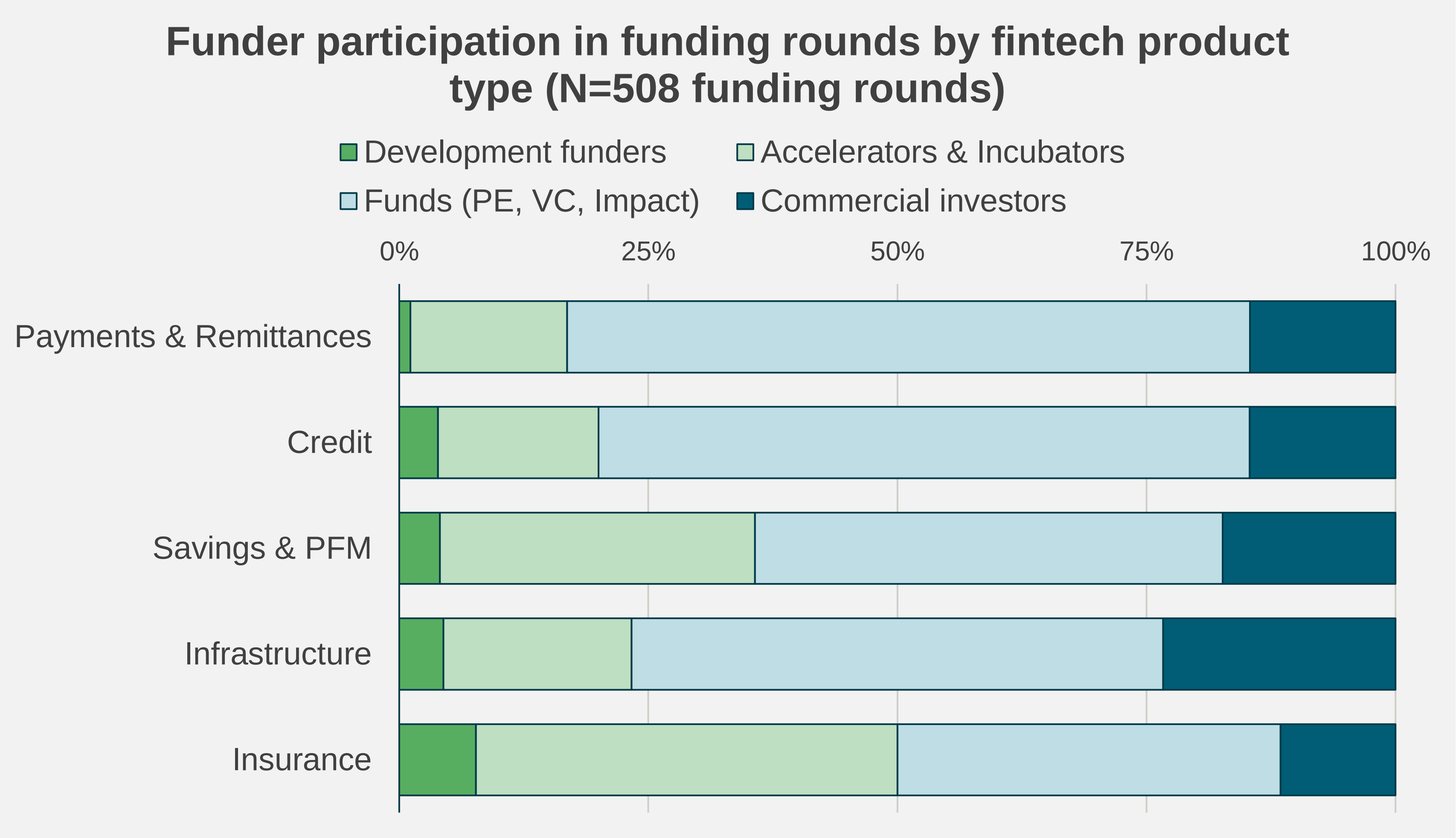
Development funders' average deal size is highest for savings fintechs, then payments and infrastructure. Investments into credit and infrastructure fintechs are relatively smaller on average. This means that while development funders invest less frequently in savings and infrastructure fintechs, they fund these fintechs with higher amounts.

PFM = Personal Financial Management



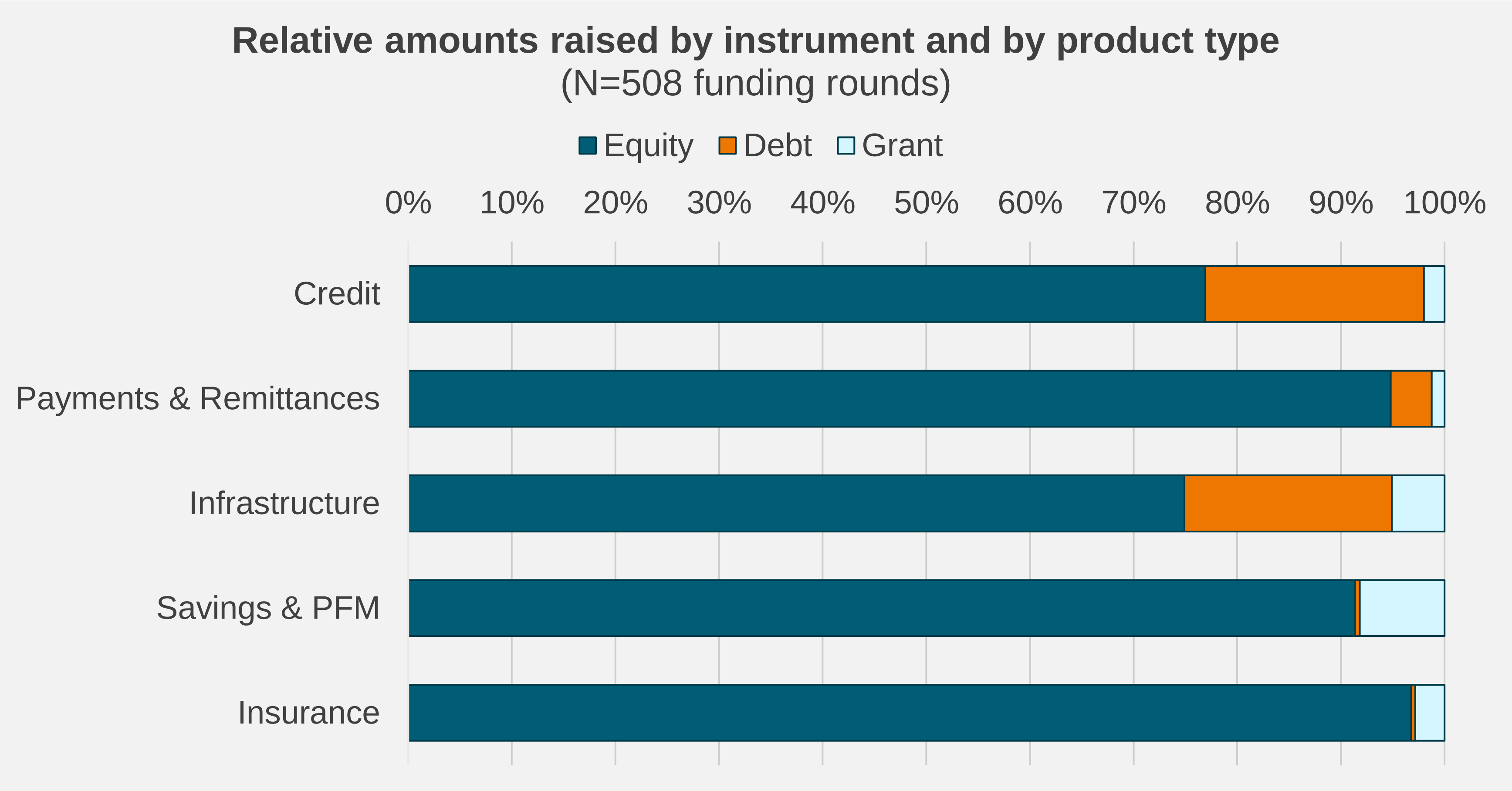
Compared to other funding sources, development funders have a stronger representation in funding rounds for insurance fintechs

Although playing a relatively small role across all product types, development funding seems to have played a stronger role for insurance fintechs. Insurance fintechs strongly rely on accelerators and incubators and seem to receive very little attention from commercial investors and funds.



Most funders provide equity to fintechs. However, credit and infrastructure fintechs also receive debt financing.

Equity is the most common type of funding for all types of fintechs. Debt is more commonly provided to credit and infrastructure fintechs, which are more capital intensive. Fintechs rarely receive grants; and when they do, these are of small value.



Key takeaway #6

Development funders are actively investing in fintechs in Sub-Saharan Africa, which receive relatively less attention from commercial investors. There is an opportunity for development funders to also look at other regions where fintechs have difficulty attracting commercial funding and where there are opportunities to develop fintech solutions for underserved populations.

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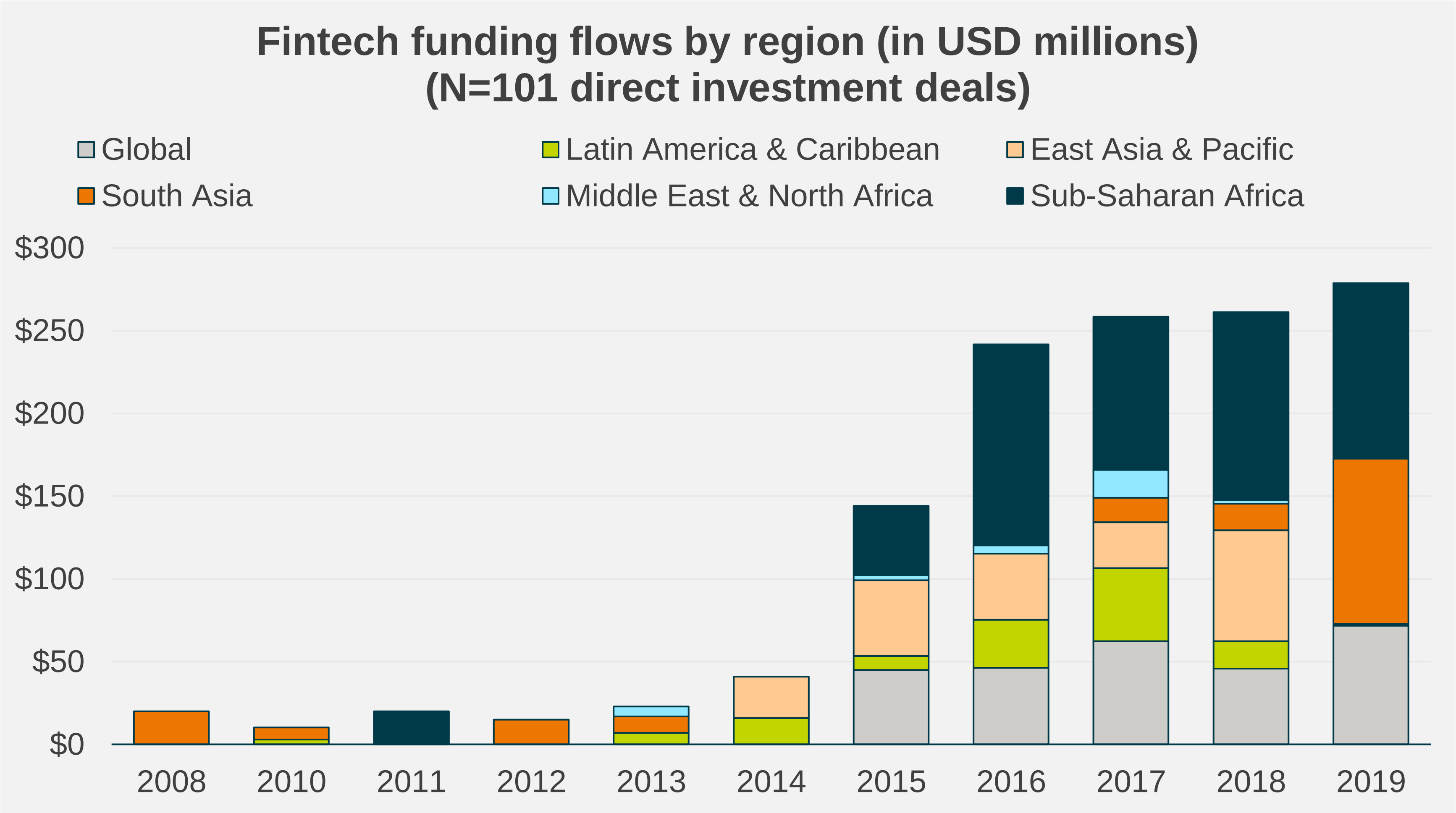
In terms of geographic focus, development funders provide most funding to fintechs in Sub-Saharan Africa and East Asia and Pacific

Most of development funders' direct investments went to fintechs in Africa (over USD113 million, or 43% of all direct investments between 2008 and 2019). South Asian fintechs have attracted more funding only recently. Fintechs in Latin America have continued to attract development funding, but investments have decreased in size.



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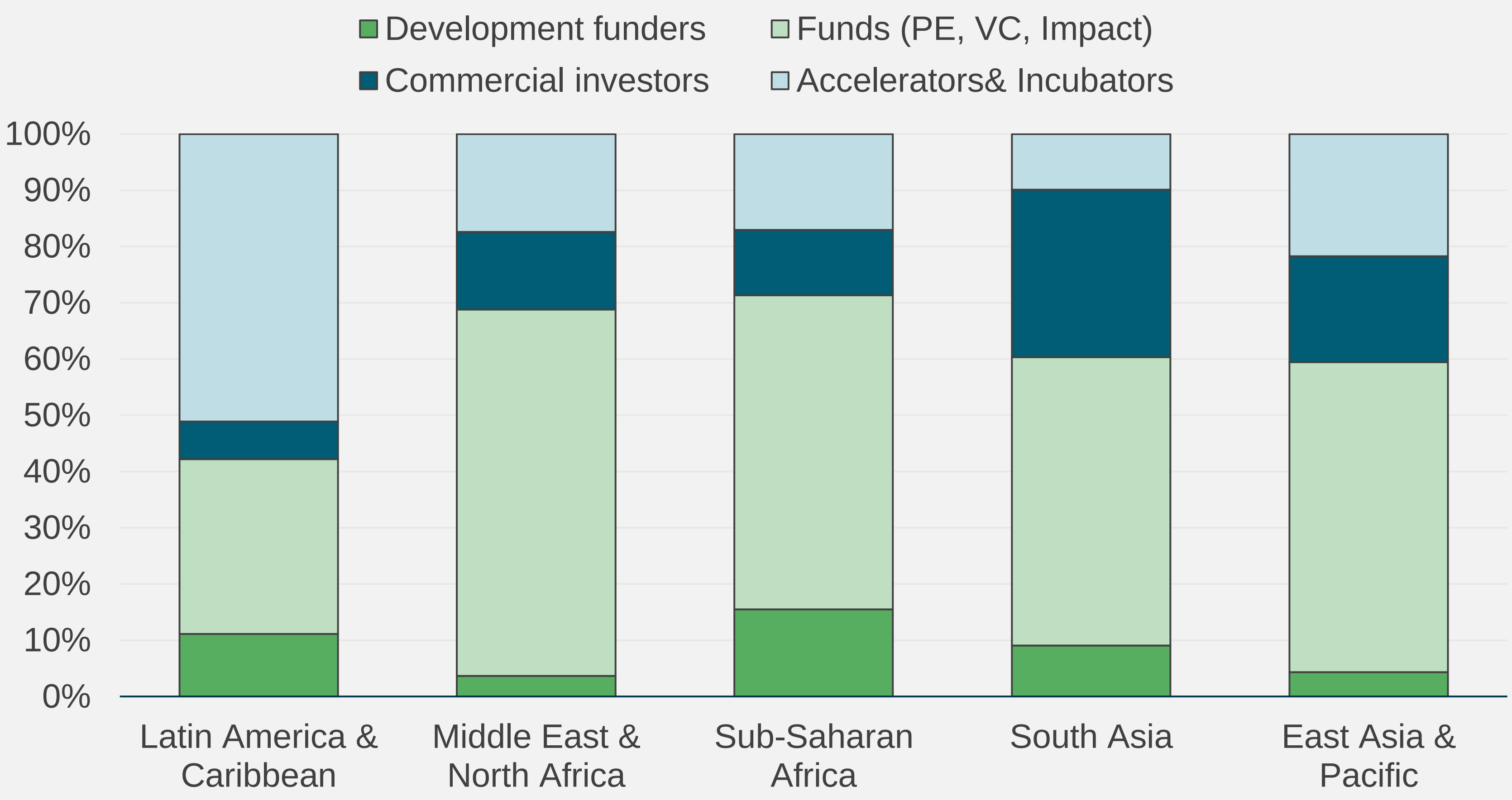
Compared to commercial funders, development funders are more frequently investing in funding African and Latin American fintechs

Funds are the most common funding source for fintechs across all regions but Latin America, where accelerators and incubators play a more important role in funding rounds. Development funders are relatively more actively involved in funding rounds of fintechs in Africa and Latin America compared to the other regions.

Funder participation in funding rounds by fintech's primary region of operation (N=473 funding rounds)



IV. Conclusions

This analysis indicates that development funders may be able to be more strategic in their investment decisions to create sustainable and inclusive fintech markets

Development funders’ direct investments tend to target fintechs that already receive attention from commercial investors. Their funding may not add value or have impact, unless they seek to (i) encourage more mature fintechs with better proven business models (like credit and payments) to reach underserved segments or follow more responsible sales practices, and (ii) support early stage fintechs develop solutions for underserved segments and grow sustainably.

There is a need for more transparency on development funders’ indirect investments to identify if intermediary funds, accelerator and incubator programs use development funding to support inclusive fintechs.

Development funders can add value by investing more into fintech ecosystem development projects that support the creation of conducive market environments that allow fintechs to grow, become more inclusive and attract commercial funding.

Annex

Definitions

Fintech innovations: Refers to digital technologies that have the potential to transform the provision of financial services spurring the development of new – or modify existing – business models, applications, processes, and products. Examples of these technologies include web, mobile, cloud services, machine learning, digital ID, and Application Programming Interfaces (APIs). In practice, the term “fintech” is also broadly used to denote the ongoing wave of new DFS.

Fintech company: A new entrant in the financial sector that specializes in offering digital financial services. Examples of Fintechs include digital payment providers, digital insurers, digital-only banks, and peer-to-peer lending platforms.

Type of funders: There are primary funders, including public and private funders, who invest money directly into fintech companies or indirectly through funds, accelerator and incubator programs, or through ecosystem support. These primary funders may be commercially driven or driven by development objectives. Secondary funders are those who receive funding from primary funders and invest them into fintechs or use them to support fintech market development. Secondary funders can be commercially driven (most VC and PE funds) or impact driven (e.g., impact investment funds).

Aligning definitions of fintechs between the different data sets

What is (and is not) a fintech?

- Core offering as a financial service (Business-to-Customer, B2C) or as an enabler of a financial service (Business-to-Business, B2B, or Business-to-Business-to-Customer, B2B2C)
- A technology-led business model
- An entity with its own branding and legal identity

Examples of fintechs included in the analysis:

- Infrastructure companies (e.g., Interswitch)
- Platform companies (e.g., Compare Asia)
- Established financial technology providers (e.g., The Software Group)
- Fintechs owned by larger companies but with own branding and legal identity (e.g., GoPay)

Examples of fintechs <u>not</u> included in the analysis:

- E-commerce where payments is not the core offering (e.g., Jumia)
- Established general technology providers (e.g., Infosys)

Fintechs are further classified by product type

- Credit: A fintech whose main business is to provide credit or to enable credit.
- Payments & Remittances: A fintech whose main business is to facilitate payments, including remittances and person-to-person (P2P) payments.
- Savings & Personal Financial Management (PFM): A fintech whose main business is to facilitate or to enable personal financial management such as savings, pensions, and investments.
- Insurance: A fintech whose main business is to provide insurance or enable insurance.
- Infrastructure: A fintech that provides processes and tools that enables multiple types of financial services such as credit, payments, insurance, personal wealth management.

Aligning definitions of ‘inclusive’ fintechs between the different data sets

An inclusive fintech is a fintech working for financial inclusion. This means their model (whether their customer is an individual or a financial institution) serves people or businesses that are excluded or not adequately served by formal financial services.

In the database of investments made by funders, “inclusivity” is assumed, as all funding is coming from development funders.

Some development funder projects may support fintechs that are working in emerging markets and for whom reaching underserved segments is part of a larger mass-market business model (e.g., large digital payments providers like Net1 and Fino Paytech).

In the database of investments received by fintechs, fintechs are evaluated as to whether their model is ‘inclusive’; however, the assessment relies mostly on self-reported data.

In order for fintechs to qualify they must demonstrate that they are contributing to financial inclusion by targeting at least one excluded or underserved population segment.