

## NTIS POLICY BRIEF

**DRAFT**

# Promoting Fintech Start-ups in Africa

## 1. Introduction

Financial inclusion is necessary to ensure that economic growth performance is inclusive and sustained. However, Africa is lagging in this aspect newly emerging technologies such as financial technology may address this situation. FinTech is an industry composed of companies that use new technology and innovation with available resources in order to compete in the marketplace of traditional financial institutions and intermediaries in the delivery of financial services. Financial technology companies consist of both startups and established financial and technology companies trying to replace or enhance the usage of financial services of incumbent companies. Today, there are over 301 fintech start-ups in Africa. A range of systems and processes in areas including payment, lending, retail banking, asset management, fraud protection and regulatory compliance are now populated not just by well-known and established institutions but also by challenger start-ups vying for a say in the future. These new entrants, alongside reconfiguring incumbents, are reformulating service design and delivery through technological developments and advancements in software, user experience and data mining

The spread of mobile phones and mobile internet in Africa has played a huge part in laying the groundwork for fintech to grow. The mobile penetration rate of 80per cent<sup>1</sup> makes Africa of the fast growing mobile market globally. With 1 billion SIM cards<sup>2</sup>, mobile phone is the most

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<sup>1</sup> Jumia mobile trend report for Africa

<sup>2</sup> Ovum, Africa Market Outlook, 2016

used communication medium in the African region, and is consequently increasing the adoption of internet at an exponential rate.

Financial technology has developed on a large scale in Africa for several reasons and mobile phone becomes an online banking terminal. With approximately 80% of adults in Africa not having access to formal banking services according to McKinsey and Company, the continent is facing an extremely low rate of bank access, networks of bank branches and embryonic ATMs<sup>3</sup>, unreliable postal mandate services, as well as a majority of the working population in the informal sector with irregular income and cash payments and micro payments. For example, according to the African Development Bank, Sub Saharan Africa has the lowest penetration rate of depository institutions with an average of 16.3 % compared to 63.3% for all developing countries<sup>4</sup>. Financial technology has radically changed Africa's financial services ecosystem by bringing major innovations in the areas of utility bills payment, merchant payments, money transfer, banking services, insurance, international remittances, etc. Fintech plays a key role in facilitating access to financial services and allowing banks to grant and monitor microloans easily and quickly while reducing operational costs.

As a result, today in Sub Saharan Africa, 12% of adults have access to financial services via Fintech especially in rural areas through 140 mobile money schemes deployed in 39 African countries and more than 40% of adults in the region use the service on an active basis. Africa leads the world in money transfers using mobile phones, with 14% of all Africans receiving money through mobile transfers<sup>5</sup> and 134 million mobile money accounts active in 2016. These services increase not only financial but also social inclusion with products that facilitate access to basic services in health, agriculture and education. To this end, key policy issues are emerging from promoting innovation to creating enabling regulatory environments to address competition and enhancing capacity and skills both to accelerate growth and manage regulatory issues.

In this context, this policy brief is drawn from a recent study by the Economic Commission for Africa (UNECA) on 'Emerging issues in ICT in Africa and provides key policy recommendations for considerations by African policy- and decision-makers.

## **2. Overview of Fintech in Africa**

In the last couple of years, Africa saw a boom in Fintech startups across the continent. According to the *Finnovating for Africa Exploring the African Fintech Startup Ecosystem Report 2017* released by Disrupt Africa, there are 301 African Fintech startups currently active. The data

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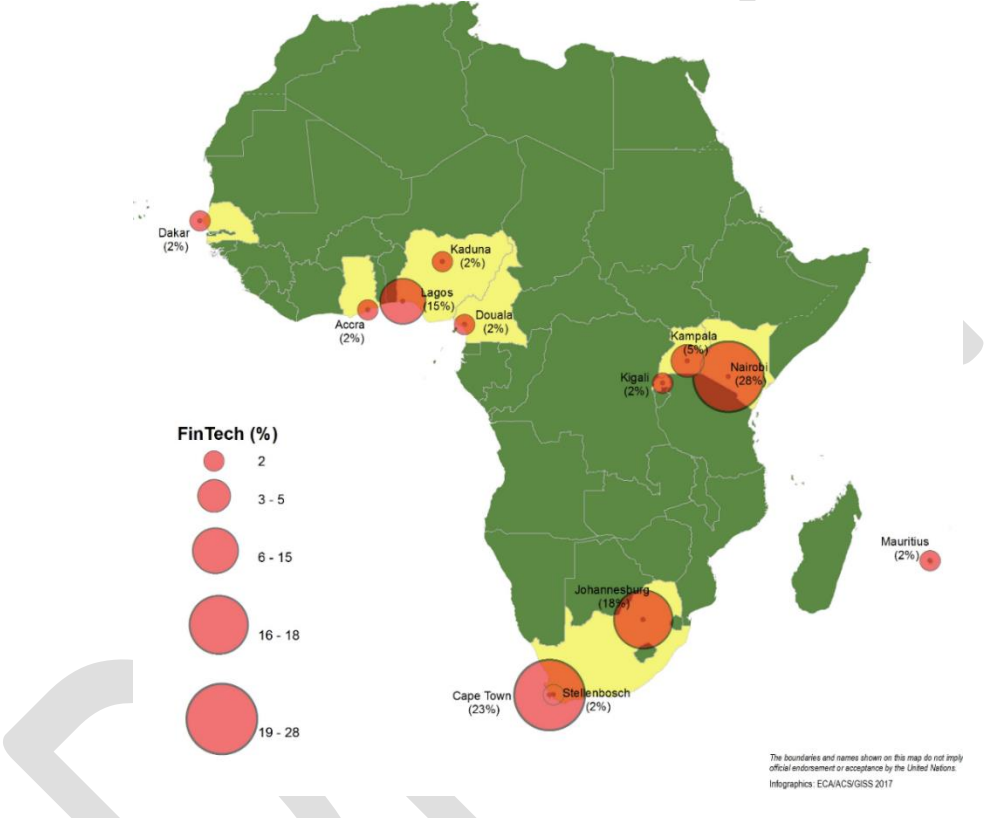
<sup>3</sup> Beck, Thorsten – Cull, Robert, Banking in Africa, CSAE Working Paper, WPS/2013-16, First Draft August 2013, Centre for the Study of African Economies

<sup>4</sup> <https://www.afdb.org/en/news-and-events/fostering-financial-inclusion-with-mobile-banking-12125/>

<sup>5</sup> UNCTAD Information Economy Report 2015

spread across the African continent, with the Southern, West and East African regions equally active, while North Africa lags behind. Among the countries, South Africa leads as the top destination for Fintech startup activity hosting 31.2 per cent of the continent’s Fintech startups while Nigeria and Kenya follow in the second and third position respectively<sup>6</sup>.

**Figure 1: Fintech Companies in Africa**



Source : Economic Commission for Africa, Report on Blockchain Technologies, 2017

Further, a number of countries have also emerged as a vibrant destination for Fintech, particularly in West Africa where Ghana and Cameroon are increasingly becoming prominent markets. Among the nine Fintech categories considered in the report, payments and remittances startups dominate the market, with 41.5 per cent of all startups focused on this space. While lending and financing services also prove a popular priority for Africa’s Fintech innovators. African Banks have adapted to modern technologies by increasingly collaborating with Fintech to embed new services and technologies that ensures an enhanced customer experience and drive efficiency. In this regards, major African Banks are starting to explore digital technologies and solutions (wealth management, lending payment, mortgage, etc.) to optimize their operations. The FinTech sector is experiencing explosive growth, attracting \$414 million in 2014 to \$608 million in 2018, according

<sup>6</sup> See also <http://disrupt-africa.com/finnovating-for-africa/>

to the Financial Times. FinTech revolution may not have come to an end, but its benefits are already evident in several countries, as seen in Kenya with the M-Pesa system. Today, more than 80% of the continent is covered by mobile money services and mobile money account ranging from 10 percent in Namibia to 58 percent in Kenya).

In Kenya, the rate of banking has increased by 19 per cent in 2007 (year of launching the national unicorn M’Pesa) to 58% in 2015. It is undeniable that access to basic services has been reinforced on the continent with 15.4% of the total value of transactions in 2014 going back to bill payments and market transactions. In Gabon, Ghana, Kenya, Namibia, Tanzania, Uganda and Zimbabwe more than 40 per cent of adults pay all their daily bills directly through the mobile money application: tuition fees, electricity bills and even simple taxi rides. In this regards, Fintech service has become a powerful lever for growth and financial inclusion in Africa by providing large numbers of services to people excluded from basic financial services. Access to basic services has increased on the continent with 15.4% of the total value of transactions in 2014 for bill payments and market transactions<sup>7</sup>. Mobile money has also been seen as a lifeline to a number of social and economic clusters in Africa, from the increasing number of agents, growing from 100,000 agents in 2011 to 1.5 million in 2016, 47% of revenues from mobile money in the region went to agents<sup>8</sup>. The impact on macro-economic development is real in several countries, for example as a proportion of the GDP, Togo (10.7%), Cape Verde (9.4%), Senegal (9.3%), and The Gambia (8.2%)<sup>9</sup>,

### 3. Challenges

FinTechs have had a positive impact in Africa’s banking sector and mobile money remains today the most advanced platform for financial inclusion in Africa through the variety of services offered to users. To promote the development of these innovations, many issues need to be resolved to increase the coverage of Fintech services and their accessibility to all. Despite the efforts put in place, there are some noticeable challenges of implementation. Among them:

- **Poor Regulation:** Regulation is a big challenge when technology is moving so quickly and developing across so many different jurisdictions. Indeed, this new financial ecosystem which involves entities such as telecommunications operators, on transactions partly regulated by central banks and partly by telecom regulatory agencies, creates a paradigm shift because financial regulation has so far been built around existing actors. While on the one hand, the interoperability of the platform is not effective and it hampers the transfer of

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<sup>7</sup> GSMA

<sup>8</sup> Source GSMA : <https://www.gsma.com/mobilefordevelopment/page/13?cat=vmfwerppz>

<sup>9</sup> <https://www.oecd.org/aidfortrade/casestories/casestories-2017/CS-15-AfDB-Mobile-payments-and-banking-on-the-unbanked-in-African-countries.pdf>

domestic and international money. The taxation of mobile money and other similar services is often beyond the control of states which do not have any visibility on the volume of transactions. On the other hand, the majority of Fintech start-ups are unlikely to be regulated in the same way as official banks and often fail because of the instability of regulatory frameworks and huge legal risks ranging from enabling access to digital services to all through making infrastructure available to regulating prices and making it affordable and finally introducing new regulatory mechanisms for financial services enabled by Fintech such as e-money, processing data from Big Data in compliance with the Data Protection Act, etc.

- **Limited Infrastructure:** While Internet is likely to be a huge accelerator of Fintech as it reduces transaction costs and brings financial services to people in remote locations from the nearest financial service facilities, adequate Infrastructures to support the Fintech services (power, telecommunications network, broadband technology penetration, quality of IT) remain difficult.
- **High cost of bandwidth:** The major problem among African Fintech startups today is the high cost of bandwidth<sup>i</sup> because of the high cost of international connections to the global telecommunication backbones and this in turn affects access to Fintech services in Africa. Users in landlocked countries in Africa pay on average \$232 more per month for fixed broadband access than those living in coastal areas<sup>10</sup>
- **Cybersecurity:** With the development of Fintech and the rise of virtual currencies, such as Bitcoin, which do not depend on any issuing institution and have no legal status, cybersecurity is the biggest worry when it comes to financial transactions and services. Mobile money fraud, intrusions, attacks, money laundering and terrorism are the major concern on the continent and could put Africa in danger. For example, according to the Central Bank of Kenya 37% of mobile transactions are fraudulent compared to 10% when done by traditional banking institution. The outbreak of Fintech opens up vast horizons and at the same time poses significant challenges in the fight against cyber-fraud. These Fintech platforms, especially crowd funding sites, can be used to finance activities related to terrorism. In addition, these services, which make it possible to withdraw cash at points of sale using codes exchanged by SMS, present the most important risks in terms of money laundering
- **Skills and digital literacy -** Other factors that are considered barrier to the digital financial inclusion are the level of education to allow people to benefit from the opportunities of

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<sup>10</sup> World Bank's recent 2016 Digital Dividends report

being online; availability, affordability and relevance of the services or content on the Internet, etc.

#### **4. Policy Implications and Recommendations**

The following are some of the policy recommendations for considerations by African policy and decision-makers including other public-private stakeholders. This includes building the capacities of regulators both in the ICT and financial sector to catch up with new and emerging technologies and start-ups, administrative and legal framework to promote the development of Fintech start-ups, as well as to create concrete incentives and make better connectivity available to promote innovation.

**Policy** – ICT policies should be continually reviewed to adapt to the new and emerging technologies. ICT policies must also be linked to investments in education in order to develop the necessary human skills and raise levels of education, and thus bring more people online. Furthermore, harmonising the financial system policy and regulatory mechanism with the legal and regulatory environment for the development of the ICT sector, specifically with respect new and emerging fintech technologies is of paramount importance. African governments need to develop policy guidelines in encouraging the use and the development of Fintech services, enhancing competition and protection of customers against fraud, terrorism finance and money laundering.

**Regulation** - The role of governments will be important, both from an adoption perspective, as well as the creation enabling policy and regulatory environment while encouraging innovation to enable Fintech. Efforts should be made to reflect international best practices in the development of new legislation on Blockchain, digital banks, mobile wallets, coupon, etc. African Regulators should assess the potential of Fintech technology to reduce costs and enhance transparency within multiple sectors of the economy. Effective coordination between telecom and financial regulators is also needed. As fintech may involve international transactions, regulatory issues such as cross-border enforcement and regulations, data security and data privacy laws, and globally recognized certification and standards should be put in place.

**Improving access to broadband** - For Fintech applications to run, users need to have access to high quality and speed Internet. To this end, African policy- and decision makers need to enhance their efforts in expanding connectivity among the population particularly ensuring reliable and affordable broadband infrastructure which is key to facilitate use by people applications that require high bandwidth and quality broadband services.

**The promotion of a safe and efficient payment system** - Government, banks and others actors have a significant role to play in the development and the improvement of the payment system

infrastructure, ensuring their robustness and effective mitigation of systemic risks in the payment systems. That way, the consumers' confidence will be ensured.

**Promoting fintech start-ups** –the role of private sector in investing in new and emerging technologies plays a great role in promoting financial digital inclusion. Partnership between banks, financial institutions, telecom operators and Fintech startups should be encouraged. At the technical level, it is necessary to make the digital payments ecosystem interoperable to ensure that the products and services are linked not only within a country but also across borders.

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