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Improving access to finance through fintech

Ashly Hope, Volunteer

The financing gap for business in Africa is well recognised. Small firms, especially, face challenges accessing finance. Financial technology – 'fintech' may be able to contribute to increased access to finance for small businesses. Fintech can be enabled by a range of measures, mostly at the national level. However, some barriers to cross-border fintech can be removed as part of the African Continental Free Trade Area (AfCFTA).

While there is no universally agreed definition of fintech, it is generally used to describe businesses using technology for financial services. This can mean new financial services (such as mobile money) but typically means new ways of delivering existing financial services. The technology might provide a new or better user interface, such as an app; it might enable a greater reach (more people have mobile phones than local bank branches) or lower costs (for example 'robo-advisors' use algorithms rather than humans to give investment advice, typically making the advice cheaper).

A lack of access to finance has been shown to have a significant, negative effect on employment growth in African SMEs.[1] Studies also tend to show a positive relationship between SME access to financing and exporting behaviour. While this does not mean a causal relationship, it does suggest that businesses which export may more easily access finance, or, those which access finance may be able export more readily.

SMEs account for up to 90% of businesses in sub-Saharan Africa.[2] Small businesses lack access to finance for several reasons – lower financial literacy, poor credit information, physical remoteness, informality, gender discrimination and high costs for funding SMEs. In addition, the main form of financing tends to be debt finance – usually in the form of collateralised bank loans – which are unsuited to many small businesses, either because they lack collateral, are not yet income generating, or have a new or innovative business model. Due to these reasons, and the general low levels of competition in the banking sector in African countries, finance can also be too expensive for small businesses.

Technology is enabling new and old forms of finance to reach more businesses. Fintechs are expanding access to finance for SMEs through new business models or the use of technology to change or increase existing businesses. Africa is the global leader in mobile money and there are already many fintech solutions improving access to finance. These include businesses offering:

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- factoring (where a business sells its accounts receivable), an historically unwieldy and expensive form of finance made simpler and cheaper through technology;
- alternative credit scoring (using data including social media networks or mobile phone contacts) to expand credit access to those who might not have a good (or any) credit score;
- equity crowdfunding where small investors take a portion of the equity of the business in exchange for funding – similar to public issuance of stock, but without the high barriers to entry;
- rewards-based crowdfunding, where funding is provided in exchange for a reward, such as a first run of products or film credits, opening funding to businesses that may not be able to offer a financial return on investment;
- marketplace and peer-to-peer lending where loans are either pooled or made directly using an online platform offering a new source of funding;
- digital versions of existing tools such as rotating savings and credit associations and microfinance expanding the reach of these traditional tools through technology;
- tools that provide financial and business education alongside transactional services to support SMEs in developing financial statements and business plans that assist with getting loans;
- basic lending through digital channels; and
- angel investing, connecting angel investors digitally with SMEs.

The AfCFTA can support fintechs, and therefore contribute to increased access to small business financing in three key ways. Firstly, by eliminating unnecessary barriers to cross-border trade and access to markets for financial services within the continent; secondly, by encouraging a welcoming regulatory environment for fintech firms and thirdly by creating the conditions for expanded access to fintech services by improving communications and energy infrastructure.

Many barriers to financial services trade are justified on prudential or other regulatory grounds. However, it is important that as part of the AfCFTA services sector scheduling process, countries closely interrogate regulatory restrictions in the *African* context. Restrictions that might be appropriate when considering global financial services providers will not necessarily be appropriate in the region. This is already the case in the East African Community, where countries including Burundi, Rwanda and Uganda commit to unrestricted access, even though they have not made commitments under the GATS. On lending specifically, while Kenya, for example, has made commitments under the GATS, the commitments made under the EAC expand the national treatment commitment to also cover mode 3 (commercial presence). To achieve the kind of greater financial integration necessary to support fintech, AU members should expand at least some of these REC-level commitments continent-wide.

AU members should commit to principles of proportional regulation, as part of the financial services regulatory framework. Financial regulation is typically designed for banks offering a full suite of financial services and therefore posing significant systemic and consumer risk. Proportional regulation, whereby regulation is applied in proportion to the risk profile of the financial business, accommodates innovation and is more flexible. It is particularly valuable for fintech businesses doing business in unorthodox ways.

Finally, to increase access to fintech, and therefore the new ways of lending that have the potential to support SMEs, the AfCFTA can include commitments that will support the digital economy more generally. For example, market access commitments in electricity and telecommunication services to expand compete-

tion; tariff reductions on tech hardware to reduce costs; or data transfer provisions to ensure that businesses can operate cross-border. This will all help expand access to finance through fintech, by making it easier for SMEs to have access to the services, and easier for fintechs to deliver.

Commitments in the AfCFTA to liberalise financial services, towards better regulation and to expand access to devices and the internet will have some impact on the availability of credit to small businesses. However, the real work must be done at the national level – capacitating regulators; making or clarifying legal and regulatory frameworks and improving business conditions.

[1] https://www.sciencedirect.com/science/article/pii/S1879933717300106

[2] https://www.ifc.org/wps/wcm/connect/f086c783-0f7d-4d53-b5d0-73c7492a4230/IFC+SME+Ventures+Final+low+res+30+Nov+2018.pdf?MOD=AJPERES