

ALTERNATIVE FINANCE IN SOUTH AFRICA
RESEARCH FINDINGS & PANEL DISCUSSION
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Alternative Finance Introduction & Trends

Alternative Finance Use Cases

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Key Findings

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What is Alternative Finance?

Definition

“**Alternative finance**” refers to financial products and services that are developing outside the traditional, regulated banking and capital market sectors via innovative and predominately online channels, instruments and systems.

Alternative Finance instruments

1	2	3	4
Asset Based Finance:	Alternative Debt:	Hybrid instruments:	Equity Instruments:
<ul style="list-style-type: none">• Asset based lending• Factoring• Purchase Order-Finance• Warehouse Receipts Leasing	<ul style="list-style-type: none">• Corporate bonds• Securitized debt• Covered bonds• Private placements• Crowdfunding (debt)	<ul style="list-style-type: none">• Subordinated loans/bonds• Participating loans• Profit participation rights• Convertible bonds• Bonds with warrants• Mezzanine finance	<ul style="list-style-type: none">• Private Equity• Venture Capital• Business Angels• Crowdfunding Equity• Initial Coins Offering• Specialized platforms for SMEs listing

Key enabling factors



Reliable and widespread internet penetration



The regulatory and supervisory environment



Financial literacy



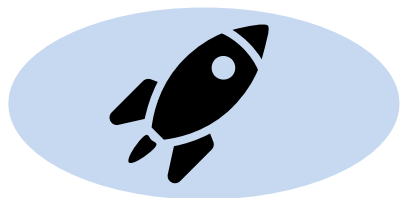
Existence of a solid financial ecosystem and well-developed financial markets.



Growth in Fintech sector



Leading Alternative Finance business models have 4 key characteristics in common



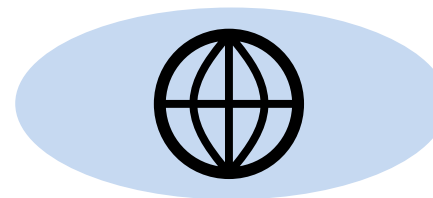
They offer funds in a speedy manner

Bank finance, for instance, can take weeks or months, from application to approval, but many forms of Alternative Finance can approve the funds in a single day.



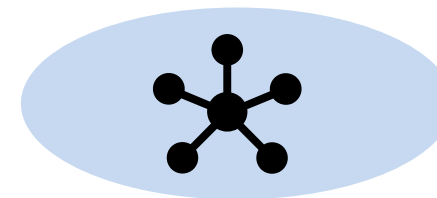
More leniency is afforded to businesses and consumers through alternative data

Alternative financiers do not display the same level of intense scrutiny as banks, with more willingness to consider alternative data sources.



They offer access to wide range of funders

Allows businesses and consumers to connect to a large pool of investors to obtain relevant funding (rather than tie up to a single bank).



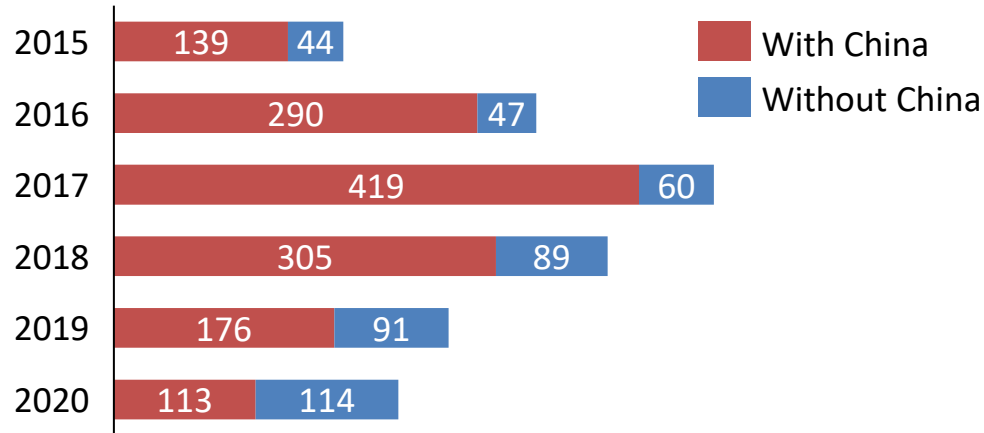
They are mostly technology enabled

Mostly conducted via an online platform by Alternative Finance companies, processes are usually automated with minimal intervention.



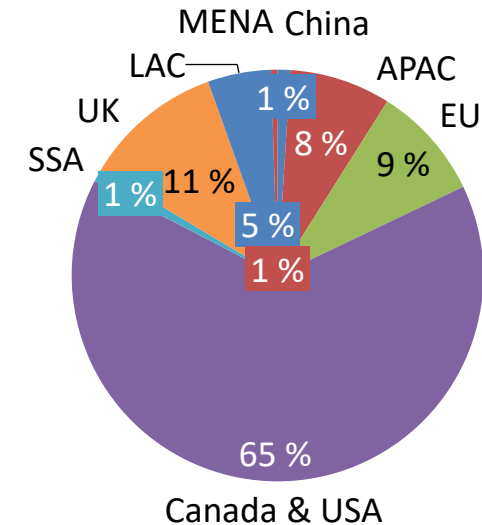
Globally, Alternative Finance activities have grown over the years

Size and Growth of Alternative Finance Market in \$ billions



- China dominated the global alternative finance market up until 2019.
- But local market developments and regulatory changes have led to a considerable decline in volumes and its global market share.
- In 2019, the Chinese market accounted for 48% of the global volume, and in 2020 for only 1%.
- Excluding the Chinese market, it emerges that global alternative finance market has grown consistently over the past three years, despite COVID-19 in 2020.

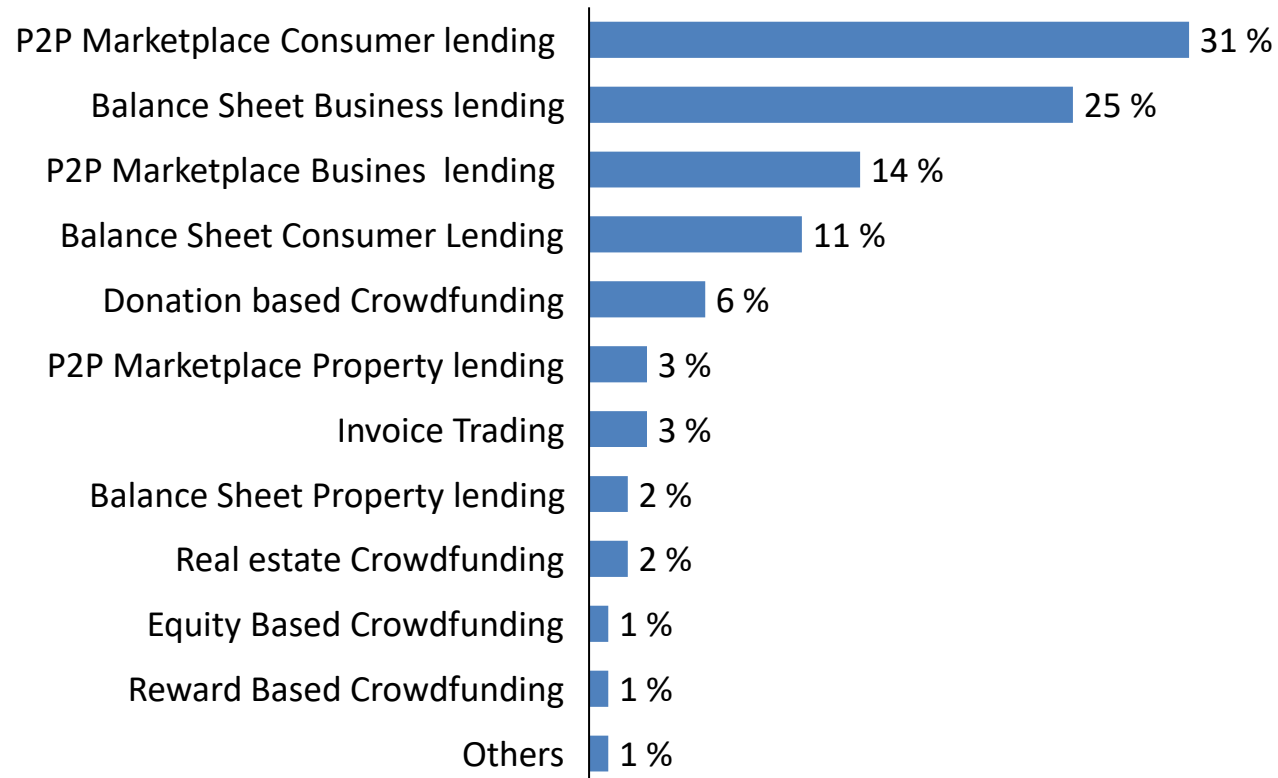
Market Share of Alternative Finance by Region



- In 2020, the largest regional alternative market was the United States and Canada which accounted for 65% of global online alternative finance market value.
- This is followed by the UK 11%, Europe 9%, the Asia Pacific excluding China 8%, Latin America 0.5%, Sub Saharan Africa 1%, China and MENA 1%.

There are various of business models underpinning Alternative Finance activities

Global Alternative Finance Market Value by business model in USD Billions



- The largest model globally in 2020, was **P2P/Marketplace Consumer Lending**, accounting for 31 % of the overall value of alternative finance market.
- This was followed by **Balance Sheet Business Lending 25%**, **P2P Market Place Business Lending 14%**, **Balance Sheet Consumer Lending 11%**, **Donation Based Crowdfunding 6%**, **P2P/Marketplace Property Lending** and **Invoice Trading 3 %** respectively.
- The Donation-based Crowdfunding model has experienced exponential growth globally in 2020.
- The leap in annual growth, can be attributed largely to the flurry of COVID-19 related charitable, community and health-related online fundraising activities around the world.

Various Jurisdictions have introduced varying approaches to regulate alternative finance activities in their areas

China



- The central bank, the People's Bank of China and China Bank and Insurance Regulatory Commission initiated a program to regulate P2P/Marketplace lending.
- Under the new rules:
 - All marketplace lenders must adhere to AML/CFT obligations;
 - Lending platforms must meet a certain minimum capital requirement to become a regional small loan provider;
 - P2P/Marketplace lenders posing serious credit and fraudulent risks would be banned from making the transition and forced to close.

Australia



- Alternative finance transactions are generally regulated within the framework of the Corporations Act 2001.
- The Australian Securities and Investments Commission (ASIC) treats P2P lending platforms as managed investment schemes.
- Any alternative lender seeking a financial license to operate in the Australian retail financial market is obligated to seek approval through ASIC, or
- alternatively, can operate under an existing license via a third party.

Brazil



- The CMN National Monetary Council(CMN) issued a resolution to increase accessibility to equity and P2P financing in 2018.
- The resolution provides for the creation of two new types of financial institutions to fund clients through electronic platforms.
- Direct credit companies are allowed to fund their loans exclusively through equity capital.
- P2P loan companies are allowed to connect lenders and borrowers and to intermediate the negotiation through digital platforms.

United Kingdom



- The United Kingdom was one of the first nations to create bespoke regulation for crowdfunding activities in 2014.
- The regulating body that monitors and supervises crowdfunding activities in the UK is the Financial Conduct Authority (FCA).



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Top 4 (of many) Alternative finance use-cases



P2P/Marketplace Lending

P2P/Market place lending enables Individuals and/or institutional funders provide a loan to a **consumer borrower, business borrower** ascribed to off-balance sheet lending.



Balance Sheet Lending

Balance Sheet lending platform entity provides a loan directly to a **consumer borrower, business borrower** ascribed to on-balance sheet non-bank lending.



Invoice Trading

Individuals or institutional funders purchase invoices or receivables from a business at a discount.



Crowd funding

- **Real estate crowd funders** invest money for real estate investment
- **Equity based crowd funders** invest in early-stage unlisted company in exchange for **shares**
- **Donation based crowd funders** individually donate a small amount of money in a project
- **Reward based crowd funders** donates to a project or business with the expectation of receiving a non-financial **reward** in return.



Alternative finance has the potential to play a significant role in deepening competition and increases consumer choices

Overview

- Founded in 2013, Fundera is an online marketplace for small business financial solutions.
- With Fundera small business owner can apply for financing with more than 30 different lenders with one easy application.
- Fundera offers guidance for small business owners to secure solutions for any of their financing needs, from credit cards to SBA loans and everything in between.
- They partner throughout every stage of their business, helping them weigh the best-fit financial options based on their current needs and eligibility.
- Their combination of technology and financial expertise ensures business owners make smart business decisions.

How it works

- Because Fundera works with several different funders, it does not have any specific requirements regarding how long you've been in business, how much revenue you make, what your personal credit score is, or any other business characteristics.
- Each of Fundera's partners has its own requirements regarding business characteristics; as such, you may not be eligible for certain products.
- If you make an account and find you are not eligible for the products you're interested in, Fundera offers an eligibility tracker that can inform you when you do qualify for new products.

Key Outcomes

- Easy-to-use customer interface
- Fast time from application to funding
- Provides a seamless and simple online application process.
- Lower fees for borrowers with no early settlement penalties.
- Giving borrowers access to a number of investors.
- Giving investors access to a new asset class, which is alternative lending for high growth medium to small businesses.

Alternative finance has the potential to play a significant role in deepening financial access

Overview

- Iwoca Ltd is an online Fintech company based in London.
- It offers credit facilities to small businesses trading in the UK and Germany via an automated lending platform.
- They aimed to offer custom-built loans to small businesses, who usually struggled with fair access to finance from big banks.
- To start with, these were exclusively e-commerce businesses, but in April 2014, Iwoca began lending to all types of small businesses.
- By July 2015, it was reported to have seen 250% year-on-year growth in issuance.

How it works

- Iwoca provides credit lines of up to £200,000 and business loans of up to £250,000.
- It uses various machine learning models to automatically assess businesses based on data taken directly from Xero, eBay, Amazon, PayPal, Sage Pay, business bank accounts and other online and offline platforms.
- It's also integrated its credit API with the Tide bank.
- A 3% monthly interest rate and maximum loan term of 12 months are typical.

Key Outcomes

- Their working capital loans have helped thousands of businesses to realise their true potential.
- Increase in speed and accuracy with which applications are assessed and decisions made.
- Increase in employment and economic growth.

Alternative finance has the potential role to play in increasing access to finance and economic growth

Overview

- KredX (formerly Mandii) is an online invoice discounting marketplace for SME lending.
- The platform connects enterprises looking for financing with investors looking to earn higher short-term yields with lesser risk.
- The KredX invoice discounting platform provides businesses and their suppliers with quick access to working capital.
- As an off-balance sheet solution, the KredX invoice discounting platform allows businesses to use unpaid invoices as a collateral to get immediate working capital, thereby helping in growth and expansion.

How it works

- Borrowers can sign up, upload payment pending invoices or post date instruments of their customers, select from among the best bids available and receive funds.
- Investors can view invoices/PDIs from companies along with credit profiles to post their bids against them.
- Post the tenure, investors can get the funds directly to their account.
- The company receives a commission from both the parties once the trade is settled.

Key Outcomes

- KredX's working capital solution helps businesses gain quick access to funds, without the need to pledge any collaterals,
- thus providing liquidity for growth and expansion through a healthy cash flow balance.
- This solution allows businesses to take care of all short-term liabilities without the need for physical assets by unlocking money tied up in unpaid invoices via invoice discounting.

Alternative finance has the potential to play a significant role in growing entrepreneurship activities in the economy

Overview

- Thundafund is one of the first and largest crowdfunding platforms in South Africa.
- Thundafund believes that by changing the way entrepreneurial funding works, and by making this transparent and inclusive, they can build trust and loyalty between entrepreneurs and their customers thereby growing economies and creating jobs.

How it works

- Project creators (e.g. entrepreneurs) register their idea on the platform and sponsors can then register and make contributions to the projects.
- The Thundafund team works with the project creator to understand the idea or project and including its funding needs.
- Each project then devises a variety of project related items, known as rewards, that will be presold to backers in turn for their funding contribution.
- These rewards include retail items, recognition and experience/exposure.
- All projects on Thundafund are required to reach their tipping point before their project closes in order to receive all their funds.
- If their target is not reached all backers of the project will be reimbursed minus the banking fees.
- Once a project is successfully funded, Thundafund receives a commission on the final amount.

Key Outcomes

- Entrepreneurs are able to test their ideas and build a base of supporters.
- Entrepreneurs can get more than capital support, as backers usually want the business to succeed and provide advice and assistance.
- It is a risk free model, allowing project creators to raise awareness within their market or audience by pre selling the product before engaging in significant resource.

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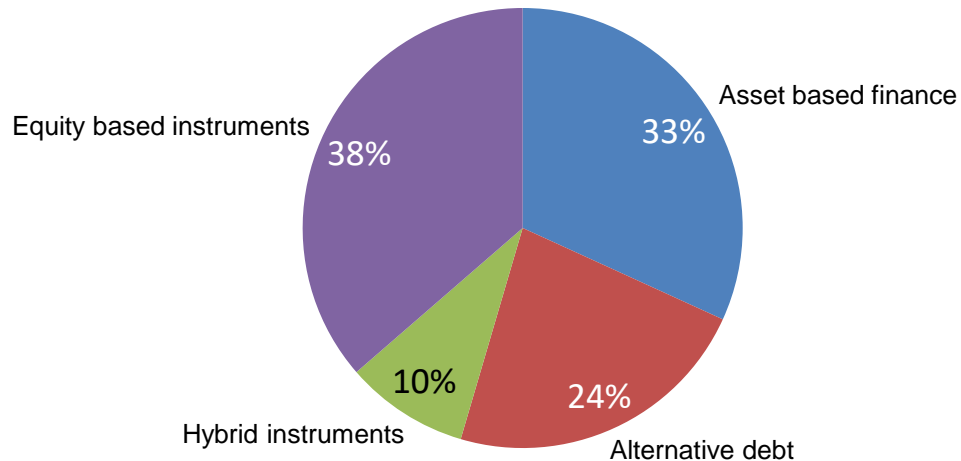


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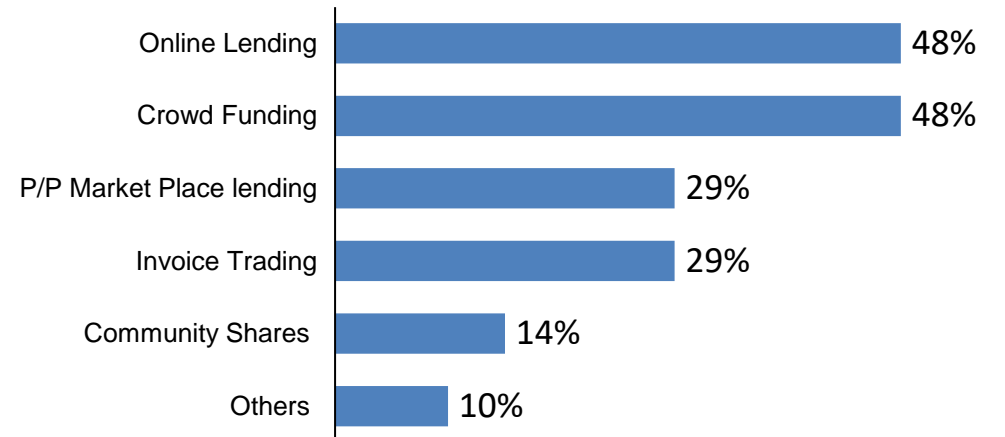
Alternative Finance Survey Results (1/4)

The most prominent Financial Instrument underlying Alternative Finance offerings in South Africa



- Equity based instrument is the most prominent financial instrument underlying alternative finance offering in SA, followed by Asset based finance alternative debt and hybrid instruments.
- The prominence of equity-based instrument is being driven by crowd funding equity, venture capital and private equity investors.
- Asset based finance instrument such purchase order financing is gaining popularity in SA within the SMMEs sector.
- SMMEs though are having bank accounts, they are still struggling to get funding from traditional finance institution and alternative finance instruments such as purchase orders finance are filling the gap.

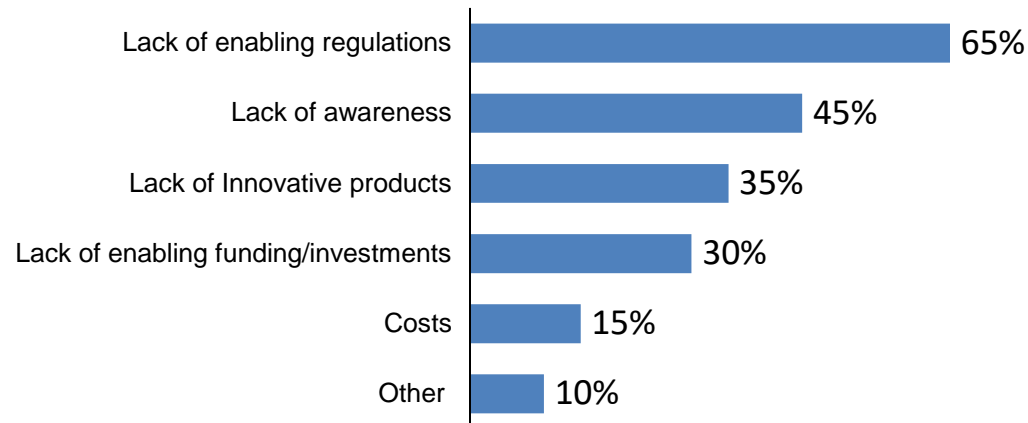
Two most prominent Alternative finance use cases in South Africa



- The most prominent alternative finance use cases in SA are Online lending and Crowdfunding.
- This is followed by invoice trading and P/P marketplace lending as well as community shares.
- Online lending is skewed towards the consumer market, especially towards unsecured lending space.
- Crowdfunding has always existed in SA in a form of Stokvels and nowadays it is been technologically backed.
- Both Invoice trading and P/P marketplace lending, community shares alternative finance use cases are still in an early phase of development in SA and are expected to mature in the near future.

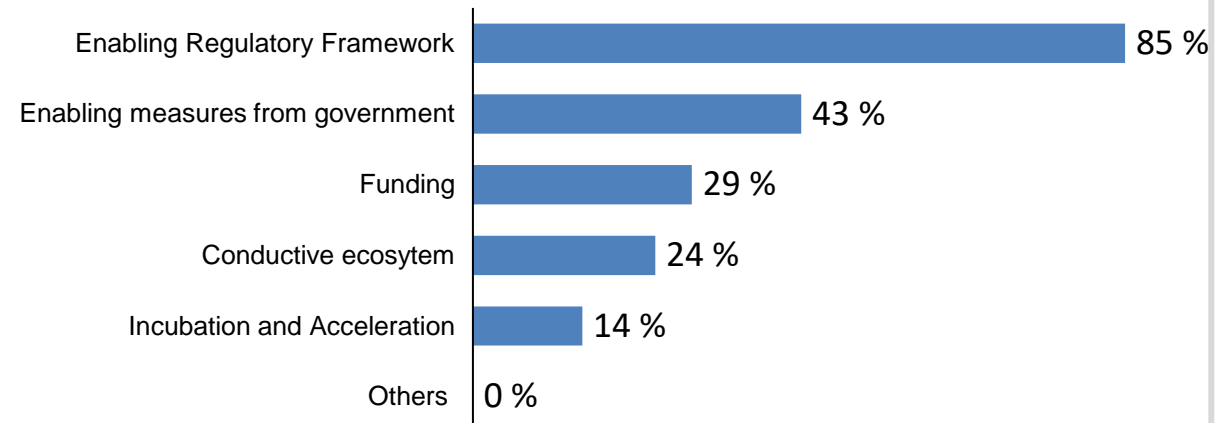
Alternative Finance Survey Results (2/4)

Top two barriers for consumers to access Alternative Finance in South Africa



- The dominant factors for the relatively low take-up of alternative financing in SA is lack of enabling regulation followed by lack of awareness.
- The absence of regulations governing alternative finance makes it difficult for people to trust the products, while lack of awareness is a reflection of the inefficiency of the channels of information to the requirement for improved communication to consumers.
- Consumers and SMMEs are mostly not aware that there are other forms of financing beyond their tradition banks.
- Lack of innovative products and lack of investments also emerged as some of the barriers for consumers to access alternative finance in SA.

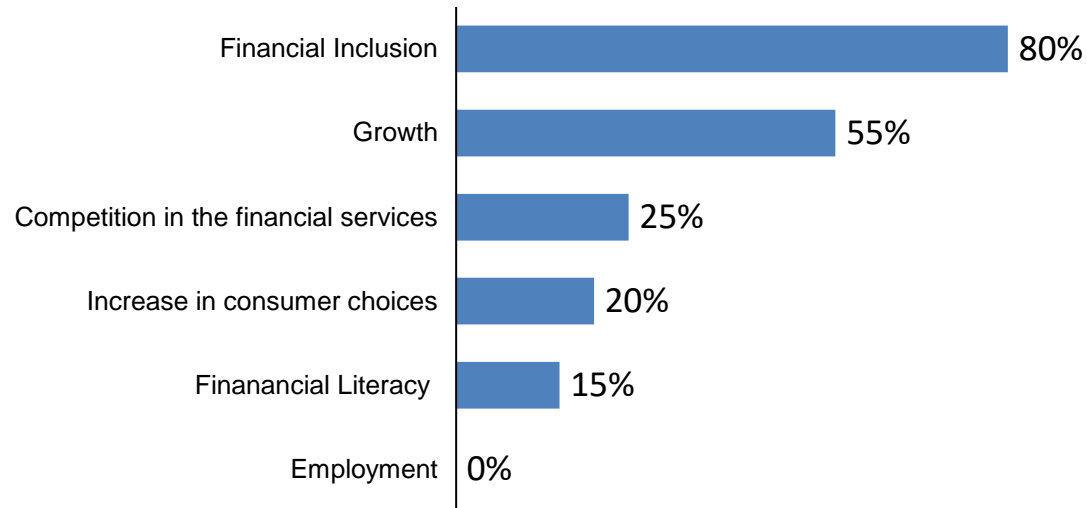
Top two Interventions that should be put in place to support Alternative Finance in South Africa



- Enabling regulatory frameworks and enabling supporting measures from government are the most commonly mentioned interventions by the respondents.
- These were followed by funding and conducive ecosystem.
- Some respondents indicated that ensuring that SMMEs have adequate access to financing should be a government highest priority since SMMEs are the greatest generators of employment in the economy, hence there is a greater need for enabling regulatory framework and enabling measures from government to support alternative finance.

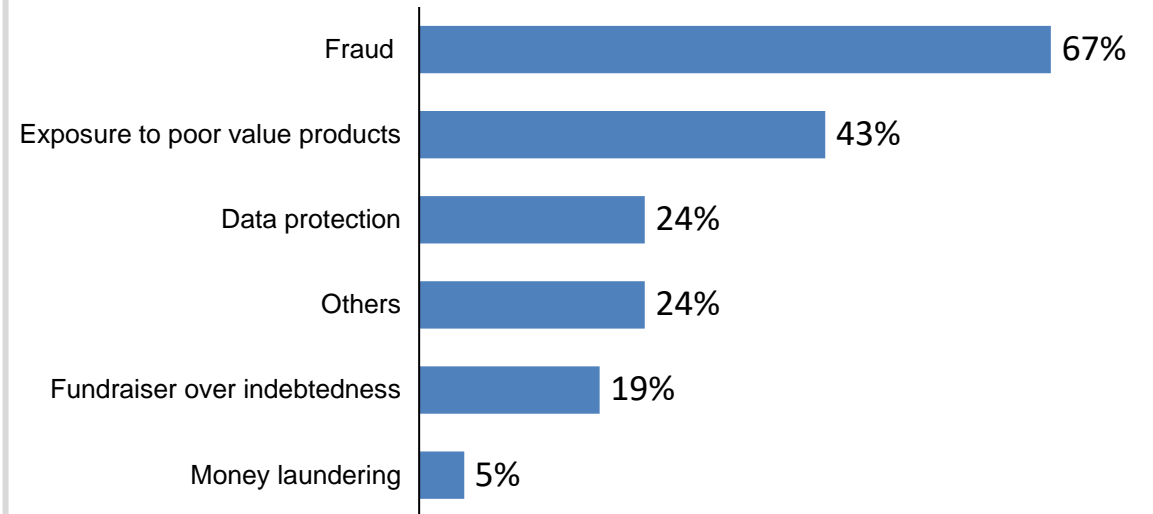
Alternative finance data survey results (3/4)

Two Key benefits associated with Alternative Finance



- The survey results show that financial inclusion, followed by growth are believed to be the leading benefits associated with alternative finance.
- This is because traditional financial institutions have struggled to find cost-effective, profitable approaches to serving both the SMMEs market and low-income consumers and Fintechs have found ways to fill the gap.
- Alternative finance products are making it possible for SMMEs to acquire much required capital to drive growth in their operations. Something which is very difficult to attain if they follow the current traditional finance funding models.
- Competition in the financial services and increase in consumer choices are some of the most prominent benefits associated with alternative finance.

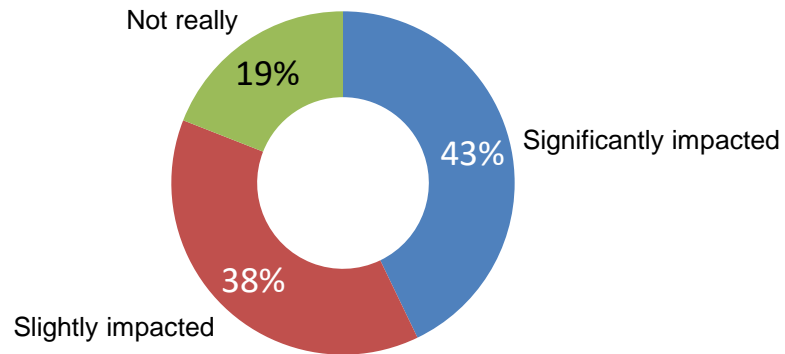
Two Key risks associated with Alternative finance



- Majority of the respondents indicated that fraud and exposure to poor value products are major risks associated with alternative finance to consumers and SMMEs.
- This was followed by data protection and other risks e.g. (operational risk, market risk, cyber security risk).
- Fraud is mostly being driven by lack of proper due diligence on issuers of alternative finance products, lack of consumer education about the products and absence of regulations.
- Poor value products risk being driven by the fact that some of these alternative finance products are highly priced and there seems to be no correlation between the risk and pricing of the product.

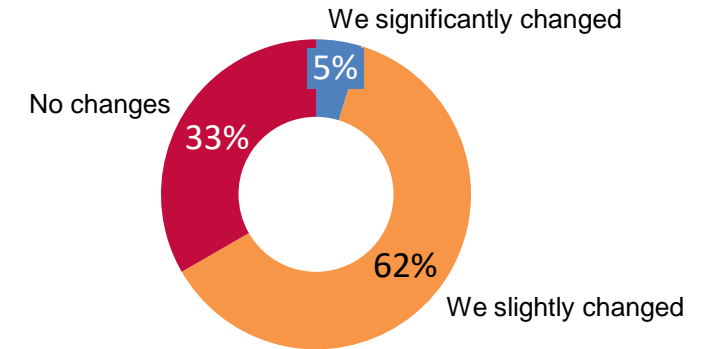
Alternative Finance Survey Results (4/4)

How organizations were impacted by Covid-19 in the past 2 years



- Large proportion of respondents indicated that they were significantly impacted by Covid-19 in a negative way.
- This was due to drying up in funding as most investors became risk averse during this Covid 19 period;
- Business was also very low as most SMMEs cut back on their operations and consumers demand was also low; and
- Majority of Fintechs are still in a building phase, and they did not have enough resources to cushion themselves against pandemic of this proportion.
- To those Fintechs who were slightly impacted by Covid-19 indication was most of their operations were already online and most of their employees were working remotely before Covid 19.
- However, it is also important to note that there were some Fintechs who saw their business growing greatly during the Covid-19 and this was due to an increase in POs to finance Covid-19 protective gears.

Has Covid-19 led to changes in Business Models, product and services in the past 2 years



- Large proportion of respondents slightly altered their business models, products and services due to Covid-19.
- This was followed by those who made no significant changes to their business model products and services, while small proportion indicated that they significantly altered their business models, products and services.
- To those who significantly changed their business model, products and services, they had to move their operations from manual to online platforms and most of their staff members started working remotely.
- They also have to make changes to some business requirements e.g. reduction in affordability requirements when lending to applicants.

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Our survey uncovered several benefits and risks emanating from Alternative Finance activities in South Africa



Benefits:

- **Financial inclusion:** Fintechs are reaching out to consumers who were previously excluded by incumbents FSPs.
- **Increase in consumer choices:** Consumers are getting exposed to variety of financing products and services.
- **Financial literacy:** Consumers are getting exposed to new financial products services and ways of doing things.

Risks:

- **Exposure to poor value products:** There is a lack of information regarding the pricing of some of these products.
- **Data protection:** Consumer personal information on the platforms can be compromised.
- **Money Laundering:** Alternative finance Platforms can be used as a vehicle to launder money.
- **High cost of borrowing:** Some of Alternative Finance offerings are highly prized.
- **Lack of Consumer education:** consumers are not informed on the risks and benefits emanating form these products.
- **Fraud:** lack of proper due diligence on issuers of Alternative Finance products and lack of regulations leaves consumers vulnerable.



Benefits:

- **Financial inclusion:** Fintechs have found profitable way to serving SMMEs who were previously excluded.
- **Growth:** SMMEs are accessing needed finances to drive growth.
- **Competition in the financial services:** Alt Finance offerings challenges incumbents FSPs offerings.
- **Financial literacy:** SMMEs are getting exposed to new financial products, services and way of doing things.

Risks:

- **Exposure to poor value products:** Lack of information regarding pricing of some of the products.
- **Data protection:** SMMEs data on the platforms can be compromised.
- **Fundraiser over indebtedness**
- **Money Laundering:** Alternative finance platform can be used a vehicle to launder money.
- **High cost of borrowing:** Some of Alternative finance offerings are highly prized.
- **Cyber security risk:** Platforms are susceptible to cyber attacks.



Our survey uncovered a number of barriers and enabling factors to Alternative Finance activities in South Africa

Key barriers

- **Lack of enabling regulations:** The absence of regulations governing Alternative Finance activities makes it difficult for consumers and SMMEs to trust the products.
- **Lack of awareness from consumers and SMMEs:** The lack of financial knowledge by Consumers and SMMEs as well as the lack of a recognised source of business finance advice for SMEs, hamper the use of Alternative Finance options.
- Absence of trust from both consumers and SMMEs in **unconventional financial products**
- High **cost of borrowing** regarding some Alternative Finance instruments, e.g., some of these Alternative Finance products are highly priced and there seems to be no co-relation between the risk and pricing of the product.
- **Lack of innovative products:** pool of products to choose from is still limited in SA.

Key enabling factors

- **Enabling regulatory framework:** This will include well developed regulatory and supervisory environment.
- **Enabling measures from government :** This will include programs aimed at growing the SMMEs funding sources.
- **Conductive ecosystem:** For example, well developed financial markets, financial literacy, growth in Fintechs and others.
- **Incubation and Acceleration:** The Sandbox as a facility to take a closer look at Fintechs offering Alternative Finance products should be leveraged in order to encourage innovation in new products and services, understand risks (and benefits) in the markets as well as inform how we supervise and regulate this activity.
- **Development of open application programme interfaces (APIs):** open APIs enable third party developers to leverage on the database of financial institutions to deliver faster, cheaper and customized solutions.

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Six key considerations for SA Fintech ecosystem (1/2)

1

Lack of Enabling Regulation

Establish bespoke regulations governing all forms of Alternative Finance available to MSMEs and consumers.

- All providers of alternative mechanisms, should be covered by market conduct regulations, with appropriate oversight to ensure compliance with the regulations.
- Regulations should ideally require the **licensing** of all participants in the Alternative Finance environment and detail the licensing requirements, describe the roles and services that such participants may provide and deal with responsible and fair market conduct, both to investors and to users.

2

Lack of awareness

Outreach and market engagement.

- Intensifying public engagement and education initiatives to raise awareness among SMEs on available alternative financing avenues.
- The communication should address the issue of the possible lack of trust in Alternative Finance providers ; and
- Information such as all providers should at least be licensed and subject to some regulatory oversight, this should be communicated to improve trust in and the use of the Alternative Finance systems.

3

Lack of innovative products

Promoting the development of open application programme interfaces (APIs) that enable third party developers to leverage on the database of financial institutions to deliver faster, cheaper and customized solutions.

- This will need to be supported by common standards for data sharing by financial institutions as well as requirements on information security, data exchange and other data-related policies.





Six key Considerations for SA Fintech Ecosystem (2/2)

4
Data & Cyber security

Minimize the risks associated with data and cyber security by ensuring data protection and privacy rights through appropriate legal frameworks.

- Ensure compliance with data privacy regulations among those offering Alternative Finance mechanisms that guarantee there are appropriate rules for the use, security, and control of MSMEs' and consumers data ,e.g., POPIA.

5
Other risks (market, operational and market conduct)

Encourage the use of Regulatory Sandbox to understand the benefits vs risks of the products

- The Sandbox as a facility to take a closer look at Fintechs offering Alternative Finance products should be leveraged in order to encourage innovation in new products and services, understand risks (and benefits) in the markets as well as inform how we supervise and regulate this activity.

6
Money Laundering & Fraud

All Institutions participating in Alternative Finance mechanism to register as an accountable and reporting institutions under the Financial Intelligence Centre Act.

- All SMMEs and consumers to report to the Financial Intelligence Centre on any transaction they are aware of that appears to be suspicious or unusual.
- 