Changing competitive landscape

Fintech and the Banking sector in Nigeria

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Executive Summary

Globally, the financial services industry has come under intense competition from fintech firms - agile and innovative firms leveraging technology to deliver tailored financial service offerings to consumers and corporates.

Government and investors are increasingly drawn to the fintech evolution given their ability to revolutionize how people save, borrow and spend money. Global fintech investments stood at over US$100 billion in 2018, as investors staked their bets on the innovative platform of fintech business model, which is reducing operational costs and boosting profitability.

Africa is home to more than 400 fintech firms[1]. The continent's three key tech hubs – South Africa, Kenya and Nigeria – account for a larger proportion of this number. Both foreign and local investors are attracted to the continent's burgeoning tech landscape. In 2019, fintech startups in Africa raised about US$132.8 million from investors. Fintech holds promising prospects for Africa, especially in their attempt to onboard the financially excluded into the formal financial sector.

In Nigeria, Africa's second largest technology hub, investors are taking positions or stakes in the country's growing tech ecosystem fueled by attractive fundamentals like the country's youthful and tech-savvy population, increasing smartphone and internet penetration, large unbanked population, among other factors. Over the past eight years (2011 – 2018), fintech investments in Nigeria recorded more than US$200 million.

Despite this, the COVID-19 outbreak is impacting the promising FinTech landscape in Africa. By Q1 2020, global funding for FinTech was estimated to have declined to US$6 billion due to significant drop in corporate VC-led investments. This decline in investments, combined with higher hurdles for accessing funds in the medium term (on account of the pandemic's impact on investors), will likely put pressure on the valuations of FinTech companies in later-stage rounds.

Consumer and SME-lending platforms, as well as FinTech platforms focused on mortgage and insurance digitalization, coupled with FinTech enablers focused on Artificial Intelligence (AI), Internet of Things (IoT), Blockchain and other essential technologies stand to gain in the COVID-19 and post-pandemic era. While traditional banks with weak digital presence, in addition to those providing wealth management and payment/foreign exchange-focused FinTechs could be on the losing end of the spectrum in the short-term.

Meanwhile, the need to develop a robust regulatory structure for the fintech sector in Nigeria has become topical. Currently, the CBN and NCC provide oversight for certain segments of the FinTech sector in the country, though ambiguities still exist in the extant laws, which need to be addressed.

Essentially, this paper aims to achieve the following objectives:

- To assess the changing global competitive landscape and its impact on Nigeria's banking sector
- Evaluate the current and future trends in the banking sector in Nigeria, particularly in the area of fintech and digital banking.
- Provide recommendations for the traditional banks and fintech players on navigating the emerging trends and challenges (including COVID-19) in FinTech.

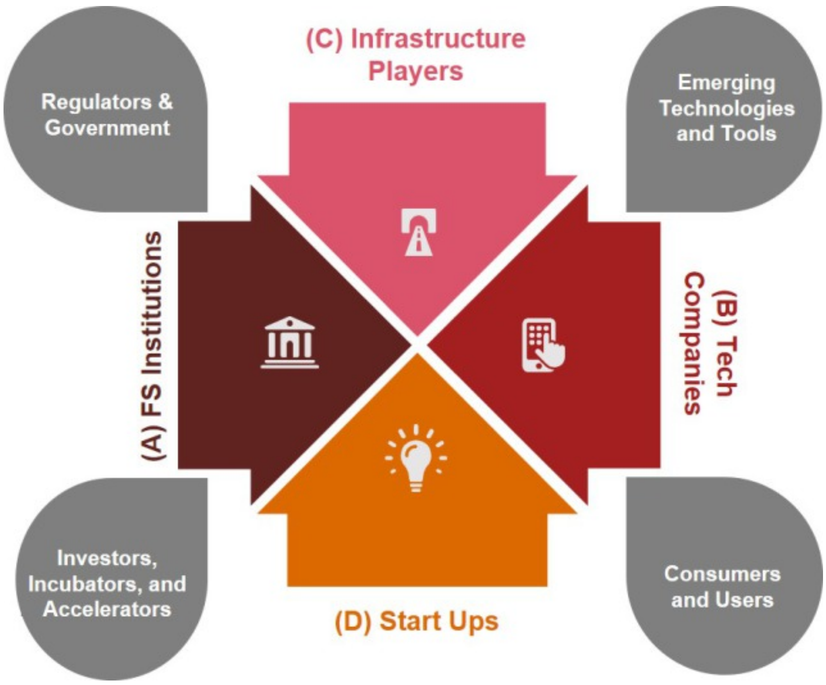
1. https://disrupt-africa.com/finnovating-for-africa/

Introduction

1

The Global Fintech Ecosystem

Fintechs are companies disrupting the conventional banking model by using technology to make financial operations easier, faster and more accessible to businesses, institutions, and the general public at large (consumers). Fintech is a product of creative innovation that grants consumers access to financial transactions (such as online banking, investment, risk and wealth management, payments, online trade, and much more) in the comfort of their homes, offices or while on the move, hence causing continued competition between banks and fintech companies.

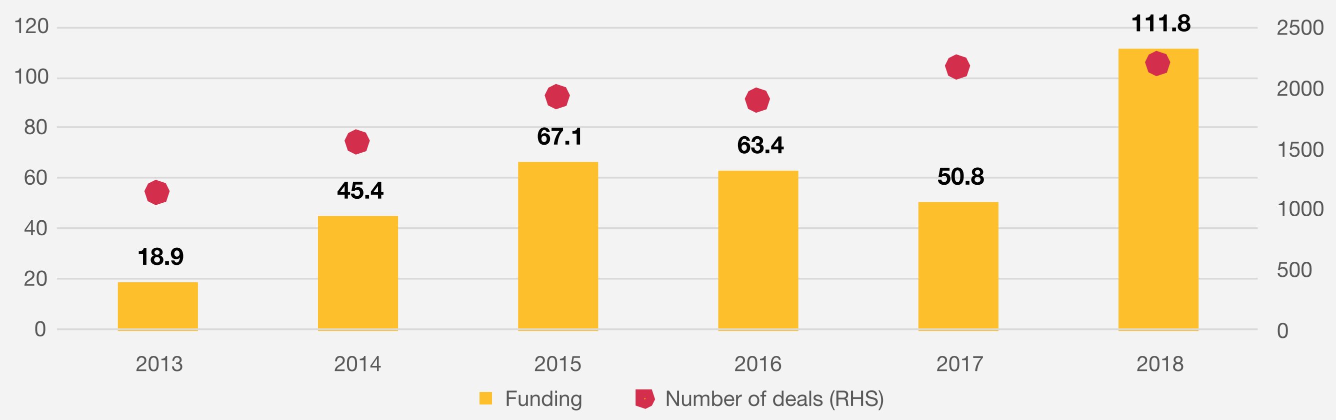


The number of fintech companies has grown astronomically over the years, driven by increasing digitization of financial services, relatively low cost of operations, strengthening global regulatory structures and the upgrade of fintech services beyond mobile banking to include lending, insurance, investment, personal finance management, among others. Globally, the number of fintechs more than tripled over a period of seven years to about 4,464 fintechs in 2017 from 1,076 as at 2010[2].

Global investment in fintech reached US$111.8 billion in 2018[3], more than doubling the value in the prior year. China led the pack, securing more than US$18 billion in fintech investment in 2018, the bulk of which came from the US$14 billion Venture Capital (VC) fund raising by Ant Financial, the financial arm of Alibaba and operator of Alipay.

2. https://go.quid.com/hubfs/Sales%20Account-Tailored%20Content/FinTech%20Market%20Landscape%20&%20Competitive%20Intelligence.pdf
3. Statista

Global fintech investments (US$' billions)



Source: Statista, PwC analysis
Funding is total investment activities by VC, PE and M&A

The popularity of fintechs in the global financial space and among investors is hinged on the evolving technology being leveraged to deliver personalized financial services. Consequently, the recognition of fintechs as one of the fastest growing business segments in the world, in recent times, is underpinned on its lowered cost of operation made possible by the changing landscape of technological innovation. Several banks are now collaborating with fintechs, hence increasing the prospect for profitability which appeals to investors.

Currently, North America, led by the United States (US), is the world's largest fintech market and is expected to achieve US$80.85 billion by 2023[4]. In Latin America, the increase in fintech projects in Mexico and Brazil is positioning the region as a promising market for fintech.

In Africa, technological innovation is gradually evolving with the mobile economy contributing about 3 million jobs and 7% to the continent's GDP.

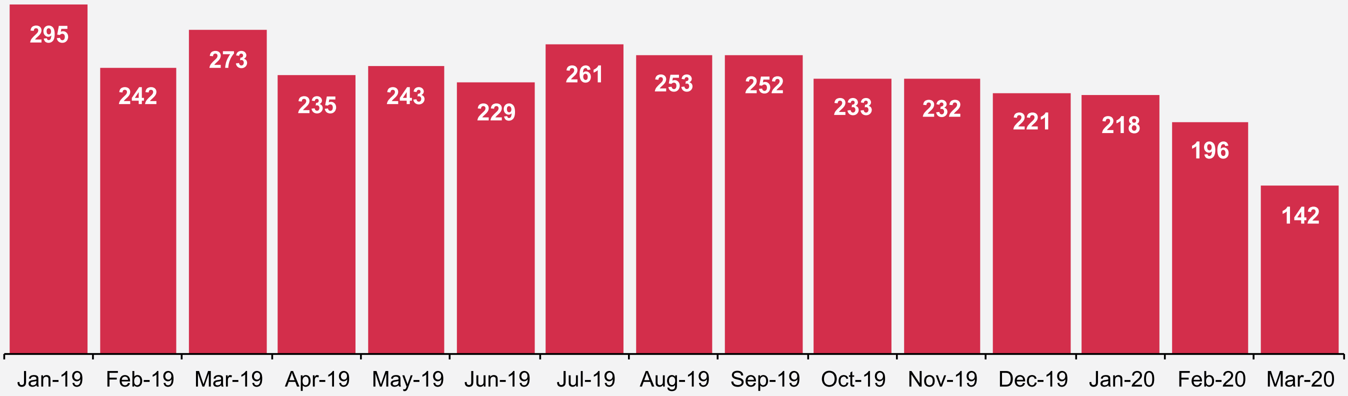
Africa is home to more than 400 fintech firms[5]. The continent's three key tech hubs – South Africa, Kenya and Nigeria – account for a larger proportion of fintech firms. Both foreign and local investors are attracted to the continent's burgeoning tech landscape. In 2019, fintech startups in Africa raised about US$132.8 million from investors. Fintech holds promising prospects for Africa, especially with their potential ability to onboard the financially excluded from the informal financial sector into the formal financial one.

However, the outbreak of COVID-19 has impacted the global FinTech landscape. According to Finch Capital, there has been significant decline in corporate VC-led investments (global deals by corporate VCs weakened significantly by about 20% in Q1 2020). This decline in investments, combined with higher hurdles for companies' seeking to access funding will put pressure on the valuation of FinTech companies in later-stage rounds. Consequently, global FinTech funding was estimated to have declined to about US$6 billion by the end of Q1 2020, as COVID-19 forced investors to divest from different asset classes to strengthen their cash positions.

Globally, consumer, SME-lending platforms and FinTech platforms that adopt Artificial Intelligence (AI), Blockchain, Internet of Things (IoT), Big Data and Open Banking are best positioned to benefit from the effect of the pandemic. For instance, call center disruptions using chatbots, automated claims management, increasing drive towards branchless banking among others, have become commonplace. On the other hand, traditional banks with weak digital presence, in addition to wealth management and foreign exchange-focused FinTechs will experience significant pressure due to de-risking by clients, reduced transaction activity, as well as lower expected activity post-pandemic.
The post-COVID era could lead to more capital inflows into lending and mortgage, property technology (proptech), while insurance technology (insurtech), payments and wealth management FinTechs, on the other hand, could experience reduced investment inflows

4. Statista
5. https://disrupt-africa.com/finnovating-for-africa/

Global deals to fintech companies



Source: CBInsights, PwC analysis

COVID-19 will have a disproportionate impact on FinTech companies in Nigeria depending on the segment of operations. Every segment of FinTech (ranging from payment, savings/investment, insurance etc.) will be impacted by COVID-19. However, the payment and digital lending segments are, perhaps, the most vulnerable, particularly because majority of Nigeria's FinTech companies operate in both segments.

The payments segment will be impacted by the decline in global fintech investments, which could hinder capital required for physical upgrade or expansion of digital infrastructure and services. For the digital lending segment, the impact of the lockdown measures (to limit the pandemic's spread and mitigate further spread) on business activities, employers, employees, entrepreneurs and other entities could affect the ability of digital lending clients to pay back their short-term loan obligations as at when due.

COVID-19 and the current lockdown has led to increased usage of digital banking services and online payment platforms for financial transactions. This is due to banks closing some of their physical branches and operating limited physical services to eliminate the risks of transmittal through interactions within the bank. Hence transactions have naturally being shifted to online platforms. FinTechs are better placed to leverage this opportunity to scale up profitability and growth prospects, especially with the World Health Organization's advice to consumers on the need to utilize contactless payments[6].

Still, Nigerian FinTechs face challenging times in the days ahead especially as foreign investment, a significant source of funding for most Nigerian FinTech firms, is expected to dry up. Early-stage FinTech firms would be affected the most as they would have to compete with larger-sized FinTech firms and traditional banks to stay afloat. The situation becomes particularly tough with the looming economic slowdown which will affect transaction volume and value across the economy. This would lead to a sharp drop in transaction fees and a decline in valuation and profit-level of FinTech firms.

Furthermore, Banks are equally fortifying their digital capacity to remain relevant in the financial space. On one hand, the pursuit of digital to deliver tailored financial services could lead to further collaboration between traditional banks and FinTech companies in the short term. On the other hand, fierce competition for customers' patronage and loyalty could ensue given the need to secure market share, increase profitability and boost valuation.

6. https://www.crowdfundinsider.com/2020/03/158319-who-encourages-using-contactless-payments-to-avoid-spread-of-the-coronavirus/

Nigeria's Digital Banking and Fintech Ecosystem

2

Nigeria's Digital Banking and Fintech Ecosystem

The Nigerian digital banking and fintech ecosystem has evolved over the years to emerge as one of the top ecosystems in Africa alongside South Africa and Kenya. There are presently over 100 fintech companies in Nigeria engaged in a broad range of product offerings spanning payment solutions, investment, online banking etc. Many fintechs in Nigeria are predominantly concerned with payment systems disruptions especially in the retail segment of the financial services value chain.

Fintech investments in Nigeria, over the past eight years (2011 – 2018), stood at US$204 million. Nigerian fintechs secured about US$103.4 million in funding by end-year 2018. This represented more than half (58%) of the total start-up funding in the same period under review.

Some key players operating in various segments of the Nigerian fintech ecosystem are shown in the diagram below.

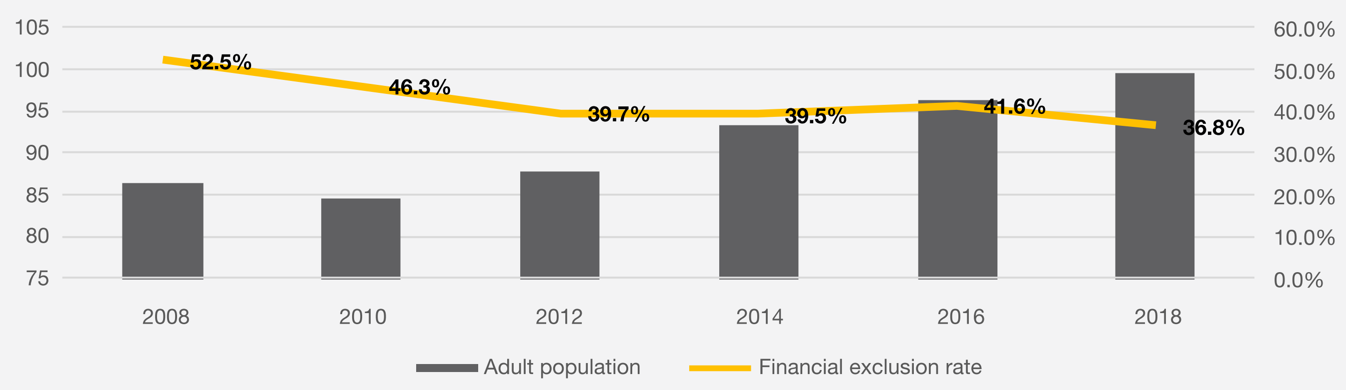
1 Potential impact of fintechs in Nigeria

The financial landscape of Nigeria has evolved considerably with the entrance of nimble, efficient financial technology firms. Fintechs hold much promise for Nigeria, especially in ensuring inclusivity in financial product and/or service offerings and in credit disbursement to the real sector.

Fintechs and financial inclusion

More than one-third (36.8%) of the over 99 million adult population in Nigeria were excluded financially as at 2018. In other words, over 30 million adult Nigerians do not have or use formal and/or informal financial services/products. The CBN's National Financial Inclusion Strategy (NFIS) is designed to ensure a financial inclusion rate of 95% by 2024. Doing this will require collaborative effort between industry stakeholders, including fintech companies. Mobile Money Operators (MMOs) are key to driving the actualisation of a financially inclusive society. Kongapay, Paga, Fetswallet are some of the MMO in Nigeria currently.

Bankable adult population in Nigeria (millions)



Source: Statista, PwC analysis
Funding is total investment activities by VC, PE and M&A

Increased lending through fintechs

The real sector players need credit to scale their operations and contribute meaningfully to the country's economic growth. Recently, the CBN increased the loan-to-deposit ratio from 60% to 65% to stimulate banks' lending to the real sector and Micro, Small and Medium-scale Enterprises (MSMEs). Fintechs can increase credit particularly to the real sector given their extensive financial footprints and, the relative ease at which loans can be accessed without the unnecessary rigour and cumbersome documentation processes required by traditional banks.

Fintechs and the drive for a cashless economy

Fintechs can help drive the actualization of the CBN's cashless policy, which will in turn help to stimulate economic growth, boost tax revenue and prevent money laundering and terrorism financing. Fintechs are better placed to drive a digitalized economy because they provide customers with easy, swift and user-friendly processes of making payments and carrying out online banking transactions without the physical involvement of cash.

2 Current trends driving the adoption of fintech in Nigeria

Many of the trends driving fintech adoption are somewhat interrelated. Here are some key factors propelling fintech adoption in Nigeria:

01 Internet penetration

Internet penetration stood at 51% as at 2018, which was higher than the African average of 34%. This was partly due to the proliferation and adoption of cheap smartphones by mobile phone consumers. Currently, there are over 20 million smartphone users in the country.

02 Dissatisfaction with traditional banks

The cost of banking services and challenges in accessing loans caused some dissatisfaction by customers with traditional banks, and therefore led to a shift in loyalty to fintech players - offering similar but accessible and lower cost-services.

03 E-commerce

The emergence of the e-commerce segment also enhanced fintech activities in Nigeria. According to Jumia, about 10% of online shoppers on its site prefer to pay using their mobile phones.

04 Rising population growth

Nigeria has about 200 million people, the largest in Africa. More than half of the country's population are under 35 years. The future of fintech in Nigeria will among other things hang on the country's population strength providing the talent and the market for fintech service/product offerings.

05 Investment

The Nigerian fintech landscape has attracted the attention of both foreign and local investors. In 2018, more than half of the total funding to tech startups, representing over US$100 million were received by fintech firms

3 Regulatory structure for Nigerian fintech

Fintech regulations in Nigeria is still in its nascent stage, and does not have a unique regulator, which is statutorily empowered to coordinate stakeholders in their sphere of influence.

Aspect of fintechs regulated	Regulatory authorities
General oversight on service offerings of fintechs.	The Central Bank of Nigeria
Fintech service offerings that leverage telecommunication infrastructure such as the USSD and mobile money banking.	The Nigerian Communication Commission (NCC)
Fintech in asset management	The Securities and Exchange Commission (SEC)
Data privacy	The National Information Technology Development Agency (NITDA)
Cryptocurrency	No regulation yet

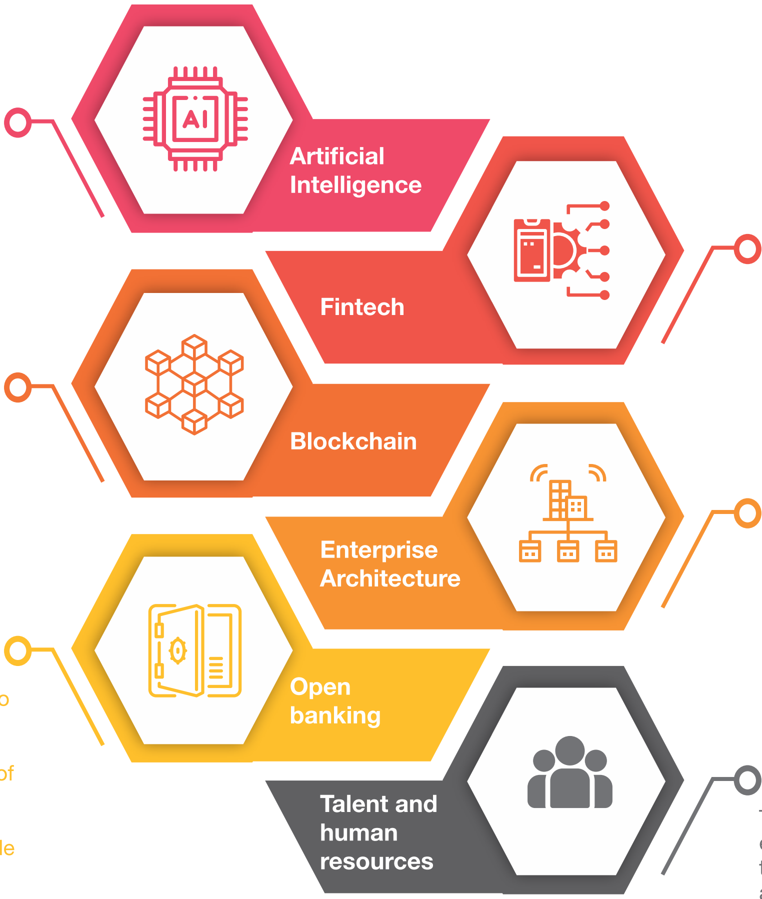
The CBN, NCC and NITDA, through their various guidelines and circulars, attempt to influence fintech activties. Some of these regulatory endeavours include:

- Circular on the Exposure Draft of New CBN Licencing Regime (Licence Tiering) for Payment Service Providers (PSPs) issued by the CBN
- The Licence Framework for Value Added Services (VAS) issued by NCC.
- NITDA Data Protection Regulations 2019 issued by NITDA.

4 The role of technology in the future of banking

The conventional banking model has been disrupted following advances in technology and the birth of machine learning, artificial intelligence (AI), robotics, big data, amongst others.

Here are the crucial roles technology will play in the banking of the future.



This is already changing the banking sector, minimising manual, mundane and repetitive work, allowing for faster and accurate processing time. The use of visual assistants have now become more rampant as 37% of consumers in the US are said to have digital voice assistance

There is focus on the expansion on fintech especially to Africa and developing countries where people still don’t have bank accounts. FinTech investments in Africa is expected to grow to $3 billion by 2020, with Nigeria accounting for about $200 million of investment.

Blockchain is a decentralised ledger that promotes transparency, real-time tracking backed by security and trust. The understanding of the use of blockchain network and related technologies will continue to spread and cause the face and the ways of banking to change.

The benefits financial services organisations reap from EA can be distilled from four critical areas of business value: decreased cost, reduced complexity, reduced risk and increased agility, according to findings from a study by Strategy&, PwC’s global strategy consulting team.

Countries have now begun to set up policies that will encourage open banking. There has been mass influx of customers into the system especially in the UK with the government educating people on the benefit. In the future there will be little representation of the present banking system instead there will be a new flux of internet related banking process.

The workforce of the future has evolved as a result of emerging technology, new knowledge and sophisticated innovation. A different set of skillset and competencies is required in this new world. A co-blend of human and machines becomes the order of the day.

Challenges of Fintechs in Nigeria

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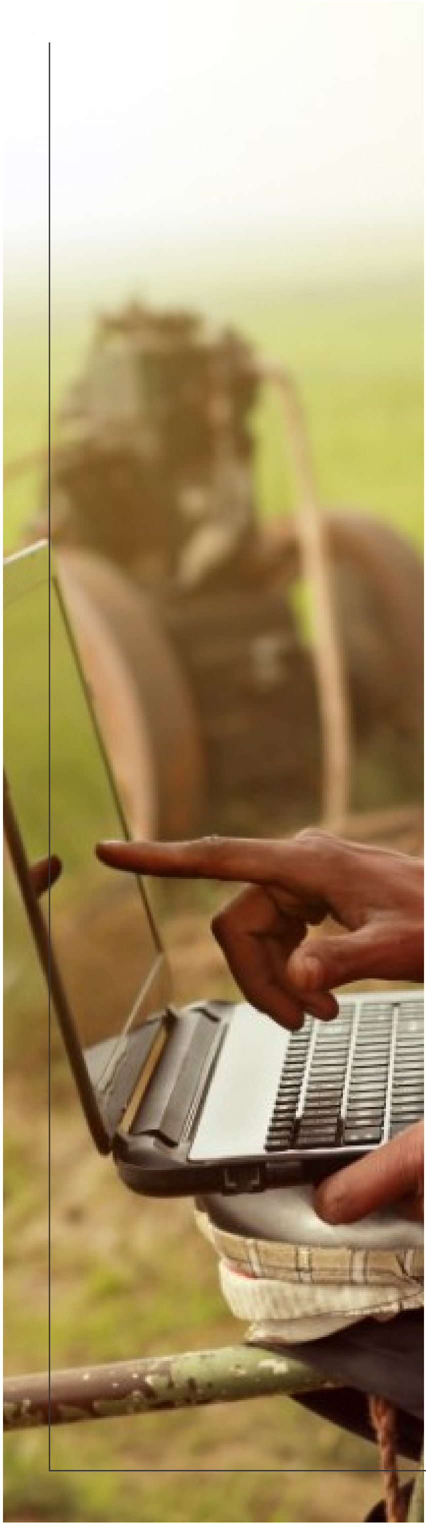
Challenges of Fintechs in Nigeria



At inception, activities of fintechs were viewed as competing with product offerings of incumbent players in the financial services sector including traditional banks. As time went on, banks needed to embrace the disruptive force fueled by the creative innovation of fintechs. However, both banks and fintechs still grapple with certain challenges that hamper their operations.

- Increasing susceptibility to cyber attack is a key challenge for fintechs in Nigeria.
- Nigeria's limited infrastructure (such as broadband, cloud computing, data center, power supply etc.) impacts the availability and uptime of Internet connectivity . In addition, soft infrastructure such as appropriate government regulations are either lacking or non-existent.
- Absence of a veritable platform for fintechs to raise capital for expansion has stalled many fintechs from taking off from the ideation stage. Again, the bulk of the funds raised are from foreign investors with little participation from local investors.
- Another key challenge affecting fintechs in Nigeria is the inaccessibility to traditional banking customer data, a key input needed to develop or modify existing product offerings based on understanding customer behaviour and preferences.
- Absence of regulatory structures that stipulate registration requirements and a statutory body that oversees fintech activities in Nigeria.

S Strengths	• Healthy competition among financial services companies, for enhancement of customer experience in financial transactions • Enhanced process and cost efficiency • Agile, youthful and tech-savvy population • Increasing internet and smartphone penetration
W Weaknesses	• Large capital requirement and limited investors • Distrust for fintechs and preference for traditional banks among certain segment of Nigerians • Lack of requisite technology skillset in the Nigerian labour market
O Opportunities	• Rising internet penetration rate driven by cheap smartphones • Collaborative initiative between banks and fintechs • More regulatory oversight that would ensure players keep to global best practices
T Threats	• High vulnerability to cyber attack. In 2018, the Nigerian cybercrime rate stood at 54% • Unrestricted access to loans provided by fintechs could lead to personal debt accumulation, excessive spending and looming inflation, especially if the fund is diverted to consumption rather than capital goods.

Fintech vs Traditional Banks in Nigeria

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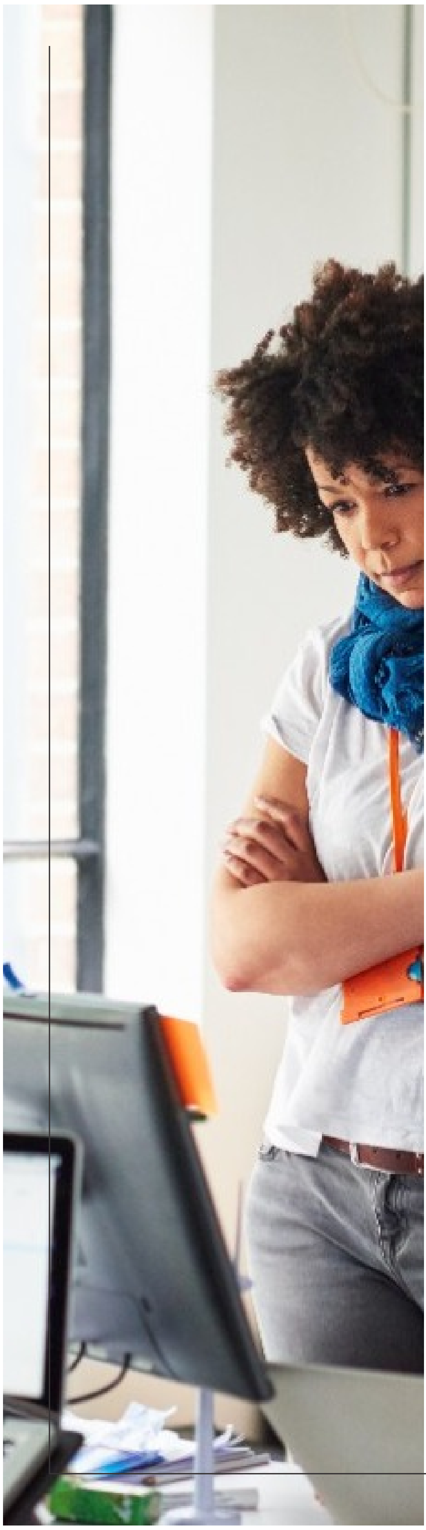
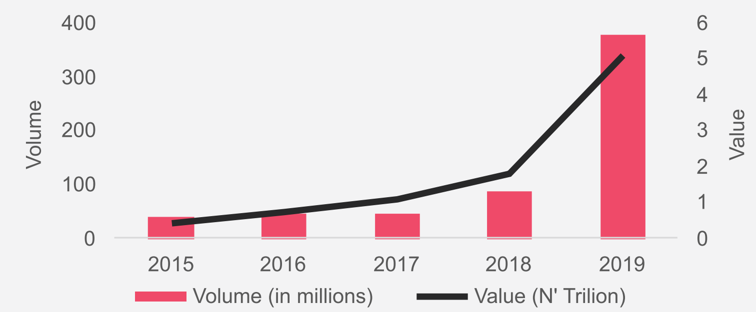
Fintech vs Traditional Banks in Nigeria



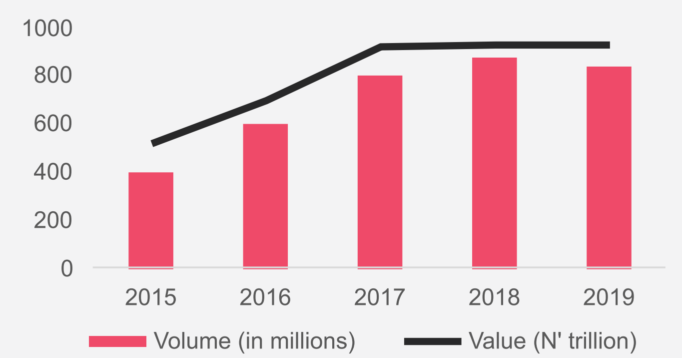
As at 2018, there were over 100 fintech companies in Nigeria engaging in mobile money, credit, e-payment and e-collection. In the same period, the total number of commercial and microfinance banks stood at 23 and 940 respectively. Banks have been increasingly collaborating with fintechs to improve customer experience and enable faster and seamless access to financial services. The collaboration of fintechs with traditional banks has the potential to increase the performance of the industry at large, as both combine their unique attributes for greater success.

Total mobile transaction



Source: NIBSS, PwC analysis

Total ATM transaction: value vs volume



Source: NIBSS, PwC analysis

Total active cards in Nigeria stood at more than 84 million by year-end 2019 compared to 29 million cards in 2016. In the same vein, total number of ATM machines and active cards per ATMs also increased. As at 2018, an average of one ATM in Nigeria served more than 4,800 active cards.

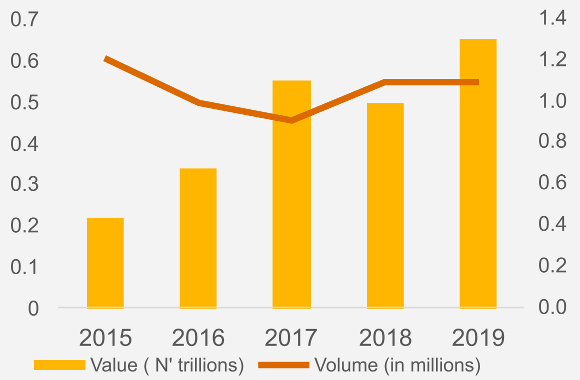
On the other hand, about 0.8 billion transactions valued at N6.5 trillion were processed via ATMs in 2019 relative to 0.9 billion valued at N6.5 trillion in the preceding year.

Meanwhile, mobile channels have emerged to become the most preferred way of making financial transactions in Nigeria.

With the preponderance of affordable smartphones and the rise of e-commerce in the country, many people now prefer to shop and make payments online using mobile phones. More than 377 million mobile money transactions valued at about N5.1 trillion was posted in 2019 compared to 87.1 million valued at N1.8 trillion posted in 2018. By the end of 2019, the volume of mobile money operations more than quadrupled, while the value processed was about thrice that of 2018.

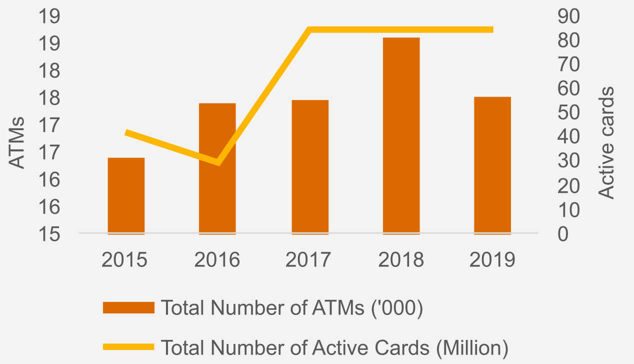
Payment for e-bills such as utilities grew by 40% from N0.5 trillion to about N0.7 trillion in 2019.

Total E-bills pay (N'trillions)



Source: NIBSS, PwC analysis
Note: Active cards in 2019 is same at 2018
2. Number of ATMs in 2019 is as at December of same year

Total number of active cards vs ATMs



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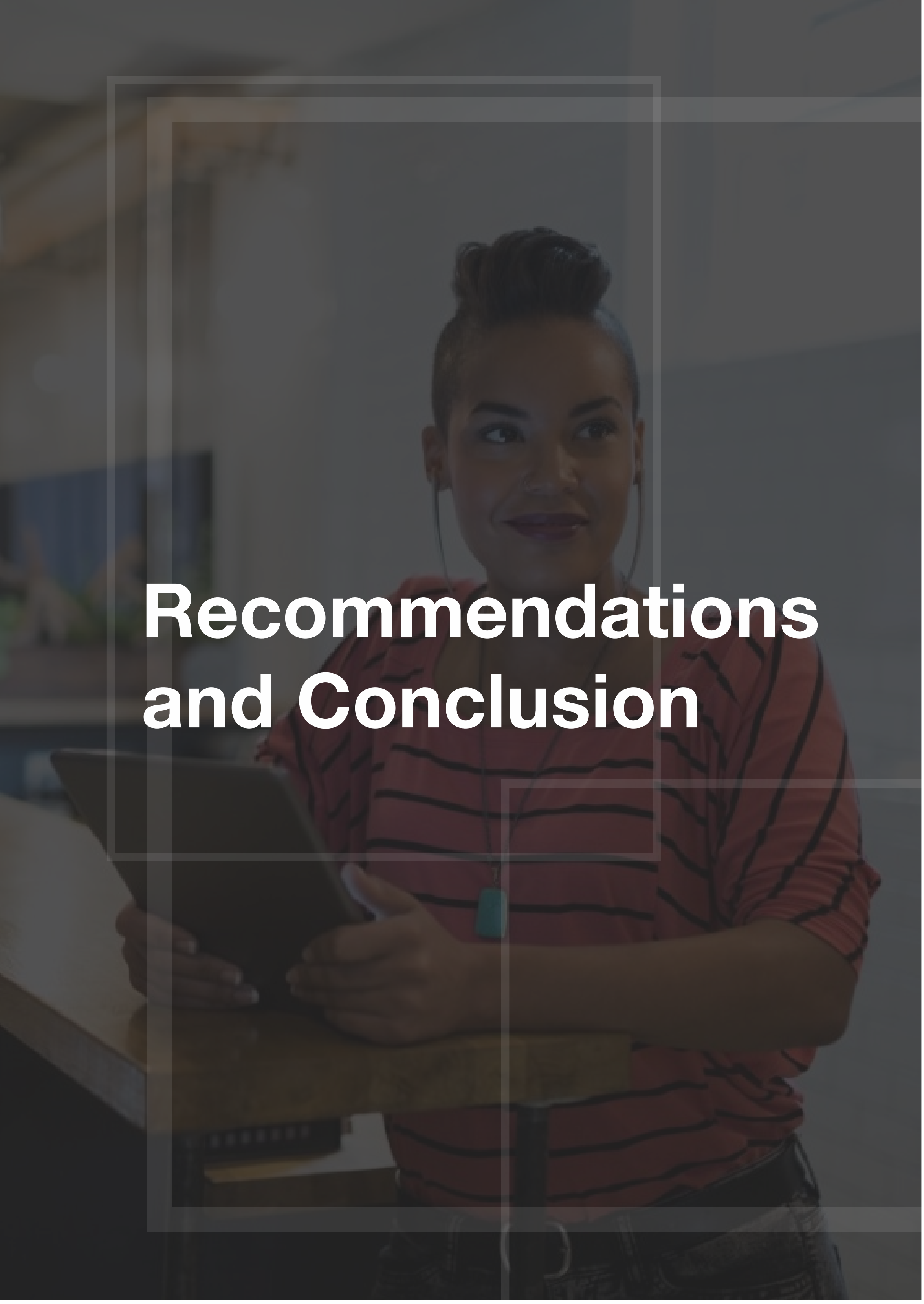

Recommendations and Conclusion

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Given the role that FinTech plays in the economic transformation of any country, it becomes imperative for the government and other key stakeholders to support initiatives that stimulate their growth. Below are recommendations that could be adopted to support the growth of the FinTech ecosystem in Nigeria.

- Strengthen the synergy between banks and FinTech players in a way that is beneficial to both parties.
- Create a unified regulatory system for coordinating the activities of FinTechs.
- Encourage investment in local FinTech startups by simplifying the process of listing on the capital market.
- FinTechs and banks should now, more than ever, focus on strengthening their digital infrastructure platforms and systems
- Financial service players should also provide enhanced digital products, as well as personalised services (digital and non-digital) that could provide significant return on investment.
- With the advent of COVID-19 and tand its far-reaching impact on the country's business landscape, financial service players need to make tough decisions regarding operational efficiencies.
- Tighten internal governance frameworks and strategies on cybercrime mitigation.
- Seek provision of reforms (such as tax breaks) by government, especially for early-stage FinTech firms.
- Engage in stakeholder engagement and capacity development programmes with SMEs, micro-businesses, employees, trade groups, employers, among other stakeholders, to enlighten them on the benefits of utilising digital platforms as a channel for financial transactions and commerce.

In conclusion, corporate entities in the financial services space must begin to realign their business strategies to recognise the sweeping technological changes in the business environment. In addition, financial service players need to recognise the changes brought upon the sector as a result of the coronavirus pandemic. The playing field should be levelled for both FinTechs and banks to compete or collaborate efficiently.

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