Taking flight: Checklist for SA fintechs eyeing global expansion

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At a recent Webber Wentzel panel titled "The ever-changing landscape of Fintech," speakers discussed various topics including the expansion plans of several South African fintech companies that have developed products ready for the market and are now exploring opportunities beyond the limited domestic market.

Source: Unsplash

In doing so, they face a list of new issues. These include how to raise funds for growth, how bringing in international funding will affect their local BEE status, and how they will be affected by changing regulations in the pipeline.

These were some of the issues discussed by speakers at a recent Webber Wentzel panel, “The ever-changing landscape of Fintech”.

Scaling up

Scalability is key to success. Many locally grown fintech companies have expanded into the US, Europe and the rest of Africa. Scaling up requires funding, and a company with a good product is wise to look internationally. An early-stage fintech that could raise R20m in South Africa could probably raise $30m from US funders.

One of the lessons from successful fintech start-ups is that instead of pouring those funds into recruiting more staff in its target foreign market, the company should consider initially working through partnerships. With a foreign partner, the South African company can build networks in another country and gain regulatory knowledge, while drawing on home-based IT experts, which limits human resources costs.

It is critical for fintech companies expanding internationally and seeking global funding to prepare in advance. They should ensure their share registers are up to date and that the necessary resolutions are in place when shares are issued. Having good basic governance will reassure financiers.

Many fintech funders require reassurance that the intellectual property is based offshore. If this is done too late, when the value has increased significantly in the pending transaction, there is a significant capital gains tax implication for the South African developer. At an early stage, the only possible valuation measure is the cost of development.

A risk in partnering with a larger corporation which will deploy that fintech technology is that the corporation may take a long time to get to market, which delays the timing of its partner being able to recognize revenue. Another issue is that, if the funding arrangement entails a large percentage of foreign ownership, the local company may find its BEE score in South Africa is affected.

If it has a services agreement with a big bank or corporate in South Africa, it may be required to be at “level 3” and to remain at that level or improve. The BEE aspects should be addressed at term sheet stage, not a year after the transaction has closed.

BEE

South Africa has no BEE sector code for fintech, although there is one for financial services and one for ICT companies. The financial services sector code requires 25% black ownership plus one vote to qualify for maximum points for black ownership. In the ICT code, the black ownership requirement is 30%.

A fintech company that earns the majority of its revenue from financial services falls under the financial services sector code. On the other hand, if the operations are at its core technology-based, then the ICT sector code is applicable. Further fintech companies may potentially be regulated in terms of the. Conduct of Financial Institutions (CoFI) Bill and as a result may be required to abide by prescribed BEE terms and conditions.

Innovative structures should and could be considered to meet ownership obligations for fintech companies which are foreign-owned. One of the transactions on which Webber Wentzel has advised involved a fintech company that has been bought out by a UK entity. The South African company, however, still requires a BEE rating.

The structure that has been approved by shareholders and verification agents is an ESOP for the South African employees, who are mostly black, which will take up a shareholding in the multinational. In the multinational, this shareholding is equivalent to about 3%, but it equates to more than 30% at the South African level because of the calculation methodology applied.

Another under-utilised provision in the sector codes, the “YES Youth” programme, which could be useful to fintech companies. Any company that employs a targeted number of unemployed black youth for a year can earn BEE credits, which enables them to move from level up to 2 BEE levels.

Regulation

Under planned changes to the National Payments Act, regulations will become stricter – not, as generally reported, more relaxed. The new regulations, however, will not be exclusionary.

In the past few years, South African regulators have moved away from monitoring from the sidelines to becoming more involved. They are also adopting a more collaborative approach with other regulators, which is evident in the Intergovernmental Fintech Working Group, which is generating more regulations. The approach is to use existing regulations and frameworks, although the looming CoFI Bill opens up the possibility of an entirely new form of regulation.

Amendments to the Financial Advisory and Intermediary Services (FAIS) Act now embrace the providers of crypto assets, who will be subject to the same requirements as other providers of financial products. The Financial Intelligence Centre Act (FICA) has been amended to bring in crypto assets and their service providers. The regulators have also barred pension funds from investing in crypto assets through a specific amendment to Regulation 28 of the Pension Funds Act.

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