Responsible Finance for Digital Inclusion: Investing for Impact
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Session Date & Time: April 3, 2019, 15:15-16:30
Title: Innovative Partnerships for Digital Transformation
Panelists:

- Till Bruett, Director, UN Secretary General's Task Force on Digital Financing of SDGs, UNCDF
- Maelis Carraro, Deputy Director, Inclusive FinTech Catalyst Fund at BFA
- Monica Brand Engel, Co-Founder and Partner, Quona Capital

- Till Bruett (UNCDF) started the session by saying that the digital world is based on partnerships and networks and connections. When looking at the theory of change, UNCDF noted that one accelerator for digital financial ecosystems growth is the development of specialized functions. Partnerships became an end in and of themselves because UNCDF saw that specialization within the industry was a catalyst for growth at a market level.
- Till discussed challenges and lessons learned with partnerships. When he first joined, UNCDF was focused on loan financing. When it started engaging with companies in the digital space, it learned a number of things:
    - "When you have institutions with a very fixed ways of doing things, it's difficult to get them to budge."
    - UNCDF money was relatively small compared to what the digital industry already had, and it wasn't going to incentivize people to do things that UNCDF wanted them to do.
    - Often, partners wanted to do the things UNCDF wanted them to do, but they just didn't know how to do them. This was true even with large institutions. UNCDF had to find a different way to work with them through failure.
    - "Just because you think you have a certain approach or great idea, you can't assume your partner is thinking the same way."
    - Institution-centric approaches never allowed for them to spend a lot of time with their partners.
    - UNCDF assumed that its partners had the wherewithal to close the deal, but the partner was no more familiar with the process than it was. "We never really asked in a serious way whether this strategy would be good for this partner's business."
    - "We assumed there would be a win-win in this…In our early investigations, we discovered that the agricultural supply company we were working with 10 years ago was not going to benefit from the terms and conditions in the partnership."
- Till said UNCDF tried many different approaches to partner models over the last 10 years.

- Single-partner model
- Lead-partner approach: UNCDF would go out and speak with the partners to make sure they were all together and ensure they had a designated lead partner.
- Brokered-partner approach: UNCDF takes a hands-off approach. Markets can come in and self-identify through a series of exchanges. Once the partnerships are formed, UNCDF waits for them to come to it and fill the gaps.
- UNCDF approach: "We see that these partnerships are complicated and no single organization can lead them, so we hire someone to lead them and manage those partnerships."
- Incubated approach: Working with smaller companies to develop and design ideas. Have a large institution there with someone who can take their ideas to scale

- Till noted that there is no one successful path to finding a partnership, and it's a process.
- He also said that starting with the "hard stuff" – such as technology and money -- is the absolute worst place to start.
    - "If you start figuring out how much money you'll get from the client, then it will get in the way of partnership discussions going forward. We often found we spent too much time with this discussion and ended up saying it wasn't going to work out. It's easy to start ignoring the client needs. This will kill a partnership and make it unsustainable."
    - Instead, UNCDF worked with partners with a very long buy-in phase. "We had a long buy-in phase to take baby steps together, so we got to know each other. We worked with mutual improvements that each partner needed to improve so that it wasn't forcing our ideas or a new partnership on them; it was more focused on improving what was already there as well as existing relationships. Then we tried to move to innovation."
    - This whole process could take 6-12 and up to 18 months depending on nature of complexity of the partnership UNCDF was trying to develop. Taking it slow at first was the best approach.
- Maelis Carraro (BFA) described how Catalyst Fund's AAA Framework, which is a blueprint for building and assess products and services low-income people need and want, looks at partnerships.
    - She said that based on experiences she's had playing matchmaker between financial institutions and startups, hands-on and brokered partnerships are much more effective.
    - She investigated what makes these partnerships fail/succeed. "The fact that we had a front row seat on the ground really gave us some interesting insights."
    - There is an idea that fintech startups are leaner and eccentric and are digital, adaptable, and moveable, and can provide more value to the customer than financial institutions.
    - There is an idea that financial institutions have the licenses and marketing dollars to make things happen, which make it a perfect love story up until now.

- "Think of this like marriage. A love story at the beginning, but when you look at the logistics that's when you start to see the limitations."
- Catalyst Fund works with middle tier 2 institutions. It found they often are exposed to startup and tech vendors, but it's hard to tell between different offerings. The institutions don't have the internal knowledge and expertise to make the right choice.
  - Step #1 – Know what you want, and choose the right partner. When looking for the right partner you want someone who:
    - Is looking to solve the right problems,
    - Is aligned with your mission and what you're trying to accomplish,
    - Has a good track record and experience,
    - Is good with technology, and
    - You can work well with
  - Step #2 – Make sure there is buy-in at the top and middle level of management.
    - Who are the right champions internally? Sometimes it is the middle management staff that can really help with your interests.
  - Step #3 – Ask the right questions to ensure the customer is finding value and buying in.
- She noted that problems need to be identified at the beginning. There has to be an understanding in partnership of what is being try to achieve.
- She discussed takeaways from a partnership in Mexico with Destacame.
  - Important question to ask: Where do the incentives align for both sides? How do you negotiate to get the price you want since the banks are sometimes in a stronger position?
  - She said Catalyst Fund made sure there was buy-in at top and middle management. Who are the right champions internally to help with success?
  - "You need a win-win situation. Once these are set, then incentives can be established and the so-called dating begins. At the dating level, we tried to pilot things in a clean manner with simplicity for 3-4 months. We asked if the customer is going to see the value in this and buy into it and go through all these hurdles."
  - Investors should assess the impact of bottom-line institutions from the start -- from the institution and customer perspective. This is where AAA framework comes in to assess value based on making sure the solutions are affordable, the pricing is low, and you pay attention to appropriateness, quality, and accessibility, as well as asking whether it is affordable

- Monica Brand Engel (Quona Capital) discussed themes Quona has seen regarding partnerships.
  - She said it does not set impact goals; instead, it measures. There are unintended consequences of setting impact goals, and often these don't lead to the types of

impact that is being envisioned. For example, one DFI's goal to have X amount of bank accounts open within a certain time period. What ends up happening is that those bank accounts get created, usually due to incentives, but the accounts are then abandoned and the users are not active customers. Is financial inclusion even happening there?

- Quona works in scale-up stage fintechs. Not cash flow positive, but work is done by partners. It provides access and services to the unbanked (B-to-B and B-to-C)
- Partnerships fail for a few reasons:
  - Everyone wants to be the solution.
  - Many people don't want to be taken advantage of. There is a lot of distrust because there are information asymmetries. Tech literacy is low, which creates a comparative disadvantage.
  - Most banks weren't designed to be agile.
  - "Part of failure is an ego fight and who gets bigger part of revenue share. Who gets the most spoils. Have to get over ego and make the pie bigger. Big egos make partnerships difficult."
- Case example of Creditas
  - Had too much volume quickly (increased by 10x overnight), so it was unable to process requests.
  - It started working with banks, but Creditas was processing so much volume on the client acquisition side that the bank branches couldn't approve them quickly enough. Banks had their own risk committees. Creditas harmonized their underwriting criteria with the bank (in this case, Banco Itaú) to make it easier, but the bank couldn't keep up.
  - To accommodate growth, Creditas started creating its own special purpose vehicles and mobilizing capital separately because it was more efficient for them to do this, even though they could only mobilize a fraction of what the banks could. But they could do it faster.
  - Fast forward three years, and they have grown 10x since Quona invested.
  - Creditas has an excellent balance sheet, top investors, and over 500 employees
  - "So it's now a marriage of equals. It's now the banks that are rushing to work with them."
- Takeaways on partnerships:
  - "I don't think you have to be successful before you partner. Be sure you partner with someone who understands problem you try to solve."
  - Incentives have to be aligned
  - Have to partner with someone who has a successful track record and understands the problem that you're trying to solve
  - Understand your comparative advantage. Where are you on the value chain? Many banks/financial services can probably build what fintechs are building, but what is the opportunity cost of ignoring a potential partner and trying to do it yourself?

        - A lot of what Quona does for successful partnerships is making sure partners on both sides understand that they're still important even if they partner. It's about ego.
        - There are many cultural elements that make it hard. Banks are an establishment, and tend to have very different people from the guys in hoodies doing fintech. There's also a large age difference.
        - Your product and your solution are aimed at vulnerable people. They're surrounded by risk. It takes a lot to have them change. Have to take this into consideration when you're building your model and approaching how you'll go digital (i.e. through partnerships, etc.)
    - Where Quona has found success:
        - When comparative advantage is understood
        - Realizing digitization is a journey
        - Having really clear goals
        - Minimum viable product
            - Focus on the easy stuff
            - Make a simple pilot
            - A lot of our models start with zero tech- talking to potential customers first
            - Iterate and build out from there
    - There are some problems with digitization. For example, in some places, such as Kenya, many places don't accept digital payments. If I get paid digitally, how do I pay for household supplies or stock?
    - Merchant cash advance - lends against receivables
        - Quona has a couple of companies that do this in its portfolio, one in Asia and one in Africa
        - Both chose a high-touch model of implementation, in which loan officers go talk to people.
        - When they partner, they know exactly which parts of the process they can outsource. For example, one company gives two options to partners of involvement and revenue sharing:
            - Option 1: If you acquire customers, we will underwrite them and process them. It will be a "loan in a box." Revenue split is 1/3 to partner, 2/3 to company
            - Option 2: If partner wants to underwrite and provide the balance sheet, they'll get 2/3 of the revenue; company will do analytics and keep 1/3
- Till asked Maelis and Monica what the right level of involvement is when you're a funder. Where is the limit?
    - Maelis: We do work with many investors and play that role of giving strategic advice and connecting them with future partners. It is important to value investors that can bring you a large portfolio and can connect companies; it is also

important that investors have active roles and hands-on approach to support these companies. Advice is invaluable to start ups; it is what they seek. Connections, advice about what works, and their expertise are all heavily sought out by startups. Enabling trust between the organizations is key.
    - Monica: Some are not as actively engaged because they need to learn for themselves at the stage we are investing at. We need to think about ways to punch above our weights and invest heavily in lessons learned. They help facilitate things, but sometimes it's like kids and you have to help guide them.
        - We are not as engaged as Catalyst or even Venture Lab, mostly because of the stage of the business; our involvement is at a board level. We will engage if a portfolio company asks. We will guide them through partnership negotiations or development, but we don't roll up the sleeves and get engaged like Maelis.
        - At Quona, we think about ways we can punch above our weight and harness lessons learned and leverage our network. For example, Quona organized a trip for Yoco (a South African portfolio company) to Brazil to see how Stone Pagamentos (payments unicorn in Brazil) has grown
- Audience question: What did you see as failure/success on MFI side?
    - Monica said you have to meet people where they are. She referenced the Innovator's Dilemma, which is a book that explains why Blockbuster doesn't exist. To understand why, there are often innovation areas, and you have to reward people for failing and make that through safe space. You also have to champion the board and encourage them actively, or else you'll move back. There are many politics involved in these organizations, so you want everyone going in same direction, which is why creating incentives is important - especially at the beginning.
        - To solve inertia in MFIs:
            - Reward people for taking risks and failing
            - Need a champion at the board
            - There are a lot of politics in these institutions. You want everyone rowing in the same direction. Incentives are better here than creating competition
    - Maelis said the innovation mindset must change. Constrains of a budget sometimes increases efficiency. You also need a series of checkpoints to measure where you are.
- Audience question: How often are governments involved with these organizations?
    - Till: We had to establish trust. We need to increase dialogue between government and central banks. The dialogue is key. In the developing world, a challenge is there are lifelong central bankers and private bankers, so there is such a large gap between them.
- Audience question: How do you approach stakeholders in the market? How do you figure out what problem to target and solve?

  - Figure out what problem you are trying to solve -- reduce cost, bring in clients, etc. -- and what the solutions will offer you. Not a believer of one size fits all.
- Audience question: How do you facilitate partnerships when you work with earlier stage fintechs. Testing small and piloting fast, I haven't seen whether that actually works, so when the sector is evolving, how do you compete with different ends of the spectrum?
  - "I am not seeing plug-and-play work very successfully, which is why a hands-on approach is more effective. Customization is important. You need the partners to really know each other. We approach clients but many don't have any idea on digital strategy. Most important reason is to embrace change to avoid becoming obsolete."
- The safe space of good returns and getting good returns year after year is a temporary spot. Panelists warned against the intoxication of big numbers all the time. Focus more on purpose and internal intricacies that move institution forward.
- Takeaways from the breakout discussion:
  - In summary, this session talked about fintech and bank partnerships, and then partnerships in general. Lots of benefits for partnership as they allow for innovation in FIs, but these institutions also have resources, money, and connections to make things happen. It's a perfect love story. Implementation of it requires careful steps and understanding. You need to really know what problems you need to solve. We have worked with start-ups and FIs, and the institutions often don't have the tech skills to make that happen. Make sure incentives are aligned, and you need to choose that partner carefully. There has to be a win-win with both seeing the value. You must leave ego aside because it's not the best for the consumers. Piloting partnerships or various types of other partnerships could help depending on situation. "Before you marry someone, you want to see if they are good." How can we facilitate this as investors? Help institutions think through steps and understand what is trying to be solved. This can be done at a board level.