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The importance of Cashless for Impact in Growth Markets

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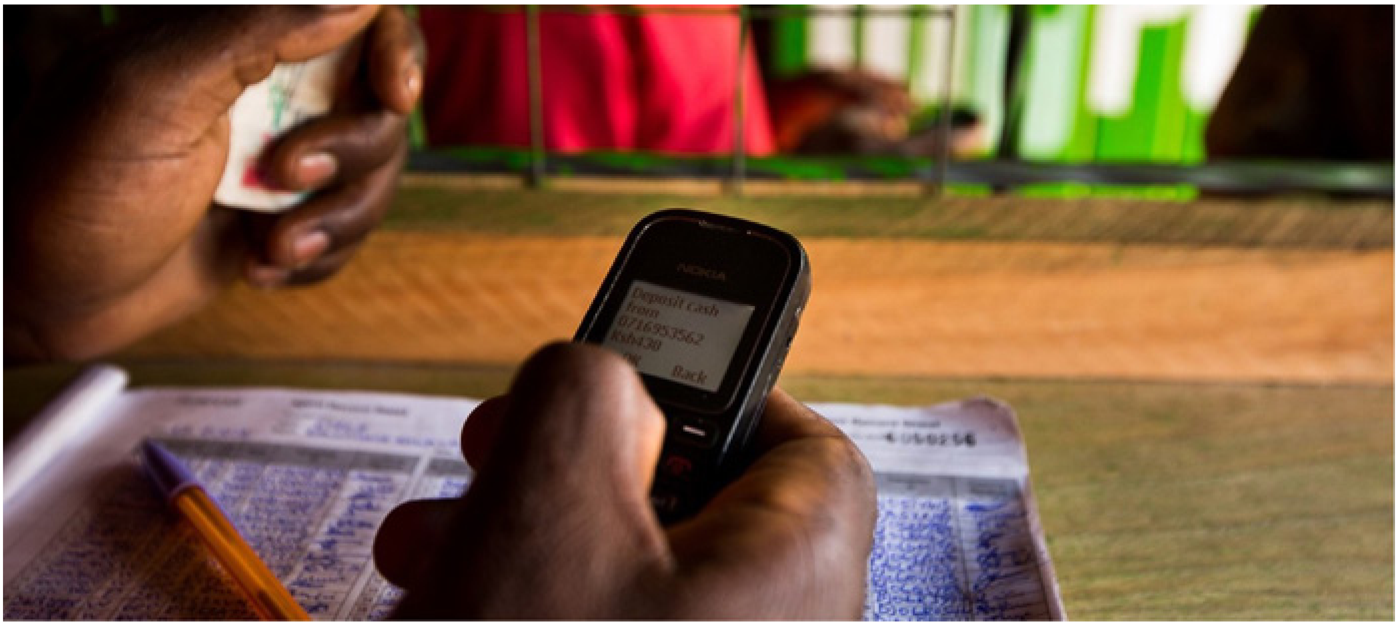
Ravi Bhatt explores a key aspect of Apis Partners' impact thesis - a focus on Cashless:

As an ESGI (ESG & Impact) native investor in financial services, the broader impact thesis of Apis Partners' investment mandate is centred around financial inclusion. Whilst the importance of financial inclusion is well documented and has long been considered an important tool for economic development, it's helpful to explore specifically how Apis thinks about this in its investment activities, and how this manifests in terms of the actual social impact created by Apis' investment activities. One of the key aspects of Apis' focus on financial inclusion is a focus on 'Cashless'.

Background: A focus on Cashless

We consider the central tenet of cashless to be facilitating the increase in non-cash payment transactions for retail and business customers in our markets of focus, though the importance of cashless is not limited solely to the payments sub-vertical; all financial services interactions (and indeed all economic activity) involve transactions, and so the transition to digital payments has important implications for the underlying financial systems in these markets. The ability for consumers and MSMEs to make non-cash based payments and also to save funds electronically is considered as the first step for improving access to formal financial services.



> *Capital-light and technology-led models allow lower value transactions to be facilitated profitably for the first time, as the marginal cost of processing a digital transaction is near zero.*

We see the continued 'electronification' of financial systems in emerging markets, as giving rise to additional digital financial services ('DFS') built on top of this cashless transaction infrastructure, such as credit and insurance offerings, which can be accessed and delivered through digital channels. These cashless / digital distribution channels include the Internet, mobile phones (both smartphones and feature phones), point of sale (POS) terminals, and electronically and biometrically enabled cards and wallets.

The main challenge to financial inclusion has been providing financial services at price points that are low enough for un-banked and under-banked customers to be able to afford. The high fixed costs of branch-based financial services distribution infrastructure meant that reaching these underserved segments on a commercially viable basis was difficult. However the development of technology has facilitated the creation of newer and cheaper distribution mechanisms to reach populations that previously could not be reached. The rise of mobile money offerings across global emerging markets are a good example of this: in 2020, the number of registered mobile money accounts globally had grown to 1.2 billion, representing 4x growth over the last five years. Agent networks, both first-party, as well as third-party intermediaries, are another example of this. These capital-light and technology-led models allow lower value transactions to be facilitated profitably for the first time, as the marginal cost of processing a digital transaction is near zero. These models vastly improve accessibility and are financially inclusive by nature.

Whilst cryptocurrency and blockchain technology promises to further develop the form of electronic transactions (which we have written about in a recently published paper), Apis' focus on cashless from the impact perspective considers the transition from cash based transactions to non-cash overall (as opposed to their specific form), and the role of Apis' portfolio companies in facilitating this transition.

The development of less cash-dependent financial services business models creates social impact in various ways:

The impact created by Cashless in emerging markets

As one of the co-founding signatories to IFC's guidelines for responsible investing in digital financial services, Apis is passionate about the developmental impact that cashless can create, which spans both micro and macro levels within the regions that we invest in.

The impact created by cashless in emerging markets

Micro-level impact		Macro-level impact	
Consumers	**MSMEs**	**Economic growth & transparency**	**Financial sector deepening**
Access to key financial services: remittances, savings, insurance	Efficient fund collection	Increase in GDP	Enables efficient collection of high volume, low value payments
Increased convenience	Reduced friction in capex	Increase in fiscal receipts	Enables DFS models such as digital lending & micro-insurance
Enhanced security	Expansion of customer base (offline & online)	Reduction in grey / shadow economic activity	Enables new business models such as ride-hailing & off-grid solar financing
Access to eCommerce & the virtual economy	Access to working capital credit	Efficient social transfer payments	Decentralised finance models reduce friction & cost

The financially excluded are typically reliant on a number of informal mechanisms such as friends and family, rotating savings schemes, pawnbrokers, moneylenders, and money under the mattress. These informal mechanisms can not only be unreliable, but are often very expensive also - those of us that are fortunate enough to have access to formal financial services can often take for granted the financial flexibility that they provide, and as outlined, digital financial services or cashless, facilitates this access for those without.

According to a study in Harvard Business Review, the attractiveness of cashless is highest in cases where the cost of cash is high (convenience, transport, security), where technology uptake is accelerating, or where governments struggle to collect sales tax. Emerging economies exhibit all of these traits, making them and their citizens prime beneficiaries of cashless.

Micro-level impact - Consumers

At the micro level, the expanded access that cashless creates, in forms such as mobile money, enables the use of key services such as domestic remittances or low denomination, short-term money safekeeping. Electronic payments can provide convenience by alleviating the need for consumers to carry large amounts of cash in public (and the potential personal security risks of this), and also provide access to the rapidly growing eCommerce segments and virtual economy in these markets.

Micro-level impact - MSMEs

For MSMEs, who are considered the drivers of economic growth in emerging markets, access to cashless transaction systems can reduce friction and increase efficiency by allowing them to buy stock and materials, and get paid more easily and quickly. Cash management also costs merchants money - businesses need to store cash securely, deposit cash when they have too much on hand, and in some cases, hire companies to transport it safely. Access to the means to accept electronic payments can help merchants to expand their customer bases (both offline and online), and also provide access to working capital in the form of advances backed by future customer receipts.

Macro-level impact - Economic growth & transparency

At the macro level, cashless payments infrastructure is a key focus area for governments in emerging markets (as well as globally) as an important tool to increase fiscal receipts, reduce shadow economic activities, and ultimately boost economic growth. BCG research estimates that a move to a cashless model would add more than 3 percentage points to the annual GDP of emerging economies, due to an increase in the velocity of value transfers, greater transparency, and the increased ability to offer and obtain financing. By removing cash from the economy, there is an increase in available capital for investment for growth (working capital and long-term capital). Cashless also enables more comprehensive oversight and monitoring which can better inform central banks' monetary and economic policies, as well as improvements in the ability to clamp down on practices such as illicit activity, money laundering, and tax avoidance from undeclared cash payments that leads to tax gaps. In addition, efficiency in the distribution of social transfer payments (from governments or NGOs) can also be improved by cashless, particularly when electronic payments are combined with unique IDs (such as the Aadhaar program in India), to reduce cash leakage. As such, policy makers are actively driving uptake - in 2016, the G20 heads of state and government endorsed the High-Level Principles of Digital Financial Inclusion (HLPs), recognising the capacity of digital to help people get access to financial services.

> *A move to a cashless model would add more than 3 percentage points to the annual GDP of emerging economies.*

Macro-level impact - Financial sector deepening

Ubiquitous, low-cost electronic retail payment platforms also deepen the financial sector in emerging markets by enabling additional services that utilise this infrastructure such as credit and insurance, and they also make new business models viable that rely on collecting a high volume of low value payments, such as repayments for financed off-grid solar units, as well as tech-enabled ride hailing services. Payment platforms have been critical to the growth of digital lending models as they facilitate cost effective means of disbursement and repayments, and also provide transaction data is utilised to assess creditworthiness. In addition, emerging blockchain-based Decentralised Finance ('DeFi') systems allow users to transact directly, removing the long line of current intermediaries in the payments value chain, reducing friction and cost. Emerging markets stand to benefit significantly from this as they do not have extensive legacy payment systems, allowing potential widespread take-up of DeFi-solutions, and the transaction cost savings to be passed on to transacting consumers and MSMEs.

The multi-layered nature of the social impact that cashless creates is the reason this is one of Apis' core areas of impact focus, and there are a number of clear examples of this across the companies that Apis has invested in:

Examples of Cashless impact from the Apis portfolio

Cashless is typically associated with the payments sub-vertical of financial services, of which there are many examples within the Apis portfolio:

Direct Pay Online is a leading online payment service provider in Africa allowing merchants in 19 markets to accept online payments, thus enabling the formation and growth of these businesses across the continent. The company has also significantly expanded the range of payment types available to payers (retail consumers) in these markets by processing payments from all major credit cards, mobile money, and also eWallets.

Cashfree in India also offers an online payments gateway and payments solution for merchants, and its Payout product facilitates the mass disbursement of payouts by businesses including card repayment companies, NGOs, NBFCs, and logistics / delivery companies, allowing them to operate more efficiently. For example, in the case of a mobility service (a customer of Cashfree) that has drivers that carry out thousands of deliveries daily, these drivers are able to use Cashfree Payouts to withdraw their earnings to their bank account, whenever they want, and instantly. This leads to them being able to better manage their personal cashflows, as well as increased driver retention for the mobility service also. Cashfree also provides an early settlement financing option for merchants which allows them to receive their online payments immediately (same day) instead of the 2-3 business days which is more typical in the market. This provides crucial working capital for merchants, especially in the context of the COVID-19 outbreak when lenders in India have significantly curtailed the number of loans they are disbursing, particularly to SMEs.

For physical / offline payments, Tutuka enables its ecosystem owner clients, such as mobile network operators, transit companies, retailers, and fintech companies, to open their closed-loop wallet ecosystems, which allows growth markets consumers to transact at any ATM, POS (and eCommerce sites also), through the issuance of prepaid virtual and physical cards in 15 countries across Africa and Asia. In doing so, Tutuka provides consumers with the freedom to transact electronically in more places that are convenient to them, and with the use of payment types they already own and will be familiar with. This is the definition of relevant and appropriate provision of financial services for inclusion.

Total electronic payments processed by Apis Fund portfolio companies in 2020

1.6 billion
Transaction volume

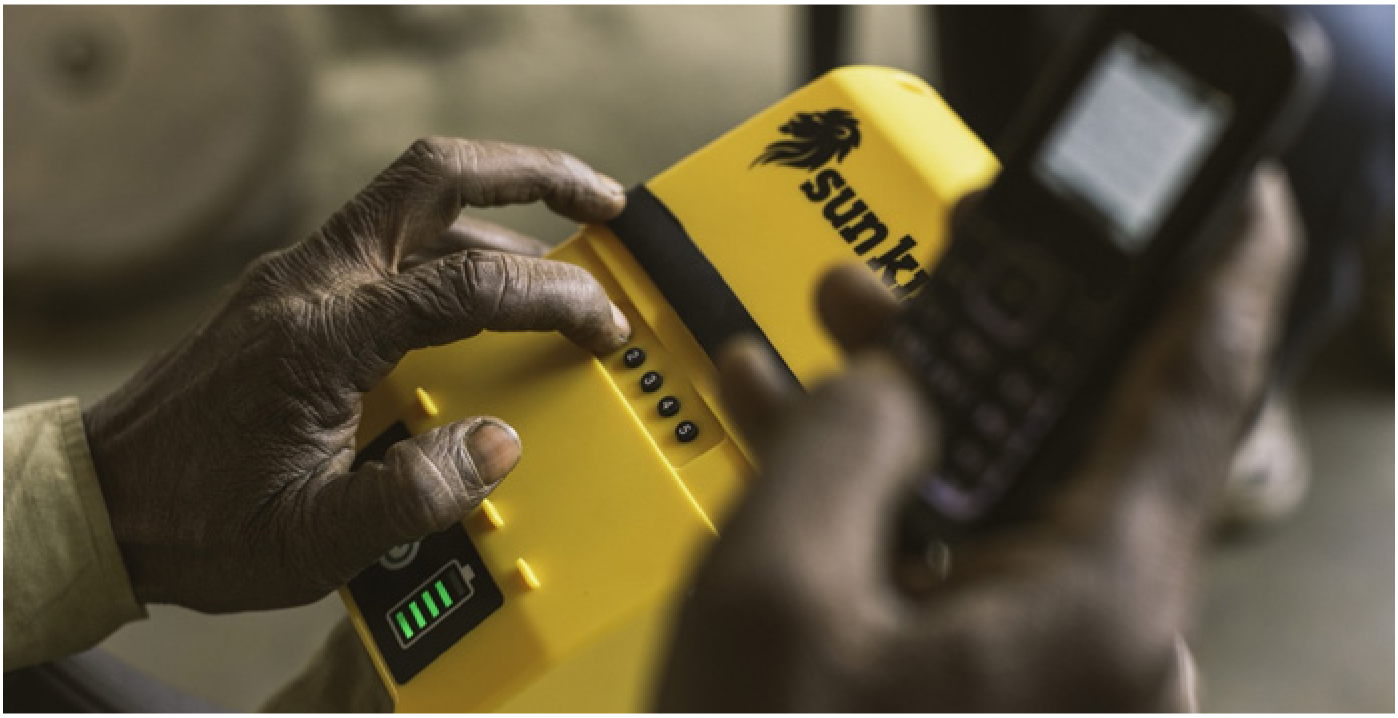
$22.7 billion
Transaction value

Note: Apis Growth Fund I & II portfolio companies on a consolidated basis for 12 months ending 31 Dec 2020

Apis' cashless impact thesis is not limited to the payments sub-vertical alone - as outlined, the development of cashless enables other inclusive financial services models within emerging markets, and there are examples of this in the Apis portfolio:

Star Health Insurance, is the leading private retail health insurer in India and has the largest footprint amongst all stand-alone health insurance companies in India. Star Health's policies are accessible to a large portion of the population who otherwise would have to resort to out-of-pocket expenses for health treatment (and in some cases resort to substandard medical treatment). A core part of the company's overall footprint in India is its agreed network of hospitals (numbering c. 6,600 across India) where Star Health enables claiming patients to receive their health insurance claim and hospital treatment completely cashlessly. Here, Star Health settles any medical expenses directly with the hospital to reduce the financial burden on insured individuals at the time of hospitalisation, resulting in a seamless experience at a time when convenience and affordability can be most important.

Another example is that of Greenlight Planet, a provider of off-grid solar financing products for energy and financially underserved consumers in Africa and Asia. The company's low-cost domestic solar lighting and power devices help families live brighter, safe and more productive lives, by substituting costly and polluting kerosene lamps for a cleaner and safer alternative. Globally there are 840 million people living off-grid, and in offering affordable financing, Greenlight Planet helps more consumers to gain access to clean, off-grid sources of light and electricity. In order to make repayments for these financing loans, consumers are able to utilise mobile money to make affordable repayment instalments of $0.25-$0.50 per day electronically, for a period of 6-12 months - after all instalments are made, consumers own their device outright. Importantly, Greenlight's financing is usually their customers' first access to formal financial services in the form of credit for a high-value asset that is paid off over time, which then creates credit history for these consumers that can help them access additional financial services in future. The key to their success has been an innovative financing model that is enabled by cashless mobile payment systems.



Conclusion: A reiterated focus on Cashless

Whilst the financial inclusion opportunity from cashless in growth markets is clear, barriers to uptake remain. These can include a lack of trust of in electronic payments from consumers (such as cultural factors, as well as the increasing sophistication of financial crime / fraud), an absence of broader supporting infrastructure (such as unified national payments infrastructures, or uneven electrical networks), and a lack of customer-centric solutions (such as low levels of interoperability, or tech-centric as opposed to customer-centric solutions). As such in any given market, a focus on a cashless economy should typically begin with a holistic and overarching national payments agenda, driven by a consortium of key stakeholders including the government, the central bank, financial institutions, consumer protection agencies, as well as merchants.

In this context, Apis' portfolio companies have a key role to play in contributing to the growth of cashless, and Apis has a key role here also. We are dedicated to working with all relevant stakeholders within our ecosystem to overcome any barriers to the adoption of cashless to help to maximise the tangible social impact benefits that can accrue within the markets and constituencies that we invest in.

The design and provision of relevant and affordable formal financial services, delivered through the appropriate distribution channels, is key to ensuring that these offerings continue to be utilised beyond the initial 'access' stage, and that cashless models are grown in a sustainable and scalable manner.

Through our continued focus of cashless as an impact thesis, Apis' investments will ultimately lead to inclusive financial systems, more economic growth, and an overall reduction in poverty in growth markets.

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Apis, through its team of c. 30 professionals and staff with deep industry expertise, manages total committed capital from investors (including drawn and invested capital) of c. $1.3 billion. In addition to its headquarters in London, Apis has representation in seven countries across North, East and West Africa and South and Southeast Asia.

Responsible investing and financial inclusion are the cornerstones of Apis' investment philosophy, with the firm incorporating ESG requirements into investment analysis and decision-making processes, policies and practices. Apis is a signatory to the UN Principles for Responsible Investment.

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