



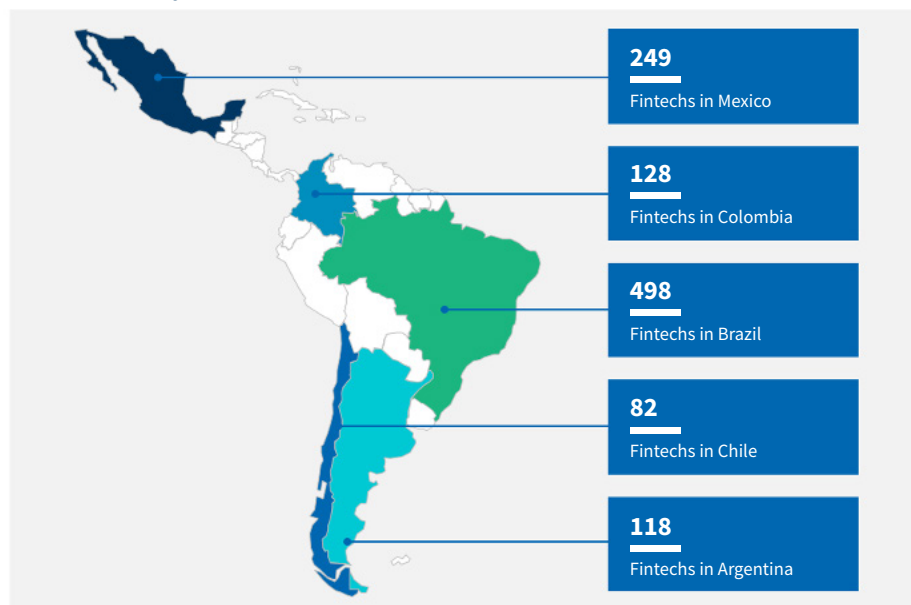
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# Private Equity Investment in Latin America's Fintech Sector

## 5 Things to Consider

It's no surprise that COVID-19 has shrouded Latin America's investment outlook in uncertainty: the region's private capital transactions totaled \$3.6bn across 228 deals during 1H20, a decline of more than 50% compared to 1H19<sup>1</sup>. Private equity was the hardest hit asset class, with only \$850m worth of deals. Yet despite headwinds caused by the global pandemic, the region's PE exits accelerated to \$5.1bn during 1H20 — the best first-half total since 2011<sup>2</sup> — as investors bet big on fintech.

### \$ 8bn Raised by 1,000+ Fintechs in Five Countries



Source: KoreFusion Analysis (2018 data pulled from Crunchbase, LAVCA, Fintech National Association, World Bank)

The fintech ecosystem is evolving as digitization transforms the way folks live and interact. Emerging neo-banks and payment startups focused on financial inclusion seek to penetrate and scale in this new environment and are reinforcing just how prevalent consumer financial technologies have become during COVID-19: after all, 85% of Brazilians received their stimulus payments through Caixa Tem, an app created by the Brazilian federal bank. In fact, with newcomers like Nubank and Credits respectively raising \$400m and \$231m<sup>3</sup>, fintechs account for more than a third of Latin America's investment dollars<sup>4</sup>.

PE investments, like Softbank's \$5bn Latin America Innovation Fund, show that firms are committed to deepening their foothold in the sector and the region. There are substantial windows of opportunity to capitalize upon as this segment expands. For investors betting on fintech, here are five considerations to bear in mind:

1. **Newly developing legal frameworks require public affairs expertise.** With the emergence of fintech players, lawmakers are balancing new regulations and consumer protections with the existing financial laws. While countries like Mexico have established frameworks to account for crowdfunding and electronic payments, other countries like Brazil, Colombia, Peru and Chile still need to adopt sandbox legal frameworks to prevent money laundering and financing of criminal activities, for example.

Further complicating the matter are the traditional banks and large business groups aligned to heavyweight families in the region. These "special interest groups" are immersed in government affairs and carry political sway, challenging proposed policies and threatening the region's pro-innovation regulatory history<sup>5</sup>. Some industry players want steeper hurdles for entry, like higher minimum capital threshold requirements or more stringent processes for international firms to obtain licenses<sup>6</sup>.

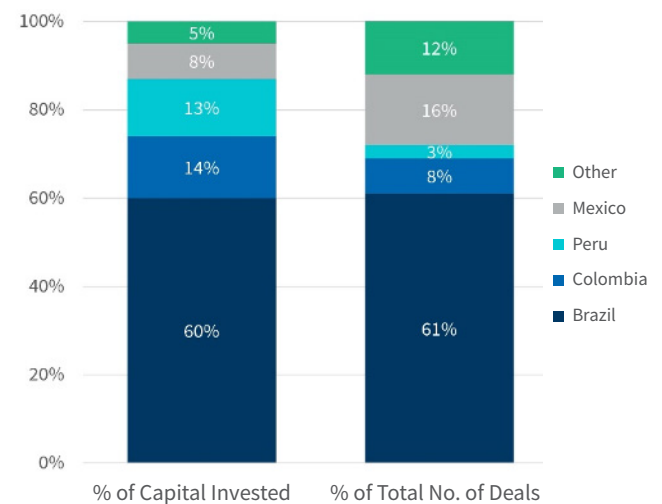
Players in the fintech sector need advocates who can deftly navigate this rapidly changing environment. Public affairs expertise and a keen understanding of the region's nuanced policies, high-level stakeholders in the landscape and consumer protections are integral to navigating regulatory hurdles, complex tax systems and red tape.

2. **ESG factors weigh heavily on consumers.** People care deeply about how companies behave, and COVID-19 has accelerated pressure for organizations to align their business practices and objectives with things that matter to their communities – such as employee welfare, fair labor practices and environmental issues like sustainable supply chain management. Although transformation may be long term, newcomers to the region have the chance to establish themselves as diverse, transparent and accountable from the get-go. Prior to acquisitions or capital markets transactions, it's crucial for companies and investors to assess these

risks, conduct thorough reputational due diligence and incorporate a more comprehensive ESG approach into their operational strategy.

3. **Cross-border relationships are key.** In 2019, more than a third of the region's investment deals and 70% of all VC dollars involved at least one global and one Latin American investor – and all but one \$50m+ transaction was deployed via co-investing<sup>7</sup>. The region's main players pair with international firms who are increasingly attracted to budding opportunities in Latin America's fintech startup scene. For savvy investors maneuvering this landscape, it's imperative to identify and nourish strategic partnerships with relevant stakeholders. Having a global presence, networks in local communities and an understanding of nuances between different countries are critical for making impactful inroads to the region's investors.

**Investment in Latin America by Geography, 1H 2020**



Source: LAVCA/EMPEA

4. **Amid a booming IPO market, effective financial communications are essential.** The pandemic-induced unemployment levels, local market turbulence and low interest rate environment have given rise to various challenges – but they've also created the perfect storm for a flourishing gig economy. Sales numbers for rideshare and delivery apps are soaring, and innovative tech companies are finding ways to benefit from the new normal despite economic contraction<sup>8</sup>. Emerging investors will continue to identify opportunities for market penetration over the long term, given that deal activity is piping hot across seed, early and

expansion stages.

With capital markets transactions showing no signs of slowing, effective financial communication with executive teams, boards of directors and the broader investment community is essential. Transactions like M&A deals, IPOs and restructurings require nuanced understanding of potential impediments, stakeholder attitudes, analyst perceptions and valuations.

5. **Business transformation requires cultural competency and effective people and change management.** Attractive valuations for Latin American fintechs will likely lead the number of M&A deals to soar over the short- to medium-term<sup>9</sup>. But following mergers or major growth phases, investors and business partners may struggle with integrating their operational models, internal teams and cultures. Adapting to these changes and improving productivity and competitiveness require expertise in navigating transformation. To unlock revenue growth and profitability post-transaction, it's imperative to equip leaders with the skills to guide their teams through change. Investors should ensure that organizations are setup for success with support to navigate enterprise-wide transformation, implement new processes and business strategies and help teams reach their full potential.

As disruptive technologies impact Latin America's investment landscape, the evolving fintech sector presents opportunities and risks for investors seeking entry and expansion in the region's key markets. With so much of the terrain undeveloped, fintechs must proactively advocate for well-rounded legal frameworks; prepare for scrutiny when it comes to environmental, social and governance factors; nurture global relationships; own their narrative in the investment community; and navigate complex business transformation processes. Betting on fintech can reap payoffs for investors in the short-, medium- and long-term, and bearing these five considerations in mind will be key to success.

#### Endnotes

- 1 Emerging Markets Private Equity Association (EMPEA), Association for Private Capital Investment in Latin America (LAVCA). *Latin America Mid-Year 2020 Data Insight*. Retrieved October 30, 2020.
- 2 Ibid.
- 3 LAVCA. (August 2020) *Annual Review of Tech Investment in Latin America*. Retrieved October 30, 2020.
- 4 LAVCA. *2020 Industry Data & Analysis: Update on Latin American Private Equity and Venture Capital*.
- 5 Atlantico. (October 2020) *Latin America Digital Transformation Report 2020*. Retrieved November 2020.
- 6 Feliba, D., S&P Global Market Intelligence. (2019, March 07). [LatAm Turns to Mexico's Year-old Fintech Law as a Model for Regulation](#). Retrieved December 01, 2020.
- 7 LAVCA. *Annual Review of Tech Investment*.
- 8 Barron's. (October 9, 2020). "[How Brazil Became a Hot Market for IPOs](#)."
- 9 Bnamerica. (August 27, 2020). "[Lower valuations at LatAm fintechs expected to entice investors, M&A](#)."

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