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CATALYZE ENGINES OF GROWTH

CATALYZE LEARNING BRIEF:
FinTech

The overall purpose of the EoG Activity is to support the resilience, growth, and job creation of small and medium-sized enterprises (SMEs) in the Western Balkans by improving their access to and utilization of appropriate finance. EoG helps mobilize capital to sustain distressed but viable SMEs and jobs in the wake of COVID-19 in the near term and promote improved SME growth financing in the long term. The EoG Activity engages market actors and other stakeholders in a co-design process to identify key opportunities and develop activities to minimize access to finance constraints.



Access to Finance FinTech learning event in Tirana, Albania. Photo: Brian Oh

EoG is working with local partners to address the following two main objectives:

1. Mobilize capital and/or restructure debt to otherwise viable but distressed SMEs which have been adversely impacted by COVID-19 to sustain them, retain/rehire workers, and preserve capacity for future growth.
2. Facilitate additional alternative financing to high-growth potential SMEs in the Western Balkans to enhance their growth, productivity, and job creation.

BACKGROUND

Learning is a core piece of the EoG Activity and a fundamental component of the Activity Monitoring, Evaluation, and Learning Plan (AMELP). The AMELP explicitly includes the Learning Questions assigned to CATALYZE for contribution to USAID's Blended Finance Learning Agenda. The EoG Learning Agenda explores and helps identify the opportunities to leverage blended finance to promote SMEs' resilience, recovery, and growth in the current context of the Western Balkans.

EoG uses learning events to provide opportunities for networking among CATALYZE partners, USAID, and private sector actors. The events are forums where EoG's partners share knowledge and data to determine progress, answer learning questions that help guide the progress of the Activity, uncover best practices, and surface practical suggestions on how to better mobilize private capital for development.

The learning events also function as research tools intended to go beyond EoG partners' reflection on their current activities to answer larger questions around the Activity's methodology, long-term strategies, and implications of increasing the availability of private sector financing in the Western Balkans.

This learning brief on FinTech highlights lessons learned from EoG's regional learning events held in Serbia and Albania. The findings can be used by USAID and the private sector to explore ways to mobilize private capital collaboratively to achieve development objectives and grow the local market for financing. The FinTech Learning Event addressed the following key Learning Questions that have been developed to help guide and inform EoG's methodology and activities.

LEARNING QUESTIONS



- 1 What is the overall diversity of existing financial products and services offered by different financial institutions in the countries of focus? How is it changing over time?
- 2 Why aren't Financial Institutions already providing financial products and services relevant to high-growth potential SMEs? Is it a matter of capability, opportunity, perception, or motivation?
- 3 Are existing products and services provided by Financial Institutions relevant to SME needs? What new products and services are being introduced to meet needs?
- 4 How can USAID intervene with FIs most effectively to expand their interest and ability to increase financing to high-potential SMEs (to include new product development, capacity building, pipeline development, etc.)?

PROCESS METHODOLOGY

As a part of its learning activities, EoG organized forums with partners and key stakeholders to examine the barriers and enablers to developing financial products (alternative or otherwise) in the Western Balkans, with a special focus on W-SMEs. EoG organized two regional events in Serbia and Albania on three different topics: Private Equity and Venture Capital, Fintech, and W-SME Access to Finance. EoG collaborated with partners, stakeholders, and donor representatives to organize the learning events. Topics were selected based on EoG's objectives and the potential for transforming

the financial markets in the region. The events brought together 65 ecosystem stakeholders, including 34 women, from the Western Balkans who openly shared their experiences and recommendations in an interactive discussion with one another.



CHALLENGE

Identify effective strategies to promote the mobilization of private capital to SMEs in the Western Balkans.



OPPORTUNITY

By presenting and refining the Activity's strategies, CATALYZE EoG will identify synergies with stakeholders to allow for scalability and sustainability.

KEY TAKEAWAYS AND LESSONS LEARNED

Local financial markets are not able to sufficiently finance Western Balkans SMEs. Even though a robust SME sector is critical to the economic development of the Western Balkans, SMEs' potential as engines of broader economic growth is stifled, as is reflected by low rates of economic growth and high rates of unemployment. SMEs' contribution to value-added production and exports remains disproportionately low as they struggle to expand into high value-added activities. The banks and traditional financial service providers have many advantages, such as their size, reputation, and ability to serve a major portion of the mass market. However, they also have high-cost branch networks and stringent regulations, resulting in less or zero interest in SMEs and start-ups, financial inclusion, or innovation.

Digital financing and FinTech are filling the gap between what traditional banks offer and what today's economies need, in terms of fewer collateral requirements, more flexible risk assessments, a better understanding of the digital economy, and digital business models. FinTech also provides speed, efficiency, and a better user experience. FinTech solutions are

“FinTech is just the result of the digital transformation of financial services. FinTech is bridging the gap between what traditional banks offer and what modern consumers (SMEs owners) have grown to expect in terms of speed, efficiency, and better user experience. Since banks remain the key source of SMEs financing in the Western Balkans their partnership with FinTech can only positively impact SMEs access to financing.”

■ Sandra Rodic, Financial Consultant

innovative and focused on future clients/consumers and their business models. FinTech solutions also simplify financing, lower its associated costs, and offer some improved/new products that are more accessible and adequate for SMEs, in particular women-owned and women-led SMEs and startups. FinTech is filling gaps left by traditional financial service providers and enabling the development of products and services in various sectors of the economy.

Businesses are using FinTech financing to increase both short-term and long-term leverage.

SMEs substitute long-term bank debt with FinTech debt or equity and reduce the proportion of secured debt. In short, FinTech provides firms with an alternative to access new money and release pledged assets to retain financial and operational flexibility. In addition, the availability of FinTech funds allows firms to reduce their dependence on their main bank and allows SMEs to diversify away from the banking sector and reduce their exposure to banking shocks.

Obstacles to rapid growth of FinTech solutions in the Western Balkans include specific local issues, such as archaic regulatory frameworks and an underdeveloped cashless economy. All economies suffer from the same leading constraints: lack of capital, financial literacy and skills in FinTech among SMEs, bankers, financial institutions, and investors (in particularly future investors on different crowdfunding platforms).

Western Balkans entrepreneurs have limited access to suitable capital. Startups, including FinTech companies, are generally funded by their own funds, grants, venture money, or business angels. In the early phases of expansion, businesses seek funding from banks, yet they typically do not have access to these loans due to a lack of historical performance.

Banks and FinTech Partnerships. Traditional and conservative bankers lack knowledge of innovative business models and the global digital economy. They randomly support new business model companies by exception rather than by the rule. The same lack of knowledge applies to the majority of SMEs. SMEs do not expect, nor push the banks to explore the opportunities that exist on the global market, as they themselves do not understand financial products and mechanisms outside of the traditional commercial banking framework.

Cooperation and communication among FinTech stakeholders in the Western Balkans are insufficient and sporadic. This prevents forming meaningful partnerships, for example, between banks and FinTech, limits the ability to learn from each other's experiences, and hinders donors' ability to understand and design timely and coordinated initiatives.



FinTech learning event in Tirana, Albania. Photo: Brian Oh

With the right enabling environment and ecosystem of market actors, digital finance — or more broadly, FinTech — can foster greater efficiency and transparency, resilience, and empowerment across a variety of contexts in the Western Balkans. The impact of these gains can be felt by many communities as they progress on their journey to self-reliance, this includes women, youth, micro, small, and medium-sized enterprises (MSMEs), rural communities, and others. Experience shows that donors have a clear role in helping account for both the opportunities and risks of a digital economy to ensure it is truly inclusive. Moreover, donor resources are insignificant relative to the amount of capital and expertise that the private sector can bring to address some of the most difficult development challenges. USAID and other donors can increase the probability that these gains will be realized if the private sector’s strengths are effectively harnessed — whether those strengths are capital, ideas, technology, relationships, or technical expertise.

FinTech solutions are borderless. They open access not only to regional but also to global markets and investors. This is especially important for small developing economies, such as that of the Western Balkans. In addition, FinTech is gender neutral, reducing prejudices or bias toward women’s entrepreneurship and enabling women to get financing easier. FinTech can foster greater efficiency and transparency, resilience, and empowerment across a variety of contexts.

RECOMMENDATIONS:



- To expand the number of regional FinTech providers, donors should invest in platform/software development of solutions, help with gathering initial working capital or equity, or support the fundraising of individual FinTech companies. Helping FinTech companies become “investment ready” and/or facilitating matchmaking between private investors or other sources of capital (e.g., VCs, DFC, and IFC) would allow for FinTech solutions to reach sustainability and serve SMEs faster, increase the trust of the market in new technological solutions, and contribute to the stability of FinTech Industry in the Western Balkans.
- Work on regional solutions covering a larger market with more variety, thus attracting more investors.
- Build awareness, understanding, and use of formal financial services among SMEs and investors. Financial illiteracy and lack of business sophistication are common throughout the Western Balkans, resulting in mistrust of businesses (and governments and financial institutions) in non-traditional financing/FinTech.
- Creating and sharing success stories that promote the benefits of FinTech has proven to be one of the best ways to educate the market.
- Support the establishment of a regional FinTech hub/association that would enable continuous communication between banks, alternative finance providers, experienced professionals, and PE/VC and investors.

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RECOMMENDATIONS *CONTINUED...*



- Help FinTech identify and better understand viable market segments among underserved communities. Collaborate (via cost-share of research or provision of either technical expertise) with financial service providers on research that covers market-segmentation, market size, barriers and incentives, and the level of digital literacy.
- Encourage new projects to ensure continuity of donor support, as this enables achieving more results with fewer resources and less time. There is no need to reinvent the wheel and duplicate the efforts in a situation where various USAID programs have already put in the effort in creating and supporting FinTech solutions.
- Be prepared to take a multi-pronged approach to market gaps. It is important to support policy and regulation programs that can support the growth of the FinTech industry in the Western Balkans.
- Policymakers and regulators frequently struggle to maintain an adequate understanding of the implications of evolving business models and the rise of technology in the financial sector in the face of enduring priorities of financial stability, integrity, and consumer protection. In the Western Balkans regional regulatory frameworks are not explicitly adapted to the FinTech sector and there is no specific legislation which governs the FinTech space.
- Facilitate the establishment of an Innovation Gateway at the national level with plans for local support over time, for gov-industry exchange.

USAID CATALYZE (2019-2027) is a \$250 million contract designed to mobilize \$2 billion in private capital towards underserved sectors, geographies, and populations across 28 countries in Africa, Asia, Latin America and then Caribbean (LAC), and Europe.

CATALYZE, implemented by Palladium, co-creates with Missions, Bureaus, and Independent Offices (MBIOs) to design multi-year, results-based activities that are managed by Palladium and implemented by a broad network of principally locally led implementing partners.

FOR MORE INFORMATION

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