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Cashing in on a new customer base

Jake Robson and Nick Davies from the Singapore office of Morrison & Foerster LLP, highlight how joint ventures or strategic M&A can often be the most effective way to roll out and scale up a fintech product offering in multiple jurisdictions in southeast Asia

The promise and challenge of fintech adoption in southeast Asia

If the future of money and financial services is fintech, then in southeast Asia a far wider spectrum of industry participants than those traditionally engaged in banking, insurance and wealth management are destined to play a leading role in developing and distributing financial services products.

According to a survey of the Asian fintech landscape by Ernst & Young and DBS, whereas in China 40% of consumers were already using fintech payments methods and 35% of consumers used insurtech products by 2016, only between one and five percent of customers had done so in other main southeast Asian countries such as Singapore, Indonesia, Malaysia and Thailand. The reason for this is likely to be a lack of fintech product providers, or awareness of such providers rather than a lack of demand or interest – in another survey in Singapore in 2017 (carried out by Ernst & Young), 56% of respondents said that they anticipated using one or more fintech/insurtech products or services in the future.

However, the typical fintech business model requires large economies of scale and a nimble approach to product development and distribution. Customer acquisition and brand recognition are proving to be formidable barriers to entry for many fintech startups in the region. Furthermore, traditional financial institutions have been slow to adapt to the new financial services landscape in this region.

To fill the gap, consumer-facing companies with large customer bases in Asia are looking to become distributors, and often providers, of fintech payment, lending or insurance solutions. This allows them to increase service offerings to their existing and new customers by satisfying demand for frictionless and innovative financial services from an

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He regularly advises on cross-border regulatory matters and product rollouts in the financial institutions and fintech sectors. Jake has a particular focus on the financial institutions, insurance, technology and telecommunications sectors, which locates him at the nexus of the fintech and insurtech sectors.
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increasingly affluent population.

Many of these fintech products may be complementary to the primary business of the retailer (for instance, a retailer offering consumer finance loans to drive sales) and increasingly, these merchant fintechs see fintech as a new pillar of their business and a means of increasing customer loyalty and gathering and monetising additional data on their customer base.

An example of a successful merchant fintech product is Alibaba affiliate Ant Financial, whose money market fund *Yu'e Bao* (leftover treasure), which started as a convenient way for users to store excess cash in their digital wallets, has attracted more than 300 million depositors in China to become the world's largest fund, with in excess of $230 billion in assets under management.

This demonstrates the scale that a merchant fintech can bring if the market is large enough. However, as the regulatory environment across southeast Asia remains fragmented, merchants who are keen to enter this sector and achieve regional scale often need to target customers in many different jurisdictions simultaneously.

Intuitively, a merchant fintech's growth plan may be to incorporate and apply for new licences in all jurisdictions. This is, however, often unlikely to be an efficient use of time or capital. Instead, merchant fintechs would be well advised to analyse whether it is best to (1) partner with third parties on a joint venture (JV) basis; (2) engage in M&A, or; (3) incorporate new regulated entities in order to enter a new market.

New distribution models often require more formal JV structures

At a basic level, financial services distribution by merchants is not novel, traditionally taking the form of a contractual agreement to distribute financial services products on behalf of a third party financial services provider. An example is an airline offering its clients the ability to sign up for travel insurance offered by an insurer as part of the booking process.

These original distribution deals often involve up-front fees paid to merchants in return for exclusivity or preferred status. The licensed financial services provider would then be introduced to the customer and would carry out all customer sign-up steps and the administration of the product in order to satisfy regulatory and commercial requirements. In return, the merchant would receive ongoing commission income.

However, distribution strategies are evolving. As customer acquisition and retention is costly, and with profit margins in fintech potentially lower, we increasingly find that merchants are only willing to partner with a financial services provider if the merchant can play a more active role in managing the customer relationship and overseeing the delivery of financial products. A JV model can often provide the most efficient means of achieving this objective.

In the equity JV model, regulatory responsibilities and reporting requirements are increasingly borne by the merchant. A separate JV vehicle with a financial institution is also desirable from the merchant's perspective in order to maintain flexibility to attract external funding or potential additional partners, provide long term growth through the equity holding, as well as to segregate fintech business lines from the merchant's other businesses.

If this model is being adopted in one or more markets, close attention needs to be paid to local regulatory requirements at an early stage so that comfort can be obtained that such restrictions do not conflict with the commercial objectives of the project.

Even if a JV is not a merchant's preferred route to develop a fintech offering, in certain countries, due to foreign ownership restrictions, this model may be unavoidable. For instance, many jurisdictions in southeast Asia have foreign ownership restrictions on activities in the fintech sector.

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We grew up in Northern California—in its cities and in the Valley. So it's no surprise that we are a leading technology firm. Our tech acumen and entrepreneurial spirit, together with our financial services regulatory expertise and capital-raising experience, put us at the center of developments in the FinTech sector. We provide innovative advice to companies focused on payments, remittances, marketplace lending and digital currencies. Few firms bring together capabilities in each of these areas to help companies to succeed in a fast moving, highly competitive market for technology-driven financial services.

Strategically based in Singapore and with over 40 years of collective experience advising clients in the region, our lawyers are uniquely placed to guide companies through their investments, planning and implementation of commercial collaborations and product roll-outs across the region.

We would be delighted to speak to you about your groundbreaking venture.

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Planning for a successful distribution JV

The commercial dynamics and potential outcomes of an equity JV are much more complex than those for a pure contractual distribution agreement. Companies looking to enter into such arrangements should seek input from fintech legal counsel on key pressure points that are likely to arise in commercial discussions and during the life of the JV.

Examples of key issues in fintech JV discussions include:

- development and ownership of intellectual property and technology transfer;
- initial and future funding commitments, including the right to obtain third party funding;
- speed of product rollout in jurisdictions where relevant licences need to be applied for;
- responsibilities for licence application;
- related party agreements – for example when existing licensed activities of the financial institution JV partner will be used on a white-label basis;
- operational responsibility and quality standards for the financial product development and delivery;
- termination or exit rights and consequences, including non-compete clauses; and
- exclusivity, non-competes and future access to customers and use of customer information.

M&A as an alternative to contractual arrangements and JVs

An alternative to the JV model when looking to enter a new market is to acquire a licensed incumbent operator. This can be quicker and less burdensome from a regulatory perspective compared with the JV model, and although the acquisition of shares in a licensed entity will usually require specific regulatory approval for the incoming shareholder, this is often quicker than setting up a new entity and applying for licenses from scratch.

Due diligence, including a detailed review of the proposed target entity's regulatory licences and compliance, is fundamental, as well as a deep knowledge of the underlying regulatory regime in the relevant jurisdictions.

Greenfield market entry

An alternative to the market entry models mentioned above would be to establish an entity from scratch in every jurisdiction. Whilst this might seem to be the natural and preferred route to market entry, in practice, this tends to be the most time, resource and capital intensive strategy.

For merchant fintechs or fintech startups without a deep experience and significant track record in financial service provision, the challenge of starting a new line of business in a new market, where the product may not fit within the country's current regulatory framework and where significant capital needs to be deployed to meet regulators' requirements can prove to be a significant challenge.

Regulatory and legal input is critical at the planning stage for any fintech product targeting southeast Asia

Conclusion

In southeast Asia, a one-size fits all approach to developing a regional fintech business is often impracticable. Compared to the EU, where there is a degree of regulatory harmonisation in many relevant areas for fintechs, in southeast Asia, the specificities of each country's licensing regime need to be taken into account as part of long term planning for a product roll out or expansion.

Specialist fintech international legal counsel can help to provide a significant advantage for merchants to explore, develop and co-ordinate the execution of an efficient route and sequence for the deployment of a fintech roll out across multiple jurisdictions.