Time is now: US investors seek fintech opportunities abroad

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We are at the forefront of a global transformation in financial services that had its roots in the US over 20 years ago but is now accelerating globally as financial inclusion for both consumers and smaller businesses has brought larger, addressable markets and lower technology development and operating costs have enabled emerging companies to quickly develop and iterate their solutions to ensure a product-market fit.

US fintech investors are looking abroad

Fintech investors are looking outside of the US for greater returns as home markets become increasingly saturated. While the US has been the foundation for innovative and disruptive technologies across fintech, proven business models are now emerging in other markets.

It is important for companies in these non-US markets with viable business models to begin thinking about how they can position themselves to attract growth equity and private capital from US investors to support their growth and help achieve an exit for early shareholders.

The US investor checklist

Emerging growth fintechs looking to attract US investors need to meet a number of criteria. They have to demonstrate several important characteristics: Is there is a significantly large addressable market in their core or neighboring geographies? Are they truly differentiated from incumbents and do they have a unique approach to their product or market? What is their competitive advantage and have they demonstrated profitable unit economics and a growth trajectory of 50-100% annually?

Additionally, before US investors will invest in a company, at least one institutional investor needs to be in place as most US investors prefer not to come in as the first institutional investors in non-US entities.

International fintechs need to have the right corporate structure and having an institutional investor already in place helps to address less sophisticated corporate structures and governance. This may also include domiciling the holding company in an investor friendly jurisdiction that has the right protections in place for investors and creditors. Some jurisdictions are more challenging than others. For example, we recently advised a client operating in several non-EU markets and set up individual companies for each market owned in equal share by the original shareholders.

To help prepare for an investment, the company established a holding company in an EU member country where all the country subsidiaries rolled into. This made the company more investor friendly with greater protections in place for foreign investors and eventually led to an equity investment from a strategic financial institution (FI) investor. It's an extreme example of how companies in developing markets can prepare themselves for a capital raise.

There should be other global corporate standards in place. For example, companies should have their financials audited by reputable international accounting firms such as Deloitte, KPMG or PwC so investors will have confidence in their financial performance to date.

Team pedigree is another checkbox that investors would be looking at in order to feel comfortable. Ideally, management should have international operating experience from globally recognised companies.

The right model

US investors have already begun placing bets on emerging companies that address both the needs of consumers and businesses in their respective markets. Consumers and businesses need access to financial products whether it's in banking, payments, credit, asset management or insurance and those are the services many fintech companies are offering in a more efficient or cost-effective manner. To the extent that fintechs operate in markets where it's not efficient or expensive to obtain one or more of those services from incumbents, that creates an opportunity for disruption and with early evidence of success, fintechs can attract the interest of US investors.

Assessing competitive advantage

Finding competitive advantage is key

Customer acquisition costs and lifetime customer value are both key areas for companies to demonstrate their competitive advantage. If a company can offer the same value to the customer at a lower cost or if they can offer premium value at the same cost as competitors, these create sustainable competitive advantages. Perhaps the best example of this is Ant Financial. Its competitive advantage comes from its ability to acquire customers inexpensively from its affiliation with Alipay, which has 700 million users. Once these customers have been acquired, Ant offers a variety of financial products including banking, credit, insurance and asset management. By monetising its client relationships by delivering multiple products, Ant generates value in multiple ways.

Scaling beyond the home market

Given most developed and developing markets are smaller than the US, fintechs should demonstrate their model can be scaled beyond its home market. Unless fintechs operate in large markets such as China or Brazil, their ability to address customer needs in adjacent or related countries expands the total addressable market.

Best example of US model transfer to developing markets

One of the best examples is Transferwise. The company took a similar model to Paypal and Venmo which both focused on peer-to-peer payment service and then expanded their model to focus primarily on cross-border peer-to peer-payment solutions. While Paypal was the innovator in this space,

Transferwise has since become a market leader, securing a $3.2 billion valuation in 2019 in a transaction led by Lead Edge Capital, a US-based private equity firm with participation from BlackRock. Previously, Institutional Venture Partners and Andreesen Horowitz had invested in the company's earlier investment rounds.

Home advantages for local innovators

Fintech innovators going up against global giants have the advantage of not relying on legacy technology or conflicting business objectives. Furthermore, the cost of customer acquisition, technology and product development continues to decline allowing companies to build and test their products at a fraction of the cost from a decade ago.

As an example, Mutuo Financiera, a Mexico-based fintech and innovative commercial vehicle leasing platform has integrated its technology with natural-gas refueling stations and their data systems that collect vehicle mileage and refueling data. Mutuo's technology enables it to adjust its lease prices based on the cost of natural-gas and miles driven and collect lease payments whenever their natural-gas powered vehicles refuel.

Lower technology development costs and its partnerships with commercial vehicle fleets has allowed Mutuo to test its product and quickly iterate its technology to ensure it meets the needs of its market segment. Mutuo, due to its technology driven approach, is able to address a market need where other finance companies focus on more traditional leasing solutions. [Middlemarch has an equity stake in Mutuo and helped facilitate a $100M financing earlier this year to address a $2.5B annual opportunity.]

Timing the investment cycle

For growth equity-oriented investors that are seeking to deploy $25 to $50 million of equity, emerging growth international middle market companies represent a unique opportunity to invest after the majority of the execution risk has been mitigated and the company is now focused on scaling in its target market. This timing offers an advantage of coming in before larger private equity funds or when the company may be ready for an IPO, allowing investors to generate a more meaningful return.

While the US has been the foundation for innovative and disruptive technologies across fintech, proven business models are now emerging in other markets outside of the US. Investors are now seeing opportunities in fintech companies outside of the US to generate attractive returns in their respective markets. So why not strike while the iron is hot.

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