Brazilian banks set for disruption

Analysis of opportunities in Brazilian fintech

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Contents

Key Takeaways	1
Introduction	1-2
SME Lending	3
Back-office Infrastructure	4

Key Takeaways

- Brazilian consumers are currently saddled with the world's third-highest borrowing costs. We believe alternative lenders that can leverage technology to offer consumers more attractive rates have an opportunity to gain market share from politically influenced incumbents.
- According to Statista, Brazil boasts the fourth-largest number of smartphone users in the world: 80 million. As we anticipate substantial fintech disruption to be facilitated by smartphone-based tools and applications, the country is certainly primed for an increased share of this activity.
- Online consumer and SME credit products, as well as back-office SaaS platforms, have accounted for the majority of VC financings as they hold the potential to transform otherwise unorganized operations into scalable investment opportunities.

Introduction

The structure of the incumbent Brazilian banking system makes it uniquely susceptible to disruption by fintech innovation. According to research by Charles Calomiris of Columbia University and Steven Haber of Stanford, Brazilian banks have historically been a conduit for populist policies and government largesse rather than an engine to fuel private sector growth and household wealth. The political influence on banks has led to overstaffing and inefficient back-office processes. On top of these inefficiencies, Brazilian megabanks typically offer a poor customer service experience; visitors to retail branches are typically greeted by heavily armed private guards and bulletproof glass.

Most active investors by deal count

FIRM NAME	DEAL COUNT
Kaszek Ventures	10
QED Investors	8
Monashees Capital	8
500 Startups	7
Ribbit Capital	6
Redpoint eventures	6
SP Ventures	6
Valor Capital Group	6
Sequoia Capital	5
Bozano Investimentos	5

Source: PitchBook
*Data as of 2009 to 10/10/2017

While consumers suffer, this highly centralized system has spawned an oligopoly of large, politically connected institutions. Three of the top five by assets—Banco do Brasil, BNDES and Caixa Economia Federal—are backed outright by the government. Further, according to a recent talk delivered to the IMF, the five largest banks account for 71% of all lending in the country.

The lack of competition has made Brazilian banks highly profitable. Consumer lending rates with APRs in the hundreds of percent (not basis points!) are not uncommon, though typical APRs stand closer to 50%. These have contributed to healthy margins given the wide spread between lending rates and deposit rates, even as the country recovers from a deep recession. Illustrating the extent to which borrowing rates have risen in the country, The World Bank estimates that as of 2016, consumer borrowing costs are higher only in Madagascar.

The egregious interest rates charged by the incumbent banking monopoly has created opportunity for alternative lenders and credit card issuers. In the US, a uniform rate on federal student loans historically deterred lenders; however, fintech startups such as SoFi have been able to penetrate the market by using technology to lower underwriting costs. This has allowed them to target borrowers with limited credit histories yet impeccable educational credentials and strong career prospects, and offer loans at lower rates. A similar approach is being taken by Brazilian fintech lenders, which have been able to find a profitable market equilibrium interest rate below the current high rates charged by issuers.

Mobile technology has been the primary tool for fintech disruption in the US and China, where many firms have been successful with a mobile-first strategy to compete with brick-and-mortar financial services. With 80 million users, Brazil represents the world's fourth-largest smartphone market, behind only China, India and the US. A mobile strategy allows fintech startups to broaden their reach beyond a physical branch network. In turn, this enables such lenders to break the limitations that can deter traditional regional banks from lending to more profitable market segments that could fall outside of their geographical jurisdiction. Brazil is also the third-largest market of Facebook users globally. In addition to garnering increased marketing reach via mobile strategies, social media has served as an entirely new source of alternative data to analyze creditworthiness and product-market fit, while also serving as a substantial customer acquisition tool.

Most frequently funded companies

FIRM NAME	DEAL COUNT
ContaAzul	7
Creditas	5
Nubank	5
GuiaBolso	4
QueroQuitar	4
Asaas Gestão Financeira	4
Vindi	4
Bidu Corretora	3
Concil	3
Contabilizei	3
WorkCapital	3

Source: PitchBook
*Data as of 2009 to 10/10/2017

SME Lending

Brazilian SMEs have been largely shut out from credit markets unless politically connected. BNDES, the state-run development bank, has received the nickname Bolsa Empresário, or ”tycoon grant,” a pejorative reference to Bolsa Família, the state welfare scheme for poor families. In spite of extensive branch networks, the large banks target primarily multinational enterprises and retail clients. This strategy stems from a desire to build access to foreign currency deposits and revenue streams in a country with a long history of hyperinflation.

During Brazil’s recent recession, many banks further cut lending to the smaller enterprises hardest hit by the downturn, given their riskier credit profiles and banks’ priority to maintain marquee relationships. This has created new demand and opportunities for fintech innovators; that said, while Brazil boasts the necessary human capital for innovation, the Brazilian fintech ecosystem is a few years behind the US and China. As Brazilian fintech gains traction, startups are quickly finding new areas to branch into. Another interesting area of innovation is point-of-sale payments providers that offer revenue-based financing based on transaction data. While this has been done successfully in the US, Brazilian consumers make a greater percentage of purchases in cash as various barriers to credit card usage deter consumers. Unlike the US or other developed nations, credit cards in Brazil come with high fees beyond interest payments—even for borrowers who pay back in full each month. However, should cashless payments become more widespread, a new frontier enabled by payments data will foster further innovation for tech-enabled lenders.

Most heavily funded companies

FIRM NAME	CAPITAL RAISED ($M)
Nubank	$178.6
Canal do Credito	$36.0
Creditas	$30.9
GuiaBolso	$26.7
ContaAzul	$26.0
Avante	$11.7
Bidu Corretora	$8.9
Nibo	$6.3
Concil	$3.7
Bling	$3.0

Source: PitchBook
*Data as of 2009 to 10/10/2017

Back-office Infrastructure

Another factor contributing to lack of access to credit for SMEs has been the opaque recordkeeping practices of closely held small businesses. Several VC-backed Brazilian fintech companies have attacked the market for back-office management and accounting software. Brazilians refer to these unglamorous B2B financial software businesses as “in the kitchen” (cozinha). They aren’t as flashy as lending or other more consumer-facing services, but have been getting a disproportionate amount of interest from VCs in the country. One example can be seen in the invoicing platform ContaAzul, a tool for SME management to more easily outsource accounting tasks. Some of the need for these services has in part risen out of the traditional “make work” nature of Brazilian financial institutions, whereby many accounting professionals gain their initial experience through apprentice programs rather than educational institutions. These professionals frequently take the highly inefficient processes learned at these state-backed banking institutions and adopt the same practices in the private sector. Furthermore, tax policy contributes to even relatively large businesses remaining closely held as owners pay themselves dividends, which are untaxed under Brazilian law, rather than sell equity stakes. This can create a disincentive to build proper back-office infrastructure as owners may not be looking to sell neither majority nor minority interests to outside investors in the near future. As SMEs use software to standardize their back-office and accounting practices, a potential benefit is that companies may be able to transform into more scalable businesses, and thus, new investment opportunities for private investors could arise down the road.

Select Company Profiles

Location: **São Paulo, Brazil** | Year Founded: **2013** | Capital Raised to Date: **$178.64M** First Funding Date: **July 2013**| First Funding Amount: **$2.0M** Latest Funding Date: **December 2016** | Latest Funding Amount: **$80.0M** | Latest Funding Post-Valuation: **$500.34M***

*Valuation is from January 2016 Series C venture funding

Description: Nubank offers consumers a no-fee credit card managed online and via Nubank's mobile app. With nearly 8 million applications and 500,000 consumers on its waitlist, the company can afford to be conservative in issuing credit, minimizing risk of default. Nubank generates revenue from from transaction fees, unpaid balance interest, and fees from purchases abroad. The company was founded by a former Sequoia employee, David Vélez, whose research into the Latin American VC ecosystem led to the foundation of Nubank. The company was subsequently Sequoia's first Latin American investment in 2013, spurring on further fintech investment in the region.

Location: **São Paulo, Brazil**| Year Founded: **2012** | Capital Raised to Date: **$68.75M** First Funding Date: **March 2013** | First Funding Amount: **$500,000** | Latest Funding Date: **October 2016** | Latest Funding Amount: **$19.24M** | Latest Funding Post-Valuation: N/A

Description: GuiaBolso, often compared to Intuit's Mint.com product, began by offering a mobile personal finance management application to consumers in Brazil, focusing on budgeting and debt elimination. The company has since expanded to provide information about users' credit status (by reviewing their taxpayer ID, called a CPF), and help users review, optimize, and secure personal loans. Notably, GuiaBolso received funding in 2016 from the International Finance Corporation (IFC), marking the development institution's first investment in Brazilian fintech. Other backers include Ribbit Capital, Kaszek Ventures, QED Investors, Omidyar Network, and several angel investors.

creditas

Location: **São Paulo, Brazil** |
Year Founded: **2012** | Capital Raised to Date: **$30.90M**
First Funding Date: **October 2013** | First Funding Amount: **$1.4M**
Latest Funding Date: **February 2017** | Latest Funding Amount: $19.0**M** |
Latest Funding Post-Valuation: **N/A**

Description: Creditas is an online lending platform which provides Brazilians low interest rates by allowing them to use homes and cars as collateral. The company uses capital from VC fundraising and bank partnerships for its credit program, though its loan origination and processing platform provides a degree of freedom from reliance on banks. Creditas' risk-sharing model brings asset-backed leverage to the mainstream credit market, which was previously predicated on costly short-term unsecured loans. Creditas has also received funding from the IFC, Kaszek Ventures and QED Investors, in addition to Naspers Ltd, Quona Capital, and Accion, amongst others.

avante

Location: **São Paulo, Brazil** |
Year Founded: **2012** | Capital Raised to Date: **R$38.6M** ($11.73M)
First Funding Date: **July 2017** | First Funding Amount: **R$38.6M**
($11.73M) | Latest Funding Post-Valuation: **N/A**

Description: Avante provides microcredit, banking services, and payment processing to Brazilian "microentrepreneurs"—formal and informal business owners such as street vendors and caregivers. After its 2016 acquisition of Israeli startup Sling, much of Avante's mobile and online financial service technology is developed abroad and supplemented by on-the-ground credit agents who evaluate entrepreneurs throughout 100 Brazilian cities. As a certified B Corporation, the company's accessible, tech-based financing targets low-income Brazilians, with an average loan size of 2,600 reais or about $820. The company received backing from impact investor Vox Capital in mid-2017.