Fintech: All Serviceable Addressable Markets are Not Created Equal

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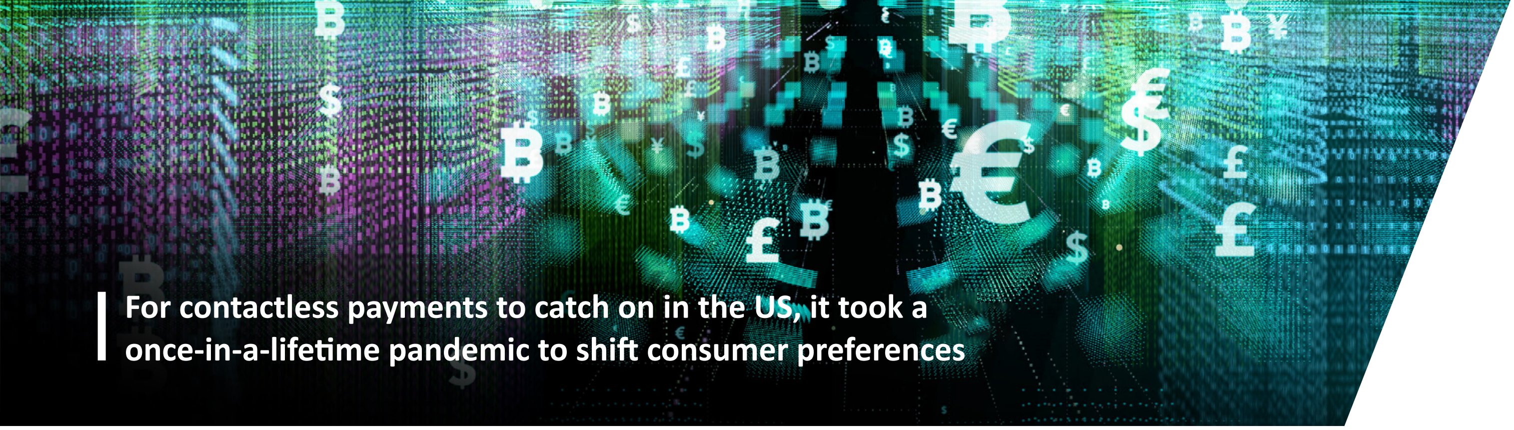
When evaluating new investment opportunities, a key part of due diligence is determining the size of the company's Serviceable Addressable Market ("SAM"), or the market opportunity that exists within the company's existing core products / services and geographical reach. To determine the size, Adams Street starts with one defining question: is the SAM local or global?

For many software companies, the default assumption is that the SAM is global. This is for two key reasons. First, software solutions that solve a problem in one country, are often able to solve the same – or similar – problem in another country. For example, because malware doesn't discriminate based on location, cybersecurity threats are effectively global threats – all companies need to protect their assets against cyber criminals. Therefore, most cybersecurity products' serviceable addressable market is global, not local. This same line of reasoning can be extrapolated to many other software verticals. Second, while there might be some localization product development as well as go-to-market investment needed, generally speaking, there aren't any major barriers to geographic expansion for most software companies.

However, when we are evaluating Fintech companies, our default assumption is that the SAM is local. Why? There are two key characteristics inherent in many Fintech markets that result in a default local SAM:

1. Consumers' financial preferences and needs differ by locality and population demographic
2. Fintechs operate in highly regulated markets and that regulation differs significantly by geography



Consumers' Financial Preferences and Needs Differ by Locality and Population Demographic

Financial preferences and needs differ so significantly by locality and population demographic that it makes it very difficult for Fintechs to have a single product with global appeal. Even simplified down to one aspect of our financial lives - investing - consumers have an extremely wide variety of desired outcomes based on factors such as age, assets, time horizon, risk profile, and investing acumen, among many others. One of our investments in this space is Robinhood, the popular investment platform that allows users to buy and sell stocks, options, ETFs, and cryptoassets with zero trading commissions. Robinhood's mission is to democratize finance for all and empower the next generation's participation in the financial system. As a starting point, Robinhood is targeting the tech and mobile savvy demographic of 18-39 year-olds in the US by creating an effortless user experience.

However, there are a variety of other investing tools which target users with different needs. For example, there is an enormous Muslim population who would like to make investment decisions in accordance with Islamic principles. This includes avoiding certain sectors such as the manufacturing or marketing of alcohol, gambling or gaming activities, and conventional interest-based financial services, among others. Wahed, a company that raised a $25 million Series A from Aramco Ventures, is addressing this market need by creating the world's first halal robo advisor, providing investment services that are compliant with the Islamic religion. Another company, Groww, is addressing Indian consumers' specific investing pain points. While Indians have a high savings rate, these savings have traditionally been invested in physical assets and rarely in public equities. As a result, Groww is targeting these first-time investors by offering approachable and easily understandable investment products such as zero-commission mutual funds.

Investing is not the only vertical of Fintech where we think consumer preferences create hurdles to global expansion. Consumers have a variety of payment options to choose from but often select one method over another largely due to cultural preference. For example, contactless payments have been incredibly popular in the UK and Asia for years. However, in 2018 just 3% of cards in use in the US were contactless, versus 64% in the UK and up to 96% in South Korea.[1] For contactless payments to catch on in the US, it took a once-in-a-lifetime pandemic to shift consumer preferences.

Our portfolio company, GoCardless, is addressing a different payment preference: direct debit over credit card. While the typical US consumer prefers to use their credit card to get reward points, many consumers around the world prefer limiting their debt position and thus typically reach for their debit card instead. GoCardless is capitalizing on this trend and made it simple to collect recurring payments from customers by building a unified global payment infrastructure on top of the fragmented bank direct debit rails.

Fintechs Operate in Highly Regulated Markets and that Regulation Differs Significantly by Geography

Not only do consumer preferences influence the size of a SAM, so do differing regulatory frameworks. Because of the importance of financial infrastructure to governments for consumer well-being, economic stability, and national security concerns, it is typically highly regulated. We have seen over and over again the regulatory challenges that Fintech companies face in their plans for growth.

Two recent examples show how important navigating the local regulatory environment is to even the largest and most established Fintech companies:

- First, earlier this month, the Shanghai stock exchange announced the postponement of Ant Group's highly anticipated IPO. This delay occurred one day after China's top financial regulators held a closed-door meeting with Ant and unveiled significant regulatory changes "to bring stability to the Fintech sector". Ant was caught off guard by the new regulations, despite years of courting regulators; they even brought on government-controlled investors and attempted to rebrand as a technology company to avoid competing with state-owned financial institutions. As of this writing, there is no new date for Ant's IPO, and many speculate a second attempt will not occur for at least six months.
- Second, in the same week, the US Department of Justice sued to block Visa's planned $5.3 billion purchase of the start-up, Plaid. The DOJ is alleging that the deal would allow Visa to unlawfully maintain a monopoly in online debit, leading to higher prices, less innovation, and higher entry barriers for online debit services.

While tech companies in the past have been encouraged to "move fast and break things," these two high profile events are reminders that for Fintech, regulators are heavily involved in how and where Fintechs operate.

For Fintech startups, local regulation can create a bubble of opportunity preventing foreign incumbents from accessing certain markets

For Fintech startups, local regulation can create a bubble of opportunity preventing foreign incumbents from accessing certain markets. For example, regulation plays a key role for point-of-sale payment providers. In every country worldwide, a payments license is needed to process point-of-sale transactions. Square, the mobile payments processor that has dominated in the US, has been unable to expand into China given the regulatory environment. Adams Street's portfolio company Yeahka (SEK:9923) has homefield advantage, given its headquarters in Shenzen, China. At the time of our investment, Yeahka was one of less than a handful of licensed mobile point-of-sale providers in China due to the rigorous application process. This gave Yeahka a significant head start.

What Does all this Mean for Our Investment Approach?

Unlike the overwhelming majority of software companies, a Fintech company may be interesting because of its location and not *despite* of its location. Across most software verticals, traditionally it was a dangerous proposition to "invest in company A because it is in country B." For a Fintech company, however, if country B has unique regulatory requirements and demographic and population preferences, "investing in Fintech A because it is in country B" can be a primary rationale to make the investment. ■

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1. Source: Why US Banks Should Make Contactless Cards an Immediate Priority. Published in 2018 by A.T. Kearney.