

CASE STUDY

Making the Case: Konfio



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MUNK SCHOOL
OF GLOBAL AFFAIRS
& PUBLIC POLICY



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1.1 Background

Latin America remains one of the most unequal regions in the world, second only to the Middle East. In Latin America, the top 10% of the population holds 54% of the total national income.¹ Within the region, Mexico stands out as an exceptionally unequal country where the total percentage of income held by the top 10% sits at 58; Chile and Brazil are also accompanied by higher-than-average rates of inequality within the region.²

A report by the IMF states that income plays a key factor in determining financial inclusion in the region.³ In this case, a gap has been identified in which those with low income face barriers to financial inclusion, which can further perpetuate their low-income status. Attempts to increase income by starting businesses, however, can often be stifled by the barriers currently posed by traditional financial systems. If an individual is looking to scale their small business, they are likely to find themselves denied loans from a bank or forced to turn to a microlender.

In a recent report by Nasdaq, lending was highlighted as an opportunity for disruption by the fintech industry.⁴ Getting approved for credit through traditional financial institutions in Latin America is increasingly difficult. Although microloans did make their way to the region in the 1990s, they were accompanied by exorbitant interest rates, sometimes as high as 120%.⁵ These high interest rates trap vulnerable people in debt cycles and represent a cost barrier for entrepreneurs.



1.2 Konfio: Making business loans for MSMEs more accessible

It is this barrier that led to the inception of Konfio, a Mexican-based fintech company that aims to lower barriers for entrepreneurs looking to access loans. Konfio was created in 2014 by David Arana, a Mexican native who was working on Wall Street and identified this gap in the market. In a 2016 interview with Accion he noted that during his time on Wall Street his company was repeatedly funding already large and well-established firms, limiting the potential for small businesses to scale up.

Konfio was created to target micro, small and medium enterprises (MSMEs). In his 2016 interview, Arana noted that 95% of companies in the region are micro and over 5 million are not serviced by traditional financial institutions.⁶ Closing this gap requires pivoting away from traditional ways of issuing credit. To this end, Konfio uses a unique algorithm that scans existing data points to gain an understanding of the customer's transaction patterns and make a credit decision within minutes. Today, Konfio has grown past being just a lender and now also handles software tools and payment platforms, making scalability even more accessible for MSMEs.

2.0

Built for All: Applied



2.1 Pillar One: Equitable access to resources and opportunities

Outcome: Financial systems are accessible, safe, and affordable for everyone.

Strengths of the Konfio approach

The very essence of Konfio's business model is to help small businesses expand their operations and compete in the market by leveraging technology and data analytics to grant small business loans. According to the OECD, "there are 4 million SMEs of which 97.4% are microenterprises that represent 12.4% of total gross production (TGP) and employ 47.2% of the workforce".⁷

Microloans are a vital component for small businesses in Mexico, which make up the majority of the Mexican economy. Konfio has leveraged technology to assess credit and deliver loans to those who do not have access to financial systems. In 2016, Konfio was recognised for its efforts and received an investment of \$8 million from the Accion Frontier Inclusion Fund.⁸ Now valued at \$1.3 billion in 2021,⁹ Konfio has established themselves as a "unicorn" in Mexico, having grown exponentially and become a financial player serving microbusinesses and an inclusive alternative to the traditional banking system, which often neglects small businesses.

Konfio specifically targets underserved businesses including MSMEs without any formal credit history, strengthening Mexico's local economy as a whole by providing capital to boost their businesses. Co-founder and CEO, David Arana, attested that Konfio's services have positively impacted more than 50,000 families through their targeted loans.¹⁰

Area for improvement

Despite being a healthy alternative for MSMEs in Mexico to receive lifeline loans for their survival, Konfio still boasts an average interest rate of 28%, which can be high for many MSMEs struggling to survive.¹¹

While Konfio's interest rate is competitive relative to Mexico's national average for microloans, which hovers over 60%, Konfio has room to improve in comparison to other Latin American countries who provide a lower interest rate for MSMEs.¹²

Lessons for action

With the COVID-19 pandemic negatively impacting MSMEs in Mexico, Konfio adapted by forging relationships with financial institutions and leveraging high-speed fintech to access their capital to deliver to underserved MSMEs across the country.¹³

Expanding their product offering and diversifying their platform and tools has enabled Konfio to better serve their clientele. Konfio's clientele experienced an average increase of 28% in annual sales as well as a 14% average increase in transactions.¹⁴ This has also benefitted Konfio, whose product adoption has increased from 1.0 to 1.4 services per customer.¹⁵



2.2 Pillar Two: A level playing field for work and competition

Outcome: Circulating capital and making capital accessible to marginalised populations

Strengths of the Konfio approach

Konfio levels the playing field by providing accessible business loans to a financially under-represented and underserved population — micro and small business owners who would typically be deemed 'a risky investment' by traditional financial institutions. Leveraging a proprietary algorithm Konfio is able to make credit decisions differently than traditional financial institutions while offering lower interest rates than traditional microfinancers, thus lowering barriers to financial inclusion.

Konfio furthers its inclusivity agenda by investing in women entrepreneurs. In Mexico, only 39 % of small and medium businesses are led by women.¹⁶ Konfio aims to increase this number by extending further financial support to women entrepreneurs; to do so, they have partnered with the Inter-American Development Bank (IDB). IDB has invested an initial \$36 million in Konfio with the possibility to expand to \$60 million USD.¹⁷ These funds are available to use for up to 6.5 years and are disbursed and repaid over three cycles. The goal of this partnership is to expand access to capital for women-led businesses in Mexico.¹⁸

"Mexico is a very interesting place for several reasons, but I think it's one of the best places to be for fintech — especially in Latin America. It's a good environment to be in. It's important to work with a partner locally and also a partner outside of Mexico who has seen other businesses grow and who has all the best practices needed to survive and to grow."

– David Arana, CEO & Co-founder of Konfio, Accion podcast

Area for improvement

While Konfio has implemented initiatives to increase the number of female business owners and make business loans more accessible to them, only 33% of their disbursed loans reached women-owned business. Meanwhile a total of 39% of MSMEs in Mexico are owned by women.¹⁹ If Konfio wishes to close the gap for women entrepreneurs accessing financial services it would be beneficial to explore any structural reasons as to why their disbursements are reaching women-led MSMEs at a lower rate.

Lessons for action

Actively pursue incorporation of marginalised communities with the recognition of class, race and gender intersections posing as barriers for financial inclusion.

Going forward, Konfio can increase outreach to business owners who may lack awareness of Konfio's digital academy, which provides important resources for business owners on leadership, operations and innovation.²⁰

2.3 Pillar Three: Collective stewardship of shared resources for future generations

Outcome: Sectors align long-term R&D efforts to solve complex societal challenges that transcend any one industry or sector

Strengths of the Konfio approach

Konfio is maximising the value added to the Mexican economy by focusing on MSMEs. According to the OECD, there are over 4 million SMEs in Mexico of which 94.7% are microenterprises employing 47.2% of the workforce.²¹ In prioritising support to underserved MSMEs, Konfio is increasing the chances of MSMEs' survival, equipping them to grow, thrive and more fully contribute to regional economic development. With just under half the population employed by microenterprises, improving business success improves workers' quality of life and allows micro and small business owners to transition from a focus on survival to local economic development, innovation and wealth generation for future generations.

Opportunities for enhancing inclusion

COVID-19 has increased financial institutions' hesitancy to lend to 'more risky' MSMEs. Since the start of the pandemic, Konfio has had large enterprises and financial institutions reach out wanting to address the challenges together.²² Konfio proprietary technology can provide financial institutions with the technical tools necessary to both critically assess organisational risk and approve and distribute loans in a more efficient and cost-effective manner, benefitting entrepreneurs as well as financial institutions.

The barriers hindering MSMEs from accessing capital are not unique to Mexico. Entrepreneurs and small business owners are facing similar challenges across Latin America. As Konfio grows, branching out to serve more countries in the region will improve inclusion for MSMEs (which typically make up the majority of businesses in an economy) as well.

Offering additional support or benefits to forward-thinking MSMEs focused on solving unique local problems, meeting regional needs or developing innovative solutions to pressing issues such as sustainability could incentivise Konfio and the MSMEs it supports to prioritise collective stewardship for future generations to a greater extent.

"Any company, any industry needs a financial partner to succeed. And there's a lot to be done. There's been a strong wave in Latin America as well for fintech companies to grow. There's obviously a lot of business opportunities there and a lot of inefficiencies."

– David Arana, CEO & Co-founder of Konfio, Accion podcast

Lessons for Action:

Partnering with organisations and companies that provide real-time data can be an effective way of facilitating risk analysis. Relatedly, artificial intelligence and data analytics can be powerful and cost-saving measures. Konfio has been able to leverage technology to drastically reduce the need for field visits, which can sometimes cost 66 cents for every dollar lent.²³ By relying on transactional data from partners like Mercado Libre, more MSMEs are eligible for financing, able to receive financing quicker and Konfio's operating costs are reduced – a win-win for all involved.

While real-time data offers advantages for risk analysis, future initiatives will need to work closely with governments and financial institutions to overcome regulatory obstacles like privacy concerns. Although Konfio can provide organisations with support in facilitating data analytics for risk assessment, regulatory challenges are currently the biggest barrier preventing financial institutions and the government from leveraging existing data as effectively as they could.²⁴

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