

Financial Inclusion in the Digital Economy-A Report of ADB

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ABSTRACT

Inadequate access to financial services is a problem facing a significant portion of the population across the world. However, the nature of the challenges varies significantly among developed and developing countries, and even between different groups of the population in the same country and region. Only 62 percent of the adults globally have access to basic financial services, defined as having a bank account or a mobile money account. Small enterprises face similar challenges in access to credit that limits their ability to grow and thrive.

1. Introduction

Billions of adults across the globe lack access to the financial services they need to achieve even modest levels of financial well-being. Many households and small businesses in emerging markets have no or very limited access to formal financial services. Even in developed countries, they only have access to a limited menu of cost-effective products from financial institutions for addressing their financial needs. Over two billion unbanked adults in the world, representing 38 percent of all adults globally, lack access to basic financial services and another 57 percent have basic accounts but do not have access to diversified investment and savings options, low-cost payments systems, core household and business insurance, or credit. The resulting poor financial wellness—indeed, for many households and small businesses, the resulting financial insecurity—is not just a low-income bottom-of-the-pyramid problem in developing economies. It has been democratized with growing income inequalities in developed economies too, and now is an issue for nearly half the American population. Achieving financial inclusion and financial security is not an end in itself, but a means to an end. It is broadly recognized as critical to reducing poverty and achieving inclusive economic growth. It also has positive effects on consumption, employment status and income, and on some aspects of physical and mental health. Greater financial inclusion is one of the key priorities of the United Nations' Sustainable Development Goals as it enables households and informal economies to increase resilience and capture economic opportunities.

Common threads of limitations and frictions across countries at different stages of development and different parts of the population are: 1. Access 2. Product market Fit 3. Affordability

Access

The availability of financial services can be limited by basic problems with access, for example where they are only distributed through branches that are not available in rural areas. Access can also be restricted by regulation that establishes requirements that parts of the population cannot fulfill. In more established markets, services may be widely

available but access is hampered by confusing and complicated terms, limited transparency, and poor usability. Technology today offers a range of solutions to these problems. Example of this is how innovative companies have used mobile phones, online marketplaces, comparison sites and big data to solve these problems in different parts of the world.

Product Market Fit

Another common problem is that existing and available financial products do not address the needs of large segments of consumer demographics. This can be due to the design of the products or services or the way they are sold, for example where there are requirements such as minimum balances, credit scores or other thresholds that cannot be met by a large number of people. Often pricing becomes a barrier to usage when pricing terms do not accommodate the capabilities of potential users, either because prices are simply too high or because prices are set and charged in a way that is too inflexible to be affordable for them. The situation is no different for micro-enterprises and small businesses. They need products and services that are appropriate for them but their financial needs are often characterized as high in complexity and low in scale. They have become the Goldilocks of digital banking: corporate solutions are too complex and at too large a scale for them but retail ones are too simple. Small businesses as a result often must resort to using retail products, though their diverse needs call for a more customized service. Banks are often reluctant to serve this segment, absent regulatory pressures or as part of philanthropic ambitions.

Affordability

For financial services to be widely available, prices need to be affordable and hence the cost to the providers must be sufficiently low so that the services can be offered at a profit in spite of the limited revenues. If the providers are unable to generate profits, they have no ability or incentive to scale the services. Unfortunately, offering financial services to small businesses streams to the provider. Technology can help providers to lower their costs along the whole value chain, from distribution to customer service and back-office operations and

thereby plays a key role in making financial services more widely available. Examples of such include digital distribution by mobile phones; cheaper customer sourcing and servicing by using Bots, messenger services, and social networks; better fraud prevention and low-income households tends to have higher cost while often also offering lower revenue and credit assessment using machine learning; and lower back-office costs by automating previously manual processes.

The innovations outlined in this situation highlight different solutions to these three core problems that we will highlight across different verticals. The report does not aim to be complete but rather uses select examples to demonstrate how greater financial inclusion can be achieved by building innovative business models and applying technology to different types of financial services for individual consumers and small businesses. As we consider these different efforts to expand financial services, we broadly define financial inclusion for consumers as access to cost-effective means of managing their financial lives— spending, borrowing, saving & investing, and protecting their financial well-being through insurance. For businesses, we define financial inclusion as having access to fairly-priced funding and working capital facilities, insurance, and efficient means of managing their revenues and expenses. All the innovations and companies outlined in this report are pursuing strategies for expanding financial capacity and, as such, are increasing financial inclusion according to this definition. And, importantly, all of these companies are for-profit entities, demonstrating that it is possible to provide services that expand financial capacity while being profitable.

The digital economy is rapidly developing worldwide as the largest driver of innovation, competition, and growth. Even though many people have been excluded, tremendous opportunities are available for the digital economy to support financial inclusion for sustainable economic development.

By discussing opportunities and challenges, that helped to identify how multilateral development banks such as ADB can support the development of digital finance through policy advice and providing financing for projects that use digital financial technologies.

The report focused on the following themes:

- Trends in digital financial inclusion—key opportunities and challenges for reaching the
- unbanked and under banked
- A customer-centric approach to financial inclusion
- Digital business models for accessing financial services
- Supervision and regulation of digital financial services
- Cost and value of digital finance

The report based on conference was organized with the support of Transactives. The main points of the reports are;

Bambang Susantono Vice-President Knowledge Management and Sustainable Development Group Asian Development Bank,” It is fascinating to learn the importance of knowledge management, given the speed of technological change in a new digital economy that is often being referred as

the “sharing economy”. A sharing economy generally brings together the full range of individuals, companies, governments, and policy makers to share information and resources, creating a network effect and impact that increases access and value for all involved. To many of us, “sharing resources” is emerging, will expand and flourish in the coming years as a new norm and a “new normal”.

2. Facts

Living in the Digital Economy

- 90% of the world’s data has been generated in the last 2 years
- By end 2020, 212 billion things will be connected
- In 2015, 51% of workloads were processed in the cloud
- 4.By 2020, 6.1 billion smartphone users in the world

Rapid change, digital finance trends, and why they matter

The digital economy is rapidly developing worldwide. It is one of the most important drivers of innovation, competitiveness and growth. The advancement and adoption of digital technologies and business models will enable companies to achieve greater scale, penetrate new markets more swiftly, and understand their customers better. Your collective participation underscores the potential business and new job opportunities that this sector is expected to create in Asia and the Pacific. This is in addition to maximizing development impact by bringing more improvements in living standards.

Customer centricity and new business models

The digital footprints we make in every transaction or interaction can help financial service providers to interact more easily and adapt to the financial needs of a diverse set of customers. Digital technologies and big data now allow financial service providers to more effectively serve the financially excluded, with a “customer-centric” approach. New technologies from groups like Fino in India are also helping to provide access to affordable financial services to more than 50 million people who live at the bottom of the economic pyramid, that is, on low incomes. New fintech players like bKash in Bangladesh are reaching out to more than 22 million people in Bangladesh, and grow even more rapidly than the trail-blazing M-Pesa in Kenya.

3. The Role of ADB

ADB’s vision is an Asia and Pacific region free of poverty. Its mission is to help its developing member countries reduce poverty and improve the quality of life of their people. Despite the region’s many successes, it remains home to half of the world’s extreme poor. ADB is committed to reducing poverty through inclusive economic growth, environmentally sustainable growth, and regional integration. Based in Manila, ADB is owned by 67 members, including 48 from the region. Its main instruments for helping its developing member countries are policy dialogue, loans, equity investments, guarantees, grants, and technical assistance.

The role of responsible and inclusive digital financial services is an important aspect of ADB's Strategy 2020. Our overarching strategy identifies supporting finance sector development through the role of innovation and the enabling environment as important drivers for inclusive economic growth. ADB is committed to assist its developing member countries in the development of digital financial services, and to assist the wider population and small business to benefit from its multiplier effects."

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– Bambang Susantono,
Vice-President, Asian Development Bank.

Digital financial services are changing rapidly with new technologies, new players, and new partnerships. While these developments and new financial players bring tremendous opportunities, policy makers and regulators also need to understand and balance challenges and risks against the potential benefits these developments offer.

4. Key Developments to Increasing Financial Inclusion

- **Identification and biometrics:** Developments in the use of national identification cards, especially those in India and Pakistan that support biometrics, not only facilitate know-your customer compliance, but also those that reduce risks and support transactional verification at much lower costs.
- **Faster payment infrastructure:** Technology now provides the opportunity to improve payment infrastructure. The importance and benefits of a faster payment infrastructure in lowering barriers and reducing costs for financial inclusion is key. The Unified Payments Interface System in India and the Faster Payments System in the United Kingdom (UK) are good examples to learn from.
- **Digitizing government-to-person (G2P) payments:** The Indian government's initiative to link direct transfers and other subsidies to the national identification system made substantial progress in including the poor in the digital space.
- **New models of collaboration and partnership:** On the supply side, Duncan Woods of Oliver Wyman pointed out that players entering the digital economy are creating new models and the kind of collaboration that leverages each other's strengths and expertise. Successful examples include Telenor in Pakistan and its partnership with Tameer Bank on mobile e-money accounts that brought together the infrastructure and outreach of a mobile network operator and the financial expertise of a bank to reach millions of customers.
- **Customer-centric models:** Examples of customer-centric models that work with people formerly excluded from financial access have been showing the way to address some of the barriers to inclusion. Realini referred back to the example of Juntos Finanzas, which developed solutions to the problem of account dormancy by sending reminders to mobile phones. She stressed how understanding and focusing on a problem and developing solutions that are based on "trickle-up approach" to learn the needs and demands of customers can get them on board and keep them engaged in making use of digital financial services. This included the innovative use of automated short message service (SMS) messaging that provides customers with reminders and encourages them to save or pay a loan on time. Crowd funding: As noted by Rochelle Tomas of the Bangko Sentral ng Pilipinas, crowd funding is a new development that can provide access to small and medium-size enterprises having difficulty obtaining financing from banks. These players offer more flexibility and use alternative data to provide access to financing for entrepreneurs.
- **Big data analytics:** Technology has allowed analysis of the mass of information now available through digital sources, generally referred to as "big data" analytics. This creates opportunities to reduce the costs of dealing with clients. Several private sector players have started using big data for credit and insurance, since this brings down the costs of providing these services, especially for low-income customers. This is where the economics come into play to support greater access to a full range of financial services. Prime examples include the more than 9 million customers of M-PESA who now have access to savings and credit from the Commercial Bank of Africa in Kenya and millions of small and medium-size enterprises that now have access to almost instant credit from Ant Financial in the People's Republic of China (PRC) using the analysis of e-commerce sales histories on Alibaba, a Chinese e-commerce company.
- **Digital currency:** The use of digital money through licensed e-money issuers is able to broaden the access and ability for people to send and receive funds as well as become financially included. While there are several examples such as M-PESA and Tigo Pesa in Kenya and Tanzania, there are also examples such as GCASH and Smart Money in the Philippines, Easy Paisa in Pakistan and WING in Cambodia.
- **Blockchain technology:** The use of Blockchain technologies also demonstrates the potential to support financial inclusion, especially in universal identity ownership,⁴ support for interoperable mobile payments infrastructure, trade finance, land titling, and ownership of moveable assets.
- **E-commerce:** Electronic commerce players in partnership with banks are also driving financial inclusion in new ways. Alibaba in the PRC and Lazada in Southeast Asia are helping to drive both access to

finance as well as broader digital inclusive economic opportunities to millions of customers.

- **Regtech (regulatory technology):** As Tomas pointed out, technological solutions are providing both the opportunity to better ensure regulatory compliance and allowing regulators to have better tools to supervise financial institutions. Regtech solutions can also give regulators more real-time access to data and information.
- **Trickle-up banking:** As Realini noted, an evident “trickle-up” approach is helping to advance banking services. The digital finance solutions new fintech players are using to serve low-income customers will make breakthroughs that will be adopted by mainstream banking and will benefit everyone.

5. The biggest challenge in digital financial services

- **Entrenched interests:** Realini pointed to entrenched interests and traditional actors that profit from the status quo and a lack of interest on their part as inhibiting the development and implementation of infrastructure that would facilitate new and more efficient digital financial services such as faster payments.
- **Know-your-customer verification:** As Woods pointed out, one of the biggest challenges still facing the digital financial services industry is how to deal with regulatory compliance around know-your-customer regulations. Countries that adopt proportionate, risk-based tiered know your-customer regulations that allow the opening of small accounts without the requirements imposed on larger accounts, broaden access to financial services and financial inclusion in general. Last-mile access: Woods pointed out that cash-in/cash-out and financial access points are still one of the biggest challenges in several markets, including in large countries like the Philippines and Indonesia.
- **Partnerships:** As Realini mentioned, while partnerships between traditional players like banks and new players, such as mobile network operators and fintech companies, offer tremendous potential to reach large numbers of customers, getting partnerships right is a big challenge. It also creates challenges for regulators as new players develop partnerships within the financial services ecosystem. As more players connect to financial institutions, they are all only as strong as the weakest link in the value chain.
- **Balancing regulation and innovation:** Tomas discussed the challenge of keeping up with fast paced changes in digital finance. She cited the principles that the Bangko Sentral ng Pilipinas uses in supporting new technological developments. These include openness to change, providing space for innovations in a test-and-learn approach, and adopting proportional regulations. Regulators have to be mindful, too, of protecting consumers, and complying with the requirements for

antimony laundering and terrorist financing. Realini emphasized the major barrier of regulatory burdens that players have had to contend with, and underlined the need for continuous review of regulations and innovation to support financial inclusion. New players should also be allowed, under controlled approaches, to offer more services.

- **Improving customer adoption:** On the demand side, technology is only good when people use it because it solves a specific problem for them. Woods underlined the challenge of improving customer adoption and said that deepening this is important to drive scale and encourage use. Simple design of products and services that address customers’ problems can drive adoption. Good examples of this are the M-Pesa “Send Money Home” product and India’s digitization of government transfers and benefits to millions of citizens, which was done to lower costs, plug leaks, and simplify administration. In addition, we need to see more financial deepening which would help to further broaden access to additional financial services such as savings and insurance.

Last, but not least the way forward and how ADB can support expansion of responsible inclusive digital financial services that promote broad-based economic growth. ADB understands that developments in digital financial services can help significantly expand the access of the poor to formal financial services, accelerate their rise from poverty, and build financial security.

ADB’s strategy commits to develop financial infrastructure, including alternative delivery channel ecosystems using digital platforms and to encourage and expand access to banking, insurance, and financial services, including remittances. We also see that digital financial services can promote the access of low-income households to financial services such as microfinance, micro savings, and micro insurance. Financial services can also increase financial literacy and SME access to financial services, including affordable credit, to facilitate their integration into global value chains and markets. ADB assists its members, and partners, by providing loans, technical assistance, grants, and equity investments to promote social and economic development. As an agent for change able to catalyze private sector involvement, we advise governments on the investment environment and support public-private partnerships. ADB refers to the trio of finance, partnerships (third party finance), and knowledge (through technical assistance) as Finance++. The organization is seeking to make this “an integral part of its long-term mission”. Our member countries to work with our finance sector teams in our regional departments, which can work under current or future program loans with government clients to ensure that financial technology is a vital consideration of any ADB project. This opportunity provides enormous potential for projects focused on government-to-person conditional cash transfers, microfinance, insurance, retail saving and credit products, and more. All target the key socio economic demographics of developing Asia. However, to be successful, such projects require coordination across various bank and nonbank players and with government stakeholders. Coordination is also

needed with our private sector operations division, whose job it is to represent the interests of financial institutions and emerging fintech players. Competition for good fintech investment and rich valuations is high. ADB must therefore find its niche as an enabler, targeting the more developmental

players that leverage technology for financial inclusion. ADB is uniquely placed to advise on this balancing act between private sector innovation and proportional risk management of our regulator clients.

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