

EXPLAINER

Three Ways to Enhance Digital Financial Services



A well-designed and implemented digital infrastructure for financial services can bring individuals into the formal financial system.

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Promoting national digital ID systems, interoperable systems, and cloud-based infrastructures can make digital financial services more efficient.

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Introduction

The coronavirus disease (COVID-19) pandemic has shown the importance of digital financial services. In many countries, digital payment systems have become a key channel for effective distribution of disaster support funds and has sustained business operations despite the lockdowns, social distancing, and other restriction measures. Global payment companies, such as VISA, MasterCard, and PayPal, reported a swift growth of contactless and online transactions globally during the pandemic.

However, the financial sector in many developing countries has struggled to adapt to digitalization as only 20% of adults from these countries have access to a formal financial system for savings.

A well-designed and implemented digital infrastructure for financial services can narrow the inclusion gap between genders, income levels, education, and degrees of urbanization, and bring individuals into the formal financial system

. It can also foster a healthy digital ecosystem by promoting fair competition and cooperation among stakeholders. Such infrastructure includes a national digital ID system for individuals and interoperable systems and cloud-based processing for small and medium-sized enterprises (SMEs).

Put in Place a National Digital ID System

Reliable identification has become even more important because most digital financial transactions occur remotely through mobile phones and computers.

In 2018, the Group of 20 major economies recognized the importance of digital ID as a crucial enabler for financial inclusion. It was estimated in 2019 that roughly one billion people lack official foundational identification. With no formal documentation, women, refugees, migrants, and other marginalized segments are often excluded from the financial services in place.

Having a digital ID system can eliminate the common challenges and fears that the unbanked and the underbanked experience when they register or join the formal financial sector. This will also make banking institutions more efficient in processing customer applications. For example, India's new financial accounts increased from 48 million in 2016 to 138 million in 2017 with the Aadhaar national ID system in place.

In times of emergency, a national digital ID system could make government distribution and management of disaster aids and subsidies, such as cash transfers, timely and efficient despite lockdowns and extreme restrictions.

Build a Healthy Digital Ecosystem

Interoperable systems are instrumental in building a healthy digital ecosystem through active participation of various suppliers and consumers.

Interoperability means the ability of systems and applications to communicate and share data in a seamless manner, without particular action required by the end user. With this in place, individual customers can compare various financial services and easily select and use the ones they need most from the service provider of their choice.

Interoperability keeps the competition between market players, like small fintech companies and existing financial institutions, fair and sufficient. This is crucial for providing digital engagement and more convenient services to customers in a demand-driven market.

To launch an interoperable infrastructure within a short period of time, strong policy support from the government is essential.

In the Republic of Korea (ROK), an open banking service was launched through the national retail payment system on 18 December 2019. As of June 2020, 72% of the economically active population in ROK has used open banking services, and 1.05 billion API transactions, which include balance inquiry

and direct debit transactions, were recorded.

Promote Efficiency with Cloud-Based Processing

Many countries are interested in digital payments to achieve financial inclusion, low-cost cash management, and payment system stability. However, payment is only one part of the whole picture. For peer-to-peer and peer-to-business transactions, digitalized payment systems are enough to handle most transactions. However, business-to-business transactions have other requirements.

For example, SMEs are expected to submit notary documents, such as business licenses, certificate of properties, and financial statements to lenders. For efficient operation, the task of processing these documents must be digitalized.

Cloud computing technology enables one to work and access documents anywhere regardless of their geographical locations. Cloud systems can also provide business flexibility and scalability to SMEs in the process of digital transformation, helping SMEs reduce operational and maintenance costs.

In this regard, SMEs' interest in cloud-based financial solutions has increased further because of the pandemic. For example, about 62% of the 1,000 SMEs surveyed in Singapore used online business solutions during the pandemic to improve the efficiency of their business operations and engagement with customers, yielding a 30% increase in overall cloud adoption from 2019.

Using digital financial services without the appropriate digital infrastructure for SMEs in place, such as cloud computing, would make business processing less efficient, scalable, and agile. The value of this infrastructure will continue to increase as business-to-business transactions, including those with SMEs, account for 97.8% of the cross-border payment market.

Conclusion

Digital financial services can help countries overcome the economic impacts of the pandemic and promote financial inclusion. The true value of a high-performance car shows when there is a highway on which it can run freely. The same goes for digital financial services. When accompanied by the right infrastructure, digital financial services can exhibit their true potential.

Resources

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Junkyu Lee

Chief of Finance Sector Group, Sector Advisory Service Division, Sustainable Development and Climate Change Department, Asian Development Bank

Junkyu Lee serves ADB's financial sector operations as Chief of Finance Sector Group. He is a seasoned economist with policy-making experience and knowledge in financial development and stability and international economics. Since 2013, he has led policy and operational discussions on banking stability, NPL resolution, and capital market development in ADB. As a former G20 finance advisor, he has deep policy-making experience in macroprudential policy, capital flows management measures, and financial development policy in the G20 and ASEAN+3 finance processes.



Lisette Cipriano

Senior Digital Technology Specialist (Financial Technology Services) Sector Services Advisory Cluster, SDCC

Lisette Cipriano currently works as a Senior Digital Technology Specialist in Financial Technology Services with ADB. Prior to her current role, she worked for Vodafone Group in the UK, as Commercial Country Manager for Ghana and DRC, providing support and consultancy services for Vodafone Cash/M-Pesa. Her areas of expertise include payments, financial inclusion, mobile money, and financial services in the EMEA region.



Jae-Deuk Lee

Financial Sector Specialist, Sustainable Development and Climate Change Department, ADB

Jae-Deuk Lee is responsible for fostering financial inclusion and developing innovative financial services. Prior to ADB, he worked for Korea Financial Telecommunications & Clearings Institute, as a payment infrastructure specialist. His areas of expertise include technology, financial services, and legal and institutional issues pertaining to payment and e-commerce.



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