INSIGHT

Increasing Financial Inclusion through Digital Solutions

Small and medium-sized enterprises often face difficulties in getting financial resources, such as credit and e-payment tools. Photo credit: ADB.

Digital finance offers the potential to reach underserved groups, but it is vital to first understand the needs of this segment.

Introduction

Digital solutions play a critical role in closing gaps in financial inclusion. According to a report, digital technologies could address about 40% of the volume of unmet demand for payment services and 20% of the unmet credit needs of people in the base of the pyramid and micro, small, and medium enterprises (MSMEs).

However, digital innovations cannot automatically provide access to finance for all. During the 3rd Asia Finance Forum, Rama Sridhar, the Executive Vice President of Master Card, underscored the importance of understanding the needs of the financially excluded population pools and developing corresponding comprehensive digital financial action plans to make them part of the digital economy.

Analysis

Digital innovations could increase financial access for target population groups, such as those who are outside the financial system, MSMEs, and those who are part of the formal financial system but need to be persuaded that going digital is not scary.

People outside the formal banking system

About 1.7 billion adults remain unbanked and they live largely in Asia and the Pacific. They don't have accounts at a financial institution or through a mobile money provider. They pay high fees, trust risky systems for simple transactions, and rely on cash or barter for necessities.

The Word Bank's 2017 Global Findex database shows that the scale of digital financial exclusion is profound in some Asian countries as citizens have never paid their bills or shop online.

To counter this, greater ICT access is required, accessibility of broadband infrastructure must be extended, digital skills gaps must be addressed, and regulatory actions should be in place to reduce socio-economic barriers.

Millions of small businesses

SMEs account for over 95% of all businesses, employ half of the workforce, and contribute 20% to 50% of the gross domestic product in the Asia-Pacific region. However, they often face challenges in getting financial resources—both credit and e-payment tools.

According to the International Finance Corporation, 65 million firms, or 40% of formal MSMEs in developing countries, have a funding gap of $5.2 trillion every year with East Asia and the Pacific accounting for almost half of the deficiency. This gap exists as it is difficult and costly for large banks that control capital investments in emerging markets to assess the creditworthiness of small firms.

SMEs need easier access to capital, need to get paid on time, and need to ensure that digital payments are seamlessly integrated into doing business.

Alternative credit-scoring models which leverage new data, like telco data, online behavior and customer views, can give SMEs easier access to capital. Alternative financing also offers multiple options ranging from peer-to-peer (P2P) business lending to invoice factoring and equity-based crowd funding. For example, Indonesia's Akseleran, a crowdfunding P2P platform, has a 0.5% ratio of nonperforming loans compared to the 3% national average—proves that there are alternative lending options that are not risky.

New technologies can also help SMEs to better and more efficiently manage their cash flow. For example, digital payments can increase cash flow efficiencies as well as create valuable data.

Included in the financial system but excluded digitally

Most e-commerce orders today especially in India, Indonesia, Malaysia, Philippines, and Thailand are still paid via cash-on-delivery arrangements. A consumer's inability to access digital payments or lack of trust in digital payments squeezes SMEs as it takes longer for them to get paid. This can create payment cycle pressures throughout the supply chain and cost economies billions of dollars in annual cost.

To bring the financially included deeper into the digital economy, businesses need to win their trust by investing in adequate processes, technology, and security standards for collecting personal information. All digital transactions must be secured. Technologies, such as tokenization, must be leveraged so that unsecured data does not flow across the network. Security infrastructure against cyber attacks must also be deployed.

Implications

The impact of a fully realized digital dividend—the broader development benefits from using digital technologies—in ASEAN is estimated to add more than a trillion dollars to the GDPs of ASEAN countries by 2025.

While adopting digital solutions is a prerequisite to realizing digital dividends, it is just one of the building blocks of digital transformation.

Digital solutions must be accompanied by trust, user identification, financial enablement, security, quality ICT infrastructure, and a regulatory framework which enables growth. These building blocks must be present for people to share ideas, to innovate, to buy and sell, and ultimately make the transactions that are quantified by the definition of GDP.

Resources

ADB Knowledge Events. 3rd Asia Finance Forum: The Future of Inclusive Finance.

ADB Knowledge Events. The Digital Revolution: Access to Finance for All.

Asian Development Bank (ADB). 2017. *Accelerating Financial Inclusion in South-East Asia with Digital Finance.* Manila.

World Bank. Small and Medium Enterprises (SMES) Finance.

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.

Asian Development Bank (ADB)

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