<table>
<thead>
<tr>
<th>Title</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Introduction: Welcome to the Next 10 Years</td>
<td>1</td>
</tr>
<tr>
<td>Brandee McHale</td>
<td></td>
</tr>
<tr>
<td>Why Financial Inclusion Matters</td>
<td>3</td>
</tr>
<tr>
<td>Timothy D. Adams</td>
<td></td>
</tr>
<tr>
<td>Financial Services Through the Eyes of Customers</td>
<td>7</td>
</tr>
<tr>
<td>Elisabeth Rhyne</td>
<td></td>
</tr>
<tr>
<td>Ten Years Gone, Ten Years to Go</td>
<td>14</td>
</tr>
<tr>
<td>Garance Watte- Richard</td>
<td></td>
</tr>
<tr>
<td>Making Payments Better</td>
<td>18</td>
</tr>
<tr>
<td>Mark Pickens</td>
<td></td>
</tr>
<tr>
<td>Getting Credit Right</td>
<td>21</td>
</tr>
<tr>
<td>Buhle Miranda Goslar</td>
<td></td>
</tr>
<tr>
<td>Bridging the Digital Gender Divide in Financial Inclusion</td>
<td>27</td>
</tr>
<tr>
<td>Shameran Abed</td>
<td></td>
</tr>
<tr>
<td>Getting Data Right</td>
<td>31</td>
</tr>
<tr>
<td>Katharine Kemp</td>
<td></td>
</tr>
<tr>
<td>Getting Infrastructure Right for Financial Inclusion</td>
<td>39</td>
</tr>
<tr>
<td>Chris Skinner</td>
<td></td>
</tr>
<tr>
<td>Getting Policies Right in the Digital Era</td>
<td>43</td>
</tr>
<tr>
<td>Ariadne Plastakis &amp; Simone di Castri</td>
<td></td>
</tr>
<tr>
<td>The Role of Investors in Getting Inclusion Right</td>
<td>53</td>
</tr>
<tr>
<td>Jonathan Whittle &amp; Monica Brand Engel</td>
<td></td>
</tr>
</tbody>
</table>
Welcome to the Next 10 Years

This spring, the World Bank released its latest Global Findex report, which is the most comprehensive scorecard available for measuring the progress of financial inclusion. While the data shows that the number of people without access to a financial account of any kind has dropped from 2 billion to 1.7 billion between 2014 and 2017, a closer look at the numbers reveals that many of these new accounts are not actively used and that credit, savings and resilience showed no progress during this period. Globally, at least 3 billion people remain financially excluded or underserved, with 30 percent – a large portion – being disproportionately young, underscoring the importance of getting financial inclusion right today for our future generation. These findings, among others, are discussed in Financial Inclusion Hype vs. Reality, a report from the Center for Financial Inclusion at Accion (CFI) that deconstructs the Findex data and draws attention to the need for the industry to go beyond access to drive increased usage and improved financial well-being. As access increasingly becomes a reality, a second generation of challenges emerges: to capitalize on the openings made possible through access to offer products and services that truly improve lives, reduce inequality and ultimately drive development.

As access to financial services increasingly becomes a reality, a second generation of challenges emerges: to offer products and services that truly improve lives, reduce inequality and ultimately drive development. It is in this spirit that the Citi Foundation brings its support to the thought leadership initiatives CFI is pursuing in conjunction with its 10th anniversary this year, under the theme of Getting Inclusion Right. The ten essays presented in this series – in celebration of CFI’s ten years – showcase diverse views from across the financial inclusion sector and beyond on questions that must be addressed to ensure that financial services bring about tangible benefits for the financially excluded and underserved.

Starting with Garance Wattez-Richard of AXA, who reflects on inclusive insurance, we move into Elisabeth Rhyne’s discussion of the need for greater customer centricity in how providers design and deliver financial services. Tim Adams of the Institute of International Finance writes about why financial inclusion matters. The series also examines consumer issues through its exploration into the digital divide (Shameran Abed of BRAC) and we hear from innovative providers such as Buhle Goslar of Jumo on credit, and Mark Pickens of Visa on payments. We then look at the ecosystem that makes it all possible, with an overview from Chris Skinner of the Finanser and essays from Simone di Castri on regulation, Katharine Kemp of the University of New South Wales on data privacy and security, and Jonathan Whittle of Quona Capital on the role of investors.

Each of these writers is highly qualified to speak on their issues, and we are grateful that they have chosen to include their voices in the series. All the essayists have combined their own hopes and dreams for their work with their personal expertise, and the result is a comprehensive vision of “true North” for the sector during the next decade.

The Citi Foundation is delighted to support and recognize CFI’s 10-year track record in challenging and engaging the industry and in protecting and empowering low-income, marginalized consumers. As a longstanding partner of Accion, the Citi Foundation welcomed CFI’s 2008 launch and has since supported
CFI’s efforts to bring stakeholders in financial inclusion together to measure progress and highlight future challenges. During its second decade, CFI has the credibility to continue serving as a focal point for integrated thought and action across the industry and to maintain a unique web of relationships with stakeholders from all segments of the sector.

Financial inclusion has gained new ground in recent years, thanks in part to the acceleration of the digital revolution and the growth of organizations dedicated to expanding financial inclusion. It is our goal with this essay series to seize this momentum in order to forge new relationships and take our efforts to the next level. As you read these essays, we hope that they will trigger clear thinking and convictions about next steps that set the stage for a new generation of breakthroughs in our collective efforts to advance financial inclusion.

Brandee McHale  
President, Citi Foundation and  
Head, Corporate Citizenship, Citi
Moving individuals into the financial mainstream is not simply an aspirational goal, it's an attainable goal. Financial institutions can now reach new customers with formal financial services—in payments, savings, credit, and insurance—transforming individual lives and creating a ripple effect that drives improvements across the global economy.

I don’t remember exactly when I first read the Rev. Jesse Jackson’s now famous line, “capitalism without capital is just plain -ism—and we can’t live off -ism,” but this idea has stuck with me. It planted the seed for what has become a professional pursuit of mine: working to narrow, and hopefully one day close, the gap between those who have access to the formal financial services industry and those who have been left on the margins. This was something I was able to devote time and attention to during my tenure at the U.S. Department of the Treasury and is also why I added financial inclusion to the Institute of International Finance’s agenda (with the Board’s blessing, I might add). At a time when global growth is still strong, but currently encountering headwinds, it’s essential that the underserved population is included into the larger financial ecosystem. The future of finance is brightest when it provides valuable services to the broadest swath of society and the economy.

Put simply, financial inclusion matters.

Reciprocal Benefits

Underserved individuals, entrepreneurs, and SME business owners benefit from being incorporated into the formal economy. Reciprocally, banks and governments benefit from incorporating the underserved into the formal economy.

Individuals are looking for more convenient and secure ways to accumulate, hold, and transfer value. Inclusion helps families save for retirement or unforeseen emergencies and plan for recurring expenses such as education or rent. Several studies have highlighted that inclusion could improve income and increase savings thus enabling the previously underserved to invest in necessities such as healthcare, education, food, growing their business, and managing financial risk. Digital inclusion, specifically, can lower the cost associated with sending and receiving payments such as subsidy payouts, or remittances, and paying recurring bills. One study showed that receiving social benefits through mobile phones saved recipients an average of 20 hours in commuting and wait time. In other words, financial inclusion enhances economic empowerment, which in turn improves overall welfare while providing the building blocks for further growth.

Entrepreneurs and SME owners have innovative ideas and considerable energy but need services, markets, and capital to thrive. Bringing entrepreneurs and their businesses into the formal financial sector is an important first step to building better-connected financial markets—and ultimately—global markets. It allows those operating in mature markets who have capital to connect with the next generation of young entrepreneurs in emerging markets who need capital. Gaining access to financial services enables entrepreneurs and SME owners to utilize these institutions’ valuable consulting services to help invest capital and grow their businesses. This in turn empowers them to make better business decisions, which results in business expansion, job creation, and supports economic prosperity.

Banks are looking to grow and serve future markets,
which are larger and more inclusive. Scale matters for banks, and growing the business and market means developing products and services for more segments of the economy. This is particularly true now that technology is facilitating competition from new types of players who provide similar services and readily take advantage of the skyrocketing value of consumer data. Creating brand equity for new customer segments and reaching new, previously underserved customers early will help create a valuable, enduring relationship.

Governments benefit when all citizens are connected, the velocity of money and economic activity is increased, and transmission mechanisms efficiently execute monetary policy. Decreasing the size of the informal economy also provides greater transparency into financial transactions by increasing security and regulatory oversight. Financial inclusion and account ownership can help reduce corruption, discourage tax evasion, and allow for more effective subsidy payouts. Reverting to digital payments for subsidy and pension payments instead of the traditional cash disbursement method has cut down administrative costs and has improved efficiencies.

Over the past three years, financial inclusion has made great strides and delivered numerous benefits to these four segments of society. As noted in the 2017 Global Findex report, the latest findings available, 69 percent of adults now own an account at a financial institution or through a mobile money provider, up from 62 percent in 2014 and 51 percent in 2011. Financial institutions are a driving force in this inclusion story. All but 2 percent of that 69 percent had accounts in financial institutions. And the 67 percent in 2017 reflects substantial progress in the past few years: up from 51 percent in 2011 and 61 percent in 2014.

When we first launched our financial inclusion efforts at IIF, there was an assumption that banks were secondary players in the efforts to foster financial inclusion. Successive Findex reports have now confirmed that banks are playing a critical role in these efforts and, in many ways, act as the backbone.

We have described some of the more innovative efforts made by our members. To finish the job and to extend financial services to the remaining underserved population—nearly 2 billion people around the world—we’ll need banks, policymakers, NGOs, and others to work together to eliminate obstacles and explore new solutions.

Financial inclusion, built on sustainable business models with mainstream financial service firms, brings individuals and small businesses into an ecosystem where they can flourish and integrate into the broader formal economy. Getting the word out to industry, the public sector, civil society, and other parties working on financial inclusion is important to ensure that these parties’ efforts are additive to one another, coherent and cohesive, and force multipliers. Only by working together can we make a lasting impact.

**Technology Changing the Equation**

Technology’s role in fostering financial inclusion cannot be understated. It is changing the cost equation and increasing the benefits for all parties involved. It is making it more cost effective for traditional financial institutions to reach previously untapped markets and allowing new market entrants to better serve customers at every part of the economic pyramid. For example, financial institutions...
are digitizing the customer journey to create a seamless customer experience utilizing technology to increase customer reach, make access on-demand 24/7, and decrease transactional costs.

One particularly exciting improvement is modernizing the customer onboarding process. Regulators, in partnership with financial institutions, have introduced e-Know Your Customer (e-KYC) initiatives which have significantly increased the account ownership percentages acknowledged earlier. Biometric information and digital IDs are being used to authenticate users and create credit histories, which in turn lowers default and fraud rates.

However, it is not enough for financial institutions to merely improve the number of underserved customers, they must also ensure that accounts are being used by looking at activity rates. One way to accomplish this is by developing innovative products focused on design and tailoring solutions to low income consumer needs.

The four types of products offered through financial institutions mentioned in my opening paragraph—payments, savings, credit, and insurance—have undergone massive transformations over the past several years.

◊ **Payments:** The use of digital payments, meaning access through a mobile phone or the internet, is on the rise, newly connecting 11 percent of the world’s population between 2014 and 2017 to reach 52 percent of adults. The electronic mobile wallet, an application that enables person-to-person, person-to-merchant and bill payment transactions, is a good example of an innovative product utilizing digital payments. Electronic wallets allow remittances and bill payments to be conducted in a matter of minutes vs. hours or even days, saving low income segments valuable time and money. According to the Groupe Spéciale Mobile Association (GSMA), unique mobile subscribers reached 5 billion in 2017 (a penetration rate of 66 percent of the global population), making electronic mobile wallets an ideal channel for reaching consumers and enabling payments.

◊ **Savings:** Financial institutions have been increasing financial service accessibility in rural areas. In emerging markets, for example, they are using agent networks to reach underserved rural populations. These systems—wherein financial institutions designate authority and responsibility to third parties in order to offer services to typically low income or remote customers—have increased customer trust, financial capability, and use of products. They have also lowered the costs associated with providing services to these underserved segments of the market and reduced the costs to savers who make smaller deposits. The use of technology by agents and tailoring savings products to the needs of savings groups and low-income segments will further ensure the underserved are being incorporated into the formal economy.

◊ **Credit:** Financial institutions are using social media data, mobile call data records, bill payment patterns, and psychometric testing to establish credit profiles and target previously invisible consumers. Advanced analytical techniques enable financial institutions to provide access to credit to clients, with historically low financial transaction data, who are otherwise excluded from the formal financial sector. Predictive analytics are being used to assist financial institutions in forecasting the credit needs of SMEs and low-income consumers, helping previously unbanked customers grow their businesses.

◊ **Insurance:** Machine learning is transforming insurance, analytical tools are re-defining traditional risk models, and identity and onboarding solutions are creating a more convenient on-demand service while decreasing costs for insurance firms. Safeguarding the underserved against financial risk can help people at the base of the economic pyramid manage the stresses of illness, crop failures, natural disasters, or income loss due to the death of a wage earner.

Financial institutions have and will continue to innovate, creating products and services that are best suited for the unbanked market, while acting as financial consultants and risk managers for individuals and SME owners alike.
Setting a Vision

The 2017 Global Findex highlighted that, globally, about 1.7 billion adults remain unbanked. High costs, long distances, lack of documentation, and distrust of the financial system generally, have been identified as the main barriers to opening an account. Financial institutions have an unprecedented opportunity to dramatically grow their customer base in a sustainable manner by leveraging new technologies.

Incorporating the previously unserved into the economy is becoming a more attainable goal for financial institutions, and while financial institutions and regulators are embracing new technologies to make financial services more affordable and accessible, it is critically important to always keep the consumer’s best interest in mind. Educating underserved consumers, transparently communicating service offerings, and addressing the persistent gender and wealth gap are of utmost importance to increase trust in the financial services industry.

Technology is helping to realize the vision of creating tailored financial products and services for vulnerable consumers. And while digital technology is not an end in and of itself, it is a means to achieve broad-based financial inclusion and to ultimately achieve the United Nations’ Sustainable Development Goals (SDGs), those 17 interrelated goals that endeavor to ensure peace and prosperity for all. Emerging technologies are empowering financial institutions to go the extra mile and serve the underserved market. Increasing access to finance and doing it in a manner that protects this segment of society is coming closer to reality with each passing day.

As we accelerate into the digital age, it is critical for us to get financial inclusion right. The last century has seen global trade fuel dramatic GDP growth and remarkable improvements in life expectancy, literacy, and democracy around the world. Although it is not without some shortcomings and challenges, this system of global trade and financial intermediation is the most successful system we have developed to improve human living standards. Connecting people to capital matters. Helping individuals take advantage of economic opportunities matters. Ensuring that as many people around the world are connected to our global economy and its benefits matters. This is why financial inclusion matters.
Imagine that low and moderate income consumers created the financial services of their dreams. How would they describe what they want from their financial services? Would the description resemble the services they actually receive?

Since 2008, the Center for Financial Inclusion at Accion has explored the customer perspective in financial inclusion by conducting research and engaging with financial service providers and their customers in dozens of countries. Through our research, we have been privileged to talk with people across the globe who are new to formal financial services, and with organizations serving them. Insights gleaned from our interactions with clients constitute a roadmap of sorts on how to “get financial inclusion right.” They point the way along the long road the sector must travel before the vision of meaningful financial inclusion is realized.

As it moves into its second decade, CFI intends to dedicate itself to search out and promote the elements of financial inclusion that bring customers what they truly need and want. With that in mind, this essay reflects on some of the findings about customers gleaned from a decade of CFI research. Customer wishes are actually pretty simple, whether customers are poor or not and whether they live in frontier, emerging or high income markets. First, they want services that help them accomplish goals and solve problems. In the words of a customer we spoke with in Chile, “How can banks help me in my actual life?”

Second, when they use those services they want a positive experience. When consumers speak about financial service experiences, they use words like confidence, safety, trust, and understanding – or their opposite: confusion, doubt and stress. These words convey the serious emotional stakes involved in money matters. By contrast, financial service providers tend to use bloodless jargon like “addressable market”, “customer acquisition” or “user interface”. Providers must turn these business concepts into a customer experience that evokes confidence and affirmation.

This essay looks first at products that solve customer problems and then turns to the elements of a positive experience. In the first section we identify four ways to use a financial health framework to design products aimed at reaching goals and solving problems. In the section section we discuss six attributes that lead to positive experiences with financial services. We conclude with a brief reflection on how financial service providers can orient themselves more broadly toward empowering customers.

**Financial Health Solving Customer Problems**

In a customer-inspired financial inclusion system, the system’s ultimate goal would be the financial health of their customers, whether they are farmers, employees, day laborers or small business owners. The Center for Financial Services Innovation (CFSI), which promotes the concept in the U.S., defines financial health as “day-to-day financial systems that build long-term resilience and opportunity.” We like this definition: it’s succinct and complete.

We find that people speak about financial health with similar words no matter where they live. “Financial health is when I have what I need every day.” “Financial health is when you can pay your bills and have money left over.” “Financial stability is when you
don’t have to ask other people for money.” These quotes come from people in India and Kenya, and we have heard much the same from consumers in Latin America and Eastern Europe. It all comes back to three things: day-to-day financial management systems that help balance income and expenses, the ability to bounce back from the many financial shocks that beset lower income people and the ability to pursue important goals and opportunities, including those that require longer term planning and financial discipline.

People we speak to do not just talk about financial health – they are actively striving to be financially healthy. This striving is an everyday fact of life, and it shapes the arc of families’ lives across the years. Yet, for an enormous share of the world’s people, financial health is elusive. CFSI’s research in the U.S. shows that fewer than half of Americans are financially healthy, and the Global Findex 2017 reports that about half of the people in the developing world are resilient – i.e. able to come up with the cash needed to meet a typical emergency (see page 80).

If they were to embrace financial health as an objective, financial service providers would design products aimed at supporting the elements of financial health, and would become engaged with customers as partners in their pursuit. We offer here a few thoughts on how to support financial health through financial service provision. While people can use many financial services to improve their financial health, some products or product features contribute more directly than others.

1. Short-term money management products, especially if they are convenient, quick and affordable.

To assist with the day-to-day requirements of financial health, good financial services assist customers to manage their money, allow them to pay for things or send money home, help them keep track of budgets and provide access to ready money when needed. No one wants to spend time and money traveling to a bank branch and standing in line, and for many of the poor, if products cannot be accessed quickly and conveniently, and at a reasonable price, their value disappears altogether.

Short-term services contribute to financial health in large part by enabling consumption smoothing, the all-important process of maintaining a steady standard of life in the face of unsteady income and expenses. Consumption smoothing is often discounted for not being as sexy as economic growth, but in fact, it is at the very center of what financial services are for. The value of getting money to the right place at the right time cannot be underestimated. Impact studies also confirm that access to mobile payments allows people to manage emergencies and broaden their business horizons.

The vast majority of the effort in financial inclusion goes to create such services, and this effort is dramatically increasing the number of users and the variety of services available. In 2017, 48 percent of the adults in the developing world had active bank accounts, and 44 percent used electronic payments, according to the Findex. Both these numbers represent substantial increases in just a few years. The momentum behind faster, cheaper banking services and payments stems in part from the competitive advantage gained by companies that create speed and convenience. We applaud the great progress that these numbers represent and the momentum that will increase them in the next decade.

2. Products that support customers’ “better selves.”

One of the chief challenges consumers face in day-to-day money management is maintaining self-discipline. That’s why products to support financial health would also support customers’ “better selves”.

We heard from a hawker near a train station in India who after losing an eye – and a job – in a train accident, began placing a few rupees with a money collector at the end of every day. After several years, she had enough to purchase her own kiosk – a lifetime accomplishment that gave her enormous pride. Not everyone can be so disciplined, and if this woman had not found a trusted money collector, she might not have succeeded either. People want to build financial health, but temptation – or “life” – gets in the way.
The “nudge doctors” in behavioral economics have demonstrated biases in the way humans make decisions, many of which strongly apply to financial decisions. But customers don’t need a degree in psychology to recognize that they are liable to break their own best resolutions, make unrealistic promises, or decide to act before they have the full picture. While everyone has foibles like these, the fragile financial health of lower income people makes the consequences of poor choices that much worse. As behavioral economists have learned, products like commitment savings can help consumers maintain savings discipline, while aggressive marketing can lure them into financial decisions they later regret.

Developing and spreading services that support self-discipline is, in my opinion, one of the most important future challenges for the financial inclusion community. Although small savings products may not be big revenue generators, they can be central to consumers’ financial health, and providers that incorporate them into their product mix may be rewarded with loyal and prospering customers.

3. Products that help create resilience.

Checking back with our definition of financial health, we note that unless daily systems also support resilience and opportunity, they can only be said to support financial survival, not health.

Good financial services assist customers to protect themselves from the many shocks they experience, like loss of a job, a car accident or a health crisis – all of which have direct financial consequences that are especially severe for lower income people living closer to the edge. The ideal suite of products for resilience includes savings accounts for building rainy day savings, access to emergency credit, and insurance that covers a person’s most important assets – their physical health, property, and lives of family members they depend on. Today, although the numbers of people who have some form of insurance is rising fast, the value and usefulness of that coverage has a long way to go. We see a great deal of innovation in inclusive insurance, but so far that innovation remains mainly at a niche level.

This is an essential takeaway: when we talk about financial health, insurance and savings must become larger parts of the conversation.

4. Products that support customers’ most cherished life goals.

As one interviewee stated, “Financial health is a house and a good salary.” The ‘big four’ lifetime goals that are often the core of a person’s financial life include: education for themselves and their children, business growth (for the self-employed), safe and comfortable shelter, and a secure old age. Good financial services can assist customers to plan for and ultimately obtain a comfortable home, their kids’ education, or security in old age – and to grow the farm or business that so many self-employed people depend on. In the past several years, with the rise of mobile payments and data analytics, we have witnessed tremendous vitality in services for small and micro enterprises. However, there is less progress in housing, education and pensions. Products addressing these latter needs are some of the most difficult products to provide, especially in emerging financial markets and for poorer people, exactly because of their long term nature.

Services that support education, shelter and old age are another frontier area for the future of the financial inclusion community.

Product Delivery To Create Trust and Confidence

We turn now from financial products to their delivery and the experience that comes with using them. As we learned in our Client Voice research, the experience is often as important to customers as the product itself.

Customers new to formal financial services often approach providers hesitantly, especially if they also struggle with literacy. Interviewees often say that they feel intimidated or unwelcome when entering a bank. Such new customers may be easily turned off if their first experience leaves them feeling disrespected or confused.

With digital services, the client experience shifts in ways that can be both better and worse for the financially excluded and underserved. There is less chance of disrespect from staff, but instead, the customer faces the impenetrability of an electronic device.
In the next few paragraphs we sketch some of the most-desired attributes of the customer experience at the present moment in which the financial inclusion sector offers a mix of traditional and electronic delivery methods.

5. Simple products and interactions.

Simple and transparent product design enables consumers to use products appropriately and builds trust. As customer touch points shift to digital, interface designers must strive to use very simple language or images – and it helps if the products themselves are actually very simple. They should not come with hidden terms and conditions, exclusions or confusing prices. The inclusive insurance sector is finding that radical simplification of products – like doing away with costly claim verification processes – is a key to serving lower income segments, as Garance Wattez-Richard writes in her essay in this series.

We observe that many providers attempt to move towards simplicity but only get halfway there. It is easy to forget that customers may not understand ordinary banking terms, as we learned ourselves when asking people to take a financial health quiz. MicroSave, among others, has pointed out that, for people with limited literacy – or, as they call it, orality – the long number strings needed for mobile money transactions can be barriers to confidence and create errors. In Latin America, Fundación Capital found that poor women unused to ATMs were grateful to be able to practice in private on the tablet-based simulator Fundación Capital developed. We could cite many more such examples.

6. The ability to talk to a person when necessary.

Routine financial service use in high income countries has become almost entirely digital; digital will soon become the norm everywhere. However, the target customers of financial inclusion are not yet prepared to live in this future.

Research by CFI Fellow Alexis Beggs-Olsen showed that after almost a decade with M-Pesa, consumers in Kenya are very comfortable conducting transactions digitally. But when they are considering whether to take up a new service, learning how a service works, and especially when something goes wrong, they would strongly prefer to talk to a person face-to-face. According to Beggs-Olsen, call centers, while they do feature human conversations, are considered – by Kenyans at least – as a poor substitute to face-to-face. Chatbots attempt to simulate human interactions, but customers still want a lifeline to a real person.

In the transition away from branch-based banking, many banks have outsourced face-to-face interactions to banking agents. However, CFI Fellows Shreya Chatterjee and Misha Sharma, who studied banking agents in India, showed that agents are not often well-trained or incentivized to fill these supportive roles.

Getting the balance of tech and touch right is a significant future challenge for providers.

7. Trust that providers protect them from harm and have their interests at heart.

Like many useful tools, financial services can be dangerous. They need to be provided and used responsibly. As consumers begin to use new financial services, they need confidence that providers are aligned with their interests.

Until recently, consumer protections lagged under a buyer-beware philosophy that designated financial system regulation’s purview as stability. But when the 2008 financial crisis demonstrated how consumer protection failures in the U.S. mortgage market could trigger a global cascade of additional failures, regulators acknowledged that consumer protection gaps could upset stability and began to include it in their mandates. Despite a decade of effort, much remains to be done, and in many situations the incentives for providers to act responsibly need to be internally motivated – based on the business case for consumer trust.

The Smart Campaign is a global effort led by CFI to embed Client Protection Principles into the fabric of the financial inclusion sector. We have examined provider practices and heard from customers about the harms they have experienced. While much of what we have seen is not pretty – like public shaming of debt defaulters in several countries – we also know...
that many providers are eager to apply good practices. We have certified over 100 financial institutions for meeting such standards.

The digital revolution is creating new consumer protection challenges, which must be adequately dealt with if customers are going to fully engage with the new offerings. Concerns about legitimacy, security and the ability to fix mistakes are frequently topmost in customers’ minds. Transparency is a special challenge for mobile money and credit providers who must convey sufficient information to customers through the limited USSD. Aggressive marketing has also risen as a concern. Mobile money customers from Kenya to Peru receive loan offers, and some feel pressure to borrow, but they don’t know which companies to trust. (I also get robocall loan offers every week. I don’t trust any of them.)

While much research has identified consumer protection issues arising in digital financial services, there has been relatively less effort to translate that learning into standards of practice and promulgate those practices throughout the sector.

8. Trust that institutions use customer assets (money and data) appropriately and safely.

A special set of consumer protection concerns involves how financial institutions handle the money and data clients entrust to them. The need for assurance of the safety of deposits has been a central regulatory concern for so long that it should hardly need remarking. And yet customers are increasingly entrusting their money to new entrants, witness the P2P collapses in China, that may not have the same regulatory oversight as full-fledged banks, for example, when they store money temporarily on payment apps. So the deposit-protection concern is still with us, though in new guises.

The appropriate use of data has become a hot-button issue not only in financial services, but throughout the realms of commerce, politics and national security. In financial services, strong feelings surface on both sides. One side is enthusiastic about the opportunities opened by the mushrooming of consumer data footprints that can be analyzed with new data science techniques. The other side hoists the banner of privacy rights and asserts the need for consumer ownership and control of their own data. While many agree that consumer consent for data use is part of a solution, making consent meaningful has proved difficult. No consent often means no service. The recent promulgation in Europe of the General Data Protection Regulation (GDPR) has implications reaching all over the globe.

Perhaps more than any other issue raised here, how to get to positive practices on data rights is an open question. Katharine Kemp’s essay in this series explore, the challenges in greater depth.

9. Protection from frauds and scams.

Low income people are continually exposed to frauds and scams. Many of these come from rogue players posing as legitimate ones. A client in Benin showed us a photograph he had taken of a storefront that opened an office in his city, collected deposits from hundreds of people, and then closed up shop. The photographer confessed that he had not known how to recognize that the business was fraudulent. Assurance of legitimacy was a major preoccupation of the Kenyans interviewed by Beggs-Olsen about the blend of tech and touch. They relied for this assurance on the word of friends and family.

With digital services, the opportunity increases for frauds to occur inside institutions, through security breaches. CFI Fellow Patrick Traynor documented significant vulnerabilities among digital financial service apps. Given the frequency of major hacks into high-profile companies, vulnerabilities throughout the financial system are no surprise. Hackers seem always to be a few steps ahead of cybersecurity. And as Kemp argues in her forthcoming essay on data, the risk rises when more and more data is stored and moved throughout the financial sector.

Providers and clients are on the same side in the effort to stop fraudsters. As the success of credit card companies over the years shows, the rewards of sustained investment in fraud control include customer loyalty, trust and usage.

Considering the Customer More Broadly

If all the above conditions are met, customers would gain confidence and control in their financial lives and would relieve the stress that often accompanies the use of financial services. That in turn would promote more
active use and customer loyalty.

The new players like to consider themselves as disrupters. They should also think of themselves as creators and take time to imagine the kind of financial world they want to create. How many financial institutions have taken a Hippocratic perspective and set their purpose in terms of helping their customers to achieve good financial health? A few are doing so, and we’d like to see more.

To take on an authentic consumer perspective, financial service providers would shift their mindset in important ways. They could begin by investigating the financial health of their customers (not difficult to do – see CFSI’s Financial Health Toolkit) and spending more time listening to and seeking feedback from them. CFI’s Africa Board Fellows program requires its fellows – CEOs and board directors of African financial institutions – to spend time with clients regularly. These visits have sparked important new insights, according to many of the fellows.

A new mindset might also involve a more holistic view of product offerings. Initially, many fintech start-ups focus on a single product. A customer perspective would recognize how deeply interconnected financial decisions are and would seek to offer a broader range of services, thus creating deeper customer relationships. We are starting to see a welcome shift among some of the more established fintechs Accion invests in, such as Lydia and Zoona, which began with a single product and are now working to evolve a broader, more supportive product suite. Partnerships with various providers, such as those established by Dvara for its rural channels program, are another route to such an offering, which may be especially important for products like insurance and pensions.

With a new mindset, providers would also support their customers to build their financial capability – the knowledge, skills, and behaviors needed to manage their financial lives well.

They would provide more support for new customers to use their products well, and would assist them in managing their financial lives and planning for their goals.
For the insurance industry, 2008 is more often reminiscent of the bailout of AIG than of new beginnings. However, 2008 also launched an unexpected wave of creative destruction. This essay series not only celebrates the 10-year work of the Center for Financial Inclusion, but also several pioneers that strive to make insurance inclusive for all: the ILO’s Impact Insurance Facility, the Centre for Financial Regulation and Inclusion and the Microinsurance Network—all of which began a decade ago.

As a more recent settler on the inclusive insurance planet – although almost three years have flown by – others may keep the flame, but I would like to offer a personal opinion on the past decade of innovation, and my perspectives into what more needs to happen to combine sustainable business and social impact for those who need insurance most.

Back in 2008, microfinance institutions predominantly distributed what was then called microinsurance. MFIs provided insurers with a readily available pool of clients for credit life insurance, which reimburses the outstanding loan amount in case of death or disability of the borrower.

This was the first era of inclusive insurance.

**Accomplishments Since the Beginning**

MicroEnsure, for instance, a specialist provider in which AXA holds a stake, built on this credit life model and now protects micro-borrowers against risks of accidents, hospitalization, and even fire, theft and natural catastrophes. Across the industry, new products flourished, often guided by frameworks such as the ILO’s client value assessment tool (PACE: Product, Access, Cost and Experience) or the Microinsurance Centre’s design principles (SUAVE: simplicity, understandability, accessibility, value and efficiency).

Beyond life and accident policies, which cover critical risks because of the severity of their impact on households, much attention has been given to health, where the frequency of events is significantly higher. The hospital cash product, a cover where the policyholder receives a predefined indemnity in case of hospitalization, independent of the reason for that hospitalisation or the actual costs incurred, is a brainchild of this wave of innovation. While it does not aim to provide comprehensive health cover, is a scalable combination of affordability and simplicity. There are no assessments of pre-existing conditions, waiting periods or co-pays – all features that are hard for first-time insurance buyers to understand.

Providers also made great strides in extending distribution strategies beyond microfinance institutions. Mobile network operators proved a cost-effective pathway to cover millions of previously uninsured people in Africa and Asia. In Ghana, for example, GSMA research found that 7 out of 10 customers preferred this channel over buying insurance from an insurer. This says a lot, even though experience has shown these tie-ups are not always sustainable, not least because of regulatory challenges impeding the use of airtime to pay for insurance premiums in many countries. MNOs are not the only innovative distribution channel: in South Africa you can buy funeral cover at your local supermarket, while ACRE Africa, and, more recently,
Pula Advisors bundle insurance with bags of seeds for Kenyan farmers. The firm relies on mobile technology to geolocalize the insured crop. I even once bought a local newspaper in Mumbai and noticed that subscribing to it would get me a free personal accident policy.

Finally, processes are surely the most underrated innovation. Enrolling for insurance is historically complex, with many questions asked during underwriting, or with health checks. Today, however, API technology and experience now allows us to insure on the sole basis of a name and a phone number, In India, even just a fingerprint can provide the basis of a policy thanks to the India Stack and Aadhaar ecosystem. Claims intimation can be digitalized too, with documents submitted by WhatsApp or other messaging systems, which significantly reduces turnaround time. Pioneer in the Philippines took the decision that only the Head of Microinsurance could take the final decision to reject a claim, ensuring management focus on what is the moment of truth for first-time buyers: when they submit their first claim.

While many schemes failed, they have provided valuable experiences upon which success has been built. The overall picture is positive: ILO research showed that in 2016, 60 of the largest insurers in the world launched programs for low income and emerging segments, compared to only seven in 2005. This number will only grow in line with the demographic shift of billions towards the middle class. In 2025 the number of people in the consuming class, defined as those earning over US $10 (PPP basis) per day, will exceed the number still struggling to meet their most basic needs. I am proud to say that today, AXA is already protecting over 8 million emerging customers.

Now at the end of its adolescent years, the inclusive insurance industry is faced with a dichotomy. The shorter, easier path would be to stick to existing models, where insurance is largely mandatory for the client because it is tied to another good or service such as credit or airtime. This was a necessary first step to understand the market and build volume, but such programs are short-lived. Forcing products on clients does not build their insurance culture nor their will to renew them. The road to sustainability is longer and includes hardships. It is one which requires us to spin the traditional insurance model on its axis.

### From Exclusive to Inclusive

Insurance traditionally manages the so-called “subprime” risks by using exclusions, waiting periods, and/or health checks, which are ill-adapted to first-time buyers who may not be aware of their health history. Some hospitalization policies sold to the emerging customer segment have 20 or 30 exclusions, drafted in “legalese” terms. If these clauses do not outright scare off new clients, they can certainly cause quite a negative perception in the community when they have not been well explained and a claim is rejected on their basis.

An example of this comes from our work with the IFC-World Bank to tailor insurance products to the needs of women. As part of this research we were shocked to see that around the world, including within our own entities, many policies have discriminatory terms, for example personal accidents policies which exclude maternity-related accidents from cover.

This philosophy of exclusion needs to be challenged. This is much easier said than done, and requires a real mindset shift in the way products are constructed. One of the ways AXA has been able to accelerate this shift is by taking our actuaries to the field during customer research so they can get as close as possible to customer realities. As an illustration, this has allowed us to limit the exclusions on our basic life, accidents and hospital cash policies to claims linked to crime, illegal activities and self-inflicted injuries. To work for the inclusive market, policies should be designed to be short and clear enough to fit in an SMS and written in layman’s terms.

### From Value to Claimants to Value for All

Insurance is a low-touch business: contact points between the insurer and the insured are limited to premium collection, renewal and claims. But with low frequency risks such as life, accidents, hospitalizations or natural catastrophes, only a small percentage of clients will claim during the year. This is a very strong challenge for the industry: how can we convince customers to continue with coverage they have not
Insurance is about helping people to be resilient and the importance of resilience for financial well-being.

The cost of administrating the insurance scheme, the risk of fraud, as well as the claims process burden for the client all challenge the suitability of insurance for managing these risks. It may be better value for money for customers to address them through other financial inclusion tools such as health savings or credit. Insurers can participate in creating better value bundles for the emerging customer segment.

In this regard, MicroEnsure partnered with clinics in East Africa to bundle hospital cash insurance covering overnight hospital stays with a microcredit facility that clients can immediately draw upon to pay for outpatient treatment or medicines. The goal was to address the cash constraints that often force clients to choose between proper lab exams and medicine, with an obvious impact on health outcomes. Although it proved difficult to crack the distribution model for the scheme, as the bundle remained complex for clinics staff to sell as a side activity, customer feedback was very positive, and the idea will undoubtedly be leveraged with more success elsewhere.

At the industry level, it is a positive signal that the ILO’s Impact Insurance Facility is launching a new program focused on these integrated risk management solutions, combining insurance with credit, savings and prevention. Insurance is about helping people to be resilient and the importance of resilience for financial well-being.

Remaining Bottlenecks

These are some of the steps needed to get us from access to insurance to actual usage of insurance with durable impact on customers’ lives. But beyond these changes in the value proposition design, other structural bottlenecks remain.

The first bottleneck is that inclusive insurance cannot happen on its own. Not only is insurance complementary to payments, credit and savings in improving resilience, as noted above, but the different
branches of inclusive finance need each other to grow. Collecting tiny premiums in cash makes no economic sense, and making digital payments a reality will also drive insurance uptake. It is no wonder that Kenya, where mobile money is widespread, is so strong in innovative insurance schemes. Conversely, insurance takes some of the default risk away from microfinance institutions, helping credit flourish, and can also be used as an incentive to create a formal savings culture. In Ghana for instance, MicroEnsure partnered with microfinance banks to design a policy called Edusave, which rewarded savers with a free insurance covering children’s educational costs in case of death of a parent. The sum insured was proportional to the amount saved, and this allowed to more than double customers’ savings habit with the bank.

The second bottleneck lies in the hands of regulators. It is positive to see how much attention on insurance for the underserved has increased these past years, with specific, simplified regulatory frameworks appearing in over twenty countries, including Egypt, Peru and the Philippines. This owes a lot to the capacity building and best practices sharing work performed by the Access to Insurance Initiative (A2II), among others. But issues such as product approval remain considerable. In India, a new filing or even basic tweaks on small-ticket, plain vanilla products for emerging consumers can take months, hampering innovation in a field where decisions are made on a day-to-day basis and priorities often change while the product is being approved. Beyond product approval, rules on distribution should reflect the role played by innovative channels such as mobile network operators as well as mobile money providers. Across the board, paperless processes for enrollment and claims should be allowed and encouraged. Bringing together regulators and industry experts is the only way to progressively bridge the regulatory gap.

Last but not least, the question of last mile distribution remains central. Insurers will compete on their ability to work with new channels, but also to build upon existing ones in a more sustainable manner, combining boots on the ground for customer education with digital technology to reduce costs. Building insurance culture from scratch is a difficult process, and surveys show that up to 90 percent of clients who got insurance through mobile network operators never had a policy before.

Developing the culture requires adequately training frontline staff, using claims as a marketing tool, and leveraging influencers from local communities. I once met in a Ghanaian market a woman who claimed to be the “queen of the market”: she had seen the positive impact of insurance on merchants who had lost their shops to a fire, and after a discussion with our team, she said she would sign up the whole market to the product. And she delivered: the next day, after a speech she made to them, hundreds came forward to purchase the property scheme.

Much has been achieved in ten years. But the paradox is that despite all the players in this space – insurers, think tanks, NGOs, multilaterals, distributors, regulators – we are counting policyholders in millions instead of billions. Let us hope that the next decade will yield the necessary breakthroughs to take inclusive insurance from adolescence to adulthood.
To Tasiu Abdurrahman, burying cash feels more secure and easier than keeping it with a formal financial service provider. “My business partners need cash,” he said. So he stopped putting money into the bank and closed his account eight years ago. Now he buries money several times a week, usually at night, and digs it up to transact in person and in cash when he needs to pay suppliers for his spice shop.

Mr. Abdurrahman’s example illustrates the need for a stronger value proposition for digital payments for small businesses and consumers worldwide. Otherwise, the promise of digital financial inclusion may fall short of its full potential for social impact.

We know digitizing money flows has positive effects for society as a whole. According to Moody’s, digital payments add $983 billion in global economic growth and 0.8 percent to GDP in emerging markets every 5 years. If the people in the world’s 100 largest cities all used digital payments as often as the most active 10 percent of users today, the uptick would generate $470 billion annually in net benefits to consumers, businesses and economies. These benefits would come from reduced cost, time saved, curbed crime and greater transparency.

However, despite the past decade’s excitement, innovation and investments, digital payments are spreading unevenly and overall more slowly than one would hope. Nearly two-thirds of adults in emerging markets have a bank account, according to the World Bank. Yet in 2017 just 22 percent made a payment through a mobile phone, and only 25 percent made a payment with a credit or debit card. In short, Tasiu’s story from Nigeria is a story with global relevance.

With all the potential benefits to society, what keeps businesses and consumers loyal to cash?

To some extent, closing the digital payments gap depends on big global trends. The long arc of history points toward accelerating digitization of our lives, more travel, and larger social and business networks, all of which drive the need for safe, secure remote payment. Many industries will increasingly rely on digital payments, some with great potential for social impact.

Solar home systems, for example, are safer, cleaner and cheaper than kerosene and also enable extended hours for productivity for adults and children doing schoolwork. But the bulk of targeted consumers also tend to be un- or underbanked and also need a convenient and reliable means of paying. It is not hard to imagine a future where innovation in adjacent industries – health, education, power, entertainment – become the engine pulling financial inclusion forward. While we wait for those trends to bear fruit, what opportunities do we have to accelerate toward a world where digital payments work better for everyone? What is to be done? I see five areas of need.

1. Proving identity is still troublesome for many businesses and consumers.

Worldwide, 1.1 billion people lack identification, including one in three in low-income countries, creating an absolute barrier for them to access formal financial services. Proving who you are after account opening is a separate kind of challenge. PINs, passwords, signatures are clunky and forgettable. I have one friend who finds it easier to reset his passwords every time he accesses his bank’s online...

Mark Pickens, Financial Inclusion, Visa
We need a stronger value proposition for digital payments for small businesses and consumers so we can bury burying cash for good.
platform rather than remember it. How much harder is it for lower income consumers with less exposure to technology, and probably a lower margin of error for making mistakes with their finances?

Biometric solutions hold a lot of promise. There is buzz around “smile to pay” facial recognition technology, with high profile launches in China and in Brazil. And no biometric initiative is more ambitious than Aadhaar, the Indian government’s identity database, which holds fingerprint, iris and other bio-data on 1.1 billion citizens. Aadhaar aims to make proving identity – for a financial account, mobile phone, basic government services, etc. – universally accessible. And, with a series of potential data breaches, Aadhaar also highlights the universal concerns around security, and the heavy and continuing investments required to get it right.

2. Keeping money in an account is often unappealing.

Despite decades of mass-market banking in developing economies, basic bank accounts often fail to beat informal money management tools. I remember meeting a man in Uganda who was so averse to saving in a bank or mobile money that he turned his motorcycle into a piggy bank. He dropped plastic-encased cash into the gas tank where he knew he couldn’t get at it until he truly needed to “withdraw”. Although his self-created deposit product was quite effective at protecting his money from temptation to spend, when the tank was destroyed to get at the money he effectively cut his own return on savings.

Consumers and business owners want bank accounts to be more than an empty vessel for funds. This kind of thinking enabled OXXO, a convenience store brand, and Banamex to become the leading suppliers of bank accounts in Mexico with an integrated saving-payments-transfers product accessible at 14,000 corner stores. We could leverage insights from the academic world of behavioral economics to better design products, using nudges, user-set limits, differential pricing and gamification to make a bank account or mobile money wallet more appealing than keeping cash under the mattress or in a jar at home.

3. Stop thinking about payments as only a way to pay for products and services.

As mentioned earlier, paying digitally yields a number of benefits for society and can potentially enable even more. For the billions of consumers and business owners without a credit score, the data associated with their payments to merchants, property owners, and utility companies already exists as proof of their ability and willingness to pay on time and in full. When digitized, this data becomes easily aggregated. And with enough data to analyze, innovative lenders can enable a first time or radically improved offer of credit. A growing cohort of emerging market fintechs are scrambling to explore this space. We should be careful to avoid over-indebtedness and other risks that can come with rapid credit expansion to the poor – the 2010 crisis in the Indian state of Andhra Pradesh comes to mind. Hopefully, the fintech revolution takes advantages of lessons learned.

4. Governments have more of a role to play than they often take up.

Creating a balanced, broad payments ecosystem intrinsically lends itself to public-private collaboration. The private sector’s technical expertise and deep investments in secure and stable platforms compliment government not only in setting the rules of the road but actively encouraging the shift from cash. In Uruguay, the government introduced a temporary reduction of value-added tax for purchases made digitally and a related set of tax incentives aimed at expanding the country’s network of POS terminals. Debit payments increased by a factor of eight in less than 24 months. South Korea spurred the digitization of payments beginning in the 1990s with tax rebates to consumers and businesses if more than 25 percent of their income/revenue was spent via non-cash methods, and offered a weekly lottery based on invoice and card numbers, split between the consumer and merchant.

And let’s not forget government’s opportunity to be a market maker with its own payments. What would happen if presidential offices directed government agencies to actively seek opportunities to digitize their transactions on a commercial basis? The ensuing
step change in consumers and businesses making
and receiving payments – and the network effects to
follow – would be a significant spark to help the digital
payments engine fire on all cylinders.

5. We need to ramp up our collective
focus on small businesses.

For a start, we will never “get payments right” for
the poor and underserved if one-half of the two-
sided market do not readily see value in accepting
digital payments. There will not be enough places
for consumers to pay digitally. Hundreds of millions
of small businesses account for 98 percent of
businesses in developing economies and handle 4.5
billion transactions daily worldwide, yet fewer than 10
percent currently accept digital payment.

Beyond the critical role they play in the payments
ecosystem, small businesses deserve more attention
for their impact on the wider economy. They
contribute 60 percent of GDP in low-income countries,
according to the OECD. Looking forward, the World
Bank estimates small business will generate 80
percent of new jobs in the developing world.

It’s time for more focus on solutions that help small
businesses thrive and be more resilient. The Visa
Foundation’s first $20 million grant went to Women’s
World Banking to improve the supply of financial
products aimed at female entrepreneurs. Digitizing
supply chains above small businesses will help
them have the inventory they can sell when there is
demand, not what they can buy with cash on hand
when the delivery truck comes round. A recent deal
with fintech Behalf will help small businesses grow via
easier-to-access capital (as part of a ramped up Visa
commitment to partnering with fintechs, including a
$100 million fintech investment fund).

Conclusion

Let’s come back to Mr. Abdurrahman and the hole in
the ground. The challenges he faces in his spice shop
are more typical than they should be. More than ever
before the technology exists to build better solutions.
There is deep expertise, rising government attention,
growing flows of private and public capital aimed
at making payments better. The know-how and
resources exist.

To some extent, we have solved the easier problems
and are left with more challenging hurdles: easy and
secure ways for everyone to prove identity; defeating
the mattress and other informal mechanisms as a
place to store funds; leveraging alternative lending to
broadly but safely expand credit; governments taking
more of a role to encourage the shift from cash; and
last but not least putting small business solutions
more at the center of our collective efforts.

Tackling each of these will help us get to a place and
time where the notion of burying cash in the ground
is an antiquated tale Mr. Abdurrahman tells his
grandchildren, saying “Can you believe we used to...?”
In the last few years, the rapid growth in mobile money account ownership has established a new launchpad for the digital economy in emerging markets. As a part of this new economy, digital credit has been instrumental in giving significant numbers of people first-time access to formal borrowing options, along with unprecedented levels of convenience and reduced financial vulnerability.

Many of these borrowers are entrepreneurs or self-employed, often with low incomes. The theory goes that this increased access to digital finance should translate to an increase in economic inclusion and development: more resilient households, job creation and thriving micro and small businesses. These outcomes are indeed possible—when we get digital credit right.

However, despite enormous strides in the provision of digital loans, the credit gap for individuals and micro-, small and medium enterprises (MSMEs) in emerging markets persists. Supply still fails to meet demand. Also, where credit is available, voices mount around important issues such as vulnerable segments being left behind, insufficient controls to manage overindebtedness, lack of transparency, inappropriate enforcement techniques, and poor customer marketing and support practices.

This essay explores contributing factors to the lag in digital credit completely fulfilling its promise. It offers four focus areas to help the sector return to its true north and tackle some of the unintended consequences of the first wave of digital credit innovation. In the end, it suggests that at the core of getting inclusive digital credit right is a return to customer value—and intentionality around inclusiveness in the design and delivery of products.

**Mind the Customer Value Gap**

As a practitioner, I am fortunate enough to spend a lot of time in the field speaking with customers who use or would like to access digital financial services (loans, savings and insurance), many of these customers are new to the use of mobile money and in some cases even new to mobile devices altogether. We often speak broadly about these customers’ financial needs and aspirations, in addition to testing new product features, benefits and user journeys. In the many hours I’ve spent in the field in multiple countries in Africa and Asia, I have yet to meet a customer who asked, “so, how is it going with getting all of us “included”?” Instead, customers ask questions about how they can qualify, how products work, or if they can get bigger loans for their businesses and more time to repay. They show an interest in tools that can help them grow their income, run their businesses better and reach their goals sooner and more cost-effectively.

As one customer, a duka (small shop) and restaurant owner once told me “my phone is my bank,” setting high standards for the types of services she expected to be possible on her tiny feature phone device. Customers want digital financial services to be shaped in a way that moves their personal life situations forward and delivers real utility. They do not see the provision of these services as merely a social impact obligation on the part of providers.

These observations provide some clues as to where the supply of digital credit in emerging markets needs to be improved. Though important, we need to go
beyond monitoring reported reasons for loan use and metrics like non-performing loans (NPLs). It is critical for our collective concern to also extend to assessing the actual levels of inclusiveness and customer value delivery in the current models of digital credit. That is the “why.”

We need to look for the building blocks that will help us bridge the customer value gap, as we build a digital credit market that includes more customers in the formal economy, on their terms, and in a way that allows them to achieve individual financial health and economic prosperity in an enduring manner. This sustainability is essential in a context where many customers are already vulnerable to shocks, including financial, social and political ones.

I believe that the following four focus areas are critical to bridging this gap and getting digital credit right for customers.

**Focus Area One**

**Opening More Doorways to Include Those Still Left Behind**

Much has been made of the use of mobile (big) data in the creation of credit scores for hitherto financially excluded customers. However, it is important to note that, while this is not the intention, many customers will be left behind by digital credit models that focus solely on such data as a means for qualification. Such models do remove access barriers, such as requirements of proof of address, income and so on, but they do not address many other economic, technological and social barriers that customers in emerging markets face.

Customers who live in extreme poverty (under $2 per day)—the bottom billion—have limited funds to spend on phone calls and other mobile activity required to generate the data footprint often used in initial digital credit scoring algorithms. Similar economic factors and other social factors that lead to lower active and advanced mobile usage among groups like women, rural residents and farmers, mean that they too are more likely to be left behind if there is an over-reliance on these data points.

The other issue is technology as a barrier. While emerging market smartphone penetration is rising, take up is not balanced. Many customers are still on feature phones, which can access the internet but lack full smartphone functionality, and are highly sensitive to transactional costs associated with the purchase and use of smartphones. As a result, for these customers, credit that is only available via smartphone apps is inaccessible. It is essential that the digital credit products offer a wide range of low-cost access options in addition to apps.

Data points that carry a cost for the customer to generate will exclude the customers and communities with limited liquidity. These segments need to be served too, even if they have less disposable income, lower confidence with mobile usage, lighter digital footprints, and more basic—or even shared—devices. Indeed, we know they want to be visible, and many are creditworthy, but they cannot afford the costs of access to a credit score.

Getting credit right will require providers to start thinking: “Mobile data is one doorway, but it’s not accessible to everyone. What are the other doorways?” Availability of digitized data, especially in Africa, remains a challenge. This notwithstanding, we are starting to see some exciting new models that use alternative behavioral data to open new doors.
for customers. Some examples include PAY-Go solar repayment data, retail data and agriculture-related data. No doubt many new partnerships will emerge in this space.

Focus Area Two
Marking the Doorways More Clearly

Even where customers theoretically have multiple doorways to qualification, one finds that the rules to achieving, maintaining or improving access remain opaque. The customer does not feel in control. It’s as though providers are saying: “there is a door, and the prize goes to the person who finds it because we will not be putting any signs up.” The insanity of this is perhaps best captured by one customer’s Facebook post to a digital credit provider in East Africa. She asked this provider how the qualification and loan offer process worked. She listed all the various things she had tried: saving, using mobile money transfers more, buying data and so on. To her frustration, this provider’s algorithm still found her unworthy of credit. Finding no logical reason for her exclusion this woman concluded her post with this assertion, “I can only assume that you have something against fat women!”

While we cannot expect providers to make their IP or credit algorithms public, surely the opaqueness in the current models needs to be addressed so that customers are not wrestling their way through qualifying structures with no visibility on whether they are close to qualifying or not. Indeed, much of our work on developing our JUMO Score and JUMO Points products has been driven by the fundamental belief that the platform needs to give the end-user more access to alternative ways of making themselves visible and also more insight into how we view their performance. This transparency matters to customers and has implications for healthy repayment.

To get digital credit right, we need to move a focus on increasing reach to new groups. We need more doorways to access digital credit and more transparency with regards to eligibility, qualification and terms. This is integral to empowering customers and allowing them to unlock more value from their digital footprints.

Focus Area Three
Creating Empowering Choices and an Exceptional Experience

While the majority of borrowers in emerging markets are self-employed or micro-entrepreneurs, a significant fraction of their loan use is for emergencies, cash flow smoothing and household expenses. Consequently, a frequent critique of digital credit is that it fails to promote economic development through MSME growth due to the diversion of funds to non-business uses, especially consumption. A suggestion has been that if loan sizes were more meaningful, then business loan use would increase.

I believe this is true to a certain extent, but the reality is that there is high fluidity between the business and personal lives of micro-entrepreneurs, especially sole-proprietors. So, given how financially vulnerable many of their enterprises and households are, the frequent misalignment between the incurring of expenses and receipt of income means that there will always be a significant level of loan use that is non-business. It is also worth noting that for customers, especially low-income customers, the dignity of being afforded privacy in the borrowing process and being able to choose how they spend the money is often empowering and valuable.

That said, there is a clear need for more meaningful and relevant choices. Unfortunately, in some markets, especially in Sub-Saharan Africa, the evolution of digital credit products has not been fast enough. Loan sizes and terms are important considerations. For example, there is unmet demand from MSMEs for credit to finance income-generating assets, such as machinery or upgrades to business premises. Achieving this with the current digital credit products is problematic, as most of them do not meet the required finance values or address the high variability and unpredictability of the customer’s income. In the most extreme cases, such as farming, where income is seasonal, customers might still be expected to make a loan repayment within 30 days. Consequently, some customers may choose not to take these products rather than risk default, and others may take the loan accepting the inevitability of penalty fees as a necessary expense when there are no other viable alternatives.
All these scenarios have implications for the customer’s credit history. This might lead one to ask why there are so few digital credit products that offer more flexible repayment terms in markets where there is limited formal employment?

Another critical part of designing high-quality financial choices is keeping an eye on the customer’s end goal. One of the things I’ve observed with customers in our markets is that they toggle savings and borrowing. It is not an “either/or” for many of them – both are tools to reach an end goal, often the acquiring of income generating assets or assets that are a store of value (cows, goats, construction materials for building a home, etc.). There is significant value in offering customers good digital borrowing and savings options, and even insurance to allow them to make their own decisions on how to achieve their objectives.

Digital credit products also need to give customers the means to increase their financial capability. The good news is that providers have made good progress in delivering SMS and in-app financial education. However, there is room for more investment in interactive and measurable customer engagement and support. Organizations such as Juntos have done much in this area to advance the use of engagement as a tool to make digital financial services more effective and enjoyable for end users. There is no reason why the digital credit customer experience should not be a delightful engagement, where customers feel well supported across touchpoints.

It is within our power to avoid situations where people are excluded, inactive or perform poorly purely due to the limited design of the credit experience and choices provided to them. These need to be customer value imperatives in digital credit.

**Focus Area Four**

**Rethinking Capital and Innovation Approaches for Radical Cost Reduction**

There is no doubt that for the most part, the loan costs in digital credit have remained stubbornly high in many markets. The explanations are varied; I will focus on two aspects that I think are the most pertinent for inclusive digital credit in emerging markets. Firstly, for some providers, high pricing is driven by the high costs of capital and higher risks associated with serving the harder-to-reach segments where there is little or no data available. Secondly, for others, it is due to inflexible pricing technology, which does not allow for personalized pricing. These are two very different issues and with different potential remedies.

The first is a structural issue in digital credit business models: many providers, especially in Sub-Saharan Africa, are reliant on foreign (USD) capital to fund their loan books. This foreign capital often requires a return on assets (ROA) that can be as much as two to three times higher than local banks (which may have mid-single digit ROA requirements).

These are not the most efficient pools of capital to solve the customer value and inclusion problems we have described so far.

One of these problems is the question of whether the most invisible (thin-file) people, who have few comparable alternative options, should still get digital credit – even if the cost to reach them is (at least initially) high. Having spent time with people in this segment, I have observed how digital credit often represents not just a solution to an immediate personal or business need, but often creates a feeling of dignity, where customers value the privacy and security of access, placing a high value on being empowered with the ability to make choices. If the answer to this question is “yes, they should have access too,” then the next step needs to be to find a way of lowering the prices of loans for these customers as well.

These are business model innovation challenges for the industry, distinct from product issues. Fortunately, they are not without solutions. We see the leveraging of local balance sheets happening effectively in Asian markets such as India, where the growing digital credit market has relatively low interest rates. On the JUMO platform, we have also begun this transition in our African markets, where we operate inclusive banking service marketplaces. We are finding that local, well-capitalized balance sheets are as crucial as low-cost cloud infrastructure in creating the necessary conditions to deliver pricing value to customers on credit products.

Pricing friction is the second major issue. Digital credit that is fair to customers does not apply blanket pricing...
and allows customers who have built up a good credit record to access better pricing as a reward. Secondly, when customers repay their loans early, they should be able to realize a reasonable pricing discount. On the ground, we find that for many customers their digital credit experience remains far removed from these two ideas. Sadly, there are digital credit products that continue to apply flat non-personalized pricing, and for customers such as daily fruit and vegetable traders in East Africa, early settlement is routine, but are still often required to pay a 30-day loan rate, even if they only borrowed for 2-3 days. Addressing these issues is a real and attainable opportunity to deliver value to customers. Many practitioners have pointed out the need for more flexible pricing mechanisms, such as early settlement discounts, personalized risk-based pricing, and so on. This is to ensure that customers are not merely price takers. I tend to agree, we on the supply-side of digital credit need to keep each other honest; when we talk about helping customers a create a digital financial identity and generate value from this identity; surely this needs to extend to them sharing the upside of their behaviors such as good repayment or even early settlement.

I would balance all this by noting an aspect of pricing that digital credit already gets right. When assessed holistically, the costs to access it, including all transaction and opportunity costs, are far lower than in traditional banking. Poorer customers and the self-employed cannot afford time away from their work or small businesses, or high travel costs, and they are generally able to access digital credit wherever they are, saving them both money and time. Unfortunately, these benefits are fragile and can erode quickly when digital transaction costs rise unexpectedly, for example, due to the introduction of new taxes on mobile money transactions and other mobile services. The costs of reporting and compliance are also likely to increase as the digital credit industry matures and therefore becomes more regulated. While this is good and welcome from a customer protection perspective, due care needs to be taken to ensure that customers are not left carrying the full cost of this provider compliance.

Researchers and inclusion practitioners would do well to look at and more effectively standardize measurement of “total cost to access,” as it may well be a new reason people get left behind. Interestingly, pricing and “total cost to access” is probably the area that will potentially open up the digital financial services market to large technology companies who are looking to broaden their emerging markets footprint. Many of these companies may have limited constraints, armed with low cost of capital to reach the invisible segments, and also have significant technological capability to be more agile in product design. Perhaps, further inspiration for current providers of digital credit to respond to the issues raised here quickly.

**So What?**

With large segments still unserved, it is clear that digital credit has not yet reached its full democratizing and empowering potential. For the customers who can access it, there are still unresolved frictions including, but not limited to, the quality of choices, costs and transparency. Besides this, there are many other issues that I have not touched on, such as data privacy, security and regulation. These too warrant attention, and the other essays in this series discuss them.

It is important to acknowledge the progress made in the first wave of digital credit innovation. It is also worth celebrating the fact that the feedback from customers using these products provides us with many of the answers we need to ensure that digital credit realizes its full promise of inclusive growth and development. In the different deployments of digital credit across emerging markets, there are also more
lessons in what works and what does not create customer value. These strands of customer feedback and live studies in product design, service delivery, financing and business models, offer a solid base to fix forward.

I have advocated for a focus on seriously addressing the issue of those left behind, creating new doorways to access that are easy to find, designing meaningful financial choices and innovative approaches to financing digital credit and pricing strategies that lower costs of access for customers. The golden thread in all of this is returning to the why: customer value.

Our “true north” is the customer context and what customers are trying to achieve in their lives with these products. An intentional focus on inclusiveness by design and pushing boundaries to deliver more customer value will ultimately help the actors in digital credit to address any unintended consequences more effectively and ensure we get credit right for customers.
In the summer of 2011, as BRAC Bank in Bangladesh prepared to launch its mobile money subsidiary bKash, those of us in charge of BRAC’s microfinance operations held a series of discussions about what the advent of mobile money would mean for microfinance generally and for our organization more specifically. In those heady days the excitement about bKash was palpable, but so were our concerns about its immediate impact on our work. We were particularly worried about the possibility that bKash would cannibalize some of our deposits. At the time, customer deposits accounted for over 40 percent of our liabilities, and we worried that if our clients opted to save in their bKash wallets instead of their microfinance accounts, not only would our cost of funds increase significantly, but our asset quality and customer retention might suffer as well. We planned for multiple scenarios, assuming each time that a sizeable hit was sure to come.

Then in August, bKash launched. In the months that followed, bKash set up tens of thousands of agents and signed up millions upon millions of accounts. By the end of its first year the word ‘bKash’ had become a verb in the Bengali language, meaning to send money. And yet, we saw no change in our overall deposit collection or deposit balances. The millions of women living in poverty who saved with us weekly or monthly, were continuing to save at exactly the same rate as before. Granted many of our clients did not have access to a mobile phone to begin with, and many of those who had a phone did not have their own bKash account. However, even for the increasing numbers of people who did have a bKash account, the relative convenience and ease of saving money in their bKash wallet did not prove to be a strong enough incentive to make the switch. They continued to save in our microfinance branches, and with microfinance institutions (MFIs) generally (Bangladeshi regulations allow MFIs to collect deposits from their members).

We realized quickly that our assumption—that what our clients want most is convenience—was wrong. For women living in poverty across Bangladesh, as for women in many parts of the world, among the most important considerations in deciding how and where to save is the ability to protect their savings, mainly from male members of their own family (typically husbands, but often brothers, sons or even fathers). MFIs, which typically make it rather cumbersome to withdraw deposits, were unwittingly providing a service of tremendous value to their female clients – protecting their savings. The ability and ease of “cashing out” anytime was not what most of these women wanted or valued. Quite the contrary.

A Switch to Technology Isn’t Automatic

We learned some important lessons from this experience. We realized that in order to serve our clients better in a rapidly changing world, we would need to do a better job of understanding their needs and aspirations—some evolving and others constant—and solve for them. The most important thing we realized was that even though technology offered the best opportunity to close the financial inclusion gap, the switch to digital, especially for women who are particularly excluded, would not happen automatically. Rather, if we are not deliberate and thoughtful about how to serve more women in poor and hard to reach areas, technology will not help to reduce the gender divide in financial inclusion.

We are already seeing this in the numbers reported in
the latest World Bank Global Findex database, 2017. The gender gap has remained unchanged from 2014 at nine percentage points in developing countries. Greta Bull, CEO of CGAP, wrote in a recent CFI blog post, “Bangladesh, Pakistan and Nigeria all have substantial gender gaps: 29, 28 and 24 percentage points, respectively. If in these three markets alone, access for women had grown at a rate equivalent to that experienced by men, the access numbers for 2017 would have increased by nearly 50 million, representing a 9.5 percent boost on the 515 million new account holders added in the three previous years.” But the situation is more complex. In Financial Inclusion Hype vs Reality, an analysis of the 2017 Findex by Elisabeth Rhyne and Sonja Kelly, the authors write that in countries with large gender gaps women face multiple barriers beyond financial access, and that “multi-faceted strategies in a range of development areas will be needed to overcome these disparities.”

Why is it important for women to have access to financial services? From purely an equity perspective, it is important that women have the same access to services—including financial services—as men. For that reason alone, it is vital to close the gender gap in financial inclusion, but it’s even more compelling than that. In every community, and particularly in low-income communities, it is women who manage scarce resources and ensure the wellbeing of their families. They are much more likely to spend money on education and health, and in their homes. They are also much more likely to save from their already meagre household incomes and invest for the future. Giving women options and tools to better manage their money can be transformational for their own lives and for that of their families.

And yet, the fact remains that for poor women in particular, access to even the most basic financial services—let alone the full range of financial services that they need—is still very limited. The growth of microfinance over the last four decades, through which over 200 million people, the vast majority of whom are women, have accessed basic credit and savings, has addressed this gap to an extent. But even the number of people the global microfinance industry has reached is dwarfed in comparison to the number of people who still lack access to institutional financial services. Certain countries and regions have been better served, but availability of microfinance is still largely concentrated in urban and peri-urban areas. Poor infrastructure and prohibitively high transaction costs have meant that poorer clients in the more rural areas still remain largely unserved.

The spread of mobile phones and the advent of mobile money is supposed to change all that. By drastically reducing high transaction costs, technology should eliminate the challenges posed by distance and remoteness. Technology should make it possible to collect small deposits and offer low-value credit at reasonable prices to poor people in hard to reach areas, just as easily as we do in high density urban areas. An integrated set of services that includes electronic KYC, digital credit scoring and mobile transfers should make it seamless for clients to save money, apply for and get loans and make repayments. However, in practice, all of this is much more difficult to do at scale than it sounds, and when it comes to closing the financial inclusion gap for women, the complexities only intensify. There are myriad challenges that will need to be

However, while MFIs bring the focus, credibility and knowledge of clients into the mix, they can’t go it alone given the number and complexity of the challenges that need addressing.
overcome before low-literacy and low-income women can gain access to a range of affordable and responsibly delivered financial services. Many of those challenges—financial, technological, behavioral, cultural and more—have already been written about extensively. Instead of fixating on the problems, we need to quickly start finding solutions. But who will lead the charge?

How Much Should We Embrace Technology?

The microfinance industry has taken its fair share of criticism over the years, but it is difficult to deny that its principal focus on reaching people who are underserved, and women in particular, has led to hundreds of millions of poor families becoming financially included and benefitting from access to financial services. As we now build on that to include many hundreds of millions more, I believe that focus is essential. Without it, we will continue to see the absolute numbers of people who are financially included increase, but the most excluded and the most vulnerable will remain excluded.

Who better to ensure that focus than the microfinance industry itself, which instead of seeing the advent of digital financial services as an existential threat, should embrace technology more energetically as an opportunity to expand its reach. The social mission of MFIs, coupled with their knowledge and understanding of the clients and the trust and credibility they have built up over decades, will be critical to ensuring that technology extends financial services to those who need it most and in a manner that is most appropriate. However, while MFIs bring the focus, credibility and knowledge of clients into the mix, they can’t go it alone given the number and complexity of the challenges that need addressing.

Even after seven years of bKash, we have not been able to find a way to use bKash for microfinance loan disbursements and installment collections in Bangladesh. This is not because of the lack of will or organizational buy-in. As a matter of fact, it should help that the director of microfinance at BRAC and the chairman of the board of bKash is the same person: me. Rather, it’s because of several other factors that neither BRAC nor bKash can address on our own. While some of the challenges can be addressed together by the two entities, like tweaking certain processes and moving to a tariff structure that works for both sides, there are other challenges that are more difficult to surmount, such as the lack of a biometric national ID for all adults and that a credit bureau for MFIs requires public investments in critical infrastructure. Slow progress is being made to resolve these challenges. The financial regulator has not helped matters by putting arbitrary limits on mobile account usage, and unless these limits are lifted or liberalized, we won’t be able to realize the full potential of mobile money for financial inclusion.

I believe that we need more collaboration and partnership to make sure that technology works for those who need it most. The example above demonstrates why not only the providers of different services (traditional financial institutions, mobile network operators [MNOs], mobile money services [often the same as MNOs but not always], fintechs, behavior change experts and human centred designers) need to partner to address some of these challenges. Governments, donors, policymakers, regulators and civil society organizations also need to come together and work towards finding the right solutions.

A Bridge Built with Collaboration

Fortunately, we are already seeing a lot of collaboration. Different types of organizations are partnering to address some of the challenges, especially ones associated with providing financial access to women. Opportunity International, with the support of PHB Development, ran a number of gender-focused initiatives to increase DFS adoption by women in Ghana. Nearly two-thirds of their customers are women but “it was discovered that women represented less than half of the customers registered for mobile banking. Furthermore, when it came to the actual use of mobile banking services, women represented less than 30 percent of active users.” Opportunity conducted a study to identify challenges faced by women when trying mobile banking, focusing especially on customers who had voluntarily registered for mobile banking. Furthermore, when it came to the actual use of mobile banking services, women represented less than 30 percent of active users.”
materials that created a safe space for women to ask questions and build digital literacy.

The Pakistani private development finance institution Karandaaz brought in GRID Impact, a consulting firm specializing in financial inclusion product design, to help design a smartphone application for mobile money that would specifically target women. GRID used a human-centered design (HCD) methodology, which involves researcher immersion in the customer’s milieu so that design ideas spring from the customer’s daily experience, and then tests rough prototype designs repeatedly with customers to refine concepts before a formal pilot. GRID’s challenge was to design a service that was easy and appealing for low-income and low-literacy women. With the understanding that cultural norms in Pakistan limit women’s travel and movement beyond the home, the interface included audio instructions which allowed the women to build confidence to use the application within the comfort of their homes. User input also led to changes in the icons on the screen, for instance, a question mark became an image of a woman wearing a headset (that is, someone a customer can talk to in a call center). This helped women who still wanted personal help from an agent should something go wrong. (More insights from this project are available on the CGAP Blog).

In Uganda, a multi-partner project including UNCDF’s MM4P, worked with MTN and Commercial Bank of Africa (CBA) to provide insight and guidance to launch MoKash, their mobile savings and loan product. This engagement utilized HCD and financial diaries research to improve product adoption in rural areas, especially for women and people living in poverty. The results of the research clearly indicated a need for direct engagement when it came to educating the client on the terms and conditions of the product, and that on-the-ground support such as service centers, agents and a helpline are critical to assist rural customers with registration and initial transactions. After one year, MoKash had 2.5 million registered customers with about half of them actively using MoKash. However, MTN and CBA acknowledge that more engagement around education and customer protection will be needed as they go more rural.

BRAC in Bangladesh has been piloting several approaches, with support from the Bill and Melinda Gates Foundation, to help more people access financial services through mobile money. One of those efforts has led to over 15,000 female clients using bKash to pay small amounts into monthly commitment savings plans. So while bKash itself has not eaten away at BRAC’s deposits, BRAC is now using bKash to make it easier for many of its clients to make regular payments into their microfinance savings accounts. Withdrawing the money from these accounts still requires the clients to physically visit a BRAC microfinance branch and write out an application to the branch manager. Partnerships, like some of the ones we are already seeing and many more, are key to unlocking the potential of technology for the most excluded, especially women. These examples indicate the different types of actors that have a role to play and also show the investment in customer understanding and feedback needed to make products successful. Sometimes the challenges might seem daunting, but by focusing on the women who we are trying to include and understanding their specific conditions, we might be able to find the solutions.

Can we serve an abandoned woman left to provide for herself and her five children in rural Tanzania, or a young bride in an isolated village in Pakistan who is now responsible for the wellbeing of a large joint family? Can we come together in time to ensure that they can borrow to start livelihoods, save for their children’s education, have the resilience to manage shocks, and perhaps even contribute to a micropension scheme to guarantee a dignified existence in the twilight of their lives?

We can. We must.

The author is grateful to colleagues Bridget Dougherty and Tahjib Shamsuddin for their invaluable assistance with writing and researching this essay.
“How is that possible? They can’t have it,” Parameshwari shakes her head and waves a bangled hand. “What is ours will belong to us. We give someone information because they need it. How can they give that to everyone? Why should everyone have my information?”

Parameshwari sits next to a sewing machine in a sparsely furnished room in Chennai, India, where she earns less than $10 a day, according to a 2017 research collaboration, Privacy on the Line, between Dalberg, Dvara Research and CGAP. She speaks for many consumers around the globe, equally baffled by claims made in the name of “big data” (watch the short film version of Privacy on the Line for more consumer voices in India). How is data about individuals collected and shared? Do they have any real say in the matter? Are their governments protecting them?

The current passion for data – its promises and perils – is everywhere evident in the press and policy making. There is little new about the practice of companies and governments collecting personal information about their customers and citizens. What is new is the enormous scale on which this information is collected and stored (largely in ways which are invisible to the individual concerned); the speed and accuracy of the information which may emerge from tracking individuals in real-time rather than questioning them later; and the extra insights which may be gained by combining information from numerous sources, both public and private. These are the features which make “big data” big.

Data issues concern everyone, and not only in their financial lives. This essay focuses on how the collection and use of data for the purpose of providing financial services affects consumer’s financial lives and other parts of their lives, with a particular focus on the most vulnerable customers – the base of the pyramid in frontier and emerging markets.

**Enthusiasts vs. Skeptics**

**Big Data Enthusiasts:** “The number one most important thing for any business … is data.”

Big data enthusiasts warn that many opportunities to improve lives are wasted when we fail to collect, store and analyse data, or keep information “silied”, refusing to disclose it to other entities. Big data can reveal a picture of the world previously invisible to human faculties. With the addition of machine learning, computers can decode patterns in this ocean of information, providing answers sometimes even before we know the questions.

These advances may deliver important benefits for financial inclusion. As a first step, data can help identify areas where consumers are not being served by traditional financial services and potentially determine why. Are women not opening or accessing accounts? Are they required to transact through their husbands? Are people from a particular ethnic background disproportionately excluded from insurance?

New ways of using data can help to close identified gaps. While traditional financial institutions may see little value in opening their branches in poorly-served rural areas or lending to small businesses with scant credit history, new players have shown a willingness to serve these consumers and bring rivalry to the market, using alternative sources of information. A lender might, for instance, use customer location data...
data collected by mobile network operators to offer credit to those with no formal credit history. If, for instance, location data reveals a woman travelled to the same marketplace every day from six in the morning until four in the afternoon for the last three years, that can support her claim that she has operated a food stall in that market for this period.

Lenders have used a broad range of mobile phone data for the purposes of alternative credit scoring, including contacts, geolocation data, apps installed, SMS messages and call logs. In Kenya, for example, Branch has used such data to provide uncollateralised credit to a range of underserved customers. TLa, also operating in Kenya, has found that people who make regular calls to their family are 4 percent more likely to repay their loans. This information is based on Tala's analysis of customers’ call logs and the content of their text messages, for example, the use of the word “mama”.

Credit providers also use bill payment data, social media data (such as the size of the customer’s network), psychometric testing and e-commerce transactions to predict the likelihood that a borrower will make their repayments on time. The CEO of Zest Finance has gone so far as to say that “All data is credit data”.

Seeking more data may allow providers to better meet the particular needs of a group of consumers who struggle to use conventional products. Understanding and tracking the seasonal fluctuations in the income of small-hold farmers, for instance, can allow a lender to tailor repayment terms to those cycles.

Both traditional banks and new players have also analysed large-scale data sets to discern patterns that identify and predict fraud. Acting on this information to reject fraudulent transactions reduces costs to providers and customers alike. In a number of countries, alternative data sources permit financial institutions and fintechs to identify customers previously excluded for lack of formal identity documents.

Big Data Skeptics: “Unless we look to change course in this sector, the risks and dangers to privacy loom large”

Privacy and data protection advocates have expressed serious concerns about these developments. This should come as little surprise. The underlying approaches of “big data” and data protection are, in a sense, fundamentally at odds with each other. At the heart of data protection is the limitation principle. Data protection says: Collect and use only that information which is necessary to serve the immediate purpose. Big data says: Give us everything you have and we’ll see if we can find a purpose for it.

Is it safe to permit the unrestrained collection and use of data?

Harms from the Use of Personal Information

These concerns are not only hypothetical. The collection and use of consumer data by financial services providers has already caused harm in both well-known and relatively obscure instances. Opportunistic providers have exploited customers’ personal information for their own ends with devastating effect. In Kenya, digital lenders published
the details of defaulters on Facebook, using public humiliation as a debt collection tactic. In China, lenders have used information about students’ financial hardship to offer loans which are easy to access but include high interest rates and severe penalties for default. There was a spate of suicides among the students when they later defaulted on those loans.

Data changes power in relationships. If a customer surrenders large amounts of personal information to a company, they become vulnerable to numerous forms of intimidation and exploitation which they cannot anticipate or control. An inherently unequal power relationship has become more unequal.

These opportunities for abuse are greater in jurisdictions where there is no general data protection law or responsible lending law, or little effective enforcement of these laws, as is the case in many developing countries. But even with such laws in place the use of personal information often does consumers no favors.

Ryan Calo, Assistant Professor at the University of Washington School of Law, has described the practice of vulnerability-based marketing, which uses personal data to target consumers based on their particular weaknesses. But as Calo points out, in the online environment, companies can also engineer moments of vulnerability by designing the timing, context and interface of an online transaction in a way that creates frailty in that particular individual, influencing the consumer to act against their own best interests.

Providers who engage in such exploitative conduct exist, even on the frontiers of financial inclusion. I have heard the representatives of providers on stage at a conference or summit recite the mantra, “We would rather ask forgiveness than permission.”

But many providers and organizations are genuinely committed to the pursuit of financial inclusion and customer-centric business models, including the fair treatment of customer information. Unfortunately, even responsible, well-intentioned players can expose their customers to risks. Here it is necessary to consider the risks of unintended harms and risks that arise directly from the collection of personal information.

The consequences of new types of collection and analysis of information enabled by rapid advances in technology are still being discovered. Many champion the use of algorithmic processing and particularly machine learning to gain insights from big data, and a number of the advances outlined earlier were achieved through such processing. However, researchers have also revealed that these algorithms may discriminate, exclude and produce otherwise inaccurate conclusions to the detriment of consumers.

Sometimes these tendencies are built into the program itself as a result of human bias. Algorithms are used to identify “high value” and “low value” consumers, presenting greatest risk for those who are already vulnerable and disadvantaged. Algorithms may also produce results which are plainly wrong when the data being processed is unreliable. This is a major issue in some developing countries where studies have shown that large percentages of the data held are inaccurate, incomplete or out of date.

In other cases, machine learning produces its own discriminatory tendencies. The fact of this flawed analysis cannot always be understood, particularly given increasing reliance on “black box” algorithms which produce results based on their own form of reasoning, not evident to their creators.

These data practices may bring the comfort of scientific terminology, quantitative analysis, and sharp-edged graphs and tables, but this does not make them immune from embedded bias, error and unjust outcomes.

**Harms from Collection Alone**

Acknowledging these risks and harms, some argue that we need only be concerned with the misuse of personal information. Collection alone is innocuous; misuse can be identified and addressed. This approach would permit businesses and governments to harvest personal data at will, unconfined by regulation, then determine at a later date how they might use the information and whether the proposed use is lawful and appropriate. This approach is flawed.
The simple act of collecting and storing an individual’s personal information significantly increases the risk of harm to that person. As soon as we collect and store personal information, we increase the “attack surface” – that is, we increase the opportunities for that information to be hacked, stolen or used without authorization. The more data is stored and the longer it is stored, the greater that risk becomes.

These breaches can cause severe harm. Identity theft can cause a lifetime of expense and exclusion for the individual concerned. And harm is not limited to the individual. These events can have drastic consequences for consumer confidence, trust in the company holding their information and trust in financial services more broadly, working in direct opposition to the goals of financial inclusion.

Major breaches of Equifax, Facebook and the US Office of Personnel Management illustrate the reputational harm and losses to corporations and government from data misuse. Bruce Schneier, a security technology expert at Berkman Center for Internet and Society, Harvard University, has long pointed out that, for the firm holding the information, data can be a “toxic asset”.

Even projects launched with the best intentions are subject to these risks. Taylor gives the example of the Harvard Signal Program on Human Security and Technology which aimed, in part, to identify forensic evidence of alleged massacres in Sudan with the advantage of unprecedented detail from satellite imagery analysis. However, researchers on the program discovered that hostile actors appeared to be hacking into the Harvard systems and using the project’s data and communications to target their enemy.

Information that companies store about a consumer may also be accessed by governments, which do not always have due regard for the rule of law. In the East and West alike, the media has revealed numerous occasions where governments have required companies to surrender information about individuals in secret and without due process.

We should not forget that in some countries it is illegal to express dissent or criticize the government, to practice a certain religion or engage in homosexual activity. Information that seems harmless viewed in isolation – a person’s transaction history, social media posts or location data – can reveal highly sensitive information, especially when combined with data from other sources.

The mere collection and storage of information can be profoundly unsafe for the individual concerned.

Is consent the answer to responsible use of data?

How then should we identify the boundaries of fair collection and use? Should we leave the decision to each individual, making data practices dependent upon their consent? One study asked consumers in Uganda whether they would be willing to trade some privacy for access to a loan or a better interest rate. It reported that many consumers were willing to make such a bargain.

Privacy terms have often been viewed as a bargain or
trade of this kind. That is, companies propose certain privacy terms to consumers, usually via a privacy notice, and each consumer makes the decision whether to exchange some of their informational privacy for the benefits offered by the company. This approach is said to respect the individual’s freedom and autonomy in making decisions about their informational privacy on the basis of their own privacy preferences.

However, we should be very cautious about drawing conclusions from the fact that consumers living in poverty say that they would give up some of their privacy for money. This is likely to say more about their straitened circumstances and their lack of alternatives than the legitimacy of the supposed bargain.

The nature of privacy policies themselves also frequently prevents consumers from making informed choices, seemingly designed to hide rather than reveal the most relevant or concerning data practices. Policies almost universally begin with reassurances about the company’s concern for privacy, their diligence in protecting the customer’s information, as well as obvious, innocuous uses of customer information. More problematic terms come later, phrased in vague, open-ended language which guard the company against the accusation of unauthorised use without enlightening the consumer.

And as CFI Fellow Patrick Traynor of the University of Florida documented, the privacy policies of many traditional and digital financial service providers use language more suited to university graduates than ordinary consumers.

“Signing terms and conditions is not a matter of choice – it’s something that you have to do because you have no choice,” said interviewee Sanjay as quoted in Privacy on the Line. These terms breed incomprehension. Even with the benefit of high literacy rates and education levels, in Australia, around one in five consumers believes the existence of a privacy policy means that the company will not share their personal information with another company. Further, these policies are generally presented on a take-it-or-leave-it basis, and use “bundled” consents: that is, they do not provide separate options concerning uses of personal data beyond the immediate purpose of the transaction but require consumers to consent to all specified uses or none.

The informed consent – or “notice and choice” – model of privacy regulation is subject to more fundamental criticisms, which go beyond the deficiencies of privacy policies. This model was developed in the United States in the 1970s at a time when data practices were entirely different from those of today: collection of information was generally visible and actively involved the individual; the cost and difficulty of processing, storing and transferring data naturally reduced its exposure to misuse; machine learning, online monitoring and mobile phone location data did not exist.

Even if the clarity and usefulness of privacy policies are greatly improved, the nature of new data practices and their consequences will make it extraordinarily difficult for consumers to understand the privacy terms companies offer, let alone their consequences: consumers will lack the information necessary to make a rational choice. The mere process of consumer “consent” may be meaningless.

Prioritizing Data Protection in Emerging Markets and Developing Countries

A recent study by Dalberg, Dvara Research and CGAP revealed that, even among some of the world’s poorest, privacy is highly valued and protected to the extent that it will not be exchanged for financial incentives.

“Certain kinds of data are not tradeable. Even if you give me a 100% discount, I won’t share my browsing history,” notes Sushma, a customer in Delhi, in the report.

The Omidyar Network conducted a survey of customers of alternative credit scoring services in Kenya and Columbia which revealed that 82 percent of respondents in fact regard their mobile phone calls and texts as private information, and even more
private than medical and financial data.

But is the need for basic financial services more pressing than these sensibilities? Where should our priorities lie when there are people in developing countries who have never had the ability to save using a bank account or transfer money digitally to far-away family or insure themselves against misfortune?

The contention that the right to privacy should be subordinated to the economic needs of the poor was considered by the Supreme Court of India last year in the landmark decision of Justice K S Puttaswamy v Union of India, where the Court held for the first time that there is a fundamental right to privacy in India. It would be hard to improve on the response of Justice Chandrachud, who delivered the Plurality Opinion:

“The refrain that the poor need no civil and political rights and are concerned only with economic well-being has been utilised through history to wreak the most egregious violations of human rights. ... The pursuit of happiness is founded upon autonomy and dignity. Both are essential attributes of privacy which makes no distinction between the birth marks of individuals.”

There is no simple answer to the question of how data can be used safely and fairly to meet financial inclusion objectives.

While there is compelling evidence of potentially very serious risks to vulnerable individuals and groups, we lack certainty about the actual incidence and impact of the relevant harms. It is therefore tempting to suggest that high standards of data protection should be a second-order consideration, a “nice-to-have” which can be addressed once businesses have been persuaded to serve the underserved, free from the burden of extra regulation. Unfortunately, this is a situation where justice delayed would be justice foregone.

Once personal data is collected, disclosed and distributed to numerous parties, there is no retrieving it. The exposure of that data cannot be undone. With current technology, it can be stored and aggregated in perpetuity, throughout the lifetime of the individual concerned. When harms occur, they will undermine customer trust in the very services which might otherwise have improved their lives.

These factors weigh in favour of an approach that deliberately errs on the side of caution and restraint. Such an approach requires that we forgo some uses and disclosures of personal data until those uses and disclosures can be safely made, as explained below.

**Building Trust and Fairness**

**Global Developments and Lessons for Data Protection**

There have recently been a number of positive global developments in data protection which should interest providers concerned to adopt innovative and responsible data practices. In this part, I outline the unfolding events as well as some proposed best practices we can glean from these developments.

In May 2018, the General Data Protection Regulation (GDPR) came into effect in the European Union (EU). The GDPR is intended to create certainty for business and enhance consumer trust, placing additional obligations on organisations processing data in the EU or about individuals in the EU, including improved standards of consent, a right to erasure and very substantial penalties for infringement.

The GDPR has had ripple effects beyond its actual legal application. For instance, some organisations operating across numerous jurisdictions have seen economies of scale in adopting the same systems of data governance in all jurisdictions and adopted the GDPR requirements as the highest applicable standard.

The implementation of the GDPR has also driven an increase in the development and availability of privacy enhancing technologies (PETs) which allow organisations and their customers to use IT to manage privacy in more securely and conveniently.

The GDPR has also led to a fresh focus on privacy by design, which makes privacy part of the foundational design requirements for systems, rather than a “bolt on” down the track.

Encouragingly, a number of organisations have recognised the importance of privacy to their
customers and compete on privacy quality, including by the use of PETs and privacy by design. Apple, for example, has emphasised just-in-time privacy notifications which give users a choice about providing their data at the moment when an app is attempting to collect that data. Other organizations are using PETs such as transparent, user-friendly, easy-to-navigate online privacy policies and consent interfaces to earn their customers’ trust.

Regulatory developments in the EU have also led to growing consensus on data protection regulation outside the EU. This has been driven in part by the fact that a number of countries wish to ensure their standard of data protection regulation is sufficient obtain an “adequacy assessment” under the GDPR, allowing organizations in those countries to process data about individuals in the EU. Professor Graham Greenleaf, a global privacy expert at the University of New South Wales, believes that a new global standard is actually emerging as a result of the widespread adoption of the standards in line with the Council of Europe data protection Convention 108, a regulation which he explains includes many, but not all, of the GDPR requirements – a “GDPR-lite”.

Drawing on these developments there are certain data protection principles which providers should be implementing now in the interests of consumers, financial inclusion and their own reputations, whether or not they are currently subject to data protection regulation:

◊ **Privacy by Design (PbD).** Critically, PbD recognises that privacy is not a zero-sum game: it does not require a trade-off. It is possible to provide innovative and affordable services which respect customers’ privacy, particularly when organisations make privacy fundamental to the design of systems, from their very inception. This is not a costless exercise and some will argue that cost will deter providers from operating in developing countries. At the same time, some organisations will be establishing modern databases and IT systems for the first time, providing a prime opportunity to build privacy into these systems from the beginning, without the baggage of legacy systems.

◊ **Minimization.** According to the minimization principle, organizations should limit their collection and handling of customers’ data to that which is actually necessary for the immediate purpose and, equally, delete or destroy that data when the purpose is complete. This minimizes the “attack surface” of the data, reducing the likelihood of harm to consumers but also the organization’s exposure to liability and reputational harm in the event of data breaches.

◊ **Transparency.** Organizations must provide transparency about the fate of consumer data in the hands of the organization. Privacy policies need a major overhaul. These policies should not be used to excuse, but to inform. They should therefore highlight, and lead with, precise descriptions of the collections and uses that are likely to be least expected and most concerning for consumers.

◊ **Consent.** Customer consent should not be established on the basis of pre-ticked boxes, nor should it be implied from customers’ continued use of a service where there is a privacy policy incorporated in some section of an app or website. Customer consent should be explicit, fully informed (in a language and mode of delivery the customer understands), unbundled, revocable, and require action on the part of the customer. An organization should not refuse to supply services based on the customer’s refusal to consent to data collection or uses which are not necessary to supply the customer with those services.

◊ **Access, correction and erasure.** Customers should have a right to access the information which an organization holds about them, both so they understand the extent of the information collected about
them and so they can require corrections where that information is inaccurate, incomplete or out of date. Increasingly, new data protection regulations also provide customers with the right to require erasure of their data when the purpose is complete.

◊ **Data breach notification.** Organizations should provide customers with notice of serious breaches that affect their data and their potential consequences. This requirement is increasingly a part of data protection regulation around the world. While organizations may instinctively seek to hide or diminish information about data breaches, a number of firms have learned through bitter experience that this approach only exacerbates reputational harm when the breach is inevitably discovered.

◊ **Liability.** Organisations should take responsibility for the protection of consumer data to the extent that they accept liability for harms caused by the organisation’s failure to adequately protect that information from misuse in the hands of the organisation and in the hands of third parties to whom the organisation transfers that information. This would include liability for the re-identification of personal information which was purportedly disclosed on a de-identified basis.

These principles are not only fair to customers and likely to engender greater customer trust and confidence in the provider and financial services. They can also help us to be more rigorous in our assessment of the benefits and limitations of big data and to impose a sensible discipline on our use of data, reducing the risks of liability and reputational harm for data collectors. They may even remind us that there are still other ways of understanding our world. As Greenleaf has argued, “We must avoid the assumption that only a datafied world is understandable and valuable, and that more data is preferable to better data.”
The world is being dramatically transformed by technology such that the digital revolution includes everyone. This is a radical change from the industrial revolution, where only those rich enough to cover the costs of physical service could be included. In a digital world, digital service is cheap, fast and global. This is the transformation we see happening right before our eyes. Have you noticed?

Until recently, only one-third of people living on earth had a bank account. Two-thirds of humanity were excluded from financial services. The result of this inequality is that, for those who were unbanked, they had to pay more for any financial service as a percentage of their transactions. Then, in 2007, Vodafone’s subsidiary Safaricom launched M-Pesa in Kenya, and the world changed. Not only was M-Pesa a roaring success, but its concept was copied in most countries across Africa, Asia and South America. I say concept because M-Pesa itself has failed to repeat its success in other countries. This is a reflection of the reach, breadth and depth that a mobile operator needs to make such services work, and is why Orange dominates the mobile money market in Mali and EcoCash in Zimbabwe. More on this later. But the concept is the same across all nations: use the mobile phone to move money.

This is a wonderful change we see in the world. We see the sudden rise of the poorest people in places mobile financial inclusion touches. Now, people in areas decimated by drought can get micro-insurance services to enable them to avoid starvation; people in the remotest areas can get micro-loans to start new businesses; and people with no accessible physical financial services can save their money safely and easily through micro-savings.

All of this is driven by the mobile telephone revolution, and is best illustrated by Alipay, the Chinese mobile money giant. In 2013, China had no mobile money system as such; five years later, the Chinese transact over $15 trillion a year via Alipay and WeChat Pay. Based upon this success, Alipay is exporting their expertise, technologies and capabilities to other countries where financial inclusion is a priority: Indonesia, the Philippines, Pakistan, Thailand and more. In fact, if you didn’t know it, Alipay is the backbone partner of PayTM, the Indian mobile wallet that aims to bank 500 million Indian citizens by 2020.

This is the core change taking place, but what is it that Alipay got right and M-Pesa got wrong? Why can Alipay power financial inclusion in so many countries, but M-Pesa cannot? What is the right infrastructure play for financial inclusion, and what are the mistakes that are made?

The Four Big Aspects of Success

Having written several books about mobile financial inclusion, my takeaway is that there are political, economic, social and technological aspects that must come together to get a successful roll-out of financial inclusion.

For example, when M-Pesa was launched, it had the support of the Kenyan government and central bank (political), it was launched in a country where 90 percent of citizens had no financial service (economic), but with a real need to move money safely and easily between cities and villages (social), and with a technology that was just coming of age to do this: a 2G mobile network (technological). However, if you look at M-Pesa’s attempt to launch in other countries, it has only succeeded where similar circumstances exist, such as in Afghanistan. Where one of these factors falls down, such as in India, where almost half the population has access to financial services, it has failed.
However, M-Pesa failed in India whilst PayTM is succeeding. Why?

It is a strange phenomenon, as Vodafone had all the right ingredients for success in India with major bank partnerships (ICICI Bank and HDFC), and an existing mobile subscriber base of almost 200 million users. However, several ingredients were missing: a supportive government, an economic and social market need and the right infrastructure.

In Kenya, M-Pesa’s infrastructure largely relies on agents providing the mobile network with cash-in and cash-out services. In India, building a high-density network of humans to support transactions proved a major overhead, with Vodafone hiring almost 100,000 sales agents to get the service going.

In Kenya, the government helped launch M-Pesa but in India, the government already had its own service going: the Unified Payments Interface (UPI). Equally, the structure for mobile payments was based on GSM’s Unstructured Supplementary Service Data (USSD) technology, which is expensive in India. For example, a text message costs 0.15 rupees, but USSD sessions cost up to 1.5 rupees (USD$0.02). When the average annual household income in rural areas is 5,000 rupees, using USSD at those rates is undesirable.

The big difference with PayTM is that it’s using Quick Response (QR) codes, which is cheap for the merchant, as it requires no new technologies. No agent network is required. And no special set-up is needed to get the service up and running.

Equally, PayTM is supported not just by Alipay’s technologies but by the money of Alipay’s Chinese visionary, Jack Ma. Alibaba own over a third of PayTM’s equity and have regularly supported their funding rounds, investing $680 million in 2015 and more since. PayTM also benefited from the Indian government activities around UPI and demonetization. When Prime Minister Narendra Modi announced his demonetization initiative, which eradicated the use of 500 and 1,000-rupee banknotes in November 2016, a massive blitz of advertising for PayTM followed. This led to adoption rates exploding from just over 125 million users before demonetization to 280 million a year later (November 2017).

PayTM has also been designed to exploit the government’s India Stack. The India Stack combines many elements from a digital identity scheme (Aadhaar) to a standardised real-time payment system (UPI). It turns out that PayTM is the most used service on UPI, processing around 40 percent of all transactions on the platform in February 2018.

This all leads to the key lessons learnt from both M-Pesa and PayTM:

◊ **Political.** Both services work with government-sponsored initiatives and, if they don’t – as M-Pesa discovered in India – they fail.

◊ **Economic.** The service needs to appeal to the country’s structure and an agent-based services worked in Kenya, where most of the population was unbanked, but failed in India where far more citizens are banked; PayTM tapped into the demonetization moment.

◊ **Social.** The key thing about M-Pesa’s success in Kenya is that people are nervous about moving cash, as it can easily be lost or stolen; in India, the fact that people had to move to being cashless through the force of government made the difference.

◊ **Technological.** SMS text payments and 2G services worked in 2007, when that technology
was at its peak but, ten years later, mobile internet and QR-codes make much more sense for both merchant and consumer.

**A Giant Ant**

There’s a final key ingredient that is missing here, however, and is clear from the vision and involvement of Alipay, Alibaba and Jack Ma in PayTM. Alipay and their parent firm, Ant Financial, have a vision of two billion users by 2025. They are already well on their way towards this number from their expansion outside China, and the vision is driven by financial inclusion.

The Ant program is a mix of several factors.

First, investment. As mentioned, Alibaba has significantly invested in PayTM, as well as their other partnerships with Mynt in the Philippines, Easypaisa in Pakistan, Emtek in Indonesia, B-Kash in Bangladesh and Ascent in Thailand.

Second, experience. In the examples given above, we can see that all of them are benefitting from Ant Financial’s experiences with making Alipay a success in China.

Third, technology. In particular, the ease of the QR payments system and the benefits it can offer both merchant and consumers is a killer app. For example, the merchants can make dynamic offers to consumers when they are nearby in real time, and take payments with just a code on a piece of paper. A consumer can make payments easily in an app and get discounts and offers that are relevant to them there and then. It’s a win-win for both the merchant and consumer.

But it is more than that. The most important factor Ant Financial brings is technology capabilities and vision. Ant Financial is first and foremost a technology company that happens to deal with money, and they have developed an amazing array of open financial technology capabilities over the past 15 years. Their platforms can already process over 250,000 transactions per second – Visa globally processes 2,000 per second on average – and they have created a complete marketplace of open financial application programming interface (API) used by many Chinese banks and offered to all of their partners as a technology platform they can use if they want. Vodafone, by contrast, has good capabilities to provide text payments, but lacks a broader concept for using technology to develop a multi-player marketplace.

**4 + 4 Success Factors**

These four factors – investment, experience, technology and capabilities – combined with the other four factors – political support, an appropriate economic climate, social need and technology innovation – are the real ingredients that create the right infrastructure for financial inclusion.

Without the right breadth and depth of experience and funding, it fails. Without the right breadth and depth of government support and customer need, it fails. With all those factors together, it succeeds.

This is why many of the most successful examples of financial inclusion are not a mobile network operator or technology company working alone, but a complete ecosystem of players from governments to technology firms to fintech startups to telecoms firms working together to make it happen. For example, when GCash began in the Philippines, it was a stand-alone telecom offer by Global Telecom. It struggled for nearly a decade, until recently a partnership with Ant Financial has turbocharged the offering and it is proving far more successful.

I have personally seen many attempts to create infrastructure for financial inclusion. For every success, there are multiple failures, but the key to success is having all the players cooperate. Financial inclusion requires an ecosystem of all to make it happen.

The more that governments prioritize inclusion, technology firms deliver the capabilities, and mobile operators provide the reach, the more success we shall see in getting the two-thirds of humans on earth capable of succeeding in the future when, historically, the system has let them down.
The digital revolution has allowed new actors, such as non-bank financial service providers (FSPs) (like mobile money providers) and fintechs (companies that apply new technologies such as Artificial Intelligence to the provision of financial services and products), to leverage connectivity, new technologies, and data analytics to bring innovative financial solutions to market. This has resulted in dramatic transformations of the financial sector in both mature and emerging economies. New products such as nano-credit and mobile person-to-person (P2P) transfers have allowed alternative market players to reach consumers that formal banking and payments providers had never served before.

Such innovative solutions have often brought real competition to segments of the financial services industry, resulting in greater consumer choice, lower retail prices, higher quality of service and increased financial inclusion. Mobile money in Sub-Saharan Africa is a good example, due to its dual functionality as payments and low-cost value-storage vehicle, which matches poor peoples’ uneven cash flow. When Safaricom first launched M-Pesa in Kenya, it offered an innovative way for the middle class to send money home, competing with formal and informal providers of remittances services. That innovation and competition has turned out to be one of the greatest game-changers in the pursuit of financial inclusion that emerging countries have seen in the past half century.

Today, fresh on the heels of mobile money and digital credit, there is a much larger fintech wave challenging incumbents and creating new markets based on novel technologies, such as artificial intelligence, big data, and geospatial intelligence. These solutions range from robo-advising (such as StashAway and Autoweight) and crowdfunding (e.g., Kiva) to virtual currency-based remittances (Bitpesa) and blockchain-enabled capital raising platforms (Capexmove). At the same time, super platforms such as Google, Facebook, and Amazon are entering the financial services sector, leveraging their massive databases of customer data to do so.

Traditional, established players have been stepping up to these competitive challenges by innovating. For example, by using a combination of technology, data analytics, and client research, traditional FSPs are identifying patterns in customers’ financial behaviors and decisions in order to determine which customer segments may benefit from cross-selling and what cross-sell strategies are appropriate for each segment. Cooperativa Acreimex, Banco WWB, Capital Aid Fund for Employment of the Poor (CEP), and SAJIDA Foundation are examples of FSPs in Mexico, Colombia, Vietnam, and Bangladesh, respectively, that are intentionally pursuing cross-selling strategies that impact the institutions and their customers.

Some innovative products, however, raise concerns that supervisors should monitor and regulators consider carefully. For instance, the rise of digital lending in Kenya has raised the risk of over-indebtedness. Moreover, the World Bank’s Consultative Group to Assist the Poor (CGAP) has pointed out that at least one digital credit product in the country resembles a Ponzi scheme.

The digital revolution can render financial sectors extremely competitive at different levels of the value chain. The nimble fintechs, which are often not regulated by the primary financial authority, use technology as a way of tackling distinct parts of the financial services value chain, thereby undercutting...
incumbents that have relied on economies of scale and customer inertia for market share. At the same time, super platforms make formidable competitors to both incumbents and fintechs alike, due to the intrinsic network effects that they exhibit (whereby each new member exponentially increases the value of the platform), their lack of interoperability among themselves and their tendency towards standardization of service features, to the exclusion of small players. Lastly, traditional players, increasingly aware of these competitive threats, are repositioning themselves to remain competitive through collaborations via accelerators and joint ventures, as well as by undertaking acquisitions and internal reorganizations.

The vigorous competition triggered by technological innovation and the entrance of new players in financial services can bring a multitude of benefits to financial inclusion. Effective competition in price makes financial products more affordable, which is essential to drive adoption among low-income populations. Competition equally drives up quality and service standards, which helps adopters remain active users, and encourages the development of new products that are often targeted at specific consumer needs, including those of low-income individuals. Lastly, competition and innovation reinforce each other in a circular manner, as competition promotes further innovation, which may foster financial inclusion.

However, there is a dark side of unchecked market innovation and competition that regulators and supervisors must heed. In particular, the increasing significance of digital channels as the way to access financial services, the rise of customer data as a critical asset for business development, and the existing market power in the sector of origin of many new actors may require closer scrutiny from financial authorities. For instance, in a sector where the value of data has significantly increased, given its utility for credit scoring or customer targeting purposes, the entities that control these data have important market advantages. Similarly, the control of the USSD channel grants an advantage to mobile network operators (MNOs) for downstream digital financial services.

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Unfair leverage of these assets could ultimately stifle competition, rendering existing customers worse off and curbing the market’s incentives to reach untapped customers, including those at the bottom of the income pyramid. Traditional incumbents may also be pressured to undertake problematic actions that preserve their market share, including unfairly bundling products, preventing interoperability with competitors in regard to their proprietary platforms or to other payment infrastructure, such as switches, creating opaque pricing structures or inappropriately forcing exclusivity on their agents and distributors.

**Prioritization of Financial Inclusion Alone May Not be Sufficient to Achieve Success**

The focus on financial inclusion by financial sector policymakers and regulators has borne fruit in many countries. According to CFI’s recent review of the 2017 Global Findex, there are 22 “surge” countries in emerging markets that, starting from very low inclusion, saw dramatic increases in the number of people with access to accounts in the past three years.

However, not all countries have seen growth in formal financial inclusion in recently, even against the backdrop of financial inclusion mandates. Nigeria, Mexico, and 14 other countries actually saw a decline in the numbers of individuals with access to formal financial services since 2014 in the Findex data. This emerged even though many of their financial authorities have been explicitly tasked with implementing policies and strategies around financial inclusion, alongside their core responsibilities for promoting micro- and macroprudential stability, financial integrity, and consumer protection.

Nigeria would seem to be a perfect candidate for achieving financial inclusion using new business models that leverage widespread connectivity, mobile phone penetration, and agents, given that it boasts 84 percent mobile phone penetration yet only 4.9 bank branches per 100,000 people. And indeed, from 2011 to 2014, Nigeria’s formal financial inclusion numbers jumped from 30 to 54 percent, no doubt at least partially fueled by the launch of its National Financial Inclusion Strategy as well as its “Cashless Nigeria” policy in 2012. Yet the 2017 Findex reported a drop in those formally financially included to 49 percent, even after the Central Bank of Nigeria established the Financial Inclusion Steering Committee and the Financial Inclusion Technical Committee in January 2015, and launched the three-year Digital Financial Services Project in January 2016.

Meanwhile, the mobile money market remains undeveloped. As of 2017, fewer than 6 percent of Nigerians had a mobile money account, compared with 73 percent of Kenyans. The regulatory framework limits competition in the provision of digital financial services; mobile network operators (MNOs) are not permitted to provide mobile money services either directly (as in Kenya) or through subsidiaries (as in Ghana, Tanzania, Ivory Coast, and many other countries); while issues around fair access to the Unstructured Supplementary Service Data (USSD) channel also remain unresolved.

In Mexico, the number of individuals who were formally financially included decreased to 37 percent from 39 from 2014 to 2017 according to the Findex. All forms of savings and borrowing fell, with “saved any money” falling to 41 percent from 58 and “borrowed any money” to 32 percent from 51. These decreases occurred despite the fact that Mexico launched its National Financial Inclusion Strategy in June 2016 and enacted a financial reform law in 2014 that strengthened the country’s banking and securities regulator to increase competition and lower the cost of borrowing. Several factors suggest there are market structure issues at play in this decline, including that the financial sector is dominated by handful of major banks with low incentives to invest in inclusion, while the rest of the sector is fragmented, featuring numerous, and often informal, small financial
institutions with limited capacity.

And even in countries where financial inclusion has been seen as a success, such as Kenya – where the number of individuals formally financially excluded has decreased from 58 percent to 18 percent from 2011 to 2017 according to the Findex – competition issues are inhibiting financial inclusion from achieving its full potential. The last decade has seen the unchecked rise of Safaricom in mobile telecommunications and mobile money markets in Kenya, with a currently reported 73 percent market share in mobile telephony and a 81 percent market share in mobile money held by its mobile-money service M-Pesa. Although initially Safaricom’s market strength in mobile telecommunications created the conditions for the successful roll-out of mobile money, this dominance is now arguably resulting in lower innovation and higher prices and is increasingly drawing the attention of the market regulators such as the Communications Authority of Kenya as well as the Kenyan Parliament.

**The Mandate of Financial Authorities: The Case for Adding Competition and Innovation**

The nature of the mandates of financial policymakers, regulators and supervisors has evolved significantly. Until the mid-1990s, financial authorities were primarily tasked with ensuring price stability and preserving the soundness of the financial system, although some also aimed to promote the deepening of the financial sector. Throughout the 1990s, their mandates expanded to incorporate additional agendas, in part to accommodate a new global regulatory governance framework for international financial markets.

During the last two decades, mandates in many countries have broadened to include financial integrity and consumer protection. The push for greater integrity in financial markets was driven, in part, by a growing awareness of the extent and pernicious effects of money laundering and terrorist financing. The Financial Action Task Force (FATF) emerged in the late 1980s to define internationally agreed-upon standards for anti-money laundering (AML) and combating the financing of terrorism (CFT). Major incidents, such as the terrorist attacks of September 11, 2001 and revelations about widespread tax avoidance through opaque legal arrangements (e.g., “Panama Papers”), added urgency to the effort.

Financial consumer protection also became a prominent objective for regulation and supervision around this time, with several financial authorities taking action to better protect and empower customers. The 2008-2010 global financial crisis accelerated this trend, as it showed how closely consumer protection entwines with financial stability. In 2010 the G20 called for the establishment of G20/Organization for Economic Co-operation and Development (OECD) Task Force on Financial Consumer Protection and called on the Basel Committee for Banking Supervision (BCBS) to explore linkages between consumer protection and stability in mortgage lending. Some governments created or strengthened specialized financial conduct units within their central banks or separate authorities that field complaints, oversee firm behavior, and investigate reported misconduct. The passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act in the United States in 2010 and the establishment of the Financial Conduct Authority (FCA) in the United Kingdom in 2013 are symbolic of this trend.

In the last decade, financial inclusion has also received new global recognition from standard-setting bodies, international organizations, and financial authorities. Many countries are making international commitments, formulating national strategies, and implementing regulatory reforms to foster inclusion. Starting in 2012, financial inclusion advocacy organizations such as CGAP and initiatives such as the Global Partnership for Financial Inclusion (GPFI) introduced the “Inclusion – Stability, Integrity and Protection (I-SIP)” framework to assess the linkages among the four objectives, which could be either synergies or tradeoffs depending on the context. They argued that an inclusion mandate could contribute in numerous ways to the other three mandates, potentially forming a mutually interlocking and supportive approach, or could actually be harmful to the other objectives if there is no attention paid to potential synergies and tradeoffs – consider, for example, how directed
lending in India contributed to the Andhra Pradesh microfinance meltdown. According to the BCBS, “Financial inclusion can introduce potential benefits to the safety, soundness and integrity of the financial system. However, it can also bring potential risks to providers and customers alike, and entail the transfer of well-known risks to new players.” The Alliance for Financial Inclusion (AFI) noted, “the importance of policymakers’ understanding of these linkages. From a policy perspective, much can be gained from a better understanding of these interrelationships and coordinated policy approaches.” Some countries have also adopted the I-SIP framework at the national level.

However, the numbers from Nigeria, Mexico and others suggests that solely adding financial inclusion as a top objective to the traditional policy objectives of financial sector regulators has not been sufficient to ensure progress in certain countries. The changes the financial sector is undergoing – discussed below – suggest that competition and adaptation to innovation are becoming equally important policy objectives that financial authorities should assess and pursue when developing and promulgating policies that aim to achieve financial inclusion.

The digitization of financial services, and innovation more broadly, much of it with financial inclusion aims or potential, is transforming financial markets, affecting all four I-SIP objectives and the linkages among them. Moreover, innovative regulatory frameworks (such as the European Union’s Second Payment Services Directive and the United Kingdom’s Open Banking initiative) may be the trigger for further innovation, modifications of competition dynamics and access to formal financial systems in the long-run. The landscape is radically transforming with these developments, and the linkages (positive or negative) between competition, innovation and the four I-SIP objectives are too complex, too various, and too important to be managed so as to maximize synergies and minimize tradeoffs, unless financial authorities add attention to innovation and competitive dynamics to their mandates.

In this article we argue that recent market developments and evidence from the field call for additional mandates to be added to the financial authorities’ span of concern to make their mandate more comprehensive. Specifically a “C” for competition and another “I”, for innovation should be added to the I-SIP framework. In doing so, financial authorities should intentionally consider and address the relative synergies and trade-offs of competition and innovation with the I-SIP objectives in a structured, manageable manner, investing in tools – like the regulatory impact analysis (RIA) framework (to determine the change affected by regulations and policies and isolating the right variables for achieving the regulator’s objectives), the OECD competition assessment toolkit (to identify unnecessary restraints on market activities and developing alternative, less restrictive measures that still achieve government policy objectives), regulatory and supervisory technology (RegTech for regulators and SupTech) solutions (to harness the power of data and technology to develop intelligence for supervision and policy/regulatory development), and modern data architectures (to convert voluminous raw data into easily digestible insights) – to systematically assess those complex linkages between all six policy objectives and master the new era of digital finance.

Two Additions to the Policy Mix

Certain financial authorities already have overarching competition and/or innovation mandates in their foundational legislation, which actively support their policy approaches in this area and have helped to insure the health of their financial sectors. The Financial Conduct Authority (FCA) in the United Kingdom, for example, has three operational objectives – consumer protection, integrity and competition, as per Article 1 of the Financial Services Act. Moreover, since its establishment in 2013, the FCA has worked closely with the newly established Competition and Markets Authority (CMA) to actively promote competition in financial services.

Further, some central banks in the European Union (EU) are explicitly required in their foundational legislation to abide to the various European treaties, which include competition and technological advance as key objectives of economic policy. For example, the Estonian Central Bank is required to abide to the Treaty on the European Union (TEU) – which sets out “a highly competitive social market economy” and the promotion of “scientific and technological advance” as key objectives of the European Union –
and to the Treaty on the Functioning of the European Union (TFEU) – which states that the activities of the Member States shall include “the adoption of an economic policy which is [...] conducted in accordance with the principle of an open market economy with free competition.” Similar references are made in the Central Bank of Malta Act. A recent review of Estonia’s financial system by the OECD has not identified any wide problems relating to competition in the banking sector since its accession to the EU in 2003, while Malta has a robust and competitive financial services sector, with the banking sector having grown in the last two decades from 4 local banks to 27 licensed banks in 2016 and a 58 percent increase in the number of new financial services providers from 2015 to 2017.

The objective of promoting financial innovation, even though it is not explicit in their mandates, is prominent in many initiatives that financial authorities have undertaken. Fintech regulatory sandboxes are a clear example of this trend. The objective of the Monetary Authority of Singapore (MAS) sandbox is to “grow a smart financial center where innovation is pervasive and technology is used widely to enhance value, increase efficiency, manage risks better, create new opportunities and improve the lives of Singaporeans.” Therefore, “MAS is encouraging more fintech experimentation so that promising innovations can be tested in the market and have a chance for wider adoption, in Singapore and abroad.” Similarly, the objective of Bank Negara Malaysia’s (BNM) sandbox is to provide a regulatory environment that is conducive for the deployment of fintech. This includes reviewing and adapting regulatory requirements or procedures that may unintentionally inhibit innovation or render them non-viable. As part of this process, the Financial Technology Regulatory Sandbox Framework is introduced to enable innovation of fintech to be deployed and tested in a live environment, within specified parameters and timeframes.”

Given how fast the financial landscape is changing in emerging and frontier markets, the increasing importance of innovation in fostering financial inclusion and of competition in the development of healthy financial sectors, financial authorities should have both the mandates and the tools to intentionally consider and address the relative synergies and trade-offs of competition and innovation with the I-SIP objectives in a structured, manageable manner, as we discuss in the following paragraphs. In keeping with the I-SIP framework’s approach, the assessment, monitoring, and evaluation of any policy or regulatory intervention should evaluate – and possibly measure – the impacts of such interventions on financial inclusion, stability, integrity, consumer protection, innovation, and competition.

Below, we lay out some linkages between innovation and competition, and between those objectives and the current objectives in the I-SIP framework.

### Competition and Innovation

Most of the time the linkages between competition and innovation in financial services are positively reinforcing. While competition can be price- or quality-driven depending on the market, in financial services competition often drives increased innovation, as new business models and new technological solutions displace or build upon old ones in the market. (For example, although the mobile money services M-Pesa has ultimately conferred a quasi-monopoly power on to Safaricom in mobile money, it has also set the foundation for further competition in the newly-developed digital credit market, with M-Shwari – a credit product offered by the Commercial Bank of Africa and Safaricom – currently competing with KCB M-PESA–Equity Bank’s short-term loans and M-Co-op Cash.) At the same time, innovation is critical to boosting competition across the spectrum of financial services as it allows new players to enter a market that normally has high barriers to entry and pushes incumbent players to respond with more varied and better-priced offerings. It should, however, be noted that sometimes innovation must be fostered by the granting of exclusive intellectual property rights (such as patents), as companies otherwise are likely to be unwilling to invest in the innovative process (often the case in research-intensive industries such as pharmaceuticals). Innovation can also be used to stifle competition, such as when a significant player is able to enter a market, offer an innovative service, and then corner that market due to its market power.
Competition, Financial Inclusion And Financial Sector Development

There are numerous linkages between competition and financial inclusion. The entry, capitalization, and growth of new firms in a market economy is positively associated with more efficient allocation of capital, financial sector development, and greater financial access for both individuals and enterprises. Financial inclusion also has a positive effect on the growth of new firms in all industries, and this correlation is magnified when bank markets are less concentrated, a proxy for more competition in financial services. One reason for this is that the development of financial inclusion can mitigate credit constraints on entrepreneurial activities by reducing information asymmetry in financial transactions. It should be noted, however, that as financial inclusion is multidimensional, so its linkage with competition is equally multidimensional. The effect of competition on financial inclusion will vary by country and specific sector, as will the effect of financial inclusion on the growth of various firms and industries. Thus, a more in-depth analysis of these linkages is essential.

Competition and Financial Stability

The relationship between competition and stability is more complex; as stated by Allen and Gale, “Sometimes competition decreases stability and sometimes perfect competition is compatible with the socially optimal level of stability.” Research on Chilean banks has shown that losses on small loans created by new entrants in a market pose less systemic risk than the large, infrequent, but also less predictable losses associated with the large loans of market incumbents. Thus, as noted by CGAP in its 2012 brief on financial inclusion and stability, “Greater financial inclusion in terms of access to [retail] credit might also coincide with greater stability at the level of providers of financial services.” On a more macro-level, the process of bank consolidation and the resulting financial conglomerates have resulted in stability concerns, as “the size and complexity of these institutions might undermine proper regulation and supervision” as they are “too big to fail.” On the other hand, certain studies have found that increased bank competition for deposits erodes profits, thus lowering the market power of banks and encouraging them to take on new risks, which endangers financial stability. Further, consumer microcredit markets have overheated due to intense competition, and this has led to financial instability in some markets. Given this complex relationship, regulators would “benefit significantly from regularly assessing the combined effect of competition and innovation on financial stability.”

Competition and Consumer Protection

Consumer protection and competition are also interdependent. Although historically often viewed as a subset of competition policy (in the EU, consumer protection became a policy objective only in 1993 with the Treaty of Maastricht, 36 years after the introduction of competition policy by the Treaty of Rome), consumer protection is now seen by regulators, including competition authorities, as policy objective on par with competition policy. It has even been argued that the concept of “consumer sovereignty” links both areas of law, with competition laws striving to ensure that consumers have an adequate range of options, and consumer protection laws guarantying that consumers can choose effectively from among those options and that they are satisfied with the standards of quality and safety available. One of competition policy’s aim is to protect the consumer, and market conduct regulation contributes to the fair and even playing field where all actors may compete. If a competitor wishes to contend in a given market, it must ensure that, at a minimum, it meets legal consumer protection obligations. As per the OECD, “Competitive pressure is needed to encourage providers to offer competitive products, enhance innovation, and maintain high service quality.” Thus it comes as no surprise that national legislation often combines competition and consumer protection in the same act (for example Australia’s Competition and Consumer Act) or delegates their implementation to the same authority (e.g., Zambia’s Competition and Consumer Protection Commission). But consumer protection can also play an added role in financial services, as enhanced consumer protection can be a differentiating factor for certain actors in the market, given customer preferences for services they can trust. For example, Apple’s reputation for security, reliability and strong privacy standards has given its ApplePay solution a clear advantage over its competitors.
Competition and Financial Integrity

The relationship between competition and financial integrity is multifaceted. The trend towards the demutualization (when a company transitions from a member-owned to a shareholder-owned firm) and privatization of stock markets, for example, has led to greater efficiency in these services without compromising (and indeed often enhancing) financial integrity.

In some cases, competition can even enhance integrity. FATF has recognized, for example, that financial exclusion is a money laundering and terrorist financing risk. When competition leads to financial inclusion it can potentially increase financial integrity. However, allowing less well-capitalized market players to enter the sector may increase the risks for money laundering and terrorism financing if the new players have fewer resources for proper AML/KYC compliance, and by increasing the supervisory burden on AML supervisors.

Innovation and Financial Inclusion

As set out above, the introduction of mobile money services, such as Safaricom’s M-Pesa in Kenya, has been a catalyst for financial inclusion; following the launch of M-Pesa in 2007, financial inclusion in Kenya rose from 27 percent in 2006 to 83 percent in 2016. In Tanzania, only 21 percent of adults have traditional bank accounts while 38 percent have mobile money accounts. Further progress regarding financial inclusion has been made through the innovative use of data analytics and alternative credit scoring, which have increased the types of financial products available to the bottom of the pyramid as well as the use cases that can incentivize inclusion and adoption. Novel technologies such as artificial intelligence and blockchain are on the cusp of delivering a new generation of innovations that may drive financial inclusion even further. However, whereas an innovation that establishes a robust digital transactional platform could provide the base on which to build an entire ecosystem of inclusive products, an innovation that allows insurers, for example, to micro-segment risk could lead to massive exclusion – as bad risks are excluded from the pool.

Innovation and Financial Stability

Technology-enabled innovation in financial services could both support and undermine financial stability. For instance, while mobile money does not increase traditional systemic risk to the financial sector (due to its relatively low value), it could increase operational risk to systemically important payments infrastructure, due to the large increase in the volume of transactions processed through the national payments system and the speed of money circulation. The use of mobile money accounts to store value, as well as new digital savings and credit products, could also strengthen financial stability by increasing aggregate savings in the formal financial sector and enabling financial institutions to diversify their deposit bases and loan portfolios. On the other hand, rapid credit expansion without proper controls could reduce financial stability through over-indebtedness and high nonperforming loan ratios. According to the Financial Stability Board (FSB), “Fintech innovations can bring many opportunities. Innovations may already broaden access to finance for individuals and small businesses. New applications may enhance business processes, such as payments and settlements, compliance and risk management. At the same time, fintech may lead to a number of practical issues from a financial stability point of view that regulatory and supervisory authorities should consider in order to support the development of a strong and sustainable financial system as innovations in financial services mature and are more broadly adopted.” It should be noted, however, that the FSB’s comments are focused on the potential risks and benefits of fintech innovations rather than on competitive pressures.

“Competitive pressure is needed to encourage providers to offer competitive products, enhance innovation, and maintain high service quality.”
on a sample of specific fintech activities, including digital credit, robo-advisors, wholesale payments innovations, digital currencies, artificial intelligence and machine learning, and that regulators should analyze each fintech activity individually for its effect on financial stability.

Innovation and Consumer Protection

Assessing the impact of innovative products on customer experience and customer exposure to risk (including fraud, mis-selling, and theft) is particularly challenging. The rise of digital lending requires supervisors to monitor the risk of aggressive marketing practices, over-indebtedness, transparency of product cost, awareness of terms and conditions, availability of recourse, and discrimination and bias – all of which are risks with traditional models, but which take on new guises with digital models, due to the erroneous application of artificial intelligence, machine learning and big data models for credit scoring. On the other hand, the adoption of digital financial services also enables FSPs to offer financial services that are often safer and more convenient than informal ones, to provide more understandable information to users, to embed financial literacy and suitability tests in products, and to deploy new systems to request the user’s informed consent to the collection and usage of their data.

Innovation and Financial Integrity

Finally, technology-enabled financial innovation can play a very important role in promoting the integrity of the financial system, increasing the traceability of financial transactions, and increasing the quantity and quality of information related to user identity available for AML/CFT supervision. Digital KYC may significantly reduce the cost of compliance for financial services providers while generating information that allows supervisors and financial intelligence units to fulfil their financial integrity mandates. Some new risks arise, however, when new payment channels (such as the internet and the mobile phone) and new technologies (e.g., virtual currencies) are deployed. On a different hand, some of the provisions in AML/CFT regulatory regimes could greatly discourage the deployment of new business models – identity verification can be a difficult and costly process and AML/CFT compliance requires extensive resources – and render innovative solutions commercially unattractive.

Conclusions

Only 15 years ago, the formal financial sectors in most countries were dominated by banks and a few payments providers, with a number of non-bank deposit and credit institutions such as microfinance institutions (MFIs) and savings and credit cooperatives organizations were active under limited oversight from the financial authorities. The rapid digitization of finance, the fast pace of technology advancement and the rise of data-driven innovation has transformed financial sectors and created opportunities for financial authorities that are pursuing financial inclusion to adapt their approaches by, for example, creating windows of opportunity for mobile money providers and sandboxes for fintech firms.

It has been said that, “Finance is nothing more than a long chain of innovations leading to development of novel financial products and processes used to improve allocation of capital and risk management.” These innovations change market dynamics, creating new benefits and risks for financial stability, integrity, inclusion, innovation, consumer protection, and market competition. Policymakers and regulators should specifically assess these impacts when designing their policy or regulatory interventions and monitor each to evaluate the ongoing results of their work. Including a detailed and systematic assessment of competition and innovation impacts would allow supervisors and regulators to better understand and address these dimensions that are critical for the realization of their financial inclusion objectives since new policies, regulations, and changes in supervision can hamper innovation and distort competition dynamics. This is particularly important in emerging and developing countries, where innovation within a freely competitive environment can help leapfrog several stages of market development.
It has been said that, “Finance is nothing more than a long chain of innovations leading to development of novel financial products and processes used to improve allocation of capital and risk management.”

It is becoming clear that achieving financial inclusion also hinges on the capacity of regulators and supervisors to integrate competition and innovation objectives into their mandates and activities to unleash and manage the potential of new technologies and business models, and to maintain the financial system sound and resilient. We believe that for the financial authorities that pursue financial inclusion, it is now time to invest in the full and formal adoption of an evolved version of the I-SIP framework that includes innovation and competition.

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Across emerging markets, we are in the early stages of a digital financial revolution that promises to upend the status quo while vastly expanding services to people who were previously un- and underserved. As investors, we believe we can play a catalytic role in ensuring that digital innovations have the opportunity to be market tested, refined and ultimately scaled.

This essay considers the role of investors in responding to the opportunities offered by the digital financial services revolution and bringing about financial inclusion. The comments here reflect the view from Quona Capital. Quona manages the Accion Frontier Inclusion Fund, the first global fintech firm for the underserved, and its successor, the Accion Quona Inclusion Fund. We believe that Quona brings a unique perspective with a view across a wide range of countries, business models and investor types – all focused on getting financial inclusion right.

**Fintech Innovators Are Creating an Enormous Opportunity**

In emerging markets today, financial institutions enjoy robust profits, with returns on equity in Africa well above 20 percent and in Latin America in the high teens. Incumbent banks are doing well by serving the well served, including corporate and government clients.

At the same time, there is a radical expansion of technology that changes the way financial services can connect to the underserved, and this has bred a new generation of entrepreneurs. These entrepreneurs are leveraging technology to, firstly, dramatically reduce delivery costs to enable services to groups that were previously too costly to reach, and, secondly, better understand – and therefore serve – customers who were previously hidden from view. These opportunities exist at both consumer and small business levels.

And the opportunities are enormous. In the U.S., even with its relatively well-developed financial sector, the alternative lending market for small business loans has gone from a market that barely existed ten years ago to one serving a projected 16 percent of the market in 2018. If this kind of opportunity exists in the U.S., it is even greater in emerging markets where small companies are much less well served.

With the advent of technologies like cloud services and smartphone apps, entry barriers are lower, and this is a great equalizer – both for fintech startups (who wish to compete with incumbents) and for the lower end market (no longer as disadvantaged relative to the middle class). The two biggest opportunities arise in lending to small enterprises and individuals and in digital payments. The payments and lending opportunities go hand in hand, as digital payments provide the data footprint that supports credit underwriting.

There are green shoots popping up in insurtech, too. The vast majority of the innovations in these areas are coming from startups that directly serve customers, though we also see partnerships with incumbent financial institutions, such as models in which banks provide capital while fintechs do loan origination and underwriting.

We also see opportunities in adjacencies to traditional financial services that bring together technology and finance. For example, we considered investing in a company offering an Uber-like motorbike ridesharing service in an African country. This thesis around
mobility-linked financial services was appealing in part because transportation is an important economic enabler which financing can further unlock. As an added benefit, this company insisted on the use of helmets, bringing greater safety to an often precarious occupation.

**The New Wave of Fintechs Need Capital and Support**

The innovation we are talking about is not driven by traditional financial institutions. Innovative companies are reaching out to specialized investors, which are essential for enabling them to obtain the financial lifeblood they need to thrive and grow. They need capital that is prepared to take on the level of risk involved with companies that are startups, using innovative technologies, to serve segments at the base of the economic pyramid in frontier and emerging markets. Each of these attributes carries heightened risk and therefore necessitates specialized, risk-bearing sources of support. Impact investors like Accion’s Venture Lab and Quona are willing to provide the risk capital to get promising companies up to a level at which they can mature and scale.

In addition to capital, our investees need a wide range of support to meet the various challenges involved with building young businesses. Probably our most fundamental role in that regard is as coaches for the leadership of companies. We are in a position to have open conversations with them about confronting and overcoming challenges, including external – macroeconomic shocks, regulatory surprises – and internal challenges – personnel, systems, etc. We aim to help them problem solve in a very quick and agile way – in keeping with the necessity for rapid response that these young companies face.

Part of what we can bring to these companies is knowledge of what’s going on in similar companies in other parts of the world. Because we review hundreds of opportunities every year, we gain insight into a great cross-section of key sectors, something that is difficult for business builders to obtain, with their laser focus on shorter-term execution. We can make connections. For example, we recently connected two companies, each working in supply chain finance, on different continents. One was good at the financial end of the business, while the other was good at the logistics – each looking to learn from each other as they scaled their operations.

We urge our companies to move beyond executing to building. As startups that are beginning to scale, they often focus on short-term execution – making it all work and reaching the next set of targets. A slightly longer term perspective is needed if they are really going to scale – because they often need not just incremental growth but significant leaps.

Talent is another of the most important areas to support. The technical talent these companies need exists, but is often not available locally in emerging and frontier markets. We often encourage our portfolio companies to hire outside their familiar networks so that they can bring in diverse new ideas and knowledge. We assist them to explore the unknown in a disciplined way, neither staying in their comfort zone nor leaping into the dark.

Companies may need assistance to broker important relationships, such as those very important, but sometimes difficult, relationships with regulators. It is tempting for Fintech companies to “fly under the radar” so that regulators do not notice them until they are well established. But this is not smart: regulators
need to be informed about how the market is evolving so that they can evolve their own regulations and avoid surprising companies later on. We can often make a difference by bringing experience from other countries into the dialogue. Recently in one country with a highly pro-incumbent regulator, we were able to discuss the rapid progress made in countries where regulators took a different view. Such conversations require nuance and political understanding, and it helps to have been through them in multiple contexts. Similarly, companies may need assistance brokering relationships with mainstream institutions with which they seek partnerships. Partnering with existing financial institutions may be one way for companies to make the leaps we mentioned above, but they are not easy to establish. As brokers, we have worked to enable both parties in negotiations to see the mutual benefit that can come if they partner effectively.

**The Gamut of Investors**

As companies grow from their earliest stages, they work with different types of investors that are equipped to shepherd investee companies through specific points in their lifecycle. Many of the earliest investors are incubators, including some funded by mainstream banks. Accion’s Venture Lab is a seed stage fund that comes in as the main elements of the business model have been developed, even before the business has broken even. Quona’s work comes in as companies are well-tested and beginning to scale. Quona seeks to catalyze the next wave of capital, including technology venture capital firms, mid-market private equity and buy-out firms, and financial institutions. These are the kinds of groups we look to as co-investors, new investors at later stages, and ultimately, buyers of our companies.

Mid-market private equity companies like General Atlantic (a $20 billion, New York-based fund), Advent (a $30 billion fund based in Boston) and Temasek (a $300 billion investment fund based in Singapore) have the ability to invest in amounts ranging from $50 to $300 million, taking a proven business model to significant scale. Ideally, we would like to have General Atlantic (or the like) look at one of our investee companies and say, “Wow, this company is capturing a good business opportunity and they’re executing well. We can provide the capital they need to scale.”

This is what happened recently with Clip, a company that makes it easy for small merchants to accept digital payments. This company, in which Accion’s Venture Lab invested at the seed stage, is working in the enormously untapped market of small merchants in Mexico. General Atlantic came into Clip’s Series C in a big way, allowing it to scale dramatically.

Technology venture capital funds, especially local ones, are often co-investors with us. In addition to capital, they bring experience in digital marketing, technology development and local markets, while we add the specialized lens of social impact, as well as specific fintech expertise. Also we see banks backing startups by setting up accelerators and funds.

Impact investors also play an important role: in reminding both investors and fintechs of the important goals underlying the work. In smaller and less developed markets, social impact investors more often take the lead. In bigger and more advanced markets, these investors had an important catalytic impact early on and are now able to cede some of the financing to more commercial players. In both cases we find that impact investors help companies to develop broader and longer-term vision, especially around market opportunities that might otherwise be overlooked.

And that brings us to an important point. Both mainstream and impact investors play essential roles in scaling companies. Accion Venture Lab identified promising early stage companies like Konfio – a digital lender for small and micro businesses in Mexico. Quona came in to provide growth capital followed by mainstream investors like QED and Vostok. Access to mainstream capital allowed Konfio to scale and capture a growing share of the Mexican SME financing market. But building companies is as much about vision as it is about capital. At Quona, we often say we’re practicing venture and private equity the way it was invented – around business building and value creation. Investors focused on financial engineering or looking for quick and easy returns lead to more zero sum outcomes, rather than creating greater value for the company, shareholders, and the ecosystem at large.
Theory of Change and Impact

Our theory of change is about creating a demonstration effect. Though we aim for our investees to grow and prosper, we know that they will not transform markets alone. Sector-wide change will happen when other businesses are drawn into the same markets and services when the success of our portfolio companies opens their eyes to the business opportunity. Sometimes the demonstration effect includes directly applying business models in new markets – or even as competitors to our own investees. All this is good.

We observe that in places where innovations are driven by startups we tend to see greater innovation in mainstream banking. The entrepreneurs bring new models to market, and that sparks a response from existing institutions.

The demonstration effect requires proven business models in order to draw in the interest of other investors. In many countries, this effect is already kicking in for the fintech sector. In fact, we are seeing fintech-oriented companies receiving an increasing share of all early stage venture capital in emerging markets – as much as 25 to 40 percent. Many of these companies are aiming directly at the previously underserved market segments as more investors recognize the opportunity to expand the market by reaching these new customers. We see investors shaping their own in-house expertise to be better equipped to support such businesses. Right now this activity is concentrated in a subset of markets – generally the larger and more advanced of the emerging markets, including Southeast Asia and countries like India, Brazil, Mexico, and South Africa.

As this shift toward more mainstream investors proceeds, concerns are sometimes raised about mission drift. We try to identify companies that are squarely focused on the underserved, whose entire business model is built around innovative ways to serve these segments. Such companies are not likely to move away from their impact focus as they grow. However, we also work with some companies that did not begin exclusively with the inclusion segment, and our role is to help them see the opportunity in inclusion and bring them tactical knowledge about reaching these segments.

We also think of the investor role not just in terms of building individual businesses but also in terms of building an ecosystem. In this regard, investors and often investee companies need to cooperate to make a market that works well and need to move beyond a winner-take-all mindset. Of course companies must consider their own needs in terms of confidentiality, intellectual property and competitive advantage, but it is often better for companies if there are multiple businesses establishing a new market in a given country.

Part of what needs building is the investor ecosystem itself. Investors need to contribute to a positive environment through knowledge sharing and talent development. One part of the ecosystem we would especially like to support is the market for debt. Our portfolio companies face extreme shortages of access to debt, and so we are happy to work with people and organizations who are putting debt mechanisms in place. Experienced impact and early stage investors can help new-to-fintech investors learn more about the sector through deep dives with their teams on a subsector or a region.

A Concluding Thought

As technology crosses borders, capital and talent flows to all corners of the globe. Money flows with great force toward places where it is most effectively deployed. This is an exciting and encouraging process to watch and even more to take part in. As investors, we have a great opportunity and responsibility to be proud of the world we are building.
The Center for Financial Inclusion at Accion (CFI) is an action-oriented think tank that engages and challenges the industry to better serve, protect, and empower clients. We develop insights, advocate on behalf of clients, and collaborate with stakeholders to achieve a comprehensive vision for financial inclusion. We are dedicated to enabling 3 billion people who are left out of — or poorly served by — the financial sector to improve their lives.

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