Strategic Partner

The Arab Financial Inclusion Hackathon

Financial Inclusion | Financial Literacy | E-KYC and Customer Onboarding

AskMeAnything Session

Fintech disrupting MENA: Will it Solve a Billion $ Question?

November 3, 2020

Digital Debate Highlights

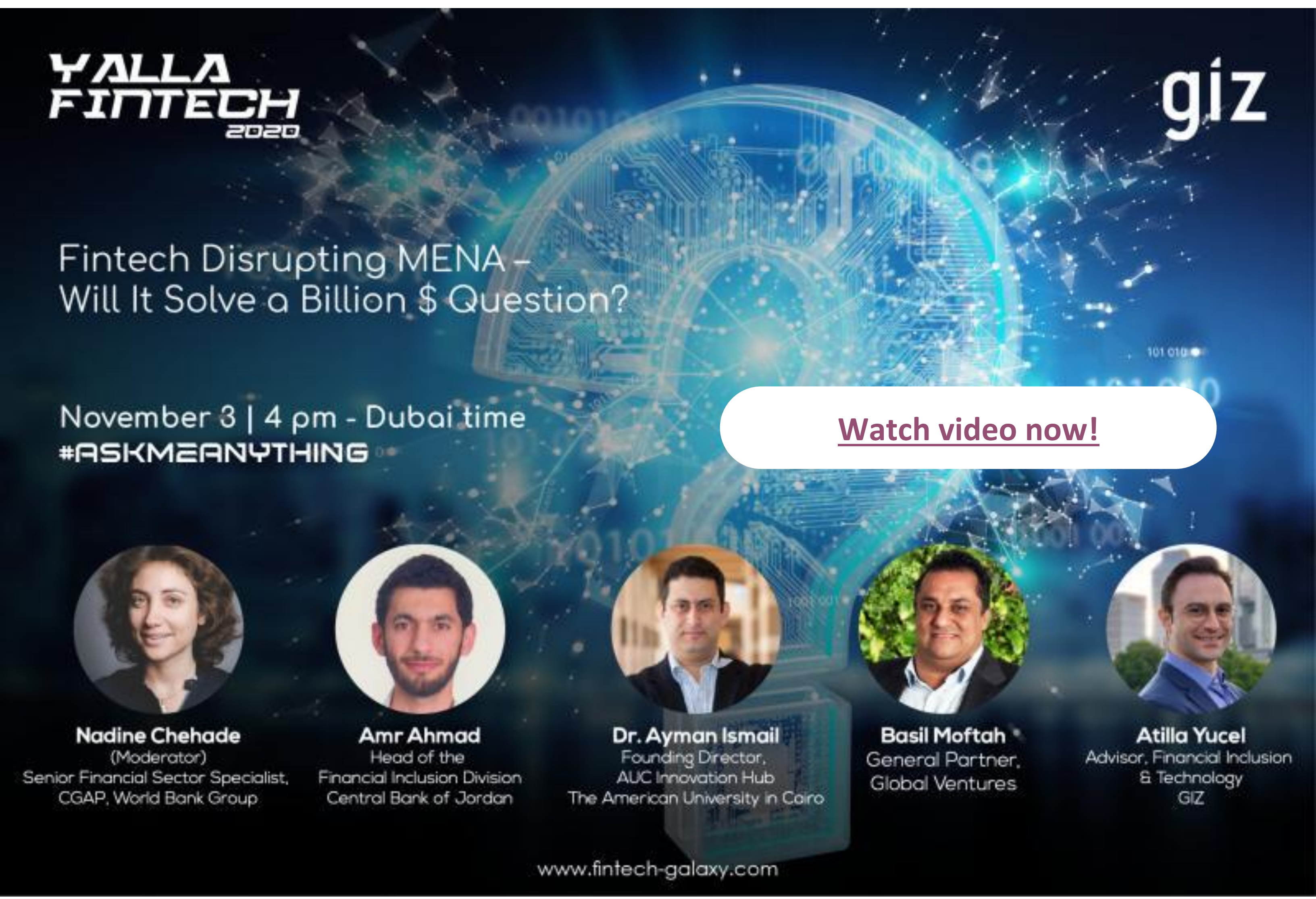
Background

Yalla Fintech 2020 is the Arab world's first digital hackathon to boost collaboration and novel solutions in Fintech that make a difference for Financial Inclusion. The AskMeAnything Session established dialogue with sector innovators to gear collaborative innovation towards development objectives.

The new era of tech in finance (Fintech) is affecting societies and economies worldwide but it is far from certain how the impacts will play out in the long run, including for 1.7 billion people yet left outside the financial sector. Covid-19 risks to aggravate inequalities while in some areas it accelerated the uptake of digital finance. In the Arab region, around 300mn people are excluded from the traditional financial sector: Can they be served - better - or will they get lost in the digital divide?

In fact, access to financial services relates to a potential market of 63% of adults and a combined funding gap by MSMEs of USD 186 billion. Additional financial inclusion in Arab countries, reaching half the untapped market for individuals and MSMEs by 2024, is estimated to bring about an additional revenue potential of USD 7 billion for financial services providers, notwithstanding spill-over effects into labour markets (CGAP 2019). Can Fintech provide the investment opportunities for inclusive growth in the Arab?

With our outstanding panel we discussed: what will it take to solve this billion-dollar question?



Setting the scene: The current situation regarding financial inclusion in the MENA region

The overall financial inclusivity rate of households in eight MENA countries is only 20%, well below the global average of 76% (FinTech Consortium 2020). Looking at MSMEs, the financing gap in the MENA region is approximately USD 186 billion (SME Finance Forum 2020). According to a joint business survey by the World Bank (WB), European Bank for Reconstruction and Development (EBRD), and European Investment Bank (EIB), 47% of companies based in the MENA region required credit in 2019 of which 31% were basically discouraged from applying for a loan at all (latent demand). Between 2013 and 2019, the overall credit demand even increased.

The figures presented are concerning. Especially as the socioeconomic impact of the SARS-CoV-2 pandemic could threaten or even undo the progress made in terms of financial inclusion over the past decade (AFI 2020).

But the SARS-CoV-2 pandemic also revealed that countries that had already invested in digital infrastructure were generally able to disburse government aid payments more efficiently and quickly (The Economist 2020). For example, the number of active JoMoPay (Jordan Mobile Payments Switch) users increased by nearly 40% to 1.4 million between March and July 2020. The value of transactions also increased significantly during this period, until a sharp decline occurred from July onwards. This may indicate that a significant portion of National Aid Fund (NAF) recipients used the system only to receive financial aid. Therefore, it is likely that at least some of the changes observed in the system will not persist in the future (JOPACC 2020).

What it will take to realize the potential of financial technology in the long term

First, an adequate regulatory infrastructure is the basic prerequisite to make this possible. This is because the legal framework defines the scope of possible financial technology innovations and thus indirectly provides the perspective for fintech entrepreneurs on which innovation efforts might be worth putting resources into. After all, digital financial services can only be purposefully built on a foundation of legal regulations that govern areas such as fintech, but also cross-cutting issues such as customer as well as data protection and cybersecurity. In other words, regulation is a field of action in which policymakers and regulators play a key role in shaping the prospects for innovation.

Secondly, fintech entrepreneurs can only build use cases and applications on top of the existing payment infrastructure. If people and SMEs are to make increased use of financial technology, a payment infrastructure must be in place that allows the development and integration of the required user-oriented applications. Egypt serves as a good example here. Debit cards were issued by the state, government salaries were subsequently only paid out digitally via those and POS machines were installed nationwide in order to increase the acceptance of the cards through increased usage options.

Third, a range of digital use cases and applications is needed in order to encourage the recipients of digital salary or auxiliary payments not to simply withdraw the amounts received digitally and thus to stick to the use of cash. In this context, innovative entrepreneurship is essential to develop customer-serving digital financial services and thereby generate long-term demand.

Fourth, inclusive financial services need to be affordable. Low value, high volume transactions and balances must be possible in economic ways and yet be affordable for consumers. If entrepreneurs are unable to offer real added value over cash, it can be assumed that digital payments will not be taken up, especially by people with low incomes and SMEs with low profit margins. Inclusive financial services therefore mean making financial transactions and balances of low value possible on a large scale and in such a way that these services are affordable for consumers.

Fifth, digital financial services must offer real added value over cash or other informal services to be used by people and firms. In the Arab countries around 23 million people are part of rotating savings and credit associations that enable them to take out a loan from community savings if necessary. These informal service collaborations are very trust-based and work well. Accordingly, for digital financial services to be used by all social strata, financial technology solutions need to add value over informal services as well as gain consumer trust. Addressing privacy and security concerns is one aspect of building trust.

A unique selling proposition and a loyal customer base are key for fintech firms to attract investors

Fintech entrepreneurs need to gain a competitive advantage to be attractive to investors. This implies being strong in one area and known for it. The challenge is to create something that is better from a user/customer experience perspective than comparable applications from other fintech companies and that regular banks cannot implement in this way. Consequently, it is ultimately specific features or products where fintech entrepreneurs can carve out the necessary competitive difference.

A key aspect of competitive advantage is a very loyal customer base. This is because a growing customer base reduces overheads over time and thus generates increasingly reliable revenue, so that profits can be used to invest in new products or other service offerings.

Accordingly, entrepreneurs need to question strategically: Is the market within one economy potentially large enough to successfully market the service, or must market entry be sought in multiple countries? Is there a greater chance of success by offering multiple services in one country, or does it make more sense to focus on developing a specific digital financial service for multiple countries?

As competition intensifies, the strategy of trying to establish a value-added service in multiple countries is probably the most promising. However, if entrepreneurs aim to cover several service fields, it is essential that they stand out with a core unique selling proposition in order to be successful.

Fintech companies must address local issues to compete with Big Tech players

The question of whether fintech is a global or local market is a very important one. Certainly, big tech companies are looking for adjacent markets that offer them a new level of growth. Payments, fintech, as well as education through tech are these next big adjacent markets for the Big Techs of the world, so they will certainly try to penetrate and disrupt those.

However, for local problems such as lending or bill payment, local solutions will essentially be the most appropriate. But that, in turn, does not mean that local solutions are bound by state borders. The extent to which innovative solutions can be viable across the board depends on whether local (market) knowledge is available. This is a weighty reason why there will be no thoroughly global dominance in the fintech sector soon.

However, to prevent global forces from emerging through mergers in the future, regulators must keep a watchful eye on such potential developments and block them to prevent competition-destroying monopolization. This is how great companies will continue to emerge from this region in the future.

Innovation-promoting and responsible regulation is a multi-faceted field of action, but indispensable

Basically, the first thing to consider is that central banking as well as regulators are also undergoing a mind shift and are therefore also in a learning process. In order to find out what regulatory obstacles might be for entrepreneurs and digital innovation, it is essential to get in touch with the fintech sector. Regulatory sandboxes, for example, are a suitable means to this end. Experimentation in a safe environment makes it possible to determine where and what regulatory adjustments will be conducive to innovation. Such interactive approaches are much more target-oriented and goal-promoting than imposed framework conditions can be.

One of the main topics when it comes to promoting financial inclusion through digital innovation is certainly Open Banking. Open APIs enable innovators to build service or product innovations on top of already generated data, thus extending the value chain. Furthermore, opening APIs can reduce innovation costs for both innovators and investors, which in turn might also reduce costs for consumers. Basically, it can be said that cost reductions for both businesses and consumers, as well as speeding up credit assessment and simplifying access, make the goal of financial inclusion more tangible.

From a regulator perspective, further development in the areas of cybersecurity and data protection is also critical to not only facilitate access to financial services, but to do so in a secure and responsible manner. This also means that financial services must be transparent regarding the terms and conditions of the offer. And this, in turn, is only one side of the coin. Because transparency, on the other hand, also requires people to be able to understand the contractual terms and conditions as well as the opportunities and risks of financial services. Consequently, financial literacy is a very significant issue. And it will be important in this respect to explore innovative ways to reach and support people.

However, in order to act in the interests of the population in general, the overriding premise is to generate economic growth. Given the economic potential of financial technology, digital transformation can no longer be considered a luxury path; it has become inevitable. And to realize the potential, regulators also have a responsibility to review current regulations to see how they need to be designed to best promote digital solutions.

Conclusions

To ignite the socioeconomic potential of financial technologies, an adequate regulatory infrastructure is fundamental. "Adequate" in this context means that regulatory frameworks must be conducive to digital financial system innovation without neglecting other essential aspects such as financial market stability, cybersecurity, consumer and data protection. Cooperative approaches between regulators and fintech entrepreneurs may well prove beneficial in this regard.

Furthermore, the digital payment infrastructure is crucial, as use cases and applications can only be as innovative as the opportunities opened by the existing infrastructure. Government institutions can also play a leading role in this field of action.

To achieve inclusive digital financial systems, a diverse set of challenges must be overcome:

(1) **Innovative entrepreneurship is needed to develop digital financial services that address and satisfy the needs of the lower social strata and SMEs.** This means, first, that fees for low-value accounts and financial transactions must be affordable for the target groups and, at the same time, economical for the providers. Second, in order to stimulate the use of digital financial services, they must be secure and trustworthy at most. Thirdly, digital financial services must be transparent regarding their terms and conditions, and users must be enabled to make financially responsible decisions. Forth, effective solutions must be found to accelerate credit assessment and to increase creditworthiness of vulnerable groups and SMEs without undermining financial market stability.

(2) **Access to financial services must be guaranteed for the target groups of financial inclusion.** On the one hand, this implies that they must have unrestricted access to the necessary devices, internet access and reliable power supply. On the other hand, the digital applications must be designed to be intuitive and simple. Regarding digital E-KYC, for example, this means that the onboarding experience must be user-friendly and inviting on the one hand, but on the other hand the solutions must be so sophisticated that new money laundering and terrorist financing practices are not made possible.

(3) **Financial inclusion needs investment-worthy fintech companies.** In order to attract investors and build a successful fintech business, entrepreneurs must therefore: (a) based on in-depth local knowledge, (b) tackle a local problem, (c) create a service with a unique selling proposition, (d) which clearly adds value to the life of people / SMEs and so can (e) generate a loyal customer base. Financial inclusion is a matter of eliminating the shortcomings of the conventional financial system by adding specific products or services. Accordingly, Open Banking is essential.

(4) **Regionally harmonized framework conditions are a prerequisite for the greatest possible success of fintechs.** Given the inherent transnational nature of digital, regionally harmonized framework conditions are a prerequisite for digital solutions to be applied as easily as possible across national borders. And that, in turn, is basically just a question of political efforts and the will to create the best possible regulatory conditions for inclusive digital financial systems in transnational cooperation.