PROCEEDINGS

Leapfrogging Development Through Innovation: Showcasing Successful Innovation and Partnership Between Banks and Fintech

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Executive Summary

New opportunities have arisen that make it possible for the SMEs in low-income African economies to leapfrog other countries by adopting technologies that are suitable to their specific circumstances. Technologies, such as open application programming interfaces (API), allow people to connect and collaborate. Innovation enables closer interaction between different markets, improving the efficiency of business exchange. Thus, the top priority for financial inclusion is to make finance useful. Currently, 43 percent of the African population has active bank accounts compared to 69 percent globally.

The rapid development of digital banks, as well as advanced information sharing systems, have contributed to the fast growth of SMEs in Africa. To continue the leapfrogging momentum, SMEs need to improve business-customer relations and address the challenges of the quickly changing landscape of financial services.

The micro, small and medium enterprise (MSME) financing gap in developing countries currently totals US$5.2 trillion. Leapfrogging can play a role in bridging this gap.

The "Leapfrog" Effect of Technology

- The financial inclusion landscape is rapidly changing. Financial service providers are creating tools to generate new types of digital footprints. For example, by using voice recognition features, small business owners can track their stock in a simple and intuitive way that facilitates the keeping of an accurate record of the company's activities. Mobile solutions offer an alternative to physical banks, creating an entirely new financial mechanism, whereby trusted members of the community act as agents to verify identities, providing real-time solutions to everyday problems.
- FinTech will build on organic and formal systems that are already in place, providing people with a sense of security, and access to features that go beyond payments. As such, it will empower them with greater control over their preferences.
- Innovation enables closer interaction between different markets. The ability to translate services and languages from one market to another is crucial to scale up the impact of innovation. In this regard, it is important to test & tweak promising concepts from 'origin' markets to regions that may have similar end users profiles and strained access to financial services. For instance, Mastercard has a global R&D practice, essentially a network of labs that thinks about the future of commerce. This practice explores how emerging technology like distributed ledgers, artificial intelligence and digital identity will impact commerce. In 2015, Mastercard set up a lab in Nairobi, Kenya to focus on applying these capabilities towards inclusion challenges faced by SMEs and financial institutions in frontier markets. Mastercard has seen its incubations initially piloted in with farmers and micro-retailers in East Africa graduate to rollouts in larger markets like Egypt and India, supported by commercial footprint in these countries.
- The centerpiece of financial inclusion is finding out how to make finance useful, particularly for underserved customers. For example, Equity Bank, one of the largest banks in Kenya, East Africa, started as a building society about 30 years ago. Now, it has become one of the largest commercial banks, offering financial services to a large portion of the MSME segment. It is present in 6 countries in the region, with 12 million customers. Currently, it has the largest market capitalization among the banks in Kenya. More importantly, what makes Equity Bank special is that 60 percent of its total loan portfolio is in the MSME segment, accounting for US$1.6 billion. In addition, Equity bank has invested heavily in FinTech and new technologies. As a result, it has gained a few million subscribers in the last 2 years, accounting for 20 percent of the total money transfers in Kenya.
- Surprisingly, the emergence of digital banks has improved bank-customer relations. Digital banks are entirely web and mobile based, without conventional banking infrastructure such as automatic teller machines (ATMs). The key priority for digital banks is to reduce some issues customers face from their traditional banks, enabling a digitalized and paperless environment. With the prevalence of smartphones, banking relationships can be improved, and customers can be the focal point. For example, Fidor Bank, a digital bank founded in Germany in 2009, has already expanded its business to other European territories. What underpins Fidor's vision is its dedication to the community and its transparency, enabling account holders to directly engage with bank leadership and management.
- Targeting micro-retailers, also known as "Kiosks" or "Dukas" can be a powerful engine for SME development. Kiosks provide informal credit to their loyal clients for fast moving consumer goods, which in some countries represents the largest credit channel for the poor and financially excluded in rural and peri-urban settlements. Their informality and limited capacity implies existing systems such as traditional POS systems and barcode scanners are appropriate. However, with the emergence of the greater computing power on smartphones, new cloud based & voice activated approaches, an SME owner can now talk to his/her phone to receive updates on the fastest moving products, use

his phone camera to rapidly identify goods, even respond to real time offers from manufacturers & financial institutions. This scenario is by no means far-fetched and under trial across several Mastercard's labs.

The Essentials of "Leapfrogging"

- The key criteria for the development of digital banks are openness and quick problem-solving capabilities. From a technology standpoint, allowing people to plug into the core system would be the first step. Learning to become collaborative is crucial because working by oneself will be too costly and time-consuming. Finally, after quickly identifying problems, a key task would entail going through a cycle of continuous improvement and enhancement of the solutions.
- The ability to cooperate with regulators is very important during the start-up phase of digital banks. The first thing to recognize is that the central banks from the various countries want to play a role. Usually, the money that central banks ask to hold will be safeguarded in the form of a trust account. In addition, bankers should establish good relationships with regulators from neighboring countries because they normally have the capacity to drive regulations that enable mobile savings solutions to move forward.
- It is necessary to bridge the gap between SMEs and banks. SMEs in Africa often confuse personal finance with business. Thus, it is a good idea to start by building software that specifically serves the needs of SMEs. Next, tools need to be provided to manage cashflow, forecasting, working capital and budgeting. These tools will help SMEs to move one step further in managing their finances.
- An analysis of the digital footprint of businesses will need to be provided to strengthen SME bonds with banks. In this way, banks can better understand their customers.
- Building good user experience is important. Even if a software program is very intelligent, it will not work unless it is user-friendly.
- Behavioral biometrics is a new branch of biometrics that could be used to counter potential fraud in the SME financing space. The approach, pioneered by Mastercard-acquired 'Nudata Security', accurately verifies users based on their inherent behavior, such as typing speed, device angle, and hundreds of other behavioral patterns.
- SMEs often lack high-quality accounting data. As small businesses are not very formalized, they are more accustomed to keeping records in notebooks instead of doing it digitally. Afraid of background checks such as tax inspectors, some small business owners do not want to formalize their business and have difficulties accessing take loans from banks. Therefore, a change of mindset from the entrepreneurs is required so that they can understand the benefits of formalizing their businesses. As finance becomes more data driven, it is important that SME's start formalizing their businesses at an early stage.
- The future will be about remodeling identity and the entire customer experience, that is, using data to understand who is being served and how.
- Partnerships will be important in leapfrogging SMEs into the future.

The Way Forward

- To continue to leapfrog in the future, SMEs are confronted with two major challenges. First, they need to recognize the fast-changing landscape of financial services. A financial provider can shift to a completely different field in 5 years due to the rapid pace of market developments. Second, it is difficult to establish convenient ways to communicate and process transactions.

- Two important opportunities exist for SMEs to leapfrog. First, it is necessary to combine the strengths of both humans and machines to continue pushing forward on data processing and client relationship management. Second, it is important to improve business-consumer relationships by expanding access to capital as economically and efficiently as possible.