



The Role of Inclusive Financial Systems in a Digital Economy

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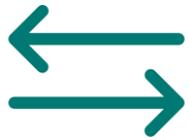
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Key terminology



A **digital economy** includes the stakeholders, systems, and enabling environment that empower people and communities to use digital technology to access to services, engage with each other, and pursue economic opportunities.¹



Digital transformation is the process by which digital technology is disrupting and re-inventing traditional sectors, services, economies and societies. This process has different trajectories across contexts and supports the progressive expansion of a digital economy.²

The spread of digital technologies is transforming economies



2.5B smartphones in the world



2.3B active social media users globally



51% of payments made digitally



161 countries have ID systems using digital technology



47% penetration of mobile internet, projected to reach **61%** by 2025



9.1B connected to IoT devices, expected to exceed **41B** by 2025



>90% of internet data was generated over the last 2 years

> 5x Expected growth by 2025



\$25B of internet data was generated over the last 2 years

The digital economy is a powerful economic driver

As more individuals, governments, and businesses move online, **digitization and economic growth are becoming inextricably linked.**

Opportunities for poor and marginalized segments to access **income generating activities** are also increasingly moving online.

Some estimates suggest that as early as 2023, 88 million Africa-based workers will rely on digital technologies, especially smartphones, to find, manage, and execute work.³



CGAP members are showing an increased interest in the digital economy

The **COVID-19 pandemic** has greatly accelerated the digital transformation process. Governments around the world have relied heavily on digital technology to manage the pandemic, with individuals relying on digital technology to continue their social and economic lives.

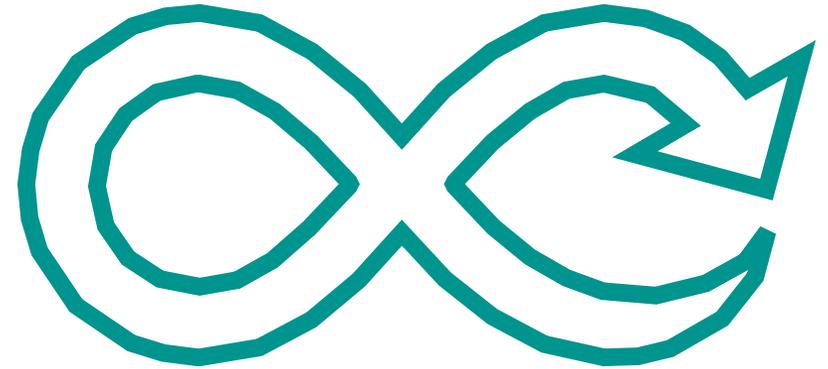
As a result of this acceleration, many of **CGAP's members and stakeholders** noted an increased interest, or increased investment and activity, in the digital economy.



But significant knowledge gaps exist

There remains a lack of understanding amongst CGAP members, governments, and other stakeholders on how the decisions they make today will affect the trajectory of digital transformation, along with the ultimate impact generated by an economy digitizing.

In particular, members have expressed concerns regarding the affects of digital transformation on poor and marginalized communities. Evidence to measure and articulate these impacts is scarce.



And there is concern around “digital harms”

Furthermore, there is growing concern that surging digital transformation could affect poor and marginalized segments in unintended and harmful ways. The process can affect both digitally *included* and *excluded* segments.

The digitally included have been exposed to new risks, such as increased surveillance and new forms of digital fraud. The digitally excluded increasingly lose opportunities to access work, education, health care and other essential services that move online.



“ This crisis is an important moment in which behaviors, norms, and policies around digital economy have shifted more in a few chaotic months than they have in a stable decade.”

—Jonathan Donner, *Caribou Digital*.

FI practitioners were interested in the role of financial services within the digital economy

In this context, financial inclusion (FI) practitioners asked **CGAP** to articulate the following:

- 1) How the **digital economy** affects the growth of inclusive financial systems.
- 2) How **financial services** can be positioned to generate impact in the digital economy.

A narrative of financial services in the digital economy

- CGAP developed a **high-level narrative** to illustrate how the digital economy affects the growth of inclusive financial systems.
- This narrative is designed for **financial inclusion practitioners** who want to understand how financial systems and the digital economy intersect.
- The narrative also illustrates how financial services can be positioned to **optimize impact in the digital economy**.

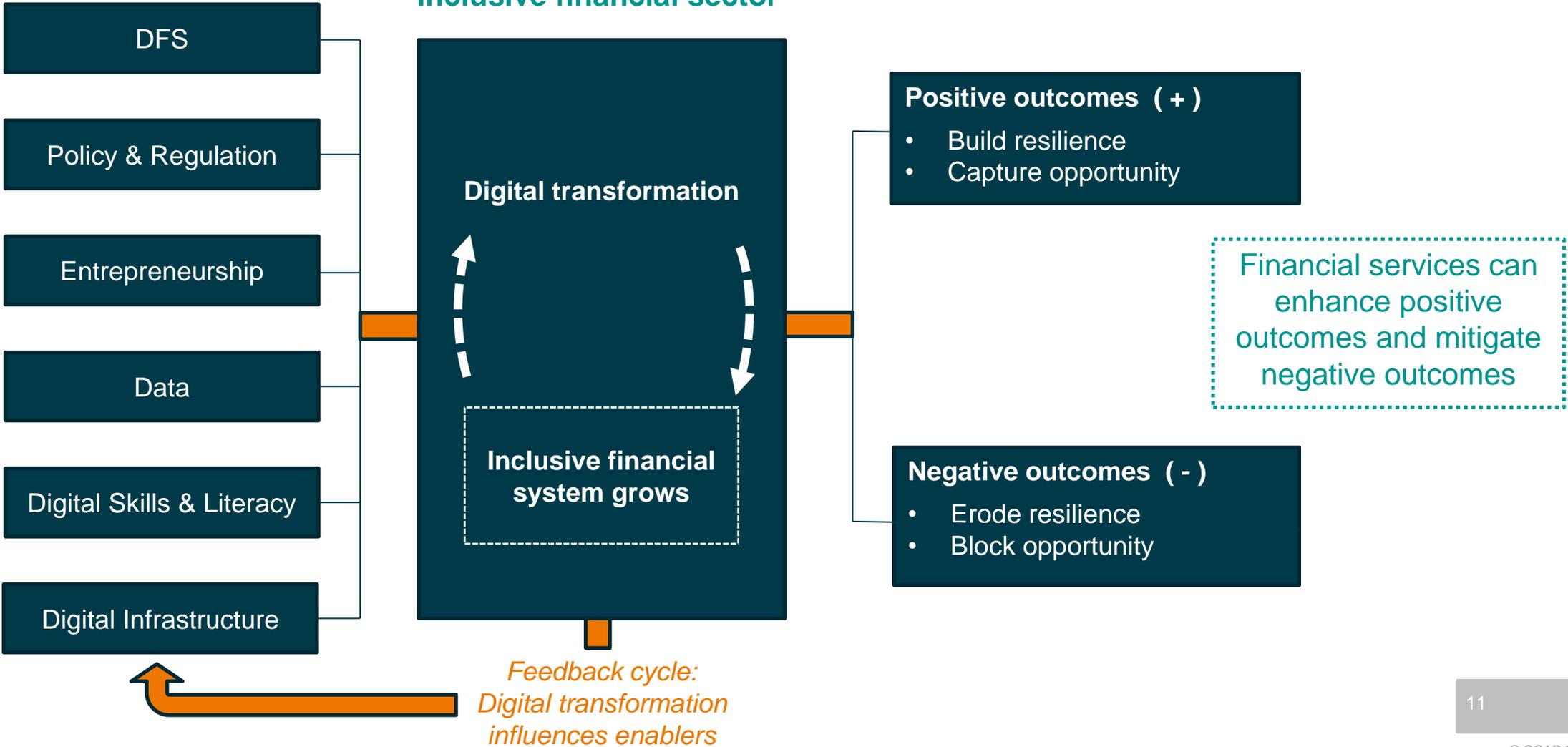


Inclusive financial systems in a digital economy

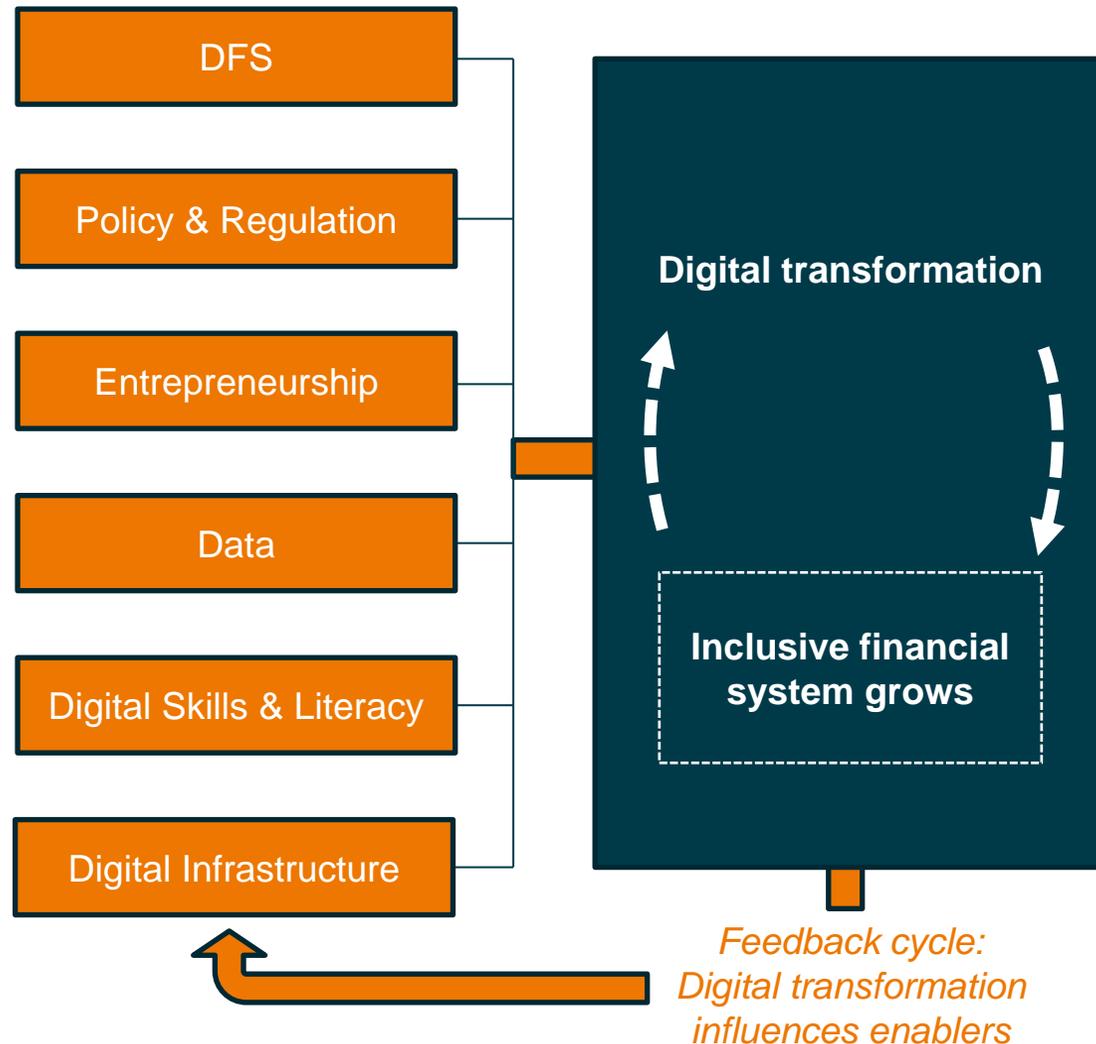
Several **enablers**....

....drive **digital transformation** and the development of an **inclusive financial sector**

....and result in **outcomes** that affect the **well-being of the poor**...



Enablers



Enablers affect the trajectory of digital transformation. Different contexts have treated these enablers differently, and globally there has been substantial variation in how this process has manifested.

These enablers also affect the growth of inclusive financial systems, because **the processes of digital transformation and inclusive financial system growth are inextricably linked**. These enablers are affected and shaped by the process of digital transformation.



Financial inclusion practitioners might need to invest in these enablers to unlock growth in inclusive financial systems.

Enablers explained

Enabler	Description
Data	<ul style="list-style-type: none">• Often referred to as the fuel of the digital economy, data are created when users interact with applications through their devices. The use of data is transforming business models, facilitating new products and services, and powering the growth of adjacent technologies and industries such as artificial intelligence and the Internet of Things (IoT).• Data also play a pivotal role in the development of inclusive financial systems, facilitating both the personalization of financial products but also the development of entirely new solutions such as on-demand digital credit.
Digital skills & literacy	<ul style="list-style-type: none">• Crucially important to the transformation process is a population that knows how to effectively use digital technologies and unlock the potential of such technology, especially as smartphones become more pervasive and the number of applications on these devices continues to grow.• Only when effective usage of technology is increased can the benefits of such usage be unlocked. The drive to develop a digital economy would be of little use without human capital that possesses the digital skills to operate and reap its benefits.• Digital skills are not only the backbone of a digital economy, but they are critical to leveling the playing field and facilitating innovation. The ability to harness talent, encourage technological innovation, and mobilize digital skills is key to economic growth.

Enablers explained

Enabler	Description
Digital infrastructure	<ul style="list-style-type: none">• Digital infrastructure provides the pathways for people, businesses, and governments to get online and link with local and global digital services – thus connecting them to the global digital economy.• Broadly, digital infrastructure consists of connectivity (e.g. highspeed Internet), the IoT (e.g. sensors) and data repositories (e.g. clouds). It also includes the ‘digital rails’ or software platforms that unlock use cases, enable scale, and drive growth in the digital economy. This includes digital identity, digital property rights, and open APIs. Digital infrastructure supports scale and reach, which is crucial to inclusive financial systems.
Digital financial services (DFS)	<ul style="list-style-type: none">• DFS offer a convenient, secure, and efficient way for people, businesses, and governments to access a range of products, services, and opportunities.• They enable fast and efficient payments across an economy, enabling the growth and scale of other digital services, from education to health and beyond.• DFS are increasingly viewed as central to the health and development of a country’s economy, digital and otherwise.

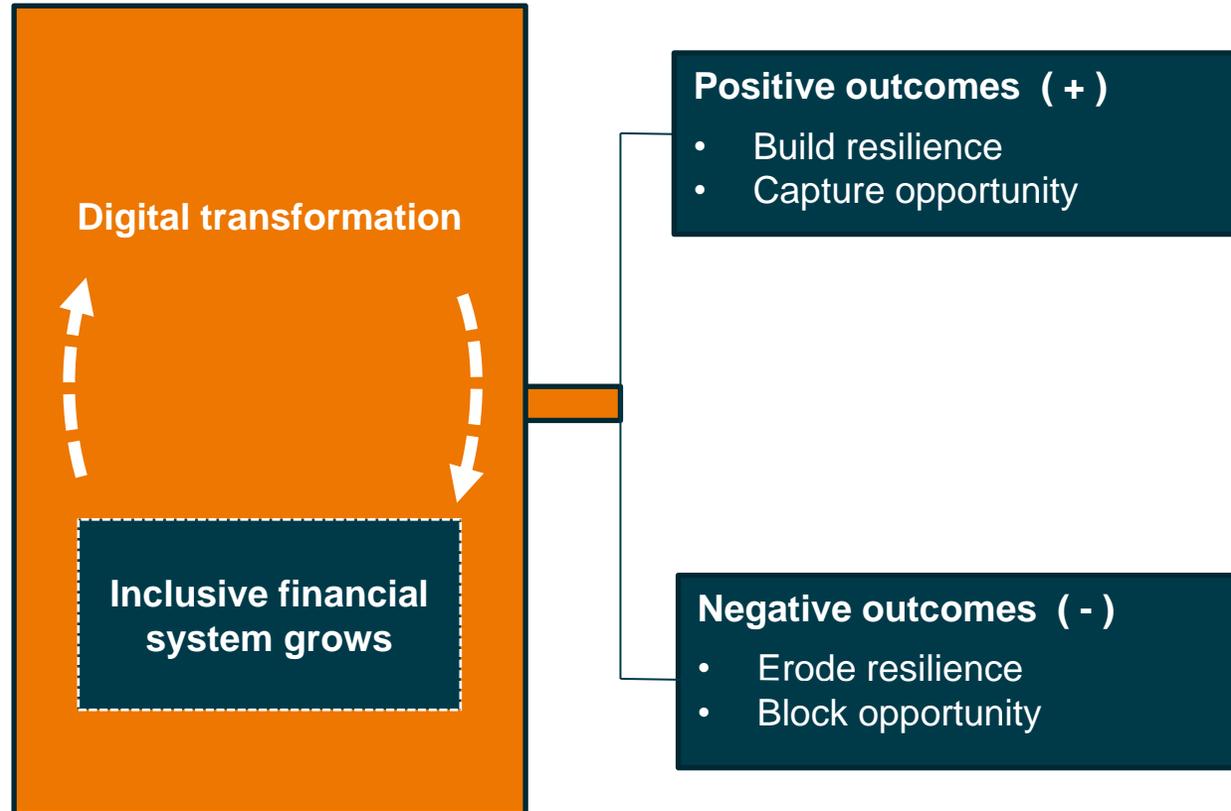
Enablers explained

Enabler	Description
Policy & regulation	<ul style="list-style-type: none">• Enabling policy, regulatory, and governance frameworks can accelerate the digital transformation process, manage the risks and challenges emerging from this process, and ensure that the process is aligned for optimal developmental impact, across sectors and across population segments.• This expansive category focuses on a wide array of themes: digital infrastructure expansion and improvement, taxation, privacy, security, surveillance, sovereignty, data protection, competition, and cross-border data flows, among others. These frameworks are developed and deployed across ministries and departments, but may link back to a broader digital agenda to ensure complementarity and alignment to the country's broader developmental goals.
Entrepreneurship	<ul style="list-style-type: none">• Digital technologies generate opportunities that can be seized by new ventures and push existing businesses to adapt.• Digital enterprises are characterized by a high-intensity utilization of new digital technologies (particularly social, mobile, analytic, and cloud solutions) to improve business operations, invent new (digital) business models, sharpen business intelligence, and engage with customers and stakeholders through new (digital) channels.• Establishing entrepreneurship economies depends on a range of factors beyond investment into traditional inputs such as R&D, infrastructure, and education.

Digital transformation

Digital transformation is a process that can be **shaped and directed**.

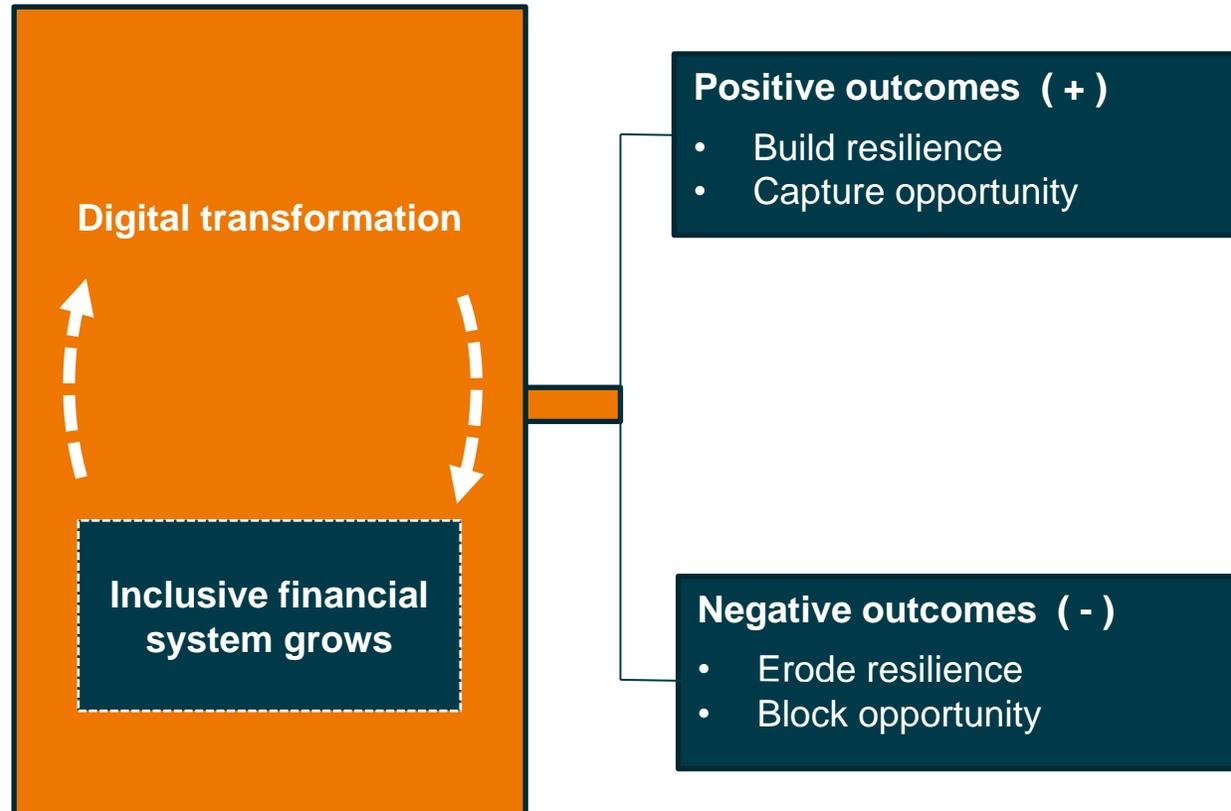
This means that the outcomes that it generates can be affected through sound policymaking and focused interventions.



Digital transformation & inclusive financial systems

The trajectory of digital transformation directly affects the development of inclusive financial systems.

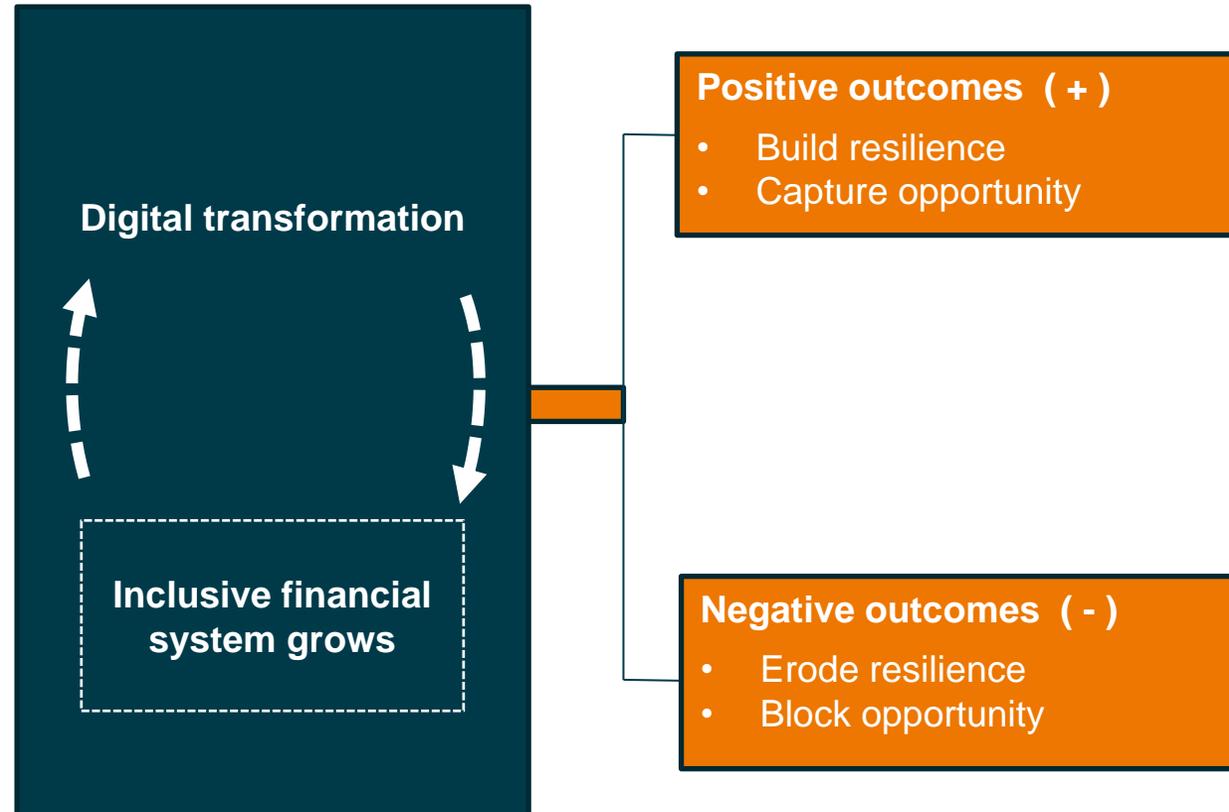
At the same time, inclusive financial systems are themselves a critical driver, and accelerator, of digital transformation.



The outcomes of digital transformation

Digital transformation generates a range of **outcomes**, both **positive and negative**.

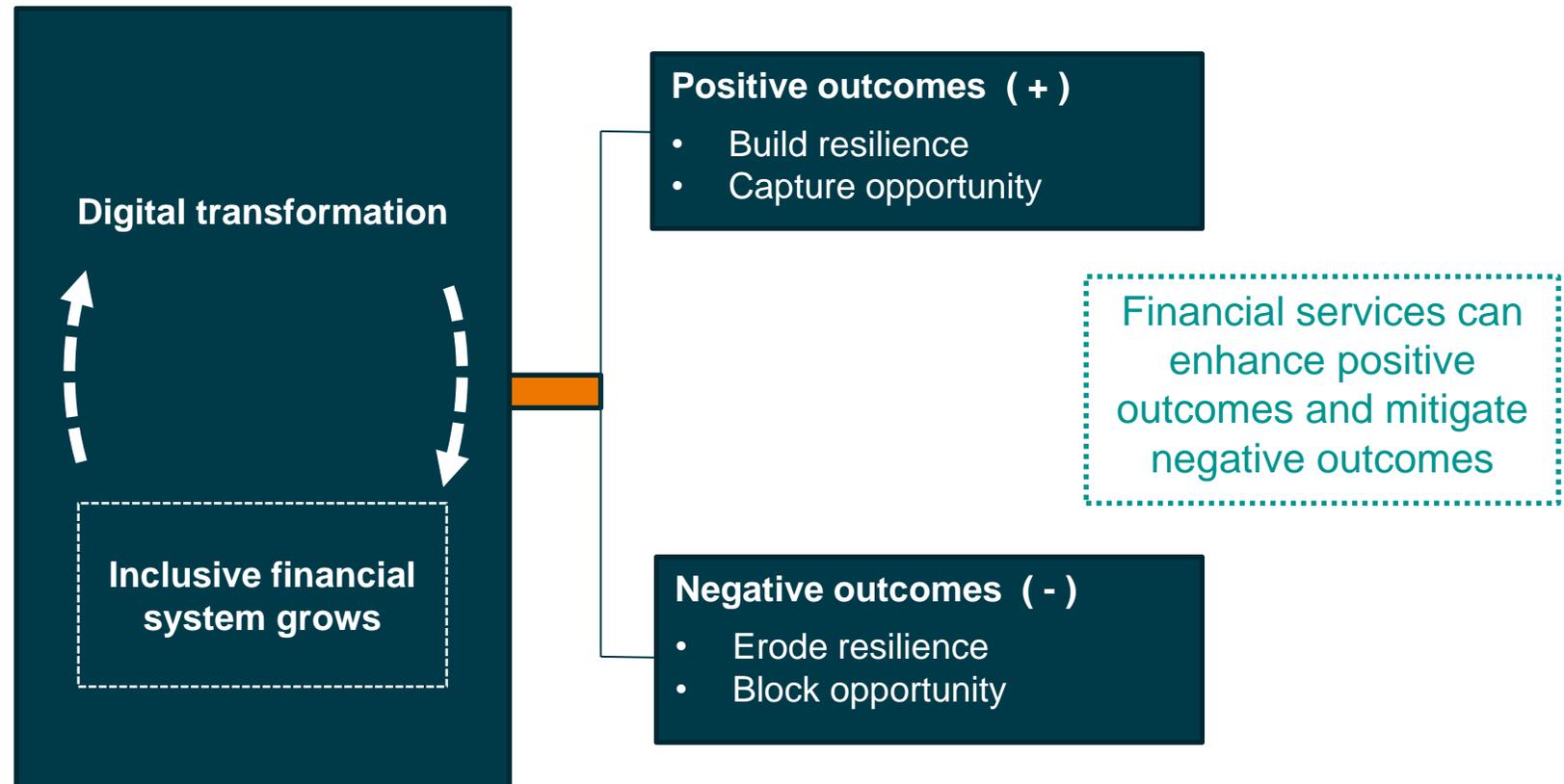
These outcomes **directly affect the lives of the poor**, impacting the ability to generate income, gain access to essential services, and protect basic standards of living.



Financial services and outcomes

Financial services have a critical role to play in **affecting and optimizing the outcomes of digital transformation for the poor.**

They can be positioned to enhance the positive and reduce or mitigate, the negative outcomes.



Enhancing *positive outcomes* for the poor: The role of financial services

Positive outcomes of digital transformation (+)

1. New forms of digital work are emerging via gig platforms.

2. E-commerce platforms are helping MSMEs to expand their access to new markets, and clients.

How financial services enhance positive outcomes

Digital payments facilitate fast and direct payments to platform workers. Digital credit allows for loans that can increase productivity (e.g. better tools) and drive revenues.

Example: Digital platform Lynk in Kenya is offering its tradespeople start-up capital to purchase high quality equipment. Loan repayments are conditioned on income earned from the platform

Digital payments are allowing MSME sellers to collect money easily and quickly from buyers. Digital credit offered through e-commerce platforms is allowing sellers to increase their stock and volume of sales.

Example: Jumia, Africa's largest e-commerce platform, expands access to markets for over 80,000 micro and small enterprises across Africa. It has partnered with several credit providers across Africa to extend collateral-free and on-demand loans to merchants on the platform.

Enhancing *positive outcomes* for the poor: The role of financial services

Positive outcomes of digital transformation (+)

3. New forms of high-quality and affordable *healthcare* are being offered digitally to poor and marginalized segments, remotely.

4. New forms of high-quality and affordable *education* are being offered digitally to poor and marginalized segments, remotely.

How financial services enhance positive outcomes

Digital payments are allowing new forms of healthcare to scale and reach underserved areas.

Example: Mobile healthcare platforms like mTOMADY in Madagascar are facilitating remote consultation and diagnostic to reduce rates of infection during the COVID-19 pandemic. Payments for services can be made through mobile money.

These new models of education are often subscription-based and have integrated digital forms of payments to facilitate scaling.

Example: Eneza Education in Kenya is an SMS-based EdTech solution that can be accessed on feature phones. It was developed by teachers and is aligned to the local curriculum. The service is subscription-based, and payments through mobile money unlock access to the solution.

Reducing *negative outcomes* for the poor: The role of financial services

Negative outcomes of digital transformation (-)

1. Individuals who cannot afford a *smartphone* or *data*, are increasingly marginalized from the social and economic opportunities that emerge in a digital economy.

How financial services can reduce negative outcomes

Pay-as-you-go (PAYGo) smartphone financing schemes have been developed to break up the upfront cost of the handset into more manageable sums and drive uptake amongst the poor. Digital payments and digital credit are facilitating these schemes.

Example: Payjoy allows customers to purchase a smartphone on credit and pay in installments over time. Each payment provides the customer with 30 days of use, after which the company's "lock" app deactivates the phone until the next payment is made.

Cost of data is prohibitive across many developing markets. Data bundling and financing schemes have been launched by MNOs with preferential rates for excluded and marginalized segments.

Example: Robi in Bangladesh launched a monthly smartphone bundle program, which includes data and provides preferential rates for female customers.

Reducing *negative outcomes* for the poor: The role of financial services

Negative outcomes of digital transformation (-)

2. Increase in cyber attacks

How financial services can reduce negative outcomes

Cyber attacks are on the rise, and lead to financial service clients being blocked from accessing their accounts and losing money. Financial service providers are investing in better safeguards to mitigate threats and educating customers on how to protect themselves against malicious attacks.

Example: In 2017, M-Shwari customers in Kenya were left without access to their savings and loan products for five days after a malicious cyber attack. After the outage, several found inconsistencies in their account balances. In response, Safaricom launched a targeted campaign to help clients identify and react safely to cyber attacks.

Annexes

Our Process

What we did



Expansive **review of literature:**
current state of knowledge



Thorough **stakeholder mapping:**
current landscape of players



Stakeholder consultation
(external and internal)



Framework developed and tested
(external and internal)

WHO WE TALKED TO

- Accion
- BFA
- Caribou Digital
- DIAL
- European Commission
- GSMA
- Mastercard Foundation
- Omidyar Network
- Oxford Digital Pathways
- Seven Hills Advisors
- Smart Africa
- USAID
- UNCDF

Plus independent consultants, CGAP colleagues working on various projects, and the CGAP Leadership Team

List of key sources

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