Responsible Finance for Digital Inclusion: Investing for Impact
Washington, DC| April 3-4, 2019

Session Date & Time: April 3, 2019, 14:00-15:15
Title: Responsible Digital Transformation of Financial Institutions
Moderator: Momina Aijazuddin, Global Head of Microfinance & Principal Investment Officer, IFC
Panelists:

- Shamina Singh, Founder and President, Center for Inclusive Growth/Executive Vice President, Mastercard
- Andrée Simon, President and CEO, FINCA Impact Finance
- Anup Singh, Manager, Banking and Financial Services (Africa) MicroSave Consulting

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- **Anup Singh (MicroSave Consulting)** started the session by setting the stage for the need for digital transformation in the microfinance industry.
  - He noted that there is a lot of complacency within the microfinance industry. "A large part of the microfinance sector still has very limited innovation," he said.
    - There's hardly any customization of products, and we're still seeing mostly individual loans and the same old group loans.
    - "MFIs are not keeping pace with the changing times. Digital transformation is a reality. You name the sector, and there is a tech startup that is thinking about innovating around the existing value chain."
  - He said the microfinance industry needs to reinvent itself to remain relevant.
    - "A significant shift is occurring. The microfinance industry is under immense pressure. Customers are backing away from lengthy business processes and moving towards increased privacy and convenience."
    - In urban areas, we are seeing Fintech startups eating away the share of microfinance industry. Microfinance thrives on cross-subsidization. They need the urban customers to be able to afford to reach the rural, low-value customers.
    - "We are examining the question of whether an existential crisis for microfinance industry is going to be a reality, and if it happens, how it is going to impact the investors. There is a role for everyone. There is a role for tech service providers. The microfinance industry, by and large, lacks the capacity to transform digitally and adopt technologically."
  - MFIs need to:
    - Realize a mindset of cultural change
    - Develop digitized solutions aligned with users' expectations and experiences
    - Deliver innovative solutions within time and space transitions
    - Drive the institutional focus based on user experience
    - Manage emerging institutional and user-level risks
    - Think through the question, "Are we building all of this to eventually pass on the efficiencies to customers, or are we just building this to milk the customers?"
  - Anup said investors need to focus on this because:

- The value of their microfinance portfolios decreases each day that the MFIs are not focusing on digital transformation.
- The digital divide is serious between the "have and have-nots." Displacement within the microfinance institution is occurring. Digital transformation with either include or exclude more people

- Investors need to know:
  - Digital transformation is a journey
  - Not being on this journey is untenable. These changes need to happen for institutions to remain competitive.
  - Clients need to be at the very center of this change. There needs to be focus on customer centricity and leveraging technology and infrastructure.
  - There are many players in this financial ecosystem to transform digitally and responsibly.
- Responsible digital transformation of financial institutions entails:
  - Design around users' needs and aspirations
  - Support of institutions to transform
  - Leverage technology and infrastructure
  - Build strategic partners

- **Momina Aijazuddin (IFC)** said that IFC looks at digital transformation through a number of different lenses. It's involved in a number of ways through debt equity, MFIs, retail MFIs, advisory work, and with organizations looking into new platforms and markets. IFC has more than 800 relationships, 300 with banks. It also works with about 300 MFIs. It has been a founding shareholder of many of the networks.
  - "We're seeing that digitization is inevitable for most industries," she said. "I don't know a single industry that hasn't been disrupted. In microfinance, we used to consider ourselves the disrupters. We were changing things, going after the unbanked. Now we're almost like the incumbents."
  - There are still 1.7 billion unbanked people, most in Africa. It's reached a point where you do need to use digitization. We need to leverage technology.
  - There was a survey of MFIs that asked how long it takes them to process a loan. The answer ranged anywhere from three days to four weeks. You can imagine a market where a player can come in and do it within 10 minutes.
  - What we're seeing with the development of platforms, products, and networks, is that it is all about being cheaper, access to credit, digital lending, driving efficiency, etc.
  - IFC has a large microfinance portfolio. Digital transformation is important to them to remain relevant in the market. One of the challenges we're seeing with MFIs is that the cost of operations is very high. If you started lending at 40% interest rates 20 years ago, you would assume that you would be at half that.
  - There are also internal issues at MFIs: strategy, the role of the board, change management, etc. The mindset needs to change for digital transformation to work.
  - Many institutions are using, "digital lipsticking," where people are putting lipstick on, but not changing much of the problem.
  - "It really comes down to who has the appetite and capacity to reach the clients we want to serve," she said. Challenges in different markets do exist. The way we've been framing it is looking at the incumbents who obviously play a role.

    - We're really focusing on this matchmaking aspect. To be able to see how one can leverage some of these strengths and trends. Some of the work we're doing in Africa examines how partnering across boundaries works to achieve digital transformation.
    - Customer centricity and customer-usage should be a focus. In one example, a bank in China opened 100 mobile wallets in a year, but they didn't realize that customers weren't using them. You need to look at how you'll fit into the clients' lifestyles.
    - It's much more than credit or savings, it's really entering into an ecosystem.
- **Shamina Singh (Mastercard)** said the financial inclusion journey for Mastercard started on the business side and moved toward the philanthropy side. The way Mastercard has framed this is, "How would you approach it from the business sense?" In reality, this segment of the economy is not where Mastercard makes money. The grant investments are about building out the ecosystem and capacity so that eventually these customers will move up the chain economically and eventually become Mastercard customers.
    - Mastercard began working with governments to digitize social subsidy programs. It was part of the coalition of businesses for the universal financial access goal.
    - "However, we've all realized that access just isn't good enough. It doesn't mean anything," she said. "We're working on usage. Once you move from access to usage, that's where digitization becomes important."
    - Mastercard is partnering with Accion, "because we realized that if MFIs didn't start to digitize or increase tech capacity, the people they're trying to serve would get further and further left behind" she said. "If we believe in financial inclusion and that the unbanked deserve good quality products, it's incumbent upon us to strengthen the intermediary lender, in this case the MFI."
        - Mastercard started with Grameen and Apple to upgrade Grameen's technology. The CTO was so good that they actually created a case study. The efficiencies gained have been great. They've moved from servicing 50,000 women to 100,000 women. "How do we figure out how to spend time with the women to successfully create small business owners? It's not all about filling out the paperwork. What does the time look like? It's about giving them the framework for the work they want to do."
        - With Accion, Mastercard is thinking through: Can we do this at scale and do this with a partner that has a lot of other partners? "We have identified targets and said, 'Let's make sure every piece of the ecosystem gets taken care of.' We're not going to just fund the technology and forget about the governance or the customer acceptance."
    - Mastercard is also partnering with commercial banks and Unilever in Kenya.
        - She said the shop owners don't have access to credit or capital the same way larger SMEs do. A lot of women doing this work were going into debt. We wondered if there was a way to get the interest rate down.
        - Working with Unilever, we realized the buying and selling behavior of customers on the Unilever platform could be a proxy for creditworthiness. Brining in Kenya Commercial Bank, we formed a partnership to provide loans at lower interest rates for shop owners. We started with a goal of 30,000 shop owners in Kenya. We have 20,000 right now. The average

sales increase is about 25%. What we're hearing, is that the ability to borrow at regular interest rates allows them to buy more. This is changing the way they think about inventory.

- "There is a need for digitization to be sure," she said. "It's filling a big gap. It has to be done responsibly. As investors, I would offer to please keep these standards and principles front and center."
- Momina noted that the merchant acceptance piece is critical because it's a large percentage of employment in the markets many of us are working in
  - Shamina said, "The work around access to credit is all upstream. You can't walk in and say, 'Here's a POS device and now you're digital' and then walk away. It doesn't work that way. That's all about access and nothing to do with usage. We have to look at credit for small businesses; the consumer side, the supply side. We take our cues from a lot of the work you all are doing. It's the work you all have already done that we're able to scale."

- **Andrée Simon (FINCA)** discussed digital transformation from the perspective of a financial service provider.
  - "It's been a learning journey for us at FINCA. Anup said it beautifully: MFIs are complacent. When MFIs gets invited to panels these days, it's like the cousin that never gets invited to dinner."
  - There had to be some kind of radical transformation. "The question was, 'What did that transformation need to look like?' The immediate leap we made was to mobile because it's so cool. The idea that you can take a bank and put it into the pocket of your client in rural Uganda is massively seductive."
  - "We learned that in most of the markets we work in, mobile is an unreasonable fantasy at this point. Data costs are high for clients in many parts of Africa. There's that question of access vs outcome. We can sign up a lot of people for wallets, but If they don't use those wallets for anything, then it is a waste of money."
  - She shared the example of the agent network in the DRC.
    - The core building block for our agent network is the central interface where digital transformation occurs in our work. Our clients need to get cash in and cash out of the system quickly. They don't live in fully digitalized systems.
    - It is from that keystone that we started to build out: What are the things we need to build out to make that client experience better? If you're working with agents and not working with expensive branches, you have a lower cost infrastructure. However, you have less of an ability to engage with clients. You need to find a way to engage with clients through avenues such as investing in call centers.
    - Then you can layer scoring on top of that. But few of those investments look like this theoretical definition of digital transformation. For us, these are basic transformations, but they're the transformations that our clients want. Clients want risk-based, appropriately sized, fast credit.
    - FINCA DRC used to be able to onboard 8 clients in one day, and now they can onboard 1 client in 8 minutes.

- FINCA has started to partner more after trying previously to do everything themselves.
  - "We test a lot. We fail fast now. We learn from those experiences, and we're able to reposition into what is a clear roadmap now."
  - "Back to that initial question of is microfinance relevant: the inclusion vs outcome question is one that we don't talk about enough, particularly with digital. A lot of new players haven't proven they can do anything, and a lot aren't focused on outcomes. They're focused on attracting investment and building the company. They mention impact, but I have a significant question about whether that intention is there. There needs to be that intentionality around achieving outcomes."
- The old model was beautiful in its simplicity. Moving into this space, there's a tremendous amount of uncertainty.
  - We launched a mobile savings app in Tanzania, but we really been able to convince anyone to take this savings product up because they want credit.
  - We started to think much more on a product basis. There's not much difference across countries. Credit is credit.
  - But how you talk to people in various countries is different, and regulation is very different. We asked countries what they want to focus on. We took the motivations of different places and capitalized on those. And then we held ourselves accountable for the impact. Sad to say, many of those things didn't have a positive impact on the bottom line of our business, so we had to turn away from it.
- Momina noted that we say fintechs will crowd out the MFIs, but in many places that is not the case. How can we leverage our existing strengths to reach the last mile? Rather than the MFI going on and setting up branches, they're able to do a lot of this offline. A process that would normally take a month focusing on where to put the branch, they can now do in about a day. Access to data points is facilitating that.
  - Andrée said that institutions and people need to connect over a human interface. When we talk about the markets we work in, the protections that make it easy to switch over are not there. For example, my students use Venmo or PayPal without thinking about it or even verifying it. We're working with populations where access to cash and knowing you can access it at any time is very powerful.
  - Momina said that it's about trying to leverage the high touch of microfinance and the low cost of leveraging technology. Andrée agreed and said, "Let machines do what they best and let humans do what they do best. Humans are really good about building relationships. At the same time, we put our credit teams up against the algorithms, and they lost."
  - Anup noted that it has to be high touch and high tech. He also noted that MFIs need to look at what the customers are demanding. The clients and the products themselves are changing, so we need to leverage aspects of the culture.
  - Momina agreed, noting that "we need to realign ourselves rather than pushing people into products they won't necessarily use."

- *Audience question*: What is the unique positioning of a microfinance network with digitalization?
    - Andrée said that it comes back to the human connection. "We need to assess understanding and look at the question of access versus outcome."
        - "The tools I see are not designed to ensure the person on the other side of the tool is making a well-informed, sound decision. I presuppose that people care in microfinance because they want to see an outcome. MFI staff live in the community, so there's a feeling of social responsibility to the people they serve. There is a level of accountability with over-indebtedness because workers are living in the community. We also know that providing people with one-way education works well for clients but is not enough."
        - "My staff sit down and tell clients, 'You have to save more.' How do you convince someone to have that same interaction over the mobile phone? How do we encourage sound financial behavior via an electronic format? If we're going to replace the human interaction, how do we ensure it is still present in the machine?"
    - Shamina said the microfinance world brings accountability. Once you lose that human connection, paying back the loan becomes a more distant and theoretical concept. More human interaction means there is more interaction with repaying the loan.
- Momina said technology is really a game changer. It would be foolish not to use that. There's a lot of room to digitize without the full process being digital. There's so much efficiency to be gained with MFIs, but that does not mean the client-facing side has to be digital.
- Andrée said the biggest investment is around the culture change. "Managing the business process change is really complicated. It's not about these big hairy unknown IT projects. It's about helping institutions think about changing their behaviors and models."
- Anup said MicroSave did a study about what makes clients most likely to repay a loan. Meetings followed up with human interactions were most likely to lead to repayment. SMS reminders to repay are often ignored, he said.
- *Audience question*: How do you pitch to your board that, "I want to make this investment, but I can't tell you if it will succeed or fail?"
    - Andrée said she spends a lot of time saying, "I don't know," and we all have to get comfortable with that.
        - "The majority of the board does not have a technology leaning bone in their body, but they're very forward-thinking people. But they know we have no choice. The speed that customers expect has to be competitive with all these other players. You have to jump of the bridge. But what about value you'll deliver? We do go through an exercise of predicting the value of these experiments. We're wrong a lot of the time, but it is important to have transparency."
        - Talking about what went wrong, deciding if it's worth trying to do it again differently is helpful. Working with our partners, it would be a mistake to promise things that we can't possibly promise. If you look at fintechs, there are few that have actually delivered on what they've promised.

- Shamina said that existing client data is available; it's just not being leveraged. There is so much data and access but not much usage. Mastercard announced a partnership to invest in data philanthropy through the Rockefeller Foundation.