The Future of Fintech to Push the Digital Economy and Electronic Payments Ecosystem

Njuguna Ndung’u
African Economic Research Consortium (AERC)

June 24, 2019
Gaborone, Botswana
What is African Economic Research Consortium, AERC?

- AERC is a highly integrated knowledge organisation spanning research, collaborative training graduate training in economics and policy outreach, It was established in 1988.
- Its mission is to strengthen local capacity for conducting independent, rigorous inquiry into the problems facing the management of economies in sub-Saharan Africa.
- Its mission rests on two basic premises:
  1. That development is more likely to occur where there is sustained sound management of the economy.
  2. That such management is more likely to happen where there is an active, well-informed cadre of locally-based professional economists to conduct policy-relevant research.
- It is a vast network of researchers, educators, students, universities, policy makers and international resource persons.
- AERC is was ranked 1st in the category of the Most Significant Impact on Public Policy in Africa and ranked amongst the top 28 development think tanks globally.
Our Approach
The Bali Fintech Agenda

- The Bali Fintech Agenda is a restatement of what we have seen in the last decade or so on the digital evolution in the delivery of financial services.

- The question is what role we assign Fintechs now and in our economies:
  - They should support us to deepen and enhance the efficiency of our financial systems.
  - Broaden the accessibility to financial services to reach the poor and the underserved (in African economies to reach the women).
  - Support the national electronic payments ecosystem including cross-border payments – including remittances.
  - Support a broader economic development and inclusive growth agenda.
Electronic Payments Ecosystem – the Route to a Digital Economy

• Use of electronic payments cheaper than other forms of physical payments - Emerging evidence supports this proposition.
• Payments are the entry point into the financial services and so electronic payments makes financial inclusion easier and cheaper.
• The mobile phone financial transitions pioneered by M-Pesa introduced the retail electronic payments transactions platform
• Further, retail electronic payments system have supported inclusive finance – especially for women and low income earners
• Digitizing payments allows for economic efficiency and creates new opportunities for businesses
• Therefore countries need to explore their own policy mix and options to unlock the power of digital payments ecosystem
• This is the route where the Fintechs will take the lead and push the digital evolution
Electronic Payments Are Cheaper to Consumers

- A survey methodological frameworks developed by the WB to measure retail payments costs and compare them across payments instruments and across countries: The Case of Albania:
  - Cost of physical instrument of payments – like cash and cheques – cost the economy roughly 2% of GDP
  - Migrating 70% of payments to digital channels would reduce these costs by 50%

- Who bears cost physical payments instruments (cheques, credit/debit cards etc)?
  - 50% of the costs borne by consumers; 25% by businesses; 24% by payments service/infrastructure providers and 1% by government agencies

  ➢ With **electronic payments**, this pattern changes
  - 55% of costs borne by payment service and infrastructure providers; 30% of costs borne by consumers; 14% of costs borne by businesses and 1% of costs borne by government agencies
From Retail Electronic Payments to Financial Inclusion and Digitization

• An accessible, safe and efficient payments system will support a successful financial inclusion goal

1. Payments and/or transactions in general is to entry point for financial services

2. Evidence is emerging that the success of financial inclusion in African economies is being driven by the success of retail electronic payments system.

• The mobile – phone based transactions accounts have given way to retail electronics payments system and to digital financial services and to an overall digital revolution in the some economies in Africa.

• The Kenyan case stands out.
The Kenya’s M-Pesa Developments can be used to illustrate this evolution in 4 stages:

I. First Stage – mobile phone based transactions platform for P2P transfers, Payments and settlement.
   - The novelty of this stage is that a retail electronic transactions platform emerged supported by a Trust account in commercial banks and Telcos providing the transmission backbone – they were real time transactions.

II. Second Stage – Virtual savings accounts were developed – A virtual banking service and a technological platform to manage micro accounts by commercial banks, MFIs and SACCOs.

III. Third Stage - Transactions and savings data used to generate credit scores for use as the basis to evaluate and price short term micro credit.
   - This has changed the collateral technology that for years formed the major obstacle in the credit market development in Africa.

IV. Fourth Stage: cross-border payments and international remittances based on this electronic payments platforms.
Fintechs have Pushed the Digital Evolution – The Outcomes

1. A Retail Electronic Payments System – effective, efficient, transparent, safe.
   - Retail electronic payments is an easier entry point for financial services and also formalising the informal market
   - Those retail payments platforms are operated from commercial banks.
   - An electronic payments platform is game-changer – Fintechs can roll out new products across all sectors.

2. Financial inclusion, development, inclusive finance and poverty reduction
   i. Banks now have a technological platform to manage micro accounts and to reach out to customers cost-effectively
   ii. Virtual savings and virtual credit supply platforms have emerged.
   iii. Strong banks with intermediation capacity will emerge.
   iv. Allows the formulation of an effective and forward looking monetary policy
   v. Allows improvements in the AML/CFT regime.
   vi. Women can save in instruments that cannot be encroached, they are efficient savers.
   vii. A recent study, Tavaneet and Jack, 2017, shows that 2% of Kenyan households have been lifted from poverty.
Fintechs have Pushed the Digital Evolution – The Outcomes.

3. Fintechs rolling out **sustainable business models**. These business models cut across all the sectors of the economy – Some Examples from Kenya and east Africa:
   
   i. One Acre Fund – Raised productivity and incomes for smallholder farmers in East African countries
   
   ii. M-Kopa on domestic Solar energy supply in Kenya and Tanzania
   
   iii. Water vending machines for urban slums for poor households in Nairobi
   
   iv. M-Tiba on financing health services in Kenya
   
   v. M-Akiba on investments in Government securities in Kenya

4. Fintechs developing tax payments platforms and revenue administration to minimize leakages

5. Finally, Fintechs designing platforms for e-government services that are effective and easy to reach, as well as for Government to design social protection programs.
Fintechs will Push and Sustain the Digital Evolution

What factors will sustain the digital evolution for inclusive growth?

- **Connectivity** – infrastructure for fibre optic cables is important – Scalability of the digitization process is important for sustainability.

- **Interoperability** of retail electronic payments platforms, market conduct and competition are challenges that require feasible solutions.

- **Transformative regulatory Technology for Fintech** - RegTech

- **Electronic-ID** system to cope with market innovations and secure the market.

- **State and Institutional capacity** to cope with market innovations and dynamism – Not to stifle innovation. We need to develop institutions to regulate and protect the market especially the financial market in Africa – but capacity is critical here.