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Research – Alternative Financing

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Plugging the Gap

Financing Southeast Asia's underbanked

Southeast Asia and the potential for Alternative Lenders

Home to one of the world's youngest and fastest growing populations, Southeast Asia presents a tremendous opportunity for FinTechs to innovate and support the region's over 570 million inhabitants, 70% of which according to a joint report released by Bain, Google and Temasek, face limited access to financial services.[5]

UOB also estimated that while the mature banking markets of Malaysia, Singapore and Thailand have thriving and deeply entrenched traditional financing players, there are still gaps in the landscape, including loans for MSMEs, freelancers, and other niche gaps such as short-term project financing.[4]

All these indicate tremendous opportunities for FinTech players to disrupt the market and address these key gaps by developing meaningful and innovative solutions.

What is financial inclusion and what are some challenges to financial access in Southeast Asia?

Financial inclusion refers to the availability of financial services to all individuals and businesses that require useful and affordable financial products and services that meet their needs.[10] The World Bank notes that even though financial inclusion is prevalent in any given economy this does not necessarily correlate with financial access[15].

There are many factors which hamper financial access, but the ones affecting Southeast Asia the greatest include a diverse range of financial needs in an economy, local regulatory requirements (e.g. AML), having indirect access through another individual (i.e. shared bank account), cultural or religious reasons, preference for historic barter/cash methods or failure to meet the thresholds or risk tolerances set by financial service providers (e.g. lack of credit history, poor financial infrastructure, restrictive regulations).

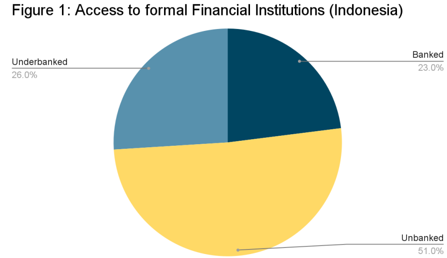
The existence of these challenges and opportunities paints the perfect picture for up-and-coming FinTechs to usurp the landscape with innovative and disruptive technologies by better understanding the market and supporting people currently excluded from the financial landscape.

A study by the Asian Development Bank (ADB), noted that leveraging on digital technology to provide banking services for unbanked could boost gross domestic product (GDP) by as much as 6 percent in Cambodia and 2 to 3 percent in larger markets such as Indonesia and the Philippines. Examples of alternative lenders promoting financial access in Southeast Asia are Friz, Funding Societies and UangTeman who have made waves for supporting various segments of the underbanked and unbanked throughout Southeast Asia.[16]

Who are the unbanked/underbanked and why is it a challenge to finance them?

Unbanked individuals can be defined as individuals who do not have access to banking products.[3] In contrast, the underbanked are individuals who have access to a bank account but often rely on alternative financial services such as money orders and microloans rather than traditional banks due to the inconvenience and cost of traditional banking services in their region.

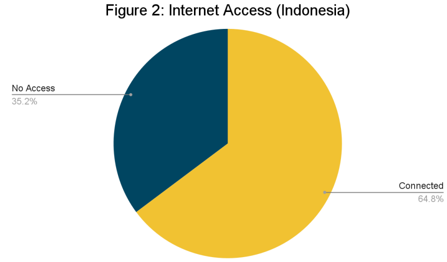
Figure 1: Access to formal Financial Institutions (Indonesia)



Source: "Indonesia at digitalisation crossroads," 2020

Southeast Asia's largest economy, Indonesia has a significant population of unbanked and underbanked individuals as represented in Figure 1. The combination of unbanked and underbanked individuals constitutes a whopping 77% of the total population which equates to approximately 208 million individuals.

Figure 2: Internet Access (Indonesia)



Source: "Indonesia at digitalisation crossroads," 2020 [6]

It is also worth noting in Figure 2 that approximately 65% of the Indonesian population have access to the internet.[7] This presents a significant opportunity for FinTech's to start up in the region, understand the needs of the market, create tailored products and bank the underbanked and the unbanked through the use of the 'internet of things'.

Many traditional lenders typically require existing bank accounts, bank statements, notarized statements of cash flow and income statements which are not traditional in the state of Indonesia. This presents a huge culture shift to be able to bank the unbanked, and due to this difficulty, there may be extreme reluctance to get banked.

Should financial institutions succeed in plugging this gap, economies across Southeast Asia could see this demographic triple their economic contribution from US$17 billion in 20xx to US$52 billion by 2030.

What are alternative lenders and how do they plug the financing gap?

Alternative lenders, also referred to as non-traditional lenders and sometimes neobanks are quite simply non-institutional lenders. Alternative lenders do not typically utilise traditional credit scoring methods to assess the risk of funding a loan and may instead choose to assess the loan by using algorithms that comb through internet search history, social media and device data to overcome the lack of formal documentation to approve loans.

Some examples of alternative lending include; Peer-to-Peer (P2P) lending, a type of debt-based crowdfunding which allows for non-bank investors to lend money to borrowers via online P2P lending platforms, circumventing conventional loan processes, requirements, and intermediaries.[8]

Another type of alternative lending is balance sheet lending, which is when the alternative lender itself provides a loan to the borrower instead of connecting an investor to the borrower. In this situation the risk of the loan is borne by the platform directly rather than an external lender.

No matter the type of lending provided, alternative lenders are often leaner and mobile-first in comparison to their traditional counterparts. This strategy appeals greatly to younger and underbanked segments due to the relative ease of access and convenience and hence they are able to plug the funding/financing gap much more efficiently in mobile-first markets like Southeast Asia.

From a customer's perspective, an alternative lender might amount to nothing more than a mobile application which allows you to manage money and apply for credit without needing to visit a physical bank. [11]

It is worth noting that these alternative lenders also utilise alternative credit scoring methods which make use of Artificial Intelligence (AI) models often built off data obtained from alternative sources such as social media activity, telco data, utility data, search data, e-commerce transaction and many more. These alternative credit scoring models increase in reliability with larger sets of data over time leading to decreased credit and operational losses for the alternative lenders.

Alternative Financing Innovations

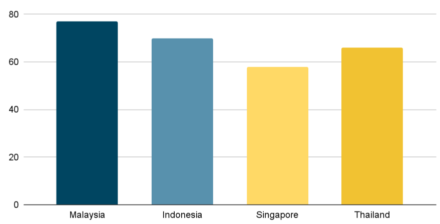
Besides traditional banking products such as savings accounts and credit cards, here are some financial innovations looking to bridge the financial access gaps by both institutional and alternative lenders.

Digital Wallets

Digital Wallets, also known as e-wallets, are software, electronic devices, or an online service that enables individuals and businesses to store money and transact electronically.[1]

In Southeast Asia, digital wallet payments in Southeast Asia were worth over $22 billion in 2019. A 2020 survey by Rapyd (Figure 3.) even found that over half of its Malaysian, Indonesian, Singaporean and Thai respondents had used a digital wallet at least once a month.

Figure 3: Proportion of residents who use digital wallets at least once a month (%)



Source: 2020 State of Disbursements: Asia Pacific Outlook Report, Rapyd, May 2020

Virtual Prepaid Cards

For digitally-savvy youth who lack access to financial services purely out of a lack of credit history or due to being saddled by student loans, virtual prepaid cards present an interesting opportunity for this group to build a credit history and perform financial transactions in a safer manner.

While the transactions made are smaller, these cards help to build a credit profile on the user and can thereby act as a bridge between this underbanked sector and traditional loan products and credit cards.

De-Fi

Built on the foundations of blockchain technology, decentralized finance (De-Fi) may pave the next wave of financial inclusion according to Gemini.[2] De-Fi solutions make use of smart contracts to automate transactions, eliminating the need for intermediaries. This gives rise to a new wave of digital products which may allow currently unbanked consumers to obtain and store cryptocurrency in virtual wallets, access alternative credit markets as well as invest in global asset markets without utilising traditional financial infrastructure.

FinTech players plugging the gaps

Friz: Unlocking Finance for Freelancers

Friz is a neobank whose offerings are tailored for the growing field of remote workers and freelancers.

The team was founded in April 2020 and its products include a debit card, credit line service and invoice financing, especially crucial to this underbanked sector, where most struggle to maintain a regular paycheck, rendering them ineligible for most loans or SME financing services from traditional institutional players.

Funding Societies: Working Capital for SMEs

Founded in 2015, Funding Societies | Modalku ("Funding Societies") is Southeast Asia's largest peer-to-peer digital financing platform. The company aims to close the financing gaps in the MSME landscape by bridging MSME borrowers with institutional and retail investors.

The company is currently active in Singapore, Malaysia, Indonesia and recently launched in Thailand, where it was one of the first in the country to receive a crowdfunding license, paving the way for more SMEs to receive crowdfunded loans as compared to traditional balance sheet loans.

UangTeman: Microloans

UangTeman is a Series B startup who is a key player in the Indonesia microlending space.[12] At present, UangTeman offers instant approval of loans up to $3.5mm IDR or the equivalent of $350SGD utilizing only internet surfing history, social media data and device data to replace the traditional 'credit check'. This innovation enables financial access by appealing to the 65% of the population (Figure 2.) that are connected to the internet, whilst providing an alternative solution to those who may not have sufficient credit worthiness due to lack of banking products (Figure 1.).

Other ways to address financing gaps

Although alternative lending FinTech firms seem poised to have a transformative impact on financial inclusion in Southeast Asia, their services often require consumers to have access to mobile phones and the internet which remain a challenge in the remotest parts of the region where infrastructure supporting internet access is underdeveloped.

Hence, here two ways players in the financial landscape can support the underbanked while tapping on existing infrastructure in the region.

Financial Literacy Programmes

While digital wallets and microloans provide crucial access points for underserved communities in the region, they are not the solution for the socioeconomic disadvantages that keep Southeast Asia's poorest outside formal financial systems.[14]

Financial literacy is an oft-overlooked part of education systems, and rural communities where members live on paycheck to paycheck often make unsavoury decisions when these crucial sources of funding stop, turning to loan sharks rather than banks due to a mistrust of institutional players.

Hence in order to bring about permanent economic change to this group, both institutional and alternative lenders could invest in financial literacy programmes and relevant training opportunities. These financial literacy programmes and resources should not just educate people on how they may for example learn how to budget but also introduce them to government agencies and organisations providing emergency assistance beyond the scope of these lenders.

Mobile Banking

Although Southeast Asia has a mobile connectivity rate of 133% (which means that some users own more than one SIM card or mobile phone), only 27% of the population have a bank account. For example, according to a 2017 Asian Development Bank (ADB) report, Cambodia has the highest mobile connectivity in Southeast Asia (173%) but only 13% of the population has access to banking (KPMG puts the percentage even lower at 5%).[13]

Hence, regional players could invest in creating services similar to Kenya's M-Pesa, a text-based service for storing and sending money which does not require a bank account or even internet access to work.[9]

Such a service would benefit parts of Southeast Asia where current network infrastructure is either poor or nonexistent to gain valuable access to financial services.

Conclusion

While alternative lending does not seek to replace traditional banks for all customers, however for the unbanked, they serve as a good entry point for the unbanked and underbanked of Southeast Asia to build a credit profile and gain access to larger credit facilities from traditional players.

These alternative lenders instead complement existing lenders and this healthy competition has given rise to innovations such as digital wallets and virtual cards as well as the emergence of decentralised finance.

However, with the emergence of these alternative lenders and their innovative solutions, there still remain unbanked communities in the region who lack access to both the knowledge and the infrastructure to access these services. Hence, both alternative and traditional players should strive to innovate and collaborate to provide greater financial access for all.

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