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Guest editorial: Poverty reduction in the FinTech age

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In recent years, debates on microfinance have gravitated towards a discussion of financial inclusion and away from the role of microcredit in poverty reduction. A consensus has emerged that although microcredit may not reduce poverty, neither does it cause harm for the most part. At a minimum, access to microcredit gives people options for managing their financial lives, usually with greater predictability, privacy and dignity, while opening the door to other forms of financial service – certainly not something to be dismissed. But, now that financial inclusion (access to finance) is almost synonymous with the financial technologies (FinTech) that enable inclusion, is financial inclusion enough and what role does FinTech play?

Recent studies are illustrating (reconfirming perhaps) that, with a nuanced understanding, we can identify circumstances under which microcredit is more likely to reduce poverty and improve the well-being of low-income households. In this issue of the journal, Samuel Annim's paper examines outreach and poverty reduction dimensions of microfinance institutions (MFIs) in Ghana. In a study of 2,884 respondents, microcredit interventions demonstrated greater poverty-reduction effects at the household level, depending on a mix of dimensions; for example, the greatest impact is realized when larger loans are targeted at clients in rural areas. Hala Elhaddi reports on parallel findings from Egypt with almost 800 respondents, revealing that microcredit has a positive impact on the household income of women borrowers who spend three years in the scheme as compared with newer borrowers. Such studies can guide decisions around the application of financial solutions so that we can go beyond financial inclusion to poverty reduction.

The digital revolution is probably the greatest boon to financial inclusion, and the rise of FinTech along with blockchain, regulatory sandboxes and other innovations that support FinTech speaks to this dominance in financial ecosystems. In Kenya, Tanzania and Bangladesh, significant percentages of the population use mobile phones to transfer money and make payments. But digitization does not exist within a vacuum. FinTech can only ever be a mechanism for delivery (albeit a powerful game-changer), and it would be very difficult to create digital processes without the decades of experimentation through bricks and mortar establishments and the ubiquitous loan officers – both of which are still critically important in many environments today. It remains to be seen whether the growth of FinTech will actually democratize financial systems and enhance opportunities to reduce poverty while offering inclusion and additional benefits besides.

In a recent study, the International Finance Corporation (IFC) reports that many of the same constraints that have always limited financial access in developing economies are also barriers for FinTech: limited levels of formal financial services

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and the predominance of cash; lower incomes and financial literacy on the part of potential clients; underdeveloped technologies and capital ecosystems; and relatively weak infrastructure from data, to coverage to regulatory frameworks (IFC, 2017). As Costa and Jakob explain in their contribution to this issue, even in the USA the risks around loan repayment are financial hazards that must be controlled in community development financial institutions (CDFIs) today. Interestingly, Costa and Jakob found that loan repayment is influenced by loan term at origination, with longer term loans paid back relatively more quickly. Such learning further nuances our understanding of what makes financial inclusion impactful for the borrower – something far more complex than a delivery mechanism.

Organizations such as the United Nations Capital Development Fund (UNCDF) lead the way in our understanding of the complexity of financial inclusion and underscore that it is not technology alone that can bring benefit to the financially excluded, but rather there is a need for a wide range of services that are provided responsibly, and at reasonable cost, by sustainable institutions in a well-regulated environment. For example, the UNCDF describes in practical terms how the winners of the Sierra Leone FinTech Challenge and the first participants of the Bank of Sierra Leone's pilot 'sandbox framework' are contributing to both the financial inclusion of clients and also providing enhanced benefits, recognizing technology as the delivery mechanism and not the solution per se (UNCDF, 2018). One of the winning ideas resulted in InvestED and the Salone Microfinance Trust (SMT) receiving an award of US$100,000 to pilot a platform for training low-income entrepreneurs, using a mobile app, on topics such as entrepreneurship, business skills and financial literacy. Moreover, users of the mobile app can qualify for credit products offered by SMT and other lending partners.

With financial inclusion achieved through FinTech, there are obvious benefits of reducing operating costs – but does digitization speak to all, most of, or just some aspects of cost reduction and value for money? In this issue, Mia et al. report on a study of 169 MFIs in Bangladesh that demonstrates how internal sources of funds, such as clients' savings and cumulative surplus, have a significant negative effect on the financing cost of MFIs. On the other hand, certain external sources of funds, notably donations and funds from government apex bodies, serve to reduce financing costs. An interesting parallel takes place at the household level with asset transfers from government to low-income households. We know that with digital payments there is significant reduction in leakage and outright corruption. In this case, does FinTech become more than the delivery mechanism when it acts not only as a cost-effective delivery mechanism but also a secure one that results in both financial inclusion and household benefit? Will reduced transaction costs due to FinTech benefit households and financial institutions going forward?

The Consultative Group to Assist the Poor (CGAP) has covered the growing digitization of social transfers in India (Venkatesan and Murthy, 2017). In the past, villagers in many parts of India had to wait in long lines and present multiple forms of identification to banking agents in order to collect their pensions in cash. Today, these same pensioners can visit a mini ATM, scan their fingerprints, and then either withdraw cash from a pension account or transfer money to other accounts. IDFC

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Bank not only offers this service to pensioners but has also enabled digital payments in local government and retail shops. CGAP notes, however, that in India 43% of digital accounts are dormant because they do not have the same services as those offered by IDFC Bank. Studies have shown that digital payments could increase usage of digital accounts while reducing the challenges associated with cashing in and cashing out (travel to bank branches, wait times, identification requirements, customer service).

Other questions are raised by contributors to this issue that are relevant to the inclusion, benefit and FinTech discussion, such as: How do financial crises and digitization interconnect? Can technology circumvent the various damaging crises that have occurred in the microfinance industry? For example, also in this issue, Guérin et al. explore the dynamics that have led to a number of major crises over the last decades, by analysing a set of factors at three levels – customers, institutions, and markets – in India, Morocco, the Dominican Republic and Senegal. Relevant to the inclusion-versus-impact discussion, the paper offers a broad conception of sustainability as not just a financial issue but also one with sociocultural and political implications. With regulatory differences among countries and the lack of protection in some, it is not clear whether and how financial inclusion dominated by FinTech will reduce or magnify risk and the impact of financial crises on low-income households. If regulations do not offer equality in access, then this could lead to greater disparities in inclusion rates let alone benefits that result from inclusion.

So what does the future hold for financial inclusion, poverty reduction and FinTech? McKinsey and company have identified seven FinTech trends to watch (Kuepper, 2016):

1. Expanding scope, with an increase in the types of financial services and greater granularity of those services
2. Increasing diversity in targeting a range of customers
3. Improving collaboration among FinTech companies to offer competitive services and maximize market share
4. Impending consolidation by large players through acquisitions
5. Normalizing valuations so that there are now established players and massive growth in valuations has slowed from 77% to 9%
6. Shifting regulations can curtail FinTech companies but also allow financial institutions to focus on the needs of their customers
7. Emerging ecosystems that are meeting the needs of clients.

These FinTech trends will certainly contribute to financial inclusion, even for some proportion of disadvantaged households, but what impact will this have on poverty reduction and household well-being? Will FinTech level the playing field for the female smallholder farmer in rural Zambia who still spends eight hours a day watering her vegetable garden and does not know what a treadle pump is and could not afford the cost of $150 anyway? Or will it enable the same farmers' seed supplier to offer inputs on credit, thereby both improving farmers' productivity and establishing sustainable village-level supply chains? Can FinTech be used to support shifting norms and regulations around land ownership and collateral?

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In short, what role can FinTech play and how can FinTech be leveraged as a powerful tool in the toolkit of change?

In the hullabaloo of the FinTech age, we are once again reminded there are powerful tools but no silver bullets. It will be up to practitioners and policy makers to ensure that FinTech results in benefits beyond financial inclusion to have a meaningful impact on the lives of those who move from 'excluded' to FinTech-enabled 'included'.

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