Economic impact of digital financial inclusion in Bangladesh

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ROUNDTABLES

Unlocking economic potential with
DIGITAL FINANCIAL INCLUSION

Policy Research Institute of Bangladesh in collaboration with The Daily Star organized a roundtable titled “Economic impact of digital financial inclusion in Bangladesh” on February 29, 2024. Here we publish a summary of the discussion.

Sun Mar 31, 2024 12:00 AM

Dr. Ahsan H Mansur, *Executive Director, Policy Research Institute of Bangladesh*

The initiation of digital financial services (DFS) in Bangladesh has been quite satisfactory, yet its untapped potential remains substantial, presenting significant opportunities for further development. Bangladesh's prospects are immense, as we have yet to surpass the midpoint in realizing the potential gains achievable through financial inclusion. We can boost female participation and contribute to overall economic activities by fostering financial inclusion.

Dr. Bazlul Haque Khondker, *Director, Policy Research Institute of Bangladesh (Keynote Presentation)*

Only 35 percent of the total private investment in Bangladesh in 2021 was financed from formal (e.g., banks) and quasi-formal (MFI, Grameen bank, etc.) channels. Thus, the remaining 65% of private investment was financed through non-formal channels, such as own savings and informal borrowing. The average interest rate on borrowing from informal sources is 40%, while for formal and quasi-formal borrowing, the interest rate ranged between 9% and 20%. If this unbanked investment can be financed via digital banking and nano-credit offered by MFIs, the economic and social benefits must be very large.

We developed a tool linking the real side of the Bangladesh economy with the financial side to simulate the socio-economic impact of extended financial inclusion through digital banking and nano-credit. A simulation was carried out assuming that half of the borrowing from informal sources (at a 40% interest rate), estimated at BDT 2,125 billion, is now channeled through a digital nano-credit scheme.

The economic and social impacts are extraordinary – GDP growth may reach double-digit growth of over 10%, employment generation of an additional 3 million workers, and a reduction in poverty of 3 percentage points from 18.7% to 15.8%. Transforming the unbanked to banked via digital and nano-credit will require appropriate strategies. Some of these include the expansion of digital nano-credit, establishment of an allocated fund for innovation and risk mitigation in digital lending, awareness programs, customized financial products, financial and digital literacy programs, and efforts to reduce the digital divide.

Khondokar Shakhawat Ali, *Emeritus Fellow, Unnayan Shamannay & Visiting Research Fellow,* *BRAC Institute of Governance and Development (BIGD)*

Transitioning from MFS to DFS to Digital Banking, we've seen that strong technology and innovation can lead to success. We expect similar advances in nano loans. However, doubts remain about how competitive the business environment is and whether there are enough options for customers, especially those relying on social safety nets. If we don't tackle these concerns, it could weaken the principles of digitalization, especially in terms of access and independence.

Debdulal Roy, *Executive Director (ICT), Bangladesh Bank*

The launch of digital banking platforms promises enhanced accessibility, while third-party credit rating agencies aim to streamline decision-making processes for lenders by offering comprehensive borrower profiles.

Despite introducing Bengali keywords for digital lending, rural adoption remains limited due to incomplete ecosystem development. Achieving full financial inclusion necessitates integrating digital transactions into every segment of the economy.

Improvements in digital lending methodologies hold the potential to bolster overall economic growth. Initiatives such as Social Accounting Matrix (SAM) can amplify positive social impacts, while continued support for SMEs through refinancing initiatives reflects our commitment to nurturing economic resilience.

Dr. Sayema Haque Bidisha, *Research Director, South Asian Network on Economic Modeling (SANEM)*

The success of nano loans relies on a robust digital ecosystem, necessitating digital infrastructure improvement, a current challenge in our country.

Gender issues require due consideration, especially in Mobile Financial Services (MFS), where a significant gender divide persists. Assessing women's inclusion and empowerment, understanding the multiplier impact on growth and employment, and strengthening channels for realization are crucial. Financial inclusion should empower individuals to actively participate in economic activities, creating more opportunities for employment.

Dr. Mohammad Yunus, *Research Director, BIDS*

While services like bKash expedite urgent liquidity transfers, their alignment with the essence of financial inclusion remains debatable. Using bKash agent account doesn't necessarily signify full participation in financial inclusion efforts. Despite the time-saving benefits of bKash for money transfers, those without personal accounts encounter agent-dependent procedures, adding complexity to transactions.

Challenges faced by Small and Medium Enterprises (SMEs) underscore the importance of nano credit in fostering economic growth. However, existing accounting frameworks for SMEs, applicable to nano credit, often lead to loan rejections. Achieving an economy of scope through nano credit demands a nuanced understanding of its contributions across sectors.

Syed Yusuf Saadat, *Research Fellow, Centre for Policy Dialogue*

SAM possesses a static rather than dynamic nature, capturing a snapshot of a specific period without accounting for subsequent changes. Addressing evolving dynamics is crucial, considering that individuals may not always act rationally, and Bangladesh's market lacks full competitiveness. Our focus should encompass these issues within the framework of input-output modeling.

While Japan relied on physical currency for basic transactions, Bangladesh, exemplified by platforms like bKash, has embraced mobile financial services, democratizing access across the country. BB's decisive actions in this arena are commendable, even as challenges arise with the proliferation of digital banks, necessitating careful definition of niche and value addition.

Moinuddin Mohammad Rahgir, *Chief Financial Officer, bKash Ltd.*

Trust, essential for the industry's growth, evolves with effective governance. Traditional point-to-point transfers lack the data trail for robust credit ratings, but as more transactions generate data, credit rating accuracy will improve. Despite commendable growth, bKash aims for more, investing in fraud awareness and assuring customers through proactive measures.

BKash, with a free onboarding process and open-market agent operations, fosters healthy competition. Despite initial losses, the company aspires to be synonymous with comprehensive financial solutions, positioning itself as a cornerstone in an evolving industry. As understanding deepens and services diversify, the benefits of this pioneering effort will manifest over time.

Sandeep Debnath, *Chief Operating Officer, Shohoj Limited*

I am concerned about the adaptability of our plans and policies. While we are actively creating various initiatives, it's crucial to assess whether these programs resonate with people. Policymakers could consider introducing incentives to encourage the adoption of these policies. Government-backed incentives would particularly contribute to fostering greater financial inclusion among the rural population.

Dr. Lila Rashid, *Former Executive Director, Bangladesh Bank*

This research paper indicates that 60 percent of private sector borrowing originates from the informal sector. Shifting 50 percent of this borrowing to the formal sector could reduce operational costs for borrowers and provide access to government facilities, potentially generating additional revenue. Establishing a comprehensive database would enhance private investments and empower the government to formulate more effective policies.

Transforming the informal sector necessitates diverse avenues, including micro-credit and enhancing women's integration into Small and Medium Enterprises (SMEs) and banking. Exploring innovative financing methods like crowdfunding and agent banking can play a pivotal role in this transformation.

Shariful Islam Chowdhury, *Project Officer, UNCDF*

Comprehensive financial inclusion hinges on a robust digital transformation. The UNCDF's policy tool, developed in collaboration with six organizations and four country governments, assesses digital transformation across four key scales. Bangladesh achieved a 56 percent score in skills, encompassing financial and digital literacy, in the 2022 scorecard. However, innovation lagged with a score of only 44 percent, signaling a critical gap to address for overall digital enhancement and inclusive finance. While infrastructure earned a commendable 68 percent, policies received an even higher score at 80 percent.

Dr. Ananya Raihan, *Chief Executive Officer, iSocial*

Despite satisfactory progress in payments and transfers, the absence of a robust insurance market hinders the advancement of cross-border trade and other services.

Women entrepreneurs, particularly in cottage, micro, and small-scale enterprises, face significant challenges accessing finance due to a reluctance to undergo auditing and formal business registration. Fear of falling under the tax net impedes their ability to secure loans. A vital directive exempting them from tax scrutiny for a defined period is essential, providing guarantees and incentives to encourage their transition into the formal sector and making financial inclusion for these entrepreneurs an attainable goal.

Ayushi Misra, *Senior Manager, MicroSave Global Consulting Ltd*

In the past 1.5 years, we have meticulously documented the daily financial activities of around five hundred women entrepreneurs in Bangladesh through daily diary data collection. The insights gathered align significantly with the recommendations here, emphasizing the importance of understanding the specific customer journey of women entrepreneurs. Mapping their interactions with formal channels, both with and without assistance, reveals that despite the significance of nano loans in transitioning from the informal to formal sector, only 18 percent of these women exhibit high digital literacy, 53 percent moderate, and 29 percent poor digital literacy. Recognizing this, it becomes evident that incorporating a physical element is crucial to facilitating the easy onboarding of women entrepreneurs into formal financial channels.

Dr. Ashikur Rahman, *Senior Economist, Policy Research Institute*

Prospects of Digital Financial Inclusion depends partially on the state of governance in the

DFS sector. One of our studies reveal that one in ten consumers faced fraud; and effective redress was found by only one in three victims, indicating an acute governance challenge in the MFS sector – particularly in terms of consumer protection.

The possible introduction of digital nano loans raises questions about their usage: for micro-consumption or micro-investment. To address this, we might have to reconsider the business-model and examine the potential of big data to identify prospective customers and formulate an investment-oriented framework.

Muhammad Zahidul Islam, *Head of Media and Communications, Nagad Limited*

I want to address several challenges related to our services. We are currently unable to offer all types of services to our customers upon onboarding them, which is a significant issue. In numerous instances, customers are required to pay extra fees when using card or MFS for transactions. This situation should ideally be reversed; customers should have seamless access to all services within the digital payment ecosystem without additional charges.

There's still substantial work to be done in reducing service costs overall. It would be beneficial for banking regulators to establish both upper and lower limits on service costs to ensure fairness and accessibility for all customers.

Dr. Mashiur Rahman, *Adviser to the Prime Minister for Economic Affairs*

The connection between the informal and formal sectors is notably weak, despite the substantial contribution of the informal sector to our GDP, which often goes unaccounted for. By partially integrating the informal sector with the formal sector, we could witness a significant boost in our GDP.

Bangladesh Bank has established several funds to support various sectors. It's imperative to explore how much capital Bangladesh Bank can inject into the informal sector to stimulate its growth, taking into account the constraints of monetary policy.

Our education system still falls short in facilitating the necessary digital transformation. One cost-effective solution could involve promoting ICT education among students enrolled in local colleges affiliated with the national university.

With only two digital banks currently in operation, there's limited scope to expand interoperability among service providers. Regulators could establish standard mechanisms and offer options for service providers to comply with these standards.

Transactions through bKash create a profile of the individual, providing an initial assessment of their creditworthiness. This profile could be leveraged to expand services. Nagad could capitalize on the millions of small saving accounts held at Post Offices to broaden their service offerings.

Dr. Bazlul Haque Khondker's proposed model offers an optimistic future. Institutions dealing with finance should collaborate on implementing this model.

Dr. Ahsan H Mansur, *Executive Director, Policy Research Institute of Bangladesh*

Bangladesh faces a significant challenge regarding financial inclusion. While we aim to strengthen financial inclusion, there's a notable discrepancy between micro-level achievements, such as increased financial inclusion through MFS, and macro-level trends showing a reduction in financial deepening. This inconsistency prompts us to delve into why we're falling short on the macro aspect of financial deepening – how the banking system, government, and regulators can effectively collaborate to inject adequate liquidity without triggering inflationary or exchange rate pressures.

Achieving non-inflationary liquidity expansion remains a paramount challenge often overlooked in Bangladesh. Failure to address this risk undermines the economy's financial depth. Macro-financial services and broader financial inclusion efforts must complement each other, not diverge.

Diverse stakeholders must contribute to this endeavor. Traditional micro-financial institutions (MFIs) should compete alongside banks engaging in agent banking operations, targeting the burgeoning rural economy. While digital banks and MFS providers expand their reach, global experiences underline the enduring significance of traditional banks. Yet, digital banks will carve a niche, especially in servicing sectors where formal banks may not fully cater.

Technological innovation is pivotal, shaping competition dynamics and potentially reshaping the sector. Microfinance institutions must adapt and adopt technological changes in their operations to survive by lowering interest rates to compete with banks.

Regulators must ensure fairness and balance, particularly in licensing digital banks. Excluding established players like bKash from licensing processes risks hindering progress of the sector. Interoperability issues further underscore regulatory challenges. Without the comprehensive inclusion of major players like Nagad and bKash, the system remains dysfunctional, impeding financial transactions.

Acknowledging regulatory shortcomings is crucial for improvement. Rectifying mistakes and fostering a conducive environment for all stakeholders to thrive is essential.

Mahfuz Anam, *Editor and Publisher, The Daily Star*

As a media house, our role is to bring ideas together, facilitate debates, and present them to the public. Today’s innovative topic warrants further exploration. In an evolving world, mismatches in regulatory frameworks, whether obstructive or conducive, need addressing. We aim to foster a dialogue between stakeholders and regulatory bodies, leveraging the media’s role in facilitating this crucial conversation.

Tanjim Ferdous, *In-charge of NGO and Foreign Missions, Business Development Team, The Daily Star*

The advent of mobile financing services in Bangladesh marks a significant milestone, accompanied by our banks’ adoption of digital services and integration of blockchain technology. Today, we delved into the economic implications of these advancements, facilitating business expansion while adapting to these innovations. Key areas of discussion included improving financial access for the unbanked, the impact of digitization on business processes and supply chains, and analyzing financial service providers, banks, and the payment service provider model.

Recommendations

- Micro-financial services and broader financial inclusion efforts must align, not diverge.
- Regulators must ensure fairness and balance, particularly in licensing digital banks.
- Prioritize seamless access to all services within the digital payment ecosystem to eliminate additional charges for customers.
- Enhance integration between informal and formal sectors to unleash untapped GDP potential.
- Promote ICT education in local colleges affiliated with the national university to bridge digital transformation gaps in the education system.
- Standardize mechanisms for interoperability among digital banking service providers to foster market expansion and consumer convenience.
- Gender concerns should be given appropriate attention in digital financial inclusion.
- Creating a comprehensive database is crucial for attracting more private investments.
- Financial institutions, ranging from traditional banks to digital providers, must collaborate using technology to serve rural economies effectively.
- Utilize nano credit effectively to enhance SME sector growth.