DIGITIZING MSEs FOR FINANCIAL INCLUSION: OPPORTUNITIES & CHALLENGES

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Micro and Small Enterprises (MSEs) are important pathways to improved livelihoods for low-income households.

500M
MSEs in EMs
Dalberg (2019)

Share of Job Creation across Firm Size

<table>
<thead>
<tr>
<th>Firm Size (number of employees)</th>
<th>Share</th>
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<tbody>
<tr>
<td>5-19</td>
<td>45%</td>
</tr>
<tr>
<td>20 - 99</td>
<td>30%</td>
</tr>
<tr>
<td>100+</td>
<td>17%</td>
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N = 85 countries, Ayyagari et al (2014)

Financial services are critical to the success of MSEs, yet there remains a persistent US$4.9 trillion financing gap.

Estimated Global Micro and Small Enterprise Credit Gap

**USD trillions**

- Formal Microenterprises Credit Demand: 3.1
- Formal Small Enterprises Credit Demand: 2.5
- Informal Microenterprises Credit Demand: 1.7
- Informal Small Enterprises Credit Demand: 0.8
- Total MSE Credit Demand: 8.0
- Total MSE Credit Supply: 4.9
- Unmet MSE Credit Demand: 4.9

*Sources: Dalberg (2019), Bridging the credit gap for micro and small enterprises through digitally enabled financing models*
*IFC (2017), MSME Finance Gap*
Emerging FinTech business models exhibit potential to address unmet financial needs of MSEs

Providers harness innovations in technology

Leverage digital data trails created by MSEs’ increasing embrace of digital technologies

Create Innovative FinTech MSE Finance Models

Artificial Intelligence (AI)
Big Data Analytics
Machine Learning (ML)
Application Programming Interfaces (API)

Digital Wallets
Mobile Money
Ecommerce Sales

PoS Devices
Payment Gateways
Digital Invoices

Data Driven Lending
Embedded Finance
Peer to Peer (P2P) Lending
Digital Banking

Note: Icons made from www.flaticon.com
We still don’t know much about the smallest and poorest MSEs

Existing research and data sources often exclude very small enterprises (<5 employees) and the informal sector

We know even less about the various segments within the MSE universe, their peculiarities, and nuances

• Who owns MSEs in emerging markets?
• What are their entrepreneurial goals, motivation and business trajectories?
• What are their financial attitudes, behaviors and experience?
• How can financial services help improve their livelihoods?
• What’s the role of digitization?
In 2021, CGAP undertook primary qualitative research with nearly 400 MSEs in India, Kenya and Peru, to:

- Understand distinguishing factors affecting livelihood and income generation across key MSE segments
- Understand the role of financial and non-financial services in supporting MSE livelihoods
- Recommend ways in which FSPs, particularly DFS providers, can tailor their approach and offerings to better address the needs of MSEs

**SAMPLE SELECTION CRITERIA**

**MSE Size:** three segments as defined by number of employees (1–4, 5–19, and 20–30).

**Economic Sector:** focus on three sectors: retail (including services), manufacturing, and transport.

**Formality and Digitization:** businesses along a spectrum of formality and digitization.

**Gender:** gender lens applied throughout the research.
In the wake of the COVID-19 pandemic, it appears that MSEs have accelerated their adoption of digital technologies and DFS

- MSEs embraced digitization, DFS and explored online platforms to keep commerce flowing
- Some shifted almost entirely to online social platforms, which increased the complexity of managing marketing, sales, and fulfillment
- MSEs, particularly new digital adopters, expressed need for support in understanding the long-term use of these services and concerns around security.
Although DFS use has increased significantly, it has been more in response to customer preferences than inherent enthusiasm...

... there remains a significant lack of trust in providers

“We have all the type of payments, because we saw that if we don't have the type of payments, we lose a customer”
– Woman Business Owner, Peru

- Despite increased frequency, many MSEs remain reluctant users of DFS, and strictly manage the frequency of use to limit risk exposure
- MSEs believe that DFS providers are not as well regulated as banks and other non-digital NBFIs
- Likewise, MSEs frequently note a lack of transparency by DFS providers and express concerns about the security of their data

If MSEs continue to have low trust in providers, they will limit usage, and will treat DFS providers, particularly credit providers, as lenders of last resort.
“I would want to know what the apps is going to cost me. And I should know how to use it. I don't know how a new app would work. How the data is stored. Could the data get erased? I trust the Bank but don't know anything about these apps, the people, where they're from. All your data is going into this app, and it could be misused.”

Small store owner, India
Thank you

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