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ASK:NUS Economists

Gig workers, foreign workforce may be well served by digital banks

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For The Straits Times

Q *How can digital banks increase financial inclusion in Singapore?*

A The Monetary Authority of Singapore recently announced that up to five new digital bank licences will be issued, signalling a new phase of banking liberalisation.

This will impact individuals, as well as enterprises, that have traditionally been excluded by banks due to their risk profile.

While the technology revolution has disrupted traditional business models and operations for the past decade, strict financial regulation in Singapore has protected the banking sector to date. With the proposed changes, the financial landscape is slated for change.

Digital banks provide all their banking services online without the need for a physical branch.

Nonetheless, they are not a new concept. Many countries worldwide have embraced the use of digital banks.

M-Pesa, a branchless banking service, has provided mobile payment services in countries such as Kenya since 2007.

With more than 38 million users in African countries, it has been touted as a gateway for households to gain full access to financial services in a safe and cost-efficient manner.

Hong Kong, Singapore's closest competitor as a global financial hub, had issued eight virtual banking licences to date.

New entrants include technology firms such as Xiaomi and Tencent, which have the financial capability and technical know-how to compete with the incumbents.

In Singapore, digital banks will likely harness technology and big data to shake up the banking sector.

Traditionally, the role of a bank is to act as an intermediary between lenders and savers. It channels funds from savers to borrowers and makes profits from the difference between the deposit rate and lending rate. Banks are seen to be efficient at allocating resources into productive use. They can collect and process information of borrowers on a large scale and manage risks.

But the growth of digital technology and big data have shaken up banks' operations and cost structure, turning previously unprofitable customers into candidates for banking services.

Three groups potentially benefit from digital banks.

GIG ECONOMY WORKERS

The first are those in the gig economy.

Ministry of Manpower data shows that residents engaged in own account work as their primary job are approximately 8.4 per cent of all employed residents in 2017.

Without regular income, these workers are unable to meet the lending standards of traditional banks. It takes time and effort for traditional banks to assess their creditworthiness, especially when borrowers require liquidity in the short run.

Digital banks with information on individuals' digital records can make use of their digital footprint to come up with alternative credit scores for these borrowers.

For instance, Ant Financial, an affiliate of the Alibaba Group in China, made use of individuals' transaction data with Alibaba to compute a private credit scoring, the Zhima Credit. Using both online and offline information, including social media interactions, the Zhima Credit updates a person's credit rating continuously.

This alternative credit rating will be useful for gig economy workers who wish to borrow. As long as their online presence signals their creditworthiness, they will be able to access financial products that they were unable to access previously.

Moreover, studies have shown that digital footprint variables are useful in predicting default.

A recent study by Tobias Berg, Valentin Burg, Ana Gombovic and Manju Puri from the National Bureau of Economic Research studied a sample of over 270,000 purchases from a German e-commerce company and found that a model that made use of all variables of digital footprint performs better than a model that leverages on traditional credit bureau scores.

SMEs

Alternative credit rating can also be applied to small and medium-sized enterprises (SMEs), especially start-ups that have less than three years of operations.

Banks are often reluctant to lend to such companies due to the lack of collateral and their young credit history. According to the 2017 SME Financing Survey, only 60 per cent of the debt-financing applications of micro SMEs – defined as companies with less than $1 million in revenue – were fully approved.

With insufficient working capital, these firms can face liquidity problems in the short run despite having sound business prospects in the long term.

Through the businesses' digital footprints, digital banks are able to have an intricate knowledge of their receivables and payables, and are able to have a better understanding of the needs of these firms. They can monitor management's performance at all times and are able to offer tailored banking solutions at a low cost.

FOREIGN WORKERS

The third group who may benefit from digital banking are foreign workers in Singapore.

There are about 250,000 foreign domestic workers in Singapore.

About half do not have a bank account and a third are in debt, according to a study commissioned by Experian and charity organisation Enrich.

This is due to the lack of financial literacy, as well as high barriers to opening bank accounts.

The advent of digital banks can make banking more accessible to them. Workers can open accounts at minimal cost without disrupting their daily work and have more control of their finances.

They can gain control of their remittances and even purchase goods directly for their loved ones.

Furthermore, they can borrow from digital banks (when they have an account) in times of emergencies, and not rely on unlicensed moneylenders, which has been an issue of late.

The future of digital banks in promoting financial inclusion is promising. Moreover, incumbents are beginning to play a more active role to facilitate financial and social inclusion. For example, DBS Bank and POSB Bank have collaborated with the Infocomm Media Development Authority to familiarise senior citizens with digital banking services.

There are also talking ATMs to empower visually handicapped customers to conduct basic banking transactions. This bodes well as digital banks complement the local banks in shaping the future of finance in Singapore.

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