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A STUDY ON THE IMPACT OF DIGITAL FINANCE ON FINANCIAL INCLUSION

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Abstract:

It is ironical to state that even in 21st century, more than one third of the total population in underdeveloped countries are still excluded from the banking services ambit. Many research studies conducted in this direction infer that, bringing those financially excluded population, under the banking ambit, results in not only individual welfare and results in social welfare too. Since 2010, the G-20 countries and the World Bank have led the initiative for increased financial inclusion in developing countries to help reduce poverty levels in developing and emerging economies (GPII, 2010). Today, the relevance of digital finance and financial inclusion for poverty reduction and economic growth is attracting higher attention of policy makers and academicians, primarily because of the number of issues that persist in the conventional banking system, due to which a large segment of population are unserved, which, if addressed can make digital finance work better for individuals, businesses, governments and the economy. Digital currency and mobile technology can cater the needs of small transaction at an affordable cost. It can also help in reducing time, more accurately and make faster transactions in bulk. Digital finance and financial inclusion bring multi faceted benefits to financial service users, digital finance providers, governments and the economy such as increasing access to finance among poor individuals, reducing the cost of financial intermediation for banks and Fintech providers and increasing aggregate expenditure for governments. One area where the disparity is quite pervasive and is receiving increased attention is digital financial inclusion, financial data inclusion and digital finance. The relationship between these and the issues they pose for financial inclusion have received very little attention in the past. Therefore, this study examines the impact of digital finance for financial inclusion and financial system stability. This research article provides a detailed discussion on digital finance and explores the impact of digital finance for financial inclusion and financial system stability - an issue which has not been addressed in the earlier studies.

Key words: Digital Finance, Financial Inclusion, Financial literacy, Financial Stability.

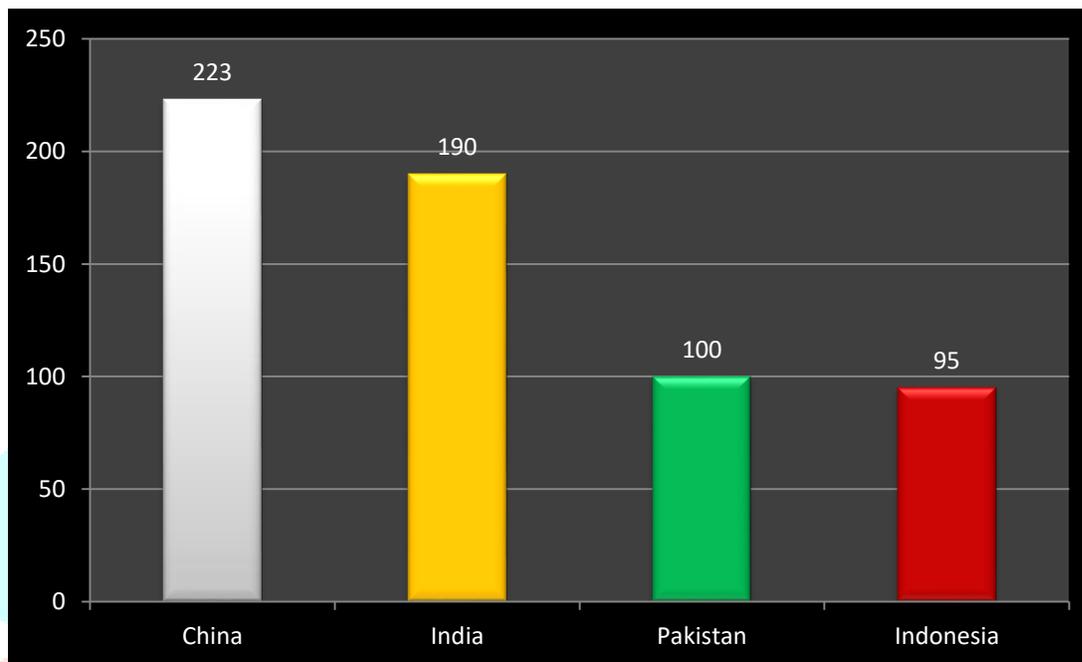
Introduction:

Digital financial inclusion involves utilizing the cost-saving digital means to reach currently financially excluded and underserved populations with a range of formal financial services suited to their needs that are responsibly delivered at a cost affordable to customers and sustainable for providers. The CGAP defines digital financial inclusion as “digital access to, and the use of, formal financial services by the excluded and underserved population” (CGAP, 2015). Currently, innovative digital financial services via mobile phones and similar devices have been launched in at least 80 countries (GSMA, 2014), to encourage millions of poor customers to exclusively use digital financial services rather than cash-based transactions. The process of digital financial inclusion begins with the assumption that the excluded and/or underserved population has some sort of formal bank accounts and need digital access to enable them to carry out basic financial transactions remotely. If the excluded and underserved population understand and can be persuaded about the intended benefits of digital financial inclusion, an effective digital financial inclusion program should be suited to meet the needs of the excluded and underserved population and should be delivered responsibly at a cost that is sustainable to providers and affordable to customers. Fintech providers can promote economic growth during good economic times by increasing the volume of financial transactions in the financial system, although, it is still unknown whether Fintech providers and their activities can exacerbate economic crises during bad economic times.

The essential components of digital financial inclusion are as follows:

- **Digital transactional platforms** enable customers to make or receive payments and transfers and to store value electronically through the use of devices that transmit and receive transaction data and connect to a bank or non-bank permitted to store electronic value.
- **Devices** used by the customers can either be digital devices (mobile phones, etc) that transmit information or instruments (payment cards etc) that connect to a digital device such as a point-of-sale (POS) terminal.
- **Retail agents** that have a digital device connected to communications infrastructure to transmit and receive transaction details enable customers to convert cash into electronically stored value (‘cash-in’) and to transform stored value back into cash (‘cash-out’).
- **Additional financial services via the digital transactional platform** may be offered by banks and non-banks to the financially excluded and underserved credit, savings, insurance, and even securities often relying on digital data to target customers and manage risk.

As per the Global Findex Database report published in 2017, globally around 1.7 billion adults remain unbanked i.e. without an account of any financial institution and banks or through any mobile banking and mobile money provider. The same report states that, China (223 million) has the world's largest unbanked population, followed by India (190 million), Pakistan (100 million) and Indonesia (95 million). Apart, these four countries, Nigeria, Mexico, and Bangladesh has also unbanked population but ratio is less as compare to China, India, Pakistan and Indonesia.



Source: Global Findex Database, 2017

Advantages of Promoting Digital Finance:

Digital financial inclusion has many benefits. Some of them are discussed as follows:

- ❖ Digital financial inclusion helps in lowering banking transaction costs by reducing queuing lines in banking halls, reduce manual paperwork and documentation and to maintain fewer bank branches.
- ❖ With digital financial inclusion, large number of depositors can easily switch banks within minutes; forcing banks to provide quality services or risk losing depositors to rival banks.
- ❖ Digital finance has the potential to provide affordable, convenient and secure banking service to poor individuals in developing countries. Recent improvement in the accessibility and affordability of digital financial services around the world can help millions of poor customers to move from cash-based transactions to digital financial transactions on secured digital platforms.
- ❖ Digital finance promises to boost the gross domestic product (GDP) of digitalized economies by providing convenient access to diverse range of financial products and services for individuals as well as for small, medium and large businesses, which can boost aggregate expenditure thereby improving GDP levels. Digital finance can also lead to greater economic stability and increased financial intermediation, both for customers and for the economy.

- ❖ For financial and monetary system regulators, digital financial inclusion also helps to reduce the amount of physical cash in circulation and is instrumental in reducing high inflation levels in developing and poor countries.
- ❖ Digital finance can lead to greater financial inclusion, expansion of financial services to non-financial sectors and the expansion of basic services to individuals since mobile phone penetration rate is very high in developing and in underdeveloped countries.
- ❖ Digital financial inclusion can improve the welfare of individuals and businesses, who have a reliable digital platform, with which, they can carry out financial transaction and access funds directly from their bank accounts.
- ❖ The expected benefits of digital financial inclusion can be fully realized if the cost of obtaining a digital transactional platform by poor individuals is negligible or low, where a digital transactional platform refers to mobile phones, personal computers and related devices.
- ❖ Digital finance benefits governments by providing a platform to facilitate increase in aggregate expenditure, which subsequently generates higher tax revenue arising from increase in the volume of financial transactions. It considerably reduces the circulation of fake currencies, which is a great boon to any countries economy.

A large amount of the excluded population owns a mobile phone and that the provision of financial services via mobile phones and related devices can improve access to finance for the excluded population. Provided that the excluded population have a mobile phone and affordable internet connectivity, greater supply of digital finance is often predicted to have positive effects for financial inclusion. Greater digital finance when applied to the lives of low-income and poor people can improve their access to basic services, thereby leading to greater financial inclusion in rural areas. Greater digital financial services channeled to rural and poor communities can improve access to finance for bank customers in rural and poor communities who cannot conveniently access banks located in the formal sector due to poor transportation networks and long waiting hours in banks. Easy-to-use digital finance can provide a more convenient platform for individuals to carry out basic financial transactions including payments for electricity, water supply, money transfer to family and friends etc.

Disadvantages of Digital Financial Inclusion:

Though digital financial inclusion appears to be rosy, it has thrones, which causes the source of worry. Some of them are:

- ❖ Customer faces, what is termed as ‘Novelty risks’ which arises due to their lack of familiarity with the products, services, and providers and their resulting vulnerability to exploitation and abuse.
- ❖ There are few ‘Agent-related risks’ since, the service providers offering services are not subject to the consumer protection provisions that apply to banks and other traditional financial institutions

- ❖ Technology related risks, inherent in the system, which might result in disrupted service and loss of data, including payment instructions, as well as the risk of a privacy or security breach resulting from digital transmittal and storage of data.
- ❖ Digital finance does not serve those individuals who do not have mobile phone or digital devices.
- ❖ The system relies excessively on internet connectivity, which excludes individuals who do not have internet connectivity.
- ❖ The way digital finance is introduced in countries can lead to voluntary financial exclusion if the population is not ready for it.
- ❖ Fee-based digital finance platforms will benefit high- and medium-income individuals at the expense of poor and low-income individuals who cannot afford the associated transaction costs.
- ❖ Many policy and regulatory environments are not enabling full-scale digital finance transactions.

Review of literature:

Banerjee et. al. (2017) suggests that awareness can facilitate financial inclusion by increasing the usage level of all financial products and services. The underlining theory used by the researcher is the Theory of Cognitive Dissonance by Leon Festinger (1957) which suggests that there is an inconsistency between action and belief and that causes dissonance and can help in a change in behaviour action and attitude. The Theory of Cognitive Dissonance, when applied in the case of Digital Financial Literacy and Digital Financial Inclusion, suggests that there is an inconsistency between awareness and usage level of digital products and services which creates a dissonance. If the dissonance is addressed in the right manner change can be seen in both awareness and usage. Therefore this theory mainly contributes towards the basis of the problem addressed. Most researches contributed to the impact of financial literacy on financial inclusion. Banerjee et. al. (2017) the main findings of those researches suggests that financial literacy and financial inclusion has a mediating variable of awareness.

Prasad et. al. (2017) contributes towards literacy and usage contributes towards inclusion and has been proven. A structured questionnaire was framed by compiling questionnaires in the same area by introducing digital concepts. The model framed by the researcher has been proven to be true i.e. Digital Financial Literacy has an impact on Digital Financial Inclusion. A sample of 200 respondents was drawn and Smart PLS Version 3 was used to analyse the data. The results show that the hypothesis framed by the researcher is statistically significant. Also, the percentage of digital financial literacy stands at 76.42% and that of digital financial inclusion stands at 62.2 % which suggests that digital financial literacy contributes towards the increase in the inclusion rate which can be said as awareness facilitates usage level.

Research Methodology: The study tries to understand the level of Digital Financial Literacy and Digital Financial Inclusion. The current study is descriptive in nature. A structured questionnaire was used to collect data. The questionnaire was framed using different sets of published questionnaires. Questions were mainly based on Financial Literacy and Financial Inclusion. The digital aspect has been added to every area in the

final questionnaire. The questionnaire consists of sets of seven questions for both Digital Financial Literacy and Digital Financial Inclusion. Awareness related questions were used in measuring Digital Financial Literacy and a set of questions related to usage facilitated the measurement of Digital Financial Inclusion. All the questions were asked on a 5 point scale. The percentage of score helped in understanding the level of digital financial literacy and digital financial inclusion of every individual used in the sample. The Reliability and Validity of the questionnaire were analysed using Smart PLS version 3. The sample size of 200 was used to measure Digital Financial Literacy and Digital Financial Inclusion.

Findings of the study:

- Digital financial inclusion involves utilizing the cost-saving digital means to reach currently financially excluded and underserved populations with a range of formal financial services suited to their needs.
- Awareness of all the digital products, services is very important and it increases the usage level which ultimately contributes towards economic growth.
- If people have good knowledge about different products and services available in the market, it contributes towards growth in their own individualistic monetary benefits.
- Bringing financially excluded population, under the banking ambit, results in not only individual welfare and results in social welfare too.
- Since 2010, the G-20 countries and the World Bank have led the initiative for increased financial inclusion in developing countries to help reduce poverty levels in developing and emerging economies.
- Digital currency and mobile technology can cater the needs of small transaction at affordable cost. It can also help in reducing time, more accurately and make faster transactions in bulk.
- Digital finance and financial inclusion bring multi faceted benefits to financial services users, digital finance providers, governments and the economy such as increasing access to finance among poor individuals, reducing the cost of financial intermediation for banks and Fintech providers.
- Fintech providers can promote economic growth during good economic times by increasing the volume of financial transactions in the financial system, although, it is still unknown whether Fintech providers and their activities can exacerbate economic crises during bad economic times.

Conclusion:

A large amount of the excluded population owns a mobile phone and that the provision of financial services via mobile phones and related devices can improve access to finance for the excluded population. Provided that the excluded population have a mobile phone and affordable internet connectivity, greater supply of digital finance is often predicted to have positive effects for financial inclusion. Greater digital finance when applied to the lives of low-income and poor people can improve their access to basic services, thereby leading to greater financial inclusion in rural areas. Hence, in a country like India, where, a major chunk of population are still unbanked, provision of digital financial inclusion and banking services has huge scope.

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