

## **Part 2 — LiA Report**

### **Executive Summary:**

SMART Goals:

1. Produce a 30-page internal brief and report on digital finance in emerging markets within 6 weeks.
2. Develop at least three actionable recommendations to improve CGAP's sustainable digital finance framework.
3. Contribute to CGAP's workstream project by analyzing policies from at least five different countries.

### **Project Focus and Responsibilities:**

My primary responsibility was to advise CGAP's digital consumer credit team on their upcoming pilot project. This involved:

1. Analyzing CGAP's existing work and future plans.
2. Conducting extensive research on digital finance in emerging markets.
3. Drafting a comprehensive 30-page internal brief and report.
4. Providing critical analysis and recommendations to strengthen CGAP's sustainable digital financial ecosystem framework.

### **Impact:**

The internal brief I produced had several significant impacts:

1. It highlighted the gap between CGAP's theoretical framework and the practical realities in developing countries.

2. It provided an in-depth analysis of the rapid expansion of digital payments post-COVID-19 and its implications.
3. It identified key concerns such as over-indebtedness and payment frauds affecting vulnerable groups.
4. My recommendations, including policy reforms for lending information disclosure and initiatives to enhance digital and financial literacy, were incorporated by CGAP.

### **Sustainability Measures:**

The project's sustainability will be measured through:

1. Implementation of recommended policy reforms by regulatory institutions.
2. Improvements in digital and financial literacy rates among targeted communities.
3. Reduction in over-indebtedness and payment fraud cases in the pilot study areas.
4. Long-term adoption of risk-management practices by Fintech companies.

### **Working with Underserved Communities:**

This project directly addressed the needs of underserved communities by focusing on expanding financial inclusion to the poorest and leveraging financial tools to advance economic development and gender equality.

### **New Perspectives:**

Working with CGAP provided me with new insights into:

1. The critical role of financial systems in driving economic growth and social development.
2. The complexities of regulating rapidly evolving Fintech sectors in developing countries.
3. The challenges faced by vulnerable groups in accessing and benefiting from digital financial services.

4. The importance of balancing financial inclusion with consumer protection in emerging markets.

This experience has broadened my understanding of the intricate relationship between digital finance, development work, and policy-making in addressing global poverty and inequality.

**Background:**

For my Leadership In Action (LiA), I chose to volunteer for the Consultative Group to Assist the Poor (CGAP), a Washington D.C.-based think tank, for a period of six weeks. CGAP's mission focuses on expanding financial inclusion for the poorest populations and leveraging financial tools to advance economic development and gender equality. I first became aware of CGAP while conducting research with the International Finance Corporation (IFC) in Sri Lanka. During this time, I visited underserved communities in Colombo to study how women were coping with and adapting to the country's ongoing economic crisis. Recognizing the strong alignment between my experience and CGAP's work, I decided to serve as a consultant for the organization as part of my LiA. In this role, I advised CGAP's digital consumer credit team on their upcoming pilot project. The following section is a report of my six-week experience working with the CGAP team, spanning from early May to late June. This report provides insights into the valuable lessons learned and the impact of our collaborative efforts during this period.

## **Part 1 — Learning About Digital Finance**

Before joining CGAP, my experience with digital finance in the context of development work was limited. I had some knowledge of digital financial firms and products, such as PayPal, a fintech company that facilitates money transactions across platforms and borders. I was also familiar with digital banking tools and trading brokerages that allow users to access financial systems and products digitally. However, I was unaware of the critical role the financial system (both digital and non-digital) plays in driving economic growth and social development.

According to World Bank estimates, approximately a quarter of the world's population lacks access to bank or digital financial services, with about 1.5 billion individuals worldwide being unbanked. This lack of access to the financial system poses a significant barrier to economic and social development. Individuals excluded from the formal financial system are unable to leverage the benefits that various financial services and products offer in mitigating risks and promoting resilience.

For example, providing farmers and agricultural workers access to insurance products is crucial in boosting their resilience against unpredictable climate events. It helps mitigate the risk of having to sell assets or engage in negative coping mechanisms when facing adverse weather patterns. Insurance products ensure that those in agriculture can sustain themselves during unexpected circumstances, reducing the risk that a single event could devastate their finances and hinder future productive output. Thus, expanding access to financial services is vital for enabling economic and social development.

The lack of access to formal financial services also harms individuals by forcing them to borrow from unregulated financial actors. These lenders often charge exorbitant interest rates and use aggressive tactics to coerce repayment. I witnessed this issue firsthand in Sri Lanka, where many households in underserved communities had to borrow from local moneylenders to cover daily expenses. These moneylenders charge excessive interest rates, averaging between 20% to 30% monthly. Consequently, most borrowers have become trapped in a debt cycle, with their new income continuously used to pay accumulated interest. In this context, expanding financial inclusion reduces risks associated with borrowing from informal financial actors.

CGAP has developed a framework called the sustainable digital financial ecosystem. This conceptual framework aims to address the increase in fraudulent activities associated with digital financial services, which have surged in popularity during the COVID-19 pandemic. Within this framework, CGAP advises regulatory institutions, such as central banks, to develop and implement effective policy solutions that promote financial inclusion while mitigating risks associated with digital lending. CGAP is currently engaged in a workstream project, reviewing policies implemented by governments worldwide and examining their efficacy. They plan to explore the implications of these policies in a pilot case study.

I had the privilege of advising the CGAP team on their workstream project by drafting a 30-page internal brief and report. The process involved first examining CGAP's completed work and collaborating with the team to fully understand their past work, current efforts, and future plans. I took extensive notes on the team's published work and critically analyzed areas that could be strengthened in relation to the organization's mission and capacity. I then

conducted independent research using academic literature and various datasets, such as the World Bank Open Data, to gain a comprehensive understanding of the topic.

## Part 2 — Writing Internal Briefs and Providing Recommendations

After gaining substantial insights into the landscape of digital finance in emerging markets, I embarked on drafting an internal brief that critically evaluated CGAP's upcoming projects in relation to the current market landscape. My first brief provided an in-depth critique of CGAP's existing sustainable digital finance framework, highlighting its strengths while also identifying areas for improvement.

In this comprehensive analysis, I argued that CGAP's framework, while robust in many aspects, was overly theoretical in its approach to examining the digital payments landscape in developing countries. The framework, I contended, did not sufficiently consider the underlying needs and concerns that lead to critical issues such as payment fraud and over-indebtedness among vulnerable populations.

The brief began with a detailed background on the rapid expansion of digital payments following the COVID-19 pandemic. I presented compelling statistics, such as the industry's revenue surge of 11% in 2022, reaching a historic peak of over \$2.2 trillion. This exponential growth was particularly pronounced in the Africa and Asia Pacific regions. While acknowledging the potential benefits of this expansion in terms of financial inclusion for the 1.7 billion unbanked adults worldwide, I also emphasized the need for a more nuanced understanding of its implications.

Following this introduction, I delved into the concerns associated with the rapid proliferation of digital payments and lending services. Drawing on CGAP's own research, I highlighted how vulnerable groups, including farmers and casual workers, have yet to fully reap the benefits of digital credit products. I presented case studies from various countries to illustrate this point. For instance, in Tanzania, alarming statistics showed that 31% of borrowers were late on their repayments, while 9% defaulted on their loans entirely.

I attributed these problems to two primary factors: financialization and lax regulation. Financialization, I explained, refers to the increasing dominance of financial motives and markets in the economy. In this context, it manifests as a shift towards portfolio finance, where the primary goal is generating investment returns rather than producing tangible capital output. This profit-driven approach often leads to questionable business practices, such as providing unregulated loans to underserved communities without adequate safeguards.

The issue of lax regulation, I argued, further exacerbates these problems. I identified several reasons for this regulatory gap, including a lack of institutional experience and resources in regulating Fintech companies, as well as a limited understanding of the complexities of these new financial technologies. To illustrate the potential consequences of inadequate regulation, I cited the P2P lending crisis in China, where uncontrolled expansion of micro-lending platforms led to widespread financial distress among millions of borrowers and lenders.

Based on this comprehensive analysis, I provided a set of actionable recommendations aimed at benefiting underserved communities while promoting sustainable growth in the digital finance sector. These recommendations included:

1. Reforming government policies to mandate the disclosure of crucial lending information, enhancing transparency in the digital finance ecosystem.
2. Implementing projects focused on improving digital and financial literacy among the poorest segments of society, empowering them to make informed financial decisions.
3. Encouraging collaboration within the Fintech sector to foster a culture of responsible risk management.
4. Advocating for government efforts to provide alternatives to digital lending, particularly for the most vulnerable populations.

I am pleased to report that CGAP incorporated these recommendations into their strategic planning, demonstrating their commitment to addressing the complex challenges faced by underserved communities in the rapidly evolving landscape of digital finance. This experience not only allowed me to contribute meaningfully to CGAP's important work but also deepened my understanding of the intricate relationship between financial technology, regulatory frameworks, and socioeconomic development in emerging markets.