The Economist Intelligence Unit

THE NEXT FRONTIER

The future of finance in the Middle East, Africa and South Asia

Sponsored by:

Dubai International Financial Centre

Contents

About this research

***The Next Frontier: The future of finance in the Middle East, Africa and South Asia* is an Economist Intelligence Unit report, commissioned by the Dubai International Financial Centre. This report explores the forces shaping the future of financial services, focusing on market, technology and policy enablers. It is based on expert interviews and desk research.**

The Economist Intelligence Unit wishes to thank the following individuals for their participation as interviewees:

- **Khaled Al-Aboodi,**
  chief executive officer (CEO), Islamic Corporation for the Development of the Private Sector, Islamic Development Bank Group
- **Kyri Andreou,**
  co-founder, ATA Plus
- **Simon Bell,**
  global lead for SME finance, World Bank
- **Ronit Ghose,**
  global sector head for banks, Citi Research
- **Sunil Kaushal,**
  regional CEO, Africa and Middle East, Standard Chartered
- **Elain Lockman,**
  co-founder, ATA Plus
- **Elizabeth Rossiello,**
  CEO, BitPesa
- **Nimit Shah,**
  partner, Helios
- **Humayun Shahryar,**
  partner, The Abraaj Group
- **Umer Suleman,**
  head of governance and Islamic finance, Yielders

The Economist Intelligence Unit bears sole responsibility for the content of this report. The findings and views expressed in the report do not necessarily reflect the views of the sponsor. Adam Green is the author of the report and Melanie Noronha is the editor.

Executive summary

The Middle East, Africa and South Asia (MEASA) region is already poised to shape financial innovation. With a combined population of over 3bn, deepening mobile connectivity, and growing prominence as a trade and investment hub, MEASA will be a source of both demand and supply for more and better financial services. For companies that move quickly, this is a multi-billion-dollar opportunity to bank on the future of a diverse region.

Some firms are at the vanguard of financial innovation, using smarter business models and the latest technologies. The rise of "challenger" providers—often from different industries, such as telecommunications and e-commerce—is bringing even more varied financial services offerings to a far larger community of individuals and businesses. This report, which draws on expert interviews and country analysis, assesses the state of finance in MEASA, the factors shaping the future of key financial subsectors, and the regulatory framework and best practices required to enable the delivery of these services.

Key findings of the report:

Gaps in financial services present an opportunity for financial companies—both traditional and non-traditional players. A growing young population across MEASA is increasing demand for digitally delivered financial services. In addition to this, women's access to finance substantially lags behind that of men, particularly among low-income groups, as regulatory requirements for accessing formal finance, such as official ID or billing documentation, create bias against them. Even among wealthier segments of the population, many individuals remain underbanked. Taken together, this untapped potential presents an attractive opportunity for companies providing financial services. As trade and investment increase in the MEASA region, there will also be a growing market for wholesale banking and capital markets.

Overcoming a strong preference for cash in the MEASA region will be imperative to move towards a cashless economy. Across the region, the majority of utility bills, school fees and even wages are paid in cash. Building trust in digitally delivered finance will take time, despite a growing preference for it among the younger generation. A fully cashless economy may be decades away.

Blockchain has the potential to change the financial architecture in MEASA, particularly for banking. Blockchain is helping to reduce high money-transfer and exchange costs by bypassing intermediaries, and blockchain-based digital registries could tackle other problems, like land expropriation. While these applications are experimental and pose regulatory difficulties, the core technologies can help to overcome some of the challenges of the existing financial system, such as money-laundering and corruption in a cash economy. More importantly, they are expected to reduce costs for financial institutions, particularly around compliance with anti-money-laundering (AML) and Know Your Customer (KYC) rules.

New business models are being developed to reach the "missing middle" of retail investors and medium-sized businesses. The rise in equity crowdfunding platforms and lower-cost portfolio investment products is unleashing new capital for entrepreneurs and businesses, and is giving middle- and lower-middle-income citizens the ability to become investors. Growth in the provision of credit, an increasing interest in private equity and a rise in venture capital are also helping to drive growth in the middle market.

In Islamic finance, the approach is shifting from "sharia-compliant" to "sharia-based". The approach to Islamic finance thus far has been to adapt existing products and services so that they comply with sharia law, for instance eliminating interest charges on credit cards and loans. Enabled by technology, companies are now developing fresh products and services that follow the spirit rather than adhering strictly to the letter of sharia principles.

Governments and regulators have a crucial mandate to drive financial innovation. Governments and regulators must ensure that regulation keeps pace with advances in technology in the financial sector. There are examples across MEASA of legislation that enables a wider array of providers to enter financial services, from postal systems and telecoms companies to e-commerce platforms. Developing regulation around the latest developments, such as blockchain, will prove challenging, but governments in the region are adopting strategies to test the water. Other key roles including increasing financial literacy to ensure that widening access to finance does not lead to debt spirals, and ensuring that government payments systems are also digitised and technologically advanced, to help drive the shift away from cash.

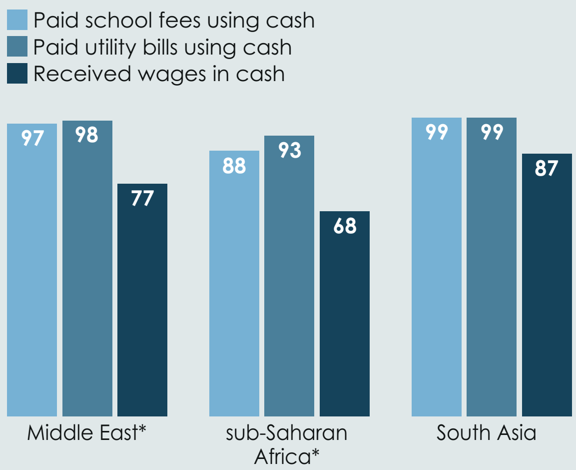
Chapter 1: The state of finance

For decades, the instruments used in the financial sector have largely remained the same: cash, credit cards and automated teller machines (ATMs). "The death of cash has been long foretold," says Ronit Ghose, global sector head for banks, Citi Research (part of Citi Private Bank). "But apart from [in] Sweden, this really hasn't been the case."

In the Middle East, Africa and South Asia (MEASA) region in particular, there is a strong preference for cash. Data from the World Bank show that across South Asia and developing countries in the Middle East and sub-Saharan Africa, the majority of utility bills, school fees and wages are paid in cash. Moreover, research by PayPal indicates that 80% of online purchases in the Middle East are made on a cash-on-delivery basis, with the rest made using credit or debit cards or PayPal.[1] Even in the more advanced Gulf Co-operation Council (GCC) countries[2], features that have been around for years in more developed markets, such as contactless payments with debit cards, are not widely used. Sunil Kaushal, regional chief executive officer, Africa and Middle East at Standard Chartered, reiterates the dependence on cash in the region: "[With technological advances,] we're moving very rapidly towards a 'less cash' society. But I don't believe we can have an entirely 'cashless' society in the emerging markets."

Figure 1

A strong preference for cash in the MEASA region
(% of total)



*Developing countries only.
Source: World Bank Findex 2014.

In this cash-based system, those without a bank account are left on the outside, without access to capital, credit and other essential banking services. The preference for cash, combined with strict Know Your Customer (KYC) rules, has meant that financial institutions have needed to have a wide physical presence in a country or region to reach the end consumer. This is an additional cost for financial service institutions, and is reflected in the high banking fees to individuals and businesses. In this way, high transaction costs and poorly designed services have constrained economic growth and impeded social welfare.

Gaps in financial services

In the Middle East, Africa and South Asia, 86%, 66% and 46% of adults respectively do not have traditional bank accounts. Among those who find it most difficult to access the financial system in the MEASA region are young people and women. "Women and young people are significantly disadvantaged in terms of having a bank account, having a loan, and having access to finance generally," asserts Simon Bell, global lead for SME finance at the World Bank. Of the US$2.2bn in savings held by young people in sub-Saharan Africa, those living on less than US$2 a day account for one-half. In addition to this, 50% of women in emerging economies lack access to the financial system, compared with 41% of men. The gap is most pronounced in South Asia, where 55% of men have a bank account, compared with only 37% of women.[3] Regulations often create bias against women, who are less likely to own national ID cards or to have documents like utility bills in their own name—crucial when setting up bank accounts.

Many members of the wealthier segments of the population are largely underbanked, experts say. One example is the provision of wealth-management services. Mr Kaushal emphasises the importance of wealth-management services, particularly in the GCC countries: "You really want to ensure that the earnings that the population make here are somehow deployed in very attractive instruments in the region. Today, [expatriates] don't keep their money here, resulting in a very large outflow that takes place on a regular basis. It is important to be able to channel those savings into the domestic economies."

In wholesale banking, multinationals and large industrial companies have been the primary recipients of capital, experts say. As a result, "you have high quality, mid-sized domestic companies that are desperately lacking access to capital," says Nimit Shah, a partner at Helios, an Africa-focused investment firm. Mr Bell of the World Bank concurs, pointing to lower levels of lending to small and medium-sized businesses, a trend that has been exacerbated in the years following the 2008 financial crisis.

It is not hard to see the growth opportunity in the financial sector in MEASA, given the strong growth trend in these economies fuelled by strong demographics and high rates of urbanisation.
- Humayun Shahryar, partner, The Abraaj Group

Taken together, these factors—raw population growth, the large young population, and unmet demand for financial services among individuals and businesses—create a large gap in provision of financial services in the MEASA region and, consequently, an opportunity for financial companies. The world's remaining unbanked consumers and businesses constitute a US$380bn market.[4] "It is not hard to see the growth opportunity in the financial sector in MEASA, given the strong growth trend in these economies fuelled by strong demographics and high rates of urbanisation," asserts Humayun Shahryar, a partner at The Abraaj Group, an investor in growth markets.

The economic potential of the region presents yet another opportunity. The MEASA region is growing in prominence in terms of global trade and investment, as Mr Kaushal explains: "[MEASA] has turned into a very significant trade and investment route. Intra-regional trade is increasing too, accompanied by a strong flow of people and capital." Providing financial services, such as access to capital and credit, to businesses operating in these emerging markets is an attractive opportunity.

[MEASA] has turned into a very significant trade and investment route. Intra-regional trade is increasing too, accompanied by a strong flow of people and capital.
- Sunil Kaushal, regional CEO, Africa and Middle East, Standard Chartered

However, there is a shift occurring in the way in which companies in the financial sector are capitalising on these opportunities. In the chapters that follow, we explore how key financial services—including banking, wealth and asset management, and insurance—are being revolutionised by technologies such as blockchain and artificial intelligence and challenged by the rise of alternative players. Following this, we consider the priority interventions and best practices that are necessary for governments, regulators and the mainstream finance industry to build on the momentum.

Chapter 2: The future of finance

The financial services sector is a vast system, with numerous actors each playing their part in determining individuals' and businesses' access to finance and the channels through which money is used. There is now evidence around the world, including in the MEASA region, that the very fundamentals of the financial system are starting to change.

At the heart of this system is the next-generation consumer who is desirous of digitally delivered services. And as consumers go digital, so do businesses. Thus, financial companies have had to adapt their offerings across the spectrum of financial services, including banking, wealth and asset management, and insurance.

Enabling these changes are technological advances that are increasing the scalability of services, driving down operating costs, improving financial inclusion and facilitating mass personalisation of services. In addition, smarter lending models and the rise of "challenger" financial firms—often from different industries, whether they be mobile telecoms or e-commerce—have done more to transform the financial system and improve financial inclusion in the past ten years than in multiple prior decades combined. Mainstream financial institutions are often, although not always, playing catch-up.

In this chapter, we take a closer look at key financial services in the MEASA region and the factors influencing how these will be delivered in the future.

Banking and capital markets

Demographic and cultural characteristics of the MEASA region are shaping the future of retail banking services. By 2050, the combined headcount in Africa and Asia is expected to be 7.7bn, out of a forecast global total of 9.7bn. Today, nearly 90% of those under 30 years of age live in emerging markets. In addition, there is a large and growing Muslim population in the region: approximately 93% of the 343m inhabitants of the Middle East and North Africa (MENA) region are Muslims, while the figure is 30% in sub-Saharan Africa and 24% in Asia-Pacific.[5] This has profound implications for financial services, since observant Muslims are obliged to use financial services that are sharia-compliant.[6,7] "In consumer finance in the [MEASA] region, particularly in Saudi Arabia, the population is very keen on sharia-compliant financial products," says Khaled Al-Aboodi, chief executive officer (CEO) of the Islamic Corporation for the Development of the Private Sector (part of the Islamic Development Bank Group).

Islamic finance: Definitions and applications

"Islamic finance" refers to financial services that accord with sharia principles. These include bans on receiving or paying interest (*riba*), excessive uncertainty (*gharar*) and gambling (*maysir*), along with restrictions on financial activities that are harmful to society.[8] Appetite for Islamic finance is not limited to people of the Islamic faith; non-Muslims are also attracted to its ethical principles and its focus on tangible assets. Islamic finance spans banking, securities and equity markets, investment funds, insurance and microfinance, although banking and sukuk (sharia-compliant bonds) account for the bulk of total Islamic finance assets. By 2016, Islamic banking had accumulated nearly US$1.9trn in assets across 50 countries.[9]

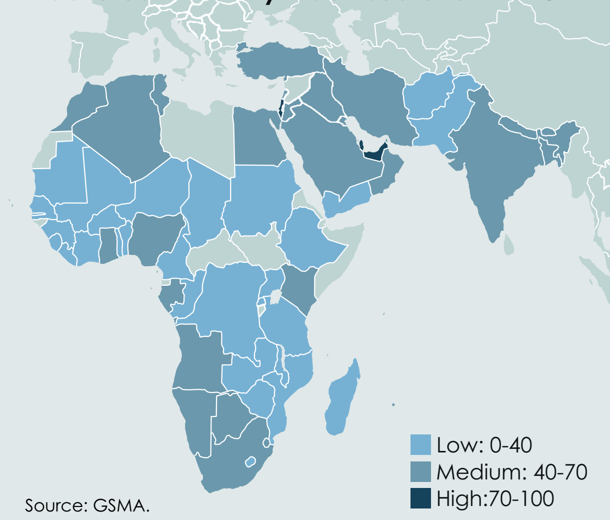
Source: IMF[10]

Young people—Muslim and non-Muslim—stoke financial sector growth by increasing demand for services as they enter the workforce. In addition, they are more willing to adopt digitally delivered finance.

The ubiquity of mobile phones, and key technological developments such as those taking place in digital authentication, are transforming crucial components of the financial system, such as payment methods. Essentially, mobile phones reduce the cost of acquiring and retaining customers, thus enabling financial inclusion and financial deepening. "Now everyone's got a mobile phone, and to get to these clients a financial company doesn't need to open a number of branches," explains Ronit Ghose of Citi Research. For the banked and underbanked, it provides yet another channel through which to engage with the system. For the unbanked, it provides the opportunity to leapfrog traditional financial infrastructure to access finance.

Figure 2

Mobile connectivity index score for MEASA



Source: GSMA.

Financial companies, both startups and established institutions, are investing in platforms to meet the demands of the next-generation consumer. In the UAE, Mashreq Bank recently launched a full-service digital bank accessible via mobile, which is expected to allow customers to open an account in less than five minutes. Mobile wallets—apps that enable users to pay directly for goods and services using their mobile devices—are growing in popularity. The Emirates Digital Wallet promises to further encourage the transition to digital and non-cash payments in the UAE.

Financial companies are not the only ones operating in this space, and incumbents are increasingly facing competition from non-traditional players—ranging from e-commerce firms to ride-hailing companies, for which cashless payments are vital. Many non-financial companies are finding that, as they scale up, they quickly have to become financial services providers as well. India's Airtel, a telecoms company, has its own wallet that allows users to pay bills, conduct transactions online and shop at registered outlets. PayFort, a MENA-based payment processor, was started by entrepreneur Omar Soudodi based on the experience of watching the "payments pain-points" in the region's e-commerce market. In Tanzania, approximately 70,000 businesses accept payments from over 16m mobile money users signed up to the Tigo Pesa mobile wallet. As more organisations accept mobile wallets, more people will transition to the new financial system.

Financial companies are not the only ones operating in this space, and incumbents are increasingly facing competition from non-traditional players—ranging from e-commerce firms to ride-hailing companies.

As with retail banking, the financial infrastructure for wholesale banking and capital markets is evolving, once again driven by technological advances. "When you look at the number of traders at a big bank in London or New York, they're probably down 70-80%," says Mr Ghose. "Now there may be changes coming to the middle and back office. When you look at fintech investments in capital markets right now, three-quarters focus on capital market activities that are in the middle and back office. They're not targeting the front office." While such a shift is not imminent in the MEASA region, Mr Ghose estimates that this will take place within a 5- to 10-year horizon.

Among the emerging technologies with the most promise is blockchain. We explore this in depth below.

Blockchain for banking

Blockchain is a decentralised ledger of transactions, held on a distributed network of computers, which records transactions, such as the transfer and ownership of cryptocurrencies. The dominant narrative is that blockchain technology is poised to transform the financial system on numerous fronts. Blockchain is promising because the ledger cannot be tampered with without overwriting all the data in the system, which, given how distributed it is, seems improbable.[11] Blockchain requires no trusted third party and no government backing. In one common application of blockchain, cryptocurrencies are either spent directly (although the number of merchants that accept cryptocurrency payments at present is small) or converted into a legal tender ("fiat") currency through an exchange.

Blockchain is making inroads in MEASA, from India to South Africa. One example is Primechain Technologies, an Indian startup, which offers blockchain solutions for banks in areas such as anti-money-laundering (AML), cross-border payments, asset registration and syndication of loans.[12] Bankymonn in South Africa provides bitcoin payment gateways to smart-metering vendors for utility bill payments.

While not without its own risks, as shown by the bankruptcy of the Mt Gox exchange and the hacking of some exchanges[13], blockchain could help to overcome some of the mainstream financial system's existing vulnerabilities. Examples of such weaknesses include recent cyberattacks, robberies at central and commercial banks, and the corruption enabled by the cash economy–from money-laundering to the siphoning off of welfare subsidies.[14]

Blockchain's underlying distributed ledger is cited as a means to safeguard financial transaction data. Kyri Andreou, co-founder of ATA Plus, a "blockchain-enhanced" equity crowdfunding platform, explains the business value: "Leveraging blockchain makes business sense for us in the long term as we strive to disintermediate processes, thus reducing both time and cost for companies to raise funds, as well as improving transparency and security of the investment." In addition, blockchain-based digital registries could help to register land and property, protecting against illegal expropriation and land grabs.[15]

Blockchain technology has the potential to drive changes to the infrastructure of the financial system. One example is BitPesa, an international money-transfer company established in Kenya (now with operations in six countries in Africa and Europe), which is using blockchain to bypass the SWIFT money-transfer system (see case study). In the banking sector, adopting blockchain for back-office functions and settlement could reduce costs by up to US$20bn a year in the period to 2022, according to one estimate.[16] Developing Know Your Customer (KYC) registries using the blockchain ledger could automate processes, cut down on duplication of effort across the system and reduce compliance errors, potentially saving institutions billions on AML compliance.[17] However, blockchain is largely untested, and the breadth of its applications and the associated risks have yet to emerge fully.

Case study

Blockchain in Africa: Payments at email speed

In Africa, financial transfers—to other African countries or abroad—are slow and expensive. It is usually only possible to get hold of a national currency when in that country, and the banking system is extremely slow to authorise and process international payments through the SWIFT system. One firm, BitPesa, is using blockchain to tackle the problem.

"If I want to send a payment from Nigeria to Japan, I first have to go to my bank and ask them to change from Nigerian naira into US dollars, which costs anywhere from 3% to 7%," says Elizabeth Rossiello, CEO of BitPesa. "I then have to request that the bank initiate an international SWIFT wire, which is the only way the dollar moves internationally. That could take anywhere from one to two weeks. It then goes into Japan, where it would change again into local currency and get delivered. It's a very laborious process, but that is the way physical currency moves."

Contrast that, Ms Rossiello says, with bitcoin. "The bitcoin system takes your Nigerian naira and instead of changing them into US dollars through the slow SWIFT network, we change them into bitcoin, which moves instantly. That means in ten minutes a bitcoin can move anywhere in the world, to anyone that has a wallet, or any other exchange. It can move from our Nigerian bitcoin exchange to a Japanese bitcoin exchange and straight out to a bank account on the other side. We're basically providing a direct way to make a market between currencies that was not possible before. We're building currency pairs from the ground up."

This could be especially helpful for businesses or organisations that are active in multiple countries, which want to pay importers, suppliers or staff in local currency. "At the end of the month, if you are a company with international salaried employees, you are sending hundreds of slow payments around the world, you're sending them through invoices, and through wires and lawyers and contractors, and it can take a week. And you'll need a whole team of people just sending out those payments. When you are sending out bitcoin payments, you do it very quickly—as quick as sending out an email, and just as cheap".

Ms Rossiello estimates that 85% of BitPesa's transactions by volume are business to business, and believes that this segment will continue to drive the company's growth. "We were only handling about a US$100,000 a month, but there was a lot of demand for higher volumes. Now, we're handling about US$8m a month and hope to increase that to US$15m by the end of the year. We have a lot more companies that we can serve, and are growing organically."Source: IMF[10]

The rise of alternative players: A threat to traditional finance?

Among the core functions of banking is providing access to finance for businesses, mainly in the form of loans and credit facilities. Assessing creditworthiness, of small and medium-sized enterprises (SMEs) in particular, has been a challenge for banks worldwide, but perhaps more so for banks in the MEASA region, which have few options for credit reporting and scoring. As a result, SME access to bank finance has been limited and expensive. Nimit Shah of Helios explains: "The credit environment is constrained for everyone that's not a giant—either a multinational or a very big domestic champion. The rest have limited access to bank loans, so all of these companies are just funding their growth from company reserves, from retained earnings, and from cashflow available to them. And this is happening at exactly the time when these economies are growing fast, when these SMEs and mid- to upper-sized companies should be driving that growth."

A factor impeding credit growth in the region is the need for collateral. Mr Al-Aboodi of the Islamic Development Bank Group believes that leasing offers a feasible alternative. "It's a major financing source for SMEs, as they don't need the [external] collateral because the collateral is the equipment that you lease," he explains. "The financial standing of the SME matters less." Mr Al-Aboodi believes that the Islamic finance sector can take the lead on this front.

Although countries across MEASA are developing mechanisms such as co-investing financing vehicles for early-stage financiers and securitisation of SME loans, the market has deployed new technologies and experimented with new business models to connect SMEs with latent sources of capital:

- **Peer-to-peer platforms**
  Peer-to-peer platforms were made possible thanks to low transaction costs that make it profitable to process small investments. Eureeca secured the first equity crowdfunding licence in the Middle East, and enables investors to fund startups in exchange for equity. Another platform, Emerging Crowd, enables investors to buy shares and bonds in emerging-market SMEs.[18] According to Elain Lockman, co-founder of ATA Plus, an equity crowdfunding platform in Malaysia: "It's opening up financial investing to a whole new class of investors, who wouldn't traditionally look to invest in, say, the stockmarket. And there is a social dynamic to crowdfunding too. People will support businesses they currently could be a customer of, or because they believe in the cause or the way the business conducts itself".

- **Credit for the middle market**
  While technology is key to financial innovation in MEASA, it is not the only dynamic worth watching. New business models to deepen financial services for the "middle" segment—consisting of medium-sized companies—is what makes economies shift gears. In recognition of underserved credit markets for Africa's middle-tier businesses, private-equity fund Helios expanded into the credit business. "One of the things we started to notice is that private equity is very powerful but the credit opportunity is just as large, if not larger," says Mr Shah of Helios. "From a borrower's perspective, it allows the company to stay in that borrower's family—often very literally". For Helios, the new approach allows the firm to fund smaller, but still sizeable, businesses. "In private equity, because of the specialised nature of the work, we're looking at geographically-diversified "platform" companies, but on the credit side we're typically looking to lend US$15m-30m often to local or regional champions." Moving into credit means that Helios can respond to a broader set of opportunities. "It's opened up a brand-new pool of capital, which we believe the market really needed."

Wealth and asset management

Wealth held by ultra-high-net-worth individuals (UHNWIs)—those with net assets of US$30m or more—grew in 2016, according to Wealth-X, a consultancy. Wealth-X estimates UHNWI wealth at US$212bn in Africa, US$1.4trn in the Middle East and US$6.8trn in Asia (including China).[19] Particularly in the Gulf Co-operation Council (GCC) countries, as Sunil Kaushal of Standard Chartered notes, there is a need to strengthen wealth-management services in order to minimise outflows from the large expatriate populations of these countries.

Wealth-X estimates UHNWI wealth at US$212bn in Africa, US$1.4trn in the Middle East and US$6.8trn in Asia (including China).

Firms are applying the latest developments in technology, such as artificial intelligence (AI), to wealth and asset management. These technologies are transforming how the services are delivered. In wealth management in particular, "robo-advisers", which use algorithms to develop bespoke investment strategies for investors, are increasingly becoming a core component of investment firms' business models. The relatively affluent Middle Eastern market has catalysed the likes of Finerd, an automated investment-management tool targeting the retail investment community and investing in exchange-traded funds. Outside the MEASA region, mid-sized banks in China are testing robo-advisers as part of their online wealth-management platforms—a model that may be replicated at banks across the MEASA region.

For the Muslim population specifically, there are insufficient sharia-compliant investment opportunities, says Umer Suleman, head of governance and Islamic finance at Yielders. Here, too, new business models are filling the gap. A UK-based property crowdfunding investment platform, Yielders, combines sharia principles with the latest digital technology and lets people invest in a share of property for as little as £100. "Real estate has outdone the stock market consistently for the last ten years," he says. "It's real, it's tangible. It's an asset you own, and that gives a yield."

Companies are experimenting with new business models for asset management, built on a foundation of high mobile-phone penetration. A prominent example outside the MEASA region is Ant Financial, the asset-management arm of Chinese e-commerce giant Alibaba. Ant Financial is a money market fund that offers customers on the Alipay app, Alibaba's payment platform, opportunities to invest leftover money in their accounts for short periods. With access to 450m customers, Ant Financial has become the world's largest money market fund.[20] This is a powerful example of a company leveraging the underlying technological trends to transform the staid business models of traditional financial services.

A place for private equity

Private equity has a prominent role to play in nurturing businesses through their next phase of growth, according to Humayun Shahryar of The Abraaj Group. "We still see enormous room for growth in private transactions, including SMEs and large-scale investments, in MEASA," Mr Shahryar says.

While there are many guiding principles for private-equity investments in the region, a particular area of growing interest has been environmental, social and governance (ESG) investments. Mr Shahryar explains: "ESG is a value creation opportunity that ultimately builds stronger, more sustainable and profitable businesses and is therefore a fundamental value driver that is included alongside financial, commercial and strategic considerations. The MEASA region offers compelling opportunities for such investments."

The MEASA region offers compelling opportunities for environmental, social and governance (ESG) investments.
- Humayun Shahryar, partner, The Abraaj Group

For private equity in the region to be successful, having boots on the ground is imperative. "It helps to reduce certain types of risk, including counterparty risk and risk of poor due diligence, significantly." But he acknowledges a role for international investors in this market: "The region's growth potential is too large to be captured completely by the regional investor base and needs investors from the developed part of the world too."

Insurance and reinsurance

The insurance sector in MEASA will be shaped by a number of macroeconomic trends. Across the region, the outlook for the sector is largely positive, rooted in a relatively young population, a growing middle class and planned expansion of infrastructure projects. There are some macroeconomic challenges, however. In Africa, the depreciation of currencies in key markets is pushing up the value of insurance claims. In the GCC, the low-oil-price environment is reducing spending on government projects and has caused consumers to become more price-sensitive.

Regulatory developments will be a key driver. In India, for instance, recent easing of restrictions on foreign investment will mean greater participation by overseas players, which will influence the dynamics of the domestic sector. Particularly in Africa and the Middle East, strengthening the regulatory framework and harmonising regulations with international standards—through the adoption of a risk-based capital framework, for example—will make these markets more attractive.

The insurance sector is also having to adapt to aggregators and other technological innovations that are changing consumer awareness and demand. But technology adoption in the MEASA region has been slow: experts indicate that whereas financial companies operating in banking and asset management are just catching up with advances in technology, insurance companies are lagging. Increasing investment in "insurtech" in MEASA may remedy this situation, and may increase insurance penetration levels as mobile phones have done for banking. Such developments include the use of technologies such as AI to find the right mix of policies for individuals and businesses. Big-data analytics can also improve the accuracy of risk assessment and facilitate better pricing strategies.

Figure 3: Impact of emerging technologies on financial services

Impact	Description	Examples
Increases scale and inclusion	The combination of high mobile-phone penetration and the provision of financial (and other) services digitally is enabling companies to reach much larger populations. In this way, financial companies are able to scale up their businesses much faster through digital (as opposed to physical) channels. The ability to provide services to far bigger populations improves financial inclusion.	Mobile money
Decreases cost	Technologies such as smartphone apps and peer-to-peer platforms offer low-cost alternatives to reach the end consumer, particularly in comparison with expansion of the physical network of branches and ATMs. Biometric IDs and blockchain technologies are expected to reduce costs, by enabling digital authentication (rather than more expensive paper-based processes) and lowering risk (through improved transparency of financial transactions).	Mobile banking; Peer-to-peer platforms; Blockchain; Biometric IDs
Increases mass personalisation	The ability to deliver services digitally allows companies to customise their offering based on the profile of the end user. Using AI, robo-advisers learn an individual's or institution's risk appetite in order to develop bespoke investment strategies.	Mobile banking; Robo-advisors
Facilitates new revenue models	With low-cost technologies, financial companies are able to target segments of the market that were previously too expensive for traditional financial firms (for example, high cost of assessing the creditworthiness of SMEs). Traditional models for financial services are being transformed by technology, for instance through the use of AI for investment strategy development and mobile wallets as a base for asset management.	Credit for middle market; Asset management

A key question is what regulation is required to accompany these technological advances and new revenue models. In the next chapter, we explore regulatory developments and best practices that can help to usher in changes to the financial system.

Source: The Economist Intelligence Unit

Chapter 3: Enabling finance: Regulation and best practices

Governments, central banks and financial regulators shape the evolution of financial services, but their role is not straightforward. They must balance innovation with stability and consumer protection. They can prime the market by using better services and technologies themselves, or they can set it back by using outdated systems and approaches. Initiatives like the issuance of national biometric IDs can profoundly enable financial inclusion. The final chapter of this report outlines key considerations for nurturing financial innovation going forward: the regulatory environment and best practices.

Regulation for the future: Balancing prudence with innovation

The regulatory environment for the financial sector has been developed around the infrastructure of the past. Know Your Customer (KYC) rules serve as an example: one such rule requires financial institutions to meet clients in person and verify key characteristics using physical documentation. The cost of compliance with this requirement has been high.

The ever growing use of technology to deliver financial services is forcing regulators to adapt. The existing regulatory framework has been set up primarily to ensure that money moving within the system is not directed towards illicit activities such as drug-trafficking and terrorism. But for many financial companies, particularly startups and financial innovators, this framework is stifling, resulting in high barriers to entry. However, striking a balance between preventing financial crimes and allowing innovators to thrive is no easy feat. There are compelling examples of solutions in the MEASA region.

Allowing non-traditional players to compete in the financial sector is critical. India's 2015 financial reforms, which enabled non-bank entities, ranging from India Post to Airtel, to set up payment banks, is a case in point. While it is challenging for regulation to keep up with the pace of financial innovation, such regulation is vital to enable financial services to evolve. Financial reforms passed in Uganda in 2015 permit commercial banks to liaise with agents to collect deposits and facilitate withdrawals, allowing them to tap into the mobile-money business model and avoid the cost of setting up physical branches.

Allowing non-traditional players to compete in the financial sector is critical. While it is challenging for regulation to keep up with the pace of financial innovation, such regulation is vital to enable financial services to evolve.

Simon Bell, global lead for SME finance at the World Bank, notes some reluctance in this regard among central banks in the Middle East in particular, saying: "It's been very difficult to get them to embrace a little more innovation although we are slowly beginning to see some hopeful signs." The UAE issued a regulatory framework for digital payment systems in early 2017, but similar efforts in other countries in the region are absent or lagging. Other rules, such as those mandating that investment firms meet their customers face to face, are obstacles to the use of automated investing.[21]

To keep up with the pace of technology, some recommend the use of "sandboxes" as a testbed for regulation, such as those recently launched in South Africa. Ronit Ghose of Citi Research explains: "The idea is, if you're an innovative company you basically get light regulation rather than the full weight." Regulation relating to blockchain is particularly challenging, given that this technology is still in its infancy. But the commitment of some governments in the MEASA region to use blockchain technology may help to expedite the development of necessary regulations. Says Mr Ghose: "If you're the central bank or a government institution and you're on the blockchain, you can see everything happening in real time inside the blockchain, and that gives you a really good view of what's happening."

If you're the central bank or a government institution and you're on the blockchain, you can see everything happening in real time inside the blockchain, and that gives you a really good view of what's happening.
-Ronit Ghose, global sector head for banks, Citi Research

Governments can also promote innovation while minimising risks, simply by reducing bureaucracy in ways that encourage banks to lend and entrepreneurs to borrow. Streamlining insolvency and bankruptcy procedures would be a big help. "In many countries, it's very complex and lengthy to go through a bankruptcy or insolvency proceedings," says Mr Bell. "This, of course, makes banks even more resistant to doing business with clients in the SME sector if they know they can't get out of a bad deal."

Best practices

- **Smarter data can help to improve credit scoring**

In addition to cumbersome bankruptcy and debt-recovery processes, a lack of data on the creditworthiness of individuals or businesses is one of the main reasons why banks are reluctant to lend. A mere 16% of adults in the Middle East and North Africa, 14% in South Asia and 8% in sub-Saharan Africa, are covered by private credit bureaus.[22] Sunil Kaushal of Standard Chartered recommends the creation of central registries at the national level. "With the help of the regulator and participation from all the banks, you can create a central repository. Every bank should be able to tap into that and get information, rather than each one asking the client for reams of information." He points to efforts that are under way in South Africa and Nigeria. "To me, that would be one of the biggest changes that can impact these markets, because it will give confidence to everybody." In addition, such a change would level the playing field for smaller banks.

There are also innovative approaches that utilise big data and advanced analytics to generate credit scores for people with a limited or non-existent official credit history. German-based Kreditech spots patterns in social-media activity which, along with online personality testing, can assign credit scores to customers.[23] Tala, a data-science and mobile company active in East Africa and South Asia, mines smartphone data and scores customers by tracking everything from their mobile-money spending patterns to their personal organisation skills; loan repayment is more likely if a person's mobile contacts are listed with both first and second names, for instance, and a large contact network also suggests higher likelihood of repayment.[24] Other promising methods include psychometric testing, which has been used in South Africa and Ethiopia to allocate store credit and loans to customers.[25]

- **Governments are financial services players too—and can promote the shift to digital**

Government payments, including payments to businesses and those to citizens through welfare payments, constitute a sizeable chunk of total financial transactions, as do payments in the other direction in the form of taxes and fees. Governments themselves can therefore drive financial innovation through their own services. E-taxation, e-procurement and e-customs have all reduced corruption and increased transparency, and have helped to encourage digital-first interaction with government.[26] The digitisation of government service encourages the populace to feel more comfortable going digital, challenging still dominant preferences for cash.

- **Financial services collaboration can bring dividends**

The discourse around financial innovation often pits startups, challenger banks and non-traditional players against mainstream financial services firms. But incumbents and disruptors can collaborate. A rise in financial technology (fintech) hubs and accelerators across MEASA, from Johannesburg to Dubai, is bringing large banks together with technology startups. This trend has the potential to lead to best-of-both-worlds products. One example is M-Shwari, which allows people to earn interest on their savings, rather than just sending and receiving cash; this service came about through a collaboration between Commercial Bank of Africa and Safaricom.

- **Financial education must be supported**

Too often, financial inclusion efforts, such as microfinance, are followed by debt spirals affecting those customers who may not fully understand products or who have been subject to outright exploitation. Education could ensure that people are not taken advantage of and do not fall into debt. "Financial education and consumer education are very important," says Mr Bell. "Once you start bringing relatively unsophisticated users into the system, you run the risk of problems. We had issues in Morocco, for instance, where you have multiple loans by microborrowers from multiple institutions, which led to debt problems. It led to a whole shakeout of the microfinance industry." Other microfinance crises have occurred in Bosnia, Nicaragua, and Andhra Pradesh, India.[27] Governments should include financial education components in their national financial inclusion strategies.

- **Developing educational hubs can attract the next generation of innovators**

Mr Ghose poses an important question: "The challenge is, how do you get the type of talent that's going to create a fintech ecosystem?" Establishing high-quality educational facilities, and particularly universities, will be pivotal in attracting the right talent to MEASA, and thus giving birth to a new generation of entrepreneurs who will develop financial solutions that cater to the needs of the region. "It's a very important factor," he asserts. "It's why the US does so well."

- **Deepening Islamic finance**

Despite the appropriateness of Islamic finance for driving financial inclusion, more needs to be done to realise these in practice. While the Islamic Financial Services Board (an international body) has set standards and guidelines for Islamic finance, "these need to be implemented by central banks in the MEASA region," says Khaled Al-Aboodi of the Islamic Corporation for the Development of the Private Sector.

Some obstacles are regulatory. The World Bank and the Islamic Development Bank cite the need to harmonise sharia screening standards for equities across jurisdictions and strengthen investor and consumer protection laws. Other developments needed include improving financial literacy among target populations. People need to know more about the sharia-compliant services available to them. Non-bank financial institutions—such as housing finance, leasing and asset-management institutions—can also play a larger role in driving the expansion of Islamic finance beyond banking.

How do we create something that is based in sharia, that is not already available and that benefits all the parties involved, where risk and reward are shared equally?
- Umer Suleman, head of governance and Islamic finance, Yielders

In general, approaches should also shift from "sharia-compliant" to "sharia-based". "Sharia compliance means looking at a conventional product and thinking about how to make it compliant," says Umer Suleman, head of governance and Islamic finance at Yielders. "For example, take a credit card. We know that you can't lend money at interest [in Islamic finance], so how do you make a version of the credit card that is sharia-compliant?" This might typically involve methods like adding administration fees. "You are taking an existing product and you're trying to make it sharia-compliant. Sharia-based, on the other hand, is when you look at it the other way and say: 'How do we create something that is based in sharia, that is not already available and that benefits all the parties involved, where risk and reward are shared equally?'" ATA Plus, an equity crowdfunding platform in Malaysia, while not sharia-compliant (which would require the business to be vetted by a sharia council), is taking a similar approach, choosing to be sharia-based by listing ethical and sustainable companies and halal-centred businesses.

Conclusion

Over the past ten years, technology has helped to address many of the fundamental causes of financial exclusion—of both firms and individuals—in emerging markets. It is bringing down the costs of transactions and increasing the ability to scale up services rapidly. Technology is also enabling financial companies to deliver new and better services, transforming staid business models.

If the portfolio of financial technologies—including next-generation mobile money, alternative payment systems, blockchain and low-cost peer-to-peer platforms—can be optimised in a competitive market, the financial ecosystem will become better able to accommodate different stakeholders. Each of these emerging technologies raises regulatory questions, as do new technologies in areas like ride-hailing and the sharing economy. Governments must balance innovation with prudence, protecting consumers and stability while encouraging promising new ideas to help increase the efficiency of the financial system.

The future of finance in MEASA will not be determined solely by technology. Strengthening educational facilities in the region, in order to attract the next generation of entrepreneurs, will be vital. Equally important will be the development and diversification of financiers themselves, especially from within the region, including alternative investors in areas like private equity, venture-capital funds and non-bank lenders. These firms, which are already breaking ground across many MEASA markets, could further help the region to unlock the finance needed to sustain long-term business growth and improve the lives of its citizens.

Notes

1. N Curley, "PayPal Insights e-commerce report reveals trends in mobile, travel in the Middle East", Wamda. Available at https://www.wamda.com/2013/09/paypal-e-commerce-report-middle-east

2. GCC countries include Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates

3. World Bank, Infographic: Global Findex 2014—Financial Inclusion, 2016. Available at http://www.worldbank.org/en/programs/globalfindex/infographics/infographic-global-findex-2014-financial-inclusion

4. Accenture, *Billion Reasons to Bank Inclusively*, 2016. Available at: https://www.accenture.com/_acnmedia/Accenture/Conversion-Assets/DotCom/Documents/Global/PDF/Dualpub_22/Accenture-billion-reasons-bank-inclusively.pdf

5. D DeSilver and D Masci, "World's Muslim population more widespread than you might think", Pew Research Center Blog, 2017. Available at: http://www.pewresearch.org/fact-tank/2017/01/31/worlds-muslim-population-more-widespread-than-you-might-think/

6. Consultative Group to Assist the Poor (CGAP), *Understanding Demand for Sharia-Compliant Loans: Results of a Randomized Experiment in Jordan*, 2016. Available at: https://www.cgap.org/sites/default/files/Brief-Understanding-Demand-for-Sharia-Compliant-Loans-March-2016.pdf

7. L Klapper and S Ansar, "Can Islamic finance boost financial inclusion?", Brookings, 2017. Available at: https://www.brookings.edu/blog/future-development/2017/06/08/can-islamic-finance-boost-financial-inclusion/

8. IMF, "Islamic finance and the role of the IMF", 2017. Available at: http://www.imf.org/external/themes/islamicfinance/

9. World Bank Islamic Development Bank Group, *Global Report on Islamic Finance: Islamic Finance – A Catalyst for Shared Prosperity?*, 2017. World Bank, Washington, DC. Available at: https://openknowledge.worldbank.org/handle/10986/25738

10. A Revenga and S Shetty, "Empowering women is smart economics", *Finance & Development*, March 2012, 49(1). Available at: http://www.imf.org/external/pubs/ft/fandd/2012/03/revenga.htm

11. "The next big thing—Or is it?", *The Economist*, May 9, 2015. Available at: https://www.economist.com/news/special-report/21650295-or-it-next-big-thing

12. https://www.forbes.com/sites/suparnadutt/2017/09/01/blockchain-is-slowly-changing-digital-banking-in-india-thanks-to-these-startups/#3389390d4a17

13. S Gibbs, "Head of Mt Gox bitcoin exchange on trial for embezzlement and loss of millions," July 2017, *The Guardian*. Available at: https://www.theguardian.com/technology/2017/jul/11/gox-bitcoin-exchange-mark-karpeles-on-trial-japan-embezzlement-loss-of-millions

14. *The Economist*, "If financial systems were hacked: Joker in the pack", June 16, 2016. Available at: http://worldif.economist.com/article/12136/joker-pack

15. L Shin, "The first government to secure land titles on the bitcoin blockchain expands project", *Forbes Magazine*, February 7, 2017. Available at: https://www.forbes.com/sites/laurashin/2017/02/07/the-first-government-to-secure-land-titles-on-the-bitcoin-blockchain-expands-project/#2ba819f84dcd

16. https://www.finextra.com/finextra-downloads/newsdocs/the%20fintech%202%200%20paper.pdf

17. https://www2.deloitte.com/content/dam/Deloitte/ch/Documents/innovation/ch-en-innovation-deloitte-blockchain-app-in-banking.pdf

18. H Green, "Beyond the frontier: Emerging Crowd founders take crowdfunding to emerging markets", *City A.M.*, April 16, 2017. Available at: http://www.cityam.com/213796/beyond-frontier

19. https://www.wealthx.com/report/exclusive-uhnwi-analysis-the-world-ultra-wealth-report-2017/

20. https://www.ft.com/content/28d4e100-2a6d-11e7-bc4b-5528796fe35c?mhq5j=e5

21. https://www.ft.com/content/87d48142-53e5-11e6-9664-e0bdc13c3bef

22. World Bank, Doing Business project. Available at: https://data.worldbank.org/indicator/IC.CRD.PRVT.ZS

23. J Vasagar, "Kreditech: A credit check by social media", *Financial Times*, January 2016. Available at: https://www.ft.com/content/12dc4cda-ae59-11e5-b955-1a1d298b6250?mhq5j=e4

24. J Aglionby, "US fintech pioneer's start-up in Kenya", *Financial Times*, July 2016. Available at https://www.ft.com/content/05e65d04-3c7a-11e6-9f2c-36b487ebd80a

25. "Tests of character", *The Economist*.

26. A Wrage, "Government technology reduces corruption", April 2017, *Forbes Magazine*. Available at: https://www.forbes.com/sites/alexandrawrage/2017/04/13/government-technology-reduces-corruption/#43c160a42f94

27. International Finance Corporation (IFC), World Bank Group, *Ending the Microfinance Crisis in Morocco: Acting Early*, Acting Right, IFC Working Paper. Available at: https://openknowledge.worldbank.org/handle/10986/26054.

LONDON
20 Cabot Square
London
E14 4QW
United Kingdom
Tel: (44.20) 7576 8000
Fax: (44.20) 7576 8500
E-mail: london@eiu.com

NEW YORK
750 Third Avenue
5th Floor
New York, NY 10017
United States
Tel: (1.212) 554 0600
Fax: (1.212) 586 1181/2
E-mail: americas@eiu.com

HONG KONG
1301 Cityplaza Four
12 Taikoo Wan Road
Taikoo Shing
Hong Kong
Tel: (852) 2585 3888
Fax: (852) 2802 7638
E-mail: asia@eiu.com

DUBAI
Office 1301a
Aurora Tower
Dubai Media City
Dubai
Tel: (971) 4 433 4202
Fax: (971) 4 438 0224
E-mail: dubai@eiu.com