# Digital Banking: The Inclusive Agenda

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KPMG in Malaysia

In a post COVID-19 world, the financial services sector will be a key driver of economic recovery and growth. Among those most affected are the B40s and Small, Medium Enterprises. The pandemic has forced customer behaviors in both retail and commercial sectors to evolve in support of digital banking services. Financial services providers that design its products around customer needs and the financial inclusion agenda, will stand out most.

As a relatively new entrant to the financial services landscape, digital banking can be seen as either a disruption or a value contributor to the financial system.

In developed economies, digital banking plays a challenger role to conventional banks, providing alternative banking channels to customers, with the promise of lower costs, better services and customized products. Convenience, of course, is seen as the main pull-factor as well, where banking can be done anywhere, anytime. The customer is king in the digital banking world.

In developing nations, digital banking offers a different value proposition to the system. Financial inclusion agenda is often one of the development needs in these countries, Malaysia included. To understand how to achieve financial inclusion in an economy, banks need to understand the demographic and customer needs, the strategic direction and national agenda from an economic and social development perspective.

In current challenging times, Malaysia is affected by many global and local events – a global pandemic, the nose-dive of oil prices and a global trade war. A changing socio-economic landscape will alter the way businesses are run and how they operate, customers' money management and spending patterns, and for both individual and businesses, mode of payments and channels of financial management will also change. The new normal is being redefined as we speak.

Is this a timely entry for digital banks?

## The Bank Negara Objective

The potential for digital banking in Malaysia gained attention when Bank Negara Malaysia (BNM) announced on 27 December 2019 its intent to issue five digital banking licenses, with financial inclusion as a primary objective, to complement the national agenda of shared prosperity.

While we await the final license application guidance to be issued by BNM, interested parties have begun efforts to assess the suitability and feasibility of partaking or extending their financial services through digital banking.

Interested parties include bank and non-bank institutions ranging from credit businesses, telecommunications, e-commerce platforms, advanced technology companies and local conglomerates. This is consistent with the trend seen in Singapore's digital bank license application, which is underway where at least 35 non-banking institutions were part of or led many of the 21 digital bank license applications. The Monetary Authority of Singapore will issue up to two digital full bank licenses and three digital wholesale bank licenses. It is widely anticipated that BNM will see a much larger number of applicants for the five digital bank licenses in Malaysia, due to the lower entry requirements in minimum capital and significant market opportunities locally and in the region.

### What is Financial Inclusion in Malaysia?

The conversation on financial inclusion in Malaysia revolves around the unserved and underserved.

Malaysia has a high banking penetration rate of 96%[1]. However, this metric does not provide a complete view into the types of banking facilities and corresponding transaction volumes. KPMG estimates that only 70% of the banked population are active users of banking facilities, with more than one transaction performed monthly [2]. For example, salary credited into a bank account is done once a month. Cash is withdrawn and, from there, used for cash transactions to purchase goods and services in the economy. This begs the question on whether currently "banked" customers are extended appropriate wealth preserving or creation products, suitable financing support or credit facilities, which can provide much needed cushioning or support in times of need?

Achieving financial inclusion in Malaysia also involves the need to improve on financial literacy in the country. The Credit Counselling and Debt Management Agency (commonly known as AKPK)'s Financial Behavior Survey 2018 indicates that 2 out of 10 Malaysian working adults did not save in the last 6 months and more than half (53%) of individuals earning less than RM2,000 a month cannot afford RM1,000 in emergency expenses. Furthermore, almost 3 out of 10 (28%) individuals need to borrow to buy essential goods. These results signal a need for further initiatives to improve on financial awareness, inculcate good financial habits and behavior, while other national policies addressing national income are run in parallel.

From a commercial perspective, Malaysia's Small and Medium Enterprises (SMEs) have expressed that access to financing is one of the main pain points to their operations, with most issues arising from insufficient financing amounts, high financing costs and onerous documentation requirements being the top 3 SME financing issues[3]. Based on KPMG's analysis, loan approval rate for SMEs are approximately 35%, of which micro SMEs experience approval rates of 33%[4], which likely is a contributor to the reason why 68% of micro SMEs borrow through friends and families[5] or use their own cash to run business operations.

## Where is the gap?

Despite there being more than 1,823 bank branches[5] in Malaysia as of December 2019 and more than 37 banking institutions covering commercial banks, Islamic banks, and development financial institutions, there is still a lack of coverage for segments of customers requiring financial services.

> Most customers who fall into the unserved or underserved segments are more likely than others to have a profile that is deficient to the minimum requirement of the banks.

This is in part due to the current product offerings of conventional banks which mainly caters to preferred customer segments of the population. While banks are more than keen to receive deposits from all segments of the economy, the financing business is where the bank's risk appetite is more deeply and comprehensively assessed.

A bank's business is in risk-taking. Where exposures are present or arise from the risks, mitigations such as collateral taking and restructuring efforts are implemented.

The notion that the higher the risk, the higher the reward is also true for the bank and is reflected in the higher returns required for the bank to shoulder this risk. Hence any applications for financing facilities are scrutinized for the customers' ability to repay their obligations.

The gap lies here in – most customers who fall into the unserved or underserved segments are more likely than others to have a profile that is deficient to the minimum requirement of the banks.

Segments where income generation is volatile, or inconsistent from month to month, where there is no clear indication of the consumer's credit profile, where there is a lack of quality collateral, typically fall short of the conventional bank's credit criteria when financing is sought.

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1 Alliance for Financial Inclusion (AFI) Core Set of Financial Inclusion Indicators , Bank Negara Malaysia
2 Global Findex Database 2017
3 SME Finance Survey 2018, Bank Negara Malaysia
4 KPMG Analysis, Bank Negara Malaysia Financial Inclusion 2019 statistics
5 Association of Banks Malaysia *(note: does not include standalone Islamic bank branches)*

## What do customers need?

KPMG in Malaysia conducted a nationwide survey in 2019-2020, with the aim of understanding the consumer appetite and concerns in digital banking.

Customers in general need institutions that can provide them with access to services that are customized to their profile and behavior, that can be tailored to their current lifestyle needs. Our survey indicates that 79% of respondents expressed interest to have financing products be made more accessible to them, where 52% of respondents prefer to perform online application for these financing services.

For the unserved or underserved in retail and non-retail segments, micro-savings or deposits, micro-financing and micro-insurance are some of the basic products that is needed.

With the conditioning of using mobile or internet services during the MCO period, it is expected that familiarity with online registrations and onboarding will increase. Our survey indicates that consumers are most concerned about cyber security and convenience of information uploading, hence this is one area that digital banks need to pay attention to when designing a good customer experience for users.


For the unserved or underserved in retail and non-retail segments, micro-savings or deposits, micro-financing and micro-insurance are some of the basic products that is needed. These "bite-sized" products enable consumers to access affordable financial enabling services in manageable quantum, and introduces those who are financially unaware to products that can gradually improve their financial literacy and economic livelihood.

Approximately 16.4% of households in Malaysia are categorized in the B40 segment where household income is less than RM4,360, The median household income in this segment was RM3,000 in 2016, while average monthly income of employee segment is RM2,463 in 2015.

Going cashless also translates to several benefits for both retail and non-retail customers. These include having the ability and information to

**77%** view digital banks as the next evolution in financial services

**82%** are already using the internet banking function of their banking service provider

**82%** will open a bank account through online platforms as long as they are regulated by Bank Negara Malaysia

**79%** expressed interest to have financing products be made more accessible to them

**52%** prefer to perform online application for these financing services

**45%** of respondents use e-wallets at least once a week; almost 31% use this channel more than once a week

*Source: Survey on digital/virtual banking in Malaysia by KPMG Management & Risk Consulting.*

*The online survey was conducted from September 2019 to February 2020, involving 1,220 respondents in Malaysia.*

manage cashflows better, to track and control expenses, increase personal safety (by not carrying physical cash).

KPMG's survey indicates that 45% of respondents use e-wallets at least once a week, with almost 31% using this channel more than once a week.

In 2018, 79% of SMEs receive electronic payments from businesses (B2B). However, 90% of SMEs receive cash payments from retail customers (C2B). It is also noted that 20% of SMEs utilize remittance services, but 89% find that the service is inadequate[6].

In most recent times, payments platforms such as Grab, Touch 'n' GO and Maybank's e-wallet MAE have revealed that a surge in cashless payments and account opening has increased as much as twice, during the Movement Control Order (MCO), due to a preference to use contactless payments channels during this period. This customer behavior is anticipated to continue in this direction where contactless payments will be more consciously and actively adopted by consumers. Correspondingly, this will become another payments channel for merchants in the economic system.

## What can digital banks offer?

The value proposition of digital banking is attractive particularly in jurisdictions where high mobile penetration rates and customers are familiar with the use of smart phones, and electronic banking.

As at 2018, internet penetration rate in Malaysia in stands at 81.2%, while smart phone penetration rate was 78%. Active mobile banking adoption has increased to 52.9% while a staggering 417.9% growth in network-based e-money transactions is seen in 2019[7].

In terms of familiarity with non-branch banking, KPMG's market survey indicates that 82% of respondents already use the internet banking function of their banking service provider.

77% of respondents are of the view that digital banks are the next evolution in financial services, although 57% of total respondents are not keen on banking with a bank without physical branches at the time of the survey.

We have also noted that 82% of respondents will open a bank account through online platforms as long as they are regulated by Bank Negara Malaysia.

Digital banks have evolved into becoming a piece of the digital ecosystem, where the customers' lifecycle leaves a digital footprint as increasing numbers of merchants and consumers adopt digital platforms as financial transactions channels.

A business model that designs its products around customer needs is crucial to establishing a 'Customer-first' model to digital

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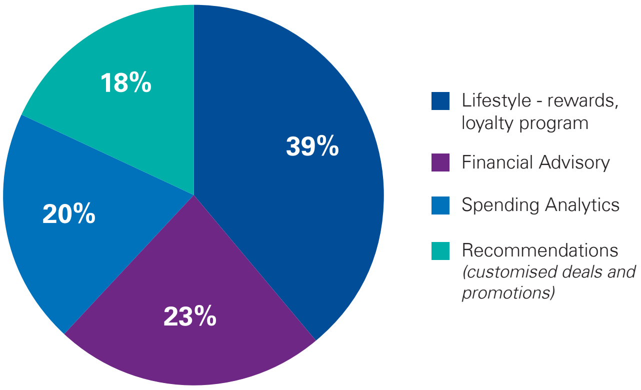
6 BNM Financial Stability and Payment Systems Report 2018

7 BNM Annual Report 2019, Department of Statistics Malaysia, Malaysian Communications and Multimedia Commission, Fintech News Malaysia

banking. Banks need to incorporate advanced analytics into understanding customer preferences and behavior, from a historical as well as a forward-looking point of view. Information and data are key to providing customers with better products and services, thereby translating to economic value for the digital bank.

From shorter and more efficient onboarding processes to alternative and innovative credit assessments and monitoring, to analytics customized to the individual and relevant segment of the customer. Digital banks need to provide products that are relevant to their customers, and end-to-end processes that are convenient and practical to their needs.

**Preferred features of digital banks**

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KPMG's survey indicates that consumers look forward to lifestyle benefits such as rewards and loyalty programs (39%), financial advisory (23%), spending analytics (20%), and recommendations such as customized deals and promotions as services of digital banks.

The unserved and underserved of the B40 groups in Malaysia should be onboarded to financial service platforms that can help in cashflow management, enabling micro-savings or deposits, micro-insurance that safeguards their basic needs, and basic financing products to tide them over their financial trouble if the need arises.

The underserved M40 and T20 segment can also benefit from the convenience and value add that digital banks can offer from a lifestyle and advisory perspective as well, with a different set of customized targets to help achieve their financial needs.

Transaction and maintenance costs are key considerations that digital banks need to factor. Maintenance and service fees that commensurate with the customer's balances and transaction patterns will encourage higher adoption and bring the underserved and unserved into the system. This will then translate into practical usage throughout the customer's lifecycle, via various savings and spending behavior.

Ideally, we would seek to have users achieve higher financial literacy through the provider's ability to advise, recommend and encourage positive financial behavior.

## Pre-requisites to a successful digital bank

Infrastructure and network capabilities in Malaysia needs to be stable and sound, for digital banking to work. Digital banks thrive where advanced technology can be deployed in all A,B,C,D aspects of technology in the 21st century. This refers to Artificial Intelligence, Blockchain, Cloud, Data Analytics.

Network enablement will be a crucial factor that drives adoption of digital banking to the areas where previously unserved and underserved segments lay.

The will to educate and create financial awareness needs to be evident and strong across the retail and non-retail sectors. From types of products to post-sale customer services via omnichannel support, the purpose of digital banks will be wider, in embracing social responsibility in the process of achieving financial gains.

## Will digital banking make Malaysia a better place?

The short answer to this is: Yes, it will. Digital banking, when implemented well with the right level of investments, will raise financial awareness and literacy, and will bring economic growth to various sectors and segments in Malaysia.

In most recent times with the MCO in place, consumers and businesses seek alternatives to safely run operations, which includes using digital platforms in its transactions, through payments, payroll, and point of sale terminals. The adoption of cashless transactions in these challenging times has also altered the spending platforms of consumers, providing a new channel of distribution by businesses. This is expected to be the new normal as businesses acknowledge the benefits of going digital and cashless.

The key to achieving success in digital banking in Malaysia can be seen in three phases. First, to understand what the customers need in the target segments. Secondly, digital banks should play a key role in improving financial literacy and financial inclusion in the country. Thirdly, to be an active platform in the economic lifecycle of the segments it serves.

Through advanced technology, digital banks can fill the void that is within our economic environment and address the pain points of the unserved and underserved in both retail and non-retail segments.

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