Emerging Fintech Possibilities and Impediments in the Southeast Asian Economy

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The fintech industry in Southeast Asia holds immense potential for growth and innovation in the post-Covid era. The region has seen a significant shift towards digitalization, with a large number of consumers actively engaging in digital financial services and embracing virtual payments. However, there are important challenges that need to be addressed to fully unlock the fintech industry's potential, ***writes Harsh Mahaseth***

The post-COVID era has been particularly foundational for the fintech industry in Southeast Asia ("SEA), a region that has been catastrophically affected by the pandemic. It is unsurprising, however, that a digital boom has spurred over 350 million people local to the SEA, to tap into the convenience offered by the integration of smartphones in their daily lives, to fulfil even their most basic commercial needs. While most countries are striving to recover from the impact of the tumultuous last few years, the Southeast Asian region is racing ahead to revamp its location in the Global South. This piece is an attempt to map out the emergence of the fintech industry in the SEA and the possible impediments to its ultimate expansion as a world leader in the space.

The surge in the use of Digital Financial Services (DFS), specifically to replace traditional payment systems has led the SEA economy to witness a tremendous spike. This development is unsurprising seeing as a sizeable portion of the SEA's population may be categorised within the under-30 demographic. Market analysts strongly expect that over the next two years, digital payments in the SEA will generate a gross revenue nearing 40 billion dollars, and will process DFS transactions exceeding 1 trillion US dollars. While these goals may at first instance, seem far-fetched, the only hurdle obstructing the further growth of digitalisation in the country, is the lack of financial literacy and access to digital financial services in the area, as compared to its counterparts in the Global North. It is these hindrances that restrain the widely-anticipated acceleration of the Southeast Asian economy and digital forwardness.

Micro, Small, and Medium Enterprises (MSMEs) face the most significant challenges in transitioning to DFS and digital payments. The majority of these businesses are located outside urban areas, and their owners are often not part of the tech-savvy millennial generation. The lack of customer outreach and service is a significant barrier for MSMEs to access credit from big DFS providers and traditional banking institutions. However, there are platforms like Grab and First Circle that offer various DFS options such as credit, insurance, and portfolio management. These platforms have not yet penetrated the MSME segment, requiring substantial government intervention to drive change.

To address this issue, governments in the region, such as the State Bank of Vietnam (SBV), have established regulatory bodies aimed at integrating fintech companies with the local population legally and ethically. Projects are also underway to promote cashless payments among MSMEs in rural areas and increase digital payment transactions to 50% within five years. The replacement of traditional lending models with peer-to-peer (P2P) lending is crucial for MSMEs to access capital without the need for collateral and benefit from low-interest rates. Fintech businesses are creating parallel credit history reports for the formerly unbanked population by utilizing transactional data. By tracking and analyzing the life cycle and scale of MSMEs, fintechs can assess credit risk and offer loans or investments within 24 hours.

Banking-as-a-Service (BaaS) and Platform-as-a-Service (PaaS) industries are gaining traction in SEA, gradually overshadowing physical banking services. Large banks are losing customers to digital competitors due to factors like low registration and interest rates, lower maintenance costs, and infrastructure expansion. The BaaS market share, dominated by B2C vendors, offers SEA the opportunity to dominate a $ 7 trillion industry set to grow by 50% in the next five years. PaaS systems, facilitating cashless transactions, have seen a rapid increase in popularity, driven by high smartphone penetration and user-friendly technologies.

Despite the potential, data privacy remains a major concern for consumers relying on fintech services. Inconsistent and inadequate data protection and privacy laws in the region pose a threat to the Master Plan on ASEAN Connectivity. Governments need to proactively address data surveillance, unfair collection, and disclosure to encourage free and fair entrepreneurial practices, promote foreign investment, and invigorate local spirit towards digitalization. The fintech industry in Southeast Asia holds immense potential for growth and innovation in the post-Covid era. The region has seen a significant shift towards digitalization, with a large number of consumers actively engaging in digital financial services and embracing virtual payments. However, there are important challenges that need to be addressed to fully unlock the fintech industry’s potential.

One of the key obstacles is the lack of financial knowledge and literacy among the population, leading to hesitancy in adopting new financial behaviours. This is particularly true for Micro, Small, and Medium Enterprises (MSMEs), which face difficulties in accessing digital financial services and credit due to limited customer outreach and support from traditional banking institutions. Government intervention and initiatives, such as the State Bank of Vietnam's Steering Committee on Financial Technology, are crucial in bridging this gap and providing the necessary support for MSMEs to thrive in the digital economy.

Data privacy and cybersecurity also pose significant concerns in the region. Inconsistent and inadequate data protection laws, as well as the potential for data breaches and hacking, undermine consumer confidence and trust in fintech services. Governments must prioritize the establishment of robust data protection frameworks, drawing inspiration from successful models such as the EU's General Data Protection Regulation (GDPR), to ensure the security and privacy of users' personal information.

The integration of Banking-as-a-Service (BaaS) and Platform-as-a-Service (PaaS) technologies offers great opportunities for the region to dominate the fintech market. These services provide convenient and accessible options for cashless transactions, benefiting both individuals and businesses. However, it is essential to address data privacy concerns and establish a regulatory framework that promotes fair practices and protects users' rights. To fully realize the potential of the fintech industry in Southeast Asia, governments, regulatory bodies, and industry stakeholders must collaborate to create an enabling environment. This includes fostering financial literacy, supporting MSMEs in adopting digital financial services, and establishing comprehensive data protection laws. By doing so, Southeast Asia can position itself as a thriving hub for fintech innovation, attracting foreign investment, driving economic growth, and empowering individuals and businesses to participate fully in the digital economy.

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**The views expressed in the blog are those of the authors alone. They do not reflect the position of the Saw Swee Hock Southeast Asia Centre, nor that of the London School of Economics and Political Science.*