Brankas

Lending Redefined

Harnessing Digital Opportunities in Southeast Asia

May 2024

Lending Redefined: Harnessing Digital Opportunities in Southeast Asia

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Building the next generation of digital lenders

As more global financial institutions identify themselves as technology companies, digital innovations are disrupting capital markets on what seems like a daily basis.

Lending is the bread and butter of the banking business. Traditional lenders have been ramping up their IT investments to stay competitive in today's marketplace. Meanwhile, digital startups are cropping up in every corner of the financial world to capitalize on pockets of opportunity that have emerged with new technologies.

When evaluating these opportunities, any discussion would be incomplete without anchoring it to the three dimensions behind a digital loan:

1   **PROCESS**

Every step in the lending process could be impacted by technology. From a customer's loan application to the management of credit risk, digitalization could add significant stakeholder value.

2   **TECHNOLOGY**

Technology has made digital strategies more varied and versatile. Choosing the right deployment pathway is critical to a company's return on investment.

3   **PRODUCT**

The loan products offered could determine a digital lender's unique positioning in what is traditionally a commoditized market.

SOUTHEAST ASIA THE NEXT FRONTIER

Most lenders in Southeast Asia are just scratching the surface in terms of realizing the full potential of digitalization. That said, the operating environment is increasingly conducive to market entry and growth, supported by favorable socio-demographics and a more robust regulatory environment in markets like Indonesia and the Philippines.

Market leaders of tomorrow will be companies that look beyond obvious cost savings and focus their energy on strategic monetization. Digital lenders that can successfully navigate challenges in regulatory compliance, data governance and system design stand to gain at the expense of those that are beset by legacy infrastructure.

In this report, we take a deep dive into these industry dynamics and explore what it takes to build the next generation of digital lenders.

Key insights

DIGITAL LENDING: A GLOBAL PERSPECTIVE

Global IT spend in financial services has surpassed US$650 billion a year. Asia holds tremendous potential as the region with the most active online banking users.

REDEFINING THE LENDING BUSINESS

The value of a digital loan depends on how a financial institution calibrates its lending process, technologies and product offerings to meet its customers' needs.

APIs: UNLOCKING THE FULL VALUE OF DIGITALIZATION

The incorporation of APIs into a lender's infrastructure can drive cost savings, higher customer satisfaction and more efficient capital management.

DIGITAL LENDING TRENDS IN SOUTHEAST ASIA

While incumbent banks in the region invest to defend their foothold, sweeping regulatory reforms are changing the way credit is extended to the underbanked.

MANAGING THE DIGITAL TRANSITION

Reinventing the lending model comes with challenges like regulatory compliance and legacy system overhaul. But there are ways to effectively manage the transition.

1.4 bn…

… 5G connections will be available in Asia Pacific by 2030, equivalent to 41% of total mobile connections, as per the Global System for Mobile Communications Association (GSMA). 5G will underpin much of the innovation on mobile-based platforms in the coming years.
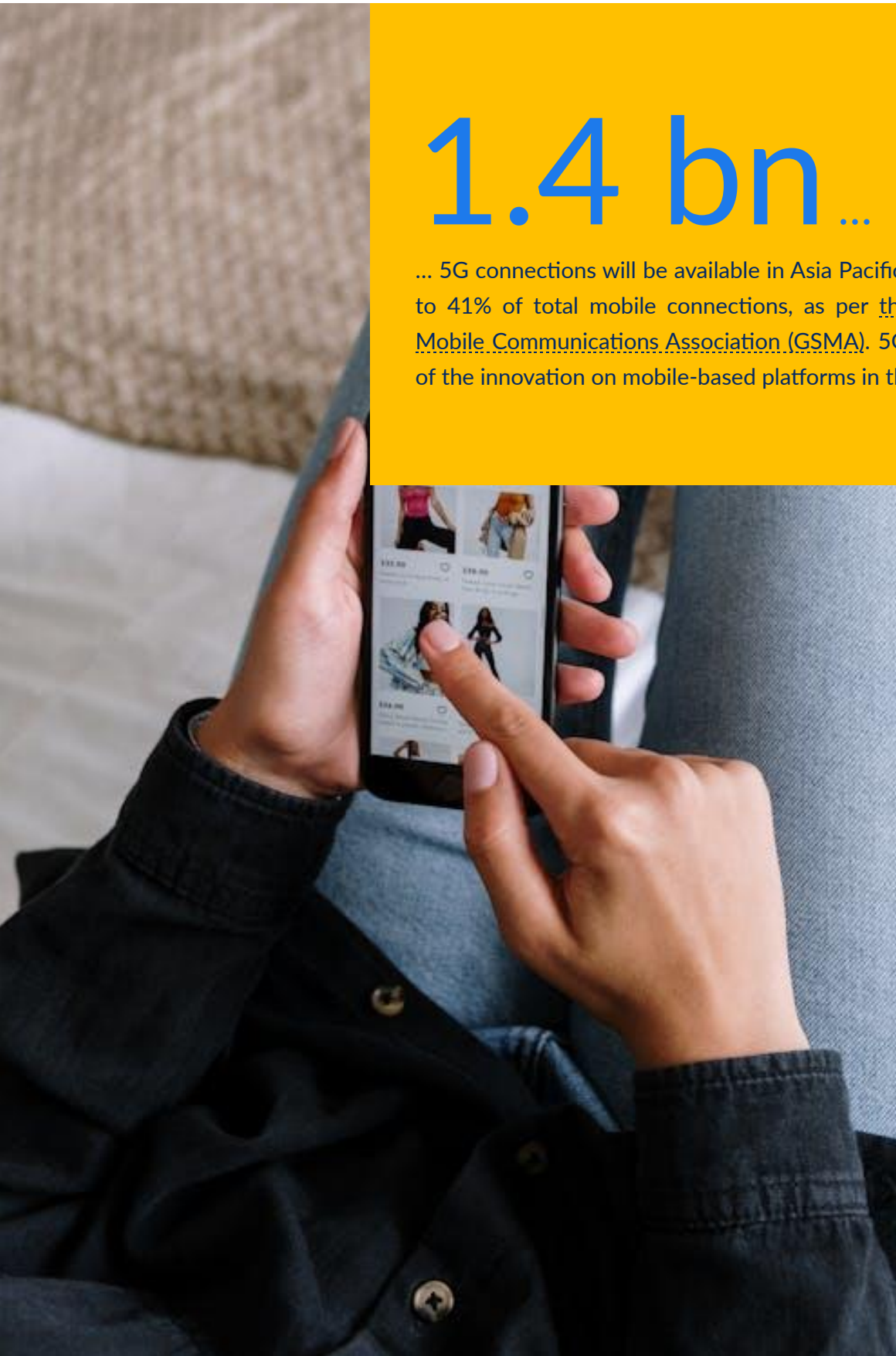
Digital lending:
A global perspective

GLOBAL IT INVESTMENTS

Globally, the financial services industry spends more than US$650 billion a year on technology. [1] IT budgets are set to rise further in the coming years as institutions accelerate their deployment of critical solutions. In a race to upgrade and upscale, banks, non-banks and fintechs of all sizes are counting on these investments to drive positive business outcomes.

Blockchain, cloud computing, machine learning, generative AI and digital infrastructures continue to transform how financial institutions interact with their customers, manage their businesses, and create value. Technology has also spawned lucrative opportunities by removing barriers to entry in traditional financial markets.

Lending activity is at the center of these seismic shifts in the industry. At its core, digital lending involves the reimagining of the credit creation process in a web or mobile application environment.

While cost efficiency remains a primary motivation, technology's impacts can extend to a host of other performance metrics. For traditional banks, the decision to go digital may be one of necessity.

PREVALENCE OF DIGITAL BANKING

According to a survey published in February 2024, 70% of US households are enrolled in digital banking, and among them, 95% said they bank online "often" or "occasionally." [2]

In a separate study in Europe, almost half of the respondents have considered opening accounts with Big Tech players as banks struggle with customer satisfaction. [3]

In Asia, demand for digital finance is underpinned by growing smartphone adoption, which is expected to reach the global average of over 90% by 2030 from 71% in South Asia, 76% in Northeast Asia, and 84% in Southeast Asia in 2022. [4]

In terms of the number of active online banking users, Asia is already the largest region, with an addressable market of 805 million customers as of 2020, followed by Europe (362 million) and North America (240 million).

Meanwhile, technology has allowed digital-only lenders to be formidable market disruptors. The challenge is to identify the processes, technologies and product lines that may deliver the highest returns on investment.
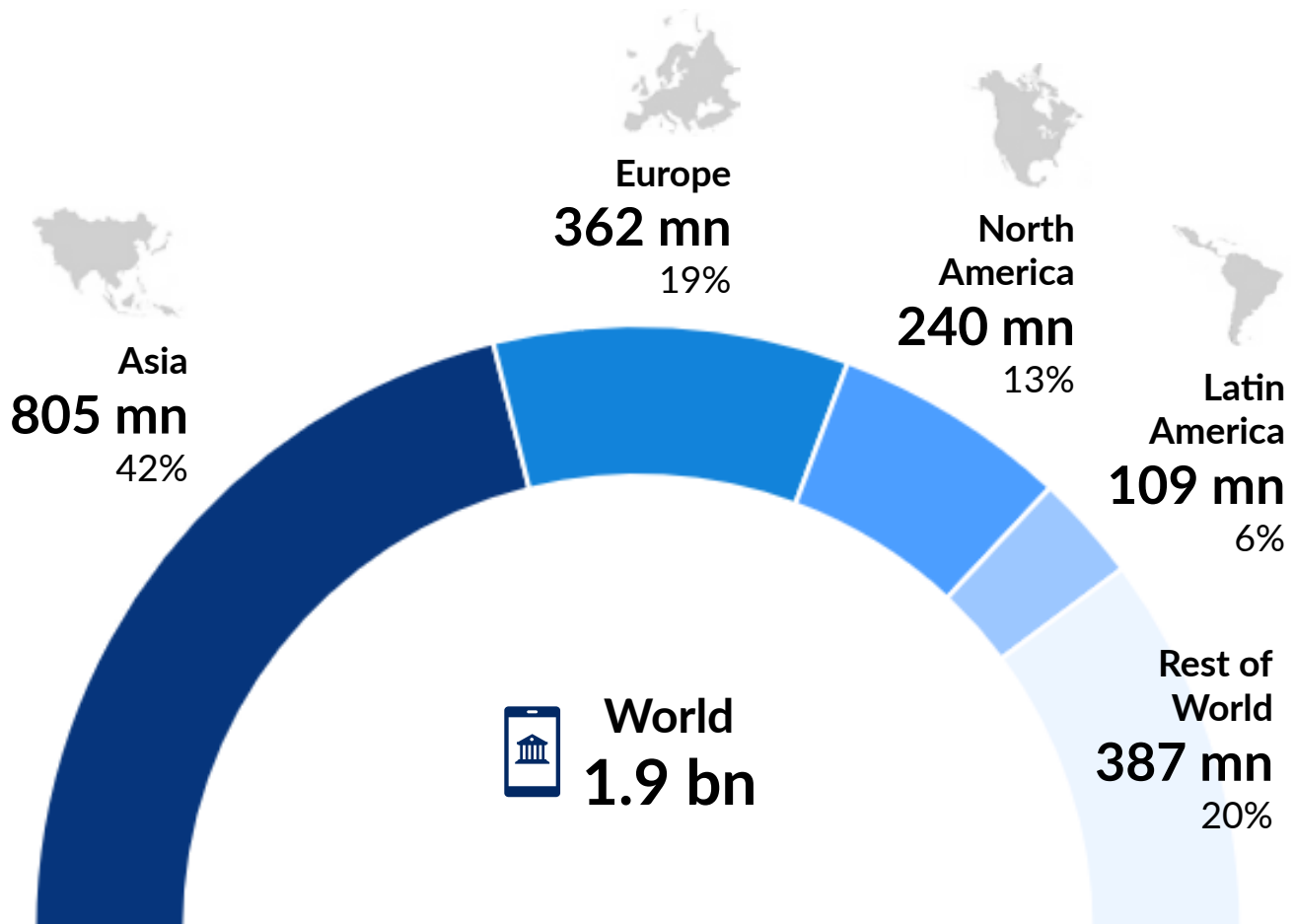
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[1] *Gartner Forecasts Worldwide Banking and Investment Services IT Spending to Reach $652 Billion in 2023*, Gartner, June 2023
[2] *Banking in the Digital Age*, CapitalOne, February 2024
[3] *Digital Banking Experience Report 2023*, Sopra Steria, November 2023
[4] *The Mobile Economy Asia Pacific 2023*, GSMA, 2023

Exhibit 1: Number of active online banking users worldwide

Europe
362 mn
19%

North
America
240 mn
13%

Asia
805 mn
42%

Latin
America
109 mn
6%

World
1.9 bn

Rest of
World
387 mn
20%

Source: Statista based on 2020 survey data. Brankas

US$35bn

The global Buy-Now-Pay-Later (BNPL) platforms market is estimated to be close to US$35 billion in 2024 and expected to top US$140 billion by 2031, as per Coherent Market Insights.

Redefining the lending business

The definition of a "digital loan" is fluid, owing to the myriad pathways of technology deployment. To conceptualize a lender's digitalization strategy, it is useful to consider its business along three dimensions: the lending process, the technologies adopted, and the products distributed. A well-designed combination of these factors is pivotal to a lender's success.

① PROCESS

The loan origination process begins with marketing and a customer's application, both of which traditionally involve some form of human interaction. Face-to-face interactions are often one of the first steps for lenders to verify client identity and fulfil their know-your-customer (KYC) requirements.

Digitalization can streamline the onboarding process through the use of targeted marketing, AI-assisted customer service, biometric identification, and multifactor verification. Borrower documentation can be submitted within minutes in a desktop or mobile application.

Data collection can also be enhanced through secure connections and APIs aggregated from third-party providers such as online merchants, social media platforms and other participants of the digital finance ecosystem.

Traditional banks have to rely on manual or semiautomated credit approvals by risk managers and centralized systems, but their digital counterparts can make use of an array of alternative credit data such as mobile payment records, real-time revenue feeds, and other online activity indicators.

Exhibit 2: Notable differences between traditional and digital lending processes

	Traditional	Digital
Application	● Physical presence usually required	● Web or mobile application
Data collection	● Hardcopy ID, income, address proofs	● Biometric ID, digital data
Credit approval	● Manual / semiautomated approval	● Credit algorithms, alternative credit data
Loan disbursement	● Preset account details and terms	● More flexible facility drawdown
Credit management	● Manual / semiautomated reviews	● Credit algorithms, alternative credit data
Collection	● Preset autopay or manual payment	● More flexible repayment methods
Recovery	● Self-declared assets, manual searches	● Automated searches
Refinancing	● Manual / semiautomated reviews	● Credit algo, alternative credit data
Funding & liquidity	● Manual / semiautomated analysis	● Automated funding & liquidity options

Source: Brankas

The scope, efficiency and timeliness of digitalized credit assessments may be far superior to mainstream risk frameworks based on infrequent, backward-looking information like annual financial statements, income tax returns and utility bills.

Once a digital loan is approved, disbursement and repayment options can be customized to govern the use of proceeds and facilitate fund transfers among the lender, customer and any third party involved. The built-in flexibility has the added benefit of fostering product innovation, with revenue-share financing and buy-now-pay-later (BNPL) products being notable use cases.

For digital loans in good standing, the credit review process stays current for as long as alternative data are available. The recovery process for loans in arrears may be enhanced by collateral tracking technologies, as may be used for auto loans, and real-time revenue or personal income records obtained through transaction data access. These data create a virtuous feedback loop for future loan pricing.

The use of technology may optimize a lender's balance sheet as well, by improving the quality of its credit portfolio. Data analytics can be employed to design funding options to match the lender's liquidity needs with its investors' risk parameters. Credit risk securitization could in turn scale the lender's digital loan book, supporting future asset growth.

UnionDigital BANK

75%

Union Digital Bank is a digital bank spinoff by Union Bank of the Philippines. As of May 2023, the bank had a market share of 75% of loans among the six licensed digital banks in the country. It is also one of only two digital banks in the Philippines to be listed in the Global Top 100 Digital-Only Bank Ranking 2023.

2 TECHNOLOGY

Data is the lynchpin of any digitalization strategy. As digital information becomes increasingly entrenched in our lives, data production, capture and storage have expanded exponentially.

Each day, we generate almost 300 billion emails, 65 billion WhatsApp messages and 720,000 hours of YouTube content. Global data consumption grew from 33 trillion GBs in 2018 to 59 trillion GBs in 2020 and is forecast to reach 175 trillion GBs by 2025. [5]

The technologies selected to collect and synthesize these data form the second dimension of a lender's digital strategy.

Open data architecture

The open data concept is embraced by a rising number of financial institutions in their digital infrastructure. Access to shared customer data via APIs enables real-time credit transactions involving multiple parties, such as a customer / borrower, an online merchant and a lender.

The technology is a core enabler of loan products such as daily revenue share financing and BNPL. Third-party data gathered by the lender could be further harnessed for use in strategic planning, sales and marketing and credit analytics.

Chatbots / Virtual assistants

AI-powered chatbots and virtual assistants are effectively a customer's personal banking manager in the digital age. The integration of this technology into a business's client interface can drive direct cost savings in human resources and physical infrastructure. More importantly, a responsive and resourceful virtual interlocutor may boost customer interactivity, declutter the loan application process, and strengthen the lender's ability to cross-sell and upsell. Higher customer satisfaction will spur asset growth and retention.

Biometrics / Network security

The digital lending industry has come a long way since the days of six-digit PINs and security fobs. The use of facial mapping, iris and fingerprint scans, and signature and voice recognition empower remote loan application, credit data processing, contract signing, fund disbursement, and loan repayment. There are also internal applications in credit approval and risk management, especially for organizations that adopt work-from-home or hybrid work arrangements.

Generative AI

Generative AI could have a profound impact on digital lending far beyond its application in chatbots and virtual assistants. As compared to robotic process automation, the technology is capable of analyzing complex datasets, adapting to changing scenarios, and recommending and executing an optimal course of action.

Similar to use cases in securities trading and investment portfolio construction, generative AI could be deployed in credit analytics. By leveraging their access to alternative credit data, digital lenders could acquire competencies in risk selection, loan pricing, fraud detection, internal auditing and regulatory compliance, bolstering returns on investment.

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[5] *The World's Data Explained: How Much We're Producing and Where It's All Stored*, The Conversation UK, May 2021

LINE Bank
by Hana Bank

1 mn

LINE Bank is a collaboration between LINE Financial Asia and PT Bank KEB Hana Indonesia, a subsidiary of South Korea's Hana Bank. It is the third market that LINE Bank operates in, after Thailand and Taiwan. The digital bank offers time deposits from as little as one million rupiah.

3 PRODUCT

Digital lending is uniquely suitable for the small and medium-sized loan market, where the credit creation process could be augmented by high-frequency datasets.

Consumer loans

Consumers with no collaterals may frequently find it difficult to obtain credit approvals from traditional lenders. Open architecture allows digital lenders to access a borrower's income and spending data as they are produced and captured. In return, consumers may benefit from simplified application and less burdensome approval procedures.

BNPL represents a subset of consumer loans that are digitally-empowered. BNPL options may deepen financial inclusion in emerging markets or among lower-income customer groups. While easy credit may disadvantage the less financially literate,

technology itself may present mitigating solutions in the form of transparent credit scores and financial planning tools.

Small business loans

A fundamental problem in small-business financing is information asymmetry. Traditional lenders lean heavily on financial statement data in their underwriting process. They often lack the tools to assess the creditworthiness of early-stage ventures, particularly those with no monetizable fixed assets. Corporate governance is also a concern.

Digital lending addresses some of these hurdles by incorporating higher-frequency alternative data in the credit approval and monitoring process. Real-time data on a borrower's cash receipts and its customers' behavioral patterns could increase a lender's ability and willingness to extend credit. To deter fraudulent loan applications, the use of proceeds could be controlled via preset payment algorithms.

Subscription revenue-based financing, where a working capital loan is secured against a borrower's recurring fee income, is an archetypical example of a technology-enabled small business loan. The technology could equally apply to brick-and-mortar merchants that collect the bulk of their sales via mobile payments.

Sustainable loans

Technology has vast deployment potential in sustainability-linked lending, with applications in use of funds oversight, impact data tracking, and performance reporting. In addition, AI could be deployed across the energy, agricultural, manufacturing and other industrial sectors to achieve favorable climate and environmental outcomes, which can in turn be linked to lending terms and conditions.

Such technology is generally scalable for large, complex project financing. But opportunities abound for lenders targeting the small business segment as well, as digitalization could materially lower the costs of sustainability data collection and analysis.

Cross-selling / Upselling opportunities

Digital lending could generate meaningful cross-selling and upselling opportunities. Complementary products that may appeal to digital loan customers include cash management, insurance and investments. Open architecture can also facilitate affinity programs with the likes of shopping platforms and airlines.

These incremental fee income opportunities are central to the business case for the Banking-as-a-Service (BaaS) model, where an organization can focus on serving its customers via digital channels while remaining nimble and avoiding onerous regulatory requirements.

68%

ANEXT BANK

Banking the underserved micro, small-and-medium enterprises (MSMEs) has been the key focus for Ant International-backed Anext Bank since its launch in Singapore in June 2022. This group makes up 68% of the bank's customer base, as per the Business Times.

10 minutes

With Brankas APIs, you can trim down your loan application process from 7 days to 10 minutes.

APIs: Unlocking the full value of digitalization

Among the digital applications currently available, open API-based lending is an area that may produce the best risk-adjusted returns for digital lenders. APIs are already viewed as an indispensable component of global banks' operations. In fact, a survey in 2023 reveals that 88% of respondents believe

APIs have become more important since 2019; 81% consider APIs a priority for business and IT functions; and large banks are allocating an average of 14%of their IT budgets to API programs. [6]

Exhibit 3: Level of API maturity across key dimensions from a scale of 1 (low) to 5 (high) among bank survey respondents
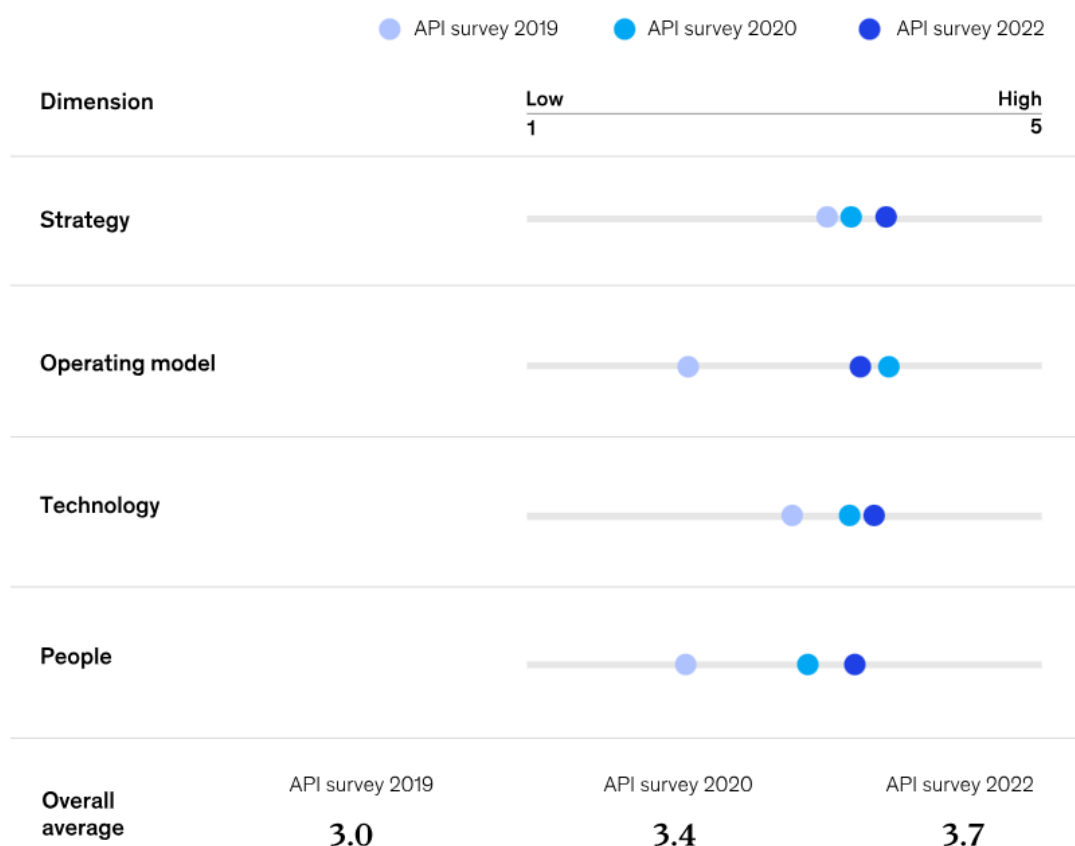
Source: _McKinsey Global Surveys on APIs in Banking_, January 2023

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[6] _McKinsey Global Surveys on APIs in Banking_, January 2023

WHAT ARE APIs?

In short, Application Programming Interface (API) is a set of rules that specify how software can communicate with each other.

A front-end application can request data or functionality from another system through the API, which authenticates, processes and performs the request in the backend, and returns the results to the frontend.

Banking APIs can be classified as:

- **Internal APIs**, which connect different inhouse systems, including customer details, account information, transaction history and mobile applications;

- **Partner APIs**, which connect a lender's systems with those of authorized third-parties, such as online merchants, payment service providers, other banks, fintechs, insurers, wealth managers, etc; and

- **Open APIs**, which are published for use by any third party and accompanied by terms of use. They may encompass data that facilitate customer identity verification, credit scoring and payment processing etc.

POTENTIAL BENEFITS

The benefits that may be realized through API deployment range from low-hanging cost savings to higher-value strategic initiatives.

Cost savings

API infrastructure can reduce labor, system and physical location costs. Human resources can be redeployed to value-added activities such as providing customized lending solutions to more sophisticated customers.

Product development

The product development cycle can be expedited by utilizing third-party data that were previously unavailable to the lender.

Product partnerships with other participants of the digital ecosystem can be seamlessly integrated into a lender's operations. This may afford digital finance providers an opportunity to progressively adopt a BaaS business model and focus on competencies that suit their specific risk and regulatory preferences.

Enhance marketing capabilities

New marketing capabilities can be acquired through API-driven data insights. Targeted initiatives can also drive cross-marketing and upselling opportunities.

International expansion

Depending on each jurisdiction's regulatory constraints, API deployment may extend a lender's cross-border reach by removing geographical barriers associated with brick-and-mortar setups.

Scalability

Open data infrastructure could accommodate a digital lender's evolving needs as its loan book and product lines grow. There are also considerable network economies of scale, as the digital finance ecosystem expands in breadth and depth.

Operational risk management

API deployment can meaningfully enhance a lender's operational security by reducing manual errors and securing data transmission. This can be supplemented by the use of biometrics, multi-factor verification procedures, and other network security measures.

Credit risk management

The implementation of a robust internal credit scoring system based on alternative credit data may allow digital lenders to achieve differentiation in credit risk selection, loan pricing, funding options, and capital management.

Exhibit 4: Illustration of Open API-based Digital Lending

Customer submits loan application through a third-party mobile app or directly to the lender — ①

② Automated onboarding

Loan Application

Customer accepts loan term and conditions after the lender's API-based approval process — ④

③ Lender aggregates and analyzes customer data via open APIs and offers loan terms and conditions

Open API's
Personal, income, spending, credit data etc. gathered from third-parties

Customer can retrieve real-time loan data in third-party apps or directly from the lender via APIs — ⑧

⑦ Real-time loan data such as outstanding balance and refinancing options are made available via APIs

Customer

Digital Lender

Customer receives loan proceeds and makes future repayments — ⑥

⑤ Lender releases loan proceeds and collects future repayments

Third-party Payment Provider

Source: Brankas

Exhibit 5: Examples of alternative credit data for small businesses

Payment data

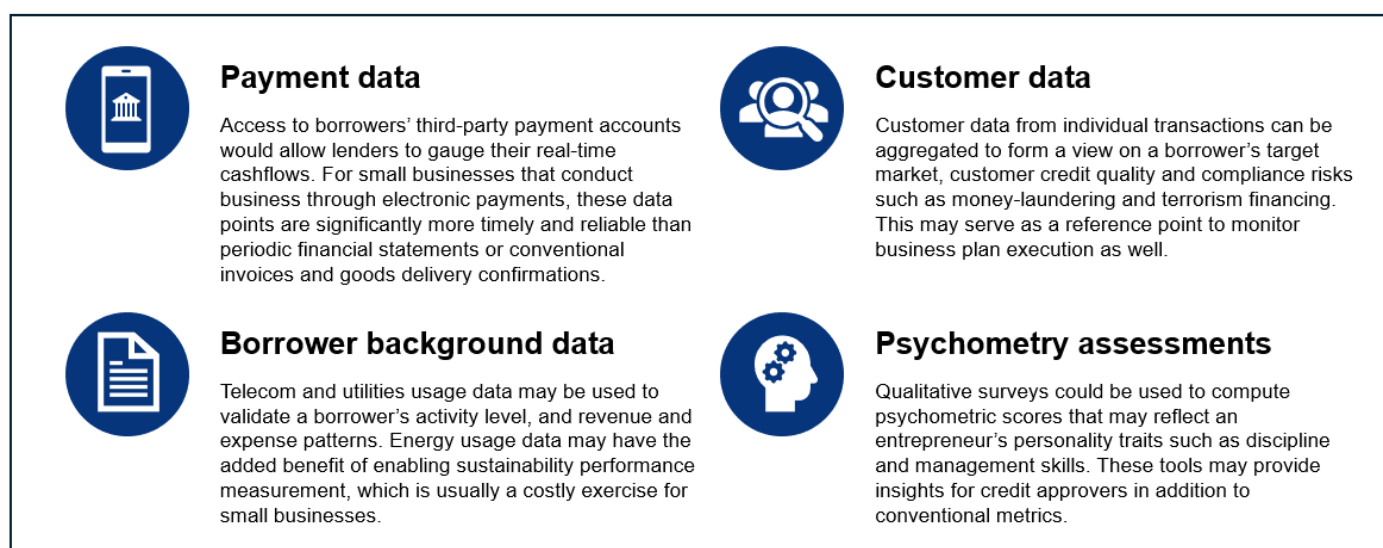Access to borrowers' third-party payment accounts would allow lenders to gauge their real-time cashflows. For small businesses that conduct business through electronic payments, these data points are significantly more timely and reliable than periodic financial statements or conventional invoices and goods delivery confirmations.

Customer data

Customer data from individual transactions can be aggregated to form a view on a borrower's target market, customer credit quality and compliance risks such as money-laundering and terrorism financing. This may serve as a reference point to monitor business plan execution as well.

Borrower background data

Telecom and utilities usage data may be used to validate a borrower's activity level, and revenue and expense patterns. Energy usage data may have the added benefit of enabling sustainability performance measurement, which is usually a costly exercise for small businesses.

Psychometry assessments

Qualitative surveys could be used to compute psychometric scores that may reflect an entrepreneur's personality traits such as discipline and management skills. These tools may provide insights for credit approvers in addition to conventional metrics.

Source: Brankas

LENDING AS A SERVICE (LaaS)

LaaS allows businesses to offer credit products and services to their customers in conjunction with established lenders through open APIs. LaaS can be embedded by virtually any vendor in the digital ecosystem, allowing businesses to provide a one-stop shopping experience to their customers. In markets where digital adoption is prevalent, LaaS could be an increasingly important source of competitive advantage and ancillary revenues for vendors. For digital lenders, LaaS is a rapidly growing channel of loan distribution, with a host of benefits described above.

The embedded loan platform could be in the form of:

- Digital loan application API and front-end
- eKYC/eKYB API
- Alternative data API for Loan applicant assessment
- Loan Scoring services
- Loan administration module

However, product and service quality levels on the market vary widely, and digital lenders should exercise caution when they select a technology partner.

OPTIMIZING BALANCE SHEETS

An API-powered credit analytics framework may measurably enhance a digital lender's risk management capabilities, which may in turn enable innovative funding solutions that are traditionally reserved for large financial institutions or corporations.

An example is the securitization of small business trade receivables. Imagine a group of small businesses that supply their goods and services to their customers (debtors) with payment terms ranging from 30-90 days. This creates a working capital need for the sellers, which can be financed through digital loans, with the underwriting process capturing vital real-time credit data on the borrowers as well as debtors.

The lender could obtain funding from capital markets through a special-purpose vehicle (SPV) which houses the portfolio of receivables, circumventing the need to raise funding through conventional channels that may be more costly and restrictive. The technology involved throughout the structure can be managed by a qualified external service provider.

Exhibit 6: Simplified small business receivables securitization structure
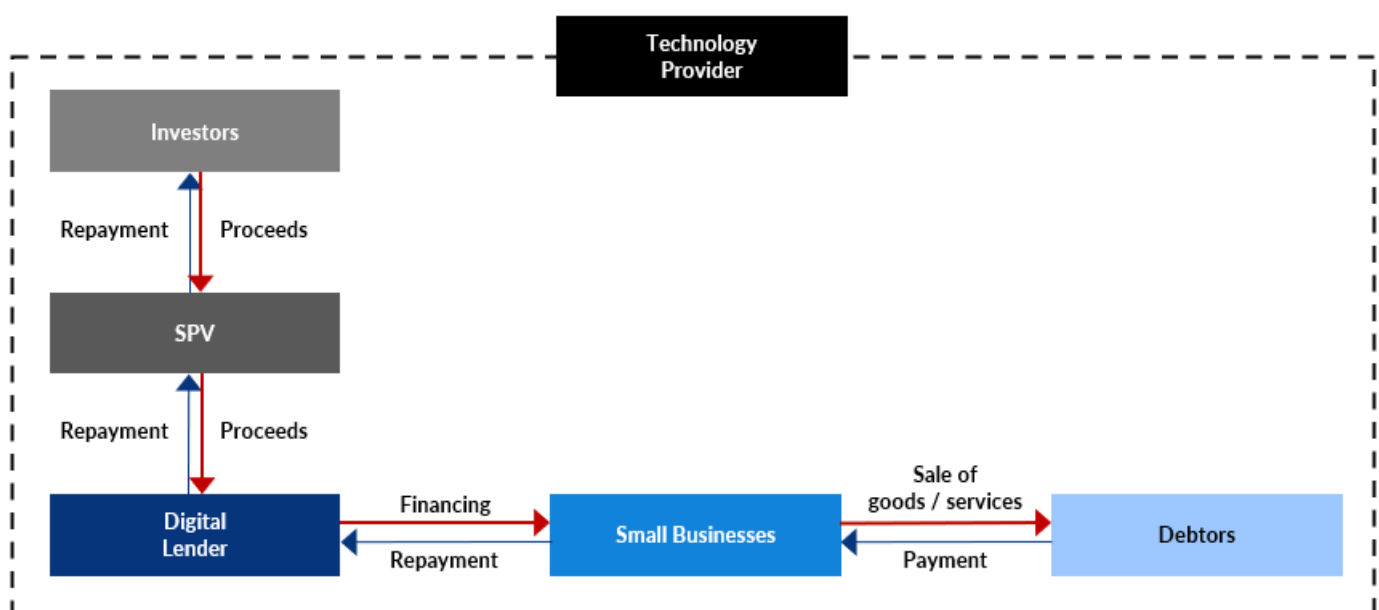
Source: Brankas

US$2bn

Fintechs in the ASEAN region raised US2 billion in 2023, according to Kapronasia. A confluence of macroeconomic factors has put pressure on startup funding. Investors are also more focused on companies' long-term financial viability.
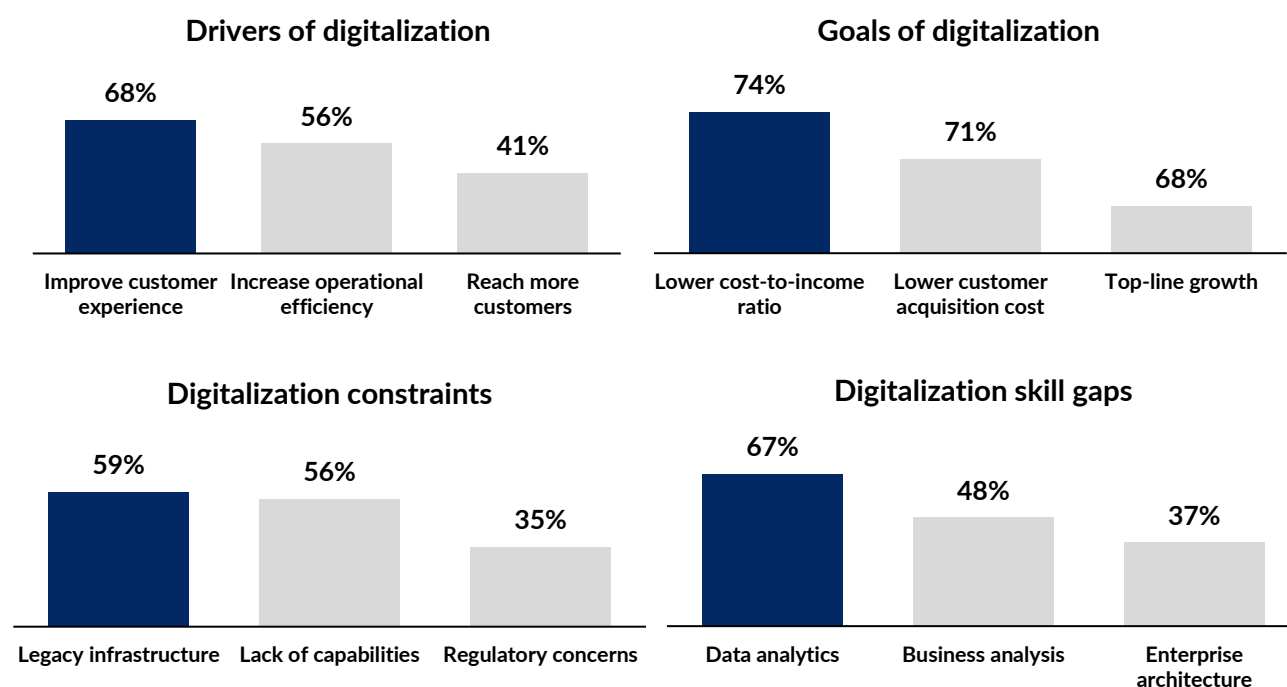
Digital lending trends in Southeast Asia

As in the rest of the world, the evolution of digital lending is challenging traditional banks' business in Southeast Asia. Most banks in the region feel that digitalization poses a significant risk of disruption to their business models, as per a survey in 2023. [7] In response, the majority of banks are undergoing transformation to stay relevant and competitive.

However, most banks are cognizant of the risks of digitalization, and appear to be primarily focused on low-hanging fruits in customer interface, operational efficiency and cost-to-income ratios. While a conservative transition strategy may appease shareholders in the near term, consistent under-investments could prevent lenders from realizing long-term growth potential and scale economies in their digital loan book. Legacy issues and the lack of interoperability of core system features stand out as major roadblocks in the industry's transformation drive.

Exhibit 7: Selected findings of PwC's 2023 digital banking survey for Southeast Asia

Drivers of digitalization

Improve customer experience	Increase operational efficiency	Reach more customers
68%	56%	41%

Goals of digitalization

Lower cost-to-income ratio	Lower customer acquisition cost	Top-line growth
74%	71%	68%

Digitalization constraints

Legacy infrastructure	Lack of capabilities	Regulatory concerns
59%	56%	35%

Digitalization skill gaps

Data analytics	Business analysis	Enterprise architecture
67%	48%	37%

Source: *Digital Banking Survey 2023: Southeast Asia Landscape,* PwC. Brankas

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[7] *Digital Banking Survey 2023: Southeast Asia Landscape,* PwC

As an indication of the obstacles facing large incumbent players, close to 60% of banks in the region cite the prevalence of legacy applications as a digitalization constraint. Almost 70% of respondents believe data analytics is an area where skill gaps exist.

At the same time, the fintech sector continues to be propelled by the region's thriving digital economy and underbanked populations. Alternative lending is drawing especially strong investor interest, accounting for almost a third of venture funding in 2023. [8]

The competition between traditional and digital lenders is poised to intensify, with each group pivoting towards a more service-oriented operating model. Moreover, the operating environment in each market affects lenders' digital strategies to varying degrees, with Indonesia and the Philippines offering insightful case studies on how industry dynamics may play out in the years ahead.
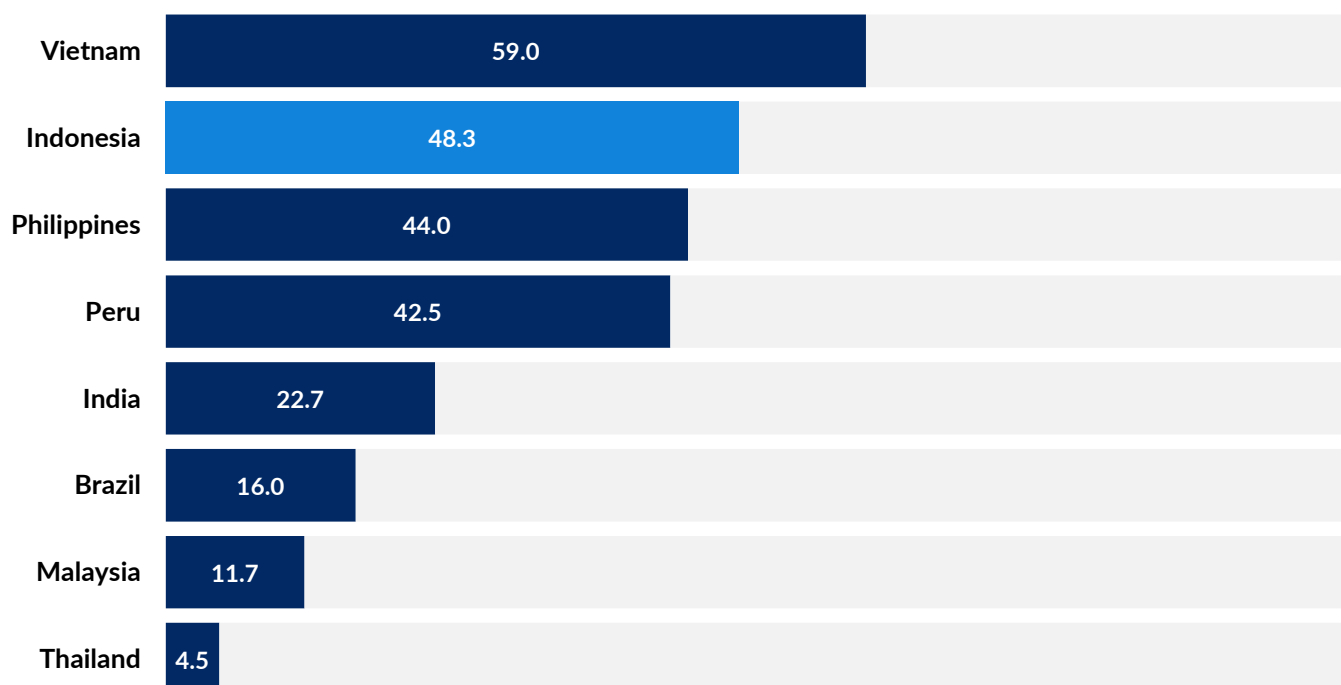
INDONESIA

Indonesia's policy ambition to boost its digital readiness is outlined in the central bank's *Payment Systems Blueprint 2025*, which has introduced measures since 2019 to bring a 91.3 million unbanked population and 62.9 million micro, small and medium enterprises into the formal financial system through digitalization. [9]

Specifically, the blueprint sets forth five systemwide initiatives, all of which are highly relevant to the sustainable growth of the digital lending industry:

1 **Developing open banking**

An open data infrastructure is a core enabler of digital finance and can serve as a bridge between traditional finance and fintech. Bank Indonesia's efforts to stimulate the growth of

Exhibit 8: Share of unbanked population among those aged 15+ (%)

Country	Value
Vietnam	59.0
Indonesia	48.3
Philippines	44.0
Peru	42.5
India	22.7
Brazil	16.0
Malaysia	11.7
Thailand	4.5

Note: As of 2021; Source: *On the Verge of a Digital Banking Revolution in the Philippines,* McKinsey & Co, May 2023. Brankas

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[8] *The Southeast Asia Fintech Sector is at an Inflection Point,* Forbes, February 2024
[9] *Indonesia Payment Systems Blueprint 2025,* Bank Indonesia, November 2019

open banking are centered on the standardization of technical, security, contractual and data protocols. Harmonized protocols have buttressed the market's governance, while widening access for the underserved demographic.

2 Strengthening the configuration of retail payment systems

Modernizing the country's retail payment systems could improve the efficiency and security with which digital loans are processed. Bank Indonesia Fast Payment (BI-FAST), the National Payment Gateway (GPN), and the National Clearing System (SKNBI) comprise the backbone of the revamped payment infrastructure.

The launch of BI-FAST in December 2021 was a notable milestone for the industry, as it has enabled round-the-clock, real-time transactions using proxies such as phone numbers or email addresses.

3 Strengthening financial market infrastructures

In a broader context, the country's financial market infrastructures have also been reconfigured and upgraded. In particular, the Bank Indonesia Real-time Gross Settlement (BI-RTGS) system has been designed as open architecture to boost interconnectivity and compatibility with the digital retail economy.

4 Developing public infrastructure for data

The digital transition calls for a rigorous approach to Managing data infrastructure, defined by the central bank as the "ecosystem that consists of technology, processes, and actors / institutions for the collection, storage, maintenance, distribution, and use of data by end-users." Preventing data monopolies, concentration risks and privacy infringements is the regulator's ongoing priority.

5 Strengthening the regulatory, licensing, and supervisory environment

Finally, the country's regulatory landscape continues to be reshaped by technological and financial innovations. Risk-based and compliance-based supervision has the overarching objective of ensuring customer protection and preserving systemic stability. The industry has to optimize its use of technology within those confines.

THE PHILIPPINES

Despite explosive growth in the digital economy, incumbent banks in the Philippines remain laggards in related IT investments. As per an analysis in 2023, Philippine banks spend less than 10% of their revenues on technology, compared with around 15% elsewhere in Asia-Pacific. Across the industry, digital channels contribute a modest 5-15% of revenues, well below the average of 25% for other Asia emerging markets.

This has led to the formal banking system's strong skew towards wholesale business and a critically underbanked retail market. In view of the widening gap with neighboring countries, the banking regulator has put in place a digital bank licensing regime, real-time payment system and standardized QR network in recent years.

As in many emerging markets, there is a massive rural population and small business community that may lack the documentation, including personal IDs, to fulfil the banks' documentation requirements. The SIM Registration Act (SRA) of 2022, which links SIM cards with verified users, was a major step forward in this regard.

As a further example of the Philippine lending industry's distinctive characteristics, over $30 billion, or around 10% of GDP [10], in remittances are systematically excluded or undercounted as income in the incumbent banks' credit approval processes.

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[10] Bangko Sentral ng Philipinas (BSP) remittance statistics

In a market where three-quarters of the population has internet access, mobile usage is nearly universal, and the bankable population is projected to grow 30% from 65 million in 2022 to 85 million by 2030 [11], the potential for digital startups is tangible.

To date, six digital banks have been established in the Philippines, namely Tonik Digital Bank, GoTyme Bank, Maya Bank, Overseas Filipino Bank, UNObank and UnionDigital Bank. A number of payment providers have also branched into the lending, investment and insurance space, after weighing the costs and benefits of engaging in more regulated activities.

While the central bank is open to granting new digital licenses, it is proceeding with caution, noting that only two of the six digital banks are profitable at present. [12]

The regulator also notes that the online banks already have about 8.7 million deposit accounts, although they seem to be making inroads into lending at a more deliberate pace.

As the industry continues to traverse the startup lifecycle, asset accumulation will gradually accelerate when technology investments start to pay off.

Exhibit 9: Breakdown of banking system loan portfolio in 2022 (%)

■ **Wholesale** □ **Retail**

Country	Wholesale	Retail
Philippines	75.6	24.4
Turkiye	65.6	34.4
Colombia	53.1	46.9
Mexico	51.8	48.2
Indonesia	46.0	54.0
Brazil	40.6	59.4
Thailand	38.3	61.7
Malaysia	31.5	68.5

Source: _On the Verge of a Digital Banking Revolution in the Philippines_, McKinsey & Co, May 2023. Brankas

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[11] Based on World Bank population estimates as of December 2022
[12] _BSP Open to Issuing More Licenses to Digital Banks_, BusinessWorld, March 2024

US$6 mn

A data breach could cost a financial firm an average of US$6 million, as per Fintech Magazine.

Managing the digital transition

While the benefits of adopting a digital lending model are quantifiable, managing the transition may be a daunting task for many institutions. The challenges commonly facing digital lending businesses include:

Regulatory compliance

In developed and emerging markets alike, the digital finance landscape is still rapidly evolving, resulting in regulatory uncertainties across product lines and technologies utilized. As discussed, the trend in Southeast Asia is toward the standardization of technical, security, contractual and data protocols. Ensuring an organization's ongoing compliance is critical to its viability as a business.

Data privacy

A digital lender's social license to operate is built upon customer trust. For organizations looking to access customer data directly or through a third party, the ability to demonstrate clear advantages in terms of loan application efficiency is crucial.

Data security

An estimate in 2023 puts the average cost of a data breach in the financial services sector at nearly US$6 million [13], a price that many digital startups would struggle to pay. For more established institutions, the direct and indirect costs could be astronomical, considering damages to their franchise value and potential regulatory and liability exposures.

Data governance

Managing a lender's data systems as part of a complex ecosystem demands robust governance standards for individual participants above minimum regulatory requirements.

Legacy issues

Existing core banking systems and applications may be years, if not decades, behind the digital innovations disrupting the marketplace today. Under-investments, organizational inertia, and a shortage of talents in many geographies are making the transition more costly and time-consuming than it needs to be.

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[13] *Average Data Breach Costs Financial Services Firms $6m*, Fintech Magazine, October 2023

Key takeaways

DIGITAL LENDING OPPORTUNITIES ABOUND

The opportunities for digital lending have become too big to ignore. The regulatory environment remains a long-term positive for lenders with the required competencies.

A HOLISTIC STRATEGY IS CRITICAL

Lenders have to craft a digital strategy leveraging the strengths in their lending process, technologies and product offerings in order to deliver an attractive return on investments.

OPEN APIs OFFER COMPETITIVE EDGE

The use of open APIs will only grow in the region, with a proliferation of use cases. Early adopters with robust, scalable systems in place are best positioned to compete.

BALANCE-SHEET MANAGEMENT POTENTIAL

Cost savings and enhanced client interface are low-hanging fruits that digital lenders have to capture. But ultimately, strategic monetization of technology in balance-sheet management will be the differentiating factor.

CHOOSING THE RIGHT TECHNOLOGY PARTNER

Not all technology service providers are alike. In addition to technological expertise, digital banks should look for partners who understand their business models and unique operational challenges.

About Brankas

Founded in 2016, Brankas bridges the access to modern financial services for all consumers and businesses around the world. We work with numerous banks and financial institutions to improve accessibility for the market, allowing technology companies to build better financial experiences in their own products.

With Brankas APIs, you can trim down your loan application process from 7 days to 10 minutes.

What's more:

Remove the need for manual KYC data collection and processing. You can speed up the onboarding process by using your users' existing KYC data from banks and other platforms.

Boost conversions and repayment with data segmentation. By enabling quicker access to reliable data, you can segment customers, personalize their experience, and provide a better experience to your end-users.

Verify credit history and personal identification within minutes. View expenses, paycheck, bonus, and other financial data to verify your users' credit history faster.

Disburse loan proceeds to your borrowers with minimal hassle. Focus on providing a better end-to-end experience for your customers; automatically disburse loan proceeds as soon as the loan is approved.

Provide personalized financial tips, insights, and recommendations. Help your users make better financial decisions using bank and alternative financial data, taking the in-app wealth and personal finance experience to a whole new level.