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Digital disruption reshapes financial inclusion

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Key takeaways

- By lowering costs and generating new business opportunities, digital innovations are helping make financial services more accessible to the underserved population.
- Digital connectivity helps nontraditional financial services gain traction in emerging markets (EM).
- In developed markets (DM), banks and financial technology companies extend services to the unbanked and underbanked populations in varied ways.
- Small business lending, once considered one of banking's more challenging business lines, is seeing increased competition from digital disruptors.

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Introduction

Financial inclusion refers to provision and accessibility of a broad range of affordable, quality financial services, enabling businesses and individuals to participate in the economy. About a quarter of the world's adults don't have financial accounts, which largely excludes them from such services. Bringing them into the formal financial system has important investment implications. Access to financial services promotes economic growth by allowing individuals to save and invest, supporting entrepreneurship and business growth, and helping to reduce economic inequality. Along the way, it also opens the door for new business and investment opportunities.[1,2]

The rise of low-cost, innovative digital financial products and solutions has been a key enabler of financial inclusion over the last decade or so. We expect the digital transformation of financial services to continue to spawn innovative products serving a broad base of customers, including previously underserved communities; and that could bring diverse long-term investment opportunities.

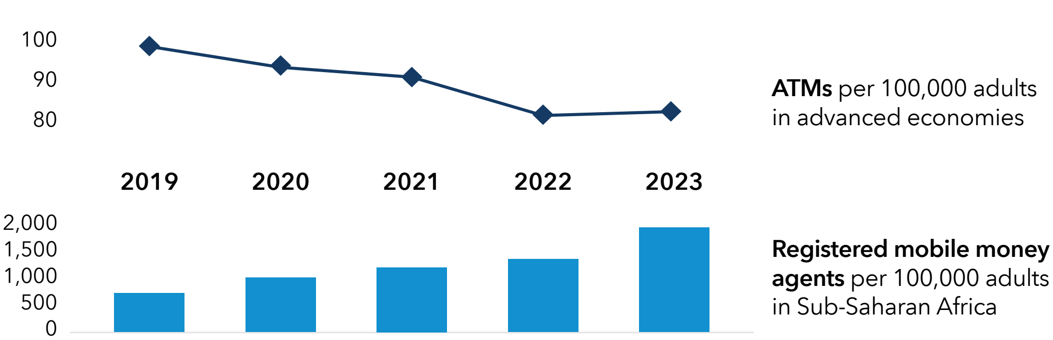
Most of the world's unbanked population, or the population without financial accounts, is in developing economies. Financial accounts can be those at a bank or another financial institution, or mobile money accounts, per the World Bank. In recent years, increasing digital connectivity has been a key driver behind financial inclusion. The rise of nontraditional finance, such as mobile money,[3] has greatly improved the ease and efficiency of accessing financial services, especially in areas where traditional banking infrastructure is limited. Many developing countries have made strong progress in financial inclusion as a result, where the share of people aged 15 and older with a financial account rose to 71% in 2021, from 42% a decade earlier.

Financial inclusion is not just an issue in emerging markets. About 4% of adults in high-income countries do not have financial accounts, but the diminishing presence of physical bank branches and automated teller machines (ATMs) endangers access to financial services, especially in rural and low-income communities where digital connectivity and digital literacy may lag. Some solutions are emerging. Digital financial products aiming to replace high-cost alternative financial products, such as payday loans, are gaining traction; some banks see the business potential and are opening new branches tailored to the needs of low-income communities.

Difficulty in accessing financial services extends from individuals to small businesses in both developing and developed countries. In developing countries overall, about 43% of formal small and medium-sized enterprises (SMEs) are estimated to have a combined unmet financing need of nearly US$4.1 trillion, according to the International Finance Corporation (IFC).[4] Digital innovations are again at the forefront of efforts to tap this underserved market. A broad range of technologies — from automating customer onboarding to mobile-enabled services — has emerged to help mitigate the higher risks and higher costs often associated with serving small businesses.

For long-term investors, these structural changes will present both opportunities and risks as innovations disrupt the financial services sector. Here, we highlight key trends and some of the compelling investment opportunities they are creating.

From cash to clicks: ATM numbers stagnate as mobile money takes off



Source: International Monetary Fund Financial Access Survey, as of December 2024. Notes: Country composition of "advanced economies" and "Sub-Saharan Africa" groups can be found on IMF webpage. For each metric, the numbers represent simple averages of each country's data in the specified group for the five years, where data are available. Mobile money agent refers to a person or business contracted to process transactions for users on mobile money networks.

See page 7 for footnotes.

Digital connectivity helps nontraditional financial services gain traction in EM

In Brazil, digital financial services are the focus of competition between incumbent banks and financial technology (fintech) firms. Brazil is Latin America's top fintech hub, partly because the government has encouraged greater competition in the financial services sector to improve access and affordability. As a result, the share of adults with accounts in Brazil rose to 84% in 2021 — above the global average — from 56% a decade earlier.

Brazil-based digital bank Nubank was founded in 2013 and started offering zero-fee, low-limit credit cards to attract clients often overlooked by banks. By the end of 2024, Nubank had attracted a total of over 110 million customers in the three countries in which it operates: Brazil, Colombia and Mexico. In Brazil, it has become the third-largest financial institution by number of customers, which includes nearly 60% of the Brazilian adult population.

One factor behind Nubank's success is its focus on fixing pain points for customers. "Nubank's focus on customer service seems to have helped win it a loyal client base in Brazil," said Ana Reynal, an equity investment analyst at Capital Group. "The bank has managed to hold on to customer deposits even though it's no longer offering interest rates that are substantially higher than other banks do."

Brazil's rapid progress on financial inclusion contrasts with the pace of change in Latin America's next largest economy, Mexico. (See next page.)

Sub-Saharan Africa is another example of digital connectivity's importance in driving financial inclusion, largely in the form of mobile money. As of 2021, about a third of adults in this region, excluding high-income countries, owned mobile money accounts, up from 12% in 2014. Telecommunications companies have led the charge, partly motivated by the high growth in the mobile money business. Today, the entry of non-telecommunications fintech companies has increased competition in the mobile money market in the region, with a focus on lower fees.

Mobile money relies on a network of local agents who facilitate transactions for users, such as loading cash into and taking it out of their mobile money accounts. This low-cost and effective model of providing financial services to underserved communities is also employed by some banks, including India's Axis Bank. It has a large network of over 64,000 nonbank retail agents — locals that provide basic banking services — as part of its strategy to build a low-cost distribution model with digital at the core.[5]

Rise of Nubank, in numbers

	Nubank	Traditional banks
Customer acquisition cost	US$7	Typically spend up to **5 times more**
Cost to serve	<US$1	Typically spend **85% more**
Cost-to-income ratio	36%	Typically have a ratio of **between 50% and 70%**

Sources: Nubank, Kearney, as of March 2025.

Note: Cost estimates are from Kearney (April 2024). Nubank's cost to serve data is sourced from fourth quarter and full year 2024 financial results (Nu Holdings Ltd. Reports Fourth Quarter and Full Year 2024 Financial Results). Cost to serve refers to monthly average cost to serve per active customer. For illustrative purposes only.

See page 7 for footnotes.

Seeing green shoots for financial inclusion in Mexico

Mexico's relatively slow progress in financial inclusion has been a bottleneck for growth and poverty reduction.[6] While there have been signs of improving access to financial services, as companies expand digital solutions to reduce costs and reach underserved populations, structural challenges still present obstacles.

For example, Mexico has a relatively large informal sector made up of mostly small businesses that are not taxed or regulated. These firms have limited access to finance as they are not officially registered and have little incentive join the formal sector, which bears greater regulatory and tax burdens. As a result, informal sector workers – some 55% of Mexico's workforce – typically get paid in cash, do not pay income taxes and may not have the documentation necessary to open bank accounts.[7] And there is the long shadow of the 1994 Mexican peso crisis. It spelled financial ruin for many individuals and businesses and sowed the seeds of distrust in the banking system. In addition, some regions lack reliable power and internet connections, hindering the expansion of internet and mobile banking services.

As of 2022, only 49% of Mexicans over the age of 15 had a financial account, versus the Latin America average of 73% (as of 2021). The top three reasons cited for not having a financial account in Mexico were the high cost of financial services, insufficient funds and a lack of trust in financial institutions.

Recognizing the untapped business potential from underserved individuals and businesses, both fintech companies and incumbent banks have started offering lower cost digital products to win over customers. While still in early days, there are signs of progress. Between 2017 and 2022, the share of adult population using a mobile phone or internet to check account balance had more than tripled to 25%.

Driving adoption of other financial products, such as credit, remains a challenge in Mexico. For example, consumers are still lukewarm on credit cards. The share of adults who own credit cards in Mexico has stagnated around 11% over the past few years, which is lower than in the early 2010s.

"Financial inclusion is far weaker in Mexico than in Brazil. The share of population with access to formal savings products is about half of that in Brazil, and the share of credit card owners is less than one-third of that in Brazil," said Jeff Garcia, an equity investment analyst at Capital Group. "That, combined with the fact that most legacy banks lag in digital capabilities, helps make Mexico an attractive place for providers of digital financial services."

Relatively limited financial inclusion in Mexico makes it a potentially attractive marketplace for digital financial service providers

Share of population of age 15 and older, 2021/2022

	Mexico	Brazil	Latin America & Caribbean	Upper middle income (global)	World
Account	49%	84%	73%	84%	76%
Owns a credit card	11%	40%	28%	33%	24%
Mobile/internet banking	25%	51%	38%	57%	41%
Mobile money account	18%	27%	23%	10%	10%

Source: World Bank Findex database. Note: Mexico data is as of 2022, and the rest of data is as of 2021. Latin America & Caribbean refers to Latin America and Caribbean excluding high-income countries. Each number represents the share of population over the age of 15. Upper middle income countries refer to the countries globally classified by the World Bank as such. The list can be found on the World Bank's website. Account refers to an account at a bank or another type of financial institution or a mobile money account. Mobile money account is defined as using a mobile money service in the past year. Both are defined by the World Bank.

See page 7 for footnotes.

In DM, banks and fintech companies extend services to the unbanked and underbanked populations in varied ways

> **“Some of these digital wallet products charge zero fees, which is a feature that legacy financial service providers have not yet been able to duplicate.”**

– **James Bray**
Equity Investment Analyst

Access to financial services is still a struggle for millions of people in developed countries. Banks have been closing branches and moving more services online, which presents challenges particularly in low-income communities and rural areas where digital connectivity and digital literacy may lag. Mobile banking has become the most prevalent method of bank access in the U.S., but its popularity varies by income, age, education and proximity to metropolitan areas. Households with lower income, lower education, and living outside metropolitan areas tend to use mobile banking less, a recent survey from the U.S. Federal Deposit Insurance Corporation shows.[8]

The lack of access to standard banking services has driven many unbanked and underbanked individuals to use expensive informal financial products, such as payday loans (high-interest loans borrowed against the next paycheck) and check cashing (having checks cashed for a fee). In the U.S. alone, about 12 million people use payday loans a year.

Some innovative digital financial products have emerged to meet the needs of unbanked and underbanked individuals. Earned wage access is one example. First launched in the early 2010s, earned-wage-access products allow individuals to access their earned wages before payday and have become popular particularly among lower-income employees.[9,10]

“Digital wallets with earned wage access help reduce the need for payday loans, which often charge interests and fees equivalent to an annual percentage rate of 400 to 600%,” said James Bray, an equity investment analyst at Capital Group. “Some of these digital wallet products charge zero fees, which is a feature that legacy financial service providers have not yet been able to duplicate.”

The reach of such innovative digital financial products partially hinges on internet access. High-income countries overall have relatively high broadband and mobile internet coverage – some 80% of the population in high-income countries were using mobile internet as of the end of 2023 – but access can be uneven across different income levels.[11]

For low-income and rural areas where digital connectivity may be lacking, physical bank branches are still key for access to standard financial services. Banks across developed countries have been closing branches for decades, but in recent years some banks have bucked the trend by opening new branches, including in low-income and rural areas. The two largest U.S. banks, JPMorgan Chase and Bank of America, both have made ambitious plans to expand their presence, including in underserved communities. Banks have cited increasing demand for in-person consultation for complex financial needs, typically from wealthier clients, as one of the reasons to open new branches. But they also recognize the potential to attract deposits[12] and acquire small business clients, even in lower-income communities.[13]

Revival of the brick-and-mortar bank?

U.S. banks race to open new branches

Bank	Expansion plan
JPMorgan Chase	• 500+ branches by 2027 (having already added 650+ in the previous five years), including around 100 in low-income areas • Entering several new markets – including low-to-moderate income and rural communities with little access to traditional banking services
Bank of America	• Open more than 165 branches by the end of 2026 • 30% of the bank’s branches are in low- and moderate-income communities
PNC Financial Services	• Open more than 200 new branches in 12 U.S. cities over the next five years • Renovate 1,400 existing branches

Sources: JPMorgan Chase, Bank of America, PNC.

See page 7 for footnotes.

Small business lending, once considered one of banking's more challenging business lines, is seeing increased competition from digital disruptors.

Globally, SMEs represent more than nine out of 10 businesses, account for more than 50 percent of employment, and represent on average 60 to 70% of the gross domestic product (GDP) of most countries.[14] And yet, finding suitable funding has proven a pervasive problem among SMEs. The rapid development of digital financial services has the potential to help solve the SME funding challenge and is helping turn SME banking into a more competitive space.

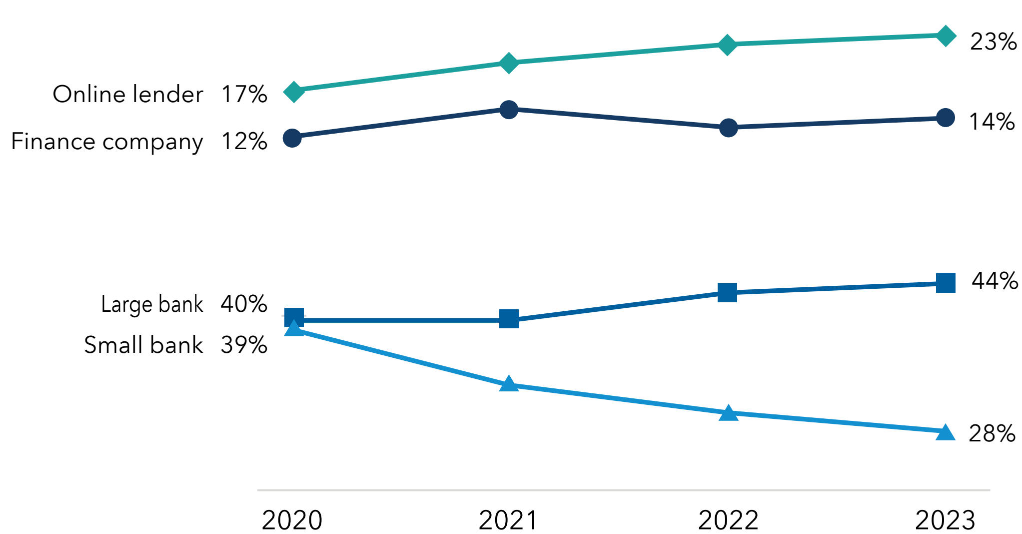
Higher cost and higher risks have been the main reasons behind banks' hesitance to serve SMEs. The cost to acquire and serve SMEs is high relative to the revenue potential, and the lack of financial and credit data makes it difficult to assess the creditworthiness of small companies. Digital products and solutions have started to emerge to tackle these issues. For example, a range of technologies – from automating customer onboarding to mobile-enabled services – can help lower the costs of serving SMEs. The digitization in the banking ecosystem, including the potential for increasing sharing of financial data across the system, can help banks make better and more automated underwriting decisions.

The market for SME-focused digital financial solutions has attracted big tech companies and fintech firms alike, including e-commerce platforms Shopify and MercadoLibre. In the U.S., a growing share of small businesses have applied for financing with online lenders since 2020, seeking quick decisions on funding and improved chances of getting funded.[15] In contrast, small banks appear to have lost some ground. These banks traditionally attract small businesses with local presence and personalized services but lag larger banks and online lenders in digital tools and the services that many SMEs demand.[16]

Over the last 12 to 18 months, an increasing number of banks globally have launched SME portals that consolidate a range of services as one-stop shops. Examples include India's Kotak Mahindra Bank and HDFC Bank. The banks often use merchant services, such as payment processing and collection, to acquire new SME clients. Over time, they tend to offer more services, such as credit, supply chain financing and advice services to meet needs of growing small business. Some banks' SME service portals even include website development and digital marketing tools. The breadth of services offered is what banks can often use to their advantage compared to fintech apps.

Among U.S. small businesses, nonbank lenders have become increasingly popular

Share of small business credit applicants



Source: "2024 Report on Employer Firms: Findings from the 2023 Small Business Credit Survey." Federal Reserve Banks. Notes: The chart shows the share of credit applicants among the survey respondents that had applied for loan, line of credit and cash advance at various types of lenders in the 12 months prior to the given year's Small Business Credit Survey. Large banks are defined as those with at least $10 billion in total assets; small banks are those with less than $10 billion in total assets. Finance companies are nonbanks that provide loans, leases and other financial services. Examples include mortgage companies, equipment dealers, insurance companies, and auto finance companies. Online lenders are nonbanks that operate online.

See page 7 for footnotes.

Final thoughts

The world has made strides in financial inclusion, particularly in emerging markets, thanks to the proliferation of innovative digital financial products and solutions. Case in point: Neobanks, or digital-only banks, have been around for just a decade or so, but some of them have won significant market shares and forced incumbent banks to catch up on digital capabilities.

Financial accounts and basic transactions are just the first steps on the financial inclusion journey. We see opportunities ahead for financial services providers – traditional and nontraditional – to explore how to provide innovative solutions to encourage usage of other financial products, such as credit, insurance and investment.

As digital financial services expand, new challenges, such as higher risks of money laundering, cybersecurity and customer protection, emerge. Regulatory clarity is also needed on some products that are in regulatory gray areas. In addition, access to credit in countries that lack proper guardrails could lead to potential risks to financial stability.

Overall, we believe that the digital transformation of financial services that started over a decade ago has made a business case for serving the unbanked individuals and small businesses. It has laid the groundwork for compelling long-term investment opportunities, as traditional financial service providers and fintech firms compete to attract and retain customers with lower-cost, innovative digital financial products and solutions.

Footnotes

[1]Sahay, Ratna, Martin Čihák, Papa N'Diaye, et al. "Financial Inclusion: Can It Meet Multiple Macroeconomic Goals?" International Monetary Fund, September 2015.

[2]"Financial Inclusion." World Bank. January 27, 2025.

[3]Mobile money is a digital medium of exchange and store of value using mobile money accounts, facilitated by a network of mobile money agents. Mobile money agent refers to a person or business contracted to process transactions for users on mobile money networks. The most important of these are cash in and cash out (i.e., loading value into the mobile money system, and then converting it back out again). Traditional financial services include deposits and loans, debit and credit cards, and insurance. Nontraditional financial services include mobile and internet banking, and mobile money. (IMF, 2024 FAS highlights)

[4]IFC. "Banking on SMEs: Driving Growth, Creating Jobs Global SME Finance Facility Progress Report." International Finance Corporation, World Bank Group. September 2022.

[5]"Axis Bank Document Classification | Confidential Bharat Banking Building at Scale, Profitably OM." 2023.

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[7]Perez, Michael, "Mexico Seeks to Reduce Consumers' Longstanding Reliance on Cash." Southwest Economy, First Quarter, 2020. Federal Reserve Bank of Dallas.

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[12]Reosti, John. "Some Banks Will Go to Any Lengths for Deposits, Even Opening Branches." American Banker. January 25, 2023.

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[14]World Bank. "Fintech and SME Finance: Expanding Responsible Access." 2022.

[15]"2024 Report on Employer Firms: Findings from the 2023 Small Business Credit Survey." 2024. Small Business Credit Survey. Federal Reserve Banks.

[16]"Community Banks Appeal to Small Businesses, But….". PYMNTS.com. November 26, 2024.

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