International Journal of Current Science Research and Review
ISSN: 2581-8341
Volume 05 Issue 07 July 2022
DOI: 10.47191/ijcsrr/V5-i7-33, Impact Factor: 5.995
IJCSRR @ 2022
www.ijcsrr.org

Optimizing Digital Transformation Initiative to Serve Next Billion Users

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ABSTRACT: Microfinance as one of the working capital providers for millions of micro to ultra-micro business owner is now facing the challenged of digital disruption. Microfinance such as cooperatives, BMT (Islamic cooperative Baitul Maal wa Tamwil), CU, Rural bank, Ventures is no longer compete to each other as Fintech is starting to enter the ecosystem. The existence of microfinance remains valid as institutions offer requirement that easily can be fulfilled by the segment such as non-collateral and easy access to payment but, fintech with the aggressive expansion and strategy for growth would find them as non-threatening value proposition. Hence microfinance need to aware of the level of threat and be prepared. Nonetheless, digital transformation in the institution could be one of the options to stay competitive.

In order to optimize the digital transformation of microfinance, this study is prepared to validate the area of digitalization and its relation to answer the need of the customers and stay relevance to the underserved market.

KEYWORDS: Digitalization, Digital transformation, Microfinance, Underserved segment.

I. SITUATION

During pandemic, many institutions took decision to re-thinking their strategy in order to survive the business, some other used the moment to fasten their current on-going strategic agenda including digital transformation. The idea of digital transformation brings value and benefit to the institution such as cost-cutting, innovative leadership, new culture. It basically opens many opportunities. Microfinance is unique institution because of the segment that they serve, the question remains, why microfinance need to go through digital transformation and not digitalization?

Digital transformation is beyond changing the manual process into digital process. As institution, the changes include the culture, the vision and mission shift and include acquiring new capabilities within the institution. Most of this would result many outcome including resistance within the organization, therefore, the long and careful assessment needed to be conducted to support the decision maker to make well-informed decision making. Meanwhile, digitalization can be implemented for microfinance through automation, integration to opensource, credit scoring model etc. In summary, digitalization would only be affecting the business process and not the whole institution. In Indonesia, the business process and the adoption of technology of microfinance can be considered as very low. Most of the institution still using manual process using paperbased forms, conventional analysis. Hence, the business process could take more than 1 week to disburse loan with small ticket size.

As for market size, there are about 64 million business owner categorized as micro enterprises which is about 23% of the population. There is no research explaining how much of micro enterprises today has received services by microfinance. BRI as largest state-owned-enterprise bank that serve rural and micro enterprises claimed in the report that it serves about 13 million customers. And many of the customer also have active loan to microfinance. This means, the potential to reach and serve micro-enterprises is big.

Further exploration about the relation of digital transformation and the market segment will be described in the next section.

II. COMPLICATION

For financial institution especially microfinance, one of the constraints to implement digital transformation is the hypothesis of the underserved segment that is not ready with digital world itself. There are many other reasons such as the limited infrastructure and also the low penetration in digital device ownership that could withdraw the customer to apply for loan.

Microfinance that undergoes the digital transformation strategy which maintained million customers in rural area have to be careful with the decision as it would affecting the business at larger scale. This research is heavily focus on case study to one of microfinance in Indonesia in its digital transformation journey. One of the main questions asked is whether or not the digital transformation would be the right move if the customer base dominated by non-smartphone users, if so, what would be the approach to serve the customers.

Based on BPS latest survey, the digital penetration in Indonesia can be seen in the table below:

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Table 1. Digital Penetration in Indonesia

Indicator	**Male**	**Female**
Use computer	14.67 %	13,62 %
Own cellular phone	68,12 %	57,51 %
Access to internet in the last 3 months	56,65 %	50,78 %

Source: BPS Report 2021

Table 1 showed the ownership of smartphone in 2021 has reached up to 68,12%. Author assumed the increase was due to the pandemic. Data above can not be used by microfinance because of its limited information on the detail of demographic. Microfinance serves the underserved that mostly located in rural or peri urban area. This type of segment has more complex situation and therefore, microfinance need to conduct its own research to understand if its customer has high rate in term of smartphone ownership. Author is adopting the term of Next billion users from google because it representing the same characteristic in term of new adopter of technology (or potential adopter). They face challenge to operate technology devices for various reason. One of them is because they are underserved, limited financial capacity, disability and other reason [5].

Beside the customer smartphone ownership rate, microfinance institution also needs to consider the digital literacy level of its customer. Digital transformation with low adoption from the customers will only mean the strategy is failing and not bringing any value to customers.

However, latest research by AFTECH showed that number of micro-enterprises served by fintech is the highest among 4 categories (43%). It is also showed the high interest from fintech to leverage their operation to rural area (75% mentioned their plan to reach rural area where about 69% mentioned the have served the rural area). It means, as new entrance, fintech should not be underestimated by microfinance because of their readiness with technology provide them opportunity to reach the market without having an office in the rural area [2]

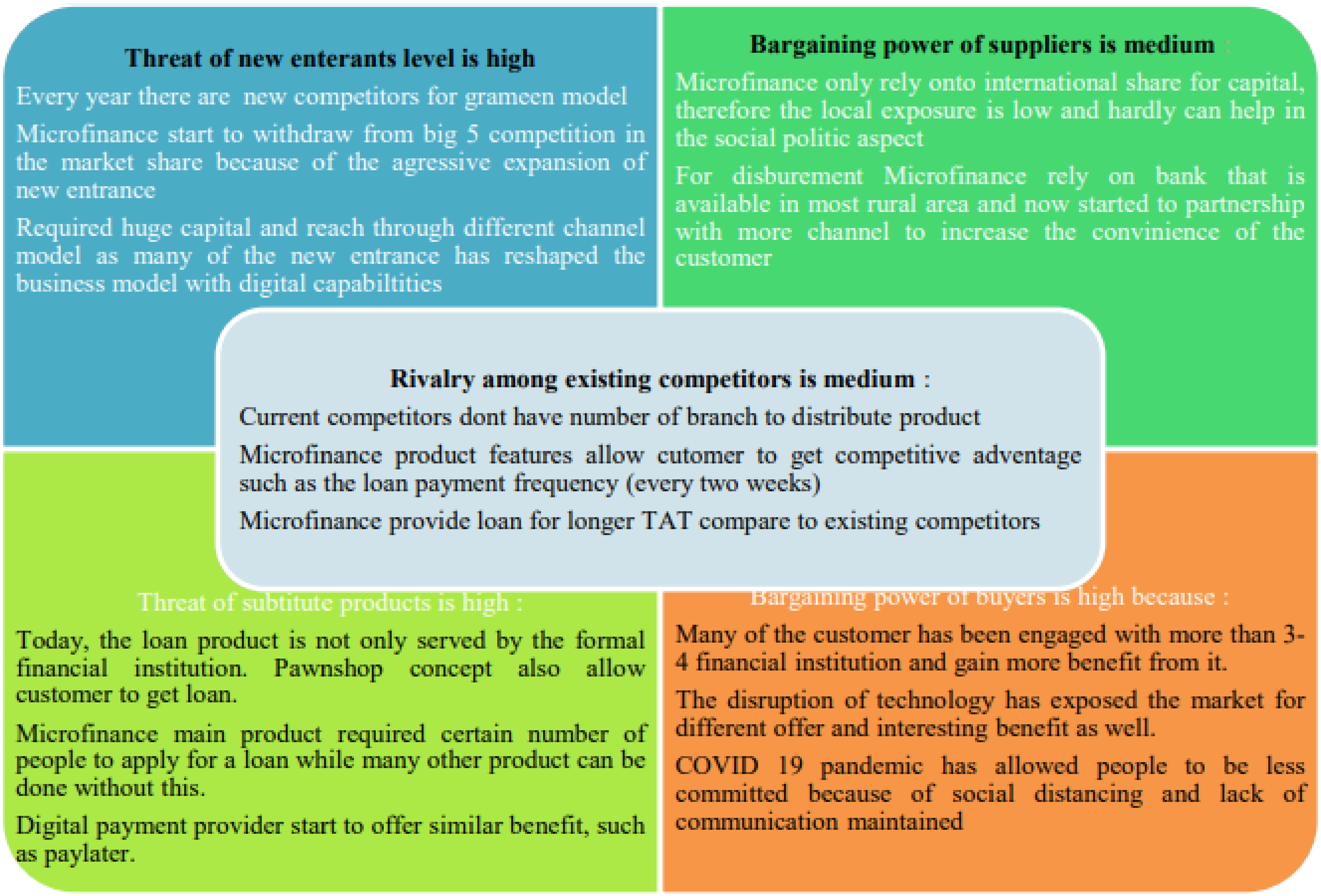

Figure 1. Porter's Five Forces Framework (**Source:** Strategic Management, Frank T.)

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Therefore, in the competition landscape, microfinance not only need to be aware of the new entrance but also consider to acquired technology in the business process. The two elements of this has created a dilemmatic problem to a microfinance whether to go through digital transformation (with the fact and study releases that the market not yet ready) or let the financial technology company expanding their reach and grab the market share that the microfinance is currently maintained.

Based on Kenichi Omhae, there are 3 elements to consider in deciding the business strategy. Company, Customer and Competition (Ohmae, 1991) [7]. In this study, author will heavily focus on the customers. The approach to understand the customer is essential because their level would determine how the microfinance can approach the digital transformation that is inevitable.

Customer is one of very critical stakeholders for a company. Therefore, it is mandatory to study customer in order to satisfied their need. Freeman (2016) categorize customer as the most important stakeholders. Kotler and Keller (2016) further distinguish its role in a company's development.

In general, the market of microfinance such as low-income household would suffer more than the other level business owner because of pandemic. Microfinance who serves the NBU from low-income household need to be cautious on the capabilities of their customer to avoid loss and over-indebtedness. The customer characteristic and experience below are based on the research conducted with interview to over 780 respondent with respondent criteria.

Sampling design: 780 respondents from 24 districts across Java Island. All the 24 districts have same characteristic which is satellite city and/ or district with enough representation of peri urban area.

A. Customer Characteristic

In general, microfinance targeted customer that runs business with level from micro to ultra-micro. An ultramicro business is usually categorized as underserved and un-bankable. Usually, the amount of capital needed to runt the business is less than 10 million rupiah. While the micro segment is segment where business owner that runs business in much larger scale and some probably have access to bank.

With the generic definition above, the research is meant to further analysis the behaviour, need, pain points/ boundaries and concern with the approach of human centric design.

Customer Characteristic-1 Need and Behaviour: Aiming to get higher ticket size and most likely got rejected by formal institution due to incomplete requirement fulfilment. Lending to formal institution seems the last option. Would rather to reach to relatives or friends but once they get loan, they tend to be loyal customer. As the segment with highest level of financial literacy, this persona would be more careful in making decision. They need transparency for consideration and comparison.

Customer Characteristic-2 Boundaries and Concern: Concern to become in blacklist in credit scoring. Once it got rejected, customer tends to leave (no further try). This is because the customers tend to look for the alternative financing with minimum awareness whether the financing comes from legal or not legal institutions. The customer can be easily received offer for taking loan and easily convinced especially if people they know taking at the same place. Experience in taking loan from banking but rarely pass the requirement criteria. The customers are constraint by the requirement of banking such as hard collateral. The ultra-micro segments are rarely able to provide such requirements.

B. Customer experience

Customer experience – in relation to financial products: The participant express the need of financial product such as higher chance for approval: with 10 days process some time customer still got rejected. Simple requirement: with no-collateral requirement, Microfinance has alternative checklist of customer to fulfil. Institution credibility (secure and well-informed): many illegal financial institutions take advantage of customers uninformed decision. Lower interest rate.

Customer experience – in capabilities to adopt technology: There are 3 type of capabilities identified which are those who does not have smartphone nor exposed to smartphone. Those who has access to smartphone (owned or have family member owns smarphone) that has basic level of understanding on how to use smartphone. And the last one is the higher in the hierarchy who actually able to operate several applications in the smartphone such as whatsapp and facebook.

C. Customer Persona

Customer Persona – starterpreneur: Is the type of customer that prefer to take loan once in a year.Received information regarding lending from friends and relatives. Interested to non-bank institution for lending (cooperative and leasing). Exposed more to online lending compare 2 other segments. Usually have 2 active loans. Prioritize payment based on the amount of payment they can afford

In term of demography, this persona is early in their business, age group between 20 to 39 years old, low to middle income level, mostly business related to food and beverages. Low financial literacy, average digital literacy but higher education.

This type of customer also has needs in relation to lending such as fast process lending, payment flexibility though pick up, between weekly and monthly payment and shorter tenure.

They have fear and boundaries such as do not have access to capital, failed to run the business as starter, do not have asset for collateral, often rejected by bank due to inexperience in running business, low margin, does not accept too many documentation requirement for loan application, do not have financial report of their own business.

Customer Persona – conventional entrepreneur: This type of customer have behaviour in lending Prefer to take loan once in 1 or 2 years. Received information regarding lending from relatives. Prefer to take loans from family member or friends and non-bank institution. Second segment that expressed the experience apply to online lending. Usually have > 2 active loans. Prioritize payment based on the over due and the Bank Institution (brand).

The profile of this type of customer would be Running business in more than 2 years. Age group of 25 -39 years old. Low to middle income level. Almost equal segregation in gender. Located in semi urban. And the business usually in the area of F&B, production, home industry, trading in general and services. They have financial and digital literacy in average level, and education almost similar to starter-preneur.

Their need and wants related to lending would be not complicated process and requirement. Payment flexibility through agent and picked up. Variety on payment term (daily, weekly, monthly with 1 year tenure. Start to be aware on the price (interest rate/ installment amount) and document proper financial report to their business.

Meanwhile their fear and boundaries coming from these factors. Activity required technology based (taking KTP picture etc). Approached by online lending. They afraid fail of running business. And the challenge they face is related to business is the only source income, low to medium margin, lower access to information in business.

Customer Persona – modern experience entrepreneur: this type of customer prefer to take loan once in 1 year or above. Have good knowledge in term of loan type (working capital, investment loan). Received information regarding lending from relatives, business partner, marketing from Financial Institution. Interested more to SOE banks or Private banks due to higher ticket size. The least segment ever proposed to digital lending compare 2 other segments. Usually have >2 active loans. They also prioritize payment based on the over due of the Bank Institution (brand) and asset as collateral.

The profile of the customer would be Running business more than 3 years with age group dominated by 35 - 49 years old. They are middle to high income level. Majority in term of gender, 3% men higher than women. Major location in peri urban to urban area. Business run in retails/ seller type of business. They have already have proper financial report and variety of source of income. They have higher levelof financial literacy as well as digital. In term of education, they tend to have higher education compare to the 2 previous type of customer.

Based on this persona, microfinance institution should be able to determine the digitalization and transformation they wish to aim. The above persona has explained the level of literacy level, behavious, need and fear.

III. SOLUTION

As for solution, the best approach to the given customer profile is to combine tech and touch or in other term phygital journey. The phygital journey is not the same to omni-channel. The omni-channel is heavily focus on providing many different channels to purchase, the phygital or tech-touch approach means that the customer experiencing the process in combination of partly technology and partly conventional process due to the limitation of the customer. This term is decided to be used by Microfinance to give the actual process through non-full-digital journey to reduce. As stated in the core competence, Microfinance ability to serve the underserved is categorized as sustained core competence. It implies, full-digital process would be a disadvantage for Microfinance in scaling up and maintain its existing market portfolio now. However, this can be evaluated overtime as microfinance grow together with the customer.

The Phygital approach is basically to combine the tech and touch in the process of microfinance in accordance to the limitation and challenge faced by its customers. It is also embracing its core competence to reach the most remote area. In other words, the suggestion to change or move to different segment is currently not pursued. It totally makes sense knowing that the majority of

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microfinance portfolio lies to the customer with persona of conventional entrepreneur. The phygital journey can be visualized as follow:

1. Journey of customer acquisition
   The approach in order to increase the number of leads currently from 3 different channels. Canvassing is the conventional way reaching to business owner, sales team provide brochure and information to the potential customers. Meanwhile the facebook ads campaign is purchasing the facebook ads within certain period and certain location. The CEP customer platform is basically expecting the existing and new customers access the CEP app through google play store and reach microfinance through it
2. Journey of loan application
   The leads generation will be integrated to different platform that is being used by the employee. Such as the loan origination system. However, to ensure microfinance comply with the government regulation, the loan application process still required the manual/ wet signature of the customer. Therefore, the phygital process started from this stage because there is a combination approach between the digital and conventional model
3. Journey of loan disbursement
   In today process, the disbursement happened through bank transfer or cheque or handing cash directly to customer at office (for group lending). The senior management is considering to change the approach to digital. But given the profile of the customer who are very low penetration in bank account and e-wallet, the technology can be a constraint for the customer.
4. Journey of collection
   Today, the payment/ collection can be done through agent (mini market), pick -up by officer, or via transfer. However, there are other opportunity to be explore and test as today there are type of services provided by the payment gateway. Microfinance need to determine the correct flow before deciding the best solution to this process.

In general, the phygital journey should be able answer the constraint that has happened to the customer it served. Yet as mentioned, technology could be a burden as well. Below are some constraint and solution to consider because of the technology gap based on the research done by the institution:

a. Limitation in infrastructure: The digital capabilities need to be able tackle this challenge whereby technology might fail due to low internet connection. The solution to this is by enabling the offline mode for the customer app.
b. Low smartphone penetration in some areas. Based on the research, although the smartphone user penetration significantly increased but it still not covering the whole customer base: Microfinance need to provide the assisted onboarding process and equipped the staff to have similar app to support the customers so both smartphone and non-smartphone users would be able to receive the same experience.
c. Afraid of giving the Identity Card/ personal information due to bad reputation given by "pinjol (illegal digital lending)". Microfinance need to gain trust by the customer despite of the fact that the customer has been with Microfinance for a quite long time. On the technology side.

The research also un-lock the insight on the high penetration in the Whatsapp usage among customers. Microfinance can leverage Whatsapp services to communicate and assist the customers. There is also tendency of customers to change their phone numbers quite frequent. But author assume once a customer set phone number for Whatsapp the possibility to reach the customer via Whatsapp number is higher rather than direct contact through phone call or SMS.

IV. CONCLUSION

One of the pain points of underserve segment is their inability to provide collateral which mostly required by banking sector for taking loan. Secondly is the reach of physical branch in many rural area enabled the underserved segment to get access to microfinance product and services faster. With the digital transformation, the physical office is still needed as we found many of the customers still need assistance on the digital journey. In the competition to fintech who provide online lending, the branchless approach creates a discomfort and insecurity for customers.

Beside discovering the internal value proposition, this project also evaluates the market competition today to see the value proposition offered by the competitors and how microfinance placed in the competition today. Among the many entities serving the underserved customers, it is identified several players that is considered as direct competitors. All of them has the same customer characteristic served, the type of product being offered and lastly the operational area covered and the entity they are holding. However, in the competition, it is important for microfinance to aware of value proposition they offer.

It is important to clarify who are the targeted customer of the digital transformation as it is going to affect the product offered. The finding has divided typical Microfinance customer into 3 different personas the starterpreneur, the conventional entrepreneur and the modern entrepreneur. It is suggested that the development and initiative created considering each of the persona's as targeted market to optimize the digital transformation value and minimize the risk of high drop off in customer acquisition and retention. Technology was supposed to eliminate the pain points of customers and increase the satisfaction from customer. With the 3 personas, Microfinance need translate the assisted journey as the optimum balance of technology intervention and physical approach to the customer to ensure customer get full-rounded of support in services.

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Cite this Article: Novita Sari, Dr. Jacob Silas Mussry (2022). Optimizing Digital Transformation Initiative to Serve Next Billion Users. International Journal of Current Science Research and Review, 5(7), 2490-2495