MicroSave India Focus Note 4

Electronic Banking: The Next Revolution in Financial Access?

Graham A.N. Wright and Manoj K. Sharma

Background

E-banking has the potential to revolutionise access to financial services for the poor. There is growing consensus that e-banking offers a unique opportunity to address mainstream banks' two major barriers to serving the low-income market: the need for a branch infrastructure and managing high volumes of low value transactions. The potential of e-banking to significantly extend the reach of financial institutions into rural areas, without investing in "bricks and mortar" branches, is widely acknowledged.

In India, for example, both the Government and the regulator are quite concerned about the skewed outreach of the banking sector including the nationalised banks. Of the 428 million deposit accounts in the country, only 30% are in rural areas. With a rural population of 741.6 million, the rural penetration of banks is as low as 18%. Even when access to banking is available, the transaction costs of savings in formal institutions in India are as high as 10% for the rural poor.

However, for all the growing talk of a revolution in financial access for the poor through e-banking, there is limited evidence of it actually happening. Indeed markets across the globe (including India) are littered with examples of unsuccessful e-banking initiatives that failed to achieve their potential. Careful examination of the reasons for the failures almost invariably traces the cause to one or several of three key factors:

1. Inadequate customer value proposition for the end users; and/or
2. A poorly developed business case for the companies collaborating; and/or
3. A debilitating environment.

Successful implementation of an e-banking solution is not dependent on technology – which has been available for a long time now – but rather on understanding these three key factors.

Customer Value Proposition

As too many e-banking solutions providers have discovered, if there is no value proposition for the customer, the solution will become a problem! Cash is an extremely effective exchange mechanism that has been used for many years, is low cost and highly acceptable to the poor – replacing it is no easy matter. Furthermore, most e-banking solutions providers over-estimate the value poor people attach to their security and time[1].

Business Case

The development and costing/pricing of the business case is central to a successful e-banking solution. There are of course, individual and mutual business cases for the partners involved in a solution. The business case will revolve around the level of functionality that the institution wishes to develop. Developing an appropriate revenue strategy depends on the functionalities offered, the segments targeted and the anticipated volume of transactions. The dilemma here is that high volumes are required to leverage the potential of e-banking systems and to allow solutions providers to offer the services at prices acceptable to the market. And it takes time to achieve these volumes. Indeed, one of the major lessons from the South African experience has been that take-up of e-banking solutions by the poor has been slower than anticipated … patience and deep pockets are likely to be essential! In this context, it is important to control costs during the development phase to generate positive returns on investment – this once again dictates that solution providers identify key core functionalities and deliver on these first before expanding the range of options available to the customer.

For banks with existing infrastructure, migrating customers onto e-banking infrastructure can free up their existing physical infrastructure. In Kenya, *MicroSave*'s partner Equity Bank now serves a million customers and is implementing an aggressive campaign to move them onto its ATM, POS and m-banking infrastructure in order to empty its crowded banking halls … with a view to welcoming the next million customers in 2007. With the huge number of potential customers in India, achieving adequate scale should not be a challenge.

Multiple business partnerships are essential in building a multi-functional e-banking solution and in supporting the

[1] For more on the Customer Value Proposition see *MicroSave* Briefing Note 47 "Mobile Phone-Based E-Banking: The Customer Value Proposition"

distribution network. Each partner involved in the solution must benefit, whether through reducing costs, increasing efficiency, increasing turnover, or through direct income. Those involved in providing solutions should also be aware of the costs too – for example the cost of compliance with know your customer/anti-money-laundering (KYC/AML) legislation may be prohibitive. A particular risk for MFIs using group-based lending methods is, of course, that an m-banking solution will undermine the attendance of group meetings – clients will simply send their repayments to the MFI over the mobile from their businesses. M-banking solutions have huge potential to make individual lending programmes hugely more efficient for both MFIs and their clients but are the nemesis of groups.

Environment

The environment for electronic banking will be determined by the nature of the financial and retail market - for example existing e-banking infrastructure in terms of ATMs and POS devices already in place. In South Africa the widespread presence of these devices meant that there is demand for access to these service points and a hybrid card/mobile-based system is most likely to succeed. These factors will drive product features, accessibility and transaction volumes.

Another key environmental determinant is the financial literacy of the target market. The level of financial literacy influences communication of the product, the nature of the distribution channel and the nature of transactions made. Creative campaigns that combine key financial education and product marketing will be essential for e-banking for the poor to succeed. Nonetheless, it is important not to under-estimate the creativity and flexibility of the poor when it comes to using technology. In most of Africa and Asia, airtime has already become a surrogate currency with people sending the PIN code numbers of prepaid cards across to their relatives/friends or business associates. Indeed this system has already been formalised with value transmission services in some countries. In Kenya, Safaricom launched the *Sambaza* product that allows subscribers to send small amounts of airtime value across the network to others. Within a few weeks of its launch, many thousands of transactions were being made using this service.

However, the biggest challenge and in many cases, obstacle, to harnessing the full potential of e-banking to massively increase financial access is the regulatory and policy environment. This includes banking regulations and appropriate communications, security, and information policies. Across the globe, central banks and other regulatory authorities are struggling as they assess how to respond to the opportunities offered by e-banking, and particularly m-banking. Specifically, they typically remain concerned about agency arrangements, KYC/AML requirements and the creation of a parallel payments system.

A recent review by Bankable Frontier Associates for DFID noted "Most African providers of … m-banking services noted that the major barriers to their growth related to (i) uncertainties over customer adoption, which is common at an early phase of market development; and, in South Africa at least, (ii) specific regulatory issues such as remote customer due diligence requirements and access to the payments system."

Conclusion

India's 400 million un-banked represent a tremendous opportunities for financial institutions, and telecommunications companies interested in serving the bottom of the pyramid. Serving this market requires the management of high volumes of low value transactions – which is precisely what robust e-banking systems are designed to do. Indeed profitable e-banking systems are dependent on managing large volumes of transactions, since it is these transactions that drive the majority of their revenue. With the significant and growing penetration of mobile phones, linked to the potential the public call office system, and the low cost of mobile telephony in India, one can only hope that m-banking will be allowed to play a significant role in the push for financial inclusion.

With India's leadership in technology one can only wonder why countries like Brazil with its correspondent banking system, and the Philippines/South Africa with their m-banking solutions, are so far ahead. Policy makers in India are clearly committed to optimising financial inclusion whilst maintaining the integrity of the financial system, securing depositors' savings and suppressing money laundering – this is a balancing act that will continue to challenge regulators worldwide.

However, even with the most enabling of regulatory environments e-banking solution providers are only going to be successful in the short term if they concentrate on areas where cash is inconvenient and the e-banking solution can do things that cash cannot. To do this effectively, they need to spend more time on understanding the market and building the value proposition and business case … the technology is ready and available!