

# Including Africa – beyond microfinance

Mark Napier



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## Including Africa – beyond microfinance

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### Foreword

It is perhaps no surprise that financial inclusion in Africa presents itself as a challenge and an opportunity. The under-banked and underserved market is immense; the barriers to financial exclusion are material. The goal is to provide access to appropriate financial products and services to people who can use them.

Addressing financial exclusion requires much more than the scaling of microfinance. In Africa, there are large numbers of “near-poor” whose financial needs extend beyond money transfer and savings products.

New business models are emerging to address the barriers to inclusion. Achieving success in reaching the underserved with appropriate and affordable services includes focusing on banking individuals and lending to small and medium enterprises (SMEs) higher up the pyramid than traditional microfinance. Fostering investments in financial infrastructure may be as important as the capacity-building of MFIs or sector-focussed financial institutions.

Some of the successful initiatives and business models are the subject of this paper. It has been written for the CSFI by its first Development fellow, Mark Napier, the former CEO of FinMark Trust in South Africa. He is the author of a recent book on financial innovation in Africa, and many of the ideas in that book are reflected in this paper. Some of the issues raised in this report were covered in the series of ten round-table discussions (sponsored by Citi and DfID) that were an integral part of the fellowship programme and that focussed in particular on the problems of financial exclusion in Africa.

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## Summary

The microfinance community - already riven by a bitter argument between devotees of “pro-poor” microfinance and those who say microfinance needs to be run commercially - has been transfixed by the events in Andhra Pradesh where government and the microfinance industry are locked in a dangerous dispute over abusive lending practices. Serious though this is for the microfinance industry, the business of building inclusive financial systems requires us to look much more broadly than traditional microfinance. This paper considers the state of financial inclusion in Africa - the continent with by far the worst levels of financial access in the world. There, banks and mobile phone companies have been engaged in innovation that has already had an impact on vastly more people on that continent than traditional microfinance. The paper explores the circumstances that have given rise to this innovation, describes the form that this innovation is taking and suggests that the outlook for financial inclusion in Africa is potentially very promising.

## Microfinance is in crisis...

## 'Pro-poor' vs 'commercial'

# I Introduction

One state in India, Andhra Pradesh, has almost as many microfinance borrowers as in the whole of Africa. Imagine, then, the outcry if the Government of Africa (if such a thing existed) had passed a law against all microfinance institutions (MFIs) on the continent forcing them to adopt wholesale changes in their business practices and requiring them to stop collections altogether until they were registered under new procedures with local authorities. Imagine, again, the outcry if the Government of Africa had also tried to encourage African banks to take over the loan books of the continent's MFIs - but only if they charged the lower rates of interest more typical of banks, rather than of MFIs. For this is what the government of Andhra Pradesh has also proposed - and, predictably enough, the response from banks has been "tepid".

The widely reported events unfolding in Andhra Pradesh clearly have grave implications for the future of microfinance in the Indian state in which so-called commercial microfinance is most heavily concentrated and for the global microfinance industry too.<sup>1</sup> But they also raise questions about the role of government intervention in building inclusive financial markets and about the respective roles of banks and MFIs in the future.

Conceived as "pro-poor", microfinance has been criticized (by Grameen's Muhammad Yunus, no less) for profiteering off poor people and for actually making them more vulnerable. CGAP<sup>2</sup>, the leading global authority on microfinance, felt the need to address the criticism. Its highly introspective focus note "*Does microcredit really help poor people*", published in January 2010, concluded that microfinance does have a value proposition for the poor. But it also conceded that microfinance may have been "oversold".

Microfinance has also been attacked for "dumbing economies down", for failing to provide solutions that actually drive economic growth and create jobs, and as suitable only for financing the activities of petty traders.

The debate between the devotees of "pro-poor" microfinance and "commercial" or "sustainable" microfinance is as bitter today as it was a decade or so ago, when the schism in the microfinance world first started to appear. People are passionate about microfinance precisely because they care about the poor and because they have strong opinions about how best to serve the poor. The "pro-poor" lobby argues that its kind of microfinance has to be defended as a new kind of capitalism that actually can reach the poorest in society. The "sustainable" microfinance lobby argues that we do the poor a disservice if we do not encourage the development of financially robust institutions that can be relied on in bad times as well as good.

1. See *The Economist*, November 18, 2010; *Financial Times* December 1, 2010.

2. The Consultative Group to Assist the Poor – a multi-donor initiative to support microfinance, housed at the World Bank

## Microfinance is not the only tool for attacking poverty

... or, necessarily, the best

The global growth of formal microfinance - from a zero base not much more than three decades ago - has been extraordinary. It has brought economic and social benefits to large numbers of borrowers and depositors, who continue to use MFIs despite having to pay the high interest rates for which these institutions are routinely criticized. Its contribution towards the empowerment of women, although disputed by some, is well-documented. It has also been a conduit that has enabled billions of dollars to flow from North to South – from profit-seeking investors as well as donor organisations. The future of microfinance, in one form or another, clearly matters to a very diverse range of stakeholders.

But it is also the case that microfinance is not the only story in “pro-poor” finance, and it may not even be the main story. The main thrust of this paper is to suggest that we should stop describing traditional microfinance, as many observers do, as if it were the only weapon in the “common fight for access”<sup>3</sup> to financial services. Instead, we should think creatively about how to support innovation across a much broader range of institutional and service delivery models, which - alongside microfinance - can offer consumers choice at scale.

Why is this?

For a start, microfinance is still only a very small part of the financial landscape in most countries, and other developments are taking place - especially on the back of the mobile phone revolution - which are already beginning to overhaul traditional microfinance and may possibly accelerate its obsolescence. Traditional microfinance is just too small and unscalable to be the cornerstone of financially inclusive markets.

Secondly, microfinance has not proved to be effective at serving the poorest in society (although in some countries, notably Bangladesh, it does this better than in others<sup>4</sup>). Its loans are too expensive for really poor people and it is still a mainly urban phenomenon - which means that it is too far away to be of use to the largest numbers of poor people, namely, those living in rural areas. Because the poorest have never had access to these loans, there is still an important job to do to get the financial services that are relevant to the poorest out to them.

The main story, this paper argues, is not whether microfinance is a good or bad thing, but that financial access *of any kind* is dismally poor in developing markets.

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3. Raghuram Rajan, former Chief Economist of the IMF, speaking at a World Bank/Brookings Institution conference in Washington in May 2006

4. See Helms, 2006 (*Access for All*, Ch 2), World Bank, for a discussion on this



## II Microfinance and inclusive finance systems

In the world of development finance, as anywhere else, language matters. “Microcredit” used to be the favoured term, but this soon gave way to “microfinance” - which, in turn, has been superseded by “financial inclusion” and “inclusive financial systems”. *Microfinance* was an improvement on *microcredit* because it described more accurately how the financial needs of the poor extended beyond credit – they also needed to save, to send money and to protect themselves against financial shocks.

The idea behind financial inclusion, however, was that microfinance needed to be seen as an integral part of a financial system that was itself “pro-poor”. This meant that policymakers and regulators were encouraged to think in terms of creating a financial system:

### The key is inclusion...

- that provided for the establishment of financial institutions at all levels of the pyramid;
- that allowed MFIs to graduate into fully-fledged banks, if they chose to do so; and
- that also gave banks and insurance companies incentives to compete effectively in lower income markets.

An effective and inclusive financial system was one in which the availability of appropriate skills and market information would stimulate innovation that would benefit the poor by giving them more choice. Electronic or mobile payments systems would knit the disparate institutional types together, bringing network benefits to poor consumers. Financial capability would be strengthened and rights protected through appropriate consumer rights legislation and voluntary codes of conduct. Thus, microfinance would be brought out of the ghetto and into the mainstream, and the users of microfinance would no longer be constrained by the mono-product of the MFI.

In the old days, accessible finance was provided by development banks and non-governmental (typically non-profit-making) NGOs. But the line between this “old paradigm” and the commercial provision of microfinance has been becoming more and more blurred to the extent that, through the late 1990s and 2000s, increasing volumes of microfinance – ie loans, savings or other financial services, delivered in very small amounts to poor people – were being managed by institutions that did not look at all like Mohammed Yunus’s Grameen Bank.

## The split within microfinance

Savings banks have always straddled this profit-making/non-profit divide, combining a mandate focused on outreach with the need to deliver a profitable return<sup>5</sup>. However, in the first decade of this century, convergence gathered pace and the institutional form through which microfinance was delivered began to lose relevance. Ironically, through this period, country after country poured scarce regulatory resources into creating regulations specifically for MFIs that catered to remarkably few of their citizens.

Already by 2003, 39 non-profit MFIs had converted into banks<sup>6</sup>. By 2005, nine international banks reported lending wholesale to MFIs, and some were involved directly in the provision of microfinance. As a result, by 2006, ICICI Bank in India had a microfinance portfolio of \$321 million. Ironically, one institutional group that actually had “micro” in its name – the commercial microlenders in South Africa – were actively shunned by the microfinance fraternity, who considered them to be exploitative renegades at best and who were criticized in terms that SKS and Compartamos<sup>7</sup> would now find very familiar.

Nevertheless, there was a commonly accepted view that “pursuing higher profits and focusing on poorer customers [could] go hand in hand”<sup>8</sup>, and so financial inclusion became more and more associated with a market-led view of financial systems. Commercially-run MFIs bought into that market-led view; NGO MFIs did not. And so the divide between the two camps became markedly entrenched.

The commercialisation of microfinance encouraged types of organisation not ordinarily associated with the bottom of the pyramid to get into microfinance - multi-national and domestic banks, retail chains, providers of payments services, even mobile phone companies. Indeed, one respected industry commentator<sup>9</sup> suggested that the extent of convergence between the commercial and non-commercial world in microfinance showed that the “Versus Decades” were coming to an end – the years of endless debate about the merits and de-merits of the profit-seeking versus non-profit models, group versus individual-based lending, subsidies versus sustainability, and so on.

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5. Peachey (2006) reports that in 2003 only six of the 70 World Savings Bank Institute members reporting profit data made a loss

6. As quoted in *Building Inclusive Financial Systems* (Barr, Kumar, Litan – Brookings Institution, 2007)

7. Two MFIs that achieved stock market listings and made spectacular profits for their promoters. They have been heavily criticized for allegedly betraying their “pro-poor” roots. SKS listed in August 2010 on a forward multiple approaching 30x and at 6x book value and was 11 times oversubscribed – this, despite the regulatory criticism of the industry in Andhra Pradesh which by then had already become very vocal.

8. “*Financial Performance and Outreach: a Global Analysis of Leading Microbanks*” - Cull, Demirgüç-Kunt and Morduch (2006)

9. Marguerite Robinson, speaking at a Brookings Institution conference in 2006

The great hope with this much more variegated view of financial markets for the poor was that the poor could pick and choose the services they wanted from a range of institutions specializing in services that were suitable for that market. You would no longer need to buy the bundled suite of products and services from an expensive bank if all you wanted to do was to send money home. Indeed, banking services would become increasingly dis-integrated into particular product lines, delivered by specialists able to compete much more effectively for business from lower income population groups because they were no longer hobbled by the expensive overheads and creaking and overburdened IT systems of conventional banks.

To an extent, this is happening. Specialist services are being provided (notably in mobile payments), and banks are recognizing they need to change their “look and feel” in order to make a success of “banking the unbanked”. New-style banks and payments service providers are rightfully acknowledged as members of the modern microfinance community. But, as we shall see, legacy banks are also innovating in this field: with their scale and resources, some are proving to be effective competitors for lower income specialists.

A room full of microfinanciers today would, therefore, include a remarkably diverse mix of people. Thus, while the term “microfinance” is still generally associated with MFIs, it ought simply to mean financial services for the currently excluded, irrespective of the type of institution providing them.

## III Microfinance and inclusive financial systems in Africa

According to the Microfinance Information Exchange<sup>10</sup> (MIX), there are still only 8m microfinance borrowers in sub-Saharan Africa, in a continent of 900m. This figure is boosted by significant contributions from new-style banks, such as Equity Bank in Kenya and South Africa's Capitec, that are categorized by the MIX as microfinance providers, and by one country, Ethiopia, which has almost one-third of the continent's microfinance borrowers.

**Africa  
still  
largely  
untouched...**

And although there are 20.7m microfinance depositors, these numbers are boosted by the postal banks which are arguably not really MFIs at all but quasi-banks. So it is not unreasonable to argue that, using the narrower definition of microfinance (ie services supplied by MFIs), microfinance has made only a very modest contribution to financial inclusion in Africa and, even then, only in certain areas. On one measure<sup>11</sup>, sub-Saharan Africa has a lending penetration rate of just 3%.

Between 2007 and 2008<sup>12</sup>, the number of microfinance borrowers in Africa rose by 12%, whereas the loan book increased by 26% - suggesting that MFIs were lending larger amounts to a more selective group of borrowers. More positively, demand for deposits grew strongly, however, between 2007 and 2008 - up 40%.

To put all this into context, Bangladesh alone has more than 20m borrowers, compared to Africa's 8m. Just one Latin American country, Peru, reported having gross microfinance loans outstanding of \$5.5bn, more than in the whole of sub-Saharan Africa (\$4.8bn).

In many countries, microfinance is arguably still in its infancy as an industry - which would explain why growth rates can be fairly high, yet penetration very low. Nevertheless, MFIs in Africa are constrained by high operating costs (notably salary costs, as a result of a shortage of skilled personnel) and are barely profitable - with the result that there are poor prospects for sustained growth at the kind of rates that would bring in the unbanked in large numbers.

One way to measure how inclusive financial markets are in Africa is to consider the extent to which people engage with financial institutions of different types, formal and informal.

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10. [www.mixmarket.org](http://www.mixmarket.org)

11. From MIX: Active borrowers as a percentage of population living below the national poverty line

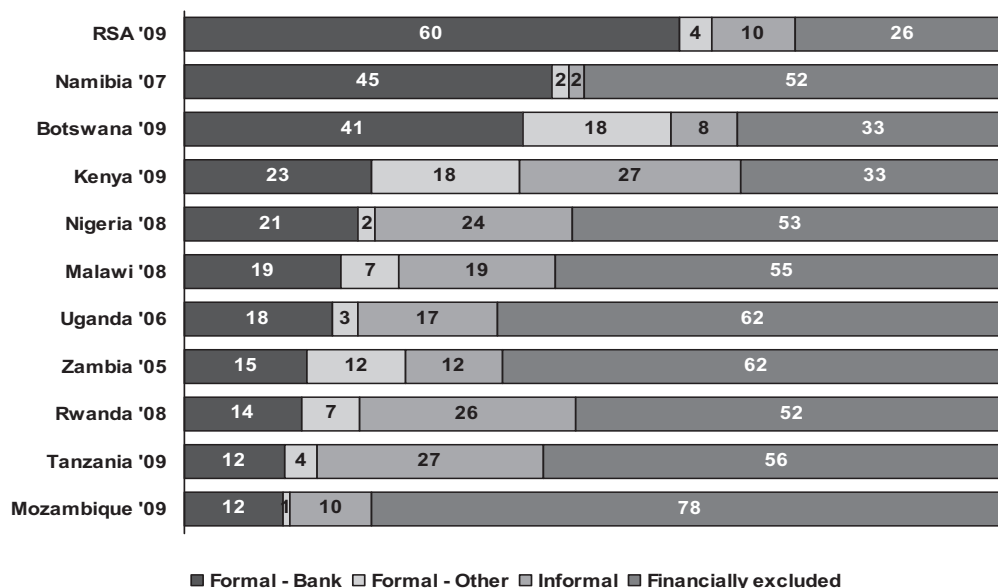
12. Latest detailed data available is the 2009 Benchmarking Report which compares 2007 and 2008

## Low penetration - but banks matter

The figure below shows that, although the banked population in most countries is still small as a proportion of the adult population as a whole, banks make a very material contribution to financial inclusion<sup>13</sup>, banking not just the wealthier population groups but also substantial numbers of people on surprisingly low incomes. For example, in South Africa<sup>14</sup>, 40% of people with incomes of less than R500 per month (£45) had a bank account and 60% of all banked adults in South Africa (ie 12m people) had incomes of £70 - £100 per month.

On the whole, policymakers in Africa recognise that a substantial improvement in levels of financial inclusion is contingent on creating stronger incentives for banks to engage in lower income markets.

**Figure 1 Access Strands from Africa**



(Source: FinScope surveys)

*Note: "Formal – Other" includes any regulated financial institution that is not a bank – for example, MFI, money transfer company, insurance. "Informal" includes mechanisms such as rotating savings and credit associations (ROSCAs), burial societies, moneyguards. The way to read this chart is as follows. In South Africa, 60% of adults have a bank account. 4% of people use some other kind of formal product, but do not have a bank account. 10% only use informal products and 26% of people do not use any financial products or services at all.*

13. The diagram is visually biased in favour of banks because a person who uses multiple products – eg money transfer and a microfinance loan – as well as a bank account will appear under 'Banked', rather than 'Formal –Other'.

14. FinScope South Africa 2008

## Total financial exclusion still a problem

Overwhelmingly, what stands out from the chart is the extent of financial exclusion, ie people who use no financial products at all, formal or informal. The point here is that it is a mistake to assume that if you do not have a bank account, you will be using microfinance or some kind of informal product. Some markets (Rwanda, Kenya) do have a vibrant informal sector; other markets (Zambia, Mozambique) have surprisingly weak informal sectors, perhaps for historic reasons. The reality is that 40-50% of the population of most lower income sub-Saharan African countries live entirely in a cash economy, outside any form of financial system other than what goes in the household or in an *ad hoc* way between friends and family.

The irony here is that economies in which these people live have been performing quite strongly, proving to be much more resilient to the global economic downturn than observers had feared. The IMF is forecasting growth of 5% in sub-Saharan in 2010 and 5½% in 2011, which (ignoring the blip caused by the global crisis) is entirely consistent with the performance of the region for well over a decade. More than a third of Africa's populations live in countries that have experienced average annual growth over 10 years (1996-2005) of more than 4% - including Rwanda (7.6%), Tanzania (5.3%) and Senegal (4.5%), all non-oil producers.

Faster and more balanced economic growth, rapid urbanization, population growth and, above all, a much better communications infrastructure augur well for the retail financial sector in coming years. Mobile phone penetration in Africa should have reached 41% by the end of 2010<sup>15</sup>, meaning that there are now 400m mobile phone users in Africa compared to only 16m in 2000. Internet penetration is also increasing rapidly – still low at 10%, but this figure has doubled in just two years.

It is probably true to say that the foundation for more inclusive financial systems was laid in the 2000s, but the benefits are yet to shine through. So, why are the figures for financial access still as bad as they are?

Of course, part of the problem is that the benefits of economic growth have not been shared across the economy. Growth has been highly unequal in many countries, and incomes for the vast majority are still very low and often irregular. In Rwanda, for example, three-quarters of the population live on less than \$20 per month and so it not surprising that 80% of people who are unbanked (yet have money) say that after covering their living expenses they have no money left to put into a bank<sup>16</sup>.

It is worth recalling here a key insight from a recent influential book on microfinance, *Portfolios of the Poor*<sup>17</sup>, that we cannot usefully talk in terms of people living on \$2 a day when the irregularity of income flows means that a person may go for days on end with no income at all and then succeed in earning a reasonably large sum that

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15. ITU figures – the global average is 76%

16. FinScope Rwanda 2008

17. Collins et al (Princeton, 2009)

## **Hard to adapt formal financial institutions to the African experience**

only then brings the average up to \$2 a day. The reality of this intermittent income is much more fraught than what \$2 a day would imply, and it explains why there is often a mismatch between the needs of the poor consumer and the demands of a formal financial institution for regular payments such as loan repayments, account maintenance fees or insurance premiums.

Growth in Africa has been fuelled by commodities and by the development of more broad-based urban economies where construction and business services have been strong contributors. However, the vast majority of the labour force lives and works in the agricultural economy – 80-90% in countries like Malawi, Tanzania, Uganda and Rwanda – where formal finance has yet to make any serious in-roads.

In Tanzania, for example, banks lent approximately<sup>18</sup> £230m to agriculture (equivalent to 12% of all bank lending) - but only 8% of this (ie £18m) went into agricultural production, the rest went into agricultural trading. Penetration of formal microfinance in rural areas in Tanzania is also very limited – only 1% of the rural population saves with an MFI, compared to 7% of the urban population.

Physical distance and often sparse populations also make the economics of running a conventional branch infrastructure completely unworkable. Add to this the very real problem of unreliable power supplies, and it makes the challenge of distributing financial services very serious indeed. In these circumstances, inevitably, formal finance tends to be concentrated in urban centres. Nigeria is a good example of this; of the country's 901 microfinance banks (MFBs), 166 are in Lagos and a further 42 are in Abuja. Katsina and Jigawa, two of Nigeria's northern states, meanwhile, have only five and seven MFBs respectively, and yet these states have a combined population of 10 million.

A host of other factors conspire to keep financial exclusion high. They include inappropriate (or absent) financial sector regulation, the high cost of banking for consumers, lack of market information, inappropriate products and poor levels of financial literacy. And, of course, many post-conflict countries are simply very underdeveloped – the Democratic Republic of Congo is reported as having just 2,000 bank accounts in a population of 62m.

## **But there are profits to be made...**

Interestingly, banks in Africa are among the most profitable in the world, shielded in the main from the collapse of global financial markets and much better-capitalised and regulated than a decade previously<sup>19</sup>. Buoyed by deposit-taking and transaction fee income, and lending relatively little to the private sector, banks have managed to turn in returns on equity as high as 40% in some countries (Botswana, Ghana) and returns on assets well in excess of global norms. Spreads have been huge. In Zambia, loans yield 6.5 percentage points over the risk-free funding rate and there is a spread

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18. Tanzania National Business Council figures - £1 = TZS2,300

19. Nigeria's banking system can at least be said to be better regulated now, and the leading banks that did survive are well capitalised

of about 10 percentage points between what banks pay their depositors and what they can earn on government bonds<sup>20</sup>. Spreads in the East African countries have been high throughout the 2000s, averaging 800 – 1,200 basis points.

As mentioned, Africa is a high-cost environment, particularly for salaries. Bank profitability has been achieved despite these high costs. In an environment where it is easy to make money while being relatively inefficient, and where there is a general lack of competition, the incentives for banks to move into new markets - such as lower income markets, or harder-to-reach markets such as agricultural finance - have been weak. Accordingly, exclusion has remained high in this atmosphere of profitable inertia.

But this may now be changing. Many banks recognise that they cannot keep mining these profitable niches and ignore long term opportunities elsewhere. It does not make political sense to do so; nor does it make commercial sense either. Competition is intensifying in some markets and developments in technology (notably for mobile phones) are making the prospect of being able to deliver financial services profitably to the poor more of a reality. There is also much better understanding of the dynamics of how the poor manage their money.

For these reasons, and against the backdrop of a generally benign economic outlook for the continent, prospects for significant improvements in financial access in Africa are promising.

In the next sections of this paper we discuss the innovations taking place within banks as they reach out to serve poorer consumers, and we contrast this with the developments in the mobile payments arena. Of course, these developments are not mutually exclusive – mobile payments can bring huge efficiencies to conventional banking processes, for example. However, there is plenty of innovation taking place within banks that has nothing to do with mobile phones. New models of doing business are being tested that appear to be highly profitable, sustainable and replicable.

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20. Supply Side Study of the Inclusiveness of Zambia's Financial System (Oxford Policy Management, 2007)



## IV Innovation in mass banking

In this section of the paper, we discuss:

- new-style banks, set up specifically to meet the needs of lower income customers; and
- large incumbent banks that are diversifying (or downscaling) into lower income markets.

These two categories of bank have both identified opportunities in the mass market, and are making inroads into it in different ways. By mass market, we mean that part of the market that is un- or underserved, but economically active enough to be of potential interest to service providers.

### New-style banks

Equity Bank and Capitec Bank are both examples of banks whose strategies are specifically geared towards the mass market. Equity was originally established as a building society that moved into microfinance and eventually converted into a bank to provide services to “the microfinance and missing middle sectors”. Capitec’s roots were in commercial microlending (ie providing short term loans to lower income salaried workers), before starting to take deposits and introducing a broader range of loans. Both have been extremely successful.

#### Equity and Capitec

- Equity Bank’s profits before tax grew from £1.7m in 2004 (when it converted from a building society to a bank) to £41m in 2009. It now has 52% of the banked population in Kenya and is capitalized on the Nairobi Stock Exchange at £750m
- Capitec’s profits grew from £6.0m in 2004 to £42m in 2009, and it is now capitalized on the Johannesburg Stock Exchange at £1.2bn

Equity spotted a huge opportunity among a mainly urban, non-salaried and collateral-less population that was being ignored by the bigger banks. It concentrated on providing outstanding service delivery, disbursing loans quickly and making customers feel accepted.

Capitec also took advantage of what was seen as high-handedness on the part of the incumbent South African banks to focus on service delivery, opening branches in poorer neighbourhoods and former homelands, and pioneering innovations such as providing flexible opening hours so that commuters could get to the bank after work.

Differentiation and a relentless focus on service delivery, including accessibility, have been key to the success of both these banks. Both recognised that lower income consumers needed to be treated very differently, and products and processes were designed accordingly, without ever compromising on operating performance.

## Incumbent banks downscaling into lower income markets

### Moving downmarket...

Increasing numbers of well-established banks in Africa are now exploring opportunities in lower income markets. For these institutions, the strategic incentives are rather different from the new-style banks. While both groups are looking to make profits, the incumbents are already (by and large) profitable in other areas, and so need to convince themselves that there is enough profit to be made in these new markets to justify the diversion of resources and management time away from the core business. This dilemma helps to explain why financial inclusion has stayed low – in these growing economies, there has simply been far more money to be made from corporate or high-end retail banking.

Most of these institutions recognize that there is a need at least to start exploring lower-income markets because their core businesses are becoming more and more saturated. In most African markets, there is no shortage of loan products for salaried employees. But in lower-income countries these people typically constitute only a small proportion of the adult population – perhaps 10-20% - and so the market is constrained.

For the larger institutions, innovation is spurred by the prospect of being able to deliver at scale. For example, the South African banks, including Absa, have worked closely with the government to support the payment of government grants (pensions, but especially child support grants) which are paid to around 12m beneficiaries a month. Beneficiaries can open a low-cost bank account, which they can access through the ATM, and the government pays the bank a processing fee for each grant transfer. It saves the government money (the costs of handing cash out to grant beneficiaries are immense) and creates meaningful revenue for the banks because of the scale effects. Within four years of the launch of the product, Absa had around 750,000 customers using it.

Similarly, Barclays Bank in Ghana pioneered the distribution of loans through the informal networks of ‘susu’ collectors in markets in Accra.

Susu collectors perform a service to market traders by taking their day’s takings and banking it on their behalf in return for a fee. The susu collection system is

widespread, and collectors typically have between 300 and 1,000 clients each. Barclays considered them to be an interesting channel through which they could wholesale microloans partly because they were able to reach so many clients, but also because they had an intimate knowledge of their clients and so would be able to judge who was a good risk and who was not. The system proved to be extremely successful. By February 2007, seven months after its launch, the scheme had disbursed \$375,000 to around 1,000 clients of susu collectors and had garnered \$2m in deposits for the bank. The loan repayment rate was 100%. Accordingly, Barclays launched a second and a third cycle, increasing the reach of the scheme and also the size of the individual loans.

Banque Misr in Egypt has also had great success pioneering small business lending to microenterprises in Upper Egypt. The senior management of Banque Misr (Egypt's largest bank) agreed to allow the SME lending programme to be conducted in a completely different way to its normal lending. Crucially, for example, loan officers were recruited from young graduates who, although supervised by experienced loan officers, had none of the preconceptions of experienced bank staff as to what constituted a good risk and what did not. The loan programme offered borrowers a series of step-up loans which enabled them to graduate to a bigger loan upon repayment of the existing loan. As with the Barclays example, Banque Misr's repayments have been practically 100%.

Political incentives have undoubtedly played a part in nudging established banks towards lower income markets. Generally speaking (and Nigeria is an exception), state intervention in the direct provision of financial services or subsidies is fairly limited in Africa. But many governments are frustrated by what they see as established banks doing too little too slowly to expand access to banking.

In South Africa, this signaling of political frustration led to the launch by the banking industry of a basic banking product - the so-called Mzansi account. This provided a simple transaction and money storage facility (no credit was allowed with this account) at relatively low cost to the user. Cross-industry collaboration over Mzansi meant that users could withdraw cash from any banks' ATM without additional charges. The Mzansi initiative was pretty successful. Although churn proved to be high (roughly 40% of accounts became inactive during the period), more than 6 million accounts were opened, 72% by people who had not had a bank account before. It was the prime reason why the banked population in South Africa rose from 46% in 2004 to 63% in 2008. Banks complained that it lost them money, but privately a number conceded that it gave them valuable intelligence on a part of the market they did not know much about but which was strategically important to them for the future.

The Indian authorities also promoted "no frills" accounts in 2007. Interestingly, recent reports suggest that the government is now prepared to subsidise around 50-60% of the cost of every account opened.

Across Africa and elsewhere, there are now numerous examples of “bottom of the pyramid” innovation by formal financial institutions<sup>21</sup> – whether in the form of new products, reconfigured business processes, branchless banking strategies, innovative partnerships and so on. In many cases, the innovation has been highly profitable – not always material in the context of existing institution’s group profits, but sometimes exhibiting dramatic growth rates. Common to most of the successful innovators we have seen has been a commitment to getting the disciplines of service provision right, to understanding the different needs of these new customers, and having the operating space within the institution to be able do things differently with strong (ie CEO-level) support.

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21. See *Real Money, New Frontiers – Case Studies of Financial Innovation in Africa* (ed. Mark Napier, publ. Juta 2010)

## V Mobile money – breaking through

To date, there have been 78 mobile money ventures launched globally<sup>22</sup> and a further 83 are in the pipeline. Of those launched, around half are in Africa, deployed in approximately 20 African countries. These figures exclude the mobile banking offerings of established banks, which means that the real impact of mobile phones on financial services is greater than the numbers of ‘pure play’ mobile money ventures would suggest.

The most aggressive players in the m-payments field have been the mobile network operators (MNOs) – notably, Safaricom and MTN. Safaricom’s M-Pesa, in Kenya, is by far the most successful mobile money deployment anywhere, although MTN Uganda’s MobileMoney, which turned cash flow positive after 14 months, has notched up 400,000 active customers who make 385,000 person-to-person payments (P2P) each month.

M-Pesa is a phenomenon. Launched in March 2007, M-Pesa:

- now has around 12m active customers, more than half the adult population of Kenya and three times the number of people with a bank account;
- transacts \$415m each month in P2P payments, equivalent on an annualized basis to 17% of Kenya’s 2009 GDP<sup>23</sup>;
- contributed \$94m in revenues to Safaricom in the 2010 financial year, about 9% of group revenues; and
- has registered over 350 business users, companies who routinely use M-Pesa either to pay their staff or to be paid for services rendered (eg utilities).

In other words, M-Pesa has transformed the financial landscape of Kenya profoundly. It is becoming the “payment rails”<sup>24</sup> on which other financial services can ride. And the numbers are showing up already in national surveys.

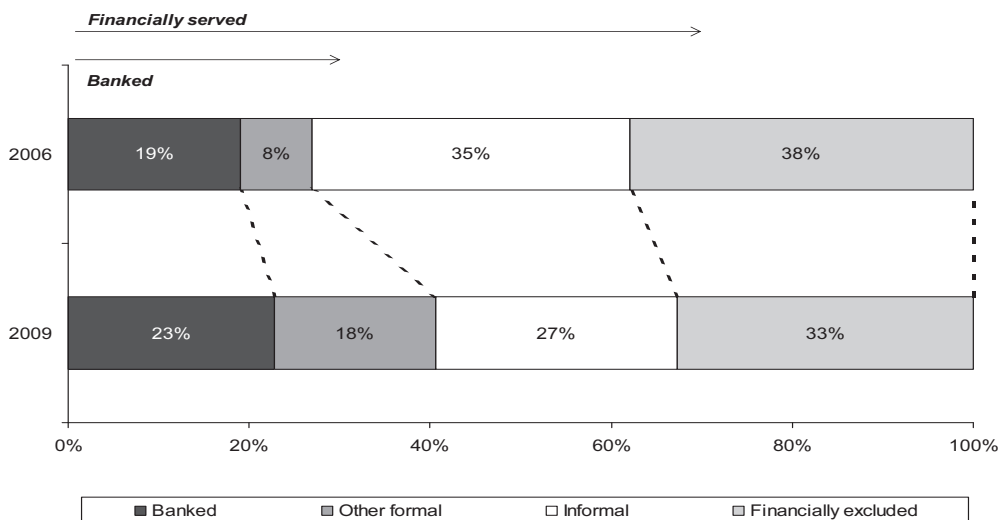
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22. Leishman, *ibid*

23. From Scaling Mobile Money (Mas, Radcliffe – Gates Foundation, September 2010)

24. Mas, Radcliffe - *ibid*

Figure 2 Access Strands from Kenya



(Source: FinAccess surveys)

In this chart, the “Formal-Other” segment has increased substantially in just three years, showing that large numbers of people who are not banked are using M-Pesa.

Nevertheless, M-Pesa is also considered to be an anomaly. Safaricom had (and still has) a dominant market share (80%) among mobile operators in Kenya, which helped it achieve scale very quickly. And the Central Bank of Kenya was prepared to give Safaricom the regulatory space to try M-Pesa out, rather than devise regulations *ex ante* that could have hampered M-Pesa’s growth.

The impact of these factors in other countries has been apparent. For example, take-up of M-Pesa in Tanzania was much slower than in Kenya<sup>25</sup>. Fourteen months after launch, M-Pesa in Tanzania had 280,000 customers and 1,000 agents, whereas M-Pesa in Kenya, after 14 months, had 2.7m customers and 3,000 agents. Vodacom (which promotes M-Pesa in Tanzania) has a market share of only 40% in Tanzania and at the time of M-Pesa’s launch there, there were at least two other operators already looking to get into the mobile money market (Zain and ZanTel), not to mention the mobile money businesses of banks as well. Vodacom had only 5.2m subscribers when M-Pesa was launched, compared to Safaricom’s 12.5m in Kenya.

There are other problems. For instance, Nigeria’s central bank (in common with most central banks in Africa) is worried about the consequences of letting a parallel financial system develop outside the banking system under the auspices of institutions (MNOs) over which it has no authority. Such concerns are legitimate but

25. The market share of the MNOs is likely to be only one of the reasons why M-Pesa’s take-off in Tanzania was much slower than in Kenya. See “What makes a Successful Mobile Money Implementation? - Learnings from M-PESA in Kenya and Tanzania” – GSM Association Mobile Money for the Unbanked

## Regulators are nervous

it has meant that mobile money has not taken off at all in Africa's most populous country in which three-quarters of the population does not have access to formal financial services. First, there was a delay in agreeing what model of mobile money service provision would be permitted (eg bank-led, rather than telco-led) and, secondly, in awarding licenses. Guidelines for bidders seeking licenses were published by the Central Bank of Nigeria in June 2009 but no licenses have been awarded yet, despite numerous applications for them. Regulatory conservatism is a major impediment to the spread of mobile money in Africa.

Nevertheless, mobile money continues to offer the greatest hope for rapid advances in financial inclusion in Africa. We are likely to see many more start-ups and more innovation around existing m-payments platforms. These will demonstrate that, in some countries and for certain applications, mobile phones will have allowed Africa to leapfrog from a position where there were no bank branches (or very few) to one in which the majority of economically active citizens have access to financial services of one kind or another.

But there are reasons to be cautious too. First, as previously mentioned, the regulatory environment in many countries is not supportive of innovation in m-payments.

Secondly, the environment is becoming increasingly competitive. It is reasonable to assume that as competition in m-payments intensifies, returns will fall. Start-ups will have to invest more, and wait longer, to get their money back with a profit and only a few will have the financial stamina for this.

Indeed, in this fast-evolving field, the financial incentives for m-payments service providers are far from certain, not least because the regulatory and competitive dynamics of each market are very different and so it not easy to say what works and what does not. Furthermore, while we are beginning to see data coming out of M-Pesa in Kenya and MTN Uganda's MobileMoney<sup>26</sup>, there is very little in the way of detailed analysis of other m-payments ventures.

Safaricom is estimated to have spent \$25-30m on the roll-out of M-Pesa (on marketing, training, merchant acquisition etc.), and it started to deliver a profit for the company two years after launch. Nevertheless, in terms of operating margin, M-Pesa is significantly less profitable than Safaricom's main telecoms business, producing an EBITDA margin of 15% compared to 44% for the group as a whole. While these margins may converge to an extent, no one is suggesting that M-Pesa will become a more profitable business than Safaricom's mainstream telecoms business - and certainly not if competition forces M-Pesa to reduce its charges.

Besides profits, however, there are additional benefits to operators in terms of enhanced cash flow (for example, with mobile money, an operator sells airtime

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26. Leishman – Is there really any money in mobile money? GSM Association Mobile Money for the Unbanked, October 2010

## **Telcos and banks? Or telcos or banks?**

directly to customers instead of through resellers) and, especially, reduced churn. The analysis of MTN Uganda's MobileMoney found that while the churn rate for regular mobile customers was roughly 4.5% per month, the churn rate for an active mobile money customer was no more than 0.2%. In aggregate, therefore, the financial incentives for a MNO are probably more pronounced than what is apparent from the EBITDA figure, but these additional benefits are difficult to quantify from the outside.

Thirdly, the mobile money business is not just complex, but it is rapidly changing as well - requiring not just outstanding branding and brand promotion and consistently reliable performance, but also the management of a retail network of agents and super-agents who actually keep the system liquid. This involves putting in place a commission structure that incentivizes all the players appropriately, and also training.

The success of M-Pesa has caused a degree of speculation about whether the dominant force in financial services in Africa in the long term will in fact be the telecoms providers, not the banks. However, the announcement in May 2010 that M-Pesa users in Kenya without a bank account will be able to use their mobile phones to open a proper savings account (called M-Kesho) with Equity Bank through M-Pesa suggests that the future will consist of telecoms providers and banks forging mutually advantageous partnerships, rather than competing head to head.

Banks are here to stay. For a start, they have the regulatory advantage of being licensed to take deposits, unlike mobile money ventures. Secondly, more complex financial services, such as borrowing, require skills (eg risk assessment) that mobile money operators do not have - and do not want to develop. Generally speaking, they want to work with banks, but not to become banks.

It seems entirely possible that price competition in mobile money will weaken (and possibly even eliminate) the appetite of investors (including the MNOs) to back new ventures in this field, not least because of the significant up-front costs needed to build scale rapidly. In these circumstances, it seems highly likely that the more enduring providers of mobile money services will be, after all, the banks. Banks will continue to invest in their mobile banking businesses as an attractive additional channel for their customers. They will also be well placed to build scale in the mobile money arena by acquiring viable operators who have simply run out of cash.



## VI Conclusion

### ... beyond microfinance

As we have seen, financial inclusion is about much more than traditional microfinance. The advent of mobile payments has disrupted the established order, and financial institutions of all kinds are wondering what happens next. On the one hand, they are worried about where they will fit in the new world order; on the other, they are excited about the opportunities that seem a little less elusive than in the past.

Rightly, considerable attention has been paid to what poor consumers need most from financial services – a safe place to store money easily and cheaply, and a reliable way to send money easily and cheaply. But we must also be careful to nurture other forms of innovation as well – in more intractable industry sectors such as SME finance, housing finance and agriculture – so that financial markets offer a value proposition not just to the poorest but also to people who are economically on the way up.

In many African markets, there are large numbers of *near-poor* whose financial needs extend beyond basic money transfer and savings services and who currently lack access to affordable credit and pensions (and other forms of long term savings products), as well as insurance. Such people have *access*, in the sense that they may have a basic bank account or use M-Pesa, but it is still a form of access that is too constrained for someone looking to build a house, acquire farming tools or simply build up capital for investment at a later date.

There are already yawning gaps in the supply of certain kinds of finance to population groups who probably can access basic transactional services, thanks to the increasing spread of mobile money transfer services, but who can get no further than this.

Not surprisingly, donors have been anxious to ensure their resources are used to target the poorest in society, and many are therefore, focused on population groups who could not even afford a bank account. While we must respect these mandates, there is a good argument, based on support for economic growth as well as poverty alleviation, for taking a broader view of where it is justifiable to support innovation. To support more challenging markets - such as SME finance or agriculture - donors may need to contemplate providing incentives higher up the pyramid than they would ideally wish.

We still need the grant-giving, the competitions and the challenge funds. Indeed, with solid economic growth taking place in much of Africa, there is a very good opportunity for governments and donors to strengthen their support for market-leading innovation through these kinds of mechanisms.



Mark Napier has just completed a year as the CSFI's first Development Fellow. He has also just published a book of case studies on financial innovation in Africa '*Real Money, New Frontiers*' (published by Juta).

Mark is a former investment banker, who ran FinMark Trust in South Africa for five years. Finmark is a non-profit, dedicated to making financial markets work for the poor. He is currently an independent consultant, whose clients include DfID, the World Bank, the Gates Foundation, GTZ and the Gatsby Foundation. He is based in London.

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