MicroSave Briefing Note # 98

Branchless Banking Update: Should We Bank on Phones or The Post?

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July 2011

The term "branchless banking" may no longer be the most accurate way to describe what is currently going on in financial inclusion and microfinance. Are banks and branches even the two most important components? For the past five-six years, most efforts to move money via mobile phones or point-of-sale (POS) terminals have required full bank participation, or at least bank partnership and oversight. Reasons include deposit insurance, customer and payment authentication, fraud control, G2P government disbursements, and the actual issuing of money. (For more detailed explanations—and there are more details—please see below.)

There are several notable exceptions—Safaricom's M-PESA in Kenya, Telenor's EasyPaisa and Mobilink in Pakistan—whereby mobile network operators manage the money transfer and banks play only a secondary and supportive role. In general, however, most governments, particularly those focused on improving financial inclusion numbers like India and Brazil, have preferred to work through banks and bank regulators to ensure customer security and deposits. This is changing. India is a useful example of how the model can expand to include other players via the Interbank Mobile Payment System (IMPS) and unique biometric IDs, while still maintaining acceptable levels of surveillance.[1]

The range of interested participants is multiplying as well. Until recently, the debate was simply between banks and telecoms as to who was best suited to lead such initiatives. The list now includes technology firms partnering with telcos and banks to build agent networks (FINO, Eko, A Little World, and Nokia/Obopay in India, and EasyPaisa for clients without mobiles in Pakistan): global consumer brands who want to add financial services to their distribution networks (Unilever, Bayer, Coca-Cola and PepsiCo),[2] and the post office. The Universal Postal Union and the Bill & Melinda Gates Foundation aresupporting several efforts to restructure postal networks with mobile and point-of-sale (POS) technology to easethe problems of bank-authorised agents and cash management, and to improve financial access for the poor in rural areas already served by post offices.[3]

"Branchless banking" may no longer adequately describe how the estimated 2.7 billion low-income individuals around the world without access to formal banking services[4] manage their payments, savings, loans, remittances, and other transactions—now, and in the future. Branches, as we currently conceive of them, may become like brick and mortar storefronts in an ever-expanding universe of e-commerce: still important for branding, trust, and complex financial negotiations, but otherwise unnecessary. The definition of banking may also broaden, particularly in northern Africa and other developing economies, to include regulated e-bartering for groceries and other fast-moving goods (FMGs), pharmaceuticals, vehicles, and consumer electronics.[5]

In addition, m-wallets may finally have a more meaningful future for people with phones, but without credit or debit cards. Google, Citibank and First Data are collaborating on a mobile wallet that initially will work only on Google's Android phones and with U.S. retailers. Nevertheless, both Citibank, a pioneer in no frills accounts for Mexican border workers, and First Data, former owner of Western Union and current owner of India's ICICI Bank merchant services, are likely to have more patience and a better understanding of the solid, long-term potential 2.7 billion new accounts offer than their current m-wallet competitors (Bank of America, Visa, PayPal, Apple's App Store, and even FNB in South Africa).[6] Square, a new m-wallet led by Twitter's founder Jack Dorsey, is targeting small businesses and the 27 million U.S. merchants who do not accept credit cards and currently have no access to the standard NFC (near field communication) technology other wallets use.[7] This, too, bodes well for both retailers and their customers anywhere else in the world without credit-card terminals, electronic cash-registers, and other expensive POS devices.

All this good news notwithstanding, we ultimately come back to banks—in their current, less expansive role—and the ambivalent, but essential, role they play in all new technology involving money. Banks are responsible for:

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[1] See *MicroSave's* IFN 61 "Interbank Mobile Payment System: Will It Catalyse Financial Inclusion?" and IFN 69 "UID and Financial Inclusion – Solution or Not?"

[2] "Snacks for a Fat Planet," *The New Yorker*, 16 May 2011, by John Seabrook; http://technology.cgap.org/2011/05/09/branchless-banking-gains-momentum-in-india/

[3] http://www.arcep.fr/uploads/tx_gspublication/Cahiers_ARCEP_01.pdf

[4] This often-cited 2009 World Bank figure may be even higher now, despite progress in many areas for financial inclusion. http://www.cgap.org/gm/document-1.9.38735/FA2009.pdf

[5] Regularly referenced at the Swiss-African Business Exchange,16/17 March 2011, International Conference Centre, Geneva

[6] http://www.nytimes.com/2011/05/27/technology/27google.html?hpw, http://www.nytimes.com/2011/05/24/technology/24pay.html?ref=technology

[7] Ibid, and http://www.businessinsider.com/square-card-case-2011-5

- guaranteeing deposits and money transfers, however small and unprofitable;
- authenticating customers, including those with no fixed address or formal identification papers;
- safeguarding against fraud in places where corruption and graft flourish;
- reconciling daily transactions, sometimes many days late;
- issuing cash for government and other disbursements since, in most cases, only banks can do so; and
- potentially more tiresome and problematic than any of these regulatory requirements—managing branches and agents in rural areas with unreliable IT, poor roads, crime, and insufficient resources to train and motivate both groups.

Banks are also the guardians of the financially underserved because, in most places, they are required by law to play this role.

Nonetheless, how banks cover costs, for rich and poor, has not changed much since 14th century Florentine goldsmiths invented modern banking: they buy and use money wholesale and they sell it retail. The convenience, deposit security, and the services they are selling have obviously advanced, but the business plan has not. Their reluctance to rethink it now in order to better accommodate new low-income customers around the globe is understandable. When deposits are small and transaction costs are high, the increased volume does not sufficiently improve potential revenues or offset individual expenses. Banks lose money and their real business—serving the middle-class and high-net-worth clients—suffers.[8]

Most other contenders in this space—mobile network operators, technology service providers, global consumer brands—have business plans that hinge on volume and ever-increasing transactions. The problem is deposit insurance. Government policy varies from country to country, but in most cases, full and guaranteed coverage is limited to commercial banks with specifically regulated reserves, even more strictly regulated audit procedures and bank-grade software, and the insurance guarantee remains under the strict control of the government or private entities with government backing. Before the 2007-2008 global credit crisis, eligibility for this type of insurance was easing, most notably for large phone companies, such as Norway's Telenor and Japan's NTT DOCOMO, who were already partnering with banks for mobile financial initiatives. Since then, not surprisingly, restrictions have tightened and are likely to remain in place for the foreseeable future. A well-funded telco could doubtless find an independent, mutualised insurance marketplace such as Lloyds to underwrite deposits. But most regulators have no wish to extend the audit and IT protocols noted above to non-licensed financial intermediaries. And if the MNO were to merge or go under—all too likely in most developing countries—authenticating and reimbursing depositors would be almost impossible to guarantee.

This means that, despite the promise M-PESA and comparable mobile and branchless banking efforts seems to offer, too many low-income customers are highly vulnerable if an enterprise is managing their money without a full bank license or partner. Legally, the responsibility in case of loss or fraud lies with the customer. And bank fraud, estimated atUS$2.9 trillion worldwide, according to the Association of Certified Fraud Examiners, only rises in places where the regulatory environment is lax and criminal activity is more prevalent. Once again, most banks are loath to assume the full burden for these losses in return for the benefits of improved technology or distribution.

The role of the post office in branchless banking remains an open question. They offer both "branches" (in most cases, better staffed and more locally accessible) and "banking"—just under half of postal revenues in Asian and Arab countries derive from financial services.[9] The cash-in/cash-out problem that bedevils all branchless banking efforts in rural areas is only partially solved with local shopkeepers and other bank-authorised agents. Given a choice, those currently without bank accounts, or with inconvenient dormant accounts, might open and more actively use postal accounts if the post office were close by and able to offer full banking services. These services would have to include credit, unavailable for example in India, and more timely cash management in any region that depends on internal or external remittances, plus of course guaranteed deposits.

The post office may inspire more trust than most mobile operators, technology providers, or vendor of soft drinks and snacks, but the safekeeping of money requires a level of security and confidence that most depositors only accord to banks. For the present, in answer to the opening rhetorical question: yes, a full banking license and a safe place in which to conduct banking business will remain necessary for full financial inclusion to succeed.

[8]For a more detailed description of banking and other business plans, please see "The Business Case for Branchless Banking - What's Missing?" *MicroSave* Briefing Note # 97
[9]http://www.arcep.fr/uploads/tx_gspublication/Cahiers_ARCEP_01.pdf