MicroSave Briefing Note # 31

Electronic Banking for the Poor

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Why Electronic Banking?

Electronic Banking brings the potential to extend low cost virtual bank accounts to a large number of currently un-banked individuals worldwide. Change is being driven by falling costs of technology, by competition and by the ability of electronic banking solutions to offer customers an enhanced range of services at a very low cost.

Whichever technical option is chosen the development of an electronic banking solution should consider the customer perspective – the customer value proposition; the institutional perspective – the business case; and the local environment for electronic banking.

Technical Options

Technologies used in electronic banking include, but are not limited to:

- *Personal Digital Assistants*: Used by microfinance programmes to automate record keeping.
- *Automatic Teller Machines & Point of Sale Devices*: Used in conjunction with Magnetic stripe or Smart cards.
- *Magnetic Stripe Cards*: Low cost cards operated through a magnetic stripe on the reverse of the card.
- *Smart Cards*: More expensive chip based cards that can store information off line on the embedded chip.
- *Cell-phone banking*: Banking through cellular phones, either through menus or through SMS.

Customer Perspective – The Value Proposition

An electronic banking solution must provide sufficient value to persuade the customer to move transactions away from cash. However, cash is an incredibly versatile medium of exchange. It is universally recognised as a store of value; and it is accessible, portable and divisible.

- *Features*: What needs does the e-banking solution meet? What features encourage the user to maintain an electronic account in preference to cash? For example, improved personal safety and the ability to transfer value from person to person.
- *Accessibility*: Limited distribution of transaction points strongly reduces the value proposition to the customer. Walking many kilometres to access services is inconvenient and costly. Saturation of an area with the service is preferable to a wider thinner, distribution.
- *Affordability*: Cash is inherently "frictionless" there is no charge that gets levied each time value is transferred. Given this, start up and transactional costs need to be as low as possible for both the end user and the merchants these users frequent.
- *Ease of use – convenience*: The e-banking solution needs to be simple to use, fast and user friendly.

Institutional Perspective – The Business Case

From an institutional perspective, the electronic banking solution should increase profitability. This means careful consideration of functionality, business volumes, fees and charges, efficiency gains, development costs, partnerships, and distribution channels.

- *Functionality*: The level of functionality that the institution wishes to develop, whether this should be narrowly or widely focused.
- *Building volume through segmentation*: By careful development of different business segments the financial institution is able to build transaction volume through the core e-banking infrastructure.
- *Fees and charges*: Developing an appropriate revenue strategy is heavily influenced by the functionality offered, the segments served and the anticipated volume of transactions.
- *Efficiency Gains*: The financial institution is able to handle substantially increased business transactions without corresponding investment in physical infrastructure.
- *Controlling development costs*: Costs must be controlled during the development phase to ensure positive returns on investment.
- *Partnerships*: Multiple business partnerships are essential in building a multi-functional e-banking solution and in supporting the distribution network.
- *Distribution network*: The distribution network must meet customer requirements for accessibility, ease of access and widespread functionality, whilst meeting institutional cost requirements.
- *Developing multiple business cases*: Each partner involved in the solution must benefit, whether through reducing costs, increasing efficiency, increasing turnover, or through direct income.

The Environment for Electronic Banking

Many e-banking projects are developing in South Africa. This is not the result of chance, but rather that the South African environment is more favourable for electronic banking. There are well-developed banking and retail sectors, a supportive central bank, good communications and a generally positive policy environment. The environment for electronic banking is influenced by the:

- *Evolution of the financial and retail sectors*: The nature of the financial and retail market in which the solution is being launched is a key determinant of product features, interoperability, potential volume drivers and basic financial literacy.
- *Level of financial literacy*: The level of financial literacy influences communication of the product, the nature of the distribution channel and the nature of transactions made.
- *Regulatory and policy environment*: The regulatory and policy environment should be supportive of electronic banking. This includes appropriate banking regulations and communications, security, and information policies.

Testing an Electronic Banking Solution

The development of an electronic banking solution is far from easy it will have considerable impacts upon the financial institution. Risks during development and design must be carefully managed.

- *Institutional capacity*: The financial institution will require new technical competencies in order to run the e-banking solution. New functions like risk management, call centres and relationship managers may be necessary. Existing functions such as treasury management, internal audit and marketing may need to be strengthened.
- *Managing development risk*: The development phase caries considerable risk that the solution will not be developed as anticipated or will run over cost.
- *Pilot testing*: Whilst pilot testing may demonstrate the product to the competition, it represents the final opportunity to make changes to the design and/or implementation of the product.
- *Research*: The pilot test phase provides an opportunity to research client acceptance of the product, to refine marketing and communications to test the suitability of the distribution infrastructure and to test assumptions in the business case.

Options for Microfinance Programmes

Developing an electronic banking solution will be beyond the capacity of most microfinance programmes. However, with a good back office system, the MFI can consider a number of options. These include:

- *Personal Digital Assistants*: Using PDAs to improve loan processing and data collection (e.g. SafeSave in Bangladesh)
- *Credit scoring for micro-loans*: Using scorecards to improve credit appraisal for new and existing customers.
- *Microfinance programmes as issuers of their own cards through a wider initiative*: In this case, microfinance programmes do not need to develop their own back office systems. (e.g. Opportunity Bank operating with Malswitch in Malawi)
- *Microfinance programmes operating low-end closed loop ATM systems*: A relatively low cost ATM system can be built (e.g. Prodem in Bolivia).
- *Groups of Microfinance programmes implementing a focused programme*: In this case development costs are shared (e.g. Ferlo-MEPS in Senegal).

The Case for Donor Involvement

Donor subsidies need to be carefully applied. The Virtual Conference on Electronic Banking for the Poor (Feb 2004) derived the following general principles.

Principle 1: Donor subsidies should focus on building shared infrastructure and consider scalability.

Principle 2: The recipient institution should cover the recurrent costs of the e-banking initiative.

Principle 3: A careful cost-benefit analysis should be conducted before an e-banking initiative is launched.

Principle 4: There is a considerable amount that can and should be learned from the successes and failures of existing and previous initiatives. Donors should document this experience.

Principle 5: There is a potential role for donors to help governments understand and develop appropriate policy environments in which electronic banking initiatives would flourish.

Principle 6: Donors can invest in promoting e-literacy.

References:

References can be downloaded from www.*MicroSave*.net. The Electronic Banking paper has an expanded list of references and still more information is available on the *MicroSave* website

Cracknell David**,** "Electronic Banking for the Poor – Panacea, Potential and Pitfalls", *MicroSave* (2004)

Waterfield, Charles, "Conference Summary – Virtual Conference on Electronic Banking for the Poor", *MicroSave* (2004)