MicroSave Briefing Note # 97

The Business Case for Branchless Banking - What's Missing?

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July 2011

This is an interesting moment in the history of banking and money. It is especially important for the approximately 2.7 billion, or 72% of adults in the developing world, who have limited or no access to guaranteed deposits and other licensed banking benefits.[1] We are in the process of reinventing how these people send and receive money in remote locations, how they pay bills and loans, how they save and insure against emergencies, and for increasing numbers, how they enjoy greater freedom and control over their financial future.

And these numbers are growing. A recently released CGAP report on branchless banking in low- and mid-level income countries around the world shows an estimated 185 million active users for 2010, up from 137 million a year earlier, and though regular savers make up only 45 million of the total, their ranks show 174% growth, up from 16 million in 2009.[2]

The dilemma is how to make all these new ways of banking—by mobile phone, via card readers and enhanced ATMs, and with third-party agents who act on behalf of branch staff—either profitable or at least sustainable. But even if we limit the definition of this success to small or break-even gains for banks and others who underwrite these efforts, and even if we somehow monetise the broader benefits of financial inclusion, this dilemma is likely to remain unresolved with the current models. A useful example of leveraging the costs involved in opening and servicing low-income savings accounts is outlined in The Lydian Journal's, "Improving the Economics of Small Balance Accounts".[3] The focus is on internal bank costs, deposits, and margins—as in all conventional business models for banking—and the full burden for improving potential revenues lies in augmenting these individual deposits, reducing costly branch transactions, and extending margins and float.

No amount of creative math can really make this work. The reason seems obvious. This is not conventional banking any longer, at least not for the estimated 238 million registered users in what the World Bank now defines as branchless banking.[4] In most scenarios, new customer acquisition is the highest cost—anywhere from US$6 over a three-year period to $50 for inactive customers.[5] To put customer volume in perspective, Bank of America, rated number one globally in terms of tier-one (regulator-approved) capital and financial strength by The Economist and The Banker, has only 57 million retail customers. Citibank and ICBC (Industrial and Commercial Bank of China), two other retail banking giants, report 200 million and 158 million customers respectively.[6] None of these banks can boast an estimated 37% jump in active new accounts for 2010.

Branchless banking is about customer growth, potentially extraordinary growth, in ways that few large commercial banks need, or wish to pursue. It also depends on reliable mobile and other network technology, and an equally trustworthy cadre of agents in areas where branches are not easily accessible. Yet these three critical factors—new and active accounts, optimal technology pricing and collaboration, and a highly motivated agent network to serve them—are seldom the primary focus for most banks and regulators when they build financial models for the vast new markets 2.7 billion new customers represent.

Why ever not? The first reason is the uncomfortable truth that most banks do not want this business. The burgeoning middle classes, already famous in India, are expanding in Africa as well. The Wall Street Journal recently reported 34% of the population, or 313 million people, now swell these ranks in all parts of the continent, not just the southern tip.[7] The conventional banking business model works just fine for these larger deposit accounts. And dormancy in the smaller accounts is an expensive problem that will not go away. CGAP reports inactivity as high as 70%, and it is apparently "not uncommon" for only 10% of the new mobile money accounts to be in regular use.[8]

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[1]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

[2]http://technology.cgap.org/2011/05/11/the-state-of-the-branchless-banking-sector/?utm_source=feedburner&utm_medium=email&utm_campaign=Feed%3A+cgaptechnology+%28CGAP+Technology+Blog%29

[3]http://www.pymnts.com/improving-the-economics-of-small-balance-accounts/ Illustrating the Challenges, Levers for Reducing the Costs.

[4]http://technology.cgap.org/2011/05/11/.

[5]http://www.pymnts.com/improving-the-economics-of-small-balance-accounts/, http://technology.cgap.org/2011/01/25/the-lurking-challenge-of-branchless-banking-activating-the-inactive-customer/

[6]http://www.economist.com/node/16486707

[7]http://online.wsj.com/article/SB10001424052748703703304576296663397991894.html

[8]http://technology.cgap.org/2011/01/25/the-lurking-challenge-of-branchless-banking-activating-the-inactive-customer/

Meanwhile, mobile network operators (MNOs) have a business model predicated on volume, more volume, and diversified services to minimise churn. Nothing creates more loyalty than banking, so operators would dearly love to take on as much mobile banking as regulators will allow, which is not much, unless the operator is lucky enough to be located in Kenya or an equally forgiving regulatory environment. Most MNOs are precluded from awarding interest on savings, managing investments or insurance, disbursing government benefits, and—most important to any customer—offering guaranteed depositor transfers.

This means that although local operators may now be able to transmit money instantly from mobile to mobile, if subscribers try to pay a bill or send part of their monthly wage to another phone or bank account and the money does not arrive, legally this is not the phone carrier's responsibility. The sender may have entered the phone or account or his/her passport number incorrectly, or the transfer may simply be delayed.[9] Unlike a bank transaction, however, the onus of proof lies with the customer. This only has to happen once for customers to have a new appreciation of licensed banks. Authentication, fraud, and other accountability issues also pose higher risks without bank-grade security systems. To offer the level of service and trust customers need, MNOs must partner with banks or obtain their own banking licenses.

Most banks, however, see few shared rewards in such joint ventures and numerous potential new liabilities. Until more success stories emerge—which means until banks can figure out how to make money on their own terms in branchless banking—the dilemma persists.

A final key piece are the third-party agents who serve either as cash-in/cash-out points for mobile and other branchless money transfers in remote areas, or as field officers with responsibilities for new accounts and basic financial planning. For the second group in particular, increasing numbers complain that their revenues do not sufficiently compensate for costs, time away from core business, and the extra sales effort and expertise required. But the principal problem for all agents involved in cash transactions is liquidity management (up to $1,250 for their 19-28 daily transactions). Many must pay the banks for advances necessary to cover peak cash-out periods and all run the risk of robbery—in their shops or en route to and from branches. Insurance covers some, but not all, such losses, and generally agents, not banks, must absorb the cost of both the insurance and the theft.[10]

There is also the subtler but equally important issue of control. Most agents cannot charge customers directly for deposits, withdrawals, money transfers or any other services they perform. Only banks can levy these charges and thus banks also decide on the fee structure (flat fee, commission, tiered service), the fee amounts—and when and how agents get paid. Examples abound—in East Africa and India for example where some agents charge extra fees for no extra service—as to *why* banks need to supervise both fees and agents to protect customers. But the end result is unfortunate. Too often, agents feel their relationship with the bank is punitive and without trust.

Relations worsen when bonuses, and in some cases basic monthly commissions, are based on meeting goals for new accounts and more account activity with minimal attention to the regional and demographic differences. Both can heavily and unfairly skew results. In addition, few agents have access to bank IT tracking systems for customer complaints, valid paper receipts for legal disputes, promotional material for new services, and other basic financial-intermediary support needs.

For branchless banking to work and work well, agents must feel more valued and more involved. The first necessary split may be between sales agents—those who promote new accounts and services in more meaningful ways to poor customers—and cash-in/cash-out merchants who simply facilitate mobile and other money transfers. Both need more support and more clearly defined ways to earn trust from branch supervisors. Prospective agents should choose which role they prefer and understand the benefits and drawbacks of each.

Training, insurance, and better liquidity management are all significant costs, but this is the wrong column in the Excel chart from which to subtract in order to make the business case look better. A more productive challenge is to rethink all the columns. Every other industry has had to revise how they make money in new markets with new technology. Banking may finally be forced to as well. There may be no traditional "business case" for financial inclusion. The scope and needs of these customers are too different. This reality may ultimately persuade banks to share risks, and rewards, with MNOs and—watch this space—the post office, global consumer brands, and technology service providers. Each brings new value and possible solutions that banks alone cannot solve.

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[9] *MicroSave* Briefing Note #94 Riding the M-Pesa Rails: Advantages and Disadvantages, March 2011

[10] http://www.cgap.org/gm/document-1.9.49831/AgentManagement_TG.pdf, Agent Management Toolkit, Building a Viable Network of Branchless Banking Agents Technical Guide, Mark Flaming, Claudia McKay, Mark Pickens, 2011 Consultative Group to Assist the Poor/The World Bank, pp.4, 28.