The Latest Frontiers for Financial Inclusion: Using Mobile Phones to Reach the Unbanked

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Financial institutions are not winning any popularity contests these days. Banks are derided as the instigators of crisis and pillagers of wealth instead of caretakers of savings and partners in growth that they are meant to be. Even worse, many claim that it was policymakers' obsession with helping uncreditworthy low-income households gain access to mortgages that caused the crisis in the first place. Subtly implicating the poor in the colossal mismanagement of the financial sector by the (primarily) rich and the regulators that enable it is wrong. The truth is that banks and other financial service providers haven't done nearly enough to help the poor. The good news is that this is beginning to change–and we have the world's mobile network operators to thank.

What is financial inclusion?

As much as the citizens of the developed world may disdain banks, they still rely on all sorts of financial service providers for dozens of services such as checking accounts, automated teller machines (ATMs), Point of Sale (POS) devices, credit cards, and insurance just to name a few. In most developed economies more than 90 percent of households use bank accounts to save and to make payments. In many developing economies nearly 90 percent of households lack access to bank accounts and operate in a world of cash and informal borrowing and saving arrangements that are neither transparent nor regulated. The basic premise of financial inclusion is that the only way to bring financial services to the poor is to engage the formal financial sector. While specialized microfinance institutions are part of this, it makes little sense for 90 percent of the population to be excluded from the mainstream financial sector. To borrow from the United Nations, "Inclusive financial sectors are defined by a continuum of financial institutions that together offer appropriate financial products and services to all segments of the population."[1] And this goal is important even in low-income communities in the United States where the percentage of unbanked people can rival the numbers in the developing world.

Much more than microcredit

In the popular imagination, microfinance is microcredit, making small loans to groups of women to support a family business or farm. While this remains an important part of finan-

1 UNCDF and UNDESA. "Building Inclusive Financial Sectors for Development." May 2006.

cial inclusion, it represents a decreasing share of a rapidly growing movement to change the world's financial systems to better serve the financial needs of everyone, including the poor.

Some groundbreaking research has shown that despite a lack of options, poor households across the globe are incredibly active money managers and create mechanisms that imitate formal financial services. In "Portfolios of the Poor: How the World's Poor live on less than $2 a day," the authors assist dozens of low-income households across three countries to track their daily cash flow.[2] The diaries show that these families are often using ten or more "financial instruments" during the course of the year to allow them to accumulate (and spend) money in the needed amounts to get by. The records also suggest that poor households can grow their way out of poverty if they are able to avoid (or better manage) major calamities that destroy their savings or force them to sell off their possessions. When a family member loses a job, gets sick or dies it can push an otherwise upwardly mobile family back into poverty.

In developing economies low-income families lack government-sponsored social safety nets. To protect themselves, they seek different ways to save and manage money for medical treatment, funerals, school fees and costly family obligations. In other words, the benefit of financial inclusion is not just about providing financial opportunity; it is helping households everywhere to increase financial security.

The problem of distribution

As C.K. Prahalad noted in "The Fortune at the Bottom of the Pyramid: Eradicating Poverty Through Profits," that for decades companies have learned how to package things small enough and distribute them wide enough to reach the low-income market.[3] Satchels of shampoo, small bars of soap and bottles of cola can be found in the most remote places in the world. The global financial services industry needs to do the same. While the microfinance industry has helped show how to package services for the poor, including credit, savings and insurance, it has has not been nearly as successful at distributing them widely. When a microfinance institution reaches ten thousand clients and does so profitably, it is considered successful. But there are a billion more to reach.

Microfinance institutions and those that support them look to the business community for lessons on distribution. There have probably been hundreds of studies and articles on the distribution networks of Coke and Pepsi. Almost anywhere in the world you can find a cola in a shop that is painted or decorated with the colours and logos of one or both of the soft drink companies. In the past decade there have been experiments in using the distributors of everything from gasoline to beer to help solve the problem of mass marketing financial services.

2 Collins, Daryl and Morduch, Jonathan, Rutherford, Stuart, & Ruthven, Orlanda. *Portfolios of the Poor,* Princeton University Press. 2009.

3 C. K. Prahalad, *The Fortune at the Bottom of the Pyramid: Eradicating Poverty through Profits* (Philadelphia: Wharton School Publishing, 2005).

The masters of distribution are the mobile network operators (MNOs). For readers who have never been in a developing country or subscribed to a prepaid mobile phone service, it is worth explaining how it works. The prepaid mobile phone services is a "pay-as-you-go" business in which subscribers purchase air time incrementally (or "top up") as they need it. Subscribers first purchase their own phone and SIM card (which contains their unique mobile phone number) and then buy air time from a local store or street vendor, usually in the form of a scratch card. These air time distributors are ubiquitous in most developing countries–in any small village the local shop is likely to sell air time along with sugar, soap and cola. In most cases, these air time sellers have no contact with the mobile network operator. They are part of a vast, multi-layered distribution network that is often managed by one or more companies that specialize in getting goods and services to the mass market. MNOs are increasing the rate of mobile connectivity in developing countries from below 10 percent to 90 percent in just a few years. And this is exactly what we wish to accomplish with financial services.

If you've read the mainstream news in the past year, it is likely that you've heard about mobile phones being used for banking. In this case the developing world is far ahead of developed economies. A New York Times article recently noted that while about 50 percent of Americans used on-line banking, only about 10 percent use mobile phone-based banking. In the developing world hundreds of millions have recently begun using their phones through an entirely new method of banking which is called "mobile money."

Mobile money's roots date back nearly a decade to the Philippines when two operators, Smart and Globe Telecom, introduced domestic payment platforms that operated through mobile phones. These two companies realized that the mobile phone is a securely connected channel for data not unlike that which is used for ATMs and POS devices around the world. Rather than having to work through traditional and often expensive money transfer services, customers could go to Smart Money or GCash (Globe) agents throughout the country, deposit money into their m-wallet accounts, and then transfer it to someone else using their mobile phone number. This is commonly known as a person-to-person, or "P2P" transfer service. If either the sender or the recipient of a transfer lack a mobile phone the notification will be sent to the nearest agent, the same agent that offers "cash in" and "cash out" services. The technology is not so different from the system used for prepaid air time. Mobile money operates like a system of prepaid debit cards, with m-wallet holders "buying" electronic value (cash in) which remains in their account until they "sell" it (cash out). Because all m-wallets are prepaid, all transactions are performed in real time and balances of all clients are updated instantly so there is very little risk of fraud. The same technology that allows MNOs to track how much air time a subscriber has in real time is ideally suited for managing millions of small financial transactions.

The holy grail of mobile money is Safaricom's M-Pesa service in Kenya. Safaricom, a subsidiary of the Vodafone Group, launched a mobile money service four years ago that now serves over 12 million Kenyans. Once users add value to their m-wallet, they can use that electronic value to purchase goods, buy top-up (purchase air time) , or transfer funds immediately to another Safaricom user anywhere across Kenya. M-Pesa's subscribers can also exchange the electronic money for cash at an M-Pesa agent or at a number of ATMs around Kenya. M-Pesa was not the first to use mobile phones to provide financial services to the mass market, but the almost "viral" way in which the service has grown has changed the way we look at the world and in particular, financial inclusion.

Banks are also becoming more active in the market. As one example, ANZ Bank launched a subsidiary to complement its banking activities in Cambodia. ANZ's WING service initially focused on providing a reliable and inexpensive money transfer service for garment factory workers, mostly women, who often supported their entire families back in the villages through their wages. This was a customer segment that they never could have served through their bank branch. They also provide WING debit cards that allowed users to get cash at ANZ's ATMs rather than rely only on WING agents. MTN, a large regional mobile network operator in Africa, has partnered with a regional bank, EcoBank, to launch its service across the continent. In late 2010 another MNO, Orange Telecom, launched an m-wallet that is an actual bank account held on the books of Kenya's Equity Bank.

The spread of mobile money is accelerating. In Kenya, there is one mobile money user for every three Kenyans after only four years of operation.[4] In the small Pacific island nation of Fiji, 25 percent of the population had a mobile money wallet within four months of the service being offered. There are nearly 100 mobile money deployments now active around the globe. The mobile money industry is still in its early phase and there are certainly fears that we are witnessing an "m-bubble" that could burst if MNOs are unable to make the service profitable. Still, it is the most promising solution to financial exclusion to date.

Transformational change

Technology is often the driver of change in policy, industry, and consumer behaviour and leads to a transformational change. As an example, digital music has radically changed the industry, the laws around it, and the way we access music and other media all at the same time. The same is happening with financial services.

Mobile phones and other technological innovations are bringing financial services to the mass market and forging new alliances between telecommunications and banking companies. It would not be surprising to see deeper integration between the two in the future. M-wallets are also changing consumer behaviours and will continue to do so as consumers find new ways to use the service. Wage earners are less tempted to spend all of their cash if they don't receive cash (or have to stand in long bank lines) at the end of the week. Family members supporting others can now send money more regularly in smaller amounts, better managing the family's finances.

4 Reports from Safaricom press releases.

Mobile money is forcing regulators and supervisors to deal with a new actor in financial services and reconsider the best way to regulate services. Most regulators have taken a "watch and learn" approach, allowing mobile money services to grow provided that all of users' money in the system is kept in trust accounts in regulated financial institutions. The global financial crisis has also led to some soul searching by policymakers on how to shape a global financial system that serves the masses rather than itself. In 2010, the G20 took on the issue and developed its own "Principles for Innovative Financial Inclusion" as well as list of key action items for its member countries.[5] At the top of this list was working with the global standards setting bodies, to review their own policies and how they might help or hinder efforts toward greater financial inclusion.

Perhaps the most important is reviewing the work of the Financial Action Task Force (FATF), affectionately known as the world's "finance police." The FATF sets guidelines for the world's regulators on how to enforce anti-money laundering laws and combat the financing of terrorism. At a very practical level, it sets standards for client identification and customer due diligence. The new buzzword is "proportionate regulation" which means that regulators will consider regulations in proportion to the perceived risk of the financial service to the client and the financial system as a whole. It is now suggesting that regulators provide some flexibility to mobile money providers in verifying a user's identity.[6] So far, mobile money has proven to be a low risk activity.

Globalization certainly has its detractors, yet this combination of international bodies, multi-national mobile network operators, and yes, even commercial banks might just be on the right track to reach the next billion with appropriate financial services. And this creative mix of actors and new tools might yield important breakthroughs in reaching the unbanked in low-income communities in the United States as well.

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5 G20 Financial Inclusion Experts Group. Adopted in June 2010. Report is available at: http://www.microfinancegateway.org/gm/document-1.9.44743/Innovative_Financial_Inclusion.pdf.

6 FATF 40. Recommendations. Financial Action Task Force. November 2010.