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Over the past decade, mobile banking – the use of cell phones and other wireless devices to deliver financial services – has emerged as one of the most promising ways to increase access to financial services for the 2.2 billion “unbanked” adults in developing countries. Most of these people do not have access to brick-and-mortar branches. But they do have mobile phones, and even the simplest phones can be programmed to send and receive payments securely.

Mobile banking has already had notable successes in places lacking both the income level and infrastructure to support traditional financial services. But, for the moment, these are the exceptions; introducing mobile banking at scale has proved difficult.

It’s fairly clear why. Potential providers – banks and telecommunications companies – lack the capabilities to succeed in mobile banking on their own. And while in theory partnerships between banks and telecoms could allow them to achieve what they cannot on their own, in practice partnerships have proved difficult to execute.

Yet despite the formidable challenges, there are compelling reasons for the private and public sectors to invest the money and effort to build systems with sufficient scale to make mobile banking practical. The success stories to date suggest that the potential economic and social benefits are significant.

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WHO ARE THE UNBANKED?

The two billion-plus adults in Africa, Asia, Latin America and the Middle East who don’t use formal financial institutions to save or borrow money make up nearly 90 percent of the world’s “unbanked” adults. They’re generally poor and engaged in informal and unstable employment, like seasonal farm work. Complicating matters, they often lack a formal home address and have no financial or credit history.

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About 800 million of them live on less than \$5 a day in terms of purchasing power. So, if they are willing to pay for financial services at all, the services must be inexpensive. That makes them a bad fit for many large banks, which are burdened by the high costs associated with extensive physical infrastructure and legacy operating models. As a result, many traditional banks serve only the margins of the poor, and they are generally unable to offer services at a price not only that low-income customers can afford but also that allows the banks to make a profit.

As a consequence, low-income households turn to unregulated savings-and-loan clubs or

here is modest relative to the cost of serving these customers. And the issue is compounded by the fact that a high percentage of MSMEs are located in rural or otherwise hard-to-serve areas. These are exactly the kind of conditions that make MSMEs prime candidates for mobile financial services.

THE CURRENT STATE OF MOBILE BANKING

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borrow from family, friends or a local informal lender. These sources have important limitations, however – not least, their illiquidity and unreliability. What options does a poor person have, for example, when she needs the money she has lent to a neighbor who does not have the cash on hand or refuses to give it back?

The problem, moreover, is not confined to households and mom-and-pop businesses. A surprising number of enterprises in emerging markets – businesses with fewer than 250 employees – do not use external financing from formal financial institutions.

Within the constellation of micro, small and midsize enterprises, the micro and informal enterprises are the least served and are even less likely than small and midsize enterprises to have any formal banking relationships. For big banks, the revenue potential

tries that we tend to forget how critical they are to managing risk and smoothing purchasing power over long periods, as well as to improving productivity and increasing growth.

The shift from traditional to mobile banking is a step in the development of lower-cost banking models, one that parallels the shift to branchless banking. In more developed markets, branchless banking anchored on ATMs and secure Web sites is partially replacing traditional banking and cutting transaction costs. In many developing and developed markets, banks replace traditional branches by using hybrid networks – post offices, convenience stores, filling stations. But in areas lacking both physical banking assets and fixed-line access to the Internet, mobile banking on wireless voice and data networks provides an opportunity to leapfrog the invest-



ment in expensive infrastructure.

Even barebones networks linking cheap “dumb phones” are adequate to send or receive money – paying for goods, servicing loans and depositing savings. The technology enabling these activities ranges from simple text message-based software to versatile banking apps downloaded to smartphones.

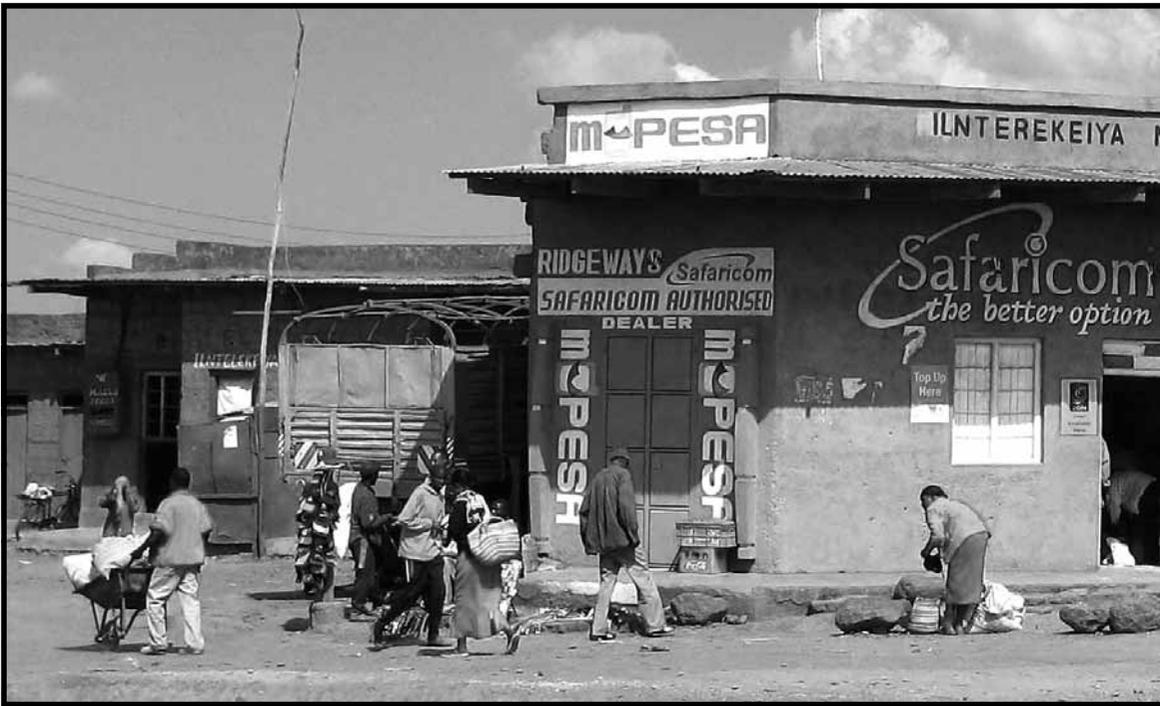
Note, however, that while mobile wireless technology underlies electronic money transfers, the model still depends on a system of reliable agents to facilitate cash deposits and withdrawals. The agents may be existing bank branches, retail stores or post offices that process financial transactions on behalf of banks or telecom companies, or they may be local mobile-phone company agents. Along with cash handling, these agents provide critical customer care, quality control and sales.

In the last few years, the appetite for mobile-banking services has grown, driven by the

widespread use of mobile phones by low-income consumers in emerging markets, especially in Africa and South Asia. Ghana, India, Kenya, Madagascar, Nigeria, Pakistan, Tanzania, Uganda, Zambia and Bangladesh have all experienced the introduction of three or more mobile-banking operations in the past five years.

Strategies for entering mobile banking have so far focused on providing access to payments and remittances. But pioneering companies in Kenya (M-Pesa) and the Philippines (GCash and Smart Money) have gotten a leg up on the competition by offering a broader array of financial services.

Still, the promise of mobile banking in the developing world is unfulfilled. A Gallup survey in June 2012 sponsored by the Bill and Melinda Gates Foundation found that in 11 African countries, 53 percent of adults – or about 134 million people – had completed



financial transactions involving distant counterparties in the 30 days before the research was conducted. Of these adults, 30 percent employed informal channels – using couriers, sending money by bus or with friends who were traveling, or simply carrying cash themselves to deliver it in person.

This illustrates the extent of the need for better financial-services options. But building mobile-banking systems to sufficient scale is difficult – in reality, no more than five of the numerous operations in Africa, Asia and Latin America can truly be called successful. And in some of these cases, the mobile operators owe much of their success to their very strong starting positions.

BUILDING DURABLE MOBILE FINANCIAL SYSTEMS

Mobile banking could be a low-cost channel leading to new sources of revenue and profit for banks and telecoms. And, according to a study by McKinsey, financial institutions could reduce their channel cost by as much as 50 per-

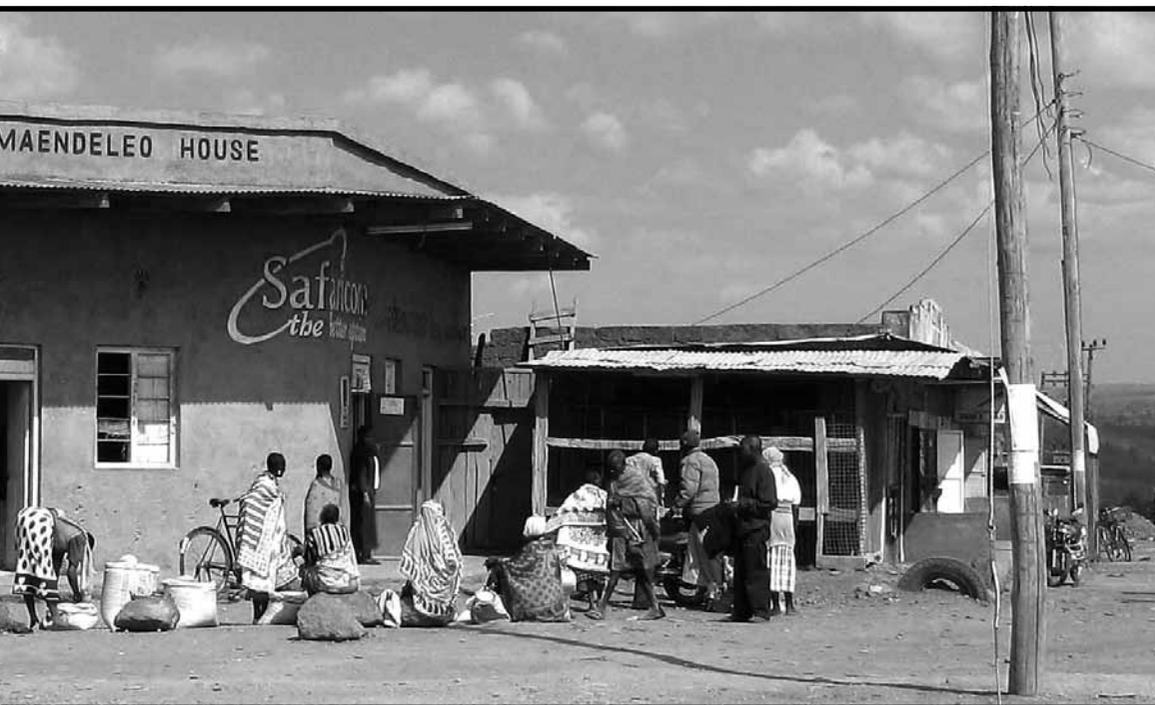
cent by adopting a mobile banking model. A handful of successful mobile-banking deployments have demonstrated the promise of mobile banking to generate revenue not only from direct fees on financial transactions but also through indirect benefits such as increased average revenue per user and reduced customer turnover.

But getting to profitable scale can be quite a challenge. McKinsey research suggests that the most crucial requirement is finding the right partners. The partnership imperative plays out in three ways.

1. Integrating core capabilities

Effective mobile banking requires coupling assets and capabilities from two distinct domains: banking and mobile telephony. Telecoms contribute the customer base, expertise in wireless technology and network resources, while banks deliver the financial services.

But many partnerships have stumbled at the outset because the parties fail to align goals, responsibilities, branding and customer own-



ership. Mobile-banking partners must play to each other's strengths. Current experience suggests that telecom companies have a clear advantage in marketing and sales and distribution. Banks, on the other hand, are more adept at auditing and managing float and liquidity. Branding, customer care, processing and regulatory management seem better undertaken jointly.

Take the First National Bank of South Africa, which has successfully partnered with every major telecom in the nation. Dealing primarily with customers already in the formal banking system, First National has become the most popular mobile-banking service in South Africa, with 2.6 million users.

2. Establishing distribution networks for cash handling

A high hurdle for these partnerships is managing the inherent complexity of mobile banking. The partners must focus on creating effective, low-cost agent networks where customers live and work in order to close the loop – to

take and dispense cash. The importance of the quality and density of this network cannot be overstated. We found, for example, that when a cash agent is located more than 15 minutes from consumers, mobile financial services have relatively little appeal and customers use them only once or twice a month.

The agent network, moreover, must grow in tandem with the volume of transactions and the location of the customers, offering agents sufficient incentives to provide quality service. In addition, liquidity must be managed – agents must have the cash to meet peak demand. Coping with the complexity of managing tens of thousands of independent agents across hundreds of thousands of square miles is frequently a source of friction between partners. Yet success in this regard is a make-it-or-break-it issue with customers who are generally skittish about using formal financial networks.

Safaricom Ltd's M-Pesa service, widely recognized as the most successful deployment of mobile money to date, didn't originally

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have a partnership with a bank. But it now works with nine banks to manage agents' liquidity. Since its start in 2005, M-Pesa's network has grown to more than 40,000 agents across Kenya. The network comprises Safaricom authorized dealers, retailers like gasoline stations and supermarkets, as well as bank branches and microfinance institutions.

3. Working with regulators

Banks and telecoms are hardly strangers to regulation. But mixing the two businesses can add layers of imponderables, especially if the mobile-banking system crosses borders and/or broadens its portfolio of financial products beyond simple payments.

So far, few players have managed to collaborate with regulators in ways that minimize friction and cost. Our work in the field suggests that regulators are often eager to support financial inclusion in order to drive economic development, yet many don't know how best to get from here to there – especially when unconventional financial providers like mobile phone networks are involved.

A McKinsey study found that 60 percent of mobile operators believed that regulators are open to designing rules that allow providers to serve target customers. Yet 80 percent did not think that regulators would grant low-value transaction exemptions from the key rules in account opening and servicing designed for more affluent customers. Operators believe such changes might make the difference in being able to offer such services profitably.

In some cases, mobile-banking providers have worked with regulators successfully. In Zambia, for example, Mobile Transactions Zambia Ltd (now known as Zoona) partnered with the U.S. Agency for International Development and national regulators to smooth the way. Their dialogue led to a “controlled

but non-restrictive” environment for mobile banking.

Flexibility was built into the know-your-customer procedures to accommodate the fact that user verification through formal identification can be difficult in rural Zambia. The regulations require a national registration card, driver's license or passport along with proof of name and address to open a bank account. But once a bank customer receives an identity document, another customer, the potential customer's employer or a village chief can verify his or her identity.

In the Philippines, the mobile operators Globe and Smart Communications worked with the central bank to reduce the regulatory burden. While the know-your-customer procedures were not relaxed, the regulations do permit retail stores (working as remittance agents) to perform the vetting and paperwork on behalf of mobile operators. These retail merchants soon became one of the engines driving customer recruitment for Globe.

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For all the challenges, mobile banking may be the single most convenient way to put financial services in the hands of a large, unserved population. Mobile financial services represent a huge opportunity for institutions that are able to offer high-quality, affordable products and services through a mobile device.

But, as noted, there are big obstacles to scaling up. To overcome them, the private and public sectors must be willing to commit to the long-term by dedicating time and energy to partnerships and by providing the support to developing products and creating an agent network. The beneficiaries of this approach will be low-income consumers, who in turn will drive economic growth through reduced economic vulnerability and the ability to plan for a better future. **M**