

# PERSPECTIVE

## One Billion Opportunities: Banking the Unbanked Globally



Look and you'll see an exciting landscape emerging in the banking arena. One where there is a billion-strong market actively seeking financial services but remains largely unattended to. These globally distributed prospective customers represent enormous earning potential for banks, but constitute the unbanked.

The unbanked are those who do not utilize banking services and have limited banking needs. The unbanked are not the poorest of the poor. However, they certainly include those whom banks need to serve but cannot do so profitably in the existing banking environment.

If the unbanked in India, China and Brazil were to generate even 50 percent of the revenues currently brought in by the banked, low-income consumers in these countries, the total amount of new revenues produced by 2015 in these markets could be above 20 billion euros.

If this market of around a billion people constituted a nation by itself, it would be the tenth-largest economy in terms of GDP, ranking after Spain but ahead of Brazil, India, South Korea, and Mexico. In its development, the next billion 'nation' stands today where India stood in the 1990s and China stood in the 1980s – on the cusp of high growth and voracious consumption.

Though these consumers need access to banking for savings, loans and microfinance, they do not have bank accounts. The reasons for this are compelling.

- Lack of steady and substantial income leading to a fear of insufficient funds for an account
- Limited access to banks, especially in remote areas
- Lack of formal employment that precludes a financial history
- Poor financial literacy
- Psychological factors such as mistrust of financial institutions

This unbanked billion is not outside the banking sector by choice. An important reason for their predicament is that banks do not offer them suitable products tailored to their needs. In effect, they have been excluded by the banks' inability to understand their requirements and the unwillingness to adopt innovative models to serve them.

However, this billion also constitutes an enormous opportunity – if banks are willing to accept the challenge of including them with an eye on the bigger picture. This paper provides a regional perspective to this issue and examines what banks can do to capitalize on this opportunity.

## How to bank the unbanked

In China and India only about a third of the population participates in the formal banking sector. In Africa the number is just 25 percent. India has the second-highest number of financially excluded households in the world – 135 million – after China's 263 million. Africa as a whole has 230 million unbanked households, and Central and Eastern Europe and Latin America have 19 million and 42 million respectively.

But irrespective of where in the world they might be, this unbanked section of society has similar needs for financial services. Apart from the obvious requirements of savings, loans, transactions, and investments, the unbanked have certain special needs, which are:

- Flexibility in savings and repayment schedules owing to a lack of steady income
- Simplicity and speed in processing
- Small product sizes when it comes to loans and low-balance savings accounts
- Proximity and ease of access
- Basic financial education or information since the unbanked may not understand even elementary concepts of banking

Most banks find it difficult to meet these needs because of the high economic cost of servicing these demands. However, a little out-of-the-box thinking in devising products that are simple and accessible can help ensure inclusive growth.

Some of these measures could include tying up with an NGO or with a retailer and using village residents and empowerment groups as representatives. These can lower customer acquisition costs and increase customer base, thus helping banks overcome the high cost challenge. Such groups also help banks mitigate risks associated with dealing with the unbanked. An estimated 2.6 million self-help groups in India are linked to banks, giving financial institutions access to 40 million households.

It is important that the products are downsized without being downgraded to match the unbanked population's smaller requirements by offering low installments and flexible repayment options. Banks also require performance metrics and regulatory conditions that are more suited to including the unbanked in the financial mainstream.

Some banks are using inter-industry partnerships to increase financial inclusion. For example, banks in Brazil have added 100,000 point-of-sale locations to distribute products by tying up with retailers. Not only are these channels cheaper for banks but they are also more convenient for consumers.

Banks must realize – and they are seeing the light – that since the unbanked have remained unaddressed by traditional financial institutions, they will not hesitate to choose newer players for basic banking services such as payment and deposit transactions. Collaborating with telecom players, adding a mobile channel, and utilizing cross-selling opportunities will go a long way in meeting the needs of the unbanked.

In many emerging economies, mobile consumers are growing at a much faster rate than bank customers. Mobile banking is taking off because it is convenient, fast, simple, and secure. Moreover, it is a cost-effective option for banks. A reputed analyst firm estimated that there will be 33 million mobile payment users worldwide in 2008, with the Asia Pacific taking the lead. The number is expected to triple to 103.9 million users in 2011.

Other forms of branchless banking and e-payment gateways such as payment cards and the Internet can also help banks increase their outreach. Banks need to experiment and include the next billion consumers not merely for the socio-economic assistance they will gain. The step will also have a strong business imperative for banks. Not only will

a bank increase its customer base, but it will also ensure increasing numbers of future customers as incomes increase.

Let us examine how banks are reaching the unbanked in various parts of the world, namely, India, China, East Europe, parts of Africa, and Latin America.

## India

The Indian banking market is zooming, with assets expected to reach \$1 trillion by 2010. An expanding economy, a growing middle class and technological innovations are contributory factors, according to a research report.

The industry is focusing on the retail side of the market, with a CAGR of 23 percent in the past five years. However, despite this thrust on retail banking, banks will have to come up with creative and simple solutions to make money in India. This is because India has a huge unbanked population and unless this is included, neither will banks prosper, nor the country.

Banks have also realized the potential of this market and have come up with innovative means of reaching it. They are going back to rural pockets for financial inclusion. State Bank of India Ltd. is drawing up plans to reach out to 100,000 villages. In September 2007, ABN Amro Bank announced its microfinance division had provided basic financial support to some 500,000 underprivileged households.

Building more branches in the countryside may not always be cost-effective. So banks need to explore other options by developing a better understanding of what rural households need and offer new products and distribution networks to suit them.

If we consider the number of bank accounts vis-à-vis the entire population, the percentage comes down sharply to 31 percent. When it comes to accessing bank loans, the scene is worse. The credit market is very small with the number of loan accounts constituting only 14 percent of adult population in India. In rural areas, the coverage is 9.5 percent. The unbanked turn to informal credit sources owing to their greater availability.

Providing banking services through 'Banking correspondents' represented by self-help groups, NGOs and other approved organizations is one branchless banking mechanism. Touch-points may be set up by such organizations at places commonly visited by the unbanked, such as the village markets or schools. This may be supplemented by outreach teams equipped with hand-held devices on which simple banking transactions can be performed.

Mobile banking is another way of reaching out to such customers and is also a huge opportunity for banks in India. According to a report, the total number of mobile subscribers by March 31, 2008 was 261.08 million as against 2007's 165.09 million (an increase of 58.14 percent). This figure shows that in just three years, the number of mobile subscribers has grown over 4.5 times. India is adding more subscribers per month than any other country. The next billion subscribers will come from the BOP (Bottom of the Pyramid) market, of which India will have the largest share. The growth of mobile phone subscribers is outpacing the growth of banking customers as also PC and Internet users in India.

In 2006, banks were allowed to take the help of NGOs and microfinance institutions as intermediaries in offering banking services through the use of correspondents. This was perhaps a factor for many banks that opened six million no-frill accounts with low or zero minimum balances between March 2006 and 2007.

ICICI Bank, HDFC Bank and Citibank have launched their own microfinance programs. HDFC Bank thus has tied up with NGOs in Andhra Pradesh and Tamil Nadu to make money accessible to the rural poor. Citibank has linked up with NGOs. Standard Chartered plans to lend \$100 million for micro-financing by 2008, up from current commitments of \$40 million.

Banks are looking at technology to provide banking services at low cost – and this includes rural banking too. Citi has set up a bio-metric ATM as a part of its 'no-frills' Pragati account for the under-banked. The ATM recognizes the customer through her thumb impression and can interact in regional languages.

## China

Estimates about the numbers of unbanked Chinese vary. The People's Bank of China (PBC) estimates that only 36 percent of Chinese rural households have access to financial services. As one indicator of demand, the informal finance market has been estimated at anywhere between CNY 1 trillion (\$132 billion) to CNY 2 or 3 trillion.

But the bigger Chinese banks have for many years now been moving out of rural areas, goaded by commercialization and competitive pressures. The four big state banks have reduced their presence in rural areas by over 43 percent in ten years, closing 30,000 branches in the last five years alone.

The Chinese government has launched several initiatives to test out new forms of rural financial service providers. Among them:

- The People's Bank of China in December 2005 launched a pilot initiative to establish Microcredit Companies using commercial licensing
- The China Banking Regulatory Commission in December 2006 introduced their own pilot, creating new types of licenses for rural financial institutions

It is believed that given the reliance on cash in rural China and that additional ATMs do not appear to be the answer, the existing mobile Short Message Service network could quickly and cheaply provide an SMS-based payment system in rural areas. Since the most expensive parts of the infrastructure — the network and phones — are in place, this solution would be relatively low in cost, between \$40 million and \$60 million. By forming a partnership, banks, network operators and merchants could unlock spending.

The Chinese largely rely on cash payments, thus increasing the importance of the cash-based e-payment channel. Some leading third-party payment providers are adding cash-based and non-bank based payment options to their offerings. These include:

- **Cash remittance:** Alipay is a third-party payment provider, allowing users to top up accounts with cash through China's postal service. This service was launched in March 2007 in selected China Post branches throughout China.
- **Mobile toll stations:** Smartpay, China's leading mobile top-up company, has formed a network of approximately 30,000 dealers. Smartpay dealers allow users with bank accounts to easily use Smartpay's services, which in turn gives Smartpay access to a much wider range of potential users.
- **Targeting the unbanked with pre-paid cards:** E-payment player IPS uses mobile and telephone prepaid cards in order to reach unbanked users. This service takes advantage of the popularity of prepaid top-up cards used for phone bills, online games, and virtual currencies in China. The cards are usually purchased with cash at newspaper kiosks, small shops, and internet cafes. IPS operates a service called lpay.

## East Europe

In Poland, only 50 percent of the country's population has a bank account, according to ING Group. Banking penetration was 69 percent in Hungary at the end of 2003.

Many East Europe (EE) residents avoid setting up bank accounts because they lack confidence in the banking system. This mindset is gradually changing as governments encourage salary payments directly into bank accounts.

Austria's Erste Bank has the largest network in the region and intends to target the unbanked in Hungary, the Czech Republic, Croatia, Serbia and Romania. Western banks in EE are focusing on meeting the needs of the younger population. In Poland, only 49 percent of people over the age of 15 have a bank account, according to a Polish research company.

Almost 40 percent of Poles who participated in a recent banking survey attributed the low level of banking penetration to their lack of savings. Only 5 percent of Polish people use Internet banking, against an average of 24 percent in Europe as a whole; 4 percent of Poles use telephone banking services compared with 7 percent in Europe.

To make it easier for Poles to access banking products, ING Bank Slaski, the Polish operation of ING Group, has simplified some products. The new offerings include a savings account which offers one flat interest rate and a low-interest credit card.

Plastic card technology is expected to present the banking industry with an important means of tapping the unbanked market. Moreover, according to a research firm, electronic payments are expected to grow from \$3.8 billion in 1999 to \$25.8 billion in 2009, thus indicating greater use of non-traditional banking options. This also offers banks a channel for growth.

Similarly, post offices, which constitute more than 50 percent of the physical infrastructure for access to the financial sector, could provide an innovative POS alternative to reach out to the unbanked.

According to an August 2003 report, banks in the region are looking to move beyond branch-centric distribution. This includes extending ATM networks and looking at online and phone banking. The highest growth in IT spending was expected to come from Romania and Bulgaria.

## Africa

According to the IMF, African countries are enjoying their best period of sustained economic expansion since attaining independence. Real GDP growth is expected to rise from 5.7 percent in 2006 to 6.8 percent in 2008. Still, only 20 percent of families in Africa have bank accounts.

Ethiopia has less than one bank branch per 100,000 people – a developed nation like Spain has an average of 96 branches. Even in South Africa, where the sector is more sophisticated, only 40 percent of adults have bank accounts. But there is a huge demand for bank services. Finding this demand unfulfilled, millions of Africans turn to informal services or invest in cattle.

But banks are increasingly adopting innovative methods. South Africa has physically taken branches to the unbanked, either as prefabricated units, or in vans that make visits to under-served areas. In remote areas, machines have been installed in shops where customers print out a slip and present it to the shopkeeper, who provides the cash. Some rural branches and ATMs rely on solar energy and satellite phone.

The 'Big Four' banks of South Africa (ABSA, First National Bank, Nedbank Group and Standard Bank) and the government developed the innovative Mzansi account in 2003 which is a low-cost transaction account. It enables banks to cover at least 70 percent of the unbanked market in a relatively short time. The government provided a small subsidy to cover the cost. It is targeted at people who earn less than R2,000 (US\$264) a month. It now has more than 4 million subscribers.

Studies conducted in 2004 have suggested that point-of-sale (POS) facilities can play an increasingly important role in providing the unbanked access to basic financial services in South Africa.

West African financial services biggies Zenith Bank and Ecobank and multinationals Citibank and the International Finance Corporation have set up the Acción Microfinance Bank in Nigeria. It aims to provide low income earners and entrepreneurs with credit facilities and finance.

Mobile banking seems to be the most promising option in Africa. Few Africans may have bank accounts, but many have mobile phones. Wizzit (a financial services provider), First National Bank (FNB) and MTN Banking (a joint venture between Standard Bank and a mobile-phone network), are targeting the 14 million unbanked South Africans.

In Kenya and Botswana, 17 percent of the unbanked own a mobile phone. In Kenya, Vodafone and Safaricom, Kenya's leading mobile operator, launched an m-commerce payment service, M-PESA, aimed at the unbanked in March 2006. Within three months, it had 150,000 customers, with 2,500 new users signing up each day.

First Bank linked-up with Nigeria's second biggest mobile operator, Globacom. The partners introduced the GloFirst card in conjunction with the switching company Interswitch. GloFirst can be used to withdraw money, check card balance, print mini statements, change the Personal Identification Number (PIN) and transfer money to another cash card or bank account.

## Latin America

Chile reports the highest penetration and the lowest percentage of its population living below the poverty level. It is followed by Brazil, where the majority of households have checking accounts because most payrolls in the formal economy are

disbursed electronically. Until recently, 40 million Brazilians had no access to banking services. Nonetheless, access to consumer credit in Brazil is mostly limited to the middle and upper class, and even foreign banks target primarily customers with an annual income of at least \$20,000.

In Mexico, the formal banking sector has targeted only the top 15 percent of the population, while the other 85 percent is considered too risky and unprofitable. Now, however, more foreign banks in the sector have begun to pay closer attention to the retail credit card business and other remittance-linked products. In Colombia, where 55 percent of the population lives under poverty level, access to bank credit is low at 23 percent.

Therefore, Latin America's huge unbanked population offers an enormous opportunity for banks recognizing their potential. To serve the banking needs of a relatively low-income economy with low penetration requires innovative and imaginative non-branch solutions. Microfinance and IT are enabling banks to serve the excluded at relatively lower costs. Banks are also helping create financial literacy with the help of community leaders.

Bancomer, one of Mexico's nationalized banks, is reaching out to the lower-income segment by offering simplified and more accessible products, such as pre-paid credit cards or cards with fixed monthly payments. To cultivate a culture of savings in Mexico, Bancomer has made available a savings account-debit card combo for a minimum deposit of about \$70.

Santander Banespa, a Spanish-backed bank in Brazil, manages about 5.1 million customers and 1800 branches. It has grown steadily in recent years by concentrating on personal lending, car financing, insurance, and investment funds. It helps that local interest rates are dropping and that Brazil's government has introduced incentives to increase credit. For example, payroll loans, whereby installments are debited from paychecks are now permitted.

In Brazil, banks are using nonbanking outlets, such as kiosks and even supermarkets, to reach customers. However, the central bank's efforts in the way of promoting community representatives or agents and microfinance efforts are slowly bringing more of the unbanked into the mainstream.

However, obstacles remain: agent-handled accounts are subject to transaction limitations, interest rate caps render microcredit unprofitable and credit information is scanty. Electronic payments in Latin America are slowly taking off, but are hampered by factors such as low income and lack of banking penetration. Banks are trying to keep the reform momentum going. For example, Mexico has launched a three-year public-private initiative to expand the number of chip-enabled point of sale terminals. The goal is to divert the use of cash taken from ATMs to POS debit-card transactions in its continuing battle to suppress the informal economy.

## Conclusion

The numbers involved in meeting the needs of the unbanked may seem daunting, but in reality they represent a billion-strong opportunity for banks. By paying greater attention to their wants and developing sensitivity to their needs, banks will be able to develop customized products and include the unbanked in their scheme of things.

Banks may do well to remember that they have a business imperative in converting the periphery into the mainstream.

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