The profile of retail payment services and models in South Africa

Focus note 1: Key findings

About the focus note series

This is the first in a series of six focus notes based on the full FinMark Trust report titled **The Profile of Retail Payment Services and Models in South Africa: Assessing the potential to increase financial inclusion and market participation,** by Insightworx (Colin Donian; Maire Eltringham). The full report can be downloaded from: **www.finmark.org.za**.

The study aimed to sketch the landscape of retail payment services in South Africa that have a positive impact on financial inclusion and market participation. It also aimed to start to develop a typology of models based on shared characteristics witnessed across various services. The prime inputs to the study were a series of interviews with market participants, desktop research, mystery shopping excursions, as well as feedback received during a stakeholder workshop in March 2011[1]. The models are not *"final"* or cast in stone; rather, they are intended to form the basis for discussion and to identify issues and trends in this market segment.

The focus note series draws out the key findings on a thematic basis. The full list of focus notes are:

- Focus note 1: The SA retail payment services landscape: key findings and issues
- Focus note 2: Towards a common understanding of terms
- Focus note 3: The regulatory framework for retail payment services in South Africa
- Focus note 4: Retail payment system market participation framework
- Focus note 5: The landscape of retail payment services in South Africa
- Focus note 6: Towards retail payment services models in South Africa

1. Overview

The South African retail payment services landscape has developed significantly in the past few years. There is a wall-to-wall tapestry of payment services and models that cater for a range of diverse needs for entry-level customers and others. New types and styles of payment services have arisen, providing for greater potential levels of inclusion. In essence, South Africans that seek financial inclusion face a materially more accommodating landscape than was the case a few years ago. This is reflected in financial services usage: according to the FinScope survey findings, the percentage of South Africans that are formally included (banked and/or served by other formal financial institutions) increased from 57.6% in 2006, to 67.6% in 2011. FinScope 2011 reports that 97% of banked adults had or used some kind of transaction product, suggesting that the need to transact is the primary driver of financial services take-up.

1 Please note that the information contained in the notes was current at the time of research, namely February to March 2011, and therefore does not necessarily account for all recent developments in this rapidly changing market

At the same time, South Africa has a sizeable market segment that is not yet included in formal financial services. According to the latest FinScope (2011) findings, 27% of South African adults are financially excluded and a further 5.5% use only informal financial services. In describing the landscape of financial inclusion-relevant payment services in South Africa and the innovation that has taken place, this study therefore, does not state that all the work has been done. Rather, this is a stock-taking exercise at a particular moment in time, aimed to inform further innovation and actions in the ongoing quest to maximise financial inclusion.

The primary catalyst for the changes witnessed in the past few years was arguably the sector-wide accord aimed at transformation and financial inclusion in the financial sector, known as the Financial Sector Charter, negotiated between government and industry and in force since 2004. In particular, the broad-based negotiations that resulted in the accord, and the subsequent commitment to deliver more accessible retail financial services, triggered the conviction among industry that there are innovative ways to serve previously un-serviced market segments in a commercial manner. The socio-political commitment to substantively improve access to financial services ultimately led to the business imperative of doing so. This resulted in a multiplicity of endeavours by both banks and non-banks to seek innovative methods to serve excluded markets.

In addition, the regulatory authorities have systematically adjusted the regulatory regime to accommodate more accessible payment services and allow a broader range of players. Notable is the allowance made for third party payment providers (including non-banks) and the definition of "payments due" to a third party as outside the definition of deposit-taking. FICA Exemption 17 and the associated lowering of the documentation burden facing customers has also played a significant role, as has the allowance for non-face-to-face origination in cellphone banking, subject to certain transaction limits.

The opportunities of convergence within and across sectors and services (for example money transfers and mobile phone transactions, or financial services and retailers such as supermarkets) also fundamentally changed mindsets about 'the art of the possible'. Innovation continues to happen among banks and non-banks (including technology providers) and will surely push the current boundaries of services, business models, pricing, convergence partnerships and new suppliers.

Though this is a supply-side review, the point of departure is a demand-side orientation, namely: what are the payment services needs of the unserved market? This then forms the lens for further questions, notably: do current service offerings cater for these needs? How do new technology, new business models, improved competition, regulatory changes and so forth improve the market's ability to service entry-level customer needs? How do service offerings differ in this regard, that is: into which distinct payment services models can the various payment services in the market be classified?

To do so, a range of 30 payment services were reviewed (see Focus note 5 on the landscape of retail payment services in South Africa)3. When the individual payment services are grouped together based on their shared "customer-experience" characteristics, eight models of retail payment services emerge (in no particular order):

1. The **'Grocer'4 Model** – covers five of the 30-retail payment services reviewed, mainly national retail store-led, bank sponsored money transfer services. The customer experiences the service as if they were grocery shopping. No bank accounts are required on either end of the transaction. This model is most closely aligned with the basic need as defined. KYC compliance requirements fall within FICA Exemption 17.

2 Financial Intelligence Centre Act – see Focus Note 3 for a full overview of the regulatory framework pertaining to retail payment services.
3 Note that the 30 services selected to represent the retail payment service landscape provide a snapshot at the time of the field research, namely early 2011. It is recognised that the market evolves and there may therefore be players and services not described in the report. However, the key characteristics and, hence, models, remain valid.
4 Note that the term grocer does not necessarily limit this model to supermarkets – it can encompass any type of retailer.

Making financial markets work for the poor

2. The **'Poor Person' Model** – this is the Mzansi Money Transfer, also a pure no-account based money transfer service. It is a creature of the Financial Sector Charter and is treated poorly by both customers and suppliers. It has technical potential but seems to have the albatross of coercion around its neck. Compliance requirements are also Exemption 17 driven, but more complex than for the Grocer Model services as both sender and recipient are impacted.

3. The **'Mobile Money' Model** –this service through some mechanism creates e-money on a mobile platform and enables it to be used in an eco-system of e-money. The lowest KYC requirements pertain here, governed by the 'prepaid' FICA exemption if so compliant. A customer's primary interface point is their mobile handset, and this defines the model. There are four services in this model, including FNB's *eWallet* and Flash's Flash Cow services.

4. The **'Smart Card' Model** – there is only one true smart card product offering in South Africa at present, namely that provided by Net1. It has high technology on the card platform, in the processing of on-line and off-line transactions and biometric customer verification. The customer experience is likely defined by the nature of the high-tech card and its dissimilarity to a bankcard. Currently it operates in its own closed loop proprietary system, much as all the bank services do through various levels of interoperability. Plans are afoot to integrate the card into the EMV[5] environment. Compliance (KYC[6]) is also Exemption 17 based.

5. The **'Electronic Voucher' Model** – this model is defined by a card-based prepaid platform, offered by banks in concert with the card associations, Visa and MasterCard. Services need to be FICA Exemption 17 compliant.

6. The **'Buy and Pay' Model** – services here typically provide purchases and payment intermediation for mobile phone top-ups, prepaid electricity, utility television licenses, lotto purchases and the like. A customer uses the service to buy or pay for services without the need to have a bank account. KYC requirements do not prevail at all.

7. The **'Mobile Banking' Model** (or **Mobile Bank Account Model**) – which is primarily different from the Mobile Money Model in that e-money is not created and stored on the mobile, but is accessed in an underlying bank account, at least not on one side of the transaction, but often both. A customer experience is likely to be that they have an additional channel attached to their bank account, albeit in a more convenient way via their customer-owned handset. KYC requirements range from full FICA to Exemption 17, depending on the nature of the underlying account/s.

8. The **'Bank Account' Model** – this is the stock standard two-sided bank account model where customers are intermediated through a bank via a range of channels, from branch to internet to mobile. These services also have compliance ranging from full FICA to Exemption 17.

While some service features are shared amongst the models, there is at least one core distinguishing factor in each model to ensure that they are all mutually exclusive, but collectively form a relatively complete picture of the full retail payment services landscape. See Focus Note 6 for a complete overview of the models.

5 Eurocard, Mastercard and Visa
6 "Know your customer" requirements – see Focus Note 3 for a full overview of the regulatory framework.

We argue that a "transformational" basic payment service (defined as a service that is most likely to incorporate people who previously transacted in cash, that is, were financially excluded), will meet the following typical basic customer service need parameters:

- **No need for an account,** i.e. the ability to conduct *ad hoc* transfers and payments;
- Single function or purpose services that can be used and paid for on a **'pay-as-you-go'** basis;
- **Direct costs** that are in line with the target market's low and intermittent incomes;
- Low transactional costs (**indirect costs**), generally achieved via either **broad distribution** infrastructure in areas close to the target market individuals' homes, places of work or commuting routes, or **customer-owned infrastructure** such as a mobile;
- Low **compliance requirements** to reduce indirect costs and complexity;
- The more **open the service's system loop (i.e. the more interoperable)**, the better. This factor is aligned with broad distribution footprint; and
- Use of the service can be **packaged with other activities** or transactions the customer may have, which reduces transactional costs and/or improves familiarity with the service.

The models that exhibit the above factors best tend to be the ones that are most transformational, i.e., that are likely to have the biggest financial inclusion impact. According to our assessment, the most transformational of the models is the Grocer Model, followed closely by the Mobile Money Model and Smart Card Model.

2. Drivers of RPS market development

The eight retail payment services models described above reflect the prevailing market conditions. The South African retail payment services landscape has changed markedly over the past seven years as existing, new bank and non-bank players started seeking commercial ways to serve the under- and unbanked markets. A number of factors have shaped the evolution of the market:

1. **Country conditions:** As can be learned from the well-documented Kenyan experience with M-Pesa, a number of conditions may be the incubator for the large-scale take-off of innovative retail payment services that aim to go beyond the traditional branch-based model. These include very high levels of financial exclusion, low reach of the classic banking system, a flexible regulatory regime, high penetration of mobile telephony and a strong demand for a money transfer service. In South Africa, not all of these conditions hold. This shows that transplanting a particular (successful) recipe from one jurisdiction to another with a materially different context does not necessarily guarantee success[7]. While mobile penetration in South Africa is high and there does seem to be a strong money transfer demand, the banking sector is sophisticated and the majority of the population is banked. Nevertheless, a substantial part of the population has traditionally been excluded. Uptake numbers would suggest that new, alternative ways of engaging with financial services are gaining traction[8].

7 This is illustrated by the different initial experience of M-Pesa in South Africa as opposed to Kenya, as explained in the following press quote: "Mobile money platform M-Pesa has failed to live up to Vodacom's expectations for the product in SA, Pieter Uys, the group's CEO, has admitted. Vodacom has registered "more than" 100 000 M-Pesa users in SA since its launch in August 2010, but says this has fallen short of its expectations for the product. When it unveiled the product last year, Vodacom said it expected to sign up 10m M-Pesa customers within three years — an ambitious target given that SA has a total unbanked population of 13m." Nedbank lags in cellphone banking. Mpho Lukoto. Business Day. 30 May 2011. http://mobile-financial.com/node/14226/M-Pesa-disappoints-for-Vodacom-South-Africa. 15 June 2011

8 For example, FNB announced on 31 May 2011, based on a recent report by global market research firm TNS, that its cellphone banking and e-*Wallet* customers have now passed the 3 million marks. Absa is close on its heels, reportedly now with 2.7 million cellphone banking customers. Nedbank and Standard are thought to add another 500,000 customers using cellphone banking (Business Day, 31 May 2011).

2. **New entry and convergence:** Market dynamics have changed over time, sparked partly by the entry of nimble technology-driven players, as well as the increasing interest of other entities that are traditionally outside the financial services space. These however, have a large customer base that can be leveraged with a potential for diversification of income. Examples of such new players include retailer chains, technology companies and telecommunication companies. This has in essence led to a "convergence" across industries. This process has played off within a bank-based model, as mandated by the South African regulation; whereby all models that entail deposit-taking as broadly defined involve a bank as partner. Nevertheless, the role of banks has changed somewhat from primary players or drivers in the partnership, to co-players along with partners such as retailers, telecommunications and technology firms. The telecommunications, retailers and technology companies are generally able to deliver certain services at materially lower costs than through the banking infrastructure, to the direct benefit of customers. Regulatory developments in terms of payment system participation as well as know your customer compliance requirements have facilitated this trend[9].

3. **Innovation sparks competition, competition sparks innovation:** The innovation and increased movement in the non-bank space has enhanced competition that, in turn, has spurred innovation on the bank front. Banks are increasingly aware that there is scope for them to be disintermediated by entities that can do much of what they do, better, faster and at lower costs, and have close relationships with large chunks of the market (for example: retailers, who have a large customer base and who want to add financial services to their service offering). There is also a growing sense of competition between banks to gain the edge in the 'new frontier' provided by innovative retail payment services[10]. The first 'mobile banking' services of the early 2000s were simply channel-additive, providing existing, mostly high-end customers, with another access channel. This approach did not initially prove to be popular. Today, based on learning from experience and through more marketing, the drive is to provide *entry level* transformational services via mobile communications systems. It is this re-positioning of the target market, based on serving the needs of those without ready access to other channels, that is proving a better recipe, or at least the start thereof. At the same time, from the banks' perspective, it serves as a cost-cutting measure by partially channelling customers out of branches and reducing the use of cash.

4. **Increased awareness of demand-side needs:** The Financial Sector Charter had a clear demand-side orientation, sensitising suppliers to the particular needs and capabilities of entry-level customers. Banks and other financial service providers were galvanised into action, first producing collective (industry-wide) socially-oriented service solutions such as the Mzansi Account[11] and Mzansi Money Transfer services, and then progressing to develop proprietary solutions for entry-level consumers. Many of the services that are reviewed in the report are 'children of the post-FSC wave'. Financial service providers realised that the entry-level market could be served commercially by innovative solutions, such as retail-led transfer services or mobile banking.

5. **Global developments:** The South African financial services dynamics are very much aligned with financial service developments elsewhere in the world. South Africa continues to be an incubator for new ideas and practices in the domain of making financial services more accessible to a broader market place.

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9 |Notably: Section 7 of the National Payments Systems Act, NPS Directive 1 2007, FICA Exemption 17 and Guidance Note 6/08

10 This trend is described in a recent quote by John Campbell, business development executive at Standard Bank's *Beyond Payment*, who stated that there is no doubt that one senses "a 'land grab' is under way in SA's cellphone and banking industries as big companies — retailers, banks and telecommunications operators — begin vying for a stake of the fast-emerging market for mobile payments. All the big banks and mobile operators are experimenting with different models, trying to find the one that will prove a massive success. There's no question of the banks backing away, either, as they view mobile payments and commerce as core to their future strategies. That means the fight could soon turn into a full-scale war." http://www.techcentral.co.za/inside-sas-mobile-payments-land-grab/13674/.

12 Mzansi is a low cost, easy to use transactional account, launched by the Big Four commercial banks and the Postbank in 2004. Additional defining features of the Mzansi account are free debit cards, no monthly administration fees, minimum opening and on-going balances, a flat fee for withdrawals from the client's bank or any other participating bank, the option to make withdrawals and deposits at Post Office counters. Source: http://www.finmark.org.za/search/search.aspx?SearchTerm=mzansi

3. Where to from here?

In summary, the analysis shows that the recent 'step up' in the retail payment services market and increased levels of participation has improved creative competition. As the converging marketplace continues to break new ground it is likely that the range and depth of financial service providers will increase, enhancing financial inclusion across the board. It is the authors' view that, going forward:

- The 'Grocer' Model will continue to grow in depth and scope. Its reach will expand firstly to cover more of the existing retailer footprint, but also beyond retailer infrastructure (e.g. where people use their mobile phones as interface or where the ATM network is harnessed as access points for retailer-based service offerings). It is likely that additional services to the domestic money transfer will evolve so that retail outlets increasingly become a one-stop shop for the intermediation of a range of financial services.
- The use of customer-owned devices (mobile money and banking) will follow an expansionary dynamic too. Non-supplier devices used as service channels and access platforms cater for ubiquitous and 24/7 access – both of which are important requirements for transformational clients.
- Near field communication (NFC) technology integrated with mobiles or on card platforms will become an additional technology, driving quick, easy and low-cost payments in specific streams.
- It is likely that there will be an increase in the number of retail outlets that are mobile and/or NFC enabled to ensure that usage can be facilitated.
- It will be important to increase the levels of collaboration (e.g. sharing of distribution networks) and interoperability to broaden the depth and breadth of financial inclusion.
- There are already signs that technology-enabling firms providing wholesale platforms for retail distribution will add to their portfolio of services, including moving value between parties, independent of 'buying or paying'.
- The level of competition, at various levels, is set to improve; with greater customer choice for services, channels and platforms. There may be less distinction between who does 'banking' and 'non-banking'.
- Many of the above market dynamics will lead to lower costs to customers, both direct and indirect.
- The regulatory regime will continue to play a core role in facilitating such development. A responsive and adept regulatory regime is guided by market developments and allows the regime to evolve in such a way as to appropriately manage risk.
- There is always room for improved financial literacy amongst the most vulnerable customers who can least afford to make bad decisions. This is a national problem and as such there must be a good public component to the solution.

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