THE WORLD BANK

POVERTY REDUCTION AND ECONOMIC MANAGEMENT NETWORK (PREM)

Economic Premise

AUGUST 2010 • Number 26

Facilitating Cross-Border Mobile Banking in Southern Africa

Samuel Maimbo, Tania Saranga, and Nicholas Strychacz

The use of mobile banking is an increasingly important component of national and regional economic development in Southern Africa. Mobile banking can help bring the large unbanked population into the formal financial sector, and can facilitate cross-border trade by easing the difficulty for small businesses and traders to make financial transactions. For mobile banking to reach its full potential in Southern Africa, however, African governments must establish more efficient regulatory frameworks and implement well-designed pilot programs to gain more insight into the challenges facing a full rollout of mobile banking.

The use of mobile banking in Southern Africa is widely recognized as an increasingly important component of national and regional economic development. Mobile banking can benefit countries in two key ways: First, mobile banking may enable faster and more efficient financial transfers, increasing the volume of trade and subsequent payments to workers and their families. This dynamic is especially important for informal trade, which is practiced primarily by low-income, unbanked international, regional, and domestic migrants. Second, mobile banking greatly increases access to finance for a large segment of the unbanked populace in developing countries. In Africa, where borders often were drawn arbitrarily, cross-border trade is an important business activity for a large subset of the population. Developing mobile banking capacity offers great potential for facilitating trade in both goods and financial services.

This report provides a description of the supply-side factors influencing the development of mobile banking services—remittances, informal trade, and the financial and telecommunications landscape. On the basis of this description, the report highlights the key regulatory issues facing Southern African countries; and it concludes with recommendations for overcoming the constraints to developing accessible mobile banking in Africa.

Understanding the Demand for Mobile Banking in Southern Africa

Mobile banking in this report refers to a range of mobile phone–based financial transactions (including actual payments made with a mobile phone and mobile phone access to banking services). The demand for mobile banking services is occasioned by the two key areas of migrant remittances and cross-border payments for trade-related transactions.

The first area—migrant remittances—is driven by the strong migration patterns that exist in Southern Africa; and migration patterns, in turn, are important for increasing the demand for mobile banking services. Although determining the exact number of migrants is difficult because available data only capture the flow of registered migrants), estimates suggest that the number of migrants sending remittances is high. Significantly, the available data also indicate that a no-

table portion of migration flows are South-South, or between developing countries. Research has shown that, because income differentials between these countries are small, geographic proximity and networks have a greater influence on migration patterns than do income levels. Other determinants of migration patterns include civil conflict, ecological disaster, and seasonal dynamics—factors that often affect many African countries.

Common characteristics among migrants include low income and a lack of skills or a limited formal education. These characteristics are some of the causes of migration—workers tend to migrate to places where there is work that they are able to do. For example, a recent study on migrants leaving Mozambique showed that 8 percent have no education, 15 percent have secondary education, and 70 percent have basic primary education (Truen et al. 2005). However, there is evidence also that a significant number of migrants from other African countries are highly skilled. In these cases, political upheaval or political violence is likely the primary cause of the migration. As one scholar notes, "The pressure of uncertain economic conditions in several countries has acted as a push factor sending skilled professionals to the booming economies of Botswana, Namibia, and South Africa" (Waller 2006, p. 4). In all cases, a lack of education and job prospects or the presence of political unrest and economic uncertainty help explain why migrants are often the most financially excluded people in a community. These migrants, therefore, are the people who would benefit most from the opportunities presented by mobile banking.

Crucially for policy makers, migration flows will continue or even intensify in the future. Instead of futilely attempting to control these flows, policy makers are better off seeking to regulate these flows more effectively by selectively easing barriers to migration, including barriers to cross-border mobility. One key way in which cross-border mobility can be facilitated and regulated is through more effective regional integration. Although some efforts at regional integration are under way in Southern Africa, closer integration of labor markets through increased cross-border mobility could bring significant efficiency gains to the region.

Remittance Flows

In the formal financial sector, remittances generally are sent by migrants through banks, post offices, or money-transfer operators; and by carrying cash personally or sending it through a friend or relative. As with the size of migration flows, gauging the true magnitude of remittance flows is difficult. What is certain, though, is that the true size of remittance flows is larger than the officially recorded numbers, because the official figures do not take into account the unrecorded flows through both formal and informal channels. Indeed, a large proportion of remittances is believed to flow through the informal financial sector.

From a policy perspective, it will be important to know the size of migration and remittance flows because inaccurate information or estimates could lead to policy initiatives that do not help raise the level of formal financial sector participation. Similarly, from an efficiency standpoint, large remittance flows suggest that policies should attempt to bolster competition among formal financial services providers, such as banks and money-transfer operators. In this case, engaging with the formal financial system could provide positive externalities through efficiency gains from transferring money, increasing access to credit, and raising the level of savings. These benefits will be especially helpful for those migrants who do not currently have access to the formal financial sector. For example, engagement with the formal system would provide greater physical security for many workers who would no longer have to carry cash in hand.

Economically, there is limited participation in the formal financial sector simply because of the sector's high cost, compared with that of informal transfer methods. This is a primary reason why the informal financial sector is more popular among migrants. Indeed, a 2006 study of remittances in South Africa showed that 7 percent of migrants used a post office to send money, 1 percent used a bank in South Africa, and 6 percent used a bank in the migrant's home country. The rest (86 percent) used informal means for remitting money (Pendleton et al. 2006). Whereas other studies have shown a higher percentage of migrants using banks, a significant number still use informal methods for transferring remittances. Although current estimates of informal sector participation are imprecise,[1] economist are in broad agreement that migrants who are engaged with the formal financial sector are a small minority.

There are several reasons why many migrants choose to use informal channels rather that the formal financial sector to remit payments:

- *Ease of use*—Migrants prefer methods with less paperwork.
- *Familiarity*—Informal channels have been used or recommended by family and friends.
- *Cost*—Higher costs in the formal financial sector drive away migrants. Fees in informal networks tend to be lower than at banks or with money-transfer operators. Studies have shown that the cost of formal transfers can be up to six times as great as those of informal transfers, with fees exceeding 50 percent of the remittance value (Pendleton et al. 2006; Truen et al. 2005).
- *Risk tolerance*—There is a perception among migrants that banks are untrustworthy and may lose or steal migrants' money.

- *Access*—It can be difficult for the recipient to reach the point of delivery.
- *Source of remittances*—Many migrants are working in the informal labor sector in South Africa, so their remittances are, by definition, the result of illegal employment.

Given this context, it is not surprising that banks generally are unable to provide services to unbanked migrants.

Finally, in some countries there are regulatory restrictions that prevent the entry of financial institutions into the remittance market—even those institutions that may have a greater geographic reach or are closer to migrants. All of these reasons explain migrants' disincentives for engaging with the formal financial sector.

Trade Patterns in Southern Africa—Implications for Cross-Border Payments

Besides migrants, the other key source of demand for mobile banking is informal cross-border trade, generally defined as an economic activity that is legal but unregulated. The unregulated nature of this cross-border trade means that most informal trade is undocumented, unregistered, and unaccounted for in countries' national accounts and official trade statistics. However, many cross-border traders pay duties and taxes; and studies have estimated the value of informal trade within Southern Africa to be $17.6 billion per year (Musonda 2004). The payments system that typically supports these various monetary exchanges is characterized as unrecorded cash-to-cash transactions.

A 2008 study on the topic (Matorofa 2008) described informal cross-border traders as including the following:

- traders or merchants who under-declare their imported goods or wares,
- traders or merchants who declare nothing (smugglers),
- traders or merchants who do not declare through clearing agents,
- traders or merchants who sell directly to the final customer, and
- agents of established wholesalers and retailers.

The study also noted that informal traders crossing the borders tend to be predominantly female (70 percent). In this way, informal cross-border trade can be seen as closely linked to the feminization of migration—an emerging trend in Africa. This link makes sense because low-income women may be more likely to be unemployed, and unemployed women seek other—often informal—trade opportunities for generating income. And, by African standards, cross-border traders may generate relatively large amounts of revenue: estimates put the average monthly value of goods traded at $2,506 per trader (although profit margins may be substantially lower) (Matorofa 2008).

Despite the magnitude and importance of informal cross-border trade, especially with regard to income generation among poor people, government policies have tended to focus on formal trade activities. More recently, though, this trend has begun to change. For example, Zimbabwe signed a memorandum of understanding with the government of Malawi to facilitate informal trade, specifically between small and medium-size enterprises. In Southern Africa, negotiations are under way for the signing of similar memoranda with Namibia, South Africa, and Zambia.

Financial and Telecommunications Landscape

In an environment characterized by international, regional, and national migration and significant levels of cross-border trade, the financial and telecommunications sectors play an important role in the development of mobile banking services in the region.

Financial Sectors

Despite some recent developments increasing competitiveness in financial markets, the number of financial operators and instruments remains low in many countries. In general, financial sectors in migrant-sending countries may be characterized by weak competitive environments (especially in the remittance market), lack of access to technology-supported payment and settlement systems, and burdensome regulatory and compliance requirements for banks. Developing a strong financial sector and efficient payment systems is essential for economic development and for support of increasing cross-border financial flows. Among other factors, this includes developing the commercial banking sector and other financial institutions, strengthening the domestic payments system, developing foreign trade financing instruments, and creating correspondent banking relationships between countries in the region.[2]

Countries face a number of challenges in reforming domestic financial sectors and creating regional financial markets. In some countries, such as Angola, conflict has left weak institutions and governance, degraded infrastructure and public service systems, high inflation and unemployment rates, and a shortage of human and technical capacity. All of these factors make more difficult a country's complex process of establishing a sound and efficient financial system that can support economic growth and job creation for its population. Mobile banking provides an efficient mode of financial access while the components of more traditional financial systems are being built. In some countries with incomplete financial markets, several innovative initiatives for

expanding access to mobile banking have been implemented, but they remain nascent.

Telecommunication Sectors

As with financial sectors, the telecommunications sectors of Southern Africa are at different levels of development. Countries such as Namibia and South Africa have telecommunications sectors that are relatively more developed; but in countries such as, Angola, Malawi, and Zambia, the telecommunications sectors are characterized by the monopoly of state-owned operators and service providers. Furthermore, few countries in the region have extensive telecommunications infrastructure in place. Although Namibia and South Africa have achieved relatively significant fiber-optic deployments, the international bandwidth available in general to Southern African countries is extremely poor, compared with those of Asia, Europe, or North America.

Regionally, there are several key issues facing Southern Africa. Some of the countries (Malawi and Zambia) are landlocked, so they do not have no option to connect directly to a submarine fiber-optic cable. These countries will have to rely on expensive satellite links for their international traffic, and they may be unable to afford or access high-bandwidth links. There are plans to link Southern Africa with a submarine cable, and progress (which has been slow) could be expedited if a regional solution can be found.

Policy Recommendations for Regulation to Promote Development

Faced with migrant populations, informal markets, and underdeveloped financial and telecommunications networks, policy makers must take on a broad reform agenda if they are to strengthen their opportunities to develop mobile banking.

African countries' first and perhaps most important action is continuing to improve the regulatory framework for domestic branchless banking. Regulation is essential for both national and international financial transactions, and a robust and efficient regulatory framework must be in place to enable branchless and mobile banking to flourish. For all Southern African countries, it is important to develop clear and easily followed guidelines for implementing branchless banking. Because the overarching goal is to expand financial services to the currently unbanked population, specific policies include expanding permitted points of service for small-value, cross-border transactions; eliminating the requirement to prove legal residence so one may set up a bank account; and expanding the scope of Exemption 17 to cover money transfers among countries in the Southern African Development Community (SADC).[3]

Developing such regulatory frameworks, however, can be a difficult and time-consuming task. Therefore, it would be useful to implement pilot programs to test various regulations. This has been done in countries such as Kenya and the Philippines, and is generally regarded as a positive step in crafting strong and efficient regulation. These pilot programs have several benefits, such as encouraging innovative regulatory solutions to difficult problems and demonstrating for governments how regulation can yield tangible outcomes for economic development. Similarly, the pilot projects can help identify and overcome problems with proposed regulation. The final result is regulation that is more effective at expanding access to banking services, while it limits negative externalities.

In terms of specific regulatory prescriptions, policy makers should consider permitting the use of retail agents for cash-in/cash-out, perhaps first developed through a pilot program. They should also consider developing a risk-based, community-driven development approach with the flexibility to incorporate small-value accounts and transactions. Good regulation also includes a legal basis; and policy makers should develop directives to provide legal clarity on outsourcing, branchless banking, and electronic transactions. Finally, as previously mentioned, policy makers should ensure that the financial system expands permitted points of service and reduces reporting requirements for small-value cross-border transactions. Taken together, these regulations can help expand access to financial services while creating an environment in which banks and other stakeholders may benefit.

Recommendations for a Proposed Action Plan

Following the policy recommendations described above, there are four key elements of a strategy for a follow-up action plan. This plan is designed to ensure that the initiatives and pilot projects outlined above are given the greatest chance to succeed.

First, provide policy support for branchless banking initiatives that target the unbanked population. This note has discussed the variety of constraints that prevent many poor and migrant workers from using formal financial services; and overcoming these constraints will require direct stakeholder support for branchless banking. For example, providing matching grants or other financial assistance to financial service providers who would like to offer services to the unbanked but are wary of taking on excess risk could help expand the market. In addition, the World Bank and other donors could assist pro-poor branchless banking initiatives by providing technical assistance and sharing start-up costs.

Second, African countries can learn from branchless banking leaders around the world. Although branchless

banking is still a relatively new phenomenon, some countries have developed regulatory frameworks that provide space for innovation while minimizing risks. In the Philippines, for example, the Central Bank has worked with mobile operators to permit branchless banking to flourish; and Brazil has nearly a decade of experience in the branchless banking space. In Africa, regulators and financial service providers could benefit from learning how branchless banking operates and how it is regulated in other countries. The World Bank, in association with the Alliance for Financial Inclusion, could take a lead role in organizing and funding study tours, regional conferences, and workshops to disseminate this information.

Third, the World Bank could play an important role in facilitating and supporting opportunities for extensive stakeholder collaboration. By providing training, capacity building, and other assistance at the regional level, donors can help create a cadre of expert stakeholders who ultimately can support the growth of the entire sector. Similarly, the World Bank could support training and the creation of formal mechanisms for collaboration among branchless banking stakeholders, including policy makers, regulators, banks, mobile network operators, payment-service providers, and other interested parties. For example, regional institutions such as the SADC or the Common Market for Eastern and Southern Africa could provide a forum for cross-country discussion and sharing of experiences. Such a forum also could define best practice for regulatory frameworks and future policy action. Regionally accepted regulatory frameworks would be of great help in facilitating cross-border mobile banking.

Fourth, as previously discussed, a pilot project should be launched with the specific aim of bringing "taxi money" into the formal financial sector. *Taxi money* refers to funds transferred across borders via taxi drivers and similar informal mechanisms. Most small-value remittances from South Africa are transferred in this manner. The goal of the pilot project would be to identify the sources of the high costs of cross-border remittances from South Africa. The initial project could start with in country that is an important recipient of small-value remittances from South Africa—Malawi and Mozambique would be logical choices. Mozambique, in particular, has extremely high volumes of small-value remittances from South Africa.

Notes

1. The differences among studies may result from differences in the sampling method and survey timing.

2. *Correspondent banking* refers to banks that agree to perform reciprocal financial services for each other—for example, accepting deposits from or transferring funds for each other's customers. Correspondent banking enables a bank to serve its migrant clients without having to set up a branch in another country.

3. Exemption 17 of the Financial Intelligence Centre Act allows "first-time" customers in South Africa to open certain types of bank accounts without having to provide a proof of residential address document.

About the Authors

Samuel Maimbo *is senior financial sector specialist in the Africa Financial and Private Sector Development Unit of the World Bank*. Tania Saranga *is a consultant in the Africa Financial and Private Sector Development Unit*. Nicholas Strychacz *is a consultant in the Africa Poverty Reduction and Economic Management Unit of the World Bank*.

This work is funded by the Multi-Donor Trust Fund for Trade and Development, supported by the governments of Finland, Norway, Sweden, and the United Kingdom. The views expressed in this paper reflect solely those of the authors and not necessarily the views of the funders, the World Bank Group, or its executive directors.

References

Matorofa, E. A. 2008. "Optimising Regional Integration in Southern Africa: Assessing Informal Cross-Border Trade in SADC." Presentation prepared for the SADC International Consultative Conference on Poverty and Development, Pailles, Mauritius, April 18–20.

Musonda, M. 2004. "Overview of Informal Trade in the SADC Region: Where Are We Now?" Presentation prepared for the Regional Workshop for SADC Informal Traders, Harare, Zimbabwe, February 11–12.

Pendleton, Wade, Jonathan Crush, Eugene Campbell, Thuso Green, Hamilton Simelane, Daniel Tevera, and Fion de Vletter. 2006. *Migration, Remittances and Development in Southern Africa*. Southern African Migration Project, Migration Policy Series No. 44. Cape Town: Institute for Democracy in South Africa.

Truen, Sarah, Richard Kentley, Hennie Bester, Ben Davis, Hugh-David Hutcheson, Kofi Kawakwa, and Sydney Mogapi. 2005. *Supporting Remittances in Southern Africa. Estimating Market Potential and Assessing Regulatory Obstacles.* Washington, DC: Consultative Group to Assist the Poorest.

Waller, Lyndith. 2006. "Migration of Skills in South Africa: Patterns, Trends and Challenges." Migration Policy Brief No. 20. Southern African Migration Project, Cape Town.

The *Economic Premise* note series is intended to summarize good practices and key policy findings on topics related to economic policy. It is produced by the Poverty Reduction and Economic Management (PREM) Network Vice-Presidency of the World Bank. The views expressed here are those of the authors and do not necessarily reflect those of the World Bank. The notes are available at www.worldbank.org/economicpremise.