PARTNERSHIP for FINANCIAL INCLUSION

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Microfinance Institutions and Mobile Financial Services Channels
The Partnership for Financial Inclusion aims to scale up commercial microfinance institutions and develop mobile financial services to bring financial services to 5.3 million previously unbanked people in Sub-Saharan Africa by 2017.

It is a $37.4 million initiative by The MasterCard Foundation and IFC that brings together the intellectual and financial capital of the Foundation with IFC’s market knowledge, expertise and client base. The partnership is also joined by The Development Bank of Austria, OeEB, and collaborates with knowledge partners such as the World Bank and CGAP.

An important objective of the partnership is to contribute to the global community of practice on financial inclusion, and to share research and lessons learned. This publication is part of a series of reports published by the program.

To find out more, please visit www.ifc.org/financialinclusionafrica
Microfinance Institutions and Mobile Financial Service Channels

The Business Model
Key Strategic Channel Decisions
Core Competencies
Agent Network Management
• This presentation draws lessons from IFC’s experience with 7 MFIs that are in various stages of launching an MFS implementation in Sub-Saharan Africa.

• The content covers the key strategic, business planning, and operational aspects of MFS implementations.
The Business Model

Microfinance Institutions and Mobile Financial Service Channels
MFS channels make retail banking viable for the mass market.

For many MFIs, MFS channels will be the most promising strategy for reaching scale where branches are not viable.

The business model is based on leveraging the channel to drive core revenues from portfolio growth while reducing funding and operating cost ratios.

The Core Business Model for an MFI

- Portfolio growth
- Transaction revenues
- Lower cost of funds
- Lower operating cost ratio

INCREASE IN ROA
Key Drivers: Customer Acquisition

- MFS channels enable MFIs to serve customers beyond the reach of the branch network.
- But this means that MFIs must be able to acquire large number of customers.
- This requires marketing and promotion capabilities typically foreign to MFIs, and more familiar to fast moving consumer goods companies and mobile operators.
- Nevertheless, the MFS channel has potential to reach a scale that far surpasses the current branch-based growth plans of MFIs.

- Mass market marketing and promotion
- Beyond branches
MFIs must dedicate significant resources to encourage customers to use the channel, and this happen over time.

Products and services must be adapted to leverage the convenience of the MFS channel.

In addition, the MFS channel must be developed to produce a customer experience that encourages adoption.

In short, successful MFS implementations must manage new clients, new products, and new service channels to create an entirely new kind of customer experience.

For most MFIs, this will require a transformation of every aspect of systems and services.

Managing the adoption curve
Channel appropriate products
### Key Drivers: Channel Adoption

- The adoption curve is a function of how many and what kind of transactions clients perform in the channel.

- Behavior will change over time. For most MFIs and their clients, cash transactions at agents will launch the channel, enabling the MFI to expand its deposit base and portfolio.

- As clients become more comfortable with the channel, the MFI will be able to add additional services, such as P2P transfers, bill pay, and airtime purchases.

<table>
<thead>
<tr>
<th>MONTHLY AVG TXN PROFILE (per customer)</th>
<th>1</th>
<th>12</th>
<th>24</th>
<th>36</th>
<th>48</th>
<th>60</th>
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<tbody>
<tr>
<td>TOTAL MONTHLY TXNS</td>
<td>5.6</td>
<td>5.6</td>
<td>5.6</td>
<td>5.7</td>
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<td>6.2</td>
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<td>Cash in at Agent txns</td>
<td>0.5</td>
<td>0.6</td>
<td>0.6</td>
<td>0.7</td>
<td>0.8</td>
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<tr>
<td>Transfer from other bank or PSP txns</td>
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<td>0.0</td>
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<td>0.1</td>
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<td>Government payments txns</td>
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<tr>
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<tr>
<td>P2P txns</td>
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<tr>
<td><strong>Bank loan activity</strong></td>
<td></td>
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<tr>
<td>Customer loan withdrawal at agent txns</td>
<td>0.1</td>
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<td>0.2</td>
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<tr>
<td>Customer loan repayment at agent txns</td>
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<td>0.3</td>
<td>0.3</td>
<td>0.4</td>
<td>0.4</td>
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<tr>
<td>Mobile purchase txns</td>
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<td>2.0</td>
<td>2.0</td>
<td>2.0</td>
<td>2.0</td>
</tr>
</tbody>
</table>
Key Drivers: Channel Appropriate Product Development

- The potential of an MFS channel lies in the possibility of creating financial products that imitate and ultimately replace the informal products that most MFI clients use currently.

- The fact that most MFI clients use a large number of informal financial services is both an indictment on the limits of branch-based banking, and an indication of the huge demand that MFIs have not yet reached.

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**Overview of Findings**

*So why aren’t people using formal devices more?*

*...it’s not because they don’t use financial devices.*

- **Usage of Financial Devices (% of Sample)**

  - Giving credit to clients: 8%
  - Supplier credit: 10%
  - Bank loans: 12%
  - Acting as a money guard: 14%
  - Ikbina loans: 15%
  - ASCA: 15%
  - Arrears owed to respondents: 17%
  - Lending to others: 20%
  - Mobile Money/Tigo Cash: 20%
  - Friends and family borrowing: 24%
  - ROSCA: 32%
  - SACCO/Cooperative: 39%
  - Shop Credit: 46%
  - Bank: 59%
  - House: 75%

- Commonly used financial devices in FinScope were savings groups (34%), informal borrowing from friends and family (28%), shop credit (28%), savings in the house (21%), and bank accounts (15%).

- The average person in our sample used 5.5 financial devices, 2 of which were formal.
For most MFIs, transaction revenues will not cover the cost of the channel.

Agent commissions alone will likely consume over half of transaction revenues.

An MFI that expects to grow from 100k to 400K customers can expect that the channel will incur a net loss of as much as $2 million per year.
A moderately profitable MFI can expect to burn up to $5 million in accumulated losses before returning to profitability around year 4.

However, the investment will drastically improve the MFIs margins as the MFI grows.

Channel costs are typically 15-20% of branch costs, so expansion with the channel can significantly reduce the overall operating cost ratios.

Note that for many MFIs, the losses would consume most of existing capital. Therefore, an MFS implementation may require additional capital investment.

$5 million in net losses before breaking even in Year 4
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Key Strategic Channel Decisions
The Beginning: MFIs and PSPS

- The structure of the IT platform, and integration with other banks and PSPs, will have fundamental strategic implications.

- Many MFIs are currently operating in markets where PSPs are offering e-wallet services that MFI customers are beginning to adopt.

- These MFIs have no connection to the PSPs, and MFI customers cannot transact between their MFI and e-wallet accounts.
OPTION 1: BACKEND LINKUP

- In this option, the MFI creates a communication link between its core banking system and other PSP platforms.
- This enables the e-wallet customer to transfer money between his or her e-wallet and MFI account.
- But it is very difficult for an MFI to exploit this architecture to attract new clients. In this scenario, the MFI has to rely on the e-wallet customer’s interest and ability to navigate the e-wallet ecosystem to do business with the MFI.
OPTION 2: SEPARATE ECOSYSTEMS

- Alternatively, an MFI can install its own mobile app, and even build out its own agent network.

- In this scenario, the MFI maintains control over the ecosystem where the customer transacts, but the ecosystem is small and isolated, and its value is therefore limited.

- MFI customers will still have to be customers in the PSP ecosystem to benefit from the PSP system infrastructure and services.
OPTION 3: SWITCHED ECOSYSTEMS

- The MFI can expand its ecosystem by linking to other PSP systems.
- However, MFI customers will still have to have e-wallets to be able to use the agents or services of the PSP systems.
- This can be confusing to clients, who have to be able to navigate through two systems.
Ideal scenario, MFIs would link their system to the PSP so that MFI clients can conduct Over-The-Counter transactions in other PSP systems in their bank accounts.

- In this scenario, MFI clients do not have to have an e-wallet to conduct cash transactions at the agents of partner PSP systems. In other words, the MFI keeps its clients, but gives them the convenience of using cash agents in other systems.

- The MFI may be able to enable this ecosystem without having its own agents, if the MFI believes that the other PSP agents can provide adequate services.
OPTION 4.1: INTEROPERABLE ECOSYSTEMS

- MFIs can also expand on the previous option by building out their own network of agents.
- This may be necessary if the MFI needs to have some agents that are branded, trained and controlled by the MFIs.
- In this scenario, the MFI is able to provide two levels of service: an MFI branded and controlled service at MFI agents, and cash in/out services through the agents of other PSPs.
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Core Competencies
MFS require an array of core competencies that MFIs typically do not have.

The graph aligns these competencies with the implementation phase where they must first develop.

The vertical timeline reflects IFC experience with the time it takes for MFIs to move through the different implementation stages.

This helps illustrate the magnitude of the effort, and the investment, to launch a MFS implementation.
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Agent Network Management
3 Business Cases

- The MFIs Business case – Customer Acquisition, deposit mobilization, survival?
- The Customer Business Case – Convenience, products?
- The Agent Business case – Profit Story, footfall?

MFIs must identify a strategic objective that fits with the organization, driving them to invest in the business.

Based on this strategic objective, the business should then identify a key pain point to the customer. The key pain point will lead to development of the customer value proposition.

The business must identify the key drivers that translate agents into product champions. Agents look for revenue, traffic, brand recognition. If incentivized, agents drive customer acquisition and transactions.
Increasingly, financial institutions are using agents to extend their reach and reduce branch expansion costs.

Agency networks enable businesses to roll out faster and cost efficiently. Agents leverage their personal communities, enabling transactions. Some MFIs have seen an increase of over 10% of business within 1 year of deployment.

Some financial institutions roll out and manage agents around their branches. Other institutions deploy agents centrally with no direct link to the branch.

Extending Financial services through agents.
– To replace construction of own branches
– To complement construction of branches

Agent Structure – Ecosystem of participants required to manage successful agent network

Small deployment – Simple, directly controlled
Large deployment – Complex, highly decentralized.

MFIs should never abdicate agent management even when services are outsourced to third parties.
### Stakeholders in an Agent Network

<table>
<thead>
<tr>
<th>Role</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agent management team</td>
<td>Team within the MFIs business responsible for agent management. May be an independent team or a unit of a larger team.</td>
</tr>
<tr>
<td>Master agent</td>
<td>Organization(s) responsible for identifying and/or recruiting agents. A master agent may be responsible for one or many agents.</td>
</tr>
<tr>
<td>Agents</td>
<td>Individual outlets that carry out agency business on behalf of the MFI. May be contracted by master agents or directly by the MFI.</td>
</tr>
<tr>
<td>Third party contract team</td>
<td>An MFI may appoint a secondary organization to carry out agent management. Works well especially in large deployments.</td>
</tr>
<tr>
<td>Third party agents</td>
<td>An MFI may completely outsource agent recruitment &amp; management to third parties. Outsourcing may be driven by regulatory requirements.</td>
</tr>
<tr>
<td>Super-agents</td>
<td>An organization charged with providing liquidity to agents on behalf of MFIs.</td>
</tr>
</tbody>
</table>
Features of an Efficient Network Plan

- Service availability and variety – the financial service must be available
- 100% buy in from all stakeholders including channel providers (agents)
- Product flexibility to changing environment (from product positioning to additional services)
- Adequate, timely reward and compensation for agents
- Trusted and reliable corporate brand and stakeholders
- Visibility - easily identifiable brand identity
- Strong relationship between all stakeholders
The Agent Life Cycle

- **Agent identification & recruitment**
  - Requirements for agents, agent value proposition, contracting
- **Agent roll out**
  - Training, set up, merchandising, commencement, branding, float deposit/redemption
- **Agent management**
  - Compensation, commissions
  - Logistics, refresher training, performance mgt, issue resolution, communication, penalties, sanctions compliance mgt
- **Agent retention**
  - Motivation, relationship management, recognition
- **Agent extension**
  - Strategic partnerships, value addition, new services
Principles of an efficient agent network system

- Agent growth must be in line with growth of numbers of customers in order to balance coverage and business growth. Having too many agents affects agent profitability, and having too few agents creates gaps in customer experience.

- Agents’ obligations must be clear and documented. Agents should be rewarded for meeting and exceeding their obligations. They must be held accountable for falling short of expectation.

- Liquidity structures must be built into agent structure. Liquidity is critical for cash based transactions.

- Identify customer needs
- Plan and design
- Know the agent lifecycle
- Listen to agents & customers
- Carrot and Stick
- Channel growth vs business growth
- Governance – self checking, scalable
- Flexibility
- Liquidity
- Size of the deployment

Agent growth must be in line with growth of numbers of customers in order to balance coverage and business growth. Having too many agents affects agent profitability, and having too few agents creates gaps in customer experience. Agents’ obligations must be clear and documented. Agents should be rewarded for meeting and exceeding their obligations. They must be held accountable for falling short of expectation. Liquidity structures must be built into agent structure. Liquidity is critical for cash based transactions.
Challenges in Agent Network Structure

- MFIs may be under-resourced to afford the upfront costs of design and implementation. Making the decision to implement MFS is even harder for MFIs since agent management is new and largely unknown.

- There are very few practitioners who can do agent management and design. MFIs may have to develop internal resources to effectively do this.

- Identifying the right platform to deploy and the business requirements is a major challenges which takes time to address.

- Designing proper strategy
- Fraud
- Customer/Agent support
- Technical platform
- Availability of human skill set
- Regulatory challenges
- Customer pricing
- Agent management cost
Institutions must rapidly acquire viable, active customers. Some institutions develop a service that aggressively drives customer acquisition such as savings, payments, credit. Other institutions use their brand to attract customers.

MFIs must roll out agents in parallel to driving customer acquisition to ensure that agents have customers to transact. In many deployments agents have become dormant due to lack of customers.

The most successful customer acquisition activities involve the use of experiential and below the line activities.
Key Considerations in Customer Acquisition Strategy

- Many organizations build out channels without developing the right products for the channels leading to low adoption.
- There is temptation to have many messages for different products targeting many users. Many messages may confuse customers and should be carefully delivered.
- Due to the need for customer education, the use of below the line is much more effective in delivering the message to customers.
Fraud and Risk Management
Fraud and Risk in MFS

- **Fraud** = intentional & deliberate action undertaken by players in the mobile financial services ecosystem aimed at deriving gain, and/or denying other players revenue and/or damaging the reputation of the other stakeholders.

   - Any deployment that does not plan is in danger of losing credibility. Planning helps the MFI prepare well for possible risks and seek intervention early enough.
   - Preparation for mitigation against fraud may require purchase of specific software to detect and prevent fraud. It may require changes to existing procedures of the organization.
   - When a fraud occurs, communication is key as it will limit damage to the ecosystem and therefore reduce costs.

- Understanding investment cost
- Importance of the study of fraud
- Understand required interventions
- Lowers future cost of intervention

Planning
Enablers of Fraud

- Weak regulation increases chances of fraud. Weak regulation may result in poor technology, weak controls, etc.

- Organizations that do not pay attention to their markets face greater fraud. An organization must carry out compliance monitoring processes to limit fraud.

- The product lifecycle will lead to different types of fraud. Some deployments have seen that when there are few customers fraud levels are lower; as they register more customers, fraud targeting customer registration increases. When transactions improve, fraud targeting usage increases.
## Customer Acquisition Stage
- MFI is acquiring customers to use the service.
- Agent value proposition is still unproven
- Learning phase for all stakeholders.
- Fraud largely on customer acquisition – commission, pricing etc.

## Transaction Activation Stage
- Customer transactions increase.
- Agent value proposition proven, agents ramping up investment into business.
- More cash coming into the system.
- Fraudsters begin to target transactions due to higher values at agent, and customer level.

## Value Addition Stage
- Deployment is maturing.
- Specialized products introduced into the channel.
- Partners using the channel for services.
- Fraud sophistication increases as channel usage expands.
<table>
<thead>
<tr>
<th>Types of Fraud</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Consumer driven fraud</td>
<td>• Counterfeit currency; Phishing and social engineering; Unauthorized PIN access</td>
</tr>
<tr>
<td>Agent driven fraud</td>
<td>• Unauthorized charges by agents; Split deposits – resulting in more commission to agents; Unauthorized PIN access</td>
</tr>
<tr>
<td>Business partner driven fraud</td>
<td>• Linking wrong mobile numbers to bank accounts; Settlement fraud by business partners; Employees of business partners defrauding partners</td>
</tr>
<tr>
<td>System admin fraud</td>
<td>• Password abuse and sharing; Creation of fake/non-existent users; Weak password/transaction PIN strength</td>
</tr>
<tr>
<td>MFS provider fraud</td>
<td>• Theft of MFS providers funds by employees; Unauthorized SIM Swaps; Employees defrauding agents by collecting deposits from them</td>
</tr>
</tbody>
</table>
Impact of Fraud

- Brand can be severely dented by fraud. Clients will associate the MFI with fraud affecting other services offered by the organization.

- Defrauded agents will be unable to adequately invest in the business to drive transactions. Agents have been known to stop trading after loss of significant investment.

- Potential client organizations become less willing to integrate with operators with high exposure to fraud. They may have to invest more in fraud mitigation interfaces to limit fraud.

Credibility of services

Determines investment by agents

Affects overall uptake of services

Affects partner adoption

Impacts pricing of services

Impacts global adoption

Affects innovation

MFIs brand image
Most critical mitigating factor is consumer awareness. Organizations must communicate new fraud occurrences and measures to avoid and report fraud.

Operators with weak processes lose more. MFIs must build good processes that have adequate controls both in the documentation and on the system.

Monitoring and supervision of agents deters agent driven fraud. Mystery shopping enables the MFI to observe what is happening in the market and take corrective measures.

Key Mitigates of Fraud

- Research
- Stakeholder groups and information sharing
- Consumer education and communication
- Development of smart tools and processes
- Mystery shopping or compliance reviews
- Monitoring and supervision of agents
- Client protection reviews
“The enthusiasm with which people in the region have embraced new technology for financial transactions shows it all. The future of Mobile Financial Services is bright.”

David Crush, Head of IFC Access to Finance Africa