The Center for Financial Services Innovation
An Initiative of ShoreBank Advisory Services

October 2005

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Financial Services Trends and Recent Innovations in South Africa: Lessons for the United States

At the end of apartheid in 1994, South Africa was left with first-world financial markets and third-world social infrastructure.[1] The South African financial services sector, like the rest of South Africa, has undergone dramatic changes, seeking to extend access to financial services to the traditionally underserved population. Still, more than ten years after the end of apartheid, 42 percent of South Africans have never had a bank account and 54 percent are currently unbanked.[2] One recent estimate indicates that about 17.5 million South Africans are still unbanked.[3] In contrast, published statistics on the unbanked in the United States place the range of unbanked at approximately 22 million or 20 percent of U.S. households.[4]

The unbanked are those without a basic checking or savings account. In addition, many households are underbanked, in both the U.S. and South Africa, relying on alternative financial institutions even though they have bank accounts because they are not fully integrated into the banking system. As a consequence of being underbanked, individuals might pay more for basic financial services. In addition, the underbanked lack the tools they need to save and build assets which, according to the South African Reserve Bank, can enable poor and vulnerable households to protect themselves from negative economic shocks.[5] The following diagram represents the landscape of financial services available to South Africans with the unbanked and underbanked tending to transact in the alternative financial services sector and informal economy.[6]

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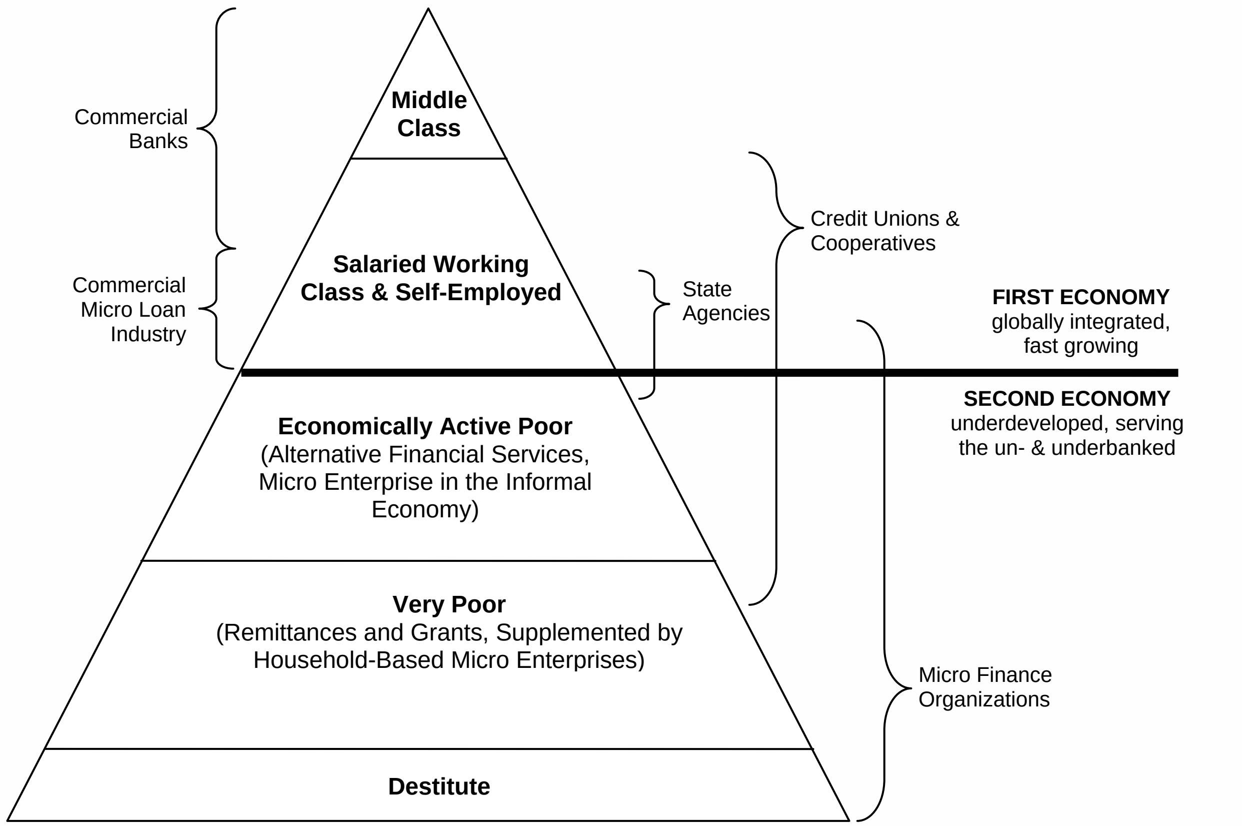
[1] Porteous, D. (2004a). *Banking on Change: Democratising Finance in South Africa, 1994-2004 and Beyond*. Double Storey Books: Cape Town, p. 2.
[2] FinMark Trust. (2005, February). Country Case Study: Provision of Financial Services in South Africa. Service Experts Meeting 3-4 February 2005. Retrieved March 1, 2005, from http://www.finmarktrust.org.za/documents/2005/FEBRUARY/WBCaseStudy.pdf, p. 4.
[3] Kitten, T. (2005, May). Reaching the Unbanked: Learning from South Africa's FIs. *Green Sheet, Inc. in Print*.
[4] In 2002, the General Accounting Office released a report that estimated more than 22 million households, encompassing 56 million adults, in the United States remain unbanked. The discrepancy in estimates might be caused by sampling decisions; some surveys tend to focus on a population more likely to be unbanked, whereas others might oversample wealthier households.
[5] Lobenhofer, J., Bredenkamp, C., & Stegman, M. (2003, July). Standard Bank of South Africa's E Plan: Harnessing ATM Technology to Expand Banking Services. The Center for Community Capitalism, University of North Carolina at Chapel Hill. Retrieved April 25, 2005, from http://www.kenan-flagler.unc.edu/assets/documents/CC_Standard_Bank_of_South_Africa_E-Plan.pdf, p. 3.
[6] Sisulu, M. (2005, February). Micro Finance for Poverty Alleviation Towards a Pro-Poor Financial Sector (keynote address, Johannesburg, South Africa) February 5, 2005, p. 6.



This diagram is adapted from the keynote address of Max Sisulu, Chairperson of the Economic Transformation Committee of the African National Congress.

This paper provides an overview of South Africa's unbanked problem based on the existing financial services landscape, describes the role of the South African government in addressing the problem, and highlights trends in financial services innovation in the private sector. It includes comparisons to the U.S. situation and highlights South African innovations that could inform trends in the U.S. financial services sector.

Who Are South Africa's Unbanked?

Like the unbanked in the U.S., the unbanked in South Africa tend to be low-income.[7] Moreover, 72 percent of all black South Africans are unbanked, compared to 53 percent and 43 percent of

[7] The low-income designation is based on a Living Standard Measure (LSM) developed by the All Media & Products Survey (AMPS), the major source of long-term data for South Africa. The categories range from LSM1 to LSM10 and are based on durable goods ownership. LSM1 through LSM5 are considered by international standards to be poor, living on less than $2 per person per day. Porteous, p. 15.

coloured and Indian South Africans, respectively. In contrast, only 12 percent of white South Africans are unbanked (Table 1).[8]

However, while many South Africans are currently unbanked, approximately 12 percent of the population is previously banked.[9] This suggests that having a bank account does not necessarily mean that an individual is fully integrated into the financial system, and that South Africans move along the spectrum of banked to unbanked. A 2003 survey by MetroEdge, a market research firm specializing in lower-income urban markets, found that the line between being banked and unbanked is quite fluid for lower-income households in the U.S. as well, as families move in and out of the financial mainstream to meet their financial needs. Half of unbanked families in the survey previously held bank accounts.[10] These similarities imply that the U.S. and South African financial sectors can learn from each other's experience.

Overview of Issues for the Unbanked and Financial Services Innovation in South Africa

In a 2003 private study, a third of South Africans felt that "you can easily live your life without having a bank account".[11] For some, having a bank account is actually more difficult that living without one. In South Africa, the unbanked overwhelmingly cite the lack of job or money as the reason for not having a bank account.[12] South Africa's banking fees are the world's highest, with approximately two percent of an individual's gross income paying bank charges.[13] Banks assert that these high fees are a consequence of the high administrative costs traditionally associated with small account balances and low transaction volume. Most of the banking products and traditional distribution channels of the most established financial institutions are ill-suited to the needs of the majority of South Africans, serving only a minority of more affluent, educated, and financially sophisticated South Africans. The most basic bank accounts can be costly and have a complicated mix of charges, minimum balances, and withdrawal and transaction fees. In addition to issues of affordability and complexity, accessibility is also a frequently cited reason for not having a bank account.[14]

For the rural poor, physical access to banks is problematic. Only five percent of the 8.1 million South Africans living on tribal lands indicate that they have a bank nearby.[15] This means that South Africa's large semi-urban and rural population must incur transportation costs in addition to bank charges in order to access financial services, which are primarily located in urban areas.

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[8] Lobenhofer, et al., p. 3. Demographic groups are based on options provided by Statistics South Africa, the South African equivalent of the U.S. Census Bureau. There are five options for population group classification – Black African, Coloured, Indian or Asian, White, and Other. Membership in a given population group is based on self-perception and self-classification rather than a legal definition. (Lehohla, Pali (Statistics South Africa). (2005). *Achieving a Better Life for All: Progress Between Census '96 and Census 2001*. Pretoria: Statistics South Africa, 2005, p. xii. Retrieved June 15, 2005, from http://www.statssa.gov.za/publications/Report-03-02-16/Report-03-02-16.pdf, p. xii.)
[9] FinMark Trust, p. 4.
[10] MetroEdge Financial Services Survey 2003.
[11] Goering, L. (2005, February 27). South African Banks Having a Problem with Interest. *The Houston Chronicle*.
[12] FinMark Trust, p.4.
[13] Deloitte. (2004). Banking the Unbanked in South Africa. *Global Regulation*, Issue II, p. 4.
[14] Ryan, C. (2004, September 24). Mass Market Banking: Cellphones Promise to Get Cheap Services to Poor. *Financial Mail*.
[15] FinMark Trust, p. 4.

In addition to geographic barriers, are language and social barriers that contribute to the isolation of the unbanked. All of these factors, while experienced on a different scale, are issues for the U.S. unbanked population as well. But while banking can be difficult for many in South Africa, research suggests that bank accounts are aspirational for the nation's poor, and that given the right product offering and cost level, they would in large numbers opt to open a bank account. So there is a great opportunity to provide this much-needed service in a country where the majority are unbanked.[16]

The government made its first integrated and comprehensive attempt to ensure fairer distribution of wealth, income and skills through the Black Empowerment Commission (BEC). The BEC released a report in 2001 that led to the Broad-Based Black Empowerment Act in January 2004, which included Codes of Good Practice, partnerships with the private sector, and the development of sectoral Charters.[17] The goal of Black Economic Empowerment (BEE) is to achieve sustainable development and prosperity by ensuring that previously disadvantaged individuals, including Black South Africans and women in South Africa, have broader participation in the South African economy. BEE aims to accomplish this by transferring ownership, management, and control of the country's financial and economic resources to previously disadvantaged individuals.[18] The Codes of Good Practice, partnerships with the private sector, and the development of sectoral Charters of the Broad-Based Black Empowerment Act differ markedly from the Community Reinvestment Act in the U.S., which takes a more lending-focused approach. In addition, the U.S. CRA requires banks to report information on lending and other activities, while South Africa's paradigm is voluntary.

Financial institutions have begun to recognize the market potential of the 54 percent of South Africans who are unbanked. In South Africa, 90 percent of the unbanked use prepaid services, accounting for between 300,000 and 400,000 transactions per month.[19] Financial institutions are eager to tap into the traditionally underserved and are counting on innovation to make this possible. Recent innovations have reduced the costs of account maintenance and transactions, suggesting that it is more profitable to serve the lower income market segment than ever before. In 2002, the number of electronic, or cashless, payments in South Africa exceeded the number of paper check payments.[20] Both the public and private sectors in South Africa have adopted strategies to bring a greater percentage of the overall population into the banking system.

Private Sector Experimentation and Innovation

Key Private Sector Innovations

Before the passage of the Broad-Based Black Empowerment Act but after years of debating roles and obligations, the private sector representatives of the financial services industry signed the Financial Sector Charter in October 2003. Though the Charter is a voluntary commitment to

[16] For more information, see Porteous, D. (2004b). *Making Financial Markets Work for the Poor*. FinMark Trust.
[17] Porteous 2004a, p. 103.
[18] FinMark Trust, p. 5.
[19] Kitten, T. Reaching the Unbanked: Learning from South Africa's FIs.
[20] Ibid., p. 2.

transformation of the financial services sector and BEE, it is partly an attempt by the private sector to pre-empt legislation and regulation. The Charter sets detailed targets for ownership, management representation, and procurement policies. It also sets access targets for the provision of retail financial services products to lower income South Africans, including transaction accounts, bank savings products, life assurance products, collective investment savings products, and short term risk insurance products. The overall goal is to increase effective access to a bank account from 32 percent today to 80 percent by 2008.[21] Even before the Charter was signed, financial services providers had experimented with innovative ways of serving the large unbanked population. Approximately 3.6 million fewer South Africans were unbanked in 2004 than in 1993.[22]

One of the first private sector innovations that focused on reaching the unbanked was Standard Bank's E Plan, launched in 1994. E Plan is considered the first significant innovation, offering an electronic transaction and savings product through E Centres that do not handle cash, but provide hands-on training and support in the use of automated teller machines (ATMs). By relying primarily on ATM technology rather than personnel, Standard Bank was able to lower the cost of providing accounts to customers who were traditionally viewed as unprofitable because of their small account balances and low transaction volume. By designing a product to meet the needs of low-income customers, relying on simple processes and a fee structure that encouraged electronic-only transactions, and offering extending hours, these E Centres cost the bank nearly 30 percent less than traditional branches.[23]

After failing to attract the necessary critical mass to be profitable, it was re-branded as Standard Bank's primary mass market product and 570,000 low balance customers were involuntarily shifted to the E Plan from other products with little opposition since the products had similar balance requirements.[24] As of 2004, three million South Africans were E Plan customers. Given the proprietary nature and strategic importance of E Plan data, a direct assessment of profitability is not possible; however, industry reports suggest an overall profitable performance.[25] The E Plan experience suggests that it may be profitable to serve the unbanked market segment, but the key is looking beyond low-cost products to appropriateness of services and fees while exploiting technology and creative distribution channels.

The most concerted recent private sector effort to serve the unbanked came with the launch of Mzansi accounts in October 2004 by South Africa's four largest commercial banks – ABSA, First National Bank, Nedbank, and Standard Bank – as well as Post Bank, a division of the South Africa Post Office. With a collective launch cost of between R25 and R35 million (approximately $3.6 million to $5 million in U.S. dollars), the product is offered independently by each bank, but product features are the same for the first year. While the Mzansi account, which is a basic bank

[21] Ibid., p. 16.
[22] Planting, S. (2004, November 5). The Wonderful World of Money. *Financial Mail*.
[23] UNEP FI African Task Force. (2005). Sustainability Banking in South Africa. *CEObriefing*, p. 5. In addition, Standard Bank was careful to locate the kiosks in convenient locations, but away from busy areas with high incidences of crime (Lobenhofer, et al., p. 5.)
[24] Lobenhofer, et al., p. 5.
[25] Ibid., p. 14.

account targeted to lower-income South Africans, emerged with little government subsidy or legislation, the Minister of Finance insisted on competitive pricing.[26]

Mzansi accounts are targeted at South Africans who earn less than R2,000 per month (approximately $307 in U.S. dollars). Analysts estimate that these limited basic bank accounts are between 35 percent and 60 percent cheaper for customers than existing entry-level products.[27] They offer customers a debit card and no-fee banking as long as transactions are limited to debit-card purchases, one deposit, and a limited number of ATM withdrawals each month.[28] The participating banks have pooled their infrastructure to make 12,000 ATMs available to account holders.[29] However, analysts predict that the final cost of launching the Mzansi accounts will prevent the accounts from being profitable initially.[30]

As of February 2005, approximately 560,000 customers have opened Mzansi accounts through the participating banks with a total balance of R160 million (approximately $23.3 million in U.S. dollars) and an average account balance of R290 (approximately $42). More than 6,000 new accounts are being opened daily. According to the Banking Council Director responsible for the Mzansi initiative, Colin Donian, 90 percent of Mzansi customers who opened accounts were new customers and had not held an account at *that* bank previously[31] and Mzansi accounts do not seem to have cannibalized existing accounts.[32] The Mzansi account is one example of a private sector initiative occurring in South African that could be instructive for U.S. banks looking to reach emerging domestic markets. Examples of other South African innovations follow.

Standard Bank's Broadband Satellite Terminals and MTN Banking Partnership

In January 2005, Standard Bank signed an agreement with Telkom, one of South Africa's leading telecommunications companies, for 400 Internet protocol-based (IP-based) broadband satellite terminals to power ATMs in remote areas after a successful pilot during August and September 2004. The broadband satellite links will be used in conjunction with Standard Bank's prefabricated ATM concept to coordinate faster and more cost efficient services. As of March 2005, 13 terminals were opened in deep rural areas while another 15 opened in urban townships. The terminals in rural areas help Standard Bank meet the objectives of the Financial Services Charter by providing banking services to South Africans in poor and rural communities, while those in urban townships are intended to increase the bank's footprint.[33] According to Herman Singh, Director of Technology Engineering at Standard Bank, the satellites are deployed in low-traffic and low-volume areas, allowing Standard Bank to serve areas where branches are not commercially sustainable. In addition to being less expensive than branches,

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26 R stands for rand, the South African unit of currency. FinMark Trust, p. 17.
27 Planting.
28 The exact number of free ATM withdrawals varies by participating bank. Goering, "South African Banks Having a Problem with Interest"
29 FinMark Trust, p. 17.
30 Planting.
31 "Mzansi Customer Numbers Beat Forecasts." (2005, February 10). *Business Day*.
32 Preuss, H. (2005, February 9). Mzansi Accounts Hit 557,439. *iafrica.com*.
33 Standard Bank. (2005). *Standard Bank in Groundbreaking Broadband VSAT Solution*. Media Release 2005. Retrieved May 2, 2005, from http://www.standardbank.co.za/SBIC/Frontdoor_02_01/0%2C2354%2C10293765_11066021_0%2C00.html, p. 3.

the satellite ATMs should also be cheaper to maintain since they lack the copper wiring needed for traditional ATMs--which is often stolen in rural areas, according to Singh. The flexibility and simple set-up of the satellite ATMs should help Standard Bank extend banking services where land-line connections are expensive, more difficult to install, and unreliable. The satellite ATMs will be rolled out during the next year with Standard Bank projecting a per unit cost of R2,000 to set-up.[34] This model could be instructive for U.S. banks that are seeking to locate in areas of low-wealth or population density.

Standard Bank has gone further with its efforts to reach the unbanked through mobile technology through its partnership with cell phone company MTN. The two partners have developed a new financial services brand, MTN Banking, which uses an interactive voice response system in conjunction with prepaid cell phones. In order to get an account, an extra digit is simply added to a customer's cellphone number, creating a MobileMoney account number. Customers open accounts using software downloaded over the air or already embedded on their SIM cards. Customers can also receive MobileMoney CashCards, which enable withdrawals at Standard Bank Autobanks and branches, for free from Standard Bank branches or identified MTN Service Providers. There are no monthly service fees or minimum balances with MTN banking, and CashCards can be upgraded to MasterCards.[35] Sample transactions include person to person payments, account transfers, ATM withdrawals, as well as bill payment options and other limited purchase options. Though MTN Banking is brand-new to the market, having just been launched in August 2005, mobile-phone banking has potential to increase access to basic banking services for unbanked South Africans. As U.S. telecommunications and financial services companies struggle with implementing mobile banking, the lessons learned from the experience of Standard Bank and MTN will be quite instructive.

First National Bank's Million-a-Month Account

In an effort to encourage a culture of savings, First National Bank has created an innovative investment product – the Million-a-Month Account. Launched on January 17, 2005, the Million-a-Month Account is a 32-day investment product with a minimum opening balance of R100 and no maximum account balance.[36] This minimum opening balance is less than the minimum amount needed to open most investment accounts in South Africa. In addition, there are no fees or transaction costs.[37] However, the account does not pay interest. Instead the account replaces interest payments with a chance of winning R1 million, R100,000, R20,000, or R1,000.[38] For each R100 in the account, a customer will be entered in the drawing. For the purpose of determining the number of entries, account balances are rounded down to the nearest R100 so that a customer with an account balance of R385 will have three entries in the monthly drawing. According to Robert Keip, Chief Executive of Investments at First National Bank, the account

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[34] "Bank Goes Satellite Route." (2005, February 1). *Wireless Satellite and Broadcasting Newsletter*, 2(15), p. 9.
[35] "MTN and Standard Bank Ring in a New Era for Financial Services." (2005, August 10). MTN Company Press Release.
[36] "FNB Incentivises a Culture of Savings in 2005." (2005, January 23). *Liquid Africa*.
[37] Clayton, C. (2005, January 29). "Save and You Could Win R1m." *Personal Finance*. Retrieved on March 1, 2005, from http://www.persfin.co.za/index.php?fSectionId=592&fArticleId=2390175
[38] "Promoting a Piggy-Bank Culture" (2005, March 29). *Africa News*.

offers a "realistic chance of return".[39] While entries depend on an individual's balance, an account holder's chance of winning declines as overall deposits increase.

First National Bank believes that by offering an account with a low minimum opening balance, no transaction fees, and a risk-free chance to win up to R1 million, they will be able to attract unbanked and underbanked South Africans who like the excitement of the lottery. However, unlike the lottery, Million-a-Month account holders do not risk losing any of their investment contributions. According to Keip, the bank views the account as a savings vehicle rather than a lottery since customers do not pay a fee to enter the drawing and do not lose the investment that has been made. By getting free use of these funds, the bank can offset the costs associated with the accounts, including funding the cash prizes, opening the accounts, and marketing the new accounts by charging interest on loans made with the deposited funds.[40]

The lack of interest payments does not seem to be a deterrent. First National Bank reports that they have received at least one lump-sum deposit of up to R100,000.[41] In addition, the lack of interest payments means that Muslims who follow Shariah law can take advantage of the product.[42] On average, each account has had an opening balance of about R1,000. Some new Million-a-Month account holders have moved from their Mzansi account into other savings products.[43]

First National Bank's Million-a-Month account has the potential to attract significant numbers of South Africa's un- and underbanked into the mainstream financial services sector. This recent innovation should provide unique insights into the role of rewards in facilitating asset building. Applicability to the U.S. market will depend on the success of the product covering its costs and the extent to which it prompts the targeted population to open accounts.

Capitec Bank Pre-Authorized Debit Card on the Global Chip Card (EMV) Standard

Pre-authorized debit cards are a type of stored value card (SVC), serving as a check or cash alternative to link customers to transactional services and broader financial opportunities. These cards can be either closed-loop, allowing consumers to make purchases for limited purposes in limited locations, or open-loop, allowing customers to make purchases for multiple purposes in multiple locations. In the U.S., closed-loop cards were introduced first during the early 1990s, with open-loop cards becoming available in the mid-1990s. During this period, discussion in the U.S. focused on chip-based cards, otherwise known as smart cards. However, magnetic-stripe

[39] Hogg, A. (2005, January 13). Robert Keip: CEO, FNB Investment Products House. *Moneyweb*.
[40] Clayton.
[41] Ibid.
[42] Shariah law prohibits the receipt of interest, requires that risk and profit be shared, and prohibits investment in certain business activities such as alcohol, tobacco, pornography, armaments, and gambling. Islamic regulatory institutions have emerged to guide investors, but the interpretation of Shariah law varies. (Gray, S. (2004, March). Islamic Finance – An Alternative Alternative. *investorsoffshore.com*. Retrieved May 17, 2005, from http://www.investorsoffshore.com/html/specials/march05_islamic.html)
[43] "Promoting a Piggy-Bank Culture"

cards, which link to networks when consumers conduct transactions, have come to dominate the extremely new SVC market.[44]

Innovation in South Africa's SVC market is even newer than in the U.S. While innovation in South Africa also began with closed-loop cards, the SVC card market in South Africa is moving decidedly toward chip-based cards rather than magnetic-stripe cards. Announced on October 12, 2004, Capitec Bank's pilot has been a long time in the making. South Africa began testing electronic purse smart cards in the late 1980s, and hit a milestone in 1999 with the decision by the nation's major banks to embark on a nationwide migration to smart cards that would conform to the international EMV (Europay, MasterCard, and Visa) standard for chip-based payment cards. Since 1999, issuers in South Africa have worked to update their own account systems to work with smart cards and to upgrade most of the nation's 130,000 point of sale (POS) terminals to accept smart cards.[45] The EMV standard sets requirements to ensure interoperability between debit and credit chip cards and terminals on a global basis, regardless of the manufacturer, the financial institution, or where the card is used.

According to Capitec, its new "smart" debit card is specifically designed to provide a straightforward, low-cost banking product with easy access to the mass market. Unlike magnetic stripe cards, chip-based debit cards do not depend on the need for 'always online' telecom infrastructure.[46] This is because retailers can accept a guaranteed payment directly from the chip without needing an online authorization. In a country with high telecommunications costs, the ability to process purchases once a day rather than numerous times during the day saves retailers time and money. Moreover, in a country with high crime rates, it is important that Capitec Bank cardholders can avoid carrying large amounts of cash to buy goods and services. The card is being piloted in the rural Qwa-Qwa town of Phuthadjitjaba in the Free State province. In addition to being more convenient for rural customers, by reaching out to these areas, Capitec addresses some of the requirements of the Charter.

Capitec Bank customers receive a pre-authorized debit card with both a magnetic stripe and personal identification number (PIN) protected microchip. Cardholders can load the chip with funds from their bank account, allowing retailers to deduct purchase amounts from the pre-authorized amount without being online. The cardholder continues to use the card in an off-line mode until the amount requested exceeds the card's open-to-buy counter. Since the chip keeps up with the balance, the card cannot be overdrawn and can be reloaded at any Capitec Bank branch or POS terminal.[47] Customers pay 50 cents per transaction with no fees to issue the card or for loading funds. In addition, a personal card reader suitable for a key ring is issued for cardholders to check the balance on the card.[48]

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[44] Jacob, K., Su, S., Rhine, S. L. W., & Tescher, J. (April 2005). Stored Value Cards: Challenges and Opportunities for Reaching Emerging Markets. The Center for Financial Services Innovation. Retrieved June 15, 2005, from http://www.cfsinnovation.com/managed_documents/svcpaper2.pdf, p. 3-4.
[45] Foster, A. & Davis, D. (2005, January). South Africa Gets Ready for Smart Cards. *Card Technology*, 10(1), p. 28.
[46] Capitec Bank. (2004, October 14). Capitec Bank and MasterCard Pilot World's First Pre-Authorised EMV Debit Card. Press Release. Retrieved May 3, 2005, from http://www.capitecbank.co.za/pressreleases/MCardFinal.pdf
[47] "EMV Piloted in Rural Free State Area." (2004, October 12). *Africa News*.
[48] Capitec Bank. (2005, February 8). International Recognition for Capitec Bank's Debit Card. News Release. Retrieved May 5, 2005, from http://www.capitecbank.co.za/pressreleases/CapitecMasterCard_8Feb2005%20-%20Eng1.pdf

In South Africa, the financial services industry has focused on smart cards as a means of avoiding high telecommunications costs associated with using magnetic stripe cards at retail locations. Despite investigation into smart card technology by the U.S. financial services industry in the 1990s, magnetic stripe cards have come to dominate the SVC market due in part to dramatically lower telecommunications costs and the legacy of an existing network system for processing transactions.[49] Like providers in South Africa, U.S. SVC providers struggle with retailers as distribution channels. In the U.S., SVC providers face challenges around how SVCs are sold and reloaded at retail locations and encounter regulatory ambiguity.[50] Though the challenges differ, it is clear that providers must overcome their nation-specific challenges to take advantage of the potential for SVCs and to reach the un- and underbanked market.

Portable Banking Device to Open Accounts and Issue Sekulula Debit Cards For Social Welfare Recipients

Launched in August 2003 as a joint venture of Amalgamated Banks of South Africa (ABSA) and its subsidiary, AllPay, the Sekulula debit card, which uses smart card technology, allows the province of Gauteng to distribute benefits to low-cost bank accounts of social welfare recipients. Recipients can withdraw funds at any ATM or use the card at POS terminals. Sekulula is Zula for "It's Easier," allowing recipients to access their benefits without waiting in line to receive benefits.[51] Recipients may make two free ATM transactions per month after receiving the card and the accounts have no maintenance fees.[52]

In the U.S., SVCs have been used for years to access public benefits with the Debt Collection Improvement Act (DCIA), passed in 1996, requiring the use of electronic funds transfer (EFT) for most Federal payments, with the exception of tax refunds, beginning on January 2, 1999.[53] Similarly, the Sekulula card is not the first time smart card technology has been used in South Africa by provincial governments and banks to distribute social welfare benefits into low-end bank accounts through debit cards. The real innovation is in the portable device that complements the debit card. This device enables ABSA staff or agents to open accounts, issue debit cards, and select personal identification numbers where people have limited access to a physical bank. According to ABSA, the portable banking device is a world first, containing a laptop, a printer and a scanner which is used to read identity documents.[54]

The system provides almost one million social welfare recipients access to low-cost bank accounts with ATM and POS access and the innovation has cut pension payment costs from R24 to R15 for the Gauteng province, where the program is being piloted.[55] Gauteng is

[49] Jacob, et al., Stored Value Cards: Challenges and Opportunities for Reaching Emerging Markets, p. 4.
[50] Jacob, K. (May 2005). Retailers as Financial Services Providers: The Potentials and Pitfalls of this Burgeoning Distribution Channel. The Center for Financial Services Innovation. Retrieved June 15, 2005, from http://www.cfsinnovation.com/managed_documents/retailpaper.pdf, p. 10.
[51] "ABSA Launches Bank Account for Social Beneficiaries." (2003, August 21).South African Press Association.
[52] "Welfare Boost for Low-End Banking." (2003, April 23). *Africa News*.
[53] Jacob, K. (July 2004). Stored Value Cards: A Scan of Current Trends and Future Opportunities. The Center for Financial Services Innovation. Retrieved June 15, 2005, from http://www.cfsinnovation.com/managed_documents/storedvaluecard_report.pdf, p. 3.
[54] "ABSA Launches Bank Account for Social Beneficiaries."
[55] Goering, "South African Banks Try to Expand Customer Base."

geographically the smallest province in South Africa, but has approximately 8 million residents and is highly urbanized, including Johannesburg. ABSA believes the cards will be used mainly in urban areas, but claim that the system can provide payments in remote areas where there are no electricity or telecommunications facilities since the card relies on smart card technology.[56] Recipients are not required to be paid through the Sekulula debit card and can opt to receive their cash at existing paypoints in the province. This product has the potential to bank the unbanked in South Africa, and might also help empower people to better control their finances.

Lessons Learned

Even though South Africa's unbanked population is a much greater percentage of total population and the economy is drastically different, the South African experience is instructive for the U.S. for several reasons. The following important lessons from South Africa highlight strategies for promoting innovative financial services among underbanked groups:

- There is a role for the federal government to play. When South Africa was in the midst of reforming institutions and policies across the country, the central government chose to emphasize financial services. Through the creation of the Black Empowerment Commission (BEC), the government fostered public-private partnerships to encourage innovations in reaching the nation's unbanked. The resulting Broad-Based Black Empowerment Act is not a mandate and is loosely structured to encourage experimentation in keeping with the goals of Black Economic Empowerment. While South Africa had a crucial historic moment to exploit when creating these initiatives, countries like the U.S. that are not currently undergoing drastic governmental change can nonetheless consider such public-private partnerships.

- The South Africa case is similar to the U.S. in the sense that the retail financial system is overwhelmingly privately owned, and a combination of carrots and sticks have been useful in promoting innovative change. On the other hand, a key difference from the U.S. is that the South African banking system is dominated by four large banks. Thus, the system has limits to cooperation and competition; South Africa struggles with how to allow new entrants into the market in order to drive down price and increase choice. In the U.S., though there are "mega-banks" with trillions in assets, there are thousands of other financial institutions, from very small credit unions to medium-sized regional banks, that can develop innovative practices and provide services to the underbanked.

- It can be profitable to serve the unbanked market segment, but the key is looking beyond low-cost products to appropriateness of services and fees while exploiting available technology and distribution channels.

[56] "ABSA AllPay Supports the Poor." (2004, June 23). *Africa News*.

- Creative incentives can encourage very low-income people to access financial services. Lotteries and other incentive programs could be used to bank the unbanked and to encourage saving behavior. However, incentives must be strong enough to attract customers both in terms of the value of the reward and the expectation of receiving a reward.

- Low-balance accounts held by underbanked individuals in low-density locations can still be profitable, especially when services are bundled, electronic transactions are encouraged, and offsite distribution channels such as kiosks and mobile branches are used. In some ways, South Africa has leapfrogged past certain technologies and moved into using wireless ATMs, making low-population-density areas easier to reach. In the U.S., legacy systems create a different set of hurdles for this type of technology and distribution strategy, but the opportunity remains.

- The main advantage of smart cards, which have yet to gain ground in the U.S., is their multi-functionality. Smart cards can be used for a range of purposes through a variety of touchpoints. Stored value card (SVC) providers in the U.S. continue to struggle with reloadability, functionality, and distribution channels, but again, because of the systems already in place, it is unlikely that smart cards will be a significant force in the U.S. in the near future. Though the products are different, SVC providers can take a lesson from smart card adoption internationally and focus future efforts on making products multi-functional and easy to port and use.

Each innovation presented in this paper highlights strategies that U.S. financial institutions might use to reach lower-income markets such as rewards programs and lotteries, smart cards with multiple functions and easy reloadability, mobile branches and ATMs, and low-cost entry level bank accounts. Of particular interest is the role of these and other innovations in facilitating asset building. It is important to note, however, that the South African experience is quite different from that of the U.S. As U.S. financial services providers, government officials and others consider ways to learn from these South African innovations, they should give considerable thought to practical replication and focus on efforts that can realistically provide benefit to both the company and the consumer.

APPENDIX: Other Innovations with Potential for the Unbanked

• Pick n' Pay Go Banking, a division of Nedbank, is offering a cheap way to transact from a supermarket banking platform by providing bank account information packets on the grocery store shelves.[57]

• Standard Bank has introduced PureSave, a card-based savings account with no monthly management fee and some transactional functionality.[58]

• Teba Bank (formerly Teba Cash) has provided cost-effective financial services to miners and others in rural areas, including savings vehicles and remittance services.[59]

• First National Bank offers a direct deposit payroll card to reduce crowding in their branch lobbies on paydays.[60]

• ABSA's 28-ton mobile bank, which can be lifted by crane onto a truck and transported anywhere it is needed.[61]

• ABSA has cellular network phone booths where the unbanked can open accounts remotely.[62]

• Standard Bank's pilot that used fingerprint scanning in ATMs beginning in 1996, which was the first live installation of biometrics on an ATM.[63]

• African Bank has a loan program where every customer is granted a loan. The type of loan and repayment terms depends on risk profile and the bank takes credit risk only.[64]

• Home Loan Guarantee Company has developed a product that will enable banks to deal with the HIV/AIDS risk when providing housing finance to low-income borrowers.[65]

• Insurance companies and banks have developed funeral insurance partnerships, including cross-selling products.[66]

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[57] Needham, C. (2005, May 8). "Pick Your New Bank Off the Supermarket Shelves." *Sunday Times*, p. 13.
[58] Ibid.
[59] Grawitzky,R. (1999, April 6). "Smart Shopping on the Cards for Miners." *Business Day*, p. 1.
[60] Lobenhofer, et al., p. 2.
[61] Goering, "South African Banks Having a Problem with Interest"
[62] Kitten, T. Reaching the Unbanked: Learning from South Africa's FIs.
[63] Kitten, T. (2005, January 25). "Back to the Future: Biometrics Revisited." *ATM Marketplace*.
[64] Planting.
[65] Ibid.
[66] "Life Carriers Face Challenges Galore Amid Huge Growth Opportunities." (2005, January 25). Life Insurance International.

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The Center for Financial Services Innovation (CFSI), an initiative of ShoreBank Advisory Services with support from the Ford Foundation, was founded in 2004 to encourage the financial services industry's efforts to serve un- and underbanked consumers. The Center provides funding for innovative solutions, a meeting place for interested parties and resources for testing products and services. CFSI also identifies, develops and distributes authoritative information on how to respond to the needs of the underbanked profitably and responsibly. CFSI works with banks, credit unions, technology vendors, alternative service providers, consumer advocates and policy makers to forge new relationships and pioneer products and strategies as it seeks asset-building opportunities that create value for both customers and companies. For more on CFSI, go to *www.cfsinnovation.com*

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