



**Africa Trade Policy Notes**

# **Facilitating Cross-Border Mobile Banking in Southern Africa**

**Samuel Maimbo, Nicholas Strychacz, and Tania Saranga<sup>1</sup>**

**May, 2010**

## **Introduction**

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 can allow faster and more efficient financial transfers, increasing the volume of trade and subsequent payments to workers and their families. This dynamic is especially important with regards to 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 in developing countries. In Africa, where borders were often arbitrarily drawn, cross-border trade is an important business activity for a large subset of its population. Developing mobile banking capacity offers great potential for facilitating trade in both goods and financial services.

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

## **Understanding the demand for mobile banking in Southern Africa**

Mobile banking in this note refers to a range of mobile phone based financial transactions including payments—actual payments that are made with a mobile phone—as well as using a mobile phone to access 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, 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 is strong. Although determining the exact number of migrants is difficult—available data only captures the flow of registered migrants—estimates suggest that the number is high. Significantly, the available data also indicates that a notable portion of migration flows are South-South, or between developing countries.

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<sup>1</sup> Samuel Maimbo is Senior Financial Sector Specialist in the Africa Financial and Private Sector Development unit. Nicholas Strychacz is a Consultant in the Africa Poverty Reduction and Economic Management unit. Tania Saranga is a Consultant in the Africa Financial and Private Sector Development unit. This work is funded by the Multi-Donor Trust Fund for Trade and Development supported by the governments of the United Kingdom, Sweden and Norway. 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.

Research has shown that, since income differentials between these countries are small, geographical proximity and networks have a greater influence on migration patterns than income levels. Other determinants of migration patterns include civil conflict, ecological disasters, and seasonal dynamics which are factors that often affect many African countries.

A common characteristic of migrants is that they are generally of low income and unskilled or of limited formal education, which is indeed one of the causes of migration—workers tend to migrate to where there is work. For example, a recent study on migrants leaving Mozambique showed that 8% have no education, 15% have secondary education, and 70% have basic primary education. On the other hand, there is also evidence 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 political unrest and economic uncertainty help to explain why migrants are often the most financially excluded in a community. These migrants, therefore, are people that would benefit the 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 underway in Southern African, the closer integration of labor markets through increased cross-border mobility could bring significant efficiency gains to the region.

## **Remittances**

In the formal financial sector, remittances are generally sent by migrants through banks, post offices, or money transfer operators, and by carrying cash personally or 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, as these figures do not take into account the unrecorded flows through both formal and informal channels. Indeed, a large proportion of remittances are 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, as inaccurate information or estimates could lead to policy initiatives that do not help in raising the level of formal financial sector participation. Similarly, from an efficiency perspective, 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 due to efficiency gains from transferring money, increasing access to credit, and raising the level of savings. These benefits will be especially beneficial for those migrants that do not currently have access to the formal financial sector. For example, engagement with the formal financial sector would provide greater physical security for many workers, in that a worker would not have to always carry cash in hand.

Economically, there is limited participation in the formal financial sector simply on account of the high cost compared to informal transfer methods. This is a primary reason why the informal financial sector is more popular among migrants. Indeed, a study of remittances in South Africa conducted in 2006 showed that 7% of migrants used a post office to send money, 1% used a bank in South Africa, and 6% used a bank in the migrant’s home country. The rest (86%) used informal means for remitting money. While other studies have shown a higher percentage of migrants using banks, a significant number still used

informal methods for transferring remittances. So while current estimates of informal sector participation are imprecise—the differences between studies may be due to differences in the sampling method and survey timing—economists 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 than the formal financial sector to remit payments:

- *Ease of use*: Migrants prefer methods with less paperwork
- *Familiarity*: Informal channels have also been used, or have been 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 informal transfers, with fees that can represent over 50% of the remittance value.
- *Risk tolerance*: There is a perception among migrants that banks are untrustworthy and can lose, or steal, migrants' money
- *Access*: It can be difficult for migrants to reach the point of delivery

Another reason why a large proportion of most migrants stay away from formal channels is that a significant number of migrants are working in South Africa without formal employment. Thus, the remittances are, by definition, the result of illegal employment. Given this context it is unsurprising that banks are generally unable to provide services to unbanked migrants.

Finally, in some countries there are regulatory restrictions that prevent the entry of financial institutions—even those that may have a greater geographical reach or are closer to migrants—into the remittance market. All of these reasons explain the disincentive facing migrants 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, which is 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. Still, many cross-border traders pay duties and taxes, and studies have estimated the value of informal trade within Southern Africa at \$17.6 billion per year. The payments system that typically supports these various monetary exchanges is characterized as unrecorded cash-to-cash transactions.

A 2008 study on the topic<sup>2</sup> described informal cross-border traders as including the following:

- Traders or merchants who under-declare their imported goods or wares
- Traders or merchants who do not declare anything at all (smugglers)
- Traders or merchants who do not declare through clearing agents
- Traders or merchants who sell directly to the final customer
- Agents of established wholesalers and retailers

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<sup>2</sup> M. Pailles. 2008. "Optimising Regional Integration in Southern Africa: Assessing Informal Cross-border Trade in SADC." Southern African Research and Documentation Centre (SARDC) for the SADC Poverty and Development Consultative Conference.

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

Despite the magnitude and importance of informal cross-border trade, especially with regards to income generation among the poor, governmental 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 (MOU) with the government of Malawi to facilitate informal trade, specifically between small and medium-sized enterprises. In Southern Africa, similar negotiations are underway for the signing of similar MOUs with Zambia, South Africa, and Namibia.

### **The financial and telecommunications landscape**

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

#### *Financial Sectors*

Despite some recent developments in increasing competitiveness in financial markets, the number of financial operators and financial instruments remains thin in many countries. In general, financial sectors in migrant-sending countries can 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. The development of a strong financial sector and efficient payment systems are essential for development and for supporting increasing cross-border financial flows. This includes, among other factors, developing the commercial banking sector and other financial institutions, strengthening the domestic payments system, developing foreign trade financing instruments, and establishment correspondent banking relationships between countries in the region.<sup>3</sup>

Countries face a number of challenges in the reform of domestic financial sectors and the creation of 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, and a shortage of human and technical capacity. All of these factors make more difficult the 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 built. In several countries with incomplete financial markets, several innovative initiatives for expanding access to mobile banking have been implemented, but remain nascent.

#### *Telecommunication Sectors*

As with financial sectors, the telecommunications sectors of Southern Africa are also at different levels of development. While countries such as South Africa and Namibia have relatively more developed

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<sup>3</sup> 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 allows a bank's clients to be served without having to set up a branch in another country.

telecommunications sectors, in countries such as Zambia, Angola, and Malawi, the telecommunications sector is still 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, in general the international bandwidth available to Southern African countries is extremely poor in comparison to Europe, North America, or Asia.

Regionally, there are several key issues facing Southern Africa. Some of the countries (Zambia and Malawi) are landlocked, meaning that they do not have the option of connecting directly to a submarine fiber-optic cable. These countries will have to rely on expensive satellite links for their international traffic and may be unable to afford or access high bandwidth links. Although there are plans to link Southern Africa with a submarine cable, progress has been slow and could be expedited if a regional solution can be found.

### **Policy Recommendations**

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 mobile banking development agenda.

The first, and perhaps most important, factor is that African countries must continue 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 allow branchless and mobile banking to flourish. For all Southern African countries, it is important to develop clear guidelines for implementing branchless banking that can be easily followed. Since the overarching goal is to expand financial services to the currently unbanked population, specific policies include expanding permitted points of service for low-value cross-border transactions, eliminating the requirement to prove legal residence in order to set up a bank account, and expanding the scope of Exemption 17 to cover intra-SADC money transfers.

Developing such regulatory frameworks, however, can be a difficult and time-consuming task. It would therefore 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 benefits for economic development. Similarly, the pilot projects can help to identify and overcome problems with proposed regulation. The final result is that regulation will be more effective at expanding access to banking services, while at the same time increasing limiting 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 CDD approach with flexibility to incorporate low-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 low-value cross-border transactions. Taken together, these regulations can help to expand access to financial services while creating an environment in which banks and other stakeholders can also benefit.

### *Recommendations for the proposed follow-up 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. 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 support for branchless banking by stakeholders. 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 to 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 at the same time 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 gaining an understanding of 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 to create a cadre of expert stakeholders that can ultimately 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 SADC or COMESA could provide a forum for cross-country discussion and sharing of experiences. Such a forum could also define best practice regarding regulatory frameworks and future policy action. Regionally accepted regulatory frameworks would greatly help to facilitate cross-border mobile banking.

Fourth, as previously discussed, a pilot project specifically aimed at bringing “taxi money” into the formal financial sector should be launched. This refers to funds that are transferred across borders via taxi drivers and similar informal mechanisms, and 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 pilot project could start with a country that is an important recipient of low-value remittances from South Africa; Mozambique and Malawi would be logical choices. Mozambique, in particular, has extremely high volumes of low-value remittances from South Africa.