



Can developing countries afford a developed world payments system?

Poor people will not adopt banking services if they are required to pay the full cost of service and transaction fees, because the use of cash is considered by many to be 'free', writes Peter Goldfinch – GFG Group's General Manager for South East Asia. In this issue of the monthly Goldfinch Report, Peter uses the Maldives to discuss how pricing and other barriers can be managed to successfully create an effective payments system in developing countries. Peter's credentials have been earned over 23 years experience in electronic payments, including pioneering work on ATMs and EFTPOS, and the introduction of credit and debit cards in Russia.

There are not too many countries where almost the only payment method is cash, with a few cheques. Such a country gives a payments specialist the opportunity to start almost from a clean sheet. Similarly when we think of a country, the vision is of a land mass. Not hundreds of islands spread out across the ocean.

Such an idyllic place does exist. It is called the Maldives but I am sure it is not the only country with this topography. There must be many in both the Pacific – such as Fiji – and in the Caribbean region.

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The demographics of the Maldives are also probably not unusual, with a capital city or island that is the hub of all activity. A significant portion of the population resides there, working for the government, corporate head offices, banks and the major importers and suppliers of goods and services. The remainder of the population is spread out over the rest of the country, earning a living mainly from tourism, fisheries or agriculture.

In the Maldives the capital is the head quarters for the national and foreign banks. The foreign banks have established a presence to service corporate and high net worth clients. Debit cards are issued for acceptance in a few ATMs around the capital. POS is also deployed in a range of merchants in the capital. Credit card issuance is limited - not necessarily because a large sector of the population is credit challenged, but because credit histories are simply not established. In any case, the points of acceptance are restricted solely to the capital.

Cheques are used by corporates or Government for B2B payments. Payment of employees by government and the corporates by cheque is also not uncommon. The inter bank settlement process is manual and only involves a small number of cheques each day as most are drawn and deposited on the national retail bank.

Person-to-person payments, wages, small business payments and retail payments are all in cash. Those living outside of the capital have no option but to use cash.

Is there a problem here? Or could the status quo continue? More importantly, can countries such as this afford to implement a developed world payments system?

Payment systems in the developed world are also imperfect, but countries such as Maldives have issues that do need to be addressed. The key reasons to change are obvious, but for these small countries where the extended family is important and social values have been strong, the reasons are new.

- People are not so keen in holding life savings in cash. A life long practice is changing because of security concerns.
- Counterfeiting is becoming an issue to the point where central banks need to react. In small economies this can have a serious impact. Upgrading the notes to 'plastic' is expensive. It's even more expensive if large amounts of currency go out of circulation in the form of "savings under the bed".
- As the economy grows the organizations paying workers, sub-contractors and suppliers need a far more efficient payment system. Currently these organizations when operating in a cash economy are required to hold large tranches of cash. The cash needs to be distributed, and buffer stocks have to be held in case the distribution process fails. Security again is becoming a big concern.
- As economies develop consumer payment needs become more sophisticated. Not all payments can be made conveniently by cash. Products and services are not all purchased from local suppliers as in the past.

Rolling out a conventional payment service is not necessarily the answer to this solution. Simply, there is not the volume to justify the investment.

There is no branch network. A mobile bank (boat) may turn up once a month to provide a level of service. The issue for the inhabitants is liquidity - if they deposit funds and those funds are then needed, they must wait for the next monthly visit. The alternative is to travel back to the capital which may be a three day round trip. This often results in informal borrowing. The banks are not generally providing unsecured lending facilities to these low or irregular earning customers. Unofficial moneylenders provide the service.

Providing an ATM service at a remote location - even if the transactions could justify the installation - would prove a logistical nightmare. ATM state of health monitoring software will allow engineers on regular visits to conduct effective preventative maintenance. But ATMs require consumables to be replenished, and more importantly,

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to be reloaded with cash. Striking the correct balance between the value loaded and the denominations supported requires knowledge of local demand.

Deploying ATMs with a note recyclable feature is another option. The local shopkeepers could be engaged to deposit their daily takings into these ATMs for the notes to be redispensed back into the community.

Low cost wireless point of sale devices could also be deployed into the local stores. There are low cost terminals now available from China and India that should be cost justifiable. These terminals would allow shopkeepers to become agents for banks, supporting both deposit taking and encashment services. Possibly, they could even offer other services such as account opening. In some countries the Post Office has taken on agency banking successfully.

This type of environment is ideal to deploy a wireless payments solution, although not necessarily an exclusively mobile service. Wireless in many of these countries has the coverage that terrestrial networks have not and never will achieve. In the Maldives mobile coverage is 97%. Handset penetration is also high.

Cash cannot be totally replaced, and there needs to be a transitional strategy. But there are critical short-term goals that must be achieved:

- Eliminate the need to ship large amounts of cash to make payments to suppliers and workers.
- Remove the need for people regardless of where they reside to keep large amounts of cash.

To achieve these goals there is a need to encourage all those receiving payment to open a bank account. The key to achieving this is through pricing. The payer is benefiting from not needing to handle cash and should carry the cost associated with the direct credit to payees' accounts.

As cash is considered by many as being free it may be necessary to reinforce the fact it is the most expensive payment instrument by introducing or increasing cash management fees. This is under central bank control as the supplier of notes and coins.

Cash will be required at the community level because people are slow to adapt. But there is a need to reduce the dependency.

The introduction of new bank notes and placing an expiry date on the old notes is a method of uncovering all the saved currency. The value of the currency does not need to change. The objective is to encourage the old notes to be banked and not simply exchanged for the new notes. Attractive one-off interest rates on longer-term deposits may need to be increased for a limited period.

The bank account should be accompanied with a debit card to support eftpos purchase, as well as supporting the withdrawal of small amounts of cash at the local bank agency.

Mobile payment services should be launched to support the transfer of funds. The key transactions must enable individuals who are not paid wages but work on a contract bases to be paid. Then to allow those individuals to make bill payments and to transfer funds to members of their family.

In many communities, those members of the extended family who are working support the other members. Often the family members are in different locations. The working member needs to remit funds to support their family. Similarly it may be a parent remitting funds to a child away at school.

The mobile will also allow account holders to manage their funds, view their balances and the last "x" number of transactions, transfer funds from a current account to a savings account and make loan repayments.

About Peter

Peter Goldfinch, GFG Group's General Manager South East Asia, is a respected analyst and commentator on global trends in payment technology.

One of the original founders and shareholders in GFG Group, Peter has a background of more than 23 years in the information technology industry, most of which has been involved with consulting and systems development for banking and finance customers in 25 countries.

He has particular expertise and experience in payment systems, including mobile payment systems. His career highlights include pioneering work on the first ATM and EFTPOS networks.

In the mid-1990s, he played a key role in the introduction of credit and debit cards into the Russian market, working with GFG's customer SBRF.

About GFG

GFG Group is a highly-specialised payment solutions company, providing its clients with products, advice, and systems integration and outsourcing services. Accredited by the World Bank, the company has established a global presence over the last decade – delivering leadership payment solutions to more than 50 customers in over 40 countries.

A key element in GFG Group's success is its focus on development and investment in five high-demand payment solution areas:

- Card Management
- Mobile Payments
- Payment Tools
- Managed Services

The company's core research and development team is based in Auckland with consultants and technical staff located in the international offices to provide front line 24 x 7 support for customers in multiple geographies.

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A core element to success is the pricing. Again there is the perception that cash is free. Mobile payment services are definitely not free - mobile operators will charge for data transmission, and banks will wish to charge transaction fees.

In pricing it is important to understand who are the big winners;

- Individuals will have funds on deposit, securely earning interest.
- Central banks have reduced cash management costs, less notes in circulation and unhindered circulation
- Corporates are not shipping large amounts of cash around the country. Funds once held as 'mountains' of cash will remain in the bank earning interest until required.
- Businesses - especially retailers - will have less cash on their premises.
- Banks will have an increase in funds on deposit.

It is essential to ensure that all the cost, or even a disproportionate share of the cost, does not fall on individuals. If it does, the individuals will reject the new payment system and stay with cash. Making services available for free until usage becomes excessive and charges can be justified has proven to be a successful model for pricing for individuals.

The largest share of the cost should fall to the central bank and the larger corporates.

For individuals, an effective payments system has a host of important benefits, including improving the security of savings, solving problems around liquidity and enabling the purchase of products and services from non-local suppliers.