Bridging the financial gap and unlocking the potential of informal businesses through mobile money in four East African countries

The informal sector mainly a cash and face-to-face driven sector continues to face many challenges and obstacles preventing informal businesses from reaching their full potential. Informal businesses are generally small, often lacking the capital, skills and expertise necessary to expand and improve their businesses. Rigorous tax laws, labour laws, the registration process and the lack of access to finance and other resources hinders the growth of these businesses. Mobile money provides a potentially powerful tool to create financial inclusion and enhance the informal sector. Transaction histories can be built-up and trial balances automatically generated. Overdrafts can be extended without human involvement based on this data. This overcomes the information and cost asymmetries, removing obstacles to extend formal financial services to the informal sector profitably.

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Informal Sector is the safe haven for the poor

In the developed world, the informal sector is mainly seen as undesirable, linked to tax invasion and illicit labour practices, while in the developing world it constitutes the main source of jobs and livelihoods for the poor.

Competition through mobile money means banks have to change

Banks need to get back to basics and focus on making money through financial intermediation. Mobile money is cheaper and has a wider distribution network. Banks have responded by making services free, subject to maintenance fees. While it can ensure existing clients are kept, it would not be enough to grow the client base.

The unbanked are unbanked for a reason

Serving the unbanked profitably and sustainably requires a different approach. Mobile Money has the potential to provide an urgently needed breakthrough and allow the informal sector to be served profitably. Transaction histories can be built-up and trial balances generated, allowing overdrafts to be extended, thereby overcoming the information and cost asymmetries.

Open access principles for mobile money standards

Industry standards for mobile money systems can be developed based upon open access principles. Policy-makers and regulators need to ensure that evolving systems serve the broader objectives of economic growth and development and protect consumer interests, while creating an environment that encourages and rewards innovation.

Introduction

The informal sector continues to face many challenges preventing informal businesses from reaching their full potential. Informal businesses usually do not generate enough funds to expand as profit made is often withdrawn to meet personal needs. Any form of expansion for such businesses will therefore require access to outside capital.

Although there is growing consensus that ICTs can enhance business activities, the RIA 2011/12 survey on 12 African countries shows that only mobile phones are widely used among informal businesses.

Access to Financial Services

Access to financial services continues to be expensive for informal businesses. They continue to rely on cash in transacting with their customers and suppliers. In all the countries the majority of informal businesses do not have a bank account (Table 1).

Table 1: Informal business access to formal financial services (RIA 2012)

		Uganda	Kenya	Tanzania	Rwanda
No bank account		77.8%	63.1%	88.4%	56.0%
A dedicated business account		5.9%	21.2%	9.9%	6.2%
Use private account for business purposes		16.4%	15.7%	1.7%	37.7%
major business obstacles	access to finance	13.9%	5.2%	12.7%	15.4%
	authorities/economic conditions	29.0%	37.3%	32.4%	24.6%
Of businesses with access to a bank account	had a loan	19.1%	10.5%	17.4%	6.2%
	were denied one	6.7%	6.6%	0.0%	0.3%

Whilst in Uganda the cost of maintaining a bank account was the most cited reason for not having one, in Kenya, Rwanda and Tanzania, it was more of a need factor.

The lack of access to bank accounts is partly reflected in the way the start-up of the informal business was financed. The vast majority got their start up capital from outside the banking system, either through own savings or from family and friends. The few businesses with access to a bank account that applied for a loan and were rejected indicated that this was mainly due to a lack of collateral, their informal nature and the high interest rate charges.

This indicates that informal businesses do not transact through the formal banking system. As a result, they fail to have a transaction record, which limits their chances of obtaining loans or any form of financial services from banks.

Mobile Money

The introduction of mobile money is viewed as a means to include more of those who lack access to formal financial services. Statistics show that there were 56.9 million registered mobile money users in Sub-Saharan Africa by June 2012 (GSMA, 2012). There are now more mobile money wallets than bank account holders in Kenya and Tanzania and by far more mobile money agents than bank branches.

Cash is however still “king” among informal businesses. Mobile money is catching up fast though, and in Kenya and Tanzania outperformed other methods.

Table 2: Means of sending and receiving money that the business uses				
	Kenya	Uganda	Tanzania	Rwanda
Mobile Money	58.4%	16.2%	13.8%	7.6%
Post Office	0.8%	0.7%	0.3%	0.4%
Western Union/Moneygram	2.3%	1.8%	0.1%	0.6%
Banks	20.0%	16.9%	4.7%	9.9%
Send cash with someone	**86.3%**	**80.8%**	**92.9%**	**70.2%**

Businesses in Uganda and Rwanda make use of banks a little more than they do with mobile money. This could be partly explained by the proximity of agents, as more businesses in both countries indicated that agents were too far.

In Rwanda and Tanzania, where mobile money use is not wide spread businesses mostly use it for larger transactions, such as paying suppliers. Once mobile money is more widely used paying supplier is overtaken by receiving money from customers, as is the case for Uganda and Kenya.

Most businesses agreed that mobile money had improved the way they run their businesses in terms of saving on costs and facilitating financial transactions. Few however indicated that mobile money had helped them in accessing loans.

Choice of transaction

The options available and the cost of sending and transferring money can influence the way informal businesses transact financially. In Rwanda one may use a bus company to deliver money across villages or even into neighbouring countries.

In pricing two transactions for a one US$ and a 50 US$ value, a price comparison of mobile money against bank transactions for products without a monthly maintenance fee is made, based on two registered users of the same mobile money service and two bank account holders at the same bank.

The comparison shows that sending money equivalent to one US$ would cost 25 cents in Rwanda, 33 cents in Tanzania, 6 cents in Kenya and 28 cents in Uganda via mobile money. Bank transfers for such small amounts would be more costly in Uganda and Kenya, whilst in Rwanda and Tanzania it is relatively affordable. For the 50 US$ value transfer costs both for mobile banking and traditional banking becomes more realistic, though the 2% transfer fee is still a more expensive option than just transaction in cash.

Procurement and distribution channels

Informal businesses often limit their suppliers due to convenience, payment issues and transport cost. Most suppliers are within a 50km radius of business operation and customers are mostly individuals that live close by. Businesses showed a preference for face-to-face communication with suppliers and customers, with mobile phones coming in as the second best option.

Mobile phones and mobile money can potentially improve and lower the total cost of procurement through improved communication, better information availability and a facility to transfer money over large distances.

Mobile Money as a platform to support Informal Business

The face-to-face and cash nature of informal businesses, makes it difficult for banks to service them profitably. The problem of information asymmetry, lack of transaction histories or a business plan and the geographical dispersion of informal businesses, make it impossible for banks to assess the viability of an investment for which a loan is sought.

The increasing popularity of mobile money provides a platform to address most of these issues. The movement of money generates an electronic trail that provides a rich dataset and mobile money transaction data provides amounts, frequencies and reasons for transactions that together can provide rudimentary insight into transactions amongst informal businesses. Mobile money transaction data and other operator data provide a platform for tracking informal business behaviour that can be used for better risk management.

Mobile operators run the most extensive agent/distribution network within East Africa. These agents are mostly informal businesses and as such the more successful a mobile money platform becomes, the more successful agents become as entrepreneurs.

Besides addressing financial needs of informal businesses, third party value-add applications can also support them in providing access to pricing information, sourcing for products, and managing cash flows.

Conclusions

Mobile money is cheaper and has a wider distribution network than banks. Its popularity means lower revenues from deposit fees, transfer and withdrawal fees, which has resulted in most banks in East Africa offering accounts with free deposits and transfers, albeit against a high monthly maintenance fee. While this is a suitable approach to keep existing clients it would not be enough to grow the client base.

Informal businesses will only transact electronically if there are limited or no transaction costs involved, and if doing so is convenient and secure. A paradigm shift needs to occur in order to determine how the informal sector can be profitably brought into the banking sector. Mobile Money has the potential to provide an urgently needed breakthrough. Through mobile money, transaction histories can be built-up, trial balances automatically generated and overdrafts can be extended easily based on this data.

Policy recommendations

Serving the unbanked profitably and sustainably requires banks to get back to basics and focus on making money through financial intermediation. Policy-makers and regulators need to encourage banks and mobile operators to develop solutions that are not proprietary and also allow access to potential new entrants.

Mobile banking creates a need for the convergence of the financial and telecommunications sectors. This will require policy-makers to lay the ground rules for innovation, while at the same time ensuring high levels of security and trust.

Authors

Mariama Deen-Swarray, Ali Ndiwalana and Christoph Stork