Is Financial Inclusion Viable in South Africa?

Miss Nthabiseng Mohale

Postgraduate Student at the University of Johannesburg

& Miss Ling Ting

Lecturer: Department of Economics & Econometrics

University of Johannesburg

Abstract

Financial Inclusion (FI) has been coined as one of the most critical aspects to consider in economic development and poverty alleviation. This is because it has the potential to drive savings within households in addition to offering credit for small entrepreneurial businesses and the core basic banking products. As a society, South Africa has one of the highest income disparities in the world that, in a way, projects the current dire state of the lack of financial inclusion within the country. One of the tools used to execute FI currently is through the *Mzansi account incentive*. This has not yet yielded positive results as poverty and a lack of economic development is still apparent in South Africa. The question therefore is does providing an individual with access to a bank account necessarily imply an effective implementation of FI? The research aims to resolve this by investigating the benefits as well as the costs of FI for both individuals and banks. The methodology employed is known as cost-benefit analysis. The study hopes to achieve an alternative and improved method of implementing FI in South Africa.

Keywords: financial inclusion, poverty, cost-benefit analysis

JEL codes: D61, H31, H32, I31

FOR SUBMISSION TO ESSA CONFERENCE 25th – 27th SEPTEMBER 2013 BLOEMFONTEIN FIRST WORKING DRAFT

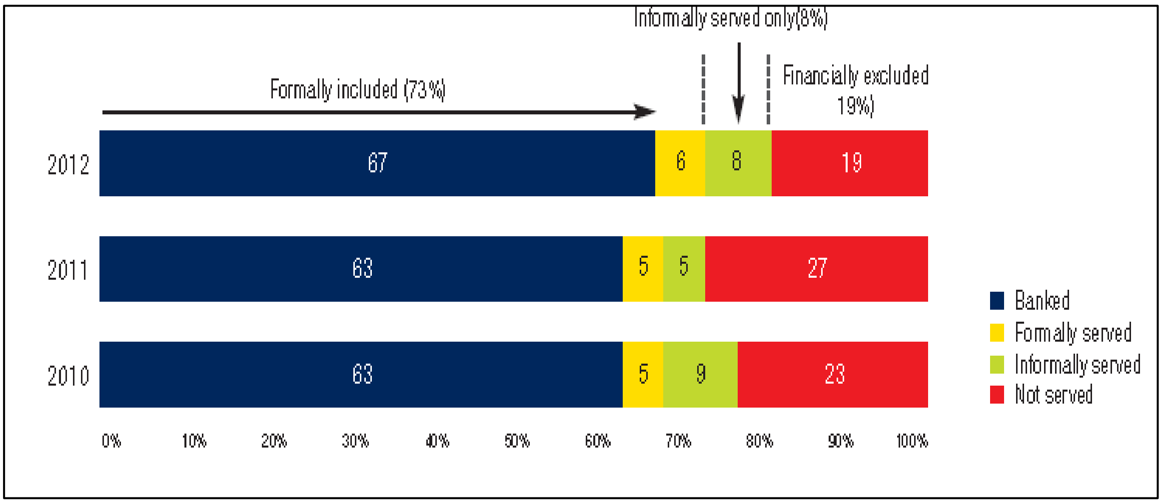
Table of Contents

1. Background

In South Africa, financial inclusion has been tackled through the Financial Sector Charter i.e. in 2004 phase 1 of the Charter was implemented through an initiative targeting the basic bank account growth that resulted in the birth of the 'Mzansi' account initiative. This initiative had also introduced a payment system to disperse government grants through formal bank accounts. The Mzansi account was offered by the big four major banks in South Africa namely: ABSA, FNB, Nedbank and Standard Bank in addition to the government-owned entity, Postbank. The Mzansi account is a basic transactional account with low fees and minimal legal documentation requirements. This initiative was aimed at providing access to individuals of sixteen years and older that were legal to open a bank account but could not due to not having the required legal documentations ('RICA') or the income to do so (Finscope 2012). The Mzansi account had low transactional fees. Further, the interbank related costs were set to be low. The number of adult population banking through an Mzansi account initiative increased from 46% in 2004 to 63% in 2008 (Finscope 2004; 2008). This was seen as a success for the initiative as more adults were being reached through this financially inclusive account.

In 2009 FinMark Trust conducted a report to analyse the impact of the Mzansi initiative. The report revealed the growth and the banking behaviour of the individuals holding Mzansi accounts. As can be seen in Figure 1 below, the growth in financial inclusion through the Mzansi account initiative is impressive, however, the changes in growth has been small. Further, of the financially included individuals many do not actively participate in the formal banking system, rather they choose to withdrawal all their cash in the account once deposited and leave their account inactive.

Figure 1: Growth of Financial Inclusion in South Africa



Source: Finscope 2012

The target for financial inclusion in South Africa is 100%. The need for all individuals to have access to financial services such as transactional accounts, savings accounts and insurance is important for the financial development of the poor and is believed to reduce overall poverty levels. Those that are not financially included, in other words the financially excluded, do not utilise even these basic products offered by formal financial institutions and are in danger of falling behind.

To understand how to reach 100% financial inclusion it is important to note any possible barriers to financial inclusion. Table 1 below highlights the relevant barriers that may potentially hinder growth in financial inclusion in South Africa.

Table 1: Barriers to Financial Inclusion

Demirguc-Kunt and Klapper Forthcoming	**Finscope 2012 Report**
Not Enough Money	Too poor
The banking services are too far away	Physical access is too far away
Too expensive	Can’t afford the fees
Lack of necessary documents	Its complicated to open a bank account
Lack of trust	No trust in banking industry

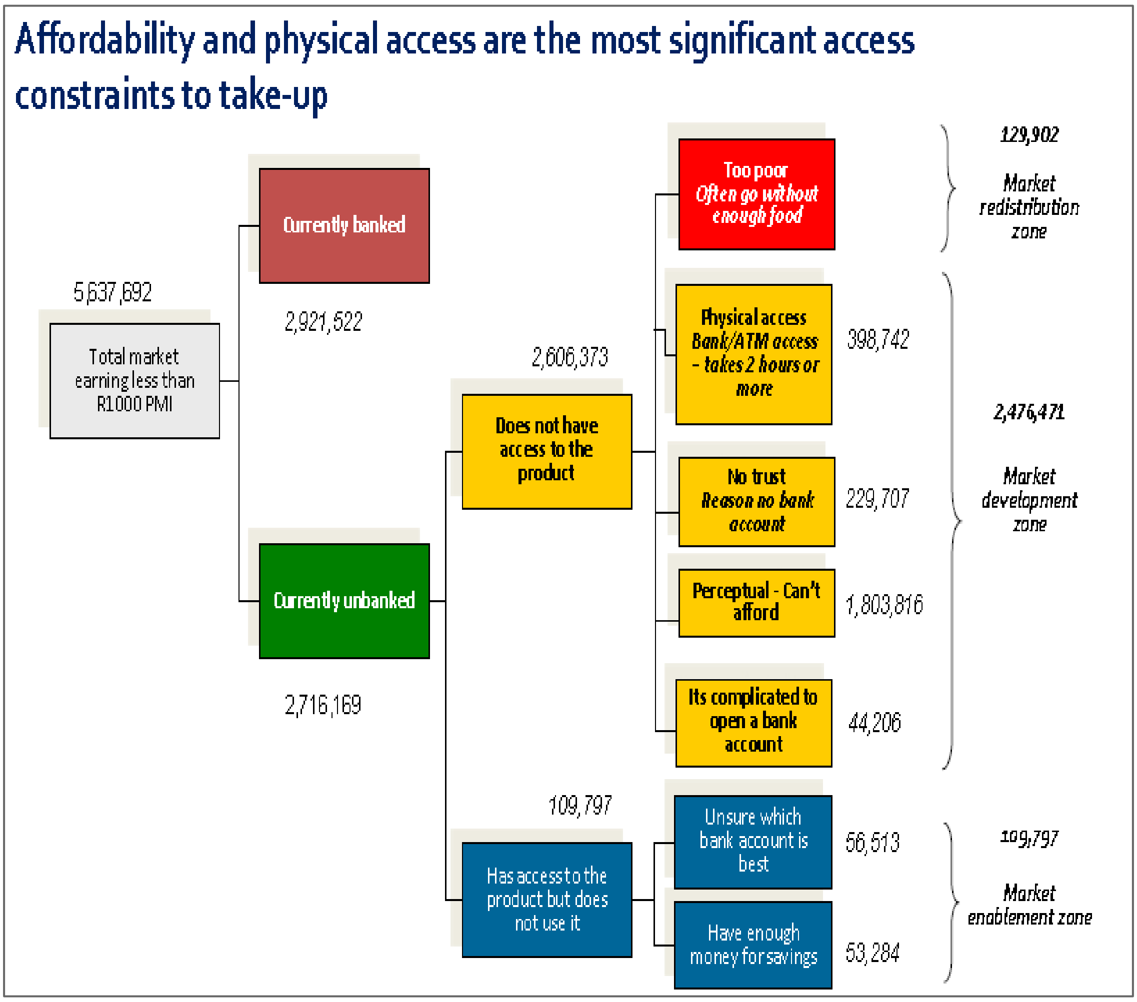
Source: Author’s own compilation from Finscope 2012 and Demirguc-Kunt and Klapper *forthcoming 2013*.

The barrier of a lack of sufficient income for the utilisation of formal accounts and the costs associated with the operation of a formal account is particularly apt for expressing the situation most financially excluded South Africans currently find themselves. In 2012, Finscope reported that 39% of South Africans earned a personal income of between R1 and R999 per month while 12% did not earn any income at all. Income was mostly generated from salaries and wages or self-generated income. These lower income individuals, the main target group of the Mzansi account initiative, appear to still be under-banked.

Another barrier, illustrated by Figure 2, of the target population is the usage rate of financial products. Understanding the benefits of holding a bank account and being banked may also be a concern i.e. low financial education and literacy may hinder the effectiveness of FI. This hindrance can also be the solution to increasing the impact through an increase in the usage of financial products. Furthermore, financial education and literacy could also ensure that the financial decisions made by the low income group is based on the correct information with few misinformed or misdirected decisions made that are potentially costly to the individual.

The distance barrier i.e. banks are too far away may be the reason why there are roughly 27% of the population (those that live in the rural areas) that do not possess a basic bank account while in the urban areas only around 15% of the urban population are not financially included. The contrast of financial inclusion in these areas raises another potential short coming of the current implementation of financial inclusion in South Africa. A reason provided in the Finscope (2012) report suggested that the lack of investment by financial institutions in rural areas as compared to urban areas may be due to the costs as well as smaller incentives (Finscope 2012).

Figure 2: Affordability and Access in South Africa



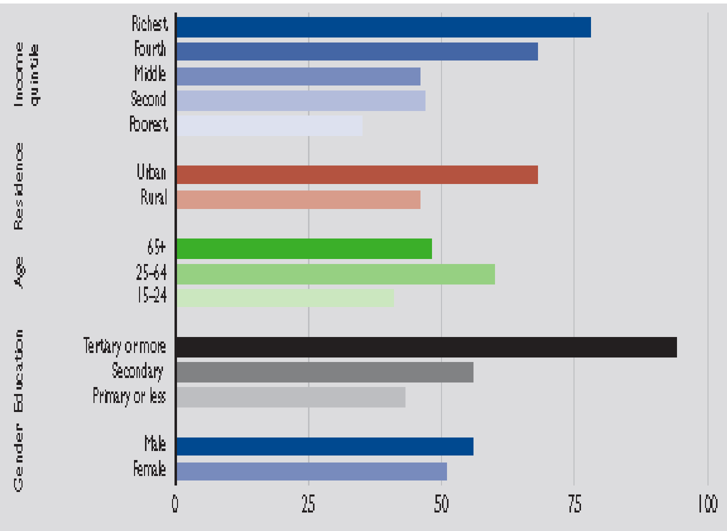
Source: Finscope 2012

The barriers to financial inclusion imply slower economic development of a country (Moloi 2009). The lack of access of financial services to the low income market through the risk assessments might lead to individuals participating in informal sector (sectors that are not regulated) therefore this might incur high costs thereby being in worse off position after entering in the informal sector; thus leading to loss of opportunity for entrepreneurial for the low income market due to lack of collateral for the credit needed.

Manji (2010) highlighted that financial inclusion is not only for increase in economic development and poverty alleviation but to realise the innovative potential within the low income market. Poverty is not alleviated as the low income market is faced with high cost of accessing the financial services and the lack of information about these services reduces potential investment there by low economic development.

As a society, South Africa has one of the highest income disparities in the world with the Gini coefficient index of 0.72 (Statistics South Africa) that, in a way, projects the current dire state of the lack of financial inclusion within the country. The financial services are accessed based on the individual characteristics such as gender, income, area and educations level therefore could possibly be another barrier for self-exclusion. The Figure 3 below illustrates the South African landscape of income, residence, age, education and gender. It also illustrates the financial account access within South Africa based on these characteristics of the South African landscape. This graph shows that 78% of the richest population has a bank account as compared to the 35% of the poorest. This can highlight that access is easier to individuals that earn higher income than the low income. The richest might have more information and are financial literate to make more informed choices. The population that is more educated i.e. have tertiary or more qualification have more access at 94% as compared to 43% of those that have primary education or less. This again highlights the importance of financial literacy in order to achieve financial inclusion. Figure 3 also shows case that the urban residences have more access than Rural, which this has been proven through the Finscope survey. The age group that have more access to a bank account is the age between 25 and 64.

Figure 3: Financial account penetration in South Africa



Source: Demirguc-Kunt and Klapper *forthcoming 2013*

The Finscope survey 2012 in addition also highlighted the following key points regarding financial inclusion with respect to South African market. The current financial market landscape is concentrating on individuals that receives regular salaries and the country mainly consist of irregular salaried employees therefore there is misalignment in the market.

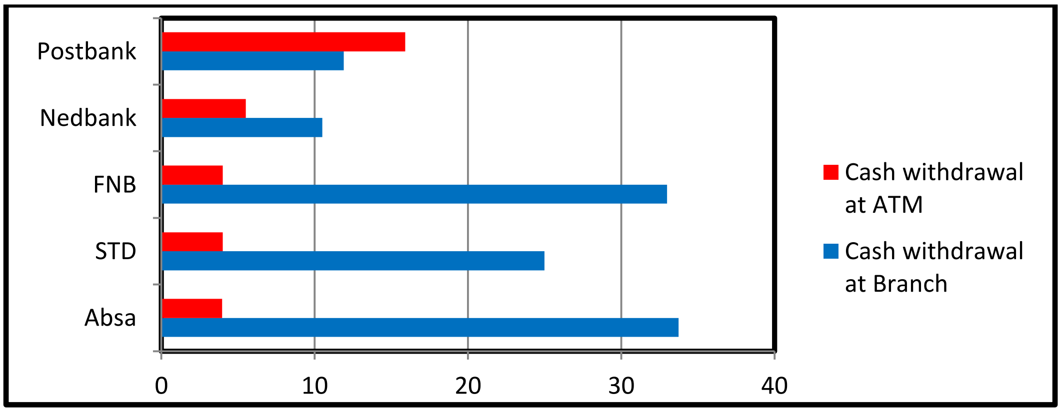
This might lead people to rather approaching informal sectors for financial assistance rather than formal sectors as their needs are not catered for therefore the informal sector has filled the gap where formal sector fall short.
This may not be the ideal solution as the players in this sectors charged high costs for providing these services.

It was also highlighted that there is a need for innovative solutions to cater for the populations in the rural area as the financial institutions are not accessible in those areas; hence the idea of branchless banking solution or mobile solution might be used to reach those individuals where the is a lack of banking infrastructure which may pose a challenge in provision of financial services. This solution can be cost effective in providing financial services to this market.

1.1 Banks perspective on Financial Inclusion

The World Bank Group's recent report on South Africa's financial inclusion process highlighted that the banking system in the country is designed to serve the higher income segments and that it was not designed to cater for simple basic accounts as the technological and labour costs are too higher (World Bank Report 2013). The Banks charge higher transactional fee for transacting within bank branches than outside the branches, this should be taken as a sign that the cost of maintain or investing in bank branch is too higher hence the higher fees. The access of actual costs for a bank to deploy and ran a bank branch are confidential information to the banks hence the use of disparity between ATM and Branch fees to indicate the costs. The branch involves human intervention from a teller therefore resulting in salaries as cost, the rental fee, electricity and all other cost incurred to run a branch unlike ATM where there is no human intervention. The branch fees charged by the big four banks and Postbank for their entry level transactional account is higher than the ATM fee. See below figure 4, the comparison of fees amongst different banks.

Figure 4: Comparison of ATM and Branch fees



Source: Author's own compilation from the big Four banks and Postbank' Websites

Cash is the main medium of exchange in South Africa, Brazil, India and other Sub-Saharan African countries, hence access to ATMs are important in these countries. Table 2 below shows branches and ATMs per 100 000 adults. Brazil is the highest country with both the number of branches and ATMs, followed by South Africa. It is also visible that there are a number of ATMs than branches; this could be due to the infrastructures costs associated with deploying a branch.

Table 2: Branch and ATM per 100,000 adults

Per 100,000 adults				
Branch or ATM	South Africa	Brazil	India	Sub-Saharan Africa
Commercial bank branches	10.71	46.15	10.64	4.9
Automated teller machine	60.01	119.63	8.9	13.47

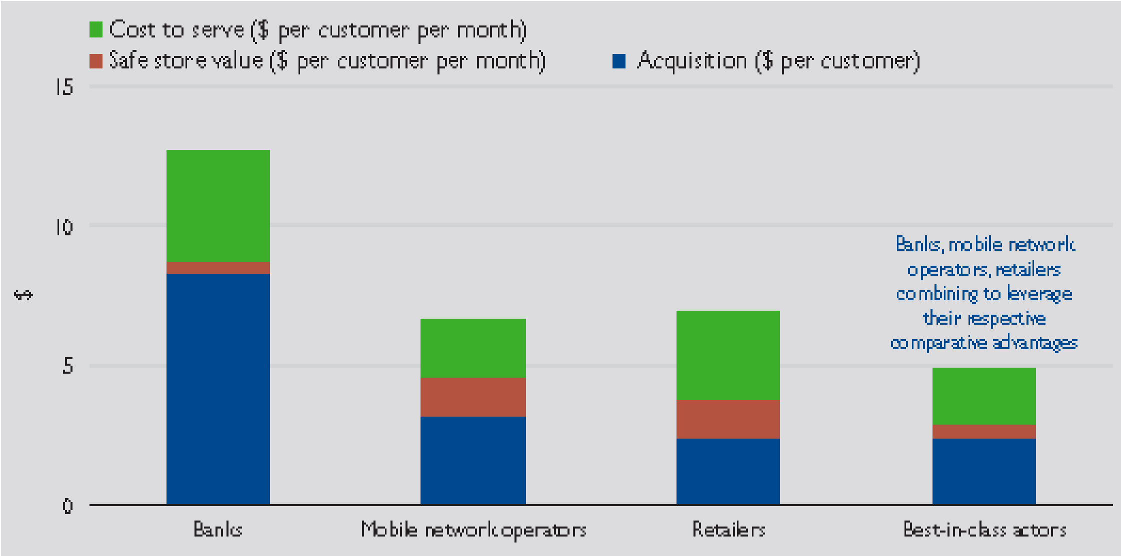
Source: IMF 2012

The closure of branches due to lack of profits is seen as a worst form of financial exclusion (Leyshon, French & Signoretta 2008). Banks are generally profit driven institutions and will normally invest in area where there is potential to make profits. The banks visibilities in rural areas are seen as providing financial services to the low income market. The bank branches provide a gate way or connection between the bank and the general population. Postbank has been positioned to provide financial service in areas where there is no formal banking. Postbank, a division of the South African Post Office, role when its final a full fledge bank as defined in Postbank Act under section 2 (c) as “expand the range of banking services and developed into a bank of first choice, in particular to rural and low income markets as well as communities that little or no access commercial banking services or facilities”. This will be done through the Post Office branch network through the country. Currently Postbank only offers limited transactional, saving and investments accounts and no credit products. This product range may not address the financial needs of the population in rural areas. Postbank currently does not have its own ATMs network forcing the customers to use other banks ATMs which is extremely expensive as the charges on average are R15.90 for R1000.00 cash withdrawal transaction. It is therefore not ideal to use Postbank to provide financial access as might even be more expensive to the individual than having a bank account from a bank.

The different banks have to find other alternative solution for example branchless banking to provide financial service even in the remote areas. This can be the innovation side of the financial inclusion initiative where banks collaborate with retailer and mobile operators to find a more cost effective solution to provider financial products. There might even be resistant form the banks side since banking is core business of a bank not a retailer or mobile operator. The other issue will be who does the customer belong to, the bank or retailer or mobile operators, it is obvious that the banks will claim the customer as their own since banking it the core business.

The figure 5 below highlights the costs associated with serving a customer, acquiring the customer and store of value for banks, retailers and mobile operators in the South African market. It is visible that it’s more expensive to acquirer a customer for banks followed by the mobile operators. It is cheaper for retailer to acquirer a customer. This could be due to the nature of business the retailer are in since the customers need to go to the retailers on daily basis to buy groceries which are classified as necessity. It is interesting to see the store of values at a bank is lower than the retailers and mobile operators therefore might prompt a question if your money is really safe at the banks. The cost associated with serving a customer is more expensive in the banks followed by retailers while the mobile operators are the cheapest. It is safe to conclude base on the graph above that a bank has higher costs than retailers and mobile operators.

Figure: 5 Estimate cost of providing financial services



Note: Best-in-class actor is hypothetical and does not incorporate the costs of collaboration, which can vary substantially depending on the relationship between the parties and the engagement model but which needs to be taken into account.
Source: Consultative Group to Assist the Poor estimates of retail, bank, and mobile network operator economics 2011.
Source: The World Bank Report South Africa Economic Update Focus on Financial Inclusion 2013.

1.2 Individual perspective on Financial Inclusion

The financial inclusive countries afford equal opportunities to the entire populations therefore unleashing the full potential of the economy to grow and develop. These are some of the benefits for an individual to be financial included from a literature perspective but in country where more than 50% of the adult population earns less than R2000.00 per month is this literature assumption correct.

The benefits associated with being financial included should always outweigh the costs. Costs/price of financial products is one of the barriers for the lack of financial inclusion. In South Africa, the costs plays a vital role in determine if people will be financial included or not.

A bank account can widen your access to other financial products but the costs are just too high especially if you are earning less than R2000 per month. Every cent count for this individual and it would be in their best interest to stretch every cent as much as possible.

The highest barrier for lack of financial inclusion in South Africa is not having enough money therefore is really in the best interest of these individual to be forced to have a bank account just for being financial included. The Finscope 2012 report highlighted that use of formal banking products is mostly transactional accounts and the use of non-banking products. The most important product is funeral cover followed by credit. Savings is the fourth on the list, this could highlight that South Africa is not a saving as it should and this can be supported by the low levels of savings in South Africa. Some banks have included in the basic accounts funeral cover benefit in order to address the need of the low income market. It is therefore important to understand why the population is still using the non-banking products for products that are available in the banking sector. This might be that the non-banking sector is offering this products at lower costs or maybe the structure of the products are tailored made for this market. An assumption can be made that maybe to provider of this products are only participating in this segments therefore understand the needs while banks have different segments and must service all these segments at lower costs therefore difficult to meet the needs of all segments.

The interesting aspect about the South African Market is that the population that has a bank account still does not use the banking products to the maximum. Finscope (2012) highlighted that attitude the population have towards general banking. The full service population would not hold a bank account if there was no regular income and also highlighted that the banking fees are too expensive; this market earns R7 600 per month on average. It also important to note that the population that earns R2000 per month, 43% take out all their money at once, therefore transact only once a month. This can be seen as sign that the society is still cash dependant. The other important aspect about the findings is that there are still a reasonable number of people that are still not sure about which bank account to use. This could highlight the need for financial literacy in South Africa. More than 50$ of the unbanked population do not have enough money to open a bank account. These really prompt the question whether to bank this population is really in their best interest and if it will change their current situation or simply make it worse. There was also a need for the banking industry should also try to simplify the process of open a bank account.

1.3 Government role in Financial Inclusion

The literature states that financial inclusion alleviate poverty and increase economic development therefore it will be in the best interest for the government to make financial inclusion a priority. The most important aspect is what kind of financial inclusion can bring about these changes, is it through provision of basic low cost account or through availability of credit to those that can make good use of it.

The provision of basic accounts has not worked well in South Africa as most of these accounts are dominant and given that more than 50% of the population earns less than R2000, the cost of having a bank account is just too higher. It could be that the provision of credit is type of financial inclusion that could contribute towards entrepreneurship thereby increasing economic development. The definition of what financial inclusion is for South Africa need to review taking into consideration the factors that are unique to the South African market.

Countries put policies together so that the lack of financial inclusion can be address. This could be achieved through collaboration from Governments and financial service providers. The policies that are design must be beneficial to the low income market and not become a financial burden that will put them in worse off position. Allen, *et al.* (2012) highlighted that such policies are needed especially when the benefits of financial service exceed the cost of providing them. Barriers to financial inclusion continue to be a challenge for countries to overcome. These barriers include high account fees, lack of physical infrastructure and the required legal documentation.

The South Africa Government through its Financial service charter collaborated with big four banks and Postbank for the Mzansi initiative. The phase 2 of the Charter in 2012 was looking at expanding access through other channels other than traditional channels such as branches and ATMs. This could mean that the financial sector looking at branchless banking and mobile banking solutions. The government is taking interest in the innovative banking as well through the phase. The role of Government could be making the regulation more flexible in terms of financial services and assist the financial service provider to address the lack of financial inclusion in order to find more suitable solutions. The financial access as well as usage should be looked at concurrently. It is not beneficial to have access readily available and individual are not use it, this will be financial waste as investments will be made to provide access but underutilised.

2. Methodology

The methodology that will be used to analyse the impact of financial inclusion in South Africa with respect to transactional accounts is the Cost Benefit Analysis (CBA) method. The CBA method describes and determines the cost and benefits in rands per month units of holding a basic entry level transactional account offered by the big four banks as well as Capitec and Postbank. Additionally, a user profile describing the low income individuals, in other words, the target group of FI is also utilised under CBA. FI is considered to be viable if the benefits outweigh the costs in rands per month terms. If, however, the cost exceeds the benefit then FI would not be considered viable for the user profile (low income individual) in South Africa.

3. Data

The data utilised in the study is taken from Finscope 2012 survey data and the official bank websites in South Africa. The methodology of CBA has been scarce when understanding the costs associated with financial inclusion. The analysis provides in a quantifiable unit of cost and benefit from the individual that is holding and using the bank account. There will be an analysis of the personal monthly incomes within the South African population and cost of entry- level transactional accounts offered by these banks as highlighted above to the low income market. The income levels will be sourced from the Finscope 2012 survey and bank charges from official websites of the different banks. In addition to the charges that will be levied by the banks, there are also hidden costs such as transportation costs incurred by individuals, particularly those that are situated in the rural areas. The population relevant to the study's objective is that of the low income market in South Africa and banks that are currently utilised in South Africa namely the big four major banks, Capitec and Postbank. The analyses of Mzansi product across South Africa will be used to identify if the South African government was successful in targeting financial inclusion through a transactional account.

The following table 3 consist of different basic transactional accounts offered by different banks and the basic features with monthly charges and cash access as South Africa is considered to be a cash base society.

Table 3: Different banks basic account and fees

Bank	Name of the Account	Opening Balance	Online Banking/ Internet Banking	Monthly Fees	Cash Withdrawal at Own ATM
ABSA	Transact Account	NIL	NO	R0.00	R3.95
Capitec	Global One Account	NIL	YES	R4.50	R4.30
FNB	Easy Account	NIL	YES	R4.20	R4.00
Nedbank	Ke Yona Account	NIL	YES	R5.00	R5.50
Postbank	Mzansi Account	NIL	NO	R0.00	N/A
Standard Bank	Access Account	NIL	NO	R0.00	R4.00

Source: Author's own compilation from the different banks' Websites

Postbank does not have its own ATM network hence there is no fee for cash withdrawal at an ATM however its clients can withdraw money at any ATM at fees of R6.00 below R100.00 thereafter R1.10 per R100.00. This is the most expensive method to access cash at an ATM hence banks encourage their clients to always use their bank's ATM to avoid such costs. This is very critical to observe given that Postbank is positioned to serve the low income market but the cost are just too high due to lack of infrastructure.

3.1 The User Profile

A user will be created for the purpose of this research in order to analyse the cost and benefit associated with a transactional account. The user will be an individual from low income market earning less than R2000 per month and situated in the rural areas where banking facilities are not close by. The profile will estimate how the user typical uses their transactional account as stated above per month and in order to calculate the costs of a bank account from the perspective of the individual. The table below describes the expected monthly usage or the "Number of Transactions" of such an account for each type of basic service that is provided by the transactional account. The user will perform two types of cash withdrawals within a month firstly a cash withdrawal of R1000.00 from their own banks ATM and also withdrawal at POS of R400.00. There will be two purchase equivalent to R400.00 and one debit order for the amount of R200.00. The total amount spend is R2000 per month.

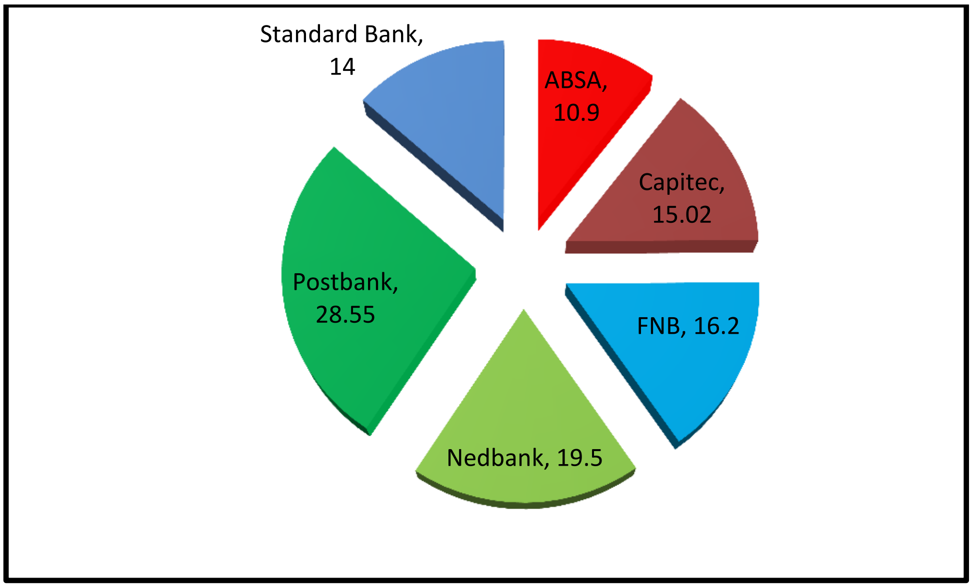
Table: 4 User Profile

Transaction Type	Number of Transactions
Monthly Fee	1
Cash Withdrawal at Own ATM (R1000)	1
Point of Sale Debit Purchase (R200)	2
Point of Sale Debit Cash withdrawal (R400)	1
Own ATM Balance Enquiry	2
SMS Notification	6
Debit Order External (R200)	1

3.2 Bank fees comparison

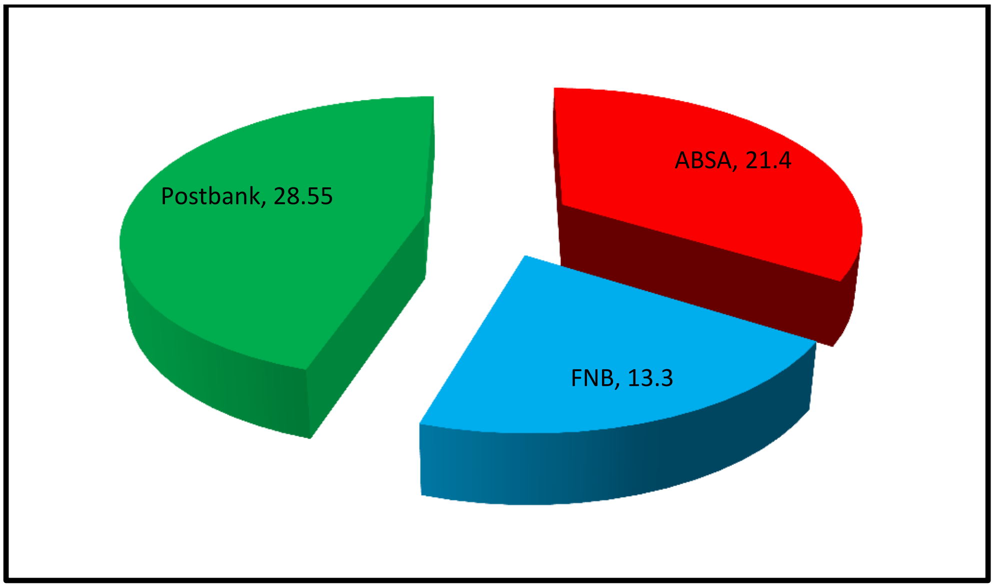
The fees charged the banks as stipulated above based on the user profile to see how much an individual will spend on banking fees. The basic account offered by the banks will be compared to the Mzansi fees currently charged so as to see if which basic account is cheaper. Standard Bank does not offer Mzansi account anymore as the features have been incorporated into the Access account.

Figure 6: Different Banks Basic account Fees



Source: Author's own compilation from the different banks' Websites

Figure 7: Mzansi fees



Source: Author's own compilation from the different banks' Websites

4. Preliminary Results and Discussion

The user profile was utilised in the cost estimation of this entry level transactional account for the low income market. The figure 6 highlights the costs of all types of transactions under a transactional account that are offered by the different banks in South Africa. Currently banks are promoting cash withdrawals within retail outlets because of this reduction in costs incurred by the banks. The results based on the user profile created shows that ABSA is the cheapest followed by Standard Bank; this might be due to the fact that ABSA does not charge the monthly fees on their account. The issue of a monthly fee on such account might be linked to a barrier that the financial product is expensive hence the lack of financial inclusion. This fee also implies that an individual must be earning a regular income in order to pay the fees on monthly basis. Postbank fees, unlike the other banks, are however high due to the fact that Postbank does not have its own ATMs. Its customers are therefore forced to utilise other banks' ATMs resulting in higher costs for Postbank customers. In general whether the bank decides to set up its own ATMs or to utilise retail outlets in order to reach all its customers depends on the costs incurred by them even though these set-ups could benefit their customers by reducing their costs.

There are three banks that currently offer an Mzansi account in the entry product range. Standard Bank and Nedbank have created new entry level account and incorporated the Mzansi account into these accounts. The Mzansi accounts do not have the monthly service fee therefore cater for the irregular income earners in South Africa. FNB Mzansi account is cheaper than the Access account but ABSA Mzansi account is more expensive than the Transact account. It can be concluded that Mzansi account has the features that can deal with the characteristic that are unique to South Africa but there has to be analysis on the pricing of this product in order to promote usage within the low income market. The tables below highlights the benefit and cost associated with a bank account form an individual and bank perspective.

Table 5: Individual with a Bank Account

Benefits	Costs
The funds are stored securely by the bank at the average cost of R15.00	Monthly fees: on average R5.00 per month The individual must earn a regular income to be able to pay monthly fees.
Convenient way of transacting safely at average cost of R10.00. On average the cost of transport to access is banking channels is R20.00 return trip.	Transaction fees of less than R30.00 per month based on the user profile transitions plus transportation cost to access the channels.
Build up credit history and have easy access to other financial product such as loans and Insurance. This based on the average cost of R15.00 per month.	The costs are based on your risk profile therefore you might have credit risk but if your profile is risky then you will be charged higher fees

Table 6: Individual without a bank account

Benefits	**Costs**
There are no banking fees therefore the funds can be stretched further. Individual saves on average R15.00 per month.	The risk associated with holding cash i.e. theft
No extra transportation costs to access the channels in order to transact. Individual saves on average R20.00 per trip.	The cost of being financial included therefore no access to other financial services.
There is no need for special infrastructure in order to access or transact	The loss of opportunity due to the lack of access to banking services

Table 7: Banks providing an entry level bank account to individual

Benefits	**Costs**
Revenue potential of R30.00 per month on this type of accounts.	The cost of maintaining the account
Extending the financial service reach to the low income market	The infrastructure cost and the operational costs

5. Preliminary Recommendation and Conclusion

<u>To be discussed in presentation</u>

6. References

Allen, F., Demirguc-kunt, A., Klapper, L., & Peria, M. S. M. (2012). The foundation of Financial Inclusion: Understanding owenship and use of formal accounts. Volume. 6290, pp. 1-53.

FinMarkTrust Mzansi Report, 2009

Finscope Report, 2008 and 2012

Fuller, D. & Mellor, M. (2008). Banking for the poor: Addressing the need of Financial Excluded Communities in Newcastle upon Tyne. Volume. 45 , No. 7, pp. 1505-1524.

Leyshon, A., French, S., Signoretta, P. (2008). Financial exlusion and the geography of the bank and building society branch closure in Britian. PP. 447- 465

Manji, A. (2010). Eliminating Poverty? 'Financial Inclusion', Access to Land and Gender Equality in International Development. Volume. 73 , No. 6, pp. 985-1025.

Midgley, J. (2005). Financial Inclusion, Universal banking and Post Office in Britain. Volume. 37 , No. 3, pp. 277-285.

Moloi, M. (2012). Strategies for optimising financial inclusion in South Africa. PP. 1-114.

No: 9 of 2010: South African Postbank Limited Act 2010. Volume 546, No. 33835

The World Bank Report: South Africa Economic Update Focus on Financial Inclusion 2013.