Making Finance Work in Zambia: Issues of demand and supply

Juliet Munro and Stephen Peachey

Zambezi Sun Hotel, Livingstone
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Sida
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Purpose of the presentation

- To provide an information platform for today's discussions about how Zambia's finance system currently works to meet the needs of ordinary Zambians
  - **Part 1**: Give a brief overview of the findings of FinScope Zambia to help us understand access issues from the consumers' perspective – Juliet Munro
  - **Part 2**: Focus in on the issue of the supply of accessible finance by introducing the preliminary findings of the supply side survey currently being undertaken – Stephen Peachey

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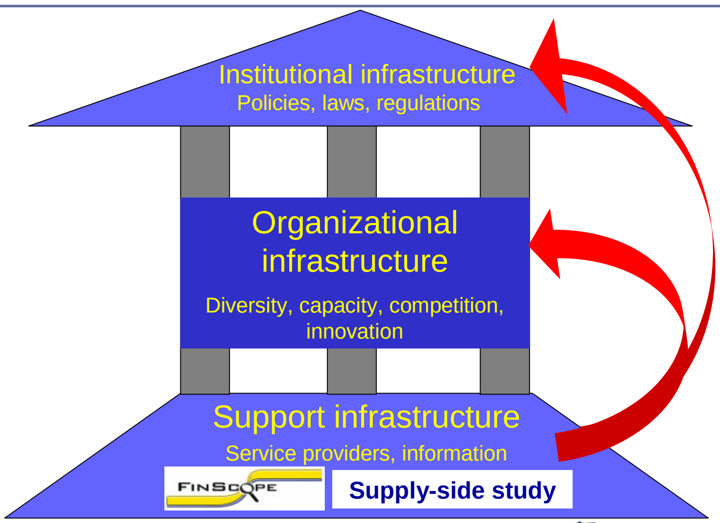
Information is the foundation of a 'finance for all' strategy



Part 1: Demand

What is FinScope?

What does FinScope tell us about current levels of access in Zambia?

What does FinScope suggest are main issues of supply of access?

What is FinScope?

Consumer survey

Dimensions of access

Affordability
Physicality
Appropriateness

Drivers of usage

Information, literacy, aspirations, cultural/social, economic status

- Financial product usage
- Financial behaviour, attitudes and interests
- How consumers source income and manage their financial lives
- Market segment profiles - opportunities for product innovation
- Regulatory and market obstacles to growth and innovation
- Financial indicators of access

A rich source of information for both policy makers and practitioners

FinScope™ Zambia 2005

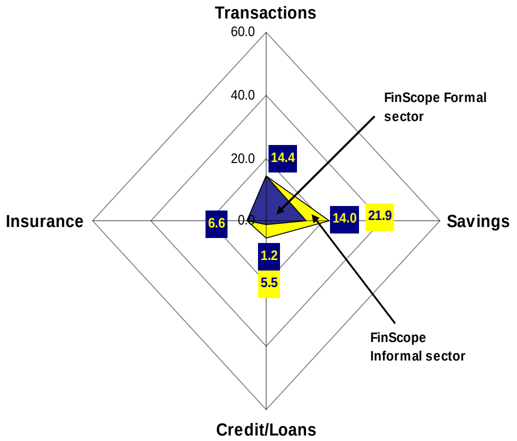
FinScope™ Zambia 2005: Methodology

- Research firm contracted to carry out survey and compile dataset
- Questionnaire developed in consultation with FSDP
- Nationally representative sample developed by CSO:
  - 4000, 16+
- Face to face interviews carried out in Nov-Dec 2005
- Sample verified against Census
  - 51% male, 66% rural, 74% 16-35 years

Questionnaire themes:

- General Banking
- Financial Perceptions
- General Money Matters
- Credits and Loans
- Investment and Savings
- Insurance
- Business
- Informal Finance
- Financial Sophistication
- Quality of Life
- Demographics/Other

What does FinScope tell us about current levels of access in Zambia?: A product perspective



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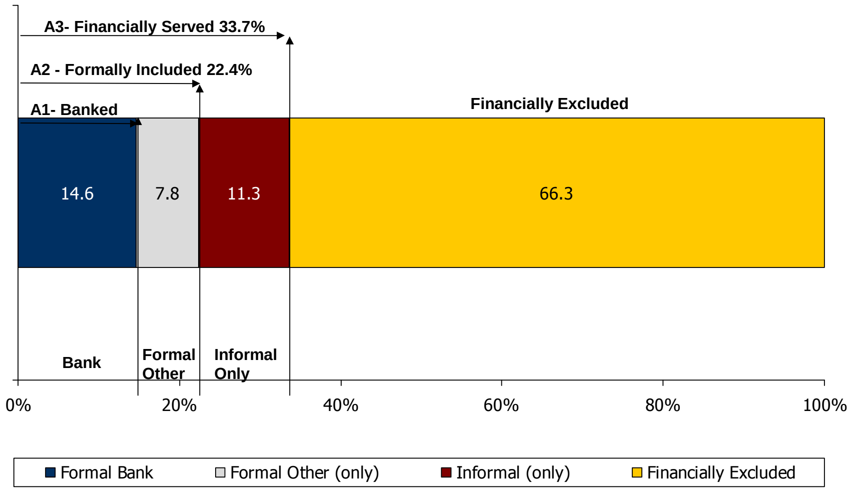
What does FinScope tell us about current levels of access in Zambia?: An institutional perspective



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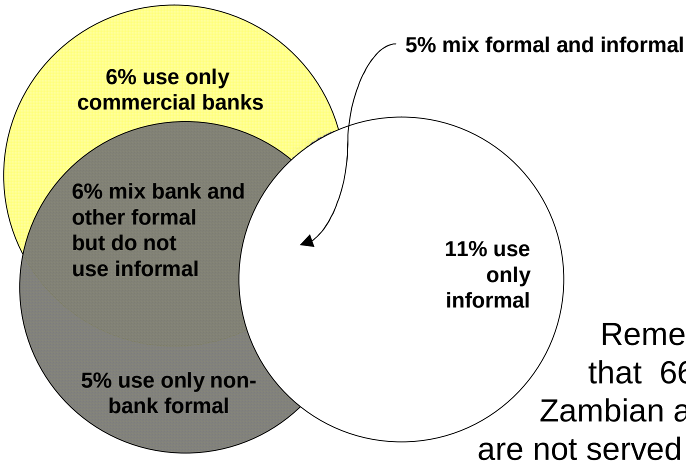
Being banked is not the limit of being financially served and accessibility likely to rise as formality declines



Remember that 66% of Zambian adults are not served at all

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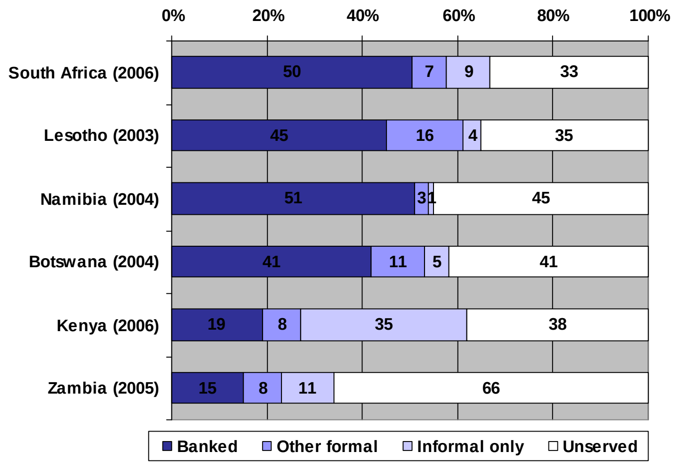
What is striking is not just how few are banked but how many go completely unserved



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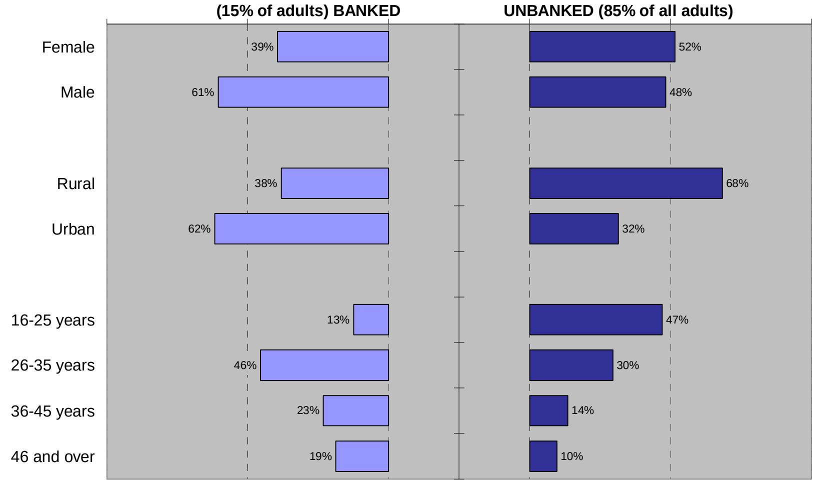
Who are the banked and un-banked?
Demographic mix (%)



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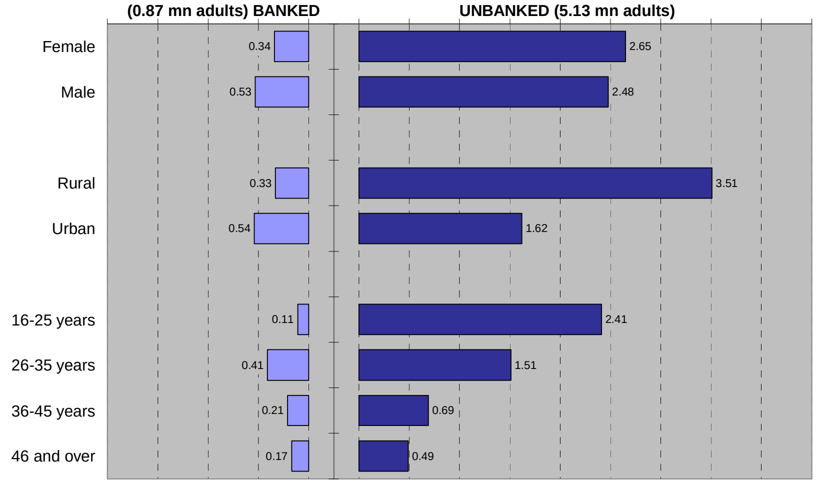
Who are the banked and unbanked?
Demographic profile (million adults)



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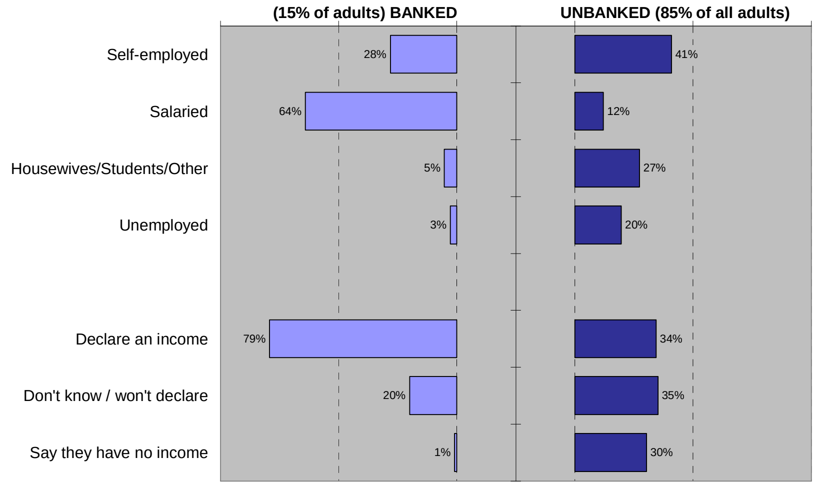
Who are the banked and unbanked?
Employment / Income mix (%)



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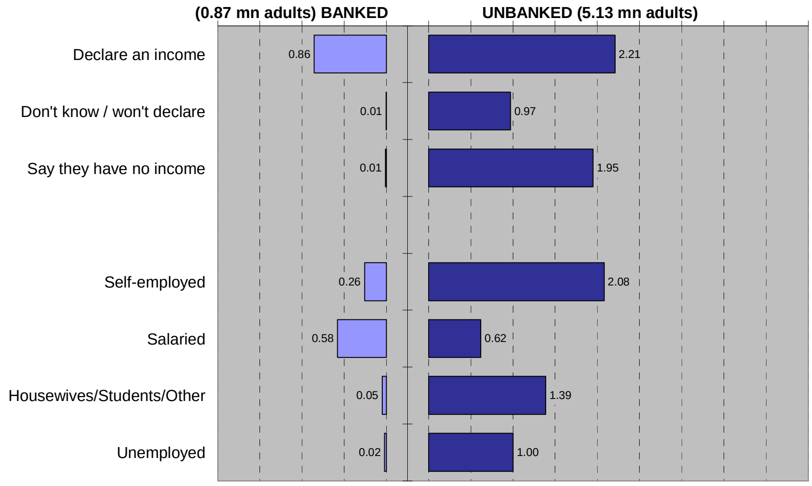
Who are the banked and unbanked –
Employment / Income profile (million adults)



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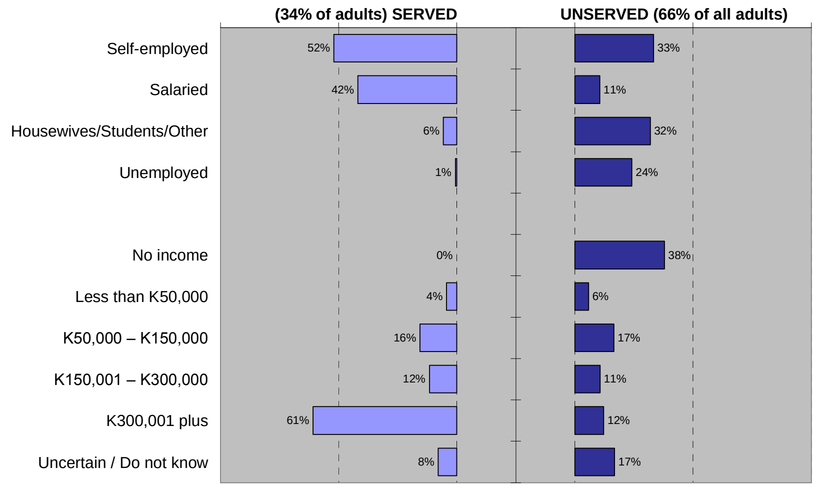
But differences of income between served and unserved are as extreme as between banked and unbanked



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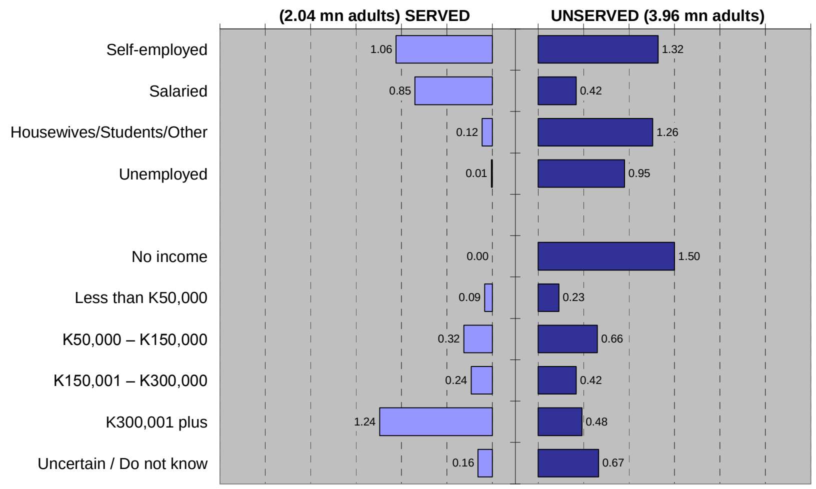
And huge numbers of Zambian adults have no income to bank but maybe the top-end of the market is saturated



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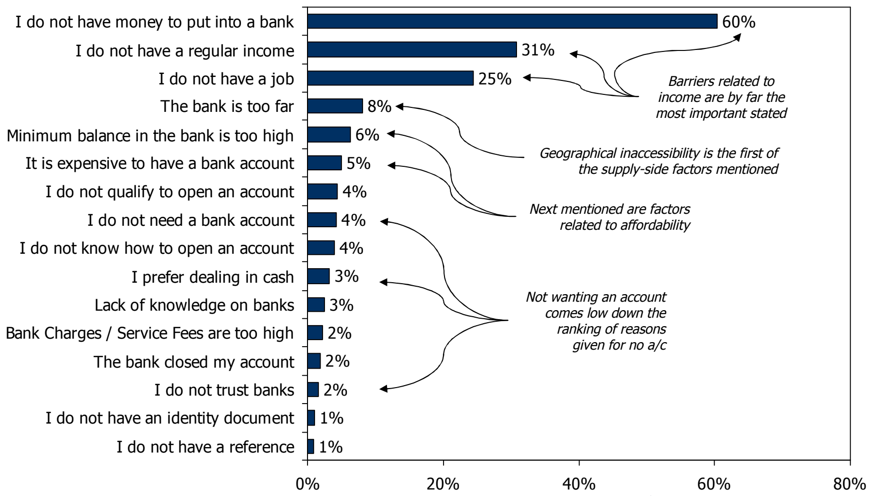
And if we look at the reasons why the unbanked have no account, lack of a suitable income is clearly the main issue



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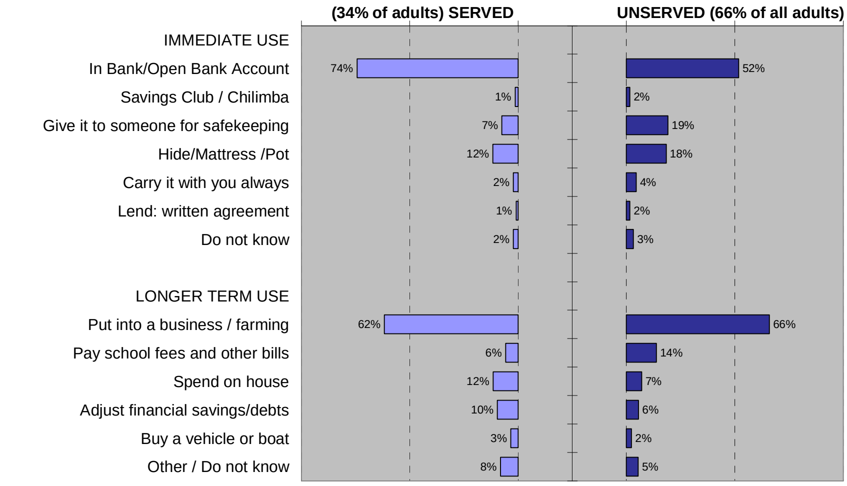
But while the served and unserved have different profiles what they would do with unexpected money is very similar



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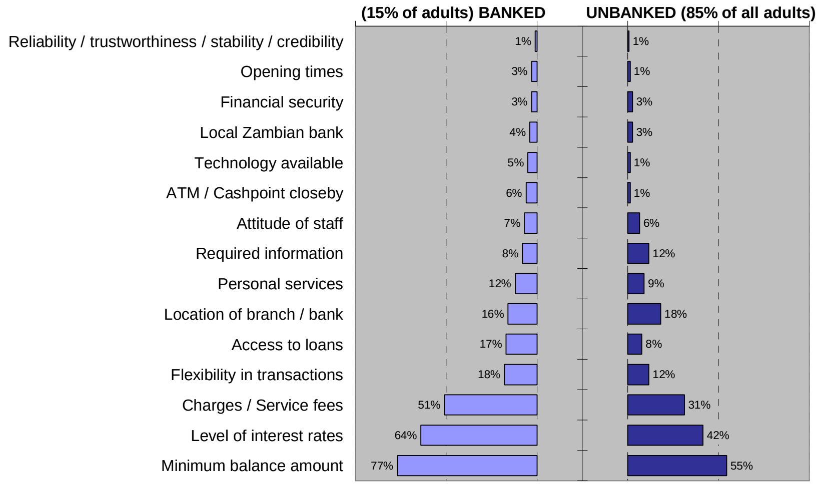
Interestingly if we observe what the unbanked would look for in a bank it is no different from what the banked look for



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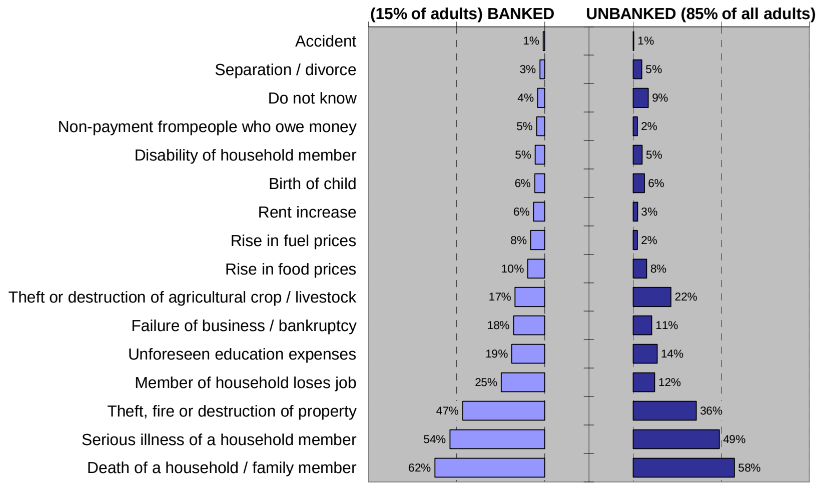
And the shocks they worry about are very similar too – so opening up banking might help open up insurance as well



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So what does this mean for the supply-side study ?

Four critical issues emerge from this analysis:

- Are the two-thirds of Zambian adults that are completely financially unserved too poor to have access ?
- Are there ways that banks could reposition themselves to serve more Zambians ?
- Are the non-bank financial institutions that are supposed to build access positioned to deliver ?
- Is there a problem with the distribution of branch outlets that explains low levels of access ?

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Part 2: Supply

Preliminary findings of the supply-side study still underway

Stephen Peachey

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Topic One – Are the completely unserved too poor to have meaningful access ?

We have looked at this issue from two different perspectives:

- what do monetary statistics say about how much cash is circulating in the economy ?
- what do income and poverty statistics say about the ability of ordinary Zambians to afford access ?

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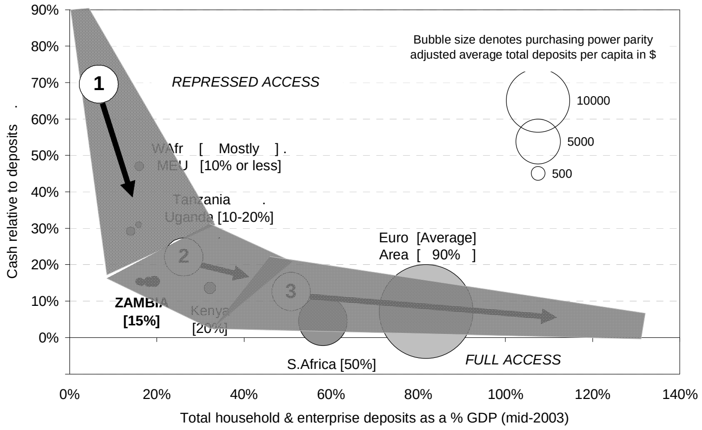
Access and monetisation – is there too little money for access to be the issue ?



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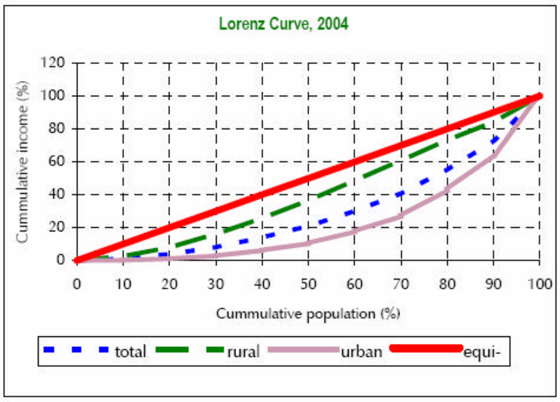
Income inequality – or lack of it – in rural Zambia



Source: *2004 Living Conditions Monitoring Survey Report (LCMS IV)*

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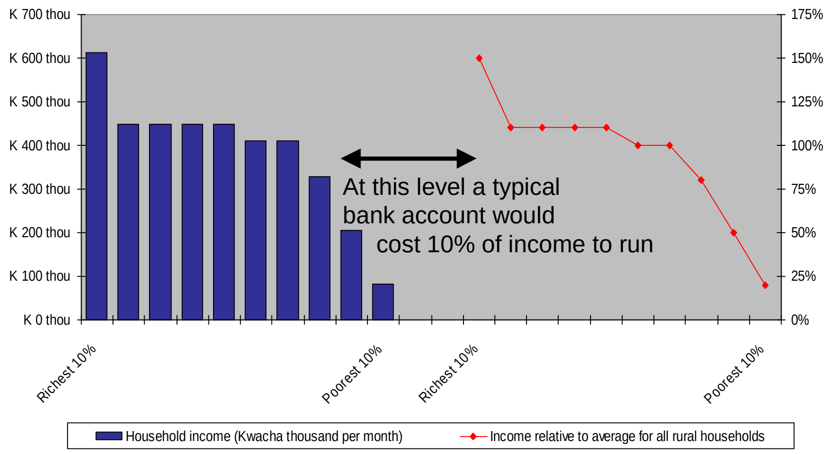
Decomposing the rural Lorenz curve



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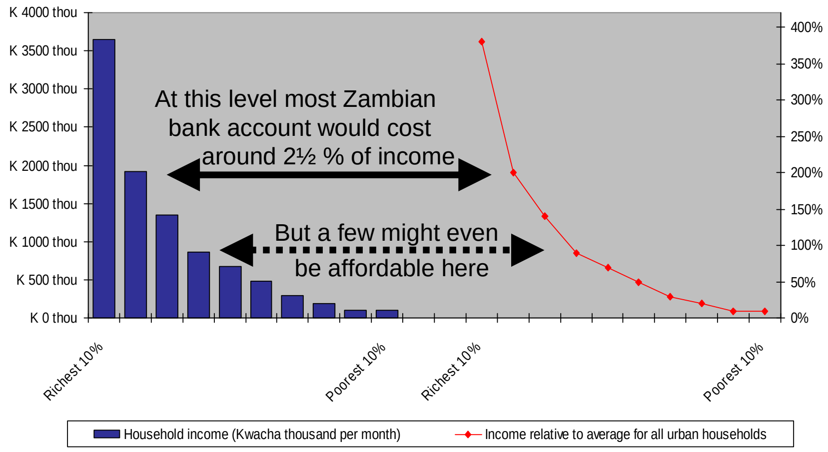
Decomposing the urban Lorenz curve



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Affordability is the key to access

- Extreme poverty is so deeply embedded and so widely spread in rural communities that current pricing of bank accounts precludes access for almost all rural households
- Extreme poverty is less common in urban areas (a third of households as opposed to two thirds) and the relatively better off poor have probably lifted themselves up by monetary means rather than production for own use
- Perversely, the greater inequality in urban than rural areas may mean greater initial opportunities to open up access by lowering prices

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Topic Two – Can the Zambian banking system be repositioned to open up access ?

Again we have looked at this issue from two different perspectives:

- how well does the Zambian banking system serve the economy as a whole ?
- how could the burden of operating costs be rebalanced between products to make banks more accessible ?

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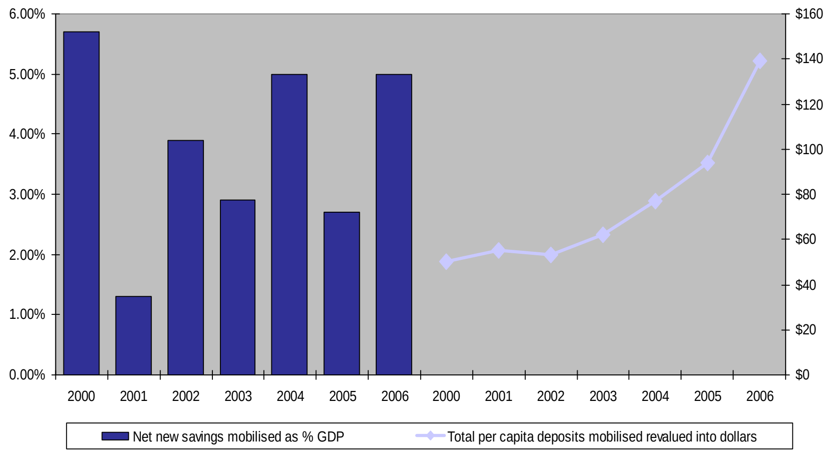
At first sight savings mobilisation going well



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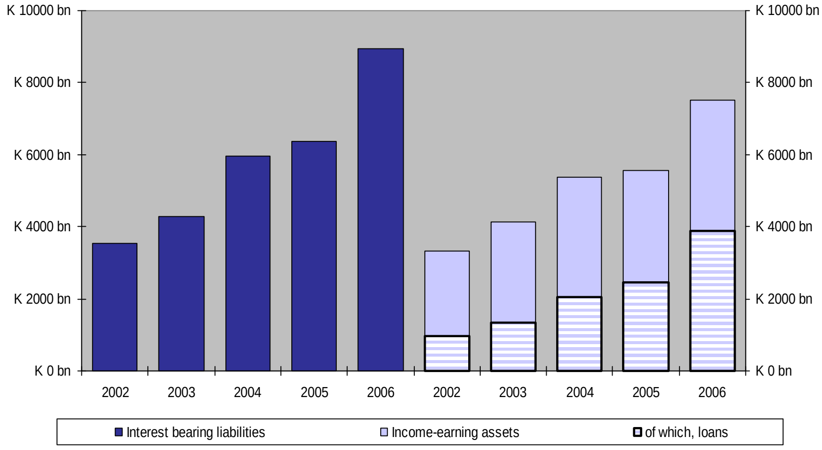
. . . but not all new interest-bearing liabilities turning into income-earning assets



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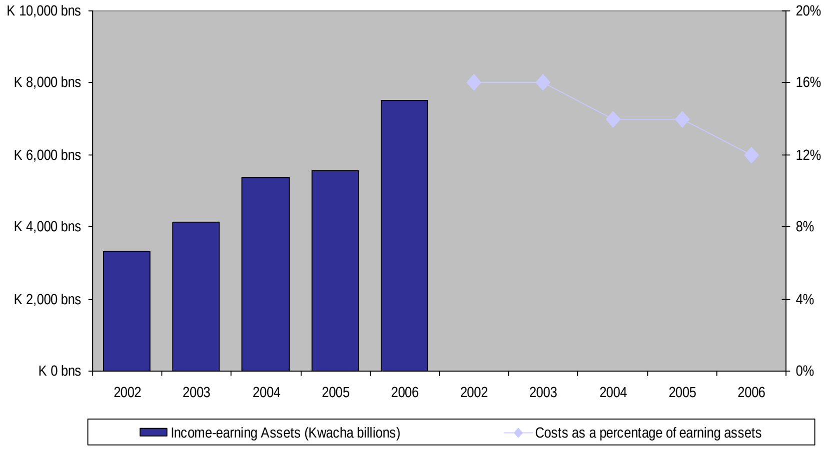
. . . and could have hoped for more of an impact on the ratio of costs to assets



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High operating costs drive up what must be charged to the customer so spreads and fees are high even for Africa

Commercial Bank Asset yields by region:

	E. Europe & C. Asia	South & E. Asia	Lat. Am & Carib.	M.East & Africa
Income as % assets	6.50%	3.60%	6.30%	10.30%
Net return on assets	1.20%	0.90%	1.20%	1.40%

Zambia:	Income ratio – typically 15~20%	Return on assets – typically around 4% for larger foreign banks and 1½~2% for most other banks

Derived from Bankscope 2004

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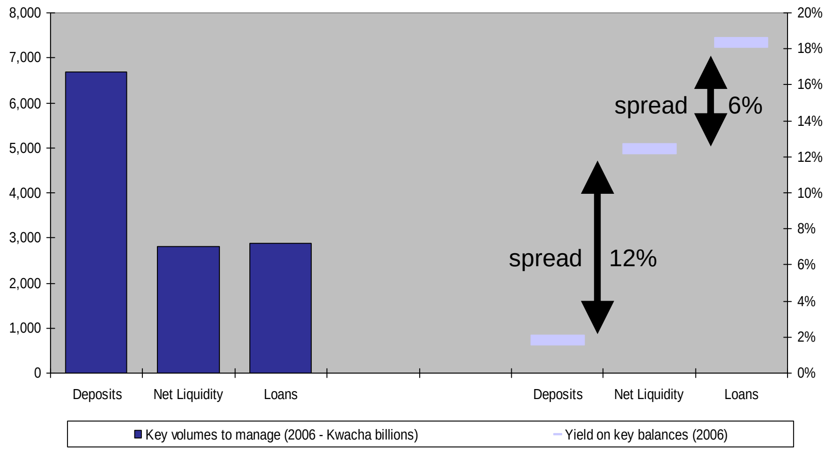
Even with falling yields on government securities the spread taken on deposits is still very high



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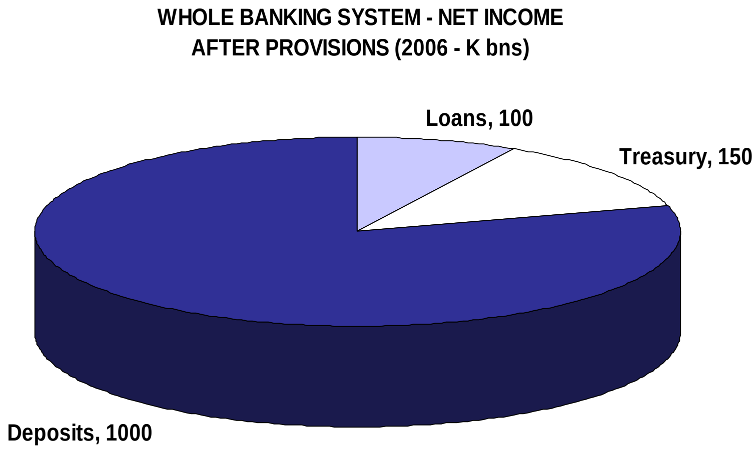
. . . and adding fees in makes the dominance of operating margin from deposits even more marked



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. . . which is not surprising given deposits are clearly priced to carry all operating costs

- The Kwacha 1 trillion of operating profits from deposits compares with total operating costs of Kwacha 0.8 trillion
- This probably explains why three times as much is charged in fees on deposit accounts as is paid out in total deposit interest
- In a more balanced banking system with retail loans as well as deposits, the loan book would contribute towards branch network overheads
- And a retail lending market to the already banked has already been developed by the microlenders (roughly 200,000 clients built up in just 5 years).

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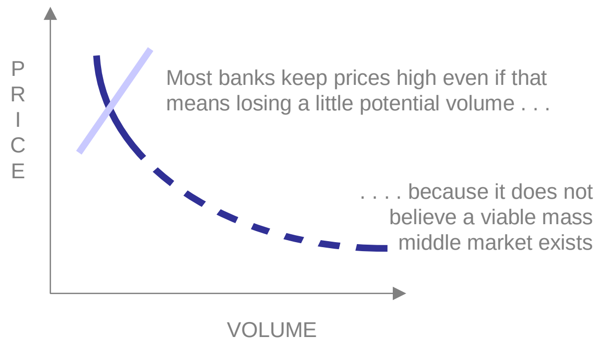
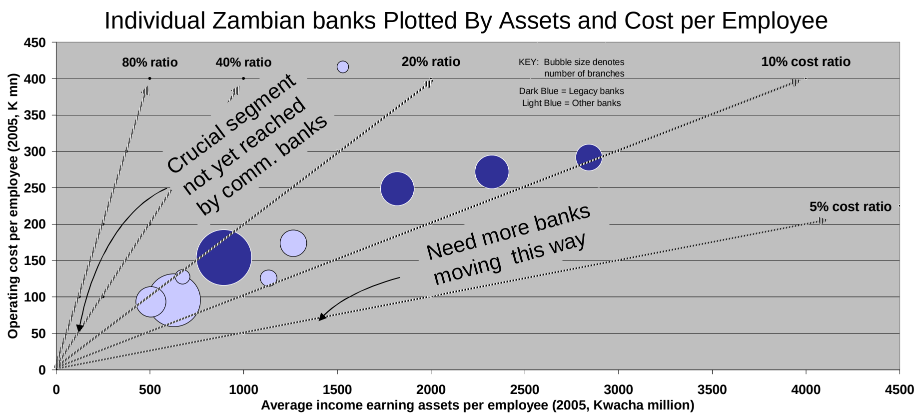
Like many repressed African banking systems, Zambia appears locked into the inelastic end of demand curve



But there a few commercial banks with potential to position themselves to do more mass-market business



Topic Three – Are the specialist accessible finance institutions (AFIs) positioned to deliver access ?

We look at this issue separately from the international then the domestic perspective:

- how well have Zambian institutions, with a social mandate to build access penetrated the market compared to other poor African countries ?
- how are they positioned competitively within a Zambian context to deliver small balance business at affordable costs ?
- where do commercial microlenders fit in ?

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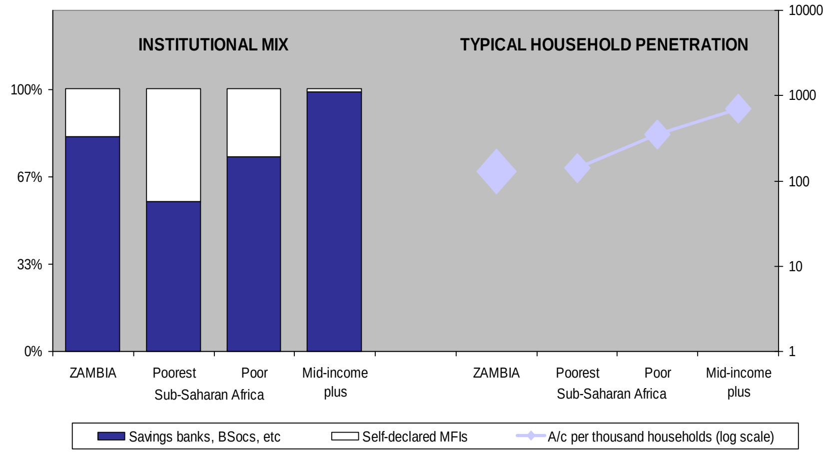
Zambia is typical of the poorest fifth of African countries with barely one house in eight reached by social AFIs



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. . . but these "social" institutions are very costly to use by any international standards and yet often still loss-making

AFI Asset yields by region:	E. Europe & C. Asia	South & E. Asia	Lat. Am & Carib.	M.East & Africa
Savings Banks				
Income as % assets	6.0%	2.0%	6.9%	4.7%
Net return on assets	1.2%	0.1%	1.1%	0.4%
Self-Declared MFIs				
Income as % assets	28.7%	20.5%	27.5%	28.1%
Net return on assets	2.0%	6.1%	4.8%	3.9%

Zambia: NSCB/B-Soc typically 35% and breakeven respectively
Social MFIs typically 60~65% and very mixed on Net RoA

Derived from Bankscope 2004 other banks

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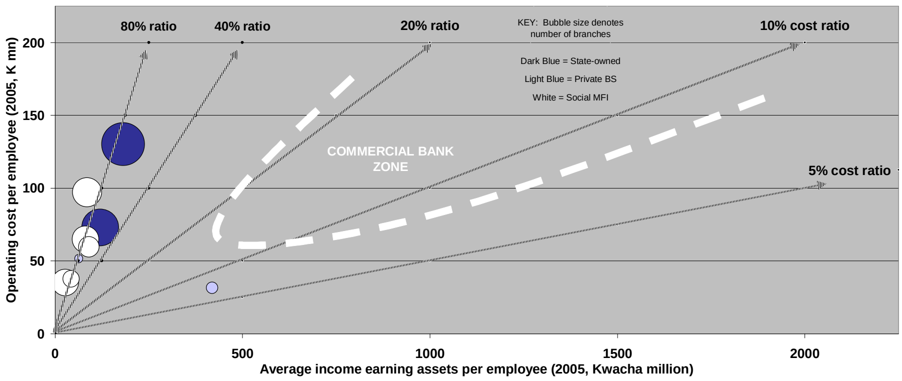
. . . and the real problem seems to be operating costs which do not scale back in line with smaller balances

Individual Accessible Finance Institutions plotted by assets and cost per employee



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The commercial microlenders have opened up credit to salaried individuals but we do not think they class as AFIs

- The commercial microlenders (Nedfin, Bayport, Microfin, etc) have proved very difficult to get data from – this is a very secretive business under a lot of pressure in its main home market (South Africa)
- We think some 200~250,000 personal loan customers have been created in just five years, many of whom will not have had access to bank loans – total individual loans by banks numbers in tens not hundreds of thousands
- Clearly a market exists that banks failed to exploit. It may be quite saturated now (there are only about 450,000 salaried adults in Zambia).

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Topic Four – Is there a problem with the distribution of branch outlets that explains low levels of access ?

Customers clearly think that lack of geographical reach is an issue but we have to ask two key questions:

- is this a priority issue – if large parts of the rural population are too poor to be monetised will expanding branch networks do anything to improve access ?
- are there alternative distribution networks or platforms that could be used to get the rural economy monetised?

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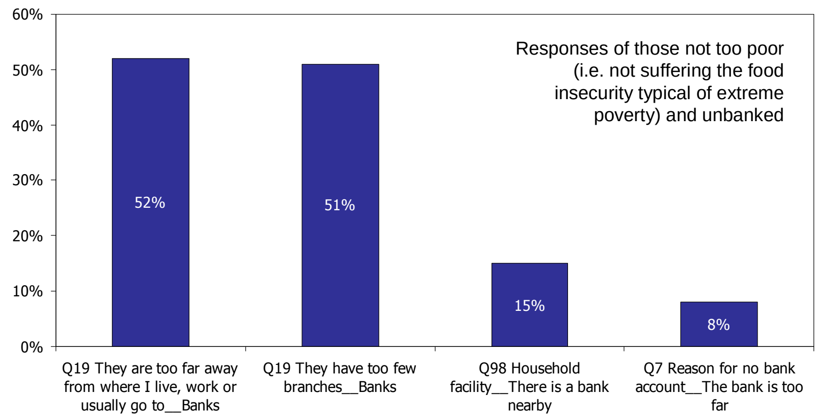
The biggest single reported supply factor holding back access is lack of geographical accessibility . . . .



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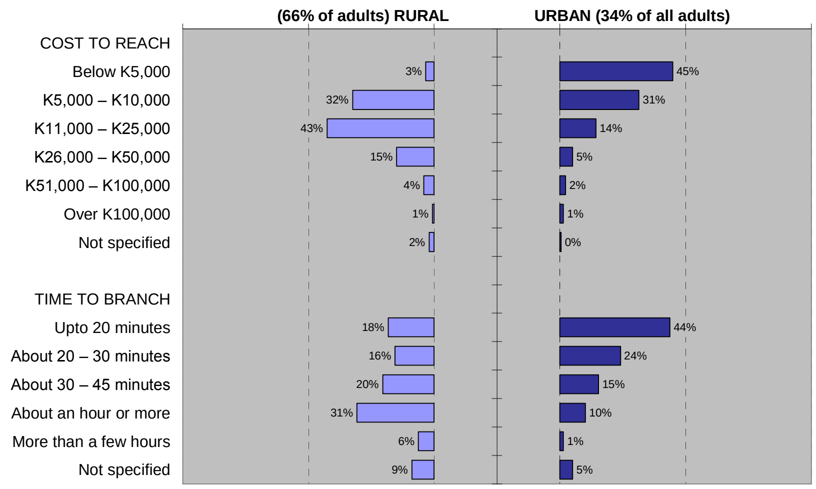
. . . and this dramatically raises already high costs of access for the rural population



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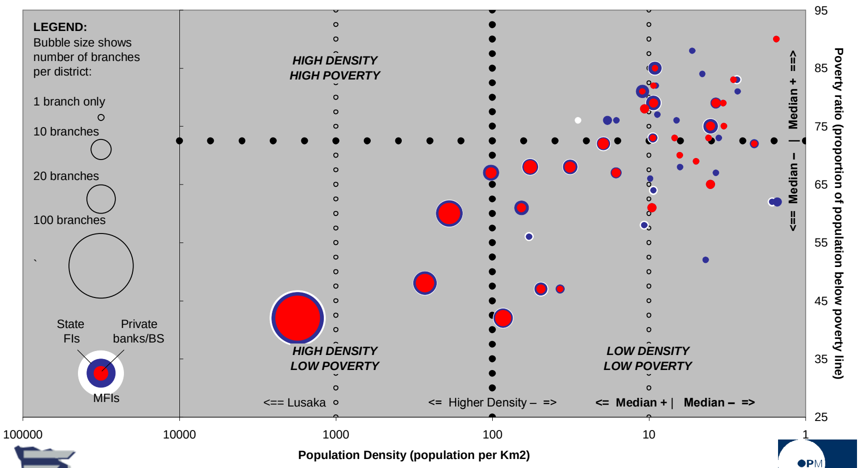
Private banks penetrate some poor, remote areas although proportionately state-owned institutions matter more . . . .

OUTLET NUMBERS BY TYPE AT DISTRICT LEVEL BY POPULATION DENSITY / POVERTY RATIO



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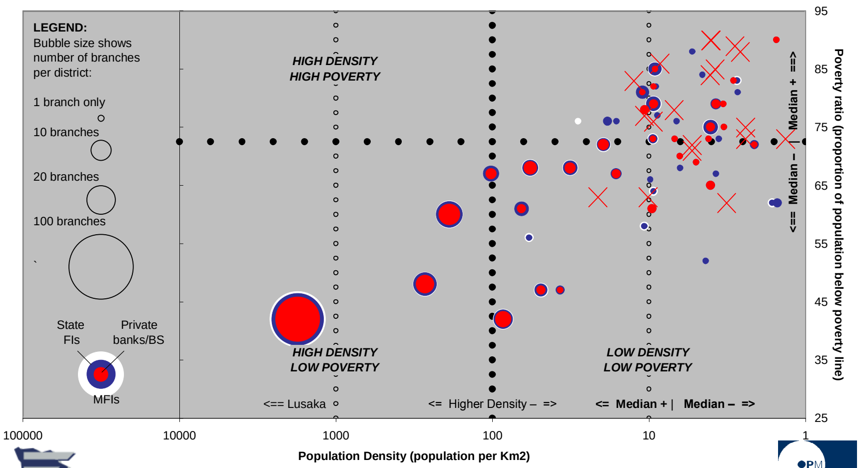
. . . . but about half of the poorer, less densely populated districts have no financial institution outlet at all

OUTLET NUMBERS BY TYPE AT DISTRICT LEVEL BY POPULATION DENSITY / POVERTY RATIO



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. . . . so clearly there is a problem with coverage but it may not be one that can be resolved at current cost levels

- There are almost one million adults living in the districts with no financial institution outlets at all and a further one and third million adults only have the choice of using a state-owned financial institution.
- The table overleaf indicates what little contact most rural adults have with a bank branch
- Equally, traditional solutions such as a postal banking services may increase competition but would still leave more than two-thirds of rural adults untouched by an expanded financial system
- Health clinics and schools seem a better platform for outreach generally

Central Statistics Office survey data on which facilities Zambians actually use in a year

Distribution of Households by Use of Various Facilities, Zambia, 2004

Facility	All Zambia	Residence	
		Rural	Urban
Food Market	82.1	70	96.2
Post Office	42.1	28.3	58.2
Community School	9.8	9.9	9.7
Lower Basic School (1-4)	10.2	9.5	10.9
Middle Basic School (1-7)	30.8	35.8	25.1
Upper Basic School (1-9)	42.3	37.3	48.1
High School	11.9	7.1	17.5
Secondary School	16	10.6	22.3
Health Facility	90.2	89.7	90.8
Hammer mill	72.1	84.8	57.3
Agriculture Input Market	26.6	28.3	24.7
Police Station/Post	55	37.9	75.1
Bank	22.2	10.3	36.1
Public Transport	77.6	67.1	89.9
Public Phone	22.4	8.1	39.2
Internet Café	3.3	0.7	6.4

Source: LCMS 2004

. . . . and the same survey shows that, apart from clinics and schools, most contact points are also hard to reach

Percent Distribution of Households by Proximity to Facilities, 2004

Facility	0-5 Km			6-15 Km			16 Km +		
	Total	Rural	Urban	Total	Rural	Urban	Total	Rural	Urban
Food Market	71.4	45.6	97.2	12.9	24.8	1	15.7	29.6	1.8
Postal office/agency	56.2	18.8	89.4	16.3	25.9	7.7	27.5	55.2	2.9
Community School	88.2	77	96.7	7.2	15.2	1.2	4.6	7.8	2.1
Lower Basic School	86.7	73.5	97.1	8	17.2	0.7	5.3	9.3	2.2
Middle Basic School	85	77.2	95.8	11.3	18.4	1.6	3.7	4.4	2.6
Upper Basic School	81	65	97.3	12.5	23.9	0.9	6.5	11.1	1.8
High School	54.8	18	81.6	13.2	19.4	8.7	31.9	62.6	9.6
Secondary School	53.4	20.4	85.7	14.8	21.9	7.8	31.8	57.7	6.4
Health Facility	75.5	56.7	96.9	17	30.7	1.4	7.6	12.6	1.8
Hammer mill	83.9	73.4	98.2	10.7	18.2	0.4	5.4	8.4	1.4
Input Market agriculture	54.6	26.5	86.8	18.4	25.9	9.9	26.9	47.7	3.3
Police station/post	63.9	26.5	96.5	13.6	27.5	1.4	22.5	46	2
Bank	50.8	9.6	82.4	12.8	17.5	9.3	36.4	72.9	8.3
Public transport	83.2	67.4	98.1	9	18.1	0.4	7.8	14.4	1.6
Public Phone	69	19.7	95.9	8.6	20.3	2.2	22.5	60	2
Internet	52.4	5.2	71.5	19	18.4	19.3	28.6	76.4	9.2

Source: LCMS 2004

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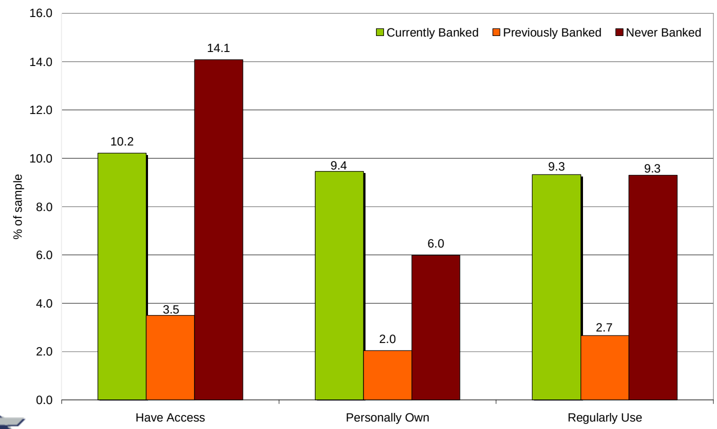
Over 1½ million Zambians have access to a mobile phone and just over 1 million of these are unbanked . . . .

Mobile Phone Access, Ownership and Regular Use by Banking Status



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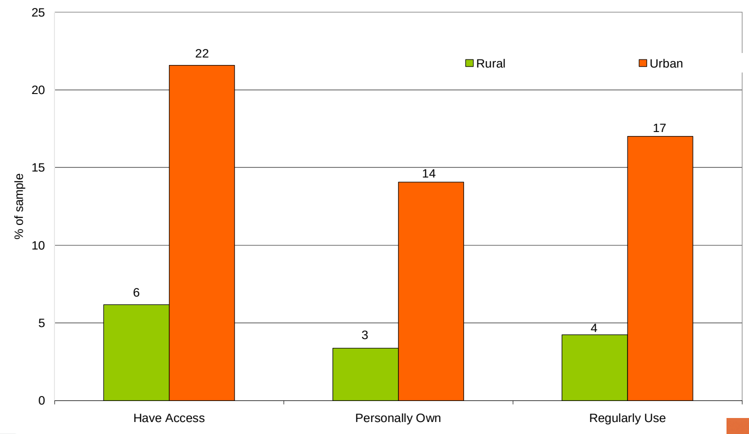
. . . . but essentially this is an urban phenomenon and only 360 thousand of those with mobile phone access are rural

Mobile Phone Access, Ownership and Regular Use by location



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SUPPLY SIDE – Concluding questions for the audience

We have presented our findings and would like to get your feedback to these findings before moving to developing recommendations for both policy makers and practitioners

- Is the lack of access constrained by lack of monetisation of the rural poor – will pushing banks to open more branches just raise costs and maybe make access even worse ?
- Equally, banks do not appear to have positioned themselves to make the most of the potential urban market – can the market be left to encourage repricing so that more people can use banking services ?
- Why are the accessible finance institutions so high cost – what can be done to revitalise this sector ?
- What alternative distribution platforms are there that could reach the mass rural market in particular ?

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