



**Mapping the Retail Payment Services Landscape
Malawi**

October 2012

FinMark Trust

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ABSTRACT

Research Approach:

The approach taken by this study divides the environment into supply and demand components to understand the current context for payment services. The demand side research looks at how the poor pay from a behavioral perspective and documents the various transaction profiles in use. The supply side research assesses the policy environment around payments, the current payment products available in the market and ultimately determines how regulatory change impacts access and usage of payment services. The report further provides a thematic view of how enabling the existing market conditions are to the development of transformative payment services.

Overview of Findings:

Malawi is a geographically small but densely populated country where 81% of people do not have access to formal payment services or mobile phones. The financial sector is not particularly innovative but has in recent years proactively pursued greater use of electronic payment mechanisms, for both wholesale and retail services. The government's support of electronic services and broader access to financial services has helped to bring more choice to the market, but mainly to the benefit of existing bank account holders.

There are few financial institutions (public or private) that are actively pursuing the unbanked market through the use of technology and new distribution channels. However, Airtel's mobile money aspirations have created interest in the market and will likely have an impact on access to payments services by the unbanked.

Before the market can maximize this opportunity, there are some important obstacles facing the goal of increased access and usage of formal payment services in Malawi. Namely, (i) improving infrastructure to support cash distribution networks and (ii) providing greater interoperability amongst providers. The market is actively seeking a solution to the latter, with little attention being paid to the former.

From the consumer perspective, Malawians are interested in electronic payment systems and innovative financial products, although they currently transact almost exclusively in cash. People report that many bank and formal money transfer services are far away from where they live and work, and are time consuming to use. There is high demand for more proximate financial services—even the popular post office linked FastCash transfer service is not available in many smaller post offices. For international remittances, Malawians have developed an astonishing number of complex and innovative transfer systems that rely on social networks. Consumers report trust in financial institutions, but feel the banks are inconvenient to get to, overcrowded, expensive and therefore out of reach for poorer Malawians.

CONSUMER PAYMENT PROFILE

HOW THEY PAY:
Consumer Payment Profile



Banked:

Geographic Location: Urban or semi-urban

Instrument usage: Likely to have ATM card, but still transacts primarily in cash for daily retail payments. Access to mobile applications for basic services (balance inquiry, etc) increasingly common.

Network Access: If urban, has access to multiple branch offices. Semi-urban, likely have access to 1 or 2 branches. Has access to ATM's for cash withdrawals and POS networks for retail payments. Likely benefits from good mobile network coverage.

Counterparty Services:
 P2P- Many options available, including account to account transactions between some interoperable bank networks.
 P2B- Bill payment available at all branches, some ATMs and mobile applications.
 G2P- All salaried civil servants receive salary via nominated bank accounts.
 B2P- Large corporate organizations pay urban based employees via nominated bank accounts.

Unbanked:

Geographic Location: Semi-urban or Rural

Instrument usage: Transacts primarily in cash for retail payments and money transfers. Does not have ATM card or access to mobile based payment services

Network Access: If Semi-urban, likely have access to 1 or 2 branches. If rural, may have access to periodic mobile (vehicular) branches, but likely to travel distances to access branches

Counterparty Services:
 P2P- Non-account based services limited to money transfer at Post Office and MSB, or informal mechanisms.
 P2B- Bill payment for non-account holders available at only at MSB branches.
 G2P- Some may receive cash based government disbursements.
 B2P- Limited cash distribution of salaries on weekly or bi-weekly basis in agriculture sector

NOTE: This graphic depicts the varied access to payment services between the banked and unbanked population in Malawi. It is not meant to present absolutes, but rather provides an indicative sense of the current state of the market in Malawi.

ABBREVIATIONS AND ACRONYMS

ATM	Automated Teller Machine
BSD	Banking Supervision Department
EFT	Electronic Fund Transfer
FSTAP	Financial Sector Technical Assistance Program
G2P	Government to Person
MPC	Malawi Post Corporation
MSB	Malawi Savings Bank
MoF	Ministry of Finance
MNO	Mobile Network Operator
NPS	National Payment System
OIBM	Opportunity International Bank Malawi
P2P	Person to Person
POS	Point of Sale device
RBM	Reserve Bank of Malawi

Table of Contents

Abstract	3
Abbreviations and acronyms	5
1. Introduction	7
1.1. <i>How to use this report</i>	7
2. Country Context	7
2.1. <i>Demographics and Service Penetration</i>	7
2.2. <i>Financial Service Penetration</i>	9
2.3. <i>Telecommunications services penetration</i>	10
3. Supply Side Overview	11
3.1. <i>Market Dynamics</i>	11
3.1.1. <i>Market Structure</i>	11
3.1.2. <i>Other Non-Bank Financial Service Providers</i>	11
3.1.3. <i>Electronic Payment Infrastructure</i>	12
3.1.4. <i>Available payment services</i>	14
3.2. <i>Regulatory Environment</i>	15
3.2.1. <i>Government institutions and their respective remit</i>	15
3.2.2. <i>Overview of existing banking and payment laws and regulations</i>	17
3.3. <i>Key Regulatory gaps and market barriers to payment system development</i>	21
3.3.1. <i>Regulatory Gaps</i>	22
3.3.2. <i>Market Barriers</i>	24
4. Consumer Perspective	25
4.1. <i>Research approach</i>	25
4.2. <i>Getting money into the house: How are people paid?</i>	25
4.3. <i>Transaction patterns: How do people pay?</i>	26
4.4. <i>Person-to-person transfers: Remittance payment systems</i>	27
4.5. <i>Government-to-person and Donor-to-Person: Social assistance payments</i>	30
4.6. <i>Attitudes toward financial services and electronic and innovative payments</i>	30
4.7. <i>Consumer priorities for payment system usage</i>	32
4.8. <i>Summary of demand side findings</i>	32
5. Thematic Analysis of NPS Development	33
4.1 <i>Government Policy</i>	36
4.2 <i>Market Barriers</i>	38
4.3 <i>Consumer Perspectives</i>	43
6. Way Forward	46
7. Annex 1: People Met	48
8. Annex 2: Location and profile of focus groups	50
9. Annex 3: Cost of Services	52

1. INTRODUCTION

This report is part of the series commissioned by FinMark Trust to examine the retail payments landscape in Malawi, Mozambique, and Zimbabwe. It distills key findings from country research conducted in Malawi in October 2011 and provides tools for understanding the landscape for retail payments in Malawi.

This study hypothesizes that the ability to make payments conveniently and affordably has a material impact on the financial lives of the poor. This hypothesis also assumes that (i) existing formal payment products are not designed for use by the low-income segment of the population, and (ii) existing distribution networks have a limited domestic outreach. We present a “payment profile” depicting how Malawians currently use payment services as well as the conditions in which current mechanisms are used.

1.1. *How to use this report*

In this report we offer a synthesis of the findings by first providing a descriptive overview of relevant Malawian demographics and financial service penetration. This is followed by a supply side review of the current regulatory and market environment in Malawi, concluding with an analysis of the respective regulatory gaps and market barriers to payment system development. A demand side analysis then looks at the consumer experience with existing payment services, drawing from focus group interviews conducted in rural and urban settings in Malawi. This relatively descriptive preface sets the stage for an analytical framework of themes that emerge from a consideration of the underlying conditions for enabling transformational retail payment services.

The analytical framework provides a lens with which to view retail payments in Malawi; a distillation of themes that emerge from the country-specific details uncovered in the course of the research. The thematic section of this report largely combines the discussion of supply- and demand-side factors. The result is a bottom-up approach to the identification of themes and priorities. We hope that this approach will offer a thorough view of the retail payments landscape in Malawi.

The comprehensive view of the landscape for retail payment services is then brought to bear on an identification of priorities for the area. Where the analytic and thematic discussions are generally descriptive of the state of play and options for development, the discussion of regional priorities is oriented around discrete actions that can be taken by policymakers and regional stakeholders.

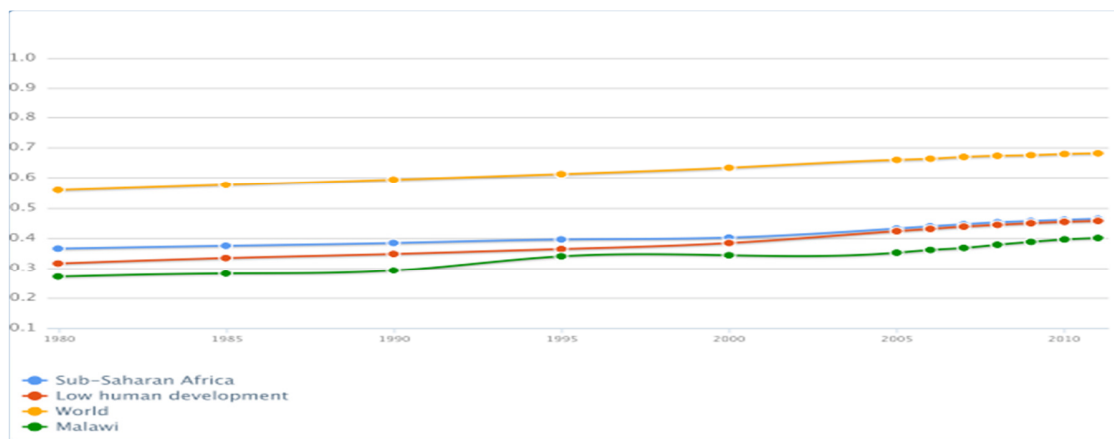
2. COUNTRY CONTEXT

2.1. *Demographics and Service Penetration*

Malawi has over the years confronted significant challenges in addressing the poverty facing its largely rural, agricultural population. The southern African country is geographically small and extremely poor, ranking

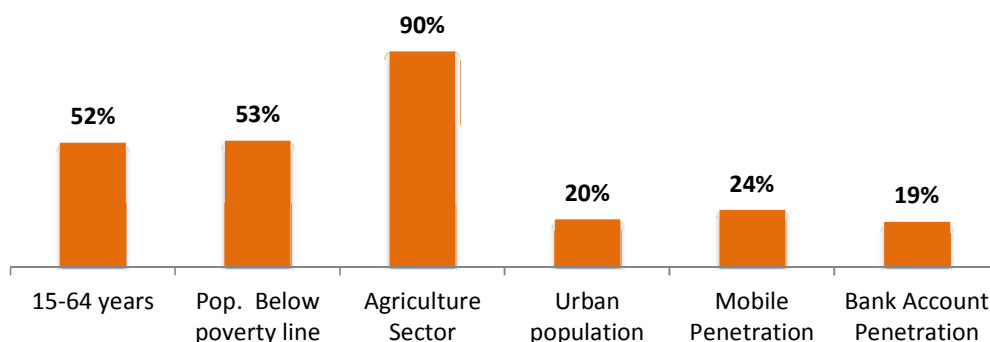
153rd out of 169 countries on the Human Development Index¹ (HDI). With a population of 15.8 million across 587 square kilometers, Malawi has an extremely high population density, one of the highest in Africa. Eighty percent of the Malawian population lives outside the main urban centers, and thus beyond the reach of most urban services. The HDI ranking demonstrates that Malawi’s development challenges are not only economic but are interlinked to absence of sufficient health care and education for the poorest Malawians. These challenges are particularly felt in the rural areas of the country where basic infrastructure is sorely lacking, which further compounds the obstacles facing the delivery of necessary services to the population.

Figure 1: Malawi Human Development Index



Further analysis of the demographic landscape in Malawi begins to expose more clearly the issues that are at the heart of Malawi’s development challenges, particularly as they relate to the provision of more inclusive financial services generally, and payment services more specifically. Figure 2 below provides a snapshot of the current demographic landscape across several relevant categories as a percentage of population.

Figure 2: Demographic Overview as percentage of population



Source: CIA Factbook, 2011

The two messages that stand out from Figure 2 are the high percentage of the population that falls below the poverty line and the low penetration of bank accounts and mobile phones. The former demonstrates the need for more secure, affordable services to be made available to help develop an ecosystem that can

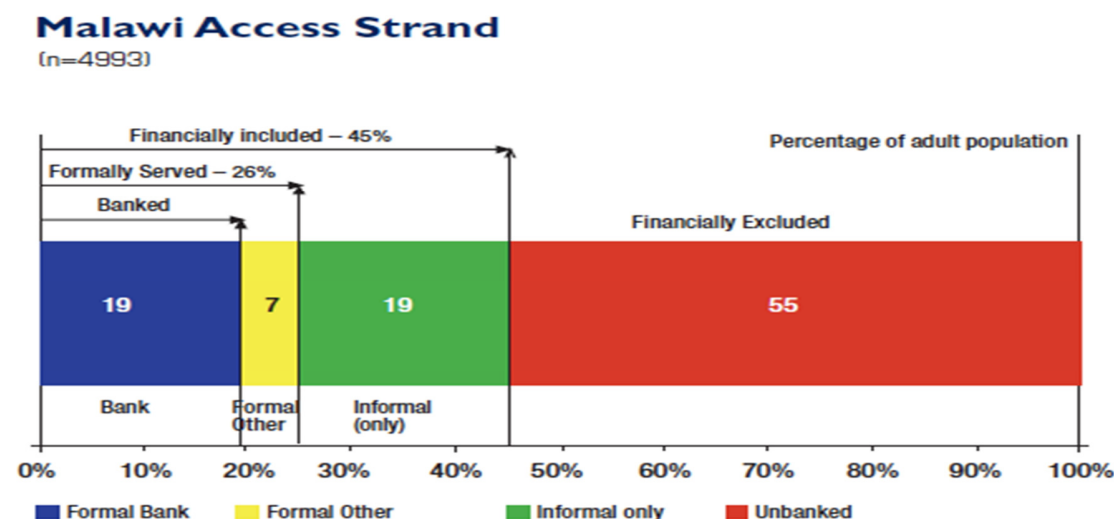
¹ <http://hdr.undp.org/en/data>

positively impact the lives of the poor in Malawi. The latter demonstrates that currently services are mainly available in urban and peri-urban areas of Malawi, excluding up to 80% from any formal services at all. The context reflects both the opportunity and challenge in extending services outside of the urban centers in Malawi.

2.2. Financial Service Penetration

To date, the financial services industry has focused its products and services on the predominantly urban population, thereby excluding the vast majority of Malawians from access to basic financial services such as savings, credit and payments. The FinScope Access to Finance Strand below highlights the breakdown of access to services.

Figure 3: FinScope Malawi Access Strand²



Using the Access Strand as a backdrop, this research has singled out payment services to understand its impact on the financial lives of the poor in Malawi. This study hypothesizes that the ability to make payments conveniently and affordably has a material impact on the financial lives of the poor. This hypothesis assumes that (i) existing formal payment products are not well tailored for the specific needs of the low-income segment of the population, and (ii) existing distribution networks have a limited domestic outreach. This study will present a “payment profile” depicting how Malawians currently use payment services as well as the conditions in which current mechanisms are used.

² One of the key access indicators developed by FinMark Trust is the Financial Access Strand. The access strand focuses on the financial system of a country in its broadest sense and places the adult population into one of three broad segments: formally included, informally serviced and financially excluded.

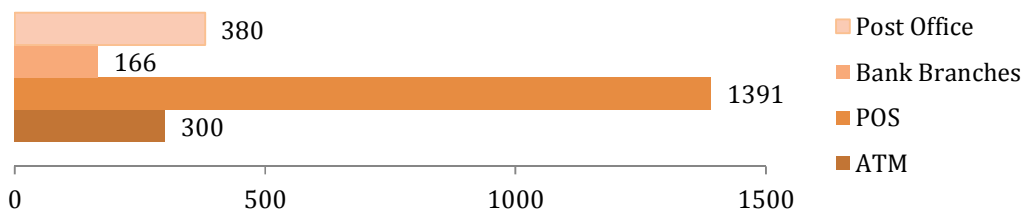
The formal sector is divided into a banked segment (the percentage of adults with a bank account), and a formal other segment (the percentage of the adult population with a formal financial product, such as insurance or a microfinance loan, but no bank account). Together, these two groups are defined as formally included.

The informal sector comprises all the organisations that provide financial services but are not legally registered to do this business – for example, savings clubs, burial societies and moneylenders. The informally serviced category in the access strand represents the percentage of adults with an informal product but with no bank account or a product from another formal financial institution. While some of those with a bank account or using another formal service may still use informal services as well, the informally included have no formal products. It therefore indicates exclusive informal usage.

It is necessary to add the informal segment to the formally included segment to derive the percentage of the adult population which is financially served. Anyone who is not financially served is financially excluded which means they are not using financial products (formal or informal) to manage their financial lives – for example, they may simply be using cash.

It is important to highlight that bank branch, ATM and POS channels are only available to existing bank customers (approx. 19% of the population), the majority of whom live in urban centers. In contrast, the post office has a presence throughout Malawi and provides some services to customers without accounts at banks or other formal institutions. Figure 4 below highlights the number of outlets of existing distribution channels in Malawi. It is also useful to note that 23% of Malawians, or 3.6 million, have mobile phones³ (see Section 2.3) thus providing the potential to expand services well beyond the existing distribution networks.

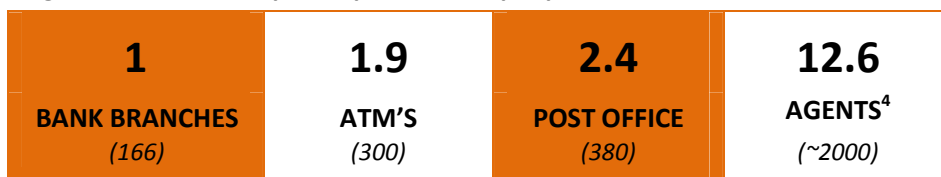
Figure 4: Available Distribution Channels



Touch points per 100,000 (branches, ATM's, or remittance 'agents')

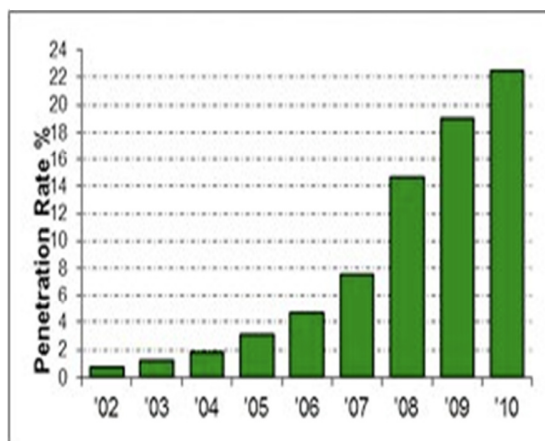
Another measure of service penetration is the number of outlets available *per 100,000 people*. This provides a tangible comparison of the number of outlets that are available to the population:

Figure 5: Total touch points per 100,000 people



Notably, even the regionally ubiquitous post office service clearly falls short of providing accessible services to the majority of Malawians. ATM and POS penetration do not fare much better, particularly when compared to the number of Airtel mobile money agents recruited for the recent mobile money pilot.

Figure 6: Penetration rate in Malawi over time



2.3. Telecommunications services penetration

Malawi's two largest mobile operators, TNM and Airtel (a subsidiary of Bharti Airtel of India), serve an estimated 3.6 million mobile customers and both operators have experienced rapid customer growth. Airtel is the larger of the two with 61% market share.

Growth in Malawi's penetration rate

Growth in the telecommunications sector has been steady,

³ Source: <http://www.tnminvestor.com/TelecomsInMalawi.aspx>

⁴ Based on approximate number of agents recruited for Airtel's mobile money pilot

increasing the efficiency, quantity and quality of services due to significant investment by telecommunications operators, and in turn improving to meet the economic and social needs of the country. Figure 6 illustrates the growth of Malawi's telecommunications measured by penetration rate⁵.

3. SUPPLY SIDE OVERVIEW

3.1. Market Dynamics

The financial services industry is very conscious of the low levels of service penetration in Malawi and is actively seeking to modernize its payment platforms, particularly through greater use of electronic delivery channels. Banks have actively sought to upgrade their respective core banking systems to introduce new electronic payment services to new and existing customers. These include wider distribution of ATMs and POS as well as limited interconnection among specific networks of banks. This industry-wide activity has developed a good level of awareness amongst senior executives in the private sector of the emerging trends and market developments. This is also most likely driven by the high degree of interest in pursuing financial inclusion initiatives from the Reserve Bank of Malawi (RBM) and the Ministry of Finance (MoF).

However, of the 12 banks in Malawi, few have operationalized a strategy specifically targeting the unbanked. These few institutions are seeking transformational opportunities in Malawi, while other banks seem to focus mainly on providing additive services to existing customers, and trying to acquire new customers mostly in urban centers.

3.1.1. Market Structure

Of the 12 commercial banks operating in Malawi, eight are local banks: National Bank, NBS Bank, Opportunity International Bank of Malawi (OIBM), INDEbank, First Merchant Bank, FDH Bank, the just launched CDH Investment Bank and the Malawi Savings Bank (wholly owned by government). International banks operating in Malawi at the time of research were Standard Bank, Nedbank, Ecobank and International Commercial Bank.

In the last ten years, several smaller banks have entered the market, including some international and pan-African banks. National Bank is the largest bank by asset volume seconded by Standard Bank (previously Commercial Bank of Malawi), both of which specifically target the higher end of the market. OIBM and Malawi Savings Bank have a lower-end focus, with a strategic focus in rural Malawi. The remaining banks target the middle to high-end income sections of the population, often oriented towards corporate clients. As the number of banks have steadily increased, marketing and product differentiation is becoming essential to remain competitive.

3.1.2. Other Non-Bank Financial Service Providers

The only non-bank financial service providers in Malawi as of the time of this study are Micro-Finance Institutions and the Malawi Postal Corporation.

There are a number of micro-finance institutions in the country, the largest of which are the Malawi Rural Finance Company, Finca Malawi and Pride Africa. These primarily target the development of SMEs in rural

⁵ Source: <http://www.tnminvestor.com/TelecomsInMalawi.aspx>

settings, which in turn foster the demand for banking services among their clientele. To date, the MFIs do not offer any unique payment service provision and do not have any noteworthy examples of uses of electronic means of disbursing or collecting payments.

The Malawi Postal Corporation (MPC) plays a crucial role in the provision of domestic remittances in Malawi. MPC is authorized to provide financial services via the Communications Act, No. 41 (1998) and therefore is not regulated by the RBM. MPC's core business of courier collection and postal services has allowed it to develop the largest network of service outlets compared to other financial service providers. The MPC's main financial service product is a remittance product, FastCash, which is popular for urban-to-rural remittances due to the location of a MPC outlet in every district in Malawi.

3.1.3. Electronic Payment Infrastructure

The payment infrastructure in Malawi has three main components: 1) the Malawi Inter-Bank Transfer and Settlement System⁶ (MITASS), 2) the Electronic Cheque Clearing House (ECCH), and 3) the Malawi Switch Centre (MALSWITCH). Membership to MITASS and the MALSWITCH Smartcard System is open to any financial institution that meets the access criteria while only clearing banks are allowed to participate in the ECCH.

The RBM and Bankers Association of Malawi (BAM) own the MITASS and ECCH respectively, but technical administration and support of both systems is outsourced to MALSWITCH, which is owned by the Government of Malawi. The Smart card scheme is owned and operated by MALSWITCH. International transfers are channelled through SWIFT while local settlement instructions are processed in MITASS using the MALSWITCH network. Messages in MITASS are however in SWIFT format.

Currently all commercial banks participate in MITASS and the ECCH while four banks use the MALSWITCH Smart Card scheme (although membership to the Smart card scheme is open to all commercial banks). Only four of the twelve commercial banks issue Visa debit cards to their clients, and none of the VISA banks are connected to the MALSWITCH infrastructure.

The electronic payment infrastructure operated by MALSWITCH has allowed the RBM to monitor the liquidity positions of all banks on a minute-by-minute basis, minimizing payment systems risks. For instance, the ECCH reduced the clearing period from seven days to around two days. Real time gross settlement (RTGS) settles transactions in real time, thereby eliminating credit risk between system participants⁷. The reduction in clearing period and immediacy in settlement: (i) facilitates increased circulation of funds, (ii) enhances monetary policy implementation, (iii) provides banks a facility to monitor their positions in real time, and (iv) facilitates cost effective investment decisions.

⁶ A Real Time Gross Settlement (RTGS) system

⁷ Source: *Payment System Reforms in Malawi: A Brief Historical Perspective*, Payment Systems Division, Reserve Bank of Malawi, February 2008

BOX 1: MALSWITCH PRODUCTS AND SERVICES

The national network infrastructure and a transaction switch called Malawi Switch Centre (MALSWITCH) links all commercial banks and discount houses onto a common network platform providing a number of electronic based payment, clearing and settlement facilities including⁸:

- i. *The real time gross settlement (RTGS) system*: High-value inter-bank funds transfer system that settles transactions in real time and on an order-by-order basis (i.e. without netting)⁹.
- ii. *Smart Card Scheme*: Chip-based card scheme that uses biometrics and personal identification (PIN) code.
- iii. *Electronic Bidding System*: This is an in-house workflow system that enables the RBM to simultaneously accept bids for Treasury Bills and RBM Bills from participating financial institutions in real time.
- iv. *Electronic Cheque Clearing House (ECCH)¹⁰*: Code line clearing based on cheque imaging and truncation.

Level of interconnection

As noted previously, all commercial banks in Malawi are connected to MALSWITCH for interbank payments. There is a clear consensus among banks that the interbank payments systems (RTGS and ECCH) are operating fine and should remain under the management of MalSwitch.

However, the retail payment systems remains fragmented after several years of experimenting with a government owned interoperable retail EFT switch (MalSwitch). Of the 12 banks in Malawi, the top four banks are interoperable via their own, privately owned switches, all of which are connected to the Visa network. The bottom four banks are interoperable via MalSwitch. This evolution demonstrates a maturity in the market where the banking sector has in recent years realized that they can take steps to introduce products that allow customer to transact between a selection of institutions and retain their respective competitive advantage through better products and services.

Ongoing negotiations between the banks and RBM have revealed a common willingness to invest in a *national* EFT switch to allow all financial institutions to fully interoperate. This switch would operate independently from MALSWITCH. The primary complication in negotiations is determining who will own and/or manage such a national EFT switch. As of September 2011, there was some consensus that the banks would likely be majority owners of the national switch. However, it is unclear whether MalSwitch will manage and administrate the national switch, and whether they would do so in addition to the existing EFT switch owned by the government. The argument of the banks is that the management of competing EFT switches by MALSWITCH would present a clear conflict of interest. The RBM has noted that it is likely that MALSWITCH would only administer the bank-owned EFT switch in order to facilitate ubiquitous interconnection between

⁸ Source: *Payment System Reforms in Malawi: A Brief Historical Perspective*, Payment Systems Division, Reserve Bank of Malawi, February 2008

⁹ Malawi launched the RTGS on 19th March 2002. Malawi was the third country in SADC to implement RTGS after South Africa and Mauritius.

¹⁰ Commissioned on 1st August 2005, Malawi is the first country in SADC to implement cheque truncation

financial institutions, consolidate the administrative functions into a singular entity (MALSWITCH) and relieve the market of any concerns regarding conflict of interest.

3.1.4. Available payment services

The vast majority of retail payment services available in Malawi are limited to bank account holders who largely transact via nominated transaction accounts. This includes person-to-person payments, as well as bill payments and high value retail payments (for big ticket items such as cars, appliances, etc). All banks in Malawi offer cards to clients, but as noted previously, only a limited number of banks are interconnected and allow customers to use their respective cards at other ATMs and POS devices.

Non-bank account holders are not left completely out of options because they can conduct some payment services at Malawi Savings Bank and the Malawi post offices (Malawi Post Corporation). The primary services offered to non-account holders at these branches are international remittances and bill payments. For domestic payments at MSB the recipient of funds must be a MSB account holder (non-account holders can pay MSB account holders, but not vice versa). The MPC, however, allows for domestic remittances for any person, whether or not they have an account with a regulated financial institution.

Because of this, the MPC leads the domestic remittance field in both usage and access. The MPC has the largest brick and mortar services network (branches in every district in the country) and runs the most popular domestic remittance products (FastCash) available to those who do not have bank accounts. MPC uses a real-time tracking system to manage payments but struggles with settlement of payments due to the difficulty of retaining sufficient liquidity in its 330 service outlets. Although FastCash is a well-known and trusted service, it is under direct threat from the Airtel mobile money product.

BOX 2: INNOVATIVE PARTNERSHIPS MAY HELP EXPAND ACCESS-

Malawi Savings Bank (MSB) and Opportunity International Bank Malawi (OIBM) appear to be the only banks with a strategy that explicitly includes financial inclusion. MSB is a government owned bank with the largest branch network (49) and OIBM is a former MFI who has established a reputation for targeting the unbanked with affordable, sector specific products and services. Both OIBM and MSB have explored partnerships with retail distribution networks beyond their own: MSB with the Malawi Post Corporation and OIBM with Kulima Gold, a local retail outlet that primarily deals in agricultural goods.

MSB may extend banking services to every district via Post Offices. MSB is now exploring a partnership with Malawi Post Corporation (MPC) that would allow MPC outlets to conduct business on behalf of MSB. This would give MSB access to 330 MPC outlets and allow them to leverage MPC's real-time transaction management system. MPC is also considering introducing ATMs to 150 of its primary branch locations. Although this would not have the same extensive reach of mobile-based solutions, it would significantly extend full banking services to a new segment of the population. If these new MSB customers were issued cards, it could create a business case for a broader network of POS terminals and facilitate an expansion of the electronic retail payment services.

OIBM introducing e-payments to agriculture sector. OIBM has partnered with a local retail network, Kulima Gold, which specializes in providing agriculture goods (such as fertilizer and seed) to the smallholder farmer. Kulima Gold has 64 branches throughout the country, all of which have been supplied with POS devices that allow OIBM customers to purchase goods using their OIBM cards. Although the volume of transactions may be limited by the size of

the network and specificity of the service, the partnership is the first of its kind in Malawi. This may set the example for other financial institutions to forge relationships with retail networks¹¹ where they intersect with an active retail activity (e.g. supplies for small hold farmers) and demand for more efficient payment services.

Mobile-Money

As of October 2011, Airtel Malawi was the only network in Malawi offer a mobile money platform. Airtel has connected several banks, including OIBM, MSB and National Bank to allow existing customers to use their mobile phones to access some banking services. For example OIBM's mobile money platform, called Banki M'Manja, is offered to existing OIBM customers and allows them to conduct basic services, such as check account balances, mini statements, airtime top up, utility bill payments, and money transfer from their mobile phones. At the time of this research, all of the existing mobile-based payment products offered in Malawi required an account with a regulated financial institution and were limited to existing customers, as exemplified by the OIBM product.

However, this may change should mobile money take a more prominent role in the payment services environment. Airtel has already launched its mobile payment product (in March 2012) and TNM is also planning to launch its own mobile payment platform.

Airtel's strategy for mobile money is to target unbanked customers who primarily live outside of the urban areas but benefit from the ever-expanding mobile network coverage (upwards of 70%). As part of the application process, Airtel was required by the RBM to run a pilot to test its product offering and system capability. As of September 2011, the pilot had been running for 18 months and had amassed 30,000 customers and 1,500+ agents.

3.2. Regulatory Environment

The regulatory framework for payment services in Malawi is fractured but improving. Although there are some critical gaps in the existing framework (e.g. no Payment Systems Law enacted as of yet), the RBM has made great strides in addressing the nascent state of payment system development and there is a clear governmental emphasis on the role the payments systems play in improving the financial lives of the citizens on Malawi. The section below discusses the governing bodies responsible for the development of payment systems in Malawi and respective regulatory frameworks that play a part in the extension of services to customers.

3.2.1. Government institutions and their respective roles

National Payment Council: The National Payment Council, made up of the Reserve Bank of Malawi, Ministry of Finance and a consortium of financial institutions, drives the strategy for payment system development in Malawi. The NPC in conjunction with the RBM monitor the modernization of the country's national payment

¹¹ Malawi does not enjoy a high penetration of retail infrastructure outside of Lilongwe and Blantyre, as one might find in markets such as South Africa. The large retail shopping chains (such as ShopRite) can only be found in these two urban centers. This model may not drive high volume of services but can still be very effective in driving a business case for new payment methods in Malawi.

infrastructure, particularly the introduction of electronic payment mechanisms. Besides new reform initiatives, authorities closely monitor already established reform programs to ensure that intended goals are attained and maintained.

Reserve Bank of Malawi: The RBM is responsible for payment system oversight (via the National Payment Systems Department), as well as banking supervision (via the Banking Supervision Department).

The RBM has actively sought to develop an “access friendly” regulatory framework, and the National Payment Systems Department has been at the center of this effort. There is a good level of coordination within the RBM in relation to new e-payment products (see E-Banking Task Force below) that has translated to a more open and relatively certain regulatory environment. However, a series of regulatory gaps remain that, if addressed, could provide more certainty to the market and incentivize greater investment in innovative payment services.

The National Payment Systems (NPS) department is responsible for the oversight of the payment systems infrastructure, as well as setting rules and regulations for payment institutions. In recent years the NPS has taken a proactive role in promoting electronic payment mechanisms in Malawi. This includes direct support of the introduction of electronic payment systems for interbank transactions¹² as well as retail payment systems¹³. To date the former has experienced a good deal of success while the latter has yet to fully meet the expectations of the RBM or the market.

The Banking Supervision Department (BSD) is responsible for the supervision of financial institutions, which includes some non-bank financial institutions (such as Microfinance Institutions (MFIs)) as well as commercial banks. As it relates to payment service provision, the BSD is responsible for coordinating with the NPS department when either new payment service providers partner with prudentially regulated banks (e.g. VISA network or mobile network operators) or when banks introduce new payment channels to their distribution network (e.g. ATM, EFT, POS etc). This coordination is ad hoc and takes place as issues arise that relate to the departments’ respective area of expertise. See reference to the E-banking Task Force below for an example of the interdepartmental coordination in practice.

Ministry of Finance: A Financial Sector Development unit within the MoF was introduced in late 2010, and is responsible for the development and oversight of National Strategy for Financial Inclusion (2010-2014)¹⁴. The Financial Sector Development unit also coordinates closely with the private sector and international multilateral organizations to further financial sector development in Malawi. Two examples of such coordination are (i) the implementation of the World Bank Financial Sector Technical Assistance Program (FSTAP) which is tasked with providing a roadmap for financial sector development in Malawi and (ii) negotiations with the banking sector to introduce low-cost basic bank accounts¹⁵.

E-banking Task Force: This task force is found within the RBM and was assembled to regulate and guide the market on mobile payment services. Membership of the E-Banking Task Force is drawn from Banking & National Payments System, Bank Supervision, Internal Audit, Information & Communication Technology, Legal Affairs & Bank Secretariat and Exchange Control & Debt Management departments of the RBM. The

¹² Real Time Gross Settlement system (RTGS) as well as the Electronic Check Clearing House (ECCH) and cheque truncation system.

¹³ MalSwitch, an EFT switch comprising of Auto teller Machines (ATMs) and Point of Sale (POS) devices that use the smart card technology for payments and transfer of funds

¹⁴ Published in January 2010.

¹⁵ Modeled on the Mzansi accounts in South Africa

guidelines produced by the Task Force in March 2011 mandated that, inter alia, interested non-bank institutions or mobile network operators (MNOs) should partner with registered commercial banks if they want to operate mobile payment services in Malawi. This position was taken after the Task Force conducted research using relevant literature reviews and site visits to Kenya and Tanzania.

3.2.2. Overview of existing banking and payment laws and regulations

The regulatory framework for payment systems in Malawi has seen the recent introduction of several regulations and guidelines that have added a good deal of certainty to the market. The NPS department has invested significant time and resources to develop a framework that supports two particular goals: (i) the introduction of electronic payment mechanisms and (ii) the facilitation of broader access to financial services to the rural population.

There are two strategy documents that frame the objectives of the NPS team in developing payment systems that support access to transformative¹⁶ financial services. These documents are the National Payment System Strategy 2009-2013 and the National Strategy for Financial Inclusion (2010-2014). In addition, the RBM issued Mobile Payment Guidelines in 2010 and a number of further pieces of legislation are of relevance to payment services. Table 1 below outlines the objectives of the strategies and regulations that support retail payment system development.

Table 1: Objectives of key financial inclusion legislation, Malawi

Strategy	National Payment System Strategy 2009-2013	<p>Outlines the agreed principles, vision and strategic framework for the envisaged National Payment System in Malawi for the period 2009 to 2013.</p> <p>The NPS strategy focuses on the development of electronic payment channels to serve the banked and unbanked, through the expansion of POS and ATM networks and greater interoperability among financial institutions.</p>
	The Malawi National Strategy for Financial Inclusion (2010-2014)	<p>The Financial Inclusion Strategy leans heavily on the result from the 2009 FinScope Survey to make the case for the need to expand services beyond the formal banking sector.</p> <p>In the context of payment system development, the strategy highlights the need to reduce the cost of a cash economy via greater access to electronic channels, including mobile. The strategy also notes that incentives should be offered to finance providers involved in piloting new, access friendly, innovations.</p>

¹⁶ The idea of transformative financial services originates from DFID's "The Enabling Environment for Mobile Banking in Africa" (Porteous 2006), which defines *additive* and *transformational* models for mobile banking as follows:

- *Additive models* are those in which the mobile phone is merely another channel to an existing bank account;
- *Transformational models* are those in which the financial product linked to the use of the phone is targeted at the unbanked, who are largely low-income people.

Regulations	Consumer Protection Act (2003)	<p>The Consumer Protection Act does not specifically address the use of new payment technologies involved in financial service delivery.</p> <p>However, the Act does outline a framework for customer redress mechanisms and specifies that contracts governing financial transactions must be: <i>(a) in good faith; (b) consistent with the instrument embodying the contract between the parties; and (c) in a manner consistent with the laws governing or regulating financial transactions.</i></p>
	Money Laundering, Proceeds of Serious Crime and Terrorist Financing Act (2006)	<p>The Money Laundering Act specifies that any financial institution must identify the customer before conducting electronic fund transfers.</p> <p>The Act denotes the Know Your Customer (KYC) requirements for individuals, which includes (i) the name, address and occupation of the person and (ii) applicable official identifying document (e.g. national identity card or passport). The requirements do not specify whether verification of identity is required through means such as utility bills.</p> <p>The Act does not specify a reduced KYC framework for low value transactions; nor does it specify transaction limits.</p> <p>The Act stipulates that records must be kept for up to seven years but does not indicate whether records can be held electronically or not.</p>
	Customer Due Diligence for Banks and Financial Institutions (2005)	<p>The Customer Due Diligence Directive provides additional clarification on the required processes that must applied to the “practices and procedures designed to determine the true identity of...customers” (Part I, Sec.1.1)</p> <p>The Directive takes into account certain circumstances as they apply to anti-money laundering, but limits its scope to purely the discussion of Know Your Customer rules and procedures.</p> <p>The most notable aspect of this Directive is the mandate that banks are “encouraged to develop graduated customer acceptance policies and procedures that require more extensive measures for high-risk customers” (Part IV, Sec.1.3). The Directive does not specify minimum or maximum thresholds for such a graduated approach, instead leaving it to the bank to determine a proportionate approach.</p> <p>Regarding identification requirements, the Directive mandates that new customers must be identified “on the basis of a reliable and independent source document” such as passport or drivers license, in addition to a letter of recommendation from an employer or existing customer of the institution. This</p>

		<p>latter statement denotes that while the Directive leaves space for banks to use a risk based approach for customer acquisition, there remain some questions as to whether it limits the potential customer base to associates of existing customers or those with regular employment, alluding to a additive rather than transformational potential.</p> <p>The Guidelines are not referenced in the Money Laundering Act discussed previously so it is unclear whether the Act supersedes these guidelines, thus cementing its more conservative approach.</p>
	<p>Mobile Payment System Guidelines (2010)</p>	<p>The Mobile Payment System Guidelines are specific to non-bank based models in order to enable Mobile Network Operators to offer payment services, defining the nature of the partnership between banks and non-banks. In particular MNOs are required to maintain a trust account in a regulated financial institution to ensure that funds are sufficiently insulated from risk. The funds cannot be used for any activities other than those associated with meeting customer liabilities on demand.</p> <p>The Guidelines allow for the use of individuals and corporates as agents to extend the service networks and limits agent activities to customer registration, accepting cash, making payments and effecting fund transfers.</p> <p>The KYC requirements for account opening are the same as those indicated in the Money Laundering Act (2006).</p> <p>Transaction limits are K20, 000 (~USD118) per day for non-bank customers and K50, 000 (~\$297) per day for banked customers.</p>

Draft Regulations

In addition to these regulations there are two draft regulations currently in final stages of approval that will likely have an impact on the market. These are the National Payment System Bill and the Agent Banking Guidelines.

Draft National Payment Systems Bill

The Draft NPS Bill is intended to act as keystone that will support the various payment system developments currently underway in Malawi, namely the modernization of the interbank payment systems (via MITASS, ECCH etc) and the push for more electronic retail payments (via MALSWITCH). The Draft NPS Bill outlines the requirements for licensing of payment service providers as well as the parameters for netting, truncation and use of electronic entries.

The NPS Bill in its draft form does not limit participation in the national payment system to banks and makes specific reference to mobile payment services, but it does not define stored value or electronic money. It may be beyond the scope of the Draft Bill to specify a framework for non-bank participants as the issues and conditions may vary and thus justify more robust guidelines or regulations. However, the Draft Bill presents an opportunity to set the stage appropriately for the introduction of new business models by clarifying key terms and concepts that relate to the use of new technologies, services and distribution networks. These issues are discussed further in section 3.3 below.

Draft Guidelines on Agent Banking

The Draft Guidelines on Agent Banking will similarly provide much needed clarity to banks in Malawi interested in extending their services beyond current brick and mortar networks. The Draft Agent Banking Guidelines are specifically targeted at improving the level of financial inclusion in Malawi and attempt to provide a framework to allow banks to safely offer services through the use of existing, non-financial business outlets throughout Malawi.

The Draft Guidelines apply only to banks and MFIs, and specify the policies and processes required to apply for the use of agents as well the criteria for agent recruitment. The Draft Guidelines also stipulate the KYC requirements for account opening the permissible activities allowed for agents.

The Draft Guidelines are intended to allow banks to reach out to the unbanked population in Malawi. They therefore have a similar objective to the Mobile Payment Guidelines, which also stipulate agent criteria for MNOs. Although the target market is the same, the two guidelines are divergent in many areas. The table below outlines the most salient provisions of each document (as they relate to agent services), demonstrating how they differ.

Table 2: Comparison of Draft Guidelines on Agent Banking and Guidelines for Mobile Payment Systems

Area of interest	Draft Guidelines on Agent Banking	Guidelines for Mobile Payment Systems
Individuals as Agents	Individuals are not allowed to be agents unless their respective business is registered as a sole proprietorship (Part VI, Section 25(ii))	Individuals can be agents if their respective identity can be verified (Section 11.1)
Permissible Activities	<ul style="list-style-type: none"> - Cash deposit and cash withdrawal - Cash disbursements and repayment of loans - Cash payment of bills - Cash payment of retirement and social benefits - Cash payment of salaries - Transfer of funds - Balance enquiry 	Limited to customer registration, accepting cash, making payments and effecting fund transfers. (Section 11.0)

	<ul style="list-style-type: none"> - Generation and issuance of mini bank statements - Collection of documents in relation to account opening, loan application, credit and debit card application - Collection of debit and credit cards - Agent mobile phone banking services - Cheque book request - Cheque book collection by customers - Collection of banking institution's mail/correspondence for customers (Part VII, Sec. 33) 	
Agent Network Management	<p>Requires the following information to be furnished by the bank regarding agent activities:</p> <ul style="list-style-type: none"> - Physical location - Certificate of incorporation, registration or valid permit - Evidence of sufficient funds - Evidence of commercial activity carried out for 18 months 	Location and certificate of incorporation only required if agents are registered business entities.
Account Opening	Bank agents cannot open accounts (Part VII, Section 36(ix))	Mobile Payment Agents can register customers for accounts with specific limits and thresholds.

While the regulatory environment in Malawi has demonstrated a clear intention to create an enabling environment for more efficient and expansive retail payment services, there remain some gaps in the existing framework, which, if addressed, would help to more clearly guide payment system development towards more transformational payment services. These gaps are discussed in more detail in the next section.

3.3. Key Regulatory gaps and market barriers to payment system development

This section looks at the current gaps in the exiting regulatory environment and market context that inhibit further development of the payment system ecosystem in Malawi. These gaps form the foundation of the issues that impact Malawi's move closer to an effective and efficient NPS that is sufficiently open to innovation and provides the necessary certainty to the market to encourage investment.

3.3.1. Regulatory Gaps

Currently there is no specific law governing the operations of the NPS in Malawi. The RBM's payment system oversight role is based on its legal mandate as outlined in the RBM Act, 1989. The combination of its statutory responsibility for promoting a safe and sound payment system and the general supervisory power to collect statistical information enables RBM to perform a wide range of oversight tasks. Service-level agreements signed by various system participants' complement objectives of RBM's oversight activities.

The NPS Strategy 2009-2013 makes specific reference to the need for a clear legal framework via the Draft Payment Systems Bill, currently tabled in parliament for possible enactment mid 2012. The Draft Payments Systems Bill should take into account definitions of key terms and concepts, address the usage of new technologies, and clarify the types of institutions that can participate in the NPS. These issues are discussed in greater detail in the paragraphs below.

No definition of e-money (or stored value). The Mobile Payment Guidelines discussed previously make specific reference to use electronic money (e-money) for mobile payment schemes although there is no definition of e-money in the document itself or the draft Payment Systems Bill. This limits the ability of the RBM to define the conditions in which payment service providers issue electronic value in exchange for cash.

In correlation with this is the absence of a definition of "stored value". The Mobile Payment Guidelines reference "cash-in" but does not define the term or clarify how cashed-in funds must be accounted for, similar to the circumstance of e-money. Defining stored value would allow the RBM to specify how financial institutions manage customer funds when customer accounts are not linked directly to a prudentially regulated deposit account. Prudentially regulated institutions are authorized to take deposits due to the protections required by law to ensure liabilities are met on demand. These protections would be too onerous for the risk posed by stored value accounts but there remains a need for a proportionate regulatory framework. This is because stored value commonly occupies a space between payments and deposit taking¹⁷, allowing customers to redeem electronic funds at full value, which therefore requires an appropriate level of protections for the funds themselves from being put at unnecessary risk by financial institutions. Table 2 explains the difference between payments, electronic store of value and deposits:

¹⁷ A payment is often limited to an exchange of funds occurring within a predetermined time frame, for example the exchange of funds must be complete within three days (T-3). Deposits on the other hand are not "time bound", therefore requiring a robust framework of rules stipulating how funds must be protected in order for them to be redeemed at full value. Regulatory frameworks for payments often focus more closely on the ability of the *system* to manage transactions safely and efficiently, while regulation of deposits focus on the ability of *institutions* to manage funds safely on behalf of the customer.

Table 3: Spectrum of treatment of consumer funds

	Payment	Electronic store of value	Deposit
Definition	Transfer between two parties; Time restricted (e.g. within T+3)	Special type of repayable funds with <i>transaction focus</i>	“Repayable funds”
Who can accept?	Payment Service Providers	E-Money Institutions; Credit Institutions	Only Banks & Credit Institutions
Prudential requirements	Low	Medium (e.g. held in trust account)	High
Deposit insurance	NA	No	Yes

In Malawi, non-bank financial institutions (such as MNOs) are instructed to use a trust account as means of protecting customer funds. This requirement aligns well with the example of *electronic stored value* noted in the table above. However, the existing regulatory guidelines do not specify the nature of funds held in such a trust account, other than implying that the funds in question are not deposits due to their exemption from prudential rules. Defining e-money and stored value would provide more clarity as to how non-bank financial institutions are expected to treat funds held in trust. For example, e-money would operate as a type of payment instrument, providing a medium in which funds are *issued* using electronic value. Stored value is the underlying store of funds that the electronic value is held against. A customer would use an e-money instrument (e.g. card, mobile, or internet) to transact using funds drawn from (or deposited into) a stored value account. This position has been taken by regulators in Kenya¹⁸ and the Philippines¹⁹, who have led the field in pursuing proportionate regulations for mobile based financial services.

Risk of un-level playing field for use of agents by banks and non-banks . At the moment agents are only authorized for mobile payment providers, although draft agent regulations for banks are likely to be passed in 2012. Despite lack of regulation for banks, approval has been granted for some to operate agency banking on case-by-case basis²⁰.

Although both regulatory frameworks are targeted at the same customer type (unbanked, poor, rural), different rules are applied to banks and non-banks, as demonstrated previously in Table 2. For example, while non-bank agents are allowed to open mobile payment accounts that are immediately active, banks agents are not allowed to open accounts of any kind. Such a circumstance may hinder banks from rapidly acquiring new customers and deploying new products and services to drive the necessary volume of transactions to sustain the business model. An additional example applies to the profile of the agent who,

¹⁸ <http://www.centralbank.go.ke/downloads/nps/Electronic%20Retail%20and%20E-regulations.pdf>

¹⁹ See page 5 of http://www.cgap.org/gm/document-1.9.45715/FN_63_Rev.pdf

²⁰ Currently MSB and OIBM have been given approval and are operating.

under the Draft Bank Agent Guidelines, must have conducted commercial activity for 18 months prior to operating as bank agents. The Mobile Payment Guidelines requires no such limitation and as such broadens that network of agents who may be utilized under the payment scheme.

Considering that agents are a critical component of national wide payment network, the current imbalance between the two frameworks risks undermining the spirit of the regulatory strategy (i.e. to extend services beyond brick and mortar branch network) by creating a framework for bank agents that is not *proportionate* to the risk associated with the agents offering cash-in/cash-out services to low income clients. A fully interoperable payment network that allows customers to pay across different systems and institutions is dependent upon all types of financial institutions to participate in the payment system under similar rules and circumstances.

Framework for non-bank payment service providers (PSPs) to drive innovation is dependent on Draft Payment Systems Bill. It is uncertain whether the absence of non-bank PSP's in Malawi is because of the nature of the regulatory framework or insufficient market demand (Other than Airtel and TNM, there is little evidence of non-bank PSP's seeking permission to operate in Malawi). Addressing this gap may not be a high priority given the activity in the market by banks seeking mobile banking solutions (discussed in the following section). However, as the market matures, non-bank PSP's may serve a purpose in (i) supporting agent networks and the extension of services beyond bank branch networks, and (ii) diversifying the product offering beyond mobile to cards and other technologies. Examples of similar PSP services can be found in e-money issuers in the EU and providers in South Africa (MobiKash) and Zambia (CelPay). Therefore it is imperative that the Draft Payment Systems Bill take these factors into account to provide a sufficient level of legal certainty to enable further market development.

3.3.2. Market Barriers

Infrastructure may be a limiting factor. A lack of infrastructure for efficient cash distribution in the rural and semi-rural areas is inhibiting expansion of payment services. The low penetration of bank branches implies that it will be difficult to support cash-based distribution services. This problem has already been faced by MPC's FastCash money transfer product where remote outlets do not conduct enough cash based business to have sufficient liquidity to meet the demands of FastCash payment recipients.

Forex poses a challenge for the private sector. Current policies on foreign exchange (forex) may be distracting from potential innovation and investment in cross border remittance products and design. However, it is likely that this is due to business constraints rather than regulatory obstacles. The current regulatory framework in Malawi does not limit the amount of forex that can be sent or received by individual account holders. However, interviews with several banks revealed that they have chosen to cap the total value of outgoing remittances per customer to USD \$100 per day. Some banks have also limited the number of customers sending external remittances (in some cases as few as 10 customers per day). It is unclear precisely why individual banks in Malawi have imposed these limitations when there does not appear to be regulatory constraints. It is important to reiterate that this is only the case for *outgoing remittances*. There are no limitations, regulatory or otherwise, on *incoming remittances*, and interviews with banks noted that they welcomed incoming remittances to shore up their forex accounts.

Mobile payments are only transformational if deployed outside of urban centers. Nearly every bank in Malawi has introduced card-based products to access (mainly urban) POS/ATM services. However only bank account holders have access to cards, which leaves 80% of the population without the benefit of electronic payment instruments. The mobile solution offered by Airtel may be the best opportunity to cost effectively access the rural population.

Mobile money has potential but must address liquidity management. Airtel has already sought out partnerships with banks to offer additive services to banked customers, specifically targeting customers without bank accounts. However, the key obstacle will be managing liquidity at the agent locations, as noted previously. TNM has not yet launched an agent network as part of its mobile money plans, but will also likely confront the liquidity issue as they seek to expand their product network in the future. Airtel's mobile money pilot used over 1500 agents, but it is unlikely that the largely urban centric pilot has provided enough experience to tackle the considerable task of extending liquidity services to agents in the rural areas of Malawi. MPC has already identified this problem at post office outlets and it is likely that Airtel will face similar challenges.

Interconnectivity in the banking sector will be primarily additive. As noted previously, there appears to be a willingness amongst the banks to invest in a national switch to facilitate an interoperable retail payment network. If this does come to fruition then Malawi may see a great deal of progress as customers have the choice to pay across networks. Given the size of the market this may rationalize the pricing of payment services through competition amongst banks and possibly expand the number of services available to customers. However, it is important to note that initially interoperability will be an additive service, benefiting mainly existing customers. If institutions such as MSB, MPC and OIBM resolve the agent network issue, then there is potential for an accessible, countrywide interoperable payment network. Until then, services will likely be limited to ATM, POS and branch services, which at the moment are restricted to urban and peri-urban locales.

4. CONSUMER PERSPECTIVE

4.1. Research approach

To understand the consumer perspective on payment systems in Malawi, BFA and IKI carried out six focus group discussions from 13-21 September 2011. We held three focus group discussions in Central Region including Lilongwe, and three focus group discussions in Southern Regions including Mangochi town and rural areas. Profiles targeted for these discussions included Malawians sending money, international remittance recipients, cash transfer recipients, and banked clients. Participants were selected using random sampling at the location, or with the assistance of local district councilors or traditional authorities. More information on the location of the focus groups and characteristics of participants are given in Annex 2.

4.2. Getting money into the house: How are people paid?

Income patterns

Cash continues to be the main medium through which the Malawians who participated in our focus groups receive income. Running a small business, working for others, often in agriculture and on an irregular, informal basis, or receiving remittances were the most common sources of income among focus group respondents. Whereas small business income is often high frequency, low value, remittances are less frequent but come in larger values. During this research, we did not encounter any examples of the government or NGOs using assistance or transfer payments as a means to bring access to formal payment systems to excluded populations.

Outside the cities, poorer Malawian focus group respondents reported that they patch together income from farming, selling handcrafted goods, such as clay pots and woven baskets, occasional remittances and working in *ganyu*, or piece-rate labor, in order to be able to cover their expenses. In agricultural areas, *ganyu* is

usually only available for three-four months at the end of the rainy season. As an example, in Duke village, people reportedly earn MK 2,000 (US\$ 12) for each acre of land prepared for planting.

Getting paid

Salaried employees working for larger businesses or the government may receive payment through direct deposit into a bank account. This was the case for teachers, nurses and public sector employees who we met. These individuals usually have a choice between two or three banks when setting up their direct deposit account. While in other countries we heard frequently that salaried employees withdraw their entire salary at once, this practice did not seem as common among the people we met in Malawi.

Some people operating small businesses reported that they sell goods on credit, accepting payment after the customer takes the good, as this permits them to charge a higher price, and earn additional income. For example, if a client buys an item worth 500 Kwacha (MK) (US\$ 2.98) on credit in the market in Mangochi early in the month, and at the end of the month he or she will owe MK 1,000 (US\$ 5.97), twice the original price. Trading in goods (bartering) was not common among the people we spoke with, but credit was.

Respondent: *"Selling on credit is fast money for us businesswomen. We make high profits when we sell items on credit because we charge a higher amount for goods purchased on credit than cash."* - Mangochi

Although late repayment is a problem for those offering goods on credit, some vendors overcome the challenge by turning to the authorities for help to recover their money. In Mangochi, for example, vendors told us that they have involved the police when clients refuse to pay, and that the police were helpful in forcing these truant clients to pay.

4.3. Transaction patterns: How do people pay?

Expenditure patterns

The expenditures that respondents cited as most important in their household budget included groceries to feed large families, uniforms and books for primary school-aged children and school fees for secondary school-aged children, medical expenses and funerals. We heard that tithing in the predominately Christian areas and religious ceremonies, such as special food during Ramadan in predominately Muslim areas, also are important expenses for Malawians. People did not mention transport costs to be as severe a financial burden as we heard from respondents in other countries, perhaps because of development around trading centers and a more dense population in Malawi.

Making payments

As is the case with receiving payments, focus group respondents largely pay for goods in cash. People who have regular jobs or receive remittances from the city or abroad (in our sample respondents received remittances exclusively from South Africa) are able to buy goods such as groceries and clothing on credit, paying at the end of the week or month, or when they can. Others with less regular income told us that they do not have the possibility to take essential goods on credit.

Some banked respondents we spoke with have ATM cards, and a small fraction of these people transact at POS devices. Among respondents with bank accounts, ATM services are valued for being fast and for offering additional services, such as checking your balance, paying certain bills and buying airtime. Even those with

access to ATM services still spend a lot of time performing financial operations. As we heard from one of the few banked respondents we met in M'Baluku:

Moderator: *When you go to the bank, how long does it take for you to be served?*

Respondent: *When I go in at 8:00 am I wait until at least 10:00 am.*

Moderator: *What about when you go to the ATM?*

Respondent: *It takes me about 30 minutes." –M'Baluku*

People also frequently mentioned that ATMS are unreliable.

Respondent: *Most of the time the ATM system has network problems, and one can wait almost the whole day to access the service. If you miss withdrawing on Friday you will go without money the whole weekend!" - Mangochi*

Respondents in Lilongwe mentioned that only a few retail outlets have POS capability, naming the bigger supermarkets like Shoprite and Game as places where you can pay with a POS. In Mangochi, respondents offered a different perspective on why people do not pay with POS.

Respondent: *Those kind of service exist, but most people are scared to use them or they don't trust them. It is also expensive to pay with a card."*

Respondent: *"I don't agree. Card payment services are rare. In all of Mangochi, the only two machines are in Peoples or Metro [supermarkets]." -Mangochi*

Some people also reported the perception that ATM cards are only for use in the cash machine, and cannot be used to pay at POS. Indeed, this may be the case for some cards offered in the Malawian market.

Another concern among respondents is the perception that one needs to have high account balances to pay with a card. When exploring this with the urban group of remittance receivers in Mangochi, these women reported that they would need to have a balance of about MK 10,000 (US\$ 60) in their account every month to "have enough money" to pay with a card in a shop. One woman said she would only feel comfortable paying with a card if she had MK 50,000 (US\$ 299) in her account.

4.4. Person-to-person transfers: Remittance payment systems

Remittances are an important source of income for many Malawians. As in other countries in the region, having a relative who is sending money from South Africa or another more developed country can make a big difference for consumption smoothing, the possibility to invest in small business and agriculture, and coping with emergencies.

Figure 7: Reported advantages and disadvantages of FastCash

<i>FAST CASH Malawi Post</i>	
<p>Advantages</p> <ul style="list-style-type: none"> • Most respondent said the service is secure • Low cost compared to banks • Reaches out to the poor who do not have bank accounts • More accessible than commercial banks • Fast 	<p>Disadvantages</p> <ul style="list-style-type: none"> • Rural post offices may not have cash to pay out until they sell goods • Long wait times and poor service by the post office staff • Remote areas do not have the fast cash service, for example, in Lisale in Nkhata-bay people have to pay MK300 in transport to collect money • The identity numbers assigned to the transaction made by the sender are sometimes mixed up by the post office personnel • Poor security in the post office: the guards sometimes ask them for money to facilitate service or to get the required forms

Informal channels, which are often costly, seem to dominate the remittance market in Malawi, especially for international remittances. The remittance tools that people mentioned most frequently included FastCash and minibus drivers for domestic remittances, and informal arrangements between Malawians in South Africa and the local area in Malawi for international remittances.

Figure 7 summarizes people’s perceptions of the FastCash service. Perceptions of the service are generally positive, but a number of last-mile challenges remain, mostly related to the fact that not all post offices offer FastCash withdrawals, and that smaller post offices experience cash flow problems:

Respondent: *“In the rural areas people travel long distances to collect money at a post office. My mother pays a lot for transport to get to a post office that offers this service, and then she has less to use for the purposes for which I sent the money.”*

Respondent: *“When I sent money to my relative he was told to wait until post office sells stamps and other service to get money which they can pay to him. My relative was then sent back to come back a few days later.” -Lilongwe*

Security is also a problem, both within the busy Lilongwe Post Office, which is reportedly plagued by loiterers trying to overhear numbers, and in the rural areas:

Respondent: *“People receiving payments in the rural areas may be ambushed if word gets out that they are receiving a payment. People can get crazy over money.” -Lilongwe*

Although FastCash is not without flaws, respondents reported that using drivers to send money is even less reliable. Respondents recounted their misadventures sending money with drivers:

Respondent: “I sent MK 4,000 (US\$ 24) through my friend who is a driver, he only delivered MK 2500 (US\$ 15) to my sister. When I asked him where the money was, he said that he had urgent expenses on the trip and that he would pay me back. But he never did.”

Respondent: “I sent MK 8,000 (US\$ 48) through a friend, who is a driver I had entrusted to give to my relative. He only delivered MK 2000 (US\$ 12) and said he spent MK 6,000 (US\$ 36) on beer.” - Lilongwe

As a respondent in M’Baluku put it:

Respondent: “There are a few truck drivers or transporters that are honest.”

For international remittances, respondents rely heavily on social networks and connections to Malawians who are in South Africa to send and receive money. Box 3 explains three slightly different ways of carrying out these remittances encountered in Southern Region.

Box 3: Sending money from South Africa to Malawi

- 1. Che Nyato.** “First my husband finds a Malawian living in South Africa who has been there for a long time and has an ID and a bank account. This person has a connection in Mangochi who has cash on hand, we call him *Che Nyato*, and there are many people doing this business in Mangochi. My husband deposits the money in the account of this Malawian and lets me know to find the *Che Nyato* in town. Most of the Malawians who use this method can’t have bank accounts in South Africa for fear of being deported so they rely others to be able to send money home.”
- 2. Account previously opened in South Africa.** “Money is also sent through people who used to live in South Africa and had bank accounts there, but are now back in Malawi. They have the sender deposit money into their account, and once the deposit has been confirmed, they pay us, subject to a charge and the exchange rate of the day. Those engaged in this business charge a commission of MK 7 for every Rand sent. For example if my husband send me Rand 1000 which is equivalent to 27000 MK, then he will take a commission of 7,000 MK. When I only get MK 20,000 (US\$ 120), I say this is theft!”
- 3. Cross boarder traders.** “Another option is for someone holding a bank account in South Africa who travels back and forth (mostly business people) to allow senders in South Africa to deposit money for their relatives in his account. Then this person has someone in Mangochi who pay out the relatives the equivalent of what he received in SA. The money deposited in South Africa is used to buy goods, which are then imported to Malawi. When this person comes to Malawi, he pays back his associate or squares the account.”

-Women receiving remittances, Mangochi Town

Emigrants in South Africa also send durable goods that are more affordable and available in South Africa to their family members in our sample. Many focus group respondents had experienced losses with this system, such as this woman in M’Baluku:

Respondent: “Last year my goods were stolen: three travelers bags, two bicycles, three cell phones, and one bale of blankets, 14 buckets... all of the items were stolen by the transporter! I never got anything, and the transporter has since disappeared, and cannot be found.” -M’Baluku.

Another woman in Mangochi described how her son once did a transfer from a South African bank to her

Malawian bank account. Although her son sent the equivalent of MK 20,000 (US\$ 120), because of the fees and the exchange rate, she was left with only MK 14,000 (US\$ 84). Now they have switched to using MoneyGram, which she likes because she is not the one who pays, and she says the service feels very secure.

4.5. Government-to-person and Donor-to-Person: Social assistance payments

The Malawi government offers unconditional cash transfers for the chronically poor. Malawi refers to Cash Transfers as unconditional since households don't necessarily have to send children to school in order to receive cash transfers, but they are encouraged to send children to school. The households that send children to school are provided with an incentive in the form of a bonus of MK 200 (US\$ 1.20) per primary school child and MK 400 (US\$ 2.40) per secondary school child.

We organized a focus group discussion with recipients of the unconditional cash transfer in Mase, Southern Region. From this group, it appears that the transfer program is effective in targeting the ultra-poor, implying it would be very unlikely for these recipients to have access to and familiarity with bank accounts. Respondents in this group use grant money to buy the absolute essentials: food, blankets and medicine. There is more interest in raising livestock to gain extra income or in case of an emergency than in banks. This

very poor segment is probably not the right target for expanding payment systems beyond cash at this time.

Box 4: The costs of collecting work-fare payments

- **Beneficiaries experience severe delays and uncertainty in their payments** for rehabilitating rural roads, organized by the European Union.
- The group operates as a “club” and three people, the foreman, treasurer, and the chairperson all need to be present to collect the payment.
- They each pay **MK 700 roundtrip, for a total of MK 2,100** (US\$ 12.60) to travel to the bank in Lilongwe and spend the whole day making the trip.
- Because they run out of money at the time they expect to be paid, **the group borrows MK 1000 (US\$ 6) at 50% interest** to pay for transport for the foreman to travel to the bank and see if the money is there.

Respondent: *“The chairperson goes to MBS bank after 20 days following the submission of the foreman’s report, to check if the money is in the account. If he finds that the money is not there, he returns home and goes back in a few days, continuing until the money has been deposited in the account. The chairperson has got no way of knowing that the money has been deposited. The going back and forth is a main concern to us.” - Duke*

We also spoke with a group of people in Central Region who benefited from a European Union workfare program called the Income Generating Public Works Programme. Each respondent works on 1 km of a rural feeder road stretching to a total of 8 km to ensure that it is maintained and passable. A foreman (also part of the group) checks on their work and submits a report to the Lilongwe District Council, which manages the project. Beneficiaries are paid based on how much work they have completed, and the program is designed so that they should be paid in cash once every month. Box 4 explains the high costs they endure to get paid.

4.6. Attitudes toward financial services and electronic and innovative payments

In Area 25, Lilongwe, we selected focus group respondents from a long line outside the bank. People had been waiting since 9:00, 10:00, and 11:00 am, when they joined the discussion

around 1:30 pm. Malawians spend many hours interacting with financial services, and this experience may understandably discourage scaling adoption of existing payment products and adopting new ones.

More sophisticated customers reported that they would like to see an expansion of POS payment possibilities. Their responses show a good understanding of how card payments work and what the efficiency gains to be had are:

Moderator: *If OIBM would put a visa, MasterCard, or Malswitch on the card and you could pay in a store using the same card, would you like to?*

Respondent: *“Yes, because it’s modern.”*

Respondent: *“Yes, because you do not need to go to the bank to get your money. It would be convenient not to carry cash or to go to the bank to withdraw money and waste time queuing.”*

Respondent: *“You would not need to go into town to get to the bank and wasting transport money.” - Lilongwe*

Airtel Money

Many respondents we met in rural areas did not have their own cell phone. Even if they did have a cell phone, many did not know about Airtel’s new Airtel Money product. In the cities people had seen this service advertised, but had not been provided with complete information.

Respondent: *“I have seen the option in my phone but I have not used it because I do not have enough information on how it works.” – Lilongwe man*

Respondent: *I have just seen some information on the Airtel Money option in my phone and tried to use it, but I received a message saying I did not have enough money on my phone. So I kept wondering, how much is enough money?” - Mangochi women*

When the idea of Airtel Money was explained during focus groups, people were generally interested. However, our research suggests that there may be challenges in introducing the product to remittance receivers, who may be illiterate and have to travel to charge their cell phones, for example.

Respondent *“This method is good, but most of us here do not know how to read the message. If the information were transferred by voice and not by SMS, it would be a better option.”*

Respondent: *“I would start using the service by giving my phone to someone who can read it out for me. Even now we ask someone who can read to read the message for us if we receive messages on our phone.” –M’Baluku*

A similar lack of clarity surrounded OIBM’s mobile service, *Banki M’manja*, or “Bank in your hand”:

Moderator: *Have you used this service” banki M’manja “?*

Respondent: *No, I’m just seeing this poster now.*

Respondent: *“We do not know very well, we know the advert says you can transfer money but we do not have all the information,”*

Respondent: *“ I have not yet used the service, but I applied to use it last week and am told it takes two weeks to have it processed. I would like to use the service for checking balances, buying airtime.” -Lilongwe*

From the focus group discussions it does not seem that lack of client interest or trust will be a challenge for innovative payment systems. Rather, much ground remains to be covered in improving access and improving the service, reliability, and long wait times that currently characterize most financial interactions in Malawi.

4.7. Consumer priorities for payment system usage

The challenges around lack of accessibility and reliability, including spending hours or entire days to make a payment or carry out an operation at the bank, is an important barrier to financial inclusion and inclusive payment systems in Malawi.

Mobile banking vans

Nonetheless, through this research on the client perspective we heard good reviews and high demand for a new service: vehicular banking, locally called “mobile banks”. Banking services offered by vans that come to rural areas is currently being rolled out by two banks. In Lilongwe we heard enthusiastic reviews of the service:

***Respondent:** “I use the bank van when I am in the rural area. This service is nice, especially for us who are employed on seasonal basis. We are able to access the bank in my home village where the van comes once a week on Thursdays. Now I do not need to travel two hours to the bank branch.” - Lilongwe*

From illiterate women in M’Baluku to road workers in Duke, people are eager to have the vans come to their community once a week:

***Respondent:** Our group of road workers would like to receive their payment through the NBS mobile van program. We want to use the NBS van because it is reliable and comes to Nkhoma (the nearest trading center) every Friday.”- Duke*

And people also asked for closer access to banks.

***Respondent:** “I have something else to add. We would love it if mobile bank van services were extended to our community so that we would have closer access to banks... You can already see that in this group only two people here have a bank account. Why? Because we are not able to go there and access the services. But if the bank would come to us, then it would be easy.” – M’Baluku*

FastCash users also mentioned that the vans combined with postal services would be a good option:

***Respondent:** “It would be great if the post office can introduce mobile vans that can transfer cash to remote agencies so that they would always have ready money to give out to the recipients when the money has been sent at the sender’s post office.” -Lilongwe*

Although the positive experiences and demand is encouraging, given Malawi’s ongoing fuel crisis at the time of research, the reliability of the vans is likely to be jeopardized, according to the OIBM Mangochi branch manager. But the demand for more proximate services suggests strong possibilities for take-up of agent and mobile (cell-phone) payment products, provided the products are appropriate and clearly defined.

4.8. Summary of demand side findings

Although six focus group discussions is a small sample, we heard clearly among all groups that cash is the main payment mechanism in Malawi. FastCash presents a popular option for domestic payments, but

respondents feel the service could improve its reach to more rural branches, and improve liquidity problems at post offices.

Malawians outside the cities are keen to access financial services in closer proximity to where they live and work. Those who can afford mobile phones are interested in mobile banking options. The effort of two large banks to reach these populations by vehicular banks is commendable. Clients and potential clients prioritize regular, predictable service from the vans. If they can achieve this, this service can have a big impact, and suggests latent demand for agent and mobile-phone financial services.

POS services are extremely limited in the types of stores frequented by the “average” Malawian wage earner, who is likely most concerned with uniforms, books, and other school expenses, small grocery purchases, and affording funerals and religious celebrations or donations. In all six discussions, a total of about five places that accept card payments were named. Services offered by the financial sector, especially in terms of wait times and reliability of network systems, stand to be improved if they are to better serve the population.

5. THEMATIC ANALYSIS OF NPS DEVELOPMENT

This section takes the context of the current environment in Malawi and applies a thematic lens to the issues that enable the development of transformative payment services. The specific categories were chosen because of their respective role in facilitating the development of transformative services, based on evidence highlighted in this report and external research²¹ regarding the use of new technologies to extend financial services. The thematic approach asks key questions and allows policymakers to determine a holistic course of action, avoiding the risk of a lopsided approach to enabling payment system development. From this perspective three main thematic categories emerge to frame the context in Malawi:

- 1) Government Policy.** The first of these thematic clusters relates to the development of retail payment systems by the public sector. This includes the issuance and development of policy and regulations as well as the role governmental authorities play in encouraging the market to develop affordable and accessible products and services.
- 2) Market Barriers.** The second cluster treats the main barriers to access. This theme pays particular attention to the conditions necessary to extend distribution networks beyond urban centers as well as the state of the payment infrastructure to support a broad range of products across multiple distribution channels.
- 3) Consumer Perspectives.** Our third thematic cluster examines the behavioral aspects of payment services usage and addresses how consumers prioritize the services available to them. Generally, focus group discussions revolved around the availability, ease of access, affordability, and reliability of payment services.

Table 2 outlines the framing categories that are used to analyze each of the three themes:

²¹ “The Enabling Environment for Mobile Banking in Africa” (Porteous 2006)

“Use of Agents in Branchless Banking for the Poor: Rewards, Risks, and Regulation” (Lyman, Ivatury, and Staschen 2006)


“Transformational Potential of Mobile Transactions” (Vodafone Group Plc. 2007)

Table 2: Thematic Categories

Theme	Framing questions
Government Policy Measures	1. Is there a holistic NPS strategy that identifies regulatory priorities?
	2. Coordination strategy with other regulatory bodies: does the NPS development impact other areas of regulation (e.g. banking supervision, telecoms)
	3. Position on use of Stored Value and E-Money: is there “space” for institutions to develop stored value instruments as a solution to low threshold accounts?
	4. NPS participation: who can play in the NPS? 3rd party providers? Settlement? Clearing? Networks?
	5. Exchange control rules: under what conditions do FX enter/exit the market? How does this impact the availability and accessibility of services?
	6. Level playing field for MNOs and banks: is the market environment open to all players regardless of nature, size, scale and complexity?
	7. How involved is the regulator in promoting interconnection amongst financial institutions?
Market Access Barriers	8. What role does competition play in driving innovations, product design and pricing?
	9. Business rules/incentives for interconnection: how prepared is the market to organize and agree on an interconnected retail payment system across all e-channels?
	10. Flexible account opening: are there barriers to opening of low value accounts?
	11. Agent network development: is there a framework to support the deployment of a broad network of cash merchants and agents?
	12. Market for third party providers: are third party providers enabled to capitalize on the opportunities in the market?
	13. Cost of expanding distribution network: is there a perceived return on investment in expansion of distribution channels?
Consumer Perspectives	14. Perceptions of formal financial institutions
	15. Attitudes toward electronic payments
	16. Importance of payment channels
	17. Use and nature of informal tools

A note on format: Tables 4 and 5 below have been formatted to explain at a glance how the existing conditions in Malawi compare against these enabling criteria. Table 4 contains the first two categories, namely government policy and market barriers, whereas Table 5 considers the consumer perspectives. Each issue is coded with a symbol indicating whether each issue is characterized in terms of *barriers to development*, *some limitations*, or *a favorable environment* defined in Table 3.

Table 3: Explanation of symbols

	BARRIERS TO DEVELOPMENT	There are significant blockages that limit the development of retail payment services. From the consumer perspective, respondents report that barriers make it impossible to use a service, or the tool is not working for them.
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


	<p>SOME LIMITATIONS</p>	<p>Although some progress has been made and favorable conditions may be developing, key limiting factors may be hindering progress. From the consumer perspective, payment systems are working reasonably well in this area, but full potential is not met.</p>
	<p>FAVORABLE ENVIRONMENT</p>	<p>Although further improvements might be possible, generally positive conditions for improved retail payment systems and access are in place. For clients, products are meeting needs.</p>

Table 4: Key framing questions

4.1 Government Policy	
What measures is the government taking to develop retail payment services?	
1. Is there a holistic NPS strategy that identifies regulatory priorities?	
<p>As noted previously, the government of Malawi has developed a strategy for NPS development, which dovetails with the National Financial Inclusion strategy. Malawi has taken very specific measures to address the low level of financial access by committing to improve the payment system infrastructure through regulatory reform and private sector engagement.</p> <p>However, the absence of a National Payment System Act is still a limiting factor in providing needed clarity to the market. Once the NPS Act is passed, the National Payment Strategy will have a stronger foundation from which to promote change in Malawi.</p>	
2. Coordination strategy with other regulatory bodies: does the NPS development impact other areas of regulation (e.g. banking supervision, telecoms)	
<p>The most notable example of internal coordination between regulatory entities is the E-Banking Task Force, consisting of both the NPS and Bank Supervision Department from the RBM. This example is noteworthy because the collaboration between departments resulted in a concreted outcome in the form the Mobile Payment Guidelines.</p> <p>Regarding inter-institutional coordination, the Ministry of Finance and RBM have established a clear strategy for payment system development, anchored by the national financial inclusion strategy. It remains to be seen what the fruits of this relationship will bear in terms of concrete outcomes for regulatory clarity or impact on market activity.</p>	
3. Position on use of Stored Value and E-Money: is there “space” for institutions to develop stored value instruments as a solution to low threshold accounts?	
<p>There is no regulatory clarity around the use of e-money or stored value in Malawi. It is difficult to determine precisely what the impact of this is given that the RBM has focused initially on the promotion of mobile based solutions offered by MNOs. The research did not discover any firms exploring a “third party solution” in working in tandem with banks and MNOs, and therefore we cannot presuppose that the absence of regulation is inhibiting innovation or entrance into the market. However, given the low levels of financial access and high population density, there may be opportunities for innovative stored value business models to extend services (niche and otherwise) to the unbanked. Therefore there may be an incentive to explore the development of a position on e-money and stored value to, at minimum, provide the “space” for innovative models to emerge where there is demand.</p>	

<p>4. NPS participation: who can play in the NPS? 3rd party providers? Settlement? Clearing? Networks?</p>	
<p>Under the current legal framework, only financial institutions (banks and MFIs) can participate in the national payment system. All other institutions are considered on a case-by-case basis.</p> <p>The draft National Payment Systems Bill takes a broader approach and does not limit NPS participation to financial institutions.. However the Bill does not provide further details regarding third party payment services providers (such as e-money issuers) and therefore no official position on how payments services provision (settlement, clearing, network access) can be disaggregated from the traditional payment services providers (i.e. banks). While the Draft Bill provides an opportunity to introduce definitions and concepts that may enable the safe introduction of new payment services providers, the current language in the document does not extend into the realm of defining issues such electronic money or stored value.</p>	
<p>5. Exchange control rules: under what conditions do FX enter/exit the market? How does this impact the availability and accessibility of services?</p>	
<p>The current framework for Foreign Exchange does not stipulate limits for incoming foreign currency, nor does it mandate daily limits for sending or receiving international remittances. The foreign currency challenges currently underway in Malawi are likely to be related to macroeconomic issues that are beyond the scope of this study.</p> <p>However, in the context of payment services, it may be the case that due to the macro economic issues, some banks have determined it necessary to impose specific caps on retail forex transactions, limiting transactions to specific volume and value of transactions per day. This would support the anecdotal evidence from consumers that they are limited to USD \$100 per transaction (incoming) and that only a certain number of customers are served at the branch level per day (sometimes as low as 10 customers per day).</p> <p><i>Respondents reported a large black market premium for foreign exchange. Exchanging international currency in the street yields a more favorable kwacha exchange rate than the official exchange rates.</i></p>	
<p>6. Level playing field for MNOs and banks: is the market environment open to all players regardless of nature, size, scale and complexity?</p>	
<p>Until Draft Payment System Bill clarifies rules for payment service providers (such as e-money issuers), the only non-bank payment system providers in Malawi are MNOs. The Mobile Payment Guidelines allow MNOs to use agent networks and issue e-money, while use of agents by all banks is dependent on the outcome of the Draft Agent Banking Guidelines, likely to be passed in 2012.</p> <p>Therefore a significant risk is that the current regulatory environment will propagate an unlevel playing field where MNO's</p>	

<p>(specifically Airtel) have the authority to develop products and services (particularly distribution networks) without competitive pressure from other financial institutions. Particularly salient is the clear discrepancy between the agents under the Guidelines for Mobile Payments versus Agent Banking. If the Draft Guidelines on Agent Banking is released in its current form there will be a considerable difference between the frameworks for banks and non-banks, even though both frameworks are targeting the same low-risk customers. This difference will likely tilt the market in favor of non-banks (i.e. MNOs) whose respective regulations for agents are less onerous than those that apply to bank agents.</p>	
<p>7. How involved is the regulator in promoting interconnection amongst financial institutions?</p>	
<p>The RBM is actively promoting interconnection in Malawi. This has been demonstrated by their role in negotiating the terms for the development of a national switch that will be owned by the banking industry and connect all financial institutions to the national payment networks.</p> <p>The RBM has applied many of the lessons learned from the experience of MalSwitch to these negotiations, the most important of which is working with the industry to determine the appropriate conditions in which interconnection can occur.</p> <p>From the industry perspective, the conditions in which interconnection "made sense" were slow to develop. The market has matured since the introduction of MalSwitch in 2002 (via investment in infrastructure and product development) and the nature of competition among banks has evolved to the degree there is a perceived benefit to leveraging other networks.</p>	
<p>4.2 Market Barriers</p> <p>What are the main Access Barriers to payment services?</p>	
<p>8. What role does competition play in driving innovations, product design and pricing?</p>	
<p>The financial service market in Malawi is clearly segmented between (i) the largest banks (in terms of value) who compete to attract the limited population of more affluent Malawians with additive services and (ii) the smaller banks who are focused on attracting the large population of underserved (and poor) Malawians with transformational services.</p> <p>In this context there is little evidence of a dominant financial services provider who is inhibiting the development of new payment products in the market. Additionally this dynamic has benefited the lower segment of the market by forcing the banks to compete on products, pricing and services.</p> <p>However, the arrival of Airtel Money may create a situation where Airtel's high network coverage (>70%) creates a de facto monopoly</p>	

of access to the network. It is unclear whether such a situation will have an impact on the banks' ability to negotiate product terms for mobile based services which customers will find sufficiently affordable.

Low-income Malawians complain about congestion in the banks that reach down-market. Focus group respondents reported taking an entire day off from work when they need to go inside the bank branch.

9. Business rules/incentives for interconnection: how prepared is the market to organize and agree on an interconnected retail payment system across all e-channels?

While the banking sector has agreed to pursue the development of a national switch, the conditions in which this will occur remain unclear.

There are a few factors to take into account. Firstly, as of the time of this research, it was uncertain who would administer the national switch, although the RBM is actively promoting the use of MalSwitch (who have the most technical expertise) to manage the system. It is unclear how the use of MalSwitch might impact the interchange pricing between financial institutions and if this would be different from the interchange currently applied the MalSwitch smartcard system.

Secondly, there does not appear to be a clear sense of what impact mobile based services will have on the conditions around interconnection and how the respective institutions will develop rules around the use of available electronic channels (ATM, POS, and mobile).

Focus group respondents mentioned that sometimes when the ATMs are not working, bank staff blame the problem on MalSwitch and do not try to do anything to fix it themselves.





10. Flexible account opening: are there barriers to opening of low value accounts?

Account opening is a clear bottleneck in the distribution of services beyond existing financial services hubs.

There are no regulations in place yet that specifically address the use of tiered KYC rules to help facilitate the distribution of services. The Customer Due Diligence Guidelines alludes to a flexible approach to KYC requirements, however it is unclear to what degree the Guidelines are superseded by the Money Laundering Act, which does allow for a tiered approach to KYC. The KYC requirement outlined in the both the Mobile Payment Guidelines and Draft Guidelines on Agent Banking are tied to the Money Laundering Act, which does not provide a risk-base approach to KYC.

From the industry perspective, the absence of risk-based KYC rules potential increases the operational cost of opening accounts and reduces the volume of customers who may be eligible for services. This may disincentivise the banks from investing resources in



<p>network development and expanding services beyond urban centers.</p> <p><i>Focus group respondents mentioned that at some of the bigger banks that are reaching down-market, it is easy to open an account. Many people choose these banks because of the low minimum balance and 50 kwacha monthly fee. However, respondents mentioned that in other banks you need a lot of money to open an account, and the process can be time consuming.</i></p>	
<p>11. Agent network development: is there a framework to support the deployment of a broad network of cash merchants and agents?</p>	
<p>Agents are considered to be one of the key components to the effective extension of services beyond bank branches, based on global practice to date.</p> <p>The Mobile Payment System Guidelines is the only framework that specifies the provision of services via agent networks, although there are Draft Guidelines for Banking Agents in consideration. The current framework (including the Draft Guidelines should they be released) may be sufficient to roll out an initial agent network at the current stage of development, the market may be limited by the unlevel nature of the two frameworks as they apply to banks and non-banks.</p> <p><i>Focus group participants mentioned that they would like to see an expansion of vehicular banking, and seemed interested and amenable to using agents. One man in Mase said, "I would like to use the banking van, but then I see my money drive away and I worry. If there could be someone here in the village then I would know my money is safe." There is likely to be demand for agents. However, the lack of liquidity in some post office branches with the FastCash products provides a caution about selecting agents who can meet cash flow demands.</i></p>	
<p>12. Market for third party providers: are third party providers enabled to capitalize on the opportunities in the market?</p>	
<p>At the moment there are no third party payment service providers active in Malawi. It is unknown whether this is due to the absence of a demand for services or the absence of a regulatory framework for such providers (see the reference to the lack of e-money regulations previously).</p> <p>The financial services market in Malawi is very small, reflected by the low penetration rate of formal financial services and therefore it may be the case that there is limited opportunity for third party PSPs to offer additive services to banked customers. However this may change once a high proportion of the population is brought into formal financial services. Precedents in other markets show that third party PSPs often provide niche services that may relate to settlement, clearing or network provision, that can create a more cost effective operating environment for other stakeholders, such as banks and MNOs</p> <p><i>Some focus group respondents reported that cards are only to be used at the ATM and were not aware of the option to transact at a</i></p>	

POS device. Some consumer education would likely have to accompany the launch of a third-party product.

13. Cost of expanding distribution network: is there a perceived return on investment in expansion of distribution channels?

The greatest financial cost in the expansion of payment services is the investment in infrastructure to facilitate the distribution of cash to the far rural corners of Malawi. The main institutions in Malawi who appear willing to invest in the expansion of such services are the MNOs (specifically Airtel) and the banking sector already focused on the low-income segment of the market (e.g. OIBM, MSB and MPC).

The promotion of greater interconnectivity among financial institutions may contribute to the reduction of distribution costs and allow stakeholders to leverage each other's networks. The RBM may play a central role in ensuring the conditions around interconnection further support the willingness of these institutions to incur the cost of expanding services via all available channels, not just mobile.

People currently travel long distances to reach bank branches, and there is likely to be demand for financial services in rural areas. However, if fees are high it is difficult for poorer Malawians to use banks. Low incomes were most frequently mentioned as the reason for not having a bank account.



Table 5 discusses the impact of customer behaviors as they relate the usage of payment services in Malawi. We can frame this assessment through a conversation with banked Malawians in Area 25, Lilongwe, where accessibility, affordability, reliability, and availability were all mentioned as reasons for opening a bank account.

Moderator: *What motivated you to open a bank account?*

Respondent: *“Because opening a bank account was **affordable**: the minimum book balance was low, between MK 1000 to MK 1300 (US\$ 6- 7.78)*

Respondent: *“Because opening of the account was **easy and secure** and you are free to withdraw any amount whether you leave something or you take out everything.”*

Respondent: *I wanted to save money and also to get an opportunity of accessing loans.*





Respondent: *Because the bank was **close to where I live**.*













Respondent: *Because keeping money at home is not a good thing since it can be stolen, so the bank can keep the money **safely** and I can access it anytime.*

Table 5 adds an additional lens to the analysis of the behavioral aspects of payment services usage, explaining how consumers prioritize different components of available services based on the results of the focus group discussions. The table compares the themes across four dimensions (*Availability, Accessibility, Affordability, Reliability*) that directly influence consumer perception of the value of payment products. The result of this approach is a more complete sense of how the consumer engages with payment services and whether the current environment adequately meets the demand for services. The four dimensions are defined here:

- **Availability** – existence of payment services within a reasonable distance. This could also include the existence of agents, mobile banking products, or other services.
- **Accessibility**- extent of transaction costs, travelling and wait times, requirements for account opening, and inclusiveness of informal instruments.
- **Affordability**- in money terms, including transaction costs.
- **Reliability**- Frequency with which services fail to deliver their supposed purpose, including delays and financial losses.

Table 5: Availability, Accessibility, Affordability, and Reliability and Consumer Behavior

5.1 Consumer Perspectives				
How does Consumer Behavior impact use of payment services?				
<p>14. Perception of formal financial institutions- Do customers trust the banks and telecom providers?</p>	<p>Malawians did not report distrust of banks or telecoms, but they do distrust drivers who transport money and good informally. People generally view the banks as overcrowded and offering poor service, but they are an institution to be trusted. Poorer, more rural people are unfamiliar with banks and the services they offer, and some cannot read SMS. This suggested that careful introduction of products and supporting people test payment systems with small amounts will be important.</p> <p>Some banks have made an effort to be more accessible to the poor, but many people reported having to travel far, even taking a day off of work to get to the bank, giving accessibility a stop sign. People did not have confidence in the ATM network or computerized aspect of FastCash, characterizing reliability with the red “barriers”.</p> <p>Although costs vary, focus group participants complemented the low minimum balance accounts offered in Malawi, giving the favorable environment in terms of affordability. Even people who said they were too poor to have a bank account recognized that the banks must charge something.</p>			
	<i>Availability</i>	<i>Accessibility</i>	<i>Affordability</i>	<i>Reliability</i>
				
<p>15. Attitude towards electronic payments- What are customers’ impressions and preferences around electronic payment methods?</p>	<p>People mentioned the desire for proximate financial services that would reduce wait and travel time. But they are unfamiliar with Airtel Money, Banki M’manja, and other products, which seem to be unavailable, or at least not understandable, resulting in the red barriers sign for availability.</p> <p>However, it should be mentioned that new products are being launched and Airtel Money was very new at the time of research. There are some barriers to (i) affordability of electronic payments due to the lack of familiarity with new product pricing and (ii) accessibility due to the limited extension of electronic services beyond urban centers and FastCash outlets.</p> <p>Network problems with ATMs was cited frequently, giving the red barrier for reliability.</p>			

	<i>Availability</i>	<i>Accessibility</i>	<i>Affordability</i>	<i>Reliability</i>
				
<p>16. How are most frequently used payment systems performing? What are current behaviors and requests from customers in remittance, G2P, and B2P payments? Are the methods currently in use available, accessible, affordable, and reliable?</p>	<p>Cash is still the most pervasive payment method. Payments in cash are available, quick and convenient. The seemingly wide availability of informal transfer systems makes the environment favorable in terms of the availability and access of these services. Thus availability is a favorable environment in Malawi.</p> <p>Turning to the remittance payment systems used, some have very high implicit and explicit costs, while others within close social networks can be free or close to free, resulting in “some limitations” for accessibility. FastCash as formal alternative is accessible, and fairly reliable, but at 10% of the amount sent, costs are still high for the poor.</p> <p>There is a wide range in the reliability of payments systems used, from drivers and ATMs being unreliable, to FastCash and informal international remittance services that people say they can count on. Thus we assign a yield sign for reliability.</p>			
	<i>Availability</i>	<i>Accessibility</i>	<i>Affordability</i>	<i>Reliability</i>
				
<p>17. Informal tools- Which informal payment and financial instruments are working, and which are not?</p>	<p>Selling assets, including livestock, in the community in an emergency seems to work well, although some people are undercut on the price since they are desperate to sell. Savings groups in Malawi seem to only serve women, but people say they are helpful. Some banks and microfinance organizations are filling the gap in informal credit markets, which do not function well in Malawi. But access to these more formal kinds of credit is also risky, expensive and very short term.</p> <p>As mentioned, international informal remittance channels using bank accounts seem to work well, but are expensive, whereas the driver systems are unreliable.</p>			
	<i>Availability</i>	<i>Accessibility</i>	<i>Affordability</i>	<i>Reliability</i>
				
<p>Summary: Reliability is a big priority in Malawi. For those using financial services, we heard that they would like to be able to count on the ATM network, and to be able to better predict how long they will spend at the bank. During the stakeholder workshop mobile network connectivity and downtime were also mentioned as risk factors.</p>				

Informal transfer systems between South Africa and Malawi that rely on close social and professional ties were mentioned as a common channel for international remittances. People generally said these systems are reliable and convenient, but they are expensive. We heard that sending goods or money with bus drivers is highly unreliable. Many Malawians have a desire to invest in livestock that can be resold and used for household consumption. If inflation continues to increase and macroeconomic uncertainty persists, this preference may grow stronger, resulting in substitutions away from banks for those customers who may not have a need for a bank account due to poverty or insufficient level of economic activity.

Proximity/accessibility is another salient priority. Vehicular banking, agents, and mobile have huge potential to meet the demand for financial services that reach closer to home among many Malawians.

These themes reflect Malawi's current state of payment system development, based on the evidence presented earlier in this report. The tables highlight the importance of understanding the interplay between the supply and demand components of the market and particularly clarifying how customers evaluate the quality of products and services. The thematic approach was designed to hone in on the key issues that impact the development of transformation payment services. By focusing on the most salient issues, we can now look to prioritizing any subsequent interventions to assist in the development of a clear roadmap for market development.

6. WAY FORWARD

The findings of this study have demonstrated many of the progressive initiatives to address the low level of access to affordable payment services, driven by the public and private sector within Malawi. The ultimate objective of these initiatives (accordingly to the national strategies) is the development of a nationwide network of outlets that allows customers of all types to access services conveniently and affordably. The success of such a network is dependent on the participation of a variety of institution types, the use of new technologies, and deeper consumer awareness of new services. The feedback from a stakeholder workshop (held in Lilongwe on March 8th, 2012) reflects that this vision is shared not only by the RBM, but also banks and MNOs. This institutional “buy-in” is fundamental to achieving the common goal of greater financial inclusion in Malawi.

However, there remain a number of obstacles to development of payment services and networks in Malawi, as discussed in detail in Section 3.3 and 5 of this report. Therefore any subsequent effort to improve the policy framework for payment system development should be prioritized to (i) take advantage of existing market activity and (ii) provide essential regulatory clarity for future development of innovative market solutions. The following paragraphs outline a series of recommended policy and market priorities.

Priority 1: Distribution Networks

The foremost priority to consider is the support of new distribution networks to extend services beyond the urban centers. The activity in the market by the likes of Airtel, OIBM, MSB, and MPC to explore new distribution channels and business partnerships has created momentum that may provide opportunities for positive impact on the market within a relatively short timeframe. A critical element of this support is to level the playing field between banks and mobile network operators by matching the requirements under the Guidelines for Mobile Payments to those set out in the Draft Guidelines for Banking Agents. Demand-side research supports the utility of a focus on distribution networks as Malawian consumers noted the need to reduce the travel time to the bank, and subsequent wait time once there, as main priorities. Improving distribution channels could therefore have widespread benefits.

Priority 2: Payment Systems Law

Second to new distribution channel development, a comprehensive payments system framework has the potential to establish a strong foundation for a legal environment for electronic payment instruments, identifying who can participate in the payment system and under what conditions. The Draft National Payment System Bill already addresses some of the critical issues. However, as noted previously, there remains a need to more clearly identify the types of instruments and conditions that can be used in Malawi to take full advantage of new electronic technologies, such as mobile phones.

Priority 3: Payment System Interconnection

Following closely with the development of a payment system framework is the support of greater interconnection of new and existing payment channels, using the momentum created by the market

demand for a national switch and recent developments regarding the status of MalSwitch. In the demand-side research, respondents mentioned that they would be more interested in trying and using ATMs and POS technology if the systems were reliably online and seen to be functioning the majority of the time. Banks and mobile companies that succeed in improving network reliability are likely to be more successful with the lower end of the market.

Priority 4: Support financial capability training linked to roll out of new products

Some Malawians are interested in mobile and other new payment products, but they are not always confident about how to use these new tools. Efforts to build financial capability around a new product, such as mobile money, could help low-income Malawians test and trust these new products, perhaps increasing take-up, and empowering people to expand their payment toolkit at the same time.

Priority 5: Tiered KYC rules that facilitate immediate account activation

Risk-based rules on KYC requirements will set the stage for greater uptake of services by lowering the barrier to opening transaction accounts. Both banks and non-banks are dependent on encouraging customers to access new payment services to drive volume to a sustainable level. The first step in this process is account opening. Therefore a tiered KYC framework designed to allow new customers to *immediately* access services upon account opening is fundamental to the success of the system.

7. ANNEX 1: PEOPLE MET

Institution	Name	Position	Contact Details
RBM- National Payment System Dept	Fraser Mdwazika	Director, National Payment Systems	fmdwazika@rbm.mw
RBM- National Payment System Dept	Osky Sichinga	Manager, Policy and Projects	osichinga@rbm.mw
RBM- National Payment System Dept	Paxon Kuade	Payment Systems Analyst	pkaude@rbm.mw
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RBM- Banking Supervision Dept	Mr Fund Mzama	Chief Examiner Banks 1 & 2	fmzama@rbm.mw
RBM- Banking Supervision Dept	Mr Keta Mulwafu	Chief Examiner Banks 3 & 4	kmulwafu@rbm.mw
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RBM- Exchange Control	Dalitso Bonongwe	Principal Inspector & Authorized F.Ex Dealer	dbonongwe@rbm.mw
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EcoBank	Grace Mphepo	Head, Operations and Technology	gmphepo@ecobank.com
EcoBank	Ferdinand Kabalawoza	Head, Domestic Banking	fkabalawoza@ecobank.com
Bankers Association of Malawi	Mbongeni Dzinkambani	ECCH Operations Officer	mdzinkambani@bankers.mw
MalSwitch	Gladson Kuyeri	CEO	gkuyeri@malswitch.mw
Malawi Savings Bank	Cosmas Phiri	Treasury Manager	phiric@msb.mw

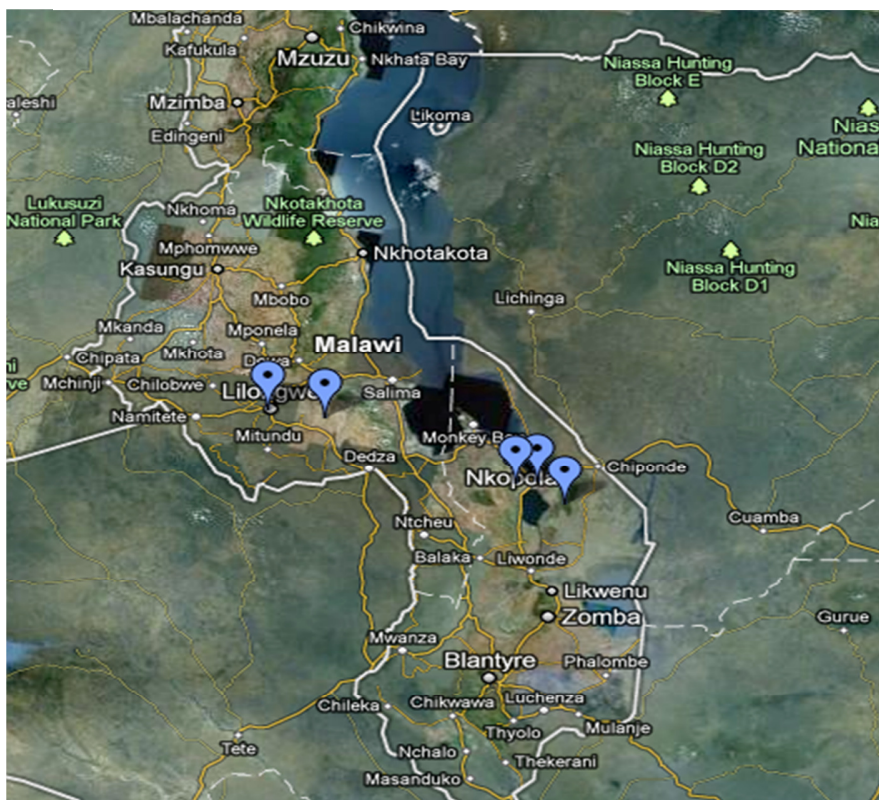
Malawi Savings Bank	Mr Remi Mussa	Int'l Payments and Financial Services Officer	mussar@msb.mw
National Bank	Austin N.D. Musyani	Head, Transactional Banking	amusyani@natbankmw.com
National Bank	Peter Khanganya	Transactional Banking Officer	
National Bank	Webster Kaunda	Operations Assistant (Customer Services)	
Malawi Post Corporation	Andrew Kumbatira	Postmaster General	akumbatira@malawiposts.com
Airtel	Andrew Santhe	Country Manager – Airtel Money	Andrew.Santhe@mw.airtel.com
Finance Ministry	Fletcher Chilumpha	Financial Inclusion in Malawi (FIMA) Program Manager & UNDP Attaché – Economic Affairs Division	Fletcher.chilumpha@undp.org
Finance Ministry	Boyd Hamela	Principal Economist	boydhamela@yahoo.com
Finance Ministry	Mphatso Mussa-Gama	Principal Economist	mmussagama@yahoo.co.uk

8. ANNEX 2: LOCATION AND PROFILE OF FOCUS GROUPS

Target population in focus groups

Focus Group Discussions, Malawi		
Site	Target group	Number banked
1. Lilongwe urban	FastCash postal transfer users	3/ 9
2. Duke rural	Workfare conditional transfer recipients	1/8
3. Mangochi urban	Remittance receivers	8/10
4. Baluku rural	Remittance receivers	1/10
5. Mase rural	Government unconditional transfer recipients	0/10
6. Lilongwe urban	OIBM Bank customers, Area 25	10/10

Location of Focus Groups, Malawi



Short description of focus groups

1. A group of nine people was randomly selected and recruited for this focus group discussion. These people had come to the post office to either send or receive money through the FastCash service offered by post office. FastCash is a P2P money service offered through select branches of the Malawi posts Cooperation. Senders complete a form and get a unique secret ID, which they then communicate to the receiver, who can collect the payment. Each member of the group had voluntarily accepted to participate in the group discussion. Most part of the discussion was centered at the FastCash service since all participants were FastCash users. The focus group discussion was held at Kiboko Hotel 15mtrs from the Lilongwe Post office.
2. The Focus Group Discussion was conducted in Duke Village, a rural area about 1.5 hours drive from Lilongwe. There is a trading center not far away called Nkhoma, but the community is still fairly isolated. The respondents in the FGD were all beneficiaries of a workfare program sponsored by the European Commission called Income Generating Public Works Programme. Each respondent works on 1 km of a rural feeder road stretching to a total of 8kms to ensure that it is maintained and passable. A foreman (also part of the group) checks on their work and submits a report to the Lilongwe District Council who is managing the project. They are paid a pro-rated rate for the work they have completed and they should be paid in cash once every month.
3. Mangochi is a district along the lake shore of Malawi, it attracts many tourists and as such has so many activities happening in the district. The participants in this focus group discussion were women who stay around Mangochi town. Most of the women had their spouses working in South Africa and sending them money.
4. The focus group discussion was conducted in M'baluku, a village about 10kms from Mangochi town in Mangochi. In this village, so many people, especially men, migrate to South Africa to seek employment. Most have left their spouses behind and other dependents to whom they send money and other needs. The participants, nine women and two men, reported that they receive remittances from their children and other relatives who work in South Africa
5. The focus group discussion took place in Mase, a small rural community about 40 km down small feeder roads from Mangochi. This group consisted of unconditional cash transfer recipients who were extremely poor. Individuals had been selected to receive the transfer through a participatory process with the community. Many were elderly and caring for their grandchildren who had been left orphans by AIDS or other hardships. A few members were disabled. A local government official delivered their transfer in person to the school in Mase every three months. They receive some warning of when the government will make the delivery.
6. The participants of the focus group discussion were OIBM customers who were picked at random at the area 25 satellite bank. Area 25 is classified as a high-density area. Outside this satellite bank there is a long line, with many people waiting angrily because they have been there for a long time. This is the only branch for the entire area, which represents a lot of people. The people were picked from a long queue on which most had been for at least two hours. They accepted to be part of the discussion only when told that they would be the next to be attended to by the bank personnel after the discussion.

9. ANNEX 3: COST OF SERVICES

This annex presents the cost of account linked services across a representative selection of financial institutions. It also highlights the account opening requirements and the respective cost opening a bank account.

	NATIONAL BANK	ECOBANK	MSB	OIBM
Documents required to open an account	Valid Passport or valid driving license, Letter from employer or referral by another account holder	Valid Passport or valid driving license, Letter from employer or referral by another account holder	Valid Passport or valid driving license, Letter from employer or referral by another account holder, Referral by district commissioner of home district	Valid Passport or valid driving license, Letter from employer or referral by another account holder, Referral by district commissioner of home district
Minimum balance to open an account	Current Account: MK1000	Current account:- MK10,000,	Savings = MK500	MK300
	- Savings Account: MK5000	Savings account, MK3000	Premium savings = MK5000	
	Special Savers Account: MK1000		Current = MK5000	
			Fixed Deposit = MK10,000	
ATM withdrawal	MK0	M50 (all MALSWITCH supported POS and ATMs)	K85.00 (all MALSWITCH supported POS and ATMs)	M50 (all MALSWITCH supported POS and ATMs)
ATM withdrawal in another bank	Visa platform at NBS or Standard Bank = MK50	MK50	MK170.00	MK100
Transfer at the counter	MK0	MK0	MK600.00	MK0
ATM Transfer	(Intra-bank only) MK0	n/a	n/a	MK50
Bank to Bank Transfer	Online only – MK2000	n/a	MK4,000.00	n/a
Annual fee	MK3100	Current = MK4300	MK750.00	MK500

		Savings = MK3000		
Cost for lost card	MK1500	MK2000		MK2000
Mobile Money				MK50 is charged for every USSD session.