
Financial Inclusion and the Payments Industry

Michael Zucarro, Pace University
Larry Bridwell, Pace University

EXECUTIVE SUMMARY

Financial Inclusion seeks to improve the lives of the lowest income citizens of the world by encouraging the shift from informal economies characterized by cash transactions towards more modern formal economies encompassing easily accessible financial services and targeted poverty reduction programs. The aggressive utilization of computers and the internet can provide comprehensive services that transform the lives of low income families. The power of digital technology, especially mobile phones, has the potential to expand economic opportunities for the two billion people out of seven billion who primarily rely on cash transactions and who do not have bank accounts. The Bill and Melinda Gates Foundation predicts that computer technology will lead to tremendous economic growth and will eliminate absolute poverty by 2030 throughout most of the world not plagued by civil conflicts. One of its major programs is their Better Than Cash Alliance which partners with the global payments industry to expedite the transition from cash to digital payments.

Keywords: Financial Inclusion, Digital Banking, Poverty

INTRODUCTION

Financial Inclusion is a recent concept that has emerged from a combination of computer technology, especially mobile phones, and political mobilization by social activists who seek to enhance economic opportunities for the lowest income citizens in the developing world. An indication of the growing importance of Financial Inclusion was accentuated at the 2016 Spring Meeting of the International Monetary Fund. The first event of the week was a panel discussion jointly sponsored with the Center for Global Development entitled, "Financial Inclusion: Macroeconomic and Regulatory Challenges" with IMF Managing Director Christine LaGarde as the Keynote Speaker. She emphasized that "The post-2015 [UN] Development Agenda squarely puts financial inclusion as a key objective for United Nations member countries...To date, more than 60 governments across the world have set financial inclusion as a formal target" (Alliance for Financial Inclusion, 2016).

Prior to the internet, many countries, especially in rural areas, had large informal economies that functioned on a cash or barter basis and were essentially outside modern formal institutions. An example of the dynamics between the informal and formal economic sectors is Argentina. In 2003, 49.6% of the workforce was in the informal sector, but due to various government programs since then, this was reduced within ten years to 33.6% in 2013 (Frayssinet, 2014). The greatest vulnerability of the informal sector was that many senior citizens who had lived most of their lives being paid in cash were not eligible for government pensions. President Nestor Kirchner proclaimed that as a matter of social justice, these workers deserved government pensions, which was then implemented beginning in 2005. Those workers who had made no or little pension contributions were allowed to collect a government pension which included a process of deducting over time the official payments that should have been made. As a result of these and other reforms, whereas in 1996, only 69% of senior citizens had pensions, that percentage had risen to 90% in 2012. Simultaneously, the government enforced new laws penalizing businesses that operated in the informal economy and also advocated that all workers should enter the formal economy by fully participating in government social security pension programs (Valente, 2012).

One of the early successful financial inclusion initiatives to move individuals into the formal sector were the Brazilian Bolsa Familia and Zero Hunger programs during the Presidency of Lula Da Silva from 2003 to 2011. Benefits for families and low income citizens were given in the form of electronic payments instead of cash or checks. Recipients went to a local financial institution to collect their funds and this process encouraged the opening of bank accounts. These social solidarity programs

provided a solid financial foundation that enabled 40 million out of 200 million Brazilians to move out of absolute poverty into more formal working-class lives (Tepperman, 2016).

A major factor encouraging financial inclusion has been mobile phones which have enabled the electronic transfer of money for business transactions and family remittances without having to use cash or traditional bricks and mortar banking. The Bill and Melinda Gates Foundation has predicted that the expansion of computer technology and the emergence of digital banking is so powerful that economic growth among low income populations will lead to the elimination of absolute poverty in most of the world by 2030 (Gates, 2016).

FINANCIAL INCLUSION AND THE PAYMENTS INDUSTRY

On a global basis, the payments industry, most prominently, Visa, Master Card and PayPal, has played a large role in spreading financial inclusion across developing countries in Africa, Asia and Latin America. The widespread use of mobile phones has allowed the payments industry to reach individuals who previously relied on cash for both economic transactions and as a medium for savings. A recent study by the World Bank declared that mobile payments “can have a positive impact on a variety of microeconomic indicators, including self-employment business activities, household consumption, and wellbeing” (Cull et al., 2014). This has been positive for the payment providers as each new person they are able to reach adds a new consumer to the market which will increase usage and acceptance of their products, all while performing a service to society.

Financial Inclusion can be defined as the delivery of financial services at affordable costs to low-income segments of society (Scronce, 2015). Today, about two billion of the world’s seven billion people are without a bank account (Kelly & Rhyne, 2015). Visa and MasterCard are looking to capitalize on these opportunities and both take a similar approach to financial inclusion. They have partnered with the Bill and Melinda Gates Foundation as part of the Better Than Cash Alliance. The goal of the alliance is to promote and expedite the transition from cash to digital payments by conducting research and acting as a catalyst for this change (About The Better Than Cash Alliance, 2015). The roles of MasterCard and Visa are to work with governments and financial institutions to create new technologies to enable the switch from cash to digital. This also enables the two largest US payment providers to continue their global growth, and their help to low-income communities can be viewed as a form of corporate social responsibility. The use of electronic and card payments has developed steadily over the past fifteen years but, as reported in 2013, 85% of the world’s financial transactions were still being performed in cash (High et al., 2013). By investing in new technology and partnering with local mobile financial service firms, MasterCard and Visa can grow their networks which expand the reach of consumers and their ability to transact. For these companies, each national market presents a unique challenge in that there are varying degrees of government regulation surrounding payments.

MasterCard has just opened a technology hub called the MasterCard Lab for Financial Inclusion in Nairobi, Kenya, that focuses exclusively on innovations aimed at providing financial services to the underserved. The Bill and Melinda Gates Foundation provided an \$11 million grant to fund the lab for the first three years and MasterCard will fund the initiative afterwards. The hub will be used as a way to test new and existing technologies in Africa, such as biometric identification to authorize payments, prepaid cards and mobile payment services (Inside MasterCard's Mission of Financial Inclusion, 2015). Recently, MasterCard and the Nigerian government created a pilot program in which 13 million Nigerian citizens were issued MasterCard branded eID cards as part of an effort to centralize all identity databases in the country (e.g., Driver’s Licenses, Voter Registration, Health Insurance, etc.). On these cards, citizens who receive social benefits have the funds automatically loaded onto a prepaid card, instead of receiving a check in the mail. This enables them to make purchases with their eID card, which in turn gives them the opportunity to purchase goods and services that many did not have access to before. The card is also less susceptible to fraud as there is biometric identification technology to prevent theft. (Finance and Markets Global Practice of the World Bank Group, 2015).

Similarly, Visa partnered with the government of the Dominican Republic to provide social benefits to its citizens. Prior to 2004, the government would deliver aid such as food, medicine and supplies to its neediest citizens. This process proved to be disorganized due to local government influence, and there were instances where the families most in need did not receive assistance. Instead, the central government and Visa launched a program called The Solidarity Card by which prepaid cards were sent to 5,000 of the poorest families in the country. The benefits of receiving aid in this way reduced corruption,

allowed the government to keep track of who were receiving funds and boosted the local economy by residents buying goods from local merchants. The program was so successful that five years later the government added six assistance programs to the Solidarity Card, including unemployment, benefits for the elderly and school lunches (Visa Inc., 2010).

Another avenue in which MasterCard and Visa seek out the underbanked is with technological innovations via the use of mobile phones to execute financial transactions such as mobile banking. (Group, 2013). This is extremely important to financial inclusion as one billion out of the two billion unbanked population have access to a mobile phone (Scharwatt et al., 2014). From a consumer standpoint, Visa has acquired Fundamo, which is one of the largest providers of mobile financial services in developing countries. This is an avenue that payment providers want and need to take to reach customers. With this deal, "Visa can leverage Fundamo's platform to offer enhanced functionality and new services to existing mobile financial services subscribers across Africa, Asia and Latin America." Fundamo has around five million subscribers with the potential to reach more than 180 million. Using Fundamo's customers and Visa's network, consumers will be able to make person-to-person transactions, pay bills and perform branchless banking services all from their mobile phones (Team, 2011).

MasterCard has also entered the mobile financial services space through a joint venture with Telefonica called Wanda. This program aims to provide mobile payment solutions to 87 million customers in Latin America by leveraging a portion of Telefonica's customer base (Arcos, 2012). Additionally, MasterCard has also partnered with Boku, a service that allows mobile phone users to pay for goods directly through their phone bill. This works because Boku has built a network of merchants that allows this method of payment for online sales. With the MasterCard partnership, Boku subscribers will be able to use their phones in stores to electronically tap and make purchases (Wester, 2012).

The mobile phone space is also a facilitator for the remittance industry. Remittance is the sending of money to a recipient at a distance and is usually performed from one country to another (Remittance, 2015). Many families rely on someone abroad to send money home, because employment or wages may not be as substantial in their home country. In 2014, \$583 billion was remitted globally, with 22% of the total coming from the United States (McCarthy, 2015). Again, both MasterCard with its MasterCard Send and HomeSend programs and Visa with its Visa Direct program have invested heavily in this space. MasterCard Send allows customers to send payments person to person globally. Customers can send money to their families or friends if they have a MasterCard or Maestro account (MasterCard Inc., 2015). Additionally, MasterCard has entered into a joint venture with eServGlobal and BICS (mobile financial service companies) to create HomeSend which is an international mobile remittance platform available in 50 countries. Prior to the partnership, eServGlobal allowed remittance, but only through its community of telecom partners. By partnering with MasterCard, this expands to an additional 24,000 financial institutions in MasterCard's network (MasterCard Inc., 2013). Additionally, this joint venture has opened up more business for MasterCard. Using the HomeSend platform, MasterCard was able to partner with eTranzact International plc, an African mobile banking and payment services company, to make international remittance services available in Nigeria (MasterCard Inc., 2015).

The Visa Direct program works in a similar fashion. It allows people to send money to eligible Visa accounts around the world. Both parties need to hold a Visa card and consumers can send funds to another person's Visa account, and transfer money to a reloadable prepaid card, pay a Visa credit card bill and merchants can disburse funds to customer accounts for returns (Visa Inc., 2015). To make the products even more attractive to consumers, Visa and MasterCard are also investing heavily to foster and expand acceptance of their cards and products with merchants. To allow small business owners to accept card payments through their cell phones or tablets, Visa developed Visa Ready and MasterCard launched MasterCard MPOS (Mobile Point of Sale). Both companies have created a requirements list for merchants to meet before they are able to use this technology. This is to prevent fraud or illicit services from being processed through their networks (MasterCard Inc., 2015; Visa Inc., 2015). The importance of acceptance cannot be understated as business owners can open themselves up to new forms of payment with the ability to reach more consumers. With the move to a cashless society, card acceptance will be important for small business owners to keep pace with the market and allow consumers to enjoy the benefits of their cashless products.

As the payments landscape has expanded to include different types of services, the market for niche and alternative payment methods has also expanded. The obvious global players in the payments space are Visa, MasterCard, American Express and Discover. Although American Express and Discover operate in a slightly different fashion than MasterCard and Visa, their platforms and products are very similar. Alternative third party payment providers present a completely different challenge to the payment giants as some of them specialize and have more experience in the areas that the big companies want to enter or gain market share. Alternative payments are online payment methods other than credit card or bank cards.

One such alternative payment provider is PayPal, which is one of the leaders in online payments and has a growing business model that is attractive to certain retailers and merchants. PayPal is able to facilitate debit transfers directly from a bank account, bypassing the Visa or MasterCard network. And while some consumers can still choose to set up a credit card in their PayPal accounts, PayPal absorbs the interchange charges for the merchants by acting as a middleman and has built this pricing into their model. They are able to offer merchants a flat rate, while MasterCard and Visa's interchange fees vary depending on the sector, card used and various other criteria. This is ideal for certain merchants because depending on their business, the fees to accept PayPal may be less than the fees to accept credit cards. (PayPal, 2015; CardConnect, 2014). PayPal is also a major player in the person to person payment space with their Venmo app that allows users to send funds to each other through their mobile phones (Rao, 2015). They also acquired Xoom, which is a company that facilitates the digital transfer of money internationally (Mac, 2015).

IMPACT OF GOVERNMENT REGULATION ON FINANCIAL PAYMENTS

The other obstacles that Visa and MasterCard face are sometimes market specific. Government regulations can hamper the credit card companies' abilities to conduct business in certain countries, which limits access to consumers. China and Russia each present conditions that are interesting to explore. Up until early this year, China did not allow MasterCard and Visa to provide bank card clearing services domestically. All domestic payments on the card networks (meaning all MasterCard and Visa payments in Chinese Yuan to merchants within country) had to be routed through China UnionPay, which is a direct competitor of the credit card companies not just in China, but globally (Oyedele, 2015). China recently deregulated this rule to allow Visa and MasterCard to enter the market. This only occurred after the two companies filed a complaint with the World Trade Organization in 2012 arguing that foreign credit and debit card issuers should be treated on par with domestic issuers. Although the deregulation has occurred, MasterCard and Visa still have to apply to the central bank for a license to enter the card clearing business, which will delay their operations further, possibly into the second half of 2016 (Speculations, 2015).

Russia also presents a unique challenge from a regulation standpoint. In 2014, Russia enacted rules that limited the influence of MasterCard and Visa within the country. The new law created a national payment card system similar to China UnionPay that would require all payments to be processed domestically. This legislation was a direct result of sanctions imposed by the U.S. and E.U. against Russia for annexing Crimea, which prompted Visa and MasterCard to block cards at four Russian banks. All transactions are to be routed through the central bank to prevent the major credit card companies from stopping their payments (Lossan, 2015). Russia plans to issue its own domestic cards and is seeking to partner with foreign card companies in Japan and China to have their cards accepted outside of the country using the China UnionPay and JCB (Japan Credit Bureau) networks (Khrennikov, 2014). As for MasterCard and Visa, they have also been in talks to work with the new Russian card issuer to co-brand cards to be used domestically and internationally on their networks.

CONCLUSION

Financial inclusion represents one of the largest opportunities for payment providers to reach new customers, while also advancing the lives of the disadvantaged and underserved. With a significant number of people globally who still transact in cash and do not have access to basic financial services, new technologies and partnerships with governments will be the key to driving change. One of the most famous of the digital banking platforms is the M-Pesa system developed in Kenya which has been featured on the CBS television program 60 Minutes. In Kenya, active government encouragement of more competition to M-Pesa has led to digital banking representing over 50% of financial activity. In the developing world, mobile financial services platforms represent a unique opportunity for Visa and MasterCard, as they are able to reach unbanked customers in new ways as more people have access to cell phones than bank accounts. As an example of how fast financial inclusion is moving, MasterCard made a joint announcement at the 2015 Annual World Bank meeting with World Bank President Jim Young Kim and Secretary General of the United Nations Ban Ki-moon that MasterCard would reach 500 million people by 2020 who had been previously excluded from financial services. Since MasterCard started its financial inclusion initiatives, they had already reached 200 million (Erenhouse, 2014). Although there are great opportunities, challenges exist for expansion in many countries as indicated by regulations in Russia and China that aim to block or limit

Visa and MasterCard's operations within their countries. The payments industry has many moving parts and the future will be interesting to monitor.

REFERENCES

- About The Better Than Cash Alliance. (2015). Retrieved from <https://www.betterthancash.org/about>
- Adyen. (2014). Retrieved from <https://www.adyen.com/blog/adyen-payment-insights-brazil>
- Alliance for Financial Inclusion, (2016). IMF/World Bank spring meetings bring financial inclusion leaders to Washington, D.C. Retrieved from <http://www.afi-global.org/news/2016/4/13/imfworld-bank-spring-meetings-bring-financial-inclusion-leaders-washington-dc>
- Arcos, G. (2012). MasterCard and Telefonica's joint venture unveils brand name. Retrieved from <http://newsroom.mastercard.com/press-releases/mastercard-and-telefonica%E2%80%99s-joint-venture-unveils-brand-name/>
- Bellman, E. (2015). India wins the remittance race again. Retrieved from *The Wall Street Journal*: <http://blogs.wsj.com/indiarealtime/2015/04/15/india-wins-the-remittance-race-again/>
- CardConnect. (2014, April 2). The hidden costs of Stripe and PayPal. Retrieved from <http://www.cardconnect.com/the-hidden-costs-of-stripe-and-paypal/>
- CEX.IO. (2015). What is Bitcoin? Retrieved from Bitcoin.CEX.IO: <http://bitcoin.cex.io/>
- Copeman, A., Peterson, T., & Reinelt, N. (2015). *Emerging players in payments evolution and disruption*. Aite.
- Cull, R., Ehrbeck, T., & Holle, N. (2014). *Financial inclusion and development: recent impact evidence*. Washington, D.C.: CGAP: Focus Note 92.
- Discover. (2005, December 5). China UnionPay and Discover Financial Services launch partnership opening Discover's PULSE Network to Chinese travelers. Retrieved from Discover: <http://investorrelations.discoverfinancial.com/phoenix.zhtml?c=204177&p=irol-newsArticle&ID=1005789>
- Erenhouse, R. (2014). Financial inclusion commitment: Reach 500 million people by 2020. Retrieved from <http://newsroom.mastercard.com/news-briefs/financial-inclusion-commitment-reach-500-million-people-by-2020/>
- Euromonitor International. (2015). China UnionPay Co LTD in consumer finance (World). Passport.
- Finance and Markets Global Practice of the World Bank Group. (2015). Innovative digital payment mechanisms supporting financial inclusion stocktaking report. Global Partnership for Financial Inclusion.
- Frayssinet, F. (n.d.). Argentina's informal economy shrinks, but not fast enough. Retrieved from <http://www.ipsnews.net/2014/04/argentinas-informas-economy-shinks-fast-enough>
- Gates, B. & Gates, M. (2016). Retrieved from <https://www.gatesnotes.com/2016-Annual-Letter>.
- GmbH & Co. (2014). Global alternative payment methods. Hamburg, Germany: yStats.
- Group, A. M. (2013). Mobile financial services: Basic terminology."Alliance for Financial Inclusion.
- High, T., Jain, A., & M. Angus. (2013). MasterCard advisors. Retrieved from http://www.mastercardadvisors.com/_assets/pdf/MasterCardAdvisors-CashlessSociety.pdf
- Inside MasterCard's Mission of Financial Inclusion. (2015). Retrieved from <https://www.theventure.com/global/en/ideas/inside-mastercard-s-mission-of-financial-inclusion>
- Kelly, S. E., & Rhyne, E. (2015). By the numbers: Benchmarking progress toward financial inclusion. Center for Financial Inclusion.
- Kerr, D. (2013). PayPal's in-store payment partners grow to 23 retailers. Retrieved from CNET <http://www.cnet.com/news/paypals-in-store-payment-partners-grow-to-23-retailers/>
- Khrennikov, I. (2014). Qiwi may gain from Russian card-payment system, Kim says. Retrieved from <http://www.bloomberg.com/news/articles/2014-06-10/qiwi-may-benefit-from-russian-card-payment-system-kim-says-1->
- Lossan, A. (2015). Visa and MasterCard join Russia's national card payment system. Retrieved from http://rbth.com/business/2015/04/02/visa_and_mastercard_join_russias_national_card_payment_system_44955.html
- Mac, R. (2015). PayPal to acquire digital money transfer company Xoom before eBay split. Retrieved from <http://www.forbes.com/sites/ryanmac/2015/07/01/paypal-acquires-digital-money-transfer-company-xoom-before-ebay-split/>
- MasterCard Inc. (2013). MasterCard, eServGlobal and BICS create remittance joint venture. Retrieved from <http://newsroom.mastercard.com/press-releases/mastercard-eservglobal-and-bics-create-remittance-joint-venture/>

- MasterCard Inc. (2015). MasterCard and eTranzact make it easier for millions of Nigerians to receive remittances. Retrieved from <http://newsroom.mastercard.com/press-releases/mastercard-and-etranzact-make-it-easier-for-millions-of-nigerians-to-receive-remittances/>
- MasterCard Inc. (2015). MasterCard MoneySend. Retrieved from <http://www.mastercard.com/in/consumer/money-send.html>
- MasterCard Inc. (2015). Mobile point of sale. Retrieved from <http://www.mastercard.com/corporate/mpos.html>
- McCarthy, N. (2015). Which country sends the most remittances? Retrieved from <http://www.forbes.com/sites/niallmccarthy/2015/08/14/which-country-sends-the-most-remittances/>
- Oyedele, A. (2015). Visa, MasterCard, and American Express are now welcome in China. Retrieved from <http://www.businessinsider.com/mastercard-and-visa-may-enter-china-2015-4>
- Parra-Bernal, G. (2015). Brazil's Elo credit card in deal to use Discover global network. Retrieved from <http://www.reuters.com/article/2015/08/20/discover-financ1-brazil-elo-idUSL1N10V18U20150820#0FwSCMILM1F117T1.97>
- PayPal. (2015). Business resource center grow your business. Retrieved from <https://www.paypal.com/webapps/mpp/brc/why-paypal>
- Rao, L. (2015). PayPal's future CEO wants it to be the operating system for commerce. Retrieved from <http://fortune.com/2015/05/21/paypal-ceo-dan-schulman/>
- Remittance. (2015). Retrieved from Dictionary.com: <http://dictionary.reference.com/browse/remittance>
- Scharwatt, C., Katakam, A., Frydrych, J., Murphy, A., & Naghavi, N. (2014). 2014 State Mobile Financial Services for the unbanked. GSMA Mobile Money for the Unbanked.
- Scronce, E. (2015). CGAP financial inclusion. Retrieved from <http://www.cgap.org/topics/financial-inclusion>
- Speculations, G. (2015). MasterCard and Visa might have trouble competing in the Chinese card clearing market. Retrieved from <http://www.forbes.com/sites/greatspeculations/2015/09/11/mastercard-and-visa-might-have-trouble-competing-in-the-chinese-card-clearing-market/2/>
- Team, T. (2011). Visa going mobile with Fundamo deal. Retrieved from <http://www.forbes.com/sites/greatspeculations/2011/06/14/visa-going-mobile-with-fundamo-deal/>
- Tepperman, J. (n.d.). Brazil's antipoverty breakthrough: The surprising success of Bolsa Familia. *Foreign Affairs*, 95, 1, 34-44.
- Valente, M. (2012). ARGENTINA: How to sustain highest pension coverage in region. Retrieved from <http://www.ipsnews.net/2012/05/argentina-how-to-sustain-highest-pension-coverage-in-region/>
- Visa Inc. (2010). Government efficiency: Dominican Republic provides for its neediest citizens. Retrieved from www.currencyofprogress.com
- Visa Inc. (2015). Visa Direct. Retrieved from <https://developer.visa.com/vpp/>
- Visa Inc. (2015). Visa Ready. Retrieved from <https://usa.visa.com/run-your-business/small-business-tools/payment-technology/visa-ready.html>
- Wester, J. (2012, February 23). Boku and MasterCard team up on mobile payment solution for carriers. Retrieved from <http://www.mobilepaymentstoday.com/articles/boku-and-mastercard-team-up-on-mobile-payment-solution-for-carriers/>
- Wimborne, T. (2014). National Russian card payment system established. Retrieved from <https://www.rt.com/business/156912-russian-putin-card-payment/>
- Wong, G. (2015, August 3). China proposes to keep online payments in check. Retrieved from <http://www.wsj.com/articles/china-proposes-to-keep-online-payments-in-check-1438593958>