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DOING WELL BY DOING GOOD: SERVING THE UNDERBANKED

A Mercator Advisory Group Research Brief Prepared for NBPCA

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Introduction

Welcome to Mercator Advisory Group's second 2018 Research Brief for the Network Branded Prepaid Card Association. It is condensed from the research report titled: *Doing Well by Doing Good: Delivery Models and Channels Serving the Financially Underserved*.

Serving people without access to mainstream financial services such as transaction accounts, loans, credit cards, and convenient payment products is a well-studied and frequently discussed topic. There is no lack of literature regarding how to improve the state of financial inclusion, and there are many organizations both domestic and international supporting this cause. Nonetheless, the need around the world to provide safe and convenient financial tools persists. Providing these tools to the underserved can produce life-altering benefits. Despite documented improvements and new solutions, reducing the ranks of the unbanked has proven difficult however, particularly in the United States. The Federal Deposit Insurance Corporation (FDIC) has conducted surveys regularly since 2008 to track the numbers of the unbanked and underbanked in the United States. The inaugural study found that 7.6% of U.S. households were unbanked. The most recent [study](#), conducted in 2015, 7 years later, estimates the percentage of unbanked to be 7%—an improvement, certainly, but not a dramatic reversal despite all the effort, reports and studies, organized outreach, and good intentions. To place the FDIC's finding in context, 7% of households equates to approximately 9 million households and 15.6 million adults, which means the unbanked represent a sizable market indeed.

Before venturing further into the topic, a definition of the distinction between unbanked and what it means to be *underbanked* is in order. For purposes of this report, we use the definitions created by the FDIC:

- **Unbanked** means no one in a household had a checking or savings account with an insured financial institution.
- **Underbanked** refers to households that have an account at an insured institution but also obtained financial services and products outside of the banking system. Specifically, a household is categorized as underbanked if it had a checking or savings account and used one of the following products or services from an alternative financial services provider in the past 12 months: money orders, check cashing, international remittances, payday loans, refund anticipation loans, rent-to-own services, pawn shop loans, or auto title loans.

Being Unbanked in the U.S.

In addition to the quantitative FDIC study discussed above, a separate qualitative study of the unbanked population in the United States ([Bank Efforts to Serve Unbanked and Underbanked Consumers, 2016](#)) uncovered a variety of reasons for being unbanked as expressed by those surveyed, including:

- Some consumers believe that banks are only interested in serving wealthy customers.

- The environment inside banks feels foreign or intimidating to them.
- Many consumers feel more comfortable at alternative financial service providers than at banks.
- Some consumers are concerned that they are likely to be rejected by banks.
- Consumers lack familiarity with banks.

Some of the participants in the study expressed concerns as recent immigrants who faced losses from an unstable banking system in other countries and weren't ready to trust the U.S. system. Others have been turned down for a banking product and don't want to face that outcome again. This is a different environment than that of the countries in which the financial products and services for the unbanked described above are provided. There, the primary hurdle is simply access to an urban center where physical banks are available.

Profitably Serving the Unserved in the United States

Is it possible to provide better, more modern banking services and make a profit at the same time? M-Pesa is reportedly serving its markets profitably, and in the United States, Green Dot, a publicly traded company singularly focused on the underserved market, [reported](#) \$85.9 million net income for 2017. Other companies that provide other products and services make it more difficult to determine if their efforts to serve this market are profitable in themselves given that they are combined with other business activities. It is likely, since these companies continue to support their services for the unbanked, that they are at the very least a break-even endeavor. In considering those that are profitable or are suspected to be profitable, we can start to see some similarities in approaches to make a profit while serving people who don't have much to pay for services.

Achieving a critical mass of customers is necessary. The fixed costs associated with deploying the necessary technology and implementing the necessary operations, network of agents, and acquiring customers, require a sufficient number of customers using services on a regular basis and paying for them. This also requires that serving the unbanked is not just offering a product and expecting that customers will gravitate to it given the improved economics and convenience for them. Achieving the needed market mass requires a deep commitment to seeking out the customers who can benefit the most.

Developing a solution on top of an efficient, cost-effective framework is the most expedient way to achieve profitability. In developing markets, this means creating products on top of existing mobile networks and the network of merchant-agents already in place. In the U.S., this is more difficult because mobile networks are not viable for conducting payment transactions and therefore reliance on more expensive card networks involving a complex string of participants - banks, brands, processors, et al. - is necessary. Building products on top of traditional banking platforms carries with it additional services and related costs that will make operating a product for the unbanked that is focused on basic transactional capabilities creates a cost burden for the business model. A more flexible, lighter platform built specifically for this market is preferred for driving profitability.

Providers that are successful in serving the financially underserved also have a common trait of having a connection with a source of customers. That may be an arrangement with a government agency that is disbursing payments such as benefits, relief payments, or tax refunds.

The Unbanked Customer Experience

In the U.S., to conduct fundamental monetary transactions, the unbanked are heavily reliant on cash, alternative financial services provided by check cashing stores, lenders such as pay-day loan providers, and general purpose reloadable (GPR) prepaid cards. In contrast to many of the services for the unbanked in other countries, mobile is not the central form factor. Mobile in the U.S. model is an optional point of service for getting balances, alerts, and with some providers, paying bills. This difference exists in part because of the way financial services and payments have evolved over several years in their respective countries.

In the U.S., financial services and payments systems have evolved over time with new payment form factors added to the old and all of them coexisting because consumers are unwilling to give up old technology that they trust and that is engrained in their habits. The introduction of new payment products like mobile doesn't yet represent an incremental improvement great enough for consumers and merchants to feel the need to adopt it. This is one of the reasons that financial services in the U.S. for the unbanked are centered on the payment capabilities of general purpose reloadable prepaid cards and not mobile.

GPR Cards: Three Models for Reaching the Unbanked

On the next pages, we compare three GPR prepaid models used in the U.S. to reach the unbanked. Each has a different distribution model for reaching its client base. For purposes of this comparison, only a few providers have been selected, but in the U.S. market, a multitude of players fit each category.

Financial Institutions

Many financial institutions offer a GPR card as a banking alternative. That may seem counterintuitive, but financial institutions position these cards as a "turn-down" product for those who want a bank account or credit union share draft account but cannot meet the new account opening requirements. They are also used as companion cards for banked individuals to provide a payment vehicle to unbanked individuals in their household such as minors who need access to funds while on a trip or at school.

Program Managers

Program managers market and sell prepaid cards and related products for the unbanked, but they are not banks themselves. They buy banking services from insured, regulated banks that specialize in supporting program managers. Banks are a necessary component based on the regulatory framework present in the United States. Banks provide the accounts necessary to hold and manage deposits for the end users and provide access to the

card networks to facilitate purchases and also guarantee program compliance to banking regulators among other duties.

Alternative Financial Services Providers

Alternative financial service (AFS) providers are non-bank, non-credit union entities that provide financial services such as short-term loans, check cashing, domestic and international remittances, bill payment, and other capabilities, often to the unbanked. They also offer prepaid GPR cards to further provide purchasing capabilities and compete with program managers and financial institutions to provide these services. The benefit that these AFS providers have for their card-based services is that they have a built-in client base of unbanked customers.

Conclusions

People in the United States who manage their finances on the periphery of the banking industry have found a way to live without formal banking services. Their experience includes reliance on a combination of cash, check cashers, bill-pay solutions, payday lenders, and other alternatives. Serving this population more efficiently, creating an improved user experience, and providing better access to services and at less cost is possible but the unbanked are not aware of the opportunity or are skeptical of the efficacy of such services and first need to be convinced that a better way can be trusted. In the U.S., there is no shortage of solutions available, including those offered by banks, prepaid program managers, and alternative financial service providers.

Although solutions are plentiful, the population of unbanked who could enjoy greater convenience and a more stable financial life is still surprisingly large. Many who make up this constituency have actually owned or currently use card-based payment options created for the unbanked in the form of a payroll card, a social benefits payment card, or a tax refund card. But these are single-purpose solutions. Once an individual's time with the employer providing a payroll card ends, that card cannot be used with the next employer. Prepaid government benefit cards don't offer all the financial features needed such as a network of cash deposit options or the opportunity to apply other direct deposit sources. These are missed opportunities.

Perhaps big-tech firms the likes of Amazon and Apple which already can count the unbanked among their existing customer base, will reach out to serve this population. There are some early indicators that these companies are headed in that direction. Amazon allows recipients of federal and state benefits to join Amazon Prime at a half-off price. It also has created a payment product for people without debit or credit cards to use on its website and receive a cash-back reward with every purchase. By attracting consumers from this demographic which includes unbanked individuals, Amazon not only entices them to buy from the website but also could present them with other bank-like services. Apple has partnered with Green Dot recently such that Apple P2P users can have funds they receive from another individual reside on a Green Dot card; this is for consumers who do not have a bank account to cash out funds they have received. Similarly, individuals who receive funds through P2P solution Venmo may now use those funds at over 2 million PayPal-accepting merchants with no need for a bank account.

For companies that want to serve this market and also make money, a concerted and focused approach is needed backed up with an efficient technical platform, convenient a distribution network, and a built-in customer base or referral source. Not all providers are finding the unbanked market profitable. For some, this may be fine. There is nothing wrong with pursuing a philanthropic endeavor when it betters the lives of individuals.



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About NBPCA



The NBPCA is the collective voice of the prepaid industry and the only trade association solely dedicated to prepaid in Washington. *Who We Are:* NBPCA is a trade association for all companies involved in providing prepaid cards to consumers, businesses, and government, which can be used nationwide. *NBPCA's Mission:* Guided by the belief that prepaid products are a valuable financial service that can offer significant benefits to businesses, governments, and consumers, the NBPCA is committed to responsibly advancing the success of the prepaid card industry.