Enhancing access to banking and financial services in Botswana

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FinMark Trust
MAKING FINANCIAL MARKETS WORK FOR THE POOR

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BOTSWANA (PTY) LTD

Glossary

AML	Anti-money laundering
ATM	Automatic Transaction Machine
BDC	Botswana Development Corporation
BBS	Botswana Building Society
BIDPA	Botswana Institute for Development Policy Analysis
BIFM	Botswana Insurance Fund Management
BPS	Botswana Postal Services
BSB	Botswana Savings Bank
CEDA	Citizen Entrepreneurial Development Agency
CFT	Countering the financing of terrorism
DFID	Department for International Development (UK)
FI	Financial Institution
FSC	Financial Sector Charter (South Africa)
GDP	Gross Domestic Product
HIES	Household Income and Expenditure Survey
IMF	International Monetary Fund
NDB	National Development Bank
NFSC	Namibian Financial Sector Charter
NGOs	Non-Governmental Organisations
P	Pula (currency)
POS	Point of sale
SMMEs	Small, Medium and Micro Enterprises
SACU	Southern African Customs Union
SADC	Southern African Development Community
SSA	Sub-Saharan Africa

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Foreword

The banking sector plays a crucial role in any economy through the provision of financial intermediation and payments services. Through these services, banks enable the efficient allocation of savings and investment, and enable financial transactions to take place at minimum cost. In discharging these functions, Botswana's banking sector has many strengths: it is reasonably efficient, it is sound and profitable, has never experienced any serious banking crises, and on the few occasions that financial institutions have experienced problems that threaten their continued existence, these problems have been dealt with quickly and without any negative impact on the financial system as a whole. The high quality of banking regulation and supervision in Botswana is internationally recognised, and in recent years there have been a number of product innovations and improvements in service quality.

Nevertheless, banks in Botswana – as in most countries – are frequently the subject of negative comments and criticism. Among the major concerns are high charges, long queues, a lack of services in rural areas, and more generally perceptions of only serving a small minority of the population. Some of the criticism is misplaced, and there is evidence that the banks have tried to address at least some of these concerns.

However, the issue of access to banking and financial services is of crucial importance. In Botswana, as in most developing economies, the banks dominate the financial system. As the dominant financial institutions, banks need to be cognisant of their role as important agents of economic development, and not confine themselves to a narrow range of activities or customers, especially given the very high rates of profit earned by banks in Botswana. There is widespread evidence and experience showing that broadening access to financial products and services has benefits for both individuals and business, and for the economy as a whole. Access to savings products, credit, and transaction services enables people and businesses to accumulate financial assets, invest, spread risks, and make payments cheaply and efficiently. There are well-established links between the size and scope of the financial system and the rate of economic growth. Furthermore, ensuring that access to finance is widespread can have benefits in terms of poverty reduction and income distribution, and there are many benefits that can flow from overcoming the obstacles and reducing the high costs that the poor often face in gaining access to financial products and services.

The recent focus of many development efforts has been on "Making Markets Work for the Poor", sometimes termed "MMW4P". I am pleased to note that among the pioneers of MMW4P in the financial sector is FinMark Trust, an organisation based in South Africa that is active across Southern Africa. In recent years, FinMark has carried out a number of activities in Botswana. These include "FinScope™", a nationwide survey of access to and usage of financial services, and of perceptions about financial products and institutions, relating these to the socio-economic and demographic characteristics of the population. In collaboration with Botswana Insurance Fund Management (BIFM), FinMark has also sponsored a series of regular Forums in Botswana, which bring together practitioners, academics and policymakers to discuss topical issues relating to enhancing access to finance.

In this regard, this publication on Enhancing Access to Banking and Financial Services in Botswana by Dr Keith Jefferis and sponsored by FinMark Trust, marks a timely contribution to an important debate. The booklet provides a range of information, much of it based on the FinScope™ survey, and presents a "landscape of access" detailing which segments of the population do and do not have access to financial services in general and banking services in particular. The results indicate that over half of the adult population does not make use of banking services, and show that while Botswana does not do badly by regional standards, there are nonetheless challenges to be faced in ensuring greater participation in the use of banking services, and participation in the benefits that can be derived from these services.

The booklet also reviews recent developments in both the regulatory and technological fields that can help to support enhanced access to banking, and provides some very useful suggestions as to how this can be achieved in Botswana. I trust that a wide range of stakeholders will consider these suggestions as the basis for a programme of action. This includes policymakers in the government and the Bank of Botswana, the banks themselves, as well as researchers, donors and NGOs. The booklet also illustrates the importance of having high quality data, which we can learn much from and use as an input to the policy process. In order to improve our knowledge and provide a means of judging progress on enhancing access to finance, I hope that FinMark Trust will consider running another FinScope™ Survey, and that financial institutions will participate and support this important initiative.

I commend this publication to all who have an interest in developing an efficient and inclusive financial sector in Botswana. Success in this will support our objectives of raising economic growth, diversifying the economy, and reducing poverty in line with Vision 2016. I would like to thank FinMark Trust and Dr Jefferis for their efforts in producing the publication, and look forward to concrete results from the debate that it will stimulate.

Hon. Baledzi Gaolathe
Minister of Finance and Development Planning
Gaborone, March 2007

Introduction

This booklet examines access to financial services, particularly banking services, in Botswana. The issue is a topical one, given widespread concerns that most of the population do not have access to financial services, and as a result may be excluded from full participation in the modern monetary economy. The aim of this booklet is threefold:

- To present general issues around why access to finance is important, from both economic development and social perspectives;
- To present comprehensive information on access to finance in Botswana, drawing in particular on data collected by the FinScope™ Survey carried out in 2004; and
- To discuss the challenges of making access to finance more inclusive in Botswana, thus enabling lower-income groups to participate more effectively in the modern economy, and to make some suggestions as to how access can be improved.

The importance of access to finance

Making financial markets work effectively is one of the most important issues developing countries face today. Indeed, the effectiveness of financial markets is one of the biggest differentiating factors between developed and developing countries. As *The Economist* noted in a survey in late 2005, in developed countries "the vast majority of people have access to interest-bearing savings accounts, mortgages at reasonable rates, abundant consumer credit, insurance at premiums that reflect the risk of losses, cheap ways of transferring money, and innumerable sources of capital for funding a business".[1]

In developing countries, however, this is not the case. Financial markets are characterised by only partial coverage – or at least only partial coverage by efficient markets offering a broad range of financial products at reasonable prices. Furthermore, it is the poor who tend to be excluded, whether as individuals or as entrepreneurs. Simply put, effective participation in a modern monetary economy requires more than cash.

The importance of the issue is reflected in widespread discussions and policy debates around the world, with a number of multilateral institutions focusing on the importance of building inclusive financial sectors. The United Nations has been particularly active, publishing the authoritative *Building Inclusive Financial Sectors for Development – The Blue Book*[2], following the Year of Microfinance in 2005. The

1 *The Hidden Wealth of the Poor – A Survey of Microfinance*, *The Economist*, November 5, 2005.
2 *Building Inclusive Financial Sectors for Development – The Blue Book*, United Nations, May 2006 (bluebook.uncdf.org).

World Bank has also taken a keen interest, promoting research and policy debate[3], and the International Monetary Fund (IMF) has recently come on board; the May 2005 *Regional Economic Outlook – Sub-Saharan Africa* (SSA) incorporated a discussion of access to finance issues in a review of *Issues, Challenges and Reform Strategies in SSA Financial Sectors*[4]. Various bilateral donors such as the UK's Department for International Development (DFID) have also been devoting resources to promoting access to finance[5].

The common thread running through all of the above is that financial exclusion, or constrained access to finance, has negative, interrelated economic and social impacts. These arise for a number of reasons:

- The lack of efficient financial service provision means that poor people are either forced to use inefficient provisions, often at high cost (for instance, with high transactions costs, excessively high interest rates on loans, or poor returns on savings) – thereby entrenching poverty – or they do not have access to certain financial products, either because of an absolute absence of suitable products or because available products are too expensive;
- This in turn tends to restrict the economic opportunities open to the poor. This is most obviously the case with credit, as almost all entrepreneurship activities need capital upfront, even if in small amounts, to fund investment;
- It makes the poor vulnerable to adverse events and financial loss (due to lack of insurance and secure savings products);
- The absence of savings products makes it difficult to build up capital;
- Poverty is entrenched, as the poor are faced with the high costs of accessing financial services, and are denied entrepreneurship opportunities that might provide them with a chance to earn an income; and
- Economic growth is below potential, as the level of investment is reduced.

There is considerable evidence that the level of financial development in a country relates positively to the level of real income. Financial development can be measured in a variety of ways, but essentially refers to the size of the financial sector and the range of financial institutions and markets that comprise the sector. The extent of financial development is often termed "financial depth", which can be measured in various ways, but typically would be measured by the ratio of bank deposits, or bank credit, to Gross Domestic Product (GDP). There is also increasing evidence that this positive relationship is not simply a correlation, but that causation runs from financial depth to growth and incomes, that is, the more financially developed an economy is, the better able it is to achieve higher rates of economic and income growth.

3 See, e.g. T. Beck, A. Demirguc-Kunt & M Peria, *Reaching Out: Access to and Use of Banking Services Across Countries*, World Bank Policy Research Working Paper 3754, October 2005; and S. Claessens, *Access to Financial Services: A Review of the Issues and Public Policy Objectives*, World Bank Policy Research Working Paper 3589, May 2005.
4 IMF: *Regional Economic Outlook – Sub-Saharan Africa*, Chapter 4, May 2006.
5 See e.g., *Banking the Underserved: New Opportunities for Commercial Banks – Exploring the Business Case*, Policy Division Working Paper, DFID, April 2005.

Not only does empirical work support the conclusion that financial sector development is pro-growth, it also shows that it helps alleviate poverty. In countries with better developed financial sectors, the income of the poor grows faster, income inequality decreases at a faster rate, and poverty falls at a faster rate[6]. Financial sector development, economic growth and improvements in poverty and inequality indicators are complementary, and governments need to ensure that policy frameworks are appropriate. There are a number of recent experiences and analysis of such policies around the world to draw on.

Policy initiatives supporting access to finance aim at developing appropriate institutions and policies that will help financial markets work more efficiently. While it is important to get all markets to work efficiently to improve economic growth, financial markets are somewhat different to other markets, as financial markets are more prone to market failure, and in particular are more prone to the type of market failure that excludes the poor.

There are a number of reasons why financial markets are particularly prone to market failure:

- Information plays a special role in financial markets, and is crucial to making efficient decisions, especially regarding loans (as information is required to evaluate the credibility/likelihood of repayment by potential borrowers); a lack of information will, therefore, tend to restrict the availability of credit, even to viable borrowers[7];
- While insufficient (imperfect) information is a general problem in the financial sector, there is a particular problem with a lack of information about low-income household market needs and use, leading to a lack of appropriate financial products and services for this group;
- Financial markets are highly regulated because of the special risks that arise, and yet regulatory structures can lead to market inefficiencies, some of which may exclude the poor. For example, the need to licence banks – for good reasons – tends to reduce the level of competition in the banking sector, which can have adverse market consequences as it encourages monopolistic behaviour. As a another example, anti-money laundering regulations that need proof of a physical address to open a bank account can impede access for the poor, especially those living in rural areas or informal settlements.
- The availability of financial services is determined in part by transaction costs (such as the costs of processing a cheque, a cash withdrawal, or a loan application); these costs can be high, making small financial transactions (such as those carried out by the poor) expensive, and uneconomic for financial institutions to carry out.

6 Thorsten Beck, Asli Demirguc-Kunt and Ross Levine: Finance, *Inequality and Poverty: Cross-Country Evidence*, presented to the World Bank conference on Access to Finance: Building Inclusive Financial Systems, Washington DC, May 2006.

7 This is the main reason why credit information bureaux play a crucial role in improving the efficiency of financial markets.

While agreement that financial services should, in principle, be widely available to the population is widespread, there is less agreement over how to achieve this. A range of financial institutions can potentially play a role, including commercial banks, microfinance entities and informal financial institutions, but those roles will be different in different countries. Furthermore, it is likely that policy interventions will be necessary, partly to correct the market failures noted above. Such interventions have taken various forms, with various degrees of effectiveness, including:

- Regulatory and legal actions (such as the United States Community Reinvestment Act, and South Africa's proposed tiered banking and community-banking legislation, or legal controls on interest rates under "usury" legislation);
- Institutional measures (such as establishing state-owned financial institutions or schemes like Botswana's Financial Assistance Policy, SMME and Citizen Entrepreneurial Development Agency (CEDA) programmes);
- Competition measures (actions against collusion and other anti-competitive practices);
- Moral suasion (exerting informal pressure on banks and other financial institutions); and
- Agreements between financial institutions and the relevant government authorities (such as South Africa's Financial Charter).

However, interventions must be carefully designed as there is potential for adverse interventions that can make the situation worse as well as positive ones. For instance, the record of state-owned financial institutions internationally is generally poor, as they are often characterised by high costs, inefficiency, and a failure to reach intended beneficiaries and achieve intended outcomes. This is generally not an approach that can now be recommended. Similarly, controls on interest rates, while well intentioned, can often result in less access to finance for the poor.

Financial access in Botswana

Geographical access

Financial access is highly topical in Botswana, reflecting a number of widespread concerns about the lack of comprehensive coverage of the population by the financial sector. This in turn relates to the dominance of the financial sector by the commercial banks, which focus their products, services and facilities on a particular segment of the population – primarily waged, urban employees. There may be valid reasons for this, related to the nature of the banks' business models and modes of operation, but the result, nevertheless, is gaps in financial coverage in Botswana. Public concern has focused on both geographical and income-related exclusion. For instance, while the development of the banking sector in recent years has led to new banks being established and new branches opening in some urban areas, as well as new products and services (such as ATMs, debt and credit cards, internet banking and

foreign currency accounts), the number of branches in rural areas has fallen, and branches in some small- to medium-sized towns have been closed. As a result, only around 45% of the Botswana population live in settlements with a permanent banking presence, and many large population centres have no local access to banking services (see Tables 1 and 2).

Table 1:
Settlements with bank presence

Location	No. of banks	Population
Gaborone	5	280,460
Francistown	4	91,430
Molepolole	1	57,951
Selebi-Phikwe	2	50,040
Serowe	1	43,250
Maun	4	42,081
Mahalapye	3	38,373
Mochudi	1	37,754
Kanye	2	37,457
Lobatse	3	29,779
Palapye	3	26,792
Jwaneng	3	16,201
Ghanzi	1	10,200
Orapa	1	9,002
Kasane	1	8,312
Tsabong	1	6,731
Total		785,813
Total Botswana		1,739,556
% of population covered		45%
Source: Bank of Botswana; CSO		

Table 2: Major unbanked settlements
(population > 10,000)

Location	Population
Ramotswa	21,927
Thamaga	19,243
Tonota	15,855
Moshupa	15,769
Letlhakane [1]	15,644
Bobonong [1]	14,461
Tutume	13,944
Mmadinare	10,798
Total	127,641
% of pop.	7.3%
[1] Part-time banking agency presence	

For much of the population, the main channel of access to (a limited range of) banking services is the Botswana Savings Bank, operating in association with the Post Office, which is well represented across the country, with 112 outlets covering 65% of the population.

Research published by the World Bank shows that Botswana, along with Namibia, has the lowest geographical penetration of bank branches out of a survey of 99 countries[8]. This is not surprising, given that Botswana and Namibia have among the lowest population densities of any countries in the world. Of more relevance is that Botswana has a relatively low demographic penetration of bank branches; with 3.8 branches per 100 000 people, Botswana ranks 73 out of 99 countries – significantly better than most African countries but below South Africa (6.0), Mauritius (11.9) and Namibia (4.5). Botswana does better with ATM availability, ranked internationally at 59 out of 99 countries, with nine ATMs per 100 000 people.

8 See *Reaching Out: Access to and Use of Banking Services Across Countries*, op.cit.

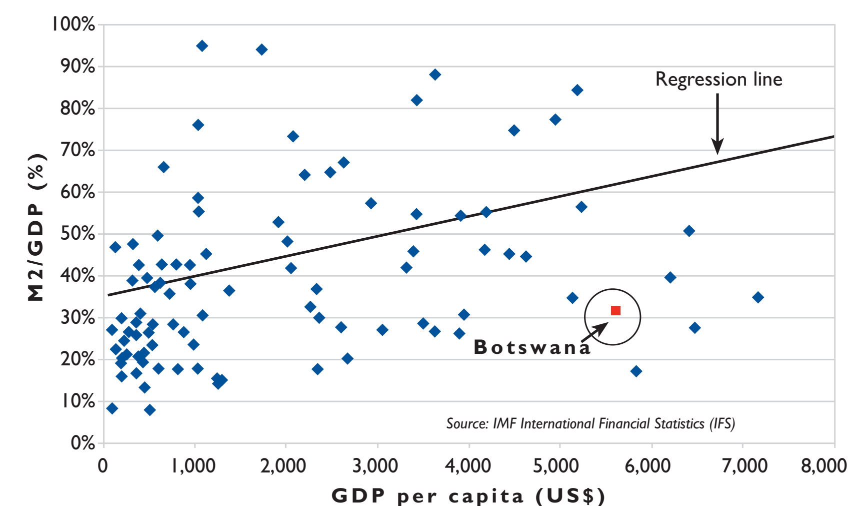
Financial depth

Besides concerns about geographical coverage, there are also concerns about the effective exclusion of the low-income or unwaged segments of the population from access to banking services, due to product design and selection criteria. Essentially the structuring of banking products and services reflects a belief that there is little or no profit to be made from serving low-income and/or rural and peri-urban/semi-urban communities, given the size of population settlements in Botswana.

Before considering measures of financial access in Botswana, it is worth looking at a more general measure of financial development in Botswana. A commonly-used measure of financial development is the ratio of M2 money supply to GDP, which is equivalent to the ratio of deposits held in the banking system to GDP, and is also known as financial depth. In general there is a positive correlation between financial depth and income levels, in other words, richer countries (with higher GDP per capita) tend to have higher financial depth.

Figure 1 shows the relationship between financial depth and GDP per capita across 100 developing countries in Africa and elsewhere, and includes a regression line showing the "average" relationship between the two, demonstrating the positive

Figure 1: Financial depth and GDP per capita (Developing countries, 2003-4)



correlation noted above. The chart shows that Botswana's level of financial depth is well below the level that would be expected for a country of its income level; the regression line indicates that a country with Botswana's level of GDP per capita ($5600) would have a M2/GDP ratio of more than double Botswana's actual level of 31%. In other words Botswana's banking sector is relatively small – and hence arguably underdeveloped – for a country of its income level.

Other financial development indicators include the level of bank deposits and private sector credit, both in relation to GDP. As Table 3 shows, Botswana's performance is only slightly below the average for middle-income countries in Sub-Saharan Africa (excluding South Africa); the main issue is that middle-income countries in Sub-Saharan Africa have far lower levels of financial development than middle-income countries generally.

Table 3: Indicators of financial development by income group, 2000-04

	Sub-Saharan Africa				Other
	Low income	Middle income	Middle income excl. SA	Botswana	Middle income
Bank deposits/GDP	18.0	50.7	29.2	25.8	39.4
Private sector credit/GDP	13.3	64.0	21.0	18.8	40.3
M2/GDP	26.9	55.6	32.1	29.4	94.2

Source: IMF Regional Economic Outlook – Sub-Saharan Africa, 2006, p.30, and International Financial Statistics

Another measure of financial development is the ratio of cash to deposits – essentially measuring the relative importance of cash and the banking system in the economy; the higher the ratio, the more dependent the economy is on cash and the less developed is the financial system. For Botswana, the measure is more positive than the financial depth measure noted above. The ratio is around 4%, which is relatively low and means that the banking system plays a generally important role in transactions and as a store of value, suggesting that the banking system is doing reasonably well in intermediating finance.

Botswana's financial sector

One of the characteristics of Botswana's financial system is the dominant role of the commercial banks[9]. Total bank assets and liabilities amounted to P18.8-billion at the end of 2005 (about 33% of GDP); of liabilities, around P13.8-billion represents customer deposits, and of assets, around P9.0-billion represents loans and advances.

Besides the commercial banks, there is one merchant bank and a number of government-owned financial institutions (FIs), including the Botswana Savings Bank (BSB) (which offers both deposit-taking and lending products), and the National Development Bank (NDB), CEDA, and the Botswana Development Corporation (BDC), all of which offer only business lending products. In addition, the Botswana Building Society (BBS), has a significant government shareholding, and offers both loans and deposits. The combined balance sheets of these institutions amounts to around one quarter of the combined balance sheet of the commercial banks (see Table 4).

Table 4: Financial institutions balance sheet (December 2005)

	Assets		Loans		Deposits	
	Pmn	% of total	Pmn	% of total	Pmn	% of total
Bots. Bdg Soc.	953	*4.1%*	726	*6.6%*	186	*1.3%*
Govt owned FIs [1]	3,518	*15.3%*	1,206	*10.9%*	181	*1.3%*
Merchant banks	881	*3.8%*	227	*2.1%*	756	*5.3%*
Commercial banks	17,686	*76.8%*	8,908	*80.5%*	13,073	*92.1%*
Total	23,038	*100.0%*	11,067	*100.0%*	14,196	*100.0%*

Note: [1] BSB, BDC, NDB, CEDA

Source: Botswana Financial Statistics; CEDA (data for March 2005)

Private-lending companies range from relatively large formal entities (Letshego, Penrich, First Funding, Peo), sometimes called "term lenders", to a large number of small, informal entities ("cash loans"). As they do not take deposits, they are not subject to banking regulations and accurate information on them is sparse. In 2003 the total lending of the term lenders was estimated at P350-million and cash loans at P50-million[10]. There are also a large number of registered credit unions, burial societies, informal savings and loans groups (*metshelo*), and two microfinance operations focused on small-scale entrepreneurs[11]. The total lending of the credit unions was P95-million in 2005, and the two microfinance lenders were P0.65-million in 2005[12].

9 This data includes Barclays, Standard Chartered, FNB, Stanbic, and Bank of Baroda. A sixth bank, Bank Gaborone started operating in mid-2006.
10 FinMark Trust/Genesis Analytics (2003) *Access to Financial Services in Botswana*.
11 Women's Finance House and Kgetsi ya Tsie.
12 *International Year of Microcredit – Fact Sheet on Access to Financial Services and Microfinance in Botswana*: UNDP Gaborone, 2005.

Besides BSB and the two microfinance lenders, few of these entities have extended financial access significantly. The NDB and BDC deal with commercial lending only to medium and large-scale enterprises; CEDA lends to a range of enterprises, including small ones, although it does not extend to micro-enterprises; BBS specialises in property lending to commercial and household borrowers, but in the latter category would concentrate on the employed. Credit unions provide a small-scale savings facility, as do *metshelo*, and burial societies combine savings with insurance, though none provide savers with an attractive rate of interest on their savings.

One of the perennially controversial issues about the banking system is its profitability, especially given concerns (discussed later) about the level of bank charges and access issues. As Table 5 and Figure 2 show, Botswana banks are extremely profitable, even by African standards where returns on assets and equity are high by world standards[13]. This has persisted notwithstanding the entry of new banks and increased competition in the sector, which would be expected to bring profits down. Lending in Botswana is not particularly risky, so high returns cannot be explained by risk. Despite new entrants, the number of banks remains small and concentration is high, although perhaps not excessively so by regional standards[14].

Nevertheless, persistent high profits suggest that competition is inadequate. However, the licensing regulations permit new entrants, subject to modest prudential conditions, and the problem may simply be market size and that Botswana is not big enough to accommodate new full-service commercial banks. Hence the main barrier to entry – and hence to more competition – may simply be the small size of the market. There may be an argument for making the bank licensing regulations more flexible to accommodate the entry of different types of banks, not necessarily offering a full range of commercial banking services.

Table 5: Banking profitability (various years, 1999-2003)

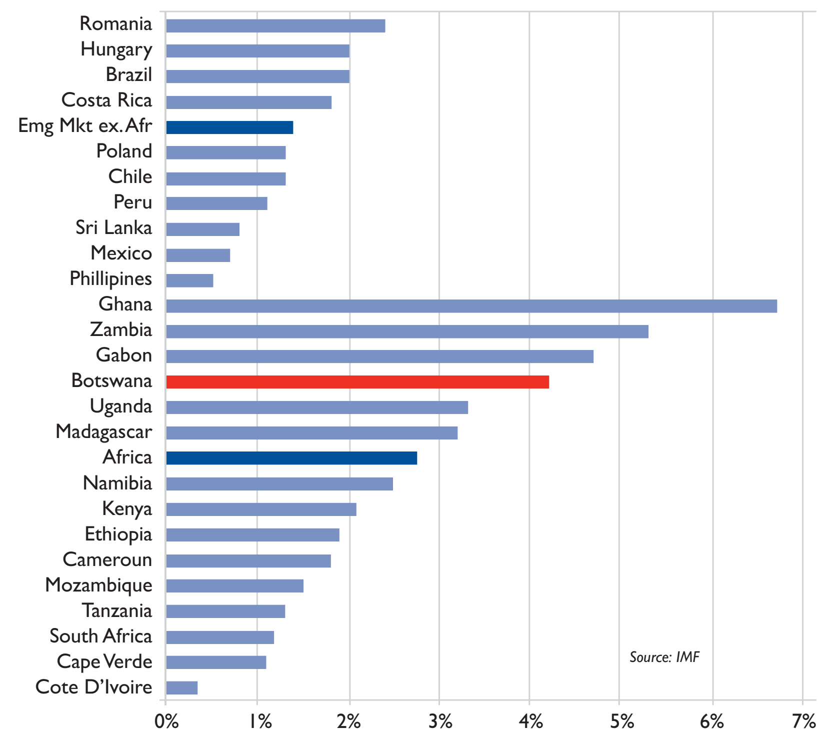
	Return on Assets (RoA)	Return on Equity (RoE)
Emrg mkt excl. Africa	1.4%	15.0%
Africa	2.7%	27.0%
South Africa	1.4%	30.0%
Botswana	4.2%	44.0%

Source: IMF Working Paper WP/05/166

13 Based on data from Emilio Sacerdoti, *Access to Credit in Sub-Saharan Africa: Key Issues and Reform Strategies*, IMF Working Paper WP/05/166, August 2005.

14 In 2004, the two largest banks had a market share of 63%, and the next two 32%. By comparison, in Mauritius the largest two banks had a market share of 90%, and in South Africa the top four banks had a market share of 85% (Soylemezoglu, A. *Botswana's Financial Sector: Issues and Prospects*, background paper prepared for World Bank/BIDPA Study on Export Diversification in Botswana, 2004).

Figure 2: Banking sector profitability (return on assets) (1999-2003)



Measuring financial access in Botswana

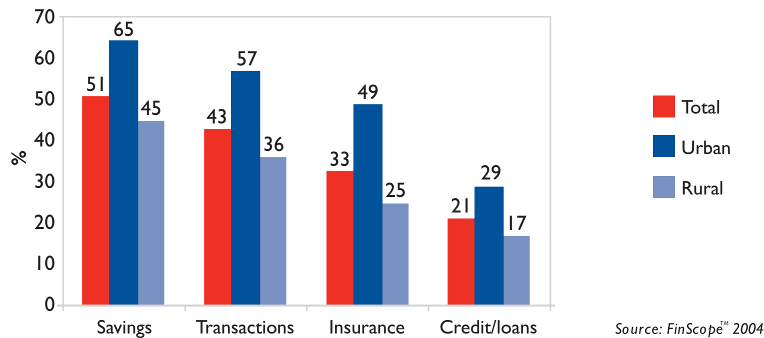
The starting point for a discussion of the present state of access to financial services in Botswana is the FinScope™ 2004 survey. FinScope™ was a representative, nationwide survey of 1 200 households, with questions on the use of a wide range of financial services focusing on four main product types: savings, credit, insurance and transactions/remittances, both formal and informal. The survey focused on the use of personal financial products and services by households, and so did not cover businesses needs (such as credit for SMMEs). The results provide a range of information about use of financial products and services, by different segments of the population, from which many conclusions about access can be derived[15].

15 The FinScope™ 2004 Survey comprised 1 200 face-to-face interviews during September and October 2004, drawn from a nationally representative sample of adults aged 18+ years. It covers two cities, five towns and 21 other census districts. It used a stratified multi-stage random sampling method applied using 2001 Census data. The sample size gives a precision level of +/- 3%. The data has been weighted by age, gender and region to bring sample profile in line with that of the population. The survey was funded by a consortium of Botswana financial institutions, including the Botswana Building Society, Botswana Savings Bank, Botswana Life Insurance, First National Bank of Botswana and Standard Chartered Bank Botswana.

The top level findings from the FinScope™ 2004 survey are:

- The "financially served", i.e. those who use formal and/or informal financial products, comprise 54% of the population. Compared to other countries in the region, this is similar to levels of financial inclusion in South Africa and higher than that in and Namibia, Swaziland and Lesotho[16];
- 49% of the population are "formally included" and use formal financial products (banks, insurance companies and formal microlenders such as Letshego), whereas 32% of the population use informal financial products (cash loan shops, *metshelo*/savings clubs, credit unions and burial societies). However, half of the financially included use both formal and informal products;
- Among the four types of products, the most popular are savings products (used by 51% of the population), followed by transaction products (43%), insurance products (33%), and credit/loan products (21%). Urban residents use significantly more products than rural residents across all product types (see figure 3).

Figure 3: Use of main products



Source: FinScope™ 2004

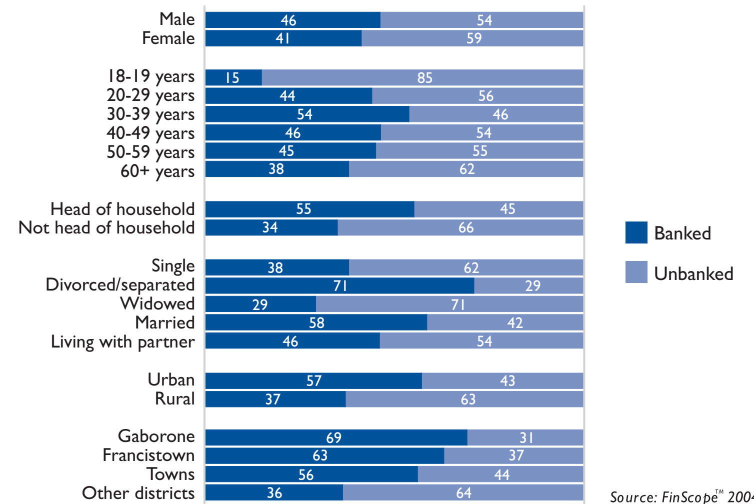
The FinScope™ Survey also looks at use of, and access to, banking products, given that banks are the most important financial institutions in the country. The most important results are:

- 43% of the population are "banked", in that they currently use at least one banking product, and 57% are "unbanked";
- There are major differences between the banked and the unbanked (see Figures 4 and 5);
- There is relatively higher use of banking among urban residents, heads of households, well-educated people and those with higher incomes; for instance, 57% of the urban population is banked, as are 81% of those in full-time employment;

16 Other comparative figures to note are that in the European Union and the US around 90% of adults have bank accounts; in Tanzania, only 6% do (S. Peachey & A. Roe, *Access to Finance – What Does it Mean and How do Savings Banks Foster Access?*, World Savings Banks Institute, 2006).

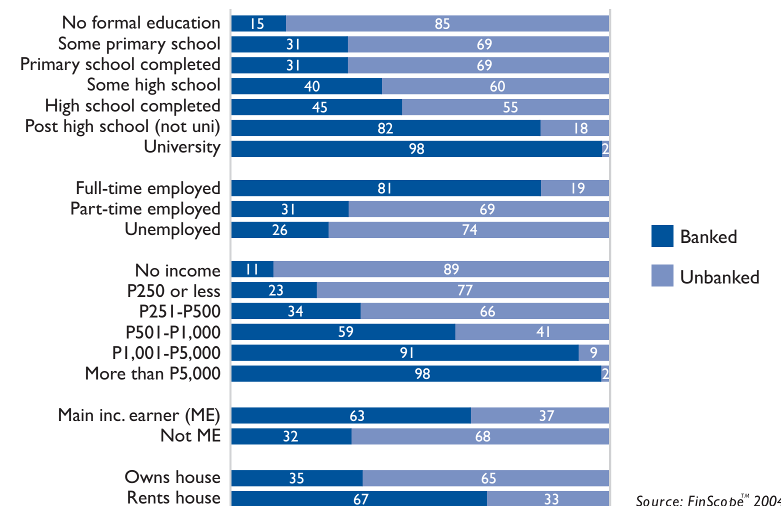
- Men are marginally more likely to use banks than women;
- Use of banking is relatively low among the rural population, the unwaged, the young and the elderly, and those with less education; for instance, only 37% of the rural population are banked.

Figure 4: Banking status by sub-groups – I



Source: FinScope™ 2004

Figure 5: Banking status by sub-groups – II



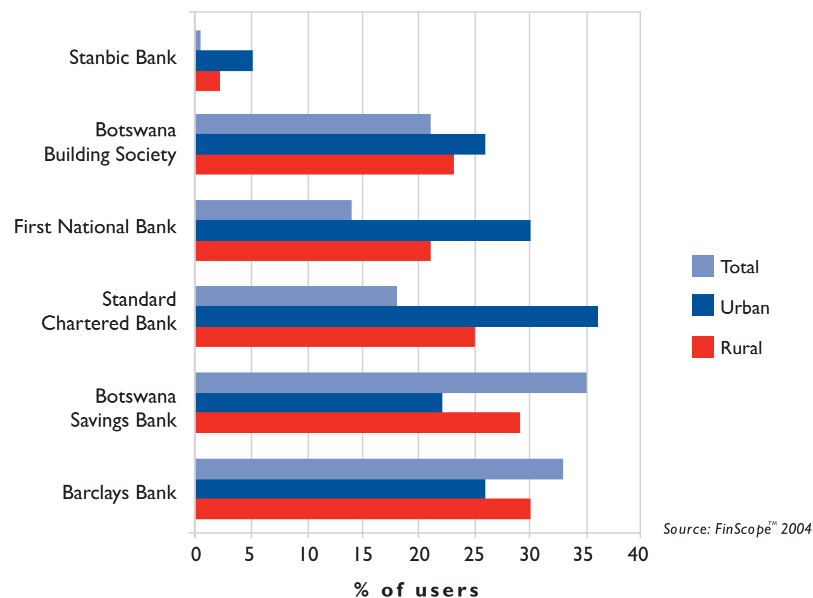
Source: FinScope™ 2004

While the result on access to banking indicates that more than half of the population do not use banks, a comparative perspective is useful. FinScope™ surveys in South Africa and Namibia give slightly higher levels of access to banking, at 47% and 51% respectively. Elsewhere in Sub-Saharan Africa, banking penetration is much lower, especially in low-income countries: the proportion of the population with a formal bank account is estimated at 2% in Angola, 10% in Kenya, 1% in Madagascar, 5% in Tanzania, 6% in Uganda, and 17% in Zimbabwe[17].

The Botswana FinScope™ Survey also investigated why the unbanked do not have bank accounts. The results show that the main disincentives to having a bank account are unemployment and low incomes – a result that is consistent with similar survey results in other countries. Beyond this, the requirement to pay service fees, the expense of maintaining an account, and distance from banks are cited as important barriers to banking.

The survey results of the penetration of different financial institutions in different areas show that Barclays Bank has the largest national penetration (30% of banked respondents), while Standard Chartered has the highest penetration among urban respondents (36%) and Botswana Savings Bank has the highest penetration among rural respondents (35%).

Figure 6: Penetration of individual banks



Source: FinScope™ 2004

17 Source: IMF *Regional Economic Outlook, Sub-Saharan Africa*, May 2006, p.69. It should be noted, however, that in many countries the quality of data on usage of financial services is poor.

Implications

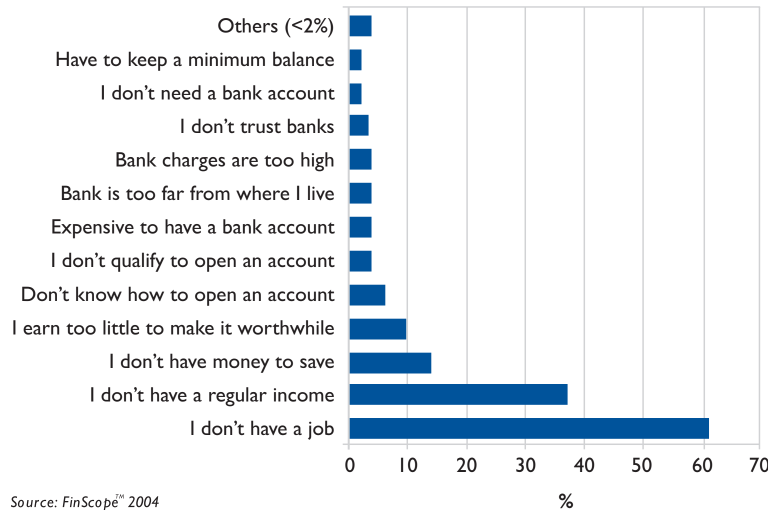
There are a number of implications of the FinScope™ 2004 results for Botswana. First, they show that nearly half of the population is financially excluded, in that they do not use any financial institutions, and that over half of the population is unbanked. While it will never be feasible to aim for 100% coverage – even in developed economies there will always be some unbanked people – there is a strong case that a "financially developed" economy should be striving for much higher levels of banking coverage.

Data on geographical coverage of bank branches yields similar results. About 45% of the population live in towns and villages with bank branches, and a further 3% live in settlements with agencies (providing a limited, part-time banking presence). A number of substantial settlements, with populations of more than 15 000, have no banking presence at all (Ramotswa, Thamaga, Tonota and Moshupa).

Why is banking coverage incomplete in Botswana, resulting in most of the population not having access to, or at least not making use of, banking services? The FinScope™ results indicate that one cause may be "self-exclusion", i.e. many people do not consider that they meet the criteria for using bank accounts, which is mostly to have a wage and/or to be employed. Beyond this, however, there may be deeper problems.

First, it is evident that banking penetration of what may be seen as the core market of the commercial banks – the employed, educated, higher income, urban residents – is getting close to saturation bank coverage. The unbanked population, however, has quite different characteristics; being predominantly rural, less well-educated, unemployed or with irregular incomes, they do not meet the preferred customer profile of conventional banking models. To a large extent, banks do not see serving the unbanked market as worthwhile, given that it is not suited to their conventional business models, and many banks have struggled to find innovative and profitable ways of servicing the low-income market, especially in rural areas. It may be, therefore, that the self-exclusion of banks and the unbanked is mutual.

Figure 7: Reasons for not having a bank account



Source: FinScope™ 2004

A second issue relates to bank charges. While these were not cited by FinScope™ respondents as being a particularly important reason for not using banks, there are reasons to believe that if the poor did wish to use banks, they would find the charges onerous. There is also evidence from the FinScope™ Survey that for people who do make use of banks, the level of charges is very important in determining which bank is chosen (see Table 6). This is discussed in more detail in the next section.

Table 6: Bank choice drivers

Bank Choice Drivers (%)	Main Consideration	Total Considerations
Bank charges and fees	32	63
Interest rates	29	65
Location of branch/bank	10	29
Flexibility in transactions	6	21
Personal services	5	20
Accessibility to loans	5	24
Attitude of staff	1	14
Minimum balance required	1	2
ATM close to where I live	1	7
Safety of money/Reliability of bank/ Trust in bank	1	2
Technology available	1	4

Source: FinScope™ Botswana, 2004

Bank charges and access

The level of bank charges in Botswana is criticised consistently, but to what extent is this justified? Various studies by the Bank of Botswana (2001), Botswana Institute for Development Policy Analysis (BIDPA) (2003), Central Bank of Lesotho (2003) and FinMark Trust/Genesis Analytics (2005) have investigated the level of bank charges in the region[18]. The Bank of Botswana concluded that bank charges in Botswana are higher than in South Africa and Mauritius. BIDPA concluded that banking in Botswana is more expensive than in South Africa. The Central Bank of Lesotho found that Botswana banks were the most expensive in Southern African Customs Union (SACU), as did the FinMark/Genesis study. While each of the four studies can be criticised on grounds of methodology, the consensus of their conclusions – that banking in Botswana is expensive – is striking.

This result should be qualified, however, as Botswana also has the highest level of average (per capita) incomes in the Southern Africa Development Community (SADC) region, and hence it is to be expected that bank charges would be higher. However, the real question is whether bank charges make banking unaffordable to a significant proportion of the population. Unfortunately there is no research that measures the cost of banking in Botswana using internationally comparable methodology[19]. However, it is possible to look at affordability on the basis of hypothetical levels of charges. FinMark Trust uses an "affordability" benchmark of 2% of income – people should not be expected to pay more than this in bank charges if banking is to be accessible. If the average level of bank charges on a basic account were P20 a month, then a household would have to have an income of P1,000 a month for this to be affordable. On the basis of household income data in the 2002/03 Household Income and Expenditure Survey (HIES), updated to 2006 prices, 53% of households in Botswana have incomes of more than P1,000 a month, and could therefore afford bank accounts costing P20 a month in charges. In fact, it is likely that average bank charges are higher than this, in which case the cost of banking would be above the affordability threshold for most of the people in Botswana; at P40 a month, banking would be affordable to only around one-third of households.

Table 7: Affordability of bank charges

Monthly bank charges (P)	10	20	40	80
Monthly bank charges (US$)	1.8	3.6	7.3	14.5
Income-affordability threshold (P)	500	1,000	2,000	4,000
% of households covered	69%	53%	35%	20%

Source: HIES 2002/03 & own calculations

18 Central Bank of Lesotho (2003) Comparative Analysis of the Cost of Banking Services in the SACU Region (CBL Research Department paper); Genesis Analytics (2005) Measuring Access to Transaction Services in the Southern African Customs Union – an Index Approach (Paper prepared for FinMark Trust); BIDPA (2003) Cost of Banking in Botswana, BIDPA Briefing, January 2003.

19 It is important to use an internationally comparable method for measuring bank charges, because the structure of bank charges, and of the usage of bank products, varies considerably across countries, and a carefully constructed standard "package" is required for comparable cost comparisons.

Options for broadening access to financial services

There are a number of related conclusions about access to financial services in Botswana:

- From the FinScope™ 2004 survey, slightly more than half of the population – 54% – is "financially served", in the sense that they use financial services of some kind, and most – 49% – use financial services provided by formal sector entities;
- Also from the survey, 43% of the population are "banked", in that they have a bank account, and 57% of the population are unbanked;
- Banking service coverage is good among the urban, waged population, but poor among the rural, unwaged, low-income population;
- About 45% of the population live in settlements where banking services are provided;
- Bank charges in Botswana are high by regional (SADC/SACU) standards;
- About 53% of the population would find banking services affordable (based on a 2%-of-income affordability threshold) at a modest level of bank charges (P20 a month), and a banking product that would be affordable to the wealthier half of the unbanked population would have to limit charges to no more than P10 per month;
- The banking sector is small relative to the size of the economy (given Botswana's income level); and
- The banking sector is highly concentrated (dominated by a small number of banks) and highly profitable.

These findings suggest that around half of the population do not have access to financial services, and hence are largely restricted to cash-based transactions and do not experience the benefits that various types of financial services (transactions, savings, insurance and credit) can bring.

A second conclusion is that the conventional banking model is unlikely to provide a viable channel to extend banking services to the unbanked half of the population. The characteristics of the unbanked (relatively poor, low and irregular incomes, rural with a low population density), and their limited ability to afford bank charges above a very low level, means that it is unlikely to be commercially viable to extend the branch banking ("bricks and mortar") network to cater for the unbanked, especially those in rural areas.

Innovative approaches – by commercial banks, other financial institutions and government – may therefore be needed if banking services are to be extended to the unbanked, with the potential benefits for economic growth and poverty reduction that this implies. These will most likely need to be based on "branchless banking"[20].

Developing strategies to make the financial sector more inclusive – thereby increasing the benefits to the poor of participating in the formal economy – could follow a number of different courses (or a combination of them). Broadly, four main approaches could be considered:

(i) Encouraging institutions that already deal with the low-income market (e.g. the Botswana Savings Bank) to broaden their services;
(ii) Encouraging private sector/market-led solutions, especially those that take advantage of emerging technological opportunities to provide low-cost banking services, perhaps making use of agents, such as retail stores;
(iii) Changing the bank licensing regulations to provide more flexibility in the provision of banking services; and
(iv) Pushing the banks (whether by moral suasion or more formal pressure) in the direction of greater social inclusiveness.

These approaches, discussed in more detail below, are not mutually exclusive and may overlap in a number of areas.

Extending the services of existing institutions

Under option (i), there is considerable potential for developing the position that the Botswana Savings Bank occupies in the banking market. BSB is already the largest provider of banking services to the rural population, and its relationship with Botswana Postal Services (BPS) offers great potential for extending this. Whereas bank branches cover only 45% of the population, the existing network of Post Offices covers a significantly higher proportion of the population (65%) than bank branches, and therefore potentially provides a way of improving access to the rural and unbanked populations. Worldwide experience suggests that providing banking services through a post office network (postbanks) can be a viable low-cost option. This can benefit both parties, given the scope for economies of scale from shared infrastructure, especially as the revenues from mail-related activities are often insufficient to make the postal network viable on its own[21]. The nature of the relationship between postal services and banking components is crucial, and there are strong arguments for an ownership link between the two (although with operational and financial separation) which can help align objectives. In Botswana,

20 For more discussion, see Lyman, T., G. Ivatury & S. Staschen *Use of Agents in Branchless Banking for the Poor: Rewards, Risks and Regulation*, CGAP, 2006.
21 See e.g. *The Role of Postal Networks in Expanding Access to Financial Services*, Discussion Paper, Global Information and Communication Technologies Department, World Bank, 2006.

this has implications for privatisation policy; the idea that has been mooted of merging BSB and the National Development Bank would not be supportive of extending financial services to the unbanked, and consideration should be given instead to strengthening the link between BPS and BSB.

Nevertheless, it must be acknowledged that often neither postal services nor savings banks are well run, and making postbanks/savings banks an effective mechanism for improving access requires considerable reform of products, services and management[22]. This applies to BSB, which has faced considerable problems in its operations and would have to undertake wide-ranging reforms to strengthen its existing capacity before embarking on any ambitious expansion plans of products and services. There is a wealth of global expertise on making postbanks effective, and considerable assistance could be provided by bodies such as the World Savings Bank Institute.

There is also a need to use technological innovation.

Using new technology

The second approach involves encouraging market-led, private sector solutions to the problem of lack of access, taking advantage of the opportunities offered by new technology. Conventional dedicated, full-service banks, with "bricks and mortar" branches, have high costs and staffing requirements, and are unlikely to be a viable route for expanding access, especially in a sparsely populated country such as Botswana. Charges designed to recover costs would in any case make services unaffordable to the majority of any potential clientele. The key is to use new technology to aid the delivery of low-cost (and hence low-charge) banking services. Many financial transactions do not require staffed bank branches; for instance, cash can be accessed through ATMs (which could, for instance, be installed in all post offices) or from merchants equipped with appropriate point-of-sale (POS) devices, through card-based transactions. The "mini-ATMS" introduced by FNB in some retail stores are an example of such an approach.

However, ATMs are now regarded as "old technology", and recent technological advances have opened up many more possibilities. Chip-based smartcards (as opposed to conventional magnetic stripe cards) permit much more than cash withdrawals and debit card purchases at retail merchants. They allow multiple accounts to be held on one card, they can be loaded with cash (electronic wallets) from, for instance, welfare payments and pensions, and furthermore they are much more secure against fraud than the old magstripe cards.

22 As one recent report concluded: "There is also consensus that offering postal financial services needs to be revamped from fragmented single products to integrated packages including payment cards, savings, deposits, insurance, and even credit", *Worldwide Landscape of Postal Financial Services: Africa Region* (World Bank/ING Bank, 2006, p.4).

A second opportunity arises from cellphone banking, which has much potential for low-cost banking and financial services, ranging from entry level services such as airtime top-up to balance enquiries, bill payments, money transfer (mobile payments or m-payments) and eventually to full mobile banking (m-banking). Where cellphone/m-banking exists, transaction costs are typically much lower than those charged by old-style financial institutions[23]. M-banking is a rapidly evolving business that has considerable potential to transform financial access through extending banking to the unbanked for a number of reasons[24]:

- It uses existing mobile communications infrastructure which already reaches many unbanked people;
- It may be driven by new players, such as telecommunications companies, with different target markets from traditional banks;
- It may harness the power of new distribution networks for cash transactions, such as airtime merchants, beyond the conventional merchant POS or ATM network of banks; and
- It may be cheaper than conventional banking, if the offering is competitive.

As a result, cellphone banking has the potential to be transformational, in the sense that it can provide a new banking channel targeting the currently unbanked[25]. Considerable success has been achieved in the Philippines, where Globe Telecom's G-Cash service, established in 2000, now provides mobile banking to 1.3-million customers, and a similar offering is being pilot-tested in Kenya[26]. There are several cellphone banking services available in South Africa, including WIZZIT and MTN Banking, primarily targeting the unbanked, while the four main banks also offer cellphone banking channels for their existing customers.

Cellphone banking may have considerable potential in Botswana, where cellphone penetration is among the highest in sub-Saharan Africa, at 46.6 per 100 people in 2005)[27]. The high take-up of cellphones in Botswana suggests that the population is ready to adopt new technology, a point that is reinforced by the finding from the FinScope™ survey that 75% of respondents were prepared to learn how to use new technology.

New technology may also facilitate the provision of banking services by retail agents on behalf of banks. This already happens to a small degree in Botswana: Botswana Post provides agency services for BSB, and retail merchants provide agency services using FNB's mini-ATMs. However, the potential is much greater than this. In Brazil,

23 In South Africa, which has three cellphone banking providers as at mid 2006, the cost of a money transfer by cellphone banking is approximately one-eighth of the cost of a transfer by money order through the post office (BIFM-FinMark Trust Forum on Technology and Access to Banking, Gaborone, April 2006).
24 Based on D. Porteous *The Enabling Environment for Mobile Banking in Africa*, Executive Summary of Report commissioned by DFID, May 2006.
25 D. Porteous *Mind the Gap: Bankable Approaches to Increase Access to Finance – Enabling Environment for Mobile Banking*, presentation to Netherlands Financial Sector Development Exchange.
26 Lyman et al, *Use of Agents in Branchless Banking for the Poor: Rewards, Risks and Regulation*, op.cit.
27 Source: International Telecommunications Union (www.itu.int/ITU-D/ict/statistics).

the use of retail agents by existing banks to deliver financial services through supermarkets, pharmacies and lottery kiosks has transformed the availability of banking services throughout the country, and a similar approach is being tried in India. Much of the potential of this type of service stems from the availability of information and communication technologies that can be used to record and transmit transaction details quickly and reliably, and cellphones and smartcards have the potential to provide stores of value. Given the widespread network of shops, post offices and airtime vendors throughout Botswana, there is scope for low-cost provision of banking services through retail agents, although regulatory issues may need to be addressed (for instance, restrictions on the opening of accounts and the taking of deposits).

Technology-based services therefore have the potential to improve access to financial services in two ways: first, by offering services that are more suited to the poor than those offered by conventional banks, and second by offering financial services much more cheaply, thus making them more widely available and affordable to the unbanked. Indeed, technology is likely to change the face of banking in general, not just for the poor, by making branches and personal contact less relevant (although not irrelevant). Building on option (i) above, technology also opens opportunities for post/savings banks to provide modern low-cost services and consolidate their leading position in the provision of low-cost banking services. However, this would require considerable investment in the modernisation of post offices, with, for instance, automation of counter services and ATMs throughout, in turn requiring power supplies and satellite communications. It also provides opportunities for existing banks to expand their networks and availability of financial services using agents rather than through branches.

This in turn suggests that access-to-finance issues should be incorporated into broader government policy deliberations about the development of the telecommunications sector, especially in the rural areas. Current policy documents provide only limited consideration of the potential for telecommunications technology to contribute to improving access to finance. For instance, a recent report on the development of a universal access and service policy for the communications sector acknowledges that there is scope for the Post Office to "provide expanded financial services to its clients", but does not go on to explore how the telecoms infrastructure can contribute to this[28]. And a recent draft document on developing a rural telecommunications strategy makes no mention of the potential role of rural telecoms in enhancing the provision of financial services in rural areas[29].

28 Intelecon Research & Consultancy Ltd, *Development of a Universal Access and Service Policy for the Communications Sector in Botswana*, Final Interim Report presented to the Botswana Telecommunications Authority (BTA), July 2006, www.bta.org.bw/pubs).

29 Icegate Solutions Ltd, *Draft Rural Telecommunications Strategy*, prepared for Ministry of Communications, Science and Technology, June 2006.

More generally, the government's responsibilities in enhancing the provision of technology-based financial products and services include as a minimum the creation of a liberalised and efficient regulatory structure that accommodates innovation, but may extend beyond this to meeting at least part of the costs of core infrastructure provision (as it does, for instance, with the provision of roads, water and sanitation). The provision of new financial products and services on the basis of technological developments will also be influenced by regulatory requirements in the financial sector. While some products will not require regulatory approval (e.g. card-based payments and transactions services), others, however, extend into the area of banking business (e.g. e-money, deposit taking) which has regulatory implications and hence may require regulatory reforms to enable such developments. The role of regulatory reforms more generally in supporting the extension of financial access is discussed below.

Regulatory reform

The banking sector in Botswana, as in many other countries, is one of the most heavily regulated sectors of economic activity. There are good reasons for this, as the banking sector has specific characteristics (such as the role of information – which is imperfect – in assessing risks) and particular vulnerabilities (whereby problems in one financial institution can cause systemic instability) that require such regulation. The fundamental reason for banking prudential regulation is to minimise the risks of financial and macroeconomic crises stemming from the banking sector. A secondary reason is to protect depositors, whose savings may be at risk in the event of a banking crisis, and a third is to help promote market efficiency, especially where such efficiency may be inhibited by asymmetric information.

There may also be other reasons for regulation. Many countries have recently introduced regulations relating to money-laundering and the financing of terrorism. These are aimed at ensuring public safety and minimising the scope for criminal activity, rather than systemic stability. Some countries have specific consumer protection objectives (beyond depositor protection) in their regulatory frameworks.

Generally, financial sector regulation does not deal explicitly with financial access, although increasingly the question is being asked as to whether regulatory frameworks should have an access dimension (beyond systemic stability and safety of depositors' money). Access may be seen as part of a broader developmental objective of regulation, which, along with contributing to public safety, may be seen as a new generation objective of regulation[30]. Introducing access as a regulatory issue does not mean that traditional regulatory concerns are compromised. However, it

30 Genesis Analytics, *A Policy Lens to View Financial Regulation*, Report for FinMark Trust, December 2004.

does mean that, at the very least, regulatory authorities should recognise that rules and decisions affect access to finance, and that regulation should not unnecessarily constrain access to finance.

The current regulatory structure for banks in Botswana is laid out in the Banking Act 1995, the substance of which dates back to the establishment of the Bank of Botswana in 1975 and the original Financial Institutions Act. Banking legislation focuses on deposit-taking institutions (hence lending-only institutions, using private funds, do not need a banking licence); the key purpose of regulation is to protect depositors and to guard against market failure in the banking system. The banking legislation provides for the issuance of a banking licence, which entitles a bank to carry out a full range of banking activities, and imposes a range of requirements on banking institutions designed to protect the public (primarily depositors) from risks that may be taken by the banks. Under the Banking Act, the Bank of Botswana has the power to issue different categories of banking licence, with different conditions and requirements attached.

This regulatory structure has several consequences. First, the need to acquire a banking license to carry out banking business provides a barrier to entry to the market, and hence restricts the level of competition. For instance, non-bank companies cannot enter many areas of banking business[31]. Second, any bank wishing to establish in Botswana and acquire a license essentially has to meet the same regulatory requirements as the existing full-service banks, even if it wishes to undertake only a limited range of business.

While some kind of regulation of entry into the banking sector is necessary, excessive regulation may unnecessarily inhibit new entry to the sector and innovation, thus contributing to reduced competition and possible stagnation.

Issues of entry and innovation are particularly relevant to the issue of access. As discussed above, existing banking forms are unlikely to extend their operations to accommodate the unbanked on any significant scale, and hence new forms of financial service provision are required – necessitating new entry to the banking sector. Furthermore, products suited to the low-income market may well be based on recent technological developments, thus requiring innovation. The regulator's dilemma is, therefore, to provide an appropriate degree of openness in the financial sector architecture, striking a balance between, on the one hand, maintaining stability in the financial system and, on the other, reducing barriers to entry to encourage rivalry, innovation and market expansion[32].

31 Take cellphone companies as an example. At present (in Botswana) pre-paid cellphone balances can only be applied to the use of airtime (or transfered to another person for the same purpose). However, it is technologically straightforward to enable such prepaid balances to be used for the purchase of other commodities. But then the pre-paid balance starts to look like a medium of exchange, i.e. money (or at least e-money), and the cellphone company the recipient of a deposit, which requires a banking licence.

32 D. Porteous, *The Regulator's Dilemma: Opening Space for Innovation and Development in the Financial System*, FinMark Trust.

While the current regulatory structure has served Botswana well, and has supported a stable banking sector with orderly restructuring of failing banks and no depositor losses, the banking industry worldwide has changed in many ways since this structure was originated, and there are reasons to believe that it should be reformed, specifically to permit new entry and innovation in the financial sector, but without introducing unnecessary or excessive risks. One way is a tiered-banking approach that allows new banks to enter the market to conduct a limited range of banking activities. As a result they are exposed to less risk, and hence there is commensurately less need for capital and technical resources, making it easier to enter the industry. For instance, a savings bank that takes deposits but does not lend, and invests only in risk-free government or central bank instruments, would require relatively little initial capital. In principle, this would also permit non-banks such as retailers, cellphone companies and insurers to offer a limited range of banking services (such as transaction facilities, small retail deposits and loans).

The key is to have a well-designed regulatory structure that accommodates different types of banking service provision with capital and technical requirements that are appropriately specified relative to the risk that the entity is exposed to, rather than relative to the full range of activities that a full-service bank might undertake.

The regulatory structure may also need to be revised to accommodate e-money developments[33]. Such developments use smartcards (or cellphones) that can be loaded with "cash", which can in turn be spent where appropriate terminals or facilities are available. At present, such card-based cash is likely to be classed as a deposit, and hence restricted to licensed banks. Initiatives such as Globe Telecom's G-Cash e-money account in the Philippines would not be permitted in Botswana under present legislation and regulations. While there are arguments for ensuring the protection of e-money users, this may not require e-money issuers to obtain a full banking licence, as at present. In the European Union, for instance, the issuance of e-money can be done either by banks or by a new category of Electronic Money Institutions, licensed specifically (and exclusively) for this purpose, and such an approach could be considered in Botswana.

Such changes – accommodating different types of banks and electronic money institutions – could be introduced within the context of the existing Banking Act, through the development of appropriate regulations that would enable the Bank of Botswana to license new types of banking operations.

A further regulatory issue concerns recent international developments related to the prevention of money laundering and the financing of terrorism. This has been the focus of a great deal of international attention in recent years, for obvious reasons, and developing countries have been pressurised to implement reforms and

33 See e.g., K. Jefferis, S. Kgosi, M. Robotham & J. Kgoadi, *Electronic Money Developments*, Bank of Botswana Research Bulletin, 22(1), pp27-36.

safeguards in their financial sectors in line with international anti-money laundering (AML) and countering the financing of terrorism (CFT) initiatives. While the objectives are worthy, such initiatives are expensive to implement and of questionable effectiveness, even in developed countries[34]. In developing countries, there are additional concerns about the possible/likely effect of AML/CFT initiatives on extending access to financial services. The regulations associated with AML/CFT typically include strict requirements for those wishing to open bank accounts, including proof of physical address, for instance in the form of a utilities bill. But many of the poor – especially in rural areas – do not have a physical address in the conventional sense, let alone access to the type of water, electricity or telephone services that come with a monthly bill. Insisting on new customers meeting international proof-of-physical-address standards will make it even more difficult for the poor to gain access to banking services, and thus entrench poverty further. Such regulations need to be implemented flexibly, in a way that will not undermine efforts to extend access to financial services. For instance, holders of small deposits and low-balance accounts could be allowed to comply with simpler customer identification requirements, so as not to impose onerous requirements that would exclude low-income customers from access to banking, given the small AML/CFT risks associated with small balances and low-value transactions.

In summary, a regulatory structure that offers "facilitative conditions" for access to finance should encompass the following[35]:

- Creating more competition;
- Improving infrastructure;
- Allowing space for innovation;
- Improving consumer education; and
- Facilitating entry to the market, institutional growth, and exit.

Getting banks to do more

A fourth dimension to access is to encourage the banks to move in the direction of greater inclusiveness and enhanced access to financial services. Typically, commercial banks shy away from providing services to low-income households, on the basis that it is too high-risk and high-cost to be able to make a profit. While there is some reason for banks to be cautious – the unit costs of managing small transactions and low-value accounts is relatively high, meaning that securing adequate volumes and achieving economies of scale is important – there is evidence that commercial banks overestimate costs and underestimate potential returns. Some commercial banks have managed to successfully operate in the low-income market, using a variety of

34 See for instance articles in *The Economist*, October 22, 2005.
35 Genesis Analytics, *A Policy Lens to View Financial Regulation*, op.cit, p.18-19.

institutional structures and strategies[36]. But this often needs new, specialised products, systems and staff, while leveraging off existing infrastructure.

Banks may not move in this direction on their own, however, especially when they enjoy large margins on their traditional business and competitive pressures are insufficient to pressure them to seek out new markets. In this case, it may take some prodding by governments and/or public opinion to get them to innovate and move closer to the access frontier.

The basic philosophy in Botswana at present is to leave the banks to operate more or less as they see fit, within the context of the prudential regulatory and licensing framework, with little or no direct intervention in their operations by government,[37] although they do require approval to open and close branches, and the Bank of Botswana uses moral suasion to try to persuade the banks to moderate bank charges.

Such an approach is consistent with a market economy and minimal state intervention, allowing the market to determine efficient outcomes. Generally, this is a good basis for economic policy. However, the primacy of market forces is not absolute, and intervention is appropriate when market failure occurs, or is likely to occur. In the financial sector there is clear evidence of market failure given the persistence of very high bank profits. Competition in the banking sector may have increased, but remains insufficient to bring profits down to levels that appropriately reflect the cost of capital and the risks involved in banking in Botswana. Insufficient competition may be due, in part, to the regulatory structure, with its restrictions on new entry. Persistent market failure, in turn, indicates a possible need for government intervention to improve the functioning of the banking market.

What form could such intervention take? One approach could be a tax on excess or windfall profits, similar to the taxation of the mining sector[38]. While this would help to bring after-tax profits down to more reasonable levels, it would not help resolve the problems of inadequate access to banking or reduce prices; indeed it might push bank charges up to even higher levels. A second form of intervention could be price controls (on bank charges or interest rates), although this is likely to be counterproductive and would generally be inconsistent with a market-led economic development philosophy.

An alternative approach could be based on the recognition by the banking industry that the award of a banking licence confers privileges (including the right to be partially protected from competition and make above-normal profits), and that the

36 DFID, *Banking the Underserved: New Opportunities for Commercial Banks – Exploring the Business Case*, op.cit., provides useful case studies. See also S. Claessens, *Access to Financial Services: A Review of the Issues and Public Policy Objectives*, op.cit.
37 This reflects the more liberalised environment that has been in place since the late 1980s.
38 The monopoly powers enjoyed by mining companies stemming from their rights to exploit mineral deposits on the basis of a government-awarded mining licence are subject to a special corporate profits tax formula that leads to a rising profit rate as the profitability of the mining operation increases.

possession of such a privilege also brings social obligations (beyond making donations to charities). There should be recognition that financial intermediation has social as well as economic and commercial functions, and that financial services should be accessible to a broad spectrum of the population, both for social reasons (reducing poverty) and long-term economic development reasons. It can be argued that the banks have an obligation to co-operate in extending financial access, even if not immediately profitable, as a *quid pro quo* for the benefits that stem from being awarded banking licences.

Once such recognition is in place, there is scope for negotiation between the banking industry and government to determine how social obligations should be met. It would be up to the banks to come up with innovative ideas on how to meet these obligations (underpinned by the threat that if they do not respond adequately there may be statutory intervention, such as an excess profits tax).

This approach has been followed successfully in South Africa, where the Financial Sector Charter (FSC) was negotiated and agreed between the banking industry and other financial sector entities (including insurers, pension funds, the stock exchange etc.), government and representatives of civil society. One of the most immediate and visible results of the FSC is the Mzansi account initiative, an entry-level bank account launched by the major banks and the Postbank, which has been effective at making low-cost basic banking services available to large numbers of previously unbanked clients.

While the content of the FSC was specific to South African history and needs, dealing with the legacy of apartheid, and hence may not be directly applicable in countries with different structures and history, the principle that the banks have a social obligation that includes, *inter alia*, making efforts to extend financial access, is more widely relevant. Also relevant to other countries is the idea of agreeing to provide certain products and services to lower-income groups within a certain timeframe, backed up by targets relating to physical access (e.g. x% of the population should have access to basic banking services within y kilometres of their homes), affordability and appropriateness. And while such a debate can be initiated by the government, and driven by pressure from the government, the outcome should be a negotiated one that ultimately rests on voluntary agreements reached by financial sector entities. This approach is likely to be more constructive than coercive legislation, which is more likely to deter investment and encourage avoidance rather than stimulate competition and innovation.

A similar process is under way in Namibia, where the financial sector, in consultation with a variety of stakeholders, is engaged in drafting a Namibia Financial Services Charter (NFSC). The NFSC, which will cover access to banking as well as other issues relevant to Namibia, was expected to be completed by the end of 2006. While the output of such a process would be expected to vary from country to country, the important point is that the process is a broad-based dialogue on how best an inclusive financial sector can be arrived at in a particular national environment.

Conclusions: The way forward

This paper has demonstrated that Botswana's banking system has a mixed record in providing access to finance for the country's population. Access levels are reasonable by the standards of Sub-Saharan Africa, but these standards are generally low, and the banking system covers less than half of Botswana's adult population. Levels of financial sector development are low for a middle-income country. These results, combined with the well-established links between financial sector development, economic growth and poverty reduction, suggest that financial sector policy should focus, *inter alia*, on making financial services more accessible, in particular to low-income groups that are presently excluded.

A number of policy developments and other initiatives could assist in achieving this objective:

(i) The regulatory system should be reviewed to establish whether reforms could be introduced that would improve access to banking; such reforms could include:
- Facilitating the entry of new institutions to the banking sector, perhaps by introducing tiered banking that would enable limited-scope banks to operate, with less onerous regulatory requirements, while ensuring that conventional regulatory concerns are not compromised;
- Facilitating the innovative provision of financial services, such as e-money and other electronic transactions services, including by non-bank entities; and
- Analysing the potential unanticipated impact of well-intended regulations, such as those relating to anti-money laundering, which may inadvertently restrict access to basic financial services.

(ii) Reviewing plans for the reform and privatisation of the Botswana Savings Bank to ensure that BSB's potential for serving low-income consumers in both rural and urban areas is developed. This is likely to include restructuring BSB to rectify long-standing operational deficiencies, as well as exploring the scope for closer co-operation with BotswanaPost, including a possible ownership stake.

(iii) Ensuring that policies on rural telecommunications and universal access to communications are supportive of technologies that would facilitate the innovative provision of financial services in under-served areas.

(iv) The 2004 FinScope™ Survey provided valuable information on the use of, and access to, financial services in Botswana, and on the characteristics of the banked and the unbanked. A follow-up survey – which could take place in 2007 – would provide further valuable information on the evolution of access to banking and finance over time. Banks and other entities with an interest in developing the financial sector (including the government and the Bank of Botswana) should be prepared to contribute resources to ensure that a second FinScope™ survey can proceed.

(v) Consideration should be given to developing a Botswana Financial Sector Charter that would help focus priorities and objectives and develop a plan for improving access to finance. Banks and other financial sector entities would be expected to take the lead in this process, with participation by government and the regulatory authorities. However, as the entity with policy responsibility for the development of the financial sector, the Ministry of Finance and Development Planning should initiate the process, perhaps through a roundtable discussion with financial sector entities and stakeholders.

(vi) The Financial Sector Assessment Programme that is scheduled to be undertaken by the IMF and the World Bank in early 2007 should include access to finance issues in its review, and make appropriate recommendations.

FinMark Trust was established in March 2002 with initial funding from the UK's Department for International Development.
Its mission is summarised in its slogan, "Making financial markets work for the poor". In practice this means promoting and supporting institutional and organisational development to increase access to financial services by the unbanked and underbanked of Africa.

FinMark Trust has been working in Botswana with Econsult on enhancing access to banking and financial services in that country.

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