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Rich Opportunity in the Unbanked Segment

Getting past the myths to tap potential

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Romina Abal leads EDC's practice in the unbanked/underbanked segment, and has provided strategy and financial consulting to clients in multiple countries including the United States, Spain, Mexico, Brazil, Chile and Argentina. She has been involved in some of the payment industry's earliest analysis of the unbanked/underbanked market, including the development of business models and economics of emerging payments products and assessing market opportunities across regions for both start-up companies as well as well-established organizations. Romina holds a Bachelor of Economics from Universidad de Belgrano in Argentina and an MBA from Harvard Business School. She is fluent in Spanish and has basic proficiency in Portuguese. Her office is in EDC's San Francisco headquarters.

"Unbanked[1]" consumers – the 15% of the U.S. adult population without a traditional savings or checking account – are unemployed, poorly educated, and not credit-worthy. Or are they? New and unique data from the PaymentDynamics℠ 2007 Preferred Payments Study shows that the conventional wisdom regarding the unbanked is overly simplistic at best, and in many ways, simply inaccurate. For instance, many financial institutions may be surprised to learn that more than half of the unbanked have attended college, or that only a third of them are rated as having sub-prime credit scores.

The PaymentDynamics℠ 2007 study shows that the U.S. unbanked market is far from a homogeneous whole; instead it is a collection of smaller segments, each with its own unique demographics and financial characteristics. And many of these segments may have far greater profit potential and lower financial services risk exposure than previously believed. While the survey focused on U.S. consumers, our experience suggests that the unbanked opportunities apply in many cases in other markets around the world.

MISCONCEPTIONS AND IMPLICATIONS FOR FINANCIAL INSTITUTIONS

A misperception is that the unbanked have the least desirable demographics – the lowest income, poorest education, highest unemployment rate, lowest credit worthiness, and so on. But empirical data tells a more complicated story. Let's examine the actual demographics of the unbanked population.

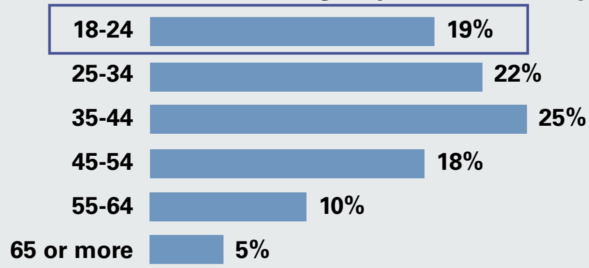
- **Age:** The unbanked population is significantly younger than the general population. Two-thirds of the unbanked are 44 years old or younger, compared to only half of the general population. And 19% of the unbanked are in the youngest age group, 18-24 years old, while only 10% of the general population falls into that category. **Implications for financial institutions:** This relative youth suggests that many of the unbanked may be on course to eventually open and use a bank account, apply for credit, and so on. Payment products such as prepaid cards that report online bill payment activity to credit bureaus allow young consumers to build credit history. Likewise, these products create opportunities for financial institutions to graduate consumers from pre-banked to banked, build consumer loyalty, and establish a basis for a lifelong relationship with increasingly sophisticated products and services.

The PaymentDynamics℠ 2007 Preferred Payments Study, conducted by Edgar, Dunn & Company and TransUnion, is an online study of consumer payment preferences, attitudes and behavior that included approximately 700 unbanked consumers.

[1] While the term "unbanked" can be defined in several ways, we use the most literal and relevant definition – those individuals without a traditional savings or checking account. This sector totals approximately 28 million adults in the U.S. The unbanked are distinct from the "underbanked," which have some limited relationship with a financial institution.

The unbanked population is significantly younger than the general population.

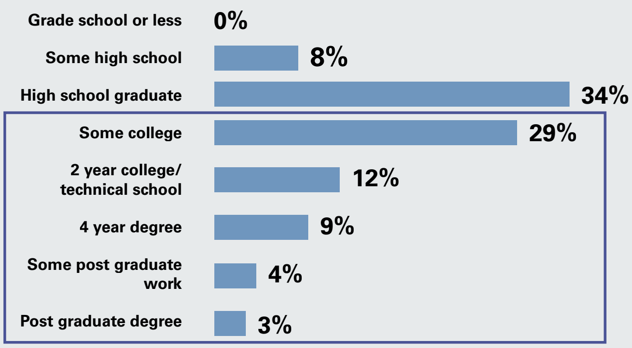
Unbanked Subgroup Distribution by Age



Source: *PaymentDynamics*^{SM} 2007 Preferred Payments Study

- **Education:** Survey findings show that unbanked consumers are much better educated than one might assume. More than 90% have a high school degree, and 57% have at least some college (compared to 97% and 74%, respectively, for the overall population). College graduation rates are relatively modest (16% have a four-year college degree or more); however college graduates outnumber high-school dropouts among the unbanked population. **Implications for financial institutions**: Advertising, marketing and other communications must accommodate a range of educational levels. A single message will not resonate with all educational levels.

Education Levels of the Unbanked

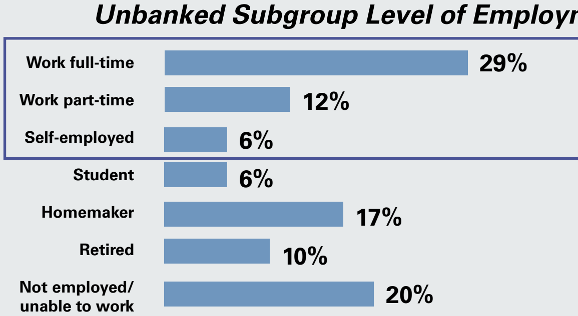


Source: *PaymentDynamics*^{SM} 2007 Preferred Payments Study

The employment and income profiles of the unbanked market are diverse

- **Employment and Income**: The employment and income profiles of the unbanked demonstrate the true diversity of the sector. About half (47%) work at least part-time, while the other half is split among students, homemakers, retirees and the unemployed. Incomes run the gamut too: 58% have a household income of $25,000 or less, but 11% report incomes over $75,000. **Implications for financial institutions**: Financial institutions and payment providers should use more sophisticated segmentation techniques to define multiple market segments within the unbanked population, and design unique offerings for each segment. For example, homemakers and retirees may be drawn to a payment product that helps them adhere to a monthly budget, while wage earners may place more value on convenience and ease of use. "One size fits all" products risk appealing to few customers.

Unbanked Subgroup Level of Employment



Source: *PaymentDynamics*^{SM} 2007 Preferred Payments Study

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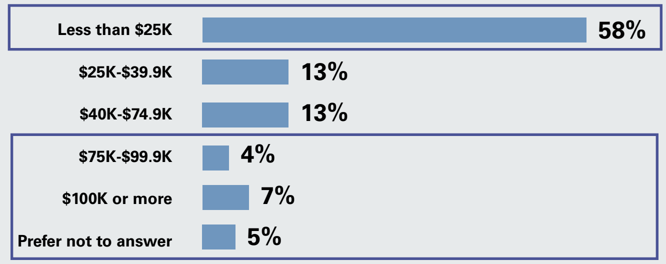
Unbanked Subgroup Level of Income

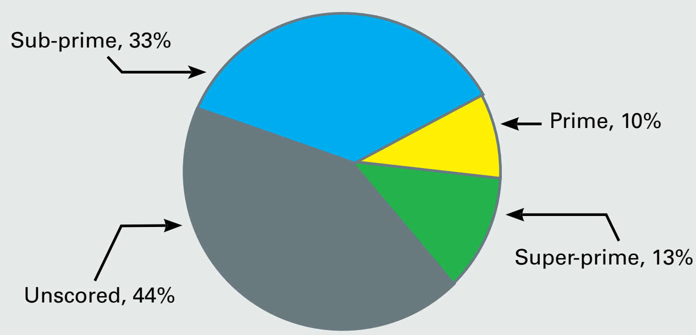


Source: *PaymentDynamics*SM 2007 Preferred Payments Study

With millions of unscored and thin file consumers, financial institutions can greatly expand their target markets by tapping non-traditional data sources

- **Credit risk:** Contrary to common perception, many unbanked consumers do have a credit file. However, the distribution of credit bureau risk scores is even more scattered than income levels – 23% are prime or super-prime, 33% are sub-prime, and the remaining 44% are unscored. **Implications for financial institutions:** There are several lessons here.
  1. With many credit-worthy consumers in the sector, financial institutions have the opportunity to attract new customers without taking on undue risk.
  2. The robust scores of many in the sector mean that many people have voluntarily opted out of banking, as opposed to being excluded. As they could easily qualify for credit and other bank services, these consumers may present the greatest opportunity for creative new payment solutions and other banking products.
  3. With millions of unscored consumers, financial institutions can greatly expand their target markets by tapping additional data sources not used by credit bureaus, such as utility and cell phone payments o bankruptcy records. The same applies to many sub-prime consumers; they do not have bad credit, just thin credit files. Using non-traditional credit data will identify many worthy prospects in this group.

Unbanked Subgroup Distribution by TRNA* Score



* The TransRisk New Account Score (TRNA) is TransUnion's proprietary credit score derived from modeling consumer credit attributes in order to predict the likelihood of an occurance of a 90 day or worse rating over the next 24 months on a new account opening

Source: *PaymentDynamics*SM 2007 Preferred Payments Study

Clearly, many unbanked consumers are experienced with at least some payment products.

- **Financial distribution channel preference:** There is no clearly preferred channel by which to communicate with and target the unbanked. Channel preference is correlated to previous banking experience. Individuals who previously had a checking or savings account that they decided to cancel ("the past banked") generally prefer to receive financial services products from nontraditional financial institutions such as retailers. By contrast, consumers who never had a checking or savings account ("the never banked") say they prefer the convenience, more diverse financial products, and good customer service of traditional financial institutions. **Implications for financial institutions:** This phenomenon illustrates the importance of good and timely retention strategies. Once a customer decides to leave a particular financial institution or an entire class of financial institutions, he is not likely to return. Instead the customer may be more open to try alternative providers.

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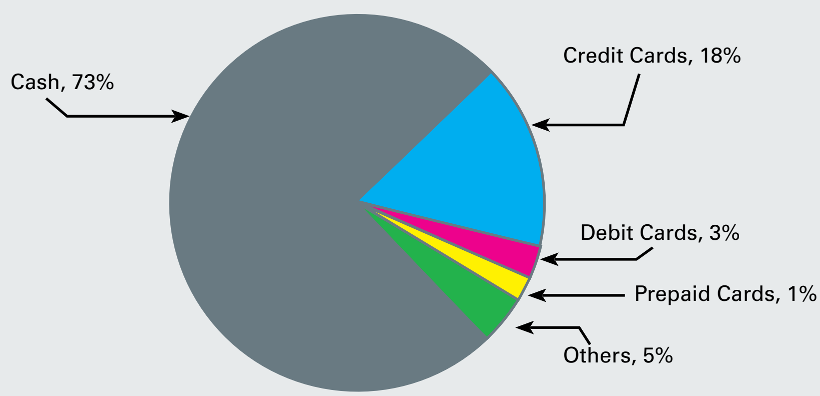
- **Card ownership:** The unbanked are not necessarily "un-carded." By definition none hold debit cards; but 25% do own credit cards - despite the inconvenience of paying their bills without a checking account. In addition, 16% own prepaid cards. **Implications for financial institutions:** Clearly, many unbanked consumers are experienced with at least some payment products. While the penetration levels for credit and prepaid cards are lower among the unbanked than the general population, the sector is far from a dead end for payment products.

- **Payment preferences:** As might be expected, the unbanked population prefers cash by a wide margin – approximately 3 to 1 – over other forms of payment. This contrasts to the general population where preferences are split almost equally between cash, credit cards and debit cards. **Implication for financial institutions:** Financial institutions cannot increase electronic payment usage simply by increasing cards in circulation. Issuers must try to shift consumers' underlying payment preferences from cash to an electronic or card alternative. Changing payment preferences is a major challenge, but a necessary first step.

Preferred Payment Unbanked Subgroup



Source: *PaymentDynamics*℠ 2007 Preferred Payments Study

These demographic trends highlight a revealing and valuable new view of the unbanked population. Most striking is the heterogeneity of the market – young and old; low income and financially comfortable; employed and retired; and so on. This fresh perspective provides a clear basis for action by financial institutions. Companies wishing to tap the potential of the unbanked sector must pursue sophisticated segmentation strategies in order to influence payment preferences.

THINK IN SEGMENTS OR SUB-SEGMENTS

To increase share of this market, it is helpful to recognize the distinct sub-segments of the unbanked universe and respond with offers that meet the needs, goals and life situations of each sub-segment. Any approach that aims at the middle and relies on a single product, single marketing strategy and/or single distribution channel strategy runs the risk of appealing to a small portion of the market. Offers designed for a specific sub-segment, (e.g. students, migrant workers, budget-conscious parents, etc.) with targeted features, pricing, and marketing messages have the greatest potential.

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FOCUS ON PREFERENCES

Product design can open some doors; but financial institutions face another challenge. They must overcome a strong underlying preference among unbanked consumers for cash payments. As described earlier, this preference is three times as prevalent among the unbanked as in the general population. Our experience is that payment preferences are difficult to change and strongly influence behavior. For in-store purchases, consumers use their preferred payment method 85-90% of the time. That means that providing cash-preferring consumers easy access to even the most innovative, favorably priced electronic payment options is unlikely to stimulate new usage. They will still reach for cash.

Altering this preference will take a multi-prong approach with emphasis on consumer education. The PaymentsDynamics℠ 2007 study identified five dominant variables that influence payment preferences in the unbanked population. These drivers, in order of importance, are:

- Ease of use
- Universal acceptance
- Ability to use own money
- Safety and security
- Control over finances

A large portion of the unbanked population feels that cash best meets these five requirements. However, one could certainly argue that a prepaid or debit card, for example, is just as effective – if not more effective – at meeting these conditions.

To reorient these perceptions, financial institutions will need to use a variety of messages, tools, and strategies. For instance, simplifying the application process (e.g., instant issuance) and extending the prepaid cards' re-loadable network can enhance ease of use. Likewise, advertising, point of sale marketing, public awareness programs, and other communications can reinforce the safety of cards versus cash, the ability to control and track expenditures with cards, and other desirable attributes.

Our PaymentDynamics℠ results show the unbanked sector in a new light: as a surprisingly diverse mosaic of sub-segments, each with its own profile of needs, wants, preferences and biases.

CONCLUSION: A WEALTH OF OPPORTUNITY

Our PaymentDynamics℠ results show the unbanked sector in a new light: as a surprisingly diverse mosaic of sub-segments, each with its own profile of needs, wants, preferences and biases. These findings are good news for banks and non-banks alike as they point to clear opportunity for new and existing financial products. But the challenge in tapping that opportunity is twofold – matching appropriate value propositions to the needs of each sub-segment, and proactively working to shift the preference among the unbanked for cash. Payment preferences directly drive usage, and usage drives profitability.

The survey data demonstrates that there is plenty of room in the payments market for both bank and non-bank payment providers. A critical dimension of payment acceptance is trust – consumers must be confident that their money and privacy are absolutely safe and secure. Non-bank providers, including major retailers, can build on existing relationships with customers, especially the "past banked," by providing mutually beneficial payment products and financial services. The greatest opportunities for banks are most likely in the "never banked" or "pre-banked" segment, particularly students and other young consumers who are establishing their financial lifestyles and are interested in building credit histories.

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EDC AND THE UNBANKED MARKET

At Edgar, Dunn & Company, we have made an early strategic commitment to helping our clients uncover what we see as a vast, largely untapped opportunity in the traditionally marginalized unbanked sector. From our market research, segmentation studies, data analytics, and experience in the development of innovative new products and services globally, EDC offers unmatched and deep expertise in the unbanked market.

EDC's proven analytical capabilities, toolsets and approaches provide clients revealing and actionable insight into unbanked customer segments for market growth and profitability. By analyzing large quantities of market and customer data, we are able to identify the most promising pockets of opportunity and recommend appropriate responses for thoughtfully designed and innovative new products and services. In addition, EDC's independent industry surveys provide up-to-date market insights of key participants, as opportunities in the unbanked segment continue to evolve.

If you would like more information about how we can help assess the market opportunities in the unbanked sector for your business, please contact Romina Abal at +1-415-442-0542 or romina.abal@edgardunn.com.

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About PaymentDynamics℠

The PaymentDynamics℠ 2007 Preferred Payments Study is the first study on consumer payment preferences, attitudes and behavior to combine consumer credit risk characteristics with consumers' choices of all payment options. For the first time, individual risk data and consumer attitudinal responses were brought together in a major payments study using the resources and data from TransUnion and Edgar, Dunn & Company. The study was conducted to help payment providers better understand how consumers prefer paying for goods and services and to provide predictive modeling solutions to improve targeting and profitability across their product portfolio. The survey included over 10,000 online surveys of individuals 18 or older who had at least some role in the payment decisions in their household. The data is being used to create predictive modeling solutions for U.S. credit grantors.

About Edgar, Dunn & Company

Edgar, Dunn & Company (EDC) is a global strategy consulting firm specializing in payments and financial services. Founded in 1978, the firm is widely regarded as trusted advisors in the payments industry providing a full range of strategy consulting services, expertise and market insight through in-depth industry and consumer benchmarking. Global capabilities include strategy, risk management, marketing, profitability improvement, operations, and new products and technologies.

EDC's offices are located in San Francisco, Atlanta, London, Frankfurt and Sydney and serve clients in more than 30 countries on six continents. More information can be found at www.edgardunn.com.