Postal Financial Inclusion
Kenya Case Study

The Post and the cash merchant model in an advanced mobile money environment

Alexandre Berthaud
February 2012
Universal Postal Union
Postal Financial Inclusion Project

Case Study No.1

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Acknowledgements

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### Acronyms and Abbreviations

<table>
<thead>
<tr>
<th>Acronym</th>
<th>Description</th>
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<tbody>
<tr>
<td>ATM</td>
<td>Automated teller machine</td>
</tr>
<tr>
<td>CBK</td>
<td>Central Bank of Kenya</td>
</tr>
<tr>
<td>CCK</td>
<td>Communications Commission of Kenya</td>
</tr>
<tr>
<td>CCT</td>
<td>Conditional cash transfer</td>
</tr>
<tr>
<td>EFT</td>
<td>Electronic funds transfer</td>
</tr>
<tr>
<td>EFTS</td>
<td>Electronic funds transfer system (used at Bangladesh Post Office)</td>
</tr>
<tr>
<td>FSD</td>
<td>Financial sector deepening</td>
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<tr>
<td>G2P</td>
<td>Government to person</td>
</tr>
<tr>
<td>KES</td>
<td>Kenyan shilling</td>
</tr>
<tr>
<td>MFI</td>
<td>Microfinance institution</td>
</tr>
<tr>
<td>MNO</td>
<td>Mobile network operator</td>
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<tr>
<td>MVNO</td>
<td>Mobile virtual network operator</td>
</tr>
<tr>
<td>CT-OVC</td>
<td>Cash Transfer Programme for Orphans and Vulnerable Children</td>
</tr>
<tr>
<td>P2B</td>
<td>Person to business</td>
</tr>
<tr>
<td>PCK</td>
<td>Postal Corporation of Kenya</td>
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<tr>
<td>POS</td>
<td>Point of sale terminal</td>
</tr>
<tr>
<td>POSB</td>
<td>Post Office Savings Bank of Kenya (Postbank)</td>
</tr>
<tr>
<td>ROSCA</td>
<td>Rotating savings and credit association</td>
</tr>
<tr>
<td>SACCO</td>
<td>Savings and credit cooperative</td>
</tr>
<tr>
<td>USD</td>
<td>United States dollar</td>
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Executive Summary

The financial sector in Kenya is considered a laboratory for future developments in financial inclusion. Indeed, it boasts a large mix of market players ranging from cooperatives to microfinance banks, and the increasing penetration of mobile money there is unique in the world.

In the last few years, the Postal Corporation of Kenya (PCK) has been confronted with decreasing mail volumes and an increased need for sustainability, given its changed status from public administration to state-owned corporation. It has had to diversify its service offering, in particular by providing instant domestic remittances and becoming a cash merchant for third parties. To do this, PCK has opted for a model based on multiple partnerships, where the Post office acts as a cash merchant for a vast number of diverse stakeholders. The case of Kenya is interesting since it represents the epitome of the multi-partnership model. Indeed, the PCK has signed 320 different partner agreements through which it offers cash-in/cash-out services. The whole spectrum of financial service providers is represented among these partners, which include commercial banks, Postbank, microfinance banks, savings and credit cooperatives (SACCOs), mobile network operators, regulated and non-regulated microfinance institutions, money transfer organizations, insurance companies, utility companies and government authorities responsible for social benefits and conditional cash-transfers. The idea behind the model is that the more contracts that are signed, the more traffic PCK will receive in its offices, which in turn will increase its viability.

This case study shows that a Post can diversify its revenues by becoming a cash merchant. There are, however, some pitfalls to avoid if this endeavour is to be successful. In particular, the cash merchant model should not be seen as a response to a failing core business, but rather as a revenue source additional to a strong core business.

One way forward could be to increase cooperation with the Postal Savings Bank of Kenya (Postbank). In Kenya, as in Tanzania (United Rep.) and Uganda, the Postal Savings Bank was separated from the postal administration soon after the breakup of the East African Community in 1977. While Posts in the region are looking to develop partnerships for bill collection and other financial services, postal savings banks are trying to build networks of agents. The answer to the needs of both parties appears to be a “no-brainer”: a partnership between an extensive network (the Post), and financial services (the Postbank). Such a partnership exists, however it has eroded to such an extent that it is almost imperceptible. Even though these entities have grown increasingly apart in recent years, governments appear to want them to again learn how to work together. Indeed, a new trend is emerging within the governments in Kenya and Tanzania, which are handing over minority stakes in their respective postal banks to their postal operators. This study analyzes the relationship between these actors in the context of financial inclusion, and whether they should be competing against one another or cooperating to regain competitiveness by adding the value of both organizations.

In no country in the world has mobile money caught on at a faster pace and revolutionized the entire financial services industry more than in Kenya. This has had a negative impact on the Post’s domestic remittances product and, worse still, it may even begin to challenge PCK’s hyper cash merchant model, on which the postal diversification strategy is based. Since there are more than 100 mobile money deployments around the globe, with varying degrees of success, it seems important to extract lessons from the case of Kenya to understand the potential role for postal operators in a mobile money environment.

To conclude, PCK is in a good position compared to other post offices in the region, both in terms of its product offer and the sophistication of its infrastructure. However, it is competing against giants with much deeper pockets and strong technological capacity. A posteriori, PCK’s choice of the cash merchant model seems accurate considering the environment at the time. However, it is now clear that such a model cannot cover the cost of the whole postal infrastructure and can only deliver a limited impact on financial inclusion. In such a scenario, the idea of developing a stronger partnership with a bank to offer affordable account-based services countrywide appears to be the best option to increase financial inclusion and the viability of the post office.
I. Financial inclusion in Kenya: an evolving landscape

The financial sector in Kenya is considered a laboratory for future financial inclusion developments. It boasts a large mix of market players ranging from cooperatives to microfinance banks, and the increasing penetration of mobile money is unique in the world.

I.1. General context of Kenya

Kenya is the largest economy in East Africa and acts as the region’s economic and financial hub. Its 40 million inhabitants (77.8%) live mostly in rural areas, as can be seen in figure 1. In macro-economic terms, Kenya is recovering from the 2008 crisis with growth rates of 2.6% and 4% in 2009 and 2010, respectively.

Fig.1 Statistical overview of Kenya

<table>
<thead>
<tr>
<th>General Information</th>
<th>Kenya</th>
<th>Source</th>
<th>Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Population</td>
<td>40,512,682</td>
<td>World Bank World Development Indicators</td>
<td>2010</td>
</tr>
<tr>
<td>Percentage of adult population (15-64 yrs)</td>
<td>58%</td>
<td>World Bank World Development Indicators</td>
<td>2010</td>
</tr>
<tr>
<td>GDP per capita (current USD)</td>
<td>775</td>
<td>World Bank World Development Indicators</td>
<td>2010</td>
</tr>
<tr>
<td>Population density (inhabitants per km2)</td>
<td>71</td>
<td>World Bank World Development Indicators</td>
<td>2010</td>
</tr>
<tr>
<td>Rural population (% of total population)</td>
<td>77.8</td>
<td>World Bank World Development Indicators</td>
<td>2010</td>
</tr>
<tr>
<td>Mobile telephone subscriptions (per 100 inhabitants)</td>
<td>49</td>
<td>World Bank World Development Indicators</td>
<td>2010</td>
</tr>
<tr>
<td>Unbanked adults (% of adult population)</td>
<td>59%</td>
<td>FSD Kenya</td>
<td>2009</td>
</tr>
<tr>
<td>Internet users (per 100 inhabitants)</td>
<td>10.1</td>
<td>World Bank World Development Indicators</td>
<td>2009</td>
</tr>
</tbody>
</table>

I.2. Characteristics of the financial services market in Kenya

The financial sector in Kenya is highly developed and competitive when compared to other countries in the region. Historical developments in the financial sphere have led to the existence of a wide range of financial service providers competing in the market. Participants include banks, microfinance institutions, savings and credit cooperatives (SACCOs) and Postbank. In addition to these players, a new type of participant has entered the market and taken a major share: mobile network operators (MNOs). MNOs are now providing instant payment services through mobile wallets, which allow clients to store value. They have become mobile money operators, even though under Kenyan law they are not considered deposit-taking institutions but merely payment service providers.
As a result of market competition, the unbanked population in Kenya is diminishing. According to the financial sector deepening (FSD) programme, in just three years (2006 to 2009) the level of banked people rose from 26% to 41%.

There are several key factors explaining this increase in financial inclusion. First and foremost, increased banked levels are the result of a proliferation in mobile money, namely Safaricom’s mobile money platform, known as M-PESA, and its competitors Airtel Money, Yu-cash and Orange Money. It is worth noting that even though the Central Bank of Kenya (CBK) does not consider these operators to be deposit-taking institutions, they are considered as providers of formal financial services and, as such, account for most of this large increase.

The second factor explaining the rise in the number of financially included persons is the increase in the number of basic payment accounts at banks, namely microfinance banks such as Equity Bank, Cooperative Bank, K-Rep and Family Bank, which together accounted for 80% of the account growth (67% for Equity bank alone).¹

A recent trend in the general picture of Kenyan financial services is that SACCOs and Postbank, the institutions that were targeting the bottom of the pyramid, are losing clients at an alarming rate. Postbank has lost more than one half of its clients, thus moving from being the single biggest institution in terms of number of accounts, with 5.6% of market share in 2006, to just 2.2% in 2009.²

While access seems to be improving at an unparalleled rate, usage could be a whole different story. There is little information on dormancy rates, particularly within the M-Kesho accounts, where reported dormancy rates have been high since the beginning of commercial tensions between the two partners Equity bank and Safaricom/M-PESA. Some measure must therefore be applied to the success of financial inclusion in Kenya.

In addition, some detractors of mobile money question whether mobile wallet users can actually be considered as fully financially included. Mobile money is mostly a transactional product, and until users of M-PESA have access to savings accounts they may be considered as underserved in terms of financial access.

In terms of remittances, M-PESA controls 93.6% of the domestic remittance market with 305.7 million transactions with a total worth of 727 billion KES. PCK’s share of this market is a meagre 1.1%, while the other actors share the remainder (5.3%).³ This clearly shows the complete dominance of the mobile money operator in the domestic transfer segment, which benefits from Safaricom’s dominant position in the Kenyan mobile telephony market (over 80% of market share).

Up until 2008, informal remittance service providers, such as bus and “matatu” companies and rotating savings and credit associations (ROSCAs) for savings and loans, were important actors, but today they are losing ground to actors in the formal sector.

I.3. The Post: a historical actor facing increasing financial services challenges

PCK lost its financial services activity in 1978, when the Post Office Savings Bank of Kenya was created and inherited all the postal savings and giro accounts. Paper money orders remained the only financial service offered by the Post.

Over the last few years, the PCK, faced with decreasing mail volumes and an increased need for sustainability, given its changed status from public administration to state-owned corporation, has had to diversify its service offering, in particular by providing instant domestic remittances and becoming a cash merchant for third parties.

² Idem.
³ Central Bank of Kenya data.
In terms of domestic remittances, in 2006 Postapay, PCK’s real-time domestic remittance service, held 27% of the total market share, including informal providers, and was by far the dominant market player among formal service providers. According to the CBK, in 2010 Postapay captured a mere 1.1% of market share with 8.3 Billion KES transferred annually (90 million USD).

With regard to the cash merchant model, the Post has become an agent for a wide variety of actors, ranging from financial service providers to utility companies and mobile money operators. As such, it offers cash-in/cash-out services on behalf of 320 partners to clients in 380 online branches (out of a total of 740 branches) nationwide, thus helping to further increase the penetration of formal financial services.

PCK has been able to identify financial services as a way forward in its diversification process. However, given the extreme level of competition, domestic remittance products are losing ground to mobile money providers, and PCK is left mostly with the cash merchant services. Unfortunately, these may also come under pressure from mobile money providers, which are aggressively turning to merchants to provide bill collection services on their behalf. In this case, the Post may need to develop a fail-safe plan involving a new value proposition for the Post in a market dominated by mobile money. It may also partner with its sister company, the Post Office Savings Bank, to regain competitiveness by combining the values of both organizations. These three topics are relevant for Posts worldwide and explain our decision to develop a case study of Kenya.

I.4. Legal framework for postal and financial sectors

Overall, the Kenyan legal and regulatory framework is considered to be enabling for financial inclusion. For example, the CBK allowed the development of M-PESA under a gentlemen’s agreement, which is still in place pending the approval of new payment system regulations in congress. The legal and regulatory framework for postal financial services is also quite flexible.

I.4.1 Legal and regulatory framework for the Post

The Kenya Communications Act of 1998 (and its 2009 amendment) constitutes the main piece of postal service legislation. It provides for the establishment of the Communications Commission of Kenya (CCK) as the regulatory agency and for the break up of the Kenya Posts and Telecommunication Corporation into three entities: the Commission, Telkom Kenya Limited and the Postal Corporation of Kenya.

In Part V - Postal Services, section 63, the Act allows for the PCK to carry out postal financial services on its own account. According to the Act, “postal financial services include money orders, postal orders, postal drafts, postal cheques, postal traveller’s cheques, giro, cash-on-delivery, collection of bills, savings service, subscription to newspapers and periodicals”.

One of the main legal limitations of the Post’s financial service offering is loan products, a common limitation for Posts, as well as offering its own insurance products. With the exception of these, PCK can directly provide its clients with a wide range of products. However, it has still not taken advantage of this legal entitlement and mainly offers bill collection services and money orders.

I.4.2 Legal and regulatory framework for financial services

1. Agency banking guidelines

Agency banking guidelines were issued in 2010 as part of the CBK's activities to foster financial inclusion and as a response to the widespread use of mobile money agents. The specific goal was "to increase financial services outreach and to promote financial inclusion to the un-banked and under-banked population without risking the safety and soundness of the banking system; and encourage institutions to use agents in the provision of banking services so as to reduce the cost of financial services and to foster financial inclusion, reach and depth."

The key features of the guidelines are that banks are responsible for the business performed on their behalf by their agents, in particular in terms of anti-money laundering/combating the financing of terrorism (AML/CFT). Agents cannot engage into exclusivity agreements, which means that they are free to offer the services of several partners if they so desire. In addition, a potential agent must have been in business for more than three years before it can be approved by the CBK.

The agency banking guidelines only apply to licensed banks but not to mobile money operators. For instance, mobile money operators such as M-PESA require the agent to provide their mobile money products on an exclusive basis. To illustrate this, Postbank even reported that some of its agents that had already been offering M-PESA services were asked to remove the Postbank agent sign outside the outlet. Therefore, the agency banking law is a policy that creates a double standard for banks and mobile money operators, heavily penalizing agent networks such as the Post working with both types.

2. Gentlemen's agreement for mobile money

At present, Kenya's legal and regulatory framework for payment systems is non-existent. As such, retail payment systems are underdeveloped and there is no common card switch for the banks. In addition, interchange fees are extremely high, which is why most person-to-person transfers are made through friends and family or the bus and matatu companies. This commercial void turned into a golden business opportunity for M-PESA and its development. However, that could not have happened without the regulatory void for mobile money. Indeed, to expand the operator Safaricom managed to take advantage of the void between the telecommunications regulator (CCK) and the financial services regulator (CBK). The CCK regulates channels, not content. Since the mobile wallet is a content feature, it does not fall within its regulatory powers. The CBK was also open enough to allow Safaricom to offer a mobile wallet even if there was no regulation for such a service. The green light to operate was given under a gentlemen's agreement which is still in place today. This applies not only to M-PESA but to all mobile wallets, with the exception of Orange Money, which in Kenya operates through a bank partner, Equity Bank.

This shows that the CBK has a specific agenda for financial inclusion. The CBK would likely welcome the development of PCK as an agent for financial service providers. Given market conditions and the legal and regulatory framework, PCK decided to become a cash merchant.

II. The business model: hyper-cash merchant

PCK has opted for a model based on multiple partnerships, where the post office acts as a cash merchant for a vast number of diverse stakeholders. The Kenya case is interesting because it represents the epitome of the multi-partnership model. According to that model, the postal operator believes that the more contracts it signs, the more traffic it will receive in its offices, which will in turn increase its viability.

Another remarkable fact about Kenya is that this country is the leading market for mobile financial services in the developing world. Nowhere else has a country been so active in terms of mobile financial services. The combination of a full-fledged cash merchant and highly developed mobile...
payment ecosystem, in terms of access and usage, is an interesting field for study. It can provide insight for Posts in other countries about how to respond to the challenges ahead with the increasing number of mobile money deployments.

The PCK cash merchant model is intended to provide financial services to both the unbanked and the underbanked nationwide, allowing them to have access to their key financial products closer to home by using the vast network of the Post. Using point of sale (POS) terminals, GSM mobile devices and postal outlets, customers can perform transactions through retail agents in a secure manner.

Text box 1

Government-to-person (G2P) payments through the Post: The example of the Cash Transfer Programme for Orphaned and Vulnerable Children (CT-OVC)

G2P payments have been identified in recent development literature as an entry point into the financial system, and should therefore be used as a tool for financial inclusion. The underlying idea is that financial institutions paying G2Ps can cross-sell their products to others. This is a programme whereby the Government of Kenya, UNICEF, the UK Department for International Development and the World Bank provide funds to orphaned and vulnerable children through their caregivers. The cash stipend is used to provide for their basic needs. Using the cash merchant model in partnership with the Post, donors and the government have been able to ensure that this money reaches beneficiaries throughout the country in an effective and transparent way.

PCK has been able to use its cash merchant model to reach community members and ensure they have access to a source of income. The PCK has a network and solid expertise in terms of cash logistics that not all banks and financial institutions can offer, especially in rural areas. This is why it became a partner of choice for these institutions.

Through the CT-OVC programme, more than 110,000 transfers are disbursed every two months at the Post (see table in Annex 1). This constitutes an important source of foot traffic for the Post and creates the potential to offer complementary financial products to the beneficiaries of these G2P payments.

Below is a description of the different steps involved in the CT-OVC cash merchant model.

![Postal Corporation of Kenya - Cash Merchant Model](image)

Source: Postal Corporation of Kenya
II.1 Description of the business model

In 2003, with the reduction in the mail business, the Postal Corporation of Kenya established a department for business partnerships to fully exploit its network potential. Since it was separated from its account-based services (Postbank) in 1978, PCK has opted for a full cash merchant model.

PCK has relatively strong cash flow and a large countrywide network, features critical to the success of a cash merchant model, according to which financial institutions, government authorities and utility companies, among others, use the PCK network and staff to reach potential customers in underserved regions.

The PCK has signed 320 partnerships through which it offers cash-in/cash-out services. The whole spectrum of financial service providers is represented among these partners, which include commercial banks, Postbank, microfinance banks, SACCOs, mobile network operators, regulated and non-regulated microfinance institutions, money transfer organizations, insurance companies, utility companies and government authorities responsible for social benefits and conditional cash-transfers. This is the cash merchant model at its best, and few countries have developed it to such an extent.

Given this wide range of partners, the case Kenya is an interesting laboratory for the cash merchant model for Posts. Step by step, we will endeavour to understand the potential impact of each type of partnership on financial inclusion. For instance, it will be worthwhile to understand whether a cash merchant partnership with an MFI has a bigger impact than one with a bank and, if so, why.

The PCK currently serves some 100,000 customers in its outlets each day, which builds up to 3 million per month. Such foot traffic is considerable in a country of 40 million inhabitants, especially when compared with commercial banks.

II.2 Rationale for adopting the business model

There are three main reasons for the use of the cash merchant business model in Kenya: i) viability, ii) separation between Postbank and the PCK, iii) existence of a well-connected and capillary network.

PCK has been a commercial state corporation since 1999, and as such is required to be financially viable with little government support. PCK has a vast infrastructure network with a total of 744 post offices, including postal agents, which need to be maintained. Maintaining this network has a cost, and the mail business is slowing down. PCK is therefore looking for ways to diversify its revenue-generating activities based on its key comparative advantages: its network and customer trust. The network, which is a fixed cost, needs to be maintained as part of the universal service obligation. Since costs cannot be reduced, improved profitability must come from new revenue streams, in this case financial services. These services represented 20% of PCK's total revenue in 2009.6

The Post/Postbank separation, which will be explored in the next chapter, put the Post in a situation where it did not offer account-based services, insurance or any other financial services (other than payment services). In the case of Kenya, Postbank's 1978 separation from its mother company, the Post and Telecommunications Corporation, left the postal operator with payment services, such as domestic and international remittances, and government payments. Account-

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Based services from Postbank were still offered on the postal network through the use of passbooks, so there was no need for the Post to develop its own account-based services. However, in recent years Postbank has begun to develop its own network, and now uses the Post only for rural areas where it has no reach and where manual passbooks are still in use.

Given the above, the only feasible option for PCK until recently was to develop payments. It could have developed proprietary payment services or payments on behalf of partners, but it decided to offer both. Unfortunately, given the competitive environment between domestic payments solutions, its proprietary products lost ground to M-PESA and other mobile payment operators. It therefore considered that the only viable option in this scenario was to become a cash merchant.

The existence of a well-connected network reaching well into the rural areas, combined with the concentration of banks in major cities, justified the Post’s use of the cash merchant model. In Kenya, only 66% of bank branches are located outside the capital city of Nairobi (Orozco, 2010). As can be seen in figure 2 below, the postal network with its 744 offices has nearly as many offices as all banks combined (850 branches). Not only is the postal network large, but it is also well developed in rural areas and covers the whole territory. Given this development level, Kenya’s postal network is extremely well connected, and 380 offices have access to an electronic network either through broadband, Wi-MAX, GSM or dial-up. Therefore, before the advent of the M-PESA agency network, the Post was the largest, farthest-reaching network in Kenya, much larger than any bank and even Pesapoint, the largest ATM network. Given the hyper-concentration of financial access points in Nairobi and Mombasa, the added value of such a network for financial service partners is clear. These are the three reasons behind the development of the cash merchant partnership model.

![Fig. 2: Access points in sub-Saharan Africa: Banks vs. Posts (UPU, 2011)](image-url)

**II.3 Analysis of the business model**
The PCK has a vast interconnected communication network and needed to improve its financial viability, especially in rural areas. Because it had lost its account-based services, the solution adopted was to promote the cash merchant function of the Post by partnering with as many partners as possible.

We will proceed to conduct an analysis of the strengths, weaknesses, opportunities and threats (SWOT) within the business model.

II.3.1 Strengths

1. Low marginal cost of implementation

The cash merchant business model is the easiest to implement given its low requirements in terms of training and IT infrastructure. The PCK is limited financially, therefore low-cost partnerships are important at this stage.

However, to carry out this work it requires an appropriate cash management system together with a well-connected network. We have seen that 380 offices in Kenya, i.e. half of the total post offices and agents, are already online.

2. Benefit from the knowledge and technology transfer from private players

In the cash merchant model, private partners make their technology available in the form of software or hardware (POS devices). For this to work, partners should train PCK staff in the use of these new technologies. PCK can therefore benefit from the knowledge acquired by its partners over the years in terms of marketing and customer service, to become a more competitive market player in the financial services sphere.

3. No need for regulatory approval

If the Post were to offer its own postal account services, it would probably need to be regulated by the CBK Banking Supervision Department. However, to perform its duties as an agent, it does not require any type of ministerial, regulatory, or CBK approval. This is therefore one of the model’s major strengths, since it can be implemented without going through tedious red tape.

II.3.2 Weaknesses

1. The cash merchant model has a limited impact in terms of financial inclusion if partner institutions do not promote their products outside their branch network.

Partnerships with the biggest impact on financial inclusion are those implemented in cooperation with banks, SACCOs, MFIs and insurance companies. Unfortunately, the present number of transactions for these operations is minimal compared to the potential of such partnerships (less than 10,000 monthly transactions in total, and 4,000 if one were to exclude Postbank). Limited results are mainly due to the fact that the partner financial institutions did not adapt their sales model to the new agency banking delivery model.

2. Revenues generated by the cash merchant are small compared to operating costs, given the limited fees received per transaction.

The cash merchant model is based on a high-volume/low-fee business model, in which volume ensures sustainability. Unfortunately, the number of transactions is low for most of the products offered in partnership. In addition, the Post’s operating costs are high, even though they are lower than building a whole branch network for the partner.
This model is more financially viable if it comes in the form of income additional to a profitable operation in the core business (mail) and is not expected to cover a large share of fixed costs, as in the case of Kenya.

3 Manual back office

The Post cannot expect to develop its cash merchant capacity without automating its back office. In a country where technology has become the motto of financial institutions, partners expect their large agents to be able to reconcile and settle the same day. In that scenario, manual back offices represent a significant barrier to the development of the cash merchant model, since they often imply slow and fraud-prone paper-based reconciliation.

II.3.3 Opportunities

1 Working with Postbank to offer a wider range of services, namely account-based services linked to debit cards (further explored in Section III.1).

2 Becoming a multiple agent for mobile money operators (further explored in Section III.2).

II.3.4 Threats

1 Increased attention of mobile money operators to P2B payments

M-PESA’s incursions into the market of offering bill collection and payroll facilities to companies places the Post’s cash merchant role under threat.

2 Limited life expectancy of externally funded G2Ps

Once funding runs out, conditional cash transfers (CCTs) in Kenya, especially the CT-OVC, which is funded by external donors, will probably have run their course in the next few years. In that case, the number of transactions operated by the PCK will be drastically reduced. PCK should therefore fully exploit such G2Ps now by linking them with bank accounts offered by a partner institution. Pension payments and other G2Ps, including public employee salaries, tend to be more resilient over time.

II.4 Success factors

As an institution, PCK has been able to extend its financial services in rural areas where other actors, such as banks, are not present. PCK attributes the success of its cash merchant model to the following factors:

- A vast network connected to the Internet;
- A cash management system (manual but operational);
- Sufficient liquidity in the system (1,000 USD in small rural post offices);
- Availability of cash-in-transit services to swiftly transport cash where needed (maximum 24 hours to deliver cash to rural post offices);
- In-house development of software to manage all bill collections on a single platform;
- Enabling regulatory framework that allows the Post to offer payment services on behalf of other providers including banks, MFIs and insurance companies;
- Existence of a business development unit responsible for developing new partnerships;
• Existence of a well-established process to sign new partnership agreements and contracts, with the involvement of several internal stakeholders: business, marketing, financial services, legal, IT;
• Existence of a strong legal department capable of drafting and reviewing contracts and protecting the interests of the Post through legal advice;
• Existence of a network of postal agents who can become sub-agents for the financial service partners of the Post;
• Hiring staff locally, as the unbanked and rural populations prefer to deal with people they know when it comes to money.

II.5 Challenges

The cash merchant business model presents three main challenges that the Post will need to act upon in order to turn it into a truly successful model.

II.5.1 Cost of multiplying partnerships

Signing up new partners and maintaining relationships implies certain costs. In order for a partnership to be concluded, PCK must involve staff from different departments (business development, marketing, IT, legal), which also involves their time. Once signed, a partnership requires a certain degree of follow-up on the commercial side, but also in terms of accounting to reconcile and settle with the partner on a regular basis. The more a process is streamlined, the more economical it becomes for the institution. Fortunately for the PCK, after 320 partnerships, it has developed a set of efficient procedures for business development, including a standard contract and a pricing committee. Despite this, or perhaps because of it, PCK has multiplied the number of partnerships without performing a cost-benefit analysis for each one. Indeed, 75% of the total number of cash merchant transactions are performed with just three partners. This means that the remaining 317 partners account for only 25% of transactions, while some partners only operate one transaction a month, which is obviously not a sustainable product for the Post.

II.5.2 Competition from mobile money operators

Mobile money operators such as M-PESA and Airtel Money have traditionally focused on P2P transfers. However, based on the success of P2P, they have begun to develop their P2B business. At present, M-PESA can perform transactions for 700 merchants. These include some of the top users of the Post’s cash merchant model, including Kenya Power Company. For now, M-PESA does not yet disburse G2Ps, which are the other main source of transactions for PCK. However, given the increasing interest of development agencies to use G2Ps as a gateway to financial inclusion, and based on previous cases such as EasyPaisa in Pakistan, it will not be long before M-PESA begins to deliver the same G2P payments which account for more than one third of PCK’s transaction volumes. Generally speaking, M-PESA is becoming the de facto switch between the financial service providers, which places it in an even more dominant position. PCK stands little chance of winning the battle against a giant quasi-monopoly that has the blessing of regulatory authorities and the development community. This is likely to be the key challenge for the model’s long-term viability. The Post will no doubt need to adapt once again.

II.5.3 Low impact on financial inclusion

The model’s third challenge is not related to economic viability but rather to its social impact. One of the Post’s policy objectives is to promote inclusion among the population. From that standpoint, results achieved are still meagre and one may wonder whether these partnerships actually have an impact on increasing access to financial services. At first glance, one might think that the development of partnerships with so many institutions, from insurance companies to banks to
MFIs, would by definition have an impact on financial inclusion, since it allows clients in far-flung areas to have access to financial services. However, examining the volumes operated by the Post for these services, it becomes clear that the impact is small. For MFIs, this represents 2,600 transactions per month. PCK also operates 300 cash transactions on behalf of insurance companies on a monthly basis. In terms of banking, the levels, while higher, are still unremarkable. Most banking transactions are made through the Postbank partnership (6,100 transactions), which alone represents 92% of total transactions with the banks. However, it is worth noting that all Postbank transactions are manual operations using paper passbooks. Total cash-in/cash-out transactions on behalf of banks constitute a minimal proportion of the total number of financial operations. The Kenya cash merchant model has laid a strong foundation for financial inclusion; unfortunately, access is there but usage is not.

In general terms, the cash merchant model has the smallest impact on financial inclusion. It mostly addresses the issue of access. However, if banks and microfinance institutions are not present in the rural areas to sell their services, cash transactions will not occur unless the teller becomes a sales agent for the financial service providers. This requires time and investment in terms of training, which the partner will have to cover.

The main challenge, therefore, is the insufficient number of transactions under the PCK cash merchant model, and the insufficiency of its marketing to the unbanked population.

II.6 Results achieved

Among the many cash merchant partnerships in place at PCK, those with the most success in their own category include:

- G2P payments: Ministry of Gender, Children and Social Development: Cash Transfer for Orphans and Vulnerable Children (CT–OVC), Older Persons Cash Transfer Programme (OP–CT)
- Bill collection for utility companies: Kenya Power Company Ltd.
- Deposit-collection/withdrawals for banks: Postbank
- Loan disbursement/repayments for microfinance: Platinum
- Mobile money cash-in/cash-out: Airtel Money

The key result achieved by PCK includes the 493,000 monthly transactions operated on behalf of third parties. It is interesting to see that, at 27 USD, the average amount processed is relatively low. The main result achieved is that the Post has managed to partially diversify its revenue streams through the cash merchant model. However, transaction fees charged by PCK are also relatively low, and the question arises as to whether this model is actually profitable for the Post.

Text box 2
Promoting financial inclusion through a microfinance partnership: A long road ahead...

PCK partnered with Faulu Kenya to act as a cash merchant. This agreement set the stage for unbanked Kenyan adults to access their loans and repayments services from postal outlets in rural areas.

The partnership was designed to leverage PCK’s 744 nationwide outlets to boost the geographic outreach of microfinance. There are expectations at the microfinance bank that agent banking practices will have great success with postal partnerships. Faulu Kenya is tapping into the huge market of the unbanked. Partnering with the Post allows Faulu’s clients to use the post office as a cash facility to perform transactions in a convenient and accessible location.

PCK connects to the Faulu Kenya platform using POS terminals installed in the postal outlets. The POS terminals are not interoperable and can only be used to operate Faulu’s transactions. A total of 69 rural post offices were equipped with POS terminals in locations where Faulu did not have branches. In the post offices, PCK tellers have been trained to facilitate deposit-taking and
withdrawals from accounts, and in the disbursement and repayment of loans. This was made possible with the implementation of the T24 core banking system, which has allowed Faulu to enhance efficiency and improve the customer service experience.

At Faulu, this new delivery method has not replaced other existing channels within the organization, such as scattered agents equipped with POS terminals and Faulu’s proprietary branch network. Instead, the cash merchant, in this case the Post, complements the existing network by displacing some foot traffic outside the branches and providing services even closer to the people. This model has helped Faulu to reach its business objective to leverage on technology and partnerships to increase the outreach of its services.

For the general population, the concrete results are the accessibility of adapted and affordable services closer to home, which should increase the uptake of Faulu’s product, thus improving financial inclusion levels in the country.

However, this partnership is underperforming in terms of number of users. Most likely this is due to the lack of promotion in areas where Faulu is not present. Agent banking only works if people know what services they can get. Marketing efforts should therefore be undertaken by the partner, Faulu, which should also send its loan officers to the rural areas around the post office to sell its financial products. PCK has become a cash facility, not a full branch. If the partner does not do its part of the job, i.e. promotion of its products, then the cash facility serves no purpose in extending financial inclusion.

With all the talk about agent banking, it appears that some financial institutions have come to think of it as a miracle solution. Unfortunately, agency banking can only do so much, i.e. lower overhead costs for development into a new area. Microfinance banks will still need to go into the field to promote their products or to forge a new partnership with the Post according to which tellers are trained to sell Faulu’s products. The disappointing result is that only 11 operations are performed each month.

This same business error seems to be repeated across the board with all financial institutions using PCK as an agent.

II.7 Recommendations to strengthen the business model

Given the above challenges to the model, a number of key recommendations can be made to strengthen it.

1 Rationalize partnerships

PCK needs to perform a cost-benefit analysis for each of the existing partnerships and analyze their financial viability over the next few years, taking into account present volumes and potential volumes if the product were to be better marketed. Underperforming products and partnerships should be eliminated, whereas partnerships with strong potential should be developed through marketing efforts. The offering could also be consolidated. This would not only require coordination between the Post and its partners, but also among the partners themselves.

2 Find ways to become a key link in the mobile money ecosystem

Develop a partnership with a large mobile money provider to become a super agent that can not only offer cash-in/cash-out services for its customers, but also act as a place for its agents to buy or sell “float.” Indeed, mobile money providers need to have super agents closer to their agents, which at present most banks are not capable of offering, given their concentration in urban areas.

3 Foster a strong partnership with a bank

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7 In the M-PESA jargon, electronic value is called “float” and is a product which can be bought or sold.
In order to increase the impact on financial inclusion, the Post should decide to concentrate its efforts on one banking partner, but not on an exclusive basis. Such a partner should be that possessing the most complementarity with the Post. It can use its staff and facilities to promote the bank’s products. However, it should still offer cash-merchant services to other banks and micro-finance institutions. This is what the UK Post Office does and it is working quite well.

4 Utilize the potential of government payments as a gateway to financial inclusion

PCK offers G2P payment services to the unbanked population. However, since there are no other financial services to be cross-sold, the financial relationship remains limited to cash withdrawals for the beneficiaries. If the Post were to develop its partnership with a bank, it could manage to bring banking services to some of the CCTs beneficiaries.

II.8 Conclusion on the Kenya cash merchant business model

PCK believes that, over time, it will meet the needs of the market. As customers increase their use of its cash merchant service to access a broader range of payments services, PCK will begin to find more value in conducting transactions in the postal network. In the view of PCK, this is a long-term process. However, the analysis shows that the model is under siege and needs to adapt to new market conditions. If it fails to do so, the hyper-cash merchant model might be outpaced by mobile money in a matter of years, if not months, as in the case of the Postapay product. In that context, PCK should take advantage of all of its tools, including the powerful tool of G2P payments, and should better utilize them as a gateway into the financial sector in partnership with a bank (possibly Postbank).

III. Looking forward: new avenues for growth

III.1 PCK and Postbank: competition or cooperation?

In Kenya, as in Tanzania and Uganda, the Postal Savings Bank was separated from the postal administration soon after the breakup of the East African Community in 1977. While Posts in the region are looking to develop partnerships for bill collection and other financial services, postal savings banks are trying to build networks of agents. The answer to the needs of both parties appears to be a “no-brainer”: a partnership between an extensive network (the Post), and financial services (Postbank). Such a partnership exists, however it has eroded to such an extent that it is almost imperceptible. Even though these entities have grown increasingly apart in recent years, governments seem to want them to again learn how to work together. Indeed, a new trend is emerging within the governments in both Kenya and Tanzania, which are handing over to their postal operators parts of their stake in their respective postal banks. Since this could be the case in other parts of the Commonwealth and elsewhere, we believe it is important to analyze the relationship between these actors in the context of financial inclusion, and whether these entities should be cooperating or competing against one another.

III.1.1 History of the Post/Postbank relationship

The PCK has historical links with Postbank. Up until 1977, the Post Office Savings was a division within the Directorate of Finance and Accounting of the Kenya Post and Telecommunications Corporation. In 1978, in a move to foster savings in rural areas, Postbank was created. The government’s vision at that time was to offer not only the basic passbook savings service but to develop the product offering as well. Despite being two separate entities since their split in 1978, Postbank relied on the postal network to reach its clients. However, over the years, with the
increase in clients and shifting needs, Postbank decided to develop its own network, mostly in urban areas where viability is easily achieved. It therefore uses the postal network only for the rural areas where developing a brick-and-mortar branch network is costly and hardly viable.

III.1.2 Current situation

The present strategy at Postbank is to obtain a full banking license from the CBK in the short or medium term, even though the formal request has not been issued. The vision behind this is business-based. Indeed, to be on equal footing with its competitors in terms of services, Postbank needs to develop its loan products. As for most postal banks worldwide, offering only savings and payment products is a major limitation when competing with full-fledged banks. In developed economies such as France, a major drive away from “La Poste” towards banks occurred during the boom years of the 1960s, when people began to shift their savings from the Post to banks in order to have access to credit.

Several external stakeholders identified that the Postbank strategy was to move up market, from its traditional segment at the bottom of the pyramid towards a more affluent segment. This might not be a good idea, both in terms of viability and financial inclusion. Indeed, competition in that segment is fiercer than at the bottom of the pyramid, and an alliance with the Post could allow Postbank to regain market share by offering services in a niche market: unbanked rural areas.

In urban areas, Postbank has deployed debit cards instead of the passbook and automated its teller counters with POS terminals in all branches. As part of the strategy shift at Postbank over the past four years, there has been a strong push for dematerialization of financial services and an increased use of non-cash payment instruments, as well as the adoption of the agent-banking model. These factors create the perfect environment for PCK to act as an agent for Postbank.

Postbank is interested in developing a partnership with the Post. Discussions to further develop the partnership between PCK and Postbank began in 2008, however the Post shows little interest in developing such a business alliance. Indeed, the Post has preferred to sign an agreement with a commercial bank, Kenya Commercial Bank (KCB), which used to be state-owned and where PCK accounts are held. The main reason the PCK-Postbank partnership has not moved forward is over a disagreement about the transfer cost, about which both entities seem unable to agree. Negotiations seem to have been put off for a difference of 0.05 USD per transaction, which is minimal given the huge impact such a partnership could have if developed properly.

An agency agreement with Postbank would make even more sense today, considering the fact that the state officially transferred its non-controlling stake (44%) in Postbank to the PCK in February 2011. Nevertheless, this transfer has only occurred on paper, and there is no guiding framework set by the government for this to translate into practice. The PCK has developed a strategy document outlining the steps to be taken for the Post to take full ownership of its new stake, however this document is pending revision by the ministry.

III.1.3 Comparative advantages of the institutions

PCK

PCK’s main advantage is its network, which covers all the territorial divisions and reaches well into the rural areas. Foot traffic is the second advantage of the Post, since each day more than 100,000 people go to post offices to access services. Since the Post does not offer its own non-payment financial services, these people are potential clients for a partner financial institution. This network is even more valuable considering that 50% of its offices are connected to the Internet, enabling them to operate transactions in real time. Such a level of postal connectivity is unheard of in most of sub-Saharan Africa and represents strong potential.
Another advantage of the Post is that most of the cost of its infrastructure has already been amortized, and therefore fixed costs are limited to salaries and other expenses, such as electricity and water. If overheads are low, transfer costs could also be low, thus allowing the partner to competitively price its products at the bottom of the pyramid. This is of utmost importance, considering that price elasticity tends to be high in these segments, where an expensive product could easily price-out the unbanked. However, as we will see later, this has not been fully translated into PCK’s pricing strategy.

Also, it is much more likely that a person in a rural area will feel confident to make a deposit at the Post than at a retail store operating as an agent for Postbank. Indeed, the Post commands higher trust capital, which small agents need to cultivate over a longer period of time.

Finally, people in rural areas enjoy a sense of discretion when walking into a post office. Indeed, rural inhabitants would often prefer to conceal their financial transactions from others. When walking into a post office, outsiders do not know whether customers are there to send a letter or perform a financial transaction.

Postbank

Postbank has a network of 95 branches and 140 non-postal agents, which is relatively small compared to the 744 post offices and agents. However, Postbank’s main advantage is that it has invested heavily in technology. All Postbank branches and their agents have a POS terminal which is connected to the GPRS or telephone. Postbank has a stable core banking system installed in all branches, allowing it to operate 1.7 million savings accounts and the debit cards linked to them.

Postbank is also a member of the country’s two main card switches (Pesapoint and Ken-switch), which enables its account holders to withdraw money from any of the ATMs linked to these switches, or to make payments at POS terminals using their Postbank cards. This is a major advantage in a country where retail payment interoperability is still an issue. Indeed, the large banks (Equity bank, Cooperative Bank, CBK) do not participate in a card switch, which results in a fragmented retail payment environment.

Postbank has also launched a mobile banking platform for its clients called “Patacash”. By using USSD technology, Postbank clients can access their accounts from their Safaricom mobile phones by dialling a code. Once logged in, Postbank clients can make transfers from their accounts, pay bills and perform other account transactions. The service also allows clients to transfer balances from their M-PESA wallet in and out of their Postbank account. This service, which tries to surf on the M-PESA wave, makes it easy for customers to do their banking remotely.

III.1.4 Possible added value from working together

As can be seen from their comparative advantages, PCK and Postbank are complementary institutions. One has the network and the other has the services. The target population is fairly similar. Although they do not exclusively target the poor, their segment is mostly the mass market at the bottom of the pyramid. The added value from working together seems therefore quite obvious.

By setting quantifiable goals for itself, Postbank has taken an aggressive stance in developing its agent network throughout the country. As such, with its 744 outlets, the Post could be a partner of choice and would more than exceed the target number of agent contact points in the coming years.

For the Post, such a partnership would translate into an increase in revenues derived from fees and commissions on services offered on behalf of Postbank. A renewed and deeper partnership
would also further increase foot traffic, thus generating economies of scope for its other products (namely courier services and other value-added services).

III.1.5 Challenges for cooperation

As mentioned previously, a partnership, while weak, is already in place between these two actors. The question is why they are not moving forward and further collaborating to offer an increased range of products.

According to Postbank, the main obstacle to the development of the Post/Postbank partnership is the lack of automation at the Post's back office. Indeed, manual processes at the Post are a source of fraud and create constant reconciliation problems, thus delaying settlement with Postbank. In a competitive environment operated in real time, weekly or bi-weekly settlements can only create lags. These issues build up a climate of tension and mistrust, which is a barrier to the sound development of a partnership.

A second challenge, that of transaction fees, which is likely the easiest to solve, brought conversations with Postbank to a halt. PCK and Postbank were not able to agree on a fee schedule for PCK to provide the services on behalf of its partner.

The third challenge has been technology. POS terminals for PCK should be GSM enabled in order for them to be able to install them in rural areas where Postbank and the other banks do not have branches.

Another major limitation for an alliance resides in competition. The sister companies have grown apart and are competing within the same segment with several similar products, especially on the payment side. As we have seen in the previous chapter, PCK has become a major cash merchant, operating mostly in the bill collection sphere, but also in domestic and international remittances and loan disbursement/repayment. All of these services are also offered by Postbank. In that context, PCK perceives Postbank as a competitor and not as an ally, and vice-versa.

The situation is aggravated by the fact that Postbank has built its own network in the most profitable areas, and only uses the Post in the unviable rural areas. Meanwhile, Postbank continues to develop its network of non-postal agents without utilizing the post office outlets to full scale.

From a public policy perspective, this may appear as a duplication of efforts, especially considering Kenya's commitment to financial inclusion and PCK's *de jure* participation in Postbank capital, which in the medium term should lead to some form of integration.

III.1.6 Recommendations

There seems to be a strong trend towards building legally independent postal financial service entities, either as fully licensed postal banks (Morocco), limited licence banks, or other intermediary forms, such as a postal microfinance entity (Benin). In that scenario, the actions to improve the link between the Post and an independent postal bank are important and should be analyzed in greater detail.

The key recommendations for the government are to:

i. Establish a “transition committee” composed of representatives from the PCK, Postbank, Ministry of Finance, Ministry of Information and Communications and, if possible, the CBK. This committee would be tasked with setting up a plan for strategic integration between the Post and Postbank and the new governance structure.
ii Fund or co-fund, together with Postbank, the installation of the management information system used by Postbank at PCK, as well as the full automation of PCK’s back office. If possible, it is recommended that the same back office system as that used by Postbank be used to facilitate future collaboration.

The recommendations for the Post are to:

iii Consider Postbank as an ally and offer its services in addition to KCB’s, but by giving priority to Postbank. The Post is considering furthering its partnership with KCB by moving from the present cash-in/cash-out facility for its M’taani mobile-banking product towards buying a switch from KCB, and thus further integrating.

iv Improve internal controls of paper passbooks in rural areas to lower fraud rates, thus increasing the relationship of trust. Internal control procedures for Postbank passbooks must be reinforced, and the Post should allow Postbank to perform random auditing of procedures in the rural offices where Postbank offers its services.

v Increase efficiency in the reconciliation process with Postbank. This can be easily achieved by placing a staff member from the accounting department to work exclusively on the Postbank case and providing him/her with the appropriate training.

vi Improve settlement procedures and ensure that settlement with Postbank is performed at least on a weekly basis. By setting up and pre-funding an account at Postbank, settlement time can be greatly improved.

vii Review the pricing mechanism in the Postbank partnership by lowering the fees charged. This renegotiation should be done within the framework of a special relationship agreement in consultation with all stakeholders, including the Ministry of Information and Communications, the Ministry of Finance and the Central Bank as part of the “transition committee” activities. PCK must fully realize that with its new status as shareholder in Postbank, PCK wins when Postbank wins.

The recommendations for Postbank are to:

viii Streamline operations with the Post by purchasing and installing an extra licence for the back office system used by Postbank at the PCK, installing Postbank’s core-banking system and ensuring real time connections between the two.

ix Install POS devices in all post offices, to train PCK counter staff in customer service and financial services, and to improve procedures for financial products.

x Share IT-investments to update, improve and develop the IT infrastructure of the Post and its network.

It is worth highlighting that Postbank is interested in developing the partnership with the Post, so it is likely that it would be willing to implement these three recommendations.


In no country in the world has mobile money caught on at a faster pace and revolutionized the entire financial services industry more than in Kenya. This has had a negative impact on the Post’s domestic remittances product and, worse still, it may even begin to challenge PCK’s hyper cash merchant model, on which the postal diversification strategy is based. Since there are more than 100 mobile money deployments around the globe, with varying degrees of success, it seems important to extract lessons from the case of Kenya to understand the potential role for a postal operator in a mobile money scheme.
II.2.1 The Post as a catalyzer in an early mobile money deployment

A major role for the Post is to allow mobile network operators (MNOs) to reach a critical mass of agents in a quick and effective manner, at an early stage of mobile money deployment.

In Kenya, Safaricom approached PCK early, as it was interested in using post offices as a cash-in/cash-out network. However, the contract contained an exclusivity clause requiring PCK to work only with M-PESA and no other mobile money provider. PCK’s legal department advised the business department against this and negotiations broke down. Had PCK agreed to become an agent, it would probably have allowed Safaricom to deploy its agent network even faster, and the Post would already be fairly well integrated in the M-PESA ecosystem.

Now that mobile payment deployments are occurring all over the world, it seems that postal operators have a clear role to play in the success of such endeavours. Indeed, mobile money is based on the network effect and requires a critical mass to become sustainable. By critical mass we understand a critical mass of customers, but also of agents. Analysts of M-PESA success determined that a key success factor was that it was wise enough to initially launch the service with a large number of agents offering exactly the same service, and then to expand the agent network proportionally to customer uptake. The Post is exactly that: a wide integrated network with the same service and the same procedures throughout. This model was adopted in 2010 by Orange Money in Madagascar, where the Post offered the service over its network of 240 offices, thus providing a solid platform from which Orange’s service could expand.

In such a scenario, the revenues from the cash merchant model might be higher than if the Post joins at a later stage. The Post’s capacity for negotiation decreases as the number of agents offering the service and customer uptake grows. For instance, in Kenya, Safaricom’s 32,000 agents make the Post’s 744 contact points redundant.

III.2.2 The Post as an additional cash merchant for mobile money, particularly for non-dominant MNOs

The success of a mobile money platform is based on customer confidence and an appropriate ecosystem. The Post offers trust, reliability and a wide, ubiquitous network which provides a supporting ecosystem. Therefore, even if the Post is not present at the beginning of a deployment, it can join the cohort of agents at a later stage of development to operate as a cash merchant. The Post benefits from strong trust capital which other agents, such as fruit stands or other merchants, have to build gradually and may never fully acquire.

This is what happened to Airtel Money in Kenya. After PCK rejected Safaricom’s offer, Zain (now known as Airtel) contacted PCK to become a cash-in/cash-out agent. The partnership agreement was signed and today PCK offers Airtel Money services in its branches. The same applies to Orange Money which, as the last competitor to enter the market, faces major challenges developing an agent network. A partnership with PCK would be a blessing for Orange Money, which expressed interest during the meetings in Nairobi. Discussions occurred prior to the mission, however no agreement was reached due to PCK’s demands which could not be met by Orange Money.

III.2.3 The Post as a super agent

In the early stages, Safaricom used its master agents, which sold airtime to become the distribution channel for their mobile money product. After realizing that by using a third-party provider for agent training and control (Top Image), it did not need master agents for its mobile money product. M-PESA began to work directly with the field agents. In a third stage, M-PESA realized that it needed to offer a facility for buying and selling float accessible to all its agents. It therefore created the concept of the super agent. Most super agents are banks, because such an activity requires significant cash availability. Given PCK’s cash-management capacities and the
capillarity of its network, it seems it could offer super-agent services even closer to the rural agents. However, when asked about the possibility of PCK becoming a super agent for M-PESA, Safaricom dismissed the idea.

From the Kenya case, we can derive a third role for the Post in the context of mobile money, which is that of a super agent for the mobile money operator. The conditions for this role are the existence of a solid cash-management system, enough liquidity in the network, and the existence of appropriate cash-in-transit services (e.g. armoured vehicle services).

III.2.4 The Post as a multi-operator cash merchant

In countries where the Post does not want to work with only one mobile money operator, it can offer cash-in/cash-out services for several operators, thus becoming a physical switch for customers.

In the case of Kenya, PCK operates with Airtel Money, however Orange Money is also interested in using the network to develop its agent penetration, which remains limited. We could imagine that at some stage the Post could offer the services of several mobile money operators. Thus far, mobile money services are not directly interoperable. An M-PESA customer cannot send money from his/her wallet to an Airtel Money wallet. However, he or she could send the money to an Airtel customer who can receive it in cash at an M-PESA agent. If the Post offers cash-in/cash-out services for M-PESA and Airtel Money, the cash can be received from M-PESA at the Post and instantly loaded it into an Airtel wallet, without having to visit separate agents. This multi-operator facility could be useful in a world where mobile money is not interoperable across operators. This model is less than perfect, because every time e-value is converted into cash the customer pays. The following model could avoid such frictions.

III.2.5 The Post as a switch among mobile money operators

Integrated platforms, compatible with all existing mobile telephone networks, are presently being developed and tested in Kenya by a local IT giant, Craft Silicon’s ELMA platform. This application, which only works on 3G smartphones, enables the user to perform transactions across networks. It claims to be the solution to the main challenge of mobile money: interoperability. The developer will make the service available to all banks free of charge, and customers will pay a monthly fee of 80 KES to perform as many transactions as they wish.

PCK’s ambition are smaller, however, and the postal operator is looking to acquire a multi-channel transaction processing platform which would allow it to perform transactions over several channels (mobiles, POS, etc.) for which it has agreements with providers. The platform will however not become a switch for interoperability among the market’s different mobile wallet providers. Given the necessity of a reliable automated back office, such developments appear easier to perform under an alliance with Postbank or KCB.

However, other countries where Posts may have a larger pool of resources available for investment and strong in-house IT capabilities could develop their own switch. This would allow them to transfer money from one mobile wallet to another, playing a consolidator’s role and thus becoming an unofficial mobile payment system.

In Kenya, PCK appears to be stuck with solution number 2, which is to be an additional cash merchant for the lesser players on the mobile money market. However, it would like to move up the ladder and is considering using solutions 4 and 5 as part of its strategy to get back at the centre of domestic electronic fund transfers. The issue of funding then becomes critical.
III.2.6 Postal-led mobile money deployments

In all previous cases, the Post is considered as a secondary element in a mobile money deployment. The question then arises as to whether or not Posts can offer their own mobile money service: a postal-led mobile payment model.

Posts in the developing world have reacted in diverse ways to the mobile innovation flourishing around them. Most have become cash merchants for mobile money operators. However, in countries like Bangladesh and Yemen, the response has been different. In Bangladesh, the development of an electronic funds transfer system (EFTS) has made it possible to connect the rural post offices through the mobile network, thus allowing for speedy domestic remittances across Bangladesh Post’s physical network. This is a first step taken by several posts even in some of the world’s poorest countries such as Mali. There, as well as in Gabon, the postal operator has acquired servers and communication technology equipment. With the help of a technology partner from Senegal, the operator is linking its rural post offices through mobile networks and offering instant domestic remittances. Service uptake in both cases is good. However, it is even stronger in Bangladesh, where postal staff receive an incentive for EFTS transactions. Incentives to postal staff should therefore be considered by any Post using mobile deployment.

While this first step seems to be implemented in several places around the world, Posts offering P2P mobile wallets are more scarce. This is mostly due to a usual lack of disposable income to invest, but also to constraining legal and regulatory frameworks.

In Italy, however, Poste Italiane has developed a mobile banking platform targeting, among other segments, underbanked migrants. Through an agreement with Vodafone, the Post has become a mobile virtual network operator (MVNO), which allows it to use the MNO physical telecom network and offer its own voice, data and value-added services over the network. PosteMobile takes advantage of the wide spectrum of financial products offered by Poste Italiane to provide its customers with mobile banking and mobile payment services. By linking their PosteMobile SIM cards to their postal bank accounts or Postepay prepaid cards, customers can engage in a number of financial services using their mobile phone as an access point. In particular, PosteMobile customers can make transfers to other BancoPosta accounts, or any other bank accounts, recharge a prepaid card from their postal bank account, transfer money from one prepaid card to another, send money abroad to their families, or purchase products and services by paying from the BancoPosta bank account or the prepaid card.9

While Italy has managed to put together successful postal-led mobile banking, few countries in the developing world have an e-money framework, and those that do usually do not allow Posts to become issuers of e-money. The Yemeni postal operator, however, has decided to challenge this situation. Yemen Post has had account-based services for many years and is one of the most financially solid posts in the Middle East and North Africa region. This has allowed it to invest in a project to develop P2P mobile payments which will be interoperable over the two major mobile networks. Yemen Post will offer access to its savings accounts directly from mobile phones. The Central Bank has agreed that this project can move forward.

The cases above demonstrate that tech-savvy Posts which offer their own postal financial services and are allowed by legislation to do so can consider teaming up with telecommunications companies to develop their postal-led mobile money scheme.

As a general conclusion about the role of Posts in mobile money, the Kenya case shows us that Posts offering financial services need to foresee and quickly adapt to changes in their competitive environments. If they fail to do so they might be crowded out by faster and more efficient services. For now, Kenya, along with the Philippines and potentially Pakistan, Tanzania and Uganda, is the only remarkable case of a mobile money environment truly revolutionizing the

9 PosteMobile: delivering innovative mobile banking and commerce solutions; in ICTs, new services and transformation of the Post, UPU–ITU, Berne, 2010.
financial services market. But others will probably come, and unless Posts have deep pockets, they must be ready to embark on cash merchant partnerships with mobile network operators at an early stage if they are to remain competitive.

IV. Conclusions and recommendations

This case study shows that a Post can diversify its revenues by becoming a cash merchant. There are however some pitfalls to avoid if this endeavour is to be successful. In that context, our recommendations to improve the cash merchant business model are to:

1. Select partners appropriately. Posts should fine-tune between diversifying its offering and rationalizing its partnerships. This can be achieved by carrying out a cost-benefit analysis and basic financial projections, either before entering into partnership or a year into it.

2. Abandon partnerships that are not scalable or financially viable, or somehow consolidate them, particularly if their impact on financial inclusion is negligible (such as for bill collection).

3. Partners should be required to invest more in promoting their products in the areas surrounding the post offices. A plan for usage improvement should be established with each of the partners offering financial services (banks, MFIs and insurance companies). Such plans must be developed by the partner in conjunction with the postal staff working in the targeted regions, who can provide insights about the local communities. In addition, Post's tellers could be trained by partners on how to sell their financial services, thus becoming financial services advisors for the unbanked and spearheads of financial inclusion.

4. Automate the back office to ensure an efficient reconciliation process, avoid fraud and reduce settlement time. This will be appreciated by all partners, including government agencies delivering CCTs over the postal network. Indeed, such agencies come under increased scrutiny from donors. The combination of an automated front office and a manual back office can be extremely problematic because it creates loopholes and inefficiencies.

Previously PCK had developed an instant domestic remittance service which worked very well, however this product failed due to high competition from the mobile money providers. Today the cash merchant model is coming under threat from the same market players. Looking forward and drawing from the Kenya case our recommendations are for Postal operators to:

5. Develop the historical partnership with the Postal bank, if such institution still exists in the country, into a full-fledged agency banking model, whereby the Post will offer the same products as a Postbank branch, including account-opening services. Among all possible options for the future, this partnership holds the most potential to develop financial inclusion because of institutional complementarity and government support.

6. If there is no Postbank in the country, then posts should consider a partnership with a commercial bank looking into developing its retail business particularly towards middle and lower income segments. A third option would be to work with a development bank which often have social and financial inclusion in their stated objectives. The important thing is for the Post to have one main bank partner on behalf of which it can open bank accounts to the unbanked that visit their branches. This does not prevent Posts from offering cash-merchant services for other financial institutions.

7. Perform a cost-benefit analysis of the partnership between potential partners, taking into account all factors. Such an analysis could be done by an independent third-party, based
on numerical projections and with the approval of the Ministry of Information and Communications.

8 Return to the negotiating table with mobile money operators that do not require exclusivity agreements, and increase flexibility as to the conditions, without foregoing sustainability. For this, partners should provide financial projections describing how the Post will gain from the partnership.

9 Continue talks with mobile-money operators for the Post to become a super agent in rural areas where existing super agents (banks) are not present. For this to happen, the partnership with a Postbank or a Commercial Bank can be an important stepping stone since it increases liquidity levels in the network and usually comes with improved cash-management capacity. Large operators such as Safaricom in Kenya, may not be interested in the Post given that they usually already command a large agent network. In such case the Post needs to elaborate a convincing document comparing its network with those of the various banks, demonstrating the missing areas where banks are not present but the Post is. This could trigger interest when combined with a good cash-management plan.
Annexes

Annex 1: Number of transactions and amount transferred for Cash Transfer for Orphaned and Vulnerable Children (CT-OVC) G2P transfer product.

<table>
<thead>
<tr>
<th>Month</th>
<th>Transactions</th>
<th>Amount (KES)</th>
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<tbody>
<tr>
<td>Feb 2010</td>
<td>45,016</td>
<td>167,028,000</td>
</tr>
<tr>
<td>March 2010</td>
<td>41,968</td>
<td>128,299,040</td>
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<tr>
<td>April 2010</td>
<td>43,840</td>
<td>133,375,000</td>
</tr>
<tr>
<td>June 2010</td>
<td>43,840</td>
<td>133,750,000</td>
</tr>
<tr>
<td>July 2010</td>
<td>43,840</td>
<td>133,750,000</td>
</tr>
<tr>
<td>August 2010</td>
<td>82,616</td>
<td>253,468,220</td>
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<tr>
<td>October 2010</td>
<td>82,439</td>
<td>252,492,000</td>
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<tr>
<td>December 2010</td>
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<td>270,277,000</td>
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<tr>
<td>February 2011</td>
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<tr>
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