# Nigeria:
# Investing in a Cashless Future

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- Utilizing digital financial services could reduce cash transactions significantly in Nigeria
- Experimenting with emerging mobile technologies like conversational interface could increase financial literacy among Nigerians
- Continous regulator support is required to ensure diffussion of agent banking across the country
- Stability of government policies will sustain investor interest in Nigeria's emerging fintech sector
- Regulators should recognize fintech as essential to achieving NFIS targets

In the face of recession, increasing unemployment and rising inflation, Nigerian policymakers are looking to new tools to revive the economy. Digital financial services are not only seen as a tool for promoting financial inclusion, but also for stimulating economic growth. According to the McKinsey Global Institute's projections, by utilizing digital financial services and reducing cash transactions, Nigeria's GDP could rise by an estimated 12.4 percent by 2025. While becoming fully digitized and cashless is still a far leap, Nigeria has made strides toward improving financial inclusion and digital finance.

## NIGERIA'S NATIONAL STRATEGY HAS ADVANCED THE STATUS OF FINANCIAL INCLUSION, BUT MORE REMAINS TO BE DONE

With the launch of the National Financial Inclusion Strategy (NFIS) in 2012, Nigeria, a signatory of the Maya Declaration, took a first step in support of financial inclusion. The strategy aims to reduce the financial exclusion rate from 46 percent in 2010 to 20 percent in 2020, through the implementation of several regulatory reforms and targeted programs. Regulatory reforms have focused on the framework for agent banking, the consumer protection framework and Know Your Customer (KYC) rules. Targeted programs have included an incentive scheme to promote usage of electronic payments, promoting National Financial Literacy, small and medium enterprise (SME) finance support, and continuing to develop mobile payment systems and other cash-less policies.

Nearly four years into its implementation, the country has made some progress in improving financial inclusion, but more work remains. Furthermore, quantifying achievements toward per capita indicators remains difficult as the National Identification System, which is needed to identify individual accounts, lags behind target. As of year-end 2015, adults with a national identification numbers represented about 7.5 percent of the population, still below the target of 59 percent set by the NFIS (Table 1).

**Table 1: National Financial Inclusion Strategy: Targets**

| | 2010 | 2015 | 2020 |
|---|---|---|---|
| **In percent of adult population:** | | | |
| Payments | 22% | 53% | 70% |
| Savings | 24% | 42% | 60% |
| Credit | 2% | 26% | 40% |
| Insurance | 1% | 21% | 40% |
| Pensions | 5% | 22% | 40% |
| KYC ID | 18% | 59% | 100% |
| **Units per 100,000 adults:** | | | |
| Bank branches | 6.8 | 7.5 | 7.6 |
| MFB branches | 2.9 | 4.5 | 5.0 |
| ATMs | 11.8 | 88.5 | 203.6 |
| POS | 13.3 | 442.6 | 850.0 |
| Mobile agents | 0 | 31 | 62 |

*Source: NFIS, 2012*

Targets based on population, such as bank branches per 100,000 adults, also show room for improvement. Between 2012 and 2015, branches of commercial banks per 100,000 adults fell by 14 percent, while the actual number of bank branches only fell by 7 percent. This suggests a real decline in bank branches, combined with an underlying growth in population. Bank branch expansion must keep up with population trends in order to meet NFIS targets. Between 2012 and 2015, ATMs across Nigeria increased by 41 percent. However, the number still falls short of NFIS 2015 target of 88.5 ATMs per 100,000 adults – the latest data suggest only 16 ATMs exist per 100,000 adults. In terms of point-of-sale (POS) devices, it is estimated that 117,000 existed at end-2015, which reflected a 42 percent increase compared to the year prior. This represents positive momentum that leaves room for improvement in POS uptake.

## FINANCIAL LITERACY PLAYS AN IMPORTANT ROLE IN ENSURING UPTAKE OF FINANCIAL SERVICES

Financial knowledge is essential to achieving Nigeria's financial inclusion target. In 2013 the country launched a financial literacy framework, later known as the National Financial Literacy Framework (NFLF). The NFLF supports the National Financial Inclusion Strategy of increasing financial literacy among the Nigerian populace through greater understanding of financial products as well as encouraging Nigerians' participation in financial markets. The Central Bank of Nigeria (CBN) is taking the lead in coordinating the NFLF.

The Enhancing Financial Innovation & Access (EFInA) 2014 Survey showed that a low level of financial product understanding exists among the adult population. 80 percent of adults were not familiar with mobile money agents, deposit insurance or POS machines and about 60 percent of adults could not explain or were even familiar with terms such as savings account, current account, loans, ATM/Debit cards.

With the national policy push for digital financial services in Nigeria, awareness about mobile money is critical, yet still remains low at 12 percent, with a mere 0.9 percent of the population using mobile money services, according to the Intermedia Financial Inclusion Insights (FII) Track Survey 2015. This reinforces the importance attached by stakeholders in driving more consumer awareness and financial education. Consumer awareness comes through public service mass media programs, educational entertainment and market place seminars.

Likewise, financial services providers (FSP) in Nigeria are taking financial education to the general public as part of corporate social responsibility activities. Occasions such as the World Savings Day (October 31) and the entire month of May (designated for children banking) are effectively utilized to raise awareness among the target audience on the important financial products, such as savings accounts and insurance.

Because Nigeria has a large youth population, this group can be instrumental in educating their parents and peers through well-designed financial education interventions. Emerging mobile technologies offer the nation's stakeholders a chance at increasing financial literacy. For example, *conversational interface* (one of Massachusetts Institute of Technology's 10 breakthrough technologies of 2016) can be used to reach and inform youth as well as mobile savvy adults about financial products and literacy.

## A DEVELOPED NATIONAL ID SYSTEM IS CRITICAL TO ACHIEVING AND QUANTIFYING NFIS TARGETS

The lack of a developed financial national identity program creates challenges in tracking metrics of Nigeria's NFIS. Likewise, lack of a unified identification program hinders the ability to assess an individual's financial history, examine aggregated data to track trends and identify areas of consumer demand that could later guide policymaking decisions. While Nigeria does use other national identification systems, such as driver IDs, international passports, and voting registration, large segments of the population lack formal means of identification. This tends to be highly correlated to income as the poor tend to find obtaining identification too cumbersome or expensive, and thus forgo obtaining formal means of identification.

In 2013, the Nigerian National Identify Management Commission (NIMC), in partnership with MasterCard, announced a pilot program to issue 13 million National Identity Smart Cards. The pilot program offers an opportunity to verify the identity of individuals and likewise provides aggregated data that can then guide policymaking related to financial inclusion. For Nigerians, the cards not only offer a biometric form of identification, but also access to financial services to those who may have previously been financially excluded. This access includes the MasterCard M/Chip4 payment application, pre-paid MasterCard functionality, and reloadable options for incoming credit from either government or private transactions. Likewise, the card can be used to address issues of duplication of individuals' identities across banks, prevent fraud and identify theft, and serve as a tool to include previously unbanked individuals in the financial system. This system will then be harmonized with other means of national identification.

On the regulatory side, CBN issued a circular in 2013 to relax the requirements for account opening for low- and medium-value accounts, which are typically held by lower income populations who tend to have greater rates of financial exclusion. Likewise, these same groups tend to lack formal means of identification, making opening a bank account and gaining access to financial services difficult. The three-tiered KYC approach makes room for different forms of identification, such as third-party identity verification. The tiered approach divides accounts by low-value, medium-value and high-value and prescribes the type of ID acceptable from customers, based on the type of account opened and level of transactional operation.

### NIGERIA'S FINANCIAL SERVICES ARE MOVING AWAY FROM PHYSICAL INFRASTRUCTURE

Brick-and-mortar channels for financial services, such as bank branches and ATMs, have been the traditional means by which financial service providers serve their customers. Yet these channels have been in decline in Nigeria due to high cost-to-service ratios and increasing choices in alternative distribution networks. Bank branch closures have been attributed to lower cost options made possible by digital finance where non-bank firms, often retailers or micro-traders, serve as mobile money services (MMS) agents for financial services. In parallel, macroeconomic factors - such as the drop in global crude oil prices - have put downward pressure on the Nigerian economy, leading many banks to seek greater operational efficiency by closing unprofitable bank branches and employee retrenchment.

Though agent banking is still a relatively new concept in Nigeria, it is on a path to progress and support growth in the number of registered mobile money accounts, which has already grown by more than 200 percent - from about 3.4 million in 2012 to 10.7 million in 2015; while the number of mobile money transactions has also increased from 2.3 million in 2012 to 43.9 million in 2015. In terms of monetary value, this represents a growth of 1,303 percent in the same period. According to the latest Nigeria Geospatial Mapping Survey, there are 8,257 mobile money agent locations, 3,567 of which are operational.

### THE ROLE OF SUPER AGENTS AND MOBILE PHONES ARE CRITICAL TO NIGERIA'S NFIS

The Central Bank of Nigeria has supported financial services providers' operational efficiency by providing frameworks for licensing super agents. Super agents' roles within the mobile payment value chain are similar to wholesalers; they serve as aggregators of sub-agents, assist in recruiting and train agents to ensure they comply with legal requirements. In 2016, four firms (Etisalat, Glo, Interswitch Financial Inclusion Services and Innovectives) were licensed as super agents, with the expectation they provide shared agent network services and thereby extend digital financial services and touchpoints across the nation.

The increased number of mobile phones across all income levels in Nigeria attracts financial service providers who recognize the channel as a means of ramping up revenue, while reaching the un(der)served population. Nigerian banks and non-bank players are targeting existing and new market segments using digital channels. A success story of mobile money in Nigeria is Paga, Nigeria's leading money transfer service that was launched in February 2011 and has achieved a user base of 5 million on its platform, with significant contributions from Person-to Person (P2P) transfers done through its 10,000 agents.

In 2016, two new banks (Providus Bank and Suntrust Bank) increased the number of Deposit Money Banks (DMBs) to 21 from 19. One of these new players is distinct as Nigeria's first digital bank, offering services entirely on electronic channels, through both landline and mobile phones and the Internet. This is a welcome development to Nigeria's financial services landscape. Only time will tell if the bank will stick to its digital only promise.

### MOBILE MONEY OFFERS A LOWER COST ALTERNATIVE IN PROVIDING FINANCIAL SERVICES

In a country as vast and populated as Nigeria, and against the backdrop of declining bank branch availability, mobile money serves as a digital solution to promote financial inclusion. In November 2016, the Nigeria Inter-Bank Settlement System (NIBSS), the payment and settlement infrastructure service and the CBN, working with telecom companies and deposit money banks, launched a mobile switch platform known as mCash. mCash relies on the same system used to add phone credit or buy ringtones, using a simple alphanumeric prefix dialed into the phone to conduct transactions.

Despite the CBN issuing the regulatory framework for mobile payment services in 2009, which gave banks the lead in the mobile payment system, the distribution network has not reached scale because telecommunication companies own the agent network necessary to support the service. Between 2012 and 2015, mobile money agent outlets per 100,000 adults declined from 29.8 to 20.6. This decline has been attributed to the CBN's arrangement, which does not make telecommunication companies directly involved in the mobile payment system. Nigeria's mobile money services (MMS) guidelines exclude Mobile Network Operators (MNOs) from becoming licensed mobile money operators. The CBN expectation was that banks would do a better job of bringing financial services to the masses via mobile money services, as seen with Kenya's Safaricom. Hence, it allowed banks and non-bank financial firms to lead. In the face of weak performance by banks to scale mobile money services, CBN approved MNOs to serve as super agents to banks, which allowed telecoms' reach and brand to be used for mobile money services beyond the technical capabilities they earlier provided. CBN has approved a framework for super agents that provides the infrastructure for mobile money agents to work and spread the adoption of mobile money across Nigeria, especially in rural areas.

Existing MMOs in Nigeria are pushing for more awareness of mobile money, while designing products that encourage usage among the rural poor and urban low-income populations. Banks are looking at more cost saving opportunities in acquiring and serving customers, particularly digital financial services.

The regulatory commitment to support the banks' efforts is evident, with CBN issuing the framework for super-agents and the subsequent licensing of two MNOs. The challenge ahead for the CBN in achieving financial inclusion strategy targets is to recognize the role of non-bank players, particularly in financial technology (fintech), and create a favorable environment for their growth, as the UK and US are doing with regulatory 'sandboxes'. The pace of financial services development is faster than the capability of financial service regulators. With that in mind, Nigerian regulators should adopt a risk-based regulation in their approach to dealing with innovation and avoid the clampdown that occurred in 2016 by CBN against remittance startups, in favor of incumbents like Western Union, ignoring the immediate implication on low-income remittance recipients. Regulator attitudes can also stall investments into the digital finance sector as demonstrated by the licensing of 18 MMOs in 2010. The overcrowding effect of that event was perceived as impeding other companies from raising sufficient funding from investors and subsequently was perceived as impeding the growth of mobile money services.

## HOWEVER, FINTECH INVESTORS' INTEREST IN NIGERIA IS GROWING

Despite challenges, Nigeria is attracting interest from fintech entrepreneurs, multilateral agencies (World Bank, IFC), family foundations (Bill & Melinda Gates Foundation, Omidyar Network), global investors (private equity, venture capital, impact investors), global technology firms and accelerators. Beyond the altruistic intent of increasing financial access, investors are driven by market opportunities created by Nigeria's large underserved and financially excluded population, a fast growing youth population and the exponential growth rate of mobile phone subscriptions.

Likewise, analysts view the government as warming up to the idea of fintech. In August 2016, the CBN issued a memo to shut down remittance startups from operating in the country. The government then quickly reversed its stance after an outcry in the market and eventually licensed some selected remittance startups.

Insights from capital raised by Nigerian fintech companies reveal that payment and consumer finance remain the most attractive segments. According to KPMG, investment in Nigerian fintech exceeded $200 million over the past two years. Beyond Interswitch Nigeria, a transaction processing and switching company, attracted private equity investment of $110 million investment in 2010 and returned over 1400 percent to initial founding investors. Other notable examples are Paga, which raised over $23 million from investors like Omidyar Network, Acumen Fund, and Tim Draper, and OneFi (Formerly OneCredit), which secured a credit facility of up to $10 million in convertible equity-linked loan notes and 25 percent acquisition from Net1 UEPS Technologies (a South Africa Based Fintech). Prominent local investors, including Venture Garden Nigeria Group and Signal Alliance's SASWARE, and international investors, such as Omidyar Network, Accion Venturelab and Irrational Innovations, are committed to investing in Nigerian startups across financial services verticals.

The country's challenge of limited bank branches, networks concentrated in urban areas, poor customer financial literacy education and poor infrastructure (power, roads, telecommunications) inhibit the expansion of financial services to the underserved population. For example, Northern Nigeria is grossly underserved and may remain so without the use of fintech. Under digital financial services (DFS), innovative business models and transformation technologies can be utilized to drive branchless banking across Nigeria.

Nigerian regulators could improve the market environment by promoting experimentation with initiatives like payment banks or open banking initiatives that will allow developers to build on Application Programming Interfaces (APIs). This will provide impetus for fintech entrepreneurs to develop competitive digital products that could help reach the nation's financial inclusion targets. Emulating the U.K., CBN and the Nigerian financial inclusion secretariat can set up a 'sandbox' - a vehicle to encourage new fintech players to develop and test-run their products under a controlled environment. Lastly, the CBN could learn from India's example of progress with payments stack. These methods should be implemented to reach the large underserved segments, especially women and population in the northern region of the country.