Driving Financial Inclusion In South Africa's Informal Economy:

The Landscape At The Bottom Of The Pyramid

A Report by Forbes Africa insights In Association With

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Foreword: Mastercard

Mastercard's *New Payment Index 2022* says that 95% of South African consumers have used at least one emerging digital payment method in the last year. Consumers in South Africa are aware and actively using solutions like cryptocurrency, digital cards, biometric payments, Buy Now Pay Later (BNPL), and open banking. The index found that while in-person purchases remain common, consumers are making purchases in multiple ways.

Three quarters of users increased use of at least one emerging digital payment method in the last year, with 97% indicating they are likely to use a digital payment method in the next year, with account-to-account payments (86%), digital money transfer apps (81%), instant payment services (80%), and digital credit or debit cards (78%) topping the list.

Security remains an imperative when deciding what payment methods to use; 79% of South African consumers say that swiping or inserting a debit or credit card is the most secure way to pay.

"We need to end up with some sort of a level playing field in the way that people can interface with the economy, regardless of the size of the business or the cash that that you're holding on hand, it has to be on the basis that we can at least provide the basic services that allows us to create the type of efficiencies that free up more time. Nobody wakes up in the morning wanting to make a payment," says Gabriel Swanepoel, Country Manager for Mastercard in South Africa. "So for you to have the ability to easily accept your wages, easily pay, or send money home to loved ones or family, easily pay for electricity bills, get a car or get money if you need to pay for things like groceries; all of those things become important," he adds.

"I think that within a digitized world where we've got the smartphone penetration, sitting at where it is at the moment, it quite frankly is our responsibility to ensure that this happens for the broader part of the population."

Introduction

The operative words for any document on financial inclusion in the informal economy has to be 'impact on daily lives'. How can financial services improve the everyday lives and concerns of people at the lower end of the economic spectrum?

According to the *World Bank Annual Report 2020,* "access to affordable financial services is critical to reducing poverty, boosting income equality, and promoting economic growth", and financial inclusion is a critical step in social engineering. The report elucidates further: "Far too many people — 65% of adults in developing countries — lack access to basic transaction accounts to send or receive payments, much less the savings, insurance, and credit services."

For this white paper, FORBES AFRICA, in association with Mastercard, investigated underserved consumers and Small Medium and Micro Enterprises (SMMEs) in the informal sector in South Africa to establish factors that would democratize and widen financial access and enable equitable financial inclusion. The report was brought out through quantitative surveys, data analysis, stakeholder interviews and desktop research.

What is the informal economy?

The International Labour Organization understands the informal economy as: "All activities that are, in law or practice, not covered or insufficiently covered by formal arrangements; the notion of exclusion lies at the heart of these parameters – that it refers to working people who are largely excluded from the exchanges that take place in the recognized system."

"I think our definitions around what we used to think of as the informal sector versus the formal sector is changing fundamentally. And I think that work, and the way we think about employment, and the way we think about labor is changing fundamentally...at the back of tech being available to the broader population. And so I think that the way that people earn a living, and therefore provide value or generate value needs to be relooked at," says Swanepoel of Mastercard.

What is financial inclusion?

According to the World Bank, financial inclusion means that individuals and businesses have access to useful and affordable financial products and services that meet their needs – transactions, payments, savings, credit and insurance – delivered in a responsible and sustainable way. Being able to have access to a transaction account is a first step toward broader financial inclusion since a transaction account allows people to store money, and send and receive payments.

"What kind of support you can give to the most vulnerable in society, particularly around assistance in going through the process of being compliant, I think can add value and also make a huge difference around financial inclusion," offers Stephen Goldberg, the CEO of Selpal.

Size of the informal economy in South Africa

South Africa has a population of 61 million, with a large informal sector. It incorporates largely unregulated businesses and accommodates marginalized communities such as women, youth and the previously disadvantaged. In Africa's second-biggest economy, micro enterprises and informal businesses are a crucial part of the National Development Plan for economic transformation, job creation, and poverty reduction, and are an attractive under-penetrated market for financial services.

Statistics South Africa's (StatsSA) *Quarterly Labour Force Survey* in 2018 found about three million people were working in the informal sector.

In the report, *Impact of Covid-19 on Micro and Informal Businesses South Africa 2021*, brought out by South Africa's Department of Small Business Development (DSBD) with the United Nations Development Programme (UNDP) South Africa, estimations by the DSBD size "the number of micro and informal businesses at ~3.3 million in South Africa".

The report states: "The 2020-2025 strategic plan of the DSBD sets out the following objectives for the small business enterprise: To grow the contribution of SMMEs to the GDP from 35% to 50% by 2024; the strategic plans are to upscale support for SMMEs and Cooperatives through the provision of blended finance instruments; to facilitate the increase of small businesses in historically concentrated economic sectors (township economies and rural development)."

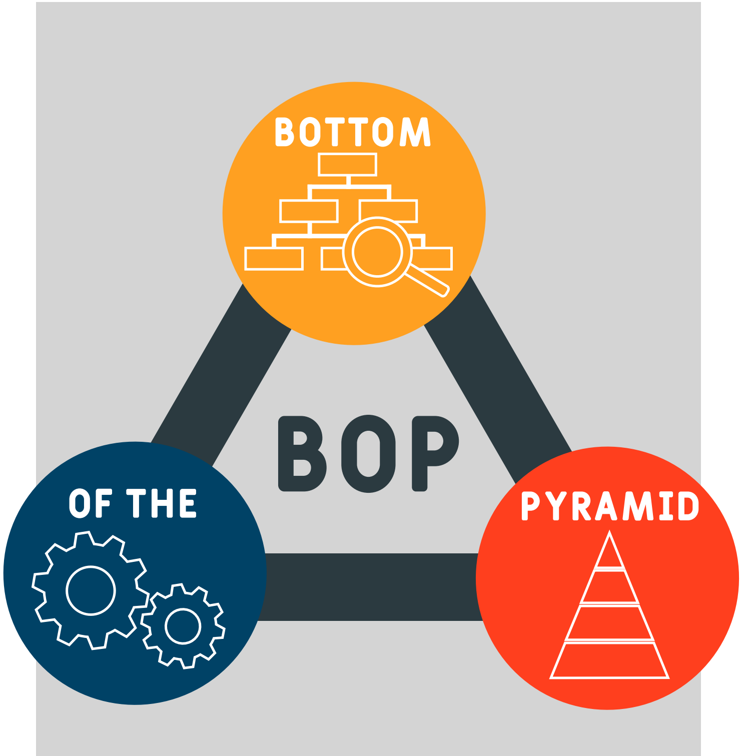
According to StatsSA, close to 4.8 million people were employed in informal or precarious work in 2020, while in the period under review (2010-2020), the number of people in informal work increased generally, peaking in 2018 at 5.79 million. However, a significant drop of around one million people was noticed in 2020 – most likely due to Covid-19.

A May 2020 study by FinScope says that in South Africa, "SMMEs contribute more than 40% of total GDP and account for more than 87% of all employment; more than 60% of the people who start an informal business do so because they are unemployed and have no alternative source of income, and the number of MSMEs is 1.65 million informal enterprises and 0.96 million formal businesses".

"The actual informal economy is actually twice as big as what the formal statistics bureaus reflect," attests Zunaid Miya, one of the senior executives interviewed for this white paper, who is the Managing Director: Financial Services of Hello Group in South Africa.

ENABLING 7 OF THE 17 SDGS

Financial inclusion has been identified by the World Bank as an enabler for seven of the 17 Sustainable Development Goals (SDGs) to be achieved by the year 2030 that are: no poverty; zero hunger; good health and well-being; quality education; gender equality; clean water and sanitation; affordable and clean energy; decent work and economic growth; industry, innovation and infrastructure; reduced inequalities; sustainable cities and communities; responsible consumption and production; climate action; life below water; life on land; peace, justice and strong institutions; and partnerships.



WHAT IS 'BOTTOM OF THE PYRAMID'?

Popularized by Indian scholar C. K. Prahalad in his 2004 book *Fortune at the Bottom of the Pyramid*, written alongside Stuart Hart, it's an economic human pyramid with the privileged on the top and unprivileged poor at the base. It's a market-based model of economic development that speaks to the profitable opportunities at the bottom.

The 'bottom of the pyramid' are financially excluded and typically would not qualify for a commercial relationship as they don't meet the KYC requirements set up by the Central Bank. These excluded consumers primarily use cash when making or receiving payments. These are also consumers who either do not use bank accounts, or have bank accounts that are inactive, or have access to facilities such as credit and digital banking but choose not to make use of them.

All are LSM 4-7.

LSM refers to the Living Standards Measure marketing tool used in South Africa, dividing the population into 10 LSM groups, where 10 is the highest living standard level and one the lowest.

Research Objectives

- To provide an overview of the current state of financial inclusion in South Africa.
- To explore potential solutions or alternatives to cash as a preferred form of payment within the informal market sector.
- To determine the accessibility of credit facilities.
- To understand the current payment journey in the informal sector.
- To understand informal sector cell phone ownership and usage.
- To understand attitudes toward Banking/Payment Apps over cash and payment cards among informal sector consumers and SMME owners.
- To provide a comprehensive view of the challenges faced by micro enterprises in accessing financial services.
- To engage with key fintech executives on possible intervention strategies for financial inclusion.

Methodology

RESEARCH SAMPLE IN 2021:

Research was conducted among the following stakeholders:

- 265 quantitative interviews with consumers who primarily use cash when making or receiving payments. These are also consumers who either do not use bank accounts, or have bank accounts that are inactive, or have access to facilities such as credit and digital banking but choose not to make use of them.
- 56 quantitative interviews with the owners of micro enterprises in the informal economy; business owners who are part of the informal sector and engage primarily in cash transactions or EFTs.
- 9 qualitative interviews with senior executives of companies in the financial services sector in South Africa such as Yoco, Hello Group, iKhokha, Nedbank, Net1 Southern Africa, Retail Engage, Standard Bank and Vodacom.

RESEARCH SAMPLE IN 2022:

Research was conducted among the following stakeholders:

- 250 face-to-face quantitative interviews with excluded consumers: Consumers who primarily use cash when making or receiving payments. These are also consumers who either do not use bank accounts, or have bank accounts that are inactive, or have access to facilities such as credit and digital banking but choose not to make use of them.
- 150 quantitative interviews with informal sector small to medium enterprise business owners (SMMEs); business owners who are part of the informal sector and engage primarily in cash transactions or EFTs.
- 4 qualitative interviews with senior executives in the financial services sector such as Kazang Pay, Mastercard, Selpal, and Blue Label Telecoms.

Where are the respondents from?
The surveys included respondents resident in South Africa's three provinces that are also its biggest economic hubs – Gauteng, Western Cape and KwaZulu-Natal.

The landscape of financial inclusion

Key findings and insights

Like any model of communication, where you need a receiver and a sender to transmit information, a financial transaction cannot happen without a buyer and a seller, or a consumer and a business owner.

At the heart of any study on financial inclusion are not mere numbers, but this essential human relationship, and we get to the bottom of the workings of these two main actors at the bottom of the income pyramid, and how they can both be incentivized for digitizing their commercial exchanges – and eventually switch from cash – so they can be included, and empowered, in a formal financial ecosystem. Helming this industry in the informal SMME markets are not the suit-and-tie entrepreneurs, but those working on everyday survival, serving consumers with similar needs.

Ashley Naidoo, Director of Kazang Pay in South Africa, refers to the reality of people walking kilometers to get to an ATM or having to take a taxi. "Financial inclusion, and digitalization allows you financial services at your fingertips. That's very much dependent on smartphone penetration, which we are seeing improving over time...Where we are struggling is that affordability point of view [that's] still a touchy point. Because when you are sitting in a country with 35% unemployment, not everyone can afford a [gigabyte] of data to do financial transactions," Naidoo muses.

In 2021, 100% of consumers used cash to pay bills (municipal, utility, airtime) and for shopping

Financial behavior of Informal Sector Consumers

The consumer group for the quantitative survey presented a heterogeneous mix of age, race, education and income, with LSM 4-7. The respondents included black, Indian/Asian, white and colored, an equal number of men and women – just under half of them single – with only 10% with some/all university/post-graduate qualification, and only 4% with a personal income of more than ZAR40,000 a month in 2021. In 2022, 10% of respondents had done some/all university degree or post-graduate qualification, and only 1% had a personal income of up to ZAR30,000.

The study in 2021 showed high awareness and usage of bank accounts and high awareness of other services in this group – with greater usage among higher-educated and higher-income earners. To break it down further, 94% of households had a bank account; 43% had a digital wallet, 43% any account; 26% insurance; 17% Telkom/instant money/other financial accounts and 16% loan facilities. Those that didn't have a bank account said they don't earn enough (65%), or the cost of bank accounts was too high (35%).

In 2022, 50% of households had a bank account, 31% used a digital wallet/e-wallet, 19% used Telkom/instant money/other financial accounts, 16% used loan facilities, and 5% used insurance facilities. Those that didn't use a bank account said the cost is too high (37%), they don't trust banks (21%), they don't have knowledge of financial products (19%) or understand how it works (18%). Other reasons included that they don't earn enough to justify a bank account (17%) or they can't provide proof of address (16%), or they don't have a work permit or residency (12%), while 4% do not want to pay tax.

"I think that the way the world is moving is to have a look at a bottom-up approach. And this would be true for financial literacy as well, where the way that we engage is to create that certainty and trust within all of the communities that we operate in. And then leverage tools like gamification, through simple interfaces," says Gabriel Swanepoel, Country Manager for Mastercard in South Africa.

As for their working status, the group in 2021 comprised 38% working full-time; 19% unemployed; 14% self-employed; 10% working part-time; 8% pensioners/retired; 7% students and 3% housewife/husband. The sectors they were most commonly employed in were retail, government/public service, hospitality/tourism, manufacturing, telecommunications, healthcare, automotive and finance.

The survey in 2021 showed that 60% of the respondents used a high-end Android phone, with only 5% using an Apple/iOS phone. In 2022, 63% of respondents used a high-end Android phone, while 3% used an Apple/iOS phone. Income and education are the two main indicators of the type of phone owned.

In 2022, the survey showed 44% of the respondents worked full-time, 21% were unemployed, 15% worked part-time, 10% retired, 4% self-employed, 3% were students and 3% housewife/husband. Sectors they were more commonly employed in were retail, hospitality/tourism, government/public service, oil and gas, healthcare, manufacturing, and domestic work.

Bradley Wattrus, the co-founder and CFO of Yoco, says that when Yoco was starting out about a decade ago, digitization in South Africa and smartphones weren't a given. His company enables financial inclusion with a small blue card machine.

"And [now], we find that pretty much everyone we engage with is familiar with a smartphone and is able to operate it. So that's a fantastic sort of baseline we rely on. The prices of smartphones are going down, and it's where things are going in our view.... looking to the future, we would anticipate a digital engagement between the customer and their providers versus a face-to-face one."

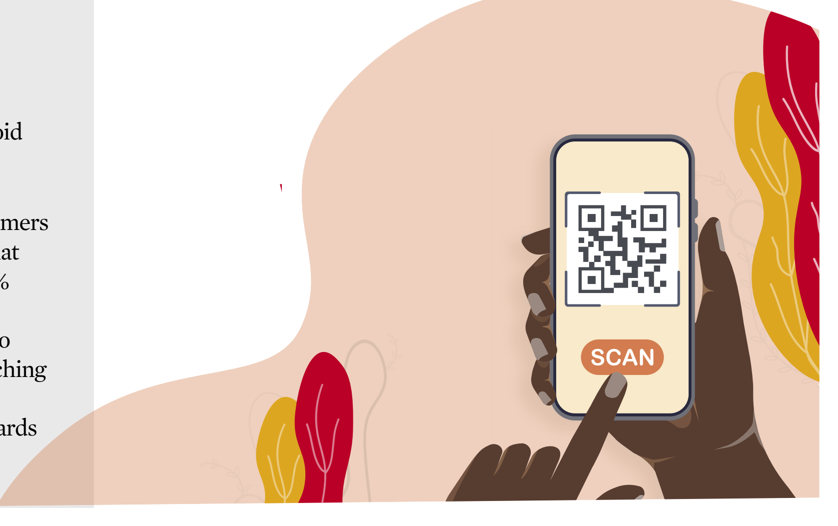
For now, although almost all respondents recorded for this survey claimed to shop in person in large retailers, the highest frequency shopping noticed was at spaza shops – especially among black, lower educated, and low- to mid-income respondents. Cash is overall the preferred payment option for spazas, home-based businesses and roadside vendors.

PHONE USE IN 2022

- High usage of smartphone Apps among informal sector consumers, particularly Messaging, Social media and Entertainment Apps
- Favorites are WhatsApp, Facebook and TikTok
- Two thirds of respondents own a high-end Android phone

Although less than a quarter of informal sector consumers use their phone to bank and make payments, those that do have a high claimed usage of the features, with 21% making payments, and 20% for banking.

"You need to be really focused and targeted in order to reach your target markets. Otherwise, you're just reaching the wrong person," says Kris van Zyl of Blue Label Telecoms. He adds that the top four they market towards are Facebook, Twitter, YouTube, and Instagram.



Cash continues rule as king

A notable finding is that the entire group of respondents in the survey in 2021 preferred to pay cash for shopping and paying bills (municipal, utility, airtime), although there was a higher usage of alternative payment options (credit/debit cards, EFTs, e-wallets, and QR codes) among more educated and higher-earning respondents. When going shopping, 70% said they preferred to use cash, mainly for the convenience (51%), habit (47%) and for the no-hidden-costs as with bank cards (43%).

In the 2022 survey, 100% said they used cash sometimes/regularly. Interestingly, from those who regularly use their phone features, 33% said they used the phone for food delivery services.

When going shopping, 38% use cash out of habit, 34% out of convenience, and 29% to avoid hidden costs that come with bank cards.

"Cash has a number of benefits, it's immediate, it's considered free – there are no credit card processing fees attached to it – and it's anonymous. I don't think you can compete with the anonymity of cash, but you can definitely compete with the immediacy and the cost," says Ricardo Platt, Managing Executive: Payments at Vodacom.

The study in 2021 showed that there seemed to be a strong movement emotionally to switch from cash – 65% claimed they are likely/extremely likely to start paying with something other than cash in 2022. As for their reasons, they need to be convinced that they need a financial service and can afford it before they will accept it. They would switch to an alternative for the safety aspect (won't get stolen and fear of viral transmission at the time of Covid) and if they were convinced of higher convenience, minimal costs and loyalty offers. Almost half the respondents opine that safety is what will push them to convert from cash – 87% said cash can get stolen, 48% cited convenience using credit cards and 42% thought it was not safe to touch cash because of the Covid-19 pandemic.

In 2021, cash-back would motivate all demographics to switch to a card; higher income earners would like access to vouchers and/or discounts, lower income earners would prefer airtime/data. To elaborate further on motivators and incentives to use a card: 59% said cash-back; 47% said access to discounts; 40% cited airtime/data and 39% said access to vouchers. Income and level of education were the two main factors also influencing change in shopping behavior during Covid-19; consumers with a low education and no or mid-income were shopping less often; while consumers with high education and high income shopped more often.

In 2022, the respondents who sometimes or regularly used a payment facility other than cash were asked why they preferred these options over cash, with 91% saying it is not safe to touch cash because of Covid-19, 60% saying it was more convenient to use a credit card, 26% saying it is more convenient to use a phone, and 25% citing safety reasons for not carrying cash.

In terms of moving towards less cash use, respondents who do not use their phones to make payments would be motivated towards alternatives if there was a potential of cash-back (58%), safety and security (49%), airtime/data (44%), no cost bank account (34%), low cost bank account (30%), access to discounts (31%), data free for the app (31%), access to vouchers (30%); 15% were entirely against using their phone to make payments.

"I DON'T THINK YOU CAN COMPETE WITH THE ANONYMITY OF CASH, BUT YOU CAN DEFINITELY COMPETE WITH THE IMMEDIACY AND THE COST."

"So, when the convenience store on your street where you live is unable to take a payment method other than cash, you're actually forcing the growth of cash rather than looking at ways of displacing or preferably replacing cash with an electronic payment method. I think particularly in South Africa, consumers are well-versed in the various non-cash payment methods that are available. And I think the trade-off in terms of the risk and the real cost of cash is getting better understood," says Stephen Goldberg, CEO of Selpal.

In 2022, 60% informal sector consumers said it was more convenient to use a credit card as a preferred option over cash; an interesting finding in a post-Covid scenario.

100% of businesses have customers who pay cash Only 1% offer card, QR codes and mobilePoS
95% like being paid in cash
96% use cash to buy stock

SMMEs (95%) like being paid in cash because

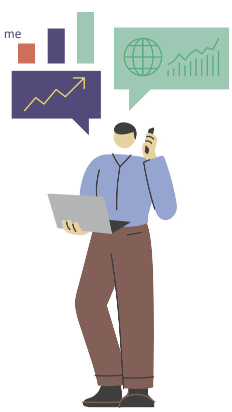
- 55% Want their money with them
- 41% Don't want to pay bank fees
- 39% Cash is easier/not complicated
- 38% Card machines are too expensive
- 35% Cash is quick
- 33% Don't have a bank account
- 32% Their customers prefer cash

Tension between
Having cash in hand
Ease of use
No additional costs
Versus
Safety

The few SMMEs that don't like cash are mainly concerned about safety

SMMEs (96%) like to use cash to buy stock because

- 22% Cash is quicker
- 17% No bank charges
- 17% I always have cash with me
- 15% More convenient
- 14% Easier



For survey conducted with informal sector SMMEs in 2022; more on next page

Financial behavior of informal sector SMMEs

The SMME respondents in the 2021 survey presented a good, heterogeneous mix of age, race, education and income, with LSM 6-7; respondents included black, white and colored, with 61% male and 39% female. The level of education attained included 39% with some/all secondary schooling, 29% with some/all post-secondary qualification, and 32% with some/all university/post-graduate qualification.

As for the personal total monthly income, only 13% earned between ZAR50,000 and ZAR60,000, the rest earned much lower; and with regard to the total monthly business income, only 2% earned between ZAR50,000 and ZAR60,000, the rest earned lower incomes.

They were mostly in the following businesses – 14% in food and beverage (catering, takeaways), 13% in beauty/grooming, 11% operating taverns/restaurants, 9% in motor repairs, 9% in transport, 7% in educare services and 7% in liquor sales.

They were mostly owners of micro enterprises and informal businesses, employing a small number of people in their businesses: 9% have no employees, 68% have between 1 and 5, and 23% between 6 and 10. They also worked very long hours – 79% worked more than 8 hours a day. More than half the respondents used high-end Android smartphones, and only 7% used Apple/iOS phones. Here too, income and level of education are the two main indicators of the type of phone owned.

"Making payments electronic is the first step to bridging the seen economy and the unseen economy, and making sure everyone gets the best of both worlds," says Goldberg of Selpal.

In the 2021 SMME group, as with the consumers, there was high awareness of banking, with 95% of respondents having a personal bank account, but only 38% having a business bank account. This group is also heavily focused on cash. As merchants, the payment options they offer customers are cash, EFTs and e-wallet. None of the respondents offered card machine, contactless e-card, mobile card, contactless PoS machine, card machine with app for phone, QR codes, contactless QR codes or tap on phone.

On average, the reasons they did not offer other payment options were: 50% said too difficult to use, 38% said data costs were too high, 37% found merchant fees too high, 37% customers preferred cash, 34% didn't think their customers would use this option, 32% thought their services/products cost too little to warrant this option, 31% felt more confident trading in cash, 30% said monthly rental was too high, 19% didn't know how this option worked, and 13% didn't know how/where to get the Point of Sales (PoS) device.

But half the group said customers asked for contactless payment options more often than before Covid. Why? Because it's safer than handling cash and safer than touching a terminal. When it comes to paying bills, whilst 100% in the consumer category said they used cash, in the SMME group, 96% used cash, 48% EFT, 20% credit/debit card, 11% e-wallet and 7% QR codes.

The SMME group in 2022 surveyed presented a heterogeneous mix of age, race, education and income, with LSM 4-7; respondents included black, white and colored, with 50% male and 50% female. The level of education attained included 62% with some/all secondary schooling and 30% with some/completed college.

In terms of personal total monthly income, only 2% earned up to ZAR50,000 per month, with 56% earning between ZAR5,000 and ZAR15,000. With regard to total monthly business income, only 2% earned between ZAR50,000 to ZAR70,000, while the rest earned lower. They were mostly in the following businesses; food and beverages – including corner groceries, spazas, takeaways, restaurants, tavern and liquor sales at 40%, creative/media services (8%), beauty/grooming (7%), clothing/apparel (7%), hardware/building (6%), health services/pharmaceutical items (6%), educare (5%), mechanics/motor repairs (5%), transport (5%), toiletries/beauty products (3%), phone sales/repairs (2%) manufacturing (1%) and traditional items such as herbal remedies (1%).

In the 2022 study, 17% only employed themselves, 67% employed up to five people, 16% employed up to 10 people, and only 1% employed up to 15 people; 39% had a low-end Android phone, while 33% had a high-end Android, 21% had a feature phone and 6% had an Apple/iOS device. There was a correlation between a higher education level, higher income, and high-end Android use.

"MAKING PAYMENTS ELECTRONIC IS THE FIRST STEP TO BRIDGING THE SEEN ECONOMY AND THE UNSEEN ECONOMY..."

The 2022 survey noted that there is high awareness of banking. In 2022, 45% had a personal bank account, while 25% had a business bank account. This group is even more focused than the 2021 survey on cash use; 100% offer cash options to customers, with 2% offering card machine or card machine with app to phone, 1% offering contactless QR codes, and 1% offering mobile card/Point Of Sales machine such as Yoco.

The reasons for preferring cash includes; wanting money with them (55%), not wanting to pay bank fees (41%), cash is uncomplicated (39%), card machines are expensive (38%), cash is quick (35%), not having a bank account (33%), believing customers prefer cash (32%), don't want anyone to know how much money they have (28%), not trusting banks (27%), find cash convenient (26%), don't know how to use phones to accept payments (26%), believe banks take too long to settle (13%), and don't want the monthly charge of PoS terminal rental (7%).

In 2022, 96% of businesses used cash to buy stock, with 4% indicating cash is less safe.

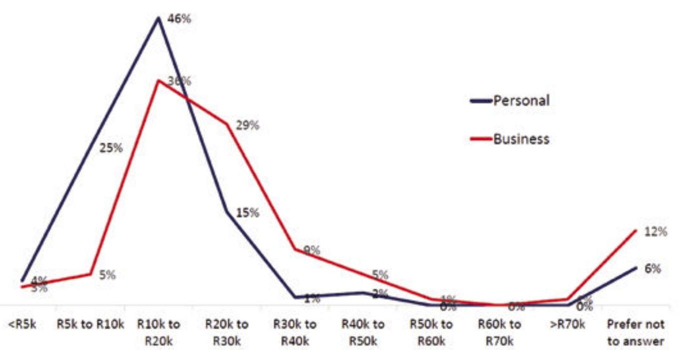
"So you know, 80% of South Africans have bank accounts. But there's a stigma attached to bank accounts always having these charges, and these invisible fees that get charged against that bank account. So what happens is most bank accounts in South Africa get used as mailboxes. So money comes in on payday and all that cash gets withdrawn. And then people operate with physical cash in the market, and that's because there's the stigma attached to 'if I keep my money in the bank, I'm going to be hit with bank charges'," says Naidoo of Kazang Pay.

While bank accounts exist in some kind of use in South Africa, there are some still trust and access issues.

The Covid-19 pandemic saw more forced entrepreneurs and small business owners surfacing in South Africa's townships and rural settings who are more vulnerable and also financially underserved.

"Ultimately, at the end of the day, regardless of the size of business you operate, you still need to make wage payments, you need to pay your suppliers, you need to have the ability to make deposits, you need access to credit. And so all of those services become important as part of what you need to have access to as a business owner to operate effectively in the 21st century," says Swanepoel of Mastercard.

In the 2022 survey conducted with informal sector SMMEs, this graph depicts the monthly business income and personal income of SMME owners



Capital connection and shift in sentiment

For informal sector SMME owners, digitization is often the first step, and then capital, which is the rocket fuel that will see their businesses take off from the ground up.

“The trick for us is going to be to recognize where are those areas of efficiency, where we should look at a product digitalization agenda, and be very specific in the type of problems that we’re trying to solve for within the communities that we are looking at. And then understanding the different stakeholders; all that needs to come together. And I think that’s probably where the biggest opportunity is for policymakers. And not simply just the policymakers itself. So it’s not a conversation of who holds the responsibility to do. So, I think that financial inclusion is the broader country’s problem,” says Swanepoel.

Most respondents expressed the need for funding or are facing challenges that require a cash injection into their business. Only 38% in the 2021 group said they got a banking loan when they started their business; most preferred to use their own savings or borrow from someone they knew. In 2022, 27% use a banking service to pay off a personal or student loan debt. Male owners of taverns and liquor sales are the most likely to be actively looking to grow their business. And to push sales, although not all in this category have a social media and digital presence, there is general acceptance that this is the way of the future, and it is not an unknown quantity.

“FINANCIAL INSTITUTIONS MUST HAVE A ‘FOR GOOD’ APPROACH RATHER THAN A ‘PROFITEERING’ APPROACH.”

“I think the South African market is very conservative to lending. And you know, it’s quite a legacy issue. And a lot of the lending in the past was done mostly by the major banks. But what we’ve seen over time is a lot more fintech players now getting involved in lending,” says Kazang Pay’s Naidoo.

Cash is king here too but the owners of these micro enterprises are slowly wanting to switch. There is definitely a shift in sentiment; in 2021, 43% of business owners didn’t like being paid in cash; 63% said their customers asked for alternative payment options; 70% would use a better alternative to cash; 68% were likely/extremely likely to start offering their

In 2022, the percentage of SMMEs in different sectors, and who would be most likely to move over to mobile payments

		Likely/Extremely likely to move to mobile payment solutions
Food/Corner grocer/ Spaza	23%	
Creative/Media services	8%	26%
Beauty/Grooming	7%	
Clothing/apparel	7%	27%
Other food and beverage, e.g. Catering, Takeaways	7%	18%
Hardware/Building services	6%	36%
Health services/Pharmaceutical items	6%	22%
Liquor sales	5%	11%
Tavern/Restaurant	5%	13%
Educare services	5%	
Mechanics/Motor repairs	5%	29%
Transport	5%	
Toiletries/Beauty products	3%	60%
Phone sales/repairs	2%	33%
Manufacturing	1%	
Traditional items (herbal remedies, sheepskin)	1%	

30%

28%

67% have 1 to 5 employees

In 2022, the top reasons why informal sector consumers don't use their phone to make payments

customers mobile payment solutions in the next year; 88% believed that digital and online payments will help them grow their business. There is tension between having cash in hand versus safety. In the 2022 study, 5% are extremely likely in the next 12 months to start offering mobile payment services, 15% are likely to begin, 63% are unlikely, and 16% are extremely unlikely. But they are all certainly starting to see the push for a world beyond cash in the marketplace.

The future of payments in Africa by McKinsey also states that "Africa's payments mix is evolving fast, with e-wallets continuing to grow the fastest".

"Traditionally, financial ecosystems function on pull. Pull means I give you my wallet to take out however much you want. And that's how credit card and debit card functions today. Whereas the cash ecosystem is push – I keep hold of my wallet, and I give you what you've asked for, and that's where that trust then gets created. Now, if we were to open up and really displace cash, I think the opportunity really lies in the mobile money ecosystem, whether it be e-wallet, QR, USSD, or flows of currency," says Mpho Sadiki, Executive for Card and Payments, Nedbank, when interviewed in 2021.

The tax component disincentivizes some SMMEs from formalization and registration of their businesses. In 2022, 13% of people with a personal bank account said they do not want to do tax payments and 7% with a business said the same. "The reduction of taxes would definitely get more businesses to become more formalized, and then they would help to unlock a lot of those benefits, to access financial instruments, to unlock lending and other credit facilities," concurs Nelisa Zulu, Head: Card and Payments South Africa, Standard Bank Group.

64% micro business owners in 2021 believed contactless payment technology is safer and more efficient.

Catering to the community

There is a need to develop affordable products and services that displace cash in the ecosystem, and create access to financial tools. The key would be instant transaction products, and the ability to get easy access to simple, low-cost credit that's easy to understand. These must offer advantages to the individual/business with good service, low fees, simple and attractive product/service, with a clear impact on life circumstances ensuring that disadvantaged communities can participate meaningfully in the economy.

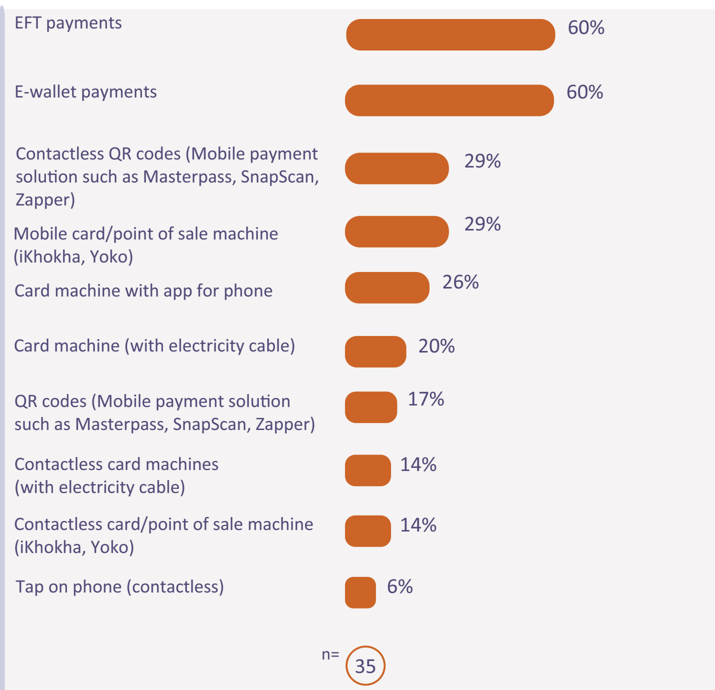
"Financial institutions must have a 'for good' approach rather than a 'profiteering' approach," offers Ramsay Daly, co-founder and Chief Product Officer, iKhokha.

The community is especially important in this context, and these services need to be market-specific in a language relevant to them.

"I found [useful] speaking to business owners in their language and not in English or Afrikaans; they are very literate and financially savvy. We feel like we need to educate them to our way of seeing it but these business owners have been often running these businesses for years successfully, in cash. And they have a very good working understanding of how to make sure this thing is sustainable. So a lot of our work is to just speak the language of our customers and meet them where they're at. There's a lot of education and support we provide which has helped to accelerate and grow their businesses. But it is more around helping different merchants share their stories with each other and teaching each other tactics or approaches or perspectives," says Wattrus of Yoco.

Consumers need products that give them value there and then, says Andrew Weinberg, CEO, Retail Engage. "For us, it's about focusing geographic location-by-location, literally block-by-block so if we've got enough people in a 10-street block that are all on our product and all utilizing a local store or tavern or spaza shop in that area, they have adopted, and then you can expand literally block-by-block, street-by-street and from there, exponentially grow. But you have got to have volume, a critical mass of people to change the behavior," he says. "I think the biggest challenge has been, and where it has come short, is that there isn't sufficient critical mass in a specific geographic area to effect change. I

For the study conducted in 2021, we asked what payment options customers asked for



In 2021, we asked the informal sector consumers their reasons for using cash when shopping majority of SMME owners from switching

think if there is a strategic approach to taking each area in bite-sized chunks and adopting and implementing and educating on the new systems, that's where the change will happen. And it will start spreading."

Platt of Vodacom, agrees: "The best way of educating is coming up with a product that is 'sticky', that people are likely to adopt and give them a taste of it. Large scale adoption happens if your product is good."

Another option is for financial institutions to spend on financial literacy initiatives through the radio, newspapers, TV and the youth in schools.

"THAT ELEMENT OF THE DIGITAL UNKNOWN IS WHAT PROHIBITS PEOPLE FROM EMBRACING THE TRANSITION."

"You have quite a large population in this space that is still reliant on radio and radio dramas from an entertainment point of view. And then obviously, remember, you've got intergenerational household members, where you've got older people living with younger people. We are now figuring out how we can use younger people to bring financial literacy from a technological point of view, to the older generation, so that they understand how to utilize a USSD string, or look at their banking balance, rather than take a taxi to go to an ATM and check what their bank balance is," says Motlatsi Mkalala, Head: Main Market: Consumer & High Net Worth South Africa at Standard Bank.

"How do we use digital platforms in the preferred languages to get the message across?" asks Lesego Chauke-Motshwane, Executive Head of Financial Services, Net1 Southern Africa. "We need to get digital platforms to get familiar. And the best way to do it is to start with what matters to the customer for them to feel trust, to feel comfort and to feel familiar. For me, language is a powerful tool. And then second to that is the cost of digital platforms. South Africa is still quite expensive when it comes to the cost of data and that, by itself, is prohibitive by nature."

However, the old school approach may still have value in increasing financial literacy and inclusive banking.

"While social media is important, it is not reaching the lower LSM. And I think that way, your billboards are still quite prominent in the townships, the bus stop signs, the marketing material that people actually display outside merchant stores that we do; we paint our merchant stores and say, 'pay electricity here' or 'cash in and cash out' or 'swipe your card'. I mean, we physically put up marketing material because we still believe it's very powerful," says Kris van Zyl of Blue Label Telecoms.

Interoperability is another major factor in driving inclusion. It means payment systems need to be accepted across service providers, platforms and countries. This can happen in a stable regulatory environment, and when cash and digital are viewed as complementary.

"We make sure that we create systems that are interoperable so that I can send money to an institution that is different from mine. I think a lot of remittance solutions in the great African markets, but also with some of the introductions of wallets that we've seen in South Africa, are largely a closed loop. So, in the partnership, you can then create interoperability between what was previously seen as a closed loop and the financial services thereby creating an environment where at a Point of Sale, you can accept all tender types including wallet-based payments. Financial institutions have already put down the infrastructure in most cases in the form of Point of Sale devices. Opening that up to the acceptance of wallet-based transactions shouldn't cost them that much more," says Zulu of Standard Bank.

Naidoo of Kazang Pay adds about remittances: "But once you move more to mobile wallets and moving money to bank accounts, it becomes a lot more affordable, because now you don't need this massive network paying on physical cash."

The trust factor

Cash is still predominant in the informal economy. Mkalala of Standard Bank elucidates it with the example of the ubiquitous taxi industry in South Africa.

"If I go to a service like a taxi – you can't pay with your card, you can only pay with cash. So that in itself says that people must always have cash, because otherwise they wouldn't be able to get into a taxi… I think we have to find a way to fuse telcos, the banking system and fintechs. You absolutely have to drive education and get people to trust this new way of doing things. And you need interoperability in a way that the payment system needs to be able to be accepted across service providers across platforms. So you have to make sure I can use my phone to transfer money to a taxi, and they must be able to accept it," he says.

Concurs Chauke-Motshwane of Net1: "People trust what they can see, what they can feel, and they can touch cash. We do not have challenges of counterfeit. A 100 Rand note is a 100 Rand note, you can trust it. And that fuels that element around cash is king… I think cash and digital are complementary, it is about coming up with solutions that maintain the prevalence and the strength and the trust of cash, and just make it more cost-effective, more efficient for both the consumer and the supplier."

"Trust and safety is a major factor in the lack of adoption. They worry if they don't physically see an outlet they can go to if there is an issue. Trying to do things through call centers and online is not a trust process. They have zero tolerance to lose any money," adds Weinberg.

Customer-centric design is thus a huge focus.

"It's about understanding what the key drivers are that are driving those economies. Trust, familiarity, language, and being able to engage with a person in a way that makes them comfortable to have a conversation about a very intimidating topic," adds Chauke-Motshwane.

"Customer-centricity speaks to data fluency, it speaks to customer outreach, and customer interactions, speaks to prototyping and testing. Because the success of what I'm developing depends on my user base and if they all hate it, they're going to leave. I think that you need to interact with people in order to build the best product. That's like the long and short of it," offers Daly of iKhokha.

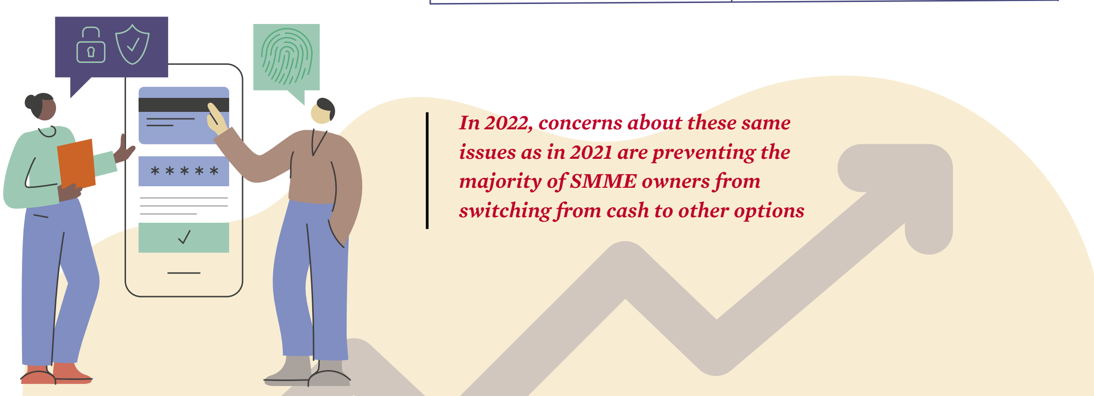
From the merchant's point of view, cash is also time-consuming and complicated because it needs to be matched, reconciled and even transported.

"It is an operational nightmare to be honest. It also holds back your flexibility within the business; you need to wait to receive cash, you have got to pay the suppliers, and you need to transport that, which takes time…. So, I think a lot of productivity will be unlocked on the merchant side and linked to that is also the level of insight and perspective that you have around your business. If you're spending all your time just reconciling, you don't have time to analyze and look at the insights. So, I think the business sees an uplift there. Beyond just the uplift, we see with consumer spending more so, about a 50% increase in sales when they start accepting digital payments," says Wattrus.

Chauke-Motshwane of Net1 sums it up best. "Financial inclusion is not about getting everybody to be formal. It's about getting the majority of South Africans to a level where they can live dignified lives that are also self-sustaining. For me, that is what the crux is!"

	Advantages over	
	Cash	Card
Guaranteed safety/security	28%	36%
Easy to use	25%	15%
Convenience	25%	27%
Quick	20%	16%
Able to do all types of transaction	11%	9%

What is stopping you from using your phone to accept payments?	What would motivate you to use (use more often) your phone to provide payment options for your customers?
Safety/security issues My phone isn't 'smart' enough Complicated/don't know how it works Not accepted everywhere Uses too much data	Guaranteed safety/security Able to make all transactions Easy to use Accepted everywhere No bank charges



In 2022, concerns about these same issues as in 2021 are preventing the majority of SMME owners from switching from cash to other options

Conclusion

The Great Unlock

The informal sector in South Africa is changing. But to understand it is to understand the dominance of cash. Cash is still the leading payment journey but this white paper shows there are encouraging signs and strong sentiments towards differentiated contactless payment solutions, and there is an increasing perception that they are safer in a post-pandemic perspective.

There is also tension related to the fear people have of petty crimes when handling cash as also fraud online. The trust with institutions and familiarity with payment systems and their security measures need to be built up.

In building trust in a digital store of value, the supply chains need to address real needs. Technology is a driver and as digital payments are embraced more, the dependency on cash will lessen. Through education and awareness, consumers and SMME owners need to be convinced of the safety, convenience and cost benefits of other payment options. The people on the ground need to be nudged in the right direction about opting for channels they will become comfortable using.

The financially underserved population in South Africa offers a clear and significant opportunity for providers of financial services: improving non-cash payment facilities but also increasing security and safety features across supply chains, at no cost to the consumer.

This will mean the right regulatory framework for interoperable solutions and building the right infrastructure.

The subjects surveyed in both 2021 and 2022 show a high potential to switch and only need the necessary nudge to make the shift. The Informal Sector Consumers and SMME merchants are very comfortable using phone Apps and the industry most likely to switch is the SMME food sector.

The big issue that financial service providers need to address and therefore reiterate is the safety and security of cashless solutions. Both the output and outcome can lead to vast economic growth.

Further innovation, investment and partnering as well as less restrictive legislation are required to ensure successful execution and optimal onboarding in a large-scale consumer environment. With a concerted effort and convenient and scalable solutions in the journey towards digitization, financial inclusion can have a lasting impact on millions of ordinary South Africans eking out a living for a better tomorrow.

IS MOBILE MONEY A WONDER PILL?

South Africa has a mature and well-established banking sector, and as this white paper proves, most consumers and SMME owners have a bank account. Which means with the right technology, banks can be the main contributors of financial inclusion. But in countries like Kenya, mobile money is more popular.

"If you look at how mobile money has taken root, it always solves an immediate problem. So if you look at what we've done in Kenya with M-Pesa... there was a massive problem in terms of moving money across the country, especially in 2007, with the political crisis and people just couldn't move money around the country, and M-Pesa, then became a perfect way of remitting money from one place in Kenya to the next," says Vodacom's Platt. "We've had a number of mobile money initiatives in South Africa being unsuccessful. When we launched M-Pesa, the remittance problem was essentially solved by the retailers. You can send money from Spar to Spar, from Checkers to Checkers, or Shoprite to Shoprite, from Pep to Pep, so just having a remit send-money use case is not enough."

Following double-digit growth in 2020, GSMA data reports over half a billion mobile money accounts in Africa – close to half of the global total.

But in South Africa, banks still reign.

"Mobile money has not taken off in South Africa. And what we've just observed is that wherever there is already an alternative to cash, mobile money doesn't take off as well. So it's a good competitor to cash. But it's not a very good competitor to an interoperable system. In card payments, you have Mastercard and Visa, you have issuing banks and acquiring banks, and then that creates interoperability between all of these different players. Whereas in mobile money, you don't have that two-sided four-party model, which allows players to play in a piece of the value chain and access different systems, it's all direct commercial agreements with telcos, specifically, which is challenging. So I think there's a lot of potential, but a long way to go to find a scalable model for mobile money. For us, it's very clear that interoperable digital payment methods are the way forward in terms of financial inclusion," opines Wattrus of Yoco.

Fintech flurry

The importance of financial technology or fintech in driving formal financial inclusion has grown by leaps and bounds. “We are far behind on the talent front as a super contributor within the tech environment. So that's one side, just contributing to greater technology development that will result in the breeding of further fintech related or fintech industry-specific applications, or agritech or edutech. Then once that exists, those industry players will start talking to each other more, and then creating a much broader ecosystem. And I think that's where the real value lies. If you start connecting edutech, agritech, fintech, all of these models that serve certain industries in a technologically forward way, that's an absolute goldmine. The digital component means that customers can self-service. Those that still prefer to have that human interaction, we are bringing it closer to the communities by partnering with retailers,” says Ramsay Daly, the Co-Founder and Chief Product Officer of iKhokha.

According to the African Private Equity and Venture Capital Association's *2020 Annual African Private Equity Data Tracker*, fintechs accounted for 70% of the total number of deals within the financial sector in 2020, and consistently attract a significant proportion of the value of private equity funding channeled to the African continent.

“Thirty-seven percent of respondents predict that specialist fintechs will be the front-runners in enabling SMEs to expand their footprint from offline to online via e-commerce. Among experts we surveyed, 92 percent predict that at least 25 percent of SMEs will have an online presence within the next three years,” reports McKinsey in a 2022 article, *The future of payments in Africa*. “They also expect that e-commerce marketplaces such as Amazon, Jiji, Jumia, and Noon are likely to play a key role in enabling SMEs to get online. Together, 68 percent of respondents predict that these two market offerings (fintechs and marketplaces) will lead the charge in taking merchants online, while only 17 percent say banks will play this role,” it highlights.

OTHER RECOMMENDATIONS

Self-sovereign digital identity (SSDI) is being seen as a game-changer for financial inclusion in Africa. SSDI not only gives consumers a way to control their personal information with less risk of identity theft, but it also gives individuals who don't have physical documents a means to build up legal proof of identity, enabling them to access benefits and financial services that they might not be able to obtain otherwise.

Although the 2022 respondents surveyed for this white paper are still unclear what the full impact of Blockchain and the Central Bank digital currency will be, Covid-19 and the associated technological advances have certainly increased digitization in South Africa's informal sector.

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