

# BANKING ON THE UNBANKED

Utilizing existing technology to capture and build a foundation for long-term growth in this market.

## Scope of paper

This paper identifies the unbanked and underbanked, describes their financial habits, explores the importance of this market, discusses the sorts of services un- and underbanked customers need and offers suggestions on using existing technology to capture this market and build a foundation for long-term growth.

## Introduction

The U. S. General Accounting Office says as many as 56 million adults, or one fifth of all adults in the nation, are unbanked or underbanked. Other studies have put the number at 40 million or 20 million. Despite the differing estimates, it is undisputed that tens of millions of adults in the United States are either unbanked or underbanked.

Unbanked is defined as having no relationship with a bank. The unbanked have no deposit accounts and generally use only alternative suppliers of financial services, including check cashing establishments, retail stores and the like for financial transactions. Underbanked people may have a basic checking or savings account but do not take advantage of advanced depository or financial services. Their finances typically are not as mature as those who are fully banked, but they are engaged in making financial decisions that are of long-term importance.

According to Synergistics Research Corporation's 2005 study, Insights into the Unbanked and Underbanked, the underbanked usually reside in households making less than \$40,000 per year, and can include educated immigrants, middle-income individuals with poor credit histories and people who may lead transitory lifestyles, such as military personnel.

People in the unbanked market generally earn less than \$25,000 per year. This market is heavily populated with newly arrived citizens, the young, singles, minorities and uneducated people. Large percentages of the unbanked are Hispanic or African-American, and the group is slightly more female than male.

According to Scarborough Research, the unbanked also are:

- Far more likely to rent than to own a home
- More likely to use prepaid cellular plans
- More likely to purchase used vehicles and substantially more likely to choose a used car dealer based on financing options >>

## Why are people un- or underbanked?

There are many reasons people are unbanked and underbanked, including the perception that banks are too expensive or discomfort with the social aspects of banking. According to Scarborough Research, many in this market say they are concerned about minimum balances and account fees. Also, un- and underbanked people may be concerned with the privacy of their financial information.

Concerns among immigrants include those listed above in addition to language barriers, concerns about alien status and lack of trust in financial institutions that stems from unstable or uninsured banks in their home countries. Also, growing up in cultures that were primarily cash-based has left some with no working knowledge of the role of financial institutions.

However, the Synergistics study indicates the main reason people are unbanked is that they do not believe they have enough money to need the services of a financial institution or to justify the fees typically charged for savings and checking accounts, a belief that is widespread among those with lower incomes.

## Current financial habits

While underbanked people may have a depository account, they do not take advantage of the advanced services, including loans and financial planning typically offered by traditional financial institutions. However, they may have loans, use credit cards or have life insurance.

Similarly, unbanked people may use credit cards, and also are high-volume users of services including check cashing, prepaid value cards, money orders and wire transfers. Among unbanked immigrants, wiring money to their family can represent a large portion of their monthly financial activity.

## Why the unbanked and underbanked are an important market

The underbanked and the unbanked market represent tens of millions of potential customers. These are customers whose lives would benefit from a relationship with a financial institution for several reasons.

First, regular banking would allow the unbanked and underbanked to grow their savings, as the cash-based financial dealings they currently use offer little opportunity to set money aside for a longer term. Allowing low-paid individuals the opportunity to

accumulate wealth over the long-term benefits the customers, financial institutions and society.

Second, using financial institutions will allow those in this market to reduce the costs of their financial transactions. Check-cashing services, money orders and wire transfers can come with high fees. The unbanked and underbanked have thus far been willing to pay those fees because they perceive them as preferable to managing their finances in a more traditional manner. Banks can provide these services and others at lower cost.

Third, the cost of attracting new customers from competing financial institutions makes gaining new customers an expensive proposition. The existence of a large, as-yet-untapped market should be greeted as good news by financial institutions.

## Why invest in this market?

While this market may not contain large depositors, the volume of the market and the need that exist make it a market worth pursuing. In addition to the goodwill that will accrue in favor of financial institutions making their services available to all markets, regardless of wealth, the unbanked and underbanked represent an opportunity to change the way tens of millions of people manage their finances, for the better. Also, pursuing this potential customer base will assist financial institutions in meeting the requirements of the Community Reinvestment Act.

Un- and underbanked persons spend \$10.9 billion on more than 324 million alternative financial transactions, including check cashing and payday loans, every year, and traditional financial institutions that are attentive to the needs of this population could capture a portion of those transactions. Retailers in many markets are moving toward providing services similar to banks, and the Synergistics study indicates the un- and underbanked are comfortable with conducting their financial business in big box retail stores. This market is likely to be courted more and more in the near future by retailers hoping to gain some of those 324 million transactions, particularly as more retailers move toward operating their own banks.

Financial institutions have been slow to invest in the un- and underbanked for many reasons, chief among them the natural tendency for banks to be risk-averse and to view a lack of credit history as a barrier that cannot be overcome. As much as the un- and underbanked may not believe they have the need for additional financial services, traditional financial institutions may believe they have no reason to court this market. But, with greater

flexibility in thinking and approach, this is a market that can be grown, leading to new services and less rigid structure to accommodate the needs of the market.

Of those who are un- and underbanked, the underbanked represent a somewhat more promising market for increasing relationships with financial institutions. They generally have higher incomes and are somewhat more financially mature. According to Synergistics, traditional financial institutions may need to change their ideal business model to cater to this market, offering new or alternative services and likely anticipating lower profits from this market

## Bank strategies

Branches located in retail stores, particularly in grocery stores, have a good chance of garnering underbanked consumers because those customers are already in the habit of visiting retail establishments while they are not in the habit of visiting freestanding bank branches. The underbanked are substantially more likely to consider such branches to be their main branch.

Likewise, according to Scarborough, among those in the un- and underbanked market, many make financial decisions based on convenience. They will use a retail store branch because it's handy or a check cashing service that's located around the corner rather than a bank branch some distance away.

Accordingly, banks wishing to capture the un- and underbanked should plan to locate branches in places convenient for this market, which includes lower-income neighborhoods and grocery stores and supermarkets serving this market.

While alternative branch locations will assist in reaching this market, rethinking the role of traditional branch locations is also a wise idea. Some financial institutions, including Key Bank, have started to include financial education centers in their urban branches to educate or re-educate consumers about the role a financial institution can play in their lives. This specific, targeted marketing is yielding results among un- and underbanked consumers.

## Services to provide

In this market, more use credit cards than check-cashing services. Banks that establish credit card relationships early with those in this market are more likely to benefit as the market matures. Additionally, this market is much more likely to use money orders to

pay regular bills, a service that banks have not traditionally provided.

Also popular among this market are stored-value cards. While these financial instruments do not encourage the user to accrue savings, they continue to grow in popularity as a way for the un- and underbanked to manage financial transactions. Financial institutions may want to consider offering such instruments to begin to break into this market.

Many un- and underbanked people avoid financial institutions because of concerns about minimum balances and account fees. However, traditional entry-level "free" accounts will generally offer lower fees than similar services purchased per occurrence by the un- and underbanked. For instance, the fees associated with check-cashing services are likely to be more costly to the consumer than will the fees associated with a basic checking account. Combined with appropriate marketing, consumer education about this issue can yield positive results.

Many in this market are recent immigrants for whom wiring money back to their home country is a significant expense. Banks should consider the costs and benefits of offering foreign remittance and wire transfer services, particularly in markets with large immigrant populations. Additionally, many banks in such areas have begun to provide marketing materials printed in Spanish to court the immigrant market.

Also among common financial strategies used by those in this market are cash advances or "payday loans," which are defined as loans of less than \$500 for less than 30 days. Such arrangements provide cash immediately against future earnings, and traditional providers often charge usurious rates for this service. Traditional financial institutions should work to devise methods to offer similar services that leverage the credibility of the bank with more traditional fee structures for the consumer.

Additional products banks could consider to attract the un- and underbanked include bill payment services, the sale of money orders, mass transit fares or tokens, prepaid telephone cards, postage stamps and lottery tickets, exchanging foreign currency, income tax preparation services, fax and copier services and direct deposit for electronic benefit payments. Existing technology can be used to automate many of these sorts of services, which will decrease costs for financial institutions.

One of the most important things people in the un- and underbanked market are likely to need is financial

advice. While financial institutions have traditionally offered this service, the sort of advice and the goal of this advice will need to be tailored to a market with fewer resources.

## The role of technology in courting the un- and underbanked

While the un- and underbanked market may have lower rates of home ownership and higher usage rates for non-traditional financial services, studies have revealed this market is comfortable with technology. They show relatively high rates of Internet and cell phone usage, and have adapted to the technology used in check cashing, money order, wire transfer and stored-value card transactions. This market is not technology-averse, as is seen amongst older consumers.

People in this market are comfortable using ATMs and have no concerns about either the security or the technology. Modern ATMs with deposit automation can be used for check cashing services and the like. Some in this market are more comfortable with automated check cashing than with a human teller. Additionally, modern ATM deposit automation can be used to garner cash transactions with both bank notes and debit cards.

Prepaid value cards also are familiar to those in this market, and can be used to complete many transactions. The technology that issues these cards is simple, familiar and secure for this market, and banks may wish to consider providing them as an alternative to cash.

While the un- and underbanked are heavily populated with Internet users, an inordinately small percentage in this market has used the Internet to make financial transactions, and those who have simple savings or checking accounts have not generally chosen to access

their accounts online. Education about the availability of online account management and bill payment options can allow the underbanked even greater flexibility in dealing with financial institutions, and should be stressed in attempts to gain customers in this market.

Additionally, the use of self-service kiosks for a growing number of financial transactions has been steadily increasing in recent years. Kiosks are convenient and provide an easy way to conduct transactions including check cashing, drawing funds off of payroll cards, moving funds from one card to another, conducting wire transfers and paying bills.

Perhaps because of their youth, the un- and underbanked have embraced the technology of modern life. It can be harnessed to bring them into the banks and to make them customers.

### Summary

The un- and underbanked market represents serious potential for financial institutions. Up to one-fifth of the adults in the United States are in this market, and they spend \$10.9 billion per year on 324 million non-traditional financial transactions. New approaches are needed to capture this market, including new ways of thinking and innovation in bank product and service offerings. The technology necessary to grow into this market already exists, and those in this market are already familiar with its use. What is needed now is for financial institutions to demonstrate the flexibility and innovation necessary to turn this market into a profitable venture for the long term.

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