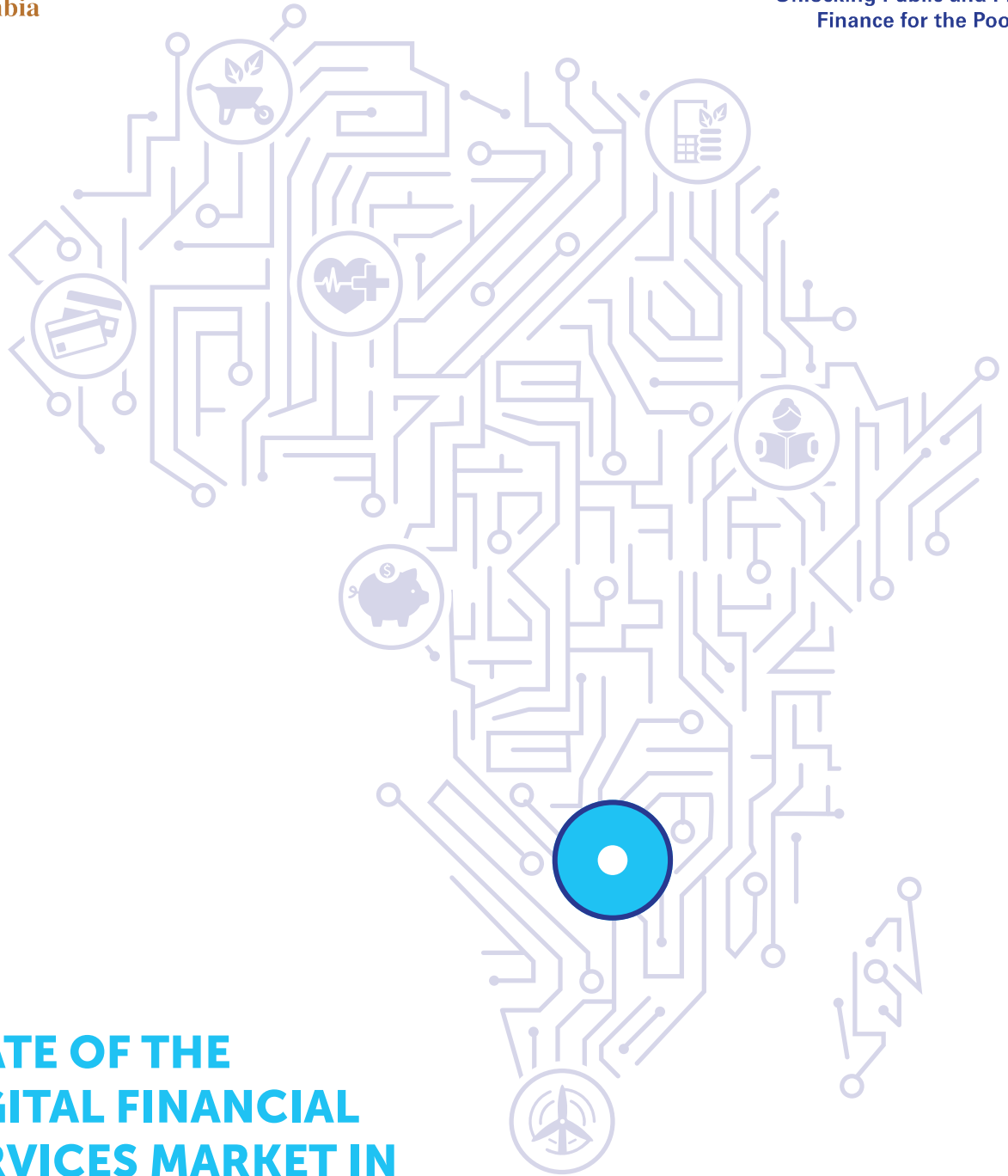




Bank of Zambia



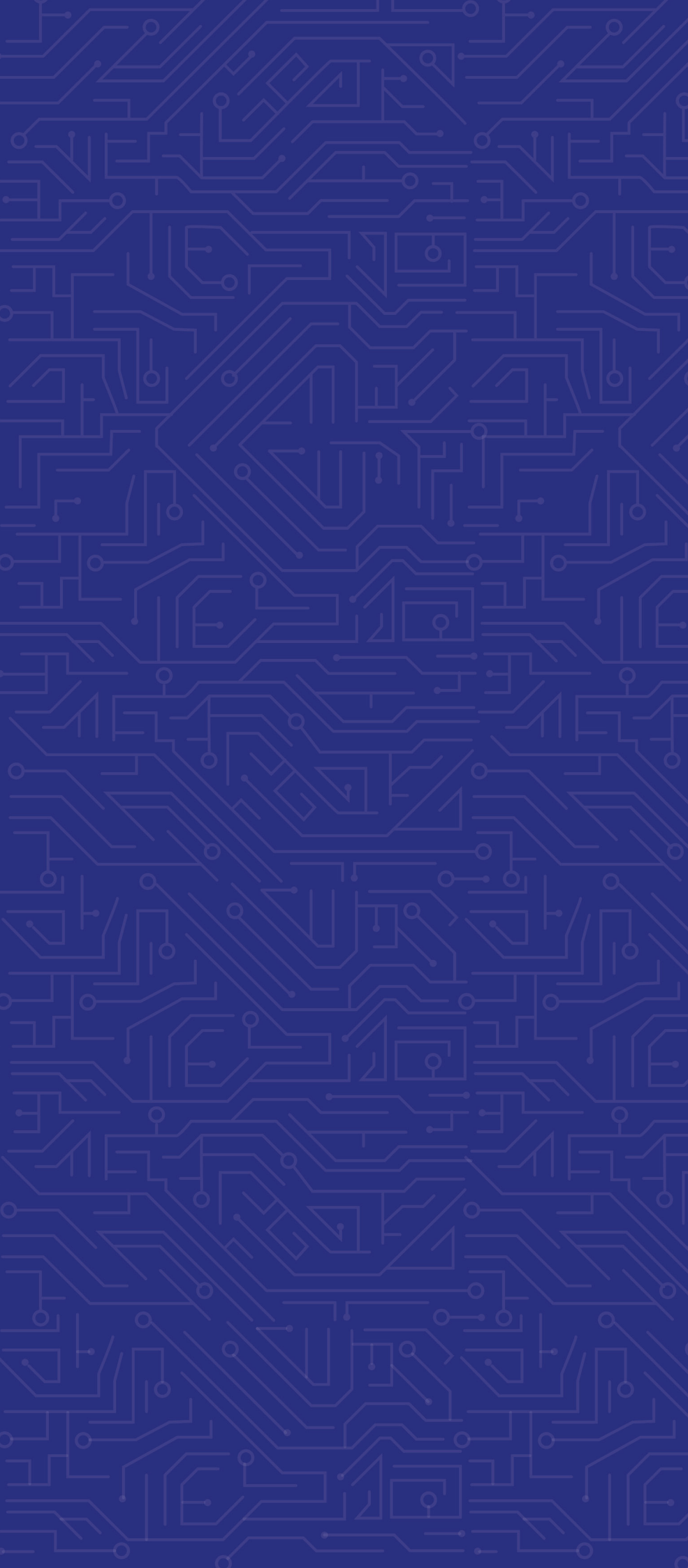
Unlocking Public and Private
Finance for the Poor



**STATE OF THE
DIGITAL FINANCIAL
SERVICES MARKET IN**

ZAMBIA 2019

Results from the UNCDF
Annual Provider Survey





About the United Nations Capital Development Fund

The United Nations Capital Development Fund (UNCDF) makes public and private finance benefit the poor in the world's 47 least developed countries of Africa, Asia and Latin America. With its capital mandate and instruments, UNCDF offers 'last mile' finance models that unlock public and private resources, especially at the domestic level, to reduce poverty and support local economic development.

Since 2015, UNCDF is present in Zambia to implement projects that address the needs of the Zambian population living at the last mile. These projects are grounded in digital solutions to improve financial inclusion, address energy and resource needs at the household level, and improve accessibility to goods, services and markets.

With these projects UNCDF provided grants and technical assistance to policymakers, financial service providers, civil society and users of digital finance to expand access to and usage of services that contribute to achieving the Sustainable Development Goals (SDGs).

In 2019, UNCDF launched a new global strategy: 'Leaving No One Behind in the Digital Era' (2020–2024). Through this strategy, UNCDF builds on the relationships, accomplishments and learnings from previous work on digital financial services (DFS) in Zambia and in other countries.

To implement the strategy, UNCDF works with the private and public sector to help deliver services and products that enable Zambians to achieve more, improve their opportunities and contribute to achieving the SDGs. The strategy has four key components (workstreams):

- **empowered customers** – recognising how users acquire the necessary digital and financial skills to adopt new digital services
- **open digital payment ecosystem** – understanding the importance of digital payments as the basis for sustainable and economically impactful digital services
- **inclusive innovation** – supporting local entrepreneurs and micro, small and medium enterprises to build inclusive services for the local digital economy
- **enabling of policy and regulation** – working with governments to develop policies that support and provide the necessary incubation for an inclusive digital economy.



United Nations Capital Development Fund Zambia IDE Team

The process for developing this report included gathering data, assessing the incentives of the providers in the Zambian digital finance context and surveying the insights of stakeholders. The content of this report is based on information gathered from May to August 2020 and represents data from December 2018 to December 2019.

The following project team members authored the report in collaboration with the Bank of Zambia:



| | | | | | |
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Foreword

By the Bank of Zambia and the United Nations Capital Development Fund

The United Nations Capital Development Fund (UNCDF), in partnership with the Bank of Zambia (BoZ), is pleased to present the findings from the 2020 Annual Provider Survey (APS). The survey was undertaken primarily to measure the progress in digital financial services (DFS) in Zambia in 2019.

APS reports have been published on an annual basis since 2016 and are useful for tracking the growth of DFS in Zambia. This APS gives an indication of how financial services are reaching the various sectors of the population from the supply side and will complement the official Ministry of Finance demand-side FinScope Survey findings on financial inclusion rates in Zambia.

In 2019, UNCDF launched its new global strategy, 'Leaving No One Behind in the Digital Era', to support the development of an inclusive digital economy (IDE), which further supports an aspiration set out in the country's broader 'National Financial Inclusion Strategy (2017–2022)'. This APS highlights market developments and identifies current challenges and barriers that DFS providers face. It also provides an opportunity to reflect on the journey of the DFS market in Zambia while looking ahead. The report contributes to the formulation and fine-tuning of evidence-based policies and strategies. Further, the APS indicators are necessary for monitoring progress in achieving the global Sustainable Development Goals around full and productive employment as well as decent work for all and partnerships, among others.

This APS was conducted in conjunction with the BoZ 'Strategic Plan 2020–2023', which focuses on two main areas: i) financial stability and ii) financial inclusion. The strategic initiatives under this plan include advancing financial inclusion in Zambia by leveraging DFS and partnerships with key stakeholder institutions.

"In addition, work will be undertaken to: increase penetration of rural finance; create an enabling regulatory environment for broadened access to financial services and products; strengthen protection of children and youth; and ramp up dissemination of financial inclusion information. Further, the Bank will continue its gender mainstreaming efforts with a view to drastically reduce the gender gap for financial inclusion"
– Bank of Zambia Strategic Plan 2020–2023.

This work aligns closely with UNCDF goals and objectives in the new IDE Strategy and further strengthens collaboration with UNCDF working towards inclusive development.

This APS survey was conducted when the effects of the COVID-19 pandemic were being felt in all sectors and industries, but the collaboration and partnership with BoZ ensured that data was collected from the majority of providers who received

the survey; in addition, the strong partnership ensured all the data was validated.

Overall, the data indicates that the DFS industry in Zambia is growing, with an increase in the number of active accounts signifying a reduction in customer dormancy and a tremendous improvement in bank customer activity rates since 2016. DFS providers have improved their collaboration in the market, which has resulted in an increase in first- and second-generation services reaching the customer base. In 2019, providers improved product offerings to specific customer segments and increased levels of financial literacy education. Further, bonus incentives and increased investment in staff working in DFS helped to improve customer understanding, which consequently increased the adoption of services. All these initiatives contributed to an expanded growth in, and greater depth of, DFS products and services.

BoZ and UNCDF are collaboratively building a DFS data reporting and analytics platform, which will automate the data collection/analysis process while providing updated and timely information to support and frame evidence-based policy decisions and guide market interventions. This system will allow for real-time visibility of data, enable users to view or access sex-disaggregated data and enable financial service providers to see their growth in the industry over shorter time-periods. The new automated system will also change the way the APS survey is administered and how these reports will evolve in coming years. This welcome change also enables providers and other stakeholders to have better access to DFS data, allowing improved strategy development and decision-making.



Isaac Holly

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Acronyms

| | |
|---------|---|
| APS | annual provider survey |
| ATM | automated teller machine |
| BOZ | Bank of Zambia |
| DFS | digital financial service(s) |
| FinTech | financial technology company |
| MFI | microfinance institution |
| MNO | mobile network operator |
| MSME | micro, small and medium enterprise |
| NFS | National Financial Switch |
| OTC | over-the-counter |
| P2P | peer-to-peer |
| UNCDF | United Nations Capital Development Fund |
| US\$ | United States dollar |
| ZMW | Zambian kwacha |

Glossary

| Term | Definition |
|---|--|
| Active customer account | An active customer account is an account with which at least one transaction was conducted in the last 90 days. A transaction includes cash-in, peer-to-peer transfer, cash-out, bill payment and/or airtime purchase. Conducting a balance inquiry, resetting a personal identification number or completing another transaction that does not involve the movement of value does not qualify for a customer account to be considered active. |
| Agent, Agent outlet, Active agent outlet | An agent may be a proprietary agent (an agent who is managed by and operates under the exclusive branding of a particular provider) or a third-party agent, either of whom handles more than 30 transactions per month, including cash-in and cash-out. In many instances, an agent registers new customers too. The country's central bank, Bank of Zambia, defines an agent as a person or entity appointed by an e-money institution to provide certain e-money related services on its behalf. "In the case of mobile money, an agent outlet is a location where one or several provider-issued tills are used to conduct transactions for clients... Agent tills are provider-issued 'lines,' which can be SIM cards or point-of-sale [POS] machines, authorized and used to facilitate mobile money transactions... An agent outlet may operate tills issued by several providers; these are generally referred to as shared or non-exclusive outlets." "An active agent outlet is an agent outlet where any of the tills were used to facilitate at least one transaction within the last 30 days... The most important of these [transactions] are cash-in and cash-out (i.e. loading value into the mobile money system and then converting it back out again)." |
| Airtime purchases | Airtime purchases (also known as top-ups) are airtime transactions funded from customer digital finance accounts. |
| Automated (or Automatic) teller machine (ATM) | An ATM is "an electronic telecommunications device that enables the clients of a financial institution to perform financial transactions without the need for a cashier, human clerk or bank teller." ATMs may be operated either offline or online with real-time access to an authorization database. |

| | |
|---|---|
| Bank account to mobile money account transfers | These transactions involve “a direct transfer of funds made from a customer bank account to a mobile money account. This transaction typically requires a commercial agreement and technical integration between the bank and the mobile money provider to allow direct transfers.” |
| Bank of Zambia (BoZ) | Central Bank of the Republic of Zambia. |
| Bill payments | These transactions involve the payment of bills using digital financial services (DFS), “regardless of whether they originate from an account or are made over the counter.” |
| Bulk payments | These transactions are conducted from one account to many accounts, or from many accounts into one account. The former, such as salary payments or government transfers, may terminate in an account or over-the-counter. They are referred to as ‘one to many.’ The latter, such as several customers paying for utilities, comprise collections by an organization from multiple payers. They are referred to as ‘many to one.’ |
| Cash-in transactions | These transactions include deposits of any value from a customer into a wallet through an agent. They also represent “the process by which a customer credits [his/her] mobile money account with cash. This [process] is usually via an agent who takes the cash and credits the customer’s mobile money account with the same amount of e-money.” |
| Cash-out transactions | These transactions include transfers of any value from an agent to a customer. They also represent “the process by which a customer deducts cash from [his/her] mobile money account. This [process] is usually via an agent who gives the customer cash in exchange for a transfer of e-money from the customer’s mobile money account.” |
| Cash-out transactions (Agent) Commissions | Commissions are the revenues paid by the DFS provider to its agents. Generally, agents earn commissions by conducting transactions and onboarding new customers. |
| Debit card | A debit card is an electronic card issued by a bank that provides the bank client with access to his/her account to withdraw cash or pay for goods and services. It eliminates the need for the client to go to the bank to remove cash from his/her account as he/she can just go to an ATM or pay electronically at merchant locations. This type of card, as a form of payment, also eliminates the need for cheques, as the debit card immediately transfers money from the client account to the business account. |
| Digital financial services (DFS) | DFS include all financial services that are accessed through a digital channel to conduct a transaction that involves a movement of value. Digital channels include ATMs, agents, point-of-sale terminals, mobile phones (SMS, Unstructured Supplementary Service Data (USSD) app and web) and PC/internet. This includes e-money and bank accounts held at financial institutions (banks, microfinance institutions) and non-financial providers (mobile network operators (MNOs), financial technology companies, cooperatives and other third-party providers) and includes all payment instruments. |
| Financial inclusion | Financial inclusion is the end state of the goal of all eligible citizens, which is to have access to a range of affordable, convenient and appropriate financial services. These services could be formal financial products/services that are provided by formal financial institutions (banks and/or non-bank financial institutions bound by legally recognized rules) or informal financial products/services that are unregulated and operate without recognized legal governance (e.g. village banks or village development funds). |
| FinTech | This entity is a financial technology company. |
| First-generation products | These products comprise basic DFS, such as peer-to-peer transfers, airtime purchases, bill (utility) payments and cash-in and cash-out transactions. |
| Float | Float is “the balance of e-money, physical cash, or money in a bank account that an agent can immediately access to meet customer demands to purchase (cash-in) or sell (cash-out) electronic money.” |
| Informal over-the-counter (OTC) transactions | These transactions occur when a customer provides cash to an agent who performs a transaction via an agent account to send funds to the wallet of a registered customer. |

| | |
|---|---|
| International remittances | International remittances can refer to the total number of cross-border fund transfers for inbound or outbound remittances. International remittances may also refer to the "cross-border fund transfer from one person to another person. This transaction can be a direct mobile money remittance or can be completed through use of an intermediary organization such as Western Union." |
| Know-your-customer (KYC) | "Financial institutions and regulated financial service providers are obligated by regulation to perform due diligence to identify their customers." The KYC term refers to these requirements and/or to "the regulation which governs these activities. The FATF (Financial Action Task Force) recommends a risk-based approach to due diligence for AML/CFT (anti-money-laundering and counter-financing of terrorism) controls. Due to the lack of formal identity documents in some markets, solutions such as [establishing] tiered KYC [requirements] and adjusting acceptable KYC documentation can help mobile money providers facilitate customer adoption and increase financial inclusion, especially in rural areas." |
| Liquidity management | Liquidity management is "the balance of cash and e-money held by a mobile money agent to meet customers' demands to purchase (cash-in) or sell (cash-out) e-money. The key metric used to measure the liquidity of an agent is the sum of [his/her] e-money and cash balances (also known as [his/her] float balance)." |
| Merchant | A merchant is an individual or a registered business using a business channel (i.e. a merchant SIM) to accept payments for goods and services via a DFS channel. |
| Merchant payments | These transactions are movements of value from a customer to a merchant to pay for goods or services at the POS. |
| Mobile microcredit (also microloans) | Mobile microcredit is a solution that enables mobile money customers to access small amounts of credit instantly via their mobile phone. |
| Mobile microinsurance | Mobile microinsurance is an option by which insurance premiums are paid from a mobile wallet through a mobile money platform. |
| Mobile money operator | A mobile money operator is "a company that has a government-issued licence to provide telecommunication services through mobile devices." |
| Over-the-counter transactions (OTC) | These transactions include money transfers or bill payments that are conducted without a registered account. "Some mobile money services [e.g., bill payments] are being offered primarily OTC. In such cases, a mobile money agent performs the transaction on behalf of the customer, who does not need to have a mobile money account to use the service." |
| Pay-as-you-go | Pay-as-you-go is an option by which an end customer makes a deposit for a product, with the end goal of owning the device, through a series of usage payments paid through a DFS channel. |
| Peer-to-peer transfers | These transactions (also known as person-to-person transfers) originate from a customer DFS account and terminate in another customer DFS account. |
| Registered customers | Registered customers are the cumulative number of customers who have registered for a service, regardless of whether the service is active. |
| (Agent) Revenue | Revenue comprises the total commissions earned by agents for all the transactions they conduct through their agent accounts |
| Second-generation products | These products are more advanced DFS, such as microcredit and microinsurance products, loan repayments, merchant payments, push (to bank)/pull (from bank) transfers and international remittances. |
| Third-party operators | Third-party operators are DFS providers that leverage existing infrastructure of MNOs. They are usually MNO agnostic, and in some cases, they could be master agents or act on behalf of a DFS provider or an MNO, whether pursuant to a service agreement, a joint venture agreement or another contractual arrangement. |
| Transaction | A transaction could involve cash-in, peer-to-peer transfer, cash-out, bill payment and/or airtime purchase. A transaction does not include any other type of activity that does not involve the movement of value (e.g. balance inquiry). |



1

INTRODUCTION



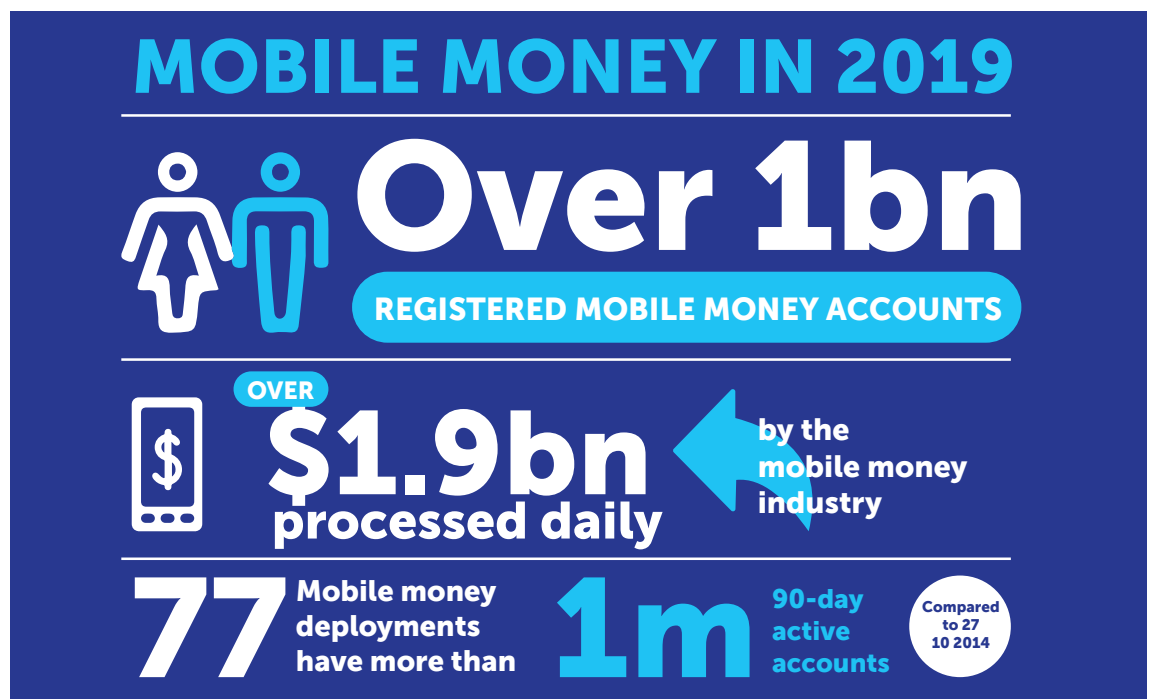
The global digital financial services industry

Mobile money saw unprecedented growth in 2019, with the global industry recording over 1 billion registered users. The biggest growth was in sub-Saharan Africa, where digital financial services (DFS) are being used to reach all people with products and services to improve their livelihoods and quality of life. Figure I below shows some key indicators of the global mobile money industry results in 2019.

Following the release of these global figures by GSMA in 2020, the digital finance industry, like other industries around the world, was impacted by the COVID-19 pandemic. While the economic impact has yet to be determined, the pandemic has been a driver of digital services adoption across many sectors, including the finance sector in sub-Saharan Africa. In this report, we discuss some of the impacts from the COVID-19 pandemic on providers.

Figure I.

Main findings from the 'State of the Industry Report on Mobile Money' (GSMA, 2020)



In 2019, sub-Saharan Africa accounted for two thirds of the total global transaction value of mobile money and almost half the total number of active accounts globally. With such indicators of growth and usage, the mobile money industry can leapfrog certain challenges that still hinder development initiatives in underdeveloped regions in many countries. Further, DFS have proven several use cases by improving and sharpening existing services, which has resulted in pushing the industry forward and expanding the reach of services.

Today, people mostly rely on DFS as their primary method of conducting business or managing their money. This is evidenced by the fact that, globally in 2019, digital transactions accounted for the majority of mobile money flow. The confidence and trust in DFS indicates stability and sustainability of the industry, which will yield further growth and expansion in the years to come.

A natural consequence of the increase in usage of mobile money and products and services is an increase in interoperability and integration. Providers are better at harmonising the products and services they offer customers to make services easier to use and to increase the possible use cases of mobile money. Further, there has been a shift in the digital ecosystem, as for the first time, the industry exhibits customers keeping

² Nika Nakhavi, 'State of the Industry Report on Mobile Money 2019' (GSMA, 2020).

³ Ibid.

more of their mobile money in circulation in the system, rather than withdrawing it for other transactions, which was more common in previous years.

Other key insights in the global mobile money market, shared in the GSMA 'State of the Industry Report on Mobile Money 2019', include:

- **Continuous investment in distribution networks** – mobile money operators are increasingly investing in their agent and distribution networks, leading to a significant increase in the number of agent outlets. The reach of a mobile money agent is 7 times that of automated teller machines (ATMs) and 20 times that of bank branches. As such, mobile money agents have had a transformative impact on financial inclusion, particularly in remote areas.
- **Providers shifting to a 'payments as a platform' model** – 2019 saw a significant drop in reliance on revenue from customer fees alongside rising revenue from business fees or shared revenues. This indicates that markets are strategically expanding the digital ecosystem to offer products and services from which they can draw revenue.



The Zambian digital financial services industry

In 2019, it was clear that the efforts to develop and expand the market were paying off and the number of active customers were growing significantly. By the end of 2019, universal DFS accounts active on a 90-day period increased to 6,522,399 from 4,345,858 in 2018.

The Zambian financial industry has changed tremendously thanks to increased trust in digital services and innovations that rely on digital infrastructure; use cases have expanded from first-generation services, such as person-to-person transfers, to second-generation services, including merchants and bill payments, microloans, microsavings and microinsurance. The industry is also testing new business models by building partnerships between financial institutions and non-financial institutions, including mobile network operators (MNOs) and financial technology companies (FinTechs).

The financial industry of Zambia echoes the growth and expansion of the global market in the number of active users, transaction volumes and transaction values. This is encouraging for the market and assures its stability and sustainability. DFS providers can continue to innovate and develop products and services that reach customers across the whole country, ensuring they are economically active and contributing to their communities.

⁴ ZamStats, 2020.

⁵ FSD Zambia, 2016.

⁶ Zambian Statistical Office

Figure II.
General statistics about Zambia, 2019

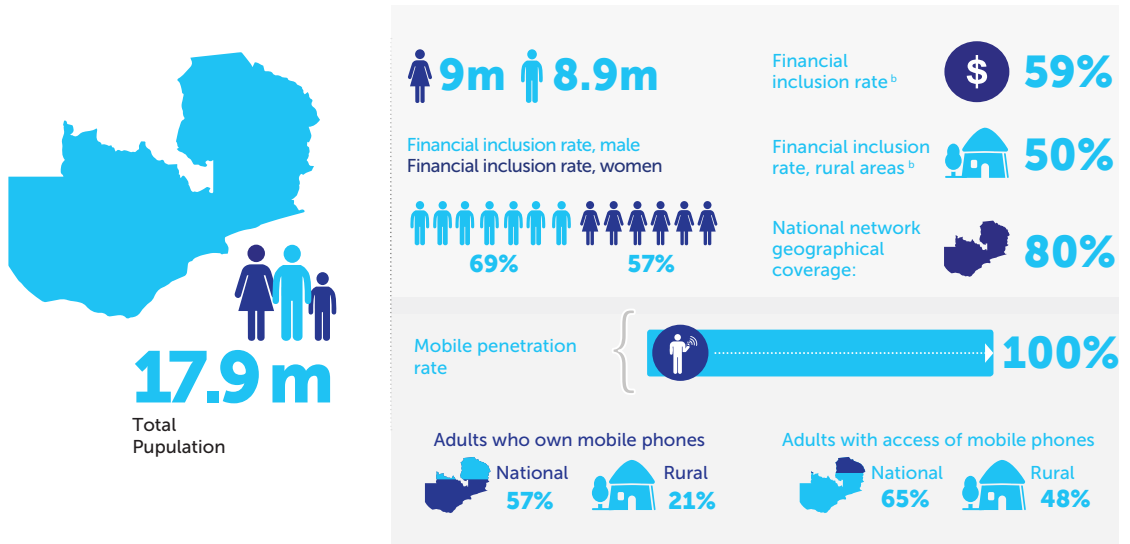
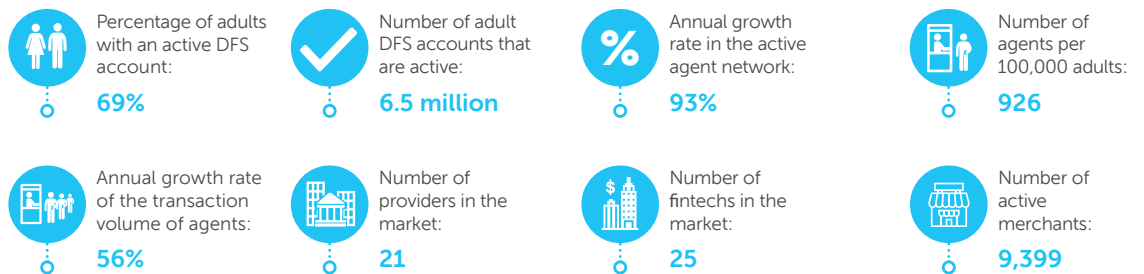


Figure III.
State of the Zambia DFS market, 2019





2

METHODOLOGY





This report provides key insights into the state and development of the DFS market in Zambia, drawing on data collected through the Annual Provider Survey (APS). This year, the survey was developed by the UNCDF Team, in collaboration with the Bank of Zambia (BoZ), and administered to DFS providers, including banks, microfinance institutions (MFIs), MNOs and third-party providers. There was a total of 21 providers in Zambia, and all of them were invited to participate in this survey. Of those invited, 19 providers responded to the 2020 survey; they are listed below. Survey data are self-reported and are validated with the support of the BoZ.



The providers that participated in the survey included 11 banks, 3 MNOs, 4 third-party operators (including one new entry) and 1 MFI.

The following providers responded to this survey for the first time:

- Access
- Cavmont
- First Capital
- Indo Zambia
- Mangwee Payments.

The 2020 survey included both quantitative and qualitative questions. Quantitative data were collected on the following indicators:



- total number of DFS customer accounts, registered and active (90 days)
- total number of unique active adult customers by service type
- composition of customer base (gender, youth)
- total volume and value of transactions conducted by active DFS customers
- total volume and value of transactions conducted by customers per type of services
- volume and value of transactions conducted by customers at agent locations
- number of agents, registered and active (30 days)
- total volume and value of transactions at agent locations
- total value of commissions paid to agents.

This year, new data was collected on:



- composition of customer base (micro, small and medium enterprises; MSMEs)
- number of females using digital loans
- volume and value of cash-in and cash-out transaction at ATMs
- volume and value of betting services (previously included in merchant payments)
- product segmentation (products targeting specific segments)
- composition of the providers' agent base.

Qualitative information was collected on the performance of the interviewed institutions along with their strategic focus areas, key challenges, engagement level with the UNCDF Zambia programme and key regulatory-related discussion areas. Even though the reporting period ended before COVID-19 reached Zambia, the survey also included questions on the provider's response to the pandemic and measures undertaken.

⁷ ZICTA, 2019.

⁸ Ali Akram, "Are fintechs the key to achieving Zambia's financial inclusion targets by 2020?" (UNCDF, March 19 2018) Available at <https://www.uncdf.org/article/3375/are-fintechs-the-key-to-achieving-zambias-financial-inclusion-targets-by-2022> (accessed on 05 November 2020).

Before data was validated by BoZ, individual data validation sessions were held with each provider. This enabled the survey team to have a more complete and accurate understanding of the market, the products offered and the profile of the customers and services reported behind the figures. In addition, the qualitative insights from the validation sessions helped strengthen the results reported from the quantitative data.

Institutions were guaranteed that their submissions would remain confidential, in line with the United Nations standard policy on handling proprietary information supplied by its members. UNCDF signed non-disclosure agreements wherever it was required by the providers.

It is important to note that the source data used for population figures in earlier APS editions has now changed. In previous years, the United Nations World Population Prospects was the source for population data used to derive the percentage of adult population with an active DFS account. However, in this 2020 survey, the population projections data by the Zambia Statistics Agency was used instead. Figures from 2017 and 2018 have also been adjusted for this study using the new adult population source, which explains their slight differences compared to the figures presented in the previous reports.

Regarding the total number of registered and active DFS accounts, UNCDF aggregated all figures reported by providers. As previously mentioned, the conversion of this number to the percentage of adult population with a registered or active DFS accounts did not consider that some customers have an account with multiple providers. The same applies to agents: agents working for multiple providers are counted more than once.

All data presented in this report were aggregated and anonymized. DFS providers that participated in the survey received a benchmarking report that allowed them to gauge their performance relative to the rest of the market in terms of adoption as well as usage of services and the distribution network.



2

FINDINGS

This section presents the results and highlights of the 2020 APS and discusses key trends in the development of the industry over the past four years.



Customers

Registered and active customer accounts

In December 2019, there were more than 16.6 million registered DFS accounts in Zambia. This corresponded to a growth of 80,000 (+0.5 per cent) new registered accounts in the market compared to December 2018. Although this figure has been increasing for several years, it shows a slowing growth curve (Figure IV).

The increased number of MNO DFS registered accounts could be an indication of continuous investment efforts from MNOs and enabling regulations that simplify the customer onboarding process for these provider types.

Regarding DFS accounts that were active for a 90-day period, this figure grew by 50 per cent between December 2018 and December 2019, reaching 6.5 million, as shown in Figure IV. This overall growth in active DFS accounts may be attributed to providers' successful implementation of their 2019 priority strategies, which ranged from improving market collaboration, expanding distribution networks to rolling out innovative customer retention initiatives, such as through their customer service teams.

Figure IV.

Number of registered and active customer accounts since 2016

Number of registered and active customer accounts since 2016

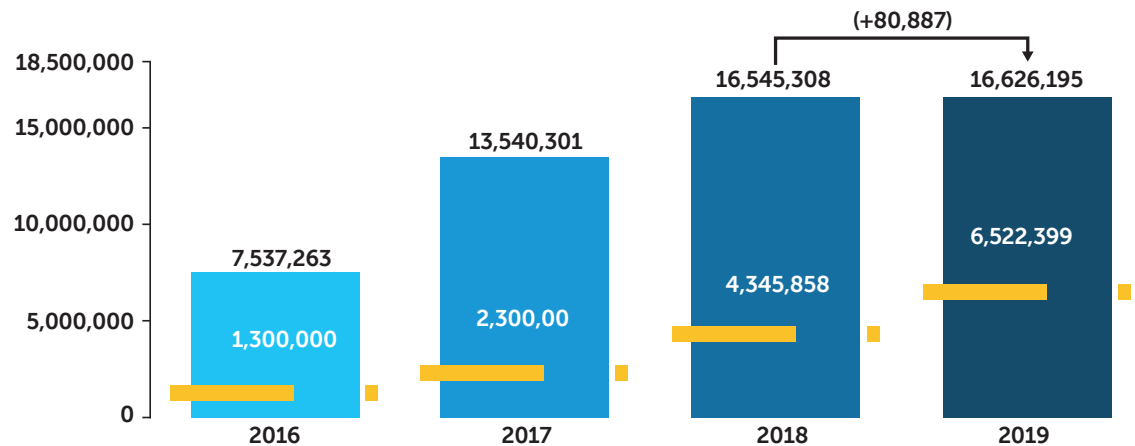
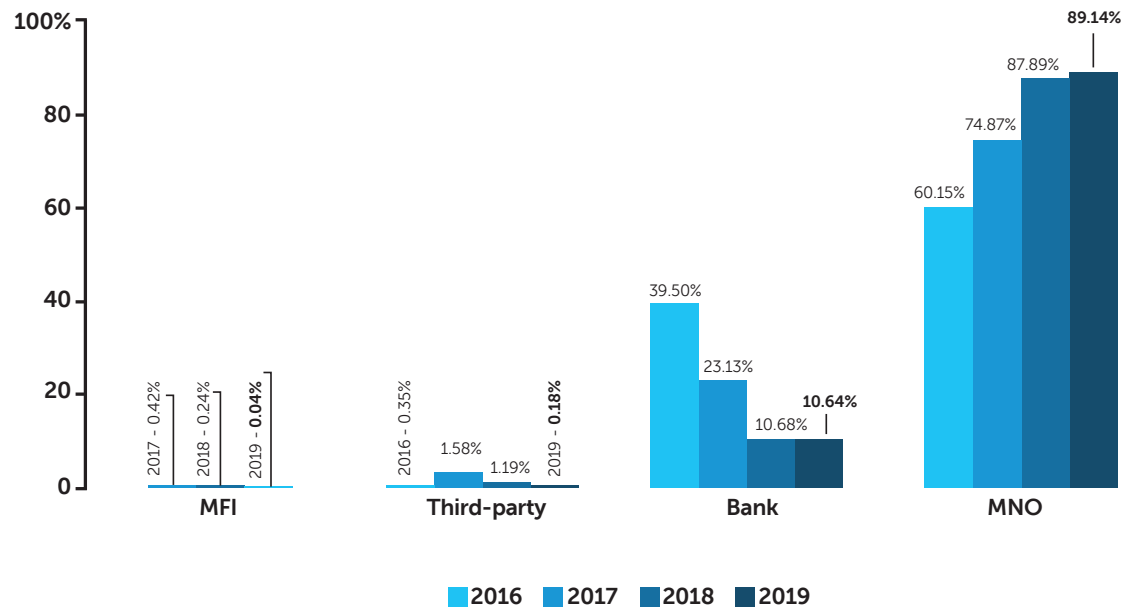


Figure V.

Market share of active customer accounts by provider type (December 2016–2019)

Market share active (90) day DFS accounts by provider type





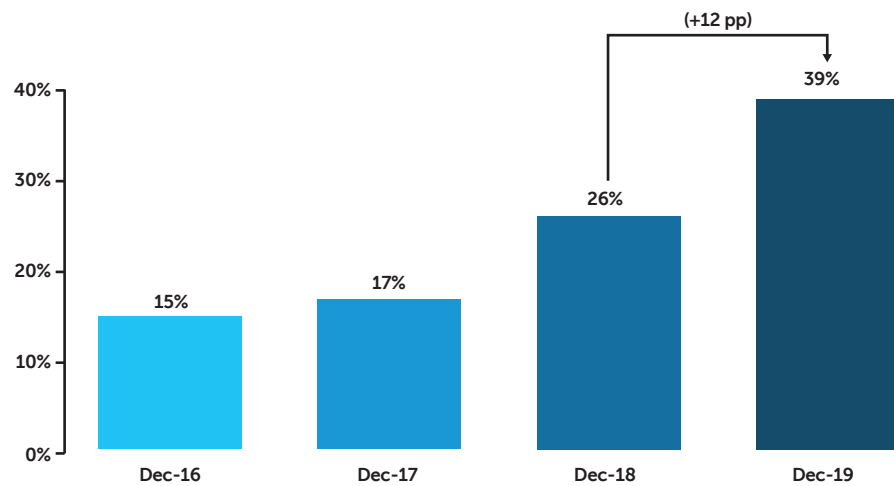
Activity rates

The customer activity rate represents the percentage of registered customer accounts that have been used at least once in the last 90 days (i.e. the account for which at least one transaction has been conducted in the last 90 days). Figure VI shows that the customer activity rate in Zambia has been improving each year since December 2016 and grew from 26 per cent in December 2018 to 39 per cent in December 2019.

Figure VI.

Percentage of active DFS accounts (December 2016–2019)

Percentage of active DFS accounts



In 2019, providers invested in initiatives to reduce dormancy. The numbers suggest these efforts have contributed to higher customer activity rates. Table 1 presents an overview of some of the initiatives that were taken.

Table 1.

Overview of initiatives invested in by providers in 2019

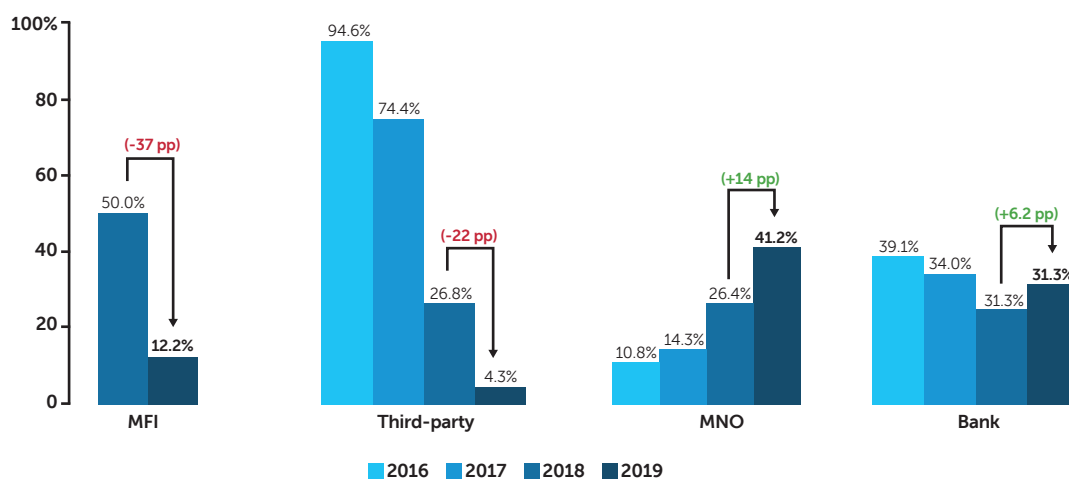
| Initiatives | Description |
|--|---|
| Profile and segment customers | Improved segmented product offering with readily available products and services, like Eaze account, AgriPay, AccessPay, Youth account, Xpress account, Evolution account, Junior Savers, Group save account and Tenga, that are targeting specific customer segments (i.e. rural, women, youth and MSMEs). |
| Target customer education efforts | There has been increased use of below-the-line marketing campaigns through channels like SMS messaging and outbound calling to reach and educate both new and inactive customers on available product offerings. |
| Offer incentives to drive usage | The use of converged offers (bonus incentives) to drive uptake and usage of available products and services has become the benchmark of a successful DFS provider. |
| Conduct data analysis | Back-office staffing increased by 70% year-on-year, reaching 131 employees across all providers. Most of the back-office staff focused on understanding customer usage trends and reconciling partner transactions. |

Figure VII shows the improvement of customer activity rates, particularly for MNOs and banks. Customer activity rates of MFIs and third-party providers decreased in 2019, while customer activity rates for MNOs and banks rose to 41 per cent and 31 per cent, respectively, in December 2019. It is important to note that banks managed to improve their customer activity rates for the first time since 2016. For MNOs and banks, the increase in customer activity may be due to the initiatives implemented to reduce customer dormancy, to improve accessibility to their agents, to develop new partnerships and roll out new products and services that better meet customers' needs.

The improved market collaboration at the bilateral level, facilitated by the National Financial Switch (NFS), may present new opportunities for MFIs and third-party providers experiencing declining customer activity rates.

Figure VII.
Customer activity rate by provider type (December 2016–2019)

DFS accounts activity rate by provider type





Product and services

First- and second-generation services

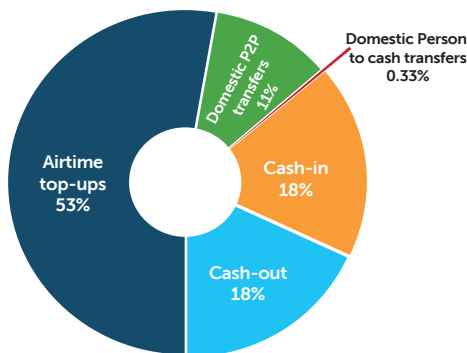
Compared to 2018, the volume and value of transactions conducted in December 2019 grew by 9 per cent and 55 per cent, respectively, reaching a total of 74 million transactions in December 2019 for a total value transacted of ZMW17 billion. First-generation services accounted for 90 per cent of the total volume and 85 per cent of total value transacted, while second-generation services contributed 10 per cent and 15 per cent of total share of transaction volume and value, respectively. This overall year-on-year growth may be attributed to some providers' willingness to invest up to 50 per cent more in their operations than in 2018 to recruit new agents, onboard new customers, develop and introduce new services, and reduce both agent and customer dormancy.

Figure VII compares the share in the volume and value of transactions by product type for first-generation services. In 2019, transaction volume and value of first-generation services grew by 92 per cent and 73 per cent, respectively.

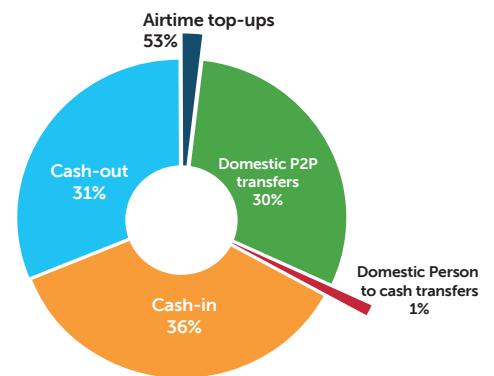
Figure VIII.

Share in volume and value of first-generation services by product type (December 2019)

Transaction volume



Transaction value



Domestic peer-to-peer transfers

The total value transacted through peer-to-peer (P2P) transfers grew by 137 per cent between December 2018 and December 2019, and P2P transfers contributed to 26 per cent of the total value of all first-generation services transacted in December 2019. Through P2P, MNOs put in place relatively cheaper initiatives that increased product usage, resulting in reduced customer dormancy.

Cash-in and cash-out transactions

Cash-in and cash-out transactions grew in year-on-year value by 69 per cent and 38 per cent, respectively, thanks to the drive of providers to expand service touch points by recruiting new agents and reactivating dormant agent accounts. Interestingly, the total value transacted at cash-in grew faster than the total value transacted at cash-out. This suggests that customers are increasingly using digital services for their financial transactions and are less inclined to withdraw their money for cash.

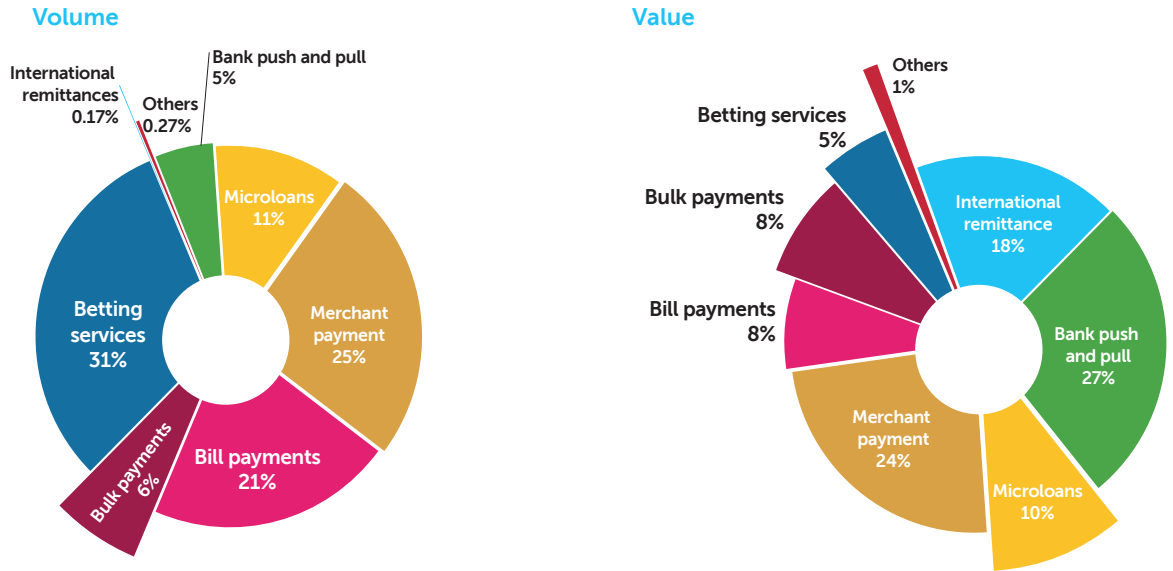
Airtime top-ups

In December 2019, the total value of airtime transactions increased by 171 per cent, compared to December 2018, again making airtime top-up the topmost use case with a 48 per cent share of overall DFS volume transacted. MNOs drove digital airtime top-ups to improve their business gross margin and distribution foothold.

Figure IX shows the share of volume and value of transactions of second-generation services by product type. The volume and value of transactions for most product types increased in 2019, including in insurance (+594 per cent), digital loans (+92 per cent), merchant payments (+53 per cent) and savings (+31 per cent). This may be attributed to providers' focus on improving their business income by diversifying their revenue streams through increasing the adoption and usage of innovative products and services that are user-centric, relevant and meet real customer needs.

Figure IX.

Share in volume and value of second-generation services by product type (December 2019). Others included savings and insurance products.



Bank push and pull

In 2019, the market recorded an increase in the value of wallet-to-bank-transfers and bank-to-wallet transfers by 95 per cent and 29 per cent, respectively. This may be attributed to the increasing collaboration between providers. The ease with which one can push funds into their bank account and pull money into their e-wallet account allows customers to frequently transact in a secure, instant and convenient manner.



Agents

Between December 2018 and December 2019, the Zambia agent distribution network grew, as illustrated in Figure X. The number of registered agent outlets doubled from 67,747 to 141,396 and the number of active agents (on a 30-day basis) reached 90,166 in December 2019. In terms of market share, MNOs contributed to 81 per cent of the total number of active agents, while banks, third-party providers and MFIs respectively contributed to 5 per cent, 14 per cent and 0.1 per cent.

These figures validate providers' strategies that focus on expanding their distribution foothold by acquiring more agents. Because of this heavy focus on onboarding agents, the number of active agents per 100,000 adults grew from 480 in December 2018 to 926 in December 2019, as shown in Figure X. This figure gives an estimate of the coverage at national level but does not say anything about how agents are distributed in the country (e.g. rural areas vs. urban areas).

In the 'State of the Digital Financial Services Market in Zambia 2018' report, agents' activity rate was defined as the percentage of registered agents who are active (i.e. have conducted at least one transaction in the past 30 days). The agents' activity rate reduced slightly from 69 per cent in December 2018 to 64 per cent in December 2019, with banks being the only provider type that improved its agents' activity rate. This market level decline, driven mainly by MNOs, may be attributed to the rate of acquiring agents being higher than the rate of converting them into active users. While providers successfully focused on acquiring new agents, the next step will be to work on reducing agents' dormancy rate.

Figure X.

Number of registered and active agents (December 2017–2019)

Registered and active (30 days) DFS accounts

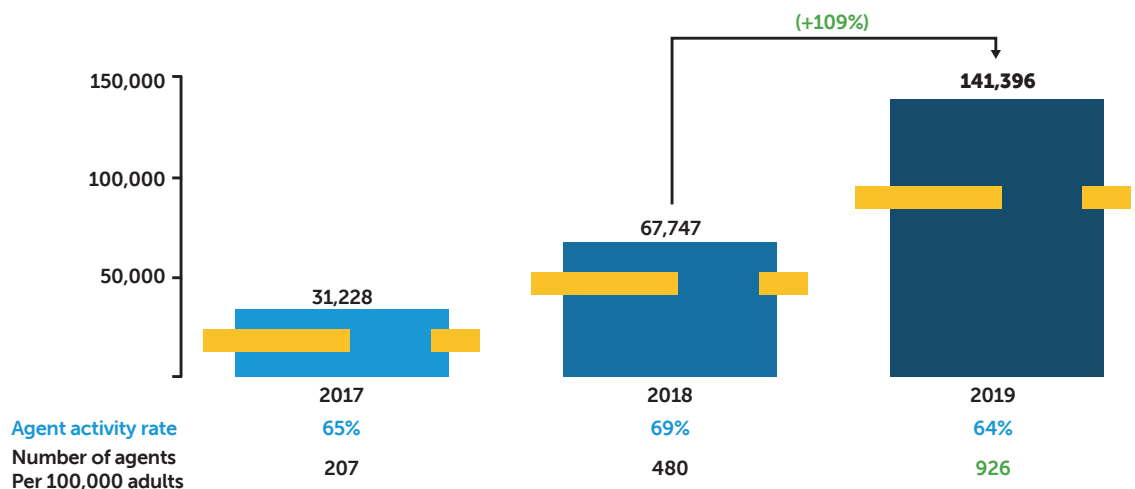
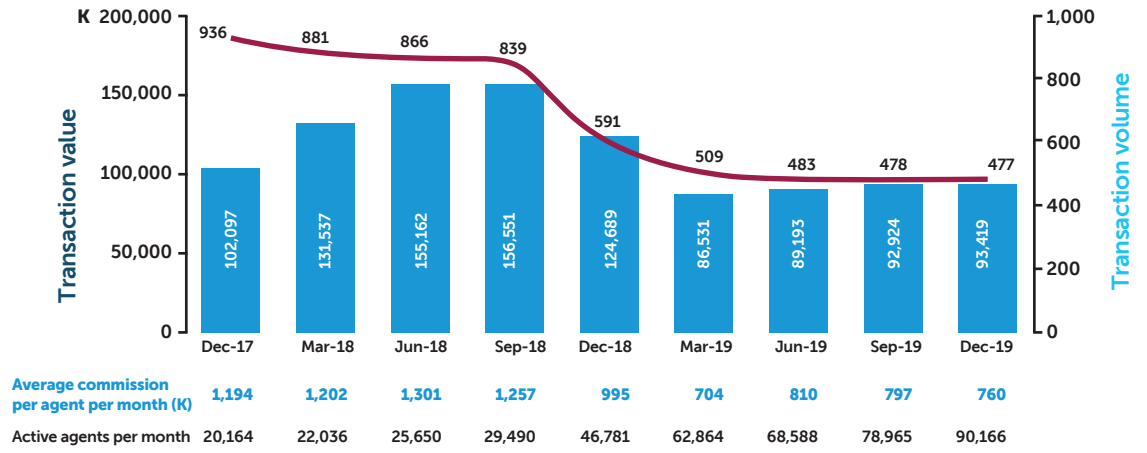


Figure XI shows the average transaction volume, value (ZMW) and commissions value (ZMW) per agent in various months between December 2017 and December 2019. On average, each DFS agent conducted 477 transactions (17 per day, in a 7-day work week) for an average monthly value of ZMW93,419 (US\$6,750) and earned on average ZMW760 (US\$55) in the month of December 2019. The share of transaction volume by agents of MNOs, banks and third-party providers was 66 per cent, 4 per cent and 30 per cent, respectively, while split of transaction value share was 80 per cent, 3 per cent and 17 per cent, respectively. However, while more agents were active, they seemed to perform less than in 2018: average transaction volume per active agent dropped by 19 per cent, average transaction value per active agent dropped by 25 per cent and average value of commissions earned by an active agent dropped by 24 per cent. There is a need for the DFS industry to conduct an agent 'health check' to ascertain the causes of diminished performance indicators and possible solutions. Designing relevant use cases, including non-financial services, could address the agent profitability challenge and solve the critical issue of liquidity management.

Figure XI.

The average transaction volume and value (ZMW) per agent (December 2017–2019)

Average transaction volume and value per agent, per month





Merchants

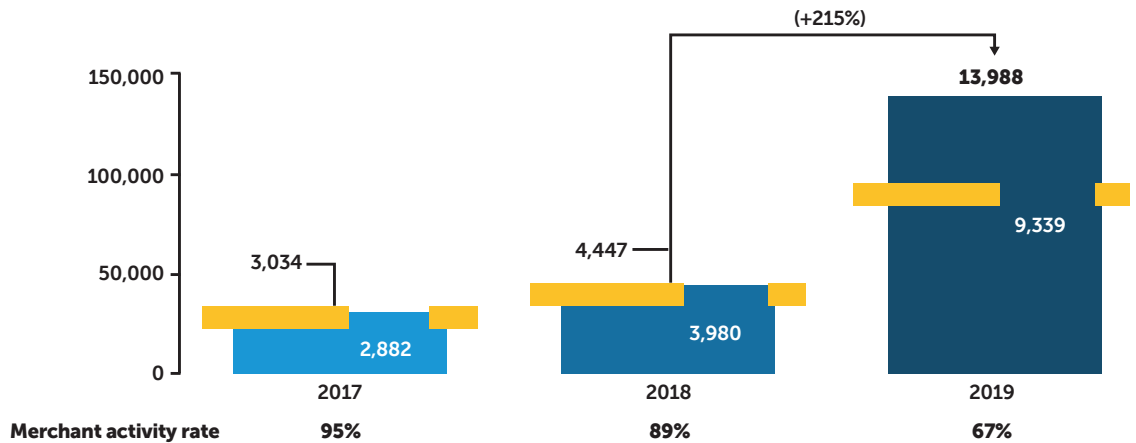
The digital finance ecosystem also includes merchants who are increasingly interested in the value proposition of digital payments. A merchant refers to a user account that receives payments for goods and services via a DFS channel. DFS channels include point-of-sales terminals (POS) for credit and debit cards, QR codes and payment via a code. Figure XII shows the growth in registered and active merchants since December 2017.

The number of registered merchant accounts rose by 215 per cent in a year, growing from 4,447 in December 2018 to 13,988 in 2019. The number of active merchants (i.e. those who accepted at least one payment for a good or service via DFS in the past 30 days) increased from 3,980 in December 2018 to 9,339 in December 2019. Third-party providers contributed to 64 per cent of the active merchant base, while banks and MNOs contributed to 33 per cent and 2 per cent, respectively.

Figure XII.

Growth of registered and active merchants since December 2017

Registered and active (30 day) merchants



Most of the existing merchants' solutions, such as POS terminals offered by third parties and banks, mostly targeted formal sector merchants because it's an easy-to-reach segment with identified needs. As a result, the solutions tended to exclude the informal trade sector. However, Zambia's considerable and ever-growing informal sector, with approximately 1.02 million informal MSMEs, offers a great opportunity for providers to build an inclusive and sustainable digital payments ecosystem.

⁹ UN operational rates of exchange - <https://treasury.un.org/operationalrates/OperationalRates.php>



Providers' views on performance and challenges

To better contextualise the 2019 performance, the 2020 survey included qualitative questions that enabled providers to share context of their reported results and performance. The following are some of the key insights gleaned from their submissions and the interviews conducted.

- 16 out of 19 (84 per cent) of the providers interviewed considered their DFS to be commercially sustainable, meaning that their businesses could generate enough revenue to cover operation costs. In 2018, only 8 out of 13 (61 per cent) providers reported commercial sustainability.
- Due to increased investments in developing the technical and organizational capacity of the different organizations providing and improving DFS, 18 providers reported an improvement in capacity in 2019 compared to 2018.
- Staff dedicated to back-office operations increased by 70 per cent between December 2018 and December 2019, clearly indicating that providers focused on improving their operational efficiency.

Despite the good overall performance reported for December 2019, DFS providers also highlighted challenges they faced when operating DFS services. Below are some of the most common challenges.

- **Limited strategic partnership** – it remains costly to integrate with other DFS players at a bilateral level. The planned implementation of phase II of the NFS will drive integration of mobile payments and enable DFS market players to actualise some of the listed benefits, including:
 - lowering the cost of interoperability
 - spurring product and services innovation
 - driving customer activity due to improved user experience.
- **Liquidity management** – a recurring and critical issue that impacts the spread of agent businesses in rural and hard-to-reach places. Identifying worthy partners and building sustainable business models and use cases for agents will be focus areas for 2020/2021.
- **Limited digital skills** – digital literacy is not a skill that is evenly spread throughout Zambian society. Most people who are digital literate are urban dwellers aged 40 and below, who have regular access to the internet. This means that people in rural settings or who do not have internet access most likely have inadequate digital literacy skills. DFS providers often find it unfavourable to extend DFS to some locations in Zambia because of these low literacy skills, compounded by both low financial literacy levels and low product awareness amongst target users. There is need for the DFS ecosystem to collaborate on developing solutions and use cases that build the digital skills of end customers, enabling them to transact successfully and to trust the digital solutions offered.

The 2020 survey also prompted DFS providers to identify the key areas in which they wished to engage with the regulators. The following two key areas of engagement were mentioned by the providers.

1. Lack of agency banking regulations – Providers increasingly express interest in setting up agency banking operations. They call upon the regulator to issue agency banking guidelines.
2. Unified forum to discuss industry matters – more than 70 per cent of providers indicated that they would appreciate the opportunity to formally congregate to discuss industry challenges and opportunities with other stakeholders. This could be done through a forum for the digital finance ecosystem. These sessions should be organized in partnership with regulators and government bodies to facilitate cross-discussion and build on the first iterations conducted by UNCDF and FSD Zambia.

About two thirds of providers were planning on increasing their DFS investment in 2020 by up to 50 per cent more than their total DFS investment for 2019. However, these projections, along with the strategic priorities for 2020 might have been heavily impacted by the COVID-19 pandemic.

¹⁰ Manju Kedia Shah, "The Informal Sector in Zambia. Can it Disappear? Should it Disappear?", Working Paper, No. F-41004-ZMB-1 (London, UK, International Growth Centre, June 2012).

¹¹ Back-office operations include human resources working on the Management Information System, partner account reconciliation support, customer and partner segmentation, etc.

¹² ZICTA 2018 Survey.



2

OPPORTUNITIES AND THE WAY FORWARD



Opportunities and the way forward

As providers have developed the DFS market in Zambia, growth in DFS has been consistent from 2016 to 2019. This year is expected to be a tipping point in the DFS industry because of the impact the COVID-19 pandemic has had on businesses in Zambia; businesses must rethink their models now that customers' habits and needs are shifting. During interviews conducted with providers during mid-2020, the impact of the pandemic on the DFS market was brought up; the resulting information provided new insights that, together with the findings from the survey, have shaped recommendations for providers on how to best take advantage of the opportunities offered by the current DFS landscape. These are mentioned below.



COVID-19 crisis has accelerated the financial industry's shift in the digital era

Because of the pandemic and the social distancing measures enforced by governments, the transition from a cash-based transactions economy to a digital one seems inevitable. This shift has been facilitated because cash was highlighted as one potential mode of virus transmission. Providers noticed a strong drop in the number of transactions conducted at physical locations (bank branches and, in some cases, ATMs) coupled with a rise in the number of customers using digital channels (mainly phone and internet banking). For example, bank push-pull transfers grew, and a provider also highlighted that merchants requested more POS terminals to avoid dealing with cash.

Therefore, this pandemic offers an opportunity for DFS providers to expand their client base and usage.



New partnerships will help build more sustainable business models

Building new partnership models will be a key aspect to look at if providers want to improve their profit margins and build more sustainable business models. Below are some examples of potential business models moving forward.

- Some MFIs and third-party providers are yet to develop a sustainable business model to retain a larger active customer base. The improving market collaboration at the bilateral level, facilitated by the NFS, may present new opportunities for providers experiencing declining customer activity rates.
- Increasing partnerships that enable shared agent networks offer an opportunity to address agents' dormancy rates and help solve the agents' liquidity management issues. Partnerships between providers with agents and banks enable agents to easily access funds, from their bank accounts or other partners with high cash-handling stakeholders in communities where the agents are located to exchange for cash (shop keepers, public transport hubs). This ensures the agents have liquidity and can continue serving their customers.
- Growing the number of partnerships could densify the access points from where customers can access their funds, which will have a positive spill over on the sustainability of providers' business models.



Innovations around product offerings

As providers strive to reduce customer dormancy, innovations for use cases that enable customers to frequently transact will be a key focus for the DFS ecosystem players in Zambia. Below are some of the proposed use cases that providers may consider for implementation:

- Roll out affordable and simple merchant solutions to empower merchants with an integrated solution that enables them to service a wide range of customer transactions (e.g. use one pool of funds to service transactions for agency banking, airtime top-ups, utilities (Zesco, Pay TV, water, etc.) and mobile money cash-ins and cash-outs). For merchants in places with low data network connectivity, encourage customers to pay against a bill pay number accessed using Unstructured Supplementary Service Data (USSD) strings.
- Build a clear value proposition for informal merchants. In 2019, the growth of P2P transfers transactions (see page 9 of this report) showed a trend of informal merchants opting to use their DFS e-wallets for business purposes to receive payments for goods and services. Further, this showed that informal merchants benefited from using DFS but they were not satisfied with

the current merchant-specific solutions, which had high acquisition costs (POS terminals) and required thorough know-your-customer information that informal merchants struggled to provide. It is, therefore, important that providers understand the benefits to using DFS services for informal merchants, identify the barriers and design innovative solutions for informal merchants. To convince merchants to sign up for specific merchant accounts, providers could look at solutions that also enable them to easily access working capital, courtesy of them owning a standalone business account that not only keeps digital records but also makes it easy to review their business performances.

- Focus on increasing the adaptability and usage of second-generation services. The increasing growth of services, like bank push and pull, bulk payments (through government-to-person and business-to-person disbursements) and international inbound remittances, enables customers to store value in their wallets and increase their likelihood to transact at a designated merchant transacting point. Customers will also be encouraged to regularly transfer funds, either by a) free transactions, b) reduced transaction fees, or c) rewards for the sender (free calls, SMSs or data bundles, etc.).

The FinTech sector is growing to become an important contributor to the Zambian financial services industry. While some FinTechs experience regulatory challenges because of the uniqueness of their product offering, many others experience challenges with securing the various licensing fees to remain compliant with the regulator. However, there is a strong appetite among FinTechs, which UNCDF and BoZ have encountered in the last 12 months, to continue developing and iterating relevant and innovative products that address gaps in the Zambian economy. With this growth, many considerations must be undertaken to protect the consumer and the business and to ensure responsible industry developments. Throughout 2019 and 2020, regulators and FinTechs demonstrated their willingness to collaborate with all parties in the DFS ecosystem to responsibly bring innovative and beneficial products to customers. For the remainder of 2020 and in 2021, regulators are likely to strengthen regulatory frameworks and systems of collaboration between capital market operators and FinTechs, so this sector should see significant growth by 2022.



Data use to identify use cases will build a more inclusive economy

Stakeholders increasingly see the benefits of using their own data to better understand their performances, the ecosystem's development and to identify challenges and potential opportunities. UNCDF is working with providers to help them build data systems and capacity to leverage data for better informed decision-making. Data can be used to grow a provider's customer base by identifying population segments that are currently excluded and by understanding their specific needs, transactions habits and financial capacity to develop more adapted products. Providers should proliferate their web of services – accessed through digital channels – to fit the needs of specific customer segments.



Build resilient and better micro, small and medium enterprises through exploring innovative financing models

DFS providers will need to develop product offerings that are adapted to the needs of MSMEs to solve challenges around accessing loans to scale their businesses either through increased capital or by investing in operations and technical expertise. In the case of DFS agents, improved access to financing could also help address the liquidity issue that has been highlighted as a challenge in this report. Possible ways to nudge financial institutions into servicing new customer segments will be to develop loans and guarantees schemes. UNCDF is partnering with the Swedish International Development Cooperation Agency (SIDA) to explore such opportunities for the Zambian digital financial ecosystem.



Disclaimer

This report is based on data collected through the 2019 Annual Provider Survey of Digital Financial Services and internal analysis by the UNCDF Digital Team.

Survey data

Survey data are self-reported and have not been verified independently by the UNCDF Digital Team; however, data are thoroughly checked and crosschecked against other benchmarks and data sources.

Confidentiality

Data published in this report have been presented in a way to protect the confidentiality of each provider. Any specific references or highlights in this report have only been presented with the approval of the provider to disclose key performance information.

Limitations

All data in this report are self-reported. In some cases, providers submitted partial data. Most of the providers that participated in the survey did not have data disaggregated by gender or rural/urban split, which limited the level of analysis that could be completed with the data.

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