

**THE ACCESS FRONTIER
AS
AN APPROACH AND TOOL
IN
MAKING MARKETS WORK FOR THE POOR**

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ABSTRACT

This paper sets out the ‘access frontier’ approach to understanding how markets work over time, and in particular, how they work to increase access by poor people. The access frontier approach is an analysis tool which can be used as part of “Making Markets Work for the Poor” (M4P).

The access frontier approach segments the market for a particular product into five groups: those who now use it, those who could have it but don’t want it, those who are within reach of the market now and in the foreseeable future, and finally, those outside of the reach of the market because of their low income.

More specifically, the access frontier approach focuses on how to increase the proportion of the eligible population who can access a product. This requires understanding the reasons for non-usage and defining effective access carefully. In particular, the approach seeks to identify those potential users in the ‘supra-market zone’, who are not able to use the product because of insufficient income and are therefore beyond the reach of direct market solutions in the medium term.

Based on the segmentation of current users and non-users, three market policy zones are identified: the ‘market enablement zone’, between the current usage level and current access frontier; the ‘market development zone’ between the current and future access frontier and future access frontier; and ‘redistribution zone’ of people in the supra-market group. This distinction enables policies for state intervention to promote or accelerate usage to be correctly matched with the state of market development, and in particular, not to crowd it out. Private providers should also adjust their long term strategies based on the market development trajectory.

The paper illustrates the access frontier approach in detail using the market for bank accounts in South Africa; and indicatively using the cell phone market.

Key words: Making Markets Work, MMW, Access frontier, supra-market zone, Financial sector development, Private sector development, transactions banking, M4P

EXECUTIVE SUMMARY

1. The access frontier approach enables greater understanding of market development over time from the perspective of who can be served by the market over time.
2. The *access frontier* defines the maximum proportion of the eligible population who have effective access to a product under existing conditions.
3. This frontier is likely to shift over time. Considering where it may move in the short to medium term is an important part of assessing the capacity of market solutions to extend access over time.
4. However, even after allowing for such shifts, there is still a group of people whom, largely because of poverty, the market will be unable to touch in the foreseeable future ('the supra-market group'). For this group, the state may decide to supply the service directly or regulate existing institutions to provide it (i.e. forced cross subsidy).
5. The access frontier approach distinguishes three zones in a market based on the positions of current usage and current and future access frontiers: a market enablement zone, a market development zone and a market redistribution zone.
6. The test of policies in the redistribution zone is whether they encourage or limit the outward movement of the access frontier so that more can be served through markets over time, so that state subsidy can be directed at those most needy.
7. The market for transaction bank accounts in South Africa is assessed as an illustration of the conceptual framework. While usage levels are currently around 46% of adults, the access frontier has shifted so that some two thirds of the population are currently within reach of this product type as now defined. Technological and competitive changes suggest that the future frontier may lie as high as 78% of adults within 3 to 5 years. Only 5% of people indicate that they do not want a bank account, hence the natural limit of this market is 95%. Analysis of those in the supra-market zone suggests that they are in general young hence their income and household status may be expected to change over time. The case for special state interventions to expand bank accounts to people in this zone is therefore weak; as opposed to promoting the maximum movement in the frontier over time.
8. The market for cell phones in SA also illustrates how these tools of analysis can enrich understanding and debate of how to grow markets over time.

Glossary:

Access frontier: the maximum percentage of people who can access a particular product on current terms and conditions.

Market enablement policies: those which close the gap between current usage levels and the current access frontier.

Market development policies: those which promote the movement outwards of the frontier (i.e. the growth in access or potential usage).

Natural limit: the maximum extent of usage possible after eliminating those who can, but choose not to, use the product.

Supra-market group: the consumers in a market who are beyond foreseeable reach of market-based solutions

Usage: the percentage of eligible people in a defined market who use a particular product

1. INTRODUCTION

How far can one expect market-based solutions to go in providing access to a socially important product or service? This paper provides a conceptual approach and an analytical tool—the access frontier—to answer this question. As an example from the case study used in the paper, over two thirds of the adult population may have access to transaction banks accounts in South Africa, compared with just under half who currently use the product. For those who do not have access today, what policies should be used to increase actual usage up to the frontier level; and also move the frontier outwards over time? The access frontier approach provides insights to answer these questions.

This paper sets out the *access frontier approach* to understanding market development.¹ As an analysis tool, this approach can inform policy debate and market strategy about how to extend access to products or services. It may be used as part of “Making Markets Better Work for the Poor (M4P)”, the broader approach espoused *inter alia* by DFID and Asian Development Bank and discussed at a February 2005 workshop in Manila.²

The paper sets out the approach for two types of reader: first, a broad conceptual overview which should be broadly accessible to a general reader; and second, a more detailed tool-kit description for those who wish to apply it in some depth. The step-by-step approach is then illustrated in detail using one key financial product class in one country: transaction bank accounts in South Africa. This is because it is the market most familiar to me, and in which new primary data has become available in recent years. Furthermore, a recent product launch has shifted the access frontier considerably.

However, the access frontier tool may be applied in the case of any good or service market (i) which has ‘merit good’ characteristics and (ii) in which private supply is important. Without the merit characteristics, there is no public case for seeking to expand access; and if private provision is not required to achieve this, then markets are not relevant to the debate anyway.

A further brief example is given of the cell phone market, also using SA statistics; and applications have been proposed to other markets such as health and life insurance, business development services, mosquito bednets and private provision of utility services such as water or electricity.

The paper then summarizes the implications of the approach both for policy makers, interested in expanding access to a good or service, and for suppliers, interested in developing appropriate market strategies.

¹ The concept of the access frontier was first described as part of a longer paper on financial markets specifically (Porteous 2004), in which the access frontier was one part of a broader approach towards making financial markets work better for the poor in southern Africa.

² DFID’s paper at that workshop (2005) best summarizes the M4P concept for those who wish the broader context.

2. HOW MARKETS DEVELOP: INTRODUCING THE ACCESS FRONTIER

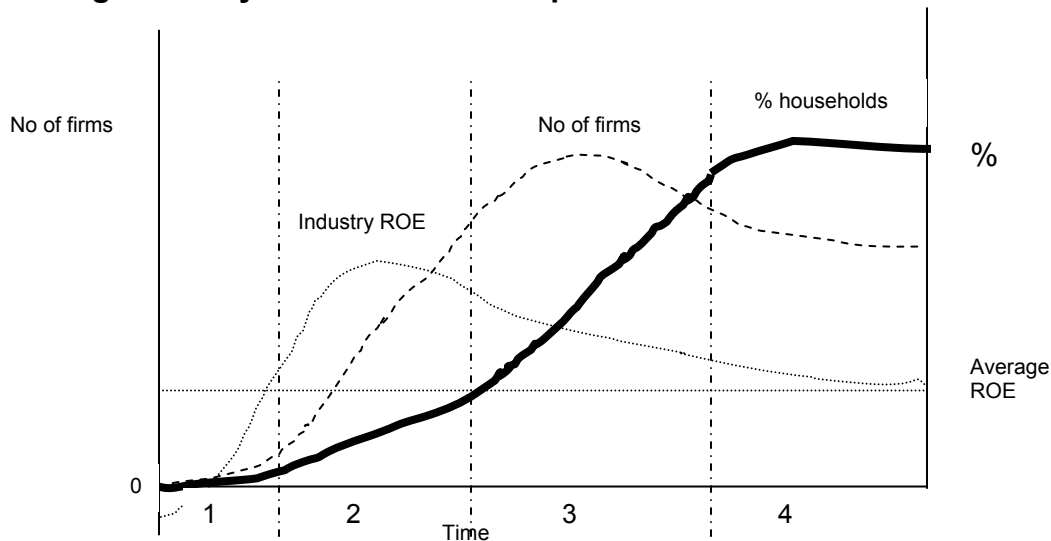
Summary

- This section describes the stylized description of how markets develop over time. Usually, the proportion of eligible people using a product rises over time.
- The concept of the access frontier is then described in broad overview.

2.1 Market development over time

Although individual markets have idiosyncratic features, market development tends to follow stylized stages. Figure 1 below summarizes the conventional model of 'stages of market growth', tracking the number of firms in a given market segment (market structure), the average firm profitability and the percentage of eligible consumers using the product (market size).

Figure 1: Stylized Market development over time



The Figure above tells the following stylized story of market development.

In the *first phase*, one firm or a few pioneering suppliers bring an early product to market. They often make losses due to heavy R&D investment which they hope to recoup at a later stage (hence the average ROE line is below zero); and they serve a small number of early adopter-type customers.

However, the experimentation results in a product which works: this is shown by increasing numbers of clients in *Phase 2*; and the consequent move to profitability

by the initial firms. This success prompts other firms to enter the market. Competition may initially be on the basis of service quality or by product differentiation.

By *Phase 3*, competition is usually on price terms as the product features start to be commoditized. As supply continues to increase, prices start to fall as these firms compete. This creates a virtuous cycle of boosting further demand. Therefore, usage grows rapidly in this phase as the market broadens. It is quite likely that the supply will overshoot demand. As a result, a number of suppliers will not be viable, and will fail or withdraw from the market as it consolidates.

In *Phase 4*, the remaining firms benefit from greater economies of scale as market acceptance and usage grows further, but prices may also fall further. This reduces the profitability of this market sector back towards the overall risk adjusted average for the economy as a whole. The overall level of usage of the product reaches saturation at some natural limit, at which point all who wish to use the product and service are able to. From that point, non-usage is a function of genuine choice rather than of other constraints, such as insufficient income.

After reaching the natural limit, turnover consists mainly of repeat sales to existing customers (such as for replacement of durable goods, or repeat of ongoing services). Any growth in volume is generated by exogenous factors such as demographics—an increase in the total number of households, for example. These can be powerful forces— even in apparently saturated consumer markets, demographic features, including immigration, have driven growth in the US economy in recent years.

The stylized trajectory in Figure 1 has been demonstrated over the long run in a number of industry sectors in developed markets, such as cars in the USA, described in Box 1 below. The level of usage there has flattened out at high proportions of the eligible population, while the number of firms supplying and the profitability of these firms has stabilized at a low level. Recent financial stress suffered by some major firms suggest that the number of car manufacturers may diminish yet further.

Box 1: Cars in the USA

At the turn of the 20th Century, very few American households owned a car. Cars were the preserve of the wealthy, until the actions of Henry Ford created a broad mass market in the second and third decades of the century. At this time, there were many car producers in the US.

By 1950, as a result of the declining cost and increasing usefulness of cars (road networks were upgraded and extended), 59% of US households had one or more cars. Growth continued: 82% of households had a car by 1970³. Since then, the proportion of households owning cars has risen further, but is generally considered to be at saturation point.

³ Data from *Statistical History of the US Datapedia*, Series Q163-174

At the same time, the production of cars has been massively centralized: eight large producers produce almost all the world's cars. The continued viability of some of these is in question as they report large losses.

The growth in usage was caused by continuous technological improvements which reduced the cost of car manufacture relative to consumer incomes in a competitive, increasingly global marketplace. It has also been supported by the development of other linked markets: for example, in 1950, over half of all new US passenger cars were bought for cash; but the development of instalment credit markets, backed by car makers, reduced this to a third by 1970. This made the purchase of a car less 'lumpy' in cash flow terms upfront. Also, the development of second hand car markets, a corollary of the growth of new car markets, offered a more affordable entry to car ownership.

Markets never develop in isolation, but rather as a complex system.

Figure 1, together with the examples above, suggests that usage inevitably increases over time. Is this the case?

Markets clearly have in-built 'growth hormones' during the early phases of growth. As long as demand increases more than proportionately to price reduction (i.e. is price elastic), incumbent and entrant firms will drive prices down in time as they seek greater profits. This in turn broadens the potential market. Broadening the customer base may generate further virtuous cycles—for example, through economies of scale in production or distribution, which enable further cost reduction and/or profitability to be achieved. Satisfied users may also promote usage of a product among others. As long as new firms can enter a market, keeping competitive forces strong, it is reasonable to expect that a healthy market will show increasing usage. However, the increase will come at a decreasing rate as the market approaches a natural limit—the level of usage at which all those who wish to use a product, can and do so; and where non-usage is the result of pure consumer choice.

However, markets are also constrained by the overall level of income and its distribution in a society, which is the result of interaction of other markets, such as the labour market. The 'growth hormones' of most markets will be overwhelmed by the greater downward drag of declining overall incomes in a country. The access frontier approach addresses the question of how to control for the level of income in market development.

It is also important to note that the usage trajectory does not assume that goods are always launched at the high end of a market, and that usage then spreads downwards over time. The opposite may happen, and still result in increasing usage. However, the norm appears to be that, after a product has become established at the high to middle range of a market, it may be vulnerable to low cost disruptive innovations. These innovations reduce the price through unbundling the product features; and may considerably increase the market usage, as observed in sectors such as air travel.⁴

⁴ For further examples of low cost disruptive innovation, see Christensen & Raynor (2003).

2.2 *The Concept of the Access Frontier*

In essence, the access frontier approach aims to identify the potential of market-based solutions to serve unserved people. In this section, the general concept of the approach is described for the general reader. Those who wish a detailed exposition will find it in the next section.

The access frontier is the maximum proportion of eligible consumers who presently have access to the product or service. The approach distinguishes between users of a good or service, who have access by definition, and those who do not use it but may have access to it under certain conditions. The focus of the approach requires defining effective access to a product, so that non-users may be segmented into four groups:

- Those who are **able to use the product but choose not to** (they define the limit of the market as they have placed themselves beyond it by choice, and therefore are not a policy concern);
- Those who **can currently access** the product as presently defined although they have not yet—these lie within the access frontier;
- Those who **should be able to access the product in the next three to five years**, based on expected changes in product or market features—these lie within the future access frontier; and
- Those **beyond the reach of market solutions** in the next three to five years; this group is the residual of non-users who are not in any of the preceding three groups, and is called the supra-market group as it is people who are outside the reach of market solutions.

An easy way to show this segmentation is using a market map, which traces usage of a particular good as a percentage of the eligible population on the vertical access and time on the horizontal access. The result of the segmentation described above is the five zones shown in Figure 2 below, where the captions describe the position of the people in each zone.

Figure 2: Market Map



It is generally only for those in the 'supra-market group' (i.e. 4 in the Figure above) that there is a case for public intervention of some form, whether by government or donors. However, the policies adopted for this group may well have an effect on how the access frontier is moved outwards over time.

The conceptual framework depicted in the market map has the following applications.

For policy makers, it enables the following questions to be asked:

- What is the best way to facilitate the outward movement of the access frontier (i.e. for more people to have access to the product)?
- What effect do policies in the supra-market zone have on the movement of the access frontier? (e.g. do they restrict or stimulate its outward movement?)

For private providers, growth strategies can be developed based on where the market is relative to its potential and its growth trajectory over time. State policies in the supra-market zone will either make it attractive for firms to pursue approaches which grow the market; or which favour cautious growth because of risk.

Recognizing these policies, and the risks and opportunities for private provision which result, will make private market strategies more robust.

A discussion about the zones in concept may help clarify the role and expectations of government and private sector. However, in order to develop the market map with precision, more detailed information is required. This will be specified in the next section.

3. ACCESS FRONTIER METHODOLOGY

Summary

This section provides a step-by-step description of the access frontier approach as an analytical tool:

- Step 1: Define the market
- Step 2: Determine the current usage level and trend
- Step 3: Segment non-usage to determine the current access frontier and natural limit to the market
- Step 4: Assess future possible positions of the access frontier in the medium term
- Step 5: Identify those in the supra-market group (SMG)

Against the background of the conceptual approach, this section sets out how the approach can be used as a more detailed analytical tool in a five step process.

Step 1: Define the market

The access frontier approach starts with careful definition of the market in question. It is generally preferable to define the market being analysed in functional, rather than product-specific, terms. This is because, first, sufficient data must be available; and second, so that the possibility of substitution, whether by consumers or producers, for the good in that market can be understood and explored.

In addition, depending on the definition of the market, the user 'unit' must be defined—for example, is it individuals in general; or only individuals over a certain age; or is it households? These units of demand form the denominator in subsequent steps where usage proportions are calculated.

Step 2: Determine current usage levels & trend

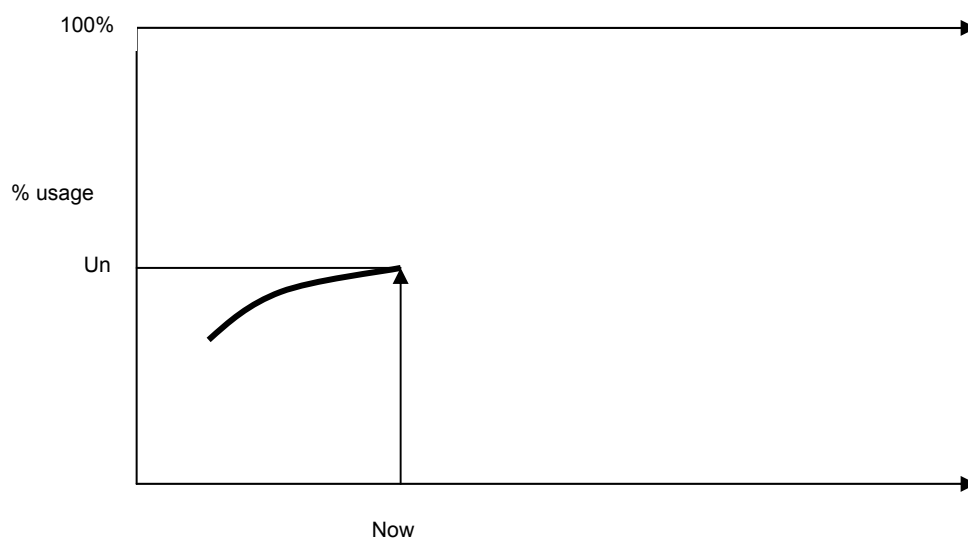
The next step is to define the current level of usage in the chosen market. This means calculating the percentage of eligible consumers in the market who are currently using the product or service. Access to statistically stratified household and product surveys is required to do this.

In addition to the level, the trend over recent years is useful to know, especially since one-off estimates extrapolated from samples may be quite inaccurate. In the absence of this data, it may be necessary to start collecting it. This can be an expensive and time consuming exercise which requires much forward planning, as the next section shows from South African experience.

The result of this step should be a mapping over time of the percentage of potentially eligible consumers/ households who do use the product, as shown in Figure 2a

below. The diagram shows elapsed time on the horizontal axis, and the percentage of eligible consumers using the product on the vertical axis. The dark line shows the trend in usage to the current time.

Figure 3a: The Trajectory of Usage



Step 3: Segment non-usage to assess the current access frontier and natural limit

The access frontier at a point in time is the maximum percentage of potential users in a market who are effectively able to make use of the product, given the current configuration of costs and market structure. This requires segmenting the current non-users of the product in order to establish the reasons for non-usage.

In order to do this, credible information is needed on the profile of non-users. The necessary information includes both the reasons for non-usage, stated by a representative sample of non-users, as well as other identifying characteristics of non-users, such as income, location. These characteristics create context for better understanding the reasons given; after all, stated reasons may be complex and/or vague. This type of information is usually generated by a survey of a representative sample of the total population.

The information should enable the following segmentation process to take place.

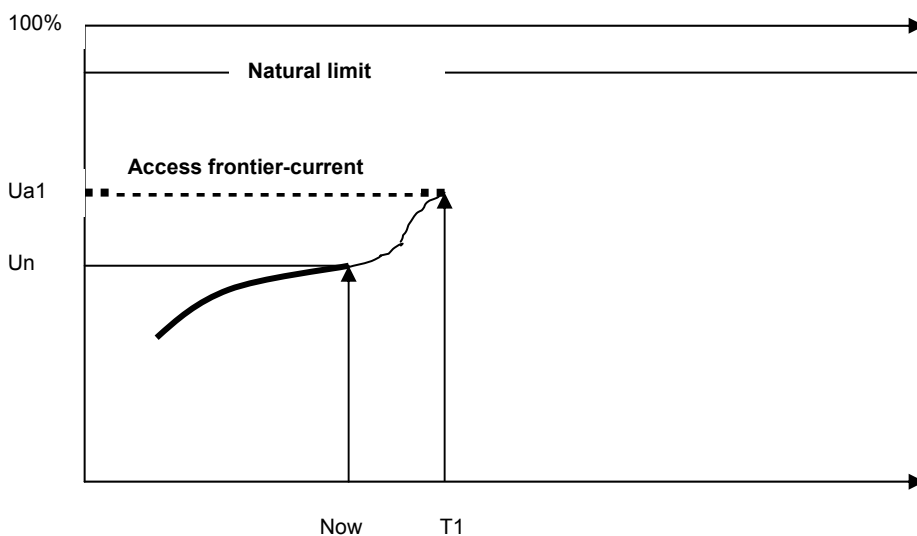
First, identify those who are not otherwise constrained but who choose not to use the product: this group will be defined as constituting the natural limit of the market. Even if the product were free, people in this group may not use it hence are beyond the reach of the market by choice. However, choice is dynamic: changing product features may alter the desire to use a product. Therefore this category must be carefully probed and monitored over time.

Second, in the non-users remaining after extracting the above group, identify those who qualify for the product in its current configuration. This would include those who can afford the typical cost, are within physical access and who currently qualify, given the product restrictions and features. The addition of this group to present users defines the current access frontier, since currently available products are within the reach of this group.

The access frontier will lie at least on or above the level of usage established earlier. In most cases, it is likely to lie above it, since not every consumer who is able to access a product actually yet uses it: some may simply not have been ‘reached’ yet by providers of the product. For example, in Figure 3b below, U_n is below U_{a1} , usage at the current access frontier.

The natural limit of those who choose not to use it is also shown at the top, reducing the available market to the dotted line.

Figure 3b: Introducing the Access Frontier

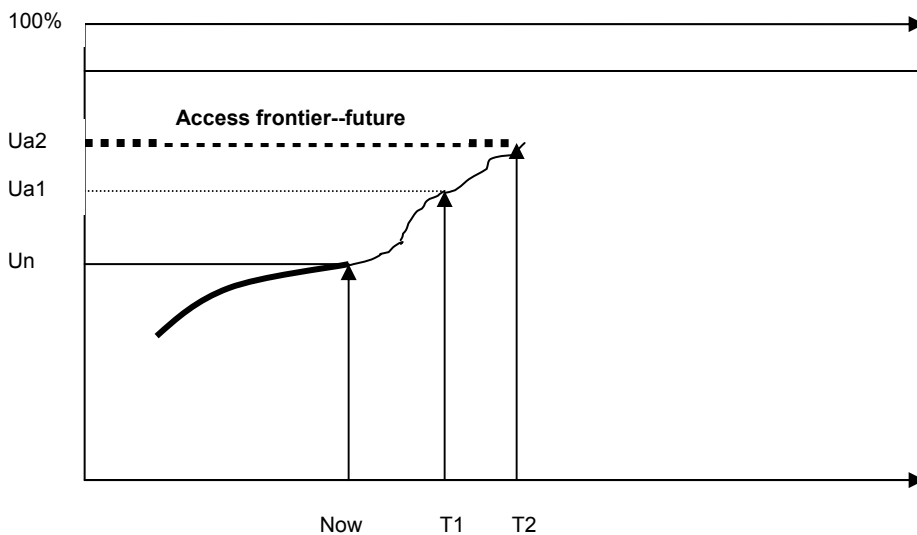


Step 4: Assess positions of the future access frontier in the medium term

Clearly, product profiles and market conditions change over time. In order to project the possible movement in the access frontier over time, it is necessary to estimate the effect of relaxing key current constraints on usage over a medium term period of three to five years, while holding constant policy changes.

This step therefore shows how far currently foreseeable changes will push out the frontier on their own without further intervention. If this assessment is not made, the limits of market solutions may be understated; and state action to expand access based on the current frontier alone may even crowd out market-driven solutions.

Figure 3c: The future access frontier



Estimating the future position of the access frontier is not always an easy process, but it is usually very instructive one. It requires a full understanding of current forces at work in this market, on both the demand (for example, tastes and preferences) and the supply side (for example, technology and competition). Some of the market characteristics listed in Box 2 below may be relevant in considering the capacity within a market to expand usage.

Ideally, mini-scenarios of the market should be built, in which key uncertainties are identified and the usage level played out under different assumptions about the realization of these uncertainties. The process of mini-scenario building ideally should incorporate a range of players—suppliers, potential customers, regulators. The interactions between these players could in itself be a useful in building a common understanding of the dynamics of the market in question. The scenario approach could result in multiple future access frontiers based on different assumptions.

Box 2: Market characteristics affecting usage

In assessing the future trajectory of the frontier, several market-specific features will determine the current and future level of the access frontier—whether high (i.e. more inclusive of the poor) or low (i.e. more exclusive). Analysis of these factors has to be brought to bear particularly in assessing the potential future movements. There are standard considerations such as the level of competition in a market; however, in terms of working for the poor specifically, three features are of particular interest.

- First, the ability of suppliers to **price discriminate** within the market, charging more to those prepared to pay more and vice versa, since this enables market-determined cross-subsidization to take place in sustainable fashion. The ability will be determined by regulatory factors—for example, interest rate caps limit the ability to do this in credit markets—and the characteristics of the product—whether these allow for re-packaging in different ways to different markets. Voluntary price discrimination by suppliers as a strategy of profit maximization is different from cross-subsidization mandated by government: the latter usually

only spreads costs, while the former may unlock profitable new market niches under the discipline of competitors with different market strategies.

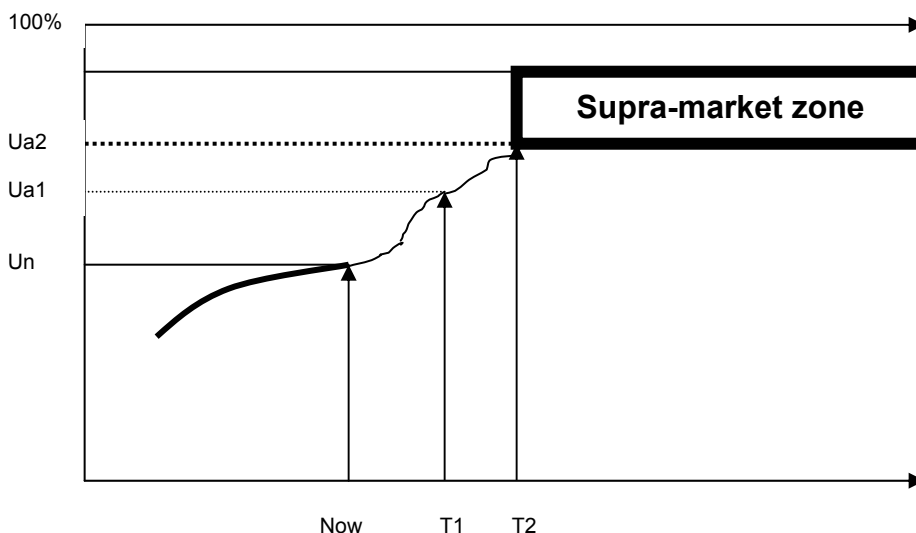
- Second, the **lumpiness of the product** i.e. how much must be laid out upfront to purchase the product relative to income. This is determined by the size and value of the good itself. Even if lumpy, there are ways to reduce lumpiness by spreading the cost over time: for example, the ability to access consumer finance reduces the upfront cost of a car (or house) to a small deposit or initial payment.
- Third, the **scale** of production and distribution which is possible in the market. This will determine whether economies of scale are achievable or not. Lower prices per unit in poorer markets require larger volumes to generate profitability levels which justify the level of capital expenditure and risk assumed by private capital. This may affect the level of market concentration, especially in small markets, therefore the issues of market conduct and barriers to entry require careful consideration.

Step 5: Identify those in the Supra-market group

The final step is to identify the group of current non-users who for reasons other than choice are beyond the medium term reach of market solutions. This group of consumers are to be found in what is termed the 'supra-market group'. This group includes in most cases the poor with very low or no cash income.

This group are to be found between the future access frontier and the natural limit of the market. The 'supra-market group' is shown as a shaded box in Figure 3d below (i.e. those between U_{max} and U_{a2} who will not be within the expected frontier at T2). In one sense, this group is the residual, after undertaking the steps above. However, it is worth checking carefully on the characteristics of the people in the group. They are beyond the reach of market solutions in the medium term, and it is on their behalf that the state may choose to intervene in various ways, discussed in Section 4, to accelerate or promote access. This necessarily involves redistributive approaches, since markets cannot sustain provision to consumers without income.

Figure 3d: The supra-market group



From the above analysis, it is clear that the following information is required about the market in question in order to perform the detailed analysis:

1. Total potential market size (in number of individuals or households)
2. Current % usage level (and the recent trend)
3. Current product features, and likely product developments in the next 3-5 years
4. A profile of current non-users, including reasons for non-usage, sufficient to distinguish:
 - a. Those who choose not to use a product even though they are able to;
 - b. Those who would use the product but are denied access by certain product features (such as where it is available, documentation required, its cost, etc)
 - c. Those who would use the product but are denied access primarily because of their income.

Typically, the information in 1 above would come from national census statistics; while 2 and 3 can be obtained to some extent from interviews with market providers. Note that overlapping of consumers means that the simple aggregation of providers' client bases is often not an accurate estimate of usage.

However, the information in 4 above (profile of non-users) requires access to accurate survey data of non-users. In the absence of such data, estimates could be made based on industry discussions and projections, taking into account historic usage trends.

4. APPLYING THE ACCESS FRONTIER: A CASE STUDY

To illustrate the use of the approach as an analysis tool, the methodology will now be applied in detail to the market for transaction bank accounts in South Africa.

The market for transaction bank accounts is susceptible to this approach because:

- There are wider individual and social benefits to be derived from higher levels of 'banked-ness' in a society, hence an incentive to develop public policy to accelerate this i.e. it is considered a merit good; and
- In most countries, and certainly in South Africa, private banks play an important role in delivering this product.

☐ In addition, as the result of recent large scale surveys, there is now sufficient data on usage and non-usage patterns in this market in South Africa to enable more detailed analysis.

A brief example from another market, cell phones, follows at the end.

4.1 Market definition

The market in question is defined as bank accounts from which it is possible to transact on a regular basis. This would include particular account types such as checking accounts, transmission accounts and card-based savings accounts. In some cases, what is called a savings account may also be used as a transaction account: the test is the frequency with which the user accesses the account, where any access on a monthly or more frequency would qualify as a transaction account.

Market definition here may be complicated by confusing product functionality with the delivery channel (e.g. it can be used at an ATM etc).

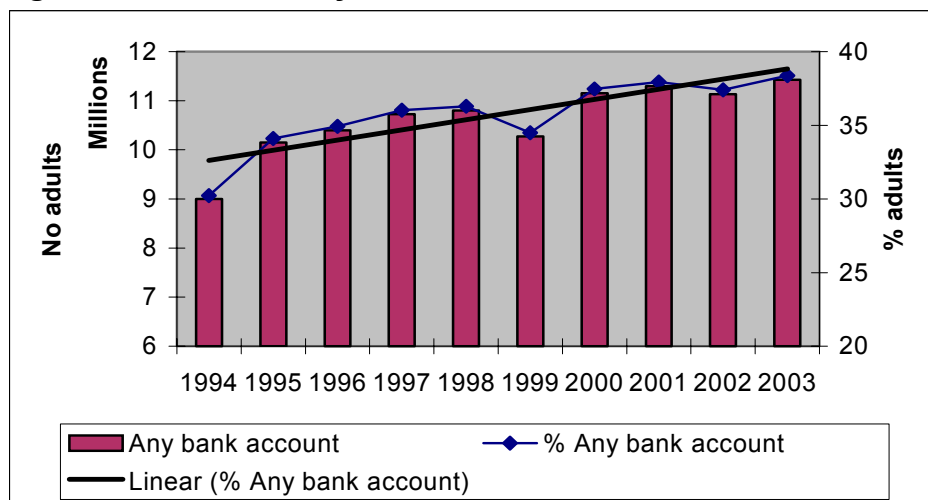
The market is defined as adults 16 years and older, since South African law allows a person 16 years or older to open an account in his or her own name. Prior to that age, the child must be assisted by a legal guardian, hence is not an independent user.

4.2 Determining usage

Fortunately, there is some long run trend data on the percentage of adults in South Africa with any type of bank account. This has been generated by the large scale annual or bi-annual All Media Product Survey (AMPS) which has been undertaken in the country for twenty years or more. Figure 3 below shows the AMPS data since 1994 both in absolute (RHS) and percentage (LHS) terms.

The overall trend is quite clear: usage has increased from around 30% to around 40% of the population. However, the trend in the period 2000-2004 is no longer clear. This cross checks with data obtained from banks about new account openings during this period.

Figure 3: Users of 'any bank account' 1994-2003



Source: Porteous & Hazelhurst (2004)

While AMPS surveys help to provide historical trajectory, they are not focussed on financial services, and did not probe reasons for non-usage of any financial service.

The national financial services survey, FinScope (see Box 3 below), reported that 46% of adult South Africans (16 years and over) had a bank account in 2004—whether for savings or transaction purposes. This result confirmed the finding of the previous year, which gives a greater measure of confidence about the starting point. It is also confirmed by industry observations that no major growth in accounts had been experienced by banks between 2003 and 2004.

Box 3: FinScope Surveys in South Africa

FinScope is the national household survey of financial service needs and usage, developed by FinMark Trust. Following a pilot of 1 000 households in urban areas in 2002, the first national level survey took place in mid 2003, and was repeated using substantially the same questionnaire in 2004. A sample of 3000 households was interviewed using a sample frame of 600 enumerator areas, drawn from the Census 2001 sample frame. Weights are applied to survey results to generate national figures. As an example of precision for the sample size, where half of respondents responded to a question, the true result will be +/- 1.8% of the given answer, at a 95% confidence level.

FinScope is funded by a syndicate of institutions, currently coordinated and underwritten by FinMark Trust. FinScope is to become an annual benchmark survey. More information, including the questionnaires used in 2003 and 2004, is available via www.finscope.co.za.

4.3 Locate the current access frontier

Using FinScope data, it is possible to segment the current non-users of banking in order to assess the current and future possible access frontier. FinScope segments the adult population into three main groups:

- Currently banked: 13m (48%)
- Previously banked: 3.6m (13%)
- Never banked: 10.5m (39%)

The last two groups, comprising 14.1m people or 52% of the adult population, together make up the unbanked. However, those who were previously banked are clearly in a different position of access with respect to the banking system: they know its products, have used them, but for reasons, mainly connected to loss of regular employment, have abandoned their accounts.

In the FinScope survey, unbanked respondents are asked to select the reasons for being unbanked from a precoded list (including don't know and other). These reasons are listed in Table 1 below, where they have been grouped into four main categories relevant to the assessment of the access frontier. The results are shown for the most recent year (2004), but the prior year results indicate stability in the rank ordering and general magnitude of findings.

Table 1: Reasons for SA individuals not having a bank account

% of individuals; reasons given are as stated in the survey but grouped by the author

	RSA 2004
A. Income reasons	78
I don't have a regular income	40
I don't have a job	63
I earn too little to make it worthwhile	6
I don't have money to save	20
B. Access related	13
I don't have an identity document/ basic docs	3
I don't qualify to open an account	7
You have to keep a minimum balance	0.5
I don't know how to open an account	1.5
I don't want to pay service fees	0.5
Bank charges are too high	1.5
The bank is too far from where I live	2.7
It's expensive to have a bank account	3.7
They don't speak my language	0.2
C. Choice	9
I don't need a bank account	5
I prefer dealing in cash	4.6
I don't trust banks	1
D. Other	3

Source: SA: FinScope 2004, Q.3a

Note that category heading % are not aggregates of the underlying %; overlap within the group was eliminated since multiple selections were allowed.

The table above segments the unbanked into the following basic categories:

- **Unbanked by choice (9%)**: where the reasons stated reflect a choice made by the individual which is probably invariant to income or changes in the product.
- **Unbanked because of lack of access (13%)**: people who can generally afford to access an account (although they may complain about high costs) but are not able to do so because of reasons such as lack of required documentation, not knowing how to, being too far from a bank, etc. Product requirements and policies will most affect this group.

- **Unbanked due to income reasons (78%):** those who indicate that they do not have a regular income or job, or who say they earn too little to save or have an account.

For contrast, Porteous (2004) gives the results from somewhat similar surveys undertaken by the Federal Reserve Board in the US. Caskey et al (2004) include the results of a recent survey of people in Mexico City only. These other surveys lend credence to the FinScope observation above that income is the biggest single constraint on being banked in the middle income countries such as SA and Mexico; while the choice not to bank is a larger factor in the US (stated by 27% of the unbanked there).

The above analysis indicates that the natural limit of this market is likely to lie at around 95%, since 1.3m people choose not to use bank accounts for reasons other than income. Note again, that the choice should not be assumed to be invariant to product choice, therefore should be monitored over time.

In order to derive the current and future access frontier, further segmentation of the unbanked is necessary, based on an analysis of current and future potential product offerings.

Until recently, the basic transaction account offered in SA was a debit card-linked account targeted at formally employed people who would receive their wages or salary electronically into the account. In 2003, a majority of basic bank account product offerings required the client to produce a pay slip in order to open a new bank account. This was because the slip indicated the presence of a regular salary flow which can be channelled through the account, making it more profitable in terms of fee income and float for the bank. In general, any formally employed person not constrained by access reasons, including low income, could open a bank account.

Hence, the access frontier until recently would include:

- (i) all formally employed people; and
- (ii) those whose income was above a certain threshold so that they could afford the product offering.

A survey in 2003 using a typical low end monthly transaction profile showed an average monthly cost to run such an account of around US\$5-6⁵. If, as has been argued elsewhere (see FinMark Trust 2003), 2% of household income is proposed as the affordability threshold for a bank account, then the current affordability frontier lies at a household income of US\$250 per month. Using these two parameters, 600 000 currently unbanked people (2.2% of the total population) would fall within the access frontier i.e. the frontier would lie at 48%+2.2%=50.2%.⁶ There was therefore a small gap between usage and the frontier.

⁵ Currency conversions are at rate of 1US\$=6ZAR

⁶ See data appendix at end for detailed sources of these and other numbers from FinScope 2004.

4.4 Changes in the access frontier: 2005 and beyond

The access frontier in this market has recently changed. This is due to the introduction of a new class of basic bank account by the large SA banks in late 2004. The features of the new account class, known as *Mzansi*, are summarized in Box 4 below. The main difference between *Mzansi* accounts and previous bank accounts is that, while the accounts are designed to receive inflows electronically, formal employment is neither required or expected. In fact, the fixed monthly fee and the minimum balance requirement has been waived, producing an account which (i) is cheaper than available offerings since it is entirely pay for service; and (ii) could be maintained at no or low cost, even with somewhat irregular inflows.

Box 4: The *Mzansi* Basic Bank Account

In October 2004, SA's large banks and the state owned Postbank launched a new low end account standard, known as *Mzansi*. This was designed as the 'first order' bank account which meets the basic transaction and savings needs of the low income, who are today largely unbanked.

Mzansi is essentially an account standard, rather than a product, under which each participating bank will make available its own branded low-end product under an umbrella brand known as 'Mzansi'. The core features of the account which have been made public to date include:

- unlimited electronic transfers into the account (but no electronic payments such as debit orders)
- cash withdrawals from any SASWITCH ATM at a fixed fee per transaction, regardless of bank (for first year at least);
- one free monthly cash or cheque deposit
- no monthly fee
- a moderate minimum balance based interest rate structure
- discouragement of large account balances to prevent downward switching of more affluent customers.

As of May 2005, the banks had opened over a million accounts, most from never banked people, a surprisingly rapid take-up which indicated both the extent of latent demand; and the power of a market-based solution.

The early take-off in usage numbers reported in the Box above is encouraging. But how far has *Mzansi* shifted the current and future access frontier for transaction banking?

While *Mzansi* reduces fees for banking, it obviously does not eliminate them: it is priced as a service which banks offer currently at a marginal cost basis but which could with scale become profitable to individual banks. It has been designed to receive one payment or deposit per month free; but electronic payments from the account (for example, to the accounts of creditors or family members) have been restricted, at least for now.

The *Mzansi* proposition therefore encompasses those who are not unbanked by choice, but who receive reasonably regular income from some source—whether employment (informal as well as formal) or from targeted state grants (such as old age pension and child grants), of which some 8 million are currently paid per month in amounts ranging from US\$28-\$130. Applying this segmentation, a further 4.8m people (i.e. 17.8%) now lie within the access frontier; the frontier now lies at 68% of adults, where 95% is the natural limit. Note that, because of state policy to provide grants to some of the poorest, some of these grant recipients now lie within the access frontier.

What of the future? A large number of poorer South Africans do not have any form employment and do not qualify for state grants. They depend on monthly receipts from family and friends to survive. As mentioned above, *Mzansi* today does not cater for this group. However, it is entirely foreseeable that the product standards will change in the next three to five years so as (i) to allow person-to-person payments and (ii) through a combination of technological change, scale and competition among issuers, the prices per transaction will reduce in real terms over time. This will bring this broader group, currently an additional 2.9m people, or 10.7% of the population, into the access frontier. In other words, the future access frontier lies at 78.7%, close to 80% of the population.

The implication of this is that the vast majority of the adult SA population is within the foreseeable reach of market-driven banking.

However, an important caveat is that the profitability of *Mzansi* accounts to issuing banks remains to be seen. If banks do not sustain the *Mzansi* offering in its present or more attractive forms, then the frontier will move back again. Profitability will depend heavily of scale of issuance achieved; and it is likely that two to three banks will emerge as dominant issuers. These will likely include the state-owned Postbank which is currently a major *Mzansi* issuer.

Other banks may well stop issuing *Mzansi* cards since, at small scale, it is unlikely to be profitable. In particular, the role of the state owned bank will have to be carefully observed to avoid crowding out private participation.

In addition to *Mzansi*, there are also other product developments by smaller banks, such as Capitec Bank, and potential new entrants to transaction/ payments markets. These will also have the effect of bringing down the real prices for transactions through competition over the medium term.

4.5 Supramarket group

Even if *Mzansi* raises the future access frontier to almost 80% of the population, there is still a supra-market group of 4.4m people at present, or 16% of the 2004 population. This number can be calculated as: the natural limit (95%) less the future access frontier (79%).

Who are these people, and what should be done about them, since they are unlikely to be served by this market in the medium term?

Further analysis was done on the demographic and income characteristics of people in the SMG, which is shown in Table 2 below, contrasted with the unbanked (of which the SMG people are of course a sub-set) and the banked populations.

Table 2: Relative characteristics of the SMG

% of each column which meets row definition	Finscope			
	Q reference	<u>SMG</u>	<u>Unbanked</u>	<u>Banked</u>
Household income <R1500	61	55.58	55.84	23.14
Personal income <R500	62	88.61	69.40	15.93

Unemployed	22	66.91	49.18	12.58
Rural	41	45.32	41.53	23.60
Single	44	68.55	52.97	37.39
Live in squatter shack	46	19.56	15.68	6.86
Age 16-24 years	39	40.86	30.79	14.03
Head of h/h has bank account	53a	36.71	29.17	27.88

Source: FinScope (2004), questions as noted in table

The analysis clearly shows that people in the SMG are different from others in the unbanked group in that they are more likely to have almost no personal income: 89% report income of R500 or less, even though they often live in households which are not poorer on average than the unbanked group as a whole. Just over a third live in households where the head of household is banked, which is higher than the proportion (29%) for unbanked people as a whole.

The reason for their very low income is their employment status: two thirds report being unemployed (using a very broad definition excluding part time and piece work jobs) versus half for unbanked people as a whole. This lack of income is correlated to age in that a higher proportion are young (41% are 24 years or younger) against 31% for unbanked as a whole.

This analysis suggests that special measures to promote access to bank accounts for this group may be unjustified: only two-thirds live in households where there is no bank account for the household; and a high proportion are still students. When/ if they obtain work of some sort, they are likely to become banked. Even before this, banks in many countries have traditionally targeted tertiary students as desirable future customers to whom they will market and provide loss-leading services in order to gain their future custom. Furthermore, they are also not likely to be difficult to reach: the proportion who live in rural areas or who live in shacks in urban areas is not significantly different from the unbanked population as a whole. In addition, as younger people, they are more likely to be open to new technology which will reduce the cost of bringing them banking services. For example, already a marginally higher proportion of people in this zone have personal use of a cell phone than among the unbanked in general (28% versus 26%).

4.6 Summary

Table 3 below summarizes this application of the access frontier approach to the market for transaction bank accounts for South Africa.

Table 3: Access frontier analysis for transaction banking in SA

	No of adults	%	Cumulative level
1. Current usage (2004)	13m	48%	
2. Previous access frontier (2004)			
• Formally employed with household income < R1500	0.6m	+2.2%	50.2%
3. New access frontier (post-Mzansi)			
• Regular income from formal sources	+5.4m	+17.7%	67.9%
		(on usage)	

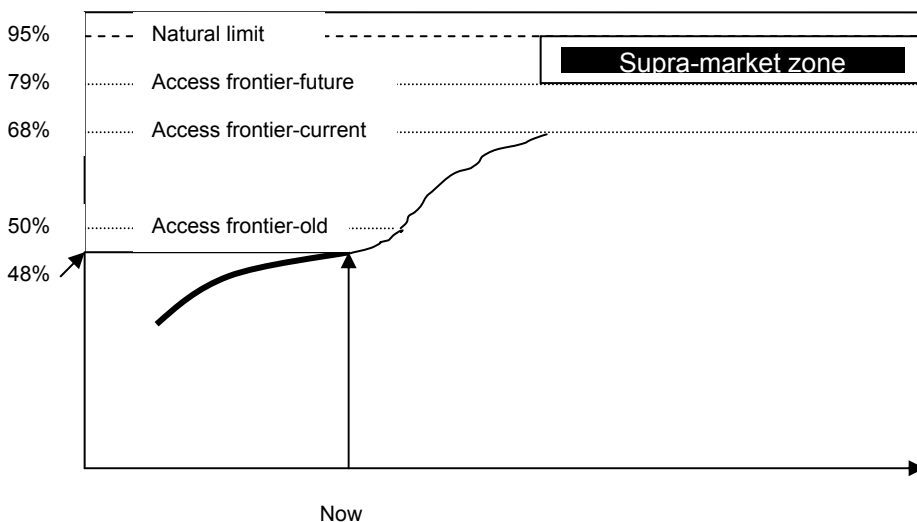
4. Future access frontier			
• Regular income including family and friends	+2.9m	+10.7%	78.6%
5. Supramarket group	+4.4m	16.2%	94.8%
6. Non-users by choice	+1.4m	5.2%	100%
	<u>27.1m</u>	<u>100%</u>	

Source: author's calculations, using FinScope 2004 data. See Annexure A for data sources

This table may be depicted using the graphical tool developed earlier, as in Figure 4 below.

Clearly, the assumptions behind the setting of the new access frontier and future access frontier can be debated; as can the conclusion that the real 'Supramarket group' here justifies no special state measures, at least for now. However, the point of the approach is that it enables rigorous debate, informed by adequate analysis, for this to happen.

Figure 4: Mapping of SA Transaction bank account market



Box 5: The cell phone industry in South Africa

The cell phone industry in SA is an example of a market which has experienced rapid growth: from a zero base in 1993 to some 16 million accounts in 2004, according to industry numbers (some 58% of the number of adults; or 36% of the total population). Many low income countries have seen similar explosive growth rates in cell phone usage.

The market has grown in classic fashion, as predicted by the stylized model: starting with higher income customers and extending downwards over time. In this process, it appears that the role of regulators and regulations in specifically promoting access for poor users to cellular telephony has been relatively small.

What does the access frontier approach add to an understanding of this sector? In the absence of a full analysis such as that undertaken on bank accounts in this section, this box can provide pointers to indicate how the approach in this paper informs understanding of the development of this market too.

All cell networks continue to report rapid growth, although at a somewhat slower rate. Some industry projections estimate that the SA cell market could peak at 24m customers by 2007—this would be close to 60% of the total population. Implicit in this number is an access frontier type analysis of the limits of the current access frontier for cell telephony.

Already, over 90% of the population is located in areas with network coverage, and the number is growing, hence technological constraints are not apparent in this market. In addition, the largest sunk costs of network establishment have largely been incurred and by now, essentially repaid to funders, which makes pricing more flexible. The ultimate frontier level will be determined by the business models of the providers. Conversations with industry executives suggest that limit is defined by the marginal profitability of a customer. From the supply side, this is determined largely by the transaction costs of taking on new customers and the very small fixed cost element in each call. Transactions costs of taking on new customers are largely incurred as commission to agents, which is variable with the nature of the airtime contract. However, there must be a lower limit at which the commission is not worth the effort to the broker involved. The cost of providing service is largely fixed except for a small per user monthly license fee to the technology provider. As long as the network makes more in revenue than this fee, and the distributor makes an absolute amount large enough to warrant each deal, the marginal benefit of signing on new, lower value customers will be positive; and growth of usage will continue in this market.

On the demand side, consumers must be able to purchase a phone and have sufficient income to pay for at least the minimum usage required to avoid dormancy of the account (which is set by network product rules). A growing second hand market is reducing the cost of older phones; and many retailers offer credit for the purchase of new phones, reducing the lumpiness of asset acquisition. If a customer does not own the phone, then she must at least be able to pay per call to access the service.

In the supra-market zone, there have been various state policies, but none has had the effect of crowding out: licensing conditions for cell networks required them to make a minor contribution (maximum US\$3.3m each per annum) to the Universal Access Fund and to roll out certain numbers of community call centres. This target was easily achieved but has had little impact on poor people compared with the numbers of individuals freely signing up. When further bandwidth was licensed to networks in 2003, the regulator set further conditions requiring the distribution of large numbers of free SIM cards. This handout requires an element of cross subsidy from existing customers; however, it is also in the networks' interests to have more active customers, so it may crowd in future consumers by reducing this element of fixed cost to the customer.

The most important regulatory interventions in making this market work have been standard: increasing competition through licensing an entrant (albeit through a much less than ideal process); and requiring number portability at a future date. This has kept the access frontier moving out, although delays and uncertainties in tendering and licensing the third operator may have slowed the process of creating more competition.

More detail on provider costs and pricing models, and on the characteristics of non-users would be required to pin down the future access frontier in this sector. But the inherent product and sector dynamics already suggest that the future access frontier will be at a high level indeed. Other countries such as India are showing similar trajectories.

5. IMPLICATIONS FOR PUBLIC POLICY & PRIVATE STRATEGY

Section Summary

- The access frontier approach enables the identification of three different zones in the market, namely: the zones for market enablement, market development and redistribution.
- Based on where a particular market is in its usage trajectory, different policies will be appropriate to promote greater access and different provider strategies.
- In particular, as the state seeks to accelerate usage of a product for those in the supra-market zone, it is important that these policies do not crowd out the further movement of the access frontier over time.

5.1 Market zones

The access frontier tool is designed to enable more informed discussion about how to promote greater usage of a particular product.

Private producers should develop strategies for selling their products based on the trajectory of the market, not only past experience. Applying the access frontier approach can help producers to understand this trajectory better; as well as how to participate in growing the market as a whole.

For many products produced by the market, the state has no reason to promote their usage—cars, for example. This is left entirely to the market; but state policies will affect the rate at which usage is expanded.

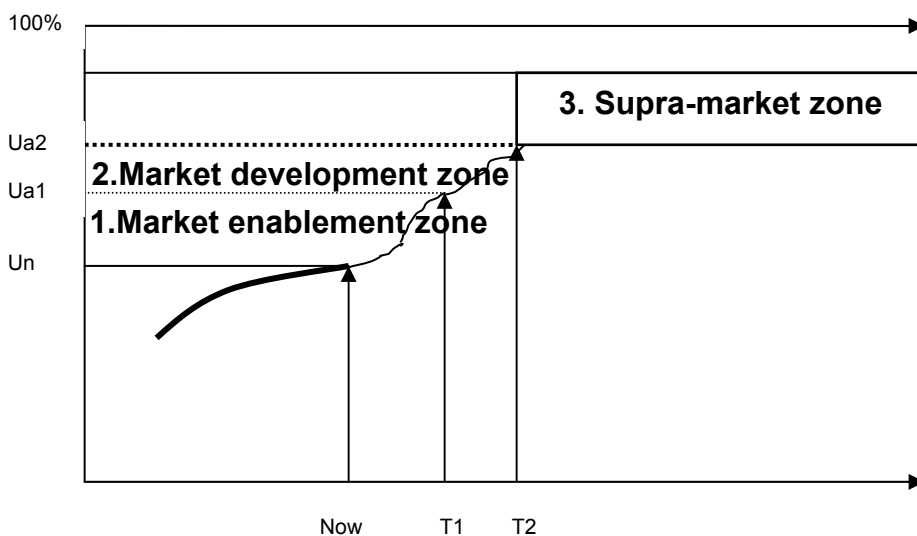
However, in the case of ‘merit goods’, the state may well seek to accelerate and broaden access actively. Telephony and basic bank accounts, featured in this paper, are examples considered by some states to fall into this category. Bank credit to underserved population groups is also sometimes categorized in this way.

Figure 5 below is an extension of the earlier Figure 2 which distinguishes three zones of policy making on the market map:

- Zone 1: *Market enabling policies*: Policies which move usage from current levels up to the current access frontier (U_n to U_{a1}) to close the current usage gap;
- Zone 2: *Market development policies*: Policies which push the access frontier outwards over time to position 2 (U_{a1} to U_{a2}) to extend access;
- Zone 3: *Market redistributive policies*: Policies for serving those unable to participate now or in the foreseeable future in the market (U_{a2} to U_{max}) due to lack of income.

In each of these zones, a different approach to ‘making markets work’ may be required. Some possible approaches are described in the section which follows to illustrate the distinction between the zones.

Figure 5: Market Policy Zones



5.2 Market enabling & market development policies

In zones 1 & 2, market enabling and market development policies may be pursued as a way to close the usage gap and push out the access frontier.

Much has been written about market enablement, ranging from the early World Bank work on housing markets (1994) to the most recent work by Prahalad (2004). Enabling policies typically include correcting dysfunction and removing regulatory barriers. More generally, this can be summarized as what Prahalad aptly calls ‘transaction governance capacity’ or TGC of a country. TGC is necessary for the provision of the basic requirements of a market economy: property right definition and contract enforcement. These requirements may be present *de iure* but not *de facto*. The improvement of TGC would also address the ‘dead capital’ problem which Hernando de Soto (2000) has identified by clarifying and providing clear title.

Enabling policies such as these are certainly necessary for the development of healthy markets, but may not be sufficient.

Certain policies can be either enabling or developing, depending on which ‘zone’ a market is in. For example, appropriate competitive conditions are generally a necessary condition for market enablement and development, but the nature of competitive policy to achieve this will differ, depending on the stage of market development. For a market below its access frontier, competition policy would seek to address anti-competitive conditions, such as price tying and collusion, which stunt the market. For a market at or near its current access frontier, competition policy

should actually encourage new entry, or at least, the threat of entry, in order to galvanize the innovation which will reduce cost structures, and consequently push out the natural limit over time.

In any market, a careful review of competitive policy and its implementation is required in order to assess whether competition levels are adequate. This may be complex and time consuming: for example, the Cruickshank Report⁷ took considerable time and resources to assemble and consider the evidence in order to reach a finding that there was evidence of complex monopoly in the UK payments system.

5.3 Market redistributive policies

The state can employ various redistributive techniques to accelerate the usage of a particular service beyond the trajectory of the access frontier into the supra-market zone. Traditional options include:

1. *provide the service directly* through a parastatal bank or government agency (such as the Postbank, a major *Mzansi* issuer)
2. *pay others* to provide the service (such as the payment to bank-linked agencies in South Africa to distribute social transfers to the poor, and even the newer plan to pay banks to open basic bank accounts)⁸
3. *transfer to consumers* the specific means to buy the service, such as through social grants or vouchers (an example is where the state provides an initial blocked deposit into a newly opened savings account, as for newborn children in the UK) or
4. *require by law or regulation that existing providers cross subsidize* the extension of the service (such as directed credit in its full blown form, or service and investment targets in its more subtle Community Reinvestment Act format in the USA).

Of these four strategies, the first and last have been most commonly used for banking the unbanked in developed (DFID 2004b) and developing countries. Targeted social grants (No 3 above) are also increasingly common in middle income developing countries, as a means of redistributing spending power towards defined categories of people. As a result of such policies, people may be moved out of the supramarket zone, since they now have the means to participate in the market.

Whichever strategy is chosen for this group, the approach of this paper posits the question: what will it do to the movement of the access frontier over time? For example, the policy of providing services directly at a deeply subsidized rate by a state bank may 'freeze' the access frontier since no private player can compete to provide service beyond a certain point. Equally, an enforced cross-subsidy requirement could lead to market fragmentation, and could have the effect of deterring new entry, and therefore innovation at the bottom end of the market.

⁷ See full report *Competition in UK Banking: A Report to the Chancellor of the Exchequer*, available via www.hm-treasury.gov.uk/documents

⁸ For more information, see Porteous & Hazelhurst (2004: 50-52): "Social grant payments: it's easy now"

The key insight which the access frontier approach brings to the debate over state policies towards the market is this. The test of state intervention in the supra-market zone is the effect it has on the present and future movement of the access frontier. If the action of the state effectively crowds out private provision for all time, then the access frontier becomes a ceiling; and that market cannot work further for the poor. The state has effectively locked itself into the long term fiscal burden of provision. But if the state intervention can meet the needs of the very poor while maintaining the incentive for private firms to push the access frontier, then the state is designing its own exit strategy and limiting its fiscal liability. Indeed, state actions such as targeted social grants may place people who otherwise would have been in the SMG within the access frontier.

For private firms, understanding the state's approach to the supra-market zone will inform perspectives on the limits of the market, and on the long term product development strategies necessary.

There is a fifth strategy however, which is really a derivative of the fourth above: even if they do not regulate or incentivize access directly, governments can exercise moral suasion on financial institutions. This may lead to a voluntary commitment by private financial institutions to offer a service in this area: for example, the UK's basic bank account (BBA) offered by the high street banks to unbanked people. The voluntary nature of such commitments makes them more flexible and less onerous, but also often less effective. This is partly because the responsibility for delivery often rests with an industry body which itself cannot 'deliver' accounts; and the incentives of individual banks which can open accounts are not aligned with their other priorities. However, the state retains the right to regulate if this does not work, as in the case of Belgium (DFID 2004b).

This is also the state strategy towards the Financial Sector Charter in SA, which is a voluntary commitment driven by the private sector. Charter performance ratings are linked to receiving or losing government business in future. This framework has led to the development of the *Mzansi* account, discussed earlier, which has pushed out the current access frontier in South Africa to some 70% of the adult population. However, the role of the Postbank as a state-owned *Mzansi* issuer will have to be assessed over time to ensure that this strategy does not crowd out others; and restrict the movement of the frontier over time.

6. CONCLUSION

This paper has sought to demonstrate that the access frontier approach can be a useful tool of analysis both for policy makers who seek to expand access to a product; and for private providers, who seek to understand and grow their market share.

Even without all the required data, the approach may be used as a high level process of developing understanding of both the potential and limitations of market-based solutions to the provision of socially desirable goods and services.

The full access frontier approach as demonstrated in this paper does require the investment of time and money. Large scale households surveys to establish usage levels and reasons for non-usage are expensive and time consuming to plan, execute and analyse. However, this type of information is vital to have before important policy decisions can be made. Furthermore, such data is likely to be of wider use to policy makers as well as private participants in a market. In this way, there may well be positive spin offs from the full process.

The process involved in identifying the current and future access frontiers can be useful in and of itself. It requires policy makers, providers and client representatives to be actively engaged in a policy dialogue which should clarify their assumptions and create a shared vision of market processes. Agreed (rather than unilateral) policy measures may result. Implemented properly, the access frontier approach should increase the probability that the market in question can indeed be made to work better for the poor.

Several different markets—from insurance to business development services—have been suggested as amenable to this type of analysis. This paper can serve as a primer for such undertakings. As the approach is applied, so the tool can be refined and extended over time.

ANNEX A: DATA ANNEX

	Number/ % of adults	Definition/ Filter used	FinScope Question reference
1. Current usage (2004)	13m/46%	None	Q2a
2. Previous access frontier (2004)		Unbanked (previously + never banked) excluding not by choice factors	Choice factors: 3a Employment status: Q22 Household Income: Q61
<ul style="list-style-type: none"> Formally employed with household income > R1500 	0.6m/2.2%		
3. New access frontier (post-Mzansi)	+4.8m/17.7%	Unbanked receiving income at least monthly from employment (incl full, part time, self), or from state (pension, child grant, UIF, workman's compensation etc)	Regularity of income & sources: Q23
<ul style="list-style-type: none"> Regular income from formal sources 			
4. Future access frontier		As for 3 above, but broadened to include those who receive some money at least monthly from family and friends	Q23.16
<ul style="list-style-type: none"> Regular income including family and friends 	+2.9m/10.7%		
5. Supramarket group	+4.4m/16.2%	Residual of 100%-sum(1:4 & 6) Analysed as: Unbanked not by choice, not receiving monthly income from employment, govt or F&F	
6. Non-users by choice	+1.4m/5.2%	Unbanked, to whom choice factors: I don't need a bank account I don't trust banks I prefer dealing in cash	Q3a
	<u>27.1m/100%</u>		

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