E-banking Challenges and Opportunities

In most developed economies, consumers take for granted the ability to engage in banking transactions performed electronically, such as transferring money between accounts or checking balances by telephone or online, and paying for goods and services using credit and debit cards. In Palestine, however, the ability to securely use plastic rather than cash to safely and conveniently buy everything from groceries to airline tickets is far from the norm.

Why does it matter? Globally, electronic banking (E-banking) has been found to facilitate economic growth by expanding financial intermediation, transactions, and financial inclusion, by diminishing reliance on external suppliers of cash, and by reducing the size of the informal economy. It benefits banks by increasing the number and revenue from transactions while reducing costs. Transactions for merchants are also increased, as are the opportunities to earn revenues as sales agents for other services. Finally, the customers enjoy the benefit of increased convenience and access to credit.

ESAF seeks to leverage E-banking technologies in order to reduce the costs of transactions to both bank and consumer, and to expand the outreach of financial services to Palestine’s under- and un-banked populations. Recognizing the need for improved E-banking services but with the industry lacking a clear path forward, the ESAF project sponsored two research projects in early 2011. The first analyzed the current electronic banking infrastructure in Palestine and recommended a technological roadmap to improving it. The second paper addressed the demand side, specifically the reluctance of consumers and merchants to replace cash with debit or credit cards. ESAF hopes to build a more cost-effective system with wider market outreach, through research and advocacy.

Key Constraints

In Palestine, cash remains by far the most favored vehicle for savings and purchases. Although access to bank accounts is widespread, a variety of technological, regulatory, cultural, and political barriers impede the growth of E-banking:

1. Palestine’s legal framework for E-banking is uncertain on issues such as the regulation of electronic signatures and ensuring the finality of electronic payments. That discourages banks from expanding electronic payment initiatives.

2. Banks’ ATM and Point of Service (POS) services are generally not interoperable. That leads to increased infrastructure costs for banks—as each builds its own networks—and reduced convenience to consumers, who will either find their ATM card rejected at other banks’ ATMs or pay a high fee to make withdrawals. The lack of a national “switch” to process interbank transfers, which currently can only be processed through international networks (Visa and MasterCard), makes such transactions costly. A national switch would cut costs by clearing transactions between banks locally, while operating the gateway to the international networks.
3. A single bank has a monopoly on clearing transactions through the international VISA network.
4. Though a public credit registry has been developed, there remains insufficient information on the creditworthiness of potential customers.
5. A “culture of cash” is deeply entrenched, and merchants and consumers prefer cash to electronic payments, either because of inexperience, religious objections, or cost. Experience from other contexts shows that changing behavior will be a challenging, long-term process.
6. Political instability discourages banks from investing in new technology and banking outlets.

Each of the above barriers in and of themselves appears daunting. Some, such as political risk, are external and cannot be addressed by the financial sector. Other internal challenges cannot be tackled at the present time. For example, new laws are needed to create a sound regulatory and legal infrastructure for E-banking, however, they are unlikely to be passed so long as the Palestinian Legislative Council remains inactive.

Next Steps

In light of such challenges, ESAF recommends a focused package of near-term interventions focused on issues the Palestinian Monetary Authority (PMA) and industry stakeholders have control over, and which can yield “quick wins” in order to spur further reform. ESAF has already succeeded in generating strong buy-in, although sustained attention to the issue is needed. In particular, ShoreBank International (SBI) consultants have been working closely with the PMA in an advocacy role. At the PMA’s retreat in February 2011, SBI Strategic Partner Jenny Hoffman, a specialist on branchless banking, mobile banking and financial services for low income customers, presented the research findings, as well as the following recommendations of actions that can be taken in the short term:

1. **Conduct a feasibility study for the creation of a Banking Service Company (BSC), to enable the development of a national switch.** There is strong industry support for sharing infrastructure to create an interoperable payments system. Because the market is relatively small, it is not cost-effective for each bank to develop its own POS and ATM infrastructure. A BSC would allow banks to share infrastructure costs and would be funded by banks using the switch. A successful BSC may also serve as the first step to offering mobile or agent banking services that could significantly advance access to financial services. At the PMA’s request, SBI is proceeding with the feasibility study.

2. **Develop new E-banking and agent banking instructions, opening the door to agent banking services.** In the short term, instructions from the PMA could permit banks to engage money changers as a delivery channel for banking services including real-time deposits and withdrawals, domestic and international money transfers, and bill payments. The instruction should also allow banks to develop pilot projects with other merchants to offer a more limited number of banking services, including acceptance of deposits. Over the longer term, mobile phone operators should be permitted to play a role in agent banking, either as a delivery channel or through a joint venture with a bank.

3. **Form an industry steering group for electronic payments, owned and staffed by the risk-carrying suppliers of the industry and chaired by the PMA.** In other countries, the extent of success of these steering groups has often depended on the level of ownership felt by the suppliers in the industry.

4. **Address limitations to information on creditworthiness.** Although the establishment of a national credit bureau has already begun to reap dividends, many individuals and organizations—particularly MSEs—have little or no credit history. Including data on payment of other obligations such as utility and telecommunications bills would help to include many of these currently-excluded to access credit.

Conclusion

Given Palestinians’ widespread access to bank accounts and the remaining high level of unsatisfied demand for financial services, there is high potential demand for E-Banking services. Against this background, ESAF is helping build a vision and action plan for the future of electronic banking in Palestine. Financial inclusion drives economic growth. ESAF and SBI believe that the use of new technologies will enhance the financial sector’s contribution to poverty reduction in Palestine.