

The new face of the underbanked—Your next generation of customers?

By George Hodges, Managing Director, New Market Partners

There is a paradigm shift occurring in the financial services industry. Perceptions of the underbanked are changing. In the old paradigm, underbanked meant “underserved” and included a narrow focus on low-income communities and less profitable regulatory compliance-driven initiatives. The new paradigm sees the underbanked as a large, growing mainstream segment of the population who are essentially “opting out” of the traditional banking model and shifting their basic financial transactions to alternative financial services (AFS) providers.

Who are these underbanked people? According to the FDIC, and earlier research completed by the Center for Financial Services Innovation (CFSI), 23% of households with bank accounts meet the underbanked definition and do most of their basic financial services transactions with alternative providers. The demographic profile of these AFS users certainly includes people with lower incomes, and traditionally underserved profiles such as single parent households, African Americans and Hispanics. But this segment also includes young people who do not fall within any of these underserved categories. What makes them underbanked is their behavior. The traditionally underserved and the new mainstream underbanked have different motivations, but demonstrate similar behavior in regard to financial services.

Driving this new paradigm of how to serve the underbanked is a combination of government regulation, new competition, product innovation and changes in consumer purchase behavior.

New regulation - Reg. E and new fee based accounts

At a recent industry conference, a senior retail banking executive observed, “When your customer value proposition is FREE, any fees you charge are viewed as punitive by the customer.” If free checking is offered to every customer, it is difficult to explain a customer value proposition that is based on paying fees for every transaction. In non-bank retailers, however, the model is fee per transaction using an a la carte model. The retail value proposition is transparency and risk avoidance. All fees are clearly disclosed and attached to completing a transaction.

As banks and credit unions shift to basic checking accounts with monthly fees ranging from \$8-\$10, the underbanked customer who does not maintain a high enough balance to avoid the fees becomes further alienated. Typical criteria for avoiding the new monthly fee model include direct deposit, maintaining an average balance of \$750 or more, or using online bill pay. The underbanked consumer usually does not meet one or more of these criteria. So, if my bank is now charging me \$10 for my “free” checking account, paying \$4.95 a month for a prepaid debit card starts to look like a more affordable option.

New fee based behavior – the pay-as-you-go model

A typical underbanked consumer spends up to \$77 per month in fees for AFS transactions, including check cashing, money orders, remittances, walk-in bill payment, and reloadable prepaid debit cards. They pay these fees one transaction at a time, a few dollars at a time. Transparency and immediate value is the key, versus more complicated bundled pricing or discounts. It’s the equivalent of buying songs and apps on the internet for \$.99 each, versus the old paradigm of buying a whole CD or record for \$17.95. Today’s underbanked consumer is comfortable with the fee per transaction model that retailers offer.

New competition – The Wal-Mart Money Center and other major retailers

Want proof that the underbanked is now a mainstream market? Look no further than the nation's largest retailer, Wal-Mart. Wal-Mart launched the Wal-Mart Money Center in 2005. They moved financial transactions out of the customer service desk into a separately staffed kiosk in the middle of the store. The Wal-Mart Money Center offers the same AFS product set found in traditional check cashing stores—payroll check cashing, walk-in bill payment, money transfer, money orders and prepaid debit cards. Wal-Mart has rolled out the Money Center in more than 1,500 stores across the country. So goes Wal-Mart, so go other major retailers. Within the last 12 months, Kroger, Sears/K-Mart, Circle K, Rite Aid, and Target have all announced programs that offer a similar AFS product offering in their stores following the Wal-Mart Money Center model.

Why is this important? Prior to Wal-Mart and other retailers entering the financial services space, the only place for underbanked people to purchase AFS products were professional check cashing stores, gas stations, liquor stores or payday lenders. Some people do not feel comfortable purchasing financial services in these venues because of the social stigma attached to check cashers and payday lenders. On the other hand, just about everyone feels comfortable shopping at a national retailer.

New technology - the “just in time” mobile generation

Anyone with a teenager or college-age child knows that the two things they have in their pocket are their cell phone and some type of plastic. Young adults today do not carry checkbooks, or use instruction manuals. They expect technology to perform intuitively, without formal training required. People under the age of 30 expect to be able to turn something on and figure it out. Need help? Google it. How does this translate into financial services behavior and the underbanked?

Compare a first-time visit to a bank or credit union branch with a visit to a Wal-Mart Money Center. To

become a bank customer and gain access to financial services, you must go through an account opening process that can take 15-45 minutes. You're required to complete multiple forms, sign a signature card, and listen to detailed explanations about how to avoid overdrafts by carefully recording each transaction in a check register and being aware of deposit holds and pending transactions. At the end of the account opening process, you leave with the completed paperwork and some starter checks, and you wait at least a week for your debit card to arrive in the mail.

To become a financial services customer at a non-bank retailer, you pull an instant issue card pack off a display rack, hand over the minimum load amount and activation fee, typically about \$25, and walk out with an activated prepaid debit card. You can also cash your check for a fee, send money, pay your bills, and buy money orders. There are no papers to sign, no explanations about balancing your checkbook, and the whole visit takes less than five minutes. If you want your name on your prepaid debit card, you call a toll-free number, give them your SSN or other ID information; within a week, your personalized debit card will arrive in the mail.

Thinking about your 22 year old, which process matches the way they're used to doing things?

What can your financial institution do?

This new generation of financial services users is creating their own definition of what it means to be banked. What is the best response for traditional financial institutions to connect with these “underbanked” people? First, you need to learn more about your existing customers who are turning to alternative financial services providers. Next, you need to consider how to reach out to these current and potential new customers.

To learn more about the new face of the underbanked and how your financial institution can successfully reach this market segment, contact George Hodges directly at 678.449.6278 or visit New Market Partners website at www.newmarketusa.com.