BETTER THAN CASH ALLIANCE | Empowering People Through Electronic Payments

Philippines Diagnostic

HIGHLIGHTS

July 9, 2015

Lessons from the Philippines' Journey to Digital Payments

By James Hokans, Bankable Frontier Associates[1]

The Philippines is in the initial stages of its transition to digital payments, with the Government leading the way and a high level of mobile penetration on which policymakers can build. However, beyond government-initiated payments, the Philippines economy remains heavily cash and paper-dependent. There is a clear need to develop a stronger digital payments ecosystem to build the confidence, momentum, and infrastructure needed to support the next stage of the Philippines' transition to digital payments and greater financial inclusion.[2] This diagnostic highlights initial lessons from the Philippines' experience including factors that have supported or hindered progress.

The Philippines Government has made significant progress towards digitizing its own payments, with 54% of all government-initiated payments now digital (16 million transactions per month), including intra-government payments and government-to-person transfers. A key catalyst for this progress has been the "No Corruption, No Poverty" campaign, launched by President Aquino in 2010 to drive growth, accountability, and transparency. However, the lack of clear legislation and authority to regulate the national payments system continues to cause challenges for the Philippines. There is a need to establish a comprehensive strategy among key government and payment industry stakeholders in order to advance the use of digital payments.

The volume of payments made by the Government is dwarfed by personal and business payments which are overwhelmingly made by cash or check. In fact, of the approximately 2.5 billion payments each month, only 1% by volume are currently digital.
This figure is higher by value, around 7%, largely because some large businesses pay taxes electronically, however very few individuals pay taxes by electronic means.

1 Research and survey support was provided by Wajiha Ahmed, Laura Cojocaru, and Johann Bezuidenhoudt from Bankable Frontier Associates, as well as Jay Sandoval from Social Weather Stations and consultants Jing Gusto and Jun Perez.

2 After this study was conducted, the Philippines issued a National Strategy for Financial Inclusion in July 2015, which addresses many of the challenges detailed in this report. This can be reviewed here: http://www.bsp.gov.ph/downloads/publications/2015/PhilippinesNSFIBooklet.pdf

Major banks increasingly offer e-banking facilities, however fees for e-services are comparatively high and banks primarily prefer to offer and promote low-cost checking facilities for businesses and individuals. Digital transfers tend to focus on intra-bank transfers between client companies and their suppliers and employees. Employees who have bank accounts often withdraw their salaries in cash through ATMs, increasing cash-churn in the economy and severely limiting digital payments at the point of sale or online.

To support progress, this diagnostic identified a clear need for the Philippines to develop a comprehensive digital payments strategy drawing together the perspectives of government, business, and key players in the payments industry specifically.

To implement this strategy, a clear legislative framework is also needed so that digital payments can be effectively regulated, attracting investment and building further confidence and inclusion in the digital economy.

Overview of the Philippines Payments Landscape

The Philippines population of 105.7 million in 2012 already has very high levels of digital and mobile penetration, providing a strong base for boosting digital payments. There is already more than one mobile device per household, with Manila known as the "texting capital of the world", and the Philippines having the world's 8th largest Facebook user base. In addition, over 12 million overseas foreign workers use the internet to stay in contact with family and send money home.

However, the Philippines also suffers from low levels of financial inclusion, linked to a vast informal sector comprising nearly 35% of the national economy. This informal sector is dominated by small businesses such as multi-purpose "sari sari" stores and local food markets where customers and owners transact almost exclusively in cash. Fewer than 3 in 10 individuals living in the Philippines have bank accounts, and only half of those account-holders have debit or credit cards, according to the 2011 World Bank Global Findex Database.

Against this backdrop, the Philippine Government has been working to boost digital payments, with key milestones set out along with key private sector initiatives, in the timeline on next page.

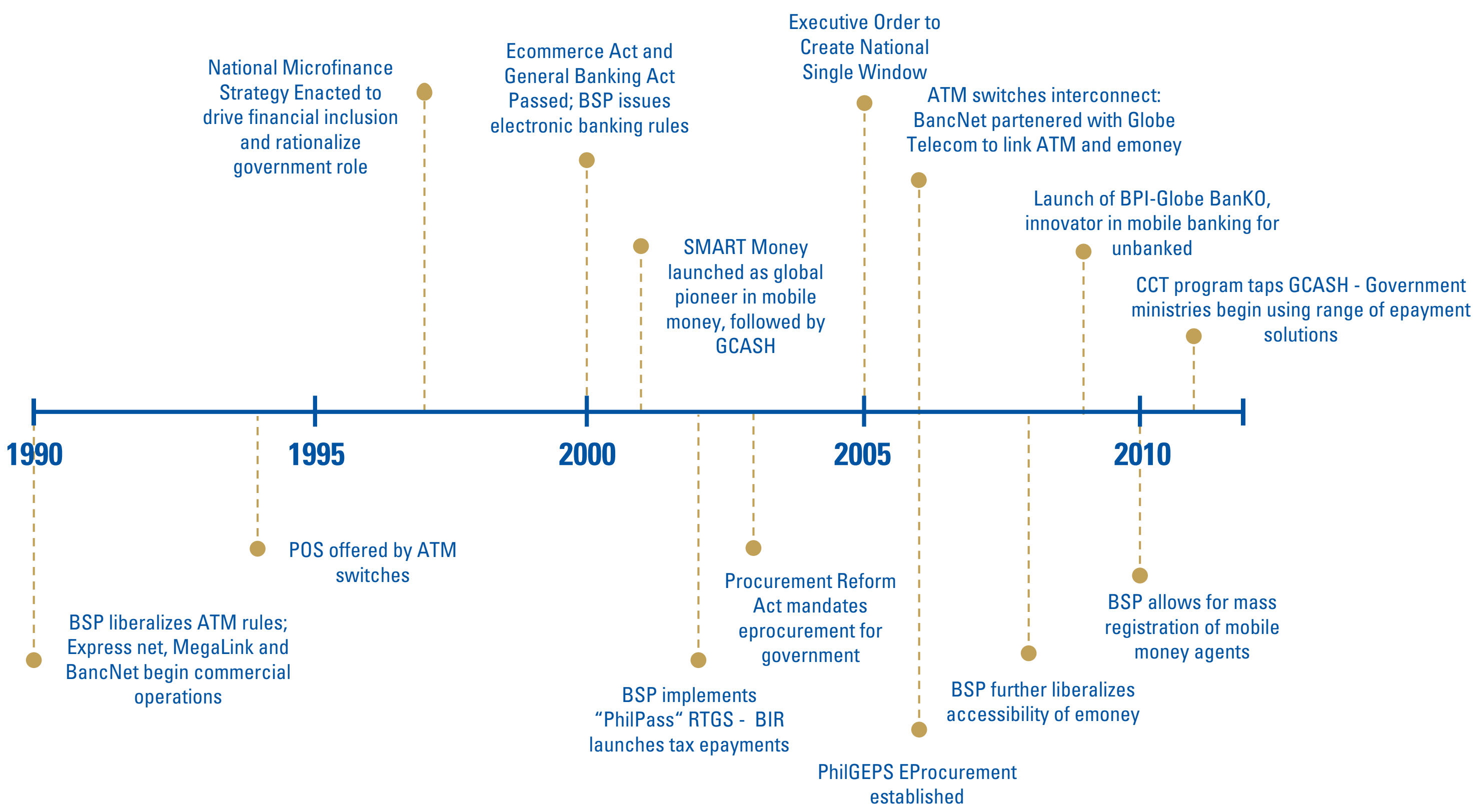
Along with boosting transparency, shifting to digital payments is seen as vital to improving the efficiency and impact of government payments by reducing operational costs. In this respect, the Philippine Government is making good progress in digitizing social welfare payments, which is itself supporting greater financial inclusion, as recipients are required to open bank or mobile money accounts as a first step. This in turn is building broader confidence in digital payments. The Government expects greater financial inclusion achieved through these means will in turn spur private sector growth and diversification, in turn broadening the Philippines' revenue base.

TABLE 1 Payments by payer in the Philippines

Payer	No. of payments/ month million	% volume electronic	Total value PHP million	Total value US$ million[3]
Government	17	54%	236,436	$5,666
Business	603	1%	2,546,647	$61,120
Individuals	1,914	0.3%	311,605	$7,479
Dev. partners	6	59%	368	$9
Total per month	$2,539	1.03%	3,095,056	$74,273
Total per year	**$30,474**	**1.03%**	**37,140,670**	**$891,279**

3 Average 2012 conversion rate used throughout the report: 1 PHP = 0.024 USD.

TIMELINE Payments System Milestones



The Philippines' central bank – the Bangko Sentral ng Pilipinas (BSP) – has also championed digital payments as a key means of boosting financial inclusion. The BSP has been vocal in explaining the benefits of digital payments, and providing technical expertise and support to specific initiatives like Smart Money – a mobile banking partnership with a major bank, accessible either via mobile phone or a reloadable MasterCard-branded ATM card.

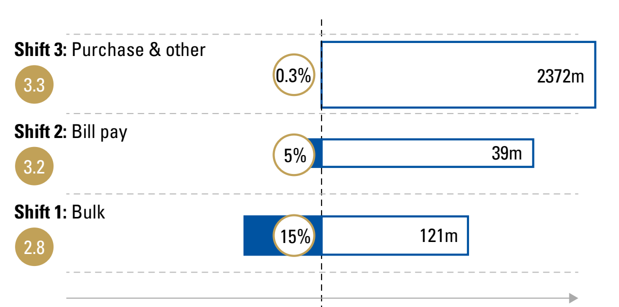
The status of digital payments: The Government is leading by example, but broader progress is very limited

Three typical phases in the shift away from cash have been documented by the Better Than Cash Alliance in a variety of country contexts:

1. Bulk Payments
2. Bill and Tax Payments
3. Purchase & Other. Figure 1 shows the trajectory of these three shifts.

The Philippines is showing clear progress in digitizing bulk payments, with the Government leading the way by converting over half its outgoing payments to digital. However, in relation to the other two key shifts – bill and tax payments, and purchase and other – progress is very limited, with payments still overwhelmingly paper-based, although there are pockets of digitization that are providing some modest momentum.

FIGURE 1 Trajectories of the Shift to Electronic Payments



Legend: 2.5 is the trajectory score for the use case connected to each shift; where 1=full shift very likely; 3=slow upward progress; 5=shift unlikely.

Note: 38% is % of total number of monthly payments in each shift (shown at end of bar) which are electronic as in 2012.

1. Bulk Payments: Clear progress and momentum, with the Government leading the ways

Bulk payments refer to the disbursement of funds from one entity to multiple individuals or firms through a single payment transaction (one-to-many). Some examples are:

- Disbursement of resources from federal government to state and municipal-level governments (G2G)
- Salary payments (G2P, B2P)
- Conditional cash transfers, or other social programmes and subsidies (G2P)
- Supplier payments (B2P, G2B)

This shift is clearly underway in the Philippines led by government-initiated payments which are now 54% digital. However, even with this strong leadership from the Government, less than one-fifth of possible payments in this category were digital at the time of research. More encouragingly, the trajectory score of 2.8 in figure 1 above – setting out the likelihood of a full shift to digital payment – suggests positive momentum in this category.

In relation to bulk payments, further progress – particularly in the private sector – will depend on a clear legislative framework being implemented. In particular, the Philippines currently lacks common standards and rules for digital payments to provide certainty to stakeholders and underpin investment in digital infrastructure. In addition, many large businesses do not yet appreciate the benefits of making inter-bank bulk payments to employees.

2. Bill and Tax Payments: Little progress so far, although large businesses making tax e-payments are providing some modest momentum

Remote bill payments occur when the government or a business issues invoices to a large number of recipients. Examples of this include:

- Collection of taxes (P2G, B2G)
- Utility payments (P2B, B2B, D2B, G2B)
- Collection of school fees (P2B)
- Credit card payments (P2B)
- Social security contributions (G2B, P2B, B2B)

Individuals in the Philippines rarely pay taxes digitally and less than 1% of business-initiated payments are digital by volume, although much higher by value (around 7%), as some large businesses must file tax payments digitally, providing some modest momentum. Notably, in the Philippines checks are accepted as confirmation of VAT payments, but records of e-payments of VAT are not always accepted, creating difficulties for businesses in relation to tax lodgments and audits, and discouraging e-payment of taxes.

Banks in the Philippines provide various e-banking services, including funds transfers to third parties and bill payment, however high fees for these services compared to checks undermine the value proposition of digital transfers.

Further, there are various low-cost, cash-based remote bill payment services that make digital bill payments (particularly of utilities) less competitive in terms of transaction fees. In addition, many billers do not perceive any benefit from shifting to digital, as they use large networks of bill collection services that might not pass on savings to consumers if they shifted to digital payments. More broadly, low levels of participation in the formal economy mean there is limited demand for digital methods of making payments to governments and utilities.

3. Purchase and Other: Cash and check still dominant, but electronic international remittances are at high levels

The third shift relates to consumers paying for goods or services digitally, using a debit or credit card or mobile money instead of cash. The Philippines is at a far earlier stage in this shift with only 0.3% of individual consumer-initiated payments currently made digitally. However, international remittances by overseas foreign workers sending money home are the equivalent of 13% of GDP and are 93% digital.

Progress in this retail level shift is being impeded by concerns among consumers that debit cards present risks of fraud and theft, as well as concerns about high fees. In turn, low use of debit cards translates to weak incentives for merchants to accept card payments. As a result, many merchants see the costs of acquiring a debit-card system as outweighing the benefits. Even so, issuance of debit cards is growing, although individuals still perceive them primarily as a means to access their cash through ATM withdrawals. Small businesses also perceive high costs in entering the formal economy, such as requirements to pay taxes.

However, on the positive side, momentum towards digital payments is being supported by various factors, including weakening legal protections for checks, and declining acceptance of personal checks, making digital payments more attractive. In addition, innovative uses of prepaid debit cards, such as adopted by the Philippines' Home Development Mutual Fund, are helping to build digital infrastructure and confidence. (See break-out box below.)

BOX 1 Pag-IBIG: The Philippines Home Development Mutual Fund

The Philippines' Home Development Mutual Fund, or Pag-IBIG, is a state-sponsored mutual savings fund that has over 12 million members and provides around 2 million loans annually. Members can borrow up to 80% of the value of their accumulated funds, with an average loan value of US$800.

The Fund experienced major problems with checks being lost, delayed, or subject to predatory practices. As a result, it sought to establish an electronic payment mechanism, and was given approval by the Philippines Department of Finance to open an account with Citibank (ordinarily the Fund would have been required to use a state-owned bank).

Citibank has immediate debit card issuance capabilities, so the Fund could issue cards on-site to successful loan applicants.

Once each card is loaded, the cardholder is immediately notified by SMS and can access funds at any MasterCard or Visa POS terminal or at ATMs. Cardholders can also access their balance and transaction histories online or by phone.

Adoption has been very strong, although 89% of members are cashing out their loans at ATMs, and only 11% are using their cards at merchants' POS.

Nonetheless, the program provides a strong example of governments partnering with financial institutions to develop digital payment platforms that increase payment efficiency, safety, and transparency, and build greater demand for digital payment mechanisms.

Figure 2 shows the status of these shifts by number and value in the Philippines.

Figure 3 shows the stages of the various shifts to digital payments, drawing on data gathered for this diagnostic.

FIGURE 2 Status of the shifts – Philippines by number and value

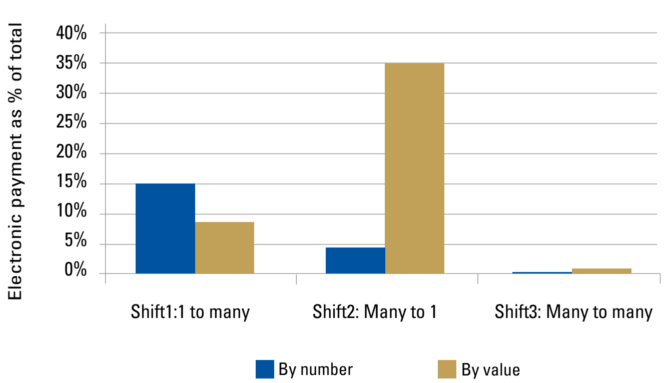
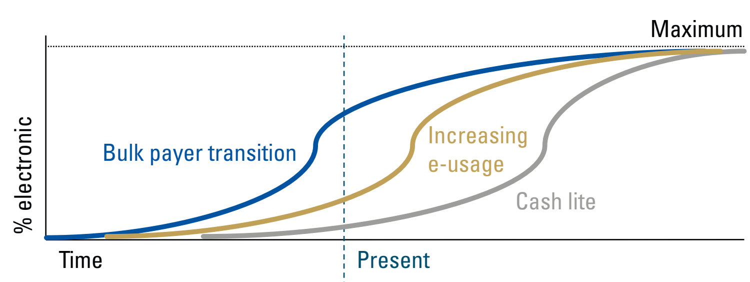


FIGURE 3 Shifts between Stages from Cash Heavy to Cash Lite



Key Lessons: What other Alliance members can learn from the Philippines' experience

1 Inadequate legal infrastructure and/or regulatory frameworks are a key barrier. As the Philippines' experience shows, a clear legislative framework is vital to provide certainty for stakeholders and underpin the digital ecosystem investments needed for digital payments to take hold, particularly in the private sector.

2 E-banking can serve as a solid foundation for further digitization. Many Philippine banks offer e-banking services, ATM-based credit transfers (inter- and intra-bank), and bill payments, building infrastructure and confidence in digital transactions.

3 High barriers to entering the banking system must be addressed to boost digitization and financial inclusion. In particular, high fees for e-banking services relative to cash and paper-based services need to be addressed, along with requirements to maintain minimum account balances, and onerous identification requirements that individuals from lower socio-economic backgrounds may struggle to meet.

4 A lack of trust in aspects of the banking system and concerns about fraud discourage adoption of digital payments. While 93% of remittances are digital , the Philippines diagnostic revealed a need for education and confidence-building measures, as well as accessible and effective recourse mechanisms for retail payments.

5 Retailers can play a leading role in educating consumers about the benefits of digital payments. Some large retailers in the Philippines have conducted studies of cash-handling costs in their businesses, and are delivering customer education campaigns to encourage the use of debit cards. Large retailers like Coca-Cola are encouraging both businesses and individuals to use debit cards. While more study is needed on the impacts of these education campaigns, these efforts are helping to build confidence in digital payments.

Conclusion

While the Philippines is at the start of its transition to digital payments, there is strong commitment backed by policy action from the Government, as it strives to bring more individuals and businesses into the formal economy and boost transparency. A vital next step for the Philippines Government is to deliver a clear regulatory framework that will boost certainty and investment in the Philippines' digital ecosystem.

While private sector progress is more limited, the key barriers to broader adoption of digital payments are reasonably clear, and relate in particular to poor knowledge, incentives (particularly in terms of fees), and infrastructure. However, large businesses are starting to recognize the cost savings presented by digital payments, and are playing strong advocacy roles. Major banks, ATM, and POS networks also say they will accelerate their efforts in the near future. The BSP is also willing to advocate further for digital payments, and support further policy initiatives, once a clear legislative framework is put in place.

As evidenced by the country's high levels of mobile and digital penetration, the Philippines already has a broadly tech-savvy population that is well positioned to embrace digital payments on a much larger scale. Realizing this potential will now require renewed commitment across government, the private sector, and the payments industry to demonstrate the benefits of digital payments, and build a stronger digital payments ecosystem. As the Philippines is currently very early in its digital payments journey, the country can look forward to huge upside advantages – particularly in terms of greater financial inclusion – if it can translate this commitment into effective action.

About the Better Than Cash Alliance

The Better Than Cash Alliance is an alliance of governments, private sector and development organizations committed to accelerating the shift from cash to electronic payments. The Better Than Cash Alliance is funded by the Bill & Melinda Gates Foundation, Citi, Ford Foundation, MasterCard, Omidyar Network, USAID and Visa Inc. The UN Capital Development Fund serves as the secretariat.

BETTER THAN CASH ALLIANCE | Empowering People Through Electronic Payments

To learn more, visit www.betterthancash.org and follow @BetterThan_Cash.