KOPO KOPO

Building vibrant merchant networks

Insights from the frontlines

Welcome

Our *Business OS* software is the culmination of five years of acquiring & managing the largest independent merchant network in the mobile money industry. We built *Business OS* for ourselves; now we're opening it to the world. Here are some of the key insights we've learned along the way.

We are on a mission to digitize one million businesses through electronic payments. To learn more, visit www.kopokopo.com or email info@kopokopo.com.

Dylan Higgins
Chief Executive Officer

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Payments alone are not enough

Recently I've seen a number of articles saying the same thing we've been experiencing at Kopo Kopo in the past couple of years.

Mobile payment acceptance alone is not enough.

By that, I mean that most of the merchants we work with in East Africa have adopted digitized payments somewhat reluctantly, and only after they saw a compelling business reason to do so.

For some, demand from their customers led them to accept mobile money at the point of sale. But that number is really a lot fewer than we thought it would be when we started signing up merchants in 2012. It's less than 10%.

In fact, recent research by Bankable Frontiers Associates recently pointed to a fact that should make proponents of mobile money everywhere take pause.

Even in Kenya, one of the world's most advanced mobile money markets, 92% of the total merchant population still prefers to be paid with cash. Only 2% list M-PESA as their preferred payment method.

So I was not surprised to read the following passage from an excellent study by CGAP into why more Indonesian merchants have not adopted digital payment devices (in this case mPOS). It's worth reading the whole piece, but if you can't here it is in a nutshell:

Most of the merchants interviewed had already been offered traditional POS by Indonesian banks and were less interested in mPOS for its payment acceptance features alone. Instead, we found that merchants are excited by value-added applications on the smartphone. Specifically, they were excited by features that would improve business processes and relationships with customers.

At Kopo Kopo, we believe in the transformative potential of mobile payments. We see them improving merchants' and customers' lives thousands of time per day.

(More than 10,000 per day now and growing!)

So it's worth considering for a moment some of the reasons why merchants like cash. Some are practical, some are strategic. All have a bearing on how to go to market to build a merchant network.

These are the reasons we spend our time thinking about: Cash, as Yogi Berra once said, is just as good as money. It's known. It's fast. There's no uncertainty about whether you transferred it to the wrong account. For many business transactions, people like cash. It works, even despite a few problems. And merchants know how to solve those problems.

Digitizing payments is a disruptive technology. As Clayton Christenson pointed out in "The Innovators Dilemma," disruptive technologies must first change the relevant axes on which markets evaluate their use before they break through to widespread adoption. This has not yet happened for business payments in emerging markets.

Cash is "free." Digital payments are a cost center. Someone, whether the business or the customer, is going to have to pay something. Merchant network acquirers need to sell a merchant on accepting payments. And the cost to digital payments is explicit whereas the cost of cash is hidden.

Digitized payments also fall prey to the classic adoption challenges of any new technology highlighted in *"Crossing the Chasm," by Geoffry Moore.*

How will this new payment type help my business?

Business owners are very busy, and accepting payments is actually a very small part of their business. If they do not see an immediate, understandable need, it's not worth their time. Mitigating internal leakage, theft, change shortages are good reasons, but unless the merchant has had a recent problem, they are peripheral to the business (like buying insurance).

None of this means that business won't adopt mobile money payments.

In fact, our experience with thousands of business customers in East Africa has convinced us that they will. But what it does mean is that acquirers need to bring more than just payment acceptance to the party if they want to build an active merchant network.

More than just a faster horse: Why Kopo Kopo merchants prefer M-PESA

I want to highlight a new study just released by Bankable Frontiers Associates, "Making Electronic Payments More Attractive for Merchants in Kenya." Kopo Kopo worked with BFA for several weeks earlier this year on this study. BFA did extensive surveys with a sample of Kopo Kopo merchants to uncover what they like and don't like about mobile money. (Our thanks to the Bill & Melinda Gates Foundation for supporting the research.)

BFA found that while only 2% of Kenya merchants generally prefer to be paid by M-PESA, 38% of Kopo Kopo merchants prefer M-PESA over other payment methods.

That is important because most of those businesses actively encourage their customers to pay with M-PESA. M-PESA payment volume for these merchants is double the transaction volume of the other businesses.

So, why do some merchants prefer M-PESA, according to BFA? Go to the BFA website and read the whole report, but I'll pull out the money quote here:

"When we asked why [Kopo Kopo merchants prefer M-PESA], we were told:

- It is more secure (from those who might want to rob their businesses of cash),
- It assists with accounting and record keeping,
- It improves internal security by discouraging theft by employees, and
- That it is a useful solution to the coin shortage that makes them have to leave their businesses searching for coins or to buy coins at a mark-up."

BFA also added that businesses also tend to prefer M-PESA when they have a large concentration of customers that ask to pay with M-PESA.

However, these reasons are all true for mobile money generally. So is Kopo Kopo just really good at finding the right merchants or is there some other reason?

We have a great sales team in Kenya that has learned a lot building our 10,000-plus merchant network. But as good as they are, there is more to it than that.

While most of our clients COME to Kopo Kopo because of the value of digital transactions, they STAY for our software-as-a-service. They need the software, they just don't know it until they use it.

It's a classic technology adoption problem that Henry Ford summarised best: "If I had asked people what they wanted, they would have said faster horses."

The Kopo Kopo Business OS gives businesses a better experience than the traditional, USSD-only mobile money interface in several key areas:

1) Better information tools. Most of our merchants use Facebook, WhatsApp and have an Android phone. They expect more than a USSD menu. The BFA reported: "Those who used the platform liked it, mostly for confirming transactions and making transfers to their bank and other M-PESA accounts. The heaviest users also valued the client-tracking features …"

2) Cash Management. Merchants value the ability to easily move cash to their bank accounts. Some even use their Kopo Kopo account as a savings mechanism.

"This is my 'rainy day' account," one told me. "It's not cash, so I can keep it aside and not use it in the day to day cash needs." Merchants also valued the ability to make bigger transfers using EFT than permitted in mobile payment.

3) Services Beyond Payments. As merchants become familiar with our core Business OS payment acceptance service, they begin to use the applications that run on top of the Business OS and digitized transaction data. GROW gives cash advances to qualified businesses based on their M-PESA cash flow. REACH lets businesses contact and market to customers who have paid them electronically through the payment service.

4) Account Setup. BFA found that the set up process has a large impact on mobile money payment adoption:

“[Small Businesses] who experienced problems during registration or with training easily gave up. The business case to them wasn’t particularly strong, and it was easy to get thrown off course. If they didn’t settle their accounts quickly after getting their tills, they forgot how, and soon abandoned the service altogether.“ That’s why Kopo Kopo has built a set of tools that gets the account from applications to live transactions in less than five business days.

The take away? If you give emerging market businesses the “whole-product” solution, they will embrace mobile money. But some will embrace it faster than others.

Both of these points are key insights from “Crossing the Chasm,” and can determine the success or failure of early merchant-network build outs. So in my next post, we will dive into some of the important lessons of the technology adoption lifecycle.

Finding the perfect merchant: The 'Goldilocks' segment

The old aphorism is right: You can please some of the people all of the time, and all of the people some of the time, but you can't please all the people all of the time.

If I had to pick one of these options, I would pick the first. But how to figure out which people to please?

Most of the mobile money network operators we talk to realize that some segments of the market take up mobile money faster than others. But they tend to divide the market into two segments that are not inherent features of the actual market, so much as they are sales and marketing tactics that the operator knows how to do.

In conversations in several markets across Africa, I have repeatedly heard a two segment strategy to pursuing the market — see if you can spot the hole.

Segment 1: Big FMCG supply chain networks, such as soda, beer, and other consumer staples.

Segment 2: Small, individual proprietors at the bottom of the pyramid who don't have access to financial services.

Having thus segmented the market, they assign your key accounts team to sell the FMCG companies and put your marketing team to work on some clever advertising and push it out in a big, above-the-line media awareness campaign. Everything's sorted!

Except there are two problems. Segment 1 takes a long time to do anything and it's ages before anything happens in the market. And most of the businesses in Segment 2 either ignore the messaging or, if they are early adopters, are already doing it.

But what about everyone else? What about the medium sized businesses that make up much commerce in many markets? We find that this is the "Goldilocks" segment. They're not too big. They're not too small. They are just right.

In Kenya, Kopo Kopo's most active merchants are the mid-market. There are several business-related reasons for this:

- Research from BFA shows that the average Kopo Kopo merchant's median turnover is 6.5x the median of all Kenyan merchants. They have more cash flow in their business and more cash that can go missing.

- They have more employees, usually between 5 and 100. As the number of employees increases, the chances that they will have a bad apple looking to steal goes up. In surveys with Kopo Kopo customers, BFA found that "More than 80% of the small and medium businesses we studied experienced theft by employees."

- Because they have enough money that they can experiment with technology. Indeed, many of them are enthusiastic early adopters of technology. Most of our merchants, almost 90%, have a smart phone. It is the primary way most access the internet. They are using WhatsApp, Facebook and other tools. They are capable of using applications and interested in solutions to help them with their business.

The thing is, there are too many of these merchants to sell to individually and only a very few tend to adopt new technology based on advertising alone. You need to sell them on it. For that you need a sales team with experience in selling to small businesses.

And, most annoyingly, they tend to want a payment service with more business tools than a basic phone-centric USSD interface can provide. See my previous post ("More than just a faster horse") which explains our approach to solving that problem.

I want to close with a final thought: The question isn't WHETHER the base of the pyramid or supply chains will adopt mobile money. All of these segments WILL eventually adopt mobile payments. It will just take them longer to do so.

Medium-sized businesses are strategically important because they are the key "beachhead" that mobile C2B payments need to cross the chasm. As Geoffry Moore explained in Crossing the Chasm more than 20 years ago:

“Every truly innovative high-tech product starts out as a fad — something with no known market value or purpose but with ‘great properties’ that generate a lot of enthusiasm with an ‘in’ crowd. That’s the early market. Then comes a period during which the rest of the world watches to see if anything can be made of this; that is the chasm. If in fact something does come out of it – if a value proposition is discovered that can predictably be delivered to a targetable set of customers at a reasonable price – then a new mainstream market forms, typically with a rapidity that allows its initial leaders to become very, very successful.”

That is why we start building any of our services with the needs of small and medium businesses in mind. And we are looking for partners in all mobile money markets who understand how to reach this group and catalyze the creation of the mainstream market.

In the tea leaves: Transaction fees have an expiry date

If you ever run into someone from the payments industry at a party, you should probably try to find a better party. If you can't, ask them what transaction fees will look like in the next 3-5 years. Chances are they'll pull you aside, look around cautiously and then whisper:
They're going away.

Why?

Because the payments industry, like countless industries before it, is being disrupted – and commoditized – by the internet. Intermediaries are being cut out. Margins are being depressed. And transaction fees are being converted to loss leaders.

How is that possible?

Because we've hit an inflection point. Today, money is little more than "bits of light assembled in secure packets" (to quote a mentor) and issued by fiat. I value KES 91.6 because you value KES 91.6 and we trust each

other because that dollar is backed by the "full faith and credit" of some government somewhere.*

Money stopped taking the form of gold bullion decades ago. Its modern form more closely resembles an email, SMS or WhatsApp message. Likewise, a payment is now little more than a secure communication that updates a ledger somewhere. That's why startups like Dwolla are able to build their own payment networks on the cheap (relatively speaking).

It's also why Google added a send money option to Gmail and why Facebook poached David Marcus from PayPal to run their messaging strategy.

Okay, but how does that affect traditional players?

Securing a communication and updating a ledger isn't that difficult, so entering the payments industry isn't as daunting as it used to be. As new players enter the arena, their first task is to differentiate themselves from the competition, which can take the form of lower fees, faster access to funds, better user experience, customer relationship management, access to finance, etc.

Most players enter the market by competing on price (see Amazon Local Register vs. Square). In turn, existing players respond by upping their service quality, increasing their service options, or lowering their prices (some don't respond at all, but this isn't a viable long-term strategy). This continues until the players reach some sort of market equilibrium, which increasingly results in a free or at-cost transaction fee.

Some new entrants launch their businesses assuming a 0% transaction fee from day one. Take LevelUp, for instance, which calls for "interchange zero" in the United States. LevelUp's bet is that it can make more money on transaction data than it can on transaction fees, so it removed transaction fees entirely for eligible merchants. If you accepted Visa via Wells Fargo for 2-3% per transaction and LevelUp offered to let you accept Visa for 0%, what would you do?

Fair enough, but how do any of these companies survive?

That's precisely the question, and it's why your friend at the party had to whisper. The industry may be at an inflection point, but it's not entirely sure where it's going. One direction, which we'll discuss in a subsequent post, is what we like to call the "lending layer" – a financial services layer that sits on top of the payment rails.
But that's only one of many – and I do mean many – potential directions.

The answer may be uncertain, but the question filling board rooms from London to Lagos is:

What do we do once transaction revenue disappears? How do we survive?

Falling margins and the rise of the "Lending Layer"

With the imminent IPOs of Lending Club and OnDeck Capital in the United States, "alternative lending" is about to go mainstream. And it's happening everywhere. In India, e-commerce giants Flipkart and Snapdeal both recently announced working capital services similar to Amazon Lending. In South Africa, an individual or business can apply for a loan online from Lendico, RainFin and/or Wonga in minutes. The list gets longer by the day.

And there's one consistent theme: DATA. Alternative lenders are using data to develop new underwriting methods to either serve traditional customers better or access new customer segments. According to a recent HBR blog post, cash flow data is perhaps the most predictive data currently available, and it's being under-utilized by traditional lenders.

Enter payment service providers.

Faced with diminishing margins from intense competition, payment service providers are increasingly looking to lending to boost the bottom line and retain customers. We like to refer to this development as the "Lending Layer" — one of the many, but perhaps most disruptive, layers being built on the payment rails. Take PayPal Working Capital and Square Capital in the US, or our own GROW Cash Advance in Kenya. Each service is based on analyzing historic transaction data to predict future cash flows and, in turn, make a lending decision. But that's not what gives payment service providers a competitive edge. Couldn't a business simply import this data to a service like Iwoca or Kabbage – or even take it to the bank – to get a loan?

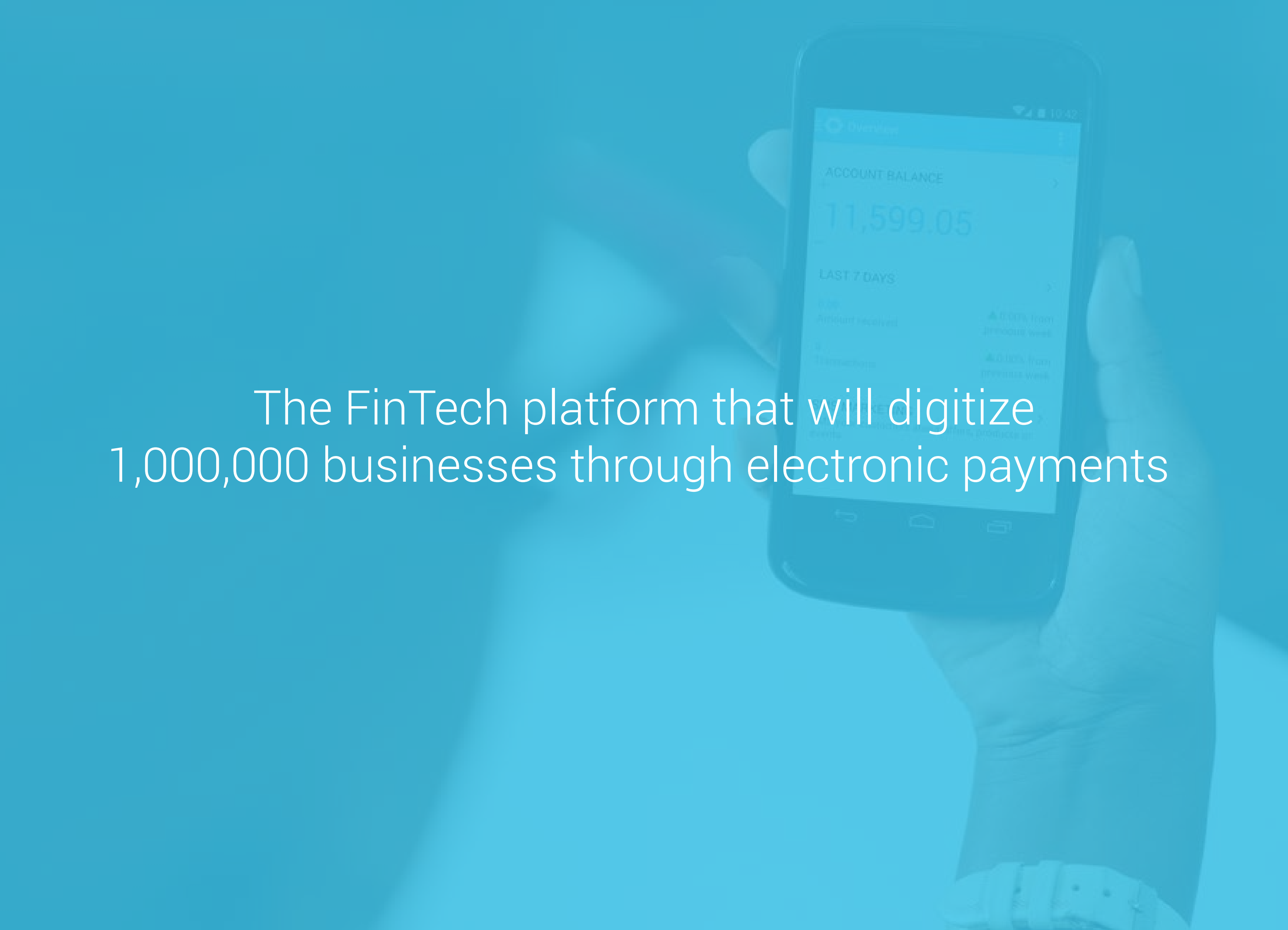
Payment service providers are unique insofar as they have direct access to a percentage of their customers' daily receivables. Square, for instance, holds funds from card payments before initiating next day settlement, which gives it the ability to automate collections by deducting some percentage of its customers' daily sales.

Under this arrangement, the payment service provider's model accommodates – and is indeed based on – its customers' cash flow, so it collects more repayments when sales are high, less repayments when sales are low and no repayments when there are no sales.

This offers the customer tremendous flexibility while also giving the payment service provider a de facto guarantee.

Payment service providers are also positioned to benefit from a "virtuous cycle" in which customers increase their electronic payments to access larger loan facilities (as we've observed in Kenya). Indeed, access to loans could very well become the reason to accept electronic payments for businesses that previously struggled to access financial services. The more a business shifts from analog to digital, the better the lender can assess and price risk, which motivates and rewards business to continue shifting to digital, and so on.

As we've hinted at before, we don't think the future of the payments industry is in payments. We think it's in data, and in layering value over that data. We'll share our views on other layers in subsequent posts.



The FinTech platform that will digitize
1,000,000 businesses through electronic payments