Inclusion or delusion?
How can financial institutions reach the un(der)-banked in low income countries?
Foreword

This report is the culmination of a two-year fellowship in International Development at the CSFI, generously funded by Citi and DFID. The Fellow was Sam Mendelson, who has established a considerable reputation in the field of microfinance (among other things, he has been the co-author of several editions of the CSFI’s series of *Microfinance Banana Skins* reports).

The Fellowship consisted of a series of round-table events set up by the Fellow, based around three themes:

- who are the clients for financial services in low and middle-income countries, and what are their needs?
- how well do the products on offer match those needs? and
- what can be done to improve financial capacity?

Each of those themes was the subject of a Working Group, which brought together recognised experts, with the Fellow acting as *rapporteur*.

The product of these Working Groups has resulted in the present report, which offers a comprehensive and in-depth look at some of the most important issues affecting those who are at (or beyond) the financial margin in what we used to call the Third World. It is a good read, with important lessons, and I am grateful to Sam for the effort he has put in.

I should emphasise that this is a CSFI report. Sam and the CSFI are solely responsible for its content. Although we are enormously grateful for the financial help and other support that Citi and DFID provided, they are not responsible for its content.

Andrew Hilton
Director, CSFI

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**Introduction**

This report is the product of a fellowship programme funded by Citi and the UK’s DfID, which was intended to promote greater understanding of, raise debate about, and provide insights into client need in low and middle-income countries, and into the challenges to increased financial inclusion. The model chosen involved several guest speakers, six roundtable CSFI meetings in London, three Working Groups, and a small industry survey. The three Working Groups addressed the questions:

- Who are the clients for financial services in low and middle-income countries – and what are their needs over their financial life-cycles?
- How well-aligned are the products that are available in such countries with those client needs – and which products have gained (or are likely to gain) most traction with currently excluded or under-served groups?; and
- What can be done (including through the use of technology) to improve the financial capability of low and middle-income clients so that they can make more productive use of the financial services on offer?

This report follows the format of the Working Groups (and where appropriate incorporates feedback and ideas from attendees at the CSFI round-tables).

In *Part One* (on the client), it is argued that the biggest differences between the unbanked or under-banked in poor countries and financially-included people in developed countries don’t lie in the nature of the financial needs as such, but in:

- the type of financial tools available to serve those needs; and
- the type of behaviour that the use of such tools requires.

The 2-3bn people outside the formal, mainstream financial services sector around the world each manage up to a dozen different financial relationships (an average of seven) in order to handle risk, to build up lump sums and to smooth their irregular and unpredictable incomes. They mainly tend to use informal tools, less suited to long-term intermediation – which is one reason why poor people tend not to have pensions. Formal tools are no good for people who don’t have regular incomes, who have very tiny cash flows, and/or who lack modern ways of communicating with financial service providers.

Tools determine financial behaviour. Formal tools – especially when linked to formal incomes – can automate many financial tasks (such as salary deductions into savings, pensions, insurance, and mortgage repayments). This allows more affluent people to concentrate on balancing risk and return in their portfolios. Informal tools by contrast cannot be automated and have to be repeatedly worked at: this requires poor people to be constantly on the lookout for ways to accumulate significant sums of money, through saving or borrowing.
But what most distinguishes people living above or below the poverty line is not education, health or wealth *per se*, but a steady job. The incomes of the poor are small – and, more importantly, they are irregular and/or unreliable. This means poor people are very vulnerable to sudden shocks, and far less equipped to deal with them.

One of the major reasons people borrow is to deal with a health emergency. That kind of shock can set back a poor household an entire decade. **Income volatility is the essence of financial exclusion.**

The excluded also face problems with the financial products that *are* offered, such as minimum balance requirements. They also may need a loan of a smaller amount or of a shorter duration than a financial organisation can offer. And the financially excluded struggle to make commitments: the boilerplate microloan must usually be repaid in equal weekly instalments.

Managing these challenges requires a stressful array of financial decisions, informal transactions and tools that are often beyond outsiders’ expectations. It is, therefore, an irony that the financially excluded probably need financial services more than any other group. Poor households have to manage a “portfolio” of relationships and transactions with family, neighbours, moneylenders, and savings clubs. The new products required for such a portfolio can only be designed with a proper understanding of who the client is, and what she or he needs.

In **Part Two** (on products), it is argued that a “me too” strategy of waiting, watching and copying products offered by competitors is doomed to fail, as is “bath-tub development” – product ideas developed on the basis of management’s gut instinct, then often rolled out without appropriate pilot testing or consultation with the target market. That said, there are features to which we know poor people aspire in financial products and services. Such products must be characterised by:

- **Convenience**, which requires proximity and longer opening hours – most obviously through a distributed agent network;
- **Accessibility**, which often necessitates ATM cards or mobile money solutions, in order to obviate the need to negotiate overcrowded branches, deal with complex forms and intolerant bank staff;
- **Affordability**, which covers direct costs (transport to the branch and food when the trip takes a full day), indirect costs (lost wages and other opportunity costs), and hidden costs (bribes and commissions for filling up and processing forms); and
- ** Appropriateness**, which reflects how poor people live and how they manage their money.

We also know that poor people need a range of products to reflect their life cycle. As a bare minimum, we might posit a suite of products that includes:
- A transaction or very basic savings account (linked to a reliable and efficient payments/remittance system that is not too costly);
- Deposit accounts for different goals (with an attached overdraft);
- A short-term loan/facility that can be used for working capital as well as consumption smoothing, education etc.;
- A credit life policy – and ideally, health/crop/livestock/funeral/disability insurance appropriate to their situation; and
- A longer-term loan/facility (secured against assets acquired with the loan).

Despite justified criticisms of microcredit/microfinance in recent years, credit remains key. The best credit products are those that have flexibility on repayments, that assure continued availability of credit, and that involve regular collection of repayments.

Insurance is broader still. Within the microinsurance industry, there is a need for a paradigm shift to understand and provide products for the low-income market. There are four broad challenges:

- The need to design simple products that are understandable and easy to administer;
- The need to educate the consumer base and sales force (who often have limited understanding of insurance in general);
- The need to handle high volume since margins are thin (which means having robust technology to handle the back office requirements of scale); and

Most importantly, the need to pay claims quickly - within days, not weeks.

Innovation – especially in terms of branchless delivery channels – will be the key.

Part Three covers capability - or “having the knowledge, understanding, skills, motivation and confidence to make financial decisions which are appropriate to one’s personal circumstances”. Even among those within the formal financial sector in low-income countries, most lack financial capability. Providing financial education (whether to groups or individuals or the mass market, whether through a financial institution or in partnership with governments, NGOs and schools) has social and financial benefits.

So far, much of the focus on the “capability gap” has been on microfinance clients. This is a good starting point, but the scope must be broadened to include remittances, government-issued conditional cash transfers (CCT) and mobile money. It is here where the growth in financial inclusion is taking place in poor countries, and here is where capability will be most important.

Ideally, financial education should be driven by the business case. As the financial sector evolves, new financial products with greater complexity will become available to low-income clients – which will make understanding financial services increasingly difficult. In low-income countries with relatively sophisticated financial markets (for example South Africa or Brazil), there is an onus on financial institutions to provide sufficient information on the
complex products available. In the least developed nations, governments and public institutions simply do not have the capacity to take on financial education. But these countries’ financial sectors are often among their strongest, and could be required to take the lead. This doesn’t just mean looking to banks or MFIs – it also means engaging with employers: consumers who have confidence in their ability to manage personal finances can contribute directly to a company’s bottom line – whether by expanding the client base, by purchasing new products and services, or by increasing activity on existing accounts.

There are times in people’s financial lives - known as ‘teachable moments’ - when they are likely to be more receptive to financial education, information or guidance. Understanding these opportunities is important for any provider of financial education, whichever of the three main options for delivery (mass market, group and individual) is used.

So far, many of the initiatives that have been undertaken to provide financial education have consisted of donor-funded outreach programmes, in which trainers run classes for people, often in rural villages. There may well be more cost-effective ways of improving people’s financial capability. Cost-effectiveness is dependent on the number of people which the initiative will reach, the impact it has on people’s behaviours, the extent to which an initiative can leverage other resources, and the extent to which the initiative is sustainable, replicable and scalable.

Whatever is implemented needs to be on a national scale. The key is to take a national government-enabling approach: the work does not need to be paid for or carried out by the government, but the government's oversight and buy-in are required to achieve scale and uniformity of reach.

Whoever is tasked with this, they should keep in mind some guidelines. They should:

- keep things simple;
- use relevant contexts;
- repeat messages;
- use a variety of channels;
- take advantage of ‘teachable moments’; and
- prioritise initiatives which are most likely to be cost-effective.

Finally, they should monitor financial capability programmes to establish which ones should be continued and which ones discontinued. And they should remember that capability is a multi-stakeholder area. Partnerships will leverage opportunity into scale.

**Part Four** is a short risks & opportunities survey of financial institutions, loosely based on the CSFI’s *Banana Skins* reports. Respondents were asked to grade ten Risks and ten Opportunities for financial institutions that are considering expanding to under-served populations in low-income countries. Respondents found the most significant risks to be:
- a stifling regulatory environment;
- difficulty in implementing ‘know your customer’ processes; and
- designing products that are well matched with clients’ needs.

They saw social impact, the large market size, and potential diversification of products to be the greatest opportunities.
Part 1: Who are the clients for financial services in low and middle-income countries – and what are their needs over their financial life-cycles?

The first Working Group looked at the client. Who are the current and potential clients for financial services in poor and emerging markets? How do they manage their finances? What mix of formal and informal financial services do they use, and how do they impact their lives? And most importantly – what do they need?

The Group brought together five people. Stuart Rutherford was the ‘thought leader’\(^1\). He is the author of The Poor and Their Money, co-author of Portfolios of the Poor – two seminal works on the financial lives of the excluded – and founder of SafeSave, a microfinance institution in Bangladesh (www.safesave.org). For more than thirty years, he has been interviewing and following financially excluded people.

The remaining members\(^2\) were:

- **Sukhwinder Arora.** Over 28 years, Sukhwinder has worked for development organisations at micro, meso and macro level, including for DFID in Dhaka, London and Delhi, and as lead adviser to the Financial Deepening Challenge Fund. His core work has been on policies designed to enable poor people to benefit from financial and other markets. He is currently a Principal Consultant at Oxford Policy Management.

- **Rosalind Copisarow.** After 15 years at Citigroup, HSBC and JPMorgan, Rosalind entered the field of microfinance in 1994. Over the next 13 years, she built two microfinance organisations, Fundusz Mikro in Poland and Street UK. She also co-founded the Microfinance Centre for Central and Eastern Europe, served on the Policy Advisory Group of CGAP, and, as SVP at ACCION, structured a number of MFI banks across Asia, Africa and Middle East. Rosalind is currently working on ways to enable major corporations to engage profitably with the 4bn population of <$5/ day families.

- **Sarah Livingstone.** Sarah was, during this Fellowship, head of Maxwell Stamp’s financial sector practice. She is now Director of the Financial Sector Practice at Nathan Associates where she is responsible for the firm’s portfolio of financial inclusion projects.

\(^1\) It was decided that for each Group, I would collaborate with one Working Group member to kick things off with a ‘think piece’, which was used as a starting point for discussion with the other Group members.

\(^2\) Thanks must also go to David Roodman, whose book Due Diligence was published during this Fellowship and from which I have gratefully borrowed.
Hugh Sinclair. Hugh has worked at Barclays and ING Barings in corporate finance, derivatives, and as a trader. Since 2002, he has specialised in SME and microfinance, and has lived in Mozambique, Mexico, Mongolia, Argentina and the Netherlands. He is the author of Confessions of a Microfinance Heretic.

The methodology followed by the Working Group was straightforward. Stuart’s responses to the initial and follow-up questions were passed on to the remaining members, who were asked to comment – as was the Consultative Group to Assist the Poor (CGAP) and its then Deputy CEO, Alexia LaTortue. I then tried to pull together all the responses into a summary of what we know about the global un(der)banked – how they use a complex mix of financial services to get by, and (most of all) what it is they actually need.

This report is not supposed to be the last word on the subject of financial exclusion. It is merely to get people who work in financial services in rich countries to think critically about how to reach the 2+ billion people out there who are financially excluded. And before we get to that, we have to know something about who they are.

Stuart Rutherford & Sam Mendelson: The poor and their money.

Let’s start with a clarification. There are poor people who don’t live in a monetised economy, and some others who do live in a monetised economy but don’t take part in it (a poor old widow who gets by on gifts of rice and firewood, for example). We’re not talking about that latter group.

The biggest differences between the unbanked or under-banked in poor countries and financially included people in developed countries don’t lie in the nature of the financial needs. Rather, they lie in:

- The type of financial tools available to serve those needs; and
- The type of behaviour that the use of such tools requires.

These differences rest on the more obvious differences between the rich and the poor - especially that the incomes of the poor are relatively small, but more importantly that they’re irregular and/or unreliable.

Financial services are about managing money, and both rich and poor have to do this. There are three big jobs involved in managing money:

- moving money through space (payment systems and remittances and the like);
- moving it through time - saving (and its derivatives like insurance) to make past income available for spending; and
- borrowing to make future income available for spending.
So how do the poor manage their money? The big difference is in the types of tools. Poor people tend to use mainly informal tools while rich people tend to use mainly formal ones. Informal and formal tools have different strengths and weaknesses. Informal tools are not good at long-term intermediation - which is why poor people tend not to have pensions, for example. Formal tools are not yet good at serving people who don’t have regular incomes, who have very tiny cash flows, and who lack modern ways of communicating with providers.

Tools determine financial behaviours. Formal tools (especially when linked to formal incomes) can automate many financial tasks (such as salary deductions into savings, pensions, insurance, and into mortgage and car loan repayments etc.). This allows rich people to concentrate their attention on balancing risk and returns in their portfolios. Informal tools cannot easily be automated and have to be repeatedly worked at: this requires poor people to be constantly on the lookout for ways to form usefully large lump sums of money, through saving or borrowing. For the poor, ‘saving’ is a verb (“I must save today somehow”). For the rich it can be more of a noun: (“I must keep my savings in an account with a better rate of return”).

The tools available and the behaviour they affect are not always well matched with needs. There are three big needs:

- **The daily grind**: Managing money on a day-to-day basis to ensure there’s food on the table every day, and not just on days when income comes in (and money to buy a child ointment on the day she gets conjunctivitis and not when the infection has already damaged her eyes for life). This requires a constant round of small-time saving-and-withdrawing-and-borrowing-and-repaying at home, with neighbours and family, or in a saving club etc.

- **Big expenditures**: This means putting together sums big enough for life’s big spends: life cycle things (like birth, education, marriage, death, homemaking and furnishing), big assets (fans, TVs, bicycles), business assets, and so on. This requires patching together savings, loans and gifts, and is made harder because the informal sector isn’t good at intermediating over the long term, so it is hard to build up big sums through saving or borrowing. They need a long time to build up or to repay.

- **Emergencies**: These include private emergencies like ill health, and public ones like fires, floods and cyclones. Obviously, poor countries – virtually by definition – are more susceptible to these emergencies, or shocks. Dealing with emergencies requires activity similar to those for big expenditures but with the added complication that their timing and their nature (mostly) cannot be foreseen.
Formal and informal tools and services

Formal tools are services that are publicly regulated and supervised, usually by government authorities such as central banks. So any financial service offered by a regulated bank, non-bank, insurance company, regulated credit union, regulated chit-fund, etc., is formal.

Semi-formal tools or services are those offered by semi-regulated NGOs and others, including microfinance institutions. They often report to government bodies that regulate charitable or welfare organisations or trusts. Some of the best-known names in microfinance are semi-formal, like BRAC, ASA, and FINCA.

However the distinction between formal and semi-formal finance is narrowing, as semi-formal providers seek greater legitimacy through formal regulation, or need to seek regulated status in order to be allowed to accept deposits (savings) from the general public. Some semi-formal providers have successfully converted to formal status (e.g. ACLEDA in Cambodia, Equity Bank in Kenya and Compartamos in Mexico).

In some cases, the distinction was very narrow from the start. For example, in Bangladesh, Grameen Bank is formal because its founder persuaded the government to grant it a special bank ‘ordinance’; BRAC and ASA remain NGOs though their group-based microfinance work is almost identical to Grameen’s. Sometimes, the links are through ownership: the NGO BRAC owns the formal BRAC Bank, for example. In many countries – India for example – the formal sector invests heavily in the semi-formals.

Informal tools include the charities and services that are not regulated nor supervised by the state, nor by local authority bodies:

- **Do-it-yourself mechanisms**: Saving at home or on the person, in cash or kind: everything from piggy-banks, mattresses, and money for funerals sewn into loin cloths to pigs and roofsheets.

- **Community mechanisms**: These include borrowing and lending interest-free with neighbours or family; devices like money-guards; advances against wages; shop-credit; for-profit services offered by unregistered savings-collectors (like traditional African *susu* collectors), and/or unregistered money-lenders.

- **Mechanisms using groups**: These include all sorts of saving clubs, ASCAs (Accumulated Savings and Credit Associations) and ROSCAs and their variants. They are sometimes taken to a higher level of organisation by non-banking welfare bodies like churches and mosques and trade-associations; they’re sometimes taken to an even higher level to become more or less permanent credit unions.

Is it a good idea to regulate the informal? Generally the answer is No, for the simple reason that the informal uses to advantage the very fact that it isn’t regulated and doesn’t have to conform to regulated norms. On the other hand, the idea that the formal sector could take some key ideas from the informal sector and develop new products is an excellent one: Indian chit-funds do this with ROSCAs, formal Credit Unions do it with ASCAs. And semi-formal operators can add value by showing people how to run informal devices better – right now the best example is the Savings Group Movement (http://savings-revolution.org/)
Of course, the global un(der)banked are no more homogeneous than are financially included people in rich countries. Trying to understand how people vary in their needs – by gender, by urban/rural, by industry or sector – often leads to confusion and bad product development. In one very important sense, however, they don’t vary: it doesn’t matter whether you are a farmer or farm-labourer, an urban rickshaw driver or small shopkeeper. You still have to deal with the three ‘big ones’. Variation by market segment comes properly into play only when those three basics are covered. This explains, for example, the disappointments that micro-credit-for-microenterprise suffered when it found that clients were using business loans to bury someone or pay doctor’s bills, or even just to eat. So it’s no good crafting a clever, seasonally-sensitive loan package for a rice farmer if she (or he) has no reserves nor insurance, and no access to loans, to cover her basic needs.

Once those basic needs are covered, however, variation by segment becomes very important, since the farmer, the farm labourer, the rickshaw driver and the urban shopkeeper will have different priorities and needs. But, right now, a huge proportion of poor people don’t have the basics covered, so the big drive must be to secure good basic tools for poor people to remedy that insufficiency.

So, what financial services are there that the financially excluded actually do use? Let’s first note that unlike formal providers who often advertise specific uses for the intermediation services they offer (car loans, home contents insurance, school fee savings, etc.), most informal tools just offer the basic intermediation service, leaving the specific use up to the user.

There are some informal services that are regularly used by many of the poor:

- **Saving at home (or on the person etc.).** Most poor people around the world try this: many succeed modestly; some do really well. It produces sums of money that can be used for anything that crops up. It is a limited tool, the absence of which would nevertheless make the lives of many poor people much harder.

- **Interest-free borrowing and lending in the community (friends, neighbours family).** In *Portfolios of the Poor*, this was the most-used tool in all three countries. It allows a community to circulate its savings. It has many limitations (the poorest often do least well; some communities just aren’t up to it; it can cause stress). But is the workhorse of informal finance around the world.

- **Savings clubs, especially Rotating Savings and Credit Associations (ROSCAs).** These have a long list of virtues. They help to maximise savings through a socially supervised commitment to regular pay-ins. They can be flexibly adjusted to suit a wide variety of needs (compare a 10-day daily ROSCA for day-to-day management to a 6-month bi-weekly ROSCA for accumulating school fees). ROSCAs are often very successfully used by specific groups for specific needs (Filipina schoolteachers run them to furnish their houses after marriage; Vietnamese fishermen use an ‘auction’ variety of ROSCAs to finance fishing gear; South Africans use them to run funeral funds). Where savings clubs are
organised by permanent social entities like social clubs, religious bodies, or trade organisations, you get another level of specialisation that results in very useful devices like the South Indian ‘marriage funds’ and burial insurance societies.

Informal ROSCAs are a form of group-based financial services. The model most often used by semi-formal microcredit providers is also group-based, and that model plays an important part in the history of modern microfinance because - for whatever complex interplay of cultural and economic and practical reasons - it ‘won’ the ‘race to scale’ with (semi)-formal individual finance for the poor.

But there are crucial differences between groups in informal savings clubs like ROSCAs and groups as used by semi-formal microcredit providers. In a ROSCA, the relationship is two way - between the member and the group. In group-based microcredit, it is three-way - between client, group, and provider. It makes all the difference to the dynamic of the group, and helps explain why joint liability doesn’t work in group-based microcredit, whereas social commitment does in a ROSCA.

What we learned from group-based methods of borrowing and saving, in the end, is that it isn’t the fact that they use groups that makes them successful. It is, instead:

- The breaking up of pay-ins into small bite-size bits (most obviously, the weekly loan repayments but also the weekly savings); and
- The combination of proximity, frequency, flexibility, convenience, regularity, commitment and (perhaps most of all) reliability that the field-workers’ weekly trip to the village brings to the clients.

So, if you can borrow $100 and have a household cash flow strong enough to be sure to be able to repay it in a year’s worth of weekly $2 amounts, you can use the $100 for anything you want - including investing, buying assets, and managing consumption. This is true whether you’re in a group or not.

Finally, what would can do to best serve current and potential clients in a way that is fair, sustainable and at least potentially profitable? In general, finance the establishment of systems (branched and/or branchless) that get close to poor people and offer them savings and credit that have that a key set of virtuous characteristics: proximity, frequency, flexibility, convenience, regularity, commitment, and (perhaps most of all) reliability. And keep at it until they’re strong enough to stand on their own.
**How are the poor different from us?**

“We need to define what we mean by ‘the poor’ or financially excluded. They are not a homogenous mass. Microfinance providers in Bangladesh, for instance, categorise their poor clients into ‘hardcore poor’, ‘moderate poor’, and ‘microcredit graduates’ (i.e. MSMEs) and provide finance products accordingly. The microfinance providers in emerging markets have definitions of income, assets and land holding for each category. So the ‘hardcore poor’ borrowing for consumption smoothing are not the same group of people as those wanting microenterprise loans. The range of financial services for those excluded from the formal financial services sector is perfectly capable of meeting the different needs of various classes of poor people - so long as it’s clear from the beginning which group is being served in each case” - Sarah Livingstone

According to CGAP, 2.55bn adults lack a formal bank account, with the overwhelming majority of these (2.38bn) in developing countries. As Stuart Rutherford wrote, they are characterised by a high level of informal financial activity, a complex array of financial transactions and services, unreliable income, and expensive sources of finance. There is a wealth of evidence now that they live extremely complex financial lives, organising up to a dozen different financial relationships in order to manage their risks, build up lump sums, and smooth their irregular incomes.

For financially included people in developed countries, complexity is a feature too. As David Roodman notes in *Due Diligence*, a middle-class American will typically have a savings account, checking/current account, wire transfer facility, PayPal, credit cards, home mortgage, car loan, student loan, retirement savings/pension, college savings, health insurance, homeowner’s insurance, car insurance, life insurance and disability insurance. This portfolio of services seeks to meet four basic and universal needs:

- to transact;
- to invest;
- to build assets; and
- to sustain consumption.

The financially excluded in poor or emerging markets have the same four broad needs, but their financial lives are very different – not just quantitatively, but qualitatively as well. As Roodman notes, “Poor households are not just microrich ones, and microentrepreneurs are not simply microversions of the iconic entrepreneurs who perpetually roil the capitalist economy”.

As he notes, the main differences between the financially excluded and included is that the financial services available to the rich outshine those for the poor in quality, diversity, and cost. And so the high cost of credit, the impediments to savings, and the lack of appropriate insurance products roll on from one poor generation to the next.
What does it mean to be poor and financially excluded?

There are many obvious differences between the poor in developing markets and the (generally) financially comfortable readers of this paper. There are also some less obvious ones. For instance, as the enormous global migrant workforce shows, poor families are more likely to send a member to the big city or another country to work (the Kenyan mobile money platform MPESA’s first slogan was “Send Money Home”). As the CSFI described in its 2006 report “Informal Money Transfers: Economic links between UK diaspora groups and recipients "back home"”, the global market for remittances - formal and informal - is growing at a staggering rate. In 2012, the World Bank estimated that US$420bn was remitted to poor countries - four times the entire annual global aid budget. And this is only what can easily be measured. The real figure may be a trillion dollars.

Being poor also means lacking control over one’s financial circumstances. The very poor are more susceptible to shocks than we are - from flood and civil turmoil to the effects of injury or illness.

By and large, too, rich people (in rich countries, this really means the financially included middle class) have salaries. Banerjee and Duflo from MIT (who in 2011 published the seminal Poor Economics) cast the extremely wide back in 2008, looking for common factors in the poor and financially excluded around the world. They found that what most distinguished people living above or below $2 a day was not education, health or wealth, but a steady job. People on $2 a day very seldom earn that much on any one day. Instead, they may earn $1 one day, $5 the next, $2 the next, and nothing the day after. As Rutherford wrote in Portfolios: “If you’re like others in that situation, then you’re almost surely casually or part-time or self-employed in the informal economy. One of the least remarked-on problems of living on two dollars a day is that you don’t literally get that amount each day…your greatest source of support is your family and community, though you’ll most often have to rely on your own devices.”

So it’s not just having very little money that makes poor people ‘poor’. It’s that they can’t control, predict or manage their incomes the way we can. If you can’t manage your income, you can’t manage your finances. And if you can’t manage your finances, you are at risk from the vicissitudes of life. As Alexia LaTortue, then Deputy CEO of CGAP and now Deputy Assistant Secretary for International Development & Debt at the US Treasury, put it in her response to this Working Group: “One of the major reasons people borrow is to deal with a health emergency (contrary to popular belief that borrowing is primarily for business-related reasons). A shock can set back a poor household an entire decade.”
The lives of the global poor

The financially excluded usually live in multi-occupational and multi-generational households. They are producers and consumers. Their sources of income vary. Even in rural areas, it’s rare that a household depends even 50% on income from agriculture. The structure of households is changing too. Migration is commonplace. Remittances and transfers may help, but the natural, in-built “social safety net” is being tested as cultures and communities become less cohesive.

From an aspirational perspective, the two billion-plus poor are hardly different from us. They want their kids to go to school, they want safe housing, and they want a decent and proper burial. But when stressed with the everyday challenges of dealing with low and irregular cash flows, it is difficult to have sufficient “peace of mind” to plan for the future.

When you live on a small, irregular and uncertain income, just getting food on the table is hard to manage out of current income. Managing all of life’s other expenditures out of current income is next to impossible. This leads to three common courses of action:

- First, in the worst case, you’re forced to go without. This happens only too often, with consequences that threaten lives and wreck opportunities.
- Second, you raise the money by selling assets - providing you have assets to sell and a buyer willing to pay an acceptable price.
- Third, in the best case, you can use past income or future income to fund today’s expenses.

The third course entails the decision to intermediate - the decision to save (to store past income that can be spent at a later date) or to borrow (to take an advance, now, against future income).

Behaviourally, the poor understand the value of commitment, says Alexia LaTortue. They seek mechanisms that allow them to save. Sometimes they also take loans to be able to save. At the same time, they are tempted like everyone to buy non-essential goods that absorb the extra income that could be saved. And the constant search for ways to manage their financial lives also takes up a lot of the “mental slack” that they could invest in productive activities.

A financial landscape

Before pressing on, it’s worth looking at the landscape of financial services in poor countries. Who is offering what to whom and how? The following framework was created by Rosalind Copisarow and focuses on the population segments at the upper and lower borders of the mainstream microfinance client base in order to try to pin down what is needed to widen access to appropriate financial services at both ends of the spectrum. (This framework excludes the estimated 500 million people in un-monetised communities.)
# A framework of financial services in emerging markets

<table>
<thead>
<tr>
<th></th>
<th>Clients</th>
<th>Providers</th>
<th>Products</th>
<th>Loan features Purpose</th>
<th>Loan Amount</th>
<th>Loan Term</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Below microfinance (1 billion)</strong></td>
<td>Potential micro-entrepreneurs with sporadic or seasonal cash income from casual work; living at bare subsistence level</td>
<td>Village savings/ credit groups, NGOs, Commercial goods suppliers, Local loan sharks, Remittance companies</td>
<td>Standardized loans, Savings (where member based ownership), Money transfers</td>
<td>Consumption items, Business start-up capital, Community assets</td>
<td>$5 - $200</td>
<td>2 months to 2 years</td>
</tr>
<tr>
<td><strong>Mainstream microfinance (500 million)</strong></td>
<td>Micro-entrepreneurs with very small but regular/daily income from their business</td>
<td>MFIs, which are deposit taking banks, NGO loan funds, Private non-bank finance companies, Loan sharks, Remittance companies</td>
<td>Standardized loans, Savings (where licensed), Insurance (usually in partnership with insurance company)</td>
<td>Working capital to purchase stock or small equipment, Housing improvements, Secondary/vocational education</td>
<td>$100 - $2000</td>
<td>Typically 6-12 months</td>
</tr>
<tr>
<td><strong>Above microfinance (500 million)</strong></td>
<td>Micro-business owners with paid employees, growing towards small businesses but not yet legally/tax compliant, Salaried low income employees</td>
<td>MFIs, which are deposit taking banks, NGO loan funds, Private non-bank finance companies, Loan sharks, Remittance companies</td>
<td>Tailored business loans, Leasing, Receivables finance, Insurance, Consumer loans, Credit, debit cards, Mortgage finance</td>
<td>Consumption, Working capital, Larger equipment purchase, Housing purchase/construction</td>
<td>$1,000 - $20,000</td>
<td>1-2 years for consumption  5-3 years for business Longer for housing</td>
</tr>
<tr>
<td><strong>Commercial bank clients (rest of world)</strong></td>
<td>Legally registered and regulation-compliant small &amp; medium-sized enterprises, Individual consumers</td>
<td>Commercial banks, Specialized Finance companies of all types, Insurance companies, Commercial goods suppliers</td>
<td>All Upscale MF products, plus Project finance</td>
<td>All upscale MF purposes plus Long term business loans, Risk hedging services</td>
<td>$10,000 +</td>
<td>Up to 25 years</td>
</tr>
<tr>
<td>Interest rate</td>
<td>12% p.a. if village/NGO-owned 300-500% p.a. if commercial with in-kind repayment (e.g. harvested crops)</td>
<td>30-100% p.a.</td>
<td>15-30% p.a.</td>
<td>5-20% p.a.</td>
<td></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>Security</td>
<td>Peer pressure; % Share of future revenue</td>
<td><strong>Peer pressure/ Cross-guarantees</strong></td>
<td>Salary deductions Business assets</td>
<td>Expected income based on historical salary Company Net profit Project assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Wholesale capital Funds</td>
<td>Villagers themselves NGO donors Commercial goods suppliers Local entrepreneurs</td>
<td><strong>NGO donors</strong></td>
<td>MF Investment Funds Development banks</td>
<td>MF Investment Funds Development banks Commercial banks Mainstream capital markets investors</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Source: Rosalind Copisarow</td>
<td></td>
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</table>
**How the poor are different from one another: segmenting the landscape**

For the first time, there is hard data to evaluate how women and rural residents around the world save, borrow, make payments and manage risk both inside and outside the formal financial sector. With the release of the Global Financial Inclusion (Global Findex) Database³, there is a comprehensive, individual-level, and publicly available database that allows for comparisons across 148 economies. Women and rural residents made up more than 75 per cent of the sample of the first round of the Global Findex database, based on more than 150,000 nationally representative adults in 148 economies over the course of 2011. It is an unprecedented census of financial exclusion around the world.

**Gender**

According to the data, in developing economies, 37% of women versus 46% of men are banked – though there are wide variations in the gender gap across regions and economies. In several economies – like Slovenia, Thailand and Uruguay – the gender gap in account penetration is essentially non-existent, while in others – like Jordan, Pakistan, and Guatemala – women are only half as likely as men to have an account. On a regional level, women in South Asia and the Middle East and North Africa are the most excluded from the financial sector compared to their male counterparts.

Modern microfinance has been based on the realisation that women are generally more prudent money-managers – and, therefore, are stronger candidates for microcredit. However, their financial activities are mostly household-based subsistence activities in sectors with limited expansion potential.

**Urban & rural**

Rural residents don’t fare much better. In Sub-Saharan Africa, adults in cities with 1m or more inhabitants report a rate of account ownership more than double that of adults living in towns/villages with a population under 10,000. And in all developing regions, adults living in cities are significantly more likely than those living in rural areas to have a formal account. For most rural people, livelihoods are related to subsistence farming activities. That means they are very vulnerable to weather and to catastrophic shocks. There are more smallholder farmers than microentrepreneurs, but while microcredit has flourished around the world, rural microinsurance has been much slower to scale.

Surprisingly, the data suggest that rural residents use short-term formal credit at a rate almost equal to that of their urban counterparts. Worldwide, 9% of low-income adults report having taken a loan from a formal financial institution in the past 12 months, and there is no

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difference between urban and rural residents. In fact, in many economies where community-based formal lending models (such as cooperatives, ROSCAs, village banking, credit unions, etc.) have been successful, the rate of formal borrowing is surprisingly high among rural residents. In Bangladesh, for instance, 25% of rural residents report formal institutional borrowing, compared to 16% of those living in urban areas.

In rural areas, finance follows the agricultural seasons. Farmers need to invest in seeds and fertilizer during the growing season and may need to borrow to pay for these, but are only able to repay the funds after the harvest. Finance providers therefore need to design facilities that follow the seasonal cycle. Another solution to this problem is for the seed merchants to provide input finance to the farmers and to be repaid out of harvest income.

The main issue for farmers is that many forms of finance require repayment to start at harvest time. This forces them to sell their produce at once, when prices are lowest. This is just one way that the lack of control in managing one’s finances can generate a negative feedback loop for the poor.

**Age**

There is a demographic bubble in virtually every emerging market - many African and Asian countries have a median age a decade lower than OECD countries. Young people there also tend to move through life’s stages much faster than peers in developed countries, and have economic responsibilities much earlier on. Plus, familial networks sometimes require young people to provide for elderly relatives, who are living ever longer.

**Why are the financially excluded, excluded?**

The Global Findex allows us to see how women and rural residents assess their own financial exclusion. Most people interviewed cite: “I don’t have enough money to use one” as the top reason for not having a bank account. However, women without an account in the developing world are six percentage points more likely than men to say “because someone else in the family already has one”. In South Asia, the gender gap is 10 percentage points. This suggests widespread indirect account use among women and highlights the impact that lack of asset ownership may have on empowerment and self-employment opportunities.

Predictably, rural residents are more than three times as likely as urban residents to cite distance to a bank as a barrier to account ownership. In all, 25% of rural residents in developing economies without an account say they don’t have an account in part because banks are “too far away”.
Using Microfinance

Microentrepreneurs and their finances

The “microentrepreneur” is the foundation of modern microfinance. According to Hugh Sinclair, there are broadly two types:

- those who have a business that generates a product or service as a result of fixed assets or skill (a repair garage, for example); and
- those who rely on turning over inventory (a typical market stall).

The former has a lumpy income, but usually moderate expenses. The latter has a more predictable income and expenses (sales, cost of goods), but thin margins.

So, what does an entrepreneur do with his or her income? It drip feeds in through time and options are limited. He or she can reinvest in the business (i.e. expand it), use the income for the regular costs of the business (pay for materials), pay personal expenses not directly related to the business (e.g. food, health), save (a store of value, with eventual destination unimportant) or repay loans or donate (usually to family).

So, when is credit required, and when are savings best?

Sinclair says that credit can be useful in an emergency, for consumption, to expand the business, or to cover short-term cash flow crises. Using credit in an emergency (e.g. for healthcare) is obviously dangerous, but this is commonplace. “Expanding a business” is what microfinance is ostensibly for, but this isn’t as common as the microfinance industry has made out, and a standard loan product satisfies this requirement. Consumption, in contrast, is about wanting things - accelerated consumption at the price of sacrificed consumption later - and is the main use of microfinance in practice. Income smoothing is a valid use for credit, but there are very few MFIs that offer a product that actually satisfies this demand.

Savings need to be accessible and voluntary. Long term, interest-earning savings are useful if only for safety from theft, but they need to be accessible in an emergency - otherwise the poor will hesitate, aware of their own volatility of income.

Like everyone, the financially excluded follow a portfolio approach. While flexibility and access are critical to deal with wide variations in income and expenditure, it is equally important for them to have externally imposed disciplines if they are to build up a lump sum for a festival, for marriage or for old age.
Volatility is the essence of financial exclusion

Financially included people in developed countries, says Hugh Sinclair, take for granted a number of things:

- Fairly stable income;
- Income insurance (or welfare support in the worst case);
- Savings to buffer shocks;
- Predictable expenses;
- Friends and family who are willing to lend;
- Rapid ability to find work, even drudgery, in an emergency;
- Certain services free at point of use – education, health etc.; and
- Relative physical security.

The ‘rich’ are, therefore, unfamiliar with the violent swings that can rock a poor person’s life in a flash. They are not simply poor - they are close to the edge, and their vulnerability is compounded by lacking the tools, contacts or education to use financial products to ride out the storms.

But the poor find complex and imaginative ways to cope with these storms. Rutherford and colleagues spent years interviewing and assembling the financial diaries of the financially excluded in Bangladesh, India and South Africa. The example below presents a revealing example of how the poor manage their financial lives.
A typical financial diary, from *Portfolios: Hamid and Khadeja from Dhaka, Bangladesh*

Surviving on approximately $0.78/person/day, Hamid and Khadeja fall into the bottom two-fifths of the world’s income distribution tables. They are borrowers, with a debt of $153 to a microfinance institution and interest-free private debts from family, neighbours, and employer totalling $24. They also owe money to the local grocery store and to their landlord. However, Khadeja has also been acting as an informal banker, or “money guard”, holding $20 at home that belongs to two neighbours seeking a way to keep their money safe from their more spendthrift husbands and sons. Hamid himself has also used a money-guard, storing $8 with his employer while waiting for an opportunity to send it down to the family home.

Hamid and Khadeja’s involvement in finance does not mean that they ended up with debts that they found impossible to manage. Although their “net worth” (the balance of their financial assets and liabilities) was negative, the amount was small relative to their total annual income and their “debt service” ratio - the proportion of their monthly income that they had to spend on servicing their debts - was manageable.

Their active engagement in financial intermediation also shows up clearly on the liabilities side of their balance sheet, for end-November 2000.

<table>
<thead>
<tr>
<th>Financial assets</th>
<th>$174.80</th>
<th>Financial liabilities</th>
<th>$223.34</th>
</tr>
</thead>
<tbody>
<tr>
<td>Microfinance savings</td>
<td></td>
<td>Microfinance loan account</td>
<td>153.34</td>
</tr>
<tr>
<td>account</td>
<td>16.80</td>
<td>Private interest-free loan</td>
<td>14.00</td>
</tr>
<tr>
<td>Savings with a moneyguard</td>
<td>8.00</td>
<td>Wage advance</td>
<td>10.00</td>
</tr>
<tr>
<td>Home savings</td>
<td>2.00</td>
<td>Savings held for others</td>
<td>20.00</td>
</tr>
<tr>
<td>Life insurance</td>
<td>76.00</td>
<td>Shopkeeper credit</td>
<td>16.00</td>
</tr>
<tr>
<td>Remittances to the home</td>
<td>&gt; 30.00</td>
<td>Rent arrears</td>
<td>10.00</td>
</tr>
<tr>
<td>village*</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Loans out</td>
<td>40.00</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash in hand</td>
<td>2.00</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Financial net worth $-48.54

Balance sheets like this one, however revealing, don’t tell the story of how Hamid and Khadeja manage their money on a day-to-day basis. That story comes from studying cash flow rather than balances - from tracing the ebb and flow of cash into and out of savings and loan and insurance instruments. In the year that led up to the balance sheet, Hamid and Khadeja “pushed” $451 of their income into savings or insurance or into loan repayments, and “pulled” $514 out of savings or by taking loans or agreeing to guard money for others. That total turnover - $965 - is more than their total income for the year, which, at an average of $70 a month, came to about $840.
**The consequences of volatility**

So Hamid and Khadeja - like hundreds of millions - have low, irregular and unpredictable incomes. This means:

- They have difficulty meeting interest payments and repayment schedules;
- They may not be able to cover other transaction costs - such as bus fares for repayments, and/or arranging for someone else to look after the shop, animals or children;
- They may be unable to find suitable products – loans in smaller amounts or of shorter duration, or that do not require the holding of minimum balances; and
- They often cannot meet the terms of the standard microloan – which tends to require equal weekly repayments.

This adds up to a combination of volatility of both income and expenses, combined with a lack of buffer, and compounded by a lack of credit (in the broad sense of the word – paying for things affordably in instalments, negotiating with a vendor, entering into legally binding contracts, etc.). The financially excluded, for the most part, either have the money in cash right now, or they do not. No cash means no product or service. Add in a shock or two, and becoming part of the ‘Hardcore Poor’ beckons.

Being that close to the edge leads naturally to risk aversion. Roodman describes an experiment in Sri Lanka that showed that injecting modest additional capital into microenterprises let the owners earn average returns of 5% per month. The same experiment in Mexico generated returns exceeding 20–33% per month. Why poor people often leave these potential winnings on the table by under-investing in their own businesses is not clear. They may not recognise the opportunities. They may struggle to pull together the lump sums needed to invest. Or perhaps micro-businesses are like tech stocks: high return on average, but also high risk. So when they do invest, poor people diversify across several small enterprises - not investing too much in any one.

Whatever the reasons, poor entrepreneurs work to survive. To this extent, labelling them “microentrepreneurs” risks romanticising their plight. This is why some distinguish between ‘necessity entrepreneurs’ and ‘opportunity entrepreneurs’, and why Aloysius Fernandez, who founded the self help group movement in India, proposed the label ‘microsurvivors’.

The following chart shows the revenues, expenses and profits of Puzma, one of the financial diarists in *Portfolios*. She cooks and sells sheep intestines out of a stall in a Cape Town slum. She made $95 per month on average during the eight months the researchers visited her (after netting out firewood and intestines). This equated to 80c per person per day for her and her

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four children. But as always, beneath the average is a story of volatility: of famine and (relative) feast.

![Puzma's income and expenditure over eight months, reproduced from 'Portfolios'](image)

**Breaking down barriers to entry**

The financially excluded face barriers to access all around them. These can be geographical, the rural/urban divide, the cost of credit, transaction costs, social exclusion, financial capability, cultural barriers, or the role of women in the household. Some barriers can be addressed by official policy (documentation requirements, for example) and by better private sector delivery (door step services, mobile wallets, etc.). Some, however, are likely to be deeper or more fundamental (religious barriers for instance, or simply lack of money).

That said, progress in different areas shows that the poor can be reached through different channels – through innovation (mobile money, as the best known example), by large commercial banks downscaling, and through new actors such as greenfield MFIs in Africa.

It is an irony that the financially excluded are the people who probably need financial services more than any other group. Poor households have to manage relationships and transactions with others - family, neighbours, moneylenders, and savings clubs - that Rutherford and colleagues first described as a ‘Portfolio’. The products suitable for such a portfolio, the role of financial capability and technology platforms and the opportunity for mainstream financial services are the focus of the next section.
“First, we came to see that money management is, for the poor, a fundamental and well-understood part of everyday life. It is a key factor in determining the level of success that poor households enjoy in improving their own lives. Managing money well is not necessarily more important than being healthy or well educated or wealthy, but it is often fundamental to achieving those broader aims. Second, we saw that at almost every turn poor households are frustrated by the poor quality - above all the low reliability - of the instruments that they use to manage their meagre incomes. This made us realize that if poor households enjoyed assured access to a handful of better financial tools, their chances of improving their lives would surely be much higher.” - *Portfolios of the Poor*
Part 2: How well-aligned with client needs are the products that are available – and which products are aimed at currently underserved groups?

The second Working Group brought together experts representing the three main financial product lines available to the underserved – credit, savings, and insurance. Between them, they have worked in dozens of countries: in banks, MFIs, NGOs, governments, universities and village groups.

The members of this Products Working Group were:

- Graham Wright, the ‘thought leader’, who helped establish the Microsave programme and is currently programme director for India. He pioneered the market-led approach used by Microsave, and has a two-decade career in international development which followed several years in management consultancy. He is also Chair of CGAP’s Savings Mobilisation Working Group.
- Narasimhan Srinivasan, former chief general manager at the National Bank for Agriculture and Rural Development in India, author of the annual Microfinance India - State of the Sector report and currently a consultant.
- Michael McCord, president of The MicroInsurance Centre - an organisation dedicated to creating partnerships in order to provide insurance to low-income markets around the world.
- Alexandra Fiorillo, then vice president for international development at ideas42 and currently founder of Grid Impact - a global research, innovation and design firm that specializes in human-centered approaches to policy, program, and product challenges. Previously, she was a vice president and COO of MFTransparency.

Further valuable input was provided by:

- Richard Leftley, president and CEO of MicroEnsure. He began working in microinsurance in 2002 after leaving Benfield Grei, and has pioneered the introduction of insurance products within the Opportunity Network. He also serves on the steering committee of the ILO Microinsurance Innovation Fund, a $35m fund supported by the Gates Foundation.
- Declan Duff, a former member of International Finance Corporation’s Management Group.
- Jeff Ashe, adjunct Associate Professor of International and Public Affairs at Columbia University, who also serves as the director of community finance at Oxfam

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5 These are not the only financial products to discuss: remittances, payments systems, CCTs are important too. But from the consultative sessions held with CSFI guests, it was clear that credit, savings and insurance should be the focus of this working group, with a special focus on insurance. This paper reflects that.
America. He pioneered the Saving for Change model, which reaches more than half a million members in several countries.

Again, this paper isn’t intended to be comprehensive. It is intended to stimulate discussion among the mainstream financial sector, the government and DFID, and the third sector, on how to develop products that are sustainable, fair, scalable, appropriate and potentially profitable.

Graham Wright & Sam Mendelson: Delivering value to low income customers with market-led products

Financial institutions trying to serve the low-income mass market rarely have time to conduct the market research necessary to identify prospective clients’ real needs. Many rely on so-called “bath-tub product development” – product ideas developed on the basis of the senior management team’s experience and gut instinct. Others prefer a “me too” strategy - and thus simply wait, watch and copy products offered by their competitors.

It doesn’t always work. India’s widely-available “No Frills Accounts”⁶, rolled out by many banks, are a case in point: dormancy is estimated to be 80-90% despite the government’s attempts to push conditional cash transfers through them.

That said, research at MicroSave has demonstrated that there are products to which poor people aspire and needs that they could meet – and that poor customers are, in the main, willing to pay for them.

MicroSave research has highlighted that people don’t just want, but need, financial services that are convenient, accessible, affordable and appropriate (see box). Services have to be ‘reliable’ too: consistently available, and on demand. A single transaction account like the No Frills Account is unlikely to meet all these criteria – particularly when delivered through the traditional bank branch infrastructure.

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⁶ The generic name of this account seems almost designed to brand it as a poor quality offering … a cue taken further by one leading bank which offered their No Frills Account as the “Tiny Account” so that the users felt really insignificant to the bank!
Key Product Criteria

**Convenience**: which requires proximity and longer opening hours – probably through a distributed agent network.

**Accessibility**: which often necessitates ATM cards or mobile money solutions, in order to avoid overcrowded branches, complex forms and intolerant bank staff.\(^7\)

**Affordability**: which covers direct costs (transport to the branch and food), indirect costs (lost wages and other opportunity costs), and hidden costs (bribes and commissions for filling up and processing forms) - and not just the fees/interest rates that are formally charged by the bank.

**Appropriateness**: which must reflect how poor people live and how they think about and manage their money.

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7 *MicroSave Briefing Note # 112 “Financial Education: Time For A Re-Think?”*
Poor people’s need for appropriate products also means they need a range of products to reflect their life cycle. They also need disciplined systems that break down their accumulation of lump sums into smaller manageable amounts.\(^8\)

The products on offer should ideally be differentiated for specific needs, in the same way that poor people often earmark specific income streams for specific uses. For example, saving for a bicycle, to buy some land or for old age are very different in terms of the time horizon and the amounts involved. Similarly, loans for a medical emergency and for investing in a fixed asset are very different in terms of size and structure, as well as the pace at which they need to be appraised and disbursed.

This has implications for financial institutions seeking to offer a range of products to lower income clients. A single transaction account cannot meet complex savings goals; equally, a standard working capital loan, repayable in weekly instalments over a year, is only appropriate for a limited set of business people.

As a bare minimum, poor people probably need access to a suite of products that includes:

- A transaction or very basic savings account (linked to a reliable and efficient payments/remittance system that is not too costly);
- Deposit accounts for different goals (with an attached overdraft to which they have automatic and immediate access);
- A general short-term (up to one year) loan facility (that can be used for working capital as well as consumption smoothing, education etc.); and
- A longer-term loan facility (secured against assets acquired with the loan).

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8. MicroSave Briefing Note # 13 “Money Managers: The Poor and Their Savings”
The need is pretty clear, but meeting these demands through traditional financial infrastructure is challenging. While the Grameen Bank II system\(^9\), Equity Bank in Kenya\(^10\), and a handful of others go a long way towards achieving this, most banks struggle to see a business case in offering such a range of products to the poor. The Financial Diaries highlighted how vigilant poor people have to be when managing money, and how many small transactions they undertake. Unfortunately, “high volumes of low value transactions” is the perfect description of a traditional banker’s nightmare. However, as Equity Bank has shown, a judicious mix of clients and products backed by a commitment to customer service, can allow banks to serve the low-income market - and keep shareholders happy.

Equity Bank gets deserved attention. It is now pioneering the use of electronic and mobile banking (e/m-banking) to deliver a range of products tailored specifically for these channels. This has the potential to once again revolutionise banking for the poor in Kenya. The introduction of agent-based services has also resulted in massive uptake – both in the number and value of transactions. The bank now has over 5,000 agents and (as the chart above shows), transactions have rapidly increased.

By August 2012, 2.2m transactions had been made in Equity Bank branches, and 1.8m transactions had been made through agents. Since then, the number of transactions in branches has remained steady, whereas transactions through agents continue to climb at a rate of 100,000 per month. Over half a million dormant accounts have also been reactivated since the introduction of agent-based banking services in May 2011 – a demonstration of how the under-banked are responding to the new convenience and accessibility of affordable and appropriate services.

Whether all banks will be willing to follow Equity Bank’s example to use technology to offer a range of financial services to a broad customer base remains to be seen. There are several important “conditions precedent” which underpinned Equity Bank’s move. In particular:

1. M-PESA had already created an environment in Kenya in which managing money on a mobile phone was accepted by the majority – thus Equity did not face the ‘first mover’ disadvantage that plagues e/m-banking pioneers;
2. Equity Bank had already invested heavily in IT platforms;
3. The bank already had a commitment to customer service and to serving a wide range of clients with a range of financially-inclusive products;
4. The bank had already invested in development of a well-staffed market research and product development and capability; and
5. As a pioneer, Equity Bank was able to access donor funds to support its foray into agent-based banking.

Whatever these enabling conditions, Equity Bank’s example highlights the desirability of collaboration among banks, telcos, MNOs, governments/regulators and other stakeholders.

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\(^9\) See MicroSave Grameen II Briefing Note # 8 “Lessons From The Grameen II Revolution” and Portfolios of the Poor Briefing Note # 7 “Grameen II and Portfolios of the Poor”

\(^10\) See MicroSave Briefing Note # 63 “The Market Led Revolution of Equity Bank”
(such as utilities and financial service providers). This collaboration is developing in Kenya and in many of the markets where e/m-banking is taking off. It is essential if there is to be real financial inclusion, and not just “low equilibrium” financial inclusion – the low-quality, high cost and potentially high risk financial inclusion associated with telco-driven, payment only systems.

It is also worth noting that, though M-PESA is a remarkable success as a payments system, it is only used by clients on average twice a month (at a cost of around US$0.35-0.50 per transaction) to send a remittance, to make a payment or to transfer funds. And it is still not widely seen as an appropriate system through which to save.

This has implications for large banks and insurance companies. Major financial institutions can be unsure how to respond to the growing market share of institutions like Equity Bank – often flirting with going downmarket and then retreating to their traditional, more affluent customer base. Others, such as the British-American Insurance Company, have collaborated to significantly increase sales and outreach.11

New technologies can offer creative banks and insurers a range of opportunities to deliver products to a lower income market without the need for traditional physical infrastructure. They offer the opportunity to enhance the scope and scale of financial inclusion – on a profitable basis.

However, if we are to achieve real financial inclusion, we must:

- Offer the poor a range of savings, credit, payments and insurance products tailored to their needs, aspirations and “mental accounting”;
- Communicate the products (and the opportunities they offer) in clear, concise client-focused language; and
- Leverage new technologies to deliver these products in a convenient, accessible, reliable and affordable manner.

**Small-scale savings: Is managing costs possible?**

Households have always saved - as insurance against emergencies, for religious and social obligations, for investment and for future consumption. The importance the poor attach to savings is demonstrated by the many ingenious (but often costly) ways they find to save. But most informal mechanisms fail to meet the savings needs of the poor. So, when poor households are provided a safe, easily accessible opportunity to save, their commitment to saving, and the amounts they manage to save, are often remarkable.

11 See *MicroSave Briefing Notes # 123 “Agent Banking and Insurance: Is There A Value Alignment?”* and # 124 “Insurance Through Bank Agents: How Can It Be Done?”
Why do the poor seldom have access to formal savings accounts? The reasons include:

- Their geographical distance from the savings institution;
- The Terms and Conditions or regulations governing the financial services on offer;
- What anthropologists call ‘Structural Violence’ (the fear that poor people have of institutions of power);
- The intimidating appearance of the financial institution; and
- The complexity of the paperwork – which may be exacerbated by illiteracy.

“Illiquidity preference”

Research also suggests that the poor often have a strong “illiquidity preference” – in that they have a need for structured savings mechanisms that prohibit withdrawals for trivial wants and that allow them to fend off the demands of marauding relatives. It’s the structure and security they want, and they’re willing to pay for that. As a result, the return on savings in the informal sector is generally barely above zero; in fact, the poor frequently pay to save (for example in the Ghanaian ‘susu’ system, described by the CSFI’s previous Development Fellow, Mark Napier in Including Africa: Beyond Microfinance\(^\text{12}\)).

That said, financially excluded families require savings for different purposes, in different amounts and at different times. Poor people need both liquid and illiquid savings – and those who save often hold multiple accounts to do so. They also use a strategy of “targeted savings” to build-up large/lump sums to purchase significant capital assets such as land or a house.

In general, the poor require little encouragement to save. In cases of compulsory savings (when an MFI requires a percentage of a loan to be ‘saved’ before disbursal, as collateral and proof of income), this tends to be viewed not as real savings, but as part of the cost of the credit. Some clients do use these compulsory savings to build up useful sums of money. But there is considerable resistance to these schemes – not least because they can confuse clients as to the real interest rate. MF Transparency has done important work exposing this\(^\text{13}\).

\(^{12}\) Available [Here](http://bit.ly/1hYcaUh)

\(^{13}\) [http://bit.ly/1hYcaU](http://bit.ly/1hYcaU)
A Note from CGAP: Demand and Supply in Savings

“Although demand is high, only around half of the world’s households have access to a savings account. Most poor people use a variety of informal savings instruments—from mattresses to savings clubs to investing in gold or livestock—to manage their small and unpredictable incomes, often at the risk of loss, theft or depreciation.

“Why is this? First of all, there’s the expense. The smallest savings accounts—those held by poor and low-income clients—are also the most costly for financial institutions to maintain. On top of that, there’s the geographical isolation of many of the poor, living in areas far removed from banks’ branch networks.

“So what can we do about it? The good news is that economies of scale and technology-based innovations can bring down costs. A recent CGAP study shows that the high operating costs linked with small-balance savings mobilization can be more than offset by the profits generated through cross-sales of loans and other products to the small savers, as well as by fee income from savings accounts and the use of technology.

“Financial institutions can bring much-needed savings services to poor people by engaging in innovations with technology and economies of scale. However, they must also remember that in order to cover their costs and be sustainable, full financial intermediation - including a sound credit business - is necessary. To design more appropriate savings services, institutions must also actively work to better understand poor people’s needs. Demand studies are still in short supply, and more research is greatly needed to help institutions better design and market their savings products to poor clients”.

Institutional reluctance

Many institutions are reluctant to offer a savings product for poor people because of the many small transactions – and therefore high costs – involved. While this is probably inevitable, several important observations are broadly agreed upon by the Working Group members:

- Generally, the overwhelming majority of transactions will be deposits. Indeed the poor seldom make withdrawals – they just want to know that they could withdraw if a pressing need arose;
- Poor people have a multiplicity of needs and are not always looking for a highly liquid account to use on a regular basis; and
- Savings accounts targeted for medium and long-term needs are particularly attractive to MFIs in search of capital for on-lending, and appropriately designed products can encourage these.

14 A LaTortue, Briefing Note on Savings, http://bit.ly/1psdGRH
There are also benefits to offering a savings product. They can:

- Develop a client base (of borrowers) for the future;
- Provide information on a client’s ability to save - and (by implication) repay loans;
- Facilitate loan repayment when a client is unable to meet repayments out of current income; and
- Encourage repayment, as clients want to maintain access to future services.

There are also many ways for financial institutions to minimise the cost of providing savings services - and possibly even to make a profit from doing so. These can include structured pricing to encourage customers to maximise deposits and minimise withdrawals. Institutions can also elect to pay interest only on accounts with balances above a certain minimum, or charge fees for specific savings services. In order to reduce withdrawals, institutions can limit the number of withdrawals per period, set minimum withdrawal amounts, require notice to withdraw, or charge for withdrawals. In addition, an institution can reduce costs through use of alternative delivery channels. Finally, institutions offering “micro” savings may also seek up-market, higher-value savers to spread the costs.
Credit

Credit has been the cornerstone of microfinance for decades. It is easier and cheaper to offer than savings – and usually a lot more profitable. But the boilerplate microcredit product has probably had its day. A range of demand-driven credit products is emerging, tailored to the needs of different market segments, and recognising what has been an open secret for a long time: that most ‘microfinance’ often isn’t really microenterprise lending, but is for consumption, income smoothing, and emergencies.

Like savings, credit varies as to whether it’s for groups or individuals. In groups, collateral substitutes in the form of group liability are typically used. Loans may be given to groups or to individual members based on the joint liability of the group. The loans to groups may then be on-lent to members, using criteria that may differ from group to group. Most of these loans are ostensibly for productive, or income-generating, purposes. But, as N. Srinivasan argues, among the vulnerable, the demand for credit is virtually unlimited – desperation for cash make the poor take a loan with any kind of feature, since any loan from a financial institution is better than a loan from a moneylender or loan shark. Institutions mistake the loan off-take by desperate borrowers as strong demand for their ‘good product’ – breeding complacency in product design and reluctance to test hypotheses.

Moreover, the credit process has often been unfit for purpose, and too supply-led. Among the questions that should be (but which seldom are) asked of a borrower, three stand out:

- Whether the amount of the loan is adequate for the purpose stated in the loan application;
- Whether the loan duration is appropriate; and
- Whether the interest can be paid from the anticipated returns.

The problem is that monitoring the use of loans is difficult. Clients tend to see cash as fungible, and use it for their immediate priorities.

Because of this, MFIs and banks are increasingly designing customised financial products that meet the specific requirements of poor borrowers and that are intended to make it harder to divert the funds to other uses. But even these products can fail. For example, MFI enterprise loans tend to be slightly larger than consumption loans. But that may just mean that they are diverted to cover the cost of sickness or death in the family.

In India over the last few years, there has been a tendency to promote loans that are supposed to encourage broader environmental and social sensitivities – health and hygiene, drudgery reduction etc. Unfortunately, these loans do not directly support activities that improve client incomes or stabilise their livelihoods, and as such they carry a higher risk of failure. Products which are more focused on specific needs are more valued by customers – who are more willing to keep up the relationship with the credit provider even in the face of personal problems.
Such products reflect demand-side considerations, rather than just supply-side concerns. “Better” credit products, Working Group members agreed, are those that are adequate for their purpose, with flexibility on repayments, an assured continued availability of credit, and provision for the regular collection of repayments from the borrower. They should also have a strong fit to both the purpose of the loan and the characteristics of the borrower.\(^\text{15}\)

The rickshaw loan and the pregnancy loan are two of many examples of how products can be both fit for purpose and responsive to demand.

\(^{15}\) For example, a loan by a fishermen’s cooperative in South India with a specified number of repayment holidays that correspond to the off season for fishing.
The ‘rickshaw loan’

Eight million livelihoods in India depend on the rickshaw, but few who pull them actually own them. The Centre for Rural Development (CRD) therefore designed a rickshaw loan. An improved, ergonomically efficient vehicle was designed with the participation of IIT, Guwahati. This rickshaw was made available on an instalment purchase plan to rickshaw pullers. The condition was that they should be in JLGs of five members and function in a cluster – called a garage – of five JLGs. Each loan was for Rs 10,500 (about US$170), and included not only the cost of the vehicle, but two years of licence and insurance costs. (The insurance covered the rickshaw and the borrower’s life and third party injuries/death due to accident.)

The rickshaw puller is supposed to repay at the rate of Rs 25 per day, over 520 days - for a total of Rs 13,000. However, the CRD generates additional revenue by renting the rear of the rickshaw for advertisements. The revenue from this is Rs 5,000 per annum - which is offset against the loan. After the loan is repaid, the rickshaw becomes the property of the puller.

While CRD gets some grant funding from the America India Foundation, banks have also come forward to provide loans. The State Bank of India (SBI), the Punjab National Bank (PNB), ICICI Bank and HDFC Bank are prominent funders. As a result, more than 4,000 rickshaws have been financed as of 2012 - and more than 1,500 pullers have repaid their entire loans to claim ownership of the rickshaws.

The pregnancy loan

At the time of delivery, women need money for hospitalisation, medicines, transport and other necessities related to childbirth. Poor families find it very difficult to put together the cash required. A pregnancy loan supports a mother through childbirth and through a follow-up period.

Hand-in-Hand, in Tamil Nadu, came up with a loan product to meet the requirements of pregnant women. The idea is that the woman should register as soon as she gets to know of her pregnancy, and should start saving from then on until the date of delivery. When she is to be hospitalised, Hand-in-Hand would then provide a loan equivalent to five times those savings, up to a ceiling of Rs 3,000.16

16 For brief outline and further info see http://www.ifmr.co.in/blog/2010/07/29/cifd-to-launch-pregnancy-financing-product/
Examples abound of specific-purpose loans. There are, for instance, rainwater harvest loans and solar panel loans in East Africa: in these cases, the financial institution partners with the vendor. While still nascent, home mortgage loans for the financially excluded are also being tried in several markets - notably MexVi and Por Fin, Nuestra Casa in Mexico17 and MiBanco’s Micasa product in Peru18. In the case of Por Fin, Nuestra Casa, the institution takes old shipping containers and turns them into single family homes for factory workers near large factories; the mortgage allows individuals to purchase their new home. Harmos in Zambia is offering small consumption loans to purchase bicycles for business purposes. Small livestock loans, fixed asset loans, and technology loans for water pumps or tractors are other examples of the many focused products being piloted at the present time.

Srinivasan believes the important point here is that it is not any single product that is key. Rather, it is the need to adopt a process for designing good products that are relevant to customers and easily marketed and serviced by the financial institutions.

Of course, the features that make a ‘good’ product depend on the specific requirements of the customer; even so, many ‘good’ products fail in the market. Demand for credit among the vulnerable and desperate makes the poor take a loan with almost any kind of feature. The frequent result is a mismatched product - such as weekly instalment loans for crop production, or small loans for large investments, or loans for investment assets with inappropriately short duration. Weekly instalment loans for crop production or an emergent treatment of the sole breadwinner in the family, small sized loans for large investment outlays and loans for investment/assets with inappropriately short repayment duration are examples of too-common and mismatched products, says Srinivasan.

There is no ‘magic bullet’ credit product that meets all the key criteria (for the lender as well as the borrower) all the time. That said, a flexible repayment loan – where the repayment term is defined, with provision to skip one or two intermediate instalments if circumstances necessitate it – will generally be the most useful product for the poor. What needs more development is the process of building loan products that fit the requirements of different kinds of people with different livelihoods – together with an assurance that the loan facility will not be withdrawn prematurely.

Assumptions as to the nature of demand are often flawed. When most problems of the vulnerable are seen as “curable” with a loan, we will tend to find that those loans fail. One problem is that many financial products for the poor have been designed by people or organisations who have worked in not-for-profit development projects dealing with the poor – and finance is a very different commercial activity requiring a different understanding of customers.

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18 See [http://www.citiesalliance.org/mibanco](http://www.citiesalliance.org/mibanco)
Why do credit products fail?

“Most reasons for product failure are attributable to supply side presumptions. Often, products are introduced without sufficient preparatory work. Equally, an overzealous espousal of ’noble’ causes has caused failure many times. Sanitation loans, for instance, have often been given to households to build toilets when they did not have a decent roof above them, resulting in diversion of funds and default. Bundling of products with loans has also resulted in failure. At various times, water filters and solar lamps have been marketed for drudgery reduction and improved health – bundled together with loans. When the physical products failed to function up to expectations, borrowers inevitably defaulted on the loans as they identified the bad product with the lender. Housing loans with a very long repayment period also tend to run into problems – particularly since poor households tend to spend the money on other uses. One MFI that gave large uncollateralised individual loans (about $500, against a normal emergency loan of $50-100) for meeting emergencies found it difficult to recover the loans. Individual enterprise loans to the poor and near poor have always faced high rate of failures. Enterprise skills appraisal and market analysis have been overlooked in making such loans. Loans without collateral are easier to manage in groups, but not in individuals”.

N. Srinivasan

Credit Product Design

The potentially unlimited demand for credit has also led to a rather cavalier approach to product design in the initial stages, with adverse fallout later. Financial institutions should follow a rigorous protocol for product development, testing and mainstreaming if the products are to survive in the marketplace.

The differences that are relevant relate to size, term, frequency of repayment instalments, pricing and flexibility. Agricultural crop loans, for instance, require short duration loans matched against the crop cycle – typically not exceeding five to six months in most crops – and bullet repayments without any instalments. In contrast, agricultural investment loans – say for irrigation or farm equipment – should be long term, repayable in one or more instalments each year based on harvesting and marketing of the crops. For their part, small trading enterprises require yearly credit limits (with frequent repayments), which can be drawn against as needed.

By contrast, small enterprises in manufacturing or processing require longer-term loans for investment in capital assets, as well as loans for working capital, argues Srinivasan. While investment loans may have quarterly/half-yearly or annual repayments, working capital may be covered by a credit limit which can be drawn on or repaid as many times as needed.
On top of all this, the individual’s household cashflow needs to be examined. In the end, it might be better to design a loan around a household’s cashflow, since most vulnerable families have multiple income/expenditure streams.

In other words, economic activities and consumption patterns drive both credit demand and product design.

It is worth noting that livestock rearing is an activity that is native to almost all of Africa – but that is financed only infrequently. Equally, in South-East Asia, many countries have three possible cropping seasons, but the poor lack resources to buy inputs and to build holding capacity so as to time the market for better prices. Here, the nature of loans would be different and would focus on helping the production side, rather than dealing with hunger and food security. Again, as more sophisticated agricultural practices are introduced, the nature of credit demand in Africa will undergo a change. Population density and the broader economic environment determine the cost of operations as well as the risks, and these have to influence product design from the supply side. In general, denser populations lead to lower costs for financial products and a better ability to cross manage risks. Overall, however, Africa imposes a higher cost of operations that often makes very small loans unviable from the supply side.

**Alternative delivery channels**

In financing the poor, it is difficult to separate the product from its delivery. A ‘good’ product can fail as a result of bad delivery. Continuing customer contact, the ability to account for money in real-time, fraud avoidance through quality authentication processes, etc. are all critical. Technology can also be crucial. Using smart cards for identification and authentication, for instance, virtually eliminates fraud arising from impersonation. Point of Sale (PoS) machines or mobiles can also help in back office accounting and MIS, eliminating delays in generating financial and other information of value to financial institutions.

Mobile phone-based technologies should enable poor customers to control more of their finances. If e-wallets can provide credit facilities, it should become possible to undertake cashless transactions – with all attendant advantages. But this will take time as most poor populations (in South and South East Asia and Africa) have only recently moved into the cash economy and might find the move to e-money a tall order. However, even if only field officers of banks/MFIs use e-wallets for handling their cash and accounting, costs can be reduced considerably.

Equally, the use of technology in livestock financing – especially to monitor animal health and to provide low-cost insurance cover – is an exciting prospect. Presently, this is in small scale isolated experiments, but it has the potential for wider application.
Dealing with Emergencies

Microfinance institutions tend to offer credit products that are ill-suited to meet emergency financing needs: the loan amounts are often too large and carry interest rates too high to be viable sources of emergency funding.

To counter this, the Emergency Hand Loan\textsuperscript{19} was developed in India by the Center for Innovative Financial Design (CIFD) at the Institute for Financial Management and Research (IFMR). It is currently offered by Dhanei KGFS, a financial service provider operating in Ganjam District in Orissa. The product provides an easily accessible loan for customers to meet basic needs in an emergency. These could be medical or education expenses, although the loan is flexible in its use.

The Emergency Hand Loan

The design of the Hand Loan attempts to replicate the convenience offered by existing informal sources of emergency finance. Once an eligible customer indicates why he or she needs such a loan, it is distributed within minutes. Like informal loans from moneylenders or local pawnbrokers, it is available even outside business hours.

A survey of 450 Hand Loan customers at Dhanei KGFS shows that 225 took out at least one loan, with some taking out several between January and July 2010. It is clear that the need for credit as a smoothing device or as a way to tide a customer over during an emergency leads to a very different kind of product than, say, small-business loans.

The Hand Loan has already displaced some sorts of informal loans, particularly those obtained from pawnbrokers, who charge high interest rates and require collateral that is sold if the loan is not repaid on time. Less expectedly, however, some customers quickly repaid their Hand Loan using salary advances from their employers – who generally charge no interest and can be repaid in small instalments.

The Hand Loan is still in its pilot phase, but has already proven successful in its objective of providing convenient, formal access to emergency finance for low-income families.

\textsuperscript{19} IFC Advisory Services, Emergency Hand Loan, A Product Design Case Study
Microinsurance

In the end, insurance may prove to be the most important financial service for the poor.

There is already a huge variety of microinsurance products beyond simple ‘credit life’. The MicroInsurance Centre conducted a landscape study in the 100 poorest countries in 2007, and repeated it for Africa in 2010 (with the Microinsurance Innovation Facility) and 2012. The 2007 study showed variety, but clearly a predominance of credit life. The 2010 study showed funeral insurance as the predominant product (primarily because of its importance in South Africa). New landscape studies in other regions suggest a further increase in the range of microinsurance products.

Credit life has dominated the market, since it offers an easy and profitable entry point. But insurers have moved on themselves – and have been pushed into a wider range of products by new delivery channels. That said, the global market is not homogenous. Different countries and regions focus on different products. India, for instance, already has large numbers of individuals covered by health microinsurance (though this is related to government subsidies). West Africa by contrast is leading in community-based health microinsurance.

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20 There is a wealth of information on this sector, including [www.microinsurancecentre.org](http://www.microinsurancecentre.org); Microinsurance Compendium: [http://www.munichrefoundation.org/home/Projects/Microinsurance/2006Microinsurance_Compendium/-Microinsurance_Compendium-Vol-2.html](http://www.munichrefoundation.org/home/Projects/Microinsurance/2006Microinsurance_Compendium/-Microinsurance_Compendium-Vol-2.html); Microinsurance Innovation Facility: [http://www.ilo.org/public/english/employment/mifacility/knowledge/publ.htm](http://www.ilo.org/public/english/employment/mifacility/knowledge/publ.htm);

21 Credit Life is insurance coverage designed to extinguish the outstanding indebtedness of a borrower who dies while indebted. The purpose is to protect both the borrower’s dependents or estate and the lender. There are many variations from this basic theme, such as expansion of coverage to include the life of a borrower’s spouse, higher coverage amounts than the outstanding loan, and insuring other risk events such as borrower disability. Credit life is sold either on an individual or group basis.
Seven general categories of microinsurance

Microinsurance comes in all shapes and sizes:

**Term life**: A fixed amount is paid if the customer dies within a fixed period of time (usually sold as a funeral product).

**Endowment**: This product pays out not just in case of client mortality, but also if she or he survives (this is like a savings product, but one which pays a lump sum). These can be bad for the poor, because of their typically unstable incomes. The client who doesn’t keep paying premiums loses everything - and the chance of being able to pay every premium over five years is low for many clients. Moreover, many policies have been missold: high inflation can mean that the endowment paid out at the end of the term is only a fraction of its original value.

**Property**: Protection against fire, and natural disaster.

**Disability**: Disability insurance is usually packaged into ‘life’.

**Livestock**: This is a difficult and immature, but potentially important, sector. An example is the IFFCO-TOKIO pilot described in Appendix A to this report.

**Crop**: There is already yield insurance, which is very open to abuse. As a result, an index was introduced. But the problem is that data isn’t often available, and this sub-sector will, therefore, take time to develop.

**Health**: This is among the most popular products. There are three general categories:

**Hospital cash**: The policy pays out a fixed sum if the customer goes to hospital - irrespective of cost. A low-admin product, so very scalable.

**Inpatient**: A premium is paid, and if the customer is admitted to hospital (as 3-5% will be in a given year), treatment is covered.

**Outpatient**: This can be combined with inpatient insurance. The policy pays the doctor upfront based on the expected number of patient visits.
Making insurance “SUAVE”

Much microinsurance is driven by the commercial sector. As competition has increased, this has pushed suppliers towards better and more diverse products, and has improved service. In the Philippines for example, much of the competition is now based on how quickly claims can be paid. This has had a positive impact on making products more SUAVE (Simple, Understood, Accessible, Valuable, and Efficient). It has also resulted in a more considered approach to client need. In insurance, it is important to recognize that need does NOT equal demand.

So, where is the market beyond credit life? According to Michael McCord, Property-based products remain problematic as the legal environment tends to be challenging. For agriculture and livestock insurance, creation of an index has been important, but the market essentially remains in pilot test. There is huge potential, but reaching scale and profitability has been difficult. McCord describes himself as an optimistic skeptic in terms of index “because there is a great need to do exactly what index [insurance] is developed for, but it has many issues that have hindered reaching scale”.

Unlike more typical microfinance (credit and savings), microinsurance is primarily driven by commercial insurers. Within conventional microfinance, institutions and processes developed to fit the needs of the low-income client. In microinsurance, insurers still need to go through a paradigm shift to understand and provide products and services for the low-income market.

What is this ‘paradigm shift”? For insurers, it requires deeper understanding of the market. Microinsurance is not disassociated from the insurance market continuum: it is simply the lower end. But the difference is not just a lower premium for a lower sum insured. According to Richard Leftley at MicroEnsure, it means a different approach to:

- **Controls**: Forget the long list of exclusions and requirements for claims settlement. At the same time, insurers need to manage moral hazard, adverse selection and fraud. They just need to do these in ways that make sense, both in terms of cost and practicality for beneficiaries.
- **Marketing**: The industry needs to build trust and convey information in a way that works for the low-income market. This does not mean relying on the same old posters and TV adverts.
- **Agents**: It is now clear that traditional insurance agents are not effective in selling microinsurance.
- **Policy documents**: Smart insurers should be able to fit them on the front and back of a business card (an idea regularly promoted by Michael McCord as well)
- **Product features**: They must be flexible in terms of the needs of the low-income market.
- **Understanding the market**: There will be no bespoke underwriting (which is too expensive), so insurers need to understand low-income clients - and their needs.

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‘Good’ micro-insurers will be those who see the need for this paradigm shift, and who implement the necessary adjustments effectively. This tends to be an iterative process. Insurers will start simply with ‘lower premium, lower coverage’ products. They will find limited success. They will then make adjustments, improve their success rate - and then, hopefully, take bigger steps to make the market work.

Michael McCord doesn’t think we need to develop new microinsurance-only institutions. These are unlikely to be very profitable, and could prove needlessly expensive for donors. In addition, in his view, community-based microinsurance is a model with limited potential. Expecting local people to manage their own insurance program has very limited benefits for a low-income community. On the other hand, the ‘mutual’ model – where professionals run a member-owned insurer – can prove effective if they are able either to generate a big enough market or if they can span different markets. When this happens, the mutuals act effectively like commercial insurers.

**Scaling microinsurance**

McCord promotes a model in which commercial insurers manage the insurance risk.

Commercial insurers have capital, access to reinsurance, and fundamental insurance knowledge. For them, microinsurance has to be seen as an evolving market.

According to McCord:

“In most countries, we start with a market attitude towards insurance (which is) strongly negative or at best ambiguous, because there is no knowledge of insurance. Thus, ‘low hanging fruit’ also evolve. As simple products show their value to the market, others will buy. As more buy, there is more demand for alterations and other products. But for this to happen, insurers must provide good products in a way that works for the market. Paying a funeral policy in 30 days does not help when people have to get the body in the ground within three days. When insurers prove they can respond effectively, demand increases and pushes the evolution to the next level.”

Microinsurance is much easier with group policies and mandatory products – as it is in developed countries. But in the case of microinsurance, the industry may need to be more flexible in its understanding of what composes a group. Plus, there needs to be a premium aggregator and a marketing/training facilitator to reduce the cost (and improve controls) of the insurer.
**Delivery**

But the biggest obstacle to scaling microinsurance remains delivery. MFIs have helped, but there is limited potential. Direct sale of microinsurance by insurers has also been limited. So there need to be new channels to facilitate the sale, premium collection, and servicing of these products to the low-income market. There are already utility companies in Latin America, pawn shops in the Philippines, churches and retailers in South Africa, cell phone companies in Ghana who are moving into the sector – and that is to be encouraged.

Among these new providers, there are some genuine innovations. For example:

- In the Philippines, a major pawn shop now sells 1.5 million insurance policies a month.
- In Ghana, the Tigo/Bima product is embedded in mobile airtime. It has doubled the number of people insured in the country in less than a year.
- In Peru, there is an ocean temperature-based index for agricultural products that pays out even before the event occurs.
- In Jordan, there is a supplemental health care policy, “Caregiver”, the country’s first private insurance offering offered by Microfund for Women, and mandatory for MfW clients.

There has also been the development of savings-linked insurance products, addressing the criticism that insurance fails to provide the consumer with anything in the event that the risk does not eventuate\(^\text{23}\).

<table>
<thead>
<tr>
<th>Country</th>
<th>Products</th>
<th>Target market</th>
<th>Distribution and administration</th>
<th>Structure</th>
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| Co-operative Insurance Company (CIC), Kenya | - Credit life: compulsory credit life  
- Bima ya Jamii: voluntary bundled health and life insurance cover  
Credit life shows large profits from inception  
Challenges with growth for the voluntary product | Members of microfinance institutions (MFIs), savings and credit co-operatives (SACCOs) and other self-help groups  
Large MFI and SACCO membership in Kenya | MFIs, SACCOs and other groups  
Leveraged existing relationship with these groups | Planning to set up a separate microinsurance business unit |
| Old Mutual, South Africa | Burial Society Support  
Plan group funeral cover  
Funeral cover is popular in South Africa, but this is a highly competitive market | Members of burial societies, funeral parlours and savings clubs  
Challenges with small group sizes | Salaried agents who work with groups are responsible for the selling and servicing of policies  
Costly distribution model | Set up the Foundation Market business unit to focus on the low-income market |
| ICICI Lombard, India | - Manipal Aranya Suraksha: group-based health insurance  
- Index-based weather insurance: crop cover based on rainfall index (Bundle with credit)  
The government created awareness for index-based insurance  
Challenges with the profitability of the health insurance product | Community groups in western coastline of India  
Clients of MFIs, rural banks and other credit providers | Network of health care providers  
MFIs and other credit providers  
First mover advantage is important in establishing relationships with these groups | Microinsurance products are managed under business units organised by product line. There is no separate microinsurance business unit |
| Aseguradora Rural (ASR), Guatemala | - Life cover: death and disability cover  
- Student cover: life policy with additional health cover  
Both products have been profitable since their launch | Clients of BANRURAL (rural bank) | BANRURAL network of bank branches  
Leveraged infrastructure of the parent company BANRURAL | Microinsurance products are managed under the life insurance business department |
| Malayan Insurance, Philippines | Life cover with additional benefits (e.g. fire assistance) | Clients of pawn shops, rural banks and lending intuitions, co-operatives and NGOs | Pawn shops, rural banks and other credit providers  
Leveraged partner’s large footprint in the low-income market | Managed by the Retail Underwriting Group  
Plan to move management of microinsurance business to subsidiary in 2011 |
Above is a table from the ILO’s Microinsurance Innovation Facility Paper 11. It suggests that insurance companies are able to provide microinsurance profitably. It also suggests that achieving sustainability is often an iterative process, and that monitoring, continuous learning, and constant adjustments to the product and the price are important. Indicative of this, Old Mutual and ICICI Lombard both incurred losses on their group funeral and MAS health insurance products at the beginning. According to the MIF, however, both were able to cut those losses, and are now working on strategies to make the products profitable.

Nevertheless, further research into the performance of microinsurance initiatives is needed.

Richard Leftley of MicroEnsure, doesn’t like the term ‘microinsurance’, anyway. For him, there is a market out there which is unserved (especially in the informal sector) – and that is pretty well mapped over to the microfinance client base - in terms of market segmentation at least, if not geography). It is what could be described as the ‘working unserved’. They have jobs, but no insurance.

There’s another target market, which is the ‘missing middle’: the employed sector which has limited access to insurance. The unserved and underserved together make up a mass market - a huge opportunity as less than 5% of the global population has access to all the insurance it wants or needs.

**MicroEnsure’s Criteria for Success**

How do you match an appropriate, profitable microinsurance product with an existing need?

Whilst some types of insurance pose special problems (index and health, for example), there are four broad challenges, which fit within the SUAVE model outlined above:

1. The need to design simple products that are understandable and easy to administer (in particular, with few exclusions);
2. The need to educate the consumer base and sales force (who often have a poor understanding of insurance in general);
3. The need to handle massive volume where margins are thin (this means having robust technology to handle the back office requirements of scale); and
4. Most importantly, the need to pay claims quickly - within days, not weeks.

MicroEnsure has focused heavily on working with Mobile Network Operators, for example yuMobile in Kenya. Its model is that you offer free insurance; you convince the mobile

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25 yuMobile has created a unique insurance scheme that gives life and disability insurance cover for yuMobile pre-pay subscribers. Dubbed ‘yuCover’, this product offering is underwritten by Jubilee Insurance and powered by MicroEnsure. This product rewards yuMobile subscribers with a renewable monthly life and disability cover based on the amount of airtime re-charged each month. Subscribers can qualify for this insurance by topping up as little as Kes.100 of airtime each month and as they increase their monthly top-up, they earn more insurance cover – up to a maximum of Kes.60,000 of insurance cover, per month.
phone company that people don’t choose insurance, unless they are offered it for free – while being sold something else they really want. People in such markets value insurance, but are seldom willing to buy it. Realising this, MicroEnsure went to the MNO and argued that, if the MNO spent a dollar giving its customers insurance, this would be leveraged by customer spending more on the network – more than covering the cost of premiums. This started as an experiment, but Richard Leftley says that this model of leveraging the premiums has worked well, signing up millions of clients (typically for life and personal accident insurance). Once they are convinced, they’re offered the chance to include their spouse or children on the policy. This is a ‘freemium’ model. After that, they are offered health insurance for an extra dollar a month.

Despite how far there is for insurance to catch up with savings and particularly credit, there is much to be positive about. As McCord says, “Attitudes will change as insurers service products more effectively. Products will expand as people become more comfortable with microinsurance. And quality will improve as there is more competition”.
“Insurance is potentially as important as microfinance to the poor. The less you have, the more the loss of some or all of it matters. Thus many of the poor are preoccupied with the risks and uncertainties that threaten their income, assets, prospects and dignity. Insurance can be a substantial mitigant – it cannot eliminate risk, but it can greatly reduce the misery of constant worry.

“The development of micro-insurance products has been slow. It’s difficult to develop affordable cover, historic data is scarce, delivery systems are traditionally expensive and moral hazard can easily slip into product design. But it is encouraging to see more potential providers entering the market, including larger insurance groups, development institutions and micro-finance agencies.

“The larger insurers have seen a major underserved market and its potential. They have rightly put a good deal of thought into developing cheaper and more effective delivery systems. But product design is still based a bit too closely on their traditional practice.

“Some micro-finance agencies have developed micro-insurance products that are better tailored to the needs of the poor. They are not averse to selling insurance which improves the creditworthiness of their loan portfolios, so some product design may not be distant enough from the Payment Protection Insurance prototype which is currently preoccupying UK banks.

“So far, design drivers have been supplier-led rather than demand-driven. When greater emphasis is given to the wants of the poor, rather than their needs as perceived by others, the market could grow very rapidly. One of the major successes is funeral insurance, demonstrating the importance of dignity to many of the poor, and proving to be a great product for reducing worry.

“There are some encouraging trends. First, new technologies, such as payment by mobile phone, are making potential delivery systems cheaper and more effective. Second, there is more experimentation with new approaches, which is essential for the evolution of practical, economic and desired products: regulators can make an important contribution by allowing flexibility in the introduction of products. Third, there is increased interest in the support that informal providers, including community groups, supply in the event of severe losses – the key point here is that help is given, but not without cost and discipline: the recipients are expected to contribute to the community in return. Fourth, the most astute providers are beginning to ask the poor themselves what cover they would value most.”
Part 3: Improving the financial capability of low and middle-income clients

The first section of this paper argued that the financial tools available to the poor and the behaviour they engender are not always well matched with needs. There are three big needs: the daily grind, big expenditures and emergencies. They in turn imply four basic financial requirements: to transact, to invest, to build assets, and to sustain consumption.

What we need are delivery systems (branched or branchless) that get closer to poor people and that offer them savings and credit and insurance products that rate high on seven key characteristics: proximity, frequency, flexibility, convenience, regularity, commitment, and (perhaps most of all) reliability.

The second section of this paper argued that, as a bare minimum, poor people need a suite of financial products that includes a transaction or very basic savings account, recurring deposit accounts for different goals, a general short-term loan facility and the possibility of a longer term loan (secured against assets acquired with the loan). In terms of insurance, success will come from using new delivery channels to provide simple, high volume products that can expand beyond credit life to health, livestock, crop, property and disability insurance.

With this combination, we are approaching a genuinely well-matched product model. But while the right products are necessary, they’re not sufficient. Improved financial capability is crucial to ensure they are useful to clients, and profitable for the institution that provides them.

The third and final Working Group was on financial capability. Client needs and product design are broad areas, but capability is broader still. An enormous range of initiatives is underway, from developing school curricula to microfinance training and workplace education. What they all have in common is that improving the financial capability of low and middle income clients everywhere is crucial to inclusion.

The members of this Capability Working Group were:

- **Shaun Mundy**, the ‘thought leader’ for the group. Shaun is a consultant who specialises in financial literacy. He has worked in Africa, Eastern Europe and Central Asia. He was head of the financial capability department at the UK’s Financial Services Authority from 2003 until 2007. Under his leadership, the FSA and its partners developed a multi-faceted approach including:
  - financial education in schools;
  - initiatives aimed at young people;
  - workplace seminars;
  - development of a guide for expectant mothers;
  - working with partners to reach groups of people with particular needs; and
  - the development of the Money Made Clear website.
- **Alyna Wyatt**, who is a senior associate in the development practice at Genesis Analytics, which offers consulting services across Africa, India and the Middle East. Her major role is team leader for the DfID-funded Financial Education Fund in sub-Saharan Africa.

- **Sian Williams**, who is head of financial inclusion at Toynbee Hall, where she is responsible for all financial inclusion programmes. She previously had a 15-year career at the Foreign and Commonwealth Office.

- **Jasmine Thomas**, who is the program officer for international financial capability at the Citi Foundation, which operates in 89 countries. She has also been a program officer at the Surdna Foundation and The New York Community Trust.

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![Financial Inclusion Taxonomy](image)

*The Financial Inclusion Taxonomy (from ‘Bridging the Gap’)"*
What is ‘financial capability’?

There is no accepted definition of the term, but it really means “having the knowledge, understanding, skills, motivation and confidence to make financial decisions which are appropriate to one’s personal circumstances”, says Shaun Mundy.

The UK’s FSA saw it as having five elements:

- Making ends meet;
- Keeping track of your finances;
- Planning ahead;
- Choosing appropriate financial products; and
- Staying informed about financial matters.

How can we judge a person’s financial capability? First, we can look to his or her behaviour. Being financially literate (having the knowledge, understanding and skills to manage personal finances) is not the same, necessarily, as being financially capable – which is the behavioural manifestation of literacy. It’s one thing to understand the importance of shopping around for the most appropriate financial product, but another thing to do so.

‘Financial literacy’ and ‘financial capability’ tend to be used interchangeably. However, ‘financial capability’ (as the FSA started using it in 2003) is generally preferred, because it better reflects the importance of behaviour:

“People who are financially capable are able to make sound financial decisions for themselves and for their families; to make informed choices between different financial products and services; to budget and to plan ahead financially; to build up some savings; to avoid becoming over indebted; to identify, and protect themselves against, financial risks (for example, through insurance); to invest prudently (if they have sufficient resources to be able to do so); and to understand their rights and responsibilities” - Shaun Mundy

So what constitutes this “financially capable” behaviour? It obviously varies according to personal circumstances. A low-income person needs to have an accurate picture of how much he or she has available at any given time, because the consequences of running out of money could be severe. But there may be no need to know much about investment. A middle or higher-income person, by contrast, does need to understand investment options, but may not need to have as accurate a picture of income and expenditure on a daily or weekly basis.

People don’t get to be financially capable from birth, of course. Financial education helps. But it’s important not to confuse financial capability initiatives with marketing activities (the promotion of a brand or specific products or services).
So capability is important, but is often notable by its absence. As the 2012 Monitor report *Bridging the Gap*, sponsored by the Citi Foundation, claimed: “Of the roughly 500-800 million people [in poor countries] who have some form of access to formal financial services, only 25% have had even the most basic financial education – a figure that is dwarfed by the estimated 2.7 billion people who are unbanked or underbanked”. In other words, as significant as the issue of financial exclusion is, even among the financially included a large majority lack financial education – and may well, therefore, lack the financial capability they need.

**Capability, microfinance and impact**

So far, much of the focus on the so-called ‘capability gap’ has been on microfinance clients. As the Monitor report makes clear, this has been a good starting point. But the scope must now be broadened to include remittance senders and recipients, government-issued conditional cash transfer (CCT) recipients and mobile money users. It is here where the biggest growth in financial inclusion is taking place in poor countries, and here is where capability will be most important.

This remains a young sector, though, and more research is needed to better understand the impact of financial education on the capability of low-income consumers - especially in developing countries. As was said in *Bridging the Gap*, “governments and financial services institutions that invest in efforts to strengthen client capabilities must improve coordination to increase impact and resource efficiency.”

In poor and rich countries alike, many people lack the knowledge, skills and confidence to manage their money.

Even before the 2007-08 crisis, the Organisation for Economic Co-operation and Development (OECD) recognised this:

“For emerging economies, financially educated consumers can help ensure that the financial sector makes an effective contribution to real economic growth and poverty reduction. But financial literacy is also crucial for more developed economies, to help ensure consumers save enough to provide an adequate income in retirement while avoiding high levels of debt that might result in bankruptcy and foreclosures...The information available on consumer financial literacy is worrying for two reasons – not only do individuals generally lack an adequate financial background or understanding to navigate today’s complex market, but unfortunately they also generally believe that they are far more financially literate than is really the case.”


Recent research has illustrated the challenge ahead, even in high-income countries. July 2014 saw the release of the 2012 OECD PISA international assessment of financial literacy of 29,000 15-year olds across the OECD. Around one in seven students in the 13 OECD economies that took part is unable to make even simple decisions about everyday spending, and only one in ten can solve complex financial tasks. Ability to understand a bank statement, to calculate the long-term cost of a loan or to know how insurance works was worryingly poor. The report’s executive summary notes that finance is a part of everyday life for many 15-year-olds: they are already consumers of financial services such as bank accounts with access to online payment facilities. As they near the end of compulsory education, students will also face complex and challenging financial choices. One of their first major decisions may be to choose whether to continue with formal education and how to finance such study.

Financial literacy, the report argues, is thus an essential life skill, and high on the global policy agenda. Shrinking welfare, shifting demographics, and the increased sophistication of financial services have all contributed to awareness of the importance of ensuring that consumers of all ages are financially literate.

In recent years, the trend in developed countries has been for individuals to take greater responsibility for their long-term financial future, rather than being able to rely on the state or their employer. Even so, there are many people in rich countries who can afford to save, but don’t. Part of this reflects the surfeit of credit available – particularly in Anglo-Saxon economies where people are more willing to borrow. Ten times more Britons per capita, for instance, have a credit card than do the Dutch. In the UK, as in the microfinance markets where repayment crises have appeared, overindebtedness is the natural consequence of easy credit.

So, for many consumers, there is a vast array of financial products and services. This means greater opportunities for consumers. It also means that the financial decisions which people are faced with are more complex and demanding than was typically the case in the past.

This is not only true in OECD countries, but in low-income markets too. Financially excluded people who have relied for generations on informal networks to save and borrow (particularly those with low financial literacy) can be bewildered by the range of financial products available now – from savings accounts to purpose-specific loans, to CCTs, m-banking, credit life or health insurance, and payday loans.

The opportunity to participate in the formal financial system is a good thing. But there is a disconnect between opportunity and capability for those who lack financial understanding and skills. Even in the UK, two million Britons still use more expensive coin-operated electricity meters because they cannot pay by direct debit. They also use pay-as-you-go mobiles, which for most users is more expensive than a contract plan. And of course, without

credit cards, they’re driven for credit to the four-figure interest rates of Wonga, QuickQuid and their ilk.

All of this is part of the financial capability ‘gap’ – the chasm that exists between those who can engage with a formal financial system and those who cannot.
Does education improve capability? And does capability improve lives?

Most of the published research on financial education is from the US. Results vary: some studies suggest that a particular initiative has been successful, while other research has cast doubt on the effectiveness of financial education. There are several problems:

1. There are many financial education programmes being delivered to a wide range of target audiences. The likelihood is that some are effective, while others are not. In other words, there can be no blanket judgment.
2. Financial programmes are often intended to influence future behaviour – sometimes months or even years ahead. It can be very difficult to evaluate such programmes.
3. Attribution is difficult – especially if a control group isn’t used.
4. Some research has used very narrow measures of effectiveness – e.g. whether people can calculate interest rates – which may be unrealistic.
5. It is not always clear what implications one programme for one audience, in one context, has to other programmes/audiences/contexts.

However, as Shaun Mundy notes, behavioural economics can provide pointers to the approaches which are more likely to be successful. In particular:

1. If people are faced with too much information, they are liable to be overwhelmed and to do nothing.
2. People tend to be over-confident about their ability to manage their personal finances. Challenging their views can help people to be more realistic.
3. People often struggle to make sound decisions. Training or counselling may help them make better decisions.

Education in schools

The research on financial education in schools makes for mixed reading. As Mundy described in a report he wrote for the OECD29:

“In many countries, financial education is in its infancy and research into how best to deliver it is, if it exists at all, barely out of the starting gate. It would certainly be premature to conclude, on the basis of research to date, that financial education has no place in educational establishments. More generally, there

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seems no reason to reach the view that, while a whole range of other subjects, many of which have little or no obvious direct relevance to the well-being of students who study the subject, can usefully be taught in schools, financial education cannot be delivered effectively.”

Some of the research carried out to date has not distinguished between different types of education. There is need to determine how best to deliver financial education, and which types of education work best for different audiences. And there is a need for more research into the medium- and long-term impact.

**The Impact of Education**

Given the damage caused by poor financial capability, even small improvements could be significant. And there is evidence from teachers that they have themselves become more confident as a result of participating in well-designed programmes.

Sian Williams of Toynbee Hall points out that, in the UK, the majority of financial education programmes capture short-term outputs – e.g. the number of people participating, the number of sessions delivered, or the immediate response from participants. But there is little follow-through. However, a 2008 paper by Adele Atkinson suggests a framework for capturing evidence better. She suggests there are two types of effective intervention:

- the use of norms (i.e. directing people towards a specific action such as saving); and
- direct intervention by a counsellor and/or individual advice.

In her work at Toynbee Hall, Williams acknowledges she doesn’t have longitudinal data to demonstrate the impact of financial education. However:

“The short term data we collect from young people who attend our sessions shows high levels of awareness-raising about financial matters; we often see participants record higher levels of confidence before a session than after, as through the session they realise that they do not know as much as they thought. This then acts as a catalyst for them to ask more questions”.

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30 India’s SEWA Bank is internationally recognised for its financial counselling programme, the ToR and content of which are available [here](http://www.transact.org.uk/shared/get-file.ashx?id=2063&itemtype=document)


32 In the UK, the FSA’s National Strategy for Financial Capability targets: school children, young people who are Not in Education, Employment or Training (NEET); students in universities and Further Education (FE) colleges; employees in their workplace; and new parents. It also provides straightforward information through the Moneymadeclear consumer website and publications, and reaches a wide range of consumers via Partnership Development initiatives with not-for-profit organisations.
Toynbee’s ‘Money for Life’ financial education programme (run in conjunction with Lloyds TSB) seems to have a lasting impact. Among 2012’s participants, several have gone on to participate in other financial programmes, and many have experienced a significant improvement in their lives.

Financial Education programs in developing countries

Alyna Wyatt is Team Leader of the Financial Education Fund (FEF)\(^{33}\). She argues that the fund has demonstrated that financial education positively affects capability. According to a Randomised Controlled Trial in South Africa, financial education did make a positive difference in savings behaviour. Another RCT in Uganda in 2010-2011, in which 240 youth clubs were randomly assigned to one of four programmes, also had strong positive results\(^{34}\). In general, the biggest change was in savings behaviour.

Overall, proving a causal relationship between financial education and social impact is difficult. However, anecdotally, financial education helps. It can also help build a market for financial service providers. So investing in financial education is probably worthwhile for the institution as well as the client. But can private financial institutions make that investment?

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\(^{33}\) FEF (financialeducationfund.com) is a multi-donor fund, with an initial start-up capital from the UK's Department for International Development (DFID). It is managed by Cardno Emerging Markets and Genesis Analytics, and run from the Genesis offices in Johannesburg. The fund has a pro-poor, low-income focus. Projects must address any of the four components of financial capability: knowledge that a person has of personal financial management and financial services; skills, i.e. the ability to apply that knowledge; attitudes, including confidence, trust and personal perceptions about the use of financial services; and behaviour, the ultimate objective of financial education being behavioural change.

\(^{34}\) “Financial education administered to groups of youth has a positive impact on accumulated individual savings. Both the Financial Education and Account and Financial Education Only groups reported modest savings increases at highly significant levels. This finding stands in contrast to previous studies of financial education courses that claim no impact on savings behaviour.

In addition to positive savings impacts, this study found positive impacts on first order outcome measures of financial knowledge and knowledge of formal banking institutions, both central components of the financial education curriculum and the first step towards “starting a lifetime of savings.” The Financial Education and Account and Financial Education Only groups demonstrated higher levels of financial knowledge as measured by an index of financial knowledge. This finding, along with the positive impact on savings behaviour, suggests that the financial education course succeeded in both improving knowledge of financial practices and the formal financial sector, and that this knowledge translated into those clubs saving more”. (Starting a Lifetime of Savings: teaching the Practice of Savings to Ugandan Youth February 7th 201, Innovative Poverty Action)
“At an overall level, data are incomplete and do not cover the range of approaches being tried, especially newer ones. A World Bank study concludes: “While the number of [financial education] interventions to improve financial literacy has increased dramatically, a rigorous monitoring and evaluation of such interventions is still the exception and not the rule, particularly with regard to the measurement of impact.

Moreover, there has been no standard template for outcome reporting in the field to date, or even standardized metrics. Outcome studies range from self-reported organizational evidence and administered qualitative surveys all the way to RCTs testing for very particular outcomes. Many studies measure against one of the certain outcomes, for instance, did the education program lead to better-informed customers? But few if any have been able to establish any causality or link between financial education training and these outcomes. This is emblematic of the lack of emphasis in the field thus far toward measuring outcomes rigorously.”
The role of private sector financial institutions in providing financial education in developing countries

Financial institutions can develop, implement and fund financial education programmes to increase the capability of their clients. Many already provide some financial education via websites, leaflets and brochures. Some have produced educational resources, or have funded programmes for schools, young people or adults. Some have also made available staff to support financial education programmes.

Much of this is part of firms’ CSR activities. However, a financial education programme needs to be objective. It should not promote a particular financial institution or its products. Consumers will quickly lose trust if it lacks objectivity.

Wyatt sees the value-add as promoting the demand for more appropriate financial services – ultimately improving the quality of the clients’ financial portfolio, and enhancing the provider’s reputation. 35

Ideally, financial education should be driven by the business case, and not be determined exclusively by CSR. It should be aligned both to social outcomes and to outcomes that the bank sees as good for the institution.

As the financial sector evolves in developing markets, new more complex products will become available to low-income clients - which makes understanding them difficult. In low-income countries with relatively sophisticated financial markets (e.g. South Africa or Brazil) where there is also a significant portion of the population that is historically excluded from the formal financial sector, there is particular onus on financial institutions to provide sufficient information on the products available. Here, the government can play a significant role.

The single bottom line: Is there a business case for providing financial education to increase capability?

It makes good business sense for financial institutions to have consumers who understand financial issues - and who are engaged. Consumers who have confidence in their ability to manage personal finances are more likely to acquire a product or service – and this can help both to reduce marketing costs and to increase business. Financial institutions also have to spend less time explaining the basics to people who are financially literate – and financially literate consumers are less likely to acquire unsuitable products, or products they don’t understand.

35 For much more on FEF’s work, see here; and for a case study on “financial education as a core component of service delivery” see here
More broadly, improving financial literacy can stimulate savings, promote financial inclusion, reduce over-indebtedness and thus take some of the poor out of poverty.

As a result, financial education can contribute to a company’s bottom line – by expanding the client base, and by increasing activity on existing accounts. It is in an institution’s best interest to have financially literate clients as they are better able to choose financial products and services that best suit their needs.

However, implementing financial education programs requires not just investment. It requires strategic planning and understanding. Timing is key – maximising impact by catching clients when they are most receptive: at “teachable moments”.

**But who pays?**

“Evaluations in the field thus far have almost completely sidestepped critical questions of cost and scale. There has been little discussion or analysis of how models compare when evaluated in terms of the cost per customer for delivering financial education, the cost of developing the various methodologies, whether they have a cost recovery rationale and the extent to which scale delivery will have an impact on these two questions, e.g., will delivery at scale in fact lower the cost per customer, as many programs claim?

To some degree, the matter of costs has gone unexamined because of the field’s historic overwhelming reliance on outside funding for its financial education programs; indeed, many of the largest and best-known programs have been entirely grant-funded. Until very recently, the general default framing even for MFIs has been to treat most financial education as a cost centre—and we found multiple examples of grant-funded financial education programs that were discontinued once funding expired. Only about 35% of the MFIs and other financial institutions interviewed for this project viewed financial education for low income consumers as a potential strategic asset to be invested in versus a perpetually grant-funded program or cost centre”. - Bridging the Gap

*Teachable moments: key points in clients’ life cycles*

Although many people want to make their money go further, this does not mean that they will necessarily be receptive to financial education or information. Thinking about financial issues can be challenging; at any given time, most people have other things they would prefer to do.

However, there are times in people’s lives when they are likely to be more receptive to financial education, information or guidance: these are ‘teachable moments’. Examples include couples who are planning to set up home together or to get married – or who are separating or divorcing; parents before, or soon after, the birth of a child; students at college or university who are facing, often for the first time, the challenges of managing their own personal finances; people who are starting work; and people who are approaching retirement.
The UK’s FSA made available to expectant parents a Parent’s Guide to Money on the financial aspects of having a baby (the CFEB, a successor to the FSA’s Financial Capability Department, is now known as the Money Advice Service, but longer distributes this guide). The guide was developed, with the help of parents and healthcare professionals, because having a baby is a major life change that also brings big financial changes. The guide was distributed by midwives to expectant parents around 16–20 weeks into pregnancy, so that it was in time to help with the financial changes that having a baby brings.

Financial services needs evolve across the lifecycle

Financial Needs Across the Life Cycle; Centre for Financial Inclusion

The UK’s FSA also ran a workplace-based financial capability programme. Employees with financial problems may well be less productive at work: it was felt that personal finance education could help reduce the risk of developing these problems.

What underpins these initiatives is recognition that people’s lives aren’t linear, but are characterised by crests and troughs of financial need - and for low-income people around the world, the consequences of failing to understand their own needs can be even worse.
Alyna Wyatt argues that there are two key ingredients:

- **Lifecycle interventions**: It is important to tailor the content of financial education programmes to the “teachable moment”. The relevance of the information to beneficiaries’ lives at the time when it is received determines the extent to which it is absorbed.
- **Applicability and practice**: Learning is also enhanced if the information received can be immediately applied – bridging the gap between theory and practice.

It is critical, she says, to tailor financial education programmes to the target audience. This means identifying the core characteristics of each group:

- **Early teens**: Are these people heads of household? Are they interacting with money for the first time? Are they starting their first part-time jobs?
- **Students about to leave school**: What is their next step? What decisions will they be making and how is financial management associated with these decisions?
- **Pregnant women/young mothers**: Do they need to save for obstetric/maternity needs? And do they plan to spend time away from work?
- **Young adults**: What are their housing decisions (purchasing versus renting)? Are they getting married, or having children?
- **Older people**: What are their retirement and pension plans?

All of this may seem common sense. But one workbook in a UK Grade 11 school financial education course has a heading “Planning for your Retirement”. It was implemented in 2008–2012, without anyone questioning its relevance for the young audience. The message must be that it is crucial to relate financial education to meaningful aspects of the audience’s life.

Key life changes can make people more receptive to learning. The first time an individual moves away from home, starts at a new place of study or work, or changes family circumstances, for instance, are ideal moments for establishing new behaviours, saving a percentage of salary, paying into a pension, or just living within one’s means. Even in the UK, these moments could be used to much better effect36.

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36 For example, see again the FSA impact paper on international evidence of workplace education on capability. The evidence suggests that, in the US at least, workplace education can lead to an increase in saving for retirement in the medium to long-term. A large-scale study of US adults suggests that this increase is focused on those who would not otherwise have sufficient in savings and whilst Kim concludes that a one off seminar may not be sufficient to change behaviour in the short-term, Duflo and Saez do provide evidence for an increase in savings following attendance at a benefits fair.
International trends

Capitalising on teachable moments also means understanding how demographics will change – figuring out which market segments will grow and how the lifecycles of those in each segment will develop. Any markets with a big youth demographic at the moment, but which have a declining birth rate (much of the developing world), will inevitably have to deal with more and more older people in the future.

So in this respect, financial education/capability require the same things as good financial product design: an understanding of the needs of the client. A new middle class client and a young poor person have different needs, and their needs will vary by market too. There may not be much point offering retirement accounts in South Africa, when what clients want is funeral savings. In the Philippines, however, clients prioritise kids’ tuition over everything else. In India, they prioritise saving for a daughter’s wedding. Financial education must recognise this, be demand-driven and stop viewing financial products simply as a savings or borrowing product.

Financial education: What can be offered?

The most commonly cited definition of the term “financial education” is the one developed by the OECD:\footnote{Improving Financial Literacy: Analysis of Issues and Policies, OECD, 2005}

“Financial education is the process by which financial consumers/investors improve their understanding of financial products and concepts and, through information, instruction and/or objective advice, develop the skills and confidence to become more aware of financial risks and opportunities, to make informed choices, to know where to go for help, and to take other effective actions to improve their financial well-being”.

According to Shaun Mundy, in practice this means:

- **Information**: This involves making consumers aware of financial opportunities, choices and consequences;
- **Instruction**: This involves ensuring that individuals are able to understand financial terms and concepts; and
- **Advice**: This involves providing consumers with counsel about generic financial issues and products so that they can make the best use of the financial information and instruction they have received.

Specifically excluded from this definition are marketing initiatives which promote a particular brand and financial advice which may lead to the recommendation of a specific product or service. Also excluded is entrepreneurship. Financial education can support entrepreneurship, and financial education and entrepreneurship can be taught together.
However, where the two are combined, Mundy argues, that it is important that education does not focus on entrepreneurship to the detriment of personal finance.

**Context**

In designing content for any financial education programme, context is important. Alyna Wyatt lists some examples as:

- **Youth-based programmes:** These need to take into consideration the expectations of young people that are being reached. They all need to learn about budgeting and saving. However, in more sophisticated financial systems, it’s also necessary to cover the various financial products (hire purchase, cell phone contracts etc.) which are available to all 18 year-olds.

- **Self-employed versus employed workers:** There is a significant difference between having irregular income and having a payslip – but having a salary doesn’t solve all problems. This is particularly important in South Africa, where people with a payslip can access credit from a whole host of credit providers (store accounts, cell phones, banks, home loans, vehicle finance, tuck shops at mining hostels) – and therefore risk serious debt. All too often, employees have more garnishee orders coming off their accounts than salary paid in.

- **Microfinance clients:** Self-employed microfinance clients need simple cashflow education – cash in/cash out accounting, and a P&L.

- **Young couples looking at housing finance:** For those who are lucky enough to be able to think about financing a home, education must include budgeting across all household expenses (including water, electricity, rates and taxes). As everywhere, prospective homebuyers need to understand how mortgages work and the implications of investing in one’s own home versus paying rent.

It is also important to think in terms of building blocks: for people to handle money effectively, they first need to be able to count and read numbers. Only a few will have entrepreneurship skills, but everyone needs personal finance skills – including basic numeracy, household budgeting, savings strategies, over-indebtedness avoidance and understanding compound interest.

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38 A court order instructing a garnishee (a bank) that funds held on behalf of a debtor (the judgement debtor) should not be released until directed by the court.
Delivering financial education

There are three main options for financial education delivery in low-income countries: mass market, group, and individual.

1. **Mass market**: Mass-market financial education is often little more than an awareness campaign to cover basic financial principles, make people aware of their rights as consumers or reinforce key messages provided elsewhere. Examples include the Central Bank of Malaysia’s online programme to disseminate teaching aids for adults and youths; the Reserve Bank of India’s “Project Financial Literacy”, and the Central Bank of the Philippines’s programme to teach the public about various banking products and services. There are also telenovelas and soap operas with financial education content (e.g., KASHF in Pakistan, Makutano Junction (funded by DFID) in Kenya, and Banco Adopem in the Dominican Republic), and financial education documentaries on local cable networks (e.g., Ujjivan in India).

2. **Group**: Most financial education in low-income countries is group-based - usually in classroom settings. Some programmes, especially those delivered by MFIs, are product-linked, but many are delivered on a standalone basis by NGOs, central banks, schools and development institutions. Group-based training can be divided into training delivered through NGOs, central banks, schools etc, and aimed at the general public, and on the other hand training funded by financial service providers and targeted at financial services customers. Examples include targeting at-risk customers to provide “delinquency management” training (e.g., Banco Adopem, Dominican Republic); targeting microentrepreneurs (e.g., Shakti Foundation, Bangladesh, KWFT, Kenya and Mann Deshi Mahila Bank, India); and DVD-based financial education at branch/village level followed by trainer-led Q&A sessions (e.g., OI Bank of Malawi).

3. **Individual models**: Delivering financial education on a one-to-one basis is usually too expensive. However, sometimes it is the most effective approach. The best example of an individually targeted model is credit counselling, which typically provides consumers with an individual needs assessment combined with suggestions for appropriate products. SEWA Bank in India has gained recognition for individual counselling through “bank saathis” (relationship managers) at the time of product sale – though that remains very expensive. Other individual programmes are offered by

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39 Within microfinance, the main mode of delivering financial education has been induction training: specialised training delivered by loan officers to new MFI customers. 80-100 million low-income customers around the world have had some form of induction training prior to receiving a loan from an MFI. Induction training is typically delivered to groups of customers at once and usually as a precondition to getting a loan. It has traditionally been built into the cost structure of most MFIs; they have usually covered the costs -at about $0.50 per customer- out of operating revenues. However some MFIs have had success with charging a small fee for a more in-depth business training programme, including P&L, marketing, KYC, customer management and cashflow.
Proyecto Capital’s “Juntos” program in Peru, the Inter-American Dialogue Program in multiple countries, the Grameen Foundation-AppLab pilot in Uganda, and KGFS in India.

As Shaun Mundy has written\(^4\), obtaining funds for financial capability initiatives is always a challenge. Typically, relatively few people are reached, and once donor funding runs out, the programme tends to come to an end.

There is also the issue of cost-effectiveness. According to Mundy, this is dependent on:

- The number of people which an initiative will reach;
- The impact which the initiative has on people’s behaviour;
- The extent to which an initiative can leverage other resources (including in-kind resources); and
- The extent to which the initiative is sustainable, replicable and scalable – especially when initial funding is finished.

Tailoring financial education to the specific audience targeted is crucial, Alyna Wyatt says. This means a financial education implementer should be aware of the core characteristics of each group – including demographics, age, stage of life, lifestyle, literacy levels, etc. Women and men have different needs, as do rural and urban markets, which have different infrastructures, access to services, and underlying capability.

Moreover, income is a huge factor for deciding on relevant capability needs. Wyatt distinguishes people who live in “survivalist” mode – allocating money on a daily basis to subsistence living and shock expenditures – from those in a slightly higher income bracket: these clients have regular economic activity (either salaried or entrepreneurial) and are likely to be involved in more advanced financial activities, such as taking loans or making long-term savings.

Sian Williams believes that there is potential for development institutions to partner with commercial and non-commercial organisations in the delivery of financial capability. When done well, this can benefit all parties. Partnership shares the burden and the risk, and leverages impact.

Whatever is implemented, though, she argues it needs to be done on a national scale. Anything that is not national will result in a "postcode lottery" outcome; if organisations without national reach attempt to ensure a nation is educated, many areas will go without. The work does not necessarily need to be paid for or carried out by the government, but the government's oversight and buy-in are required to achieve scale and uniformity of reach.

**Governmental ‘buy-in’**

The role of governments varies. As Jasmine Thomas says, Mexico has recognised the need to include everyone in the formal economy, and is working to create thousands of “touch points” across the country. Brazil is encouraging education through and within banks. Russia, by contrast, is leery of the private sector being involved too much. Rwanda claims to have a strong interest in increasing capability, but doesn’t spend any significant money – instead, it is just signing lots of small contracts with international NGOs.

Governments really need to be motivated to get involved. Whatever that motivation is, they will also need an entity to organise and involve people across different ministries so that policy is coherent.

“For examples of where there is international best practice in this, the ‘model’ countries from which others could learn a lot, I would advise commercial financial institutions to look to the Philippines, Singapore, Australia and New Zealand, Colombia, and Mexico to get a range of countries that are make financial education increase capability among their people”

Jasmine Thomas, Citi Foundation

**Moving towards financial capability**

There are several principles that underpin successful financial capability interventions. As Shaun Mundy says:

“The important thing to remember is to keep things simple and straightforward: financial capability initiatives should not aim to turn people into financial experts (since this cannot realistically be achieved), but should instead give people basic information, skills, understanding and confidence to help them to manage their finances well – including knowing where, and in what circumstances, to go for specialist help.

“Providers should use relevant and engaging language and contexts. They should repeat messages. They should use a variety of methods and channels, take advantage of ‘teachable moments’, and prioritise initiatives which are most likely to be cost-effective. Finally, they should monitor and evaluate financial capability programmes in order to establish which ones work and which ones should be discontinued.”
Part 4: CSFI Fellowship Survey

As the final part of the Fellowship programme, a survey of City financial institutions was conducted:

- to understand their attitudes to financial inclusion in poor and middle income markets; and
- to examine their strategies for providing financial services to un(der)banked customers in those places.

The survey was loosely based on *Banana Skins* – the long running series of CSFI surveys of the risks facing the banking, insurance and microfinance industries – but with some key differences:

- Firstly, this was not intended as a “risk survey” *per se*, but rather as a way to engage with the City on the challenges *and* opportunities in emerging markets and with the financially excluded.
- Secondly, this survey was much smaller, with roughly 50 respondents (compared to 500 for *Microfinance Banana Skins* and upwards of 800 for its sister Banking survey).
- Finally, the survey was much less risk-focused. Instead, respondents were asked about their perspective on financial inclusion, and – if relevant – their own institution’s strategy.
Survey methodology

A questionnaire was sent out in May 2013 to approximately 400 members of the CSFI’s database, across the banking, insurance and development sub-lists. Many had attended round-tables organized by the Fellowship programme. The preamble to the survey explained the purpose:

“In this short survey of City institutions, we are seeking to get an understanding of how a cross-section of institutional players in the financial services sector sees its future engagement in supporting financial inclusion in poor and emerging markets. What are the opportunities and challenges that mainstream financial institutions face in seeking to provide financial services to the un(der)banked?”

The survey asked respondents to:

1. Provide their name, institution, country and role
2. Identify as a banker, insurer, regulator, analyst/economist/journalist, or “other” – with a request to specify
3. Answer two initial questions:
   a. “To what extent are financial institutions - and yours, if relevant - interested in supporting financial inclusion among the un(der)banked in emerging markets? To what extent are you working with partner institutions - directly or indirectly - and with end clients?”
   b. “If you are from a financial institution, does your institution have a general strategy for its involvement in financial inclusion in poor/undeveloped countries in the next few years? If so, what?”
4. Rate (1=low, 5 = high) the following challenges to reaching new clients in poor/middle income countries, and provide comments: i) Product Design, ii) Partnership, iii) Cost, iv) Regulatory Environment, v) Technology/Infrastructure, vi) Scalability, vii) KYC, viii) Capability, ix) Competition, x) Human Resources
5. Rate (1=low, 5 = high) the following opportunities available to institutions targeting new clients in poor/middle income countries, and provide comments: i) Market Size, ii) Social Impact, iii) New Technologies, iv) Profitability, v) PR, vi) Partnership/Linkages, vii) Capability, viii) Growth, ix) Increasing Influence, x) Diversification of Products
6. Describe “any other challenges or opportunities [they] would like to mention.
Results

Fifty one responses were received. Forty of these were from the UK, two each were from the USA and Luxembourg, and seven were from other, mostly European, countries.

Of the 51, 23% were bankers; 7% insurers; 4% regulators; 27% analysts; and 45% “other”. Of this last category, most were consultants.

The overall rankings of the challenges are as follows:

<table>
<thead>
<tr>
<th>RANKING</th>
<th>CHALLENGE</th>
<th>SCORE (/5)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Regulatory environment - The challenges of compliance with/understanding of local regulatory frameworks</td>
<td>3.72</td>
</tr>
<tr>
<td>2</td>
<td>KYC - The challenges surrounding knowing individual poor clients' identities and motivations</td>
<td>3.62</td>
</tr>
<tr>
<td>3</td>
<td>Product design - The challenges of designing or providing financial products that are appropriate to the needs and capabilities of the target market</td>
<td>3.6</td>
</tr>
<tr>
<td>4</td>
<td>Partnership - The challenges of finding/working with capable partners in target markets</td>
<td>3.47</td>
</tr>
<tr>
<td>5</td>
<td>Scalability - The challenges of scaling financial services so that an offer can be commercially viable</td>
<td>3.45</td>
</tr>
<tr>
<td>6</td>
<td>Human Resources - The challenges of finding qualified and professional people in poor and middle income countries</td>
<td>3.45</td>
</tr>
<tr>
<td>7</td>
<td>Capability - The challenges to market entry posed by poor financial capability among target clients</td>
<td>3.32</td>
</tr>
<tr>
<td>8</td>
<td>Technology/infrastructure - The challenges of working in places with poor existing banking infrastructure/electricity/IT</td>
<td>3.31</td>
</tr>
<tr>
<td>9</td>
<td>Cost - The challenges surrounding the cost of working in low income countries</td>
<td>3.28</td>
</tr>
<tr>
<td>10</td>
<td>Competition - The challenges of entering new markets with entrenched institutions</td>
<td>2.97</td>
</tr>
</tbody>
</table>
The rankings of opportunities are as follows:

<table>
<thead>
<tr>
<th>RANKING</th>
<th>OPPORTUNITY</th>
<th>SCORE (/5)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Social impact - The opportunity to achieve positive social outcomes through increasing financial inclusion</td>
<td>4.21</td>
</tr>
<tr>
<td>2</td>
<td><strong>Market size</strong> - The potential market offered by unbanked or underbanked people in poor or middle income countries</td>
<td>3.86</td>
</tr>
<tr>
<td>3</td>
<td><strong>Diversification of products</strong> - The opportunity to offer a wider range of financial products or services, such as niche insurance products, rural/agri lending, m-banking, education or health savings, than in established markets</td>
<td>3.74</td>
</tr>
<tr>
<td>4</td>
<td><strong>Partnership/linkages</strong> - The opportunity, through partnering with local institutions, to leverage relationships into further commercial opportunities</td>
<td>3.65</td>
</tr>
<tr>
<td>5</td>
<td><strong>New technologies</strong> - The chance to test or demonstrate new delivery platforms or &quot;disruptive&quot; technologies, which can also be used in established markets</td>
<td>3.56</td>
</tr>
<tr>
<td>6</td>
<td><strong>PR</strong> - The opportunity for good publicity for an institution</td>
<td>3.38</td>
</tr>
<tr>
<td>7</td>
<td><strong>Increasing influence</strong> - The opportunity when entering new and emerging markets to positively influence regulatory policy to facilitate business</td>
<td>3.30</td>
</tr>
<tr>
<td>8</td>
<td><strong>Growth</strong> - With uncertain prospects for growth in established markets, especially with poor macroeconomic outlook, the opportunity for growth of any sort</td>
<td>3.25</td>
</tr>
<tr>
<td>9</td>
<td><strong>Profitability</strong> - The opportunity for high revenue/profitability in emerging markets</td>
<td>3.04</td>
</tr>
<tr>
<td>10</td>
<td><strong>Capability</strong> - The opportunity to test and translate financial education/capability outcomes in poor countries to developed countries</td>
<td>2.69</td>
</tr>
</tbody>
</table>
Qualitative Analysis

Overall, respondents saw little variation in the Challenges listed, with the regulatory environment, KYC and product design just edging the others.

Arguably, Opportunities were more interesting. Social Impact was by a large margin the most significant opportunity (although the average among bankers, at 3.8, was significantly lower than the overall average). Market size and diversification of products rounded out the top three. Capability was seen as the least significant opportunity in poor and emerging markets.

When asked to what extent financial institutions are interested in supporting financial inclusion among the un(der)banked in emerging markets, respondents cited a variety of engagements - educational (“working with equivalent bodies in lower-GDP countries to encourage base-level understanding of securities and investment in frontier and emerging markets”), consultancy (“capacity-building assistance for partner financial institutions”) and investment (“As an SRI advisory & small fund management business, we would prefer to invest in financial institutions that support financial inclusion both in the UK and in emerging markets”).

However, support for industry-wide engagement was limited. One respondent said he “do[es] not see many classical financial institutions that make a real commitment to financial inclusion…[There are] some, but in the end a minority of the financial institutions in each country”.

Another described it as an issue of focus, adding that “the closest we have seen to a real international interest has been the idea of using mobile banking to deal with the infrastructure logistics in emerging markets.”

Yet another saw awareness as a roadblock. Levels of awareness remain “relatively low and there is over-optimism on the part of those who would like to see practice/innovation elsewhere in the world feed back into developed markets (for the benefit of under or non-banked consumers).”

Encouragingly, a dozen respondents said that, while their own institution is not yet involved, there is a strong interest in getting involved.

When asked about their own strategies for financial inclusion in poor and/or undeveloped markets, respondents were enthusiastic in general, but cagey on particulars. One banker said the strategy in place was “to leverage both our businesses and our philanthropy”, working with “intermediary organisations such as NGOs, MFIs and local banks to expand access to finance through funding, to pilot new mobile payments platforms, and philanthropically to support networks, innovation and piloting and industry standards”.
Some were a bit more specific. One banker referred to his institution’s policy of “strengthening the SME legal framework in various Early Transition Countries and in south-eastern Europe (SEE); providing financial inclusion by training educators to provide financial education to remittance receivers in Tajikistan and the Kyrgyz Republic; and exploring new areas such as mobile banking in Romania, Russia, Turkey and Ukraine.”
The Top 3 Challenges

1. **Regulatory Environment**: Generally, respondents were concerned about the quality of regulation in emerging markets, citing cultural differences, lack of local support, complicated tax regimes, and difficulties in understanding what ‘compliance’ can meet in practice. One banker noted that “some regulators/central banks are more demanding than others” and that “local knowledge and support is essential, but in many cases it is the sheer amount of time to gain regulatory approval that is the challenge”.

   It’s not just the rules, but their application. One banker complained about a lack of experience in applying what rules exist, while another warned that, in South Africa, “consumers need maximum protection, but that hampers product development and design”.

   More than one respondent noted the politicisation of regulation in some markets: “Regulation of finance has become much more politicised in the past few years, not least because many of the new providers are challenging the status quo of patronage disbursed through politically-controlled financial institutions”. Plus, local regulators may have one rule for indigenous providers and another for non-indigenous competitors.

   One problem is the prevalence of informal and semi-formal groups in poor and emerging markets – many of which are not recognized by regulators.

   Overall, respondents acknowledged that regulation is difficult, but that it has a pay-off. “Financial institutions are highly experienced in and comfortable with local regulations and local regulators” said one. “The toughest, longest-to-solve issues usually lie in this area…but so do the biggest rewards”.

2. **Know your consumer**: Respondents considered an institution’s ability to gather and maintain reliable information about their clients’ financial lives a real challenge in poor and undeveloped markets. Overcoming it “requires a national identity scheme and credit information bureaus.”

   Local knowledge is probably the best alternative. As one respondent wrote, microcredit systems have shown it can be done “both socially and financially with low risk, if delivered by those who know the communities”. Another described experience in the field of “non-arms-length dealing” and the lack of birth certificates, and advised that the best way to mitigate this is by “talking to village elders” – something not always possible for a major financial institution.

   Reliance may need to be placed on NGO networks to understand groups rather than individuals. “Know Your Client” may need to become “Know Your Market”.


3. *Product design*: The key is the ‘enabling environment’. Consultants can help local institutions to design new products, but there is still reliance on the authorities to have the infrastructure in place – including regulations – to allow new products to prosper.

There must also be a return to demand-driven product design – instead of supplying products based on a presumption of what might work. As one respondent said, “designing the initial products – basic credit and savings accounts – is easy; however designing more sophisticated products such as insurance and pensions is much harder”.

That said, several respondents were quite positive – one saying that quality market research makes good product design not particularly difficult. The key point may be that the approach required is different to that of mainstream customers in developed markets.
The Top 3 Opportunities

1. **Social impact**: The most significant opportunity - Social Impact – was described as the *sine qua non* of development. That said, there was some scepticism about microfinance’s social impact. But there was strong support for the economic benefits of financial inclusion in supporting microenterprises and SME: “Where access to finance does seem to have a positive impact is on those people running microenterprises, where it allows them to take the next steps to growth”.

In other words, the focus should be on finance for livelihood development and income generation, rather than consumption. The importance of rigorous, evidence-based monitoring was underlined – with the impact needing “to be carefully scrutinised [in] the long term to prevent any negative side effects.

However, inclusion must address what has been called the “missing middle” – the gap between microfinance and mainstream bank lending, to reach SMEs. “The evidence is clear here, but we need to make sure that inclusion involves firms, and not just individuals/households...that's where the link to jobs and economic growth lies”.

Overall, social impact was – perhaps surprisingly – seen as a standout opportunity: “[There are] huge opportunities to improve the lives of whole populations and increase personal and government income through better information, access to loans/insurance/savings, improved knowledge of local markets, job creation, and speed”.

2. **Market size**: Respondents felt strongly that the potential market of the financially excluded is one of the greatest commercial opportunities. “For those institutions that crack the code of how to sell to the bottom of the pyramid profitably, a huge market awaits”, said one. The saturation of developed markets, and the negative reputation attached to mainstream financial institutions post-2008 were common themes. “Notwithstanding the public hostility to financial companies in Europe, this remains one of the most exciting growth industries in the world.”

3. **Diversification of products**: Respondents saw the opportunity to offer a wider range of products - including niche insurance, health or education savings, m-banking and agri-lending - than in established markets. But there is a need to ensure that diversification doesn’t erode the institution’s primary objectives.

One respondent deplored the cost of entry into developing markets - though “cross-subsidization within an institution should help support the development of these innovative products, in parallel [with] partnership development with governments, private sector and regulators”.

Product diversification as an opportunity was closely related to product design as a challenge. There is a “need to provide bespoke ‘local’ products and delivery channels, especially for rural communities; and at the same time to build scalable, standardised products that work well in large urban areas”. As always, one institution will see as a challenge or risk to be avoided, what another sees as an opportunity to be grasped.

Despite the small sample, there are some encouraging takeaways. In particular, there is a huge, semi-dormant interest among mainstream financial institutions in engaging in poor and emerging markets, offering quality, sustainable, fair and profitable products to the un(der)banked.
Part 5: Conclusion - The Drivers of Scale in Financial Inclusion

Over the course of the Fellowship programme, six round-table meetings were held in London; each with over fifty attendees from financial institutions, academics, observers, support providers and NGOs. It is clear that there is a significant appetite within the City to focus on how to reach the un(der)banked billions – sustainably and profitably.

However, good intentions are one thing; implementation is another. It is, for instance, clear that there is an “understanding gap” within financial institutions. Understanding what potential clients in low-income countries need is difficult. Even within the development/financial inclusion community, it is not well understood. It’s clear too that product design has too often been supply driven, or has just transplanted what works for middle-income people in rich countries to low-income populations. The poor have specific product needs – even if their overall financial needs (saving, borrowing, being protected, being able to easily transfer money) are broadly the same as ours. Income smoothing is something that is particularly difficult when you live on the edge.

Insurance is the hardest product to crack. While fascinating pilots are being implemented in many markets, with a broad range of new products, delivery remains the major obstacle. New partnerships reaching beyond conventional financial institutions will be what allow microinsurance to reach critical mass for scale.

Technology is the great equaliser. The mobile phone is now ubiquitous in most parts of the world – even when clean water, electricity and education are not. The use of technology in livestock financing, especially to monitor animal health and establish low-cost insurance cover, is an exciting prospect.

Mobile phone-based technologies will enable customers to control some part of the processes compared to others. If e-wallets are promoted while providing credit facilities, it will become possible to do cashless transactions with all the attendant advantages. But this will take some time as most poor populations have only recently moved to monetised livelihoods and might find the move to e-money a tall order. However, even if the field officers of banks or MFIs maintain their e-wallets for handling of cash and accounting, costs can be reduced considerably.

The use of technology in livestock financing especially to monitor animal health and establish low-cost insurance cover is an exciting prospect. Presently this is in small scale isolated experiments, but has scope for wider application. This would improve the appetite for financing livestock, so critical to many poor households.
Delivery is a challenge beyond insurance. In financing the poor, more so than in high-income countries, it’s difficult to separate the product from its delivery. A good product will fail from a bad delivery process, and *vice versa*. Continuing customer contact, the ability to account for money in real time and fraud avoidance through quality authentication processes are all critical to controlling risk and costs.

Combining delivery with new technologies will be what drives the next stage of progress in financial inclusion. For instance, using smart cards for identification and authentication eliminates certain frauds arising from impersonation. Using POS machines or mobiles for transactions also helps in back office accounting and MIS. And back office costs in small institutions themselves can be dramatically reduced by using the emerging suite of cloud-based, off-the-shelf MIS products – previously only affordable for the biggest providers.

Finally, as everywhere else, it’s in the institutions’ interests to have financially capable customers. Whether it’s done for social reasons or just for the bottom line, thinking about how to provide financial education means thinking about financial institutions’ partnerships with governments, NGOs, and private employers, thinking about education delivery and about the appropriate content, the segmentation of target markets, and thinking about timing – the ‘teachable moments’ at which customers are most receptive to learning.

None of this will happen overnight. But there are two billion, low-income, financially excluded future customers out there. Providing them with profitable and sustainable financial services is the biggest challenge and opportunity the financial sector faces.
Appendix

A: IFFCO-TOKIO and the livestock insurance pilot

In 2008, the rural team of IFFCO-TOKIO General Insurance Co. Ltd. (IFFCO-TOKIO) faced a dilemma. To fulfil the mission of its parent company, the team needed to bring the benefits of insurance to cooperative members. To expand IFFCO-TOKIO’s rural portfolio, it needed to expand its bancassurance business and enlist rural cooperative banks as distribution partners. To attract cooperative banks as partners, it needed to offer products to cover all assets for which banks provided loans. The problem was that cooperative banks’ portfolios were filled with cattle loans, and IFFCOTOKIO did not offer any livestock insurance.

IFFCO-TOKIO is a joint venture in India between the Indian Farmers Fertilizer Cooperative Ltd (IFFCO) and Tokio Marine and Nichido Fire Inc. of Japan. IFFCO-TOKIO has a strong interest in providing insurance cover for rural farmers because of the relationship between its parent company, IFFCO, and the rural sector. IFFCO consists of 40,000 farmers’ cooperatives and is the world’s largest cooperative manufacturer of fertilizer as well as the world’s largest cooperative.

IFFCO-TOKIO knew that it needed to provide livestock insurance to become an attractive insurance partner for cooperative banks, but was wary of the challenges facing livestock insurance in India and elsewhere. These include:

- Absence of actuarial pricing data: Limited or no mortality risk data makes pricing difficult.
- Difficulty in valuation: The value of cattle is correlated with age, health and productive capacity. The value of each cow needs to be assessed as it can vary by geographical areas and there is limited information on market prices.
- Identification of animals: Accurately identifying cattle is a challenge, increasing the risk of moral hazard and fraudulent practices.
- Monitoring and verification: To combat fraudulent claims, insurers need to monitor tagging, valuation and risk calculation. Insurers might need to appoint their own veterinarians or agents to properly monitor these processes.
- High operational cost: Operational processes related to enrolment and claims settlement can be labour-intensive and expensive. Verification of a loss in remote rural areas for one or two insured animals can be a considerable cost.

These challenges hinder the expansion of livestock insurance, in spite of the clear need for such cover. About one billion people, or about 70 per cent of the world’s 1.4bn people living in extreme poverty, depend on livestock for their livelihood. In India approximately 100 million people rely on livestock as their primary or secondary source of income, yet only seven per cent of the livestock are insured.
A typical cattle owner in India is a small farmer who owns one or two cows. The farmer raises cattle as part of a mixed farming system comprised of crop and livestock production. The regular livestock income generated through the sale of milk is used to supplement seasonal farming income. With small farmers generating nearly half their income from livestock and the value of cattle representing a substantial percentage of the farmer’s wealth, the death of a cow is a considerable risk and affects the farmer’s net worth and income. The risk is greater when the livestock is purchased with a loan because the household has the additional responsibility of repaying a loan without access to the asset that was meant to generate the income for repayment.

Given this dependence on livestock, insurance solutions that protect farmers in the event of a loss deserve attention. After 27 months of testing IFFCO-TOKIO has successfully:

- Insured 28,136 cattle with a gross written premium of US$ 496,000;
- Educated farmers about the benefits of RFID identification technology and used it as a marketing advantage;
- Monitored processes to reduce fraud and control claims (claims ratio of 35 per cent);
- Improved the business viability of the product (combined ratio of 118 per cent);
- Improved the client value proposition through product and process changes that led to doorstep enrolment and claims services and faster claims processing; and
- Used the livestock product as a strategic advantage to attract new distribution partners and expand to new areas.

The results highlight the need to pilot, to learn from the field, and to balance client value and business viability. While the project at first glance appears to be a technology project, the real value of the technology has been allowing the insurer to change business processes.