

CHAPTER NINE

The Financial Services Market

A photograph of a group of people, including a woman in a red headscarf, sitting around a table and working on papers and a calculator. The image is overlaid with a semi-transparent blue rectangle and the chapter title.



Microcredit pioneer Muhammad Yunus received the Nobel Peace Prize in 2006, a milestone in public attention to the financial needs of the BOP. Until recently the main focus has been microcredit, historically the domain of nonprofits. Now the focus is changing—as new players and new products enter the market and new technologies transform services. A dynamic financial services sector is emerging—moving toward financial access for all.

Many microfinance institutions now offer savings as well as microcredit. Commercial banks are becoming active in the BOP market and bringing a still broader range of services, including insurance. Mobile phone banking, still at an early stage, promises to dramatically broaden access and lower transaction costs. Remittances to BOP households from family members overseas have emerged as a significant cross-border financial flow, bringing new attention and new ways to promote economic growth.

As these changes expand access to financial services for the BOP, the effects can be measured in many ways, not just in the volume or dollar value of transactions:

- New jobs and income. New types of financial services, provided through mobile phone systems, are generating new jobs and income for millions of small entrepreneurs who sell over-the-air credit.
- Formal identity. Establishing a banking relationship gives people a formal identity they often lacked before, contributing to the process of political and social inclusion critical to development.
- Greater personal safety. Cash is a burden for the poor, making them vulnerable to crime. By doing away with the need to carry a lot of cash, such services as debit cards and mobile phone-based access to cash and bill-paying facilities enhance personal safety and the quality of life.

In Indonesia women who are clients of Bank Rakyat Indonesia are more likely than other women to participate in family financial decisions.

- More education for children. In Bangladeshi families that are clients of Grameen Bank, nearly all girls are in school, compared with only 60% in nonclient families.
- More timely health care. In Uganda the Foundation for Credit and Community Assistance (FOCCAS) links its microloans to participation in child health education programs and has doubled the share of its clients using practices to prevent the transmission of HIV. In Bolivia microcredit clients of Crédito con Educación Rural (Creceer) had higher rates of child immunization in their families than did nonclients.
- Economic empowerment of women. In Indonesia women who are clients of Bank Rakyat Indonesia (BRI) are more likely than other women to participate in family financial decisions. In India borrowers from SEWA Bank have organized unions to lobby for higher wages and more rights as members of the associated Self-Employed Women's Association (Littlefield, Morduch, and Hashemi 2003).

Through these effects and many more, financial services play a critical part in reducing poverty and improving the access of the BOP to goods and services.

How large is the market?

National household surveys capture extensive data on financial matters, but little on actual spending for financial services. Moreover, the costs of these services are often not fully transparent to BOP customers, who may not know or understand the actual costs of transferring remittances from sender to recipient, for example, or the true interest rate paid to an informal village lender. As a result, robust data on spending for financial services are not available in sufficient detail for meaningful analysis.

What is known, however, clearly indicates that the financial services sector is changing—and doing so in ways that are moving it toward broad access for the BOP. Three factors are powering this transformation:

- The microfinance sector is growing up, attracting new participants and creating new services.
- Rapid changes in technology are reducing the transaction costs in financial services, expanding markets, and interesting large financial institutions in markets previously ignored.

- Remittances are approaching an estimated US\$350 billion a year, and recipients, businesses, and national governments are learning how to leverage these “BOP to BOP” financial flows.

The following analysis briefly explores the financial services sector through these three lenses.¹

The changing banking landscape

Several strategies are at work to bring financial services further into the BOP. One is to expand the microfinance institutions. A growing number of traditional microcredit banks—such as the Cooperative Bank of Kenya, Financiera Compartamos in Mexico, and BRI in Indonesia—have become profitable on a fully commercial basis, with sustainable microlending now just a part of their core business. And one relative newcomer, SKS Microfinance in India, has relied on operational efficiency to power rapid growth in lending (case study 9.1).

By the industry’s own estimate, however, microcredit had reached only 82 million households by the end of 2006. Even the industry’s new target for 2015, 175 million households, would represent only 31.5% of today’s 556 million BOP households.²

Clearly, other strategies are needed to reach scale. Some are already in play. Major financial institutions are discovering that they can go “down-market” profitably, leveraging their capital, their expertise, and their back-office systems. In one of many examples, Citi in late 2006 announced plans to expand into low-income neighborhoods of India with automated teller machines (ATMs) using thumbprints to identify customers.³ Banks also are beginning to

CASE STUDY 9.1 **BOTTOM UP BANKING: DEEPENING FINANCIAL SERVICES ONE SMALL LOAN AT A TIME**

In 1998, with US\$52,000 in “family and friends” funding, Vikram Akula¹⁴ started SKS Microfinance, a microcredit institution in India. Akula had a very specific goal in mind: use modern, efficient back-office systems to lower transaction costs so radically that microloans could be handled profitably and at scale.¹⁵ Going well beyond the Grameen “lending circle” approach, SKS targeted a massive market—the 800 million people of the BOP in India.

SKS created simple loan management software with help from friends at consulting firms. And it developed simple rules for borrowers that cut transaction time and complexity—for example, requiring standard regular repayments in multiples of five rupees (the smallest paper bill in India, worth around US\$0.11).


SKS has carefully tracked its risk profile, balancing its loan portfolio when in danger of becoming overexposed in one sector or another. When loans for buffaloes rose rapidly, for example, it quickly responded by finding borrowers in such areas as retail, construction, and auto and truck repair.

Big banks are now lining up to lend SKS funds to relend to its own clients.¹⁶ ICICI Bank, India’s largest private sector bank, has given SKS an open line of credit. ICICI assesses the risk to be low—SKS has a 98% on-time repayment rate. Moreover, SKS earns a higher return on capital than ICICI’s large corporate borrowers.

SKS has loaned more than US\$57 million to more than 200,000 women. Besides its income-generating loans, SKS offers interest-free loans for emergencies and life insurance for its clients. An SKS affiliate, SKS Education, provides education services to poor children.

SKS now has 85 microfinance branches in five Indian states and plans to open in five more as it pursues its goal of serving 700,000 clients by early 2007. By its own account it is already among the world’s fastest-growing microfinance organizations.¹⁷

All these efforts add up to a significant deepening of the financial services sector for the BOP—and illustrate a strategy of **enabling access**.



Nontraditional players are entering the BOP market. Retail giant Wal-Mart has received regulatory approval in Mexico to create its own bank collocated with its stores. Grameen Foundation USA and India's largest private bank, ICICI Bank, have formed Grameen Capital India to assist microfinance institutions in raising funds.

view those receiving remittances as potential customers for a range of financial services.

Nontraditional players are entering the BOP market. Retail giant Wal-Mart has received regulatory approval in Mexico to create its own bank, Banco Wal-Mart, colocated with its stores.⁴ If the venture is successful, other Wal-Mart banks will follow elsewhere.

Some microfinance institutions and big commercial banks are meeting in the middle. Grameen Foundation USA and India's largest private sector bank, ICICI Bank, have formed Grameen Capital India to assist microfinance institutions in raising funds. The joint venture will help microfinance institutions access primary and secondary debt markets and sell portfolios of microloans to other banks—and will also supply guarantees and credit enhancements for these portfolios where appropriate.⁵

ICICI has many similar ventures in the pipeline aimed at reaching the BOP. One is a partnership with microfinance institutions and technology provider n-Logue to harness thousands of entrepreneur-run Internet kiosks as the first touch point for savings accounts, mutual fund purchases, insurance, and even equity loans—and to provide branches, franchise operators, and ATMs throughout rural India.⁶ Partnerships like these are spreading across the financial sector as a way to broaden access to services for the BOP.⁷

Steady growth of savings accounts in the BOP provides compelling evidence of its appetite for more than microcredit. Savings accounts for low-income customers in developing and transition economies are estimated to number more than a billion (Peachey and Roe 2006).⁸ Indeed, for BRI and Financiera Compartamos, savings accounts represent a much larger part of their BOP portfolio than do microloans. Savings vehicles are often hampered by outdated laws and regulations. But where permitted, they can play a powerful new role in deepening the financial sector for the BOP.

Finance for small and medium-size enterprises is growing. While this development does not bring financial services to the BOP, it does expand opportunity by creating jobs and services. The financing comes in the form of loans and equity investment beyond the limits of microfinance but too small for the traditional lending windows of large banks. The Asian Development Bank is developing a series of investment funds for small and medium-size enterprises in Asia, and the Japan Bank for International Cooperation has increased by several million dollars its pledge for private sector investment in Africa, including money for small and medium enterprises. Shell Foundation has helped launch several



investment funds in Africa that focus on small enterprises, bringing in local financial institutions as coinvestors.⁹ The most effective new models combine the provision of capital with mentoring, business education, and skills training.

Commercial banks are seeking new ways to participate in small and medium-size enterprise finance, driven by such structural factors as low rates of return on government debt in much of the developed world and stiff competition among banks at the high end of the market. The global banks usually partner with local banks, able to provide the risk assessment and community relationships critical to success. Meanwhile, the availability of capital and the support of big money-center banks are driving local banks to better serve local small and medium-size enterprises, a market many have long ignored.

Technology as a driver

Technology does two key things that help drive the development of financial services: it cuts costs, and it bridges physical distance. For BOP customers, technology in financial services can address four important concerns: convenience, accessibility, safety, and transferability (Wright and others n.d.). A mobile phone-based transaction system offers far more convenience and accessibility than a traditional financial institution, whose use may require that clients find a bank branch or attend a weekly microfinance group meeting. Electronic forms of money, less prone to theft, are safer than cash. They also are more easily transferred, especially overseas.

Technology is bringing nontraditional players into the financial services market. Most notably, mobile phone operators are introducing new products and services over their networks that look and feel like traditional financial services (case study 9.2). Start-ups are finding ways to combine mobile networks and traditional banks (case study 9.3).

The resulting hybrids—banks partnered with mobile phone operators, or companies that market both financial and mobile phone services—pose issues for banking and telecommunications regulators. But the benefits seem so great as to demand solutions, and Pakistan, for example, has instructed the two sets of regulators to work out effective solutions.¹⁰

The emerging technology-driven financial services include bank-centric models, electronic currency, and mobile commerce systems. The services are being provided through a range of technologies: ATMs, mobile phones, handheld computers, and credit, debit, and smart cards.

CASE STUDY 9.2 **BANKING ON PHONES: MOBILE OPERATORS AS BANKING PIONEERS IN THE PHILIPPINES**

Filipinos are avid users of text-messaging services. By recognizing and building on this appetite, Smart Communications and Globe Telecom have become pioneers in mobile financial platforms.

Starting with the simple notion of refilling prepaid airtime debit cards electronically, Smart has created a suite of services that operate seamlessly with other company systems. The company's "Smart Money" allows a subscriber to transfer cash from a bank account to a cell phone; to pay for goods and services in thousands of shops and restaurants; to order and, using system credits, pay for goods and services over the phone; to load airtime onto any Smart system phone; to transfer money from one Smart Money card to another; to pay utility bills; and even to send remittances from abroad (Smith 2004a).

Globe Telecom provides similar services. In 2004 it launched the "G-Cash" program, which allows users to send and receive cash and to make payments to a variety of services and businesses through text-messaging. The system also allows domestic and international money transfers. Unlike with Smart's system, the user does not need to have a separate bank account: Globe's system uses banks but also relies on a network of retail locations for users to "cash in" or "cash out" (Vega).

Globe and Smart are succeeding in the marketplace because they meet real needs of customers. They provide safety: the electronic currency relieves customers of the burden and danger of carrying cash. They enhance security: values are stored centrally, protecting customers against loss if a card or phone is lost or stolen. They provide accessibility: through the remote banking applications, they bring the bank to the customer rather than requiring the customer to go to a physical location. And they allow transferability: their systems enable customers to transfer money to another customer—a service often used within families and for business transactions.

Beyond all this, the two companies have created more than 1.5 million new entrepreneurs, engaged in reselling airtime and facilitating mobile financial services. Their approach exemplifies two strategies: **localizing value creation** and **focusing on the BOP**.

In Kenya, Vodafone is partnering with local mobile operator Safaricom and local microfinance institutions to roll out a financial transaction system called M-Pesa. The system is based on a new mobile phone card, developed for the purpose, that enables microfinance clients to make deposits, check balances, and fully manage their accounts. Neighborhood banking agents can turn electronic transactions into cash and take deposits and payments on behalf of clients, earning commissions along the way. Vodafone has plans to rapidly add more countries.¹¹

Prodem FFP in Bolivia is a sector-leading example in the advanced use of ATMs to provide savings accounts to low-income, illiterate customers in rural areas. Technology, it understood, would be the key to providing affordable service. Unable to find the low-cost, high-quality technology it sought, Prodem partnered with a local firm to create it. The result: an ATM that uses visual and audio prompts in four languages, including three indigenous ones, and a smart card that captures and stores account information and biometric identification. ATMs aimed at the BOP are now being taken up by big banks, such as Citi in its ATM venture in India.

Visa International has partnered with FINCA International, a microfinance institution in Latin America, in a retail banking program for FINCA's BOP microfinance clients. The program automatically deposits loans into a savings account opened by the client at a retail bank and issues the client a Visa debit card and a personal identification number (PIN) to access the funds. Visa and FINCA have found that the program makes clients more inclined to save now that their money is in a secure place. The program

At the same time that banks are discovering that the BOP want and need full access to financial services, financial sector analysts are discovering that the funds flowing in and out of the BOP are much greater than previously thought.

also increases security by eliminating the need for a loan check, which could be lost or stolen. And it gives clients a feeling of prestige associated with carrying a Visa card.

Remittances as a new tool for promoting growth

At the same time that banks are discovering that the BOP want and need full access to financial services, financial sector analysts are discovering that the funds flowing in and out of the BOP are much greater than previously thought. The Multilateral Investment Fund of the Inter-American Development Bank took the lead in tracking remittances to Latin America and the Caribbean, and now others are adding to the data.

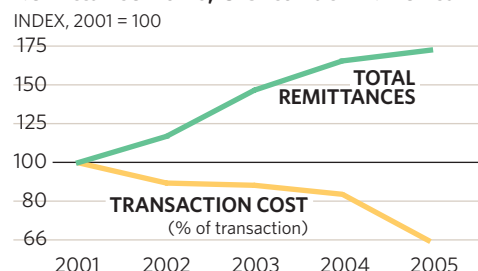
The new understanding of the size of remittances brought policy and commercial attention. Reforms were launched to bring more of the flows into official channels, and new competition emerged among transfer services (Orozco 2006). With competition have come better service and lower cost. The results have been especially noticeable in Latin America, where the reported flows from the United States have risen every year, reaching US\$53.6 billion in 2005.¹² Worldwide the total is now thought to approach US\$350 billion, with significant flows to every developing region. Indeed, reported remittances doubled between 1999 and 2004 (World Bank 2005).

This stable flow of funds provides a large share of income for many in the BOP as well as a direct “BOP to BOP” financing mechanism that helps pay for new houses, new businesses, and children’s educations. But governments and development agencies are only beginning to understand the national and local effects of remittance flows—and to find ways to increase the benefits from them.

One benefit: at the national level remittances significantly improve country risk ratings, as recent research by World Bank economist Dilip Ratha (2005) shows. Higher ratings encourage more private sector investment, which can help create jobs and fuel growth. Another benefit: several banks in developing countries have been able to “securitize” remittance flows—that is, use these dependable flows to back a financial instrument sold in international capital markets—and thereby lower their cost of borrowing. Both these benefits mean greater national financial capacity for domestic investment, increasing the growth effect of remittances beyond their impact at the household level.

Recognizing the potential in transferring remittances, businesses are launching new services. At the 3GSM World Congress in Barcelona in

Remittance flows, U.S. to Latin America



Source: Inter-American Development Bank, “Remittances to Select LAC Countries in 2005 (US\$ Millions),” <http://www.iadb.org/mif/remittances/index.cfm> (accessed February 1, 2007).

CASE STUDY 9.3 **VIRTUAL BANKING: A BANK FOR THE BOP IN SOUTH AFRICA**

Wizzit operates a virtual banking service in South Africa—relying on mobile phones, not physical branches. Its aim is to provide access to financial services to 14 million unbanked citizens. (Kramer and Paul 2006) Wizzit operates as a division of the South African Bank of Athens. It is also an accredited issuer of a debit card and offers a secure mobile payments channel for mobile phone payments. The Wizzit system enables customers to:

- Transfer money from a Wizzit account to any other bank account holder.
- Purchase cell phone airtime.
- Pay bills with utilities and other businesses.
- Get cash at ATMs worldwide.

Conscious of the barriers that have inhibited the BOP from participating in the formal financial sector, Wizzit has adopted policies to encourage new customers:

- Multilingual customer service centers.
- Ability to open accounts at any time, any day of the week—in just two minutes.
- Full compliance with the country's "know your customer" requirements for banks—without using this as an excuse not to open accounts.
- Community-based "WIZZkid" representatives who will come to the client to open an account, rather than requiring the client to travel.
- Accounts for minors as well as adults.

Wizzit also applies its socially conscious attitude to its hiring policy. It aims to hire only unemployed people and so far has provided jobs for more than a thousand. The Wizzit business model exemplifies a strategy of **enabling access**.

February 2007, a consortium of 19 mobile operators, serving more than 600 million customers in 100 countries, announced a system that will transfer remittances entirely through their mobile phone systems, radically reducing cost. The consortium predicts global remittances of more than \$1 trillion a year by 2012.¹³

These developments notwithstanding, there is still a serious shortage of infrastructure on the ground to provide financial services to the BOP. Carefully mapping where remittances are sent in Mexico and where formal banking institutions exist, the Inter-American Development Bank has identified many locations with substantial remittances but no banking services. This lack of presence represents a lost opportunity for traditional financial institutions and a barrier to full financial citizenship for the BOP. It also creates a significant opening to this unserved market for non-traditional players and branchless banking enterprises.

Endnotes

1. There are, of course, many other important aspects of financial services for the BOP not addressed here, such as supply chain finance, the deepening of credit service analysis, and the provision of all types of insurance, from crop insurance to flood, health, and business liability policies.
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8. AME Info, "Visa Encourages Banks to Partner with Microfinance Institutions," November 7, 2006, <http://www.ameinfo.com/101075.html>.
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