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Global Financial Inclusion

Achieving full financial inclusion at the intersection of social benefit and economic sustainability

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Foreword

Tony Goland

In the past decade, the goal of financial inclusion—ensuring that every individual has access to quality, affordable financial services—has become an increasing priority and possibility worldwide. And as we enter the second decade of the century, the necessary conditions for meeting this goal are coming together.

Financial inclusion aims at benefiting the world's poor, the vast majority of whom do not use formal financial services of the sort provided by banks, insurers, or microfinance instititutions (MFIs). As a result, they are unable to avail themselves of the fundamental tools of economic self-determination, including savings, credit, insurance, payments, money transfer, and financial education.

Over the past 30 years, MFIs have demonstrated not only that the working poor want and need formal financial services but also that they can afford them. Consequently, MFIs and other commercial organizations have been expanding these services at an accelerating pace, and recent developments suggest that full financial inclusion is within reach over time. Organizations operating in a variety of contexts are levering technology; innovations in distribution, risk management, and product development; and a deepening understanding of lower-income customers to develop sustainable business models that meet the unique needs of the poor. These efforts will increase benefits for individuals and private enterprises, as well as for society as a whole.

While each country will follow its own particular path to achieving full financial inclusion, most solutions require contributions from the private, public, and social sectors. Private businesses must continue to innovate and scale business models that deliver quality and value to consumers without relying on penalty-based revenues—from late fees or similar charges, for example—to generate sustainable returns. Governments must establish appropriate regulations and oversight to protect consumers while enabling a range of providers to deliver services at sustainable cost levels. And social-sector institutions should continue to contribute ideas, talent, and seed funding; use their convening power to create effective partnerships; and provide services to the hardest-to-reach consumers.

McKinsey's Social Sector office supports private, public, and social institutions as they develop and scale up solutions in the face of complex societal challenges. We have worked with organizations in a range of industries and disciplines—including financial services, telecommunications, consumer marketing, logistics, philanthropy, public-private partnerships, and economic development—to help overcome the barriers that stand in the way of full financial inclusion.

The four articles presented in this volume share some of the lessons we have learned in our work. The first of these, "From millions to billions: Achieving full financial inclusion," provides an overview of the sector, highlighting the principal challenges faced by institutions committed to expanding these services and discussing promising strategies in five important areas: distribution, human capital, risk management, product development, and regulations.

Next, two articles on distribution provide our perspectives on approaches that organizations can use to deliver financial services to customers at sustainable costs. "Banking where you shop: Correspondent banking's contribution to financial inclusion" explains how organizations can use correspondent-banking strategies to deliver financial services through existing nonfinancial channels such as convenience stores, gas stations, and post offices. "Banking on mobile to deliver financial services to the poor" provides insights into developing mobile-financial-services offerings to reach the unbanked.

And "Addressing the middle-management challenge: A conversation with four leaders in financial inclusion" draws from a discussion among leaders of cutting-edge institutions whom we convened to provide us with perspectives on human-capital issues—a concern that many institutions rank as their most pressing.

We are profoundly impressed and encouraged by the energy, effort, and resources that many organizations and individuals across the globe are dedicating to financial inclusion. The fact that their commitments continue to grow and multiply reinforces our belief that financial inclusion is at an inflection point. We offer these articles as a contribution to their collective efforts.

Tony Goland is a director in McKinsey's Washington, DC, office.

From millions to billions:
Achieving full financial inclusion

The goal of financial inclusion appears to be within reach. But achieving it depends on scaling up innovation from across the private, public, and social sectors.

Tony Goland, Jonathan Bays, and Alberto Chaia

More than half the world's working-age population does not have quality, affordable financial services. That's about 2.5 billion adults—2.2 billion of whom live in Africa, Asia, Latin America, and the Middle East.[1]

To better take advantage of life's opportunities and shield themselves from economic shocks, these unserved people and their households must be able to save, borrow, insure against risk, and make payments knowledgeably, safely, and affordably. The goal of enabling everyone to participate fully in the formal financial system is known as "financial inclusion" and achieving it across the globe will likely benefit individuals, the commercial enterprises that serve them, and society at large.

Financial inclusion will provide poor individuals with the opportunity to improve their standard of living. It can enable companies, especially financial-services providers, to do good while gaining access to many profitable new customers in dynamic and high-growth markets. For countries, it has the potential to stimulate economic activity and improve the overall quality of life of their citizens. The potential for positive social and economic impact is tremendous.

In the past 30 years, microfinance institutions (MFIs) have led the way, proving that the working poor can be served sustainably. But to achieve full financial inclusion, institutions in the private, public, and social sectors must develop innovative models that enable them to sustainably deliver

affordable, high-quality services to the working poor at scale. This remains challenging. Lower-income individuals are difficult to serve in an economically sustainable way, available products often fail to meet their needs, the risks associated with serving them can be difficult to manage, and existing regulations often impede progress. Critics have rightly asked for evidence that financial services benefit this population, and voices from all corners have reminded the world that consumer protections are critical.

The good news is that many factors are now coming together to allow organizations to pursue full financial inclusion. Organizations are gaining an increasingly sophisticated understanding of lower-income customers' needs and of how best to organize themselves to meet those needs. Technological advances are improving data transmission, collection, and analysis, enabling organizations to develop low-cost distribution models and scalable risk-management practices. More governments are supporting financial inclusion through regulatory and public-policy reforms that protect consumers while enabling providers.

Past successes have laid the groundwork for progress at an accelerated pace, and every sector—private, public, and social—has a role to play. Indeed, new models are already being developed and deployed by organizations from a wide variety of sectors, including not only financial-services firms but also telecommunications companies, retailers, utilities, government agencies, foundations, and nongovernmental organizations. And organizations that get involved early have the greatest opportunity to shape solutions and achieve impact.

This article provides an overview of the sector, including a review of some of the critical forces that are creating the conditions in which full financial inclusion can be achieved and the actions that organizations can take to accelerate progress. The three articles that constitute the remainder of this volume provide more detailed discussions of distribution and human-capital challenges presented by the sector—as well as some of the most powerful solutions available to meet these challenges.

An opportunity to create positive impact

Our research finds that more than 60 percent of adults living in Asia, Africa, Latin America, and the Middle East do not use formal banks or semiformal microfinance institutions to save or borrow money. That's nearly 2.2 billion unserved adults (exhibit).[2] Unserved, however, does not mean unservable. The microfinance movement, for example, has long helped expand credit use among the world's poor—reaching more than 150 million clients in 2008 alone.[3]

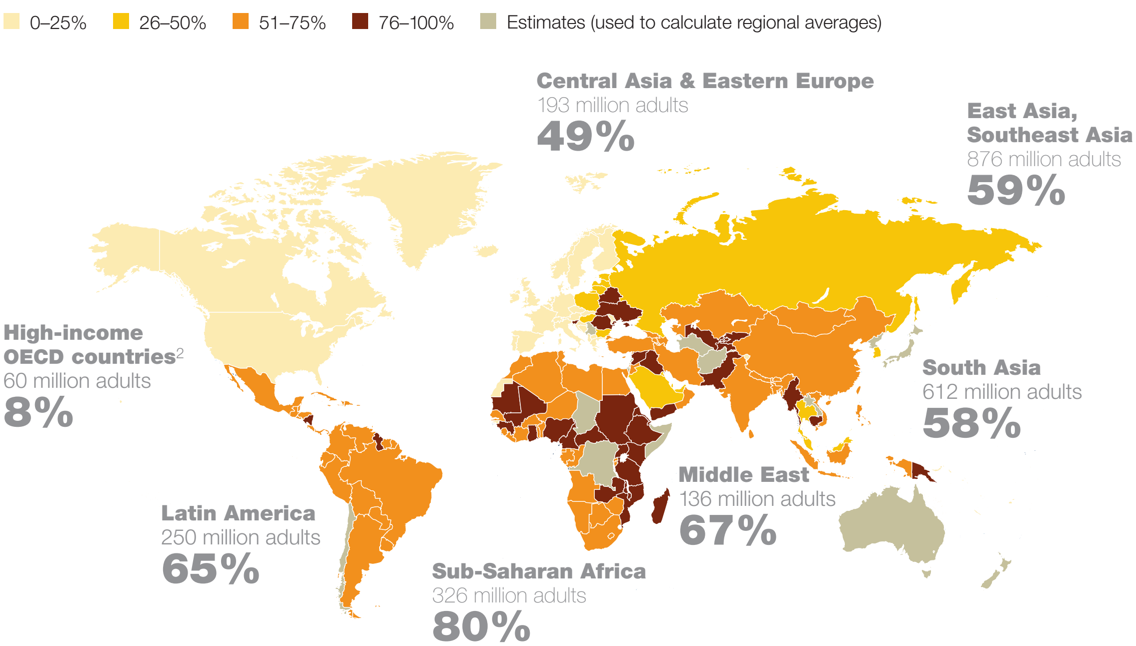
Full financial inclusion would mean providing every household with access to a suite of modern financial services, including savings, credit, insurance, and payments, as well as sufficient education and support to help customers make good decisions for themselves. These products and services must be affordable, designed to meet the population's needs, available within reasonable physical proximity, and regulated and overseen to protect consumers.

Poor households have many of the same financial needs as wealthier households, and they gain similar benefits from having access to quality, affordable financial services within a reasonable distance. For example, a recent review of impact assessments in microfinance found evidence from several studies that both credit and savings products are good for microenterprises, producing increases in investment and profits.[4]

Exhibit

More than half the world's adults do not use formal or semiformal financial services.

% of total adult population that does not use formal or semiformal financial services[1]



[1]Those not using at least one of credit or savings from formal financial institutions such as fully regulated banks or semiformal financial institutions such as partially regulated or unregulated microfinance institutions.
[2]Members of the Organisation for Economic Co-operation and Development.

Source: McKinsey research conducted in partnership with the Financial Access Initiative (a consortium of researchers at New York University, Harvard, Yale, and Innovations for Poverty Action); we relied on financial usage data from Patrick Honohan, "Cross-country variation in household access to financial services," *Journal of Banking & Finance*, Volume 32, Number 11, 2008, pp. 2493–500

Not surprisingly, demand for financial services is high among the poor, who often turn to informal channels when access to formal ones is not available.

In collaboration with the World Bank's Consultative Group to Assist the Poor (CGAP) and the GSM Association (GSMA) trade group, we analyzed 147 emerging markets and surveyed consumers in the Philippines to better understand the needs of this vast segment. Nearly 90 percent of the people we surveyed store money at home, with a friend, or in a village savings club. Some buy assets, such as cows or chickens, as a store of value. Nearly 60 percent of the people we surveyed in the Philippines keep some form of savings. These savings are typically used for managing cash flow rather than for long-term asset accumulation. The annual turnover can be many times the average balance. In India, about 20 percent of the unbanked population have access to credit, but 60 percent of the borrowing is done through moneylenders. In the Philippines, about 13 percent of the unbanked borrow: 55 percent from family or friends, 13 percent from moneylenders, and 17 percent from MFIs.

Credit is becoming increasingly available through formal channels. In the past decade, MFIs have had tremendous success reaching poor individuals in many markets, in particular Latin America and South and Southeast Asia. The number of microcredit borrowers served by MFIs increased by a factor of ten from 1997 to 2006, totaling 130 million individuals. In 2005, The World Savings Banks Institute identified up to 1.4 billion client accounts of all types at "double bottom line" institutions—including MFIs, postal savings banks, and other public-purpose institutions—in developing and transition economies.[5] And third-generation microcredit players, often run for profit, break even faster and more predictably than ever before.

Well-managed commercial providers in Latin America and India are achieving sustainable returns in addition to social impact by serving this segment. And the gains made by individuals and private enterprises will accrue to society as a whole, enabling overall improvements to quality of life and potentially spurring economic growth.

Long-standing barriers

Despite the success of MFIs and other organizations, few models have been established that meet the multiproduct needs of the economically active poor at a meaningful scale. Long-standing barriers continue to pose challenges, particularly in the areas of distribution, human capital, risk management, product development, and regulations.

Distribution is a significant challenge, particularly because many currently unserved people live in areas that are not covered by traditional financial-services institutions. In emerging markets, formal banking extends to only about 37 percent of the population. This translates into only one bank branch and one ATM for every 10,000 inhabitants.[6] The average is misleading, as the majority of the infrastructure is concentrated in urban areas. Reaching rural areas can be complicated—for example, if communications infrastructure is poor and roads are treacherous, then cash handling or ATM installation and operation become significant and costly challenges. As a result, institutions are often unable to locate ATMs—not to mention branches—in these areas.

Organizations that provide financial services to the poor also face significant challenges attracting and retaining quality talent, particularly at the middle-management level. Middle managers must understand the financial-services business, but they must also be excellent communicators, with the ability to lead the front line to successfully execute strategy developed by senior leaders. Increasingly, they will be called upon to conduct sophisticated analyses, and they may be required to articulate their organization's strategies to regulators. Middle managers must also cultivate and exhibit a sense of mission in their work, keeping the goal of serving poor individuals as a primary motivation at all times.

Risk is difficult to manage in this segment using traditional banking methodologies. Poor households that own property may not have proper titles, and savings that could be used as collateral may be limited and informal; in addition, most people have no recorded financial history, since they have not used products via formal channels in the past. Members of these households typically work in the informal economy and do not receive pay stubs, which makes it hard to assess their work histories, and some may not have permanent addresses. Providers are thus unable to rely on traditional means for assessing risk.

Product development lags significantly behind demand, and thus available products often fail to meet this population's needs. Organizations that provide financial services to the poor have had more success offering microcredit than any other product, yet only 5 percent to 10 percent of the target population uses credit. Savings accounts are becoming more widely available, yet according to a 2009 survey by the Microfinance Information Exchange (MIX), for various reasons only 27 percent of the 166 MFIs surveyed offer savings accounts. Penetration of insurance, payments, and remittances can be even lower—though dramatic increases in mobile-phone use in emerging markets are driving significant growth in mobile payments in some markets.

A number of organizations have developed innovative products, but many others still struggle to understand the segment well enough to design products that suit its needs. Simply cutting costs on existing products to improve affordability or tacking on new products without adjusting delivery mechanisms and systems are not full solutions.

Regulations have usually been designed to protect traditional financial-services customers and may not serve the needs of poor customers quite as well. Indeed, rules can sometimes stand in the way of innovations that would expand access for poor individuals. For example, many regulators prohibit nonbanks from intermediating financial products such as savings accounts, credit, or insurance. Other issues include strict limits on uncollateralized lending and "know your customer" rules that block poor households from entering the financial system. Regulators may also prohibit the use of certain types of information for risk-analysis purposes. It is of course critical to ensure that regulations protect consumers from predatory activities and promote an appropriate distribution of risk, but rules that suit the circumstances of the poor can provide this while also encouraging innovation. In Brazil, for instance, regulators gave permission to banks to provide simplified current accounts, which had limited features and were lower-cost to operate. Regulators also enabled the use of future payments, such as salaries or pensions, as collateral for lower-cost borrowing.

Reinventing the business model

Financial inclusion depends on the ability of organizations to develop sustainable new business models that enable them to meet the needs of poor customers at scale. This issue of *Global Financial Inclusion* presents two articles focused on distribution strategies and one panel discussion on human-capital challenges. In this article, we also discuss three other important areas: risk management, product development, and regulatory policy.

Distribution

The need to bring financial services closer to poor consumers is giving rise to new low-cost distribution models. Some organizations have had success adapting traditional branch-based approaches to serve the segment. For example, Bank Danamon has established several hundred branches in Indonesia that target poor individuals. They are staffed with people who are trained to serve the working poor, and the outlets are lean by design, relying heavily on technology to reduce costs.

However, alternative models that do not require organizations to establish new branches also hold great promise. Two of the most powerful new approaches, correspondent banking and mobile financial services (MFS), can enable organizations to significantly expand access while lowering the cost to serve customers by 30 percent to 75 percent.

Organizations in Latin America—particularly in Brazil, Colombia, and Peru, and, to a lesser extent, Mexico—have begun to demonstrate the potential of correspondent banking, which enables the delivery of financial services through nonfinancial retail outlets such as post offices, grocery stores, and even mom-and-pop stores. The most basic correspondent approaches involve partnerships between two organizations, typically a financial-services institution and a retailer that has already established an extensive network of outlets in the right areas. In some cases, the partnership will involve multiple retailers or other organizations, such as government agencies that can help promote usage of services by distributing social benefits through the channel.

Spurred by regulatory changes made in the past decade, Brazilian banks have developed correspondent-banking approaches that have enabled them to extend financial services to every municipality in the country. One in four Brazillian municipalities (about 1,600) is served only by the correspondent network.[7] The Mexican government is in the process of building a financial-services network that will offer banking through a selection of Diconsa's 23,000 stores, which are community-owned, government-supplied outlets that sell food and agricultural supplies in the country's poorest rural communities. Initially, the service is focused on delivering government transfer payments to recipients through these outlets; eventually the network will provide savings accounts and then, potentially, other financial services such as insurance. Pilots have already reached nearly 200,000 households,[8] and the service could reach more than two million families at scale.

MFS is also taking off, driven by the widespread use of mobile phones by low-income people in emerging markets. MFS strategies so far have focused on providing access to payments and remittances via mobile phones. Pioneers in Kenya and the Philippines have already had tremendous success. SmartMoney and G-Cash in the Philippines have more than 7 million and 2.5 million users, respectively, and Safaricom's M-Pesa service in Kenya has in excess of 10 million users. M-Pesa is noteworthy because it illustrates how quickly a well-designed MFS product can scale; Kenya's 10 million users signed up within a span of less than four years—much faster than even the fastest-growing MFIs. The next steps in MFS are to create similar platforms in other countries and to strike partnerships between mobile operators and financial institutions to add other financial services—including savings accounts, credit origination, and other services—onto this robust payment platform. Safaricom has already begun to advance the field through its efforts to offer crop insurance and by striking a partnership with Equity Bank to offer M-Kesho savings accounts linked to its payments service.[9]

The articles “Banking where you shop: Expanding financial inclusion through correspondent banking” (p. 16) and “Banking on mobile to deliver financial services to the poor” (p. 24) present detailed treatments of these strategies.

Human capital

Best practices about how to develop a strong cadre of middle managers are just beginning to emerge. The sector is becoming increasingly attractive to quality candidates for a number of reasons. It is developing and growing at a rapid rate, which means there are tremendous opportunities for people who want to shape the landscape and rise fast. And because institutions in the sector achieve important social impact as well as economic impact, the work is imbued with a strong sense of mission. Organizations should exploit these attributes to attract talented people from traditional financial institutions and respected universities who are seeking meaningful work and opportunities to achieve significant impact. But they should also invest in developing candidates already employed in the sector, many of whom have internalized a sense of mission that is critical to success and have developed a deep understanding of the target customer segment.

Leaders from frontline institutions—Bansefi, IFMR Trust, LeapFrog Investments, and Women’s World Banking—share their perspectives on this topic in “Addressing the middle-management challenge: A conversation with four leaders in financial inclusion” (p. 32).

Risk management

Organizations in a variety of sectors have begun to experiment with technology to gain access to useful data about poor customers, for whom very little data were available in the past. Transaction histories generated through mobile-phone use is one example. Organizations are beginning to use basic customer-relationship-management (CRM) solutions, enabling them to collect information about the frequency and character of their interactions with customers. Many

governments are developing improved identification and tracking systems to gather information about citizens—for instance, through credit bureaus—and thereby facilitate administrative processes and identify social needs. A good example is the Unique Identification Authority of India, which brings together top minds from the public and private sectors to provide unique IDs for Indian citizens and thereby promotes access to finance and other services. Some retailers have begun to use point-of-sale (POS) devices to gather transaction data.

Innovative organizations are using these and other sources of information to develop data-based models to better assess poor consumers' credit risk. Those that have implemented alternative risk models have succeeded in reducing credit losses by 20 percent to 50 percent. Some have also simultaneously reduced operating costs by automating processes. These encouraging examples are providing useful lessons that will inform further experiments in risk management and enable more rapid scale-up of financial-services solutions for low-income households.

Product development

Current research on the financial behavior of the poor shows that they already employ informal financial tools in a sophisticated way—in other words, their basic financial needs and behavior are similar to everyone else's, even if their circumstances differ. But although some of these needs can be addressed by traditional financial products, such as electronic payments, others require the development of new products. For example, IFMR Trust created an innovative livestock insurance policy that incorporates veterinary services to enable farmers to take better care of their cattle and thus increase milk yields.

Full financial inclusion will also depend on the ability of organizations to gather data about how poor individuals manage money. The data can enable organizations to develop an integrated understanding of the segment's needs. This knowledge base could serve as the foundation for developing educational services to help consumers understand their financial products and services. Organizations could also develop decision rules and "value meal" product menus based on this knowledge, which representatives could use to recommend appropriate products for each customer. For example, many borrowers might opt to borrow less if they had an option to direct their resources to savings or insurance products that could mitigate the impact of cash flow crises.

Developing innovative and sustainable products is essential to the further expansion of financial inclusion. Organizations should begin with three principles: one, keep products relatively simple, emphasizing ease of understanding and use. Two, design products that balance cost and profitability with customers' capacity to pay. Three, emphasize product bundling—not only to maximize cost-effectiveness but also to shift the focus from pushing a single product to identifying and serving customers' comprehensive needs.

Regulatory policy

Most regulatory regimes were not designed with the poor in mind, and regulators will have to reconsider their policies, taking into account the needs of the working poor, to enable financial inclusion. Of course, it is critical that regulations shield consumers from abuse. But regulations must also be flexible enough to allow providers to develop services that suit the segment while sustaining their own operations.

Some countries have already taken bold steps to create better conditions for financial inclusion. In the past, for example, only bank branches in Brazil were allowed to administer financial services and transactions such as receiving applications for deposit, term deposits, and savings accounts; conducting receipts and payments; and receiving credit applications. Beginning in 1999, however, a series of regulatory changes permitted financial institutions to contract nonbank entities as banking correspondents, which allowed them to provide financial services. Similarly, in Kenya, the government worked with Vodafone to ensure the innovation could take off from a regulatory perspective before Vodafone invested in the successful M-Pesa pilot; M-Pesa now has more than 10 million users. In both cases, regulators worked with private institutions to determine how nonfinancial businesses could distribute financial services in partnership with traditional players.

Another option is to use regulation to require some activity in financial inclusion as a means of encouraging development in the segment. India, for example, requires commercial banks and insurers to offer some percentage of their products to consumers in low-income and rural markets. This type of regulation could give commercial players the nudge to embrace potentially profitable business opportunities in lower-income segments.

Regulators should also consider establishing rules that allow providers to cover the costs of their operations. It is critical to ensure that regulations protect consumers from abuses, including requiring providers to explain their services clearly so that customers can make informed decisions about whether to use them. But sometimes regulations can make it more difficult for providers to develop sustainable offerings. For example, a 2004 CGAP study looked at the penetration of microcredit in 23 countries with interest-rate ceilings and 7 countries without these restrictions.[10] The study revealed that penetration rates were four to five times higher in the countries without caps. It is important to give providers the flexibility to set prices at levels that will enable them to establish sustainable models.

Private-, public-, and social-sector roles

Organizations from the public, private, and social sectors are already delivering and developing models that promise to extend financial inclusion. If the pace is to continue to accelerate, each sector will have a role to play.

Private-sector organizations should focus on building profitable businesses that meet the needs of the working poor. The unbanked segment represents a tremendous opportunity for businesses, particularly those that act early, and the segment will become increasingly attractive over time as the number of services increases.

The public sector should partner with private and social institutions to promote usage. Many government agencies deliver social benefits to the poor that could be distributed more efficiently through formal financial-services networks, giving providers the volume they need to sustain operations focused on low-income communities. Mexico's Diconsa partnership is an excellent example of a model that is being built around the distribution of transfer payments, which is expected to be the first step toward a much wider offering. Regulators must also establish fair rules and policies that enable organizations to innovate and capture sustainable returns while protecting individuals from abuse. Full financial inclusion could potentially accelerate economic development and reduce dependence on the state, and it should be a high priority.

Social-sector institutions also have a critical role to play, not only as catalysts for breakthrough innovation but also as service providers in hard-to-reach communities. Foundations and nonprofits can contribute ideas, talent, and seed funding to develop new products and approaches, as the Bill & Melinda Gates Foundation is doing for the Diconsa partnership in Mexico. Social-sector organizations can also play a role in areas that are so remote that they cannot yet be served economically by private companies. In serving these populations, social organizations will not only further their development goals but also point the way to new solutions at the frontier of financial inclusion.

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The path to full financial inclusion is increasingly well understood, and the outlook is encouraging. Although the barriers to progress are significant, past efforts have laid the foundation for future success, and innovative, forward-looking organizations are developing and scaling new business models that deliver more value at significantly lower costs, increasing the potential to achieve both beneficial social impact and economic sustainability. Success depends on the active participation of organizations across the private, public, and social sectors, and these organizations have as much to gain as to give—including, most importantly, helping 2.5 billion individuals increase their economic self-determination by gaining access to and effectively using a range of quality, affordable financial services.

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Banking where you shop:
Correspondent banking's contribution to financial inclusion

Correspondent strategies enable organizations to deliver financial services to unbanked populations through low-cost physical outlets—without building new branches.

Alberto Chaia, Robert Schiff, and Esteban Silva

Correspondent banking has become one of the most promising strategies for offering financial services in emerging markets. The model requires financial institutions to work with networks of existing nonbank retail outlets—such as convenience stores, gas stations, and post offices—to deliver financial services to the unbanked poor. In Brazil, where organizations have had the greatest success with the strategy, about 1,600 municipalities are served exclusively by correspondent banks.

Correspondent banking, also known as agent banking, benefits a range of stakeholders. The poor gain convenient access to financial services in their own communities. Financial institutions gain access to a vast new customer segment. Agents gain increased sales volume and the opportunity to develop deeper relationships with their customers.

But implementing correspondent strategies can be difficult. It can be hard to find or build networks of partners that are capable of fulfilling the correspondent role. The economics are still uncertain for players that do not offer a range of services. And because the strategy is relatively new for financial-services providers, it is difficult to know exactly what will work in each unique community.

Through our research and experience working with pioneering providers, we have identified four guiding principles to help organizations implement correspondent strategies successfully: move

quickly to capture early-entrant advantages, take a rigorous approach to building partner networks, create diversified product offerings, and conduct pilots that can be rapidly implemented and continually refined.

These principles have enabled organizations to establish sustainable operations that have dramatically increased the use of financial services by the poor. Four years after Brazil passed legislation enabling the expansion of correspondent banking, providers had extended formal financial services to every municipality in the country. A program of electronic transfers through Mexico's Diconsa stores reached 200,000 households within two years of being launched, and it has the potential to reach two million to three million more. And since 2007, Kenya's M-Pesa, a highly successful mobile-payments provider, has developed a network of more than 16,000 agent points that operate like correspondent outlets, putting most citizens within reach of a physical location that provides cash-in/cash-out services.[1]

Reaching out through correspondents

Many of the 2.2 billion adults[2] who do not use financial services in emerging markets live in areas that are difficult and expensive to serve. Most of these communities lack bank branches—but most do have other retail outlets such as convenience and grocery stores, gas stations, lottery kiosks, pharmacies, or post offices.

Correspondent banking enables financial-services providers to reach these communities by delivering services through existing retail outlets that potential customers already use for nonbanking purposes. Customers are familiar with these outlets, since they already frequent them for other purposes—such as purchasing groceries or fuel or picking up mail. And where relationships are good, customers may even have developed a level of comfort with the local proprietor and staff that may make them likelier to entrust the retailer with their finances.

The strategy is effective because it enables organizations to establish a physical presence in close proximity to customers without building new branches, thus enabling them to dramatically expand their reach at lower costs. Providers do not have to incur the cost of building new branches to reach consumers, and they are able to share fixed costs with their retail partners. Correspondent models have lower average costs per transaction than traditional bank branches as a result.

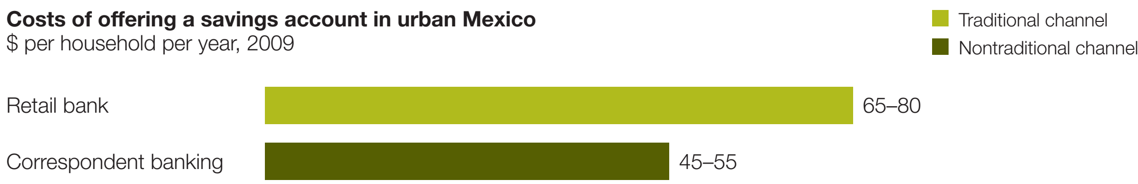
The World Bank's Consultative Group to Assist the Poor (CGAP) estimates that the average monthly cost to customers of using correspondent and mobile-phone-based models is 19 percent lower than the cost of these services in traditional branches—and the cost is up to 50 percent lower for some products, such as medium-term savings and bill payment.[3]

We came to similar conclusions in our own research. In Mexico, the all-in cost of offering savings accounts (including marketing and origination per-transaction costs) through correspondent outlets is about 25 percent lower than the cost of offering savings accounts through traditional branches. As a result, correspondent models better position organizations to sustainably serve low-income consumers, particularly since individuals in the segment typically transact in small sums (exhibit).

Nearly 30 percent of Brazilian municipalities had no access to formal financial services in 2000. But between 1999 and 2003, the government revised its regulations to allow correspondent

Exhibit

Correspondent banking can significantly lower the costs of serving low-income clients.



- Branch costs are mostly fixed, while correspondent-banking costs are mostly per transaction/marginal

Key assumptions
- Costs are amortized (capital expenditure and operating expenditure) for a household in a town of more than 15,000 people
- The product is a standard savings account offered by banks through their own branches or correspondent-banking outlets
- Assumes 4 cash-in/cash-out transactions and 1 balance inquiry per month
- For correspondent banking, assumes cash-in, cash-out channel is a retail chain

banking and improved its interbank-transfer system to facilitate expansion. By 2004, every municipality in Brazil had access to formal financial services, and one in four (about 1,600 municipalities) was served only by the correspondent network.[4]

In Mexico, more than 5,000 correspondent outlets, supported by 11 banks, have appeared since the government authorized the approach in late 2009.[5] The government itself is using the approach to build a basic financial-services offering through more than half of its 23,000 Diconsa stores, which sell food and other basic goods in the poorest and most rural communities in the country. Since 2009, a pilot program has delivered government payments to nearly 200,000 households using point-of-sale devices and fingerprint-based identity cards. The Mexican government could use the network to reach up to two million beneficiaries or more.[6] It also expects to increase the range of services that are provided through the network to include savings and insurance.[7]

M-Pesa, a successful mobile-money-transfer service in Kenya, also depends on physical locations that operate like correspondent outlets to provide users with quick and convenient opportunities to withdraw or deposit cash. This involves exchanging cash for float (in an electronic form issued by the mobile operator) at one of the organization's 16,000 retail outlets, which are also known as agent points. This is a critical component of all mobile-financial-services offerings, since consumers must be able to convert digital funds to cash, and it is much more cost-effective for providers to tap into existing physical networks to fulfill this need than it is to build their own networks from scratch (see "Banking on mobile to deliver financial services to the poor," p. 24).[8]

Formidable challenges

The potential to generate impact through correspondent banking is significant. But in many markets, the window of greatest opportunity may only be open for a short time, and the uncertainties related to implementation are not trivial.

There may be few retail outlets located in small communities, and those that are present may belong to small operators that have little or no reach across regions. Moreover, many communities can only support one or two financial institutions, which means that the opportunities to strike partnerships may be limited.

It can also be difficult to identify the right retail partner, particularly because most financial institutions have no experience operating in non-financial retail contexts. As a result, they may find it difficult to determine which retailers have the necessary relationships with customers, or they may struggle with how to build the reach to deliver sufficient volume to justify the investment.

The economics can be challenging, particularly for institutions that do not have diversified product offerings. Revenues generated by the small balance accounts and the cost of the frequent transactions that are typical of the working poor make it difficult for providers to generate sustainable returns through savings and payment services alone.

Perhaps above all else, correspondent banking is still relatively new in the context of financial inclusion. Not only do the rules of the game vary by geography, but the game itself is also changing as the strategy develops. Competition is increasing, the regulatory landscape is shifting, and customer attitudes are evolving. And while the uncertainty offers opportunities for innovative institutions, it also presents risks, particularly for those that have not developed the capability to refine their approaches by incorporating what they learn during implementation.

Guidelines for success

Correspondent banking is one of a number of models that should be deployed to advance the cause of financial inclusion. Traditional microfinance-institution (MFI) and branch-based models will continue to be important, but on their own, they cannot provide the scale needed to reach the vast population that does not use formal financial services.

The success of organizations in countries such as Brazil, Mexico, and Kenya suggests a path for the next generation of correspondent-banking models. Drawing on their experiences as well as on our research, we have identified four guidelines that can help organizations implement successful correspondent strategies: move quickly to capture early-entrant advantages, take a rigorous approach to building the partner network, create diversified product offerings, and conduct pilots that can be rapidly implemented and continually refined.

Move quickly to capture early-entrant advantages

Moving early is risky, particularly because early entrants often incur hefty development costs that followers are able to avoid. But we believe accepting the risks (while seeking to manage them) is justified in the case of correspondent banking, because early entrants may be able to sew up the most attractive partners before later entrants arrive.

Success in correspondent banking depends on the ability to develop an extensive network of retail outlets in undeserved communities. It is a play for scale in a low-margin business. The fewer partners involved in the partnership the better, as institutions that are required to manage too many relationships can be overwhelmed by complexity. The most efficient correspondent operations involve partnerships between one financial institution and one distribution partner that has extensive reach across the entire relevant geography.

Early entrants often have the most freedom to select the best partners, leaving followers to patch together networks of smaller chains and independents that are more difficult to manage and more expensive to operate. Moreover, they will have the opportunity to build the first formal relationships with their low-income customers, which may build loyalty that proves beneficial when competitors emerge.

Even in markets such as India, where large-scale partners with broad reach are hard to come by, the advantage of moving early enables providers to pick the most attractive smaller players to join the networks that they must assemble. Moving early may be less advantageous in markets where regulations limit exclusive relationships between financial-services providers and distribution partners.

After the Brazilian government took action to facilitate nonbranch banking across the country, the bank Bradesco gained a significant advantage in 2001 by acting quickly to secure exclusive access to distribute financial services through the agencies of the Brazilian post office (Empresa Brasileira de Correios e Telégrafos)—a network of 5,532 post offices, including more than 1,700 in municipalities that lacked banks.[9] Through Banco Postal, a wholly owned subsidiary, Bradesco was able to extend correspondent services to the entire network within just five years.[10]

Take a rigorous approach to building the partner network

Financial institutions must take into account a range of factors when picking retail partners. Reach is one of the most important factors, but others, such as cost to serve and local consumer trust, also play a role.

Providers can use a "cost curve" analysis to understand the relative costs and potential reach of different channels in different communities of varying population densities. A cost curve analysis of the Mexican market suggests that correspondent banking would be a good way to expand banking capacity in large cities—and the only viable option in small villages—but that it would be more difficult in midsize towns where large retail networks are scarce. This kind of evidence can help financial institutions understand how their correspondent network should be configured, enabling them to seek retail partners that provide the appropriate reach into the communities they want to serve.

Trust can also be an important factor, particularly early in the effort. We mentioned that existing retail outlets often already have relationships with the target customers. As a result, customers may be more likely to trust the outlet to act as their financial representative. This is borne out in the case of Diconsa in Mexico. Diconsa stores are owned cooperatively by the communities in which they are located, and storekeepers are elected by community members. This cultural context is an important success factor for Diconsa. In the village of San Miguel Tecpan (which has a population of 800 people), for example, Elba Arias has served as storekeeper since she was elected to the post 14 years ago, creating familiarity that makes correspondent banking easier. In her words, "The same way I sell corn, rice, and canned tuna, I sell savings accounts." Up to a third of her current customers are now making transactions.[11]

Organizations can build trust over time by providing consistently high-quality experiences for customers. Those that already operate correspondent networks may gain trust more easily when opening new correspondent locations if they already have a good reputation with customers through existing outlets. But financial institutions that are starting up networks may benefit from identifying and prioritizing partners that have good relationships with target consumers to increase the likelihood that customers will use correspondent services once they are available.

Create diversified product offerings

Providers have to develop product offerings that not only attract consumers but also enable them to generate sufficient value to sustain their operations. Correspondent partnerships that offer more than just bill payment services and savings accounts are more likely to thrive than those that do not.

Providers should consider offering four promising services in addition to savings accounts: government payments, domestic remittances, international remittances, and direct deposit. Each of these services offers significant value for customers; they also enable providers to generate value through transaction fees and lay the basis for them to provide other services in the future.

CGAP estimates that at least 170 million poor people worldwide receive regular payments from their governments, either as social transfers or as small salaries and pensions. Less than 25 percent of these, however, receive the payments in a "financially inclusive" account—one that is safe, convenient, and easy to use for other transactions.[12] These programs represent a source of immediate transaction activity for electronic-delivery systems, which can in turn add significant value for the recipients. In Mexico, Diconsa's electronic-transfer program has reduced the average time it takes customers to collect government payments from 6.5 hours to 30 minutes. And it has virtually eliminated customer travel costs, which averaged $3 per trip. The correspondent service provides customers with significant value in money and time saved.

Correspondents could also create value for consumers by reducing the costs and increasing the convenience of international remittances. The cost of sending money to a developing country is heavily influenced by the volume of flows to that country, the quality of the retail payments infrastructure, and the number of options available to receiving consumers. This cost can be 5 percent to 7 percent of the value of the remittance when sent to countries with relatively large volumes and competitive cost structures, such as the Philippines and Indonesia, and two or three times as much for other destinations.[13] The proliferation of safe and convenient correspondent outlets could help to increase volume and reduce these costs. This could also reduce the cost and increase the reliability and security of domestic remittances; this market is typically dominated by informal channels that are cumbersome, inefficient, and risky.

Direct-deposit services also offer value for both consumers and providers of correspondent services. As with government transfers, electronic payment of salaries or pensions increases convenience for consumers. Such products could also be the foundation for credit offerings based on the expected cash flow from employers. In Brazil, the volume of payroll-linked loans grew by more than 110 percent a year (four times the pace of credit cards) in the first four years after regulators authorized the products in 2003.

Conduct pilots that can be rapidly implemented and continually refined

The learning curve for correspondent banking in financial inclusion is steep, and organizations should expect to make mistakes when developing their models. The most successful operations design processes that enable them to learn from their mistakes and develop solutions as they proceed. To enable rapid and continuing learning, organizations should develop processes to conduct targeted pilots that can be quickly revised and relaunched based on customer feedback. This not only enables organizations to learn as they go but also minimizes their risk as they experiment to find the best way forward.

The Diconsa partnership in Mexico relied extensively on user-centered prototyping. Rather than trying to launch a perfect product at scale the first time around, Diconsa conducted a series of experiments in the field. It launched its first pilot soon after the partnership was formed and managed it aggressively, placing members of the delivery team directly in the community so they could observe customer behavior and implement real-time refinements. This allowed the partnership to secure early successes and move more quickly to expand its offerings.

Safaricom took a similar approach to piloting when it developed its M-Pesa mobile-payments service. M-Pesa was originally conceived as a platform for receiving and making payments on small loans, and it partnered with Faulu, a local MFI, to gain access to clients. Piloting suggested that the service would undercut Faulu's offering, but also that the population would value general payment and remittances services. M-Pesa redefined its value proposition as a result, and today it is one of the most successful mobile-money-transfer services in the world.[14]

Pioneering organizations around the world are demonstrating the value of correspondent banking, and as the strategy evolves, it will become increasingly important as a means of developing scale in financial inclusion. Not only is it an effective alternative to building new branches for more traditional organizations, it is also an important adjunct to mobile financial services, providing cost-effective outlets for cash-in/cash-out services. But experience suggests that early entrants have the most to gain. Organizations that get started now have the potential to drive social and economic benefits, dramatically expanding financial inclusion and thus helping a growing number of poor individuals to gain access to financial tools that they can use to improve their lives.

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Banking on mobile to deliver financial services to the poor

Widespread use of mobile phones in emerging markets has created the conditions for large-scale expansion of mobile financial services, which will enable organizations to dramatically increase financial inclusion.

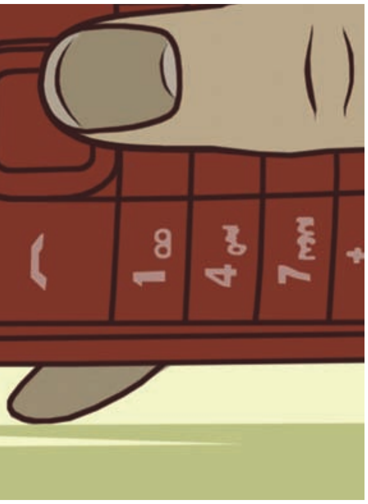
Chris Beshouri, Alberto Chaia, Beth Cobert, and Jon Gravråk

Mobile financial services (MFS) are poised for explosive growth in emerging markets. While mobile penetration is deep and increasing in these countries, the use of formal financial channels such as banks is severely limited. We estimate that about 1 billion people in emerging markets have a mobile phone but do not use formal financial channels; by 2012, this population will reach 1.7 billion.

Recent research we conducted with the World Bank's Consultative Group to Assist the Poor (CGAP) and the GSM Association (GSMA) trade group indicates not only that the unbanked poor want to use financial services but that they would use mobile devices to access them.

The spread of MFS—which includes mobile money transfer, mobile payments, and mobile banking—would be a boon for individuals and private enterprise. For customers, access to financial services lowers the transaction cost of sending and receiving remittances, improves the safety and security of cash, and makes payments more convenient. And as MFS matures, individuals will increasingly gain access to savings accounts, credit, insurance, and other services through their phones.

The commercial potential is also significant. Today, only about 45 million people without traditional bank accounts use MFS, but we expect that this number could rise to 360 million by 2012 if mobile operators were to achieve the adoption rates of



some early movers. By then, the opportunity could generate $5 billion annually in direct revenue for mobile operators, primarily from fees on financial services, and an additional $3 billion annually in indirect revenue, including income from reduced churn and higher average revenues per user for traditional voice and short message service (SMS).

Providers of financial services will also benefit. Mobile distribution can help financial institutions reduce their cost to serve by as much as 50 percent to 75 percent by making most transactions virtual, enabling them to reach a vast new customer segment at sustainable costs.

But implementing an effective MFS model is challenging, not least because it requires coupling the physical assets and capabilities from at least two distinct domains, telephony and banking. It may also require partnerships with retailers or other organizations to manage cash collection and disbursement, or with microfinance institutions (MFIs) or other social-impact organizations to support uptake and provide education to customers about how to use financial services effectively. And organizations will have to work with governments to manage risk and ensure that regulatory requirements are not prohibitive.

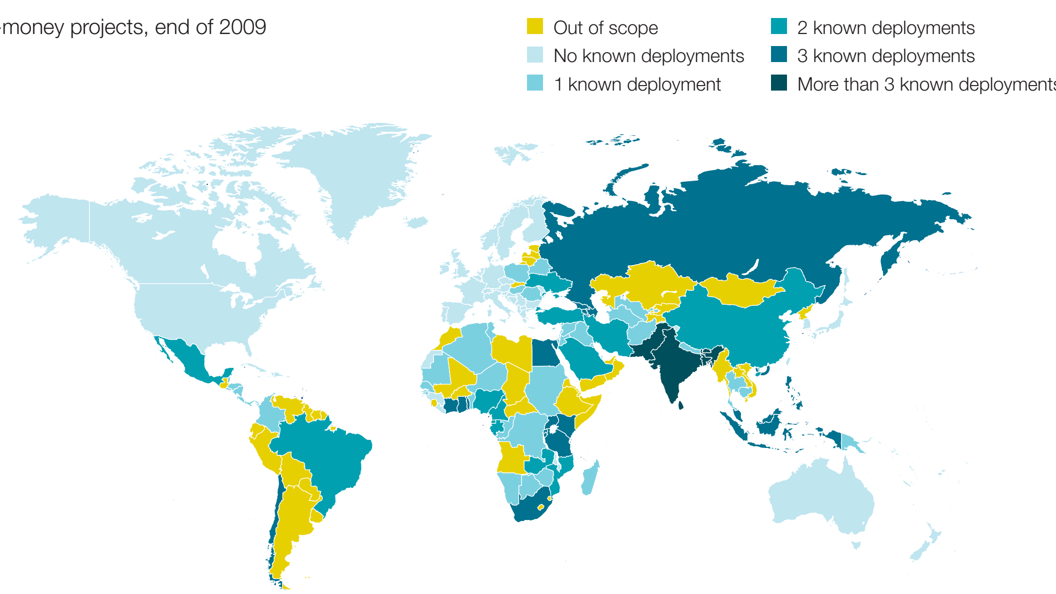
Organizations around the world are stepping up to meet the demand. Our mapping of industry developments identified 120 operators in 70 markets that planned to deploy MFS offerings by the end of 2009 (Exhibit 1). A number

Exhibit 1

More than 120 mobile-money projects have been deployed in 70 emerging markets.

ESTIMATES

Mobile-money projects, end of 2009



Source: World Bank's Consultative Group to Assist the Poor and GSM Association baseline survey, Q1 2009; McKinsey analysis; press search; interviews; company Web sites of organizations are already showing the way. In the Philippines, money-transfer and payment providers SmartMoney and G-Cash already have more than 7 million and 2.5 million users respectively, and Kenya's M-Pesa has more than 10 million users. And services such as M-Kesho in Kenya are developing offerings that provide savings, credit, insurance, or other financial services over mobile phones.

Based on our research, as well as experience with a number of organizations that have already launched offerings, we have identified three critical actions required to develop a successful MFS model: aggregate core capabilities in telecommunications and banking, establish physical distribution networks for cash handling, and shape appropriate regulations. Organizations that succeed will achieve significant social and economic impact.

Understanding the opportunity

Mobile-phone use has skyrocketed in emerging markets in recent years. The Asia-Pacific region accounted for 47 percent of the world's five billion global connections at the end of the second quarter of 2010—an increase in share of about 5 percent compared with the end of 2008. Growth is slowing in mature markets, with Europe and the United States accounting for only 27 percent of connections globally, down from 30 percent at the end of 2008. By 2013, GSMA estimates that there will be six billion mobile connections worldwide.[1]

Penetration of formal financial services in emerging markets pales in comparison. Formal financial services reach about 37 percent of the population, compared with a 50 percent penetration rate for mobile phones. For every 10,000 people, these countries have one bank branch and one ATM—but 5,100 mobile phones. Serving this population could benefit individuals as well as mobile providers and financial institutions. In the Philippines, for example, mobile-subscriber penetration is closing in on 80 percent, while banking penetration is about 35 percent (Exhibit 2). That leaves 21 million mobile subscribers in the Philippines without a bank account. If mobile operators in the Philippines could bring MFS penetration rates among the unbanked in line with those achieved by best-practice operators in other markets, they could provide the benefit of formal financial services to four million to five million people while expanding their own annual earnings by 2 percent to 3 percent, or about $80 million. This excludes banking earnings on loans and deposits, which we estimate could be another $80 million to $90 million. Another eight million people in the Philippines are unbanked but also lack a mobile phone; they become a secondary target with an enhanced proposition.

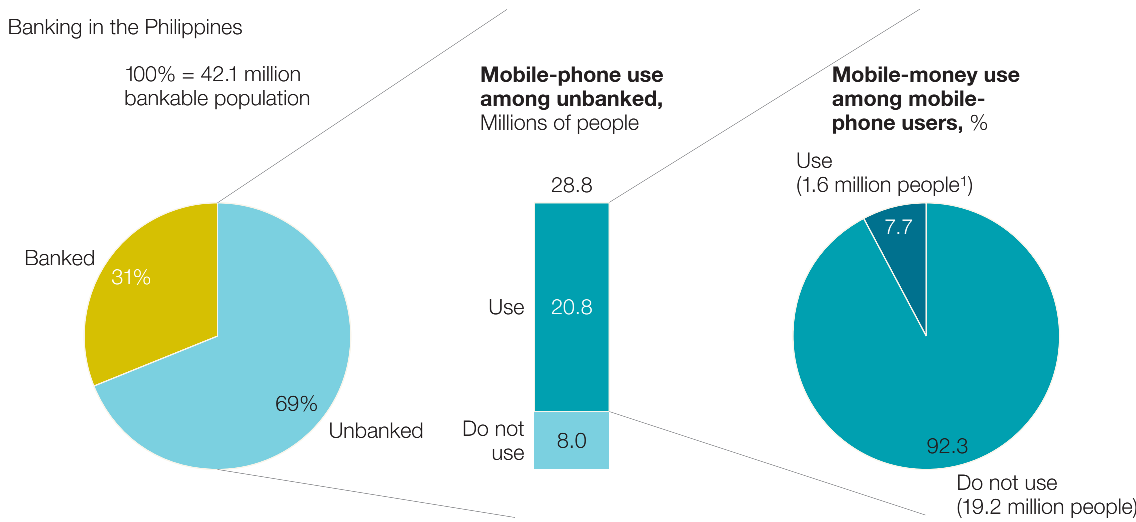
We worked with GSMA and CGAP to conduct primary research in the Philippines in order to understand what poor consumers want and need from MFS providers. The findings are very encouraging.

Products for sending and receiving money are important for low-income people who use MFS. Money transfers are the most widely used MFS in the Philippines; more than 50 percent of current subscribers use money transfer—40 percent of whom transfer funds more than once a week.

Nearly two-thirds of unbanked mobile subscribers in the Philippines knew about MFS, and almost as many—about 60 percent—expressed no misgivings about trying it. Most observers assume that low-income households are cash poor, so it may be surprising that nearly 55 percent

Exhibit 2

Mobile-money use remains limited.



[1]The Philippines has ~3 million active users of mobile money, including people who also use banks.

Source: Joint GSMA, CGAP, McKinsey survey of 900 consumers, Feb–Mar 2009; Wireless Intelligence; World Bank

of those we surveyed were interested in savings products, compared with 17 percent in insurance and 12 percent in straight credit.

Our research showed that even the lowest-income segment has a strong interest in MFS. In the Philippines, about 8 percent of the unbanked have subscribed to MFS. Of these 1.6 million customers, almost 20 percent come from households that earn less than $5 a day.

Of the lowest-income households we surveyed, about 65 percent said they wanted to use MFS as a savings vehicle, compared with 50 percent across all income groups.

A larger portion of the poorest customers save—and they save more than 75 percent as much as the others do. Overall, 6 percent of subscribers to MFS use it to store value, and their median balance is about $40. But among the poorest segment, about 10 percent have accounts, with an average balance of about $31. And the poor typically use savings products not for long-term asset accumulation but for managing annual turnover that can be many times the average balance.

Barriers to success

The MFS opportunity is vast, but organizations seeking to develop effective offerings face a number of challenges. Most MFS efforts that target poor customers are new, and only limited information is available about these customers' portfolios, what they want, whom they trust, and how they buy.

Few organizations have all the resources or capabilities necessary to execute an MFS offering on their own. Telecommunications companies have the mobile expertise and network resources, banks and other financial institutions have the skills to deliver financial services, MFIs have direct experience with poor customers, and government agencies often have enabling resources, such as databases that could facilitate risk management.

Moreover, while MFS reduces the need for brick-and-mortar distribution, it does not completely eliminate the need for physical locations. In many cases, deposits and withdrawals cannot be handled virtually. Thus providers will have to establish or tap into large networks of associated agents to deliver MFS at scale, particularly to provide cash-in and cash-out services, as M-Pesa has with its network of more than 16,000 agent points throughout Kenya.[2]

Naturally, MFS will be subject to regulation in most countries. Regulators will require compliance with "know your customer" rules to contain fraud and money laundering. Some operational aspects will also be subject to safety and soundness guidelines, including regulatory capital rules. But while there are important risks to consider, subjecting MFS services to the same regulatory requirements faced by traditional banks could undermine the economics of the offering.

For example, regulators often prefer MFS users to have bank accounts with traditional financial institutions, which they access through their mobile phones—a structure that adds a layer of the bank's costs to the model. When regulators do allow mobile operators to offer services that are not backed by a bank, the cost savings may be offset by other limitations. For example, the operator may not be able to offer insured deposit accounts or loans, and may also be required to bank a sum equal to their customers' float to ensure that cash is available to customers at all times and that the operator remains solvent.

Three steps to achieving impact

MFS is gaining momentum across the globe, but with the exception of a few notable cases, most operations are in the early stages of development. There is still an opportunity to be among the first entrants in most emerging markets.

The opportunity to achieve impact is greatly improved for organizations that follow the lead of successful money-transfer and payment pioneers such as M-Pesa in Kenya, G-Cash and Smart in the Philippines, and Wizzit in South Africa. Their experiences and our research indicate that organizations must take three critical steps to succeed: aggregate core capabilities in telecommunications and banking, establish physical distribution networks for cash handling, and shape appropriate regulations. Each of these steps will probably require partnerships in order to succeed.

Aggregate core capabilities in telecom and banking

Financial-services capabilities are required across the MFS value chain, from designing products and managing the flow of funds to handling clearing and settlement. Thus most successful MFS offerings will involve partnerships that include telecommunications and financial-services companies.

Early movers are trying two approaches. The first is to set up a partnership between a mobile operator and an established financial institution that can provide the needed financial capabilities, enabling the partnership to present a full product offering. Keeping costs under control is crucial, since burdening an MFS service with fully loaded banking costs will scuttle it. The partners must therefore work out an agreement that bases costs on the specific set of services provided by the MFS operation. This model has been deployed by Globe and Bank of the Philippine Islands (BPI) and is being explored in other markets.

The second approach is for a mobile operator to found a bank, possibly as a joint venture with an existing financial institution. The sole purpose of the bank would be to provide the core banking capabilities for the MFS business and to manage regulatory compliance, back-office operations, product design, and the distribution network. Such a bank could control costs relatively well, since it would avoid legacy costs; in the case of a joint venture, it would be structurally separate from the partner bank. Telenor Pakistan took this approach when it acquired a majority stake of Tameer Microfinance Bank, an existing organization in Pakistan, as part of its strategy to develop a portfolio of MFS offerings. The deal enabled Telenor Pakistan to offer bill payment services to all Pakistanis, even if they were not Telenor mobile subscribers.

Kenya's M-Pesa has had great success providing MFS through mobile operator Safaricom without partnering with a bank, but the scope of its offering has been limited to money transfers and payments, because regulators do not allow it to offer products such as interest-bearing savings accounts or loans without the participation of a bank. However, Safaricom recently partnered with Equity Bank to launch M-Kesho in Kenya, which provides interest-bearing savings accounts, credit, and insurance to poor individuals through mobile phones.

Establish physical distribution networks for cash handling

The adoption of MFS will hinge on whether consumers are able to access cash. MFS operators must create an access network to take cash for deposits and payments and to distribute it for withdrawals. They must also establish locations and processes for taking applications for other services, such as loans or insurance.

Our research shows that when a cash agent is located more than 15 minutes away from consumers, MFS has relatively little appeal, and customers use it only once or twice a month. But when the agent is less than 10 minutes away, usage rises to 10 times a month—and for those within 2 minutes of an agent, usage rises to 30 times a month. Clearly, proximity of access is vital for getting the unbanked to move from informal financial services to MFS. This means players must create a low-cost, ubiquitous distribution network.

Organizations are experimenting with several ways to create widespread, low-cost distribution.

All these approaches involve the use of partners. One option relies on existing retail networks that sell prepaid cards. Smart Communications in the Philippines, for example, has one million airtime resellers in a country that has only about 5,000 bank branches. Mobile operators could tap into these networks through their existing relationships relatively easily. Many of these retailers are street-side kiosks, however, and may have difficulty meeting the physical and process requirements associated with security standards and customer enrollment.

A second option is to ally with partners that already have the reach needed to access target customers—for example, microfinance institutions, post offices, ubiquitous retailers (including government-owned chains), utility-payment centers, or gas stations. Operators would provide the basic product design, service requirements, and back-office processing, while the partners would run the cash-in and cash-out facilities. The fundamental idea is that the partner would provide access to an existing distribution network, allowing the mobile operator to avoid footing the bill for the outlets.

Organizations could also develop a network from scratch. With the help of airtime retailers, for example, exclusive agents who work directly with subscribers to collect and distribute cash could be based in villages and made responsible for specific territories. Although complex to create, a village-based network would have the local knowledge needed to evaluate credit requests and pursue collections. Other industries have used similar models. GlaxoSmithKline has enlisted midwives to distribute specialized vaccines to infants in the Philippines, for example, and rural women in India work for Hindustan Unilever as sales representatives in their communities.

Identifying the right options for individual markets will involve finding the right balance among three imperatives: customer service skills beyond basic retailing, low costs, and compliance with security and financial regulations.

Shape appropriate regulations

Mobile operators will need to help regulators build a framework of rules proportionate to the services on offer to ensure MFS is economically sustainable for providers. The objective should be to create a regulatory regime that enables operators to extend formal financial services to the poor and is appropriate for the level of risk created.

In many countries, regulators have already signaled a willingness to work with mobile operators to find this balance. Our global study showed that 60 percent of mobile operators believed that regulators are indeed open to designing rules that allow MFS to serve its target customers. Yet 80 percent did not think that regulators would grant low-value transactions an exemption from rules prohibiting money laundering, something that could make it more convenient and less costly for the operators to provide these services.

Mobile operators and financial institutions are both adept at working with governments to craft regulations, and successful regulatory management often requires expertise from both industries. A first step would be to develop an integrated view of the full set of regulatory innovations that would support mobile banking while addressing legitimate risks, and to articulate the social and commercial benefits of adopting those rules. So far, few players have gone down this road.

In the Philippines, BPI, Globe, and Smart Communications are notable exceptions. These companies have worked with MFIs and the Philippine central bank, Bangko Sentral ng Pilipinas (BSP), to develop appropriate policies for regulating financial products that are designed to serve the poor. The effort led Philippine regulators to lift restrictions that rendered products economically untenable while maintaining rules that protect consumers.

As a result of industry collaboration, for example, BSP published e-money guidelines in March 2009 that allowed banks to link their microfinance operations with the electronic-cash platforms established by telecommunications companies. This enabled poor customers to access their bank accounts via mobile phones to withdraw and deposit funds and make loan payments. The rules enabled organizations that provide micro-finance to position mobile phones as an important new financial channel in the country.

In October 2009, as a result of further collaboration in the sector, BSP began to allow clients of institutions that provide microfinance to make limited withdrawals from designated "nonbranch" locations specified as "loan collection and disbursement points." Previously, cash handling was restricted to official bank branches. These nonbranch locations are much cheaper to establish and operate, and thus institutions can serve consumers through many more distribution points than they could if they were limited to using only official branches. And while the locations are subject to the necessary controls that protect consumers, the rules are flexible enough to enable institutions to serve customers sustainably.

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High mobile penetration among the low-income segment in emerging markets has created an unparalleled opportunity for the provision of financial services to the poor. But the full potential of this channel has yet to be realized in most emerging markets, as success depends on managing complex interactions among diverse organizations such as telecommunications companies, financial institutions, regulators, social institutions, and commercial agents (for example, retail stores). Organizations that have overcome the difficulties of managing such interactions have seen their businesses thrive—and, more important, are offering the unbanked poor financial services they can use to improve their economic lives.

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[2] Frederik Eijkman, Jake Kendall, and Ignacio Mas, *Bridges to Cash: The Retail End of M-Pesa*, 2010.

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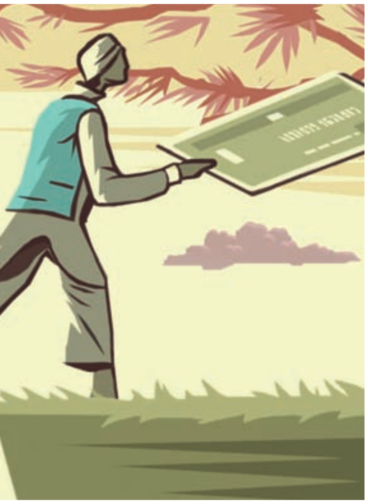
Addressing the middle-management challenge: A conversation with four leaders in financial inclusion

Four leaders of cutting-edge institutions discuss what it takes to develop and maintain strong middle managers to support the delivery of financial services to the unbanked.

Tony Goland

Over the past three decades, organizations around the globe have proved that poor households can be sustainably provided with affordable, quality financial services. And with enlightened regulations, innovative business models, and technological advances, the effort to expand the reach of financial services to the poor is at an inf ection point. But organizations face a shortage of middle managers—a shortage that stands as a formidable barrier to achieving the scale required to support financial inclusion. A majority of microfinance institutions (MFIs) surveyed in 2008 by Microfinance Insights ranked human capital as their top challenge, ahead of financial or technical issues.[1]

To assess this challenge, we recently talked with the leaders of four cutting-edge institutions—Bansefi, IFMR Trust, LeapFrog Investments, and Women's World Banking—that are grappling with different aspects of the middle-management shortage. Bansefi is a development bank created by the Mexican government to facilitate the delivery of financial services to the unbanked. IFMR Trust is a private trust that incubates new operating models designed to improve the delivery of financial services to underserved regions of rural India. LeapFrog Investments, the first micro-insurance fund, invests in businesses that provide insurance to low-income and vulnerable



people in Africa and Asia. And Women's World Banking is a network of leading MFIs and banks dedicated to the economic empowerment of women.

We discussed the skills required of middle managers, potential sources of talent and barriers to tapping them, and promising approaches to training and managing performance. Despite the challenges, all are confident that the industry is developing the solutions needed to fill the middle-management gap.

The conversation that follows is an edited version of panel interviews with Jaime González Aguadé (director general of Bansefi), Bindu Ananth (president of IFMR Trust), Mary Ellen Iskenderian (president and CEO of Women's World Banking), and Andrew Kuper (president and founder of LeapFrog Investments).

Global Financial Inclusion: *What skills do middle managers need to succeed in microfinance today?*

Mary Ellen Iskenderian: Financial skills are important. Risk management is increasingly critical, and scenario planning is becoming important given the rapid pace of change. Strategic-thinking capabilities are becoming more important, particularly because middle managers are often the only link that the corporate office has to the front line or to customers. On the softer side, the ability to communicate is critical. Middle managers need to be able to explain business objectives to frontline staff, motivate them to perform at a high level, and enable them to gain the trust of their customers. They also have to be able to explain the business to skeptical regulators.

Bindu Ananth: Middle managers are the face of the organization for the front line, and they need to be able to articulate the mission clearly and reinforce the organization's culture. They have to be able to coach and mentor frontline staff. In our business, which is very focused on operations, risk management often boils down to making sure that everyone follows all the rules that are set in place to enable the organization to identify risks. Middle managers need to be able to enforce the rules. It is important to be regimented, particularly when you can't rely on automated systems.

Andrew Kuper: Particularly in emerging economies, where data may be hard to come by, middle managers also need to have a strong capacity for empathy and an ability to exercise good judgment, which can enable them to detect issues from clients and staff early on and act quickly and appropriately to prevent them from becoming problems. These softer skills are often underappreciated during recruiting, training, and monitoring; they should be front of mind. Middle managers play a key role in embedding the values of the organization into the behavior of those on the front line—and this means not only being clear about "the way we do things here" but also personally living up to the values expounded, especially in unanticipated or stressful circumstances.

Global Financial Inclusion: *Where do you find qualified talent?*

Jaime González Aguadé: More and more private institutions and business-oriented individuals are getting into microfinance, which is positive because they bring technical expertise

The panelists

Jaime González Aguadé is director general of Bansefi.

Bindu Ananth is the president of IFMR Trust.

and financial rigor to the sector. The challenge is that individuals with strong technical skills often lack the sense of mission that is so important. That's why we spend a lot on training: to teach technical skills and cultivate a sense of mission.

Bindu Ananth: Over the past five years, we've seen an increasing number of commercial bankers taking middle-management and functional-head positions in India. This can be a great source of talent, but we've actually had a big realization about the importance of developing managers internally. The sector is growing very rapidly, and it can take time to acculturate individuals from traditional institutions. People who are brought up through an organization will have already internalized the culture and demonstrated their commitment to the mission. That said, there are also a number of organizations in India that have had success tapping alternative talent pools. The armed services is one promising area for recruitment, particularly from an operational perspective. Former military personnel are typically very regimented, and they can be excellent at execution, even when they don't have experience in finance.

Andrew Kuper: There is an evolution happening in microinsurance that parallels the evolution in microcredit, where a large number of people who had conventional banking experience entered the sector in search of more meaningful work. I believe there are many thousands of middle managers at conventional insurers and financial institutions around the world who would love to work in a high-growth sector that provides a sense of meaning and mission. This is a competitive advantage for the sector. However, I would also add that there is a tragic market failure in the sector in that there are innumerable potential candidates graduating from excellent business schools and universities in developed markets who are looking for exciting management opportunities, but who are not recruited for

Mary Ellen Iskenderian is the president and CEO of Women's World Banking.

Andrew Kuper is the president and founder of LeapFrog Investments.

positions in microfinance. We need to develop better mechanisms to tap this vast pool of talent.

Global Financial Inclusion: *What are some of the barriers to attracting and retaining talent?*

Jaime González Aguadé: Compensation is an important part of the equation. It can be difficult to attract people who have financial skills and can therefore command a higher salary in more traditional segments of the business. This is also a problem in retention. We invest a lot in helping managers develop the skills they need, but once they have those skills, they may have an opportunity to earn more in traditional segments. When they leave, the investment is lost. That's one reason that we try to identify people who have some degree of vocation for the work—they are less likely to leave.

Andrew Kuper: The situation is slowly but steadily changing with regard to compensation. People have historically assumed that you have to accept a substantial "mission discount" to work in microfinance or impact investing. Given the tremendous growth of microfinance and other social-purpose industries, people can increasingly expect to receive salaries that are closer to parity, and they may also be rewarded with higher status than those working in conventional industries. There's no doubt that morale is higher when people have a strong sense of organizational purpose and personal impact, which creates a greater sense of belonging and improves retention. The challenge for senior management is not reducible to compensation systems—they need to act systematically to frame and reflect the company's mission in ways, large and small, that embed that situated sense of self.

Mary Ellen Iskenderian: One of the issues that Women's World Banking is very concerned about is how difficult it still remains to attract and retain high-potential women candidates.

There's a strong correlation in all our work between having women on staff and being able to attract women clients. The history of microfinance clearly demonstrates that it is important to reach women. They are less risky as clients, and they often manage money more effectively for their households. Many of the available positions are located in rural areas, and we have a particularly difficult time persuading women to take jobs that are not located near their current homes, particularly if they live in urban settings where the standard of living is higher. Often their husbands are not willing to follow them to a new location. And as I'm sure you can imagine, there is a range of cultural, social, religious, and other issues that complicate efforts to recruit, develop, and retain women.

Jaime González Aguadé: I agree with all this, but I would add that it's not only women who are reluctant to move to rural areas. In general, people don't want to give up access to the services and infrastructure that are available in urban areas. It is very difficult to get skilled people to take positions in areas where they may not even have reliable access to electricity at home, for example. And yet this is where the customers are. We really need capable people in rural communities.

Bindu Ananth: We've also discovered that language can be a big barrier to attracting talent. If an organization's language of business is English, for example, that can really shrink the universe of middle managers that are able to do the job. We've made the language of business the local language wherever we operate. Everything—from in-store signs to forms to computer screens—features the local language. This makes it much easier to recruit local talent.

Global Financial Inclusion: *Could you say more about training? What are your organizations doing to build capabilities?*

Jaime González Aguadé: Bansefi provides three different types of training. It provides technical training to about 600 MFIs in Mexico with funding from the World Bank. It provides capability-building support on a variety of topics to organizations that request it. In those situations, the organizations themselves pay for 20 percent of the costs. And it offers financial education to *cajas* (community-based savings and loan institutions) and regular Bansefi customers. Through these programs, Bansefi trained about 60,000 people in 2009 alone. I believe these types of formal training programs can be replicated successfully in other markets, but they are expensive. We also administer programs that teach people who have skills how to pass them on to others in their organizations. This is a less expensive strategy for developing capabilities, and it can be very effective.

Mary Ellen Iskenderian: Women's World Banking provides training through a number of programs, including the Center for Microfinance Leadership. We have also had great success training graduates so they can train others, including certifying graduates to teach and ensuring that they continue to advance their own skills over time. One of our programs focuses on training women at the middle-management level. Participants in this program tend to develop relationships with one another, and we try to foster those relationships in a number of ways. For example, we convene regional meetings where women in a particular geography get together to share what they've learned. We also maintain a Web platform that enables the women to stay in

touch and access resources, and the platform has taken hold as a place for leaders to exchange ideas.

Bindu Ananth: We are building significant internal capability to deliver training in multiple regions and languages. Content development includes building innovative simulators that model the financial needs of households. More generally in the microfinance sector, some organizations are working with local educational institutions to put people through accelerated one-year programs that provide training in basic math, IT systems, data entry, and similar skills. The idea is to create a pipeline that can be a source of managers down the line.

Andrew Kuper: One of the biggest obstacles to developing people is that they often fear they cannot learn new approaches and are reluctant to step outside their comfort zones. Particularly in the case of developing markets, where people may have had limited previous experience, it's really crucial to help people shift their thinking so they believe they can do the job. To that end, it's important to take them out of their immediate context and introduce them to people like them who are succeeding in the kind of environment they will need to succeed in. Role models matter more than words. Mentors are more important than formal training. The tacit knowledge that senior executives have accumulated over the years must be passed on face-to-face, revealing culture in action.

Global Financial Inclusion: *What about performance management?*

Andrew Kuper: As in other industries, it varies significantly from organization to organization. Some managers have a strong grasp of what is expected of them, and some have almost no idea. With regard to what works, it's important to have a clear set of credos, value statements, and rules in place—along with people who exemplify organizational values and implement the rules to powerful effect. It is important to celebrate remarkable performance and communicate success stories. The best

organizations develop simple, communicable, and viral language that resonates for everyone, from the long-standing CEO to the newest temp. Obama, Clinton, and Reagan were masters of this, but it's as important to get it right in business as it is in politics. Performance-management systems do not work well without both formal and informal communications, which generally serve as the first reference points for people when they consider their own performance.

Mary Ellen Iskenderian: There are some organizations in our network that have superb performance-management processes that are very well-defined. Kashf in Pakistan is a great example of an organization that invests heavily in human resources, and I would argue that every middle manager in that organization has a very clear idea of what is expected of him or her. But Kashf is more an exception than the rule.

Jaime González Aguadé: Some managers know exactly what they are supposed to be doing, but I would say that is not usually the case. Often organizations rely on the founder or current leader to exercise judgment and make decisions, and virtually everyone else just follows orders.

Mary Ellen Iskenderian: I would add that there is a crying need for the current leadership of microfinance institutions to think more about succession planning. Many organizations are still being led by the pioneering, visionary generation who started the business 25 or 30 years ago, and they haven't necessarily built a pipeline behind them to ensure that they have leaders to take them into the next phase of development.

Global Financial Inclusion: *How might broader trends in financial inclusion, such as advances in technology and business-model innovations, affect the human-capital challenge?*

Bindu Ananth: Organizations can use technology to gather more data about branch activities and to maintain closer contact with the front line—thus they don't have to rely so heavily on middle managers as their only information source about branches, and middle managers don't always have to be the only ones responsible for communicating objectives and setting a tone for the front line. On the other hand, these trends can make the role more complex. Middle managers will probably have responsibility for more people and multiple channels over time. They will have to be able to manage agent networks.

Mary Ellen Iskenderian: Technology is critical, but it can cause problems if it becomes a barrier to human connection. We need to automate to reduce costs and develop scale, but it might be important to maintain the level of human contact on the credit side, particularly since microfinance has taken some hits in terms of portfolio quality recently. It is critical that organizations maintain close ties with credit clients to minimize defaults. On the other hand, technology can enable organizations to reach people in remote regions who otherwise would not be served. I was in the Dominican Republic last year talking to a client of one of our network members there, and the client said that she would have to pay more in bus fare to get to the next town where the branch was located than she was planning to deposit in the bank in the first place. So I think if we're really going to be serious about financial inclusion and outreach, particularly in remote areas, technology must play a big role.

Global Financial Inclusion: *Given the challenges, how optimistic are you about the future of financial inclusion?*

Bindu Ananth: I'm really optimistic, given the extraordinary growth in financial inclusion around the world, particularly in India. We are seeing an increasing number of people walk away from higher-paid jobs to work in the sector, partly because they are attracted by the sense of mission but also because they are excited by the rapid pace of growth. They understand that growth brings opportunity.

Andrew Kuper: I'm highly optimistic because I believe that we are at an epochal moment when emerging markets are surging and growth in financial inclusion is explosive. Organizations pursuing both financial and social returns are achieving ever-higher levels of professionalism and scale, and that is enabling them to attract unprecedented amounts of capital. As a result, the opportunity costs that might be associated with working in the sector are falling away. Compensation is often less of an issue as people (including graduates of the leading MBA programs) increasingly see the choice as being between mission-related and non-mission-related institutions. Put in those terms, it's a no-brainer. As new financial-inclusion products and services cascade throughout companies and across the globe, the value proposition just keeps getting better. People increasingly see careers in the sector as offering the opportunity to work at the intersection of money and meaning. They see that it is possible to pursue both profit and purpose, daily. Why would you want to be anywhere else?

[1] "Human resource challenges and solutions in microfinance," *Microfinance Insights*, April 2008.

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