Savings at the Frontier

Briefing note

Linking users of informal financial services with formal financial services: A Review of the Evidence

SatF is a five and a half year (2015-2021) partnership between The MasterCard Foundation and Oxford Policy Management to improve the financial inclusion of low-income individuals and communities in sub-Saharan Africa (SSA). The programme is working directly with and funding selected Financial Service Providers (FSPs) in our three focus countries – Ghana, Tanzania and Zambia.

SatF has been examining the evidence on the demand for, and supply of, formal financial services for users of informal savings mechanisms (ISMs)[1] in order to discover which services and channels are most valued by the financially disadvantaged and what drives the business case for providers to serve them. In doing so, it has found that in many cases, success can be found by creating formal account mechanisms that adapt ideas from ISMs. To find out more, read the full report on the SatF webpage.

[1] such as chilimba, tontines, stokvels, susu and dozens of other such names and formats that have existed for generations and groups promoted by NGOs such as VSLA, SILC

As part of our work, SatF is facilitating internal learning in order to underpin adaptive evidence-based programme management, ensure external accountability to stakeholders, and contribute to an expanded global knowledge based on what works and what does not, in the course of the programme implementation. As part of this learning, the programme is striving to answer questions about the following three categories:

- *Clients*: Which financial services and channels are most valued by the financially disadvantaged?
- *Institutions*: What drives the business case for providers to serve the financially disadvantaged?
- *Ecosystem*: What does an enabling environment look like and what is the appropriate role for funders to play in supporting it?

This briefing note summarises the findings of a mapping exercise in relation to the first two categories – clients and institutions. The overall objective of the exercise was to review the literature in this area for practitioners[2] seeking to work in this market, but also to encourage researchers to address the gaps in evidence that have been identified.

Which financial services and channels are most valued by the financially disadvantaged?

Informal savings mechanisms of the 'unbanked'

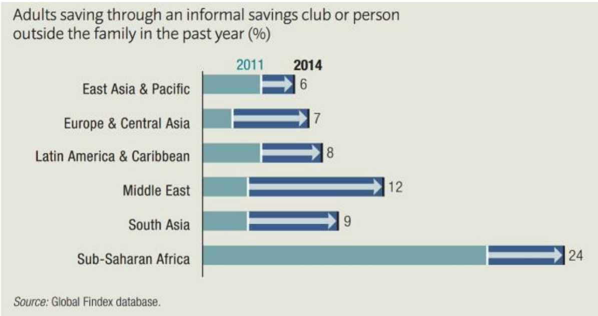
Our first enquiry sought to explore the literature in relation to the financial needs and practices of the unbanked. The broad consensus among financial services researchers and practitioners is that the potential of the poor as users of financial services and the complexity of their financial lives has been underestimated. Rutherford and Arora's (2009) *The Poor and their Money* sheds light on the unexpectedly sophisticated financial lives of the financially underserved, finding them 'creating complex "financial portfolios" of formal and informal tools'.[3] Based on their experience, the authors concluded that poor people also want to and do save, even if usually in small and irregular amounts. What they aspire to is to accumulate, from their savings, a larger lump sum of money that is useful for many different purposes.

The kinds of ISMs that are used to achieve this include cash savings and investments in kind made in order to save, as well as savings groups (SGs) and leaving savings with a person outside the immediate family (relatives, neighbours, money guard etc.). The Global Findex Database showed that in 2014, about 9 per cent of adults — or 17 per cent of savers — in developing economies reported having saved using an informal savings club or a person outside the family in the previous 12 months. Saving informally is especially common in Sub-Saharan Africa, where 24 per cent of adults — or 40 per cent of savers — reported having saved in the previous year. Almost 60 per cent of those who reported saving semi-formally (14 per cent of all adults) also reported not having a formal account.[4] Roughly half of the adults who saved using an informal mechanism also saved in a formal financial account.[5]

The use of informal savings methods increased between 2011 and 2014. In developing economies the share of adults who reported saving informally, by using an informal savings club or a person outside the family, increased to 9 per cent. The Middle East had the largest increase among regions, though from a very low base: the share of adults who reported saving informally quadrupled, rising from 3 per cent in 2011 to 12 per cent in 2014.

[2] This includes a wider group including FSPs, NGO leaders and managers and many others interested in driving the financial inclusion agenda
[3] http://www.portfoliosofthepoor.com/
[4] Global Findex Survey 2014
[5] www.cgap.org/blog/formality-and-informality-lessons-new-findex-survey

Figure 1: Informal savings by region, 2011 to 2014[6]



On the virtues of Savings Groups

SatF assumes that ISMs only meet some of the needs of their members and are not always available to those who need them. Nonetheless, we also appreciate that ISMs, particularly savings groups (SGs) are valued by their members and bring several benefits. With that in mind we looked at the literature to better understand those benefits, with a view to integrating those lessons into the models we support the FSPs to develop. The literature showed that there are peer-reviewed studies as well as findings from project and programme evaluations that shed light on the virtues of SGs. Financial diary studies have been found to be the most helpful way of exploring consumer behaviour patterns but these have only been conducted in a few countries. Several experimental studies have also been undertaken to study the impact of SGs on savings, particularly for consumption, productive/ income-earning investments, children's education and medical needs.

Members increase their volume of savings and credit after joining SGs. Research which looks at the use of funds focus on the use of loans granted by existing SGs, the spending of the share-out[7] and the use of the social fund.[8] There has been less research on how participation in an SG affects the forms in which individuals save, that is, long versus short term. There are studies though which look at the impact of SG membership on asset ownership, which it can be argued is a form of saving as well as investment. Findings on the impact of SG membership on asset purchases are mixed in the existing randomised control trial (RCT) studies. Linkage to FSPs as well as facilitation by non-governmental organisations (NGOs) appears to affect asset ownership.

There has been some debate as to whether savings accounts present an addition to the portfolios of their members or whether they replace other forms of savings. Results are divided. For example, some findings suggest that facilitated SGs crowd out other types of SGs. This is an area for further research.

We also found that individuals are often members of more than one SG – a situation that could present both advantages and risks.

As well as the financial benefits of SG membership, studies (other than RCTs) indicate that SG members also value the sense of inclusion and community that comes from participating in SGs. However, it is important to note that while there is anecdotal evidence to support these findings, enhanced social capital was not captured at all by the RCTs. It is possible that such social impacts exist but RCTs are unable to capture them. In facilitated groups, training provided by facilitators is reported as being highly appreciated by SG members.

How members would access these non-economic benefits in the absence of SGs depends on the type of non-economic benefit. There is no evidence addressing this question explicitly in the literature and the savings discipline that is instilled into members by the group could be provided by other means. There are studies simulating the peer effect as well as other features of SGs.

Demand for Formal Financial Services

Despite these positive impacts the benefits of ISMs have limits, and often pose risks to members. At home, savings are subject to theft and relatives' demands on the household (in particular, trivial spending). Moreover, cash stuffed under mattresses and in pots renders no

[6] Global Findex Survey 2014
[7] What is a share out? Groups save and borrow over the time period of a savings cycle. At the end of every cycle, the accumulated savings and interest earnings are distributed (i.e. "shared out") amongst the members. After each share-out, groups start another cycle. Members may decide to make an exceptional savings contribution right after share-out to re-capitalise the loan fund.

[8] The social fund is like an insurance fund that some savings groups use for emergency and social purposes in accordance with rules set by the group. The social fund is kept as a separate fund. Typically, any member may request a grant or interest-free loan (to be disbursed immediately) from the fund pending approval from group members.

returns. In SGs, the limited size and the often long waiting period for share-outs (and the returns) are shortcomings, as is the limited range of the financial services provided. In forming a business case to make financial linkage attractive to SGs and their members, Bankable Frontier Associates (BFA 2013) mention the inherent restriction of SG cycles as one of the limitations of SGs: members are rarely able to save for longer than a year, preventing them from saving enough for larger purchases related to housing, farming equipment or other productive investments.

Whilst these risks and disadvantages are clear, these are not necessarily the issues that members want a formal provider to address. We therefore examined the literature to ascertain what the demand was from SG members. Financial diaries reveal that the main reasons SG members want a bank account are: safety of savings, access to credit, and the wish to build a credit history.

We can therefore conclude that there is evidence of at least some demand for formal financial services, but there also remain barriers to linkage, which sometimes includes a negative view of FSPs. We found that advocacy organisations, including the authors of the *Banking for Billions* report (Barclays and EIU, 2010) state that SGs want to link, however anecdotal evidence by CARE International also shows that SG members across different countries share common perceptions and misconceptions about the possibility of financial linkage. The most common concerns cited by SG members are provided in Box 1 below:

Box 1: SG members' most common concerns about financial services providers

- *Groups are not registered with authorities so banks will not engage with them*
- *Bank charges are very high on saving accounts*
- *Groups do not have enough money to keep in a bank account*
- *Banks may not have enough cash when groups want to withdraw their savings*
- *Banks charge very high interest rates and other charges on loans*
- *Banks can be harsh on repayments*
- *Banks have high collateral requirements*
- *Members may not have all the documents required*
- *Groups will need to keep their entire savings in the bank to get a loan, so they will not be able to lend their own funds*
- *Financial sector partners ask for joint liability, so even if only one member defaults the others have to pay, which is not acceptable to the group*
- *Members do not have the ability to prepare business plans to access loans*
- *The process is cumbersome.*

Institutions: What drives the business case for providers to serve the financially disadvantaged?

FSPs

The second part of our enquiry looks at the supply of formal financial services. Our first objective was to understand what is currently being provided to SGs. The State Of Linkage Report provides an overview of the providers of financial products for SGs. The report found that the main distribution network of linkage products was the banks (67 per cent). Retail banks rather than microfinance institutions (MFIs) make up most of the market and local banks are the drivers.

In the group product market, Mobile Network Operators (MNOs) face certain limitations. These limitations are particularly restrictive for SGs as the amounts saved and withdrawn are higher than for individuals. While MNOs can provide attractive incentives for customer acquisition, there are limitations in terms of the liquidity challenges the operators and associated agents face. That said, numerous SG deposits and withdrawals may provide a source of liquidity management for MNOs or banks that manage agent channels. We did not find any evidence on the ability of one linkage model (FSP and SG) versus another (FSP, MNO and SG) to deliver better liquidity performance.

The business case for financial linkage for FSPs

Understanding that formal providers are already providing some services to the unbanked is important, but a key question SatF will seek to answer is what drives the business case for providers to serve the financially disadvantaged. The current literature is limited on this question. In their analysis of the business case for linking

SGs to FSPs and MNOs, BFA conclude the linkage model most likely to result in an incentive structure that is attractive to SGs and their members , MNOs and FSPs is digital linkage of the SG as well as of its individual members (2013). This model is based on various assumptions around acquisition cost, client cost and cost of linkage.

Our review was unable to find studies that articulated the business case for linking ISM users to a financial institution or a mobile payment system. There is limited information on market segmentation of users of ISMs and how different segments respond to financial opportunities. Surveys or consumer studies on what members value about ISMs do exist but are not broken down by types of ISM and modes of facilitation. FSPs' data on cost structures, liquidity demands and marketing channels are rarely shared. While financial products for SGs (conditions, limits, fee structure, cost) can and have been studied, FSPs are, unsurprisingly, reluctant to share certain company information.

Given their importance for sustainable service delivery and thus the business case, there are several studies on different village agent models – some anecdotal or in the form of project evaluations and technical series by facilitating agencies, and others in the form of peer-reviewed studies. Differing inclinations on investment and use of credit and savings for investment as a result of the delivery model have implications for the choice of financial linkage model of FSPs and SGs.[9]

Market Research

Despite the lack of evidence for an established business case for linkage, market research has been done to provide insights into key considerations that an FSP would need to make before entering the informal market, though there remains gaps in the literature.

The cost of acquiring an SG (and its members) as customers is understudied – with only some data on the financial effort of linkage and anecdotal data on account opening costs from selected projects. However, *the question of whether customer acquisition via SGs is more effective than individual customer acquisition has been explored*. The agglomeration effect of SGs makes marketing campaigns by promoters particularly effective. Moreover, there are factors that mean that SG members are more likely than individuals to be linked to an FSP (for example, religious and cultural factors, peer effects being stronger in youth groups, etc.).

The cost of forming or facilitating SGs and linking to SGs is also an important factor. There is little available information on customer acquisition costs for NGOs. There are some examples of NGOs funding the costs of linkage and there are details of the costs incurred. However, there is very little information available on the cost of linking SGs (existing or newly formed) to FSPs. Perhaps case studies on business models focused on clients at the bottom of the pyramid could be helpful here.

There is also research (albeit not exclusively on SGs) on harnessing mobile phone data, where available, to assess credit risk. No publicly available research compares the robustness of mobile data usage for assessing credit scores to that of deriving credit scoring from internal transactions in SGs. While data on the reliability of this method were not publicly shared, their widespread use is a testament to the potential for linking informal savers to formal financial services.

Customer retention is another area where there has been market research but the literature does not reveal whether linked SGs performs better in this regard compared to other customers. There are studies on the linkage experience and satisfaction rates with financial linkage. Moreover, there is evidence on what drives survival and drop-out rates for SGs. However, there is no comparison of whether SG members are more loyal bank customers – once linked – than others.

Product offer and pricing

If they are expected to take up the offer of linkage, users of ISMs require a tailored product that exceeds the ISM in terms of affordability, convenience and safety. This may include a variety of services ranging from (mobile) payments to insurance. While the ideal product offer will depend on the market as well as the provider (for example, MNO versus bank), a

[9] See details in the full paper

question that is relevant to most is whether there is an incentive for FSPs to provide credit to customers exclusively or too early on? It has been found that there is an incentive for FSPs to lend to SGs rather than offer a broad range of services to them. For FSPs, the potential interest income from providing credit typically far exceeds the potential float income from savings account balances. There is evidence of failed financial linkages of SGs, many of which were attempts driven by hastened or unsustainable shifts to credit. It has been pointed out that SGs and their members may have limited capacity for investment and debt and that the product offer should therefore be adjusted. In this regard, various NGOs give guidance on what product features are advisable for FSPs to offer – both in terms of consumer protection and reaching scale.

There is little information available regarding pricing. Detailed cost structures are hard to find as private providers typically do not share them. We did not find any information on the capacity of double bottom line (DBL) organisations or other financial intermediaries to price at break-even point. What has been observed is that administrative costs are the main cost component in the MFI business model.

It was not possible to see which services could be provided at break-even point from a review of the service offer in the group product market. However, the *State of Linkage Report* (Barclays, Plan UK and CARE International, 2016) lists a number of services that are typically or often features of SG products and that are provided for free or at low cost. These are SMS notifications, internet banking, ATM cards, free withdrawals, group passbooks, no account fees and no minimum balances. A number of NGOs that facilitate group formation have recommended that, in cooperation with an MNO, FSPs should absorb the cost of going digital for SGs and their members. Whether these features can be provided at a low cost to the FSP remains uncertain.

What does this evidence mean for Savings at the Frontier?

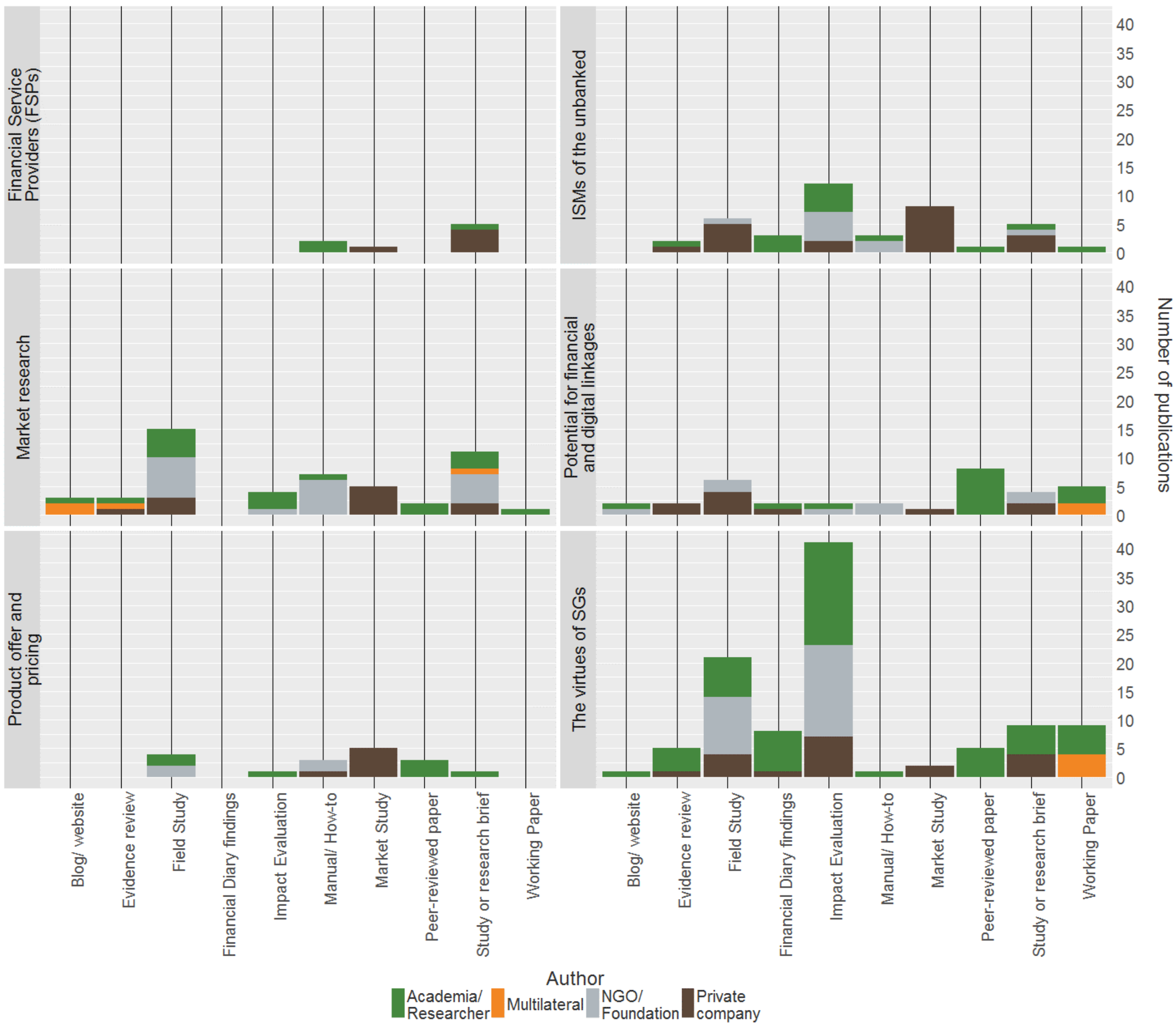
This evidence mapping has sought to broadly answer questions on which financial services and channels are most valued by the financially disadvantaged and what drives the business case for providers to serve them. We have found that a great deal of research has taken place on ISMs and the demand for formal financial services. However, much less has been written on the supply of formal financial services to ISMs and their members, particularly with regards to the cost and sustainability of such provision. With these conclusions in mind, the evidence mapping has been used to develop the learning questions below. These are being studied further in the course of the SatF programme implementation. By answering these questions, we are seeking to bridge the gaps in information identified in this paper, and encourage others to develop similar learning questions on the supply of formal financial services to the unbanked.

Learning questions

1. What are the different segments of users/clients of the ISMs and how do they differ from each other?
2. How do the financially excluded and underserved users (e.g. women, young people, people with disabilities, smallholder families and people living in remote areas) of ISMs respond to linkage experiences and opportunities and how can the mutual value proposition of linkage for ISMs be shared with FSPs?
3. What can we learn from the SatF-supported models on how best to serve the financially excluded and underserved?
4. What are the challenges and opportunities for financial institutions to contribute toward and manage the formation and acquisition of ISM users and how can the mutual value proposition of linkage for FSPs be shared with ISM users?

Evidence visualisation

We also created an evidence visualisation to show the sources of evidence we reviewed, by type of author and evidence. This provides an indication of the gaps in evidence that might be filled by future research.



In the course of our evidence mapping, we reviewed over 120 documents and 45 websites and this visualisation maps which areas each covered. The overall objective of the evidence mapping exercise was to review the available literature about linking users of informal financial services with formal financial services for practitioners seeking to work in this market, but also to encourage researchers to address the gaps in evidence that have been identified. For example, the visualisation demonstrates that a lot of research has been undertaken about the virtues of savings groups (particularly by academics/ researchers, and through impact evaluations) but very little research has been undertaken about FSPs with regards to ISMs. We hope that this visualisation will encourage further research in the areas where little research has been undertaken, in order to fill the evidence gaps identified.

About the SatF consortium

Savings at the Frontier is a five-and-a-half year US$17.6 million partnership between the Mastercard Foundation and Oxford Policy Management and is being implemented in Ghana, Tanzania and Zambia by Oxford Policy Management in collaboration with Bankable Frontiers Associates and MicroSave, country partners and other associates. Find out more about SatF at www.opml.co.uk/projects/savings-frontier and see all the emerging material under the 'downloads' section. Alternatively, email us on satf@opml.co.uk.

The MasterCard Foundation

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