

FINANCIAL SERVICES FOR THE POOR

STRATEGY OVERVIEW



Jean Louis Thomas using his mobile phone outside a mobile payments facility in Port-au-Prince (Haiti, 2010).

OUR MISSION

Guided by the belief that every life has equal value, the Bill & Melinda Gates Foundation works to help all people lead healthy, productive lives. In developing countries, we focus on improving people's health and giving them the chance to lift themselves out of hunger and poverty.

We address problems that have a major impact on people in the developing world but get too little attention and funding. Our financial resources, while significant, represent a very small fraction of the overall funding needed to improve the lives of people living in extreme poverty. We advocate, therefore, for policies and resources to increase opportunities for people in the developing world.

THE ROLE OF FINANCIAL SERVICES FOR THE POOR

Poor people don't live in a static state of poverty. The reality is much more complex. Every few years, hundreds of millions of people transition out of poverty by successfully adopting new farming technologies, capturing investment opportunities, or finding new jobs. At the same time, large numbers of people fall back into poverty due to social and economic shocks. If available at critical moments, effective tools for savings, payment, credit, and insurance can play a key role in determining whether a poor household is able to capture an opportunity to move out of poverty or weather a shock without being pushed deeper into poverty.

Of the 2.6 billion people who live on less than \$2 per day, an estimated 78 percent do not have a bank account. As a result, most poor households operate almost entirely in the cash economy. This means that they use cash, physical assets (e.g., jewelry and livestock), or informal providers (e.g., money lenders and payment couriers) to meet their financial needs—from receiving wage remittances, to saving up to buy fertilizer, to insuring against illness. These informal tools, however, tend to be insecure, expensive, and hard to use. And when large problems arise, such as a major illness in the family, the tools often break down completely, leaving households exposed.

THE OPPORTUNITY FOR IMPACT

A growing body of evidence indicates that increasing poor people's access to an improved suite of financial tools has the potential to accelerate the rate at which they move out of poverty, and help them hold on to the gains they have made. The foundation's Financial Services for the Poor (FSP) program believes that impact will occur at three levels:

- **Level 1:** reducing the resources (in both time and money) that poor people must expend to finance their current activities
- **Level 2:** increasing poor people's capacity to manage economic shocks and capture income-generating opportunities
- **Level 3:** generating economy-wide efficiencies by digitally connecting large numbers of poor people to their peers, financial service providers, government services, and other counterparties



Odetta Mukanyiko uses her phone from her maize field in Musaza village, Kirehe District (Rwanda, 2011).

In wealthier countries, banked customers conduct most of their financial activity in digital form, and value is stored virtually and transferred instantaneously. The global revolution in mobile communications, along with rapid advances in digital payment systems, is creating opportunities to connect poor households to affordable and sustainable financial tools through mobile phones or other digital interfaces. Mobile phone penetration in developing countries has increased exponentially over the past decade, and mobile networks are projected to grow steadily in coming years.

- The number of mobile subscribers in Africa grew from 25 million in 2001 to nearly 650 million in 2011, and it is expected to reach 925 million by 2015.
- By 2012, the number of unbanked people who possess mobile phones is expected to increase to 1.7 billion worldwide.
- Mobile payment networks in East Africa and South Asia have successfully leveraged this mobile infrastructure to expand digital payment services to large numbers of poor households in just a few years.

OUR STRATEGY

We started our strategic analysis by unpacking the economic barriers that prevent poor people from accessing a range of formal financial services. We then assessed how those economics must change in order to sustainably reach poor people with formal financial services at prices they can afford. We found that one of the reasons that it is too costly to serve poor people with affordable financial services is because most poor households conduct most or all of their financial transactions in cash. This perpetuates the poor's marginalization from the formal economy because banks, insurance companies, utility companies, and other institutions pay high costs to store, transport and process cash. We also found that the best way to reduce the cost of reaching poor people with financial services is to help shift the majority of their cash-based financial transactions into digital form through mobile phones or another digital interface. The digitization of cash also creates opportunities for delivering value beyond cost savings:

- Digital transactions can be disaggregated into smaller and smaller units, enabling the delivery of services that are "right-sized" for the cash flow needs of poor households.
- Digital transactions can be recorded and used to construct accessible financial histories. Providers can then use this information to develop products that are better matched to customers' unique financial needs and risk profiles.
- Digital delivery of financial services (including wages and social payments) allows money to "bypass" the

home, helping users overcome self- and household-control challenges.

- Digital financial infrastructure creates the opportunity to connect the poor to a system of automatic reminders, direct deposits, positive default options, and account labels than can help to maximize adoption and effective usage.

The FSP team believes that we can play a catalytic role in expanding access to financial services by enhancing the reach of digital payment services in poor and rural areas and expanding the range of financial services that poor people can access over these platforms. But just increasing access to services is insufficient; clients must also adopt and use these services for them to make a difference in their lives. Development interventions in health, agricultural, and financial services have been plagued by technologies that were made available to their intended users, but were not adopted.

To address this demand-side challenge, the FSP program will support research and product design experiments to better understand which product design features, price incentives, and marketing messages work best to encourage poor people to adopt and actively use financial services over these platforms. We will also support regulators as they work to develop policies and regulations that facilitate these developments.

We believe that the combined effect of these interventions will accelerate the rate at which poor people transition out of poverty while decreasing the rate at which they fall back into poverty.

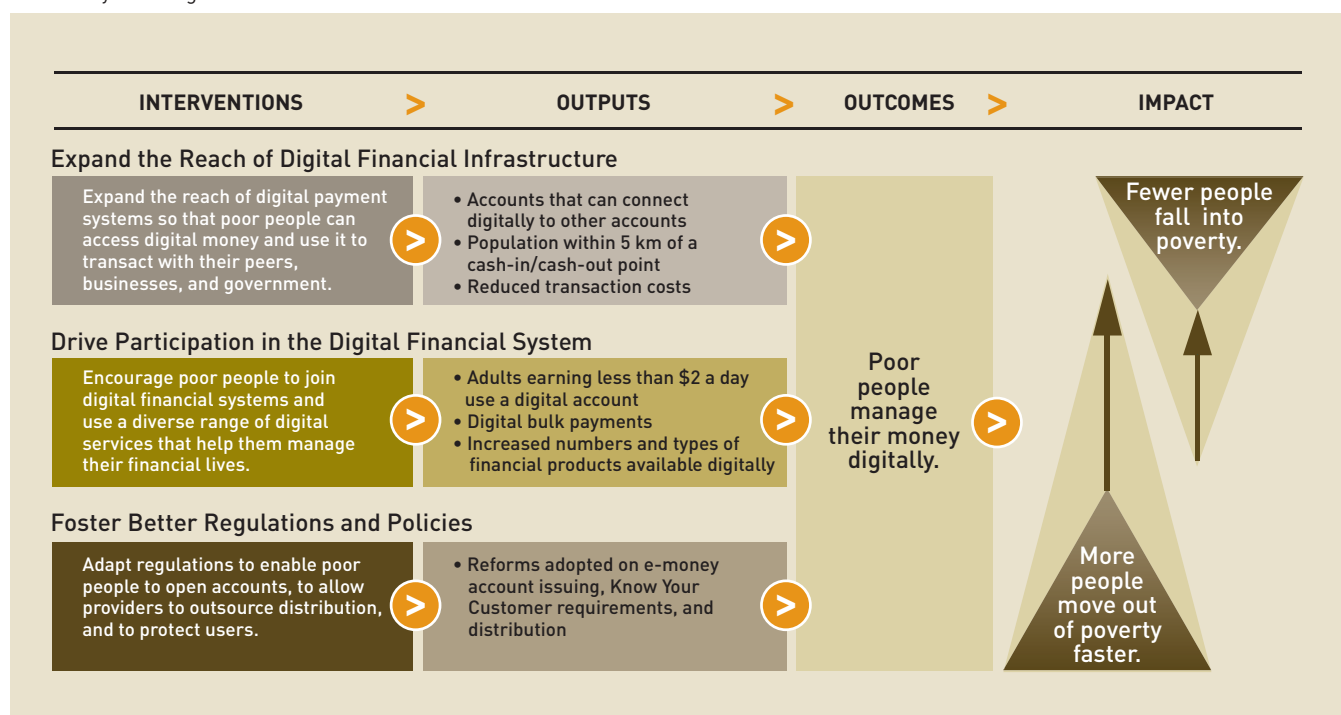
We have also worked to adapt this “static” theory of change to a more dynamic model of market development. This model recognizes that many countries are at different stages of market development along the path to an inclusive digital financial system, and we must tailor our interventions accordingly.

We plan to organize our activities around four initiatives:

1. **Digital Payment Systems at Scale:** In countries that have a minimum level of connectivity in poor and rural areas, we aim to work with a range of providers to extend the reach of digital payment systems into poor and rural communities and to encourage poor people to adopt these systems through a mobile phone or other digital interface. In general, we will work only in markets that have this minimum level of connectivity.
2. **Digital Financial Services at Scale:** While the early evidence indicates that access to payment systems can deliver substantial benefits to poor households, we also believe that poor people need access to enhanced financial services, like savings, credit, and insurance, to better manage their lives. In countries that have

THEORY OF CHANGE

The theory of change for the foundation’s Financial Services for the Poor initiative.



extended digital payment systems into poor and rural communities, we will work with banks, insurance companies, and other providers to increase the range of financial services that poor people can access in digital form.

3. **Global Partnership Alignment:** In initiatives #1 and #2, we will work with in-country partners to help catalyze demonstration models in select countries. Under initiative #3, we will work at the global level with governments, donors, global standards-setting bodies, and the private sector to maximize our collective impact on poor people's access to financial services.
4. **Research and Innovation:** FSP is committed to active data collection to rigorously measure the impact our grants and interventions are having and to supply various market players and local stakeholders with the data they need to make better decisions. We also believe that fundamental research and technology innovation will help unlock greater financial inclusion in the long run. Under initiative #4, we will collect data to track our impact and to inform key stakeholders' decisions in the short run. We will also conduct fundamental research and nurture innovations that could—in the medium to long term—create a step-change improvement in delivering digital financial services at scale.

FREQUENTLY ASKED QUESTIONS

Q. What changes has the foundation made to its Financial Services for the Poor strategy?

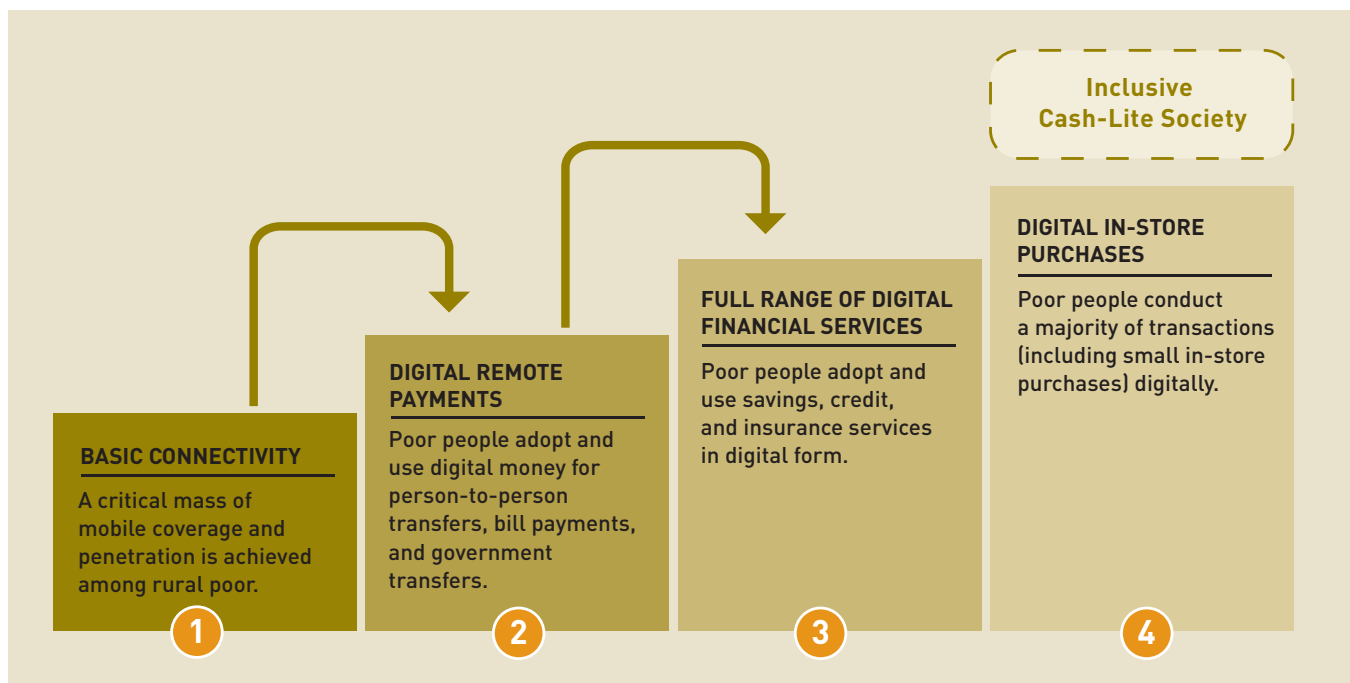
A. Over the past year, we have worked closely with a distinguished group of external advisors, practitioners in finance and telecommunications, on-the-ground nongovernmental organizations, governments and regulatory bodies, and others to examine how we can play a catalytic role in increasing poor people's access to financial services. We concluded that it is costly to serve poor people with formal financial services, in part because most poor households conduct most or all of their economic and financial transactions in cash. We also concluded that the best way to reduce the cost of reaching poor people with financial services is to support efforts to shift the majority of their cash-based financial transactions into digital form through a mobile phone or other digital interface. Our new strategy aims to capitalize on the rapid evolution of mobile communications and digital payment systems to help catalyze this transition.

To this end, there are several changes to our strategy.

- **Tighten our strategic focus:** Our previous strategy focused primarily on expanding poor people's access to savings accounts through digital and non-digital delivery channels, including (among others) agent banking,

STAGES OF MARKET DEVELOPMENT

Stages of market development toward an inclusive "cash-lite" society.



mobile money, savings groups, and microfinance institutions. Our new strategy narrows this focus by concentrating on connecting poor people to digital payment platforms and enabling them to access savings, credit, and insurance services over those platforms.

- **Establish a new end goal:** Our previous strategy aimed to reduce the cost of handling cash. Our new strategy aims to displace cash over time by migrating poor people to a digital financial system.
- **Broaden benefits for poor households:** Our previous strategy sought to increase household welfare by enabling poor people to access a savings account. Our new strategy aims to increase welfare by enabling poor people to transact digitally with peer networks, government institutions, and savings, credit, and insurance providers.
- **Map our interventions to a country's level of digital financial development:** As noted above, we recognize that countries will likely pass through several stages of market development as they seek to build inclusive digital financial systems. We aim, therefore, to tailor our interventions to a country's given level of digital financial development.

Q. Is the foundation moving from a savings strategy to a payments strategy?

A. No. While the early evidence suggests that access to a safe and convenient digital payment system increases household welfare, payments are not the end goal. We believe that poor households both want and need access to a variety of financial services (such as payments, savings, credit and insurance). However, we view digital payment systems as the “transactional rails” on which a broader range of financial services can “ride.” Experience in both the developed and the developing world suggest that remote payments—like domestic remittances and government transfers—are effective gateway products to fuel this adoption. Indeed, domestic remote payments have been the gateway products for all mobile money systems that are now serving more than one million active customers.

One advantage of leading with digital remote payments is that they clearly outperform poor people's informal alternatives. The early evidence from Kenya, Tanzania, Uganda, and Pakistan indicates that the need for domestic payments is often large, whether it is spurred by migrant labor remittances, informal support networks of friends and family, government payments, entrepreneurs' commercial transactions, or bill payments. And it is particularly difficult for poor people to move physical cash over distances due to the cost of direct fees and the cost of traveling to or from the nearest payment location.



Anita checking her bank balance on her mobile phone at her tea shop, which she runs from a handcart (Uttar Pradesh, India, 2010).

Another advantage is that customers can make a digital transfer and receive immediate validation that it was processed. Starting with payments, therefore, allows customers to build trust in using digital services by completing several transfers. Then, as they gain comfort with the new digital system, customers can start to use more complex financial services like savings, insurance, and credit.

Q. Will you expect grantees to shift their programs to specific countries or become more focused on supporting the transition to digital payment systems?

A. We see tremendous value in our current portfolio of grants, and we won't be asking our current grantees to realign their programs with our new strategy. Going forward, however, we will work with valued partners and grantees to fund interventions designed to expand access to financial services by helping to connect poor people to digital payment platforms and then enabling poor people to access savings, credit, and insurance services over those platforms.

Q. How has your new strategy changed the foundation's commitment to savings or financial services more broadly?

A. We continue to see great value in expanding access to savings accounts and other financial services that can help poor people capture investment opportunities and mitigate financial shocks. We believe, however, that the best opportunity for the foundation to play a catalytic role in

increasing access is to support efforts that help to transition the majority of poor households' cash-based financial transactions into digital form through a mobile phone or other digital interface. Our new strategy aims to capitalize on the rapid evolution of mobile communications and digital payment systems to help catalyze this transition. Our goal is not focused on a particular product or distribution channel, but on the livelihood outcomes created by scalable, sustainable digital financial inclusion.

Q. In November 2010 at the Global Savings Forum, you announced that the foundation would invest \$500 million in expanding access to savings. Has this commitment changed under your new strategy?

A. Expanding access to savings accounts and other financial services that can help the poor manage risk and mitigate financial shocks remains essential. But our review of the financial services landscape over the past year has convinced us that the foundation is best positioned to play a unique and catalytic role in expanding access to financial services by helping to connect poor people to digital payment platforms and then enabling poor people to access savings, credit, and insurance services over those platforms. Our overall level of funding for financial services in the next five years will likely match the foundation's original commitment announced in 2010. Our investments, however, will be closely aligned with our new strategy.

Q. You say that you will tailor your interventions to align with a country's current level of digital financial development. Does this mean that you are adopting country-specific grantmaking strategies?

A. Over the past year, we have worked with a distinguished group of external advisors and conducted rigorous market research to identify countries and regions where our investments can have the greatest impact. We will develop targeted strategies in those countries and regions. Given the incredibly dynamic and rapidly evolving nature of the financial services field, however, we want to be nimble and responsive as remote digital payment systems grow

and mature. This means that we will review our country investment approach on an annual basis to allow for course corrections and to enable us to channel our resources to where they can have the most positive impact in expanding access to financial services.

Q. By supporting the development of digital financial systems, you are investing in platforms that are still relatively inaccessible to the rural poor, especially poor women. What are you doing to address this critical gap in access?

A. Women and rural residents have traditionally been some of the most disadvantaged groups. Digital platforms can help address many of the key barriers that kept them from accessing traditional banking and finance models. Nevertheless, we recognize that it will take sustained effort to reach these groups and are strongly committed to this goal. To succeed in this effort, we will work with a variety of partners to identify and support the scale-up of digital financial interventions that deliver significant economic and social benefits to women. We will also leverage the increasing penetration of mobile communications to accelerate rural access.

TO LEARN MORE:

About the Global Development Program:
www.gatesfoundation.org/global-development

About Financial Services for the Poor:
www.gatesfoundation.org/financialservicesforthe poor

Guided by the belief that every life has equal value, the Bill & Melinda Gates Foundation works to help all people lead healthy, productive lives. In developing countries, it focuses on improving people's health and giving them the chance to lift themselves out of hunger and extreme poverty. In the United States, it seeks to ensure that all people—especially those with the fewest resources—have access to the opportunities they need to succeed in school and life. Based in Seattle, Washington, the foundation is led by CEO Jeff Raikes and Co-chair William H. Gates Sr., under the direction of Bill and Melinda Gates and Warren Buffett.

For additional information on the Bill & Melinda Gates Foundation, please visit our website: www.gatesfoundation.org.

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