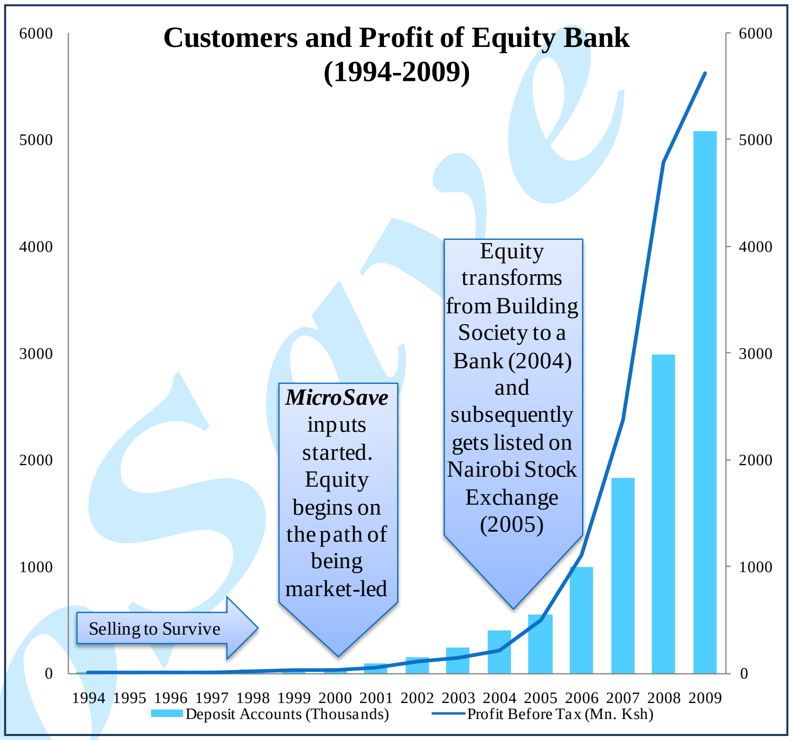
MicroSave India Focus Note 60

Speculation on the Future of Financial Services for the Poor in India

Graham A.N. Wright

January 2011

It is always dangerous to speculate about the future in public … particularly in print – so that's what this note seeks to do, not least of all to stir debate and discussion.



As Collins et al. note in "Portfolios of the Poor", three needs that drive much of the financial activity of poor households:

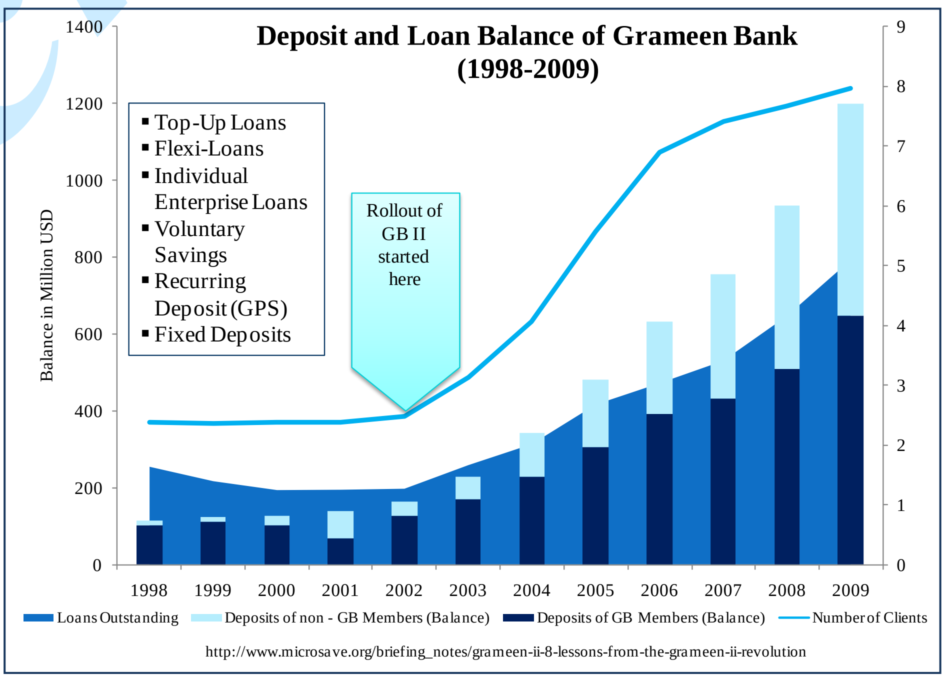
1. *Managing basics*: cash-flow management to transform irregular income flows into a dependable resource to meet daily needs.
2. *Coping with risk*: dealing with the emergencies that can derail families with little in reserve.
3. *Raising lump sums*: seizing opportunities and paying for big-ticket expenses by accumulating usefully large sums of money.

To meet these needs, as a bare minimum, poor people need the following financial services delivered in a reliable, convenient, flexible and structured manner:

1. A current savings account into which they can deposit, and from which they can withdraw, conveniently.
2. An emergency or general loan that can be taken and repaid quickly.
3. Recurring, commitment or contractual savings products.
4. A loan that can be used for a wide variety of purposes.

After a period of selling-focused struggle and limited growth, Equity Bank consulted their clients and refined their products in 2001 … since then Equity has delivered these services, and witnessed extraordinary growth as a consequence.[1] This growth was built and maintained on a commitment to:

- Listening to clients and responding to their needs;
- Excellent customer service; and
- Technology/delivery channels: IT/ATMs/POS/m-banking.



Similarly, Grameen Bank's under-recognised transformation in 2002 saw a massive increase in clients – including many who repaid loans that were long overdue in order to gain access to the new range of products offered by the bank.[2] As

[1] http://www.microsave.net/briefing_notes/briefing-note-63-the-market-led-revolution-of-equity-bank

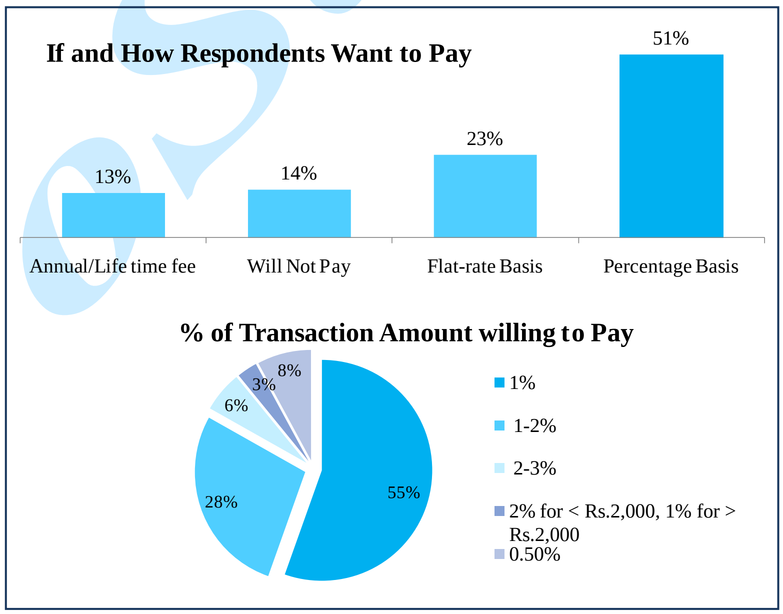
Stuart Rutherford noted in 2006, "Grameen took 27 years to reach 2.5 million members – and then doubled that in the full establishment of Grameen II" – since then the bank has added another 3 million members. But this has come with significant challenges - as can be seen from the graph. As part of it fund-raising drive, Grameen offered fixed and recurring deposit products not just to its poor members, but also to the better off people in the villages. These savings products were very generously priced, and now the bank has a significant, and growing (nearly $500 million at the end of 2009), excess of savings over the amount of loans it is able to push out to its members.

So what are the implications for India?

MicroSave has been advocating the use of the banking correspondence models to offer a diverse range of financial services for a long time now.[3] It is clear that e-/m-banking channels can be used to:

1. Offer clients a suite of financial services in response to their full spectrum of financial needs – credit, savings, remittances, payments, insurance etc., thus deepening the relationship with clients.
2. Deliver proximity so that the transaction point is in the villages/slums where the clients reside – allowing them to transact easily and as often as they need.
3. Focus on convenience (including the ability to make small transactions) so that products respond to clients' needs, and not just those of the institution.
4. Leverage technology to increase transaction efficiency and reduce costs.

Until recently, when the Reserve Bank of India (RBI) sanctioned charging "reasonable fees" for transactions, this was largely a pipedream in India.[4] But, in the current regulatory environment, and the banks' realisation that the RBI is absolutely committed to achieving real financial inclusion with active accounts, supported by the growing number of mobile network operators and dedicated agent network providers available, the dream is set to become a reality. The Unique Identification (UID) *Aadhaar* project, linking each person's UID with a bank account and a mobile number, means that the potential for the rapid roll out of effective agent networks is significant.



With reasonable charges, the stage is set to move beyond the double break-even dilemma, under which it was more lucrative for agents to just to sign customers up and then let the account lapse into dormancy. Because paying for remittances, withdrawals and payments is an accepted norm in Africa, it is ahead of Asia in the rollout of mobile money. But the poor in India are indeed willing to pay … *MicroSave*'s recent research in Uttar Pradesh suggests that transactions in rural bank branches are time-consuming (often 1-2 hours or more is required for a basic deposit or withdrawal) - resulting in cash losses and opportunity costs in the range of Rs.25-150. Unsurprisingly therefore, the poor are willing to pay for a convenient service close to their homes.

In the long-term, as multiple products are offered across the mobile money platforms, this will revolutionise financial inclusion, and the poor will have access to savings, remittances, payments, insurance, individual cashflow-based loans and air time top-up, plus a host of other services through agents based with a few yards of their houses. It is the deepening of this relationship that will allow the banks to better manage credit risk, and thus begin to make small advances to customers on the basis of their savings/insurance histories. For larger loans, detailed appraisals of the cashflows of both the household and the business to be financed will be required – but *MicroSave* estimates that these are indeed feasible for loans in excess of Rs.25,000.[5] The stage in India is set for very significant change …

[2] http://www.microsave.net/briefing_notes/grameen-ii-8-lessons-from-the-grameen-ii-revolution
[3] http://www.microsave.net/briefing_notes/india-focus-note-26-market-strategy-development-and-3rd-generation-microfinance-in-in
[4] http://www.microsave.net/briefing_notes/india-focus-note-24-making-business-correspondence-work-in-india and http://www.microsave.net/briefing_notes/india-focus-note-32-making-business-correspondence-work-crossing-the-second-break-eve
[5] http://www.microsave.net/briefing_notes/briefing-note-84 and http://www.microsave.net/briefing_notes/briefing-note-85-managing-individual-lending