
INNOVATION, INCLUSION AND TRUST

THE ROLE OF NON-PROFIT ORGANISATIONS IN MICROFINANCE

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Author's notes:

The names and short stories used in the case studies are fictional but based on the real life situations of many individuals I have met. Images throughout are for illustration only. I thank Plan International for commissioning the paper and financial support. I retained unrestricted intellectual freedom on the ideas and words put forward in this paper. I thank Ted Barnett, Sana Khan and Glynis Startz from Innovations for Poverty Action for assistance throughout, Deborah Kenchington, Jane Labous and John Schiller from Plan International and Abhijit Banerjee, Alex Counts, Chris Dunford, Julia Levinson, Alex Rizzi and Chris Udry for comments.

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FOREWORD

by John Schiller, Microfinance Advisor, Plan International

One important component of Plan International's overall development programme is the promotion of financial inclusion for the poor, specifically through the model known as Savings Groups. This new paper written by economist Dean Karlan on the role of non-profit organisations in financial inclusion helps to situate the work of our Savings Groups initiative in the context of the wider financial inclusion movement. Karlan is an accomplished American development economist, a professor of economics at Yale University and the president and founder of Innovations for Poverty Action (IPA), a nonprofit organisation that applies rigorous techniques to develop, test and scale up solutions to problems faced by the poor in developing countries.

The three areas that Dean Karlan lays out in this paper give us the opportunity to think about how we work. We've traditionally provided access to financial services but as this paper makes clear, there is a much larger and more complex body of work that can either facilitate the evolution of the poor's use of formal financial institutions, or satisfy their need for financial services directly through non-formal mechanisms until the time when formal institutions find ways of working with them.

The paper gives examples of activities within each area. Two of these refer to Plan directly: working with the unbanked rural poor through Savings Groups; and working with the ultra-poor through cash and asset transfer programmes.

IN SUMMARY

In the section **Innovations, research and development on business processes**, the paper focuses on formal microcredit and cites two examples: the development of flexible loan repayment schemes that can stimulate business development among the loan recipients, and institutional arrangements where the source

of capital serves as equity rather than the business incurring debt through loans. Plan no longer works with microcredit institutions per se, but through its Savings Groups programmes encourages both flexible savings opportunities and flexible repayment terms on loans for group members who borrow.

The second section, **Serving the unprofitable**, cites Plan twice for reaching the rural poor and the ultra-poor, both through Savings Groups and through programmes of cash and asset transfers. We must mention, in addition, Plan's work to include children and youth into Savings Groups and complementing savings and credit with financial education and life skills training. In West Africa we have reached 82,000 youth in three countries, a significant accomplishment. If others follow, using Savings Groups for youth as a first step to financial inclusion through informal institutions could become Plan's niche area and a contribution to the community of practice.

In the third section, **Building trust**, the paper shows how outside endorsement of a product or service can help convince the poor of its value. The Banking on Change project in collaboration with Barclays Bank and CARE is doing this by demystifying banks and working with mature Savings Groups to establish commercial relationships with them. The endorsement of this process can also lead to innovation, where banks are encouraged to come up with new technologies and systems to reach formerly unprofitable markets profitably.

This paper puts Plan's work into context, can inspire us to greater effectiveness by creating awareness of other opportunities and puts us in the mainstream of organisations working to build financial inclusion.

INTRODUCTION

Finance can be a glue that holds all the pieces of our life together, making it so that money is in the right place at the right time for the right situation. To borrow and save is to move money from the future to now, or now to the future. To make a payment is to move money from one place to another place. And to insure is to move money from 'good' situations to 'bad' situations.

Ideally we would never have to think about finance. Finance would be seamless, operating in the background, never getting in the way. Finance would make it possible to invest and consume exactly as one deems optimal given the other constraints one has in life.

SO WHAT DOES GET IN THE WAY; WHY IS THIS NOT THE WORLD WE LIVE IN?

For the perfect world model, finance needs perfect markets and individuals that make fully rational choices. This requires four assumptions: perfect information and enforceability of contracts; zero transaction costs; perfect competition; and fully rational consumer behaviour. There may be situations where all of these are true, but in developing countries that is rarely the case. Contracts are often not enforceable as local institutions and legal systems are not strong enough; physical distance alone can drive up transaction costs for accessing financial services; often few firms are present, thus providing each with some market power; and many behavioural biases and competing claims on an individual's attention may lead to systematic mistakes.

For a long period these issues prevented financial markets from developing, and the result was stark: the poor had little access to credit and savings with formal institutions. The cumulative

obstacles of all the inefficiencies were simply too high for traditional banks to want to serve them, and no one else was filling the gap. Then, starting in the 1970s, Muhammad Yunus changed the landscape of finance for the poor. Simply put, he developed a new business model. This model lowered transaction costs for the lender, and removed some of the information asymmetries that made it difficult to lend. This innovation required some tinkering, some exploration, and a great deal of risk. And this was not done by the for-profit world in search of profits. As first implemented, it was not sustainable, and required a subsidy. Hence the role for NGOs.¹

Recently, a flurry of randomised trials to measure the impact of the expansion of credit for the poor in developing countries has found strikingly consistent results: microcredit is having a positive, albeit small, impact. Millions are not being lifted out of poverty, as the promise once was. For example, the 2006 Nobel Peace Prize press release (2006) claimed that: "Lasting peace can not be achieved unless large population groups find ways in which to break out of poverty. Microcredit is one such means."

But evidence of massive deleterious effects has also not materialised, instead, numerous studies have shown very modest positive results.² Two early studies, one in India and one in the Philippines, show that although there is a positive impact on some outcomes, it is modest and limited to specific populations (Banerjee et al. 2013; Karlan and Zinman 2011). An earlier study on a for-profit lender in South Africa that provided expensive (by international standards) microloans to employed individuals, ironically has been the only study of the recent flurry to find an average increase in household income. This result occurred because the credit led individuals to be more likely to

remain employed a year later (*Karlan and Zinman 2010*). Moreover, the impact is not of the nature or to the degree that microcredit enthusiasts hoped for: for instance, there is limited, if any, impact on downstream outcomes such as healthcare, education, women's empowerment, or overall consumption.³ More recent studies have found similar results (*Crepon et al. 2011; Angelucci, Karlan and Zinman 2013; Augsburg et al. 2012; Attanasio et al. 2011; Tarozzi, Desai and Johnson 2013*). Results do indicate, however, that although there is no increase in consumption or household income, access to microcredit can help borrowers cope better with risk and shocks by helping smooth consumption and retain assets; there is also some limited evidence of increased investment in enterprise. These are important and positive outcomes.

With evidence building that microlending is profitable, for-profits have shifted into the space (or in many cases, non-profits have become for-profit entities). As they have done so, at least one NGO disengaged in favour of programmes which aren't served by the for-profit sector. Unitus, a large NGO, chose to move away entirely from microcredit. Its co-founder Joseph Grenny explains: "Unitus found that for-profit microcredit providers in a robust competitive marketplace tended to provide better loan products to the poor at better interest rates than NGOs. And yet in some regions of the world that robust competitive marketplace could not develop because inefficient NGOs who dominated the sector operated with grant capital. Their presence deterred for-profit players from entering as they could not compete on equal terms. In the financial inclusion sector, grant funds at some point become an obstacle to progress rather than an accelerator of change." (*Grenny 2013*) Note that embedded in this quote are interesting empirical claims, which are outside the scope of this paper

to assess. What is important here is simply the motivation, that this was the perception that shifted a large microcredit non-profit away from microcredit, and into other activities.

This leads to the main impetus behind this paper: if microcredit, as traditionally implemented, is being done just as well by for-profits, where to for non-profits? What is the role for subsidy in the financial inclusion space? Subsidies should not be used to finance operations of an entity when investor money is readily available to do the same. Subsidies should be used to address some gap created by a market failure, or merely for redistribution purposes.

I put forward three important roles that non-profits can (and some do) play in the financial inclusion arena, roles that do require subsidy from donors: innovation; reaching populations left out by for-profit institutions; and building trust between those organisations and the populations they serve.

**If microcredit,
as traditionally
implemented, is being
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non-profits?**



▲ Young artists in El Salvador received training from Plan and now sell their products at market

SECTION 1

INNOVATIONS, RESEARCH AND DEVELOPMENT ON BUSINESS PROCESSES

"Imitation is the sincerest form of flattery."

(Colton 1824)

The non-profits in microcredit ought to be proud. The fact that the for-profits have mimicked them, bringing in investor money and in some cases pushing them aside, is a huge success for the non-profit world. They innovated, made the case, and then for-profits imitated.

So the first role is simple for non-profits: continue innovating. Focus on developing products and services that improve the impact on clients, but eventually do not require a subsidy (note: I am not arguing that ongoing subsidies are bad; rather, the scenarios in which ongoing subsidies are appropriate are discussed in the next two sections).

Why not rely on for-profits for this innovation? When for-profit firms expect to reap windfall profits, they have shown themselves very willing to spend large quantities of money on high-risk innovations (take pharmaceutical R&D for example), but for several reasons this may not prove to be the case with financial inclusion. When the upside of the innovation may be all for the client and not the firm, then there is little incentive to invest heavily in research and development. This is even more true if it is difficult to reverse a change. For example, if it is not profitable for banks to offer more flexible credit with delayed start to repayment (*Field et al. forthcoming*), or lower interest rates (*Karlan and Zinman 2013; Karlan and Zinman 2008*), then the bank may find it even more difficult to reverse such a policy change to return to the more profitable prior practice. This thwarts innovation by for-profit firms, since their first priority is profit, not social impact (even a 'double bottom line' firm, if not its investors, typically faces a trade-off between profits and impact).



Secondly, the expected returns to process innovations may be small if firms are unable to harness the rewards from that innovation. Patenting business process ideas is difficult; institutions have to assume that profitable innovations will be taken up by the rest of the financial services field when introduced.

NGOs may be better suited to exploring creative improvements. Because an NGO's final goal is not profit but increasing the welfare of a population, they can innovate with a focus on impact, not mere financial profits. More than that, NGOs do not have to worry about other firms competing away the returns to a beneficial product – on the contrary, NGOs should want as much of the financial services sector as possible mimicking them by implementing the beneficial innovation.

Mission accomplished if investor money pours in and puts them out of that business (hopefully, given their talents for innovation, the NGO team will shift into other areas and continue innovating). So rather than looking at the decision in terms of costs and expected returns, when deciding whether to innovate, NGOs need only worry about the opportunity cost of not using the money in some other way.

Here I put forward two examples of potential innovations in financial inclusion: flexible repayment schedules, and equity rather than debt.

In corporate project finance, cash flows get matched: a firm wanting to build a factory

typically does not start paying principal back until the factory is generating revenue. This matching of inflows to outflows is not the standard in microcredit. Loans require steady regular payments, but many microfinance institutions' (MFI) clients have highly variable incomes – making five times as much one week as they did the week before, and a tenth of that figure the week after. Adding flexibility to repayment programmes could decrease default rates, increase the potential client base among those driven away by their fear of default, and increase the size of potential loans. In comparison to formal financial institutions, informal sources, such as moneylenders, already have the ability to implement this flexibility. In addition, their monitoring is so comprehensive that they can let borrowers miss a payment if they are likely to be able to make it up

later. MFIs could build some of these advantages into their products by providing clients with several vouchers to be presented in lieu of a payment, thus allowing them to skip if they have a particularly bad week or two, without defaulting on the entire loan (for a thought piece on this topic see Karlan and Mullainathan (2007)).

In a similar vein, grace periods early in the loan repayment cycle could help borrowers. Currently, most MFIs require repayment of a loan to start almost immediately. Since it often takes a while for business investments to generate profit, strict repayment schedules may discourage more profitable but riskier investments. One NGO tested just this, for poor, urban borrowers in India. The NGO increased the normal two-week grace

Because an NGO's final goal is not profit but increasing the welfare of a population, they can innovate with a focus on impact, not mere financial profits.

period to two months in order to give borrowers significantly more time to invest before they had to start paying. Results showed significantly higher profits and higher likelihood of starting a business in both the short and long run, but also much higher rates of default. The potential for this new repayment model among for-profit institutions is unclear (*Field et al. forthcoming*). While there may be value to gain from potential clients' willingness to pay for the change, there is increased cost in the greater risk each client then poses. Further changes could be tested by NGOs to try to decrease default rates and make the strategy more cost effective for for-profits.

Equity, rather than debt contracts, is a second example of innovation ripe for exploration. Conservative Islamic areas of the world are often more constrained in their use of microcredit because the traditional model is not considered compliant with Sharia law. In many areas there has been experimentation with and a transition to Islamic financial models, which usually use methods of leasing or selling assets instead of debt and interest. A variety of products have been introduced: Murabaha, which allows an asset to be sold in cash or instalments with an agreed upon mark-up; Ijarah, in which a monthly fee is paid to lease an asset; Musharaka, a partnership in which one or both partners provide financing and/or time and effort for a project. Because rules governing Islamic finance restrict debt, finding and evaluating different ways for populations to access capital is an excellent task for NGOs. The models found could also be applicable beyond the Islamic world, as limiting debt and focusing more on equity could be a more attractive model for small business owners all over.⁴ Equity provides a way for small business owners to invest without having to repay a loan, but how to make it profitable enough to be appealing on a large scale is as yet unknown. Questions like this provide a perfect opportunity for NGOs to make

adjustments with the possibilities in the hopes of finding a new model for future financial services.

Innovation without documentation may help the one entity that innovates, but will not provide the public good that the donor, the one who finances the innovation, should desire. Careful tests are needed, ideally ones to tackle not just whether a programme works, but why, and under what contextual factors. With clear understanding and evidence of the impact and mechanisms, results from one place can be taken more easily to other places, to help good ideas spread.

CASE STUDY 1.1 – DELAYED REPAYMENT

Maya wants to use a loan to buy a sewing machine so she can make clothing three times as fast as she currently does by hand. However, she knows that once she buys the machine she has to get it home, learn how to use it, and enlarge her customer base to get enough business for her expanded capacity. The problem is that she cannot possibly do all of these things before her first loan repayment is due in two weeks. So instead Maya makes a far less risky investment by buying some extra fabric, because she knows she can sew and sell a few more dresses in two weeks in time to make a payment on a smaller loan.

But what if Maya had a more flexible repayment structure? Would she have instead purchased the sewing machine? In other words, can changing the structure of repayments generate larger investment, and larger longer term income?

To answer this question, researchers Erica Field, Rohini Pande, John Papp, and Natalia Rigol ran a field experiment in India testing the effects of a delayed repayment strategy for microloans (*Field et al. forthcoming*). In their evaluation, the authors compared the usual two-week period before repayment starts to a treatment group given a grace period of two months.

For clients in the grace period group:

- The likelihood of starting a business was >4.5 per cent compared to 2 per cent for clients in the classic repayment

- Three years later weekly business profits were 41 per cent higher and monthly household income was 19.5 per cent greater
- 6.2 per cent defaulted compared to 1.7 per cent of other clients one year after the loan.

Because study clients were willing to pay much more for the grace period option, the authors modelled the lender profits in a world where both options were available for clients to choose from. Lenders, they found, could break even with a grace period option if the interest rate was more than twice the normal one, but only if there was no change in the quality of clients selecting into each group. Thus at first glance this seems daunting. However, this was merely the first attempt. Further adjustment could improve this, help figure out how to make this innovation work and be sustainable.

Kiva, a non-profit organization that allows individuals in the United States to lend money to microcredit institutions around the world, has just begun a new programme called Kiva Labs. Kiva Labs allows individuals to help fuel innovation exactly like the above, to help provide the subsidy (here, by absorbing the risk) necessary to motivate lenders to innovate, to tinker, to find ways to improve their loan contracts so as to improve the impact of the credit on the lives of the poor. See <http://www.kiva.org/labs> for more information.



SECTION 2

SERVING THE UNPROFITABLE



Despite the innovations that have occurred, some clients are still not profitable to reach. Thus if there are social benefits from a service, or justification for providing financial services based on redistribution or social injustice, then there may be justification to subsidise operations in order to bring the less profitable and therefore underserved people into the market. For many years this was indeed the case made for traditional microcredit, but as the business innovation improved, and costs and risks came down, this is no longer the case for the majority currently reached by microcredit institutions. The same may happen in the long run for all, but in the meantime there remains a case for subsidies in order to provide financial services to those unreached by the for-profit financial institutions. So who remains unreached?

I focus on three sets of clients who are unprofitable or impractical to serve for most for-profit financial institutions: the too rural, the too poor, and the too young.

The prescriptions here are not simply to offer the same financial service at a subsidised price. One needs to think about the particular situation of each segment, and then different policy prescriptions ensue.

▲
A participant in Plan's Youth Economic Empowerment programme in Indonesia set up a snack-selling business

REACHING THE UNREACHED: TOO RURAL

At small cost, one can make important but modest improvements in the lives of the poor by setting up savings groups.

Rural areas suffer the combined curse of being more costly for financial institutions to reach, and also poorer than urban areas. If there are fixed costs to servicing each individual client, this does not bode well for sustainable outreach. Furthermore, even in markets where formal microcredit is present, many individuals do not want to borrow from a microlender. This may be because of price, fear of reprisal in the case of default, or discomfort with the formality of the lender.

Community savings groups have become a popular type of financial inclusion, promoted by NGOs such as Plan International, Catholic Relief Services, Oxfam, Freedom from Hunger and CARE. Savings groups are like fancy versions of traditional rotating savings and credit associations (ROSCAs) or accumulating savings and credit associations (ASCAs), which are described in Rutherford (2000).

Although there are many different types of savings groups, each follows a rough structure of arranging about 10-30 people (often women, always somewhat socially connected to each other) into a single group. Each member makes a weekly contribution to a pot of savings shared by the group. ROSCAs designate one member of the group to receive the weekly group contribution as a loan, which is then repaid in weekly installments. ASCAs on the other hand, collect money in a common fund that can be accessed by members who need credit.

The theory behind savings groups is multifaceted. They act as a communal commitment device, in which individuals effectively make

pledges to save, and then have their peers there, every week, monitoring them to help make sure they do. This commitment may help overcome personal temptation and money management issues, or may help someone keep a commitment to save against pressure from spouses or family. The tight social bonds also induce loan repayment, because individuals have to pledge their social collateral to get a loan, much as was the argument behind group-lending models of microcredit (*Banerjee, Besley, and Guinnane 1994; Ghatak and Guinnane 1999; Karlan 2007*).

Importantly, although participants pay interest on the loans, they are also the bank owners earning that interest paid into the common pot. The NGO's role is strictly one of training, teaching the community members how to set up such a group. These costs are fairly small, and thus from a cost-benefit perspective the benefits need not be unusually large in order to justify scale-up. Recent studies have sought to evaluate how successful these programmes are in reaching their desired impact, and have found modest but positive impacts (*Beaman, Karlan, and Thuysbaert 2013*). See Case Study 2.1 for more details.

A key advantage of the savings group approach is the lack of initial outside capital, and their ability to

transition to for-profit financial institutions. There is evidence of exactly this type of transition, for instance with partnerships with Barclays Bank in several countries in Africa, and with the National Microfinance Bank with Plan Tanzania. This not only makes it easier to scale, but also allows all paid interest to remain as earned income in the community. However, this also means that all benefits have to accrue without any infusion of capital, and for the poor it may take considerable time to accumulate significant enough savings to make a noticeable difference in household income or consumption. Furthermore, those who participate in such groups are not necessarily the poorest, most disconnected. In one study in Mali, the more connected women in the village were more likely to participate (*Beaman, Karlan, and Thuysbaert 2013*).

In four countries (Mali, Uganda, Ghana and Malawi), Innovations for Poverty Action (IPA) conducted randomised trials of these savings group interventions (or also sometimes called savings-led microfinance, since the programme starts by women accumulating their own savings). The results of these studies are widely applicable because other NGOs (for example: Plan International and Catholic Relief Services) utilise a similar approach. In these programmes, field officers from the NGO present the savings group model to locals at a public meeting and invite those interested to form groups of about 20 in order to receive training. Once trained, the groups meet regularly to deposit savings and to allow group members to request a loan, which they will then pay back with interest. See case study 2.1 below for more details on the results

from these evaluations, with a focus on the largest, the Mali study. The punchline is simple: at small cost, one can make modest but important improvements in the lives of the poor by setting up savings groups.

CASE STUDY 2.1 – SAVINGS GROUPS

Suzy is a wife and mother in Mali. She has a small income stream, and would like to save some of that money to use on larger purchases and in emergencies. But she finds it very hard to save because she lives too far from a bank and has too little money to get a savings account. Other options are less than ideal. The local moneyhandler actually charges her to save, and stuffing the money under the mattress is a temptation. How can Suzy get access to a safe place for regular savings?

A consortium in Mali, including Plan International, Oxfam, and Freedom From Hunger (FFH) promotes the Savings Group programme throughout rural areas in the country. Innovations for Poverty Action conducted a randomised evaluation of the Oxfam- and FFH-led programme in central Mali over three years. The programme was implemented in areas too rural for formal financial institutions: only 2 of 500 villages in the area had the presence of a microcredit institution; only 35% of the villages were within 10km of a paved road; and only 25% said they were within reasonable distance to get to a bank.

The objective of the Savings Group programme is to improve the savings and credit opportunities for those who are not reached by institutional lenders and ROSCAs (a common type of savings group in rural areas in which a group of savers contribute to a group pot, which is then shared-out at each meeting). The programme uses the base model of an accumulating savings and credit association (ASCA) and builds on it by incorporating a primary innovative flexibility – the model allows members to take out loans from the accumulating funds, instead of each member taking home the entire amount at the end of each meeting. The group members, with technical support from the NGO, are fully

responsible for managing funds in the group, making decisions on who receives a loan and the loan amount, and setting the terms and conditions of the loans – including rules on weekly contributions, interest rates and penalties for delayed contributions or repayments. Furthermore, the groups can (but do not have to) incorporate elements of flexibility much like those discussed in the prior section; for example they can let a woman go a week without paying if she is observably sick to all. At the end of the yearly savings cycle, all members receive a lump sum payout equal to the total value of the accumulated funds. There is an additional learning component to this programme that trains women on an oral accounting system to keep track of outstanding loans and total savings balances of each woman.

For the randomised trial conducted with FFH and Oxfam, outcomes measured included access to finance, economic activities, food security and consumption smoothing, and social capital and intra-household bargaining power. The evaluation included a total of 500 villages: 209 villages were offered savings groups while the remainder served as comparison communities. A household survey was used to collect information on 6,000 households in the sample area.

Results from this study show that households in intervention villages increase their total savings, livestock holdings, report higher food security and better smooth food consumption over the course of the year. However, there is little evidence of increased investment in business and agriculture and no evidence of increases in investments in education; health or health expenditures; women's bargaining power, involvement in the community or social capital, despite the three-year time period of follow-up.



REACHING THE UNREACHED: TOO POOR

Microcredit for many years aimed to help the poor build sustainable livelihoods, i.e., long-lasting sources of income such as microenterprise, livestock or cash-crop farming. Some individuals are essentially too poor to access microcredit, either because microcredit institutions often require an existing source of income off of which to lend, because peers do not perceive the individual as creditworthy enough to participate in a group lending loan, or because the individuals themselves are not willing to take on the risk or the price of the loan in order to start a business. Similarly, one may posit that a microloan will not work for an individual too unhealthy to work, or so poor that they do not have the calories needed to tend to a livelihood. In these cases, a subsidised programme may be needed, much like many social safety net programmes, with an aim towards providing the poor with a sustainable livelihood. Case study 2.2 discusses a series of interventions and

evaluations, coordinated by Ford Foundation, the Consultative Group to Assist the Poor (CGAP), and Innovations for Poverty Action, that aim to provide a holistic intervention to the ultra-poor.

I note an irony here: in a sense, including this work as an answer to “what can NGOs do in the financial inclusion space?” is akin to having a very tall person with clumsy feet ask “what position would you recommend I play in football (soccer)?” and answering, “I recommend you play basketball instead.” These programmes are far more than financial inclusion. But I include this as a potential direction for NGOs intent on financial inclusion because (a) they require subsidies, something that NGOs are indeed built to do, and (b) they do achieve what many NGOs in the financial inclusion space have been *trying* to do with microcredit: help the ultra-poor escape poverty through promotion of income-generating activities.

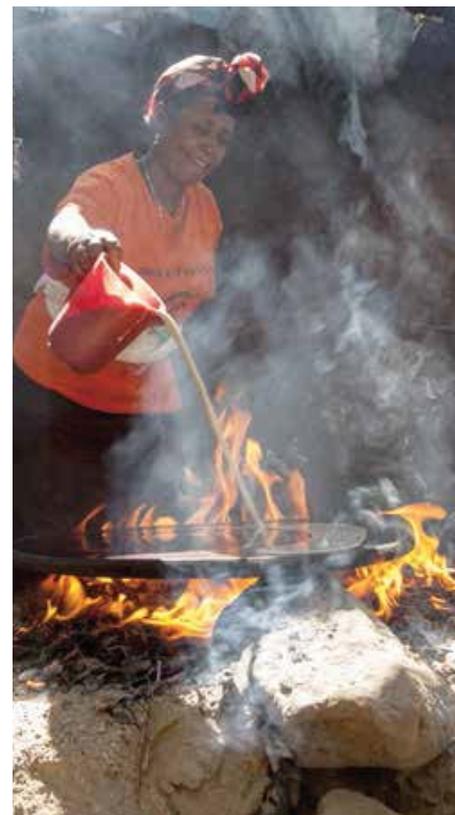
CASE STUDY 2.2 – TARGETING THE ULTRA POOR

Tigist lives in the chronically food insecure Tigray region of Ethiopia. She participates in the government Productive Safety Net Programme (PSNP) which allows her to contribute her labour in exchange for cash or in-kind support in the form of grain, pulses and oil. The PSNP is Tigist’s primary source of income and she relies on it to meet the food gap for her family. She has no savings and very little opportunity for employment. She has the option of taking out a loan from the local microfinance organisation, debit credit and savings institution (DECSI), but is concerned that she will be unable to repay the loan given her limited income sources.

The CGAP/Ford Foundation Targeting the Ultra Poor (TUP) global initiative targets individuals such as Tigist in seven different countries to help them escape (or graduate from) extreme poverty. These programmes provide beneficiaries with a holistic set of services including: livelihood and business skills training, productive asset transfers, consumption support, savings plans, frequent monitoring in the form of weekly visits, and often, advice on healthcare and education. By investing in this multifaceted approach, the programmes strive to eliminate the need for long-term safety net services by enabling individuals to form an asset base and become engaged in sustainable income-generating activities within the two years of the project life cycle.

Innovations for Poverty Action researchers are conducting randomised evaluations in seven countries to determine the impact of these programmes. These include: India, Pakistan, Peru, Honduras, Ethiopia, Ghana and Yemen. In general, results from the various sites show that the programme causes an increase in household income and consumption, and in particular food consumption. The results are now first coming out, and are showing mostly consistent and large positive impacts, even after considering the high cost of the programmes.

Plan International has implemented two of these programmes in Honduras and Peru. The evaluation results for these sites are forthcoming.



REACHING THE UNREACHED: TOO YOUNG

Youths are another group often not reached by the for-profit sector of financial inclusion, often for regulatory reasons if not business reasons (those under 18 are typically unable to open bank accounts, and even if they are, the business case to banks is less than clear for short-run profitability).

In some markets, financial institutions target youths in an attempt to build habits and brand loyalty, but this is not common. Many NGOs are now running saving and financial education programmes aimed at youth. Evaluations of these programmes have shown promising results. More long-term results are likely to shed light on whether these programmes instil financial and saving habits that last until the children are adults. Since the intervention for children may not pay off for institutions until the children are adults, this may be an example of a market failure: the bank cannot charge the future adults, and current children (or their parents) may not be willing to pay a sufficiently high price as to cover the cost of delivery for the financial institution. When the benefits to an individual (and society) are far in the future, there is a case to be made for subsidising the immediate costs since the future beneficiaries are not in a position to cover the current costs.

CASE STUDY 2.3 – SUPER SAVER

Suzu is a 12-year-old living in Jinja, Uganda. She is not able to read well, nor do basic numeracy. To learn how, she could benefit from pen, paper and workbooks. But neither she nor her family has the money on hand to buy such things.

Super Savers is a programme implemented by Private Education Development Network (PEDN) in Uganda. The programme provides access to a safe place to save for primary school students in Uganda. The programme was implemented as part of a randomised trial, conducted by Innovations for Poverty Action. The study assesses the impact of payout variations for the school-based savings programme. In one variation, students who saved receive cash payouts at the school nudging them to invest their savings towards school expenditures. In the second variation, the payout is provided in a more restrictive form: vouchers requiring an education-related purchase. Students at a third group of schools serve as the control.

The results are as follows:

- Students in the cash payout treatment arm save more, whereas the voucher payment does not change savings.
- Students in the cash payout treatment buy more school supplies than both those in the voucher payout and the control group.
- Students in the cash payout treatment have higher test scores than both those in the voucher payout and the control group.

Short term results suggest that saving at school can help youth build good habits, and that those habits can affect educational outcomes. They also suggest, however, that a soft, less restrictive commitment savings account is more effective than a highly restrictive commitment savings account.

CASE STUDY 2.4 – AFLATOUN

John is nine years old. Sometimes he gets pocket money for helping out with a chore or as a present and he uses it to buy candy. He knows he needs a notebook and pencil for school, and that his parents might not want to buy one, but he would have to forego candy for a long time to buy the school supplies and he really likes sweets.

Aflatoun Ghana provided financial education to children between six and 14 years old as well as a school-based group savings scheme. One group received the Honest Money Box programme, a simple education programme geared towards children. A second group received the Aflatoun programme which also included an educational module on social values not covered by Honest Money Box.

- Neither group had increased financial literacy
- Children in the Honest Money Box programme had improved savings attitudes (the estimate for children in the Aflatoun programme was also positive, but not statistically significant)
- Both groups reported significantly higher savings
- Children in the Honest Money Box programme reported working significantly more, without any corresponding change in school attendance, whereas those in the Aflatoun treatment arm, that includes a social values component, did not increase labour supply. This result suggests that a financial education programme for children that does not include a social values component may have an unintended deleterious effect of encouraging child labour.



SECTION 3

BUILDING TRUST



NGOs can also play a critical trust-building role in financial inclusion. Several trust-based market failures may exist that prevent consumers and firms from coming together to form a more perfect union. Broadly speaking, when trust is an issue, a buyer and seller may have a perfectly good exchange to make, but one side, or both, does not fully trust the other party. In economics, this is referred to as moral hazard.

People may find an NGO more credible, and more likely to be acting in their interest than a for-profit firm. This suggests there may be room for collaboration, with the NGO playing the role of verifier and endorser, to help for-profit firms accurately and credibly convey the quality of their product. If people believe that the NGO is sincerely working to help them, they are more likely to take action based on the word of the NGO than the word of a firm whose primary goal is profit (even if the firm has a secondarily stated goal of social welfare).

We see evidence of this in a non-financial setting in Uganda. In a randomised test, Innovations for Poverty Action (IPA), in collaboration with a for-profit firm and a non-profit organisation, ran a horse race: using the same team of marketing agents, IPA randomised whether on a given day the agents represented the non-profit or the for-

profit firm, and coordinated a door-to-door sales effort of several medicines (*Fischer et al. 2013*). This allowed the researchers to hold constant the training of the staff, and ask simply whether people will be more likely to buy a product from a non-profit than from a for-profit, or vice versa. Lastly, IPA also randomised whether the product being sold was well known (Panadol, a pain reliever) or not (Zincaid, which helps improve water quality). Results were striking: for the well-known product there was no difference in the purchase rate. The marketers, when wearing shirts emblazoned with the for-profit logo, sell to 78% of households, and when emblazoned with the non-profit logo, sell to 79%. For the unfamiliar product the difference is large and significant: the for-profit sells 31% of the time, whereas the non-profit succeeds 49% of the time.

In financial inclusion, trust problems manifest in many ways. Households do not save if they do not trust the bank to engage in prudent practices, and therefore worry if their savings will be available to withdraw when needed. People do not borrow if they think the lender is not being upfront about all of the costs, or if they fear the lender will use extreme measures – such as public shame or physical violence – to collect bad debts. Farmers do not insure their crop if they do not trust the insurance company to pay out their claims.



Financial institutions need to be trusted, by clients and investors, in order to succeed. NGOs are in a position to provide information to these populations, both on which for-profit institutions are trustworthy, and on product choice. Non-profits have the ability to build the technical knowledge base to properly evaluate institutions, and many have good reputations either locally or nationally, which they can use to give weight to their evaluations. NGOs could evaluate the transparency and practices of institutions, and endorse the ones that adhere to certain principles. An NGO could help establish guidelines for lenders, monitor their activities and endorse whether or not they are engaged in responsible practices from the perspective of the borrower. Are there hidden fees? What are the methods used for collection of bad debts? Are the costs presented in a transparent and usable fashion for clients? See case study 3.1 for an example of this, the Smart Campaign.

NGOs could even play a more active role and, for instance, co-market new products with for-profit firms. These are similar roles, but certification of microfinance institutions (MFI) that provide high-quality products and have proved themselves to be trustworthy and reliable may be the simplest option. It is less active in terms of on-the-ground engagement with consumers, and therefore less

costly than the latter. Collaborative marketing of products that are suitable for specific populations has the benefit of both increasing trust in an MFI generally, and recommending a specific product that is likely to have the best terms for populations. In both of these examples, there is a potential long run path to sustainability, either by collecting revenue to cover the costs, or by eliminating the trust problem. See case study 3.2 for an example of this for the introduction of rainfall insurance for farmers.

NGOs could evaluate the transparency and practices of institutions, and endorse the ones that adhere to certain principles.

CASE STUDY 3.1 – SMART CAMPAIGN

Michael wants to take out a small loan to start his business. There are two microfinance institutions (MFI) in his town, but he doesn't have any friends or family members who have taken out loans at either one before. How should Michael know which bank to use?

In response to a recognised need to promote and demonstrate safe and responsible treatment of microfinance clients, the Center for Financial Inclusion convened industry leaders from around the world in 2008 to launch a campaign to establish, develop and embed Client Protection Principles into the microfinance industry. The seven principles are: (1) appropriate product design and delivery, (2) prevention of over-indebtedness, (3) transparency, (4) responsible pricing, (5) fair and respectful treatment of clients, (6) privacy of client data, and (7) mechanisms for complaint resolution.

In its early years, the Smart Campaign worked to raise awareness on the importance of client protection among MFIs, investors, national associations, donors etc. and encouraged stakeholders to commit to improving their practices. For this work the campaign created indicators against which institutions could assess their performance as well as a series of tools to address specific gaps or weaknesses. The campaign worked first to win endorsers and then to help them implement the principles through diagnosing and improving their own state of practice through assessments, tools and training.

However, the campaign and its leadership realised that self-reporting alone could not provide confidence that the Client Protection Principles were actually being followed. Verification by an objective third party was needed and the campaign began work on a Client Protection Certification programme. The certification programme represents the output of several years of industry collaboration and input, managed by the

Smart Campaign. Since June 2010 the Smart Campaign has been working with the microfinance industry through a Certification Task Force of over 30 experts representing various stakeholders, to develop a Client Protection Certification Program. As a result of the Task Force discussions, the Smart Campaign developed a Certification Proposal, which they opened to a period of public comment from October – February 2012. The proposal contained a list of standards of client protection against which certification would measure compliance, as well as a proposed methodology. Following the period of public comment the Smart Campaign launched a year of certification pilots within which the methodology and standards were tested and finalised. The Campaign has since licensed the four specialised microfinance rating agencies, Planet Rating, MicroRate, Microfinanza Rating and M-CRIL, to conduct certification missions. January 2013 represented the launch of the full programme. To date nine institutions have become Client Protection Certified, with a pipeline of dozens more undergoing missions or in preparation.

Certification status will inform industry stakeholders, such as investors' decisions about supporting organisations and regulators' efforts to better understand and address client protection issues of microfinance service providers. Many industry stakeholders including investors like Deutsche Bank and Oikocredit, international networks like the Microfinance CEO Working Group, and donors have publicly committed to help support and incentivise their MFIs to become client-protection certified.

The campaign's long-run vision is to provide a similar service to microcredit clients, to create a 'trust-mark' that clients can use in selecting their financial service provider. The campaign and its partners are conducting exploratory market research of client perceptions of certified and non-certified providers in Eastern Europe.



Consumers using banking services in Haiti

CASE STUDY 3.2 – RAINFALL INSURANCE

Richmond is a farmer in Ghana. He knows that the weather is unpredictable and that if it rains too much or too little he could lose a large portion of his yearly earnings. He knows that he could buy rainfall insurance from a company that says they will give him money if it rains far more or less than usual, but he is worried that it is a scam, or simply won't really pay out, that there will be too many rules that he does not understand. What should Richmond do?

A randomised evaluation of rainfall insurance demonstrated the importance of trust in launching a new product (Karlan *et al.* 2013). In the first year of the programme, researchers offered farmers in Northern Ghana either free or subsidised rainfall insurance. In the second year, researchers then observed whether the first year experience changed whether farmers bought insurance. All households were offered the insurance at one of several randomised prices.

- A farmer who received a pay-out from the insurance (i.e., experienced bad rainfall) was more likely than the control group to buy the insurance the following year.
- A farmer who did not receive a pay-out from the insurance (i.e., did not experience bad rainfall) was less likely than the control group to buy the insurance the following year.
- If more people in a farmer's social network received a pay-out, the farmer was more likely to buy insurance in the subsequent year.

This all adds up to a likely trust story, one which is fairly stark, in that lack of pay-out is actually worse than no experience with the product at all.

In India, researchers tested out a myriad of methods to increase purchase of rainfall insurance (Cole *et al.* 2012). Before the start of monsoon season, a trained insurance educator visited households to present information on the features of the insurance, and households were given the option of buying insurance then or later if they desired. Researchers tested whether endorsement by a trusted individual could help improve the purchase rate. Endorsements were made by Livelihood Services Agents (LSAs) from BASIX, a locally known microfinance institution. The agents were locals who worked closely with the villages on a series of different financial products; they would introduce the educator, and ask the household to listen.

In households serviced by an endorsed insurance educator demand for insurance was 36 per cent higher than in those with a less-trusted educator.

Being in a village with endorsed household visits also significantly increases demand for insurance.

These results suggest that trust is a significant factor in households' decision to purchase rainfall insurance.



SECTION 4

CONCLUSION



The non-profit community cleared the path for for-profit financial institutions to provide financial services to the poor around the world. This has created a conundrum: what is next for the non-profits? Non-profits, with donor money in hand, should direct their resources to issues that actually require a subsidy. Naturally donors and non-profits could shift entirely, focusing on health or education. But this would be unlikely and unfortunate, as it would miss out on several market failures that persist in financial services for the poor.

Here I have put forward three roles that non-profits could engage in, that could responsibly use donor funds to help mitigate market failures that persist. First, is to simply learn from the past 30 years of non-profit-led innovation, and continue the march. The products offered by the microcredit world are often rigid and formulaic, not flexible, and not tailored to the needs of customers. Yet firms can be conservative, and unwilling to take on risks, particularly when the main beneficiary may be the client, not the firm. The same could have been said 30 years ago, and non-profits took the lead in figuring out how to do basic lending to the poor. Non-profits could and should continue this charge, and help figure out better ways of financing the needs of the poor.

Second, despite the expansive reach of microcredit, many remain unreached. The too rural, too poor, or too young, remain important market segments from a social welfare perspective. It may be that, as with the case made above for innovation, more adjustment will help solve the cost issues in servicing these markets, and then for-profits will enter. As has been the case for traditional microcredit, this would be a marker of great success for the non-profits.

Third, trust is a large barrier to innovation and market development. There is evidence for this at macroeconomic levels (*Acemoglu and Robinson 2012*), as well as microeconomic levels, such as the introduction of rainfall insurance as discussed earlier. Non-profits, under the presumption that people may trust them more, can help develop markets by helping people feel more comfortable that the offer is valid and trustworthy.

Naturally these are merely ideas. Some may not work. Some may be good ideas, but implemented badly. How do we know if non-profits are fulfilling their mission? The non-profit space has a fundamental and intrinsic incentive problem.

For all three activities, innovation, reaching the unreached, and building trust, there is a long-term aspiration for the financial inclusion world: to transfer successful ideas to the for-profit sector.

This incentive problem is described succinctly if we start with a basic understanding of what makes for-profit firms stay alive or go out of business. The mission for a for-profit firm is simple: earn profits (some businesses may claim to have a 'double bottom line', but alas this is not in lieu of profits). If a firm is profitable, it will stay in business. On the other hand, if a firm embarks on a bad idea, or implements a good idea badly, it may lose money. Unprofitable firms eventually cease to exist.

What determines if a non-profit stays in operation? Unfortunately, achieving its mission is not the determinant of survival, but rather raising money is. A non-profit may be brilliant at its programmes but horrid at fundraising, and thus go out of business. Or vice versa, a non-profit may be brilliant at its fundraising but horrid at its programmes, and thus stay in business. To solve this problem, either donors must demand accountability, or management of NGOs must demand it of themselves.

For all three activities, innovation, reaching the unreached, and building trust, there is a long-term aspiration for the financial inclusion world: to transfer successful ideas to the for-profit sector. We aspire for that because of the private sector's ability to take ideas to scale, and keep them there. But we are not there yet. Although for-profits do provide tremendous value in financial inclusion, many gaps remain. Non-profits can actively work to innovate to figure out how best to fill the gaps, and ideally leave behind a clear trail of evidence, for others to learn and follow (or avoid). If the non-profits succeed, making financial exclusion a concept of the past, then they will find themselves looking around and noticing, once again, that for-profits seem to have entered their space and competed them out of business. This would be a true sign of success.

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Footnotes

1. For simplicity, I am treating “requiring subsidy” as synonymous with “NGO,” since these often but not always are aligned as such. My focus here, however, is on the role of subsidies in financial inclusion, and not the legal structure of the entity.

2. However, media reports of the lack of impact are often exaggerated, despite the authors’ public efforts to correctly characterise the results. For example, see a Boston globe article (*Bennett 2009*) and response (*Banerjee, Duflo, and Karlan 2009*).

3. Naturally the microcredit supporters are not a monolithic being with only one view, and one can find ambitious as well as modest claims about the impact of microcredit from microcredit institutions. For an example of the more ambitious claims, one press release from 2006, signed by six of the leading microcredit institutions in response to the randomised trials discussed in the above paragraph, stated that “Increased income generated from these businesses allows them to pay school fees to educate their children, stabilise food sources, and pay for other expenses that lead to the improvement of the health and well-being of their families.” (*Accion International et al. 2013*).

4. See Centre for Women Co-operative Development (*2012*).

In the past several decades, the non-profit sector has made huge inroads in expanding access to financial services for the poor around the world. Now for-profits have moved in and dominate in many markets. Is there still a role for the non-profit sector in financial inclusion for the poor? If so, what exactly is the area where a subsidy is warranted? This report focuses on three roles for non-profits: to innovate; to reach those too young, too poor, or too rural for the for-profit financial institutions; and to bridge trust gaps.

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