Beyond Microcredit: Delivering Financial Services to the Poor through Agent Banking

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Anyone interested in issues related to the developing world is likely to be familiar with the concept of microcredit. Most people have heard of Muhammad Yunus and his work with the Grameen Bank. The idea behind microcredit—the notion that tiny loans to very poor micro-entrepreneurs, usually women in the developing world, can be a pathway out of poverty as entrepreneurs invest these modest sums in their small businesses—has now become standard within economic development policy and academic circles.

For the past thirty years, I have had the opportunity to work in this field. What this work has given me is a particular understanding of the financial lives of the 2.6 billion people in the world who live on less than $2 a day. Understanding the financial lives of people living on less than $2 a day has not only inspired our work at the Bill & Melinda Gates Foundation, this understanding has been the basis of a more nuanced and sophisticated set of strategies for meeting the financial services needs of the poor—strategies that go beyond the microcredit model. What I will describe here are some of the challenges associated with delivering financial services to the poor and the strategies we are supporting to overcome those challenges.

We started by considering the perspectives of all the 2.6 billion people living on less than $2 a day, not just micro-entrepreneurs and not just women. We wanted to gain a better understanding of everyone in this category and the wide variety of things they do, and then to consider how financial services could be the most helpful in their lives. We asked, “What kind of intervention can an organization like ours make that will produce the greatest impact for a much broader set of people?”

In their book Portfolios of the Poor, Collins et al. (2009) describe, in detail and on a weekly basis, the financial lives of hundreds of poor people in Bangladesh, India, and South America. In the context of particular families, the authors track all the money coming in and going out. What we learn from reading this book is that no matter how

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poor people are, they lead very, very complex lives—far more complex and difficult than ours. And I do not mean “difficult” in the sense you might expect, as in “they are poor, so their lives must be difficult.” What I mean is that in order to meet the goals they consider essential—sending their kids to school, getting to a doctor if their child is sick, repairing their roof if it is damaged, or providing for themselves in old age—they must overcome many obstacles besides the fact that they are poor. They are trying to accomplish many of the same essential things that we are trying to accomplish in our lives. But they must attempt to accomplish these important and essential goals without the financial tools that we are accustomed to using.

Just imagine that you did not have access to an organized financial system. How would you accomplish those very important life goals? How would you pay for your children’s education? Would you arrive at the college or university with a wheelbarrow and a satchel of money and drop it off at the admissions office? How likely would it be that you would make it to your destination without being robbed? It is almost unimaginable to us how life would exist without financial services. But this is the reality for people living on less than $2 a day; 90 percent of whom will never see any form of financial services unless we are successful in our work.

But it is for this reason that the financial lives of the poor are so complex and difficult. People have to plan for and organize their lives around the things that matter most but without the benefit of formal financial services. Instead, they must rely on informal means. Instead of putting their money in a savings account, they will put it in a little tin and bury it in the yard, or they will stick it deep in the rice bin, or they will buy gold jewelry so that when they need to get cash in a hurry, they can go to a pawn shop, or they will buy extra animals, hoping they will be able to sell them when they need to.

Holding cash within the household presents several problems if the goal is financial stability. Not only is cash vulnerable to theft, keeping cash within the household makes it far more difficult to maintain financial discipline. In order to get cash out of the household, people will lend money to a neighbor or ask a neighbor to hold on to money so that it can’t be used for something else. Collins et al. (2009) find that poor people typically adopt ten to fifteen different informal strategies to manage their financial lives. The problem is that these strategies are costly. If you lend money to your brother because you wanted it gone from your house and he needs it, what are the chances that you are going to get your money back when you need it? If you have purchased a sheep as a way to store $20 worth of value and your child is sick, how do you get the $5 out of that sheep to go to the doctor? If you sell the sheep, everybody in the village knows that you are in a hurry to sell. Under such circumstances, you are not likely to get anything close to $20 for the sale of your sheep.

The informal means that people deploy to save or organize their finances actually degrade value. People lose roughly 20 percent a year on average, in the value of their savings. Informal means of holding assets in reserve in case of emergency are similarly problematic. Fifty-five percent of poor people in the world end up in poverty due to health shocks. When a medical condition strikes a family member, the family starts selling assets to replace income or to pay for healthcare, and frequently they fall into poverty.
While many people have some sense of the magnitude of poverty in their own country, few recognize how dynamic poverty is. Any given rate of poverty tends to disguise the fact that a very large number of people are climbing their way out of poverty every year, and a very large number are getting pushed back into poverty every year. Health shocks and other forms of vulnerability are the common cause for why so many people are pushed back into poverty.

In developing programs that provide financial services, much of our focus is to reduce these kinds of vulnerability through the use of financial tools. The central question we ask is, “What are the kinds of financial tools that help people reduce their vulnerability and enable them to climb their way out of poverty?” But the challenge is that the 2.6 billion people living on less than $2 a day don’t have a lot of money and don’t have a lot of annual income. If you are living on $50 a month, you will typically be transacting a dollar or two at a time. If a banking system is to serve the poor, it needs to be able to engage in very small transactions.

The challenge facing the typical market trader operating in the informal sector is this: If she has an extra dollar or fifty cents and would like to save it, is there a system possible that can serve her at the end of that workday? If she gets home with the dollar in her pocket, she won’t come back to the marketplace the next day with the dollar still intact. One of her children is going to badger her to death for something, or perhaps her husband will take it from her. Something will happen such that she won’t be able to come back the next day with that dollar.

The question we need to ask is whether there is anything we can do to help her get that dollar out of her possession and into the banking system every single day so that maybe the family that lives on $50 a month can have reserves at the ready to face an emergency. If they need $10 to see a doctor, is there a safe, affordable, and easy way to get that $10 without destroying the value of their remaining assets? That’s our challenge. Can we manage transactions of $1 or $2 or $5 in a way that is sustainable and viable in the banking system? If we could, we can imagine financial progress for the vast majority of the world’s population who need but have no access to financial services.

But achieving that sustainability and viability is very difficult. Every time you or I stand in front of a bank teller it costs the bank somewhere between $0.80 and $1. And many of the costs of providing financial services in the developing world are higher still. Depositors make small transactions in small denominations. The bills they deposit are usually wadded up and dirty, which makes them difficult to handle. A transaction that costs the bank roughly $1 in the US can cost $3 in the developing world. And if we want the bank tellers to be nice to people, that increases the cost even further because then our tellers will have to chat a little bit. This may sound like a small thing, but such interactions tend to be highly valued by poor people who want to be respected and want to develop a relationship with the organization handling their money. From the bank’s perspective, that doesn’t work. Nor does it work from the customer’s perspective. For the typical poor client, the nearest bank branch will require at least an hour’s journey and payment of $1 to $2 to someone to take them there. The time spent in line can be significant, costing both the bank and the client.
As you can see, this whole system isn’t working very well.

And yet, we are at this moment facing a historic opportunity to develop an entirely new technologically driven business model for carrying bank services to where people actually live and work. We are now finding ways to turn the old banking model on its head. Instead of requiring the client to travel to the bank, we are now developing ways to bring the bank to the client. By bringing banking services to the doorsteps of where people live in their villages, they don’t have to pay money for transportation. They can send their deposits in the normal course of a working day to a banking institution.

Led by southern countries like Brazil, Mexico, Kenya, and Philippines, this “agent banking model” has been spreading around the world. Banks are signing up with retail networks like a post office, a lottery chain, or a mobile phone company. Retail networks such as these are able to use their distribution networks to capture financial transactions that are then sent to banks. What this amounts to is a teller who goes to where the clients are—someone who will make one-tenth of what a bank teller will make—to make the transactions at a fraction of the cost for the banking system.

One of the biggest success stories unfolding right now, and likely to chart the course for the future in much of the developing world, is taking place with Kenya’s M-PESA service. “Pesa” means money, and “M” is phone. Most phones in the world, particularly in the developing world, do not have prepaid plans; customers buy airtime minutes as they are needed. This arrangement, by which someone can purchase as little as five minutes of airtime, has fostered a significant increase in cell phone use around the world. This has also meant that cell phone companies have developed vast networks of people who sell minutes. Kenya has one of the biggest agent networks across Africa, with approximately five thousand M-PESA agents and fifteen thousand agents overall who sell minutes all over the country. In any market area, you can find dozens of people selling minutes from kiosks just large enough for one agent to sit at a table to conduct the transactions.

Because these agents are already set up to receive cash for airtime, they can just as easily receive cash for deposit, and with the use of a cell phone, can have that money credited to the customer’s account. And just as easily, for a nominal fee, that money can be sent back to a client’s family in their home village. This is extremely valuable in a context like Nairobi, where many people have come to work in anticipation of sending money to their families in their home villages. For example, a woman in the village may receive a text message from her son working in the city: “Hi Mom, I just sent you some money.” The mother goes to another agent, again operating from a small market kiosk close to where she lives, who can access the relevant account and disperse the cash to her. The growth of this system has been staggering. It has grown from 0 to 7.5 million clients in almost three years. Given that there are about 18 million Kenyans, this practice is changing the economic life of Kenya at an unprecedented pace.

So far, this system is just a system that sends money around. What will be very interesting—what’s on the verge of happening in Kenya—is that networks are starting to negotiate with banks to have their agents serve as the front-end transaction system.
for bank accounts.

We are also beginning to see initiatives like this develop in rural communities in Brazil, where agent banking was put in place about four years ago, not with cell phones but with cards and machines that can access accounts through the information embedded in the card’s magnetic strip. Such machines are deployed in Brazil in post offices, lottery outlets, and mom and pop stores, connecting previously unconnected villages up and down the Amazon.

As this system has developed, economic activity in the rural villages and towns on the river has increased. Prior to this system being in place, municipal employees, school teachers, and other people receiving government payments had to travel down the river five, six or ten hours to find the nearest bank branch before getting paid. Now, most of these people can get paid in the same building where they are living or working. This has meant that the economic activity in those villages has increased substantially. It may very well be that over time, delivering financial services to where people live and work may lead to profound changes in the volume and diversity of the goods and services exchanged in these smaller local economies.

In the area of microfinance, the key contribution of the Bill & Melinda Gates Foundation has been twofold. First, we are supporting and developing agent banking models like those I have described here. We are looking for ways to develop financial systems based on agents who are already in the villages. We are developing financial products and services that can ride on top of other transaction systems, which will then hopefully lead to higher-value products that will encourage people to save even more.

Secondly, we are focusing the attention of the microfinance community on the power and impact of providing a safe place to save. It is essential that we get the savings back into the microfinance equation. The solution cannot only be about microcredit. By making saving services available to people at extremely low cost, we think that the microfinance community will come to recognize that there are more people who desire to open a deposit account than want a loan. This is exactly what has been demonstrated with banks that we have supported in Congo, Malawi, and other countries in Africa. For every single client seeking a loan, we see five to ten clients coming in to open a deposit account.

This is a striking result that compels us to focus our attention beyond microcredit alone. To work well, microcredit requires the existence of investment opportunities. But consider the investment climate of, say Congo. While there may be some investment opportunities, they are small in number and magnitude relative to clients’ need to just keep their cash in a secure place outside of the household. In the entire country, there are only about five banks and virtually no bank branches outside the capital city of Kinshasa. If you look at the distribution of formal banking services across Africa, you will find virtually no presence of banks where most people live and certainly no presence in the neighborhoods where people live. So, this is a fundamental challenge. The only way to deliver banking services to the bulk of the population any time soon will be through an agent banking model.

In conclusion, we think there is a real opportunity to move the gauntlet on
affecting peoples’ lives through financial services if we bring those services to where they live and work, and in a manner that is safe, affordable, and easy to use. By making their financial lives less complicated and less difficult, the agent banking model is having a profound impact on the lives of people living on less than $2 a day.

References