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Bridging the Gap:

THE BUSINESS CASE FOR FINANCIAL CAPABILITY

Executive Summary

MONITOR

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The Financial Capability Gap: Large, Urgent and Expensive

Between 500 million and 800 million of the world's poor now have access to finance—yet our research suggests that only 110 million to 130 million of that number have received any sort of financial capability training.[1]

In other words, only 25% of these many millions have been taught how to use their newfound access to the world of formal finance wisely and to their advantage. That leaves 75%—a staggering 370 million to 690 million individuals—out in the dark, forced to make decisions about their borrowing, their savings and their entire financial future with little help and little instruction.

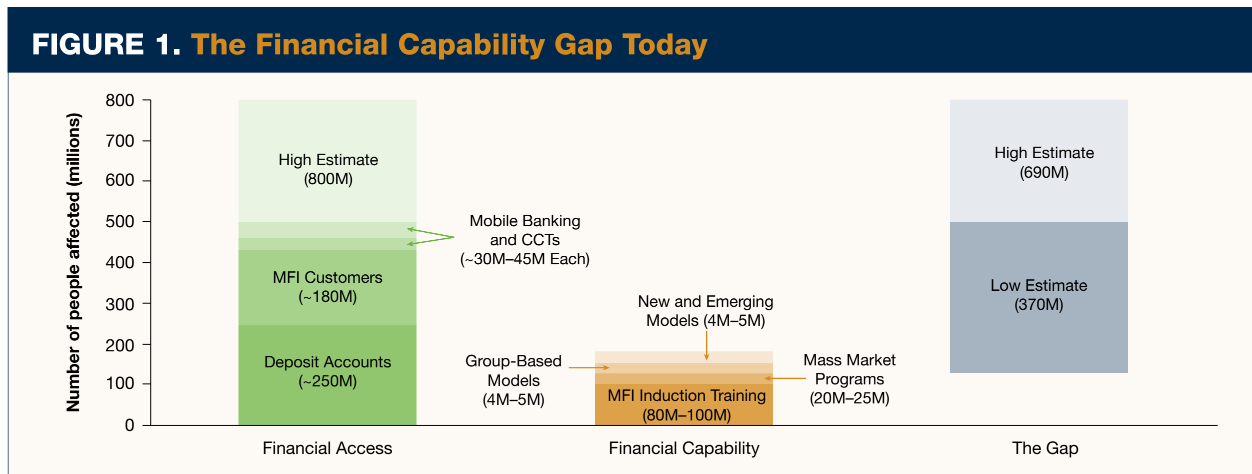
This is the **financial capability gap**—a chasm that exists between those who have been empowered to responsibly engage with a formal financial system that is utterly new to them, and those who have not. And yet, these hundreds of millions do not even take into account the 2.7 billion people who according to CGAP are unbanked today. And if the current trend of financial capability lagging access to finance continues, then this gap is certain to get bigger.

The good news is that the industry is starting to recognize the importance of addressing this gap.

> Of the 500 million to 800 million low-income consumers who have received access to finance, only about 110 million to 130 million have received financial capability training of some sort. This "capability gap" is massive, and addressing it is an urgent priority for the field.

A 2011 CFI/Accion survey of more than 300 MFI industry participants ranked financial literacy of clients as both the top enabler and the top obstacle to achieving full financial inclusion—with 57% selecting the issue as the number one concern.

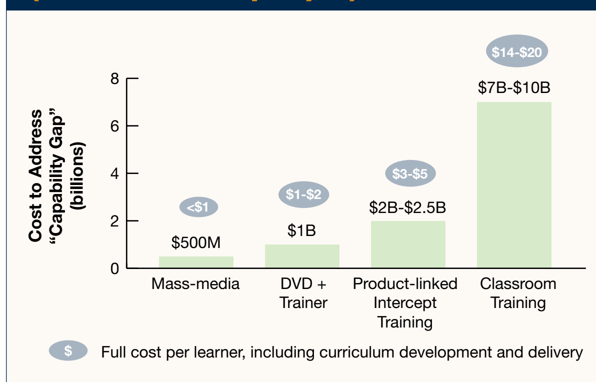
FIGURE 1. The Financial Capability Gap Today



[1]All statistics included in this executive summary are explained (and sourced) in our full-length paper.

And yet the costs of closing this gap using the current approaches in practice today will be enormous. Financial education—the primary vehicle through which financial capability has traditionally been delivered and instilled—has a high cost per learner to deliver, with the field's dominant classroom models costing anywhere from $14 to $20 to deliver. Depending on the combination of models used, our estimates suggest that it could cost anywhere from $7 billion to $10 billion to begin to provide financial capability just for those who *already* have access to finance, a sum equal to 10% to 15% of the total current asset base of microfinance institutions worldwide.[2] If access to finance were to be expanded to include the rest of the vulnerable low-income populations who are unbanked today—about 2.7 billion people by CGAP estimates—the cost of building financial capability would rise further by a factor of at least three.

FIGURE 2. The Costs of Addressing the Financial Capability Gap (est. at ~500M people)



But there are considerable costs associated with not addressing the gap as well:

- First, there is simply the moral imperative for the global community to empower low-income clients to take control of their own financial needs. Providing low-income earners with access to finance is critical—but not also giving them appropriate capabilities to use financial products and services leaves them at a dangerous disadvantage. Increasing the appropriate use of savings, insurance and other products might also significantly improve development outcomes—if done well.

> Depending on the combination of models used, it could cost anywhere from $7 billion to $10 billion to begin to provide financial capability just for those who *already* have access to finance.

- If access to finance continues to outpace financial capability, then low-income markets could easily—and quickly—become saturated or near-saturated with products and services that a shrinking proportion of people fully understand how to use. If increasing numbers of low-income customers who lack financial capability adopt these products and services, the results could be dangerous. Risks to customers include over-indebtedness, inadequate cushioning from shocks and loss of income and assets. Risks to providers also stem from having a customer base unfamiliar with basic financial principles, which can result not only in exposure to greater levels of operating risk, but also political risk and less tolerance for such lending on a societal level. And, as it did in the case of Andhra Pradesh in India, this can result in political backlash, tougher regulations and a questioning of these institutions' "social license to operate."
- *Not* addressing the gap is potentially an enormous missed opportunity for financial institutions and low-income individuals alike. The widespread uptake of financial products like microinsurance, pension and mutual funds, and mobile banking will depend—at least to some degree—on the ability of customers to understand and comprehend the features and benefits of these

[2]MixMarket reports the total assets held by MFIs to be $62 billion to $66 billion for 2011.

services and products, and the value of savings and managing risk. The uptake and usage of these offerings will be quite limited if their intended customer base does not know what they are or how to use them. Developing new and better ways to deliver financial capability could be a major engine of scale that leads to retention, reduced risk, the cross-selling of important services like savings or insurance, or other commercially viable outcomes.

Given the current economic environment, in which governments, donor agencies, foundations, and NGOs face limited and shrinking public funding, are severely constrained and face myriad competing priorities, it would be a mistake to assume that the public sector will cover these costs and address the gap. Any solution will require a mix of funding sources—but financial institutions will have a strong, if not central, role to play.

The Financial Capability Landscape: Concerns About Older Models

Although it is not by any means the only enabler of financial capability, financial education has long been the primary tool for addressing the gap. Some financial training has been offered or funded by central banks, NGOs and others. But much of the training has been delivered by or via financial services providers, who have focused on building the capacity of low-income customers in MFI settings, usually through classroom-based group trainings.[3]

During our research into these financial institution-delivered models, we interviewed leaders and staff from more than 90 organizations involved in the financial education ecosystem and documented scores of different programs and models being implemented by these and other organizations.

> Little is known about the effectiveness of the current dominant models. There is currently little cost recovery and therefore little business case for these models, which makes them nearly impossible to scale.

Indeed, 75% of the financial institutions we contacted reported that they were engaged in some form of financial capability building.

For MFIs, the main mode of delivering financial education has traditionally been **induction training**—a specialized training delivered by loan officers to new MFI customers in group settings, often over a “waiting period” and usually prior to extending a first loan.[4] This has been a scalable model, as MFIs have usually covered this cost—roughly $0.50 per customer—out of operating revenues. Induction training is by far the dominant model in this space, having reached **80 million to 100 million low-income customers** so far. However, in highly competitive credit markets (e.g., parts of Latin America, Bangladesh), many MFIs are moving away from this upfront training because significant numbers of borrowers are opting to sign on with institutions that allow access to services and products without any training requirements.

The other primary model of training by financial institutions is **classroom-based group training** for existing customers, which has traditionally been grant funded. According to our estimates, group-based programs have reached somewhere between 4 million to 5 million people—though the largest single program we surveyed had reached about 350,000 customers in multiple locations.

[3]It should be noted that this paper is primarily concerned with product-linked financial education programs delivered by or on behalf of financial institutions and their partners; it does not focus on the financial education models offered independent of financial services—for instance, school-based financial literacy training offered by the public sector—although this too is an area that requires further rigorous research. The focus on product-liked models delivered by financial institutions stems from our belief that the key to addressing this gap rests in large part in investing behind self-sustaining efforts for which there is a compelling business case, incentivizing financial institutions to build capability among customers.

[4]Induction training generally covers topics like basic financial management, product features and attributes, and group and repayment discipline.

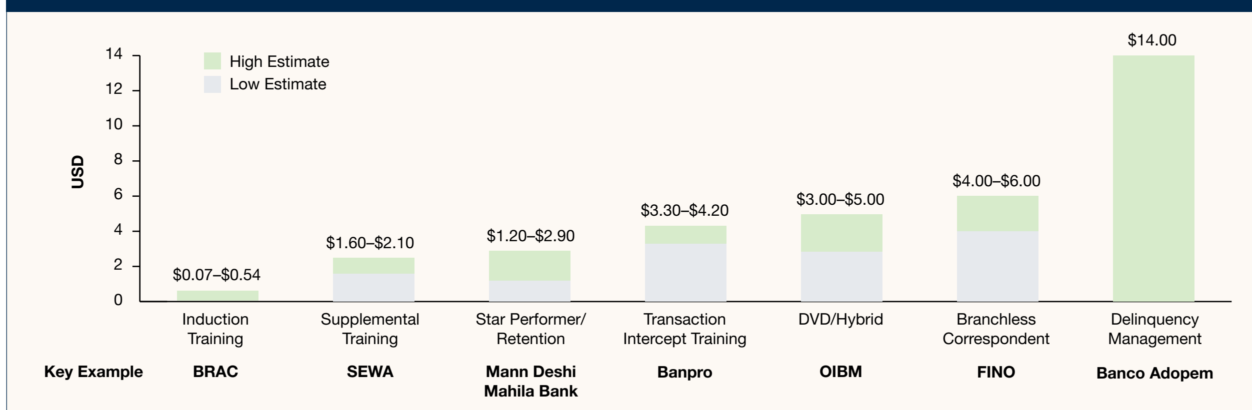
The cost of providing this training, in the absence of a business case for the provider, has been high. Group-based models cost $1.20 to $4.00 per learner on a marginal delivered-cost basis; on a fully loaded cost basis, they can cost $14 to $20 per learner. There has been some experimentation with adapting curricula to mass-market models using DVDs and broadcast channels well, in order to reduce delivered cost per learner. These reach more people but there are currently few data points on their effectiveness.

Roughly 65% of the financial institutions interviewed for this research—including those who believe that financial capability is critical—viewed financial education as a cost center, not a strategic investment. Few have explored whether there exists a business case or a cost-recovery rationale for these programs. Still fewer have experimented with segmenting customers, deriving rationales or business cases for financial education or exploring whether such capability can be supplied as a value-added service.[5] But developing such self-sustaining models will be critical to narrowing the capability gap. This is especially the case in the current resource-constrained philanthropic and aid environment, where there will likely never be enough grant money to extend financial education to billions of people.

Beyond the cost considerations, one of the major obstacles to adoption is the very limited data on the effectiveness of financial education programs and what works.[6] This is especially so regarding group-based classroom training. In the words of a 2010 World Bank study:

“The limited empirical evidence does not lend strong support that financial education is effective, i.e., that it has documented and consistent positive impact on financial knowledge and/or behavior. Most international reviews of the sparse evidence come to similar conclusions as Atkinson (2008): ‘There is little in the way of robust evidence to show the overall effect of financial training.’ This conclusion is valid across different types of intervention from more academic training in schools to more ad hoc training at the work place.…This calls for caution and not pushing for more of the same until better evidence is at hand.”[7]

FIGURE 3. The Marginal Cost of Delivery on a Per-Customer Basis



[5]The exception to this is MFI induction training, which serves as a risk-mitigating investment of loan officers’ time. To some extent, the already low PARs in the microfinance industry may have contributed to this perspective. After all, it leaves very little room for improvements in performance from repayment or retention.

[6]“While the number of financial education interventions to improve financial literacy has increased dramatically, a rigorous monitoring and evaluation of such interventions is still the exception and not the rule, particularly with regard to the measurement of impact,” Robert Holzmann, *Bringing Financial Literacy and Education to Low and Middle Income Countries: The Need to Review, Adjust, and Extend Current Wisdom*, World Bank, July 2010.

[7]Ibid.

CURRENTLY, THE DOMINANT CLASSROOM-BASED MODELS OF BOTH STANDALONE AND PRODUCT-LINKED FINANCIAL EDUCATION:

- Reach only a fraction of their intended audience
- Are neither affordable nor scalable for most financial institutions, nor seen as central to the business
- Are built on a mode of delivery—i.e., classroom training—that is time-consuming and shows little proof of effectiveness
- Are not tailored to the evolving modes of (potential) access to finance now available to low-income customers (e.g., mobile money, microinsurance, correspondent banking and remittance/G2P transactions)
- Assume that financial capability is mainly delivered through training—and one-time training at that

About one in five MFIs we contacted suggested that they were reluctant to invest more in capability work because they were uncertain that it even changed anything. In addition, the evidence base is completely underdeveloped on customer preferences or viewpoints, or even their willingness to engage in or pay for education. There are also no baseline data to use to measure improvements, although some new initiatives are under way toward this goal.[8]

The Next Generation of Financial Capability Models

Older, more traditional models of financial education are now being questioned—due to effectiveness concerns, competitive pressures or because they have not proved cost-effective or self-sustaining. Designed for a world in which customers access finance via "bricks and mortar" deposit accounts or high-touch microfinance relationships, these older models have not kept pace with new and fast-growing modes of access. Low-income customers increasingly engage in formal finance, or have the opportunity to do so, through transactional touch points—such as government-to-person payments, remittance collections and "branchless" or mobile banking—that are growing 24% to 76% annually. These new modes of access place a significant premium on new and diverse approaches to financial education that are geared toward individual, shorter interactions.

Two examples of experimental new models are "star performer" and "delinquency management." The first offers specialized training to existing high-value customers, and the second targets potentially delinquent current customers (both are documented in detail in our full-length paper). In both cases, the financial institution segments its customers to target a narrower selection of the customer base. Incentives for the customer are aligned with those of the financial institution, and both models offer evidence of a potential business case for the financial institution.

> Roughly 65% of the financial institutions interviewed for this research—including those who believe that financial capability is critical—viewed financial education as a cost center, not a strategic investment.

[8]For example, the Russia Trust Fund for Financial Literacy at the World Bank recently set out to create a baseline understanding of the effectiveness of financial education and attempt to develop standard metrics for the field. And efforts like DfiD's Financial Education Fund, which built evaluation into the funding so that learning can be shared field-wide, should become the norm.

> Though there are promising early developments in the field with regard to innovative models, much remains to be done to test and prove them out.

Another innovative model targets potential customers—or customers who only engage with a single transaction—with individual training. In Latin America, several groups are experimenting with models that intercept customers at the point of a financial occasion—either a conditional cash transfer (CCT) or remittance transaction—to provide short, targeted training lasting less than an hour on key financial issues like savings. Other new models rely on banking agents to provide a series of very short financial education sessions—a few minutes in length—attached to a product interaction, as with Microenterprise Access to Banking Services (MABS) in the Philippines or IFMR's Kshetriya Gramin Financial Services (KGFS) in India. Yet another innovation employs new technologies to lower the cost of training—for instance, in an experiment that combines DVD-based training with reinforcement from individual trainers to lower costs of delivery in Malawi. Many of these innovations have frontline agents of financial institutions delivering both a product and financial education, which means that some financial education and capability building will look close to product marketing, especially in the case of savings, insurance or other services that require some explanation or convincing of the value. This suggests a role for regulators and policymakers, which we address in the section on recommendations for a shared agenda.

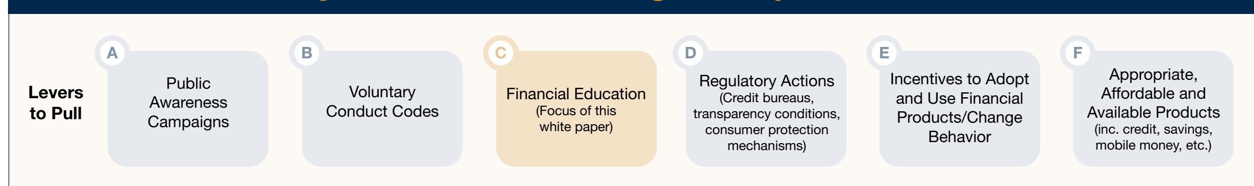
For all of these models, much work remains to be done in terms of further innovating, analyzing, documenting and propagating the business case (if any) while also ensuring there is a robust evidence base for what works and what does not. But many of them offer promising alternatives to traditional classroom-based approaches.

The Need of the Hour: Coordination, Innovation and Support

Given current considerations of cost, scale and effectiveness, much needs to change in the product-linked financial education landscape. For each old or new model, the field must take into account *what works* (effectiveness of a model in promoting behavior change), *cost reduction* and *cost recovery* (the extent to which there exists a business case).

Yet the entire gap will not, and cannot, be filled solely by models for which a business case exists. And, as Figure 4 shows, many other solutions will be required as well, including interventions that do not rely on financial education at all, but rather on a combination of other levers. Industry bodies are emphasizing voluntary conduct codes; regulatory actions encompass transparency conditions and grievance channels; newer experiments are using incentives to directly bring about positive financial behavior, e.g., savings; and simpler, better and easy-to-use products are entering the market.[9] Indeed, in a number of cases capability will be built

FIGURE 4. **The Many Levers for Addressing the Gap**



[9]The full-length paper has examples of each of these approaches in Chapter 2.

FIGURE 5. Four Initiatives for a Field-wide Shared Agenda

more through these other means. Even publicly funded mass-market efforts will have a role to play in reinforcing the financial capability messages encountered elsewhere. Nonetheless, in many cases, there will be a shared interest between the public good and the private provision of services, where building financial capability will have a cost recovery logic—and this set of interventions can address a significant portion of the gap.

Developing and propagating these efforts efficiently will require coordination and alignment across a range of players in the field—including financial services providers, foundations, NGOs, and other philanthropic funders, and regulators and policymakers.

A Shared Agenda for Progress

The field of financial education and financial capability is still in its early days, and much research and experimentation remain to be done to figure out which kinds of financial education programs and interventions work and which do not in terms of both cost and effectiveness. Given the sheer magnitude of the task of addressing the financial capability gap, it seems unreasonable to expect—or to encourage—the various and numerous actors in this field to continue working in isolation toward this goal. Rather, going forward, we strongly suggest that the field's many stakeholders develop and subscribe to a shared agenda—a set of priorities for action that can serve as a road map guiding the field forward to deliver real capability and empowerment to low-income consumers.

1. Pilot and develop new models of product-linked financial education. There is a demand for, and a potential business case behind, product-linked financial education models that not only align with credit, but also reflect other modes of access to finance like correspondent banking, remittances, cash transfers, mobile money, basic savings and insurance (as well as bundles of these products). More funding should be allocated to experimentation and testing in this area to develop models that are effective in delivering some capability, are cost recoverable and can effectively scale up to include the large number of individuals who are not being reached by current models. Though experiments should mainly focus on non-classroom models, there is scope for innovation with classroom models that offer hybrids with other formats. One way to encourage this field-wide: establish a financial capability innovation fund with a mandate to source, develop and finance new models that hold promise of being both effective and cost recoverable. Any pilots funded should also be required to have a rigorous evaluation framework in place.

> A broad agenda is required to increase the volume, quality and coordination of activities and outcomes in building financial capability.

2. Build a shared framework, knowledge and results infrastructure. A shared framework might include a standard definition of what constitutes financial capability; clear, shared outcomes guidelines and baseline data; inventory of results and "what works" (and in which situations); and detailed, shared data on customer needs and preferences—among others. Such a framework could greatly improve the ability of organizations to measure their progress, take advantage of the efforts of other actors and help prevent duplications and misunderstandings. Second, it will be critical to ensure that the knowledge, information and lessons generated by such efforts are housed in one place—a central knowledge management hub to which everyone has access. As new models are developed and tested, organizations will need a way to quickly and effectively share the lessons being learned; meanwhile, funders should require information sharing for any pilots supported.

3. Develop effective policy and advocacy dialogue. Although this paper has not focused on the role of the public sector or regulators, its finding suggests that there are at least four areas where regulators and policymakers should play a role. First, and perhaps most importantly, more should be done to establish a broad policy framework for product-linked FE that blurs across lines into product marketing. There will undoubtedly be policy concerns about individually targeted FE efforts and the fact that in many cases it could appear to be product marketing. Rather than lament the overlap between FE and product marketing—or proscribe it—policymakers would do well to recognize and support this as a key mode of building capability. In doing so they should focus on setting up a regulatory framework that allows vibrant experimentation, and also installs the required surrounding protections for low-income consumers engaging with financial institutions who are offering products and some education: grievance channels and rights of recourse, transparency norms, consumer protections and awareness building, information relevancy guidelines and other measures that ensure consumers are empowered to make smart decisions. A second area is in sharing costs, where funding can be better allocated by the public and the private sectors to different kinds of models—e.g., financial institutions could take on financial capability building for those segments and areas where a business case makes it feasible, while the public sector takes on less targeted (but still coordinated), more general financial education that is more in the realm of a public good. Coordination is key, and points to the third role for regulators, especially in helping to reduce overlap and increase efficiency. And fourth, a proactive dialogue with policymakers and regulators could usefully touch on what standards or guidelines for financial capability ought to be in place.

4. Improve coordination. The financial education field is still in a state of uncoordinated innovation. In order for the field to articulate and implement a set of shared priorities, formal mechanisms for coordination will need to be established. The field should consider creating a dedicated "institutional home" to coordinate, oversee, track and occasionally direct the shared agenda for the financial capability field. Such a home could serve a number of coordinating functions, including establishing industry "best practices" and standards and creating and managing a shared database or website where practitioners and researchers can access information about what is happening in the field, what has been successful in areas around the world, what standards and indicators should be used to evaluate programs, participating as a representative body in the dialogue with policymakers and also other functions to keep the various actors connected.

This executive summary is a companion piece to a full-length paper that includes far more detail of our analysis of financial education models and our recommendations for the field. The paper surveys the current state of the field, captures current practice and evidence, and begins to lay out the challenges that must be addressed if financial capability is to keep pace with financial access and the new realities of how low-income households conduct finance and build capability. It is not comprehensive—but meant to focus mainly on efforts to analyze where there exists a business case for financial service providers to provide financial capability and education linked to products for low-income consumers. Our ultimate hope is that the paper will catalyze a fact-based discussion among stakeholders in the field on how to create and deliver the next generation of financial capability—and, finally, full financial inclusion for all.

A NOTE ABOUT THE REPORT

Monitor Group wishes to gratefully recognize the generous support, both financial and intellectual, of the commissioners and funders of this report, Citi Foundation.

We would like to share our appreciation in particular for Lew Kaden, Pam Flaherty, Brandee McHale and Graham Macmillan at the Citi Foundation, for their commitment to thought leadership in financial capability, which has shone through in every aspect of the framing, research and writing of this report. We would also like to mention the guidance and generosity of Bob Annibale and the Citi Global Microfinance team, and the efforts of Citi and Citi Foundation staff in many regions of the world, without whom our research coverage and final output would have been poorer.

The extensive research efforts underpinning the main report's findings included interviews with more than 130 individuals representing more than 90 organizations in the financial education ecosystem (see Figure 6 below). Across all of these interviews, we tried to ensure ample diversity in stakeholder type, in country and regional coverage and in points of view. We also conducted seven site visits in six countries in order to examine financial institution-delivered education models in situ and undertook a thorough secondary literature review (bolstered by interviews with several key study authors) on the current state of the evidence base in financial education.

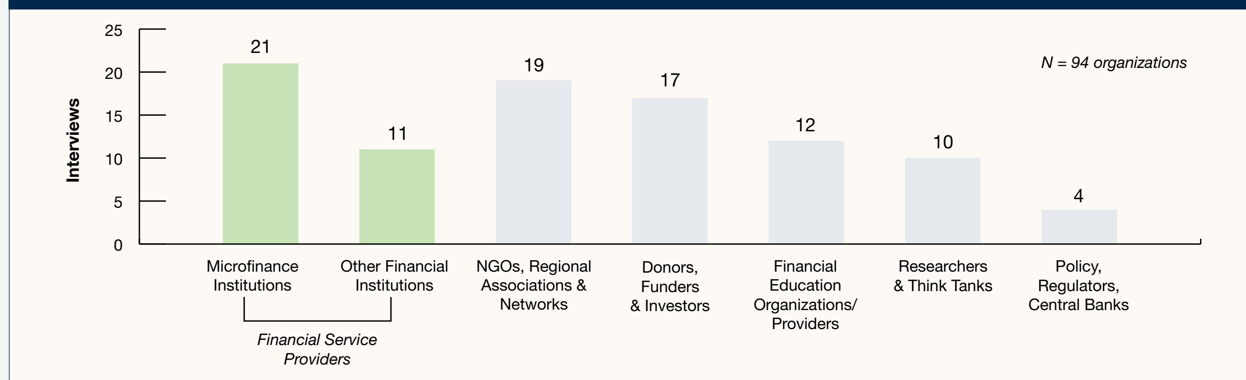
Finally, we convened a select number of field leaders and key participants in the Madrid convening in November 2011, spanning several types of organizations, to engage in a discussion around the findings and implications of the research, and jointly participate in creating a shared priority action agenda for the financial education field. Chapter 6 of the main report reflects the outcomes of this discussion. We would like to extend a special vote of thanks to the convening participants.

The full report can be found on the Citi Foundation website: http://www.citifoundation.com/citi/foundation/pdf/bridging_the_gap.pdf. Please see the Introduction section of the main report for greater detail on research and methodology. The Appendices contain full lists of individuals interviewed, site visits, participants to our Madrid convening and a bibliography of relevant sources.

There is a much longer roster of people to thank, all of whom are listed in the Acknowledgements section in the main report. This includes Monitor colleagues, PSD partners and external reviewers who helped shape the final report.

We are indebted to all of you for your contribution to this report.

FIGURE 6. Overview of Organizations Interviewed



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