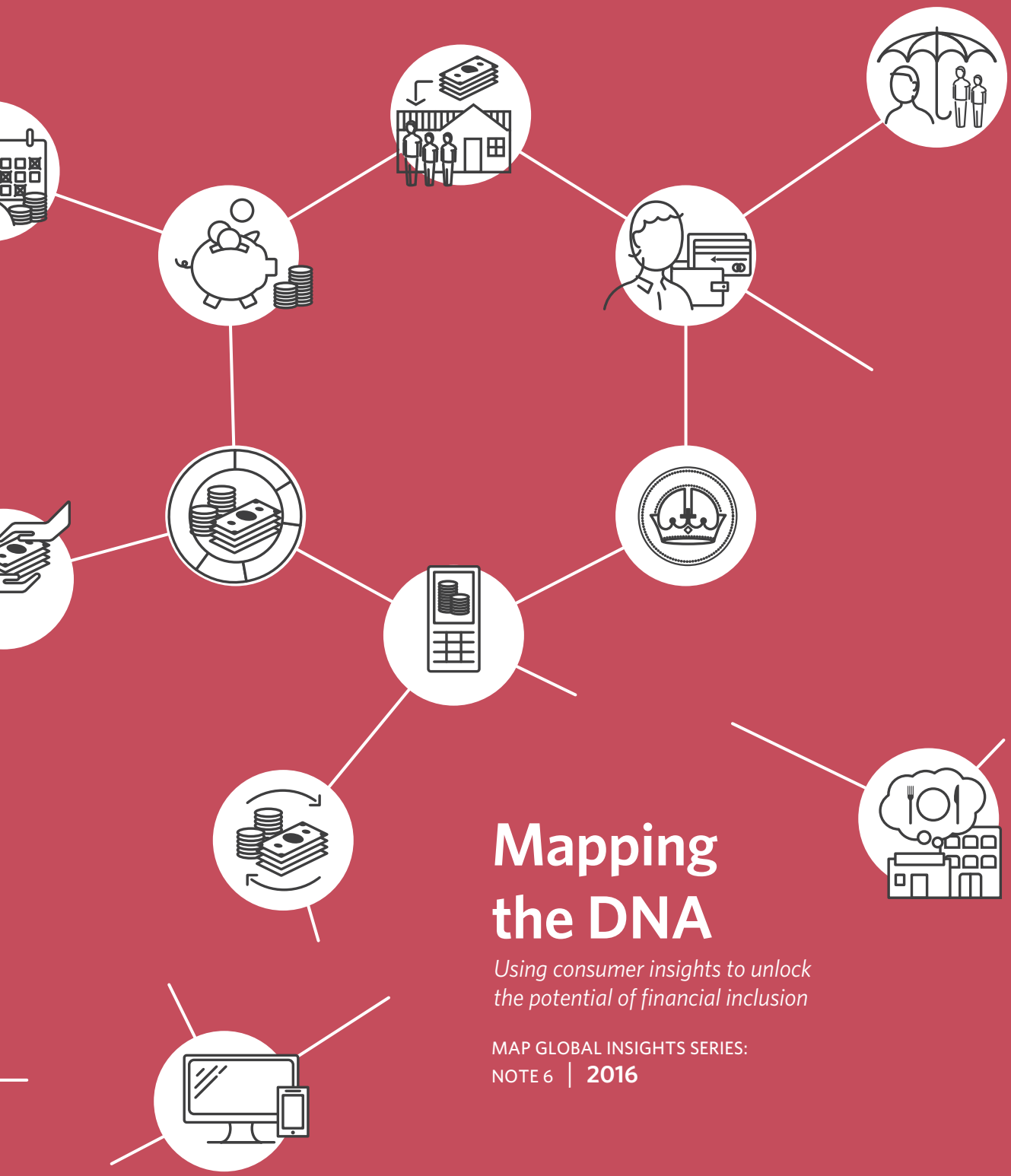

Mapping the DNA

Using consumer insights to unlock the potential of financial inclusion

MAP GLOBAL INSIGHTS SERIES:
NOTE 6 | **2016**

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Making financial markets work for the poor

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MAP
MAKING ACCESS POSSIBLE

About the Making Access Possible Programme

Making Access Possible (MAP) is a multi-country initiative to support financial inclusion through a process of evidence-based analysis feeding into a financial inclusion roadmap jointly implemented by a range of local stakeholders.

MAP was initiated by the United Nations Capital Development Fund (UNCDF) and is implemented in partnership with FinMark Trust and the Centre for Financial Regulation and Inclusion (Cenfri). In each country, MAP brings together a broad range of stakeholders from within government, the private sector and the donor community to create a set of practical actions aimed at extending financial inclusion tailored to that country.

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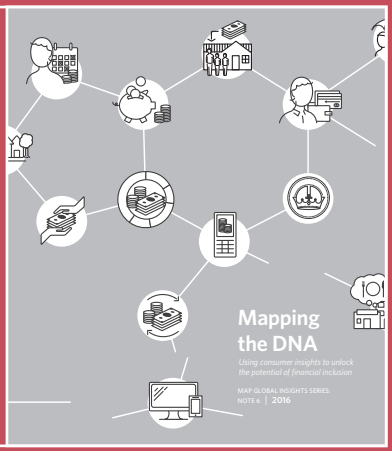
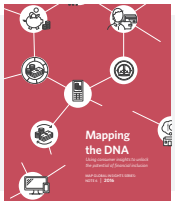
About the cover

Consumers and their needs and choices form the basis for all the work within the MAP programme. An increasing focus on household and individual-level consumer data and on qualitative insights facilitates the 'mapping of the DNA' of financial decision-making. As the valuable data encoded in consumer behaviour is decoded, financial inclusion breakthroughs become possible. The cover suggests vital and logical interconnections: between different consumer behaviours and choices; between financial inclusion policymakers, providers, donors and governments; between consumers and those seeking to improve the welfare of consumers. Mapping the DNA of financial decision-making allows for advanced and intelligent understanding of the 'genetic instructions' to be used in the growth, development, functioning and reproduction of successful financial inclusion initiatives.



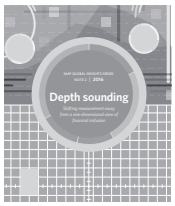
The MAP Global Insights series

The MAP Global Insights series consolidates and synthesises the learnings from MAP across the MAP pilot countries. The first of the MAP Global Insights products comprises five thematic cross-country notes plus a concluding note, based on the initial round of findings from the country diagnostic studies, which have been conducted in Thailand, Myanmar, Swaziland, Mozambique, Lesotho and Malawi.



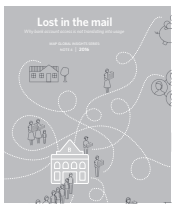
NOTE 6 draws together the findings from this Global Insights series. It shows that the MAP evidence calls for a rethink of conventional financial inclusion assumptions, based on a consumer decision-making framework that emphasises economic incentives, cost and value.

NOTE 1 unpacks the target market segmentation approach that is central to the MAP methodology of putting the client at the core of the analysis. Note 1 provides a window into the emerging cross-country segments, and the implications for providers, policymakers and donors in this regard.



NOTE 2 explores the shift in financial inclusion measurement away from focusing solely on access to more closely match the realities of how adults live their financial lives and explores the policy implications of moving away from a linear, one-dimensional view of financial inclusion.

NOTE 3 looks at the nature of informal financial services. It shows that it is the local nature of these financial services, rather than their informal nature, that makes them valuable for the majority of consumers in these countries.



NOTE 4 considers the gap between ownership and usage of bank accounts. The note queries whether bank accounts are always the appropriate product for increasing customer welfare, and argues the need for a paradigm shift away from focusing on ownership to a focus on usage in the context of a wider, systems approach.

NOTE 5 focuses on cash as a payment instrument to explore the largely undiminished popularity of cash. The different payment needs of consumers are introduced, analysed and compared with regard to the use of cash versus digital instruments.

Responding to the new financial inclusion agenda

The past two decades have seen a shift in the global economic and social landscape, which has put pressure on governments and donors to deliver on a wider set of economic and social welfare outcomes. This shifting discourse has seen the re-engineering of the Millennium Development Goals, which expired in 2015, into a focus on sustainable development and equitable growth as contained in the Sustainable Development Goals (SDGs). Access to financial services is highlighted in multiple SDGs. For example, ensuring that all men and women, particularly the poor and vulnerable, have equal rights to financial services has been set as one of the targets for the goal to end poverty in all its forms. This recognises that people's financial lives are an important aspect of their broader lives. Financial services impact on people's ability to grow, smooth and protect their income, to transact, and to build and protect their assets. By improving people's financial lives, financial inclusion can contribute towards the achievement of broader public policy objectives.

However, while financial inclusion is increasingly expected to do more, critical questions are being asked about its impact on the achievement of broader policy objectives and whether it is delivering consumer value.

A new methodology is needed to understand what it takes to deliver value. This requires insights that cut across the country context, the supply side and regulatory frameworks, as well as, importantly, across consumer needs, behaviour and preferences. The MAP methodology puts understanding the consumer at its core. By evaluating market trends through the consumer decision-making lens, new insights can be generated on how and why adults use financial services. Such insights are critical to unlocking the true potential of financial inclusion in the post-2015 development world.

This note provides an overview of the insights unlocked through use of the MAP methodology, and of the paradigm shift needed in how we think about financial inclusion as reflected in each of the five notes in the series.

Box 1: The MAP evidence

MAP is a data-driven diagnostic exercise that covers the complete context for financial inclusion within a country, looking at demand, supply and regulation of financial services across the payments, savings, credit and insurance markets.

A fundamental principle, and differentiator from comparable country diagnostics, is that the methodology centres on the demand-side perspective: what the consumers look like, how they make decisions and what their portfolio of needs are. In each country, MAP relies on the nationally representative FinScope Consumer Surveys. A minimum of 3,000 respondents are interviewed by FinScope in each country. Where available, FinScope MSME survey data is also analysed. FinScope covers a range of topics, including which financial products adults currently own and from which providers, why they do or do not use different types of products, how they make decisions, and their perceptions of these products. Global Findex is used to supplement the FinScope data. Additionally, a number of immersive qualitative interviews are conducted in each country to provide a greater depth of understanding of consumers' needs and behaviour.

On the supply side, detailed product-level and institutional data is collected across providers, based on annual reports, industry reports, product brochures, online information, extensive in-person interviews and data reported to the regulator.

The MAP Global Insights series draws on evidence from six MAP pilot countries: Myanmar, Thailand, Swaziland, Lesotho, Mozambique and Malawi. The sample thus covers smaller Southern African countries with differing levels of development of their financial and banking sectors, and two countries in Asia with larger populations – one (Thailand) with an advanced banking sector, the other (Myanmar) with a less developed financial sector. The countries underlying this analysis provide a range of environments, but are not representative of all developing economies. The cross-cutting findings extracted in the Global Insights series notes speak to insights arising from these country contexts. These insights will be tested as evidence from new MAP countries becomes available.

Taking stock: the growing divide between financial inclusion intent and outcomes

Financial inclusion initiatives not making a big difference to people's lives. In the first six MAP pilot countries, financial inclusion – contrary to popular belief and despite millions of programming dollars – has in many ways not lived up to its promises. If we move away from a one-dimensional view of financial inclusion as the percentage of adults with a formal bank account, we find that formal financial services are in fact having a limited impact on people's lives (or in some cases leaving people worse off). Indeed, many bank accounts remain dormant for long periods at a time, or are used only for withdrawing cash once wages are deposited. Cash and informal/local financial services remain the order of the day.

The traditional indicators too limited to be helpful. Global indicators still emphasise bank account-led financial inclusion, and financial inclusion strategies often encourage or mandate digital payments by bulk payers, such as government, in an effort to kick-start the move away from cash and to 'digitisation'. Formalisation is a common objective. When considering why financial inclusion is slow to get off the ground, the general wisdom is that it is because low-income consumers do not present a viable business case, and because they are not sufficiently 'financially literate' and would benefit from financial education.

Tendency to underestimate the poor. Explanations and strategies that fail to take actual consumer financial behaviour and choices seriously miss the fact that consumers act rationally. Given distinct financial needs – such as the need to transact, to smooth income, to make aspirational purchases, to manage risk, and to build assets or acquire farming inputs – consumers choose financial services, and the providers of those services, that best meet their needs in their local context and decision-making framework. If consumers fail to respond to interventions, this would indicate that those designing and implementing the interventions have not fully understood how the target audience members derive value, or the full range of real costs that they face. Such client understanding deficits lead to many unintended consequences of financial inclusion initiatives.

Sometimes financial inclusion initiatives run ahead of market readiness. Markets being organic and dynamic, consumer failure to respond to financial inclusion interventions could also indicate lack of readiness in that market, no matter how well-intentioned the initiative's aim of enabling market development. It is partly for this reason that MAP argues for a wider, systems approach that is alert and responsive to the specifics of a particular market, taking into account existing attitudes, behaviours and levels of acceptance on the part of consumers and existing market modalities and infrastructure. For example, as the discussion shows, mandating salary payments into bank accounts to kick-start financial inclusion can drive more adults away from formal financial services than to them, should encashment infrastructure be extremely limited.

A paradigm shift is needed. The insights from the first six MAP pilot countries is showing that for financial inclusion to deliver on its promise, a paradigm shift is required in how we think about financial inclusion. The MAP Global Insights series synthesises the evidence from the first six MAP study countries. By switching the lens through which we view financial inclusion – away from providers and governments to the consumer – we start to understand why financial inclusion is in many ways not working and, importantly, what providers, policymakers and donors can do to change this.

Understanding the divide: asking uncomfortable questions

Need to confront some fundamental and enduring questions. The first six MAP countries provided a rich evidence base for the Global Insights series to reflect on why financial inclusion has not fully lived up to its promises. The MAP research has shed light on fundamental questions that tend to get glossed over in the financial inclusion discourse, namely:

- Why do people continue to use informal financial services?
- Why are bank accounts not used more?
- Why do most people still live the bulk of their financial lives in cash?

Why do people continue to use informal financial services?

Formality proffered as solution. A common assumption within the global financial inclusion discourse is that financial inclusion is equated to the use of formal products (GPFI 2011). Underlying this conventional wisdom is the assumption that formal financial services are better than informal services, and that people only use informal services because they cannot access formal ones. Much of the focus in financial inclusion has thus been on incentivising existing formal providers to go down market and offer formal financial services to unserved or underserved adults.

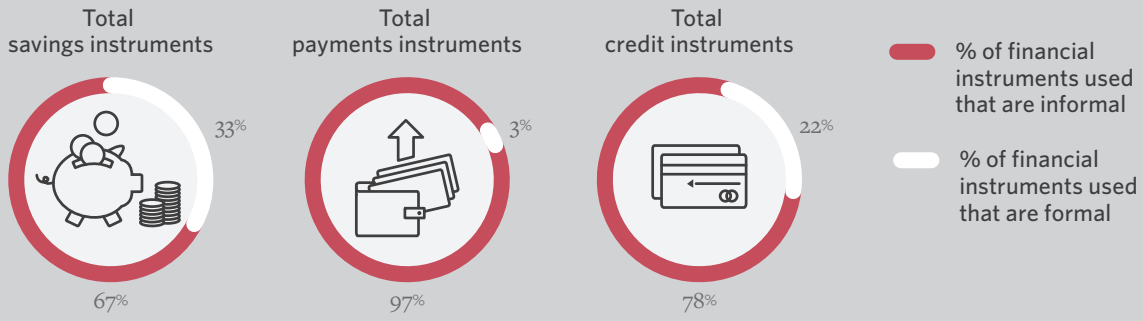


FIGURE 1: Savings, payments, credit – proportion of informal vs formal financial instruments across the MAP pilot countries
Source: FinScope Consumer Surveys.

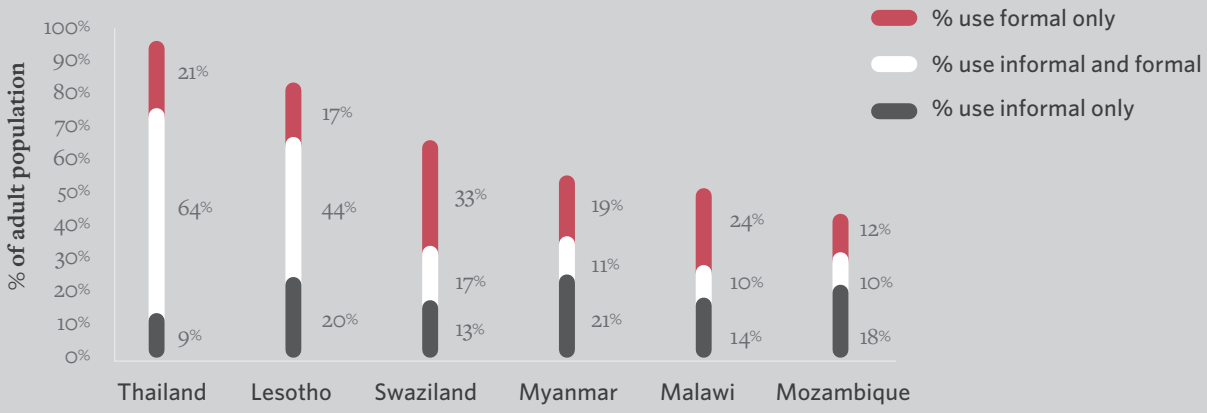


FIGURE 2: Overlaps in usage of informal and formal financial services: MAP pilot countries
Source: FinScope Consumer Surveys.

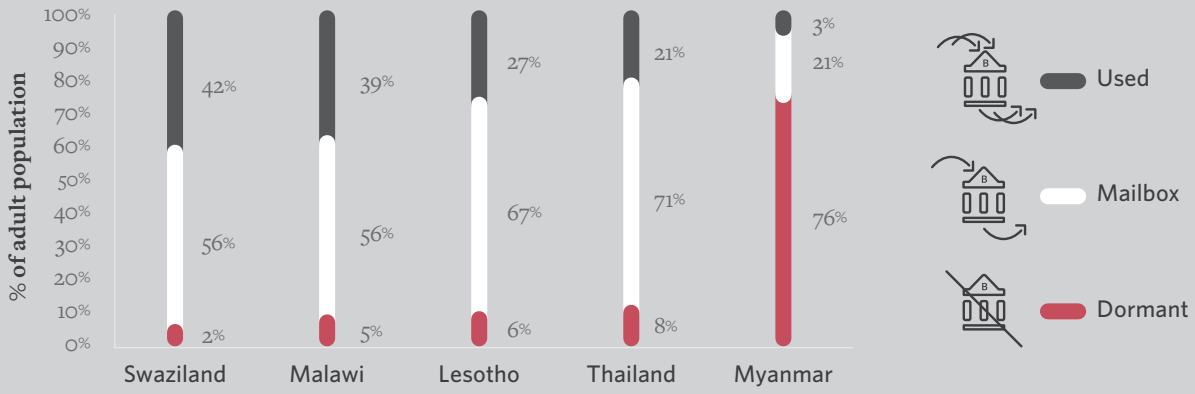


FIGURE 3: Bank account usage across five of the MAP pilot countries
Source: Malawi, Myanmar, Thailand: Findex 2014; Lesotho, Swaziland: Findex 2011.

But informality often dominates. However, as Figure 1 shows, in the six countries where MAP was piloted, informal financial services dominate, despite the explicit push to migrate users to formally provided financial services.

A deliberate choice. Why are consumers in the six MAP pilot countries favouring informal financial services? It is not because they have no other options. Figure 2 shows that there is a large overlap across the six MAP countries between adults that own formal financial services and those that use informal products. This means that those with access to formal services often continue to use informal services – by choice. For example, in Mozambique, salaried workers have much higher uptake of financial services than the average Mozambican, and almost two-thirds of salaried workers are banked. Yet 26% of salaried workers still use informal savings clubs, *xitiques*, in order to save. This is the highest *xitique* penetration of all the target groups highlighted by MAP Mozambique (2015). Thus informal usage for this target group is not a function of their exclusion from the formal sector, but a conscious decision despite formal access.

Paradigm shift: local, rather than formal nature matters most. If the use of informal services is by choice, then why would that be the case? As explained in Note 3, the MAP evidence suggests that it is not informality *per se* that is being chosen, but rather the *local* nature of these services. The case of village funds in Thailand illustrates that formal financial services that are provided at the local level and that leverage local structures can also be very popular. The Royal Government of Thailand introduced village funds as a way to leverage the culture of local decision-making institutionalised in informal savings groups (*Sajjas*) to distribute credit to rural communities. The initiative provided one million Thai Baht (THB) (US$31,114) to each of Thailand's approximately 80,000 villages. Village funds have since become the single largest providers of loans, with approximately 7.4 million adult clients, the majority of whom (77%) earn less than THB12,000 (US$373) per month (MAP Thailand 2014).

Answer seems to lie in the specific value delivered locally. Local financial services are provided by locals for locals. They differ from remote financial services, where the service is provided by an entity that is owned at a national level and where the decision whether or not to serve the client, and in what modality, is not made locally but requires standardised policies and procedures. Local providers have important knowledge on their existing and prospective clients that allows them to overcome the kinds of information asymmetries that typically challenge remote provision. For example, a local savings and loan group will know the members and their circumstances, and can exert social pressure for savings contributions and loan repayments. This removes the need for credit scoring and collateral when a person wants to take out a loan. MAP focus group discussions confirmed that consumers trust local financial services more than remote, and regard local services as more convenient, more flexible and simpler to use. Furthermore, local services provide consumers with the ability to intermediate low-value transactions, exercise recourse locally and build social capital.

Thus consumers' continued preference for local financial services goes beyond cost considerations to the overall value proposition that such services present compared to remote services. For remote services, this value creates an adoption threshold that is overcome only when people get greater utility from the services offered by remote providers than by local ones.

Why are bank accounts not used more?

Bank account-driven approach. Underlying the global financial inclusion agenda is the assumption that to achieve financial inclusion, and the benefits that come with it, people need to have accounts with financial institutions, specifically bank accounts. Global initiatives target universal access to bank accounts (World Bank 2016), and global surveys such as Findex and the country-level FinScope Consumer Survey monitor the progress of financial inclusion policies by tracking the number of 'banked' individuals. This feeds down to the country level, where policymakers set targets in terms of the number of bank accounts, which they then explicitly aim for. For example, in Mozambique, the government set a goal of no less than 35% of the adult population having access to at least one financial service from a regulated financial institution by the end of 2020 (MAP Mozambique 2015).

Don't bank on change quite yet. Having an account, however, does not necessarily mean that a person is truly financially included. The rapid growth in low-cost bank accounts has largely happened with little consideration for the conditions required for consumers to derive value from them. As Note 4 in particular highlights, this is manifesting in limited actual usage of accounts. Figure 3 shows that the majority of accounts across the first six MAP countries are used as 'mailbox' accounts. A mailbox account is defined as an account where the holder typically withdraws the entirety of their received income in cash each month. Such account holders typically only use the account for that purpose, with most choosing to store their value elsewhere and few, if any, able to use their bank account to access credit. Qualitative research indicated that adults in the six MAP pilot countries typically only go to the bank to withdraw the cash that facilitates their financial lives. For the average bank account owner in those countries, the bulk of their financial life is conducted outside of the banking context.

Bank accounts not meeting needs, and eroding value. The evidence from the first six MAP countries shows that bank accounts are not used more in those countries because the cost outweighs the value of doing so. The lack of encashment infrastructure, which is required for adults to access their income from bank accounts, significantly drives up the cost of using them. For example, in Malawi, the travel and opportunity cost of accessing a bank account is more than seven times the bank fees, and equivalent to 15% of the average monthly income (MAP Malawi 2015). The value derived in exchange for incurring these costs is limited. For the majority of consumers in the six MAP countries, bank accounts are not a good place to store value: existing pricing structures erode value and bank savings accounts offer clients neither the discipline nor flexibility of informal alternatives. Furthermore, for most account holders in the MAP pilot countries, bank accounts are not used as a gateway to credit. Simply put, other providers enable consumers to do more with their existing incomes.

Not translating ownership into usage is a lose-lose-situation. When bank accounts are not used, or are used in a very limited capacity, value is lost for all stakeholders. Consumers own bank accounts from which they get little – often no – value and that may in all likelihood be eroding value; policymakers' efforts to achieve their policy objectives are undermined; and providers are not able to recoup sufficient revenue to viably extend access into new markets. Unless the status quo is changed, bank accounts will not 'work' as an instrument of true financial inclusion.

Paradigm shift: focus on account usage rather than simple ownership. The emphasis within financial inclusion needs to shift from a focus on access to and ownership of financial services to measuring actual *usage* – in the context of a wider, systems approach to identifying and fulfilling preconditions for active usage. Alongside measuring usage must be an emphasis on understanding the complex factors that drive usage, particularly how consumers derive value from different financial products. This will in turn require lateral thinking and innovation with regard to making the bank business model work at the low-income end of the market (as Note 4 concludes).

Why do most people still live the bulk of their financial lives in cash?

Full steam ahead for the digital movement. An important recent thrust of the global financial inclusion agenda has been to migrate consumers, providers and governments to digital payment instruments, broadly defined as any non-cash payments. It makes sense; payments are far and away the most frequently used financial services for almost all adults. And MAP evidence shows payments to be the single biggest financial services need. People need to make payments multiple times a day or week: to buy groceries and clothing, to pay school fees and bills, to send money to family members, to interact with various financial services. The assumption underlying the movement away from cash is that digital instruments 'reduce costs, increase transparency, advance financial inclusion and drive inclusive growth' (BTCA 2016). Thus migrating adults to digital instruments can reap big rewards for consumers, providers and governments.

But cash (still) remains king. Figure 4 shows that, despite the significant push to migrate people to digital instruments, cash is still overwhelmingly used for payments across the six MAP countries. Nearly all adults make local payments. 'Local payments' refers to transactions where the payer and

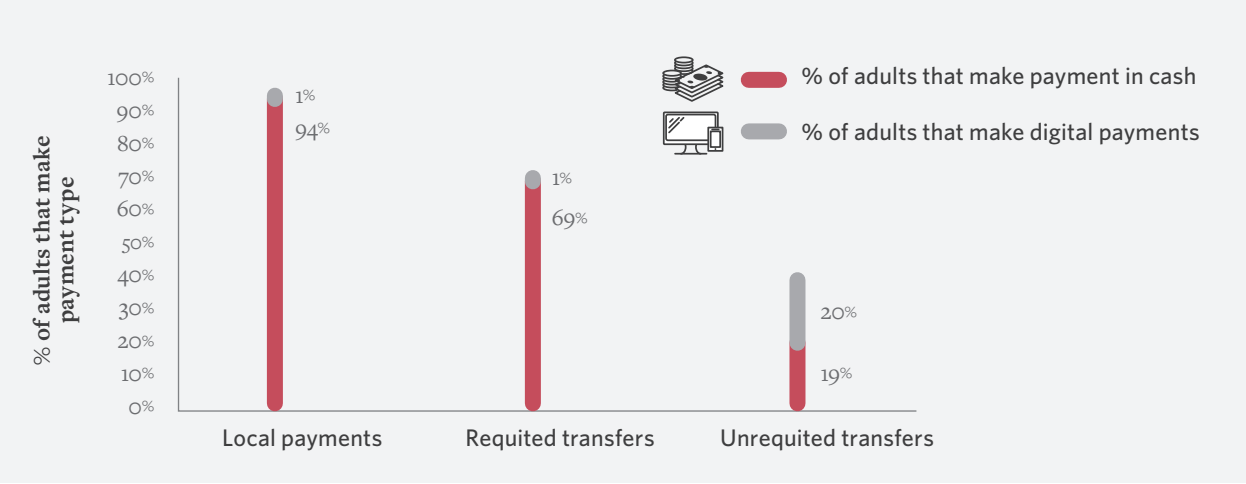


FIGURE 4: Percentage of adults that report payment need across the six MAP countries, and whether they use digital or cash instruments to meet it
Source: FinScope Consumer Surveys.

the payee are both physically present in the same location at the moment of the payment (e.g. buying a loaf of bread over the counter). Virtually all such transactions in the MAP pilot countries still happen in cash. Moreover, in Figure 5 we see that in those countries (excluding Mozambique, because the question was not included in FinScope), even consumers that already have bank accounts and live in urban areas, and so have access to the infrastructure required for digital payments, still overwhelmingly opt to use cash for various local payments.

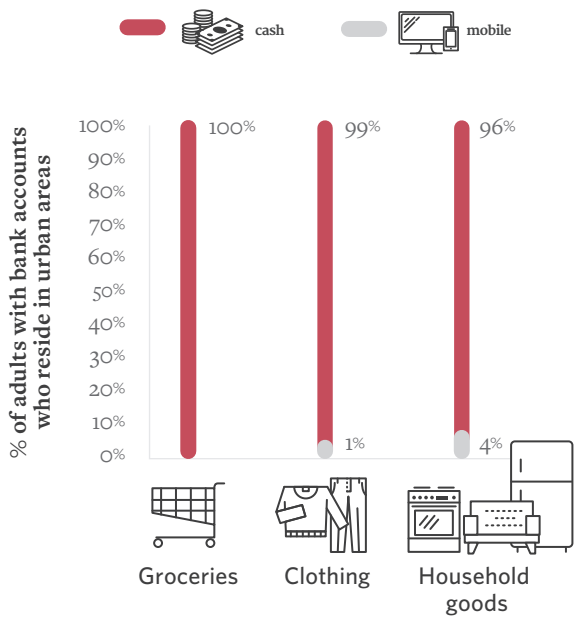


FIGURE 5: Proportion of banked adults residing in urban areas who use cash vs digital instruments for local payments: Thailand, Myanmar, Lesotho, Swaziland, Malawi
Source: FinScope Consumer Surveys.

Figure 4 furthermore shows that cash is used for almost all requited transfers in the MAP pilot countries. 'Requited transfers' are transactions where the payer makes a payment in exchange for a good or service but is not physically in the presence of the payee (whether person or institution): for example, paying a bill.

Where digital instruments are gaining traction is for 'unrequited payments' (i.e. payments over a distance where the payer 'does not get anything in return', in the sense of not owing payment to the payee). This is typically the case for long-distance remittances, where it is difficult, risky or costly to send cash physically. However, this makes up only a fraction of the total number of payments conducted by adult consumers in the MAP pilot countries. The only other areas that have seen some growth in digital transactions in the study countries are mandated payments (notably, where salaries are paid into bank accounts) and mobile phone airtime top-ups via mobile money.

It is rational for consumers to prefer cash, given the environment in which they conduct their financial lives. The MAP evidence shows that cash is preferred for reasons that are wholly rational given the existing environment. Cash is less costly to use (at least for most of the payment needs), more convenient, and widely accepted as a medium of exchange, and it can be trusted. Cash is ubiquitous, whereas digital payment infrastructure is still very limited in all of the study countries bar Thailand (and even in that country digital infrastructure lags significantly behind that of developed countries). The cost of cash is only made explicit to the consumer when it needs to be moved from one place to another – there is no transaction charge for buying a loaf of bread. Furthermore, cash is more visible at home (under the proverbial mattress) than stored digitally in an account; and cash payments have no trust barrier because the transfer of value is immediate and directly tied to the physical transfer of the instrument.

Paradigm shift: encashment is a prerequisite for digital. The MAP evidence shows that across the six pilot countries nearly everyone is transacting in cash. Cash as the medium of exchange is the status quo. Thus, any initial shift towards using digital transactions requires the availability of effective encashment infrastructure, otherwise digital payments will not fit into consumers' day-to-day lives. The current paucity of encashment infrastructure increases the friction costs for individuals of using digital financial services; if you cannot easily do cash-in or cash-out on digital services, you will have limited incentive to use digital services. Thus, while digital financial services may eventually replace cash as a payment instrument, in the initial stages digital will actually be reliant upon cash.

Bridging the divide – implications for policymakers, market players and donors

MAP demand-side research confirms that financial services matter to consumers. They have active financial lives and they choose to use services from which they derive the greatest value relative to overall cost. Where they provide relatively greater value, formal and digital financial products are gaining ground. But the overwhelming majority of financial activity still happens informally, and in cash and at the local level.

So how do we make financial inclusion matter more? To answer this, we need to re-examine some of the deeply held assumptions in financial inclusion and acknowledge the shortfalls to date. But more importantly, we need a

paradigm shift in the way we approach the provision of financial services. Five imperatives arise:

- Recalibrate what we mean by 'consumer value'.
- Change what and how we measure.
- Localise decisions.
- Break through the cash constraint.
- Solve the business model dilemma.

Recalibrate what we mean by 'consumer value'

Consumers act rationally and make deliberate usage decisions based on whether they derive value or not. The common assumption is that ownership of an account or financial service equates to value. However, value lies in whether people's real needs are met once the real costs they face have been taken into account.

More than meets the eye. MAP demand-side research confirms that it is not only the explicit costs, such as transaction costs, that are significant and contribute to the overall cost to the customer of using a financial service. The underlying costs, too – such as the cost to reach an outlet and the opportunity cost of lost time – must be taken seriously.

'It became complicated with BIM [bank]. If I make a profit, I go to BIM and make a deposit, but BIM is located in town and I use my profit money as fare to get to town.' (Inhambane, Mozambique, female, aged 20–30)

Different levels of value. The value that people derive in exchange for this cost ultimately determines whether they will use the financial service in question. They may be willing to incur significant costs if the service they use provides them with sufficient value: for example, taking out an emergency loan from an informal savings group.

'Informal lenders should be thanked for giving loans when you are in difficulties. If they do not give loans we cannot get from other sources.' (Myanmar, female, aged 31–50)

What precisely is meant by 'value' for the consumer is only beginning to be appreciated. It is determined both by the ability of financial services to meet needs and by the less tangible benefits that people derive from using financial services. Services will only be used if they meet people's underlying financial services needs.

For example:

- Bank accounts are little used because they fail to effectively meet most consumers' need to store value or access a lump sum in the event of an emergency.
- People also derive value from less tangible social benefits offered by financial services and providers. Savings groups, for instance, provide members with community support over and above the value derived from the financial products used. Similarly, the status that using a specific product conveys may provide substantial value to some users.

'There are a lot of benefits and advantages to being part of these groups especially the funeral insurance and life covers. When a crisis or death arises we know exactly who to turn to.' (Lesotho, male, aged 25–40)

Implications for policymakers, providers and donors: focus on more than just cost. The above highlights that it is value and cost, and not cost alone, that ultimately drives take-up. Furthermore, the costs in question are not only those that are evident to policymakers and providers, but also all the less obvious costs that consumers incur when using formal financial services. Policymakers, providers and donors need to be aware of this and to move away from a focus solely on low-cost financial services as a way to achieve financial inclusion objectives, rather designing services and policies that are driven by the value to be derived by consumers.

Change what and how we measure

You manage what you measure. The traditional focus in financial inclusion is on ownership and formality; financial inclusion headline indicators measure the number of adults that report having one type of formal financial service, most often from a formal financial institution. The result is that policy targets and achievements are set and celebrated around these singular metrics. However, this approach to measurement does not accurately reflect how adults, including the poor, interact with financial services to live their financial lives.

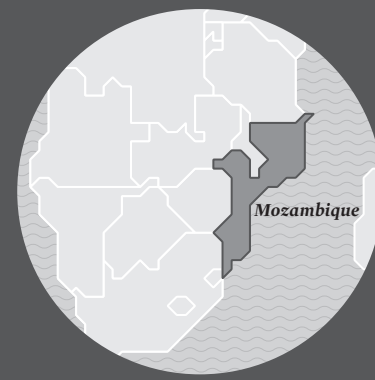
Moving from ownership to usage. As the discussion has shown, moving beyond a narrow view of ownership requires a focus on actual usage (and barriers to usage). MAP has begun to identify indicators and measurement tools to better capture some of the complexities that characterise usage:

- **Depth versus breadth:** MAP introduces a new measurement framework that goes beyond the traditional emphasis on measuring 'breadth' – i.e. the number of people that own any type of formal financial service – to add a new indicator: 'depth' of usage. This is defined as the number of different financial product classes owned per financially included person. While not yet denoting actual usage, depth can be used as a crude proxy for better understanding usage. (See Note 2 for details.)

Box 2: Headline indicators may be misleading – the case of Mozambique

In Mozambique, FinScope revealed that the percentage of the adult population with access to at least one formal financial service grew from 12% in 2009 to 24% in 2014. This would seem to indicate a healthy increase in financial inclusion in that country. However, only 12% of adults reported using more than one type of product: just over 7% use two product types, just over 3% use three product types and just over 1% are served across the full portfolio. The remaining financially included use only one type of product, mostly transactional bank accounts, to meet only two needs – sending or receiving remittances within the country and/or receiving a salary. Thus, while Mozambique has made strides in the number of adults considered financially included, relying on this simple measure disguises the fact that most of these people remain thinly served by formal financial services (i.e. there is not much depth of usage).

Source: MAP Mozambique (2015).



- **Number of instruments:** Going a step further, MAP has developed a tool that captures the number of local versus remote financial instruments (or 'devices' as referred to in the language of the financial diaries methodology) owned by adults within specific product markets. (See Note 3 for details.)

- **True cost to the customer:** MAP models the overall cost to a consumer of accessing a financial service, beyond simply the direct fees or transaction cost. (See Note 4 for details.)

Implications for policymakers and donors: rethink indicators to achieve financial inclusion objectives. Not all financial services markets are at the same stage. The indicators noted above provide policymakers with the tools to calibrate their interventions depending on their objectives. For example, in some markets the current usage pattern and country context may mean that increasing financial inclusion in an absolute sense (the 'breadth of usage' that is discussed in detail in Note 2) may be the desired way forward. Other markets may be at a stage where a policy to increase the portfolio of usage among those already served (i.e. to increase depth of usage) is a greater imperative. Then again, some countries may require a hybrid focus that differs between different target market segments, depending on their realities and needs. Understanding the depth of usage across target markets within and across countries is therefore of paramount importance for policymakers if they are to focus on appropriately targeted interventions that will achieve real welfare gains.

Localise decisions

It pays to go local. The persistence of informal financial services highlights the value that consumers derive from the local nature of these services, which represents an adoption threshold to the use of remote services. The 'localisation' of decisions is beneficial from both a demand and a supply perspective. For consumers, using local services mean that they are close to the providers, can negotiate access and terms, and usually face lower access costs and minimal or no barriers. For suppliers, leveraging local structures mean that any information asymmetries can be overcome and costs can be reduced. Thus remote services can learn from how consumers derive value from local financial services and may need to leverage local providers and structures if they want to overcome the adoption threshold.

Implications for policymakers, providers and donors: learn from local models. The success of spawning and leveraging local structures as a public policy tool to promote financial inclusion (e.g. by capitalising local entities or creating a legal framework and the capacity for it) is often underplayed. The MAP findings suggest that this theme merits particular policy attention. Learning from local models has a number of implications:

- For **remote providers**, it requires a rethink of their product offerings and their operational implementation, so that they can compete with local services.

- **Donors** need to be aware of the value derived from existing local providers and to seek to learn from and leverage them to advance financial inclusion.

- **Policymakers** need to rethink the role of local financial services in financial inclusion policy and strategy, putting more emphasis on the role that local services can play in delivering financial services to rural and low-income communities. It is also important to recognise that some remote providers will have legacy systems that make it difficult to mimic nimble local structures. It may thus be unwise to push them to play in the low-end financial inclusion space and more effective to focus on alternative providers that are more suited to that market.

Break through the cash constraint

Cash is a prerequisite for digitisation. Digitisation initiatives typically see cash as the increasingly outdated and less efficient way of doing things, and argue that consumers need to be educated to change their ways. The discussion in this note and in Note 5 clearly shows, however, that such consumers are in fact acting entirely rationally to prefer cash, given their existing environments. As reiterated across the notes, for the majority of adult consumers across the six MAP pilot countries, cash is the lifeblood of their economic and financial lives. Thus, for people to derive value from digital payments – and ultimately migrate to them – the friction of switching from cash to digital needs to be as close as possible to the friction of switching from cash to cash. If the cost is too much higher than cash then, as we have seen, consumers will stay with cash.

This is the same rationale for why using digital channels for payments over distance is gaining traction; the cost of moving cash through digital channels is much cheaper (i.e. there is less friction) than moving cash through physical channels, such as taxis, informal agent networks and self-delivery.

Implication for policymakers: consider cash reticulation as a public good. The key to reducing the friction between cash and digital lies in the ability to encash digital value. This requires effective cash reticulation. Cash reticulation is the network of encashment points within a country, which facilitates the distribution of cash through the economy and, as such, the exchange between cash and digital. Thus, it is the encashment infrastructure upon which digital networks depend that is the prerequisite for the adoption of digital financial services. However, in all of the six MAP pilot countries except Myanmar (see Note 5 for more detail), cash reticulation is left entirely up to providers, which have little incentive to invest in encashment infrastructure for consumers as it provides limited revenue while being expensive to invest in and administer. Given the broader societal benefits that would flow from the greater use of digital payments and from ubiquitous cash distribution, it may be that the state in each case has a key role to play in providing or subsidising 'the road' between the physical and electronic dollars.

Solve the business model dilemma

Providers, like consumers, respond to incentives. They need to be able to price the risk and cost of doing business with low-income consumers, in order to appropriately invest in the infrastructure and business models to serve them.

Mandates not aligned with incentives. Traditionally, bank business models derive their primary revenue from intermediating deposits, and use this to subsidise the cost of their encashment infrastructure. However, this business model is not appropriate for the low-income market, where the majority of bank accounts are used as mailboxes and many bank account holders leave very little, if any, value in their accounts. This leaves banks with little incentive to provide financial services beyond payments into this market; and, even in the case of payments, little incentive to set up a ubiquitous low-cost encashment network. As argued above, such a network is particularly important for driving the adoption of digital financial services, which requires the friction between cash and digital to be as low as possible. On the other side are non-bank payment providers, particularly mobile network operators (MNOs), which have a ubiquitous low-cost network but lack the legal mandate to offer financial services beyond payments. The majority of these providers do not make a profit directly out of providing the payments stream, but rather from the indirect benefit it has on facilitating payments for their other business (e.g. airtime).

Good intentions, bad outcomes. Donor and government policies to promote financial inclusion reinforce the business model dilemma. For example, banks are not allowed to price the true cost of distribution and cash reticulation, nor the price of intermediation. Both Mozambique and Malawi are a case in point: government policies, supported by donors, have restricted banks from charging fees for accessing and using bank infrastructure. This limits the ability of banks to recoup their investment costs, which acts as a disincentive in terms of their investing in critical encashment infrastructure. In an effort to enhance consumer protection and transparency, Mozambique implemented regulation 'Aviso' 5/2009, which sets standards for fee and commission disclosure in a comparable format. It also limits certain transactional fees and makes other transactions (such as cash deposits) free.

Another example of good intentions is interest rate caps. These are ostensibly implemented to protect consumers and increase access to credit. Yet, in four of the six MAP pilot countries (namely, Mozambique, Myanmar, Swaziland and Thailand), interest rate caps for bank credit make it unviable for banks to offer credit in the low-income market. The result is that very little credit is offered through banks to the retail market outside of the formally employed.

Implications for policymakers: enable providers to focus on comparative advantage. It may be necessary to rethink regulatory requirements such as transaction fee limits or interest rate caps that are instituted for consumer protection purposes, and consider these as part of a systems approach that also takes account of business model incentives. Furthermore, rather than trying to compel banks to serve the low-income market, it may be more effective in certain circumstances to create a regulatory space in which alternative providers, such as MNOs, are able to offer a broad range of financial services. More work is needed to understand the differential business models and incentives of non-traditional financial services providers vis-à-vis traditional financial institutions, as well as the requirements for a regulatory framework to help to induce or facilitate new models and interoperability between models.

Conclusion

For financial inclusion to bridge the divide between access to financial services and the ultimate public policy objectives highlighted in the SDGs, it needs to really add value to the lives of consumers. This calls for a paradigm shift – away from traditional financial inclusion constructs, such as measuring simply the number of people with access to formal financial services, towards a new approach that puts the emphasis on understanding the financial needs and actual behaviour of consumers and households, the value added by local services and the (counter-intuitive) role of cash in enabling digital services.

The work undertaken in the first six MAP countries has started to unlock new insights to help bridge this divide. A growing number of MAP country-level diagnostic studies will continue to add to and test this evidence base, which will be shared in future MAP Global Insights series publications.

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Notes

About UNCDF

UNCDF is the UN's capital investment agency for the world's 48 least developed countries (LDCs). With its capital mandate and instruments, UNCDF offers 'last mile' finance models that unlock public and private resources, especially at the domestic level, to reduce poverty and support local economic development. This last mile is where available resources for development are scarcest; where market failures are most pronounced; and where benefits from national growth tend to leave people excluded.

UNCDF's financing models work through two channels: savings-led financial inclusion that expands the opportunities for individuals, households, and small businesses to participate in the local economy, providing them with the tools they need to climb out of poverty and manage their financial lives; and by showing how localised investments – through fiscal decentralisation, innovative municipal finance, and structured project finance – can drive public and private funding that underpins local economic expansion and sustainable development. UNCDF financing models are applied in thematic areas where addressing barriers to finance at the local level can have a transformational effect for poor and excluded people and communities.

By strengthening how finance works for poor people at the household, small enterprise, and local infrastructure levels, UNCDF contributes to SDG 1 on eradicating poverty with a focus on reaching the last mile and addressing exclusion and inequalities of access. At the same time, UNCDF deploys its capital finance mandate in line with SDG 17 on the means of implementation, to unlock public and private finance for the poor at the local level. By identifying those market segments where innovative financing models can have transformational impact in helping to reach the last mile, UNCDF contributes to a number of different SDGs and currently to 28 of 169 targets.

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