Too small to succeed: Imagine a world with no banks

Commentary: Stuffing earnings under the mattress is the precarious reality for billions. Technology is now poised to change that.

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WASHINGTON — Imagine a life without access to financial services: No deposit account, no ATM card to get cash when needed, no fire insurance, no college savings plan, no home mortgage.

Life would be an incredibly stressful roller coaster, and most dreams would remain unfulfilled. The day you get paid for work would be good, the other days rough. Any accident would set your family back. Sending the kids to college? Too difficult. Buying a house? Forget it. Nobody can pay for that out of cash accumulated under the mattress. For us, life without access to financial services is unimaginable.

Yet in 2011, more than 2.5 billion adults did not have a bank account, according to the new Global Findex data from the World Bank. About three-quarters of the world's poor, living on less than $2 a day, lack a bank account. They live a life without access to the kinds of services available at regulated financial institutions that we take for granted. What the poor do instead is rely on age-old, informal mechanisms. They buy livestock as a form of savings; they throw a village feast to cement local ties as insurance against a future family crisis; they pawn jewelry; and they turn to the moneylender for credit. These mechanisms are risky — the goat can die, the hoped-for village solidarity might not come through — and they often are expensive.

Poor people, typically in the informal economy of developing countries, are penalized twice. They live unsteady economic lives without the safety cushion most of us have. When they use financial services to cope with unsteady incomes and expenses, and to protect themselves from economic shocks, they pay higher fees than citizens in the developed world.

Evidence shows that economies grow faster and have less income inequality in countries where financial institutions serve a critical role in providing access to finance. Policy-makers and regulators worldwide recognize this. They know that access to appropriate financial services helps improve household welfare and spurs small enterprise activity. And they have made universal access to responsible financial services a global development priority.

Advances in technology, lessons from the early success of microcredit and new ways of creating well-regulated risk are bringing banking access to working age adults in developing countries.

After microfinance's initial success in the 1990s, the nascent microcredit industry focused on scaling up its model, demonstrating that poor families in the informal economy were valuable clients and that there were sustainable ways of serving them in larger numbers. The growth of today's $70 billion microcredit industry, which serves 200 million clients, has been helped by targeted subsidies supported by a sustainable non-government and private sector growth.

But while the supply of microcredit was impressive, important demand-side dynamics were overlooked. Poor households in the informal economy are producers and consumers. They need access to the full range of financial services to generate income, build assets, smooth consumption and manage risks.

The global financial inclusion agenda recognizes these broader needs. It also recognizes the importance of financial literacy, of building consumer financial capabilities and of consumer protection regimes that take into account the conditions and constraints of poor families in the informal economy.

Moving beyond the original microcredit revolution requires new types of innovation. Pioneers in microcredit found an ingenious way to overcome the obstacle of managing credit risk and repayments at the local level when working with individuals that don't have traditional collateral. The breakthrough was known as the joint-liability group loan; social collateral that allows the poor to pledge for one another and then monitor their repayment behavior.

But the business model challenge for other financial services is different. For small denomination savings and remittances, the key challenge is the need for ultra-low transaction costs; for insurance, risks must be pooled and managed at an actuarially relevant scale.

Product and business model innovation can reach more people with a broader range of products at lower costs, including such developments as mobile phone-based business models. No single type of provider will be able to overcome the different business-model challenges of specific products. What is needed, instead, is a variety of financial services providers coming together for a local-market ecosystem that works for those at the base of the economic pyramid.

Responsible market development requires an infrastructure and regulatory environment that balances access to finance and stability of the financial system. The infrastructure requirements range from more low-cost financial service centers in harder-to-reach areas, to nationwide financial identities that facilitate customer enrollment and protection.

Globally, policy-makers are recognizing that financial exclusion is a risk to political stability and impedes economic advancement. Recently the G20 has made financial inclusion a pillar of its development agenda.

Too many people are excluded from formal financial services. Between a deeper understanding of demand, innovations in supply and recognition of the need for a supportive environment, including consumer protection and enhanced financial literacy, we increasingly have the knowledge and the tools to move towards full financial inclusion.

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