# FINANCIAL INCLUSION
## Approach and Principles

## Overview

Globally there are over 2.5 billion people who are excluded or underserved by financial systems. These are often poor or underserved populations who lead complex financial lives and typically rely on a mix of informal and formal financial services, with neither fully meeting their diverse financial needs. Mercy Corps' financial inclusion theory of change states *if there are inclusive financial market systems (made up of financial providers, market actors, appropriate technology, and an enabling environment), then target clients will have access to financial products and services that benefit them.* We also believe that *If targeted clients can access, use, and afford a range of appropriate financial services and products on an ongoing basis, then they can better manage, sustain, and grow their economic assets.*

**Problem:** It is very expensive to be poor and this is especially true of available financial services. Financial providers often perceive poor clients to be high risk and low profit. The result is not enough financial providers who adequately conceptualize, mitigate, and manage appropriate financial services for the poor. At the same time, clients may have limited ability to meet standard financial provider requirements (i.e. collateral or know your customer' identification). This is especially the case for extremely poor or vulnerable populations who lack legal documents and cash flow or credit history. They may also face cultural norms, such as gender inequality, that restrict access to and usage of financial services.[1]

Poorer clients often rely on informal finance mechanisms, such as savings groups, store credit, and cooperatives, to fill income gaps at the household and business-level. Globally, both formal and informal financial services often fail to meet the actual demand for financial products and non-financial services by strictly operating on supply-led models that do not address the core financial needs and behaviors of the targeted market segment.[2]

Note: The term *financial providers* is used throughout this document – unless otherwise indicated – to include banks (commercial and public), microfinance institutions, credit unions, savings and credit cooperatives (SACCO), mobile network operators (MNO), post offices, savings groups, and other financial providers.

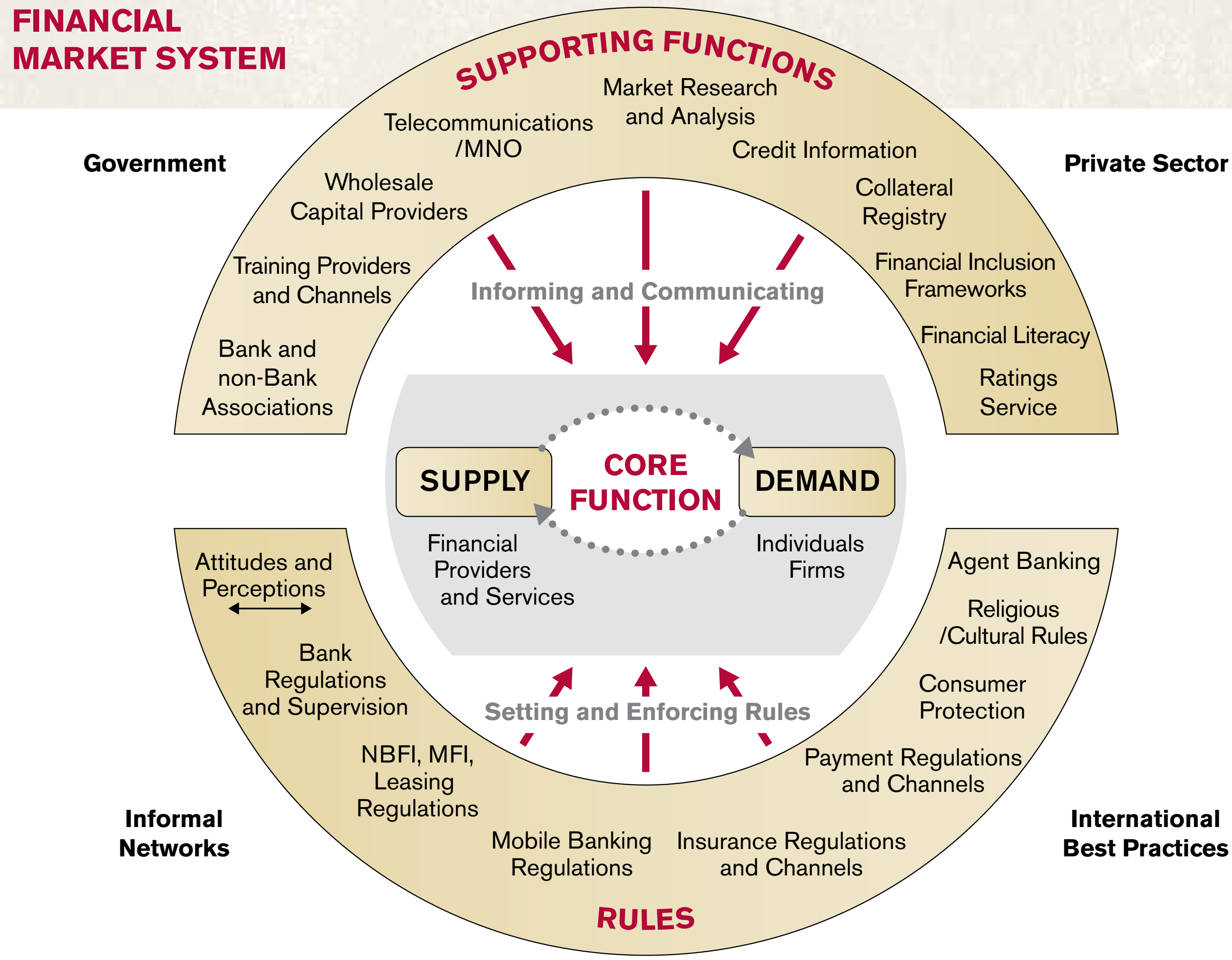
**Opportunities:** Mercy Corps' financial inclusion approach is evidence-based and adheres to market development principles. We build systems that include and serve poor clients, beginning in each market where Mercy Corps works with an understanding how and why the financial market does not currently work. We strive for full financial inclusion for the unserved and chronically underserved and in areas affected by conflict, natural disasters, and economic and political crisis. Mercy Corps embraces a broad definition of financial inclusion, seeking to not just improve access but also to ensure quality and the actual usage of financial products and services, including payments, savings, loans, remittances, leasing, and insurance. Mercy Corps works with market stakeholders at all levels – both formal and informal sector – to ensure financial products and services are **accessible** and **affordable**; age-, gender- and context-**appropriate**; and delivered in a scalable manner. We introduce new, or expand existing, financing mechanisms and products through a diverse range of delivery models to strengthen access and uptake of financial services.

# Approach to Financial Inclusion

When engaging with the financial market, Mercy Corps strives to play the role of a facilitator by designing and promoting incentives to spur financial market participation by a wide array of actors, including financial providers, clients, regulators, mobile networks,


## Principles of Financial Inclusion

- Poor clients value reliable and quick access to loans as much as, or even more than, the cost.
- Access to, and usage of, both formal and informal financial services are needed for poor households and businesses.
- Financial providers must be allowed to charge cost-covering interest rates and fees in order to grow and provide services in a sustainable manner.
- Market-driven competition between financial providers will stimulate product innovations and a gradual expansion of financial services into new areas and institutionally riskier products.
- Savings, insurance, payments, and leasing are as important as credit for poor clients.
- Deposit mobilization is an important source of funds for financial providers and long-term house hold security and should be encouraged within all Mercy Corps interventions.
- Integration of new technologies drives demand and decreases transaction costs for clients and providers.
- Ensure financial literacy is available at the point when financial decisions are made for the greatest outcome.




and market infrastructure actors. Interventions may include research and information sharing, capacity strengthening, and advocating for an improved enabling environment that recognizes and engages the poor (and specific segments of the poor) as legitimate actors in the financial system. We recognize that our role in a developed or mature financial system will be very different than in a nascent financial system or a financial system experiencing transition and we adjust our approach accordingly.

In a well-functioning market, Mercy Corps works with existing financial providers to improve market efficiencies, support innovation, expand the range of products, and extend the reach of the product base to 'last mile' clients. In nascent markets – where Mercy Corps regularly works – there are often few existing formal financial providers. In these situations, Mercy Corps may take a more active – albeit temporary – role to provide research or develop a business case for financial providers to engage with targeted clients, catalyzing new products through smart subsidies, incentivize new financial or value chain players to enter the market, and/or educate policy makers on the business case for financial inclusion and how it may be supported through enabling regulation.

In both scenarios, we encourage financial providers to make their investment decisions first and foremost on the needs of the market as opposed to the instruments they possess or their menu of products currently in use. Through our interventions, we strive for sustainable service delivery beyond the period of Mercy Corps short-term support or investment. We plan our exit at the point of entry and put in place benchmarks or identifying market signals to direct Mercy Corps' exit.

# Key Strategies for Financial Inclusion

**Use of Smart Subsidies and Financing:** Mercy Corps provides technical and financial support to financial providers to stimulate and expand the existing financial system. This can be done through a process of 'buying down the risk' of new business models or products for a limited time to test or prove their business viability (i.e. introduce a new financial product or delivery channel). Any subsidy should be short-term, have a clear objective and exit strategy, and create the space and opportunity to 'crowd-in' more players. This support could include feasibility studies; cost-share to develop, pilot, or market a new product; or subsidized costs for new services to limit the risk to the financial provider. Mercy Corps has used partial loan guarantee mechanisms to stimulate access to affordable financial services for previously unserved population segments in a range of countries including Mongolia, Ethiopia, Uganda, and Pakistan. As with other subsidies, guarantees are used to support the risk of institutions not clients.

When using subsidies, Mercy Corps ensures shared-risk with financial providers with Mercy Corps' risk decreasing over time. Mercy Corps does not subsidize interest rates or collateral requirements to avoid distorting the market. If the client is unable to meet the normal requirements of the financial product, Mercy Corps examines the range of products and product terms offered and either helps the financial provider develop more appropriate ones or looks to alternative financial or value chain actors to fill this role. *We recognize that short-term access to financial services under a subsidy will not lead to long-term usage or uptake by the targeted clients if the financial institution does not see them as legitimate clients.* Subsidies should not be used to push clients into legal financial transactions that lead to over indebtedness. We ensure a wide range of clients can access financial services beyond the timeframe of the subsidy.

**Appropriate Products and Services:** Mercy Corps promotes market segmentation of clients to under-

## Financial Inclusion 101

### What role does credit play in the lives of the poor?

- **A mechanism for making goals achievable** – converting what otherwise would be a 'big ticket' cost or capital asset purchases (e.g. house, vehicle, machinery, business inventory, land) into a regular pattern of smaller payments.
- **A tool for resolving temporary cash flow** or liquidity imbalances for routine or daily household, business, or seasonal expenses (e.g. clothes, food, fuel).
- **A Coping Mechanism** (often the main tool) used in event of an adverse shock. Relative to men, women tend to focus more on survival and risk management (mitigating downside) rather than on creating new opportunities (managing upside). At the household-level this translates into women more often viewing credit as a buffer to absorb shocks or accumulate assets (or a pool of assets) that can be sold off as needed.

stand the demand of current and potential clients as well as their ability to engage with financial providers (formal and informal). This is often done through market segment profiles so Mercy Corps can understand which interventions are appropriate or applicable to different clients based on various factors (age, gender, income levels, employment type, collateral available, repayment capacities, and religious considerations).[3] This includes understanding the literacy and numeracy levels of the potential clients as that can influence how they interact with financial providers and the appropriate design of consumer education delivery modules.

*Example:* Smallholder farmers often includes a range of sub-groups with different financial needs and repayment capacities and constraints. This includes non-commercial or subsistence farmers, semi-commercial farmers in loose supply chains, and commercial farmers in tight value chains.[4] When assessing entrepreneurs, we segment those that are in the start-up phase compared with those with existing businesses that can scale. We believe it is critical to segment clients by age, recognizing that children and adolescents have different financial needs and capacities compared to older age groups that are at different professional and life cycle stages.

*Example:* In Kenya, Mercy Corps launched the country's first Sharia-compliant index-based livestock insurance in partnership with Takaful Insurance of Africa (TIA) and the International Livestock Research Institute (ILRI) in the agro-pastoralist Wajjir region.

We document the existing and potential supply (by type of financial provider and product) and the demand (financial goals, potential products such as working capital versus consumption loans, and ideal terms for savings, credit, payments, and risk management tools) for each segment. We capture land usage, household profiles, collateral, current and potential use of technology, informal norms, and available resources. This is especially important when working to bridge clients from informal finance products (such as savings groups) to formal financial providers (MNOs, banks, or MFIs).

**Increase Client-Level Financial Capability:**
Mercy Corps increases financial capability of a range of market actors by bundling it with access to financial products. Financial capability is the combination of financial skills, knowledge and behaviors that clients require to make informed and effective financial decisions at the individual, household or business level. Increased financial capability results in increased understanding of and ability to mitigate risk, information about access to and the usage of appropriate financial products, and ability to negotiate with financial providers Financial capability is not static and must adapt based on age and life circumstances.

Mercy Corps employs a wide-range of approaches through a diverse range of actors to deliver and reinforce financial capability. This includes a range of digital and classroom channels at the client and financial provider level, including SMS, voice, video/tablet, internet and classroom training as well as wide-scale advocacy or information campaigns. For youth or first-time clients, we recognize that


additional assistance is usually required both for the client and the institution. In post-revolution Tunisia, Mercy Corps increases the financial inclusion and employability of marginalized youth through private sector links and direct access to savings-led financial and non-financial services, with a focus on increasing financial literacy.

We leverage opportunities to influence regulatory frameworks as many countries adopt financial inclusion regulations. We embed financial literacy and consumer education with agricultural and value chain actors, school curricula, and within mass media and social media. We work with financial providers to understand the role of financial capability in client acquisition and retention and ultimately the providers' profits. We ensure that financial literacy is available at the point when financial decisions are made for the greatest outcome. Training is simple, direct, and actionable, recognizing that training that provides 'rule of thumb' techniques has larger impact on individuals and businesses.[5]

**Integration of Technology and Digital Finance:** Technology provides an opportunity to increase financial capability at scale through diverse platforms that reach wider audiences. It can reduce transaction costs through the use of electronic payments and bundled services, especially for population segments which may have limited freedom of movement due to transportation costs or social norms. Technology is not viewed as external or a 'value addition', rather it is integrated – to the extent possible – within Mercy Corps interventions. We encourage the use of mobile and digital financial models at the client and institutional level. This includes by governments for social safety net payments and the use of e-payments when appropriate in humanitarian response. In crisis environments inflation, limited availability of goods and services, and constrained cash flows can hamper household coping mechanisms. Mercy Corps recognizes that selected responses to this situation can bolster long-term financial inclusion. To that end, Mercy Corps is piloting innovative methods of distributing electronic cash payments, transfers, and vouchers in Nepal and the Democratic Republic of the Congo.

Mercy Corps works in partnership with financial providers to ensure technology can actually reach target clients in rural areas and there is an adequate agent networks. We ensure technology is appropriate based on the literacy and numeracy of the targeted market segment incorporating digital literacy training as required. This work often includes strengthening the capacity of the financial providers to expand mobile and digital products and move beyond the traditional 'brick and mortar' approach.

*Example:* We encourage savings groups to use mobile platforms to collect and transport money and financial providers to use 'cloud-based' management information systems for greater transparency and reduced costs when opening new branches We advance the use of technology platforms by encouraging bundling financial products with other services including payments for utilities, and new payment structures, such as 'pay as you go' modules for the purchase of items like water pumps and electricity. Increased technology can allow individuals and businesses in the informal economy to build a credit history and track transactional data.

**Strengthen Institutions and Regulations:** Mercy Corps supports the operation and product development of financial providers as an entry point, while simultaneously facilitating the development of the overall financial market system and move from direct to indirect support in a specified timeframe. This includes addressing constraints in the regulatory or legal environment of the overall market. For example, financial providers often try to protect themselves against the risks inherent to financing the poor through excessive credit rationing and over-reliance on traditional collateral,[6] thus limiting access to the intended clients. This should be addressed both at the financial provider level and within the regulatory environment.

At the regulatory level, we encourage moveable asset registries, alternative collateral requirements, and as alternative or flexible KYC regulations and opportunities for poor clients to obtain a legally recognized ID, especially women and youth. We discourage legislation that puts caps on loan amounts or interest fee rates for financial providers, which can limit the ability of the provider to be sustainable. At the institutional level, Mercy Corps works with financial providers to

## Financial Inclusion 101

### What are the primary reasons we promote savings?[7]

- **Asset Creation** – Savings allow for the purchase of tangible and intangible assets that can have other financial or social benefits or uses. Tangible or economic assets include jewellery that be used as collateral or land that can be rented for additional income; intangible assets include school fees, health expenses or life events (weddings, funerals, births).
- **Cash flow management** – Savings can be used to manage regular expenditures for both planned and unplanned needs and protect clients from taking a loan for this purpose.
- **Risk Management** – Cash savings (or assets that can be sold or traded) can be used to mitigate the risk of unplanned emergencies (e.g. repair house after a flood, replant after a crop failure, replace stolen business inventory, pay for a family illness).This is often referred to as 'saving up' before an event to have a sufficient savings balance to cover unforeseen expenditures and 'saving down' after the event by using saving reserves to cover income that has been lost.

avoid a ‘one size fits all’ approach to products and services. This includes the recognition that traditional business loans are usually not appropriate for agribusinesses, which require grace periods or an alternative payment schedule to sync with agriculture cycles.

As part of any financial intervention, Mercy Corps builds the capacity of financial providers to directly undertake market analysis to develop new financial and non-financial products and upgrade existing products (or terms) targeted to various sectors. Interventions often include:

- Introduce new business models based on an analysis of the legal environment.
- Promote ‘human-centred’ product design, marketing, and delivery mechanisms.
- Train staff and upgrading operations (including data collection methodologies and MIS).
- Introduce appropriate risk management systems.
- Advocate and pilot expanded use of alternative forms of collateral, such as purchase orders or supply-chain contracts. This can also include working with banks and MNOs to apply microfinance best practices (cash-flow and character-based lending), reinforced with prescription of collateral-substitutes.
- Develop alternative credit-history and credit-reporting models.
- Apply and integrate client protection mechanisms.

**Appropriate Financing Mechanisms:** Mercy Corps facilitates relationships between market actors to build trust that results in long-term financing mechanisms and new delivery methods. We look to increase financial mechanisms between actors in supply chains for short-term, direct financing. Supply-chain finance (also referred to as value chain or trade finance) can move actors from informal to formal finance. Thus Mercy Corps also links actors to formal financial providers for longer-term credit and savings services. Supply chain financing can be an opportunity to document the payments received and cash transferred between hands at each step of the supply chain to build a cash flow history for clients. It may also allow clients to use buyer contracts as a source of collateral for a formal financial provider. In Nepal, Ethiopia, Niger, Uganda, and Zimbabwe, Mercy Corps selects high-impact agricultural markets and ensures financial services delivered through private sector providers are appropriate and accessible to increase farmer productivity and incomes.

Globally, Mercy Corps promotes the development of community-managed savings groups to serve as informal social safety nets and household financial management strategies in countries as diverse as Somalia, Niger, Mali, Liberia, South Sudan, Myanmar, and DRC, and Kenya.

Mercy Corps uses alternative products, such as micro-leasing, energy efficient technology, and

## Financial Inclusion Global Footprint (2014)

- Afghanistan
- Bosnia
- Central African Republic
- China
- Democratic Republic of the Congo (DRC)
- Egypt
- Ethiopia
- Guatemala
- India
- Indonesia
- Kenya
- Kyrgyzstan
- Liberia
- Mali
- Mongolia
- Myanmar
- Nepal
- Niger
- Nigeria
- Pakistan
- Philippines
- Somalia
- Sudan
- South Sudan
- Tajikistan
- Tunisia
- Uganda
- Zimbabwe

warehouse financing, to increase the options available to the poor and bring new actors into the financial system. Example: In Indonesia, Mercy Corps works with equipment suppliers and producer associations in an innovative lease-to-buy scheme for energy efficient and clean energy generation technologies for micro, small, and medium enterprises (MSME) in the soybean market chains, with associations serving as guarantors for the producers. These MSMEs are linked to low interest loans from major financial institutions for energy-efficient or renewable energy technologies.

**Research and Reiterative Analysis:** When strengthening financial systems, Mercy Corps understands that research must go beyond questioning why transactions are not happening at the core market between clients (demand) and financial providers (supply). Mercy Corps must identify the underlying causes that contribute to the underperformance of the finance market and understand potential incentives and capacities for growth. Information is continually needed on changing contexts, market actors' roles, market adaptation, and impacts of Mercy Corps financial interventions.

Mercy Corps adheres to the principles of several networks including:

- Aspen Network on Development Entrepreneurs (ANDE)
- Child Youth Finance International (CYFI)
- Financial Inclusion 2020
- Making Finance Work for Africa (MFW4A)
- SEEP Network
- The Smart Campaign

# Endnotes

1 Demirguc-Kunt, Asli; Klapper, Leora; and Singer Dorothe (2013) *Financial Inclusion and Legal Discrimination Against Women Evidence from Developing Countries.* Policy Research working Paper 6416; World Bank.

2 Addressing Customer Needs for Full Financial Inclusion (September 2013). Center for Financial Inclusion, Accion.

3 We also look at different types of employment – formal salaried, informal salaried, seasonal, and entrepreneurs.

4 See CGAP Focus Note 85 'Segmentation of Smallholder Households: Meeting the Range of Financial Needs in Agricultural Families' (April 2013).

5 A. Drexler, G. Fischer, and A. Schoar. Keeping it Simple: Financial Literacy and Rules of Thumb (January 2011). Innovations for Poverty Action, and Jameel Poverty Action Lab. http://www.mit.edu/~aschoar/KIS%20DFS%20Jan2011.pdf

6 Rural assets are often not suitable as loan collateral (e.g. communal land ownership versus individual land titles in an urban setting).

7 Holding back most of a debt and paying it near the end of the agreement.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