FSDT FOCUS NOTE

BEYOND SINGLE SOURCE SOLUTIONS

Why Creating Sustainable Financial Solutions for the Poor Demands Choosing the "Right" Partners

Innocent Ephraim, FSDT | November 24, 2017

The Financial Network

The art and science of philanthropic grantmaking in the developing world has been undergoing a shift, particularly in areas powered by financial inclusion. Increasingly, grant-giving is focused on leveraging both economic and capital markets; directing grant making to companies that can sustain themselves, de-risking the pathway, and crowding in impact investors who offer equity or structured loan financing. The emphasis on the business case in private, investable companies has never been so critical.

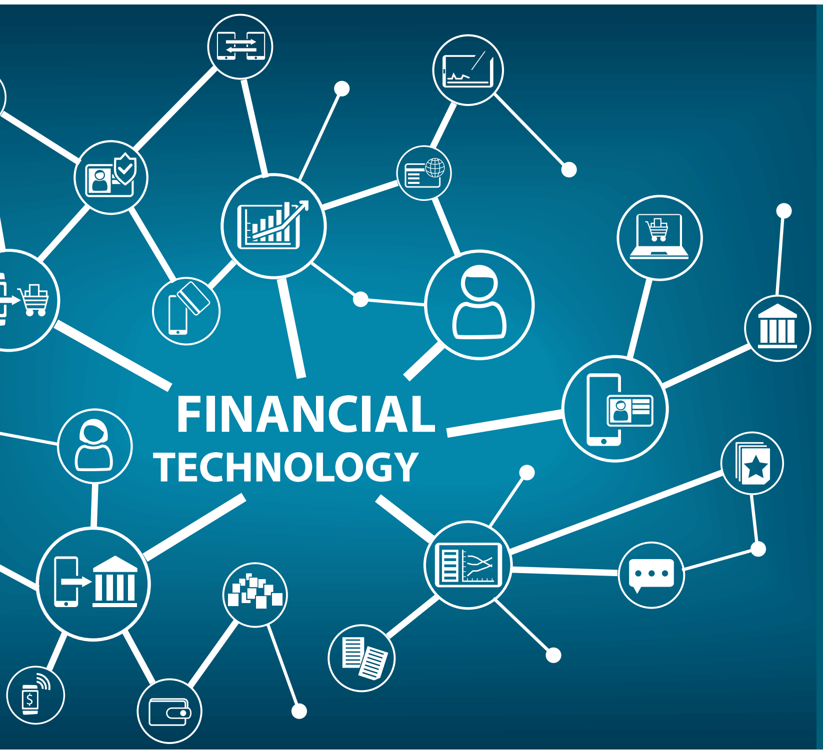
There are a host of new players (fintech, agent network managers, payment aggregators), that increase integration between the larger banks and Mobile Network Operators (MNOs) - through bespoke integrations or potentially via payment aggregators - and with smaller emerging players through APIs (Application Program Interfaces). Moreover, the landscape continues to be peppered with the "old guard" of Savings and Credit Cooperative Organizations (SACCOs), credit unions and Microfinance Institutions (MFIs) providing microfinance services like savings and loans; and non-governmental organizations (NGOs) establishing self-help groups and savings groups. Together these entities have decades of experience and have learned hard lessons serving low-income customers.

The choice of where to invest now is therefore a triangulation of a number of factors:

- Which company can garner the best business case?
- What companies can potentially be a bridge to further impact investment?
- What partners are nimble enough to be deeply involved in innovation with other partners?
- What company has an underlying motive to continue to persist on working through a poverty alleviation problem that is core (not a sideline) to their business?

As the ecosystem expands and is increasingly connected, it ultimately provides more opportunities for philanthropic capital to find ways to influence financial inclusion and poverty alleviation.

This Focus Note does not offer generalized solutions, but rather discusses one example of a collaboration between a market facilitator and a payment aggregator, to offer a digital savings group solution. It describes the multiple ways that elements of impact and sustainability were carefully considered and combined; challenges met and overcome.



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An Example of a Solution that Brings Digital Knowledge

We at FSDT have in the past two years been working with the Aga Khan Foundation (AKF), Selcom and Bankable Frontier Associates (BFA) on an effort to leapfrog the 'savings group linkage' models and fully digitize savings groups.

AKF's **Boresha Maisha** (Improve Life!) DSG design process began in 2015 with the objective of eliminating cash and bookkeeping **without** undermining the cohesiveness of groups. The Boresha Maisha platform is cashless and paperless, but otherwise similar to the traditional community-based savings group approach. Group members continue to meet physically, retaining the socially supportive role that savings groups play. Today, the platform is testing user experience with live groups in a pilot project to research behavioral change and further improve the offering.

This product will complement ongoing efforts to build an ecosystem of digital payment opportunities for financial services, and very critically, for the micro-businesses that generate the majority of employment in Tanzania. Also significant, this product will cultivate a culture of female DFS users given savings groups' membership is two thirds women. This fact alone carries a meaningful benefit: it strengthens efforts to achieve the Sustainable Development Goals (SDGs), specifically, to empower women and achieve gender equality.

While companies and projects often prioritize person-to-person and agricultural payments as key payments to digitize, we see that **households have greater volume and value in transactions with their savings groups.** Given this, it makes most sense for service providers to focus on acquiring savings groups' transactions first, followed by other transaction types.

Because of the benefits to be found in a fully digitized system (cash security, the ability to generate a share-out report, more time-savings by not having to make weekly payments in person, shorter group meetings, etc.), the more sophisticated members of the group are incentivized to help those less digitally literate to make their transactions. Operating savings groups over mobile payments eliminates cash, and therefore once the private sector develops the incentive to form savings groups as a customer acquisition strategy, scarce donor funding can be redeployed to increase the opportunity for this offering to reach remote areas through improvements to Global System for Mobile (GSM) coverage and agent network management.

Fully digitizing savings groups – digitizing all of the savings groups' transactions - engages them in the digital money world in a deep and meaningful way.

Now that Digital Financial Services (DFS) are scaling in Tanzania, and access to cash-in, cash-out points is improving, fully digital (cashless) savings groups have the potential to reduce implementation costs and member time investment; eliminate risk of theft; allow for greater variability in savings rates between members and across agricultural cycles; enable access to further financial products; yet preserve the procedures which create healthy and transparent groups.

Group failure rates have been estimated to be in the range of 5-10% per year, and there has been little research to determine how well the procedures of cash-based groups are preserved. Though some members may marginally prefer cash, (despite the potential advantages of a digital savings group), cash based savings groups are unlikely to satisfy the full scale of demand for membership in a well-run, transparent savings group.

Beyond simply meeting demand for memberships, savings groups' transactions need to be digitized to present a viable market for additional financial services to savings group members. While groups may want to deposit their savings in a bank account for security reasons, the business case for a bank to acquire new rural customers by investing in forming the groups is unlikely, as banking the aggregate amounts of savings relies entirely on float margins.

Savings Groups as a Customer Acquisition Strategy for DFS

AKF's Boresha Maisha Digital Savings Group Platform seeks to build a culture of active, rural DFS users utilizing digital savings groups as the platform for trial and adoption of DFS. Because savings groups attract a disproportionately high number of women, this becomes an effective means to ensure that DFS contribute to reducing gender inequity in financial services and household financial management.

By building the consumer, or demand side of the ecosystem for DFS, a digital savings group model is ultimately an alternative means of customer acquisition for digital services.

Based on a business case constructed by BFA, we saw that, at the moment, savings group formation still costs more than other means of acquisition of DFS customers. AKF's Boresha Maisha digital savings group is ultimately targeting an implementation cost of $10 per head; higher than the current benchmark costs of acquiring mobile wallet customers ($2-$3); or banking customers through agent channels ($6). However, digital savings group members are likely to prove to be much more active DFS users.

Reasons why digital savings groups are likely to be an attractive customer acquisition strategy include:

A **$10** per member promotion cost compares favorably to cheaper customer acquisition channels, given higher activity rates

Revenue streams arising from the promotion of savings groups could **cover the costs of promoting** the groups within a reasonable timeframe

Digital savings groups **capture a segment that cannot be reached** by those cheaper acquisition methods (such as rural women)

Digital savings groups **have the same or greater longevity** than cash-based groups, and offer their members a cost-benefit, meaning that transaction fees must be justified by time savings and greater transparency.

Satisfying Customer Needs on Multiple Levels

The business case for rural financial inclusion is currently undermined by a lack of consistent use of services. Although customers may take up a service, they do not necessarily use that service actively. Banks that target the low-income segment in developing countries bemoan the challenge of dormant accounts, which are often 50% of the total portfolio (even higher in India). The high cost of acquiring these clients did not translate into a persistent revenue stream.

Mobile money providers face similar challenges. The latest data from the Global Mobile Money Adoption (GSMA Global Mobile Money Dataset, December 2016) shows that only 30% of registered mobile money users continue to be active users and of those, a third of the transactions are for person-to-person transfers. Even when mobile money users utilize the service frequently, they often only employ it for a simple use case, typically cash-in, cash-out or person-to-person transfers. **This creates a situation in which low-income clients miss out on the benefit of multiple uses of mobile financial services, which not only generate a digital financial ecosystem but open multiple options available in the digital world to poor people.**

This suggests that it is worth a company spending more to acquire customers that provide consistent transactions to achieve higher activity and persistent use, which translates into higher lifetime customer value.

The goal is to enable companies not to acquire just any customer into the digital financial system, **but rather to consider that if the customer is acquired into the system via a savings group, they are a higher-value client.** To promote broader and increased uses of digital financial services, we should target the sets of transactions that are already important to customers, and those which have several different use cases; namely savings groups.

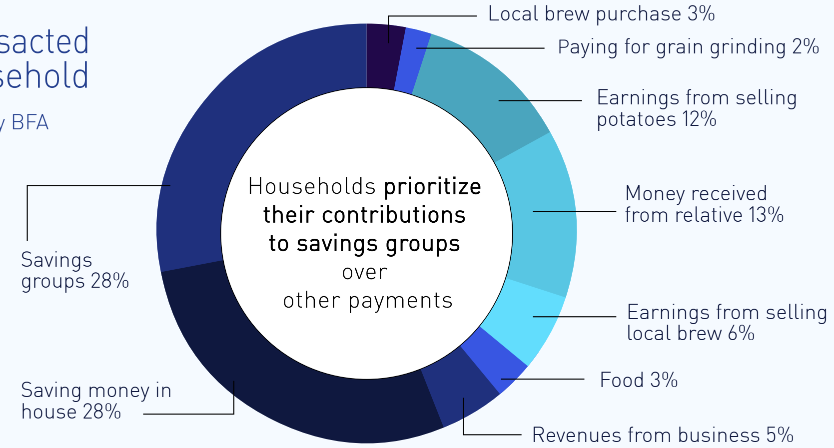
Simply digitizing the **information** of savings groups' cash transactions is not sufficient to overcome cost barriers to scale. Digitizing the group's financial transactions, to drive digital payments transaction volumes is **necessary** for financial service providers to extract the full value of savings groups.

Chart 1 below provides a picture of the types of financial transactions that are most important in terms of volume and value for an indicative smallholder household in a village outside of Mbeya, Tanzania. It documents all individual transactions undertaken within a month for this particular household, and ranks transactions in term of volume and value. Significantly, chart 1 illustrates that savings groups constitute nearly one-fifth of all transactions this household undertakes in a month and nearly one-third of the value of all transactions. According to the data found in BFA's extensive set of Financial Diaries research across 10 different countries, similar patterns exist in other household accounts.

Qualitative interviews among low income households through Financial Diaries globally have shown that **savings groups are emotionally important to households.** This qualitative research provides clear evidence that **households prioritize their contributions to savings groups over other payments.** Emotional prioritization is in part what also led to the success of M-Pesa with its Send Money Home campaign; connecting remittances to filial duty.

CHART 1: Shares of amounts transacted in a Tanzanian smallholder household

Source: CGAP Smallholder Financial Diaries, run by BFA



Crossing the Digital Divide

Examining savings groups transaction types, there are a variety of use cases: paying in, getting paid out a loan, sharing out, checking balances, keeping track of loans, etc. Each provide an opportunity for a client to perform a transaction. Altogether, savings groups are then a natural entry point to

- Familiarize new users with mobile payments
- Help providers "acquire" consistent transactions, and
- Build confidence in using a variety of use cases.

This last point is critical to continue to push financial inclusion to have a more meaningful impact of the lives of low income people. The common use case for mobile money is a person-to-person (P2P) transfer, but rarely does the use of mobile money extend to other use cases. The digital savings group product would allow women to use a variety of use cases – sending money to a common wallet, receiving money from a loan, checking balances, etc. – on a weekly and monthly basis. By repeating a variety of use cases so often, women will build a muscle memory of how to conduct them, and then grow confident to learn other ways to use digital money.

Most importantly, these savings groups give an opportunity for members to grow accustomed to using digital financial services within the "comfort of friends" leading to a more confident use of mobile payments for other financial activities.

In a broader, more futuristic vision, it means providing low-income rural residents, especially women, a safe space to assess and navigate the broader information in the digital ecosystem.[1]

Building the Business Case

To make the establishment of digital savings groups a profitable venture from the provider's side, the long-term revenue stream associated with these newly acquired digital payments users must justify the cost of forming the groups. Based on BFA's business casework with AKF and Selcom2, there is evidence that this may be achievable, with user fees and the revenue earned on idle funds ultimately covering the backend costs.

Critical to the business case for group formation, DSG's are substantially less costly to train than traditional VSLA models. In AKF's traditional, cash-based savings group model, trainers need to supervise each group over a 12-month period to facilitate each phase of the group's saving process

From assembling members

deciding on the first loans

undertaking the significant and complex process of share-out at the end of a cycle

With digitization, there will be several opportunities to reduce the cost of this training process.

Because digitization removes the need for paper record-keeping, costly experienced trainers can hand off work to community based trainers more quickly. The complex and lengthy training at the end of the cycle; teaching groups how to calculate members' share-outs is entirely eliminated. Likewise, because all transactions are digital, the need for any data collection is eliminated. All necessary monitoring information resides on Selcom's payment platform and is available 24/7 to be analyzed directly.

In all, estimated costs of training savings groups can be brought down significantly; from **$25** per member to **$9.25** per member with no loss of quality

In the process, members can reduce up to 80% of the time that they invest in meetings given they opt to cancel weekly savings meetings, and likewise, terminate the 3-4 hours dedicated to calculate share-out values at the end of the cycle as well as having shorter weekly meetings. By replacing the need for face to face contact with digital contact, the 'cost' of savings group participation from a member's perspective would fall as dramatically as the cost to train groups. In turn, this can empower groups and enable members to choose when to meet based on needs, rather than as required by cash-based procedures.

1 There is a wide body of literature about why learning in a group, or cooperative learning, is more effective, but to cite one well-known paper Roger T. and David W. Johnson (1988) in Cooperative Learning: Two heads learn better than one, cooperative learning is more powerful in producing achievement; create a more positive attitude towards learning; enhance how the group feels about each other; and create better interpersonal skills.

2 Based on estimates that BFA did with Selcom's business case funded by Bill & Melinda Gates Foundation, 2014.

Reaching into the Value Chain to Identify the Best Partner

BFA's business case research for savings group digitization[3] determined that banks are attracted to the high rates of savings steadily accumulated throughout the year that savings groups generate (approximately $125 per person in Tanzanian savings groups). This amount tends to be higher and more consistent than savings generated by their median basic bank account holder ($10 per person per year). Yet, paying for the transactions lowers their profitability from the earnings from the balances. MNO's are also attracted to supporting savings groups, although their interest is in acquiring the transactions (at least 60 per person per year; 4 to 5 transactions per month; far more than utility payments or P2P payments.) They have little interest in the balances.

By having Selcom as a third party payments provider, AKF's Boresha Maisha Digital Savings Group platform not only enables substantial digital transactions but also created a platform allowing further use of mobile channels. Having a payment provider like Selcom, as opposed to tying up with one MNO, permits savings group members to digitize their savings utilizing mobile carriers of their choice; a significant advantage over solutions provided by an individual MNO. Moreover, Selcom can build up data on member transaction activity which (beneficially) creates a digital credit history for each of Boresha Maisha's users.

In addition to transaction fees, deposits provide low cost capital to bank partners, and handling deposits generate a revenue stream from banks to Selcom. Neither MNO or bank has responsibility for the part of the transaction that does not fit their core business. Selcom can split fees every step of the process; provide group members with information such as the status of lending and saving within the group; and generate a share-out report at the end of the cycle. These services can be fee based, enhancing viability.

Similarly, Selcom can use transaction data to better target appropriate payment services to Boresha Maisha's users - buying airtime and handling P2P and bill payment for example, which has the benefits of 1) adding to their revenue stream and 2) building comfort in a range of use cases for the customer and the ecosystem. In sum, the estimates in Table 1 below demonstrate that digitizing savings groups provides a long term value proposition for savings group members and a payment aggregator (like Selcom). It certainly supports a scalable opportunity.

Table 1 illustrates customer acquisition costs and customer long term value for a basic bank account and mobile money, in contrast to our estimates of acquisition through Boresha Maisha. The profit is high enough to keep costs to a reasonable maximum of 3% of savings for group members; a level which AKF believes would be readily tolerated by group members who perceive it as a good investment (vis-a-vis risk reduction and reduced time cost i.e. attendance at weekly meetings).

3 See BFA and BMGF Focus Note 1: Outcompeting the lock box: Linking Savings Groups to the Formal Financial Sector and Focus Note 2: SG Linkages: The business case for private service providers, both on www.bankablefrontier.com and GAFIS Focus Note

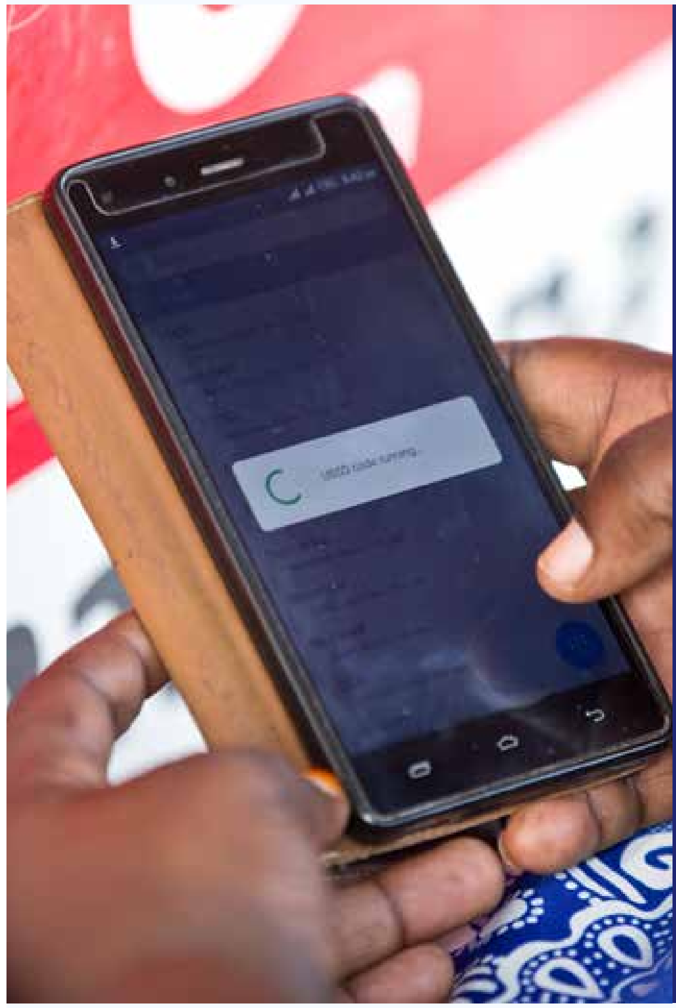
TABLE 1: Comparison between Bank, Mobile Money and Boresha Maisha

	CAC (Customer Acquisition Cost)	Monthly ARPU* (active customers, gross)	Months of active use to pay back CAC (gross)	% active	CLV** (net)
Basic bank account (branch)[1]	$15	$0.93	10	50%	-$0.92
Mobile money[2]	$2-3	$3	1	30%	$0.41
Acquisition through Boresha Maisha	$9.25	$0.35	11w	95%	$18

ESTIMATES FROM:

1. GAFIS Focus Note 3: The impact of gateway dynamics on the business case for small balance savings
2. GSMA (2016), Lyons (2010), Safaricom financial statements (2010-2013), BFA calculations
3. Boresha Maisha business case results from 2014 BMGF-funded project

*Average Revenue per Unit
** Customer Lifetime Value



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Triangulating to Find the Best Point of Investment

Today, there are many more choices for investment and grant-giving in the financial inclusion space than there were even a decade ago. Whereas investment choices used to be constrained to single source grant-giving, be it investing in an MFI to expand its customers, or a bank to introduce a new product for low income customers, or an MNO to expand its agent network for example, it is now more difficult to engage "new players" in the same way.

Not only are they inherently risky; because they are younger, they also tend to be too small to absorb much grant capital. Like an equity fund manager who has to focus on 60 or fewer stocks in a fund, a grant-maker also has a limited number of grants that can be made because each grant needs oversight and management. If philanthropic capital looks to engage with these new firms, it needs to do so in a structured way.

Against this backdrop, grant-making is not simply finding solutions to poverty alleviation (challenging unto itself), but has become about identifying winning companies who are small and nimble enough to work creatively on solutions; yet large enough to sustain the delivery of solutions once they are found to be effective and viable. Likewise, they need to be small enough to be interested in outside investment - large banks are often listed on stock exchanges which provide a cheaper form of capital. Top-down strategies of grant-giving continue to be significant, but increasingly the selection of actual companies to provide grants to has become akin to stock picking, not simply a matter of due diligence, but also a tactic on its own.

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