

Freedom from Hunger's Reaction to the Citi Foundation March 2012 Report on Financial Capability

“Bridging the Gap: The Business Case for Financial Capability” is a comprehensive, forward-looking and thought-provoking analysis of the financial capability landscape for microfinance clients. It covers all the key issues pertaining to the effectiveness of financial education and the challenges of extending financial education to those who are not yet receiving it. It also clearly presents the different models used around the world and provides a solid basis for a productive, sector-level discussion about the future of financial education.

However, three issues seem important to us at Freedom from Hunger to be analyzed deeper given their critical importance to the process of building full financial capability. They pertain to:

- The group-based models
- The product-linked financial education model
- The financial education business and social case.

Group-based education delivery models

The report appropriately emphasizes the high cost of trying to close the gap of financial literacy for 370 to 690 million microfinance clients (not to mention the 2.7 billion currently unbanked or under-banked), using group-based models. Thus, it is critical to explore new models that will help contain costs and allow MFIs to serve more clients. However, the report over-estimates the implementation costs of the supplemental model and seems to ignore any room for the improvement of group-based models.

Freedom from Hunger's extensive experience in group-based services provision (financial and non-financial) has led us to distinguish several variants of group-based models:

- The unified approach, which utilizes the same staff, usually the loan officer, providing both financial services and the financial education
- The parallel approach, in which financial and education components are provided by two separate categories of staff
- The linked approach, in which financial and educational components are provided by the staff of two separate organizations.

It is important to note that there are also hybrid approaches, which combine features from the approaches above in the context of the same organization.

Freedom from Hunger's experience has been that the most cost-effective model is a unified approach that leverages existing MFI staff and infrastructure to deliver high-quality financial education for clients.

The report did not distinguish between the different variants of group-based models in its analysis, bundling the unified and parallel approaches, which led to an over-estimation of costs.

Freedom from Hunger has conducted studies with its partners to better understand the costs associated with group-based models.

With CRECER, Freedom from Hunger's partner in Bolivia, a study of the *Credit with Education* program showed that the provision of education, delivered through the unified model, increased the total implementation cost by only 7%. A more recent study of Freedom from Hunger's Microfinance and Health Protection (MAHP) program¹ shows that health education costs can be absorbed as operating expenses with minimal impact on the overall financial performance of the MFI. It shows that the non-financial (health) services provided by Freedom from Hunger's MAHP partners can be delivered at an average marginal cost to these MFIs of only \$.29 per client/year. The study also suggests that within three years, the provision of health education is not only sustainable, but may actually contribute positively to MFI financial performance through increased fidelity, competitive differentiation and improved health of clients, leading to a decrease in late payments and defaults.

While we agree with the urgency of exploring new models to further reduce the costs of disseminating financial education, we do believe there is more room to improve the cost-effectiveness of the supplemental training model. Freedom from Hunger's experience in this area has helped us to improve cost-effectiveness by better adapting the services (financial and non-financial) to meet clients' needs, improving groups' quality and efficiency, and reducing the costs of MFI staff training by providing more cost-effective training systems. Freedom from Hunger is also currently exploring innovative opportunities for further cost reductions through the use of distance-learning tools and mobile devices to support MFI staff in the field.

We suggest a more thorough analysis be undertaken to understand the cost of the proposed models (e.g. product-linked models, client segments-linked models, performance-linked models) as was done for the supplemental training, thereby allowing for a direct comparison of costs and benefits. Until deeper analysis is done, it seems presumptuous to rule out this model, resulting in waste of experience and learning given that many organizations are currently employing this approach to the benefit of their clients.

Product-linked financial education model

While the report appropriately emphasizes the vastness of the financial capability gap, it recommends product-linked financial education as the primary strategy to close this gap going forward.

Efforts to close this gap must begin with an understanding of the diversity of client needs and the demand for a multitude of approaches to meet their specific needs. Thus, the sector must respond with a multi-pronged strategy, based on a nuanced understanding of the clients we serve.

Product-linked financial education should be regarded as but one of several strategies or models employed to close the gap. This is particularly important, given that the sector is still learning about the various approaches currently being implemented (including group-based models, clients segments-linked models and product-linked models) to understand which work and which require further

¹ The Business Case for Adding Health Protection to Microfinance (Freedom from Hunger Research Paper #10 – June 2010)

refinement to achieve a more cost-effective approach to expanding the financial capability of microfinance clients.

Freedom from Hunger has had success with product-linked financial education (PLFE) with its partners in Ecuador, Mexico (life micro-insurance, savings), Ghana (health micro-insurance) and the Philippines (savings) by linking financial education with the specific product being offered.

We have observed that this approach can create a stronger business case as well as fostering several additional benefits:

- The financial education becomes more relevant to clients' specific situations.
- Clients gain a practical understanding of how to approach and use the financial products.
- The MFIs are challenged to develop better-adapted financial products.
- MFIs are motivated to keep pace with new innovations in financial services.
- Clients' interests can be better aligned with those of the MFIs'.

While product-linked financial education is an interesting approach to pursue, it presents some potential risks or challenges that need to be mitigated:

- **The tension between financial and product marketing:** referring to a specific product makes it difficult to differentiate financial education from product promotion.
- **Costs:** Product-linked financial education may require more customization than generic financial education and thus result in higher costs.
- **Client exclusion:** Clients who haven't taken up the specific product are excluded from the financial education opportunity.
- **Client protection:** Product-linked financial education may force a specific product on clients who don't need it.
- **Measure of success:** It is necessary that the microfinance sector go beyond product uptake as the sole indicator of success. The use of financial products available does not alone indicate that we are making a positive difference in the lives of those that we serve; this point is further presented in the next section about the importance of the social case of financial education.

The sector must continue to innovate and evaluate new models, while continuing to improve existent models (including group-based). However, it must also recognize that a blend of several models and strategies will be required to meet the diversity of demand.

Business case and social case

The report emphasizes the importance of the business case as a key condition to selecting the models with the highest potential to help close the financial capability gap. This will help achieve full financial capability at a reasonable cost.

While we agree that the business case is important, we think it should be co-equal with the social case. In that regard, Freedom from Hunger and its partners seek the following outcomes for their clients:

- To empower the recipients of financial education to make informed decisions about financial services, encourage the appropriate use of financial products and promote self-confidence in dealing with financial institutions; and
- To enable clients to build solid financial assets that will reduce their financial stresses and their vulnerability to financial and other shocks.

Our experience has shown that these outcomes are achieved through the provision of financial education modules tailored to meet clients' specific needs.

Research conducted as part of the Global Financial Education Program (GFEP) concluded that when financial education is developed with input from the participants themselves, it can dramatically improve their knowledge of debt management, savings, and budgeting, and create positive behavior changes as well. The research also indicates a correlation between the financial literacy of clients and sound financial decisions, which lead to a stronger financial well-being in comparison to those who lack these capabilities. Therefore, it is critical that during the process we don't lose sight of the importance of the financial education social case.

Despite the extensive investments that Freedom from Hunger and others have made in research and impact evaluation, it is clear that more work still needs to be done to build a strong body of evidence showing the impact of financial education for microfinance clients. The sector's challenge today is to develop and expand financial education in ways that address the well-being of the client while at the same time improving the bottom line of MFIs. Therefore we must continue to build a stronger social case for financial education and to advocate for business models that emphasize a better convergence between clients' and the MFIs' bottom lines. In other words, let us not sacrifice the social case in favor of the business case.

Freedom from Hunger looks forward to pursuing the conversation with all stakeholders and to helping close the financial capability gap to achieve full financial inclusion.