DEVELOPING ALTERNATIVES

volume 10 issue 1 winter 2005

Discovering Hidden Assets—Financing the Base of the Pyramid

development alternatives, inc.

Since 1970, Development Alternatives, Inc. has explored alternative paths to development. DAI—which includes Bannock Consulting in London, ECI*Africa* in Johannesburg, DAI Palestine in Ramallah, and DAI Brasil in Rio de Janeiro—generates ideas through research, shares these ideas with the development community through publications, and tests the ideas in the crucible of development projects.

Developing Alternatives **provides a forum for DAI's professional staff and collaborators to expose their ideas to a wider audience. Articles treat policy issues of topical interest and aim at promoting broad discussion.**

The opinions and interpretations presented are those of the individual authors and do not necessarily reflect the views of any government or donor agency. Reproduction of the contents is permitted with an acknowledgment of the source. We solicit and encourage comments from DAI staff as well as from DAI's clients and collaborators.

Guest Editor: Matthew Gamser
Series Editor: Steven O'Connor
Designer: Joanne Kent

CONTENTS

1 The Giant Awakens—The Formal Financial Sector Meets The Base of the Pyramid
by Matthew Gamser

7 Banking on the People: BoP Economics in Mongolia
by Jay Dyer, J. Peter Morrow, and Robin Young

13 Migrant Remittances: A Profitable Proposition For the Financial Services Sector
by Cerstin Sander

17 Credit Bureaus in Latin America: Expanding Financial And Other Services to the Base of the Pyramid
by Robin Young

23 Looking Back/Looking Forward: An Early Report on *Eradicating Poverty through Profit: Making Business Work for the Poor*
by William J. Kramer and Allen Hammond

Jay Dyer of DAI has 16 years of experience in commercial banking, financial institution development, and project management.

Matthew Gamser, DAI's Director of Organizational Learning, works with governments and private businesses around the world to create an improved policy and regulatory environment for micro and small enterprise growth.

Allen Hammond is Vice President for Innovation and Special Projects at the World Resources Institute.

William J. Kramer is a Senior Fellow at the World Resources Institute, where he also serves as Deputy Director of the Digital Dividends program.

J. Peter Morrow of DAI has served as Chief Executive Officer of the Agricultural Bank of Mongolia since 2000.

Cerstin Sander specializes in microfinance and micro and small enterprise development. Formerly with Bannock Consulting, she recently joined the U.K. Department for International Development.

Robin Young is a senior microfinance specialist at DAI. She is the research leader on two studies for USAID's AMAP Financial Services Knowledge Generation Project.

Development Alternatives, Inc., 7250 Woodmont Avenue, Suite 200, Bethesda, MD 20814 USA
Telephone: 301-718-8699 Fax: 301-718-7968 Email: info@dai.com Internet: www.dai.com

THE GIANT AWAKENS— THE FORMAL FINANCIAL SECTOR MEETS THE BASE OF THE PYRAMID

by Matthew Gamser

We stand in the midst of a major shift in international development, in which international private capital and private enterprise are replacing international public capital and aid as the dominant resources. These new private sector players may take us much further in alleviating poverty and improving livelihoods—but only if they appreciate the opportunity at hand.

For years, corporate involvement in developing countries and emerging markets focused on exploiting key resources (natural and human). Extract the resource, make the product cost-effectively, and sell it where people have more money . . . that was the mantra. Firms kept their public profiles low, made quiet, individual deals with governments to support local operations (sometimes facilitated by behind-the-scenes diplomacy), and avoided extensive involvement with local institutions and societies.

Over time, this "stick to the knitting" approach led to dissatisfaction both in-country and back home, prompting a second phase in corporate development strategy: demonstrating philanthropic spirit. But initiatives such as building schoolhouses tended to be small, one-off projects with little if any relation to the core business and no concern for sustainability. Short-term image building was the focus.

Many corporations remain in this second phase. However, the last decade of the twentieth century saw a few companies move into a different kind of global citizenship, often through separate institutions such as foundations. A notable example is the Gates Foundation's work on HIV/AIDS, malaria, and tuberculosis. But such programs face concerns about their sustainability, and they too bear little relation to the companies' core businesses. Short-term impact on poor households is limited, as are collaboration and coordination among the firms involved, which in turn limit learning. CSR, or "corporate social responsibility," remains the dominant spirit of these ventures—not business, and certainly not profit.

Now, however, a small vanguard of companies is popularizing a radically different approach: seeing poor countries first and foremost as markets, and the poor masses first and foremost as prospective clients.

"If we stop thinking of the poor as victims or as a burden and start recognizing them as resilient and creative entrepreneurs and value-conscious consumers," says the University of Michigan Business School's C.K. Prahalad, an advocate for this approach, "a whole new world of opportunity will open up."[1]

The new vision seeks to make the corporation's business a vital part of local economic development by providing key products, services, and upstream and downstream opportunities for local entrepreneurs. In this vision, the corporation's development work is integral to its core business, generating short-term impact in-country and mutual profit. Interestingly, this new approach may generate maximum returns when implemented with other large international firms.

Mainstream Finance Meets BoP Finance

The mainstream financial sector's involvement with base-of-the-pyramid (BoP) markets has followed this same general evolution. Until relatively recently, extraction dominated the picture. If there was any

---

[1] *The Economist*, August 21, 2004.

involvement with BoP clients, it was to extract their savings and offer little else. In many countries, banks and other institutions put requirements on services, such as minimum deposits and extensive documentation/application requirements, that consciously drove poorer people away from their doors, into the hands of informal sector moneylenders and other service providers.

The past 10 years have seen increasing publicity about financial sector involvement with BoP markets, but most of this has been mere charitable participation. For all the hoopla about the progress of microfinance, there has been little real involvement of the world's largest financial institutions in microfinance successes. Grameen Bank may have "bank" in its title, but it is not legally established as a commercial bank, has no equity participation from Bangladeshi or international commercial banks, and does not operate in a way that international financiers would consider viable. Some notable nongovernmental organizations (NGOs) have converted BoP operations into successful commercial banks (such as Prodem's conversion into BancoSol in Bolivia), but few international financial institutions have ventured into this market area as a business. CitiBank and others have made contributions to microfinance through their foundations, but until recently their business operations have not been involved with this sector.

Although Dick Patten and Jay Rosengard wrote more than 10 years ago about how there could be "progress with profits" in financing the BoP, mainstream financial institutions are only now awakening to how lucrative these markets can be.[2] Patten cited the achievements of the Bank Rakyat Indonesia (BRI) "village unit" system, which at the time served 2 million borrowers and 8 million savers through its 3,600 branches across the country. Yet, many in international finance dismissed BRI's excellent (and today even better) results, saying they were due to a special relationship with central government, and even to special aspects of Javanese character (despite much of BRI's operations taking place outside Java, with similar rewards).

But times are changing, in large part because a growing band of local formal financial institutions has launched new initiatives targeting the BoP. BancoSol has been joined by other NGO conversions. A growing number of local banks and finance companies have introduced microfinance, either through their core operating structure (as in the case of the Cooperative Bank of Kenya, Hatton Bank in Sri Lanka, and BANESTADO in Chile) or by establishing new affiliates (as did Sogebank in Haiti). Today we can point to a wider range of successes by commercial financial institutions serving these markets, offering high-volume, high-efficiency services that yield strong and consistent profits. These successes are finally luring the international "big fish" into the BoP financial market pond.

This issue of *Developing Alternatives* highlights three cases in which the mainstream global financial sector is beginning to sound the depth of that pond. These cases, along with others, were presented at *Eradicating Poverty through Profit*, a conference held in San Francisco in mid-December 2004 organized by the World Resources Institute (WRI), with DAI as a major partner.

The first case, in Mongolia, involves the turnaround of a large state-owned bank, whose new BoP success has attracted a major international financial investor to take it over. The second case illustrates how international remittances from economic migrants to families back home—most of which are BoP-to-BoP money transfers—are coming out of the shadows and attracting major financial sector firms into this market. The third case shows how international credit information providers are venturing deeper and deeper into emerging markets, finding new clients while opening up new opportunities for local banks and BoP customers.

---

[2] Richard H. Patten and Jay K. Rosengard, *Progress with Profits: The Development of Rural Banking in Indonesia* (San Francisco, California: Center for Economic Growth, 1991).

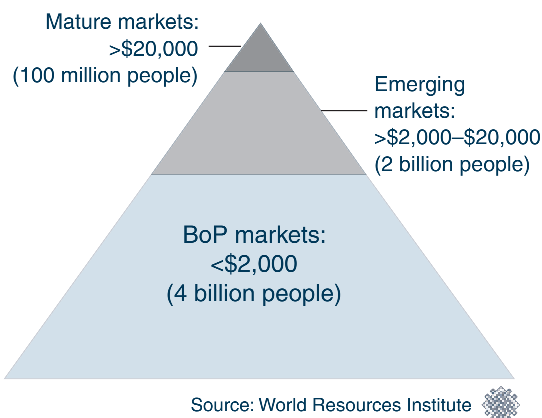
Case 1—Khan Bank: A Study in BoP Opportunity

With a per capita gross domestic product of only $430, Mongolia certainly is not rich, but it is showing signs of economic promise. Fixed-line and mobile telephone use jumped from 48 to 141 per 1,000 people between 1998 and 2002, for example.[3] The banking sector also has found good profits to be made in providing Mongolians with basic financial services—despite the BoP market in Mongolia being a highly dispersed population, in a vast, physically rugged country, with minimal infrastructure. The Khan Bank case study—co-authored by J. Peter Morrow, Robin Young, and Jay Dyer—describes how a change in management and approach turned abject failure into BoP-based success in Mongolia's only nationwide branch bank.

After many years of operating deficits, loan losses, and a failed privatization, Mongolia's Agricultural Bank (now more commonly known as Khan Bank) was placed in receivership in 1999. The only bank with branches throughout Mongolia to transfer money, make government pension and salary payments, and accept deposits, it was and is the only source of financial services for rural Mongolians, roughly half the population. The Government of Mongolia decided to recapitalize Khan Bank with assistance from the U.S. Agency for International Development (USAID) and the World Bank, and to install new management that would develop a more viable business strategy.

The management team developed a new lending program focused on the specific demands of the bank's customers, converted payment services into deposits, developed a marketing program to improve the bank's image and attract clients, implemented strong controls, improved the management structure, and increased training. Within a year, Khan Bank's operations were in profit. Pretax profits grew to $300,000 per month in 2003, and the bank's return on equity (39 percent in 2004 [unaudited])

THE WORLD ECONOMIC PYRAMID



Source: World Resources Institute

makes it one of the most profitable banks in the country—all based on serving the BoP market.

Khan Bank now has 390 points of service, many more than any of Mongolia's other 16 banks (and up from 269 when new management took over). It employs more than 2,000 people. The average deposit account is only $198 and the average loan is only $489. These and other statistics demonstrate that profit lies in high-volume, market-priced services. In short, the base of the pyramid in Mongolia provides a solid foundation for business.

The acid test for Khan Bank came when the Government of Mongolia put it up for sale and received three viable bids, all from strong, fully qualified private sector parties. H.S. Securities of Japan—a commercial investment firm—purchased Khan Bank for US$6.85 million, not out of any sense of social responsibility, but because it saw a good deal that extends its presence into a new market tapping hundreds of thousands of new customers.

Case 2—Improving Remittances Services

As Cerstin Sander notes in her article, roughly $100 billion per year flows from an expatriate diaspora in more developed nations to families in

[3] World Bank Group, Mongolia Data Profile, 2004.

poor countries (in officially tracked transfers), far more than official foreign aid. As little as one-third of all remittances move through formal financial institutions; the rest go through *hawala* and other informal money transfer agents. This huge market has developed despite limited networks of formal money transfer services in developing countries, which severely restrict these movements. Specialized money transfer operators, such as Western Union and MoneyGram, have dominated this market, aggressively expanding their network of agents and points of sale but offering a relatively narrow (and still expensive) range of services.

Now the remittances field is seeing an explosion of new entrants. There are region- and country-focused transfer specialists, such as Anelik Money Transfers of Moscow (with branches throughout the former Soviet Union and Organisation for Economic Co-operation and Development countries) and Microfinance International Corporation of Washington, D.C. (El Salvador). Some large banks are targeting specific migrant markets in new partnerships, as in the case of Lloyds Bank-ICICI Bank for the Indian diaspora, and La Caixa (Spain) and Citibank's (USA) collaboration with Latin American banks.

Technological innovation is fueling further market development. Business models for remittance transfer still build on the original basics—involving checks, correspondent banking, or fax transfers—but are increasingly becoming more innovative by taking advantage of newer technologies. Internet-, email-, and mobile phone-based transfers are becoming more common; a text message or an email through a secured system is all it takes to transfer money.

Case 3—Private Credit Information Services For Emerging Markets

Major international credit bureaus are discovering substantial markets for their services in poorer nations. As Robin Young writes in her article, BoP niches such as consumer and microenterprise lending, with their high-volume transactions, present significant potential for credit bureau expansion. Credit history information provided by privately run credit bureaus helps open up these markets for banks and other financial institutions. The proliferation of credit bureaus creates not a win-win situation, but a win-win-win equation: banks, consumers, and credit bureau operators all profit from the new services.

Using their large databases, credit bureaus are able to develop additional revenue-generating services such as credit scoring and other decision-making models that these lenders value. The recent expansion into emerging markets of established credit bureaus such as Transunion and Equifax, along with the establishment of new local and regional credit bureaus throughout Latin America during the past decade, indicate the perceived profitability of these ventures to multinational credit information firms. Private credit bureaus of some type operate today in Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, Mexico, and Peru. One bureau in the Dominican Republic is processing 600,000 credit information requests per month. At $1 per request, that is both serious business and a doorway through which many poor entrepreneurs finally get access to bank loans. DAI has helped introduce new credit bureau operations in Ecuador, where one operator has amassed 350 clients after only a short period of operations and expects clients to exceed 2,500—demanding 250,000 reports per month—by 2006.

A Global Trend

These three case studies are part of an emerging trend that has seen financial institutions all over the world reappraising the financial and social returns of providing services in BoP markets. In India, for example, the ICICI Group includes the largest private sector bank, the largest consumer credit provider, and the largest private sector life and general insurer in the nation. It has an asset base of more than $30 billion, and made $375 million in profits in its last business year (April 2003–March 2004). Why should such a behemoth

THE REMITTANCES FIELD IS SEEING AN EXPLOSION OF NEW ENTRANTS.

care about the BoP? As Nachiket Mor, ICICI's Executive Director, explained to the *Eradicating Poverty through Profit* conference, much of the bank's achievement is in the urban sector, which accounts for only one-third of India's population. The upper- and middle-income segments of this market are fairly well served today, and the market is becoming more and more competitive. At the same time, 741 million Indians in rural areas are poorly served, despite a huge demand for financial services, including an estimated annual credit demand exceeding $10 billion. In this environment, ICICI is not resting on its laurels. Its vision is "to become the largest provider of financial services in India, with a ubiquitous presence."[4]

Implementing this vision requires transforming the bank's operations from top to bottom. ICICI will move from a branch base to an entrepreneur base (seeking out business in the community rather than waiting for clients to approach the bank), from staff-intensive processes to technology-intensive processes, and from a single-product emphasis to a multiproduct emphasis. ICICI has entered into risk-sharing partnerships with NGO microfinance institutions, merging the social mobilization skills and rural presence of the NGOs with the capital resources and financial credibility of the bank. And it is developing new securities based on existing microfinance institution loan portfolios to raise expansion capital from Indian markets for the new partnerships.

Since launching the new strategy in March 2002, ICICI has extended new services to 8,781 villages and 450,000 new banking clients, and it expects to reach some 920,000 more new clients by March 2005! ICICI also has rolled out a new set of partnerships with Indian corporations to install "Internet kiosks"—offering a range of financial and nonfinancial services—in the villages from which the corporations source low-wage labor. Having established 949 kiosks during the pilot year, ICICI believes it can set up a further 10,000 in the coming year, providing convenience, flexibility, and more comprehensive financial solutions to BoP microenterprises.

South African financial institutions are charting a similar course. Motivated by social as well as economic imperatives, they have agreed on targets for improving their services to local mass markets. Taking the Government of South Africa's economic agenda into its own hands, the financial sector has committed to provide 80 percent of the poor majority with basic transaction products (money transfers, salary deposits, and so on) and with basic savings services by 2008. It agreed on similar targets for life insurance, short-term risk insurance, and other financial products for the poor.[5] The sector also established indicators to measure progress and combined these into a "scorecard" to rate each institution's performance.

Although this initiative is new, it is already showing returns. In October 2004, the four largest commercial banks in the country launched a new national savings account, the Mzansi Account. Four other banks quickly followed suit. Mzansi is a low-cost account that allows free deposits at all times and a set number of free withdrawals per month. There is no charge to open an account, and only a basic identity document is required. Mzansi is intended to

[4] See Nachiket Mor, "ICICI Bank in Microfinance: Breaking the Barriers," *Eradicating Poverty through Profit* conference, San Francisco, California, December 13, 2004; presentation available at http://povertyprofit.wri.org/program/program.html.

[5] The charter defines this "poor majority" by the standards set out in the South African Advertising Research Foundation (SAARF) Living Standards Measures (LSM). The targets refer to people from households in LSMs 1-5, which in 2002 accounted for more than 65 percent of all households and represented households with monthly incomes of less than ZAR 2,230 (approximately US$225/month). Data from SAARF presentation, September 2002.

bring new clients into the formal financial system, and already it is succeeding beyond expectations. More than 100,000 new accounts were opened in the first three weeks of the offer. This represents an increase of 1 percent of the country's 13 million bank account holders. Banks report that the vast majority of Mzansis are first-time accounts.[6]

Opportunity, Imperative, or Both?

These cases represent just a small taste of what is now cooking in the mainstream financial sector's investigation of BoP opportunities. At the *Eradicating Poverty through Profit* conference, major presentations on new BoP financial service initiatives were made by representatives of such firms as Visa, Hewlett-Packard, Vodafone (integrating cellphones with financial services), Citigroup, Lloyds TSB, ABN Amro, Equifax, and Datacredito (a major Latin American credit information provider).[7] The speakers did not come from these institutions' charitable foundations, nor from their "corporate social responsibility" arms, but from their business divisions, because they are pursuing the new financial services as viable business opportunities.

As Allen Hammond and C.K. Prahalad point out, serving BoP markets is probably more than a market opportunity—it's a market imperative: "Blocs of poor consumers increasingly have the power to reject what a multinational corporation wants to buy or sell. . . . It may not be wise for corporations to wait for governments to smooth the path of globalization, or to depend solely on formal trade talks to make developing markets safe for their products."[8] Instead, they should innovate in their product and service lines to overcome the constraints that limit access to BoP markets. The global financial giants, until recently slumbering with respect to BoP markets, may be moving to the vanguard in fighting poverty through profit-driven initiatives. ◆

---

[6] "Mzansi Signs Up 100,000 in Three Weeks," *Business Day*, November 17, 2004.

[7] World Resources Institute, *Eradicating Poverty through Profit* conference, San Francisco, California, December 12–14, 2004. For more information see http://povertyprofit.wri.org/.

[8] Allen L. Hammond and C. K. Prahalad, "Selling to the Poor," *Foreign Policy* 142 (May/June 2004): 37.

BANKING ON THE PEOPLE: BOP ECONOMICS IN MONGOLIA

by Jay Dyer, J. Peter Morrow, and Robin Young

After many years of operating deficits, loan losses, and a failed attempt at privatization, the Agricultural Bank of Mongolia (Ag Bank or XAAH, now known as Khan Bank) was placed in receivership in 1999. Many observers in the international community saw Ag Bank as an unsustainable operation that should be closed, but Ag Bank was the only bank with branches throughout Mongolia's vast territory to transfer money, make government pension and salary payments, and accept deposits—closing it would have had a devastating impact on the rural economy. The World Bank therefore made reforming the bank a condition of its Financial Sector Adjustment Credit Program for Mongolia, and USAID agreed to fund an outside management contract. In turn, the Government of Mongolia gave this outside manager full authority to manage the institution free from political or other interference.

DAI was selected to manage the bank, and in July 2000 a team led by J. Peter Morrow arrived in Mongolia to restore financial soundness, bring financial services to the country's rural population, and prepare the bank to operate independently as a precursor to privatization. To achieve this mission, the management team developed a new lending program, converted payment services into deposits, launched a marketing program, implemented strong controls through new policies and procedures, reorganized management, and increased training. In January 2003, the Government of Mongolia received three viable bids for the bank—all from strong, fully qualified private sector buyers—and in March 2003 sold it for $6.85 million to H.S. Securities of Japan, which hired DAI to continue managing the institution on a contract paid entirely out of bank income.[1]

Rural Mongolia has been the bank's main focus, and its successes there have laid the foundation for substantial growth and new services for all Mongolians, guided by its mission "to be the principal nationwide financial services company in Mongolia by delivering first-class products with the highest level of customer service." Key to the bank's turnaround was profitably developing and implementing products throughout the country. Ag Bank has shown that financial products can be created and delivered gainfully even in sparsely populated and poor areas—if those services truly meet the needs of customers. And the institution has proven that in addition to sustaining itself, it can contribute significantly to Mongolia's overall economic development: aside from the large impact of its loan and deposit activity, the opening of more than 100 new branches and the creation of more than 1,000 jobs have boosted the economies of many communities, and Ag Bank—once a cash drain on the government—is now one of the largest taxpayers in Mongolia.

In short, the case of Ag Bank shows that effective management and sound business principles applied to a BoP market can yield a viable enterprise and deliver tangible social goods. This article reviews how it was done and what was learned.

Objectives: Sustainability and Privatization

At the beginning of the management contract, the DAI team knew it would be crucial to build internal staff capacities, develop proven products for the market, and free the bank from pervasive political influence. The initial goal of privatization would require stabilizing the institution and creating trans-

[1] DAI has since taken a 2.3 percent ownership position in the bank.

parency so buyers would understand what was on offer. And it would be crucial to develop and expand the product and service offerings so the bank could generate the profitability to sustain itself.

Political Issues

Before the intervention of outside management, Ag Bank was closely supervised by political authorities, particularly at the local level. *Soum* (county) and *aimag* (province) governors appointed the bank's local managers and considered them part of the local municipal management team. Loans were directed or heavily influenced by local political needs. The head office had relatively little control over offices and their operations. Thus, a critical part of the restructuring plan was to insulate the bank from this political interference. Agreements between the Government of Mongolia, Central Bank, World Bank, and USAID required the government to refrain from interfering in any Ag Bank operations, other than continuing Central Bank supervision and monitoring.

In effect, normal corporate governance was suspended for the remediation period. An independent board of directors—two members from the Government of Mongolia, two nominated by USAID, and an unaffiliated professional chairman—was appointed to monitor the remediation process and ensure the government did not interfere. This board, a semiannual meeting between the management team and donors, an annual independent audit, and Central Bank supervision comprised the ad hoc corporate governance structure for the restructuring period. Essential to break the pattern of interference that had contributed significantly to the bank's demise, this arrangement survived a complete change in government from the Democratic Party back to the former Communist Party in 2000. Although initially suspicious of the agreements made for Ag Bank's remediation, the new government eventually supported it fully.

Credit Culture

No bank in Mongolia had previously attempted to develop and implement a fully transparent lending program available to all who qualify. Some donors suggested that Mongolia's loan culture was so bad that the bank should be remediated without lending powers, but the DAI team felt that it was critical to make loans; otherwise, the bank could not recover financially or restore services to the public.

Designing appropriate financial products and motivating staff proved to be the keys to building a new credit culture. Previously, most people in Mongolia had to rely on pawnbrokers and family members for loans, so the bank's new lending products were truly welcome: they allowed people access to larger sums of money at a lower cost. Likewise, in the past, loans secured from banks were associated with the government. Institutional pressure to repay on time was often lax, the culture of timely repayment typically weak or nonexistent.

For the sake of growth and profitability, that culture had to change, among branch managers and customers alike. Ag Bank began to hold branch managers completely accountable for their decisions and granted zero tolerance to politicians who tried to influence lending practices. Needless to say, it was easier to build this firewall with an outside management team running the bank.

Staff Culture

Some observers felt that the bank had too much of a "state sector" mentality and that the staff would be unwilling to accept changes necessary to turn the bank around. However, the employees were well educated and competent in their day-to-day tasks. Although it was clear that a new organizational culture could not take hold overnight, the key was to harness the capabilities of the staff right away and then expand on their skills. Management wrote new policies and procedures for all functional areas of the bank and developed a training program. Given the bank's regional and branch operating structure, the

DAI team used training-of-trainer programs at the *aimag* level—at provincial or regional hubs—with *aimag* staff then training staff at rural locations reporting to that hub. The program became a fast and efficient way of disseminating new products and other communication, and the "state culture" of rule-following meant employees caught on quickly and responded to the changes.

In addition, each *aimag* center branch manager now comes to the head office in Ulaan Baatar once a quarter for substantial one-on-one time with senior management, in which quarterly targets are set (for lending and deposit generation) and administrative issues handled. Because they are set mutually between the regional areas and the home office, these targets tend to be realistic yet in line with overall bank strategy and objectives.

The achievement of targets is reinforced through an incentive system that has become a critical part of the bank's success. Every quarter, employees receive incentive compensation that is a significant percentage of their salary. This incentive system is emblematic of a new culture—changed from one focused on tasks to one focused on customers and revenues—that is still evolving but clearly much improved.

Brand and Image

A major obstacle to the turnaround was changing the public's perception of the bank as politically driven, untrustworthy, and insolvent. The first step was to provide valuable products and services to customers as soon as possible. The 1 percent withdrawal fee—a major impediment to mobilizing bank deposits—was immediately dropped and rates on time deposits raised to the top of the market, quickly giving the bank the liquidity it needed.

The management team also brought in external marketing expertise and launched a public relations campaign to convince Mongolians that the bank was serious about business and open to all. The bank rebranded itself by switching its name to an acronym, "XAAH"—khan or king—a name with strong local appeal because of Genghis Khan. Television and radio campaigns followed.

Product Strategy

The management team's strategy has been to develop products that meet the needs of a large segment of the market, ensuring diversification by product and geographic area. The idea was to pilot products and then expand delivery rapidly countrywide, while maintaining a focus on quality lending. All products were designed to be integrated into the branches by existing staff responsible for delivering a wide array of products.

Loans. Ag Bank continues to identify market opportunities for new loan products. Starting with working capital loans for micro and small businesses just four months after the management team took over, the bank has expanded to medium-sized enterprise, pensioner, herder, payroll deduction, and agricultural loans. Now it is piloting mortgage loans. Although most loans are in the local currency (tugrug), some are available in U.S. dollars. Prudent credit policies ensure lending decisions are based primarily on a client's cash flow, followed by collateral, to ensure low default rates.

Deposits. DAI's deposit strategy has had three goals: (1) increase the deposit base to fund the bank's growth; (2) attract many and diverse customers (business and consumer) to solidify the bank's franchise and strengthen the network; and (3) lessen the dependence on government funds. By creating products that meet the needs of the market, dropping withdrawal fees, and providing good customer service, the bank has been able to increase its deposit base 1,129 percent since July 2000. This growth has in turn propelled the bank's expansion. Deposit products include personal or business current accounts, savings accounts, time deposits, pension direct deposit, and payroll direct deposit.

Money Transfer Products. All transfer products are available to anyone, but with reduced fees for Ag Bank customers. Quick Pay has been key to the success of the bank. It guarantees fast delivery (in three

hours or less) of cash transfers between offices in the capital and any one of more than 75 online locations throughout the country. The Money Transfer program allows the transfer of money from one Ag Bank location to another, with delivery the next day to a regional center and within three days to a rural center. Through Western Union, money can be received at any Ag Bank location in Mongolia and funds sent to more than 180 countries worldwide.

Impact

As noted above, the DAI management team developed a new lending program, converted payment services into deposits, launched an extensive marketing program to increase deposits, implemented strong controls, reorganized management, and increased training. The product portfolio has been expanded to include loans, deposits, domestic and international transfer products, and government payment services, for clients including micro and small businesses, herders and farmers, consumers, and government organizations. Individuals who would not qualify for the bank's small business loans often use a consumer loan to get started in a new venture.

Ag Bank has effectively created a new class of bank borrowers. By recognizing the informal lending sector as a real competitor, it has been able to provide a service that encourages many borrowers to move into the formal financial system. Ag Bank's branches are quickly replacing pawnshops, store owners, and relatives for business and consumer borrowers. As a result, families and businesses are able to borrow more money at better terms and lower costs. As of January 15, 2005, 1,308,352 loans had been disbursed and 143,884 were outstanding.

Another important change has been the conversion of 200,000 government social security and salary payments into deposit accounts. Experience at Ag Bank shows that one-third of all government payments made through a deposit account stay in the account for an extended period. This conversion has brought more deposits to the bank and has helped build relationships with new customers who could then take advantage of other bank services and loans.

RESTRUCTURING RESULTS

The results from the new products introduced and other restructuring initiatives have been impressive. Some of the remarkable statistics for the period July 2000 to January 15, 2005, are:

- The number of banking offices grew from 269 to 390.
- The number of employees increased from 803 to 2,134.
- The total portfolio outstanding is $70 million.
- The average loan size is $489.
- Deposits grew 1,129 percent from about $9 million to $110 million; the 471,283 deposits have average balances of $198 (as of January 31, 2005).
- In 2004, return on assets was 2.6 percent and return on equity was 38.8 percent.

Money also has moved out from under mattresses; individual deposits grew from $2 million to $54 million between December 2000 and February 2004. Most new depositors are people who were not previously depositors in banks, and the average deposit account at Ag Bank is $198.

Ag Bank's aggressive increase of deposits and loans and a subsequent expansion of other banks' operations throughout Mongolia have had an impact on the intermediation of Mongolia's money supply. In 2000, more than half the country's money supply was in the form of currency outside banks; today, less than one-third is held as currency. The long-term benefit of this intermediation for Mongolia's development is considerable because it provides internal resources for increased investment.

Another measure of the bank's impact is the growth in the small businesses that dominate rural Mongolia. Average small business loan sizes have increased steadily over the past three years as increased inventory levels have translated into increased sales. Today, with loans to micro, small, and medium-sized enterprises, Ag Bank's average outstanding business loan is $1,453.

From a cost recovery perspective on the original work begun in July 2000, the value of the bank has increased so much over the period that it could easily have paid for the turnaround by the value that was created, witnessed by the sale price and the ongoing management contract between H.S. Securities and DAI. The earnings in 2003 were close to the entire cost of the three-year, donor-financed turnaround.

Lessons Learned

Turning around a large state-owned bank is no easy matter and depends on a confluence of political and financial circumstances, both internal and external. The most critical lessons learned from the turnaround of Ag Bank are summarized below.

Management must be politically independent and qualified. Ag Bank's new management was able to pursue successful turnaround strategies at Ag Bank because of the remediation's unique design and the support of the bank's stakeholders. As the traditional state-owned bank in the countryside, Ag Bank was under strong pressure to serve the government's political needs. But because the USAID-funded project team was given full authority for the bank—a unique approach for USAID—a new credit and operating culture had the space to develop, and this in turn produced a profitable, high-quality credit portfolio. This carefully structured independence, buttressed with donor conditionalities, was essential to rebuilding a sound bank.

The starting balance sheet must be clear. Before beginning an assignment, the turnaround team must understand the true position of the bank's balance sheet and negotiate accordingly with the government. All earnings and fixed assets must be properly evaluated, and any needed capital injected into the institution to raise the capital base to no less than zero. Capital can be injected as cash or as development bonds, depending on the institution's liquidity. If bonds, the interest should be paid in cash to provide adequate cash flow. Adequate funds must be available to cover initial operating costs and to purchase immediately required fixed assets. And a long-term cash flow stream must be identified to support ongoing operations.

Staff require training, incentives, and protection from political pressures. Staff require ongoing training in skills, policies, products, and systems, especially during a time of significant organizational change. Transparent and performance-based incentive systems help ensure that priorities and behavior are aligned with the institution's best interests. When staff are threatened by political forces, senior management should provide protection by taking a hard line on new policies and giving staff an "excuse" for not succumbing to political pressure.

Marketing is essential. Focused research, strong brand promotion, and customer-responsive products that provide an income stream to sustain the organization are essential. In their market research, for example, Ag Bank's managers combined the local knowledge of branch managers, formal market surveys, and experience from other developing countries.

Financial intermediaries can profitably service low-income markets. Some doubt whether low-income populations are willing and able to pay for the financial products and services they need, but the experience in Mongolia proves otherwise. Where per capita incomes are low, experience shows there is a large market for the right kind of deposit and credit products, even if interest rates and fees are relatively high. Low-income market segments will pay for the right products and good service.

Meeting clients' financial services needs has a positive economic impact. Often, small businesses will borrow smaller amounts of money than they need, which can be valuable in building a borrowing history. However, if the lending products do not adequately meet the needs of the businesses and match their ability to service certain levels of debt, a large dropout rate will occur. Thus, the products (including the delivery and services attached to them) must grow and develop to accurately reflect the needs of the market. The most expensive part of a borrower relationship is acquisition—bringing

the borrower into the institution for the first time. Profitability and sustainability will come from loan renewals and cross-selling other products.

Penny-wise may be pound-foolish when it comes to operating efficiency. Although competitive and profitable banks must operate efficiently, the focus should not be exclusively on cutting costs. Rather than closing branches, the focus should be on revenue-generating services that take advantage of the network. Incremental revenue can add up to significant net income. Operating costs must remain under control, but state-owned banks can usually meet the needs of their market segment with relatively low-cost operations. The intent is not to compete with international banks going after high-end customers but to appropriately serve rural and low-income market segments. Banks should spend money to make the branches adequate and comfortable, but these branches do not have to be the best in town. Occasionally, only two people are needed in a location, and hand ledgers and a calculator may be adequate technology.

State-owned banks can be turned around. With a low operating cost basis and good returns from lending, Ag Bank was able to generate the profits to reinvest in physical and human infrastructure and make the bank sustainable while providing the needed services to the underserved market. The process evolved into a "virtuous cycle" driven by strong demand, as well as unmet need, for the new services. Ag Bank's experience refutes the commonly held view that state-owned "dinosaur" banks cannot be turned around and successfully privatized. And there may well be other such dinosaurs out there—banks where, despite a poor history and state sector culture, the franchise value latent in the branch network or customer flow can be capitalized into profits and sustainability.

For its part, H.S. Securities is moving quickly to consolidate the turnaround. Ag Bank's buyer has stated that it wants to continue to expand, based on Ag Bank's target markets, and will invest millions of dollars more to deepen outreach and market penetration. Since privatization, the bank has continued to grow rapidly, practically doubling its loan portfolio from $24.7 million to $49 million during the first year. This was supported by a 110 percent capital increase (from 3.9 billion to 8.2 billion tugrugs, or $3.32 to $6.98 million at actual exchange rates), through reinvesting all earnings and H.S. Securities' fresh capital injection of $2 million. This profit-driven financial commitment is the best assurance possible that Mongolia's people—urban and rural, poor and otherwise—will continue to receive the financial services they need. ◆

MIGRANT REMITTANCES: A PROFITABLE PROPOSITION FOR THE FINANCIAL SERVICES SECTOR[1]

by Cerstin Sander

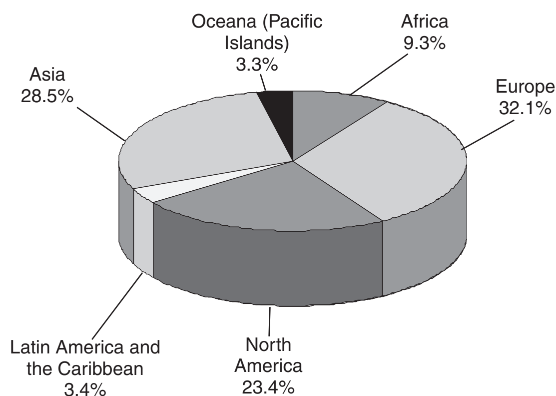
Migrant remittances have turned into a booming business for savvy service providers. In 2003, migrants sent approximately $100 billion home to developing countries, and the numbers continue to grow as people become more mobile and international migration emerges as a significant global phenomenon. Some 3 percent of the world's population is counted as migrants and many more elude the statistics. Migrant populations are highest in high-income countries but are still significant in middle- and low-income countries.

From a financial service and business perspective, at the core of remittances is money transfer or plain transactional banking, in itself an excellent business opportunity, as Western Union and MoneyGram have long recognized. More recently, many smaller providers have entered the market, especially in regional corridors such as between the United States and Latin America or between Russia and the Commonwealth of Independent States. Most of these providers focus on the business of money transfer. The key is to recognize the remittance corridors, build reliable and efficient networks to serve the sending and the receiving communities (partnerships or open networks), make the product accessible and attractive (such as through pricing, service hours, and appropriate language services), and make it known (marketing).

Although migrants and their families back home often remain unbanked, banks have begun to recognize the opportunities in this client segment and have developed business models and approaches to serve it. These concepts extend beyond transactional banking to include integrated financial services; the remittance is the entry point for service offerings that aim to provide complementary financial services to migrants and support asset building among the senders and recipients of remittances.

Reliable money transfer is one of the primary financial services migrants require. The lack of accessible services—or insufficient awareness of the services that are available—means many migrants send money through informal channels. While often efficient and reliable, these informal mechanisms actually represent missed opportunities for the senders and recipients of remittances to save and build assets, and the loss of a large flow of capital and potential deposits for the financial sector.

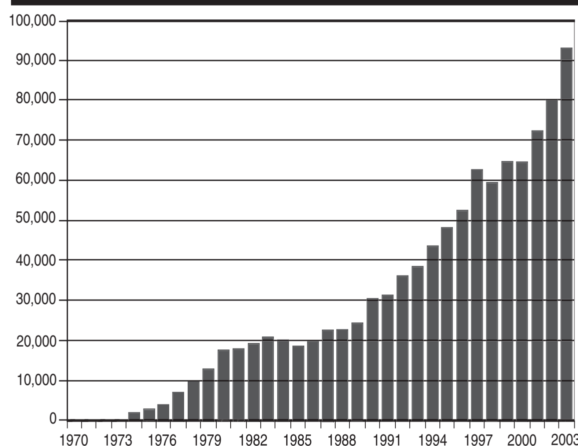
MIGRANT POPULATION AS A PERCENTAGE OF GLOBAL STOCK BY REGION



Migrant population (stock):
as a percentage of total global population = 3%
in more developed countries = 60%
in less developed countries = 40%

[1] This article combines new material with the author's contributions to *Migrant Remittances*, a quarterly newsletter published under USAID's AMAP Financial Services Knowledge Generation Project (www.microlinks.org).

MIGRANT REMITTANCES TO DEVELOPING COUNTRIES, 1970–2003 (in US$ million)



It's a Big Market: Global and Regional Remittances

Migrant remittances, recorded at $93 billion for 2003 and estimated at $200 to $300 billion a year, have grown alongside the growth of migration. Remittance flows to developing countries have tripled in the past decade or so. With $68.4 billion recorded in 2000, the data also suggest accelerated growth, although it is hard to determine how much of this increase reflects actual growth in volume and how much is due to improved records and to more of the transfers being sent through formal channels. The baseline, however, is that remittances are significant flows of funds to developing countries—second only to foreign direct investment (FDI) and much greater than official development assistance (ODA).

Migrants typically send home $100 to $200 per month; from host countries with higher incomes, transfers of $500 per month are common. Given these relatively small individual amounts, migrants would probably be surprised at the global aggregate of money remitted. Yet to migrants and their families, sending money home is a natural thing to do—to support the family, save for the long term, or invest in a family home. Remittance recipients use most of the money to finance daily needs and consumption and thereby invest in "human capital" (such as food and education); they also invest in assets (such as real estate or savings) or in business.

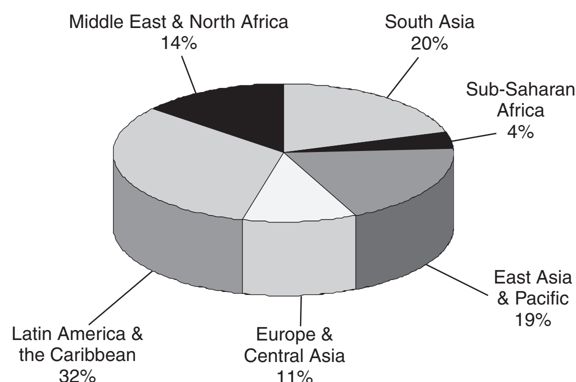
For many countries—such as Albania, the Dominican Republic, El Salvador, India, Tonga, and Yemen—remittances constitute an essential flow that is often the single largest inflow of foreign capital and exceeds both ODA and export revenues.

Regionally, World Bank data for 2003 show that Latin America and the Caribbean receive the largest share of remittances in nominal terms ($29.6 billion); South Asia is in second position ($18.2 billion). Relative to gross domestic product (GDP), however, South Asia is the largest recipient, with remittance receipts amounting to 2.4 percent of GDP (compared with 1.7 percent of GDP for Latin America and the Caribbean). East Asia and the Pacific and Sub-Saharan Africa record much smaller remittance receipts, especially Africa. However, this picture is skewed by underreported or missing data (close to two-thirds of Sub-Saharan African countries lack data).

Intraregional and Domestic Remittances

Although much of the international discussion revolves around remittance corridors between high-income industrial economies and developing countries, official and unofficial estimates typically neglect intraregional and especially domestic remit-

DESTINATIONS OF REMITTANCE FLOWS



tance flows. Yet both intraregional and domestic migration and their respective remittance flows are important. Some service providers make such corridors their niche, and profitably so.

Intraregional flows include, for instance, money sent home by Mozambican and Basotho mineworkers in South Africa, by Moldovans working in Russia, or by Nicaraguans in Costa Rica. Domestic remittances are monies sent home by migrants who move within their home countries to capitals or centers with better opportunities for employment. The data on these types of remittances are extremely sketchy; domestic remittance flows are not recorded because they are not captured as a separate category of domestic financial transactions (they can be traced only through household surveys).

While international remittance flows often dwarf domestic and intraregional remittances in value, studies indicate that domestic transactions in particular are much more common and that intraregional and domestic flows can be significant sources of income for more households than overseas remittances. And although individual transaction values are usually lower, their cumulative value can be substantial.[2] Market data are harder to gain, but savvy providers with a good sense of which migrant constituencies they can serve have developed profitable services in such remittance corridors.

Remittance Transfer Channels

The typically limited network of formal money transfer services in developing countries affects international, intraregional, and domestic remittances. Estimates indicate that perhaps two-thirds of remittances flow through formal financial service providers, such as banks or money transfer operators; the remaining third is remitted through informal channels—through services not registered for money transfers or through bus or taxi drivers, relatives, or friends carrying cash. For individual countries, the ratio of informal to formal flows can be very high. In Sudan, for instance, informal flows are estimated to be as high as 85 percent because of social instability and the barely existent financial service sector.

Not surprisingly, informal channels tend to be used more where the financial sector is either missing, weak, or mistrusted. Foreign exchange controls also make the use of informal channels more likely. Other factors that influence the sender's choice of service channels are language, familiarity, and the physical proximity of the service provider. Similarly, proximity of pay-out points for the recipient is often an advantage of informal services; formal channels tend to reach only major urban centers.

Some money transfer services have developed a niche in domestic and regional markets that lack efficient financial systems. For instance, in many countries, courier and overland bus or coach companies provide money transfer services within country borders or to neighboring countries. Where migration routes are frequently traveled, especially by overland transport, bus drivers often serve as money couriers. People use such services for private transfers, including remittances, as well as for business purposes.

Trends in Remittance Transfer Services

Specialized money transfer operators, such as MoneyGram and Western Union, have dominated the remittance market in many countries. In recent years they have aggressively expanded their networks of agents and points of sale, in part because of increased competition. Concurrently, smaller and often regionally focused operators—such as Anelik Money Transfers, headquartered in Moscow—have entered the market and quickly gained share. This healthy competition has helped cut the cost of transfers.

Banks, for the most part, still consider money transfer a service for their corporate customers.

[2] For instance, a study on Vietnam showed that seven of eight transactions received were domestic remittances, but they constituted only 50 percent of the total value of remittances (Donald Cox, "Private Interhousehold Transfers in Vietnam in the Early and Late 1990s," Boston College, Department of Economics, 2002).

NEW OR IMPROVED BUSINESS MODELS AND TECHNOLOGY SOLUTIONS MAKE SERVING THIS CLIENT SEGMENT A PROFITABLE PROPOSITION EVEN IN COMPETITIVELY PRICED MARKETS.

In select markets, however, banks such as ICICI Bank (India), La Caixa (Spain), Lloyds TSB (U.K.), and Citibank (the United States) have recognized migrants and their remittances as a profitable business opportunity and offer easy and competitively priced money transfer services, as well as access to complementary financial services.

Mortgage finance providers also are keen to profit from the migrant and remittance markets; examples include Mexican mortgage companies setting up operations in the United States and bank agreements between Spain and Latin America that allow migrants to pay their mortgages in Spain, where they earn their income, for real estate acquired back home in Latin America.

New or improved business models and technology solutions make serving this client segment a profitable proposition even in competitively priced markets. For instance, in the U.S.-Mexico corridor, ATMs and debit cards are increasingly used to transfer remittances via providers such as Citibank; Filipinos and Chinese can receive their remittances by mobile phone.

Most business models for remittance transfer still build on the basics—checks, correspondent banking, and electronic transfers—but they are increasingly becoming more innovative by taking advantage of new technologies. Internet-, email-, and mobile phone-based transfers are becoming more common; a text message or an email through a secured system is all it takes to transfer money. And yet technology is not always the panacea, in part because of still limited (although growing) mobile communication network coverage in many regions.

Many of the well-established service approaches continue to be competitive, especially where banks have recognized their room for improvement. Partner banking relationships are still successful, for instance, and new ones continue to be forged. Small adjustments to how they work—such as prepayments in settlement and daily profit netting—can provide the competitive advantage necessary to attract partner banks and market share. Similarly, targeted marketing and efforts to reduce barriers—by going to the clients with mobile units or by sending free transport to take them to a branch, for example—are effective in reaching the migrant client population.

In high-volume markets, some banks command a large market share and may generate much of their fee revenues and significant profits with remittance money transfers. Those that attract a profitable market share in this business have sought out high-volume markets, grown to scale quickly, and established networks in strategic locations. They also have found ways to make their service accessible (such as through expanded service hours, language capabilities, and competitive pricing) and have built trust in their services. ◆

CREDIT BUREAUS IN LATIN AMERICA: EXPANDING FINANCIAL AND OTHER SERVICES TO THE BASE OF THE PYRAMID

by Robin Young

Credit bureaus are being established in more and more markets, selling more information on more people to more firms. For those in the business of providing financial services to low-income populations, these institutions are critical—the information they collect on loan histories, bankruptcies, foreclosures, and criminal records enables banks, other financial intermediaries, and commercial enterprises to make informed decisions about individuals and businesses that may otherwise be considered bad risks.

Private credit bureaus, which operated in only a few Latin American countries a decade ago, are now more numerous and more profitable throughout the region. Local, regional, and international credit bureau companies are taking advantage of expansion and competition in financial markets, spurred by economic stabilization, financial sector liberalization, and the growth of consumer and microenterprise lending. They also are capitalizing on privatizations in recent years that have expanded telephone and cellular phone markets (and thus client payment histories) and on department store credit and other consumer services in the region. In Latin American countries, where 20 to 80 percent of the population can be poor, this growth among credit bureaus has only been achieved by addressing the base of the economic pyramid.

Latin America's credit bureau expansion into so-called BoP markets generates three sets of winners. The credit bureaus are winning new clients, increasing transactions, and generating growing profits. The financial institutions and other firms that use credit bureaus are reaching new markets that in many cases are more profitable than traditional client segments. Perhaps most important, the poor gain access to financial services at better terms and conditions than previously were available. This article explores the business case for credit bureaus and their relationship to poverty reduction, with a focus on Latin America.

Translating Reputation into Capital

Small businesses, low-income microentrepreneurs, and salaried employees are the primary BoP market segments that can benefit from the establishment and expansion of credit bureaus in developing countries. In much of Latin America, anywhere from 20 to 50 percent of the economically active population is employed in the microenterprise sector. Credit reference services allow people and firms to turn their reputations (credit and social history) into collateral for loans to finance businesses, home improvements, and consumer purchases and to respond to other opportunities and needs that require financial services. Borrowers can use their credit reports as substitutes for formal financial statements and traditional collateral to access loans usually unavailable from the formal financial sector.

Credit bureaus can help increase access to client information, thereby lowering costs on loan appraisal, collections, and losses. They can increase competition for smaller borrowers, which expands access to credit and lowers costs on financial services for these traditionally underserved segments. When credit bureaus expand their databases and services to include sectors beyond banking—into utilities, telephone companies, and department stores, for example—they can facilitate expanded access to these service markets as well.

In her comprehensive literature review for *Credit Reporting Systems and the International Economy*, Margaret Miller notes that “information sharing is associated with higher levels of lending in relation

to GNP [gross national product] as well as lower default rates."[1] Inessa Love and Nataliya Mylenko of the World Bank, in their empirical study of credit bureaus' impact on credit markets, found that the presence of private credit registries "is associated with lower financing constraints and higher share of bank financing. . . . Small and medium firms tend to have higher share of bank financing in countries where private registries exist and stronger rule of law is associated with more effective private credit registries." They found that 49 percent of small firms report credit constraints in countries without a credit bureau, compared with only 27 percent in countries with one, and the probability of obtaining a loan improves from 27 percent in countries without a credit bureau to 40 percent in countries with one.[2] The increasing numbers of bankers and other lenders buying private credit bureau reports as part of their credit appraisal process indicate that they are relevant for decision making among lenders.

What Innovations Have Been Necessary To Serve the BoP Viably?

The credit bureau is itself an innovation, a form of cooperation among firms that improves their business environment by sharing information on client indebtedness and credit history. Innovations in loan underwriting, data acquisition, technology, business strategy, and public policy have all been critical in developing credit bureaus that include BoP market segments.

Loan underwriting moves toward character- and cash flow-based lending. Because of various external and internal factors (insider lending restrictions, competition, excess liquidity, and so on), banks throughout Latin America have moved from a focus on corporate banking toward retail lending to public and private sector salaried employees and, increasingly, micro and small businesses. This type of retail lending is information-intensive and is based more on character and cash flow than on formal financial statements and traditional collateral. A review of an applicant's payment history, combined with a review of personal and business credit histories and other relevant behaviors, is essential to an individual loan assessment. As more banks enter the consumer, micro, and small enterprise markets, they look for tools such as credit bureaus and credit scoring to reduce costs, increase efficiencies, and control risks.

Data acquisition is expanding in its quantity, diversity, and source. Credit bureaus help overcome two challenges to assessing a microenterprise client's creditworthiness: lack of reliable information and mixing of personal and business finances. A credit report that includes data on the personal and business finances of an applicant can facilitate and simplify the loan appraisal. A credit bureau report is not a perfect substitute for reference checks and other elements of credit analysis, but it can serve as a filter to reject unqualified clients, such as those with a high level of arrears. Such screening mechanisms for bad loans free lenders to focus on other potential clients rather than wasting time searching for references and other information on applicants who clearly do not qualify.

More sophisticated credit bureau operations also offer data on the timeliness of loan repayments and outstanding loans from a variety of regulated and unregulated lenders and other service providers. This helps in both preparing credit appraisals and motivating repayment: once clients realize good repayment patterns help them access loans, possibly at better terms and conditions, they have an incentive to repay on time. Lenders reduce arrears and hence collection and provisioning costs. In a competitive marketplace, these benefits translate into lower interest rates and better terms and conditions for clients. In their empirical analysis using

---

[1] Margaret J. Miller, *Credit Reporting Systems and the International Economy* (Cambridge, Massachusetts: Massachusetts Institute of Technology, 2003): 9.

[2] Inessa Love and Nataliya Mylenko, "Credit Reporting and Financing Constraints" (World Bank Policy Research Working Paper 3142, October 2003).

data from a private credit reporting firm in Chile, Kevin Cowan and Jose De Gregorio found that "both the positive and negative information available in credit reports in Chile significantly contributes to explaining defaults. . . . Their results suggest that information sharing increases the volume of lending, and that the longer the historical record or the more data in the credit record, the greater is this effect."[3] Credit bureaus also can help provide a client risk profile, which helps lenders better tailor their products and services to clients. The benefits of credit bureaus are similar for other services sold in advance of payment, such as phones.

When credit bureaus are subscribed to by a wide variety of lenders—such as banks, department stores, credit unions, telephone companies, and unregulated microlenders—the poor can move from less formal to more formal institutions, from small consumer loans at a local store to larger business and housing loans with banks. A credit bureau helps low-income people who have developed a credit relationship with one institution signal their creditworthiness to the market, allowing them to access diverse sources of financing at competitive rates and terms. This relationship is well established in the United States, where college loans and credit cards set the stage for future car loans and mortgages.

Increasingly, credit bureaus in Latin America are incorporating the commercial and microfinance sectors, including stores, telephone and utility companies, and consumer and microenterprise lenders. In Peru, where private commercial credit bureaus have incorporated a wide variety of data, the largest and most profitable banks are rapidly expanding into the microfinance market with loans as small as $100. Although credit bureaus are not the only driver of this financial market deepening, they are certainly a critical tool for market expansion and risk management.

Other factors underlying the growth of credit bureaus include the following:

Information communications and technology enables more frequent and timely data sharing and analysis. Improving and expanding telecommunications, including phone lines and high-speed Internet connections, have drastically improved data transfer in much of Latin America. Banks and other financiers can provide more data, more quickly, and more reliably to the bureaus. The financial institutions also can use information communications and technology to improve their analysis of the data generated by the credit bureaus. This leads to improved credit reports and to the introduction of new decision-making tools, such as credit scoring. Expanded communications via extended telephone lines and the Internet provide quick and direct access to credit bureaus even in remote regions.

Business strategies have begun to target BoP data sources and tailor credit bureau services to BoP lenders. Some private credit bureaus have begun to see BoP lenders as attractive clients and have developed a business strategy and service offering for this segment. In some cases, microfinance lenders themselves have set up specialized credit bureaus, such as InfoRed in El Salvador. In other cases, donor projects have encouraged large commercial credit bureaus, such as Equifax in Peru and El Salvador, to consider microfinance institutions (MFIs) as viable clients and to tailor their services for this sector. Other local and regional credit bureaus—such as Datacredito in the Dominican Republic and Caltec in Ecuador—have catered to the traditional banking, commercial, and microfinance market segments from the start. The growth of commercial credit through department stores and supermarkets, combined with the growing trend of commercial banks moving into microfinance, should encourage more credit bureaus to expand their registries into BoP market segments.

[3] Kevin Cowan and Jose De Gregorio, "Credit Information and Market Performance: The Case of Chile," in *Credit Reporting Systems and the International Economy*, ed. Margaret Miller (Cambridge, Massachusetts: Massachusetts Institute of Technology, 2003).

Policy and regulatory frameworks that promote information collection and sharing. In some countries, such as Ecuador, public entities have developed public credit registries and provided credit bureaus with client data to kick-start the development of private credit bureaus. Establishing universal, unique, and easy-to-obtain citizen identification numbers facilitates data compilation and sharing. Many credit bureaus operate using tax identification numbers, but these are relatively costly to obtain and most microentrepreneurs do not have them. In El Salvador, where credit bureaus were using a mix of tax identification numbers and locally issued identification cards known as *cedulas*, the situation was improved with the creation and dissemination of a unique identity document.

By contrast, bank secrecy laws that prevent private credit bureaus from integrating nonbank or nonregulated institutions' data into the credit bureaus, or that prevent nonregulated institutions from gaining full access to credit bureau reports, are policy obstacles to credit bureau development. This has been the case, for example, in El Salvador. In some countries, banks can work around existing bank secrecy legislation—for example, by incorporating client notification clauses in loan applications.

How Does Serving the BoP Market Help Alleviate Poverty?

Financial services are a key element of economic development. With relatively small loans, the poor can leverage their ideas and hard work to develop viable businesses, generating incomes for their families and, in some cases, generating employment and income for others. Credit bureaus help the poor build credit histories that they can then use to shop around for the best and most appropriate financial services available, turning their reputation—defined in a formal credit history—into collateral to access financial services. As credit histories and credit bureaus develop, they facilitate other types of business transactions; for example, poor entrepreneurs can use their credit history as references for business relationships with suppliers and other business connections.

Credit bureaus can help the poor use their good reputation to gain access to other services, such as telephones, that can improve their quality of life and, in some cases, their business opportunities. Depending on the data included and used in credit bureaus, they also facilitate business-to-business transactions and commerce, in theory at least, for micro and small enterprises as well as larger firms.

How Profitable Is Serving this Market?

Once established with traditional lenders and markets, BoP niches such as consumer and microenterprise lending—with their high-volume transactions—present significant potential for credit bureau expansion. These are the highest-margin and fastest-growing sectors in many financial systems in Latin America. This is a volume business requiring upfront investments in information and communication systems, data processing, marketing, and client management. With relatively high fixed costs, capacity and quantity are critical in terms of the number of clients and transactions per client. Using their large databases, credit bureaus are able to develop additional revenue-generating services such as credit scoring and other decision-making models that these lenders value.

The recent expansion into emerging markets of established credit bureaus such as Transunion and Equifax, and the establishment of new local and regional credit bureaus throughout Latin America over the past decade, indicate the perceived profitability of these ventures to multinational credit information firms. Private credit bureaus of some type operate today in Argentina, Bolivia, Brazil,

CREDIT BUREAUS HELP THE POOR BUILD CREDIT HISTORIES THAT THEY CAN THEN USE TO SHOP AROUND FOR THE BEST FINANCIAL SERVICES AVAILABLE.

Chile, Colombia, Costa Rica, the Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, Mexico, and Peru. Their owners and operators include local business associations and chambers, local and regional private credit bureaus, and international (U.S.-based) credit bureaus.

DAI's Experience in Latin America

DAI includes credit bureaus as part of its financial sector development and microfinance work. Specifically, in projects throughout Latin America, and increasingly in other parts of the world, DAI is working to develop industry infrastructure to promote financial sector deepening, particularly for microenterprises, while supporting the sustainability of financial intermediaries. Credit bureaus are a key part of this support infrastructure.

In El Salvador, DAI has supported the increased use of credit bureaus among microenterprise lenders and supported dialogue between lenders and the credit bureaus to improve services. As part of a USAID-sponsored rural microfinance project in El Salvador, DAI subsidized credit bureau participation on a trial basis for nine of the program's participating MFIs. DAI offered the participants—two banks, three credit unions, and four NGOs—the services of two very different credit bureaus, DICOM/Equifax and InfoRed, encouraging participants to enroll in both for points of comparison. As a large, generalist credit bureau, DICOM/Equifax dominates the Salvadoran market for credit information, but it only recently began to target MFIs with the introduction of a new, MFI-focused credit-reference product, Credimypes. InfoRed, on the other hand, serves almost exclusively MFIs; it was established with USAID assistance for that purpose and maintains an inherently small, niche clientele.

Although both programs returned an impressive percentage of requested credit reports—InfoRed with 35 percent and DICOM/Equifax with 33 percent—the distinction in client focus between the two bureaus, as well as the higher costs of DICOM/Equifax's services, may have led to the final decision of many participants to continue using only InfoRed services after the conclusion of DAI's four-month subsidy program. All nine institutions using InfoRed actually decided to continue using that service at their own expense. As a direct result, InfoRed achieved profitability for the first time, and DICOM/Equifax redesigned its product and pricing to retarget the MFI market. Use of the credit bureaus allowed participating MFIs to dramatically change their loan approval process. One participant reported that resulting changes had compelled it to decline 180 applications during the trial period as a result of exceptionally poor credit history or overindebtedness.

In Ecuador, where the largest banks in the country have launched microfinance programs in recent years, DAI developed a proposal for the legal and normative framework to allow credit bureaus to operate for the first time in the country. In addition, DAI prepared a market study that demonstrated the business potential of this market; currently, six private credit bureaus have operating licenses. USAID's DAI-managed Strengthening Access to Microfinance and Economic Liberalization (SALTO) project in Ecuador continues to promote public-private sector dialogue and public policy conducive to maintaining an enabling framework for credit bureau development and assists financial institutions in incorporating the new information gained from the credit bureau reports into their microcredit loan appraisal policies and procedures.

In Bolivia, one of the more highly developed microfinance markets in Latin America, private credit bureaus are in their infancy. Here, USAID's Policy and Regulatory Enhancement for Microfinance Innovation and Expanded Outreach (PREMIER) project is taking a two-pronged approach: (1) technical assistance to strengthen existing credit bureaus by upgrading their technology and financial capacity as well as developing stronger, commercially oriented business strategies, including facilitating relationships with international credit bureaus; and (2) evaluating the legal and regulatory framework, facilitating public-private sector dialogue, and making proposals for improving public policy.

In Haiti, USAID's Financial Service Network for Entrepreneurial Empowerment (FINNET) project helped establish a "bad debtors" list among diverse institutions—including banks and bank affiliates, credit unions, and NGOs—to share regional lists of clients in arrears. This monthly list was recently expanded with a technological upgrade, and a more robust Internet-based credit liability system is being tested between two of the lenders. Although hopes for a more highly developed credit bureau remain, the political and economic landscape in Haiti is not encouraging. But this rudimentary system developed in the microfinance industry is the basis of a credit reference program in the country.

DAI's experience shows that the development of credit bureaus is much more than a technical issue. A successful credit bureau requires business acumen, financial resources, and strategic vision and management. Moreover, good public policy is essential to strike the right balance between consumer protection (privacy, data accuracy, and use) and credit bureau development. And there is no single, static, definitive framework to serve as a model—even in the United States, which has one of the most mature credit information systems in the world, laws and operations are continually being updated in response to concerns such as identify theft, for example. Developing and transition countries therefore have a lot of work to do to foster successful credit bureaus, but it seems clear that the benefits—in terms of bureau profits, financial sector development, and public goods—are justifying the effort. ◆

LOOKING BACK/LOOKING FORWARD: AN EARLY REPORT ON *ERADICATING POVERTY THROUGH PROFIT: MAKING BUSINESS WORK FOR THE POOR*

San Francisco, December 11–14, 2004

by William J. Kramer and Allen Hammond

To attempt to summarize in a few words nearly three full days of events—including 40 plenary addresses and workshops involving 165 speakers and approximately 1,000 participants—would do a serious disservice to both the spirit and the outcome of the conference organized by World Resources Institute (WRI), in partnership with DAI and others. We will content ourselves, therefore, to offer readers what we see as a few memorable moments, in the belief that they will speak to the challenges and opportunities that lie ahead.

Moment #1: Christopher Rodrigues, CEO of Visa International, at his plenary address, holds up a jewel-like bit of technology—a mobile phone with an attached, integrated, secure, point-of-sale device. Visa and its member banks view the device as a way to bring millions (dare we say *billions*) of new customers into the formal financial system. Cash is the scourge of the poor, and its eventual elimination—or at least its minimization—in low-income communities is, in our view, one of the keys to poverty eradication. For Visa and the banks, there are profits to be made. Lowering the cost of transactions is the quickest way to make the poor richer, even absent new income generation. Profits for banks and their service providers, lower prices for poor people, and greater access to goods and services—a powerful vision.

Moment #2: Ramon Isberto of SMART Communications, in a workshop on connectivity, provides a riveting account of how SMART's mix of services—text, voice, multimedia messaging, data services, money transfer, mobile banking, and textmail—is transforming the telecom market in the Philippines and, in the process, creating a new currency: phone minutes, which move through the economy not just *like* money, but *as* money. Everyone is impressed, including representatives of a global mobile operator, who confess that this agile national company is way ahead of a multinational giant. It is a compelling picture of low-income communities creating a powerful business model, delivering value for themselves and the companies that treat them as addressable markets. Connectivity—the ability to perform varied transactions, create community, and express individuality—these are transformative elements in the lives of poor people.

Moment #3: A few eye-openers from the day-long pre-conference workshop on the technology of remittances, with more than 100 participants: (1) there is an estimated $200 *billion* or so in annual remittances flowing around the globe; (2) this amount is equal to, or perhaps exceeds, the total of foreign direct investment and official development assistance; (3) remittances are the most consistent financial flows in the world and, as such, are securitizable and leveragable; and (4) available technologies are able to lower the costs of remittance transfers to a fraction of previous levels. Better regulatory policies, greater involvement of big banks, and creative use of the flow of funds—all can substantially improve the lot of the poor without an actual increase in their incomes. But opening the doors of the formal financial system to the poor holds enormous promise for providing some of the capital that will generate higher incomes.

Moment #4: J. Erik Fyrwald of DuPont Agriculture & Nutrition tells the plenary audience that he had made a call that morning to his CEO to say DuPont must pay more attention to low-income commu-

WRI's second global conference will be held in Frankfurt, Germany, at the Congress Centre, October 31–November 2, 2005. Details on registration, sponsorship, and program events will appear at http://povertyprofit.wri.org.

nities as markets and that he would return with a commitment to do more—a perspective that he acquired by attending the conference.

Companies that get it, companies that *think they've got it but are finding out they're behind the curve*, and companies, government agencies, and nongovernmental organizations that are documenting *who's doing it and how* all came together for a few days in San Francisco. If these "passionate practitioners" (in the words of another plenary speaker, Herman Mulder of ABN AMRO Bank) are inspired to do more, and to do it better, then we can count the effort a success.

The financial services sessions were among the most interesting and best attended of the conference. DAI played a critical role in that result. However, what was on view in San Francisco is just the tip of the iceberg. There is a confluence of activities among technology, connectivity, and financial services serving the interests of low-income communities, and the potential for results is extraordinary. We are, it seems, realizing that attention to serving the base of the economic pyramid for financial services is exactly what is required to begin to animate the dead capital of the poor, as Hernando DeSoto has said for a generation. If this new awareness is combined with better multilateral development bank investment policies and bilateral efforts to improve business conditions in emerging markets, we may see a significant uptick in the prospects for the industrializing nations. ◆

FOR FURTHER READING

Dressen, Robert, Jay Dyer, and Zan Northrip. “Turning Around State-Owned Banks in Underserved Markets.” *Small Enterprise Development* 13:4 (December 2002).

Hammond, Allen L., and C.K. Prahalad. “Selling to the Poor.” *Foreign Policy* 142 (May/June 2004).

Harper, Malcolm, and Sukhwinder Singh Arora. *Small Customers, Big Market: Commercial Banks in Microfinance*. London: Intermediate Technology Publications, May 2005.

Inter-American Development Bank, Multilateral Investment Fund (IDB/MIF). *Sending Money Home: Remittances to Latin America from the US, 2004*. Washington, D.C.: IDB/MIF, May 2004.

Miller, Margaret J. *Credit Reporting Systems and the International Economy*. Cambridge, Massachusetts: MIT Press, 2003.

Morrow, J. Peter, and S. Sukhbold. “From Rags to Cashmere: The BOP Success of Khan Bank Mongolia.” Presentation given at *Eradicating Poverty through Profit* conference, San Francisco, California, December 2004. http://povertyprofit.wri.org/program/program.html.

Orozco, Manuel. *The Remittance Marketplace: Prices, Policy and Financial Institutions*. Washington, D.C.: Pew Hispanic Center, June 2004. http://www.pewhispanic.org/site/docs/pdf/Remittances%20june%2004%20final.pdf.

Porteous, David. *Making Financial Markets Work for the Poor*. South Africa: FinMark Trust, October 2004. http://www.finmark.org.za/documents/2005/JANUARY/MMW4P.pdf.

Porteous, David, and Ethel Hazelhurst. *Banking on Change*. Cape Town, South Africa: Double Storey Books, 2004. http://www.kalahari.net/BK/product.asp?toolbar=none&sku=27978928&format=details.

Prahalad, C.K. *The Fortune at the Bottom of the Pyramid: Eradicating Poverty through Profits*. Philadelphia, Pennsylvania: Wharton School Publishing, 2005.

Ratha, Dilip. “Workers’ Remittances: An Important and Stable Source of External Development Finance.” In *Global Development Finance 2003*. Washington, D.C.: World Bank, 2003.

Sander, Cerstin. “Capturing a Market Share? Migrant Remittances and Money Transfers as a Microfinance Service in Sub-Saharan Africa.” *Small Enterprise Development Journal*, special issue on migrant remittances (March 2004).

———. *Migrant Remittances to Developing Countries—A Scoping Study: Overview and Introduction to Issues for Pro-Poor Financial Services.* Prepared for U.K. Department for International Development, 2003. http://www.livelihoods.org/hot_topics/docs/Remitstudy.pdf.

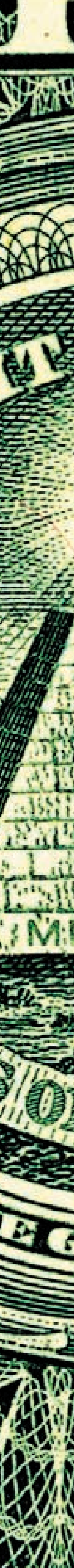
South African Financial Sector Charter. http://www.finance.gov.za/press/other/2003101701.pdf. (For research publications on the Charter, see http://www.finmark.org.za/researchmaterial/research_type/research_type.asp?uno=3.)

U.S. Agency for International Development (USAID). *Migrant Remittances*. Quarterly newsletter. Cerstin Sander (editor). USAID AMAP Financial Services Knowledge Generation Project, I (1), August 2004. http://www.microlinks.org/ev_en.php?ID=3742_201&ID2=DO_TOPIC.

World Council of Credit Unions, Inc. (WOCCU). *A Technical Guide to Remittances: The Credit Union Experience*. Madison, Wisconsin: WOCCU, undated. http://www.woccu.org/development/guide/remittances_techguide.pdf.

World Resources Institute. *Eradicating Poverty through Profit: Making Business Work for the Poor*. Conference, San Francisco, California, December 12–14, 2004. http://povertyprofit.wri.org.

This issue of *Developing Alternatives* is dedicated to Matthew Gamser, whose hard work made DAI’s participation in the *Eradicating Poverty through Profit* conference a tremendous success.



Development Alternatives, Inc.
7250 Woodmont Avenue
Suite 200
Bethesda, Maryland 20814 USA

PRESORTED
STANDARD
U.S. POSTAGE
PAID
Bethesda, MD
Permit No. 7802