Money Management, Financial Inclusion and Banking the Unbanked
Elisabeth Rhyne, Center for Financial Inclusion, September, 2012

Although financial inclusion has gained increasing currency as a policy aim and hot topic in development, there is a surprising dearth of discussion about what financial inclusion means, and in fact, why it should be a national or global priority. I have been listening, reading and thinking about financial inclusion intensively over the past few months and I am concerned that the edifice is built on shaky pillars. The conceptual framework underneath financial inclusion needs shoring up with a clearer theory about the purposes and potential benefits of financial inclusion, particularly to the individuals who are targeted. Without a stronger conceptual framework, the financial inclusion movement may be prone to making important mistakes.

In this essay, I focus on something at the very core of financial inclusion: money management. My contention is that money management is a central concept around which to build financial inclusion policy, and that failure to do so hampers the achievement of the goals that financial inclusion is intended to bring about. Money management is not the only aspect of the conceptual framework that needs improvement (another one being savings), but it is one that touches nearly everything going on at the cutting edge of the field today, from mobile banking to financial education. It is essential that financial inclusion policy makers, providers and innovators understand how financially included and excluded people manage their money, first because improved money management is in itself one of the main objectives of financial inclusion and second because wrong assumptions about how people manage their money can lead to failed experiments and unexplained client indifference.

Social benefit – what money management does for clients. The assumption behind the drive for financial inclusion is that access to quality financial services will enable people to conduct their economic lives efficiently, avoid or mitigate risks, and make the most of scarce resources. Clients who can do these things are considered financially capable. A great deal of focus has recently developed on how to build financial capability among low income people. As part of the CFI's Financial Inclusion 2020 Project,[1] I recently sat in on conversations among financial capability experts who envisioned a financially capable person as one who can make these statements:

- I am comfortable attending to my finances and can make good, informed financial decisions.
- I am aware of the consequences of poor financial decisions and am motivated to avoid them.
- I can budget, plan, set financial goals and monitor my progress.
- I know my financial limits and stay within them.
- I manage a diverse portfolio of financial services, whether formal or informal, to help me get the most from my scarce resources.
- I can use financial services to reduce my vulnerability and protect my resources.
- I can choose among financial services and delivery methods to select those most appropriate for me.

Taken together, these statements place money management right at the heart of financial capability. Of course, financial capability is not synonymous with financial inclusion, and many benefits from advances in financial inclusion (for example, improvements in affordability, convenience or access) derive from sources other than better capability or money management. Nevertheless, it seems clear that how a

[1] Describe project

person manages her financial life will be an important factor in how much she benefits from greater financial access.

The low uptake challenge. Client research such as that reported in *Portfolios of the Poor* and the Financial Diaries gives us a detailed picture of how low income people actually do manage their money. This research reveals that even very poor people conduct complex financial lives – as suggested through the term portfolios. To deal with their low and uneven income streams, poor people engage in many kinds of financial arrangements. "They keep savings at home; join savings clubs and savings-and-loan clubs; transact with family, friends and neighbors, and employers; and, where doing so is feasible and attractive, sign on with formal licensed providers."[2] Implicit in this process, individuals must keep a mental ledger of credits and debits across multiple providers, lengths of time and types of transactions -- even when their transactions are as informal as borrowing bus fare from a relative and saving cash in a coffee can.

When a new financial service is offered, say by a formal source, the prospective client is likely to use it only if he sees it as both an improvement in itself and compatible with the way he handles the rest of his portfolio. If the money management patterns of the client are poorly understood, services can be offered that appear valuable to the provider but do not attract the target clientele. The phenomenon of low uptake of innovations that designers thought were sure winners is common in the financial inclusion realm. New bank accounts are a particularly important example that I will return to later.

Defining money management. *Portfolios of the Poor* uses the term money management to denote the short term transactions that smooth consumption on a day to day basis. I would like to look at money management slightly differently, and perhaps the term financial management would be more accurate. I posit money management as a function that everyone carries out, whether well or poorly, actively or passively, with the following definition: *money management is the ongoing process of deciding on the use of financial instruments, as informed by judgment about one's overall financial status. The objective of money management is best use of financial resources in both the short and longer term*. This definition focuses on the decision making process as distinct from actual transactions, although they are closely linked. It is helpful to look both at *how* people decide in addition to *what* they do.

We know something about how people operating in the informal sector perform this money management function. Most keep no written record of their overall financial situation. Perhaps they have notes about individual transactions (such as an IOU), or a passbook if they deal with a money collector, moneylender or savings group. They may operate with what behavioral economists call heuristics or rules of thumb – simple strategies such as keeping business and personal money in different pockets, or saving by setting aside a handful of rice every day. Ignacio Mas argues, "Most people manage their money by fragmenting it, mentally assigning it to different purposes and physically storing it in different receptacles."[3]

The key insight is that informal money management requires people to hold a mental ledger – personal cashflow statements and balance sheets kept in the mind. Just as memory is important in oral traditions in other realms, financial management skills for informal sector participants would include the ability to

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[2] Daryl Collins et al., *Portfolios of the Poor: Howe the World's Poor Live on $2 a Day*, (Princeton University Press: 2009), p. 184.

[3] Ignacio Mas, "Can we make savings a little bit more interesting for people, please?" Center for Financial Inclusion blog, July 25, 2012.

recall all one's outstanding financial transactions and balances from memory and to use this information in making decisions. Some people may do this well, others poorly, and the job may be especially challenging for people in the informal sector whose income is irregular and unpredictable.

In any case, this kind of informal money management contrasts with the money management function of a thoroughly included middle class person in a developed economy. With apologies, I draw here on my own experience. My bank account is my main money management tool, and if I want to understand my financial situation, I lay out my bank statements in front of me. All my significant routine transactions pass through the bank account, including receipt of salary, purchases made by debit card, major payments (taxes, insurance, mortgage, etc), and monthly bills. Credit card purchases are incorporated into the overall picture when paid as a monthly bill. Even transactions made in cash are consolidated, in the form of ATM withdrawals. As a personal cashflow statement, my bank account is nearly perfect. In order to see my personal balance sheet and think about longer term plans, I have to consult a few additional documents, like mortgage, pension and investment records. Because everything is available in account statements, I keep only general notions about my financial situation in my head. My bank account acts as both the central node for my transactions and a tracking device for my financial life.

Consider some implications from these contrasting models.

First, whose money management function is superior? A low income client may be comfortable with her own transaction options and method of keeping track, but financial inclusion policy, with its emphasis on "banking the unbanked" comes down clearly in favor of the more formal model. However, if policy makers and service providers seek to pull people toward formal financial services, they must be able to convince people that it is worthwhile to change the way they handle and track their money.

Second, assuming that the formal model is superior, how does one move from a largely informal to a formal approach? The transition from an unwritten, mental form of money management with multiple transaction types to one based around a bank account and bank statement is unlikely to be swift or easy, and one would not expect it to be completed in one leap.

Third, as new products and services are introduced, it is relevant to ask whether the new offerings assist people to gain greater ability to track and manage their money and therefore to make good financial decisions. As *Portfolios of the Poor* states, "Because, as the diaries show us, money management is a matter to which poor households themselves already devote much time and energy, the potential impact of improved tools is exceptionally promising."[4] This statement may refer to improved financial services. It surely also encompasses better financial tracking tools. At the same time, it implies that the new, improved tools must outperform existing informal tools that already incorporate the wisdom of the time, energy and ingenuity people put into them.

In the remainder of this essay I want to examine two major issues in financial inclusion from the perspective of money management, staring with the top line indicator of financial inclusion: the possession of a bank account.

Why bank the unbanked?

[4] Ibid., p. 64.

When the Global Findex was released earlier this year, it marked the first time financial inclusion statistics from the demand side were available on a globally consistent basis.[5] The introductory headline was that over 2.5 billion adults (including 59 percent of all adults in developing countries) are unbanked, that is they do not have an account at a bank or other formal financial institution.

Why is having a bank account the top indicator of financial inclusion?

It is only fair to acknowledge that the bank account is perhaps the easiest financial inclusion number to track and is broadly applicable to all adults. However, at times, it seems that increasing the number of people with accounts – banking the unbanked – becomes a primary policy goal in itself, and this is where my questions begin.

The Global Findex shows that many bank accounts in the developing world are relatively inactive. While in high income countries, 72 percent of accounts have more than two withdrawals per month, in low and middle income countries that figure plummets to 16-17 percent. Many people appear to be using the accounts simply as a way to get paid or receive government benefits. What this suggests is that the full inclusion model of using a bank account as money management central operates in high income countries, but that in lower income countries, people who have been managing money informally do not necessarily shift to an account-based model just because they have opened a bank account. Apparently, they continue using an informal tracking model and view the bank account as one more transaction type in the mix.

Low balance accounts with few transactions are not very profitable for providers, so concern about such numbers from providers is understandable. From a policy perspective, if bank accounts are opened but not used, their value in terms of broad social or economic objectives is limited. Use of an account as a means of receiving monthly salary or benefit payments is a decided improvement over counting out cash – it costs less and is more secure. But given the numbers shown in the Findex, while we acknowledge that a bank account puts people on a path that can lead to financial inclusion, we cannot be at all certain that they are proceeding down the path.

Let's look at a village of coffee farmers I once interviewed in Uganda who were frequently attacked by highway robbers on their way home from receiving their cash payments. In the bad old days they traveled most of a day to town where a coffee marketing company clerk handed them an envelope with their payments in cash. On the way home they were prey to attackers who knew their pockets would be full. Then the system improved: the coffee marketing company arranged to pay into a cooperative bank, which distributed the payments into bank accounts in each farmer's name. At this point the farmers still traveled to town. They stood in line at the cooperative bank, and took their cash home, because they could not use the money in the village if it was sitting in the bank in town. Unless they used the account to keep money as savings for the next trip to town, they were still prey to robbers, and their lives did not change much. It is unlikely that their own money management functions changed in any significant way. However, they would now show up in national statistics as "banked".

Only if the cooperative bank puts a branch, an ATM, or a banking agent in the home village or sets up mobile payments would we expect the money management habits of the Ugandan farmers to change significantly. The actual use of the account as a money management device will depend on transaction

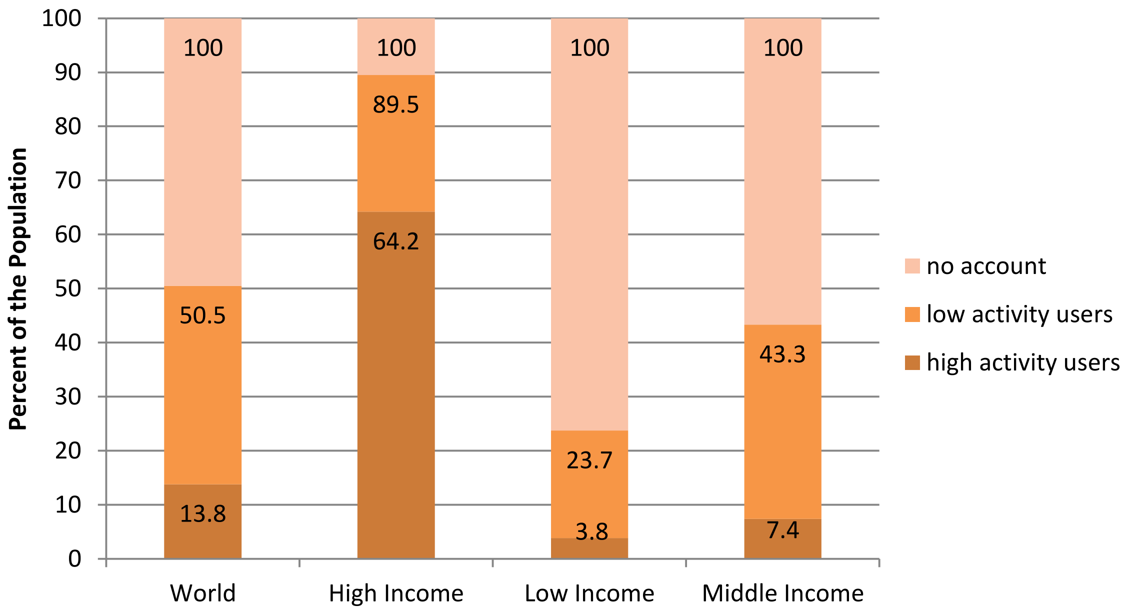
[5] reference for global findex.

fees and convenience of time and location. It may depend even more on who the farmers do business with – where they are located and what kinds of payments they accept.

All this is to say that while possession of a bank account may be a step toward financial inclusion, it should not be confused with genuine inclusion. Policy makers must pay close attention to usage and the factors that influence it, which requires understanding the money management habits and economic networks of their targets. For the purpose of monitoring national progress toward financial inclusion, measures of usage, proximity and cost are essential to put perspective around the number of individuals claimed as "banked".

To illustrate, consider the following chart, which divides the "banked" into low activity and high activity accounts (high activity defined as more than 3 withdrawals per month – a useful though somewhat arbitrary definition).

Bank Account Ownership and Activity, by Country Income Groupings



Source: Global Findex 2012

In the rich world, where 89 percent of adults have a bank account, most people use their accounts frequently, consistent with the formal money management model described above. Overall, 64 percent of adults in rich countries are active account users. This pattern contrasts sharply with low and middle income countries. In the poorest countries, where only 24 percent of adults have an account, most account holders are not active users. Overall, only 4 percent of adults in the poorest countries are active bank account users. In middle income countries the pattern is similar, though the numbers are somewhat higher.

An indicator of the percentage of adults who actively use a bank account may be a better bottom line indicator of financial inclusion than percentage of "banked". This indicator shows, however, that financial inclusion has a very long way to go. Combining low and middle income countries, only 7 percent of adults in the developing world actively use bank accounts. There is a profound difference in the way people in the developed and developing worlds manage their money. Progress toward real inclusion requires a much deeper look at and respect for the environment and habits of people who have never considered a bank account as a tool for managing their finances.

Does technology help money management?

Into this picture comes technology, with the potential to allow financial transactions to take place without cash, in more locations and at any time. It is clear that technology-enabled financial services can provide enormous benefits in terms of costs, convenience and security. The question I pose here is whether the choices providers of technology-enabled services make are conducive to assisting people with money management.

Among the most important innovations in technology-enabled financial services for low income people are mobile money payments and prepaid cards. As currently configured, many of these services are focused on a particular transaction type and do not involve true accounts or lasting relationships between customers and financial service providers. While a customer may use a given service repeatedly, each transaction is essentially independent. The customer brings cash to an agent, the money is moved electronically, and the recipient withdraws cash from another agent. End of transaction, end of relationship. It is essentially a cash transaction with an added middle man. Clients who keep track of their financial status using a mental ledger and rules of thumb may want nothing further. However, if financial inclusion policy is interested in assisting people to keep track more effectively or make better money management decisions, it might ask for more – such as the ability to store money for multiple transactions and review transactions records over time.

Ignacio Mas suggests that mobile financial services could offer exactly that opportunity. He proposes a system he calls PayPlan that would allow people to personalize mobile money accounts to help them make recurring payments or set portions of their own income aside.[6] He asserts that mobile accounts can play exactly the same kind of money management role usually associated with a traditional bank account – possibly even better as the information could be always at a customer's fingertips. This will only appeal to customers, however, if most of a customer's transactions flow through the mobile account, so that account activity becomes a good proxy for personal cashflow.

At present, few technology innovations are integrating features to assist with money management. (However, while not supporting *customers* to track their money more effectively, there is excitement over *provider* use of the electronic traces of transactions for "big data" analytics.) The edge of innovation today involves establishing new channels along which financial transactions will run, and currently these are still in flux. As channels deepen, there will undoubtedly be moves to increase their value by adding features that support the money management function. The conditions necessary for genuine progress in this sphere are two: consolidation of most of a person's transactions onto a single platform (which requires penetration of the surrounding merchant environment) and ability of that platform to provide users with a ready and useful information about their financial status.

Key Takeaways

It is important for the financial inclusion debate to focus on meaningful goals derived from an understanding of the ways financial inclusion can yield social and economic benefits. The chasm

[6] Ignacio Mas, "Making Mobile Money Daily Relevant" Social Science Research Network, March 18, 2012.

between a policy goal of "banking the unbanked" and a description of a financially capable person is wide. Increasing the number of adults with bank accounts is perhaps irrelevant and certainly misleading as the top line policy goal for financial inclusion. Emphasis on this goal implies that accounts are actively used, which we now know to be incorrect. Little-used accounts bring only a few of the benefits desired from financial inclusion. Indicators of active account use would be more revealing and relevant.

A very important objective for financial inclusion is to assist people with money management – improving their ability to track their financial status and make good financial decisions. In a traditional cash-based or multi-transaction-type setting, mental ledgers may be the only tool available. However, if most of a person's transactions shift to pass through an integrated electronic platform, whether traditional banking or mobile money, the possibility of providing money tracking tools arises naturally.

At the same time, policy makers and product designers must be careful not to assume that everyone wants to change their money management methods to conform to preconceived notions of how middle class people in rich countries use their bank accounts. If we wish to assist people to use more formal financial products tomorrow, including bank and mobile money accounts, we will have to reckon with how they manage their money today.