



## NEW DIRECTIONS, UNANSWERED QUESTIONS

*"We are really excited by all these changes, excited by all these possibilities, but we are also excited by the fact that we have excellent questions with yet no answers."*

*- Ricardo Hausmann, Harvard University*

### WHAT IS THE EMPOWERMENT LAB?

Rapid technological progress in the past two centuries has led to rapid increases in living standards in many parts of the world. At the same time, many countries have experienced increased volatility and stagnation. This divergence means that inequality between countries is growing. For example, when Adam Smith wrote "The Wealth of Nations" in 1776, the richest country in the world was four times richer than the poorest country. Today, the United States is more than 60 times richer than Malawi or Sierra Leone.

This inequality is reinforced as new technologies that build on old ones are developed. A remote control is a great convenience, but is useless to someone without a TV or even electricity; the ability to access your bank account online makes life more convenient but is pointless for someone without a bank account or internet access.

With this increasing global inequality in mind, the Center for International Development at Harvard University launched the Empowerment Lab in order to advance market frontiers to include the underserved, starting with financial markets. By bringing together more than fifty leaders from the realms of business, academia, and government at its inaugural meeting, the Empowerment Lab was able to capture the latest thinking on the subject of financial empowerment and spark new partnerships between sectors. Some of the resulting insights are described here.

### ACCESS TO MARKETS

*"The issue of financial empowerment, of providing banking services to the underserved, is taking off. The demand has grown exponentially, and both big and small providers are testing applications in the poorest of countries."*

*- Marcela Escobari, Center for International Development*

Overcoming poverty and inequality has proven to be extraordinary difficult. It is certain that simply designing products that target the underserved as consumers won't get at the roots of



this great divergence. Instead we must find a way to give people access to the markets that have historically excluded them, markets which they can use as they see fit to take control of their own lives. These markets include from the most basic utilities such as water, electricity, road, to services such as finance and healthcare.

One important area of focus is access to financial markets. Financial services allow people to pay for life cycle events like births, deaths, and weddings; to handle emergencies like illness, the death of a breadwinner, or crop failure; and to take advantage of investment opportunities in things like businesses, land, or technology that makes them more productive.<sup>1</sup> Financial services help people on a daily basis as well, smoothing consumption as income varies and making payments more convenient.

At the Global Empowerment Meeting, Harvard professor Ricardo Hausmann outlined some of the issues around access to financial markets and the barriers that keep people underserved:

### Barriers to Access

One of the biggest barriers for banks to providing financial services for low income populations is that banks face high fixed costs, and the small deposit or loan size of a low income customer doesn't make doing business with them profitable. Providing group-liability loans is one well-known way to surmount this hurdle, since it is cheaper for a bank to provide one loan to ten people at once than to provide ten loans to the same people at once.

This fundamental issue of high fixed costs means that many times it becomes unfeasible for traditional banks to service low income customers. For potential customers, high minimum balance requirements, lack of collateral, high literacy requirements, lack of trust, and lack of money to save may all keep people out of financial markets. For providers, the expense of building physical infrastructure, the risks of making uncollateralized loans to unknown people, difficulties making and enforcing contracts, and adverse regulatory environments may all prevent banks and similar institutions from dealing with the underserved.

## OVERCOMING BARRIERS WITH NEW APPROACHES

*"I don't think poverty is the problem. I think how we deal with poverty is the true problem."*

*- Tim Vang, myc4.com*

Carlos Danel discussed how entities like Compartamos Banco have been able to perfect the microfinance model by focusing on strong client relationships. Nevertheless, microfinance has

only been able to reach a tiny proportion of the population that needs it<sup>2</sup>, and microcredit addresses only some of people's financial needs.

The ever-growing ubiquity of new technologies like mobile phones is part of what makes many people excited about their potential as a platform for extending financial services. The fact that they can dramatically lower the cost of each financial transaction,<sup>3</sup> allowing banks to deal with low income customers, makes them an even more promising way to extend markets to the underserved.

Mobile Banking services like M-PESA in Kenya, Wizzit in South Africa, and G-CASH and Smart Money in the Philippines have attracted customers and attention. However "the road to implementing mobile banking is littered with discontinued mobile banking projects, failed new technology vendors, and shelved deployment plans. For customers, mobile banking presents a delicate balance between a conceptually powerful opportunity (being able to transact any time, anywhere) and practical challenges (finicky menu sequences on a small screen and tiny buttons)."<sup>4</sup>

At the Global Empowerment Meeting, Rolando Salcedo discussed his ongoing efforts to perfect the model with Platamóvil and Roy Sosa mentioned how MPOWER Labs portfolio companies MPOWER Mobile and Rêv Worldwide are using mobile phones as part of their payment systems. We look forward to following their progress in this arena and seeing how their work helps answer some of the outstanding questions about the effectiveness of mobile banking in expanding market access.

Utilizing existing distribution networks like post offices or retail stores is another way to reduce the costs of brick-and-mortar bank branches. Empowerment Lab researcher and Head of the Entrepreneurial Finance Lab Asim Khwaja discussed still another way to lower fixed costs by developing a series of tests that can lower the cost of screening small and medium-sized enterprise loan applicants.

Some participants at the Global Empowerment Meeting are finding ways to get people in developed countries involved as well. Asheesh Advani spoke to the gathering about Virgin Money US's way to bring formality to informal lending between family and friends, in a way that is much more patient and flexible than traditional loans.

Others spoke of new ways to make transfers between the developed and developing world. Empowerment Lab Researcher Nava Ashraf spoke about how giving migrants from El Salvador control over how the remittances they send are used affects remittance flows, and Tim Vang showed us how MYC4 enables anyone with an internet connection to make interest-earning loans to individual entrepreneurs in Africa.



## THE ROLE OF POLICY

Santiago Levy opened the conference raising questions about how financial access can affect the informal sector. If gaining access to financial services is one of the key incentives for firms to formalize, then making it easier for informal sector firms to gain finance may keep them there.

This sparked discussion in the audience about whether moving to the formal sector was an inherently valuable goal. Others echoed LaPorta and Schleifer's assertion that informal firms tend to be much less productive than formal ones, and that even access to finance won't do much to increase their productivity or help them move between sectors.<sup>5</sup>

Levy also discussed how governments themselves can help their citizens increase savings, smooth consumption, and access payment systems by depositing government transfers into savings accounts that recipients can access with a debit card, as in Argentina.<sup>6</sup>

Chile's Minister of Finance Andrés Velasco later shared how Chile has been using this model for government transfers and subsidies. Velasco also discussed the limits on using market mechanisms in public policy, since markets establish rules but don't guarantee outcomes, especially not outcomes that politicians can point to as evidence that they should be re-elected.

Colombia's Sergio Fajardo discussed how Medellín's promotion of entrepreneurship at the barrio and school level during his tenure as Mayor stemmed from the need to reduce violence by immediately creating social opportunities as an alternative. If policies that foster youth entrepreneurship succeed, then finding ways to provide finance to these burgeoning entrepreneurs will prove essential.<sup>7</sup>

## THE IMPORTANCE OF CONTEXT AND EVALUATION FOR INNOVATIONS

Several speakers at the meeting emphasized the importance of context. Asheesh Advani, for example, explained how each of the four Virgin Money's around the world have completely different models in order to react "to what the brand really means in each geography." Yale professor Dean Karlan emphasized the importance of testing the products and services he develops with partner organizations on different scales and in a variety of real-world contexts, because innovations that are appropriate in one place may not be suited to another.

Harvard Business School professor Shawn Cole similarly emphasized the importance of subjecting innovations in the financial sector to rigorous evaluation of the sort that academics can provide. Northeastern University's László Barabási explained how new approaches are allowing us to use data, even data collected for other

*"New technology is lowering the cost of this research by orders of magnitude."*

- Shawn Cole,  
Harvard Business School



purposes, to study things in ways that have never been possible before.

With this in mind, the Empowerment Lab is excited about forming data partnerships that will give its researchers an unprecedented amount of data on how customers in financial markets behave and interact with new products and services. Capitalizing on the private sector's ability to produce innovations and academia's ability to test them rigorously will increase our understanding of how underserved markets work and produce more inclusive solutions.

In the weeks since the First Annual Global Empowerment Meeting, the Empowerment Lab has begun forming new data partnerships and funding new research projects. MPOWER Ventures, who provided seed-funding for the Empowerment Lab have pledged to deliver financial services to 5 million underserved people in the next 5 years, and other participants are doubtless setting ambitious targets as well. With 2009's meeting on the horizon, we look forward to working with you and sharing what insights and innovations the next year brings.

For more information or to get involved, contact Jennifer Gala ([jennifer\\_gala@harvard.edu](mailto:jennifer_gala@harvard.edu), 617.495.1233).

## NOTES

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<sup>1</sup> Helms, B. (2006). Access for all: Building inclusive financial systems. Consultative Group to Assist the Poor.

<sup>2</sup> Honohan, P. (2004). Financial sector policy and the poor: Selected findings and issues. Working Paper No. 43, World Bank. [http://papers.ssrn.com.ezp-prod1.hul.harvard.edu/sol3/papers.cfm?abstract\\_id=874524](http://papers.ssrn.com.ezp-prod1.hul.harvard.edu/sol3/papers.cfm?abstract_id=874524)

<sup>3</sup> Helms, B. (2006). Access for all: Building inclusive financial systems. Consultative Group to Assist the Poor. P. 117

<sup>4</sup> Mas, I. & Kumar, K. (2008, June). Banking on mobiles: Why, how, for whom? CGAP Focus Note, 48. [http://www.cgap.org/gm/document-1.9.4400/FN\\_48%20ENG\\_9-10-08.pdf](http://www.cgap.org/gm/document-1.9.4400/FN_48%20ENG_9-10-08.pdf)

<sup>5</sup> LaPorta, R. & Shleifer, A. (2008, Fall.). The unofficial economy and economic development. Brooking Papers on Economic Activity. [http://www.brookings.edu/economics/bpea/~media/Files/Programs/ES/BPEA/2008\\_fall\\_bpea\\_papers/2008\\_fall\\_bpea\\_porta\\_shleifer.pdf](http://www.brookings.edu/economics/bpea/~media/Files/Programs/ES/BPEA/2008_fall_bpea_papers/2008_fall_bpea_porta_shleifer.pdf)

<sup>6</sup> Duryea, S. & Schargrodsky, E. (2008). Financial services for the poor: Welfare, savings, and consumption.