



ECONOMIC OPPORTUNITY SERIES

The Role of the Financial Services Sector in Expanding Economic Opportunity

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Preface

Beth Jenkins, CSR Initiative, Kennedy School of Government, Harvard University

The past fifty years have witnessed a “revolution” in global economic growth. Yet not everyone has participated in this revolution. More than 65% of the world’s population, over four billion people, still lives on the equivalent of less than \$4 per person per day. Even worse, the world’s poor are severely constrained – and often completely lacking – in opportunity to do better for themselves.

The business community has both the capabilities and the strategic, business reasons to play a major role in creating these opportunities. The CSR Initiative’s Economic Opportunity Series, a product of our Economic Opportunity Program, explores this role across a range of industries.

“Economic opportunity enables people to manage their assets in ways that generate incomes and options.”

For the poor, livelihood choices – in employment and entrepreneurship – are constrained by a wide range of interdependent obstacles, ranging from geographic isolation to market failures to political exclusion. This suggests that when we think about eradicating poverty, we should think broadly about creating economic opportunity. Economic opportunity is not, in itself, a solution; instead it is a context in which individuals can create their own solutions. It is a combination of factors that enables the poor to manage their assets in ways that generate incomes and options.

Creating or expanding economic opportunity could rightly be considered a responsibility of governments toward their citizens. But in today’s global market environment, various risks and opportunities provide reason for business to engage.

One key reason, across industries, is for business to leverage its own comparative advantage in society. As Milton Friedman might say, “the business of business is business” – and this is exactly what gives firms the capability and credibility to expand economic opportunity. Business activity creates jobs, cultivates inter-firm linkages, enables technology transfer, builds human capital and physical infrastructure, generates tax revenues for governments, and, of course offers a variety of products and services to consumers and other businesses. Each of these contributions has multiplier effects on development.

In developing countries, companies’ multipliers often fail to reach the scale or leverage of which they might be capable – often due to market failures and governance gaps. More deliberate management attention is required to unlock their full potential.

The Economic Opportunity Series explores four key strategies companies can use to expand economic opportunity:

Creating Inclusive Business Models	Involving the poor as employees, entrepreneurs, suppliers, distributors, retailers, customers, and sources of innovation in financially viable ways
Developing Human Capital	Improving the health, education, experience, and skills of employees, business partners, and members of the community
Building Institutional Capacity	Strengthening the industry associations, market intermediaries, universities, governments, civil society organizations, and grassroots groups who must all be able to play their roles effectively within the system
Helping to Optimize the “Rules of the Game”	Shaping the regulatory and policy frameworks and business norms that help determine how well the economic opportunity system works, and the extent to which it is inclusive of the poor

There is enormous variation in the roles companies can play, depending on their industries, their particular business models and relationships, and the contexts in which they operate. The industry reports in the Economic Opportunity Series explore this variation, offering more specific and detailed examples for different industry sectors. The research suggests, in general, that inclusive business models can be the most effective and sustainable ways companies can contribute. Complementary strategies such as developing human capital, building institutional capacity, and helping to optimize the “rules of the game” can also have significant impacts. These strategies are often used in combination with inclusive business models, to enhance both their commercial viability and their development impact.

The research that has gone into this series also suggests that company efforts to expand economic opportunity can draw upon core business, philanthropic, and public donor funding, depending on the balance of business and social benefits expected, the likely timeframe for their realization, and the level of uncertainty or risk involved. Hybrid approaches are increasingly common.

So is collaboration. Complex, systemic challenges like expanding economic opportunity present frustratingly frequent bottlenecks to unilateral action, corporate or otherwise. Even the best-resourced efforts eventually run into limitations on scale somewhere. Collaboration allows parties to share knowledge and information, pool scarce or diverse assets and resources, access new sources of innovation, create economies of scale, and enhance the legitimacy of the parties’ own individual activities. In addition to assembling the necessary resources and capabilities, collaboration can generate new capabilities and change operating environments in ways that create new strategic opportunities.

The Economic Opportunity Series is part of a growing effort within the business and development communities to make the links between business activity and poverty alleviation. Experimentation and learning are happening fast. As a result, the series must be considered a work-in-progress, and readers are invited to share their experience and reflections with us. We look forward to being part of the dynamic growth and development occurring in this field.

1 ■ The Role of the Financial Services Sector in Expanding Economic Opportunity

Financial services are fundamental to economic growth and development. Banking, savings and investment, insurance, and debt and equity financing help private citizens save money, guard against uncertainty, and build credit, while enabling businesses to start up, expand, increase efficiency, and compete in local and international markets. For the poor, these services reduce vulnerability and enable people to manage the assets available to them in ways that generate income and options – ultimately creating paths out of poverty.^{1,2}

The financial services sector is the largest in the world in terms of earnings, comprised of a wide range of businesses including merchant banks, credit card companies, stock brokerages, and insurance companies, among others. This report focuses primarily on large domestic and multinational commercial banks. These large firms have the expertise, reputation, and geographic reach to have significant direct impact and, through engagement and example, to change the way entire markets operate. They are using increasingly deliberate strategies to expand economic opportunity through business models that serve poor individuals and SMEs as clients. They are also developing initiatives to build human and institutional capacity and using their experience and influence to shape policy frameworks in the regions in which they work.

BOX 1 THE ROLE OF LOCAL FINANCIAL INSTITUTIONS

While an in-depth discussion is outside the scope of this report, it is important to highlight the role that smaller, local financial institutions play in expanding economic opportunity. These firms have in-depth knowledge of local operating environments, which has enabled them to become a significant source of innovation in business models targeting low-income markets. In addition, local firms provide thousands of skilled jobs.

Despite their potential, to date the impact of large commercial banks on expanding economic opportunity has remained limited in the developing world, where a vicious cycle of insufficient information, inappropriate products, inadequate infrastructure, and inflexible regulatory environments has kept costs, and therefore prices, high, limiting companies' markets to clients within the top tiers of the economic pyramid.³

One of the most critical obstacles to financial inclusion is informality. The poor often live and work in the informal sector, lacking legal ownership of land, homes, and businesses. Some one billion people worldwide live in informal settlements in urban areas alone,⁴ meaning that they cannot use their land or their homes as collateral on a loan; often they lack addresses they could associate with a bank account or credit application. Entrepreneurs can face high fees, inefficient and sometimes corrupt procedures, and burdensome regulation that essentially make it too costly to incorporate legally, forcing many small and start-up enterprises to remain in the informal or extra-legal sector. The results are telling. Of 1.1 billion people in India, only 30 million are formally employed; of 8.8 million in Bolivia, only 400,000 are formally employed.⁵ The remainder largely operate their own micro-enterprises without the legal recognition required to obtain traditional lines of credit, enforce contracts, or declare bankruptcy.

Informality contributes to insufficient market information for financial institutions. Because most of the poor have never held checking or savings accounts, taken bank loans, or entered into legal contracts, it can be difficult and costly for commercial financial institutions to determine what assets they have, what kinds of services they might need, or what levels of risk they might represent. Banking system regulations, such as interest rate caps, directed lending, and high reserve requirements discourage them further still.⁶ As a result, in developing countries, only 26% of citizens have even basic checking or savings bank accounts.⁷ Worldwide, only one billion of 6.5 billion people have bank accounts.⁸

In recent years, however, two major trends have drawn attention to the potential market opportunity associated with low-income individuals and small businesses, catalyzing increased innovation and experimentation around these challenges and enabling promising business models to emerge.

First, against a backdrop of 30 years' practical experience, widespread publicity around the United Nations' International Year of Microcredit in 2005 and Muhammad Yunus' receipt of Nobel Peace Prize in 2006 have increased overall public awareness of microfinance. Awareness has led to growing recognition of two important facts:

- the poor are able to pay (often very high interest rates) for financial services, and
- they present no greater credit risk than the average higher-income borrower. In fact, many microfinance institutions have better repayment rates than traditional commercial finance institutions.

Increasing acceptance of microfinance has, in turn, laid the groundwork for an increasing focus on “meso-finance,” or small and medium enterprise finance – loans and investments larger than micro-loans, but smaller than would be profitable for a large, commercial financial institution to make.^{9,10}

Second, remittances from developed to developing countries, sent home by migrants, have reached sizes and growth rates too large for the major commercial players to ignore. The World Bank has shown that these flows totaled some \$199 billion in 2006, more than twice the amount in 2001. And this figure includes only transfers through official channels. Available household surveys suggest that unrecorded flows through informal channels may add 50 percent or more to this estimate.¹¹

Almost all multinational banks now have microfinance initiatives, and the challenge has become moving their commitments and activities into mainstream business operations where they can scale to match the enormous global demand.^{12,13} Another challenge is to expand the focus from microfinance to meso-finance, roughly defined as financing in the \$50,000 to \$1 million range, which would enable small and start-up businesses to grow to levels where they could begin taking advantage of economies of scale and creating significant numbers of jobs.

2 ■ The Business Case for Engagement

Why should large commercial financial institutions care about expanding economic opportunity in developing countries? They operate quite profitably as it is, serving high net worth clients, investing in government bonds, and providing services to established companies in other industry sectors.¹⁴ Though these strategies have been sufficient thus far, more may increasingly be required. Industry trends, new technologies, rising citizen expectations, and government mandates that encourage the provision of financial services to underserved populations all challenge the traditional paradigm – presenting both risk and opportunity.

2.1 Mitigating and Managing Risk

2.1.1 Political and Regulatory Risk

Given the critical role of financial services in expanding economic opportunity, a reluctant industry may be regulated or otherwise “incented” into expanding its markets by national governments. Examples have occurred in the United States, South Africa, and Brazil, among other countries:

- **US Community Reinvestment Act:** In the United States, the Community Reinvestment Act of 1977, in part a result of public scrutiny and pressure applied to big banks by non-governmental organizations (NGOs), established explicit targets for lending in under-served communities.
- **South African Financial Sector Charter:** Facing the prospect of government regulation, South African financial institutions worked with government and with communities to develop and adopt a set of principles that encourage the economic empowerment of under-served communities by setting targets and giving firms individual ratings based on their performance.
- **Community Reinvestment Legislation in Brazil:** Changes in Brazilian government policy in 2003 require that financial institutions provide simplified, low-cost bank accounts for low-income people and put aside 2% of all demand deposits for microfinance operations targeting small (though not necessarily low-income) businesses.¹⁵

By taking proactive approaches to increasing economic opportunity, individual financial institutions – and the industry as a whole – can minimize political controversy and the prospect of government regulation, while at the same time addressing a critical business and societal issue.

2.1.2 Reputation Risk

Poor corporate governance, outsized executive pay packages, and white collar crime are significant sources of reputation risk for financial services firms today. As global wealth and income inequality simultaneously increase, business models that are perceived as “elitist” or “exclusive” may join this list. By exclusively serving

rich minorities in economies characterized by extreme poverty and inequality, banks run the risk of being perceived to perpetuate inequality – or even partly create it. There is by now a reasonably long history of negative publicity and activism by grassroots groups, advocacy organizations, and the media against industries and specific companies whose business practices are deemed unfair. Such campaigns are no longer limited to instances of negative impact. Firms that fail to create positive impact, in line with the expectations of society, are also subject to attack – witness the campaign for a living wage in the toy, apparel, and footwear industries. Groups increasingly couch their claims in human rights language, including economic and social rights such as the right to work and the right to an adequate standard of living.

It is increasingly clear that public relations and philanthropy are inadequate strategies for mitigating this kind of reputation risk, as they do not address stakeholders' core concerns: business models that currently exclude the majority of the world's poor from access to vital services. As public awareness of the relationship between financial inclusion and poverty alleviation grows, this risk could increase. By incorporating economic opportunity objectives into their mainstream business strategies, firms can demonstrate both commitment and results, protecting or even strengthening their brands, reputations, and “licenses to operate.”

2.2 Harnessing Opportunity

2.2.1 New and Expanding Markets

Shareholder value is determined in part by expectations about growth. While developed economies continue to grow, many developing economies are growing even more rapidly. Indeed, World Bank research shows that the developing economies will, as a group, grow faster on average than developed ones for at least the next 25 years.¹⁶ This growth can be expected to bring hundreds of thousands, even millions of people into the formal financial sector for the first time. Inclusive business models could increase the potential even further. The opportunities include microfinance, meso or SME finance, and remittances.

- **Microfinance:** Comparison of data from three authoritative sources, the Microfinance Information Exchange, the Microcredit Summit, and the Consultative Group to Assist the Poor, reveals that a core group of microfinance institutions reaches between 30 and 50 million borrowers worldwide. According to microfinance pioneers María Otero and Elisabeth Rhyne of ACCION, while it is impossible to gauge the full extent of global demand, “it is easy to determine that demand is much greater than current supply.” They put the potential market at several hundred million families at least.¹⁷ In addition, demand exists for more diversified personal financial services beyond credit, including savings, bill payment, insurance, and more.
- **SME finance:** In many developing countries, SMEs with fewer than 50 employees constitute 95% of all businesses.¹⁸ And yet, SMEs in those countries contribute far less to GDP and employment than their developed country counterparts: 17% and 30%, respectively, compared with 50% and 60% in developed countries.¹⁹ Part of the problem is informality, which limits SME access to productivity tools and market opportunities. However, with increasing attention to this topic – including the World Bank's annual Doing Business rankings²⁰ – incenting countries to reform, progress is taking place. With key bottlenecks being lifted, the SME sector could experience significant growth and development, offering new and expanded markets for financial services firms. Many are already aggressively pursuing this segment, though

undoubtedly at the larger and better-established end of the spectrum (see Box 2). Within the donor and investor communities, the focus on smaller, newer, and otherwise higher-risk SMEs is intensifying, with pointed discussion of what is required to generate attractive commercial returns.²¹

Remittances: As indicated earlier, international remittances doubled between 2001 and 2006, now totaling over \$199 billion per year. In addition to international remittances, increased urbanization has led to growth in domestic remittances. Household surveys suggest that a significant percentage – up to 50% – of these flows still happen outside formal financial channels, suggesting additional market opportunity for commercial financial institutions.²²

BOX 2 SMALL AND MEDIUM ENTERPRISES (SMES) AN IMPORTANT NEW MARKET FOR FINANCIAL SERVICES

A sampling of recent headlines includes:

“Big banks now eyeing SMEs” *VietNamNet Bridge, September 18, 2007*

“Standard Chartered targets major growth from the SME sector” *Middle East North Africa Financial Network, September 13, 2007*

“ABN Amro turning to SMEs for future growth” *Jakarta Post, Indonesia, August 23, 2007*

“Citi aims for 20% growth in SME business” *Malaysia Star, Malaysia, August 7, 2007*

“HSBC’s SME banking business up 20% annually over three years” *Channel News Asia, August 7, 2007*

“US banks turn greenbacks flow towards Indian SMEs” *Economic Times, India, July 23, 2007*

2.2.2 Innovation in the Financial Services Sector

Financial services firms have traditionally paid little attention to the poor because, by definition, the poor have limited assets. Informality, insufficient information, inadequate infrastructure and other barriers have reinforced the belief that serving the poor cannot be commercially viable, much less a driver of innovation. New, lower-cost business models have begun to challenge this conclusion, relying for instance on innovations in technology and utilization of existing retail channels.

A wide range of examples shows the power of information and communications technology to reduce distribution and customer service costs, including the village ATMs of Citibank and ICICI Bank in India, and the mobile transactions services of Wizzit and MTN Banking in South Africa, SMART Communications and Globe Telecom in the Philippines, Celpay in Zambia and the Democratic Republic of Congo, and Vodafone and Safaricom in Kenya. Indeed, a recent study by the Consultative Group to Assist the Poor (CGAP) found that 62 financial institutions in 32 countries report using technology-based channels, ranging from ATMs, point of sale devices, and mobile phones, for transactions with low-income clients.²³ Interestingly, Wizzit and Globe Telecom provide financial services without associating with a bank or other financial institution, thus eliminating the need for the poor to hold bank accounts in order to pay bills, transfer funds, and deposit or withdraw cash.

Another emerging low-cost business model for providing financial services to low-income clients can be found in the retail sector in Mexico, where Wal-Mart is providing deposits, withdrawals, transfers, and payments – going beyond consumer credit. Domestic retail chain Elektra and its banking arm Banco Azteca have already been in this business for a number of years.

A significant share of this innovation is originating outside the traditional financial services sector. As World Bank economists Mohsen Khalil and Charles Kenny have predicted, “the technologies driving change in the next decade may well encourage a further blurring of the line between access, industries and applications.”²⁴ There is a crucial opportunity for commercial financial institutions to become involved now, particularly while banking regulation in many countries favors partnership, as opposed to facilitating the efforts of telecommunications, retail, and other firms to go it alone.²⁵

3 ■ Business Strategies for Expanding Economic Opportunity

As we have seen, financial services help the poor to reduce vulnerability and manage the assets available to them in ways that generate income and options. Perhaps the most significant way banks can contribute to expanding economic opportunity is therefore to find ways of making financial services available to low-income individuals, entrepreneurs, and small business owner-operators – ideally through inclusive business models that are financially viable, and thus offer the potential for sustainability and scale.

In addition to inclusive business model innovation, large commercial financial institutions are engaging in efforts to develop human capital, build institutional capacity, and help shape supportive regulatory and policy frameworks in the geographies in which they operate. These four strategies are not mutually exclusive, but rather complementary. For instance, creating or strengthening inclusive business models may require a firm to build the managerial capacity of local partners or to promote specific regulatory changes domestically or internationally. Many of the examples covered in this report expand economic opportunity using multiple strategies in concert.

3.1 Creating Inclusive Business Models

As defined in the United Nations Development Programme's forthcoming *Growing Inclusive Markets* report, inclusive business models include the poor – whether as employees, entrepreneurs, suppliers, distributors, retailers, customers, or sources of innovation – and are or have the potential to become financially viable.²⁶

In the financial services sector, most inclusive business models to date have included the poor as customers and entrepreneurs. These have included:

- **Microcredit.** Nearly all multinational commercial banks are now involved in microfinance in some capacity. Most do not provide micro-credit directly to clients, but rather invest in or structure deals on behalf of established microfinance institutions. For example, Deutsche Bank, in collaboration with the US Agency for International Development (USAID), the UK's Department for International Development (DfID), and a group of philanthropists and socially responsible investors, has created a new investment facility called the Global Commercial Microfinance Consortium. The Consortium leverages participating donors as the first bearers of risk to generate investment from commercial investors; so far demand has exceeded expectations. Citigroup underwrote a \$45 million bond offering for Mexican microfinance institution Compartamos in 2004 that was so successful that its second issuance in 2005 was oversubscribed by 300%.²⁷
- **Microsavings.** While the poor are often precluded from opening traditional bank accounts due to high transaction fees, required deposit minimums, and the physical distance between the client and the bank, the poor still find ways to save, often through traditional networks and institutions. In Ghana, Barclays

works with traditional Susu collectors, who act as walking savings accounts. By offering a range of services via the Susu collectors, Barclays has raised awareness of formal savings mechanisms, given clients greater security, and enabled them to build their credit profiles. Barclays anticipates replicating the model elsewhere in Africa. Savings groups, in various forms, are common in many parts of the developing world.

- **Remittances.** As described earlier, remittance flows are large and rapidly growing. A number of major financial institutions have begun to offer remittance products that generate new revenue directly and also help increase the number of personal banking accounts. In the US, for example, Citibank is offering low-fee accounts to immigrants from Mexico, enabling them to send remittances that relatives at home can access via its Mexican subsidiary, Banamex, using only a card. Citi is also offering Ecuadorian clients in the US remittances of up to \$3,000 for only \$5, delivered through microfinance organization Banco Solidario in Ecuador.
- **SME finance.** Though to date it has been overshadowed by microfinance, SME finance is critical in helping entrepreneurs and small businesses reach sizes where it is possible to take advantage of economies of scale and create jobs in significant numbers. To date, much of the innovation has been outside the commercial banking sector. In South Africa, for instance, Anglo Zimele makes debt and equity investments in small and medium black economic empowerment (BEE) enterprises connected with the mining industry, sometimes facilitating linkages between its portfolio companies and its parent Anglo American. With support from the Shell Foundation, GroFin, a pan-African investment firm, provides debt and equity along with business development services to SMEs in South Africa, Kenya, Uganda, Tanzania, Rwanda, and Nigeria.

BOX 3 SMALL ENTERPRISE ASSISTANCE FUNDS (SEAF)

SEAF is a global investment firm that provides growth capital and operational support to small enterprises in emerging markets. Initially established as a private investment subsidiary of CARE, the international development NGO, SEAF now operates for-profit investment funds in more than 20 countries. It counts among its investors international finance institutions, pension funds, insurance companies, banks, and foundations. In 2003, SEAF launched an initiative to explore the impact of its investments on local communities. The first study released concluded that every dollar invested in local small enterprises generated an additional 10 dollars in the local economy.

- **Supply chain finance.** Commercial financial institutions are also offering SME finance in collaboration with large firms in other industries – such as agribusiness, manufacturing, mining, and others – that are working with SMEs in their value chains. Such relationships can help the financial institution with deal-flow, reducing the cost of identifying qualified borrowers and sometimes subsidizing interest rates. These relationships can also help reduce risk, as large buyers often provide SMEs with relatively stable markets and capacity-building support such as basic business management training, helping assure lenders that borrowers will have the income to repay their loans. In addition, large buyers can be willing to share risk explicitly by guaranteeing SMEs markets for their products at pre-defined prices or guaranteeing loans. ABN AMRO Real in Brazil, for example, has worked with Votorantim Celulose e Papel (VCP), a paper and pulp company, to finance small farmers growing eucalyptus. Because eucalyptus takes seven years to mature, VCP has reduced ABN AMRO Real's risk by guaranteeing to buy the eucalyptus at pre-defined prices, adjusted for inflation. ICICI Bank is another major commercial financial institution offering finance for small farmers as part of other large companies' value chains, providing unsecured loans to farmers growing barley for Cargill to make into malt for SABMiller in India.

- **Insurance.** The poor operate on razor-thin margins, and without significant savings, insurance, or government “social safety nets” to rely on, they are extremely financially vulnerable. TATA-AIG originally entered the micro-insurance market in India as a condition for business licensing, and has since developed a model that uses community members referred by credible NGOs as salespeople. For the millions in the developing world who rely on agriculture for their livelihoods, weather is a particularly important source of risk. In addition, constant uncertainty about future earnings prevents farmers from investing too heavily in their farms, which limits productivity growth. In India, ICICI Lombard Insurance has teamed up with the microfinance institution BASIX to provide crop insurance for rain-fed farmers. Payments are made if rain falls below a certain amount, or if certain other weather patterns occur; this weather-indexed model has eliminated much of the cost associated with indemnity-based insurance. ICICI Lombard projects that the business, first piloted in 2003, will become profitable by the end of 2008.
- **Commodity price hedging tools.** In the developed world, farmers have access to a variety of price hedging products to protect themselves in case of price instability in world commodity prices. Farmers in the developing world have few such options. Rabobank has worked in East Africa to develop affordable hedging products for cotton and cocoa farmers.

BOX 4 RABOBANK’S COMMODITY PRICE RISK MANAGEMENT PROGRAMS^{28,29}

Rabobank is a leading Dutch financial institution whose roots lie in the Dutch agrarian sector; it has become increasingly involved in small and medium enterprise development in the Netherlands as well.

Rabobank has also participated in pilot projects seeking to empower cooperatives abroad. In one such case, Rabobank worked with the World Bank International Task Force (ITF) to explore the options and intricacies of introducing market-based approaches for assisting small-scale farmers in the developing world.

In the course of this initiative, Rabobank helped educate farmers on the basics of price risk management, while also helping to restructure existing farming cooperatives. The company’s philanthropic arm, the Rabobank Foundation, provided loans and credit guarantees.

As a result of the collaboration, coffee producers in several Latin American and African countries participated in a total of five hedging transactions, at lending rates significantly below those associated with traditional financial institutions.

It is worth noting briefly that collaboration with other industries, community groups, civil society organizations, microfinance institutions, and social networks has played a critical role in many of these examples, enabling large commercial banks to get to know their markets, leverage existing – albeit often non-traditional – distribution networks, and share risk.

In addition, inclusive business models targeting low-income individuals, entrepreneurs, and SMEs often embody the concept of blended value investing, reflecting “innovations in capital finance that promise to bridge market-rate interests with strategic opportunities to create blended value that benefits shareholder and stakeholder alike.”³⁰ These innovations tend to join groups of investors with different risk-return requirements in pooled or staged approaches that enable each to achieve their objectives. For instance, Standard Chartered leveraged a grant from the UK Department for International Development’s Financial Deepening Challenge Fund to develop a new agricultural credit card product in Pakistan; purchasing has proven to be even stronger than the bank suggested, and it is now rolling the card out in additional geographic areas. Deutsche Bank’s Global Commercial Microfinance Facility has used a DfID grant and a USAID credit guarantee, as well as

social investment from philanthropists, to reduce the risk to commercial investors – bringing more than \$50 million in private, return-oriented investment into the capital market for microfinance.

3.2 Developing Human Capital

Large commercial financial institutions are engaging in human capital development activities to expand economic opportunity directly (for instance, through financial and business management training for SMEs and financial literacy programs for individual clients) and indirectly (by supporting public education and leadership programs).

Financial skills and other business training for SMEs. SME owner-operators may need training that goes beyond financial literacy to include basic business management and other skills. For instance, the farmers raising eucalyptus for VCP in Brazil are typically new to the business and they are given substantial loans to help them plant and manage their farms. VCP, ABN AMRO Real, and the Brazilian agricultural extension service are providing these clients with group and individual training in financial and environmental management, giving them the tools they need to manage those loans over the seven-year growing period for eucalyptus.

Financial literacy. Clients and potential clients with little exposure to formal banking may not fully understand fee structures or interest charges or even trust institutions with their money. As a result, commercial financial institutions undertake financial literacy programs at a variety of levels. Citigroup has provided general financial literacy education in the United States and abroad, focusing on topics such as responsible use of credit cards, using employee volunteers and paper- and web-based material. For instance, Citibank China, as part of a 10-year, \$200 million effort, launched a comic book stressing the importance of sound financial judgment. Deutsche Bank provides financial literacy training targeted specifically at clients of the microfinance institutions in which the company invests. Similarly, Barclays trains the savings clients of its traditional Susu collectors. Such programs strengthen local money management knowledge and skills, enabling communities to use financial services more effectively to expand their economic opportunities.

Public education and leadership programs. Public education and leadership programs are common in the financial services sector. Because direct benefits to the individuals involved generally outweigh those to the firm, with business benefits accruing only indirectly and over the longer term, such programs are often housed within public or community affairs departments. For example, the Goldman Sachs Global Market Institute has helped the Aspen Institute to create the Africa Leadership Initiative (ALI), which brings young African professionals from around the continent together to develop the leadership skills they need to tackle social and economic issues facing their countries. Twelve senior leaders from Goldman Sachs are selected to participate with the young professionals in the program.³¹

3.3 Building Institutional Capacity

Institutional capacity within the larger financial system is critical to the ability of individual firms to expand economic opportunity. Firms rely upon others – including credit rating agencies, microfinance institutions,

specialized SME finance institutions, stock exchanges, NGOs, social entrepreneurs, traditional leaders, grassroots federations, and more – for information and partnership, for example in marketing or distribution. Financial services firms can help build institutional capacity within these organizations through financial investment, technology transfer, knowledge-sharing, and networking. They can also create and spin off brand new institutions.

ICICI Bank in India provides a good case study in institutional capacity-building, as it is working on a number of levels:

- **Microfinance institutions.** With surging interest in microfinance on the part of donor agencies, international financial institutions, commercial banks, and even some individual philanthropreneurs, investment capital is growing and the top tier microfinance institutions (MFIs) are struggling to absorb it all. To reach the hundreds of millions of families estimated to make up the potential microfinance market, there is a need not only to increase the capacity of well-established MFIs to scale up but also to build the capacity of smaller, newer MFIs and bring additional MFIs into the market. ICICI Bank is building a network of MFIs that have local information and sufficiently low cost structures to support small transaction sizes. ICICI then provides capital for on-lending as well as equity capital for growth; product development help; and linkages with capital markets as the MFIs mature.³²
- **Market intermediaries.** As ICICI's Nachiket Mor has noted, a number of “missing markets” constrain low-income clients’ potential for growth. In response, ICICI is building market intermediaries at a number of levels. Upstream from the client, the bank partners with local organizations and large firms to facilitate access to inputs and services from cattle feed to commodity risk hedging. Downstream, ICICI is developing models for financing SMEs that procure from low-income clients, for whom cash flow and credit constraints can get in the way. These include venture capital, takeout finance, and mezzanine equity. ICICI is also building Network Companies that facilitate linkages between microfinance clients and markets, for example in handicrafts, dairy, other foods, tourism, and business process outsourcing. All of these linkages help ensure that clients both earn enough income to repay their loans and have opportunities for growth.³³
- **Credit rating agencies.** As discussed earlier, inadequate information about individuals and SMEs raises the risk – and therefore the cost to the borrower – of lending. ICICI has joined with Dun & Bradstreet, Standard Chartered, and several national banks to create the SME Rating Agency of India Ltd (SMERA) to provide “ratings that are comprehensive, transparent and reliable,” facilitating “greater and easier flow of credit from the banking sector to SMEs.”³⁴
- **Research centers.** ICICI helped found the non-profit Institute for Financial Management and Research (IFMR), which houses six research centers that conduct market research, design, and test emerging business models and methodologies, widely disseminating its results. IFMR has also established a leading business school.³⁵

3.4 Helping to Optimize the “Rules of the Game”

Financial services firms can influence regulatory and policy frameworks in ways that promote economic opportunity by engaging individually or collectively in dialogue with policy-makers in areas such as business entry and exit rules, infrastructure requirements, trade and investment policies, and financial sector regulation.

ACCION's Rhyne and Otero note that "the trajectory of the policy and regulatory environment in many countries has until recently been from state-controlled and distorted financial markets toward more liberalized financial markets," in which governments "did not follow directed credit policies, allowed interest rates to be market-determined, kept credit allocation separate from politics, and was not itself involved in direct lending." They warn, however, that "this trend is under threat in some places."³⁶

- **Public policy dialogue.** Many large commercial financial institutions are involved in various forms of public policy dialogue. For example, Visa International helped convene financial services firms, regulators, and international donors to discuss the global credit scoring and mobile banking, providing insight into policy and regulatory needs for this rapidly evolving space. ICICI Bank has a Development Strategy Group charged with identifying infrastructural gaps that constrain the economic options of the poor and dialoguing and building partnerships with governments to fill those gaps.
- **Voluntary principles.** Financial services firms can also engage with one another to develop and implement economic opportunity-related principles and practices voluntarily. In South Africa, for example, black economic empowerment has been an important development issue for the past 15 years. With the role of the financial sector under scrutiny, leading national banks, including Absa, First National, Nedbank, Standard Bank, and PostBank, came together with industry associations and government officials to develop a framework for activity and accountability. The resulting Financial Sector Charter identifies ways for firms to provide broad-based access to financial services to the South African public and provides for points-based ratings based on their performance.

4 ■ Future Opportunities

One might say that the financial services sector is, in essence, in the business of expanding economic opportunity: this is the core value proposition of its products and services to clients. Large commercial financial institutions are increasingly engaging and experimenting with ways of expanding that pool of clients to include lower-income individuals and entrepreneurs and SMEs. This report suggests a number of opportunities for these firms to enhance the impact of their efforts:

1 Engage in multi-pronged strategies for expanding economic opportunity. While each of the four business strategies for expanding economic opportunity outlined here is individually important, significant breakthroughs seem to require combinations of these strategies. Because financial services are both the core business of commercial financial institutions and a critical ingredient in economic opportunity, firms' primary focus should be to develop inclusive business models that make those services widely accessible. But constraints in the system mean that inclusive business models often require complementary strategies to be viable. For instance, SME borrowers may need basic financial and business management skills training as well as intermediary institutions brokering market linkages in order to grow sufficiently to repay their loans. Plans to offer financial transactions via mobile phone may require active engagement with governments across countries to align the incentives and policies of financial and telecommunications regulators. There is particularly significant opportunity for commercial banks to play leadership roles in institutional capacity-building, applying their expertise to strengthen entire systems.

2 Be creative in financing your economic opportunity strategies. The systemic constraints that necessitate multi-pronged economic opportunity strategies mean that financial viability, to say nothing of traditional commercial rates of return, must often be a longer-term objective. As a result, we see a number of companies creatively assembling the funding for their economic opportunity strategies from a mix of commercial, corporate philanthropy, and public or individual donor sources. For example, Standard Chartered's agricultural credit card for small farmers in Pakistan utilized an initial grant from the UK Department for International Development's Financial Deepening Challenge Fund. Similarly, Deutsche Bank's Global Commercial Microfinance Consortium leverages donor funding to reduce risk sufficiently to attract commercial investors. Other companies use in-kind support from partners to reduce the investment that multi-pronged economic opportunity strategies require. For example, ABN AMRO Real in Brazil partnered with the government agricultural extension service to provide training to its eucalyptus farmer borrowers. These examples reflect blended value investment approaches, "innovations in capital finance that promise to bridge market-rate interests with strategic opportunities to create blended value that benefits shareholder and stakeholder alike."³⁷

3 Collaborate. Collaboration is a key feature of nearly all the examples and recommendations in this report. Collaboration allows partners to focus on their comparative advantages to increase impact, share risk, and increase the credibility of the efforts with other important stakeholders. It also allows them to develop new capabilities and, by changing the context for their efforts, uncover and even create new strategic opportunities.

In the financial services sector, engagement with microfinance institutions, international financial institutions, and multilateral and bilateral donors is common, particularly around microfinance. Less common, but quite promising, is engagement with traditional social networks (such as Barclays' partnership with the Ghanaian Susu Collectors' Association) and large companies in other industries (as in Standard Chartered, ABN AMRO Real, and ICICI Bank's partnerships with large agribusiness concerns to expand economic opportunities for small farmers).

Large commercial banks have the potential to serve as lynchpins in the dynamic transformation of financial markets to offer expanding economic opportunity to the poor. While individual firms must naturally choose the strategies most appropriate for them, strong collaboration capabilities will almost certainly be essential – both within the financial sector and beyond.

5 ■ Case Profiles

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5.1 ICICI LOMBARD: WEATHER-INDEXED CROP INSURANCE FOR RAIN-FED FARMERS IN INDIA

Background

ICICI Bank is the largest private sector bank in India, and the second largest bank overall. It was founded in 1955 by the government of India, the World Bank, and industry representatives as a financial institution for Indian businesses. ICICI Lombard is a joint venture of ICICI Bank and US-based Fairfax Financial Holdings.

Established in 1996, BASIX promotes rural livelihoods in India through a "Livelihood Triad" that includes livelihood financial services (credit, savings, and insurance), human resource and institutional development services, and agricultural and business development services. The organization works mostly with farmers that, on average, earn less than \$1 per day.

ICICI Lombard and BASIX have teamed up to launch an innovative product: weather-based crop insurance. With technical assistance from the Commodity Risk Management Group (CRMG) of the World Bank, the team piloted the program with 230 farmers in Andhra Pradesh during the 2003 monsoon season. This was the first weather insurance initiative launched in India and the first farmer-level weather insurance offered in the developing world.³⁸ Its success has prompted ICICI and BASIX to expand the program, which now serves over 6,700 farmers in six states.³⁹

Drivers

From an insurance company standpoint, weather-indexed crop insurance has several advantages as a product for small farmers compared with traditional indemnity-based insurance. Administratively, traditional indemnity-based insurance requires considerable manpower to perform individualized risk assessment; highly-trained sales staff to make underwriting decisions; extensive underwriting documentation; field visits; and physical inspections when farmers file claims. These requirements make indemnity-based insurance costly to provide, often precluding firms from offering products to low-income clients.

ICICI's commitment to economic development and its belief that weather-based insurance will be profitable in India encouraged the company to undertake the project with BASIX. Its confidence in the product profit potential rests on three major factors:

- The potential market size of the product is large, as 60% of India's farmers are rain-fed.
- Pilot project participants expressed high satisfaction with the transparency of the model and its implementation.
- Weather-based insurance in India is relatively inexpensive to administer.

Activities

ICICI collaborated with the World Bank's Commodity Risk Management Group (CRMG) to design the insurance product. The partners analyzed historical weather data gathered from the India Meteorological Department and converted the results into product values that include premium rates, unit exposure, and trigger and exit points for the insurance contract. In addition to designing the initial roll-out in Andhra Pradesh, ICICI staff spent two and a half years researching the necessary weather patterns and project requirements needed for success; this research constitutes ICICI's costliest contribution in the collaboration with BASIX.⁴⁰

In addition to its work to research and develop the micro-insurance model, ICICI also provides and bears the cost of training BASIX on the technical aspects of the product. The bank also provides promotional and educational materials about the product for distribution by BASIX.

While ICICI and BASIX first rolled out the product in 2003, the partnership made changes in the subsequent two years as it received client feedback and sought to expand. In 2005, ICICI and BASIX continued to refine the product based on farmers' feedback, scaling up geographical reach as well as adding new features. These new features included the "exclusion of daily rainfall of less than 2 millimeters and more than 60 millimeters from the cumulative total that determines payout."⁴¹ To help scale the initiative in India's varied agro-climatic environment, BASIX also began to sell area-specific insurance products.

Weather-indexed insurance is expected to be more effective than traditional crop insurance, as it protects the farmers' overall income rather than the yield of a specific crop. The major difference between the two lies in administration. Because traditional crop insurance requires intensive site visits and administration, claims

settlements can take upwards of a year to be processed. Weather-indexed insurance pays out claims automatically upon trigger, thus avoiding long payment delays and enabling poor farmers to recoup their losses more efficiently.

Results

Within only three years, the small pilot graduated into a large-scale weather insurance operation in which BASIX sold over 7,500 policies to approximately 6,700 customers in 36 locations in six states during the 2005 monsoon season.⁴² Interactions with farmers indicate the potential for commercial expansion and highlight the factors necessary to bring appropriate weather insurance products to farmers.

ICICI also estimates that the business ratios for weather insurance are similar to those of other product lines; this indicates that the weather insurance business is at least as attractive as other general insurance lines. Since ICICI expects underwriting costs to decrease, the company expects overall profitability to grow even further.⁴³

In addition to its BASIX collaboration, ICICI Lombard has worked with local governments and non-governmental organizations (NGOs) throughout India to pilot similar insurance products. During the 2005 season, 250,000 farmers bought weather insurance through other collaborations based on the new insurance model, which points to the potential size of the end user market. Based on these strong sales numbers as well as anecdotal information showing farmers' satisfaction with the product – particularly the transparency with which claims are paid – ICICI continues to believe in the sustainability of this endeavor.⁴⁴

Challenges

To further expand the underwriting of weather insurance, there exist several significant challenges that must be addressed:

- *India's automatic weather station network must be improved.* Extending the geographic coverage of automatic weather stations increase the speed and accuracy with which weather data can be transmitted, which leads to a higher rate of acceptance of weather-indexed contracts by reinsurers. This increased confidence in data will lead to improved reinsurance rates.
- *Changes to the institutional framework may encourage the expansion of weather-indexed insurance.* Currently, the government subsidizes yield insurance, which “distorts farmers’ incentives to purchase weather insurance.”⁴⁵ By either removing the subsidy, or at least allowing weather-indexed insurance to be subsidized as well, government policy could give farmers additional incentive to purchase this new insurance product.
- *Training BASIX staff and developing and adapting product to local environments is costly and time-consuming.* Of India's large agrarian population, approximately 60% are rain-fed across myriad agro-climates.⁴⁶ The logistics of building capacity with implementing organizations should not be neglected.

These challenges point to the importance of achieving scale, which is necessary for ICICI to recover the capacity-building costs it has invested. In addition to the work with BASIX, ICICI has begun collaborating with other NGO and local government partners to launch similar insurance schemes, suggesting significant market potential and future profitability.

5.2 BARCLAYS: ADDING VALUE THROUGH TRADITIONAL MICROFINANCE MECHANISMS IN GHANA

Background

Barclays is one of the largest financial services companies in the world, engaged primarily in commercial banking, investment banking, and investment management activities. Barclays has operated in Ghana for over 90 years and now has a major commercial banking network in the country with branches in all large commercial centers.

Ghana's 4,000-strong Susu collectors offer basic banking to people who are employed in the informal sector, each typically serving between 200 and 850 clients a day. For a small fee these traditional micro-financiers gather their clients' savings on a daily or weekly basis and return them at the end of each month, thus acting as mobile savings accounts. Susu collectors offer basic banking to some of the least affluent in Ghana.

The Traditional Banking Sector in Ghana

Banks reach only a small proportion of Ghanaian households, partially because they are concentrated in the capital city, Accra, where less than 13% of Ghanaians live. Even within urban areas, however, low-income individuals are not able to access their services due to high minimum deposit requirements, ranging from \$55 to \$220 with penalties of \$0.50 to \$2.00 per month for dipping below the threshold.⁴⁷ These requirements pose significant hurdles for many in Ghana, which has a per capita income of \$2,700 and a 31% poverty rate.⁴⁸

Despite their lack of penetration into the broader market, commercial banks are the principal players in the Ghanaian financial sector with a domestic deposit base of about \$1.3 billion. Despite this deposit base, commercial banks in Ghana historically conduct business as they do in many other developing countries: by investing in liquid and low-risk government securities and lending to the local commercial banking sector. Little attention has thus far been given to individual investors – particularly the poor.

Traditional Susu collectors serve as the primary financial services institution for many Ghanaians. Although each client contributes only a small amount per day or week, in the aggregate the scale of financial intermediation offered by each Susu collector is substantial. A collector who receives \$1.10 per day from each of 500 clients collects \$13,426 per month, or \$161,112 per year. Of this total, he or she retains over \$5,500 in commissions.⁴⁹

Drivers

Most Ghanaians do not have bank accounts, particularly those living in rural areas. The individual incomes of the poor are too small for 'high street' banking. By extending financial services to some of the least affluent such as the small trader at the market or the micro-entrepreneur selling from a road-side stall, Barclays can expand its market reach while providing much needed capital and banking services to the poor.

The underlying philosophy behind Barclays' involvement in the Susu collection system is that to be truly inclusive, it is important to work with existing, indigenous financial institutions that already provide financial services to the least affluent. The Susu initiative sits within Barclays Microbanking, which seeks financial inclusion for the poor.⁵⁰

Activities

Barclays first contacted the Ghana National Association of Susu Collectors. The Association recommended 100 collectors from Accra and Kumasi, Ghana's second-largest city, to take part in a pilot program. When asked for ideas as to how their businesses could be improved, the Susu collectors provided a number of recommendations, which Barclays addressed in three parts, as described below:

- *Awareness creation.* Barclays organized knowledge-sharing meetings with end users to educate them about financial management generally and about the Barclays Susu collectors initiative specifically. Some of the issues discussed included record-keeping and effective use of savings. Through these discussions, end users learn about the additional services that Barclays' initiative provides. Barclays, for its part, learns about local needs, enabling the company to improve the Susu collectors initiative and redesign products and services to suit potential low-income customers better.⁵¹

- *Banking services.* The second component of the program that responded to the Susu collectors' initial recommendations is the creation of an investment account called the Dwetiri, or seed money, account, which offers capital for on-lending and a place to deposit savings. Susu collectors borrow money from Barclays at an interest rate of 2.1% per month.⁵²
- *Capacity-building.* The third component emphasizes capacity-building for the Susu collectors and their clients. As of October 2006, 173 collectors had been trained in Accra, Kumasi, and the Brong Ahafo region of Ghana, in conjunction with the Ghana Microfinance Institutions Network (GHAMFIN). Courses included Delinquency Management, Financial Management and Credit/Risk Management. In addition, Barclays provides Susu collectors' clients with a financial awareness program to help people gain skills and confidence in money management.

Impact

Barclays has built on its initial pilot involving 100 Susu collectors in two regions to reach 400 collectors across all of Ghana, all of whom have received training on the fundamentals of banking and customer service. These collectors have deposited a total of \$4.5 million since the initiative began. In addition, they have offered small loans – a service they had not previously been able to provide – totaling approximately \$400,000, with a repayment rate of 100%.⁵³

From February 2006 to February 2007, the initiative also trained approximately 1,000 end users on topics ranging from banking, savings, and insurance basics to business record-keeping.⁵⁴ From a development perspective, it is hoped that the Susu collectors initiative will encourage additional savings by end users as they learn that their savings will be secure in their collectors' accounts with Barclays. Additionally, since the accounts help build credit histories, these users will have the additional option of taking small loans for their businesses.

Barclays hopes that increased exposure to formal banking services through the Susu collectors initiative will help cultivate a new pool of potential customers for its traditional banking services in Ghana. While the Susu initiative was first implemented with primarily social motivations, it has since become a commercially-oriented operational unit within Barclays' Ghana Microbanking. The bank has high hopes of replicating the initiative in other areas of Africa, particularly those where traditional, Susu-like collectors already exist.⁵⁵

Challenges

Ghanaians have traditionally viewed Barclays as a bank for the elite. As a result, Barclays has had to work to gain trust, largely through its training efforts and its association with the Susu collectors. The bank has also had to accommodate the Susu system within its own banking practices. For instance, banking hours at Barclays locations have been extended exclusively for Susu collectors, who previously struggled to perform their daily visits and travel to Barclays branches before they closed at 3:00 pm. Lack of official regulation of the Susu system means that the collectors association might be more vulnerable to fraud than it would be with official accreditation of collectors, something Barclays has had to take into consideration. Finally, access to the bank's branches is still difficult, if not impossible, in some areas of Ghana. While it has recently announced new bank openings, Barclays must find additional ways of scaling up the Susu collectors initiative nationwide without prohibitively raising its costs.⁵⁶

5.3 ABN AMRO REAL: FINANCING EUCALYPTUS SUPPLIERS IN BRAZIL

Background

Striking income inequality and poverty characterize Brazil, particularly the country's rural areas. Despite recent policies promoting rural settlement through land reform, land access and ownership continue to be controversial issues, giving rise to a large social movement known as the Movement of Landless Rural Workers (Movimento Sem Terra, or MST in Portuguese). A number of these landless workers have been resettled through government programs.

In this context, Votorantim Celulose e Papel (VCP), a major pulp and paper company in Latin America, devised a business model involving local landowners – including some newly-resettled landless workers – as eucalyptus production partners in the state of Rio Grande do Sul, one of Brazil's poorest and most politically volatile areas. VCP collaborated with ABN AMRO's Brazilian subsidiary, Banco ABN AMRO Real (ABN AMRO Real), to provide financing for its new partners.

ABN AMRO Real provided farmers with financing in a collaborative project with VCP's Poupança Florestal (Forest Savings Account) program. As part of this initiative VCP provided educational training and technical farming assistance to farmers, while committing to buy eucalyptus timber upon maturity (seven years). Government agencies and local universities also participate in the initiative.⁵⁷

Drivers

In preparation for a major business expansion, VCP mapped potential geographical areas for new industrial operations. The southern half of Rio Grande do Sul, despite its political polarization, poverty, and environmentally degraded soil due to deforestation and cattle farming, was chosen due to its favorable logistical conditions, land and labor availability, and eucalyptus-friendly climate and topography.

VCP envisions growing its business by 300% within 15 years. This ambitious strategy is even more pronounced when considering that the eucalyptus production cycle is itself seven years.⁵⁸ For VCP, the vision required the company to explore new ways to achieve scale.

Most agribusiness firms depend as little as possible on third parties, preferring to buy land and plant crops themselves. This business model often results in concentration of land ownership in the hands of a few owners. The risk of political backlash in Rio Grande do Sul, however, effectively prevented VCP from undertaking such a strategy. In an attempt to create local livelihoods through its business model, VCP decided that 30% of its eucalyptus should be sourced from third-party suppliers.⁵⁹

ABN AMRO Real's primary motivations for participating included the potential of gaining new clients for long-term relationships. Previously, the company had almost no presence in the state. Financing volume was expected to reach up to \$30 million over seven years, with benefits for 20,000 producer families. The plan also aligned with ABN AMRO Real's environmental sustainability guidelines and promised social and economic benefits to local communities.⁶⁰

Activities

The VCP-ABN AMRO Real eucalyptus supply chain model has the following main components:

- *Vetting.* VCP performs initial assessments of local farmers' qualifications to participate in the program, ensuring that farmers live on and cultivate the same area of land, and that their land is of eligible size. A list of qualifying farmers is sent to ABN AMRO Real, which analyzes the financial risk of working with each farmer. The resulting list then goes back to VCP, which begins a two-month intensive training program on eucalyptus farming and environmental protection.⁶¹
- *Finance.* ABN AMRO Real provides financing at an interest rate of 9% per year with a four-year loan disbursement schedule. These disbursements provide farmers with enough capital to purchase inputs and remunerate labor. Loan sizes were set equivalent to VCP's costs when planting their own forests. Farmers are expected either to hire others to plant their forests, or to learn from VCP trainers how to do it themselves and use the capital saved to invest in farm equipment. ABN AMRO Real and VCP generally share risk; however,

VCP shoulders all the risk where borrowers are land reform settlers. VCP also commits to purchase at least 95% of the timber for at an agreed price.^{62,63}

- *Technical support and capacity-building.* VCP provides eucalyptus seedlings from its own forests to the suppliers in the program. In addition, VCP has partnered with Brazil's agricultural extension service to provide technical assistance. This service is free to farmers. Agricultural extension workers also monitor each farm to ensure that proper maintenance is occurring. Such maintenance is required to receive the next tranche of loan funding.⁶⁴
- *Alternative income requirements.* VCP requires that a maximum of 30% of an individual farmer's land be dedicated to growing eucalyptus in an effort to avoid dependence on the crop. This requirement also enables farms to earn a living in the seven years before eucalyptus can be harvested. VCP donates traditional crop seeds to partner farms.⁶⁵

Results

As of September 2007, more than 400 producers, with land totaling over 8,000 hectares, had signed agreements with VCP to join the Forest Savings Account program. Small producers and land reform settlers account for 78% of contracts signed and 47% of land cultivated under the program. According to VCP estimates, the producer's profit is expected to be around 2,500 Brazilian reais per hectare.⁶⁶

As Linda Murasawa, Equities Analyst with Banco Real, points out, the project represents a new way of doing business in Brazil. Murasawa asserts that everyone wins: formerly landless individuals and small farmers obtain low-risk investment opportunities, VCP builds a profitable eucalyptus supply chain cost-effectively, the government ensures that small farmers have access to economic opportunity and that environmentally degraded land is rehabilitated, and ABN AMRO Real takes part in a profitable business partnership with VCP and local farmers.⁶⁷

Challenges

One challenge for VCP is to scale up; the company must contract to cultivate a much larger area of land in order to reach its strategic goals. One bottleneck to scale is that many small producers lack formal title to their land; land regularization requires government approval and has, in general, been a slow process in Brazil. Another bottleneck to scale is the need for broad support and participation from local communities. VCP initially tried to partner with the MST to bring more land reform settlers into the fold of the eucalyptus business. MST leaders ignored the outreach but did not reject the partnership explicitly; this has allowed (though not actively facilitated) VCP's efforts to recruit settlers.^{68,69}

Another ongoing challenge is for VCP to maintain its social license to operate in a region marked by radical political polarization. As part of its strategy to strengthen relationships with local entrepreneurs, the company has sought to prioritize local businesses for its procurement needs and hired local employees for management and operational positions. It has established local university partnerships to study the environmental impacts of eucalyptus production and identify appropriate management techniques.^{70,71}

5.4 DEUTSCHE BANK: THE GLOBAL COMMERCIAL MICROFINANCE CONSORTIUM

Background	<p>Deutsche Bank was established in Germany in 1870. The company operates five businesses: global markets, global banking, asset management, private wealth management, and private and small business clients. It has over 75,000 employees in 75 countries.</p> <p>Deutsche Bank has demonstrated leadership in microfinance investment for over a decade; in 1998 the company launched the Deutsche Bank Microcredit Development Fund, which provides loans at subsidized interest rates to non-profit microfinance institutions (MFIs) with the potential to evolve into regulated entities.⁷² These loans are intended as equity-like debt that will be held by the MFI on its balance sheet to assist in capitalizing loan loss reserves or to use as collateral to obtain a loan from another financial institution. Like other early, risk-averse loan funds, the Microcredit Development Fund lent in US dollars to top-tier MFIs.</p>
Drivers	<p>By the early 2000s, Deutsche Bank and other members of the microfinance community began to envision new financial instruments that would continue to tap into existing interest from socially responsible investors, while also bringing more commercially-oriented investors into the fold.⁷³ Traditionally, commercial investors were not attracted to microfinance funds due to high risk and low return.</p> <p>As the availability of investment funds for top-tier MFIs increased over the years, so did their negotiating positions. Many MFIs are no longer willing to take out short-term, high-interest loans denominated in foreign currency. As a result, lenders have had little room to increase returns, and therefore had to focus on reducing risk. Deutsche Bank's Global Commercial Microfinance consortium addresses this challenge.</p>
Activities	<p>The Global Commercial Microfinance Consortium (GCMC) was launched in late 2005 to help overcome the constraints that MFIs face in the capital markets.</p> <p>First, the GCMC sought to attract commercial investors to the capital market for microfinance. Its fund structure leverages socially-oriented investors – including public donors and private philanthropists – to take first or second loss positions in an instrument representing a pool of loans to MFIs. This structure reduces the risk and increases the attractiveness of the asset to commercially-oriented investors. The US Agency for International Development (USAID) has provided a \$15 million Development Credit Authority partial loan guarantee and the UK Department for International Development (DfID) has provided a \$1.5 million grant. The GCMC has also sold \$9.5 million in Mezzanine Notes and \$6.25 million in Junior Notes to multilateral agencies and philanthropists. Mezzanine and Junior investors bear first losses up to \$17.5 million and USAID bears second losses up to \$15 million, leaving the residual risk to commercial investors.⁷⁴</p> <p>Second, the GCMC sought to expand access to the capital markets to second-tier MFIs in order to address an emerging bottleneck to scaling up access to finance for the poor: top-tier MFIs had begun to be offered more funds than they could administer, making new distribution channels necessary.</p> <p>Third, GCMC sought to lend in local currencies, currencies of choice, or proxy currencies whenever possible, helping borrowing MFIs to mitigate exchange rate risk. To reach this goal, the GCMC collaborates with local banks to co-lend money to MFIs; directly lends funds to individual MFIs with the expectation that they will use the money as collateral to borrow from local banks; and provides guarantees and standby letters of credit to help MFIs borrow from local banks.⁷⁵</p>
Results	<p>The GCMC has been successful in attracting significant commercial investment to microfinance. Deutsche Bank's original plan called for \$40 million in Senior Notes to be sold to institutional investors and other private investment funds, but this figure was later increased to \$53.35 million in response to high demand. Overall, the GCMC has been successful in lending in local and preferred currencies to reduce exchange rate risk, with 60% of the portfolio denominated in local currency. A significant percentage of the remaining 40% consists of US dollar loans to dollarized economies in Latin America. The mechanisms the GCMC uses to lend in local currency</p>

have also had the result of helping to build stronger relationships between MFIs and local commercial financial institutions. However, many MFIs still find the GCMC's interest rates relatively expensive and prefer to borrow from other sources.

5.5 CITIGROUP: REMITTANCE MODELS FOR THE US-MEXICO MARKET

Background

According to the World Bank, remittances from developed to developing countries totaled some \$199 billion in 2006 – more than twice the amount in 2001. Available household surveys suggest that unrecorded flows through informal channels may add 50 percent or more to this figure.⁷⁶ Banks are increasingly interested in remittance products targeting both immigrants and their families back home.

According to the Forbes Global 2000 in March, 2007, Citigroup is the world's largest company, with 332,000 employees, 200 million customer banking accounts in over 100 countries, and \$2.2 trillion in assets.⁷⁷ The company's diverse portfolio includes brand names such as Citi Cards, CitiFinancial, CitiMortgage, CitiInsurance, Diners Club, Citi Private Bank, and CitiCapital.

Drivers

International remittances are an integral part of international capital inflows into developing countries. While highly lucrative transfer agents such as Western Union and MoneyGram traditionally been the market leaders, they have also attracted criticism for high user charges. Simultaneously, the way remittances are sent – along with the way many other financial services are delivered – is evolving quickly with technological advances, entry of new market players, and increasing competition in the financial services industry. Commercial banks also cross-sell products as a strategy for customer acquisition. For the un-banked, a remittance product may be an individual's first interaction with the formal financial sector, raising awareness and potentially catalyzing demand for a wider range of services.

Citigroup has identified remittances as a driver of new accounts and other value-added services for immigrants in the United States and elsewhere. In recent years, the company has begun to leverage its worldwide presence to offer quick, affordable remittance services. In the US, Mexican immigrants are a growing population segment. Citigroup's acquisition of leading banks in Mexico in 2001 (Banamex) and California in 2002 (Golden State Bancorp) laid the foundation for the company to efficiently reach customers on both sides of the border.⁷⁸

Activities

Citibank's Global Transfer service allows US-based Citibank clients to send real-time remittance transfers to accounts at Banamex, Citigroup's Mexican subsidiary, for only \$5. Clients can also send funds to beneficiaries without bank accounts via a Banamex TriColor Card (Tarjeta TriColor), available for \$2.50 at any Banamex branch, which can then be used on an ongoing basis. The card-holder in Mexico provides the account-holder in the US with the card number. The account-holder enters that number as the destination for the Citibank Global Transfer. Funds are immediately available to the card-holder at Banamex's ATM locations. The TriColor Card can also be used for electronic purchases using stored remitted funds. The card increases security for the beneficiary, as the individual can withdraw the funds as needed, instead of incurring the risk of carrying cash.⁷⁹

In conjunction with these simple remittance services, Citigroup has developed the Access Account for customers in the US to serve as affordable origination points. The Access Account was designed for recent immigrants with its \$3 monthly maintenance fee. In response to research showing that the un-banked worried about overdrawing their accounts, Citibank introduced "checkless" checking, which relies on debit cards instead. The account includes low-cost remittance and funds transfer options to recipients in Asia, Latin America, and Europe, as well as unlimited bill payments through Citibank Online, without additional charges. In addition, the Access Account can be offered with a secured credit card that allows customers to build their credit histories. After a period of satisfactory payments, clients may be eligible for unsecured cards.⁸⁰

Results

Both those who send remittances and those who receive them often lack experience with commercial banks, and may have negative perceptions of banks' business practices and fees. This presents a bottleneck to customer acquisition and, from a development perspective, to wider financial access. To meet the challenges of inexperience and negative perceptions, Citigroup has launched a 10-year, \$200 million financial literacy program to support and promote financial education worldwide. In 2005, the company provided over \$50 million to support projects in 68 countries.⁸¹

Another educational challenge centers on the fact that remitters send money in a number of ways, including post offices, money transfer agents, and couriers. Most remittance clients are in the habit of using wire transfer services. Thus, raising awareness of the fact that commercial banks offer competitive remittance services and designing products that meet the needs of potential new customers will help Citi expand to reach full market potential.

5.6 SOUTH AFRICAN FINANCIAL SECTOR CHARTER: ENCOURAGING INCLUSIVE BUSINESS MODELS

Background

At the end of 1994, as South Africa transitioned to majority rule, whites continued to control most of the country's economic assets. In this context, the federal government launched a black economic empowerment (BEE) agenda to enable blacks and other groups to participate more fully in the country's economy.

Despite early efforts, the economic gap between blacks and whites actually increased between 1994 and 2000. In 1995, a white household earned about 4.5 times as much as its black counterpart. Adjusted for inflation, median income for black families fell by 18.2% in real terms in this time period while median income for whites rose 11%.⁸² Majority rule was empowering a small, black elite – but not the millions of other South African blacks.

In a political and economic context plagued by enormous income inequality and institutionalized racism, the financial services sector developed the Financial Sector Charter, in concert with the federal government and black professional leaders who either currently participated or wished to participate in the financial services value chain. The Charter encourages greater black ownership of financial institutions, a higher proportion of black employment at all skill levels in South African financial firms, a higher level of procurement from black-owned and -operated companies, and increased access to financial services among the black population.

Drivers

By the late 1990s, black business leaders, the South African Communist Party, and others began to take notice that BEE was failing to address massive inequality. Early in 2002, the government announced that it would compel firms to adopt new, broad-based black economic empowerment (BBBEE) policies. The Department of Trade and Industry (DTI) established a unit with the mandate to promulgate charters for the various sectors of the economy. Once these charters were written, government agencies would be obliged, when calling for contract proposals, to take the BBBEE credentials of would-be suppliers into account.⁸³

With the development of BBBEE and the DTI unit responsible for writing industry charters, the financial services industry in South Africa found itself at a crossroads: either react to legislation or proactively engage government to outline workable rules and mechanisms for change in the industry. At the Financial Sector Summit in 2002, the industry effectively voted for the latter option.⁸⁴

Activities

Following the Financial Sector Summit, the Banking Council and the Association of Black Securities and Investment Professionals (ABSIP) met to explore the possibility of a new Financial Services Sector Charter. They agreed that compliance with the charter should be voluntary and that the only sanctions for non-compliance should be lower ratings in the government's procurement process and possible reputational risk associated with weaker contributions to BBBEE. Furthermore, they agreed on targets, not obligations. Despite their different backgrounds and the contentiousness of the issues, the groups formed a working relationship; in a year of negotiations, there was never a walk-out by either party.⁸⁵

After months of negotiations, the parties reached an agreement: 10 trade associations and the ABSIP signed the Financial Sector Charter in October 2003. Soon after, the full cabinet of the South African government met and gave its blessing, while voicing lingering concerns about the target set for black female representation in management positions.⁸⁶

Main Charter Principles

The targets outlined in the charter relate to six main empowerment principles:⁸⁷

1. *Human resource development.* The charter aims to increase the participation of black South Africans at all levels of management, with a target to have black women occupy $\frac{1}{3}$ of positions in each level of employment. In training and development spending, each firm commits to spend 1.5% of total basic payroll per year training black employees. Firms also commit to report on other human resources strategies that do not necessarily have targets attached to them. These include mentorship programs, cultural diversity, and gender sensitivity training.

2. *Procurement and enterprise development.* The charter seeks to substantially increase financial sector procurement from black economic empowerment enterprises. It stipulates that 50% of all procurement should be from BEE-accredited companies by 2008 and 70% by 2014.⁸⁸ The charter also commits the financial services sector to help create new BEE entities via equity investments and joint ventures.
3. *Access to financial services.* Financial services firms aim to increase availability and affordability of banking and savings accounts. The major banking players have already gained significant traction in this area by increasing the number of branches, ATMs, and other service points, and by eliminating ATM fees. The charter also commits firms to increase lending to low-income borrowers.
4. *Empowerment financing.* The charter commits the sector to provide 73.5 billion rand to development finance in the infrastructure, SME, rural development, and low-cost housing industries. It also commits firms to participate in BEE equity deals.⁸⁹
5. *Ownership and control.* According to the charter, each institution must target minimum black ownership of 25% by 2010, and recruit board- and executive-level leaders.⁹⁰
6. *Corporate social investment.* Each firm commits to channel 0.5% of post-tax profit to corporate social investment projects, such as educational and training, youth development, and job creation programs.⁹¹

Firms use BEE scorecards to assess their own progress. The Charter Council, which was developed to govern and interpret the charter, uses the scorecards to evaluate progress in the sector overall, and the government uses them in awarding contracts.

Results

The Financial Services Sector Charter negotiations process resulted in the adoption of voluntary principles and performance targets by important stakeholders in the sector, encouraging firms to comply with government BBBEE policies in three ways:

1. The charter does not bind firms' own business-to-business transactions, though firms agreed that they should use the scorecard to evaluate these transactions.
2. Any firm that chose not to comply could expect to suffer from bad publicity.
3. Withdrawal from the charter might induce the government to impose new regulations on the industry.

Adoption of the charter is not likely to solve all of the major problems in the South African economy, which is plagued by slow economic growth, income inequality, underemployment, and brain drain.

Nonetheless, a successful charter will have important long-term consequences for South African society, likely leading to faster changes than a more passive, "trickle down" policy would have done. By encouraging firms to develop the human capital of their black workers, procure from BEE businesses, and bring affordable financial products to poorer individuals, the charter enables blacks to make critical inroads into an economic system that for decades excluded them.

5.7 GROFIN AND SHELL FOUNDATION: INVESTING IN SME DEVELOPMENT IN AFRICA

Background

The Shell Foundation, established by Shell Group in 2000 as a UK-registered charity, focuses on “enterprise-based solutions to poverty and environmental challenges linked to the impact of energy and globalization. It acts like an investor, identifying financially sustainable solutions to these challenges that can be taken to scale and replicated to achieve global impact.”⁹²

GroFin is a specialist business developer and financier. By integrating business development assistance with appropriately sized investments (below \$1 million), GroFin assists start-up and growth enterprises to reach sustainability. In partnership with Shell Foundation, GroFin has established SME investment funds in South Africa, Kenya, Uganda, Tanzania, Rwanda, and Nigeria, and is in the process of setting up funds in other African countries over the next five years. GroFin currently has over \$100 million under management.⁹³

Drivers

While much attention has recently been paid to the potential of microfinance and venture capital, less has been paid to development potential of SME finance – roughly defined as finance for firms requiring between \$50,000 and \$1 million. There is a significant shortage of investment capital for these businesses in the developing world. For instance, in Europe, more than 50% of jobs are created by SMEs while in African states, the figure sometimes dips below 10%.⁹⁴ In general, SMEs in Africa are constrained by a lack of business acumen, collateral, and established track records in the formal economy. This creates a finance gap in most markets. Unable to obtain skills and funding, many SMEs fail to fulfill their potential – and Africa misses out on a key driver of sustainable economic growth and social development. Shell Foundation and GroFin partnered to address this “missing middle” and demonstrate the viability of a new asset class – Growth Finance – that differs from microfinance and venture capital.

Activities

Both Shell Foundation and GroFin realized from the outset that a commercially viable approach to SME financing was needed to achieve scale. The business model they developed involves integrated provision of business development assistance (BDA) and appropriate medium-term finance (in local currency equivalent to \$50,000 to \$1 million) to viable start-up and growth enterprises. All funds – branded as Aspire – are locally managed by teams of GroFin specialist business developers/financiers. Unlike traditional financial risk assessments done by banks, GroFin specialists assess applicants on the basis of the entrepreneurs’ credibility and business plans rather than on proven track records or availability of collateral.⁹⁵

Through grant funding from Shell Foundation, GroFin has been able to set up operations in six African countries and train locally recruited staff to provide both BDA and financing. Acting as an anchor investor, Shell Foundation has also assisted GroFin to leverage risk capital from other investors, including development finance institutions and local commercial banks. Lastly, Shell Foundation’s corporate contacts have assisted GroFin with dealflow, generating client referrals from Shell companies, Sasol, and Unilever, for instance.

GroFin’s business model differs from venture capital in that it is based upon intensive provision of business development assistance as well as quasi-equity instruments that are better-suited local entrepreneurs in growth stages as well as the interests of investors.⁹⁶

The Operating Model

GroFin’s operating model is specifically designed to accommodate the broader strategy of delivering both business development assistance and appropriate financing, while creating a risk management framework that supports operations personnel with the administration, measurement, mentoring, and monitoring of portfolio companies. There are seven stages of the process:⁹⁷

- screening of applicants
- support for business planning
- planning for implementation
- verification of plans and projections through a rigorous due diligence process
- financing

- ongoing business development assistance, and
- exit

If the parties decide against a second round of financing from GroFin, the fund will investigate and introduce the entrepreneur to mainstream financiers for further assistance, as needed.⁹⁸

Results

In addition to delivering attractive financial rates of return to investors, GroFin's Aspire funds generate a suite of development benefits. As of June 2007, their 60 investments had resulted in the creation and or maintenance of over 1,500 jobs.⁹⁹

Success may also be measured in part by the partnership's ability to leverage investment from development finance institutions (such as the Dutch development agency and FinnFund, among others), leading local banks (including ABSA, Diamond Bank, and Commercial Bank of Africa), and foundations (Skoll, Syngenta, and Deutsche Bank).

Lessons

There is a genuine long-term partnership between Shell Foundation and GroFin based upon close collaboration, flexibility, and alignment of goals. While there is no shortage of market opportunities, the limited depth and breadth of skills in many African countries imposes challenges on GroFin's ability to recruit and train talented local staff. The need to develop human capital for the emerging SME finance sector is therefore one of the most important tasks facing the partnership and the sector as a whole.

5.8 STANDARD CHARTERED: AGRICULTURAL CREDIT CARDS IN PAKISTAN

Background Standard Chartered is one of the FTSE 100's largest companies in terms of market capitalization. Its 150 years of experience, current operations in over 50 countries, and 1,400 bank branches – as well as the fact that over 90% of its profits come from Asia, Africa, and the Middle East – make the bank an important player in the financial services industry.¹⁰⁰

Standard Chartered is the largest international bank in Pakistan, with over 140 years of operations in the country. Its acquisition of Pakistan-based Union Bank makes Standard Chartered the country's sixth-largest bank overall.¹⁰¹

Agriculture is central to Pakistan's economy, contributing 23% of national GDP and indirectly contributing 65% of total export earnings. In addition, agriculture employs over 45% of the labor force and supports, either directly or indirectly, approximately 66% of livelihoods.¹⁰² In this context, Standard Chartered launched the Kissan (Urdu for "farmer") Card in conjunction with DfID's Financial Deepening Challenge Fund in 2003.

Drivers Drivers for Standard Chartered included recognition of the agricultural sector's role in the Pakistani economy and society and its commitment to improving quality of life in the communities in which it operates. The bank was also encouraged by success stories of similar products in other developing countries, such as India. The Kissan Card was developed to enable lower- to middle-class farmers in Pakistan build credit and deepen investment in their farms.

Activities^{103,104} Standard Chartered's Kissan Card enables farmers to purchase the most important products for their farms on credit, which they then have the option to repay immediately at the conclusion of harvest. The Kissan Card is recognized at 325 merchants in two pilot provinces, Sindh and Punjab. To assemble this merchant network, Standard Chartered formed partnerships with agricultural companies Syngenta, Fauji Fertilizer, and Engro, as well as Pakistan State Oil, which runs the largest network of fuel stations in rural Pakistan.

In order to qualify for a Kissan Card, farmers must meet certain requirements showing that they are credit-worthy and that they are not already served by other consumer or SME credit schemes:

Eligible farmers must cultivate between eight and 35 acres each. Farming is a high-fixed-cost enterprise; thus, the per-acre cost of production decreases as the cultivated area increases. Farmers who cultivate less than eight acres face constant cash flow problems and thus represent a repayment risk for Standard Chartered. The upper limit of 35 acres was established because those with more land often have political affiliations that make them unattractive borrowing clients.

Eligible farmers must cultivate their land themselves. Standard Chartered believes that farmers that work their farms themselves are more invested in their success and are thus better credit risks. Standard Chartered also requires a minimum of three years' farming experience to further ensure individual investment in their business.

Approved farmers join a loan group. Standard Chartered facilitates the creation of groups of five or more card-holders. Group members guarantee each other's payments; if one person fails to pay, the cards of all members are blocked. The resultant group pressure encourages high repayment rates.

Approved farmers grow specific crops. Crops such as wheat, cotton, and sugarcane are high-value crops, with high domestic demand and price guarantees from the Pakistani government. As a result, they generate more stable incomes and therefore higher repayment rates.

Results The Kissan Card has been largely successful in Pakistan, now catering to roughly 20,000 card-holders. Purchasing has been so strong that Standard Chartered plans to expand from its original two pilot provinces to other farming areas. The bank also plans to develop a customized information technology platform to support the unique requirements of this product. A larger sales force is also planned, along with revised product features that will provide for greater ease of use.

Educating farmers about new financial products, such as the Kissan Card, is a significant challenge for Standard Chartered. Farmers have little prior experience with formal financial institutions and often harbor suspicion towards them. At the least, Standard Chartered must communicate the benefits of the card to individuals with low levels of education. In addition, the bank anticipates continuing intensive training for sales teams to maintain the mix of quality and quantity of loans. To this point, Standard Chartered has found a well-trained sales team to be instrumental to the success of the Kissan Card. Ali Zayad, Kissan Card Product Manager, points out that the sales team, as the public face of the bank, must be able to communicate effectively and build trust with potential clients. Such training is particularly important, Zayad asserts, when customer education is such a vital part of the sales cycle.¹⁰⁵

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Under the direction of John Ruggie (Faculty Chair) and Jane Nelson (Director), the CSR Initiative at Harvard's Kennedy School of Government is a multi-disciplinary and multi-stakeholder program that seeks to study and enhance the public contributions of private enterprise. It explores the intersection of corporate responsibility, corporate governance, and public policy, with a focus on the role of business in addressing global development issues. The Initiative undertakes research, education, and outreach activities that aim to bridge theory and practice, build leadership skills, and support constructive dialogue and collaboration among different sectors. It was founded in 2004 with the support of Walter H. Shorenstein, Chevron Corporation, The Coca-Cola Company, and General Motors and is now also supported by Abbott Laboratories, Cisco Systems, Inc., InBev, InterContinental Hotels Group, Microsoft Corporation, Pfizer, Shell Exploration and Production, and the United Nations Industrial Development Organization (UNIDO). Visit the Initiative's homepage at <http://www.ksg.harvard.edu/m-rcbg/CSRI>

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