From credit to savings

Jonathan Morduch

When the Gates Foundation started a programme to expand global 'financial services for the poor' (FSP), many in the field, myself included, saw this as an important complement to the foundation's work in health and education.[1] The evidence is piling up that the world's poor face the twin problems of low incomes and difficulty managing their incomes without bank accounts or insurance. Finance, in this view, allows people to invest in the future and – importantly – to marshal resources to meet needs today. Access to finance, then, is a key tool for improving the lives of the poor. The Gates Foundation's impact on finance for the poor has been most strongly felt in re-balancing attention between credit and savings.

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The importance of finance beyond microcredit was not clear to everyone. The year that the foundation started the FSP programme, 2006, was also the year that the Nobel Peace Prize was awarded to Muhammad Yunus and Grameen Bank and the year after the UN celebrated the International Year of Microcredit. The Nobel Prize brought new attention to finance and poverty, but it also reinforced the idea that finance for the poor mainly meant *microcredit*, the provision of small loans to support self-employment. The Gates Foundation ultimately turned in a different direction, with big benefits and some hazards.

At the outset the foundation seemed to be focused on learning. It tilted its list of early grants towards well-known, brand-name organizations. Playing good politics, the foundation spread its money around. It also hired a group of widely respected 'insiders' in the finance field to run the programme, many with experience in Washington DC.

Moving the focus to savings

The foundation soon took a bolder stance, turning its focus to two relatively neglected areas: savings and payments infrastructure, with savings taking a much higher profile. The turn in strategy made sense for a foundation with the capacity to make a large mark. These areas offer the opportunity for the foundation to use its resources to bring needed innovation and to be potentially transformative on a global scale (rather than just increasing the expansion rate of microcredit, for instance).

The logic was clear, but there were also good reasons why microcredit had taken centre stage. Most fundamentally, it has taken an intellectual battle to overcome the common-sense (but misguided) view that the poor can't save. Microcredit is also a far easier sell because credit beats saving when it comes to quickly bringing large amounts of capital into under-capitalized markets.

Beyond the battle of ideas, saving is far more difficult logistically – which is why the heft of the foundation has mattered. To start a credit operation, you need a group of people willing to pay interest for the privilege of borrowing from you. If a lender fails, the damage is primarily to the lender, not to customers. Savings accounts, on the other hand, have to be safe and are expected to pay interest. If a savings bank fails, the damage is primarily to its clients. For formal deposit-taking institutions to work in poor communities, you need regulation (to protect savers), business models (so that the banks cover costs by reinvesting deposits), and technology (to slash the costs of delivering to the poor). Each piece poses its own technical challenges.

How much has Gates changed the sector?

It's not clear so far. A new focus on savings is being felt throughout the sector, and certainly the Gates Foundation has played a central role in that. But the idea that we should pay more attention to saving is not new. Writing in 1999,[2] I already had ample material to highlight the coming of a big move towards saving, drawing on ideas attached to an influential group at the Rural Finance Program of Ohio State University. Those ideas had already migrated to CGAP (Consultative Group to Assist the Poor), a microfinance-focused donor consortium based at the World Bank well before the Gates Foundation stepped on to the scene. The foundation formed its strategy in part by hiring CGAP staff and drew initially on CGAP groundwork. Several studies published since 2009, including *Portfolios of the Poor* (which the Ford Foundation sponsored but the Gates Foundation helped to promote), provided compelling evidence that savings are useful and have a positive impact on well-being, and that the demand for well-structured products can be high.

All of those things have contributed to the increasing popularity of savings within the microfinance community and probably would have happened without the Gates Foundation. Yet Gates has been the most important promoter, connecting the dots and filling in missing pieces. The steps prior to the FSP programme were insufficient to propel a movement akin to the global microcredit movement.

How the Gates approach was different

There are other steps the Gates Foundation took that undoubtedly influenced the field beyond their areas of focus. The foundation went about its work differently from other funders. First, it started demanding rigour in research in a very concrete way. The programme officers made it clear to grantees that a strong case for finance had to be made, and that required reliable data from studies and surveys. That led the foundation to fund researchers, including my organization at New York University, the Financial Access Initiative, but also groups at the University of Chicago, Massachusetts Institute of Technology, Yale, and University of California. The foundation's grantees have produced a steady stream of research destined for mainstream peer-reviewed journals, the highest standard of quality for academic research.

The foundation's efforts in finance appear to differ from their work in health, where critics slam a blurring of the scientific evidence when it comes to advocacy efforts. If anything, the foundation has been one of the very few funders in the area of finance really committed to reliable data collection, rigorous studies, and evidence-based claims.

Second, the foundation invested in the quality of the delivery mechanisms in microfinance. While the academics, myself included, have focused on details of microfinance contracts, pricing and similar issues, the foundation took the view that even the best-designed product is irrelevant if you can't deliver it. That has meant taking management and regulation seriously. So the foundation put in place a series of steps they believed would lead to strong and sustainable financial institutions that could deliver more than just credit to poor customers. For instance, they created the Alliance for Financial Inclusion, based in Bangkok, a convening platform for financial regulators, central banks and finance ministries to try to improve regulation.

Third, the foundation went outside the fold of the existing microfinance sector and created a much wider conversation. Gates staff brought telecom operators into the conversation about financial inclusion, for instance. More than anyone else, it was the Gates Foundation that made Kenya's M-Pesa (a mobile payments system) part of the global policy conversation, illustrating the potential for technology to create new banking platforms.

Fourth, the Gates Foundation not only hired bright, experienced people to run its programme but encouraged those people to actively participate in the public dialogue about finance and the poor. Some staff members have contributed important policy notes to other organizations, regularly contribute to the blogs of others, speak at conferences and have generally been publicly engaged in the sector. The staff of other foundations are often part of policy conversations too, but Gates has taken the engagement up a notch. Rather than just funding advocates for a new vision and a new research agenda, foundation staff have led advocacy efforts, often bringing their own ideas and evidence to the table. There's a danger in being both a funder and an advocate, but any tensions have been well navigated so far.

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Pick your distortion

If there's a substantive critique of the Gates Foundation microfinance strategy, it is that the programme has too quickly turned from microcredit to focus on savings. The fact remains that credit and saving are intertwined, both for banks and for individuals. When major expenses arise, individuals both draw down savings and look for places to borrow. It's not just the customers who don't subscribe to an easy separation of savings and credit. Savings and credit are part of a single business model. You can't really begin accepting savings deposits until you know what you are going to do with the funds; historically that means lending them out (either directly or through another intermediary). It has been striking that the Gates Foundation has spent relatively little time on credit – when getting the credit side right is often essential to making the saving side sustainable.

In that way, the might of the Gates Foundation has clearly distorted the sector. Yet, in fairness, the foundation started with a sector that had already been massively distorted towards focusing on credit. If I had to pick one distortion or the other – the distorted focus of 2006 or that of today, I'd easily pick the present one. The global savings revolution is at least now in sight. @

1 Disclosure: I do not claim objectivity. Much of my work over the past five years has been supported by the Gates Foundation, including support for the organization I lead, the Financial Access Initiative at NYU, and promotion of a book I co-authored, *Portfolios of the Poor.*

2 Jonathan Morduch (1999), 'The Microfinance Promise', *Journal of Economic Literature*, 37(4): 1569–1614.