– *An Excerpt from* –

FROM DISTRUST TO INCLUSION: INSIGHTS INTO THE FINANCIAL LIVES OF VERY LOW INCOME CONSUMERS

With the generous support of the Ford Foundation, Kirsten Moy from the Aspen Institute joined forces with the National Federation of Community Development Credit Unions (the Federation) to study the financial service needs and behaviors of very low-income (VLI) consumers in the U.S.

The purpose of the research was twofold: first, to determine whether very low-income consumers (i.e., those with incomes of less than $20,000) constitute a distinct market segment from low- to moderate-income consumers[1] in terms of their usage and demand for financial products and services; and second, to investigate how socially-minded financial institutions could sustainably meet that market demand.

BASIS FOR FINDINGS

This study is based on a series of in-depth interviews with a diverse array of VLI people conducted by a professional market research firm. Fifty interviews were conducted over a six-month period, with VLI consumers drawn from four communities in three states. Many of these individuals had already found their way to socially-minded financial institutions, but some had not. The results of this qualitative study are more provocative than conclusive, but nevertheless serve to challenge conventional wisdom about the financial condition of VLI people, their demand for products and services, and opportunities to bring these consumers into the financial mainstream. This paper uses the words of VLI consumers themselves to present some of the central challenges they face in accessing and using financial services amidst tremendous uncertainty. In so doing, it reveals elements of our current intervention framework that may be driven more by the ease of delivery and less by the expressed needs and demonstrated demands of VLI consumers. In short, these interviews indicate that efforts to develop new products for VLI consumers may be fundamentally deficient or misguided and provides a basis to search for a better way forward.

- **Instability and volatility is the norm.**
  The overriding context and dominating factor that emerged from interviews is the profound uncertainty and unpredictability of people's lives due to their work situation and lack of a safety net. Financial gaps and severe shortfalls are the rule, not the exception. The concept of "emergency" or unanticipated expenses is not appropriate to this market segment, as shortfalls are a constant. This instability and volatility of income make traditional credit products with recurring monthly payments fundamentally flawed and incompatible with the tremendous monthly fluctuations in people's income. With adequate income there is no capacity or cushion to withstand additional risk.
- **Very low-income consumers have different needs.**
  Interviews found significant and persistent differences between the needs of VLI consumers and the products and services being developed and offered in the marketplace. While this study was not designed to compare VLI consumers with the larger low- to moderate-income market, some of the findings from these interviews may apply, albeit to a lesser degree, to the larger low- income market.
- **Trust and relationships remain key to moving toward greater financial stability.**
  The VLI people interviewed for this study expressed a strong desire for help, but almost no interest in learning about financial products. Institutions that can help solve immediate problems earn trust and patronage, but institutions that push new products, even those that may provide long term benefits, are viewed with suspicion.
- **Mobile banking technologies have not earned the trust of VLI consumers.**
  Although these VLI consumers have access to and high usage of mobile technologies, they do not entrust these technologies with their financial decisions or transactions. Interviewees expressed strong fears that they will get it wrong or get in trouble by using mobile tools to access products, services or information. They prefer to seek guidance and advice from people instead of technology.

[1] Low to moderate income is generally considered those households with incomes 80% or below of Area Median Income and ranges up to $50,000 in some counties in the US.

- **VLI consumers depend on cash.**
  Despite high levels of technology use, VLI people continue to live in a cash economy with all that connotes. In many cases, this is by preference, as negative and adverse experiences occur when trying to access formal banking systems. Prepaid card usage was still not highly prevalent, though this may be shifting.
- **Traditional budgets are not helpful in managing household finances and flows.**
  Inadequate, unpredictable and wildly fluctuating incomes confound the ability of traditional budgeting toolsto provide useful guidance to VLI consumers. Busy and stressed people seek more than just information and advice about how to do something; they want actual help to do it, especially in areas they find unfamiliar and intimidating (e.g., negotiation with credit bureaus and creditors).
- **Context matters.**
  Products and services must be matched to fit within the context of a person's overall life, not just their financial profile. When the capacity to save is uneven and small, then the ability to borrow and repay under flexible terms is needed.

FIVE QUESTIONS FOR THE FIELD

Efforts to reach unbanked and underbanked markets have focused almost exclusively on the development of new products and technologies. While some new products and technologies have achieved mainstream success and a more limited foothold in low- and moderate-income markets, this research indicates that products and technology cannot deliver what VLI people value most: trusted relationships. While this is not a new insight, the bulk of investment capital, grants and practitioner efforts remain focused on the development and scaling of products and technologies. This study gives rise to five challenging questions for investors and practitioners:

1. **Why do financial inclusion efforts promote "getting banked" as the first step, when many consumers consider opening accounts as something to do when they have enough steady income to support the cost?** Countless programs promote new accounts for the unbanked and measure success by the number of new accounts opened, yet VLI consumers who cannot maintain accounts will often open and close accounts multiple times – at significant cost to financial institutions themselves. Interviewees report that the VLI view accounts as useful only when their circumstances are stable enough to maintain them.

2. **Why promote static budget tools when people indicate their finances may be changing day-to-day?** Budgets are valuable tools when there is a high degree of consistency and predictability in income and expenses, but for many VLI people who experience frequent, dramatic and unpredictable changes on both sides of the ledger, a budgeting exercise may change frequently and not present the right support. More interactive counseling may be able surface strategies, resources and other supports to off- set a constantly shifting financial picture.

3. **How can we build services, products and operations that appeal to VLI consumers?** Marketing, outreach, financial education and other initiatives work hard to prepare unbanked and underbanked individuals to use existing products, services, and delivery systems that are a poor fit for VLI consumers. The promotion of products, services and systems that are a poor fit for VLI consumers is unproductive. Products designed to meet the unique needs of the VLI consumer will meet with more success.

4. **How can we scale relationships and trust?** As investors and practitioners in community development finance have increasingly focused on scaling products, VLI consumers have continued to seek relationships and ecosystems that meet their immediate needs. Efforts to operationalize trust in financial institutions could provide the foundation for moving VLI consumers towards a more secure financial future.

5. **How can we pay for services that improve the condition of VLI consumers and their communities?** This study points to several strategies that could reduce expenses and increase the income of financial institutions that serve VLI consumers, but there is no magic formula that will produce reliable profits from serving this market segment. While individuals, communities and society at large stand to benefit if financial institutions reduce the crippling impact of predatory lenders and increase the financial stability of VLI consumers, financial institutions themselves can expect to receive little or even negative direct return on their investments in these activities. There may be certain activities or products that are not sustainable on their own and merit subsidy whether internally generated or in the form of outside investment.

HOW WE CAN DO IT DIFFERENTLY: NEW CRITERIA FOR ASSET BUILDING AND OUR FINANCIAL SERVICES WORK WITH LOW INCOME CONSUMERS

While the themes outlined above are not new or surprising, the field has moved in the opposite direction. Subsidies are steered to scaling product or a particular type of innovation, and less investment is directed toward overall institution-building. Limited time horizons on grant funds and an increasing move toward mission-related investments, with expectations on short-term returns on investment, force organizations away from building core infrastructure that would generate efficiencies and enable more staff to focus on the member/customer relationships where they are needed most. Three key areas of innovation that the researchers propose are:

- Development and testing of a new framework with more realistic goals for our asset building and financial services work. Fundamental to this framework will be methods to scale relationships. Investments in formalized financial counseling and coaching will enable financial institutions to concentrate some of those trusted relationships into trained counselors who can provide that needed guidance and track their results over time.

- Exploration of the infrastructure needed to enable these delivery channels and distribution systems and networks to reach greater and greater numbers of people. Generate greater efficiencies in back-office operations and allow more front-office investment in helping consumers understand, select and utilize the financial products and services most appropriate to their needs. Similarly, an investment in mobile banking technology may not completely replace the need for interaction between consumer and financial institution staff, but it may improve the quality of those interactions to ensure that time spent with consumers is more educational and less focused on the mechanics of transactions.

- Initiation or expansion of demonstration projects utilizing strategies emerging from the new framework and incorporating financial products and services into a broader framework with greater emphasis on evaluating the overall business model and less focus on the particularities of a single product, service or intervention.