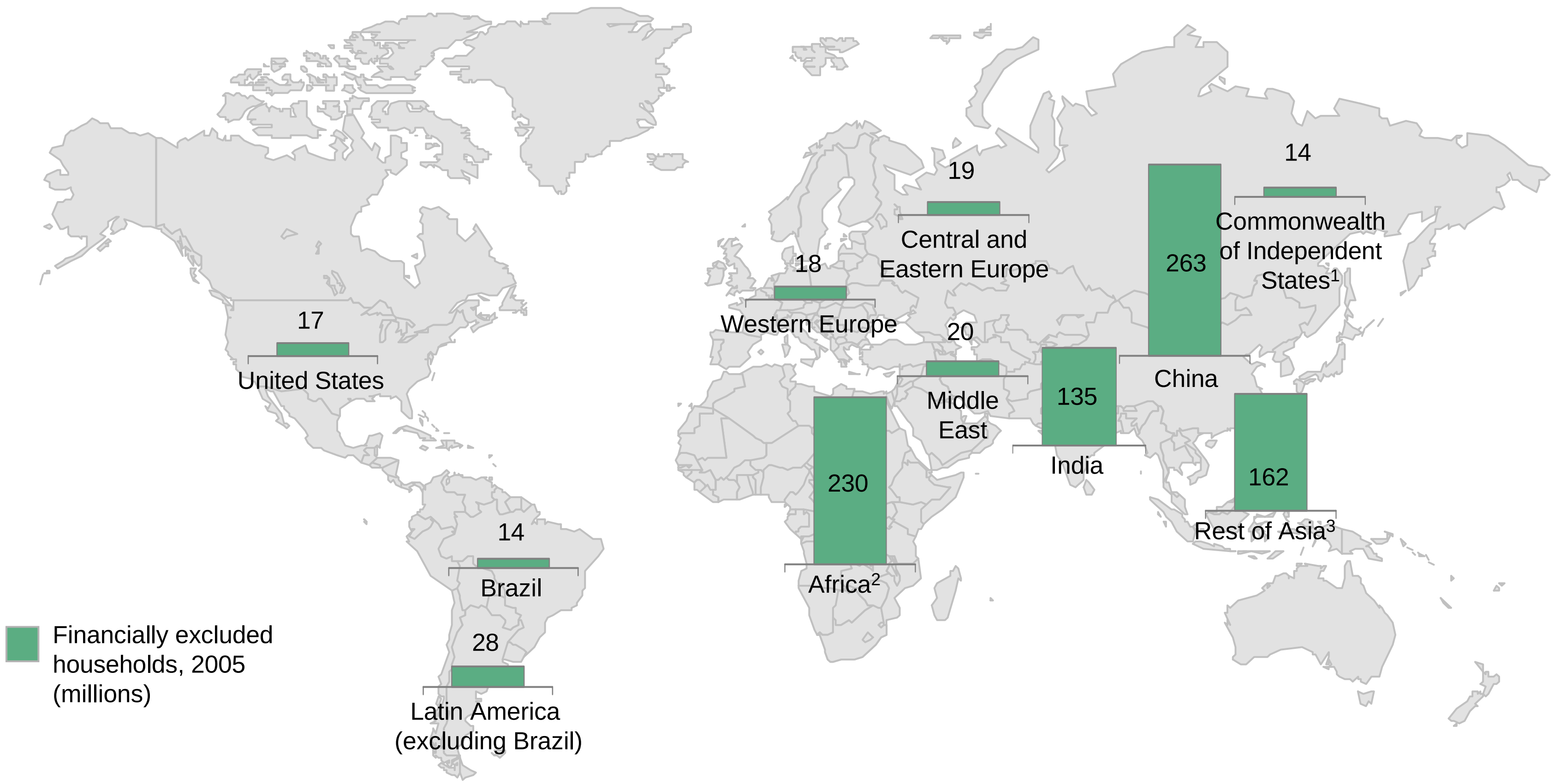
# The Next Billion Consumers

## Agenda for Financial Inclusion

11 March 2008

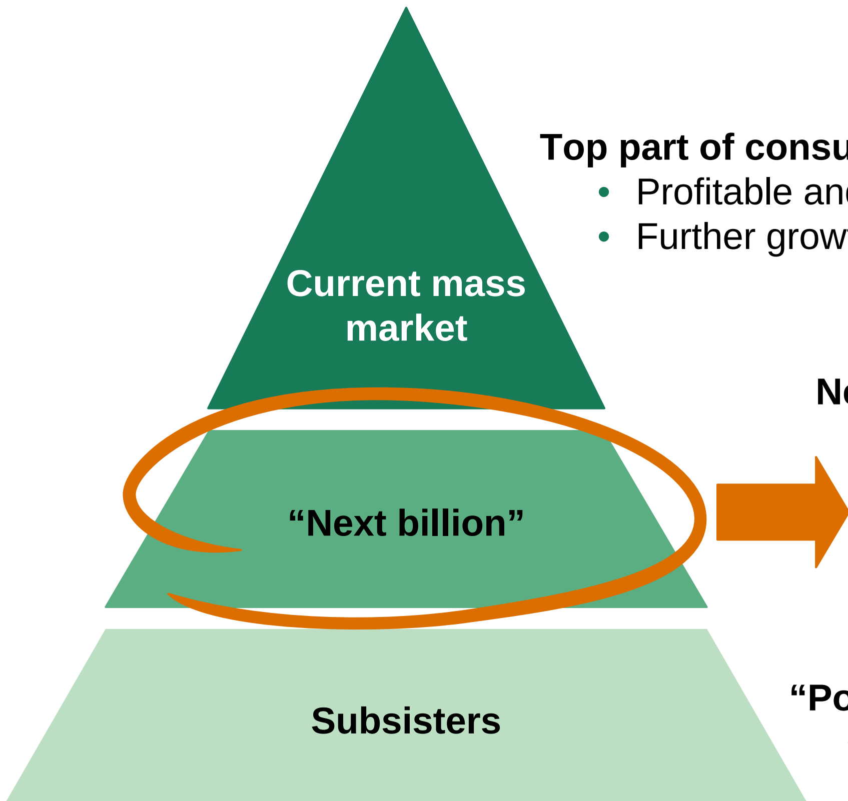
THE BOSTON CONSULTING GROUP

# India has the second highest number of financially excluded households in the world after China




1. The Commonwealth of Independent States (CIS) comprises the 11 former Soviet republics of Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Russia, Tajikstan, Tajikistan, Ukraine, and Uzbekistan.
2 Ethiopia has the largest population of financially excluded households in Africa, with 15 million.
3 Indonesia has the largest population of financially excluded households in this region, with 30 million.
Note: These numbers are only approximations; financial inclusion is based on ownership—not usage—of a banking account.
Sources: United Nations Development Program; Economist Intelligence Unit (EIU); World Bank reports; Credit Suisse; banking regulators of various countries; press search; BCG analysis.

# Among the excluded, the ‘Next Billion’ presents an important opportunity




**Top part of consumer pyramid well penetrated**
- Profitable and attractive to companies
- Further growth possible by expansion to new markets

**Next Billion not getting due attention**
- Traditional business models will not reach
- Unrecognised profit pools
- However already have sizeable discretionary spend (on average one-third of their expenditure)

**“Poorest-of-the-poor” very media-attractive**
- But this population requires ‘social’ intervention

**The next tier of customers in <u>emerging markets</u> that are commonly <u>considered unprofitable or impossible to serve</u> with current business models that <u>could become profitable</u> with new business models**

# BCG has an ongoing initiative to understand the needs of these consumers and how companies can serve them profitably

## Extensive primary research across India, Brazil and China

### India

- **Qualitative : 4 centres, 38 depth interviews, 12 FGDs**
- **Quantitative : 25 centres, 4125 respondents in 2007, ~ 10 centres, 5049 respondents in 2006**

**1 Socio-Economic Context**
- Demographics
- Exposure
- Income and Expenditure Flows

**2 Attitudes and Perceptions**
- Attitude to health, hygiene, savings etc
- Attitudes to Spending
- Attitude to Products and Brands

**3 Aspirations**
- Dreams / Aspirations
- Main "Worries"
- Purchase Aspirations and Hierarchy

**4 Current Purchase Process and Behaviour**

a. Purchase Basket, Penetration and Purchase Intention

b. Trading Up / Down Behavior and Attitudes

Key Purchase Criteria

c. Process map from origination through purchase; product, channel and brand choices; purchase drivers and barriers; influencers, decision makers; etc

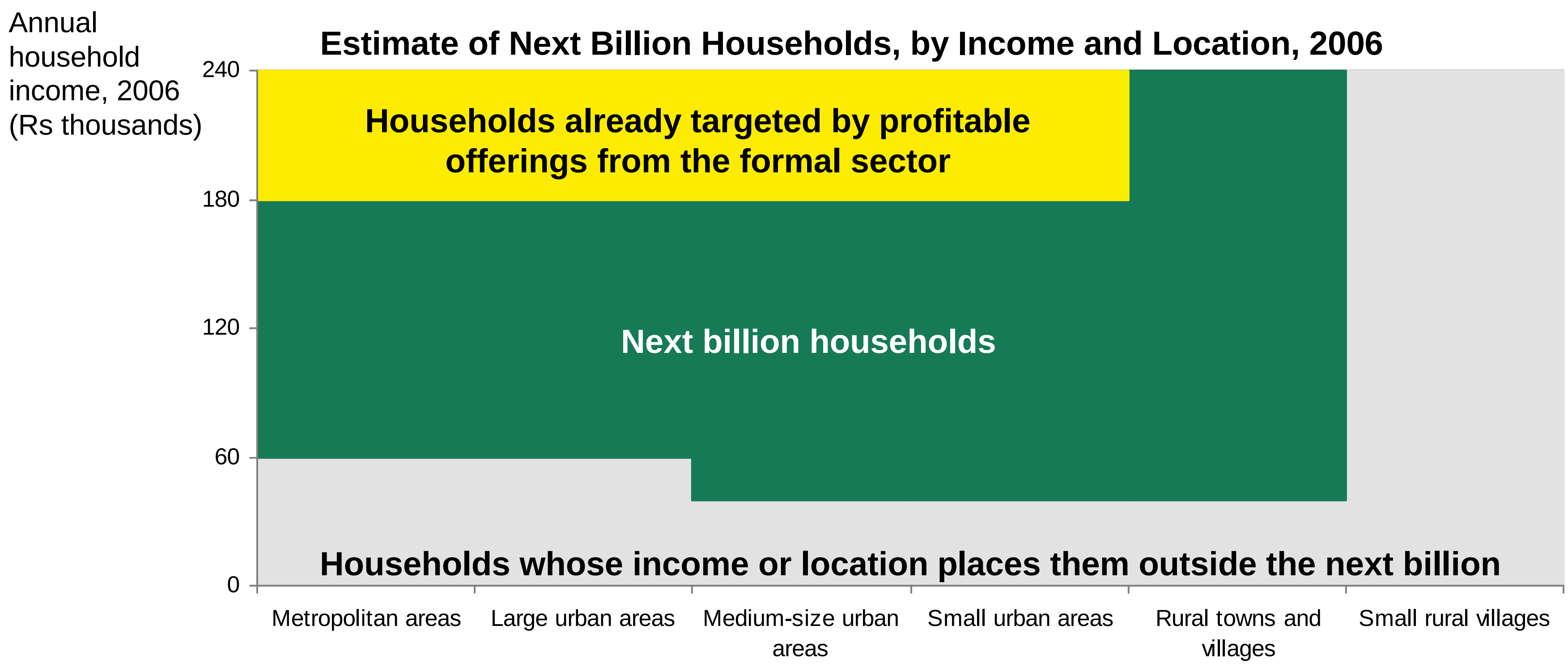
**5 Barriers and Reactions to Potential Activation Levers**

a. Purchase Barriers and Key Leakage Points

b. Reactions to Potential Solutions – Price Elasticity, Consumer Finance, Product Availability etc

# Most of India’s 91 million Next Billion households are in smaller cities

**Estimate of Next Billion Households, by Income and Location, 2006**

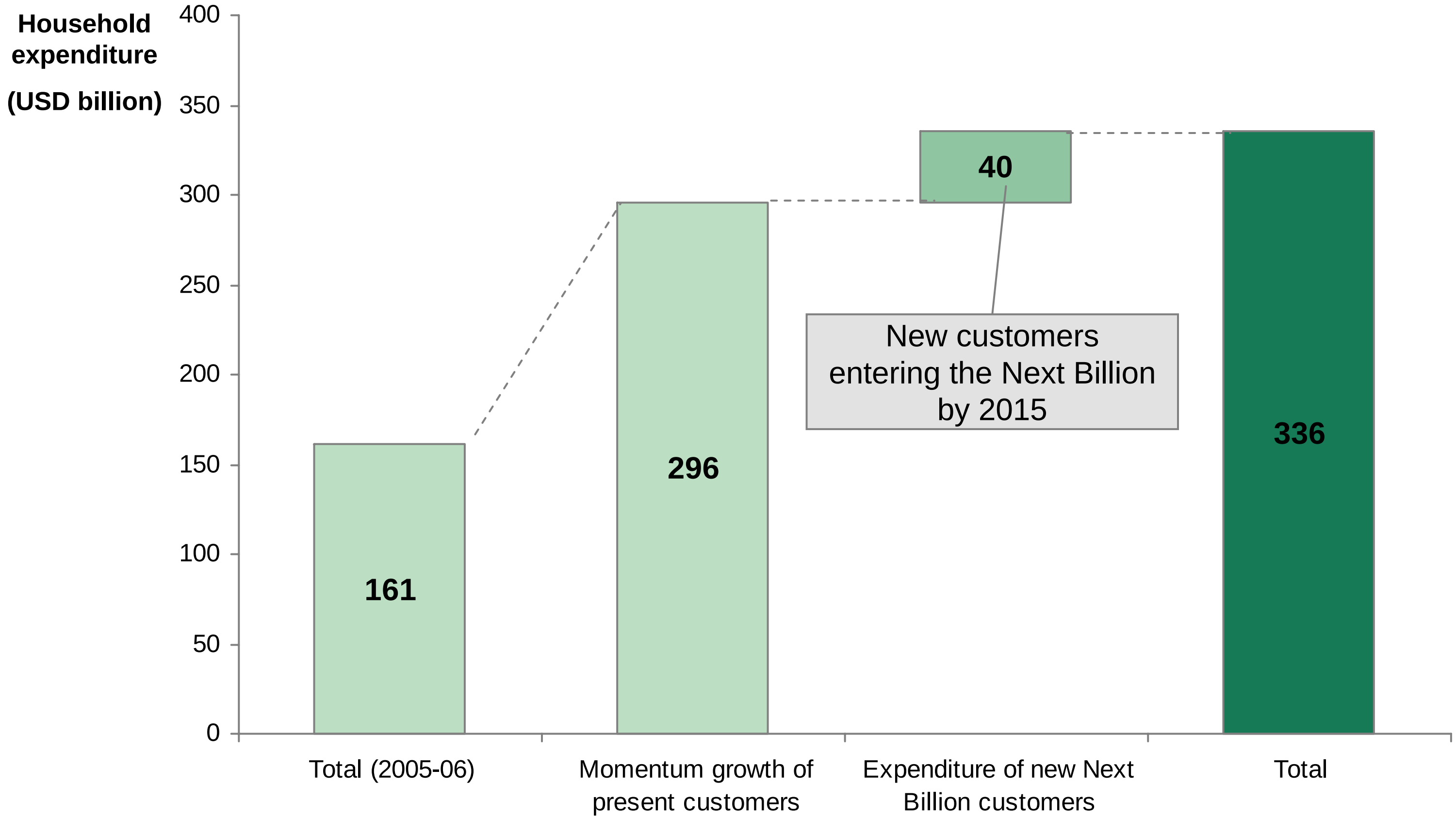



| | Metropolitan areas | Large urban areas | Medium-size urban areas | Small urban areas | Rural towns and villages | Small rural villages |
|---|---|---|---|---|---|---|
| Population[1] | >5 million | 1 – 5 million | 500,000 – 1 million | 100,000 – 500,000 | 1,500 – 100,000 | <1,500 |
| Number of cities, towns, or villages | 6 | 39 | 39 | 5,087 | ~120,000 | ~467,000 |
| Total number of households (millions) | 17 | 12 | 5 | 30 | 140 | |
| Number of next billion households (millions)[2] | 8 | 6 | 3 | 20 | 54 | |

1. Population was the primary parameter used to sort cities, towns, and villages into these categories.
2. These numbers are only approximations; financial inclusion is based on ownership—not usage—of a savings account.
Sources: Survey of 9,174 individuals in BCG’s Next Billion Consumer research, 2006 and 2007; BCG analysis.

# Consumption could double by 2015

**Current spending of ~USD 160 bn set to become ~USD 335 bn by 2015**



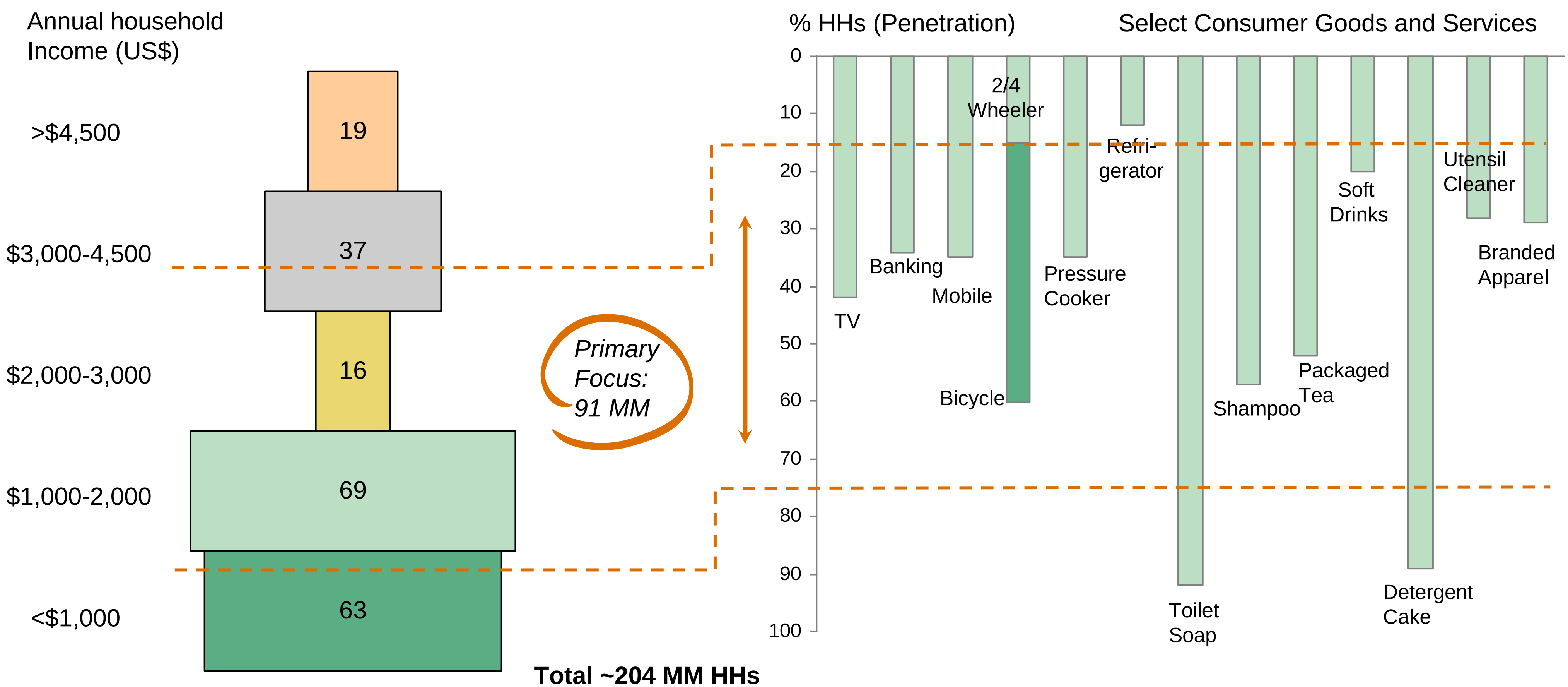

**Further growth possible from untapped savings and expenditure**

Source: Consumer research, BCG analysis

# Indian next billion consuming wise range of categories

**~91 MM households in Next Billion consideration set...**

**... with low penetration in a number of consumer goods**




National savings rate of 31% indicates expenditure (survey) numbers are under reported by ~ 20 %
Note : Mobile penetration assumes 100 mn subscriptions are distributed as ~1.5 per household; Sum not exact due to decimal rounding, income split based on NCAER 2005-06 projected numbers and actual 2001-02 data
Source: NSS Household consumption expenditure survey 2003-04; Guide to Indian Markets -2006 (Hansa research)

# The Next Billion need to be understood on their own terms

## Currently viewed wrongly as either part of the segment above or below

1 **They manage fluctuating incomes**
Wary of being locked into ongoing financial commitments

2 **They cope with severe constraints**
Space, power, water,...

3 **They are smart shoppers**
Cannot strip down features; elaborate research and evaluation

4 **They are unfamiliar with many products**
Need education, product trials

5 **They look for trusted advice**
Advocacy networks play an important role

6 **They crave respect**
Cannot sell down to them!

# Sample next billion profiles

**Barriers to financial inclusion**

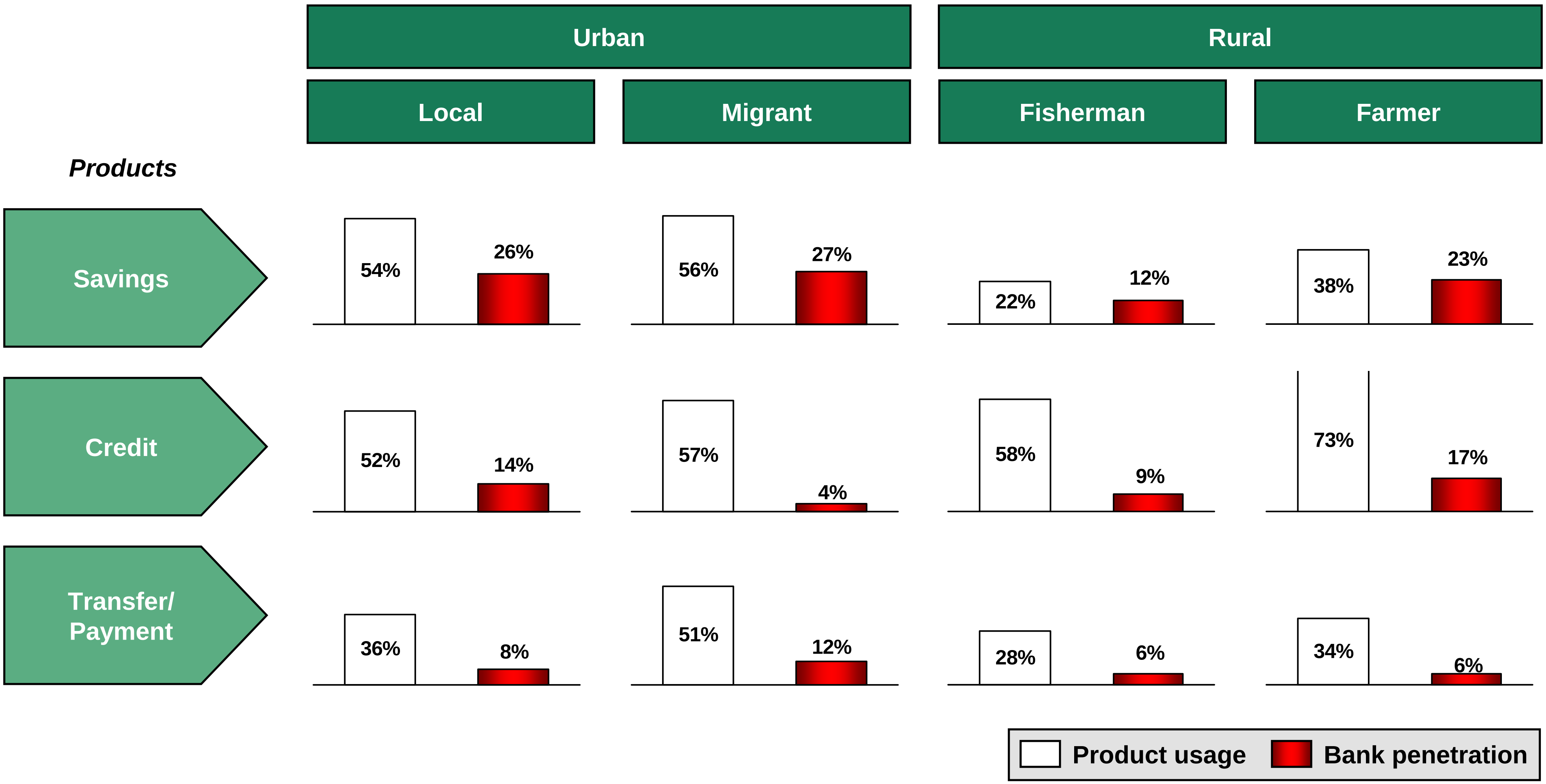
| | Biographical Information | Financial Services Activity | Key Barriers |
|---|---|---|---|
| **Anju**  | Anju, 33, lives with her husband, his first wife, and their three children in a village near Barabanki, Uttar Pradesh. Her husband is a junior teacher. His salary and some agricultural income amount to Rs 10,000 each month. | The husband's salary is banked in a branch located in a semi-urban town 20 kilometers away. Their meager savings are invested in para-banking products – "The salesman comes to our home and collects money." They have been saving up to buy a refrigerator over the past eight months. | The husband's salary often gets delayed, so they turn to the local shop for credit. They lack awareness of the most basic financial products. |
| **Varsha**  | Varsha, 27, lives in a one-room tenement in a chawl in Mumbai with her husband, a clerk, and two children. The family has a monthly income of Rs 5,000. Monthly savings can be as high as Rs 800, but can also be much lower. | Varsha has a joint savings account with her husband, but she keeps about Rs 1,000 in cash at home since "it is difficult to withdraw money from the bank when you need it." Savings are placed in postal instruments. Her husband has an employer-sponsored group life insurance policy. | They've never taken a bank loan. "We don't have a permanent address." Instead, they take credit from their local grocer and borrow from friends and the local moneylender to cover short-term needs. |
| **Padma**  | Padma, 41, lives with her children in Vijayawada. Her husband has a salaried job in Mumbai. The family meets all its financial needs comfortably and manages to save between Rs 5,000 and Rs 7,000 each month. | Most of the family's savings are invested in chit funds. They have two savings accounts – one each in Mumbai and Vijayawada. They use these to remit the husband's salary and to meet household expenses. They used a bank loan to buy their home. | They relied on informal lenders and sold land to send their son to medical school because "The bank would take too long to sanction a loan." They lack insurance, believing "it is a waste of money." |

Sources: Survey of 9,174 individuals in BCG's Next Billion Consumer research, 2006 and 2007; BCG analysis.

# Structurally need to segment next billion into four distinct customer groups

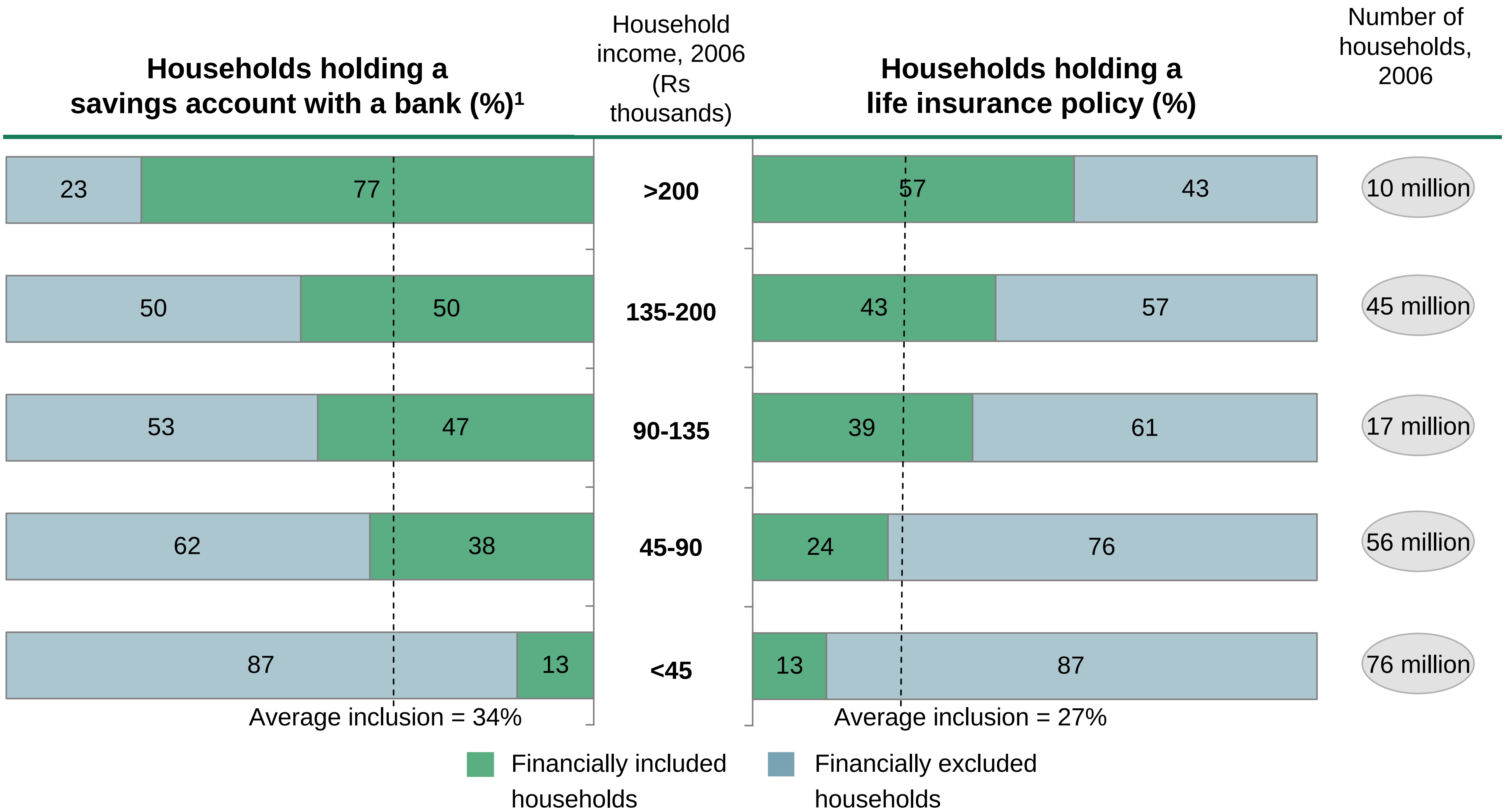
| | Urban | | Rural | |
|---|---|---|---|---|
| | Local | Migrant | "Fisherman" | "Farmer" |
| Segment characteristics | • **Family has settled in the city**<br>• **Typically minimum wage workers in formal sector** | • **Temporary move to city for work**<br>• **Typically only family member in urban area** | • **Consists of fishermen or laborers**<br>• **Independent of seasons, work daily** | • **Consists of farmers / land owners**<br>• **Has side jobs outside farming seasons** |
| | **Newer community poses high risk of loan default** | | **Strong social ties creates high-barrier to loan default** | |
| Segment needs | • **Require very basic banking needs**<br>small savings<br>consumption loans<br>• **Typically share account with family** | • **Basic savings**<br>seek security<br>• **Remittance products**<br>needs to transfer money home | • **Limited savings**<br>• **Require small size credit**<br>Consumptive loans | • **Savings-credit product to smooth out seasonable income**<br>• **Consumption and production loans** |
| Channels | • **Formal: SCBs, NBFCs, Chit Funds, cooperatives, etc**<br>• **Informal: relatives, moneylenders, employers** | • **Formal: NBFCs, Money Transfer Orgns, cooperatives**<br>• **Informal: friends, moneylenders, employers** | • **Formal: RRBs, MFIs, cooperatives**<br>• **Informal: Relatives and moneylenders** | • **Formal: RRBs, MFIs, cooperatives**<br>• **Informal: Relatives and local creditors** |

# Indonesian research shows significant demand variations among segments




(1) Defined as the % of people using banks divided by overall users of the product
Source: Market survey (n=406), BCG analysis

# Low income seen as the primary reason for exclusion

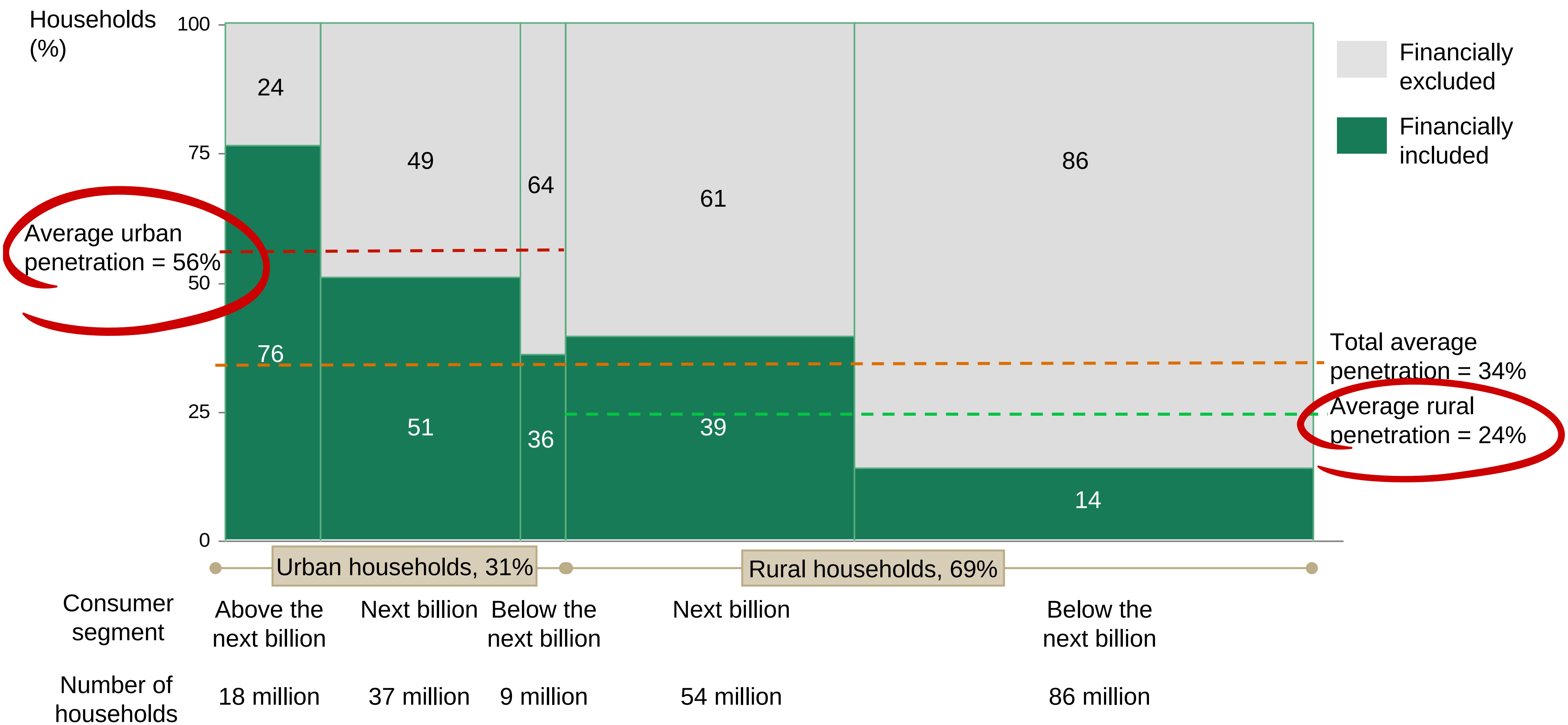



Sources: Survey of 4,125 individuals in BCG's Next Billion Consumer research, 2007; BCG analysis.
1. These figures are only approximations; financial inclusion is based on ownership—not usage—of a savings account.

# Accessibility also recognised as an important factor

## Rate of financial inclusion is much lower in rural areas

### Household Ownership of a Savings Account, 2006




Sources: Survey of 4,125 individuals in BCG's Next Billion Consumer research, 2007; BCG analysis.
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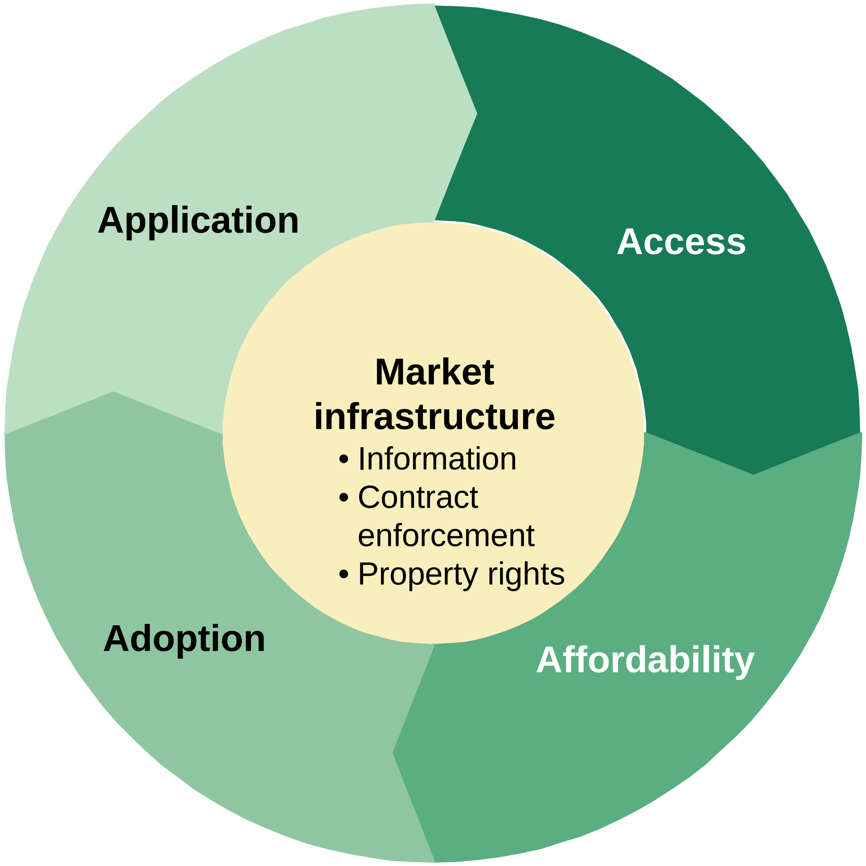
# In fact impediments need to be addressed across four interlinked aspects of exclusion

Inappropriate use
- e.g. consumption loans v/s production loans

Product design
- Lack of flexibility

Responsiveness and trust
- Vis-a-vis informal channels

Financial illiteracy
- Lack of awareness of products, their benefits and risks




Physical barriers
- Limitations of branch network

Procedural barriers
- Onerous KYC norms
- Absence of property rights

Emotional barriers
- Unfamiliarity and intimidation

Cost-to-serve small-ticket products
- Customer acquisition, operations and collection
- Cost of funds

Pricing
- Interest rate caps

**Access and Affordability alone won't ensure Adoption!**

# New mental model needed for success with the next billion

***"Seizing the opportunity"***

**Collaboration**

*Understanding the needs and limitations of all partners*

**Innovation**

*Deconstructing and reconstructing the value chain to realise aspirational goals*

**Learning**

*Systematic experimentation; not condemning failure*

**Sustainability**

*Persistence and tenacity*

# Financial institutions should deconstruct and reconstruct their value chains to serve the next billion

| Product development | Customer acquisition | Risk management | Funding | Administration | Collection |
|---|---|---|---|---|---|

## Product development

**Size and structure products to suit the next billion**
- How can products be structured around pools of customers?
- How can products be developed with players in other industries?

**Make the products appealing**
- How can products be downsized but not downgraded?

## Customer acquisition

**Broaden reach and lower barriers by improving distribution**
- How can existing infrastructure be better utilized?
- Are there any new or underutilized alternative channels?

**Explore interindustry partnerships**
- Are there any viable new POS locations?

**Build financial literacy and trust**
- How can banks ease consumers' transition to the formal sector?
- How can banks work with communities to build trust?

## Risk management

**Reduce risk through products and partnerships**
- Can group collateral or community guarantees be used?
- How can local knowledge be leveraged to reduce risk?

**Improve the broader financial services environment**
- How can the basic infrastructure be improved to reduce banks' risk

## Funding

**Increase access to wholesale low-cost funds**
- How can retail funds be accessed by MFIs and other providers?

**Extend differentiated bank licensing**
- Can the RBI introduce a special banking license that allows players, such as MFIs, to focus on the next billion?

## Administration

**Optimize back-office functions**
- Can centrali-zation, either within or among banks, achieve significant scale benefits?
- How can the RBI support the development of a central provider of back-office services for banks and MFIs?

## Collection

**Explore oppor-tunities to outsource collections**
- How can banks better leverage the most effective collection channels?

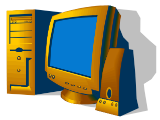
**Enhance contract enforcement**
- How can the legal system be changed to bolster contract enforcement?

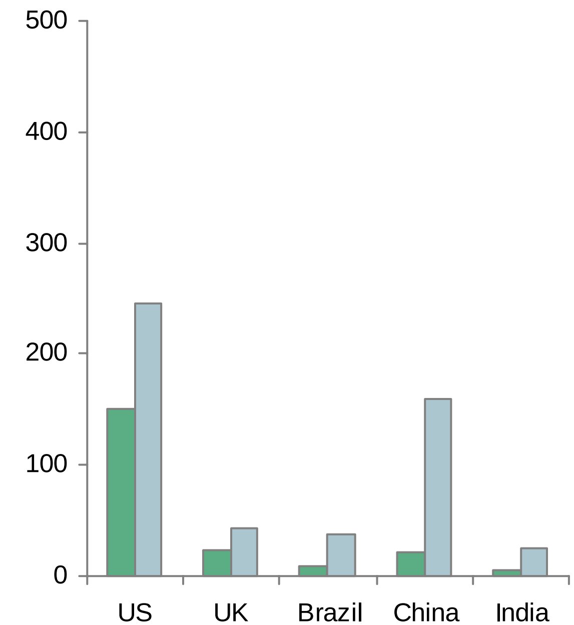
(Shaded) Action in these areas will depend largely on government initiatives or regulatory reform.

**Source:** BCG analysis.

# Mobile phones could be the PC of the developing world

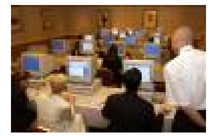
**PC**
**(Mn)**

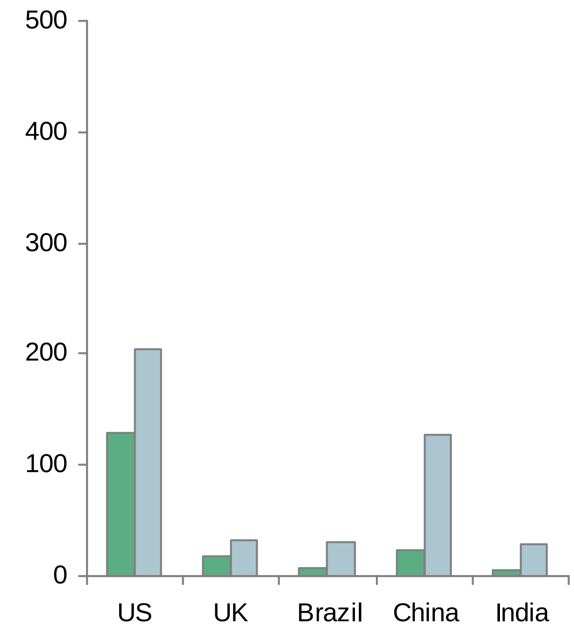





CAGR: 8% 10% 26% 39% 30%

**Internet users**
**(Mn)**

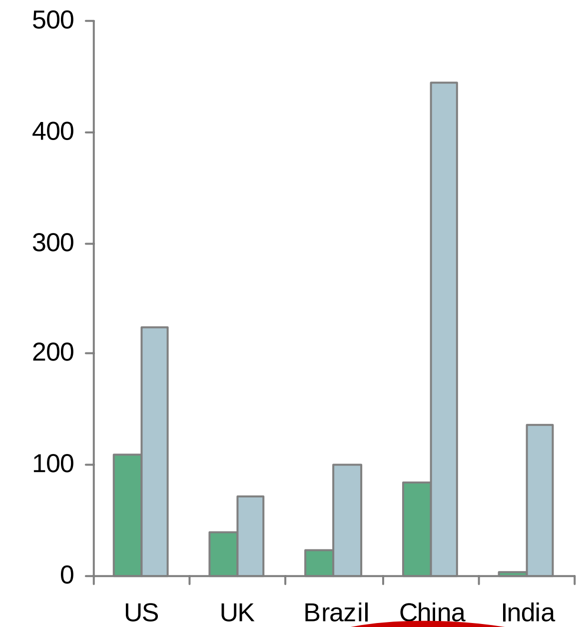





CAGR: 8% 10% 24% 33% 31%

**Mobile subscribers**
**(Mn)**

***"It's what computers have become"***

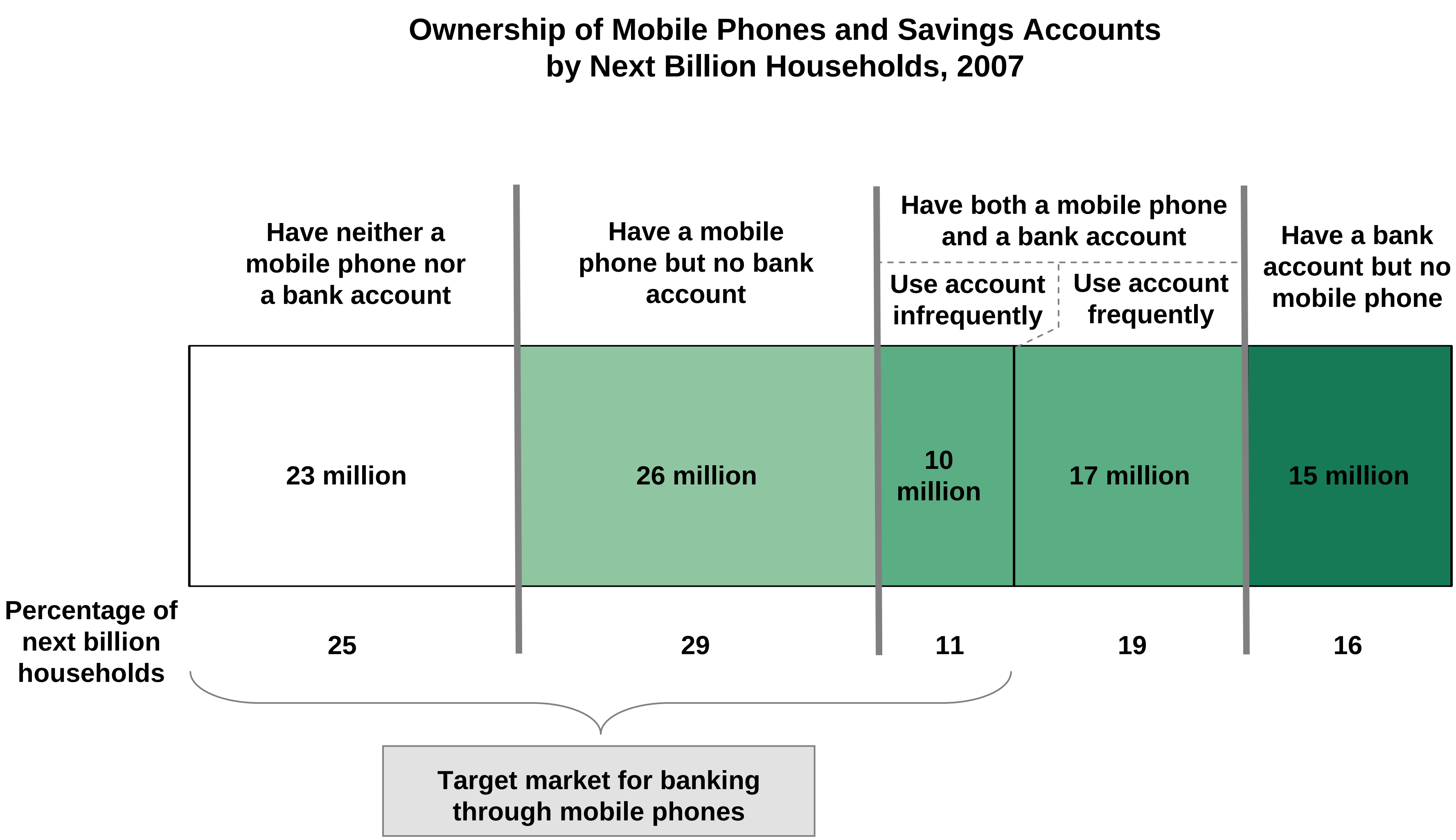



CAGR: 13% 10% 27% 31 % 87%

2000 2006

Source: EIU Market Indicators and Forecasts

# Mobile phones could become the primary platform for distributing banking services to the next billion




Sources: Survey of 4,125 individuals in BCG's Next Billion Consumer research, 2007; BCG analysis.
Note: Active banking customers are defined as those who use their savings account at least once a month.

# Can transform profit pools of several services

**Payments**

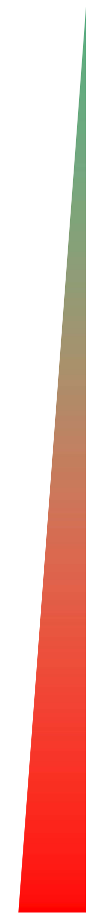
- Transfer prepaid minutes in lieu of bank remittances
- Micro (and larger) payments in lieu of credit cards
- ...

**Loans**

- Targeted marketing
- Credit and payment history
- Collections
- ...

**Savings**

- Value stored as prepaid minutes
- Balance enquiries, payments instructions, direct debits, bill payments, viewing statements
- Cash withdrawals at ATM
- ...



# Several innovative offerings already launched

**International examples**

**South Africa**

WIZZIT my bank in my pocket

*"Bringing cell-phone banking to the unbanked"*

**Kenya**

M-PESA

*"Affordable, fast, convenient & safe way to transfer money by SMS anywhere in Kenya"*

**Philippines**

GLOBE G CASH

*"With an electronic wallet feature, remittances find a new vehicle in mobile phones"*

**South Africa**

MTN Banking A division of Standard Bank

**MobileMoney**

*"Gives you access to complete banking flexibility, using your cell-phone"*

**Zambia**

celpay

*"The 'cell phone wallet service' allows usage of cell phones for transactions, payments, & fund transfer between participating phones"*

**Indian examples**

Reliance Communications Anil Dhirubhai Ambani Group

HDFC BANK

**Reliance mPay**

*"India's first virtual credit card"*

mChek SAFE - SMART - SIMPLE

*"Lets you put your credit card in your mobile phone"*

Partners include Airtel, Visa, Mastercard, ICICI Bank, SBI, etc

obopay

*"Aims to provide person-to-person payment service to all mobile users in India"*

Corporation Bank

Pilot program through banking correspondents enabled by an electronic box, smart card and mobile connectivity

# Emerging policy priorities – going beyond obligation

**Allow banks to leverage alternate channels and enhance productivity of existing channels**

- Consider lifting restrictions on NBFCs acting as bank correspondents
- Allow cash transactions across a wider range of channels
- Expand list of permitted activities in a bank branch

**Harness the power of technology**

- Define policy framework for banking through mobiles
- Facilitate shared back-office utility

**Enable companies to serve the next billion profitably**

- Remove interest rate caps and floors to help make small loans and savings accounts profitable
- Expand differentiated licensing to permit new financial institutions focused on serving the next billion

**Improve the credit environment**

- Establish a national identification system
- Strengthen the credit information infrastructure

**Take some of the risk out of serving the next billion**

- Strengthen contract enforcement through special courts or other arbitration mechanisms
- Develop national database of property holdings

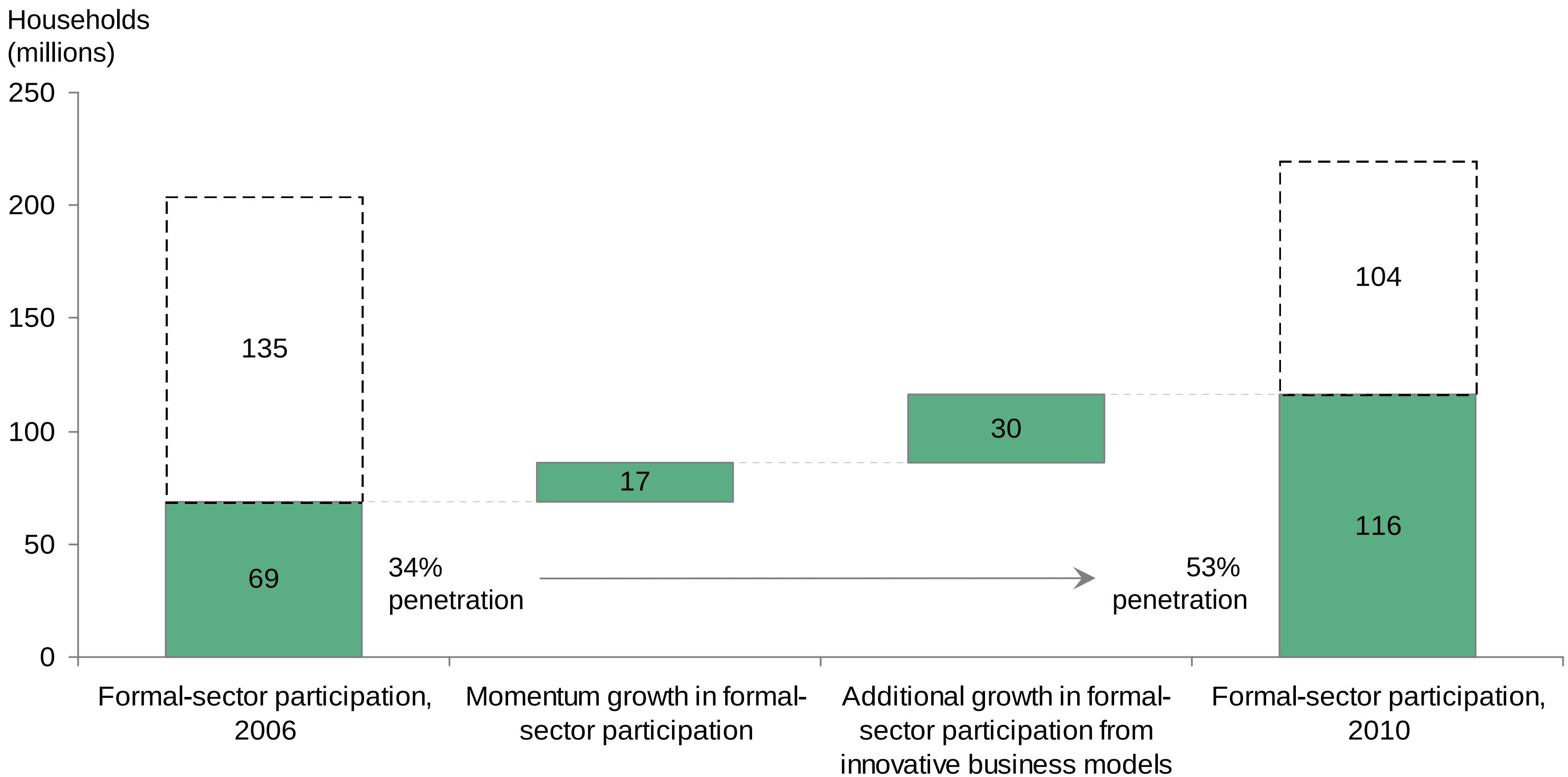
**Make it more economical to meet mandates**

- Introduce tradable securities as a means to fulfil mandated banking and insurance offerings

**Invest in customer education**

- Improve financial literacy; counsel customers on appropriate use of financial products

# BCG estimates innovative business models could pull an additional 30 mn households into the formal sector by 2010

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