

Issues in Low-cost Financial Services

- Bottom-line: Horses for courses; don't try and make banks do everything. The cost structure of banks does not allow them to serve subprime segments; the return per subprime client does not cover the marginal cost of serving them.
- 1.0 Impact of foreign banks
- 2.0 Banks & NBFs
- 3.0 Public Policy Issues

1.0 Impact of foreign banks

- Foreign banks favor markets that are:
 - Underbanked
 - Fast growing
 - Uncompetitive
 - That is, lots of low hanging fruit
- Foreign banks bring:
 - Narrowed intermediation margins
 - New products
 - New processes
 - Rivalry
- Implications
 - There will come a time when most foreign banks will no longer find retail banking in Latin America attractive.
 - Rivalry will push the banks towards serving the unbanked. (That does not mean that they will serve them across bank counters.)

2.0 Banks & NBFs

- NBFs: non-bank financials
- 2.1 Size of an average transaction
- 2.2 Sophistication
- 2.3 Documentation
- 2.4 Why segmentation?

2.1 Size of an average transaction

- Bank clientele:
 - Require relatively large transactions
 - Means fixed costs don't push up i rates much
- NBF clientele:
 - Require relatively small transactions
 - Means fixed costs weigh heavily

2.2 Sophistication

- Bank clientele: sophisticated
- NBF clientele: novices
- Analogy: Mutual funds
 - Sophisticated investors BUY no-load funds
 - Brokers SELL load funds to unsophisticated investors. The load (broker's commission) compensates the brokers for their costs in finding and educating potential investors about the characteristics of the product.

2.3 Documentation

- Banks' clientele are well-documented
 - Borrow on credit cards
 - Brazil: borrow against salaries
- NBFs' clientele are not well documented
 - Use pre-paid cards, pay day loans, tax refund anticipation loans, pawnbrokers, etc.

2.4 Why segmentation?

- Needed in order to price discriminate
 - NBF clientele too expensive for banks
- Social separation
 - Class
- Personnel
 - Banks need high quality, so pay high cost
 - NBFs need low cost; can use low quality
- Facilities
 - Banks: attractive, limited hours
 - NBFs: storefronts, long hours

3.0 Public Policy Issues

- Tax on deposits
 - Discourages savings and use of banks
 - Encourages higher cost work-arounds
- Demands on banks for social policies
 - High cost for the banks
 - Low quality for NBF clientele
- Capital adequacy rules
 - Discourage banks from lending to poor