Authors
Dean Karlan
Northwestern University

Researchers
Nava Ashraf
London School of Economics and Political Science

Dean Karlan
Northwestern University

Wesley Yin
University of California, Los Angeles

The Road from Innovation to Scale: Experiments to Improve Product Design

This post originally appeared on NextBillion.net.

The poor do not save as much as they would like. However, unlike their wealthier counterparts, the poor do not have access to a broad suite of products and services carefully designed and marketed to help them reach their savings goals. This explains why 77 percent of adults living under $2 a day still do not have a bank account (FINDEX 2012), and among those that do, usage figures are very low. Satisfying the untapped demand for savings is more complex than simply opening bank or mobile money accounts for everyone. The challenge facing financial institutions is to develop and market innovative products that satisfy the varying needs of poor clients to help them better manage their money and make healthier financial decisions.

Financial innovation can be broadly thought of as a two-part process: identifying the barriers that lead people to make sub-optimal decisions and then developing scalable solutions to overcome these barriers. In a recent review that I co-authored with Aishwarya Ratan and Jonathan Zinman, we identify five sets of constraints that may lead the poor to undersave: transaction costs, regulation and a lack of trust, gaps in information and knowledge, social constraints, and behavioral biases (such as temptation, inattention and inertia). It is not clear at the outset how best to tackle these barriers. Lowering costs might be an obvious way to start, but other targets like impacting clients' financial capabilities could involve numerous approaches with varying efficacy levels.

Let's say that we have designed a new product, how do we know if it works? A naïve approach would be to simply track account use since the product launch; but this would likely lead us to a wrong conclusion as an increase in savings might be due to factors fully unrelated to our product. We have to try to respond to the question "How did the lives of the clients and the profits of the bank change relative to how they would have changed had the product or program not been implemented?" The difficulty in establishing this causality involves figuring out what would have happened had the program not been launched; randomized field evaluations are generally the best way to identify this type of comparison.

At Innovations for Poverty Action (IPA), we bring together researchers and partner organizations from around the world to conduct rigorous experiments that test and compare product and program innovations designed to improve the lives of the world's poor. Our goal is to identify targeted solutions that work, replicate them across different contexts, and ultimately help bring successful solutions to scale.

Commitment savings is a great example of an innovation that IPA's Global Financial Inclusion Initiative is currently helping bring to scale. Here's how it works:

> *Savings constraint:* Microborrowers around the world often take out a loan, not for business investments, but to purchase something specific such as material to improve the roof of their house, or to pay for school fees. These are foreseeable and planned expenses, so why don't they save up for them instead of taking out expensive debt? A possible answer is that saving up is hard as temptation and pressures from peers lead them to spend this money in other ways. Loans might be expensive, but they are the only commitment mechanism available.
>
> *Innovation:* Working with Green Bank of Caraga, a partner in the Philippines, we designed a savings product that replicated this commitment structure allowing households to set aside money for a predefined goal and restrict their ability to withdraw funds until the goal has been met. We found that the product led to an increase in savings by *over 300 percent* for those that took up and used this product over a one-year period. It is important to note that just over one in four clients took the product, perhaps indicating that temptation was only an important constraint for certain individuals. Variations of commitment savings products were found to increase agricultural investment, output and household consumption amongst tobacco farmers in Malawi, and investments in preventative health in Kenya. Given these promising results in a variety of contexts, we are now looking for partners interested in further improving the design and marketing of this product through replications and taking this innovation to scale.

As more of the world's poor gain access to the formal financial sector, there remain a number of product design questions that still need to be evaluated before they can be similarly brought to scale. For instance, how can we best deal with the problem of "debt-savers" i.e. people who simultaneously borrow at really high rates and save at really low ones? Surely, from the consumer's perspective, this is a sign of financial services run amok. One possibility is for financial institutions to treat the client's portfolio as one entity, presenting separate "sub-accounts" that clients may desire for emotional or mental accounting reasons, but not charging them for borrowing money that they have already saved with the same institution. Another is to develop platforms external to financial institutions that manage the debt and savings payments of users and present their portfolio to them. Such platforms could optimize what debt is paid down first and present access to cash (whether from savings or debt) as an “account,” in order to convey the sense of having savings for particular needs. IPA is currently looking for partners, mobile application developers, payments systems firms or financial institutions, to develop and test product designs around this proposition.

We’re excited to join NextBillion Financial Innovation as a content partner. We view it as a great opportunity to discuss the barriers to financial capability and financial inclusion, and uncover the findings from the research and product tests that our Global Financial Inclusion Initiative is working on. We will also include questions and posts from relevant work on SME and entrepreneurship, as well as on US household finance issues.

Dean Karlan is President and Founder of IPA, a Professor of Economics at Yale University, and the Academic Lead of the Global Financial Inclusion Initiative.

September 26, 2013