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Introduction

Recently there has been a surge of interest in the market potential for mainstream financial service firms to serve unbanked and marginally banked consumers. The industry is gradually awakening to the message that low-income consumers comprise a huge untapped market for financial products and services. Despite the general recognition of unmet demand among lower-income consumers, important gaps in information about this market segment pose obstacles to conventional financial services firms. In particular, while there is an evolving consensus around the description of who is unbanked, relatively little is known about why. Moreover, many low-income consumers who have bank accounts also conduct business with fringe institutions, straddling both sides of the "dual" financial service system in ways that are as yet not well understood.

To help banks and other financial service firms learn more about the financial behavior and preferences of low-income consumers, MetroEdge, a business of Shorebank, sponsored a large survey of households in the low-income neighborhoods of Washington, D.C., Los Angeles, and Chicago. This paper presents the first analysis of the results from the MetroEdge survey and focuses on two central questions. First, what are the most important reasons why so many low-income households do not hold a checking or savings account? Second, to what extent do households with bank accounts also participate in the fringe financial sector, and in what ways are unbanked households connected to the mainstream financial sector?

Review of the Literature on the Unbanked

Beginning in the mid-1990s and inspired in part by John Caskey's important contribution (1994), a cottage industry emerged analyzing data from various national and local surveys to understand the demographics of the unbanked population (Caskey, 1994, 1997a, 1997b, 2001; Hogarth, Angeluelov and Lee, 2001; Hogarth and O'Donnell, 1997, 1998, 1999, 2000; Hungerford, 2000; Rhine Toussaint, Hogarth and Greene, 2001; Dove Associates, Inc., 1999; Dunham, 2001; Kennickell et al., 2000; U.S. Department of the Treasury, 1997). A consistent picture of the unbanked has begun to emerge. Specifically, those without banking relationships are likely to be less educated, lower-income, non-white, younger, unemployed, and renting rather than owning their residence. In addition, the unbanked are more likely to report living from paycheck-to-paycheck with little or no money left for savings.

There is less agreement as to why so many households are unbanked.[1] Common explanations include the scarcity of bank branches in low-income and minority neighborhoods, poor credit ratings that prevent some households from being allowed to have an account, and the availability of lower cost services provided by non-banks. It has also been suggested that many unbanked households desire to keep their financial transactions "off the books," that banks present language or cultural barriers for immigrants, and that unsophisticated consumers chose fringe providers because they do not fully appreciate—or are intentionally misled about—the costs. There is almost certainly some truth in each of these explanations. But there have been few systematic attempts to sort through the competing explanations and identify the relative importance of each.

Survey Design

MetroEdge sponsored a survey of households living in low- and moderate-income (LMI) census tracts in Chicago, Los Angeles, and Washington, D.C.[2] The survey design was loosely modeled on the Survey of Financial Activities and Attitudes, conducted by the Office of the Comptroller of the Currency in 1998-1999. The MetroEdge survey utilizes a similar multistage stratified random sampling design in which census tracts were stratified by city, race/ethnicity, and income. Survey households were drawn from 62 LMI tracts, 21 tracts in each of the three cities. Approximately 500 households were surveyed in each city, for a total of 1,532 interviews.[3] About two-thirds of the interviews were conducted by telephone, and one-third in person. All respondents were offered the opportunity to complete the survey in Spanish, and 10 percent chose to do so. In each household, the survey was administered to the person identified as being responsible for most of the financial decisions. The overall response rate for the survey was 48 percent, with a higher response rate for in person interviews. The survey was conducted from August to December of 2003.

[1] For a comprehensive review of the literature, see Belsky and Calder (2003).
[2] Following convention, LMI tracts were defined as those having less than 80 percent of the median household income of the metropolitan area. Year 2000 census data and tract boundaries were used.
[3] The survey estimates for a sample of 500 will have a sampling error of roughly 4.5% at the 95% confidence level.

Demographics of the Unbanked

The 1,532 respondents to this survey represent a population of 2.23 million households residing in the LMI neighborhoods of Chicago, Los Angeles, and Washington, D.C. Demographically, the survey population is about one-third white, 40 percent black, and one-quarter Hispanic, as well as 5 percent other or multiple-race.[4] The median household income of the survey population in 2003 was approximately $25,000. About 22 percent of the survey population were born outside the United States.

Following convention, we label a household with neither a checking nor a savings account *unbanked*. Households holding either type of account are termed *banked*. We find that 22 percent of the survey population is unbanked, a figure in line with previous surveys.[5] As Caskey observes, however, estimates of the proportion of the population that is unbanked vary: the Survey of Consumer Finances, which oversamples wealthy families, finds 13 percent unbanked; the Population Survey of Income Dynamics, which oversamples low-income families, suggests that 22 percent are unbanked (Caskey, 1997). Our estimates match the latter number, which is expected (and reassuring) given that we are also focused on the LMI population.[6]

Table 1 compares the distribution of banked and unbanked households across a variety of demographic variables. Consistent with several previous studies, we find that the unbanked are disproportionately black and Hispanic, poorer, less educated, younger, more likely to have been born outside the U.S., and less likely to own their homes. Perhaps the most striking differences between banked and unbanked households are in income, education, and race. Nearly 70 percent of the unbanked earn less than $15,000, and only about 3 percent have a college degree. Whereas about 40 percent of banked households were white, only about 7 percent of unbanked households were white.

In order to gauge the relative importance of these variables, we estimated a series of logit models, presented in Table 2. The models estimate the probability of being unbanked, of having

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[4] Unless otherwise noted, when we refer to white and black, we mean non-Hispanic white and non-Hispanic black.
[5] The 95 percent confidence interval for the percentage unbanked is 19 to 26 percent.
[6] Dunham (2001) estimates that 37 percent of LMI consumers in New York and Los Angeles are unbanked, but she relies on person-level survey. That is, she samples individuals and codes them based only on their own account holding. We sample households instead. For example, in a husband-wife household, we code the household as banked if either person holds a checking or savings account, whereas Dunham would code the husband as unbanked if he does not have an account, even if his wife does. This difference in the unit of analysis between our survey and Dunham's likely explains why she arrives at a higher estimate of the percentage unbanked than we do, despite otherwise comparable survey methods.

a checking account, and of having a savings account, respectively.[7] Importantly, only three variables emerge as significant predictors in all of the models: education, income, and the number of children. Unsurprisingly, the probability of being banked increases rapidly with income and education, as is evident from the simple tabulations in Table 1. In addition, households with more children are less likely to have a bank account. The relationship between the presence of children and banking is not obvious, but may arise from the fact that, controlling for income, race, and other covariates, households with children have more expenses and hence are less able to save or to meet the minimum balance requirements for a checking account.

Among the remaining variables, age is positively associated with the probability of holding a checking account, and hence of being banked. Importantly, even after conditioning on the other covariates, race matters: blacks are over four times more likely to be unbanked than whites, and Hispanics are nearly three times more likely to be unbanked than whites. Race appears to matter most for having a checking account, where the effect of being black is significant and negative, although the effect of being Hispanic is not significant. In contrast, neither of the race variables is significant in the savings model, and the odds ratios are larger.[8] Finally, we find that households receiving social security are less likely to hold a savings account. None of the remaining variables attains statistical significance in any of the models.

In summary, there are no surprises here. The results of the models reported in Table 2 reinforce the accumulated findings of past studies. Income, education, and race are the primary variables associated with account holding, along with the number of children. It is reassuring that independent studies using disparate data sources have revealed a fairly consistent picture of who is unbanked.

Behind the Correlations

If analyses such as those presented above reveal the characteristics of the unbanked, they contribute relatively little to explaining *why* so many households operate outside the mainstream financial sector. While it is important to know, for instance, that black and Hispanic households are far more likely to be unbanked than are comparable white households, we still know

[7] The models are specified comparably to those reported by Washington (2003, Table 4).

[8] The finding of differential effects of race on holding checking and savings accounts is broadly consistent with Vermilyea and Wilcox (2002), who analyze data from the OCC survey of New York and Los Angeles. They find that blacks and Hispanics are less likely to hold checking accounts, but actually *more* likely to hold a savings account than are whites. Our findings do not support the latter conclusion, however.

relatively little about why this is the case. In the remainder of this paper, we hope to contribute to understanding the financial behavior of low-income households by systematically examining a set of explanations for why so many of them are unbanked.

Income and Cost

To better understand why so many low-income families do not hold a checking or savings account we began with a direct approach: we simply asked them. Every respondent who reported not having a checking (savings) account was then asked a follow up question: What are the main reasons you do not have a checking (savings) account? These were asked as open-ended questions, and the responses were subsequently categorized and coded. The results are presented in Table 3, for checking accounts, and in Table 4, for savings accounts. The dominant answers in both cases center around household income and bank fees.

Of those without a checking account, nearly half provide explanations having to do with cost or income, with a plurality saying they "don't have enough money." Others said that fees or minimum balances are too high, or that they do not write enough checks to make having an account worthwhile.[9] The most common reasons for not having a savings account also revolve around income and cost. Nearly two-thirds of respondents gave such a reason for not having a savings account, with the majority saying either that they have no extra money to save or that they do not have enough extra money to meet the minimum balance requirements for an account. About 3 percent say they do not have a savings account because fees are too high and, interestingly, 7 percent say the interest rate is too low. In other words there may be a segment of consumers who eschew bank savings accounts in favor of more lucrative investment options or do not save at all because the perceived incentives are too small.

By far the most common explanations given for not having a checking or savings account have to do with inadequate income. The relationship between savings and income is obvious. To be able to save, a household must have money left over after paying for basic necessities, and hence we expect a negative relationship between income and savings, all else equal. On the other hand, the relationship between income and checking is more complex. Whereas

[9] The classification of the responses into these five broad categories is admitted subjective. For instance, one could interpret "don't write enough checks to make it worthwhile" to mean that it is not worth the expense of having an account, a cost issue, or that it is not worth the hassle of maintaining an account, a complexity issue. Nevertheless, in most cases we believe the coding is fairly straightforward.

households with no money to save have no need for a savings account, all households—even those with below poverty-level income—have a need for the basic services provided by a checking account; that is, making and receiving payments. The choice households face, then, is not whether or not to make and receive payments, but whether to make and receive payments via a checking account or through some other method. So what does it mean when low-income consumers say they "don't have enough money" for a checking account?

The primary alternative to a checking account for most low-income households to receive income and convert it to cash is to use a CCO or other non-bank institution for cashing checks, or to cash checks at the issuing bank. The primary alternatives for making payments are to pay by cash or money order. The cost structure of a checking account relative to these alternatives may explain why some low-income households find it more affordable not to have a checking account. Specifically, the cost of maintaining a checking account is decreasing in income, whereas the cost of using CCOs is increasing in income, as illustrated theoretically in Figure 1.[10] Previous studies show that cashing a check at a CCO costs, on average, approximately 1 to 2 percent of the value of the check (e.g., Washington, 2003). A household earning $12,000 per year would expect to pay $15 per month, or $180 per year, to cash its paychecks at a CCO charging a 1.5 percent fee. A household earning $120,000 would pay ten times as much, or $1,800 per year, to use a CCO.[11] Moreover, Dunham (2001) has shown that many low-income households find even less expensive methods of converting checks to cash—e.g., cashing checks at a supermarket that does not charge a fee to customers buying other goods, or cashing checks at the issuing bank for no cost—so that the vast majority of unbanked households in fact pay less than $100 per year in fees for financial services. Consistent with Dunham (2001), we find that only about 40 percent of unbanked households in our survey population actually cash checks at a CCO. In contrast, free or low-cost methods of converting checks to cash are generally not feasible for large checks, and in this sense high-income consumers might just as well be said to "make too much money" to use a supermarket or CCO for converting income to cash.

[10] Of course, the actual costs vary significantly across institutions and also depend on individual consumer behavior. Banks that offer no-fee, no-minimum balance checking accounts may be able to underprice CCOs even for low-income consumers, although even in this case customers may be willing to pay more at a CCO to avoid having to wait for checks to clear. These qualifications aside, the basic relationship shown in Figure 1 holds given common pricing structures of banks and CCOs.

[11] In fact, most CCOs will not cash checks as large as $10,000 (assuming the household is paid once a month), so this is not even an option for high-income households. We ignore this reality for purposes of illustration.

The price structure of most checking accounts, in contrast, is such that low-income consumers typically will pay more in fees than will high-income consumers. Many banks charge fees to customers who do not maintain a minimum balance in their checking accounts, and maintaining that minimum balance is especially difficult for low-income households. In addition, banks and merchants charge fees for bounced checks—a distinct possibility for a customer whose account balance dips to zero at some point every month, as Caskey (1994) has emphasized. Moreover, customers with low account balances face non-pecuniary costs, such as the delay of waiting for their deposit to clear if they do not have enough money in their account to cover it. On the other hand, customers that maintain a high balance in their checking account can escape most or all fees and even earn interest. Thus, when low-income consumers report that they do not have enough money for a checking account, it is likely that they mean that they do not have enough money to make a checking account more affordable than a CCO.

Hard and Soft Barriers

We find that just over 7 percent of unbanked households say the main reason they do not have a checking account is that they simply do not like dealing with banks. Our estimate of the proportion that do not like dealing with banks is substantially lower than that reported from a comparable question in the Survey of Consumer Finances (SCF). Between 1992 and 2001, the SCF has shown an increase from 17 to 23 percent of respondents who say their main reason for not having a checking account is that they do not like dealing with banks (Aizcorbe, Kennickell, and Moore, 2003). We believe one reason we find a smaller proportion giving this answer in our survey is that we ask the question in an open-ended form, allowing for additional responses that were not detected on the SCF question. In particular, the SCF question does not have the option of "don't have proper identification." We find that, when the ID option is available, more respondents actually chose this than "don't like dealing with banks." Similarly, in explaining not having a savings account, more respondents say that they do not have proper identification (5 percent) than that they "do not trust banks" (4 percent).[12] The distinction is important because possible policy responses differ. If a large proportion of unbanked households do not like dealing with banks, more research is needed to understand why this is so and what if anything

[12] The SCF does not ask a question about why respondent do not have a savings account, so we have no basis for comparison.

banks can do to change this perception. On the other hand, if identification requirements are a major barrier, policy responses are more straightforward, such as allowing the use of matricula cards.

In addition to those without proper identification, approximately 7.5 percent of the survey population report that they are barred from having a checking account due to credit issues, saying either that they have bad credit or are not allowed to have an account, possibly due to having a record in Chex systems. About 4 percent said they were not allowed to open a savings account due to bad credit. As shown in Table 5, 13 percent of unbanked households say they have had an application for a bank account denied. Interestingly, 6 percent of banked households also say that they have had an application for a bank account denied. Apparently, they were able to repair their credit rating or to find another bank with less stringent requirements.

Only a small fraction of respondents identified less tangible cultural and language barriers as important reasons for not having a checking or savings account. As mentioned above, 7 percent say they do not have a checking account because they do not like dealing with banks, and 4 percent do not have a savings account because they do not trust banked. Less than two percent of respondents said the main reason they do not have a checking account is either that they do not feel welcome or that bank staff do not speak their language. Less than one percent said that respect or language were reasons for not having a savings account. In other words, hard barriers, such as ID requirements and credit ratings, appear to be more important than “soft” cultural barriers in driving low-income consumers away from banks.

Location and Convenience

The relative scarcity of bank branches in low-income and minority neighborhoods has been commonly suggested as an explanation for why so many households in these neighborhoods do not have bank accounts (Juarez, 1997; Lieberman, 1997). Poor and minority households use fringe institutions, the story goes, because they do not have bank branches located nearby. The results shown in Tables 3 and 4 do not support this argument. Only about 2 percent of unbanked households said inconvenient bank locations or operating hours were important reasons for not having a checking or savings account. These figures are consistent with findings from the SCF (e.g., Aizcorbe, Kennickell, and Moore, 2003). Although it may well be the case that low-income, and especially minority, neighborhoods have a greater presence of fringe institutions relative to banks than high-income neighborhoods, very few consumers say that the absence of bank branches is an important reason for being unbanked. However, as we will see below, convenient locations do make a difference to consumers in choosing where to cash checks.

Complexity and Motivation

The complexity of opening and managing an account deterred about 12 percent of survey households from having a checking account. These respondents reported an inability to manage an account, uncertainty over how to open an account, or confusion over fees as the main reason for not having a checking account. These households may represent the segment of the unbanked that would benefit most from improved financial education. However, less than 1 percent of the unbanked said that issues related to complexity were important reasons for not having a *savings* account.

The most opaque reasons for being unbanked were given by those households who said simply that they do not need or want a bank account. About 16 percent of those without a checking account said either that they do not need or want an account, or that they have not gotten around to opening one. Similarly, about 10 percent of those without a savings account say they either do not need or want one, or that they prefer having only a checking account. It is difficult to make inferences about the rationale for being unbanked among this segment of LMI consumers.

Consumer Knowledge and Sophistication

It is possible that the actual reasons why a household is unbanked may differ from the self-reported reasons. In particular, it is often suggested that low-income consumers are financially unsophisticated and do not fully understand the costs associated with fringe banking. In other words, less sophisticated consumers may perceive the costs of fringe banking to be lower than they actually are, perhaps due to hidden or complex fees. This explanation for the use of non-bank institutions would not appear in self-reports, such as Tables 3 and 4, because respondents themselves would be unaware of their own misperceptions. However, the argument that low-income consumers pay “too much” for financial services because they are taken advantage of by exploitative fringe institutions is challenged by Dunham’s finding that most low-income consumers without bank accounts actually pay relatively little to make and receive payments (2001). We therefore asked a series of questions in order to understand how low-income consumers gauge the relative costs of bank and non-bank financial services.

We begin by asking those who have cashed a check at a CCO in the preceding 12 months how much they paid. First we asked the amount of the last check the respondent cashed, and then the dollar value of the fee they paid. The median reported fee amounted to 1.75 percent of the face value of the check, which is well within the normal range of CCO fees. In other words, respondents do not report unrealistically low fees. For comparison, we asked those respondents with checking accounts who have never used a CCO to speculate on CCO fees. Specifically, we asked them how much a CCO would charge to cash a $100 check. The median reported estimate was five dollars, which, although not implausible, is on the high end of industry norms. In other words, it may be that banked consumers actually overestimate the costs of being unbanked.

Of course, CCOs are not the only option for unbanked consumers who need to convert checks to cash. More than half of unbanked consumers who cash checks have done so at a bank or credit union (37 percent) or a supermarket (22 percent). We then asked why respondents chose a CCO over a bank, or vice versa, for cashing their checks, as shown in Table 6. The most common reason for cashing checks at a bank rather than a CCO is that it is less expensive, presumably because they were cashing checks at the bank of issue.[13] In contrast, a relatively small proportion of unbanked consumers said they cashed their checks at a CCO because it was cheaper than a bank. Rather, about half of unbanked consumers who cashed a check at a CCO said they did so for convenience. A more convenient location was the top reason for choosing a CCO over a bank for check-cashing. Interestingly, a significant proportion of consumers with checking accounts have also cashed checks at a CCO (14 percent) or supermarket (7 percent). Three-quarters of consumers with bank accounts who cash their check at a CCO say they did so because the location or hours were more convenient or the lines were shorter. In short, banked and unbanked households exhibit a similar motivation for cashing checks at a CCO: convenience.

If unbanked consumers seem to have a fairly clear understanding of the costs of using a CCO, perhaps they overestimate the barriers to obtaining a checking account. We asked

[13] Indeed, of the unbanked consumers who cashed their checks at a bank, only 25 percent reported having to pay any fee.

respondents without a checking account to estimate the minimum balance needed to maintain a no-fee checking account. The range of responses was wide, with a median of $100 and a mean of $220. Although minimum balance requirements vary from one bank to another, these estimates are within the range of industry norms, although clearly there is a segment of the unbanked that dramatically overestimates the barriers to banking—the highest estimated minimum balance was $5,000! We then followed-up by asking whether the respondents believed they could maintain their estimated minimum balance: 75 percent said *yes*. In other words, most unbanked respondents believe that they *could* maintain a no-fee checking account but chose not to.

The picture that emerges here is not one of uninformed consumers being exploited by predatory fringe financial institutions, although surely that does occur. Rather, unbanked consumers are generally well informed about the relative costs of CCOs and banks. Those that chose to cash checks at CCOs appear to be motivated primarily by convenience, while those that cash checks at banks are motivated by lower costs. In other words, for many LMI households, being unbanked is the result of an informed choice rather than involuntary exclusion from the mainstream financial sector. This is not to say that LMI consumers find themselves in the best of all possible worlds. Rather, for the most part, they make the best of the limited options available to them given their income. Nevertheless, the vast majority of households in our survey population appear satisfied with the financial institutions they have chosen. When asked to rate their level of satisfaction with their financial institution(s), 91 percent of banked customers said they were satisfied or very satisfied, and so did 88 percent of the unbanked.

Network Externalities

Within an economic network, each member's use of a checking account increases the value to others of holding an account by increasing the opportunities to make payments by check, the sort of benefits that economists refer to as *network externalities*. Thus, another possible barrier to checking account holding among low-income consumers is that personal checks may not be as widely accepted as forms of payment in low-income neighborhoods. In this respect, we were surprised to find that households with checking accounts nevertheless report buying an average of two money orders per month, compared with an average of 2.7 for households without a checking account. When asked why someone with a checking account buys money orders, the primary reasons, shown in Table 7, are that the person or business to receive the money does not accept checks. Moreover, almost 30 percent of households with a checking account nevertheless pay their rent by check or money order (Table 7). About one-in-five households, banked and unbanked, report that their landlord will not accept a check for rent (Table 7). We also find evidence that unbanked households are more likely to belong to social networks including other unbanked households. For example, about 40 percent of unbanked households report than none or only a few of their closest friends and relatives have a bank account. Only 14 percent of banked households said that most or all of their friends and relatives were unbanked.

To Bank or Not to Bank? **Is this the Right Question?**

To this point our discussion has proceeded as if low-income consumers fit neatly into two mutually exclusive categories, the banked and the unbanked. The banked, it would seem, are fully integrated into the mainstream financial sector by virtue or having a checking or savings account, whereas the unbanked are on the fringe, completely excluded from traditional financial networks. The reality is that most low-income households rely on a patchwork of financial services provided by both bank and non-bank institutions. If there is indeed dual financial sector, many consumers find themselves on both sides of it. As Dunham (2001) has emphasized, engagement in the mainstream and fringe sectors by low-income households therefore should be thought of as a continuum rather than a simple dichotomy of banked and unbanked. In this section, we briefly explore some of the ways in which low-income households have developed overlapping relationships with both banks and fringe service providers.

Perhaps the most direct relationship that most unbanked consumers have had with the formal financial sector is through their own past holding of bank accounts. As seen in Table 8, half of the currently unbanked in our survey population actually held a checking or savings account in the past, and therefore might be more aptly termed *formerly banked*. The most common reason for closing the account was a change in personal finances that made it impossible to maintain the minimum balance. In addition, about 10 percent said they closed their accounts because bank fees were too high. Nearly a quarter of households who used to be banked closed their accounts for reasons related to account management, with the most common reason being that they bounced too many checks. Finally, 12 percent closed their bank account either when they moved or their local bank branch was closed.

Aside from past account ownership, the most common banking relationship among the unbanked comes through using banks to cash checks. About 30 percent of unbanked households who receive income by check say they cash a check at a bank each month, and 6 percent cash checks at a credit union, as shown in Table 9. Of those who cash their check at a bank or credit union, only 25% pay any fee, which suggests that most cash their check at the bank of issue for no charge. Beyond check cashing, banks and credit unions attract about 5 percent of the unbanked who buy money orders and about 12 percent of the unbanked who send money outside the country. In addition, about 7 percent of the unbanked report having a major credit card, which represents a connection to the mainstream financial sector, if not necessarily to a local bank or credit union. In total, about 30 percent of unbanked households have at least one relationship with the formal financial sector through check cashing, money order purchases, sending money outside the U.S., or holding a credit card.

Interestingly, Table 9 also demonstrates that many households with bank accounts also have ties to the so-called fringe financial sector. About 14 percent of banked households who receive income by check chose to cash a check at a CCO in the past month, and 7 percent cashed a check at a supermarket. Almost half of banked households purchased money orders in the past year, and of these households only 30 percent bought their money orders at a bank. About 45 percent bought money orders at a post office, 34 percent at a CCO, and 30 percent at a supermarket or convenience store. Nearly one-in-five banked households who bought money orders did so at a Western Union (11 percent) or liquor store (8 percent). In addition, 15 percent of banked households sent money outside the U.S. during the past year, although only 20 percent of them sent the money through a bank. Western Union and other stand-alone wire services still dominate this market and were used by 63 percent of banked customers who send money internationally. Neither banked nor unbanked households were widespread users of fringe institutions for borrowing. Less than 5 percent of banked households had received a payday loan, pawned their possessions, or bought on rent-to-own terms in the past year. All told, 48 percent of banked households obtained at least one of these financial services from a non-bank institution: check cashing, money orders, international money transfers, payday loans, rent-to-own financing, or pawn brokering.

Summary

The main findings of the analysis may be summarized as follows.

- By far the most common reasons respondents gave for not having a bank account related to income and costs. Nearly half said of those without a checking account and over 70 percent without a savings account said that they did not have enough money or that minimum balance requirements are too high. Under current pricing structures, there appears to be a sizeable segment of LMI consumers for whom fringe institutions represent a lower-cost alternative to traditional bank accounts.

- By and large, LMI consumers are not ill-informed about the relative costs of banks and CCOs. Unbanked consumers, on average, give plausible estimates of the costs of using a CCO and of minimum checking account balances. The majority of unbanked consumers believe they could afford the minimum balance *if* they wanted a checking account.

- Explicit barriers to account holding, such lack of required ID and bad credit history, appear to be more important in keeping LMI consumers from having bank accounts than softer barriers, such as feeling unwelcome or not speaking English.

- Scarcity of bank branches in LMI neighborhoods does not appear to be a major barrier to account holding. Only a trivial fraction of respondents said they did not have a bank account because banks were not conveniently located.

- However, location does influence where consumers conduct their check cashing business. In fact, two distinct segments are evident among those who regularly cash checks: a convenience-oriented group that primarily patronizes CCOs, and a cost-oriented group that patronizes banks.

- The complexity of opening and managing an account is an important barrier for about 12 percent of those without a checking account, but complexity is almost never an important reason for not having a savings account.

- A seldom-recognized deterrent to holding a checking account in LMI neighborhoods is that checks may be less widely accepted as a form payment. For instance, about 20 percent of the survey population say their landlord will not accept a check for rent.

- The dichotomy between the banked and the unbanked, which has framed much recent discourse about LMI consumers, is too rigid. Among those currently without a bank account, about half had an account in the past, and 30 percent have some ongoing relationship with a bank. In addition, about half of those with a bank account nevertheless conduct some financial business with a non-bank. In short, it is common for households to straddle both sides of the dual financial system.

- The vast majority (about 90 percent) of both banked and unbanked households say they are satisfied with the financial institutions they use.

Opportunities for Banks in the LMI Marketplace

The sheer volume of financial activity in LMI neighborhoods should cause mainstream financial institutions to sit up and take notice. Generalizing from our survey to the total population of LMI neighborhoods in Chicago, Los Angeles, and Washington, D.C., we estimate that there are 1.6 million households with checking accounts and 1.2 million households with savings accounts. Another 470,000 households are unbanked. Together, households in these LMI neighborhoods buy 2.5 million money orders each month and cash 3.7 million checks. Moreover, 360,000 households sent money internationally last year, many doing so on multiple occasions. With so much activity in these three cities alone, the total size of the urban LMI market nationally is simply too great for any financial institution to ignore.

With over 20 percent of LMI households unbanked, and half of banked households conducting at least some of their financial business with non-bank institutions, there is plenty of opportunity for banks to acquire new customers and expand their share-of-wallet with existing customers. However, banks seeking to expand in the LIMI market face challenges. First, non-bank institutions are highly competitive, even on price. If exploitative fringe institutions charging supra-competitive prices dominated the LMI marketplace, as some critics suggest, then it would be relatively easy for banks to compete on price. However, findings from the MetroEdge survey reinforce the point originally made by Dunham (2001) that most LMI consumers pay relatively little in fees for financial services. For example, many consumers without bank accounts are able to cash checks for free at banks or retail stores; less than half patronize CCOs, and those that do pay on average less than 2 percent of face value to cash a check. Banks considering expanding their business in LMI markets, therefore, must carefully consider whether they will be able to compete on price and still make a profit. Banks that cannot compete on price for basic services may nevertheless be able to compete on value by offering products and services for which consumers are willing to pay a premium. It is clear from this analysis that even very low-income consumers often are willing to pay a premium for convenience, and so banks might focus improving the convenience of their offerings, possibly exploiting their ATM networks.

Second, low-income consumers are a heterogeneous group, and a one-size-fits all strategy in marketing and product development for LMI consumers runs the risk of appealing to no one in particular. In addition to the remarkable demographic diversity in the LMI market, we have also seen that there is substantial diversity in attitudes, preferences, and experience. For example, half of unbanked households have had a bank account in the past, and winning back old customers is a fundamentally different marketing challenge from attracting new ones. In addition, customers who find managing a checking difficult and confusing may require a different set of products and services than customers who write only one or two checks each month. Of course, any particular bank will probably want to focus on a few market segments that are suited to the bank's areas of competitive advantage. Responding to the diversity within urban neighborhoods will be a challenge for mainstream financial institutions, many of whom look upon LMI consumers as already a fairly specialized market niche. In this respect, the industry is in need of better information about the distinct segments of the LMI market, comparable to the segmentation models of affluent consumers that are widely available.

An obvious starting point for any bank is to focus on capturing additional business from existing customers. We estimate that half of bank customers do business with at least one non-bank institution. Thus, there is a significant opportunity for many banks to expand their market share in products they may already offer, such as money orders or wire transfers, with customers they already have. Convincing unbanked customers to open a bank account may be more difficult. Here, the low-hanging fruit may be the sizable portion of unbanked consumers who currently cash checks at a bank or credit union. Banks interested in tapping this segment may find it easier to identify and win over customers who are already doing business in their branches regularly.

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Table 1: Demographic Comparison of Banked and Unbanked Households

	Banked	Unbanked	Total
Race/Ethnicity			
White	40.8	6.7	33.6
Black	36.4	52.4	39.8
Other	5.6	5.6	5.6
Hispanic	17.2	35.3	21.0
Total	100.0	100.0	100.0
Highest Education Level			
Less than high school	12.2	42.0	18.5
GED	1.8	5.6	2.6
High school	18.1	27.3	20.0
Some college	20.2	18.9	19.9
Community college	3.3	1.9	3.0
Tech school	1.5	1.1	1.4
College grad	23.5	2.6	19.1
Some post-college	3.3	0.0	2.6
Graduate Degree	16.2	0.5	12.9
Income			
less than $10,000	16.8	44.5	22.6
$10,000-14,999	10.9	25.0	13.8
$15,000-24,999	14.7	16.7	15.1
$25,000-34,999	16.0	9.6	14.7
$35,000-49,999	15.8	2.5	13.0
$50,000-74,999	13.3	0.2	10.6
$75,000 and up	12.5	1.4	10.2
Employment			
Unemployed	8.6	8.7	8.6
Multiple workers	48.6	54.2	49.8
Tenure			
Rent	65.2	95.2	71.4
Own	34.8	4.8	28.6
Nativity			
Immigrant	19.4	33.7	22.4
Native Born	80.6	66.3	77.6
Marital Status			
Single	74.1	78.5	75.1
Married	25.9	21.5	24.9
Age			
Avg. Age	45.6	40.5	44.5
Children			
Avg Number of Children	0.6	1.3	0.7

Table 2: Logit Model Results

	(1) Unbanked=1	(2) Checking=1	(3) Savings=1
Dummy = 1 for single female headed household	0.962	1.338	1.003
	(0.13)	(0.96)	(0.01)
Dummy = 1 for single male headed household	1.439	0.548	0.715
	(0.82)	(1.82)	(1.09)
Black	4.303	0.431	0.816
	(3.66)**	(2.38)*	(1.11)
Other race	3.795	0.494	1.059
	(2.35)*	(1.41)	(0.20)
Hispanic	2.813	0.629	0.957
	(2.23)*	(1.26)	(0.20)
Educational Attainment	0.452	2.089	1.463
	(8.92)**	(9.67)**	(4.65)**
Respondent Age	0.965	1.022	1.010
	(4.83)**	(3.14)**	(1.48)
Income	0.621	1.671	1.305
	(5.76)**	(7.90)**	(5.78)**
Dummy = 1 if receives welfare benefits	1.271	0.684	0.927
	(0.73)	(1.19)	(0.21)
Dummy = 1 if receives social security	0.928	1.365	0.665
	(0.32)	(1.67)	(2.36)*
Dummy = 1 if no one in household is employed	0.899	1.554	0.966
	(0.33)	(1.48)	(0.12)
Number of Children	1.169	0.831	0.887
	(2.37)*	(2.74)**	(2.03)*
Number of Adults in HH	0.941	1.083	1.082
	(0.67)	(0.79)	(1.32)
Observations	1281	1284	1281

Absolute value of t statistics in parentheses
* significant at 5%; ** significant at 1%
Coefficients are reported as odds ratios (i.e., in exponentiated form).
Observations are weighted by the inverse sampling probability, and standard errors are adjusted for stratification and clustering.

Table 3: Reasons for not having a checking account

What are the main reasons why you do not have a checking account?

	Pct	Std. Err.
Income/Cost	**46.9%**	
Don't have enough money	34.4%	3.4%
Minimum balance is too high	6.2%	1.8%
Service charges are too high	3.5%	1.4%
Don't write enough checks to make it worthwhile	2.7%	0.9%
Motivation	**15.7%**	
Don't need/want a checking account	10.4%	1.8%
Haven't gotten around to it	5.3%	1.2%
Complexity	**12.2%**	
Can't manage/balance a checking account	9.0%	2.0%
Not sure how to open an account	2.4%	1.0%
Fees are too confusing	0.7%	0.5%
"Hard" Barriers	**14.8%**	
Credit problems	5.2%	1.7%
Not allowed to have an account	2.4%	0.6%
Don't have the proper ID/social security number	7.2%	2.2%
"Soft" Barriers	**8.8%**	
Don't like dealing with banks	6.7%	1.2%
Would not feel welcome or treated with respect	1.5%	0.7%
Not easy to speak with bank staff in my language	0.6%	0.4%
Convenience		
No bank has convenient hours or location	1.7%	0.8%

Table 4: Reasons for not having a savings account

What are the main reasons why you do not have a savings account?

	Pct.	Std. Err.
Income/Cost	**71.8%**	
Don’t have any extra money	37.5%	3.0%
Do not have the amount of money that banks require to open an account	24.2%	2.7%
Fees are too high	3.1%	0.9%
Interest rates are too low	7.1%	2.2%
Motivation	**10.3%**	
Don't need/want one	8.7%	1.1%
Prefer to have only checking account	1.6%	0.6%
Complexity		
Not sure how to open an account	0.8%	0.4%
"Hard" Barriers	**9.8%**	
Don't have proper ID/social security number	5.4%	1.4%
Bank would not let me open an account (bad credit)	4.4%	1.0%
"Soft" Barriers	**5.3%**	
Would not feel welcome or treated with respect	0.5%	0.4%
Not easy to speak with bank staff in my language	0.3%	0.3%
Friends/family would borrow savings if I had any	0.2%	0.2%
Don’t trust banks	4.3%	1.1%
Convenience	**2.1%**	
Banks are not located conveniently	1.2%	0.5%
Banks are not open when I need to use them	0.9%	0.5%

Table 5: Bank account denials

Has a bank ever denied your application for a bank account (not a loan)?

	Banked	Unbanked	Total
Yes	5.6	13.2	7.2
No	94.4	86.8	92.8
Total	100	100	100

Why was your application for a bank account denied?

	Pct.	Std Err.
Bad credit	36.0%	
Bad credit history	26.8%	4.4%
Bounced checks	9.2%	2.5%
No credit	42.9%	
No credit history	14.0%	4.0%
Insufficient identification	29.0%	6.2%
Unknown	8.3%	
Bank did not tell me why	4.0%	2.0%
Don't know	4.3%	2.2%
Other	12.7%	3.7%

Table 6: Reasons for cashing checks at banks and CCOs

Why do you prefer cashing checks at a banks rather than CCO

	Banked	**Unbanked**	**Total**
Cheaper	46.5	50.5	46.8
More Convenient	24.9	38.0	25.9
Faster, lines are shorter	2.0	4.4	2.2
More convenient location	18.6	29.2	19.4
More convenient hours	1.8	3.2	1.9
Can take care of other business at the same time	2.5	1.2	2.4
Safety/Privacy	12.0	5.0	11.5
It is safer	11.3	5.0	10.8
There is more privacy	0.8	0.0	0.7
Relationship w Bank	11.0	0.0	10.1
Direct Deposit	3.5	0.0	3.2
Habit/Accustomed to Bank	1.5	0.0	1.4
Have a relationship/account with the bank	6.0	0.0	5.5
Other	1.6	1.3	1.6
Don't Know	4.0	5.2	4.2
Total	100	100	100

Why do you prefer cashing checks at a CCO rather than Bank

	Banked	Unbanked	Total
Cheaper	8.9%	18.0%	14.7%
More Convenient	76.1%	49.2%	59.0%
Faster, lines are shorter	21.6%	8.9%	13.6%
More convenient location	40.1%	35.3%	37.0%
More convenient hours	11.9%	4.1%	6.9%
Can take care of other business at the same time	2.4%	0.9%	1.5%
Safety/Privacy	1.0%	4.0%	2.9%
It is safer	1.0%	2.6%	2.0%
There is more privacy	0.0%	1.4%	0.9%
Relationship w Bank	1.8%	14.2%	9.7%
Don't have a bank (checking) account	1.5%	10.9%	7.5%
Can't/don't want to use a bank	0.3%	3.3%	2.2%
Other	1.7%	6.9%	5.0%
Don't Know	10.5%	7.7%	8.7%
Total	100	100	100

Table 7: Acceptance of checks

How do you pay your rent?

	Households without a checking account	Households with a checking account	Total
Cash	37.0	10.3	20.2
Check	3.8	70.4	45.7
Money or	55.8	18.0	32.0
Other	3.4	1.3	2.1
Total	100	100	100

Does your landlord take checks for rent payment?

	Banked	Unbanked	Total
Yes	69.2	61.8	65.6
No	20.7	20.1	20.4
Don't Kn	10.1	18.2	14.0
Total	100	100	100

Person w checking account: why do you buy money orders?

	Pct.	Std Err
Person I wanted to give money to doesn't have a checking account	6.8%	2.0%
Person I wanted to make payment to doesn't have a checking account	19.0%	2.6%
Business I wanted to make payment to doesn't accept checks	17.6%	3.4%
I ran out of checks	6.3%	1.3%
Easier/ More convenient	15.5%	2.8%
Not enough funds/ Won't bounce	7.3%	1.3%
Doesn't have to clear	4.2%	1.0%
Widely accepted	2.7%	0.8%
Receipt/ Proof of payment	2.7%	0.9%
Preference	4.1%	0.9%
Other (SPECIFY)	13.8%	2.3%

Of the friends and family members closest to you, how many do you think have checking accounts?

	Banked	Unbanked	Total
None	2.4	8.1	3.6
Only a few	11.8	30.6	15.8
Most	26.7	29.7	27.3
All	55.3	21.7	48.2
Don't know	3.8	9.8	5.1
Total	100	100	100

Table 8: Past banking experience of the unbanked

If Unbanked: Have you ever had…

	Yes	Std Err.
a checking account	43.3%	3.2%
a savings account	39.6%	3.4%
any other kind of account at a bank	4.2%	1.4%
Percent with some previous account	51.0%	3.2%

If Yes: Why did you close your most recent bank account?

	Pct.	Std Err
Cost	48.4%	
Change in personal finances meant no longer could afford minimum balance	37.2%	4.2%
Increase in minimum balance or fees meant no longer could afford account	4.4%	1.6%
Fees too high	6.8%	3.2%
Account Management	23.0%	
Bouncing too many checks	13.5%	3.2%
Problem with the bank/Unauthorized withdrawls	6.5%	2.1%
Someone stole checks from me/Used my account	3.0%	1.6%
Location	12.0%	
Bank branch closed	1.6%	1.0%
I moved	10.4%	2.3%
Found it easier to use other financial	3.7%	1.6%
Other	12.9%	3.1%

Table 9: Use of fringe and mainstream financial institutions by banked and unbanked households

	Banked	Unbanked	Total
Did you receive any income by…			
Check	75.6	68.8	74.1
Cash	20.4	27.3	21.9
Direct Deposit/EFT	70.6	17.3	59.3
If received income by check: Did you ever cash your check at…			
Bank	84.9	30.2	71.9
Credit Union	13.2	6.4	11.6
Check Cashing Outlet	14.3	58.8	24.9
Supermarket	7.2	22.1	10.7
Other	2.9	1.3	2.5
Have you purchased a money order in the last 12 months			
Percent yes	45.6	71.5	51.1
Did you ever buy a money order at…			
Post office	43.2	25.3	37.9
Check cashing outlet	34.3	55.8	40.7
Supermarket/Convenience Store	29.5	30.7	29.9
Workplace	2.1	1.3	1.9
Bank or credit union	29.8	5.4	22.5
Western Union	10.9	8.9	10.3
Liquor Store	7.5	9.1	8.0
Have you sent money outside the US in the last 12 months			
Percent yes	14.9	21.0	16.2
Did you ever send money from…			
Bank or credit union	22.3	11.6	19.2
CCO or currency exchange	9.5	19.6	12.3
Western Union or other standalone wire service	62.5	66.9	63.8
Mail/Express Mail	9.8	7.7	9.2
Borrowing			
Have a major credit card	68.9	7.2	55.9
Have any outstanding loans or other debt	49.8	23.5	44.2
Payday loan	4.0	2.8	3.8
Pawned anything	3.8	8.7	4.8
Rent-to-own	2.0	4.2	2.5

Figure 1: Relationship between income and cost of making and receiving payments