Economist Intelligence Unit

The Economist

Social Intelligence

Banking for billions

Increasing access to financial services

BARCLAYS

Contents

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Banking for billions
This report, written by the Economist Intelligence Unit and commissioned by Barclays, examines the steps required to increase levels of financial inclusion around the world. It is based on two main strands of research: first, a series of in-depth interviews with leading experts and practitioners, and second, a programme of research into current levels of financial inclusion and efforts to improve the situation around the world. The author of the report was Sarah Murray and the editors were Rob Mitchell, Chenoa Marquis and Monica Woodley. We are grateful to the many people who have assisted with our research.

Interviewees
Jacqueline Novogratz, founder and chief executive, Acumen Fund **Elizabeth Littlefield**, chief executive officer, Consultative Group to Assist the Poor (CGAP) **Stuart Hart**, management professor and chair of the Center for Sustainable Global Enterprise, Johnson School of Business, Cornell University **Vidar Jorgensen**, president of Grameen America **Bridget van Kralingen**, microfinance initiatives, IBM **Jyrki Koskelo**, vice president for Europe, Central Asia, Latin America and the Caribbean, and global financial markets, International Finance Corporation (IFC) **Martin Holtmann**, head of microfinance, International Finance Corporation (IFC) **William Reese**, president and chief executive officer, International Youth Foundation **Julie Katzman**, general manager, Multilateral Investment Fund **Veronika Thiel**, researcher, New Economics Foundation **Kadita Tshibaka**, president and chief executive officer, Opportunity International **Mary Ellen Iskenderian**, president and chief executive officer, Women's World Banking **David Morrison**, executive secretary, United Nations Capital Development Fund (UNCDF) **Andrew Devenport**, chief executive, Youth Business International **Dr Gerhard Coetzee**, general manager, Micro Enterprise Finance, Absa

Foreword

In the many communities where Barclays does business, we have found that the most vulnerable people in society are often those who also have the most limited access to financial services. Access to banking and savings accounts, credit and insurance are essential for enabling economic activity. The critical issue is how to extend financial inclusion to more of the world's population.

Barclays commissioned the Economist Intelligence Unit to provide an overview of global access to financial services today and explore future prospects. Its findings are contained in this report. The World Bank estimates that in some countries, fewer than 10 per cent of people have access to financial services of any kind. As this report shows, the repercussions of financial exclusion are just as evident in developed countries; life is harder and more expensive for those who cannot use a bank account to manage payments, or save securely or build a credit record to get a loan at competitive rates.

At Barclays, we have focused our attention on increasing access in both developed and emerging markets. We are developing dedicated products and services, as well as working in partnership with other organisations that provide affordable alternatives, for those who cannot access mainstream financial services.

Our entry-level banking customer numbers are growing rapidly; in 2009, our customers in this category increased by 16 per cent to a total of 3.2 million accounts across Sub-Saharan Africa, including South Africa, and basic bank accounts in the UK. We are pioneering new approaches to micro-enterprise finance in South Africa, using innovative delivery models and risk management techniques to provide services to market traders and other underserved entrepreneurs.

In 2009, we committed to a global partnership with the non-governmental organisations (NGOs) CARE International and Plan International in order to accelerate access to basic financial services. This important three-year initiative aims to reach more than 500,000 people across Africa, Asia and South America and represents a £10m commitment by Barclays. The partnership combines their experience and understanding of local communities with our financial expertise.

As this research shows, efforts to increase access to financial services have succeeded in bringing many more people into the financial system, but there is still a long way to go. Further progress will require banks and other financial institutions working with NGOs and policymakers to create innovative solutions and a sustainable platform to increase financial inclusion internationally. At Barclays, we will continue to invest in initiatives to ensure that the benefits of banking reach a larger proportion of the global population.

Marcus Agius, Chairman, Barclays

Executive summary

A STRONG CONSENSUS has emerged that increased levels of financial inclusion – through the extension of credit and provision of bank accounts, savings schemes and insurance products – have the potential to reduce global poverty and nurture economic development. This is especially true at a time when technology is providing new, scalable delivery mechanisms that bypass many of the problems associated with physical financial infrastructure.

But the picture is a highly complex one. The ability to improve financial inclusion depends on the interaction of a large number of stakeholders, including the private sector, government, policymakers and non-governmental organisations. Moreover, there are numerous barriers that prevent further progress on financial inclusion, including: a lack of education; out-of-date regulation and policies; and cultural mistrust of formal financial providers.

It is clear, however, that there is a strong groundswell behind efforts to improve financial inclusion. In this report, we examine current trends and assess some of the main challenges and opportunities. Key findings include the following:

- **The cycle of exclusion is powerful and self-reinforcing**

Poverty results in financial exclusion, and financial exclusion reinforces poverty still further. The transaction costs of being excluded are often high, because individuals must pay extra fees as non-account holders. And, without access to deposit products, customers must store savings in unsecure places, increasing the risk of loss or theft. More generally, financial exclusion can prevent access to healthcare, education and employment, all of which reinforces the poverty cycle.

- **Financial inclusion is about much more than small loans**

Microcredit has helped to prove that the unbanked and underbanked can be worthy and reliable consumers of appropriate financial services. Now other needs like insurance, transactional accounts, payment services, financial education and savings are starting to be met by non-profits, governments and even commercial banks around the world. Meanwhile, savings – and a safe place to put them – are seen by many as the most critical means toward poverty alleviation and the expansion of financial inclusion. In some countries, up to 40 per cent of monthly household income is saved, but it has been estimated that up to 20 per cent of informal savings in rural Africa are lost through fire and flood.

- **Financial exclusion is a global issue**

The numbers are starkest in the developing world – the World Bank estimates that, in some countries, fewer than 10 per cent of people have access to financial services of any kind. But even in developed countries the harsh realities of exclusion are just as real. In Europe, the financially excluded range from an estimated one per cent of the population to as high as 40 per cent in Poland and 48 per cent in Latvia. In the UK, about 890,000 people are estimated to be unbanked, and in the US the figure is about 28 million.

- **Technology will bear fruit, but will also bring challenges**

Mobile telephony, smart cards and electronic transfers have already made huge inroads in banking. The need for new approaches to the provision of finance is leading innovation and helping to expand the reach of financial services and reduce costs for customers and providers. Mobile phone technology may present a lifeline to the unbanked, but it can also be a headache for regulators, who often have difficulty keeping pace with innovation.

- **The commercialisation of financial inclusion is not without controversy**

A growing number of financial institutions see the opportunity to attract new customers – albeit small-scale ones – through new products and services in developing countries. Critics fear this could lead to further exploitation of the unbanked, already a vulnerable group. Others welcome the investment, seeing any opportunity for greater financial inclusion as a good one. In the coming years, institutions will need to strike a delicate balance between profit-making and social responsibility.

- **The global economic downturn has had an impact**

As the global financial crisis began to develop, there were hopes that financial inclusion initiatives might be sheltered from the shock to the broader financial sector. But it is now clear that credit and funding risks now loom large for the microfinance sector too. One result may be a greater emphasis on savings rather than credit. But the main effect of the crisis may be that policymakers are spurred to increase their efforts to promote financial inclusion.

- **Policymakers need to tread lightly**

Policy measures to increase financial inclusion can have a powerful effect, but must be considered carefully in order to prevent counterproductive outcomes. Policymakers' most important roles will be to: create and empower the institutions and legal systems that support financial services and protect consumers; collect information; and promote competition.

Gurah, eastern Kenya, where the mobile phone is proving a popular way to access banking services

Introduction

The ability to open a bank account or take out a loan is something that many people take for granted, yet almost three billion people in developing countries have little or no access to formal financial services. Globally, the gap remains large too – on average, only about 26 per cent of the world's population has access to formal financial services, according to the World Bank. The big question for policymakers and institutions is how to extend financial inclusion to the other 74 per cent.

Governments and policymakers now broadly consider access to savings accounts, credit and insurance facilities to be critical to the health of a society and essential for the expansion of economic opportunity.

For the purposes of this paper, financial inclusion is defined as the ability to access transactional accounts, savings accounts, loans and insurance in order to participate in the economy.

However, while most people think of the financially excluded as existing purely within the informal sector (economic activity that is neither taxed nor monitored by a government and is not included in that government's gross national product) this does not tell the whole story. Millions of factory employees work on payroll but have no access to banking and still get their wages in cash.

Informal channels are also associated with extortionate loan rates, barriers to saving and a lack of protection against unforeseen calamities such as fire, theft, illness or a death in the family. In addition, they can deny individuals the opportunity to make meaningful improvements to their livelihoods through small business or other investments.

Many stakeholders believe that technology will play a vital role in expanding financial inclusion worldwide. Technology will certainly be an important factor, particularly in regions such as Africa, where mobile telephone penetration has expanded more rapidly than physical banking infrastructure. Mobile banking has also proved successful in countries such as the Philippines and South Korea. It is highly unlikely, however, to be a panacea, as access to transaction services does not equate to access to full banking services.

In this report, we examine the financial inclusion story as it now stands, both in developing and developed countries. We then look at examples of initiatives designed to address the problem from around the world, and assess the most promising approaches from both the private and public sectors. Finally, we consider what the next wave of innovations in targeting exclusion might bring.


SECURITY CARD
ENTER PIN
OPEN
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1.

The problem: in both high and low income countries, not having access to savings accounts and loans stifles business and exacerbates hardship

who are the financially excluded?

FINANCIAL EXCLUSION AND POVERTY are linked in a self-reinforcing cycle. Individuals who work in the informal sector have incomes that are often unpredictable and unreliable. Even a small crisis, such as injury or illness, can quickly lead to significant financial problems. Debts escalate and may be serviceable only by selling household possessions or paying extortionate interest rates charged by illegal or unofficial lenders. "In times of crisis – such as the current global economic downturn, or when global food prices spiked – borrowers often have to make the choice between putting food on the table and repaying the loan," says Mary Ellen Iskenderian, president and chief executive of Women's World Banking. "Often, they will choose to repay the loan because access to capital is still so constrained and they have so few options." The need to repay lenders reinforces poverty because, in many cases, borrowers will be forced to sell vital assets, such as the family business, just to generate cash for the loan.

The unbanked will often find it more difficult to access other services, such as healthcare, education and even employment. This leaves them without access to the tools and opportunities that are necessary to pull themselves out of poverty and become part of the real economy. "The impact is tremendous when it comes to just the basics of life," says Kadita Tshibaka, president and chief executive of Opportunity International, one of the world's largest and longest established networks of microfinance institutions. "We're talking about being able to feed oneself, send children to school, have shelter, have affordable healthcare – everyday needs depend on financial inclusion."

These are not issues that are exclusive to developing countries. In Western economies, where food and shelter are often taken for granted, life is much harder and more expensive for individuals without access to formal financial services. "The problem with poverty is that it takes up all your time," says Vidar Jorgensen, president of Grameen America, a non-profit microfinance organisation. "When you don't have a cheque account, you have to do a lot of running around just to make payments."

Moreover, payments that are not made through traditional means can often be more expensive, which again reinforces the cycle of poverty. "There's an annual poverty premium of about £1,000 in the UK," says Veronika Thiel, a researcher in the Access to Finance team at the New Economics Foundation, a think-tank. "Everything becomes more expensive if you don't have a bank account."

The lack of a bank account can even hinder employment prospects. Some companies may be reluctant to take on an individual to whom they cannot make automated credits because they will have to make complex alternative arrangements for payment of their salary. Perhaps less overtly, companies may also be suspicious of employees who lack access to banking services.

£1,000

The estimated additional annual costs for UK individuals without a bank account

CASE STUDY

gender and exclusion

FINANCIAL EXCLUSION RATES are generally higher for women than for men. In Zambia, for example, 68.4 per cent of women are financially excluded compared with 64.4 per cent of men, according to FinScope, a survey of financial inclusion conducted by the FinMark Trust. Efforts to improve financial inclusion, for example through the provision of microfinance, have often been targeted at women. The fact that one of the world's leading microfinance institutions is called Women's World Banking is symbolic of the role that gender plays in financial exclusion – it is estimated that women make up some 80 per cent of the world's microfinance clientele.

In many countries, the financial exclusion of women has been enshrined in law. Regulations such as those that bar a woman from opening a bank account without her husband's permission were once commonplace. "In the mid-1980s, we saw a lot of countries, particularly those colonised by the French, moving away from Napoleonic law under which women were considered in the same categories as minorities and the mentally distressed," explains Jacqueline Novogratz, founder and chief executive of Acumen Fund, a New York-based non-profit venture fund that uses entrepreneurial approaches to tackle global poverty. "That has changed from a structural perspective quite radically throughout the world." Today, many of these regulations have been altered, but this historical precedent has left a legacy of gender-skewed exclusion.

Even more problematically, some restrictions persist. In some African countries, women have no formal property rights and are barred from having land titles. This gives them no collateral with which to secure a bank loan; if their husband signs for the loan on their behalf, their autonomy may be curtailed. Moreover, many cultural and family restrictions remain in place. In Malawi, for example, a wife whose husband dies has to surrender her possessions – including all financial assets – to his family.

"It's a tangle of issues when you talk about women's economic empowerment," says the WWB's Ms Iskenderian. "For example, savings are quite often a positive force in women's lives. However, it's not just about the finances or economics – there's a whole set of other things." To illustrate this point, she cites the example of women who take out micro-loans with a compulsory savings component attached to the account. This can create problems for women when their husbands get wind of the savings. "He would force, often with physical violence, the women to withdraw the savings and pay down the balance rather than continuing to save," she says.

In some countries, it remains difficult or culturally unacceptable for a woman to work, let alone to take out a loan and start a business. "In some cultures, women aren't expected to leave the household," says Ms Novogratz. "So you might have perfect regulation at the financial institution level, but need a different way of accessing those women who aren't able to walk through the streets."

Boarded-up houses in Detroit, USA, showing that financial exclusion is an issue in the West and not just the developing world

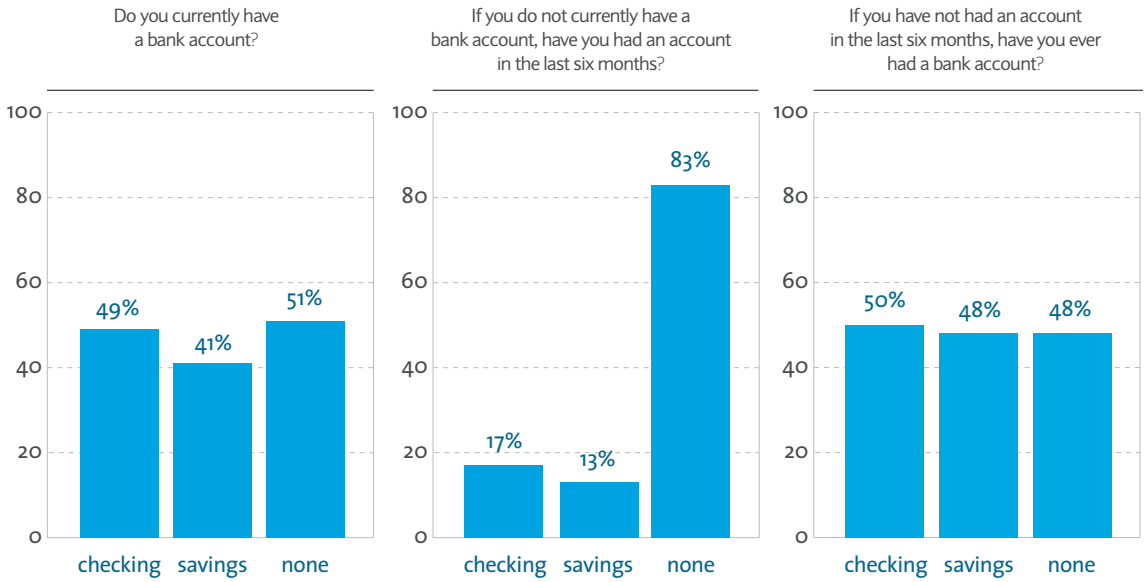
where are the financially excluded?

WHILE THE HIGHEST PROPORTION of the unbanked live in the world's poorer countries, financial exclusion is also a widespread problem in more developed economies. The financial crisis has exacerbated this situation, as many households have found themselves unable to refinance their mortgages or access loans to buy household goods. "Our customers are excluded all the time, regardless of the credit crunch – this is business as usual for them," says Grameen America's Mr Jorgensen. Many of the US's unbanked individuals, he adds, are part of migrant communities: "To get a loan in this country, you need income and collateral, and our customers have neither regular income nor collateral." Immigrant status, demographic divides such as age, and economic and employment status, all contribute to the problem.

And while the rate of access to financial services may be considerably higher in developed countries, many households remain underbanked – that is, lacking an account at a mainstream financial institution, or using a combination of mainstream banks and other service providers, such as cheque cashers and payday lenders.

One problem often encountered in attempts to assess the scope of the problem is that estimates of the numbers of financially excluded are not consistent. In the US, some 106 million individuals are underbanked, according to the Center for Financial Services Innovation (see chart below). However, the Federal Deposit Insurance Corporation, which protects deposits in US bank accounts, estimates that there are 28 million unbanked and 45 million underbanked people in the US.

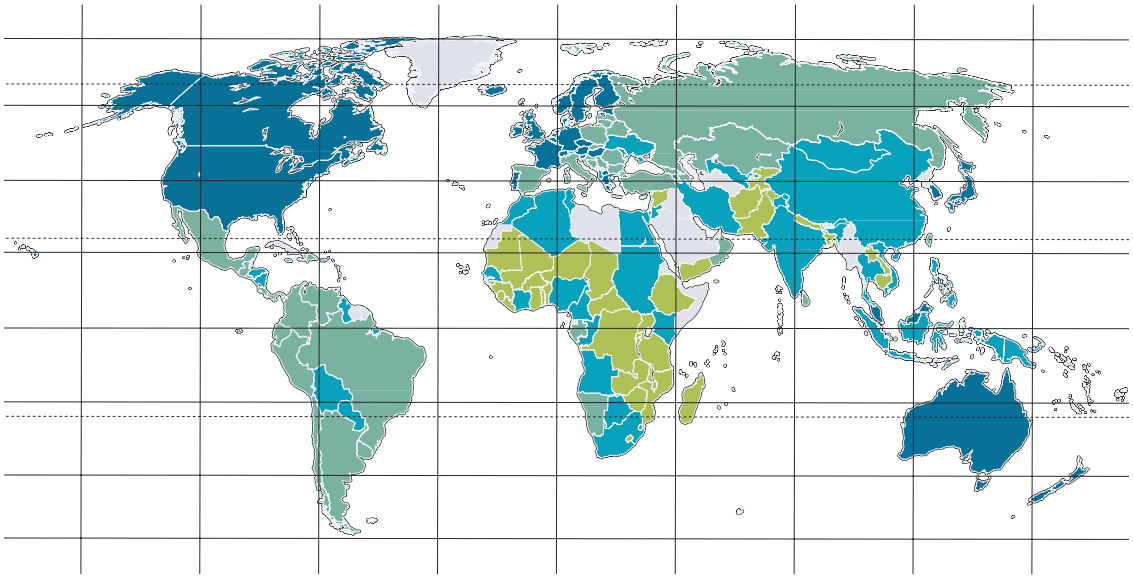
Bank account ownership
a survey of underbanked adults in the US



Source: 'The CSFI underbanked consumer study: Underbanked consumer overview and market segments fact sheet,' CSFI, June 2008

Global access to credit

the number of bank loans in a country correlates to economic development



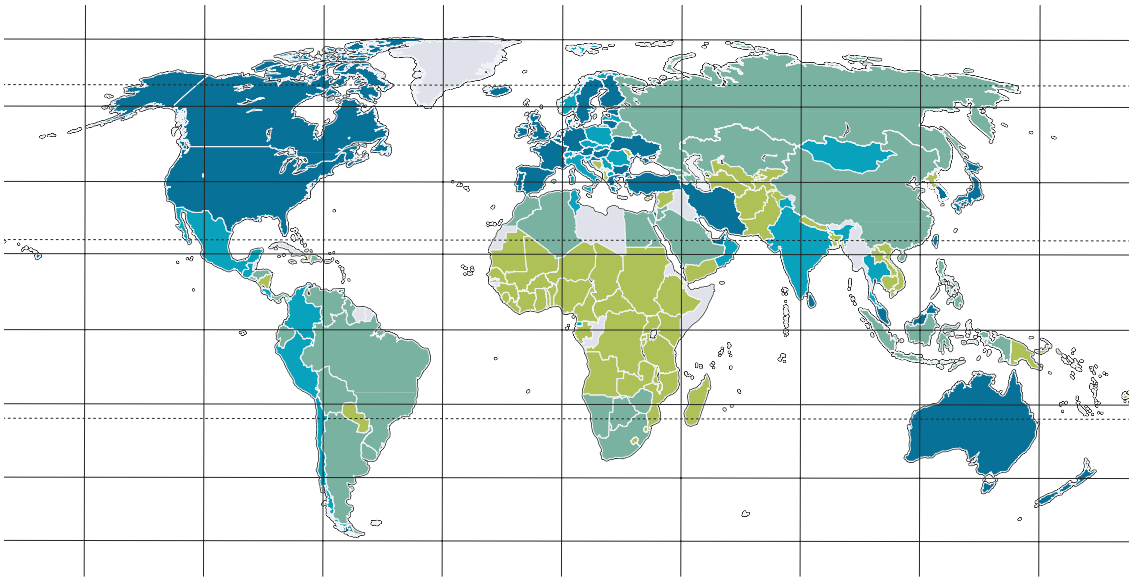
bank loans
per 1,000 adults

- 50.0 or fewer
- 50.1- 300.0
- 300.0 - 800.0
- 800.0 or more
- No data

Source: Consultative Group to Assist the Poor (CGAP)

Global access to savings

the number of deposit accounts in a country correlates to economic stability



deposit accounts
per 1,000 adults

- 500.0 or fewer
- 500.1- 1,000.0
- 1,000.1 - 2,000.0
- 2,000.1 or more
- No data

Source: CGAP

Seven countries have fewer than 100 deposit accounts per 1,000 adults

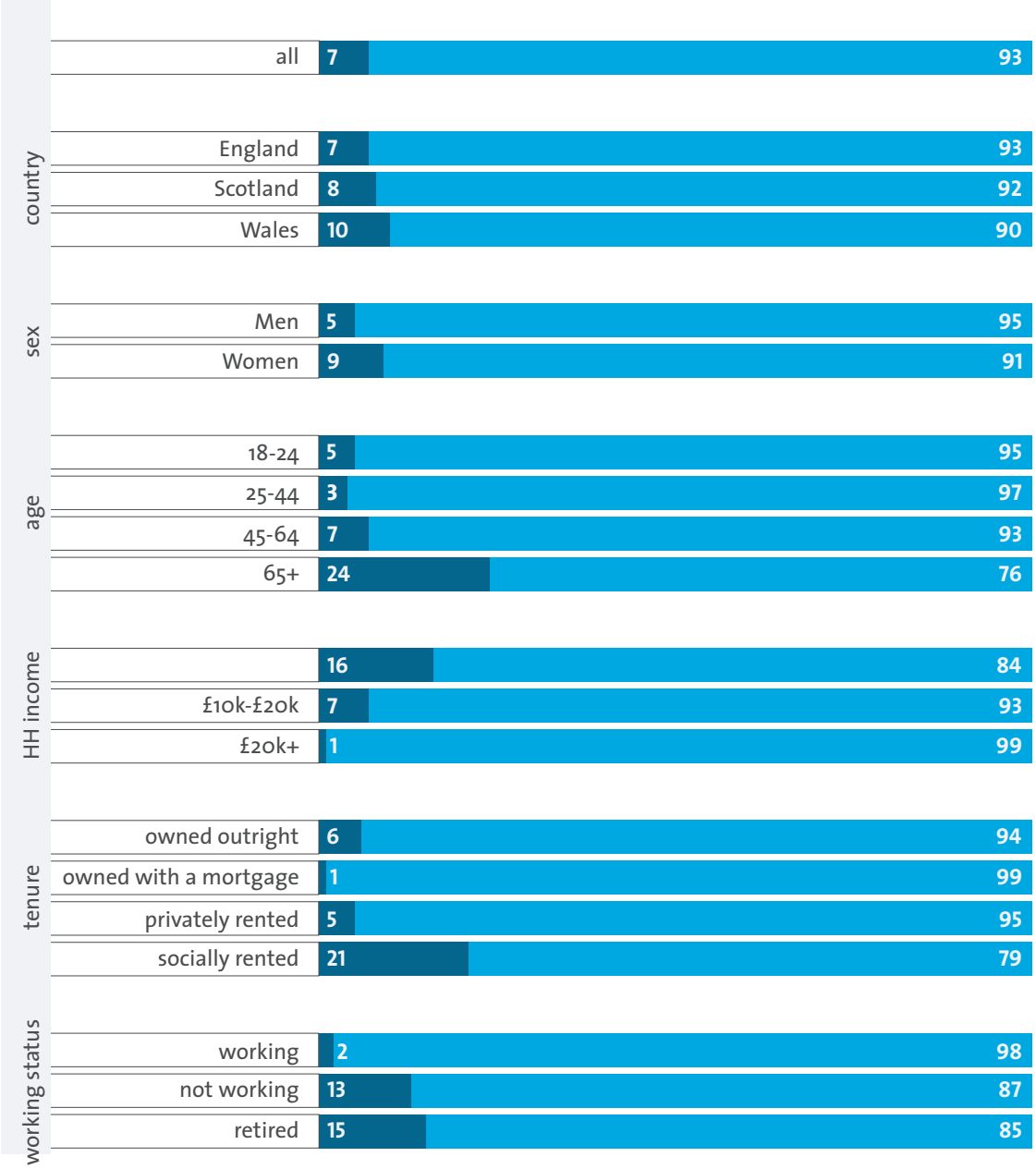
[1] 'The CSFI underbanked consumer study: Underbanked consumer overview and market segments fact sheet,' CSFI, June 2008

[2] *Financial Services Provision and Prevention of Financial Exclusion*, European Commission, Directorate-General for Employment, Social Affairs and Equal Opportunities; *Inclusion, Social Policy Aspects of Migration, Streamlining of Social Policies*, March 2008

Across Europe, the figures vary widely by country, with financial exclusion applying to one per cent or less in Denmark, Belgium, Luxembourg, and the Netherlands while in Poland, the figure is 40 per cent and in Latvia, 48 per cent, according to the European Commission. In the UK, the extent of the problem is such that the government launched a Financial Inclusion Task Force in 2005, which is charged with monitoring government progress and making recommendations. The following charts show the breakdown of the banked by demographics and also explain the reasons behind individuals' unbanked status. In October 2007, the government renewed its commitment to the issue with a new Financial Inclusion Fund of £130m to cover the period between 2008 and 2011.

Banked status

marginally banked/fully banked status by various demographic subgroups in the UK (%)



key

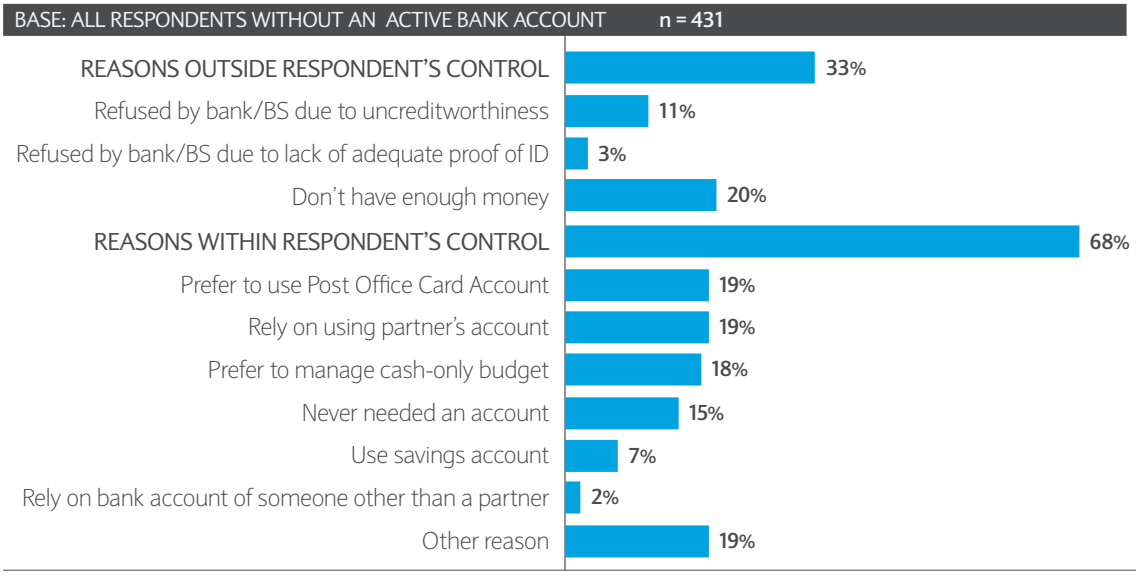
Marginally banked

Fully banked

Source: 'Access to financial services by those on the margins of banking,' British Market Research Bureau (BMRB), 2006

Underbanking causes

reasons behind unbanked individual status in the UK



The Treasury-sponsored UK Financial Inclusion Taskforce is trying to reach two groups it has identified as marginally banked: individuals who do not own (either solely or jointly with a partner) a current account or basic bank account (although they may have a post office card account or a savings account) and households in which a bank account is not available, or is not used for day-to-day money management.

The taskforce's fourth annual report, published in December 2009, found that about 890,000 individuals in 690,000 households do not have access to a bank account of any kind, down from 2.1 million individuals in 1.4 million households the year before. This sharp reduction may be as much to do with the way the taskforce counts the unbanked as any actual reduction. Whereas previous surveys included people who did not state whether they had a bank account or not, the most recent survey only counted those who positively affirmed they did not have an account. When respondents who did not state whether they had an account were included, the number of unbanked was 1.85 million, rather than 890,000.

Meanwhile, the Financial Inclusion Centre, a British think-tank, estimates that more than five million households are seriously affected by financial exclusion, and two million people are unbanked[4]. In developing countries, the proportion of financially excluded rises dramatically. The World Bank estimates that in some countries fewer than 10 per cent of people have access to formal financial services. In Cambodia the figure is 20 per cent, in Ghana 16 per cent, in Nicaragua and Tanzania just 5 per cent.

Despite economic progress in many of these regions, financial inclusion remains unevenly spread. The difference in the extent of financial inclusion between developing countries can be striking. Some African countries have relatively high rates of inclusion: for example, 47 per cent of the population of Botswana and 39 per cent of Gabon has access to financial services, while the figure for South Africa is 63 per cent – a considerably higher proportion than in many other Sub-Saharan countries.

Financial exclusion is unevenly spread within countries as well. There tends to be a significant rural-urban divide, with financial institutions facing a significant challenge in reaching remote rural populations. The distinction between the formal and informal economies can often be somewhat blurred. For example, some workers may be employed on lawful terms but be paid in cash without formal payslips or proof of income.

Levels of financial exclusion also tend to increase with age. Governments facing ageing populations must ensure that older age groups continue to have access to financial products that are appropriate for their stage in life. One problem is that financial products can exclude the over-50s, many of whom remain active for far longer than their parents did. Another issue is that an expanding population of older people will include more individuals with physical and cognitive difficulties, making it harder for them to access some financial products.

A recent report by Age Concern[5], a UK charity, identifies a number of obstacles that may prevent people from buying the types of financial products that will suit their needs in later life. These include technological and cultural barriers for those who may be wary of buying financial products over the internet, and financial barriers such as high premiums for individuals over a certain age.

Some older people also face physical barriers that restrict access to financial services, such as when branch visits are required. The UK's Financial Inclusion Task Force found that 10 per cent of people over the age of 65 were likely to find it difficult to use ATM machines, compared with just one per cent of 16-24-year-olds.

[3] *Access to Financial Services by those on the Margins of Banking*, prepared for the Financial Inclusion Taskforce by BMRB Social Research, November 2006

[4] *Financial Inclusion: The Way Forward*. HM Treasury, March 2007

[5] *An Inclusive Approach to Financial Products*, Age Concern, 2009

what prevents financial inclusion?

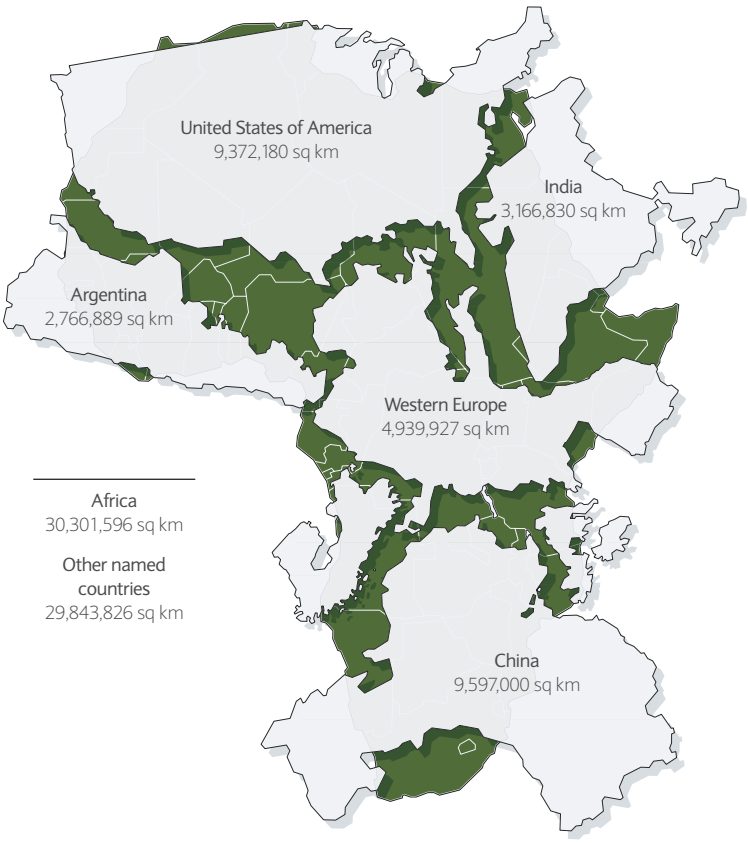
THE IMAGE OF THE FINANCIALLY excluded as poor individuals living on one or two dollars a day who are forced to keep their money under a mattress and borrow from loan sharks is a vastly oversimplified one. The factors behind the inability to access formal financial services are not always obvious.

"One simple but widespread problem is lack of an ID because [at a minimum] it's what you need to have a bank account," says David Morrison, executive director of the United Nations Capital Development Fund (UNCDF), which invests in the world's least developed countries. In many developed countries, where it's routine to present a driver's licence for something as simple as opening an account at a video rental store, the value of that ID is often taken for granted.

Geography is also an issue. Not all topographies lend themselves to the development of traditional banking systems, leaving their populations underserved when it comes to financial products. "We are investing in research in the South Pacific because there you have small island states where traditional banking models don't make sense," says Mr Morrison.

The vastness of africa

reaching Africa's remote populations is the challenge



Not all topographies lend themselves to the development of traditional banking

1 in 3,000

When the war ended in the Democratic Republic of Congo, there were 20,000 bank accounts among 60m people. Two years later there are still only 200,000

Dr Gerhard Coetzee, general manager of Micro Enterprise Finance at Absa (majority owned by Barclays), agrees. "Africa is one of the continents on which it's most expensive to serve microfinance clients because of the reality of the continent – basically, the main cost is geography," he says. The situation is different in countries such as Bangladesh and India, Dr Coetzee says, because the population density is higher: "No one will argue that the methodologies of Asia won't work in Africa because we've seen them working in Africa – but the interesting thing is we've never built up to the numbers in the institutions in Africa that you have in Asia." Grameen has eight million clients in Bangladesh, while Equity Bank in Kenya – perhaps the best-subscribed in Africa, according to Dr Coetzee – has three million.

Displaced people, whether as a result of war or natural catastrophes, constitute large populations for whom access to formal financial services is lacking. Over the last decade, aid agencies have moved away from treating refugees as dependants and focused on fostering self-sufficiency among these communities – so finding ways to give them access to the financial tools to support that self-sufficiency has been a challenge.

Unexpected disruptions to banking services, such as natural disaster or war, can mean a sudden and sometimes protracted shift in personal circumstances. Roughly half of the UNCDF's client countries are post-conflict states – particularly in Africa – in which formal systems have partially or entirely collapsed. Mr Tshibaka points to the conflict in Darfur, which caused the displacement of more than one million people, as a prime example.

The crippling effects of war on the availability of even basic banking services linger long after the conflict is over, as has been shown in the Democratic Republic of Congo (DRC). "Two years ago when the war ended there was a population of 60m in DRC, but only 20,000 formal bank accounts, of which 10,000 were dormant," says Jyrki Koskelo, vice president for Europe, Central Asia, Latin America and the Caribbean, and global financial markets, at the International Finance Corporation (IFC), an investment arm of the World Bank. "Today, while the market has grown at a very fast rate to 200,000 bank accounts, this still leaves most people in the country financially excluded."

Transient or migrant populations also represent a significant proportion of the financially excluded. Rural dwellers in developing countries who come to cities to find work on a temporary basis are highly unlikely to benefit from formal financial services, and the itinerant nature of their lifestyle makes it difficult for them to have consistent access to basic services, such as current accounts and savings.

Meanwhile, in more developed economies, migrant workers, illegal or recent immigrants and asylum seekers often operate outside formal economic systems, effectively barring them from access to formal financial services. In some countries, these populations are growing. In the US, for example, between 1970 and 2007 the foreign-born population rose from 9.6 million to 38.1 million, with immigrants from Latin America and the Caribbean accounting for more than half of this population (54 per cent) compared with 18 per cent in 1970.[6]

"There are recent immigrants who largely don't trust their banks, or people who have misused bank accounts intentionally or unintentionally and are no longer allowed them," says Mr Jorgensen of Grameen America. Language can also be a barrier. "It's not just people putting money under mattresses and it's not just driven by interest rates," says Ms Novogratz. "It's also driven culturally, by people not feeling comfortable even walking through the doors of a bank."

[6] *Immigrants and the Current Economic Crisis: Research Evidence, Policy Challenge and Implications*, Migration Policy Institute, January 2009

2.

Towards a solution: banks are finding new ways to connect with customers, using mobile technology, micro-investment models and branchless banking.

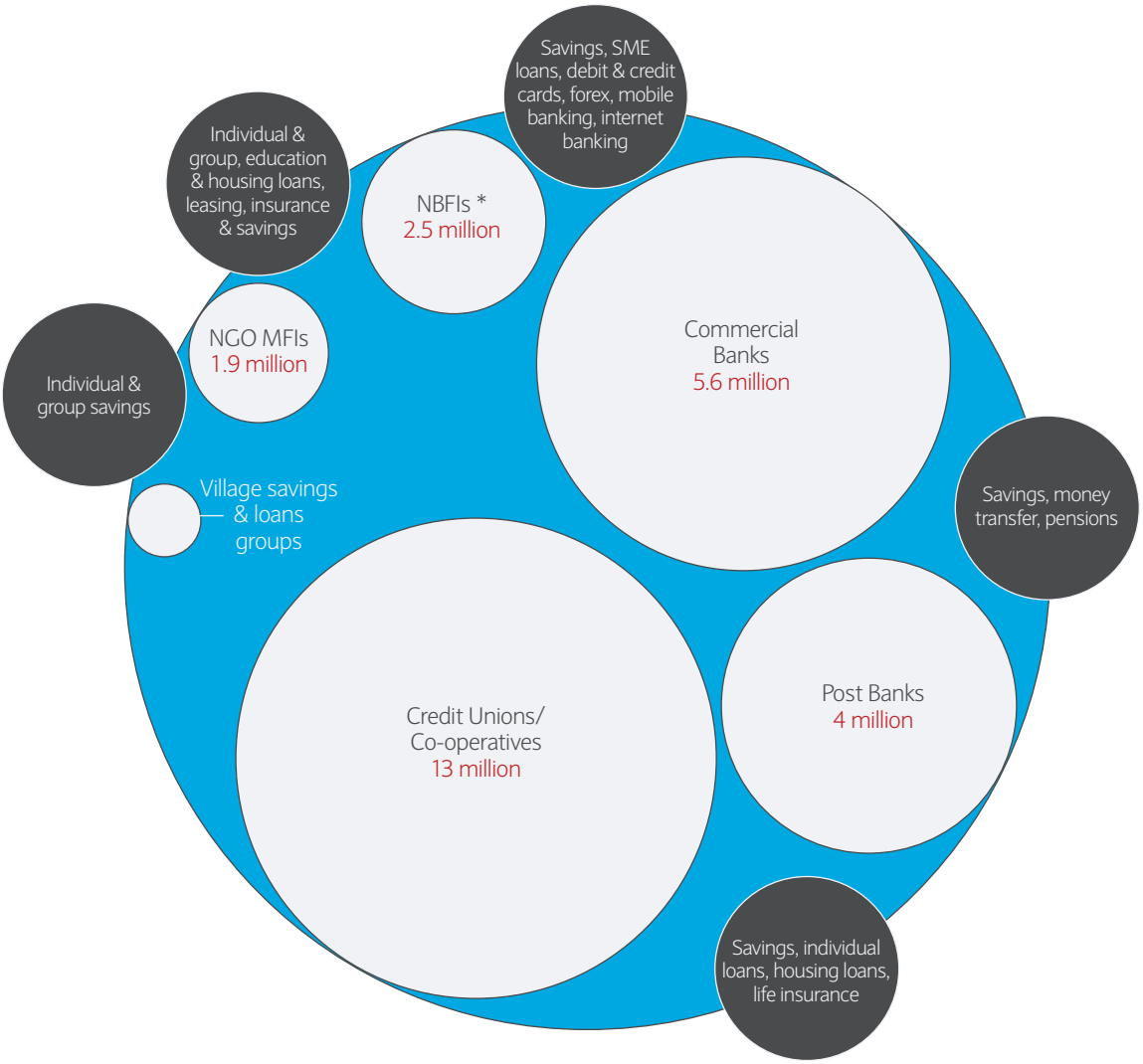
EFFORTS HAVE LONG been made to address financial exclusion in developing countries. From the 1950s, subsidised credit programmes run by agricultural development banks made loans targeted at specific communities, but these were not without their problems. Repayment rates were usually low and many of the funds found their way to more affluent farmers, rather than to the very poor.

In the 1970s, Muhammad Yunus, a Bangladeshi banker and economist, started looking for a more practical way to help the poor. He made his first transaction in 1976, lending US$27 to a group of 42 villagers who needed to buy raw materials for the bamboo stools they made and sold.

He found that by giving loans to groups of borrowers he could ensure very low default rates, by holding the whole group collectively responsible for the loan. Whenever one individual was unable to make a repayment, the others in the groups would make up the shortfall. But this rarely happened because each individual felt a strong obligation to the group and would consequently make every effort to repay their share.

Banking in Africa

providers of finance to low-income categories by number of African clients (at 2006)



Source: 'Diagnostic to action: Microfinance in Africa', Africa Microfinance Action Forum, 2007.

* Note: NBFIs are non-bank financial institutions

Today, the microfinance industry is a global movement whose institutions serve about 80 milllion people in developing countries, according to the World Bank. While micro-loans were traditionally offered by non-profit, non-governmental organisations (NGOs), commercial banks are now exploring possible opportunities for microfinance offerings, as seen in the chart opposite, illustrating the different providers of microfinance in Africa.

The commercialisation of microfinance, however, is not without controversy. In 2007, Compartamos, Mexico's biggest microfinance bank, launched a hugely successful initial public offering that divided the microfinance community. Critics said that the bank, which was charging interest rates of at least 79 per cent a year, was no better than a moneylender profiting from the poor. Others argue that evidence of commercial success will encourage more enterprises to enter the business of lending to the financially excluded, and that this free market approach will increase financial inclusion more quickly than if improvement efforts were left entirely in the hands of the non-profit sector.

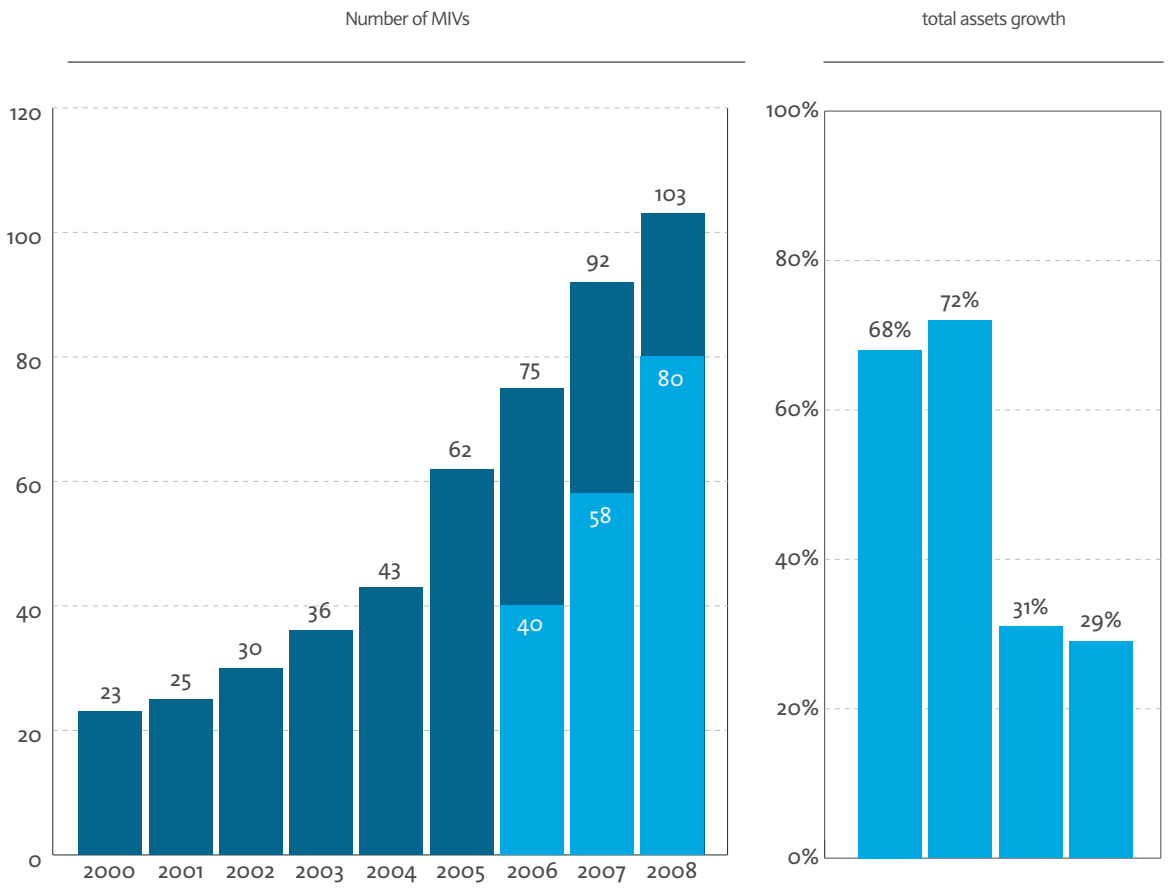
Microfinance investment vehicles (MIVs) are perhaps the more acceptable side of the commercialisation of microfinance, and they have seen huge growth over the past few years. MIVs are investment vehicles focused on investing in microfinance. They provide returns to investors and are independent of the MFIs they fund. According to CGAP's 2009 MIVs Survey[1], institutional investors, foundations, NGOs and networks comprise 42 per cent of MIV investors, followed by retail investors at 34 per cent, public investors at 21 per cent and other MIVs at 3 per cent. The survey predicted that performance of MIVs would drop below 3.5 per cent by the end of 2009.

However, the number of MIVs and their total assets has continued to grow strongly. They grew by 31 per cent in 2008, much slower than the 72 per cent growth of 2007, but still impressive considering the overall economic picture. Foreign capital investments in microfinance passed the US$10bn mark in December 2008, with more than half of this managed by MIVs. The survey found that MIVs continued to grow at an annualised rate of 16 per cent during the first half of 2009 and there were very few fund redemptions as a result of the crisis.

[1] *MIV Performance and Prospects: Highlights from the CGAP 2009 MIV Benchmark Survey*, CGAP September 2009

Growth of microfinance investment vehicles

MIVs have continued to show strong returns despite the effects of the global recession



Source: *MIV Performance and Prospects*, CGAP September 2009

beyond credit

MICROCREDIT IS JUST one piece of the broader financial inclusion puzzle. Increasingly, governments, donor organisations and others are recognising that a range of financial products – including current accounts, savings accounts and insurance policies – is also critical to promoting social and economic welfare. This requires the participation of a whole range of stakeholders, from private sector banks and the providers of general business infrastructure to governments and policymakers.

Many innovative products are now emerging. In India, ICICI Bank offers insurance products to low-income and rural customers that include health and weather insurance, while in Malawi, Opportunity International has developed a weather-indexed insurance product in partnership with the World Bank. This type of insurance mitigates the devastating consequences of drought or excess rain and also helps farmers to access credit, as banks that might have been unwilling to lend to "risky" customers (farmers who would not be able to make repayments if a drought destroyed their crops, for example) now see these borrowers as creditworthy.

Microinsurance is a risk transfer device characterised by low premiums and low coverage limits, and designed for low-income people not served by typical social or commercial insurance schemes. Its ultimate goal, as outlined in 2008 research conducted by FinMark Trust, is "to enable the poor to mitigate their material risk through the insurance market in order to reduce vulnerability." A case study in Colombia, where microinsurance is distributed mainly through two large co-operatives, La Equidad and Solidaria, shows that non-traditional channels can be much more effective than the conventional broker-agent model at offering coverage in areas where there has previously been little or no penetration. Between them, the two co-operatives account for 62 per cent of the country's formal microinsurance market.

Uganda presents a special problem for financial inclusion, as the bulk of its population still inhabits rural areas and lives in extreme poverty. The 2006 FinScope country survey found that more Ugandan adults used microinsurance than traditional insurance (4.6 per cent, against 3 per cent), suggesting that microinsurance products may be better suited to the needs of the population. The FinScope report observes that a major stumbling block to increasing the penetration of insurance products into lower-income brackets is simply that the opportunity cost of channelling disposable income into insurance products remains too high to make it viable for the very poor, even with the introduction of microinsurance.

Still, savings accounts are what many believe will be most critical to poverty alleviation and the expansion of financial inclusion. "We've definitively proven the poor can be banked and can repay," says WWB's Ms Iskenderian. "But the poor also save and, in many of the countries in which we work, up to 40 per cent of monthly household income is saved. So having a safe place to save is a tremendous need on the part of low-income populations."

In the absence of deposit accounts, individuals are forced to keep savings in insecure places and risk losing them to theft or disaster. Some would-be savers may be inclined instead to purchase a tangible asset, such as a cow. The trouble with such assets, however, is that their owners may have trouble selling them or have to sell them at a loss at the time when money is needed.

There is a huge appetite among poor populations for secure savings and related financial products. Having savings boosts people's confidence and offers them comfort. Several studies have indicated that ownership of assets has more beneficial effects than income levels – including on wealth, health, and political participation. Mr Morrison, of the UNCDF, says that savings are the product in highest demand when peace breaks out after conflict.

However, the demand has largely gone unmet. Saving has often been described as the "forgotten half" of microfinance. There are several barriers to offering savings services, not least the substantial operational costs involved in managing a large number of small savings transactions to which depositors want easy access. Regulation is much stricter for organisations taking deposits, to ensure depositors' money is kept safe. And initiatives are limited by the costs and other challenges of reaching customers. In Malawi, for example, Opportunity International has a fleet of five armoured trucks to take banking services to rural poor.

Such challenges have led to the increasing popularity of community-managed services. Recognising that most MFIs tended to emphasise credit and were not licensed to take deposits, VSL (Village Savings and Loan) Associations tried a different approach. Rather than expose customers to credit risks, they intermediate small local pools of capital to satisfy the cash management needs of individual households. The savings created can then be used to offer small loans, providing communities that previously were financially excluded with a first step from using more risky informal savings mechanisms to more formal financial services. The model was launched by aid agency CARE International in Niger in 1991, and is now being used by almost one million participants in Africa, Latin America and Asia.

Meanwhile, some microcredit institutions, including Bank Rakyat Indonesia (BRI), have conducted market research on the demand for savings, which has enabled them to build popular products. At BRI's local banking system, there were about six times as many deposit accounts as loans in 1997; at its Bank Dagang Bali, the ratio was 30 to 1[2]. Meanwhile, the more it learned about its customers' saving needs, the more BRI itself benefited. Between 1973 and 1983, the bank's first 10 years of operation, it mobilised US$17.6m; between 1984 and 1996 it mobilised US$3bn.

CASE STUDY

employment first

THERE ARE THOSE for whom microfinance is not an option, since a prerequisite for access to even the most basic financial services is access to some kind of regular income. This group is on the lowest rung on the poverty ladder. "The excitement around microfinance has enabled governments to feel that all they need to do is stimulate microfinance and be done with the problem," says Elizabeth Littlefield, chief executive of the Consultative Group to Assist the Poor (CGAP), an independent policy and research centre housed at the World Bank and dedicated to advancing financial access for the world's poor. "That leaves out one billion people," she says. To reach those people, CGAP is experimenting with a graduation methodology first developed by BRAC, a Bangladeshi microfinance organisation. The BRAC programme has "graduated" 800,000 households from safety-net schemes to microenterprises since the programme launched in 2004.

CGAP asks villagers to identify groups of women they deem the poorest in their community and then provides them with grants for current income (such as a chicken) and an asset (perhaps a goat that can produce baby goats, which can be sold) plus training in how to manage those assets, save money and eventually apply for a loan from microfinance institutions. "This kind of programme is new and pretty heretical, because the whole microfinance industry was built on commercial principles of not giving anything away," says Ms Littlefield. "But finance and financial services don't tend to create economic opportunity so much as grow what already exists."

William Reese agrees. As president and chief executive of the International Youth Foundation, which works to strengthen education, health and work prospects for children and young people, he argues that financial inclusion should be extended to more young people. But 15- to 25-year-olds tend to be unemployed (at two or three times the rate of adults over 25) which means first helping them find a source of income that generates the cash to be banked. "The challenge is how to get more young people into some sort of sustainable employment," he says. "Financial services and financial literacy are very important for all people, but they are a function of whether or not you have the money to manage."

Mr Reese's comment refers to young people, but carries a broader point – that financial products, even informal ones, are not everything. It can be argued that a steady, reliable income or job needs to come before a bank account and that, in some communities, lending schemes are getting ahead of themselves by developing banking options before supporting more employment opportunities.

CGAP provides rural Bangladeshi women with grants in a microfinance scheme aimed at people on the lowest rung on the poverty ladder

technology: making critical connections

THE RAPID DEVELOPMENT and adoption of mobile phone technology in developing countries has vastly outpaced the implementation of costly landline infrastructure. As a result, other industries are now looking to mobile telephony to help leapfrog other types of infrastructure-intensive systems such as bank branch networks. In Kenya, for example, the M-Pesa mobile money transfer service means users can deposit cash through their mobile phones and send money to other mobile users by text message. The system works through airtime resellers, who, in addition to taking cash to top up mobile phones, can also load them with cash value. This can be transferred to another user, used to pay for goods or reconverted into cash by the airtime agent at another time.

In South Africa, Wizzit has rolled out a successful model through which money is deposited into a savings or transmission account; the money can then, via a mobile phone banking facility, be transferred to others or used to buy airtime. Clients receive a linked debit card supported by the MasterCard system, which can be used almost anywhere to draw money or pay for goods and services. While Wizzit serves mainstream customers, microfinance specialists see this as another possible way of extending banking services to clients who are more remote. The chart below explains the different uses of Wizzit.

Mobile banking in South Africa

how Wizzit users conduct banking and payment transactions, per month

	Total	Buy Airtime	Balance Inquiry	Cash Withdrawal	Cash Deposit	Money Transfers	Pay Electricity	Mini-Statement	Pay Store Accounts	Electronic Bank Transfer	Set up Debit Order	Set up Stop Order	Cheque Deposit
ALL BANKING TRANSACTIONS	12.8	3.7	2.7	1.7	0.8	0.8	0.7	0.7	0.5	0.4	0.4	0.2	0.1
TRANSACTIONS USING WIZZIT (ALL CHANNELS)	9.3	2.6	1.9	1.3	0.7	0.5	0.5	0.5	0.5	0.4	0.3	0.1	0.1
TRANSACTIONS USING WIZZIT (MOBILE PHONES)	6.6	2.6	1.9	0.1	0.1	0.5	0.4	0.4	0.2	0.2	0.2	0.1	0.0

Note: Figures based on average number of transactions of each type conducted monthly, weighted by the number of users who say they conduct them. Not all users conduct all types of transactions. The "average basket" should be viewed as the mean usage among surveyed users, rather than a profile of a typical Wizzit user. Row two shows all transactions via all Wizzit channels, including mobile phone, ATM and partner bank branches. Row three shows only Wizzit transactions conducted via mobile phone. Source: Ivatury and Pickens (2006)

Mobile phones are just one of many technologies now emerging that could give the financially excluded more effective methods to manage their money. Smart cards and other forms of cashless transaction devices are being seen by policymakers and non-profit organisations as cost-effective ways to broaden the reach of financial transaction services. In the Maldives, for example, CGAP is working with the government to spread the use of debit cards for payments in a country made up of hundreds of small islands, where fishermen have to get on a boat just to reach a physical bank branch and teller to cash cheques or deposit money.

Opportunity International uses biometric technology in its services, which means that no identification documentation is necessary to open an account. This assists illiterate people by eliminating the need for form filling while protecting against fraud. In Malawi, for example, where tradition demands that a widow has to surrender all her possessions to her dead husband's family, biometric fingerprint readers make it more difficult for relatives to withdraw funds from the widow's bank account.

These and similar technology solutions are seen by many experts as a huge opportunity to accelerate the expansion of financial inclusion, particularly to remote and rural areas. Certainly, the concept has already proved highly successful in many countries, including the Philippines, South Korea and African countries such as South Africa, Kenya, Zambia and Uganda. "The potential is monumental," says Elizabeth Littlefield, chief executive of CGAP. "Globally, it is estimated that there are one billion people in emerging markets who don't have a bank account but who do have a mobile phone – so that's a billion people right there that would like to use their mobile phone for banking services." The chart below shows the prevalence of mobile phones in Africa and in a range of developing countries.

The feedback on such services is hugely positive. "We did a survey of the M-Pesa users to figure out how this was changing their life," says Ms Littlefield, "and 83 per cent of the respondents said not having M-Pesa would have a large negative impact on their life."

Using mobile phones as a banking platform

penetration of mobile phones and bank accounts in selected countries

	GROSS NATIONAL INCOME PER CAPITA (US$)	MOBILE PENETRATION (%)	BANKED (%)
MEXICO	7,310	54.71	25
SOUTH AFRICA	4,960	77.06	46
BRAZIL	3,460	56.03	42
ALGERIA	2,730	65.95	31
CHINA	1,740	34.71	42
PHILIPPINES	1,300	49.18	26
EGYPT	1,250	27.35	41
NICARAGUA	910	32.62	5
INDIA	720	14.76	48
PAKISTAN	690	32.64	12
KENYA	530	19.92	10
BANGLADESH	470	15.03	32

Sources: GSMA (Regulatory Framework for Mobile Banking). GNI per capita from World Bank (2006). Mobile penetration from GSMA's Wireless Intelligence. Population banked from Honohan (2007). Only China and India show higher banking penetration than mobile penetration. Rapidly growing mobile penetration in both countries means that it is probably only a matter of time before they fit the pattern.

50%

The reduction in costs to banks of delivering financial services when using mobile banking instead of branches

Mobile banking services can represent significant cost savings to the client. Services like M-Pesa have driven down the cost of banking for users, who no longer have to travel long distances to deposit or withdraw money, by five to 10 times. "You can't only look at the cost to serve – that only takes account of the point of view of the institution – but you must also look at the cost for the client," says Dr Gerhard Coetzee, who oversees the microfinance division of Absa. "How far do they have to travel to get to their nearest service point? How long do they have to wait in queues? What is the opportunity cost because they are not at their business or farm?"

Even in South Africa, which probably has the highest number of bank branches proportionally in Africa, Dr Coetzee says, it can cost 30 rand (about US$4) to get to and from a bank in Gauteng, a well-developed province. "For some clients on the eastern seaboard it costs 70 rand to get to the bank, and that's very costly."

CGAP has found that mobile banking can lower the cost for banks of delivering financial services by more than 50 per cent. That represents a huge saving to financial institutions, which may be reluctant to invest in branch networks. In turn, IT also has the potential to transform what goes on behind the teller's counter, dramatically cutting operating costs and therefore lowering the high interest rates microfinance institutions have to charge to cover the cost of administering such small loans.

Other problems can arise from use of antiquated systems. "One institution told me that on their spreadsheet when they get their 500th client the first drops off the edge – so they can't do any analysis or cross-selling," says Bridget van Kralingen, who leads microfinance initiatives at IBM, which is helping the Grameen Foundation develop an open-source microfinance software platform. The system, called Mifos, streamlines lending processes and cuts operational and technology costs for microfinance institutions. "Another microfinance organisation said that when they go to see donors for more funding, it takes them a month and a half to estimate their consumption of capital," says Ms van Kralingen, "so we see an incredible demand for this."

If these lower costs can be captured, that means micro-lenders can extend their services to more borrowers at lower costs. "The big challenge over the next few years will be how to use technology to reduce the costs and improve the service," says the IFC's Mr Koskelo, "and then by doing that come up with mechanisms where it is feasible to bring sustainable services to a significantly larger segment of the population."

One project that may prove useful was launched in February 2009 by the UK government's Department for International Development. Dubbed FAST (for "facilitating access to financial services through technology"), the three-year, £1.4m project will support the introduction of "branchless banking" in several developing countries, and track its progress. If it is shown to work, it will be rolled out more broadly. FAST also plans to carry out research into how to spread the technology, and help to develop industry standards to regulate it.

However, technology alone cannot solve financial exclusion. Although the adoption of mobile phones and other technology in developing countries has been impressive, penetration is far from universal. For those individuals who do not own mobile phones or have access to the internet, the problems of financial exclusion remain, and could in fact become even more entrenched. In addition, technology-based solutions can be unreliable and subject to glitches, especially in countries where technological know-how may be lagging behind other countries. Finally, some commentators have argued that regulation has been slow to catch up with technological innovation, and suggest that consumers may lack the protection they need from mobile payments and other services.

CASE STUDY

the regulation challenge

AS NEW TECHNOLOGIES and payment innovations advance, the regulatory frameworks that are needed to guarantee their fair and legal operation cannot always adapt quickly enough. This creates new obstacles to financial inclusion. After all, the merchant in a small kiosk who, instead of selling only batteries, cigarettes and phone airtime, is now taking in and handing out money via customers' mobile phones, has essentially become a bank teller.

While it is one thing to handle simple cash transactions via mobile phone, the question is whether the merchant can use the same system to take deposits and sell insurance – seen as a critical next step in mobile finance – without being regulated as a bank.

In December 2008, Kenyan finance minister John Michuki ordered an audit of Safaricom's mobile money transfer service M-Pesa, which has attracted more than 6.5 million subscribers since its launch in 2007. The service, which operates primarily to arrange the transfer of money from one mobile phone user to another, had existed outside the regulatory framework. But its popularity, and the perception that it was open to abuse, has drawn the attention of policymakers keen to prevent fraudulent activities such as kidnapping and money laundering, easier to carry out using M-Pesa because of a lack of traceable transaction records.

At the end of the audit in January 2009, Joseph Kinyua, Kenya's permanent secretary to the Treasury, said that the audit had reassured the Treasury. "I would like to assure Kenyans that this innovative idea of money transfer through the mobile telephones is safe and reliable," he said, adding that the treasury and central bank would continue to oversee its safety and reliability.

Other non-profit microfinance institutions are likely to attract similar scrutiny, since taking deposits and offering insurance products requires regulatory supervision. As recognition grows that the real power of financial inclusion lies in being able to offer precisely these types of products, many are considering altering their legal status.

Some laws provide for flexibility. Grameen America, for example, has applied for a credit union licence so that it can accept savings and deposits across the US. However, as mobile banking and cashless transactions become ubiquitous, the challenge for regulators is to reshape their legislative regimes in ways that protect account holders but do not hamper the development of innovative ways of delivering banking services.

A kiosk merchant in Russia, now effectively a bank teller, handling simple cash transactions for customers via their mobile phones

achieving financial literacy

TO MAXIMISE THE beneficial impact of microfinance products, potential customers must be educated about their relative advantages and disadvantages. One such initiative is the Credit with Education programme, which is run by Freedom from Hunger, an international development NGO. In addition to offering microcredit, the programme also offers its customers, who are mainly women, valuable information about business, health and ways to improve the lives of their families.

From the outset, the programmes are run with local input and are eventually expected to become completely locally owned and operated, making them a permanent, sustainable resource for their communities. The same staff handle both the administration of the loans and the delivery of education, helping to keep costs down and also to build a relationship of trust between the staff and the communities where they operate.

Problems of financial illiteracy are not limited to developing countries. In Eastern Europe and Russia, a large number of people lack proper understanding of savings and credit and tend to mistrust banks. This is, in large part, a legacy of communism and the years in which the government took responsibility for all aspects of its citizens' work and finances. "People have gone for a long period of time without bank accounts, so they are used to dealing largely in cash," says Ms Thiel at the New Economics Foundation. "Financial literacy levels are low in the sense that people don't know what a direct debit is, as it simply wasn't useful or accessible to them." One initiative addressing this issue in Russia is the International Business Leaders Forum, a UK-based corporate responsibility scheme that is working with banking service providers to promote financial literacy.

Financial literacy is also of particular importance to young people. Junior Achievement, a global organisation that promotes the education of school students in workforce readiness, entrepreneurship and financial literacy, has a programme showing them how to manage money and create jobs. "Financial education is a huge part of financial inclusion and this is becoming an important part of secondary education," says Andrew Devenport, chief executive of Youth Business International, which helps disadvantaged young people to start their own businesses and works with organisations such as Junior Achievement. "That's important for us because if we work with young people who don't have any financial knowledge, we have a longer journey to go with them."

Trust

A large number of people lack proper understanding of savings and credit products

tapping into remittances

Seven

countries in Latin America derive over 12% of their GDP from remittances, even though half of their citizens do not have a bank account

FOR MANY MIGRANT workers who have left families behind, part of the monthly routine involves sending a proportion of their income back home, often incurring high processing fees. For many years, these money transfers have remained largely undocumented. Recently, however, the Inter-American Development Bank (IDB) has revealed that these remittances constitute a substantial amount of money which, by and large, has not been passing through formal banking systems.

Remittances represent more than 12 per cent of gross domestic product (GDP) in seven Latin American countries. In some countries they represent the single biggest proportion of GDP, according to the IDB. Last year, almost US$70bn in remittances (expected to drop 11 per cent this year to 2006 levels of around US$62bn) was transferred from the US to Latin America and the Caribbean. "The numbers are huge and yet, until the year 2000, remittances were categorised in the errors and omissions section – that's how much of an afterthought they were," says Julie Katzman, general manager of the Multilateral Investment Fund, which invests on behalf of the IDB. "Fewer than 50 per cent of the people going into the bank to collect the [remittance] money have a bank account – those institutions aren't offering the products that the recipient needs."

Ms Katzman and others believe that the potential development impact of these funds is enormous and could be better harnessed if individuals could manage their remittances through formal banking systems. "Very little value is added at the receiving end, because the money is just consumed [rather than saved or invested]," says Martin Holtmann, head of microfinance at the IFC. The IDB estimates that while about 80 per cent of the funds are used for essential daily consumption, the other 20 per cent could be used for savings or to buy insurance given the appropriate banking tools.

The IFC is working with remittance transfer companies to create financial products, such as savings accounts for the recipients. The IDB has also financed projects to encourage remittance companies to partner with microfinance institutions and promote the development of products such as cross-border mortgages, through which migrants can use remittances to buy property for families at home. "The goal is not just to count up the dollars but to think about what they could do in these economies," says Ms Katzman.

CASE STUDY

from government to people

PENSIONS, HEALTH BENEFITS and child support are just a few examples of the long list of payments that governments make to their citizens, and yet many of the recipients have no bank account into which to deposit them, particularly in less developed countries. "The numbers are huge," says Elizabeth Littlefield of CGAP. She estimates that only 25 per cent of the recipients of these G2P (government-to-people) payments have a bank account into which to deposit them.

Most payments are made in person with the recipient travelling to the bank to collect cash from a teller. This creates very high transaction costs for both parties and leaves room for human error and theft. Making these payments electronically would serve both to reduce these losses and to create a mechanism for providing poor people with basic banking services, particularly where branch networks do not exist. "There's a huge potential out there to leverage the payment flows from government to people and create a financial infrastructure with those payments," says Ms Littlefield.

Electronic G2P payments are emerging in a number of developing countries. In a G2P programme in Argentina, payments are transferred every month to a debit card, which has led to a significant reduction in fraud. Deposits on to the debit card can only be made by the government and expire after one month if unused.

Ms Littlefield believes there is potential to make such systems even more effective. "Imagine if you used it to put those government payments into a no-frills bank account or a debit card that could be reloaded with cash elsewhere or used for other purposes," she says. Such a structure would not only connect payees to the financial system, but reduce problems caused by fraud and human error while laying the groundwork for financial planning.

This is already starting to happen. In Brazil, for example, the Ministry of Social Development is working to move family payments currently made to 12 million recipients through electronic benefit cards, to another system that uses a simplified bank account. Ms Littlefield sees this type of initiative as one with "massive potential" for expanding financial inclusion. "You can leverage the vast networks of G2P safety net payments and transfer them into financial assets for those people," she says.

A similar system has been launched by Absa Bank in South Africa. Working with the South African government, Absa launched a payments system to distribute pension, disability and child benefit payments electronically rather than via traditional cash-based methods. The Sekulula card is automatically credited with payments, and customers can then add funds to the card using cash or via electronic transfers.

The principle does not apply only to developing countries. In the UK, for example, the government has successfully migrated benefit recipients from post offices to basic bank accounts.

Rio de Janeiro, Brazil: the government is working to expand financial inclusion by making benefit payments via a simplified bank account

the role of policymakers

POLICY MEASURES TO increase financial inclusion can have a powerful effect, but must be considered carefully in order to prevent counterproductive outcomes. Even the most well-intentioned policy can backfire, leading to unintended consequences that increase, rather than decrease, levels of exclusion.

Governments play a key role in furthering financial inclusion by creating and empowering the institutions and legal systems that support financial services. There should be strong and clear rule of law, so that lenders have confidence in the ability of courts to pursue defaults and recover debts. Conduct regulation of banks is also important. Consumers should be protected against abusive practices and predatory lending, and have confidence that their data and assets are secure. Financial institutions themselves should be prevented from embarking on unwise credit binges and should be encouraged to offer basic financial services to the excluded.

Careful deregulation can help to improve levels of financial inclusion. Rather than allow banking services to be concentrated within the hands of a few institutions, governments can enable non-traditional distributors, such as post offices or retail commercial outlets, to offer basic banking services, either independently or in partnership with official financial institutions. In Mexico, for example, where only 25 per cent of the population has access to financial services, and where the number of branches in the country is well below the international average, banking agents are being established at retail outlets across the country.

More broadly, a business infrastructure that supports increases in the number and range of financial institutions can be a powerful force to improve access to finance. This could include a robust communications infrastructure, an efficient transportation system and a healthy competitive environment that helps to create choice for consumers.

Policymakers also have a role to play in promoting competition and ensuring that barriers to entry for new providers are not prohibitive. Regulatory reform can help to support new market entrants and prevent a small number of incumbents from dominating a market. Care needs to be taken, however, not to introduce policy that inadvertently distorts markets.

Another important area in which governments can add support is education. Uganda, for example, has established a programme of financial extension workers, who are recruited at a local level to help farmers to understand and make the most of microfinance issues, including borrowers' rights and responsibilities, investment decision-making, savings culture and conflict management.

Finally, commentators often point out the importance of being able to track and collect information about borrowers, for transparency, accountability and as a safeguard against misuse of informal systems. Dr Coetzee of Absa notes: "The two areas where governments, especially in Africa, must really come to the party is when it comes to information on credit use, credit registries, credit bureaux and so on – because there's a big problem brewing in many countries in terms of not enough information flowing between lending institutions – and then you have clients with multiple loans and the risk of over indebtedness."

He adds: "You also need positive information on these registries so that institutions have a better way of assessing clients – and it's very costly to create registries, so governments should assist in that at the beginning."
The creation of credit rating agencies that are able to gather and share information about credit histories of individuals and companies can help to increase confidence and reduce default rates. This can be facilitated through the adoption of a national identification system, which makes it easier to track and store information about borrowers.

3.

The conclusion: banks, allied with public organisations, through innovation and education can improve access to financial services and foster prosperity.

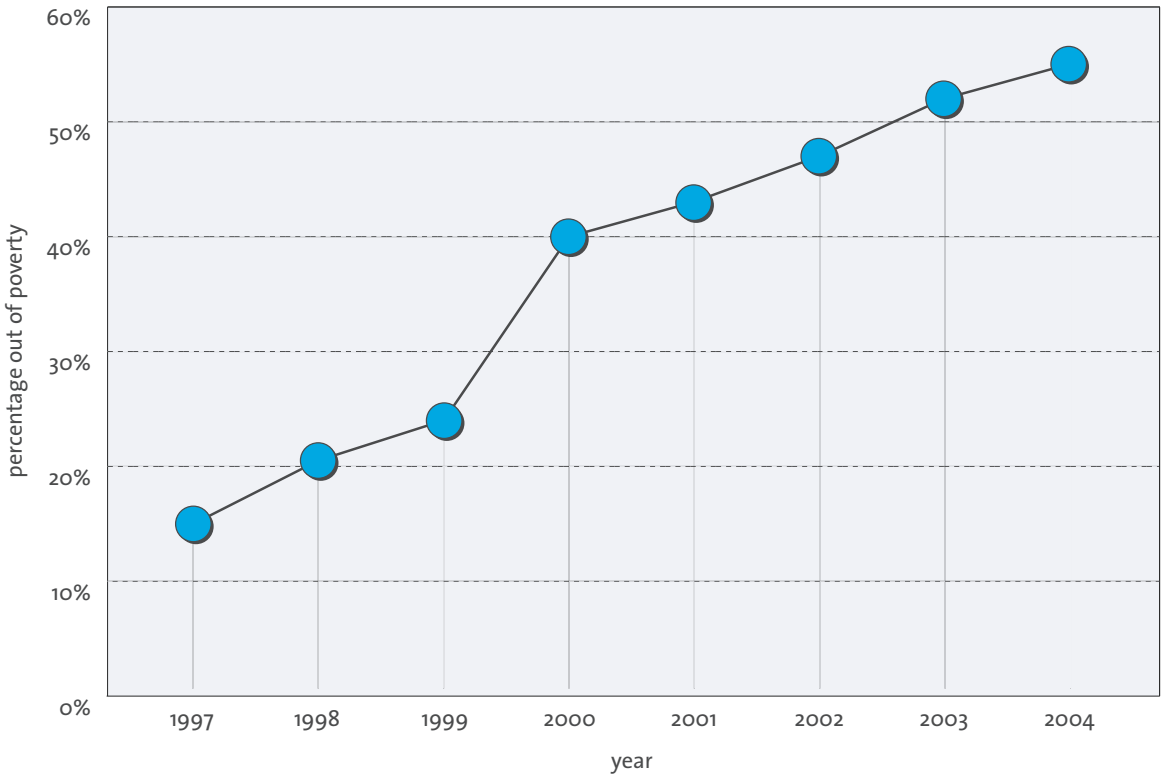
How the credit crisis has affected microfinance

ACCESS TO FINANCIAL services lifts people from poverty and fosters economic growth (see chart below). With consensus growing among policymakers, a range of public and private organisations are putting their weight behind microfinance, financial education, mobile phone banking and other initiatives. But while this momentum is undoubtedly gaining speed, new questions are emerging too.

In some respects, the global financial crisis is likely to set back efforts to expand financial inclusion, particularly in developed markets where lending has slowed considerably and access to credit has tightened. According to CGAP's latest survey, the top risks cited by the MFI sector were credit and funding risk. Both of these risks were much lower down the list in the 2008 survey (10th and 29th, respectively). Earlier surveys had raised hope that MFIs would be insulated from the "real economy", but the 2009 report found that the sector is waking up to the fact that it is vulnerable to shocks through financial markets,

Finance generates wealth

established Grameen clients of five or more years, living above the poverty line



Source: 'Measuring the Impact of Microfinance: Taking stock of what we know,' Grameen Foundation (2005).

credit conditions and the fortunes of their customers.

The crisis may perhaps lead to a focus on savings over credit instead. But whatever the focus, progressive governments and policymakers recognise that the more difficult circumstances facing many households call for greater efforts to increase financial inclusion.

There are significant challenges associated with policy efforts to improve financial inclusion. Even the most well-intentioned can backfire or have unintended consequences. And yet it is clear that, on its own, a market-based solution is insufficient to address financial inclusion in an agreeable timeframe. Policymakers must co-operate with the private sector and NGOs to create innovation and a sustainable platform for supporting financial inclusion.

Perhaps the biggest challenge for those dedicated to expanding global financial inclusion is how to balance market-driven models that drive efficiency, scale and sustainability while avoiding the "mission drift" that could result in larger loan sizes and products designed for those moving up the economic ladder – leaving out the lowest-income communities for which those services were originally designed. For institutions seeking to improve financial inclusion, changing status to become a bank or a credit union means entering the mainstream financial system, something that many worry could hamper their delivery of the related social, educational and healthcare services that they provide to clients and their families.

Of course, banking is of no use without economic opportunity. It can be argued that, to tackle exclusion for the very poorest, jobs and entrepreneurial possibilities should be the first steps towards prosperity. Yet without access to finance, young people, migrants, low-wage employees and entrepreneurs are not able to make the most of the income they can generate or access the tools they need to unlock their full potential.

Potential

Policymakers must co-operate with the private sector and NGOs to create a platform for supporting financial inclusion

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