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Banking the Un-Banked: Improving Access to Financial Services

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I. Introduction

In the wake of the Millennium Development Goals (MDGs), improving access to financial services in developing countries has become an important policy objective. This goal recognises that economic growth can be accelerated by deepening and widening the financial services sector. Financial outreach is associated with giving access to capital and job opportunities to the poor.

Photo by Steve Woods.

The limited access to financial services in the developing world is one of the main obstacles to income generation and social protection. The figures speak for themselves: it is estimated that over 4 billion people lack access to basic financial services such as credit, savings, money transfers, leases and insurance.

Various research publications of the International Poverty Centre (IPC) have discussed options for creating jobs, as well as for monetary and financial policies. The areas highlighted include policies to generate income, as well as to reduce poverty and inequality. This Policy Research Brief makes some policy recommendations for enhancing access to financial services.

II. The State of Current Access to Financial Services in Selected Countries

Banking the un-banked requires removing both price and non-price barriers to the use of financial services and access to them. Improving access means making financial services more affordable. It is easy to measure the use of financial services (since use can be observed and measured), but use is not always the same as access. "Access" essentially refers to the supply of services, whereas "use" is determined by both demand and supply (Demirgüç-Kunt, et al., 2008).

Figure 1 (next page) illustrates the gap between access to and use of financial services among the target population. There are two broad categories of non-users: voluntary non-users (who do not use financial services because they do not need them, or because of religious, cultural or social reasons); and those who are excluded involuntarily. The latter group includes people who are willing to use financial services but cannot because of a number of constraints. These individuals may be considered "un-bankable" because they are assumed to be members of high-risk groups or insufficiently creditworthy. They may not have enough income to carry out banking transactions. They may face discrimination on social, religious or ethnic grounds. The cost of service provision may be too high for the financial service providers. The cost of transport to the access points might be beyond the reach of some users. Illiteracy also impedes access, since it is conducive to a lack of information, awareness and knowledge. The involuntarily excluded require different responses from policymakers and have to be targeted accordingly.

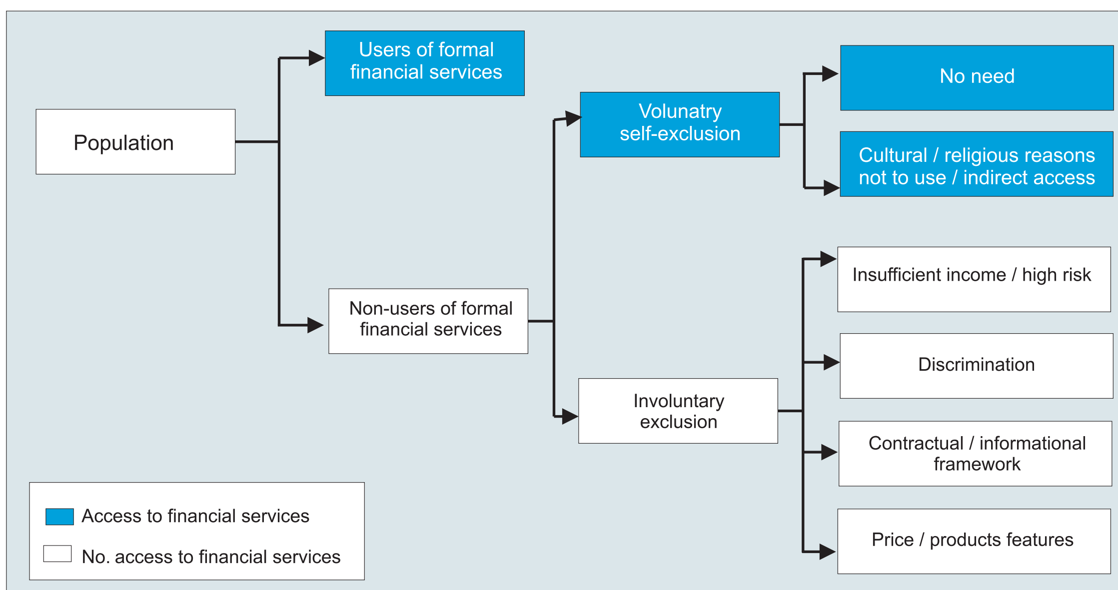
What do we know about current access to financial services? Figure 2 (next page) shows the state of access to financial services globally. Plainly, the percentages are very low (less than 20 per cent) for people in less developed countries in South Asia, Africa, parts of Latin America and so on, where access is needed most. In the advanced parts of the world (Western Europe, North America, Australia and others), the incidence of financial services access is high (over 80 per cent). These figures illustrate the significance of effective policymaking in ensuring that financial services are accessible.

III. Direct Policy Lending

Focus on direct policy lending to reach enough of the excluded is an important measure. Policy lending schemes have been successful in diversifying clients by sector and demography in many developing countries. Refocusing direct lending in an essentially segmented market is critical for future poverty reduction efforts. Rent-seeking, however, has been blamed for past failures. Policy lending may have failed

Figure 1

Distinctions between the Access to and Use of Financial Services



Source: Demirgüç-Kunt et al. (2008).

before, but its contribution must be re-examined in the light of experiences in high-growth economies.

Japan's agricultural modernisation and disaster relief programmes are good examples. In this case, when private financial institutions could not bear the risks, the state's role was confined to subsidising interest rates in order to promote agricultural mechanisation and making policy responses to natural disasters (Izumida, 2003).

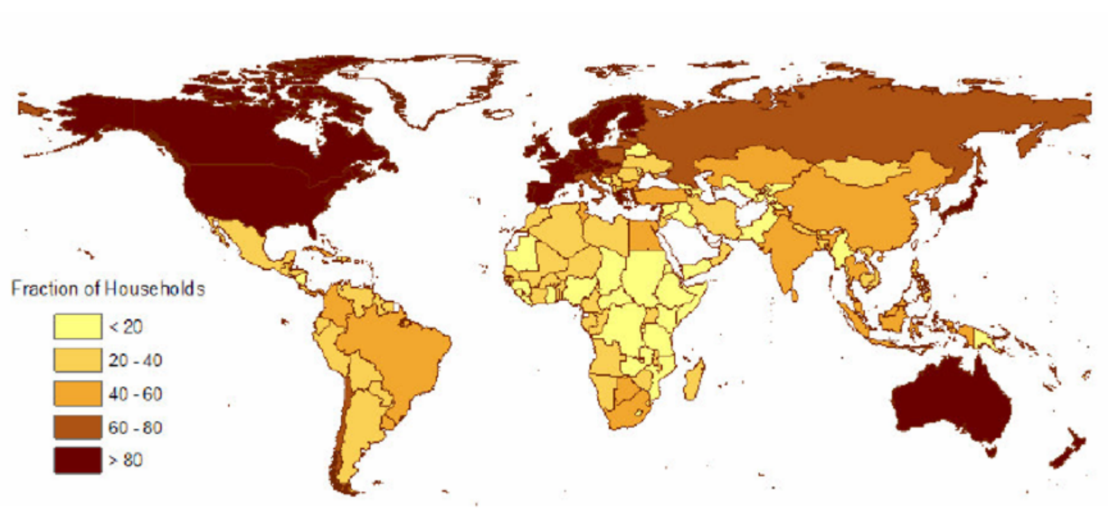
The Bank Rakyat Indonesia (BRI) was set up in 1973 for policy lending to promote rural development through credit programmes for rice farmers; the funding was earmarked for the purchase of agricultural inputs.

By the mid 1980s the BRI had become a profitable venture. Learning from earlier mistakes, and with substantial assistance from external sources, all subsidies to it had ceased by the end of the decade (World Bank, 2004).

China relied on direct lending for social policy purposes, and only recently did it partially separate policy lending from commercial lending. The Agricultural Bank of China and rural credit cooperatives (RCCs) lend to farmers, non-farm rural enterprises, and town and village enterprises. The RCCs have also been successfully integrated with other rural financing schemes, and in 1999 the outstanding credit was estimated at 30 per cent of GDP (Chandrasekhar, 2004).

Figure 2

Access to Financial Services



Source: Honohan (2007).

Vietnam is a recent case where sustained poverty reduction is an explicit goal of lending for social policy. The government established the Development Assistance Fund (DAF) and the Vietnam Bank for Social Policies (VBSP) in 2002 to counter unemployment. The DAF, which has over 60 branches nationwide, was set up to provide subsidised loans, including selective interest rates, investment guarantees and export promotion credit. DAF credits amount to 24 per cent of total domestic credit, or 3.3 per cent of GDP (Chandrasekhar, 2004). Similarly, the VBSP was set up to make loans with low, subsidised interest rates. With 600 branches, the VBSP guarantees government bonds and provides deposit and other financial services to groups that have no access to commercial finance. Financial records show that by the end of 2004, 51 per cent of its loans were provided to poor households, 29 per cent went to beneficiaries in remote areas, and 12 per cent were for job creation. Disadvantaged students and foreign migrant workers received about 1 per cent each (Izumida, 2003).

VBSP's interest rates were below monthly deposit and lending rates in the commercial sector. Critics have noted that this policy "distorts" the market: if transaction costs were low, VBSP's borrowers would deposit the same funds at the commercial banks. But this is a technical problem, and if the clients of policy lending and commercial lending are sufficiently different (by location, sector and so on), transaction costs will be high or technical solutions could be found. The critical issue is how to satisfy the demand for policy lending in the absence of commercial finance, particularly for those who cannot access these funds for spatial reasons or because they lack collateral.

The principle of domestic policy lending has its equivalent in the international policy lending of multilateral agencies. It is contradictory to oppose policy lending in principle. It is precisely the shortage of non-conditional and concessional finance from bilateral and private sources that led multilateral institutions to become involved in policy lending. These are good examples of preferential lending when international private capital is unavailable. External assistance does not replace private finance that would otherwise be forthcoming—or at least the international aid system accepts this to be the case—until countries graduate from low- to higher-income status. This has been true of East Asian and Latin American economies that graduated from aid financing to private domestic and foreign capital. When savings and investment are low, there is room for governments to provide credit directly. This can be strictly monitored to ensure that recipients would not otherwise have financed their projects from private domestic sources.

IV. Some Measures for Inclusive Finance

In many low-income countries, it will be a long time before commercial lending can attend to all their financing needs. Until then, policy will have to include a mix of measures designed to ensure that the involuntarily excluded have access to the financial services that could lift them out of poverty. In addition to policy lending, some proposed measures are outlined below.

It is crucial to remove the physical barriers to access and use, since these are perhaps the greatest obstacles that rural dwellers face. Distant bank branches, for instance, will discourage potential customers from opening accounts and accessing credit facilities. From its early days, the Grameen Bank countered this problem with the strategy expressed by its slogan "if you cannot come to the bank, the bank will come to you." Today, only the first disbursement of a loan is completed at the branch; all subsequent transactions are carried out at meeting centres in the villages, which all borrowers can easily reach. Innovative networks would link rural households to cities and thus help enable access.

Raising awareness of financial products helps greatly. Prospective users of financial services can benefit from information, instruction and advice that familiarises them with the various products available in the financial market. This allows them to develop the skills and confidence needed to make informed decisions and the right choices, as well as to take calculated risks. Banks could benefit from incentives to run marketing campaigns or to open information centres, either individually or with pooled resources, in the interest of raising awareness. The media can be exploited for such purposes. Consumers of financial services should be encouraged to spread the benefits by word of mouth, and there is scope for campaigns that encourage every user to introduce at least one individual to the services on offer.

Minimising paperwork and eliminating formalities encourages potential users of financial services. This matter is particularly important for those unable to read or write and who can be intimidated by paperwork, data collection and signatures or thumb impressions. Minimal red tape and the instant processing of customer accounts would facilitate access.

Financial services can be integrated by creating alliances among establishments. Cash disbursements thorough various transfer programmes can be handled by financial institutions, which can provide other banking services. For instance, if all welfare disbursements and public sector salaries were paid through bank accounts, that measure would introduce mandatory account opening and encourage banking transactions. Caixa Econômica Federal is the main federal government bank in Brazil. It has built a network of "banking correspondents", alliances with retail stores and outlets, equipped with a point-of-sale (POS) terminal that can offer a full range of banking and payment services. Today, Caixa has over 20,000 correspondents across the country's 5,562 municipalities, and almost 50 per cent of its transactions are handled by such POS outlets.

Since microfinancing institutions and commercial banks work to provide greater access to financial services, both could gain by forming synergies among themselves. Commercial banks have the network capability to facilitate this process, and thus each party could benefit from the expertise of the other. Consequently, target groups and intended beneficiaries could have greater access to both credit and non-credit

services. In addition to insurance and guarantee schemes, they could benefit from facilities that the banks could offer for remittances and money transfers. Moreover, they could use services to facilitate payments, such as by means of cash machines, cheques, trust receipts and so on.

It is always more costly to provide financial services in rural areas than in towns, for several reasons: economies of scale and outreach; staffing requirements; training; costs per transaction; greater use of staff time; smaller borrowings, savings and deposits; a greater number of frequent small transactions and so forth. To increase access and use, it is crucial to lower the cost of banking services by means of technology and economies of scale, scope and outreach. One effective policy measure might be the use of information and communication technologies, since they are key to a low-cost financial outreach strategy for the rural market. Apart from lowering the cost of idle cash, technology can substantially cut costs related to the infrastructure needed to handle cash. Most microbanks, such as PRODEM in Bolivia and Teba Bank in South Africa, have made innovative use of technology. Customers are issued "smart cards" with biometric data and use of fingerprints as a substitute for photographic identity cards, personal identity numbers and signatures.

One-stop shopping could attract and encourage customers by offering them several products under one roof. The provision of microloans, savings products, insurance schemes, deposit certificates, bonds, shares, housing loans, pensions, remittances and so on can make it easier for the population to access various financial services.

Legislation also provides the legal and regulatory framework. Kenya's Microfinance Act (2006), Pakistan's Microfinance Ordinance (2001), and India's Microfinancial Sector (Development and Regulation) Bill (2007) are examples of the kind of legislation various regularises and protects the rural lending sector.

V. Conclusion

This Policy Research Brief has indicated that enhancing access to financial services remains a key development challenge. At present, the level of access to financial services in developing countries is low. A substantial segment of the rural population lacks free and unconstrained access to and use of such services.

The examples cited above are known to have produced visible results, and the various measures proposed can be implemented to increase low-income groups' access to financial services. While local settings and institutional limitations may differ, such steps can make a significant contribution to inclusive finance. ■

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