Financial Inclusion: A Financial Industry Perspective

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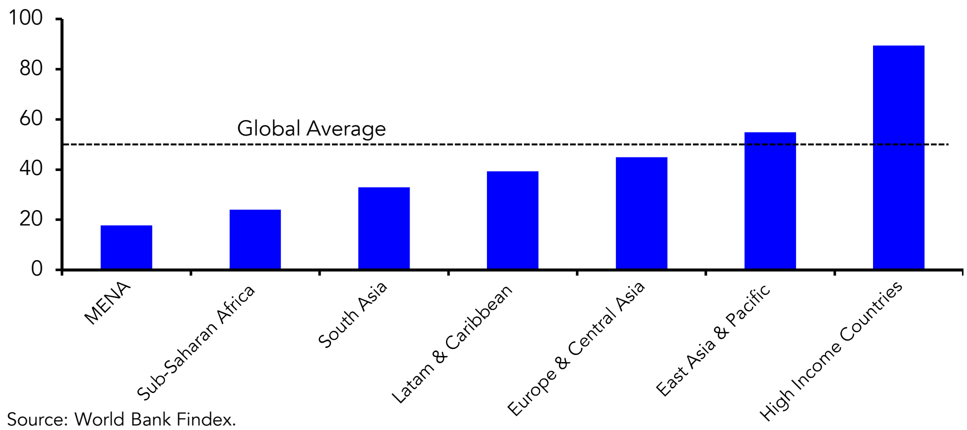
- Half of the world's population is unbanked, but financial inclusion is about more than just having a bank account.
- Mobile banking and banking via non-bank retail outlets have been key drivers of financial inclusion in developing countries, helped by technology and a favorable regulatory environment.
- There are clear benefits of financial inclusion at the individual and macro level—even though the macro effects are difficult to quantify. In any case, the benefits of financial inclusion go beyond growth.
- Financial inclusion is traditionally seen as a developing country issue, but there are broader lessons to learn for the financial industry as it seeks to tap new business opportunities and lower transaction costs.

FINANCIAL INCLUSION — WHAT IS IT AND WHERE DO WE STAND?

Defined broadly, financial inclusion is the proportion of individuals and firms with access to formal financial services. At the global level, 2.5 billion people – or half the world population – remain without a bank account, but differences are marked across countries. Access to financial services varies widely by a country's level of development as well as an individual's income, education and gender. According to the World Bank's Findex, 90% of adults in high-income countries have an account at a financial institution compared to only 41% in developing countries (Charts 1-3). Across countries – including in the advanced economies - those in the bottom income quartile have the lowest account penetration. For instance, while 88% of all adults in the U.S. have an account, the share drops to 74% in the poorest quintile. Meanwhile, only 75% of the primary-level

Chart 1
Account at a Formal Financial Institution in 2011
percent of population over 15 years old



Source: World Bank Findex.

educated population in high-income countries has an account compared to 95% of the tertiary-level educated population. In developing countries, the urban population is more than twice as likely to have an account than the rural population and almost 46% of the male population has an account compared to 37% of the female population.

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Studies suggest that barriers such as the cost of opening and maintaining an account, inadequate savings, lack of physical accessibility to banks and lack of trust in the banking system lead to such disparities in financial inclusion. Moreover, financial inclusion is about more than just having an account at a financial institution because holding an account does not automatically imply usage.

To account for such multidimensional aspects of financial inclusion, BBVA attempts to measure the true degree of inclusion in a country with an index that takes into account both the demand and supply side drivers of financial inclusion: 1) Access to financial services; 2) Usage of such services; and 3) Barriers in accessing and using such services. For example, while Denmark and Sweden rank among the highest in terms of bank account penetration, their ranking in the BBVA index of financial inclusion is much lower as they lag behind in accessibility to financial services.

OFF THE BEATEN TRACK — INNOVATIVE DRIVERS OF FINANCIAL INCLUSION

While differences in financial inclusion remain marked across countries, some parts of the developing world are rapidly catching up. However, the main drivers of this trend have not been traditional banking channels but alternate providers of financial services – such as mobile banking and non-bank retail businesses.

This has been aided by the inherent characteristics of emerging economies, such as high mobile penetration that has led to the mobile money boom, the trust of customers in local retail outlets that has helped them serve as correspondent banking agents, and the regulatory environment that has encouraged mobile network operators, non-bank retail outlets and credit card companies to collaborate and become the principal customer interface in providing financial services. But most importantly, technology has played the

Chart 2
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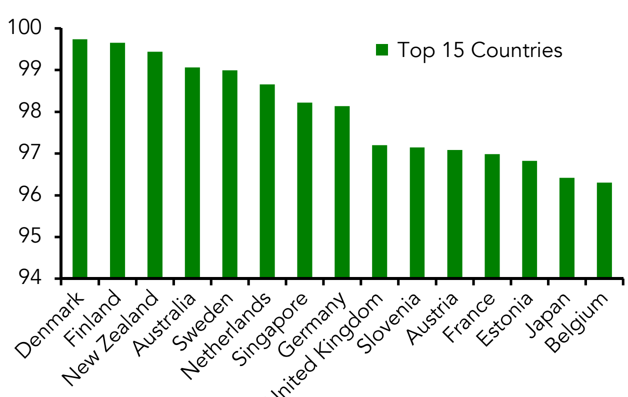

Source: World Bank Findex.

Chart 3
Account at a Formal Financial Institution in 2011
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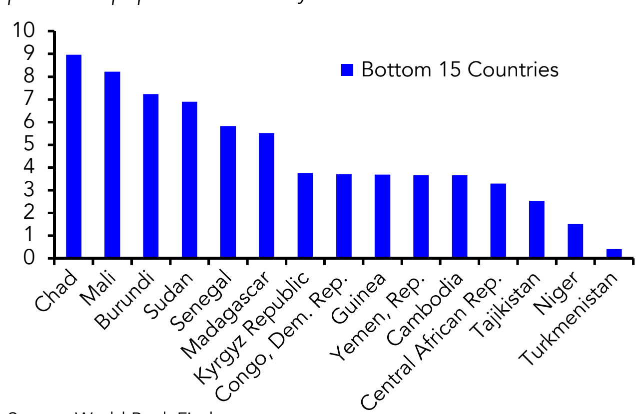

Source: World Bank Findex.

key role in accelerating financial inclusion, not only via mobile banking but also by making it easier to access financial services. For instance, in many developing countries, a bank account can be opened by submitting biometric information, downloading the bank app on the mobile phone or sending scanned copies of IDs via mobile phone. Biometric information and digital IDs are also useful to authenticate users and create credit history, thus lowering fraud rates and default risk.

In emerging economies, where for every 10,000 people there is one bank branch but 5,100 mobile phones, mobile money has enabled individuals even without a bank account to have a safe and usable store of value and conduct financial transactions. In fact, in Kenya, about 43% of the adults who report having used mobile money to make payments do not have a formal bank account. The broadest success of mobile money has been in Sub-Saharan Africa, where 15% of the adults used a mobile phone during 2011 to receive money (the figures run as high as 66% in Kenya and 46% in Gabon – most of them do not have a formal bank account) compared to 2.5% or less in MENA, Latin America and Asia/Pacific (Charts 4-5). Mobile banking has thrived even in countries with low mobile penetration. For example, Somalia has the fourth-lowest mobile penetration rate in the world but is among the top three countries with the highest usage of mobile phones for paying bills and receiving remittances (which account for 70% of GDP). Similarly, mobile penetration in Kenya was only 20% when mobile banking started – similar to Afghanistan, Rwanda and Tanzania where mobile payments have not developed in the same way.

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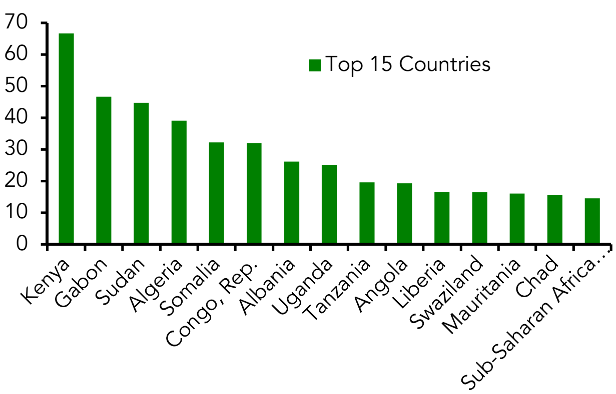
Moreover, transactions are being conducted for a variety of purposes: To make transfers between bank accounts, to send and receive remittances, to pay bills, to pay for services (businesses in Kenya and Tanzania collect small-value payments for lending out solar lanterns and basic water pumps), to manage M-Wallets (an electronic store of value to make and receive payments), and to purchase and manage crop insurance (an index-based mobile crop insurance for farmers in Kenya covers farm inputs in the event of drought or excessive rainfall; Charts 6-8).

Correspondent banking via non-bank retail outlets ("banking where you shop") is another important avenue enabling the delivery of financial services (such as deposits, transfer payments) via partnerships between financial services firms and retail outlets like

Chart 4
Mobile Phone Used to Receive Money in 2011
percent of population over 15 years old



Source: World Bank Findex.

Chart 5
Mobile Phone Used to Receive Money in 2011
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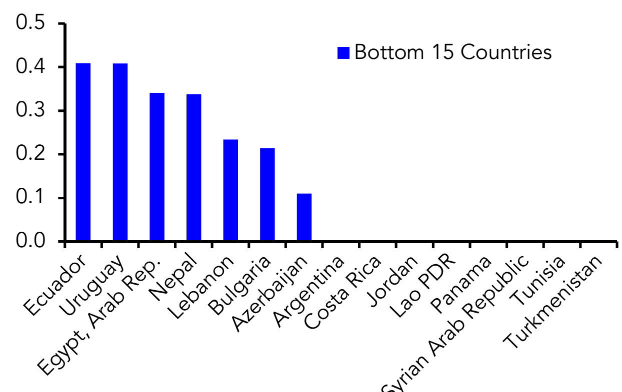

Source: World Bank Findex.

post offices, grocery stores and mom-and-pop stores. Customers' trust in local retail stores with whom they have an existing relationship has been a key ingredient in making these partnerships a success. Banking via retail outlets is also more evenly spread than mobile banking, especially in rural areas. Sub-Saharan Africa has the highest share of adults (3%) without a bank account who report that a retail store is their main mode of deposit (the figures are as high as 18% in Somalia, 12% in Sudan and 5% in Kenya) compared to about 1.5% in Latin America and MENA, 0.6% in high-income OECD countries and 0.8% in the U.S. (Charts 9 and 10, Page 6).

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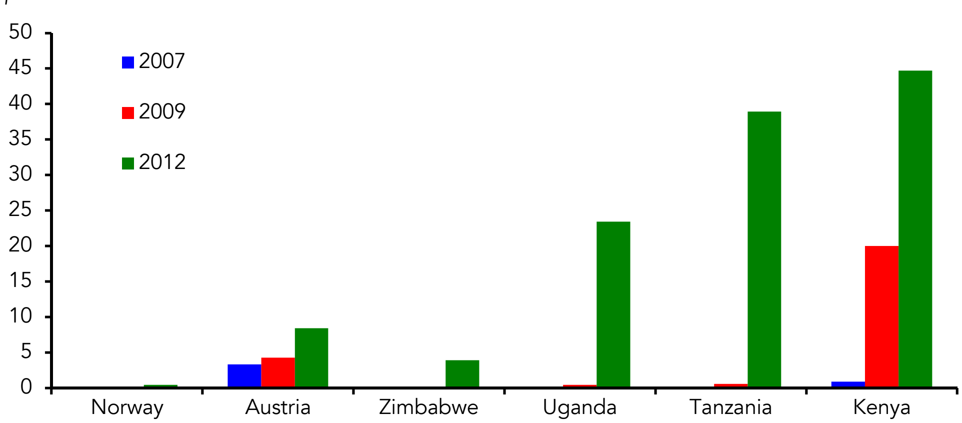
BENEFITS ON MANY FRONTS — IMPACT OF FINANCIAL INCLUSION

Studies find that providing individuals with access to saving accounts or simple informal saving technologies increases savings (for purposes such as education), the propensity to consume, productive investment and investment in preventive health. In particular, for small businesses that tend to face greater constraints, access to financial services such as micro credit is associated with innovation and job creation. The evidence on the impact of mobile banking on savings, however, has been mixed since such services are used as a mode of transaction rather than store value and many electronic payment systems do not offer savings products. But overall, the benefits of financial inclusion go much beyond simple growth effects and foster more sustainable and inclusive growth.

Mobile banking has allowed convenient payment systems to reach low-income and low population density regions (such as in Kenya and Tanzania) that tend to be high transaction cost areas for banks, making the businesses more viable and lowering the operational costs which are passed onto customers in the form of lower interest margins and higher pension and remittance payments. The World Bank estimates that the cost of reaching customers through mobile banking is around 20% lower than through traditional bank branch networks.

The boost to remittance flows from mobile money is particularly valuable for countries that rely on such flows for external financing, especially since many remittance recipients do not have a bank account. Mobile banking also increases financial security for people living in unsafe regions such as Somalia, where it is difficult to hold cash or carry cash to make deposits and payments, and saves on transportation costs in regions with

Chart 6
Value of Mobile Money Transactions
percent of GDP



Source: IMF Financial Access Survey.

unfavorable transport infrastructure or weather conditions. Access to financial services such as health and crop insurance on mobile phones promotes health care and helps reduce income risk for farmers even in regions where financial institutions are absent. Even now, less than 10% of the people involved in farming, forestry or fishing in developing countries have crop, rainfall or livestock insurance, suggesting that major benefits are yet to be reaped.

Electronic payment systems have reduced reliance on cash, which accounts for 85% of the transactions in emerging economies, hence lowering the cost of printing and safely transporting cash as well as curbing illicit transactions and income and sales tax evasion. Electronic banking has also created credit history and helped banks identify the financial needs of the under-banked, potentially increasing access to loans, insurance and health and education saving accounts and reducing dependence on traditional money lenders. Direct deposit services have helped reduce leakages (estimated to be as much as 30-45%) from government transfers and social security and subsidy payments. Similarly, smart food cards processed by credit card companies have helped cut transportation costs and leakages in food aid programs. A McKinsey assessment of India's government-to-citizen payment system estimated that connecting every Indian household to a digital payment system and automating government payment flows could save the government up to $22 billion every year, equaling 8% of the total flows between the government and the citizens. Even in the U.S., where about 4 million of the Social Security and Supplemental Security Income recipients do not have a bank account, the recipients are able to receive payments via a 'Direct Express' prepaid credit card that can be used at ATMs and for making purchases at stores and online.

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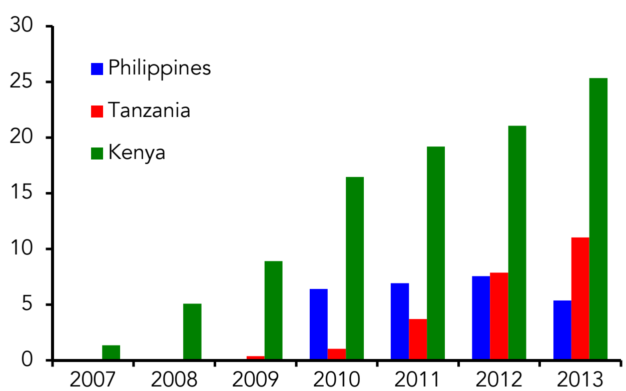
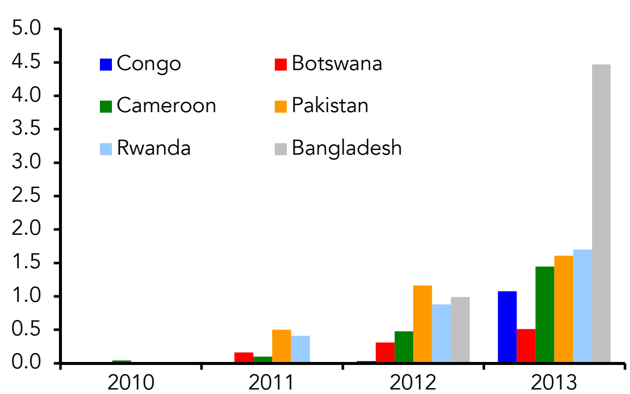
Evidence also points to financial inclusion having an impact on inequality. For example in Sweden, which has one of the most even income distributions in the world, the share of population with a bank account is the same for the rich and the poor, whereas in Haiti, where income inequality is very high, the richest 20% are about 14 times more likely to have a bank account than the poorest 20%. Moreover, country studies show that raising financial inclusion contributes to the G20's commitment of increasing women's economic participation and empowerment.

Chart 7
Number of Active Mobile Phone Accounts
millions



Source: IMF Financial Access Survey.

Chart 8
Number of Active Mobile Phone Accounts
millions



Source: IMF Financial Access Survey.

However, at the same time, financial inclusion entails risks as new technologies may reduce hurdles for cybercrime and money laundering. Also, financial illiteracy and an excessive push by banks to increase their customer base among the low-income population could result in credit bubbles and bad loans. A pro-active government role is therefore imperative to ensure that appropriate regulatory and supervisory mechanisms are in place and sound practices are followed.

CAN ADVANCED ECONOMIES LEARN FROM DEVELOPING COUNTRIES?

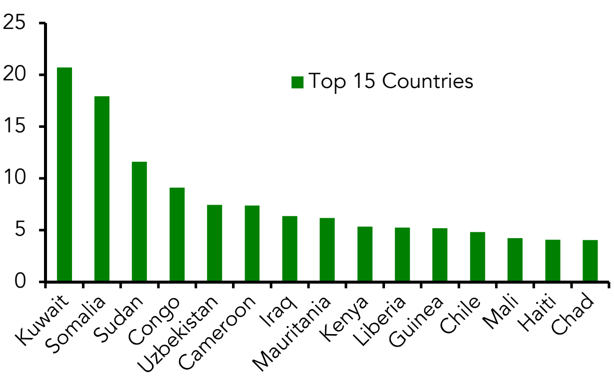
As the many examples throughout this paper demonstrate, financial inclusion is still primarily seen from a developing country perspective, i.e. how to raise their financial inclusion levels to those of advanced economies. Without doubt, the prospect of financial services to the currently 2.5 billion unbanked provides immense business opportunities for financial institutions. The positive impact of financial inclusion on savings, business investment and consumption would further boost the demand for other financial services like loans, insurance and savings instruments. The favorable impact of financial inclusion on poverty and women empowerment also implies that the healthier the social environment, the more business opportunities for financial institutions.

Financial inclusion is still primarily seen from a developing country perspective. When it comes to the future of banking—can advanced economies for once learn from the developing world?

However, this is clearly a too narrow perspective. In particular, the speed and drivers of financial inclusion in developing countries demonstrate an approach to banking that is way more innovative than what is happening in developed markets, where financial inclusion was achieved through traditional banking channels. When it comes to the future of banking - can advanced economies for once learn from the developing world?

As shown in this paper, many developing countries are ahead of advanced markets in non-bank financial inclusion initiatives and thus can offer case studies for financial institutions to use technology and innovative models to tap business opportunities in developed countries as well as other developing countries. These initiatives will also help banks looking to cut expenditure to increase efficiency, lower transaction costs and reduce the number of bank branches. According to James Gorman of Morgan Stanley, "of the 97,000 bank branches that exist across the U.S. today, all but 10,000 will disappear". In fact, the technological revolution in mobile banking and payment systems in developed markets is already underway.

Chart 9
Retail Store was the Main Mode of Deposit in 2011
percent of population over 15 years old



Source: World Bank Findex.

Chart 10
Retail Store was the Main Mode of Deposit in 2011
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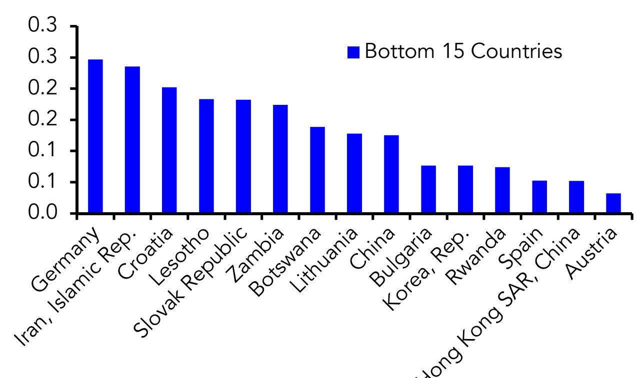

Source: World Bank Findex.

Given these opportunities, the financial industry has been fully supportive of all efforts to foster financial inclusion. One such initiative is the *Roadmap to Financial Inclusion* launched by the Center for Financial Inclusion bringing together experts and industry representatives, including several IIF members. The initiative focuses on five broad areas: 1) Addressing customer needs (chaired by CGAP – Consultative Group to Assist the Poor); 2) Technology-enabled business models (chaired by Visa); 3) Financial capability (chaired by Citi): 4) Client protection (chaired by Smart Campaign); and 5) Credit reporting (chaired by International Finance Corporation).

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As emphasized in a recent IIF report, well-managed cross-border investment flows support global growth and development, which in turn play a vital role in providing important infrastructure to support financial inclusion. Cross-border efforts in support of financial inclusion via funding and knowledge transfer have been wide-ranging, led by both public institutions (such as development banks) and global private sector firms (such as Citi Microfinance, Swiss Re's Microinsurance program and Visa's Financial Inclusion and Literacy). The efforts of global microfinance networks such as Accion and Pro Mujer have made it easier to raise funds for financial inclusion across borders. New technology is also making it possible for international micro lending to be done via innovative crowd funding platforms like Kiva.

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