Why Financial Inclusion Matters

The future of finance is brightest when it provides valuable services to the broadest swath of society and the economy

AUTHOR
Timothy D. Adams

Introduction

Moving individuals into the financial mainstream is not simply an aspirational goal, it's an attainable goal. Financial institutions can now reach new customers with formal financial services—in payments, savings, credit, and insurance—transforming individual lives and creating a ripple effect that drives improvements across the global economy.

I don't remember exactly when I first read the Rev. Jesse Jackson's now famous line, "capitalism without capital is just plain -ism–and we can't live off -ism," but this idea has stuck with me. It planted the seed for what has become a professional pursuit of mine: working to narrow, and hopefully one day close, the gap between those who have access to the formal financial services industry and those who have been left on the margins. This was something I was able to devote time and attention to during my tenure at the U.S. Department of the Treasury and is also why I added financial inclusion to the Institute of International Finance's agenda (with the Board's blessing, I might add). At a time when global growth is still strong, but currently encountering headwinds, it's essential that the underserved population is included into the larger financial ecosystem. The future of finance is brightest when it provides valuable services to the broadest swath of society and the economy.

Put simply, financial inclusion matters.

Reciprocal Benefits

Underserved individuals, entrepreneurs, and SME business owners benefit from being incorporated into the formal economy. Reciprocally, banks and governments benefit from incorporating the underserved into the formal economy.

- **Individuals are looking for more convenient and secure ways to accumulate, hold, and transfer value.** Inclusion helps families save for retirement or unforeseen emergencies and plan for recurring expenses such as education or rent. Several studies have highlighted that inclusion could improve income and increase savings thus enabling the previously underserved to invest in necessities such as healthcare, education, food, growing their business, and managing financial risk.Digital inclusion, specifically, can lower the cost associated with sending and receiving payments such as subsidy payouts, or remittances, and paying recurring bills. One study showed that receiving social benefits through mobile phones saved recipients an average of 20 hours in commuting and wait time. In other words, financial inclusion enhances economic empowerment, which in turn improves overall welfare while providing the building blocks for further growth.

- **Entrepreneurs and SME owners have innovative ideas and considerable energy but need services, markets, and capital to thrive.** Bringing entrepreneurs and their businesses into the formal financial sector is an important first step to building better-connected financial markets—and ultimately—global markets. It allows those operating in mature markets who have capital to connect with the next generation of young entrepreneurs in emerging markets who need capital. Gaining access to financial services enables entrepreneurs and SME owners to utilize these institutions' valuable consulting services to help invest capital and grow their businesses. This in turn empowers them to make better business decisions, which results in business expansion, job creation, and supports economic prosperity.

- **Banks are looking to grow and serve future markets, which are larger and more inclusive.** Scale matters for banks, and growing the business and market means developing products and services for more segments of the economy. This is particularly true now that technology is facilitating competition from new types of players who provide similar services and readily take advantage of the skyrocketing value of consumer data. Creating brand equity for new customer segments and reaching new, previously underserved customers early will help create a valuable, enduring relationship.

- **Governments benefit when all citizens are connected, the velocity of money and economic activity is increased, and transmission mechanisms efficiently execute monetary policy.** Decreasing the size of the informal economy also provides greater transparency into financial transactions by increasing security and regulatory oversight. Financial inclusion and account ownership can help reduce corruption, discourage tax evasion, and allow for more effective subsidy payouts. Reverting to digital payments for subsidy and pension payments instead of the traditional cash disbursement method has cut down administrative costs and has improved efficiencies.

Over the past three years, financial inclusion has made great strides and delivered numerous benefits to these four segments of society. As noted in the 2017 Global Findex report, the latest findings available, 69 percent of adults now own an account at a financial institution or through a mobile money provider, up from 62 percent in 2014 and 51 percent in 2011. Financial institutions are a driving force in this inclusion story. All but 2 percent of that 69 percent had accounts in financial institutions. And the 67 percent in 2017 reflects substantial progress in the past few years: up from 51 percent in 2011 and 61 percent in 2014.

When we first launched our financial inclusion efforts at IIF, there was an assumption that banks were secondary players in the efforts to foster financial inclusion. Successive Findex reports have now confirmed that banks are playing a critical role in these efforts and, in many ways, act as the backbone.

We have described some of the more innovative efforts **made by our members**. To finish the job and to extend financial services to the remaining underserved population—nearly 2 billion people around the world—we'll need banks, policymakers, NGOs, and others to work together to eliminate obstacles and explore new solutions.

Financial inclusion, built on sustainable business models with mainstream financial service firms, brings individuals and small businesses into an ecosystem where they can flourish and integrate into the broader formal economy. Getting the word out to industry, the public sector, civil society, and other parties working on financial inclusion is important to ensure that these parties' efforts are additive to one another, coherent and cohesive, and force multipliers. Only by working together can we make a lasting impact.

Technology Changing the Equation

Technology's role in fostering financial inclusion cannot be understated. It is changing the cost equation and increasing the benefits for all parties involved. It is making it more cost effective for traditional financial institutions to reach previously untapped markets and allowing new market entrants to better serve customers at every part of the economic pyramid. For example, financial institutions are digitizing the customer journey to create a seamless customer experience utilizing technology to increase customer reach, make access on-demand 24/7, and decrease transactional costs.

One particularly exciting improvement is modernizing the customer onboarding process. Regulators, in partnership with financial institutions, have introduced e-Know Your Customer (e-KYC) initiatives which have significantly increased the account ownership percentages acknowledged earlier. Biometric information and digital IDs are being used to authenticate users and create credit histories, which in turn lowers default and fraud rates.

However, it is not enough for financial institutions to merely improve the number of underserved customers, they must also ensure that accounts are being used by looking at activity rates. One way to accomplish this is by developing innovative products focused on design and tailoring solutions to low income consumer needs. The four types of products offered through financial institutions mentioned in my opening paragraph—payments, savings, credit, and insurance—have undergone massive transformations over the past several years.

- **Payments:** The use of digital payments, meaning access through a mobile phone or the internet, is on the rise, newly connecting 11 percent of the world's population between 2014 and 2017 to reach 52 percent of adults. The electronic mobile wallet, an application that enables person-to-person, person-to-merchant and bill payment transactions, is a good example of an innovative product utilizing digital payments. Electronic wallets allow remittances and bill payments to be conducted in a matter of minutes vs. hours or even days, saving low income segments valuable time and money. According to the Groupe Spéciale Mobile Association (GSMA), unique mobile subscribers reached 5 billion in 2017 (a penetration rate of 66 percent of the global population), making electronic mobile wallets an ideal channel for reaching consumers and enabling payments.

- **Savings:** Financial institutions have been increasing financial service accessibility in rural areas. In emerging markets, for example, they are using agent networks to reach underserved rural populations. These systems—wherein financial institutions designate authority and responsibility to third parties in order to offer services to typically low income or remote customers—have increased customer trust, financial capability, and use of products. They have also lowered the costs associated with providing services to these underserved segments of the market and reduced the costs to savers who make smaller deposits. The use of technology by agents and tailoring savings products to the needs of savings groups and low-income segments will further ensure the underserved are being incorporated into the formal economy.

- **Credit:** Financial institutions are using social media data, mobile call data records, bill payment patterns, and psychometric testing to establish credit profiles and target previously invisible consumers. Advanced analytical techniques enable financial institutions to provide access to credit to clients, with historically low financial transaction data, who are otherwise excluded from the formal financial sector. Predictive analytics are being used to assist financial institutions in forecasting the credit needs of SMEs and low-income consumers, helping previously unbanked customers grow their businesses.

- **Insurance:** Machine learning is transforming insurance, analytical tools are re-defining traditional risk models, and identity and onboarding solutions are creating a more convenient on-demand service while decreasing costs for insurance firms. Safeguarding the underserved against financial risk can help people at the base of the economic pyramid manage the stresses of illness, crop failures, natural disasters, or income loss due to the death of a wage earner.

Financial institutions have and will continue to innovate, creating products and services that are best suited for the unbanked market, while acting as financial consultants and risk managers for individuals and SME owners alike.

Setting a Vision

The 2017 Global **Findex** highlighted that, globally, about 1.7 billion adults remain unbanked. High costs, long distances, lack of documentation, and distrust of the financial system generally, have been identified as the main barriers to opening an account. Financial institutions have an unprecedented opportunity to dramatically grow their customer base in a sustainable manner by leveraging new technologies.

Incorporating the previously unserved into the economy is becoming a more attainable goal for financial institutions, and while financial institutions and regulators are embracing new technologies to make financial services more affordable and accessible, it is critically important to always keep the consumer's best interest in mind. Educating underserved consumers, transparently communicating service offerings, and addressing the persistent gender and wealth gap are of utmost importance to increase trust in the financial services industry.

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Technology is helping to realize the vision of creating tailored financial products and services for vulnerable consumers. And while digital technology is not an end in and of itself, it is a means to achieve broad-based financial inclusion and to ultimately achieve the United Nations' Sustainable Development Goals (SDGs), those 17 interrelated goals that endeavor to ensure peace and prosperity for all. Emerging technologies are empowering financial institutions to go the extra mile and serve the underserved market. Increasing access to finance and doing it in a manner that protects this segment of society is coming closer to reality with each passing day.

As we accelerate into the digital age, it is critical for us to get financial inclusion right. The last century has seen global trade fuel dramatic GDP growth and remarkable improvements in life expectancy, literacy, and democracy around the world. Although it is not without some shortcomings and challenges, this system of global trade and financial intermediation is the most successful system we have developed to improve human living standards. Connecting people to capital matters. Helping individuals take advantage of economic opportunities matters. Ensuring that as many people around the world are connected to our global economy and its benefits matters.

This is why financial inclusion matters.

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