FEATURED INSIGHT

RETHINKING FINANCIAL INCLUSION AT HARVARD: MY 5 TAKEAWAYS

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Last October, I attended Harvard University's seminar, "Rethinking Financial Inclusion: Innovation for Policy and Practice". This one-week event issued a bold and forthright call to action to design financial products that meet the needs of underserved populations.

The good news is, access to financial services for the underserved has been significantly expanding over the last 10 years. Twenty years ago, policy makers assumed that the poor needed microenterprise loans more than any other financial service. Today the rise of cell phones and mobile banking has significantly changed the landscape to offer a broad range of new opportunities. In Kenya alone, financial access increased from 27% to 67% in just 7 years from 2006 to 2013, notably by implementing digital business models (World Bank).

This is great news!

But policy makers and government officials are now faced with a new challenge: **how to leverage the potential of this broader financial access to boost entrepreneurship, reduce poverty, and improve well-being?**
Led by two distinguished Harvard Kennedy School academics, Asim Ijaz Khwaja (Professor of International Finance and Development) and Charity Troyer Moore (India Research Director for Evidence for Policy Design), about 60 executives from the government, the private sector, and non-profits were immersed in the topic. The ambience was collaborative and inspiring. A broad range of policy options for financial inclusion was discussed, highlighting the needs to be met and analyzing the most pressing challenges, and packed with case studies and findings from cutting-edge research.
In my view, these are the five takeaways from this Harvard seminar (one for each day). This post, however, depends neither upon the review of an exhaustive catalogue of texts, authors, and ideas dealing with financial inclusion nor upon an analysis of clearly established positions and arguments that together delimit the field of financial inclusion. My intention is rather limited to these five takeaways (or issues) that may determine if financial inclusion can deliver on its potential.

#1: Challenge -Why Does Financial Inclusion Matter?
#2: Definition - What Is It, Exactly?
#3: Data - Can Financial Inclusion Be Measured?
#4: Innovation - Is Technology A Shiny Silver Bullet?
#5: Impact - Can Social Goals Mesh With Finance?

TAKEAWAY #1: THE CHALLENGE
WHY DOES FINANCIAL INCLUSION MATTER?

Awareness is growing that finance is central to the economy and the populations in developing countries. Financial access is central to managing the ebb and flow of daily life. It helps families and businesses plan for long-term goals as well as emergencies.

In the last decade, financial inclusion has emerged as a new paradigm of economic growth. Many developing countries have adopted national strategies on financial inclusion for their most vulnerable citizens.
For instance, India's Pradhan Mantri Jan-Dhan Yojana program illustrates the country's ambitious strategy to shrink financial exclusion. Started in August 2014, this program helps low income citizens to get access to financial services, such as a savings bank account, credit, remittances facility, and insurance. As of last November, 307 million bank accounts were opened and 230 million RuPay debit cards (a card payment settlement system that competes with Visa and MasterCard) were issued through the program.

Although initial results were mixed, the program has significantly improved. Today, more than seven out of 10 bank accounts of the previously unbanked are more active, making direct benefits transfers and traditional transactions, such as savings and deposits. According to the Government of India, total deposits in these accounts have reached Rs69,026 crore versus Rs33,704 crore in early 2016. The rate of zero-balance accounts has fallen from 60% in 2015 to less than 25% today.

The impact is obvious: new account holders are not just receiving government benefits under the scheme, but have started using their accounts to manage their daily finances. The Reserve Bank of India's vision is to open nearly 600 million new customer accounts by 2020, and service them through a variety of channels, by leveraging technology such as mobile banking.

More excluded than included?

While financial services to underserved populations has grown in the last few decades, big challenges remain. An estimated 1.7 billion adults worldwide still don't hold a basic bank account. About 60% of adults worldwide say a lack of funds is the main reason why (World Bank). Some groups are more excluded than others: women, the rural poor, remote or hard-to-reach populations, informal microenterprises and small firms. Forcibly displaced populations present an urgent challenge: almost 80% of adults in fragile and conflict-affected states are outside the formal financial system.

What is more, about 200 million micro, small and medium-sized enterprises (MSMEs) in emerging economies don't have the financing to thrive and grow. According to recent surveys by the African Development Bank, the estimated value of unmet demand for MSME finance in Africa alone is around USD100 billion to USD120 billion. These MSMEs face the greatest hurdles in getting affordable finance, especially for cross-border trade. Globally, over half of finance requests by MSMEs to banks are rejected. Limited access to finance hinders the development of the MSME sector and of the broader economy.

Therefore, more than ever, it is crucial to continue innovating with financial products that meet the needs of underserved populations, while also ensuring the sustainability of financial providers. Indeed, using evidence to create successful, sustainable financial products that can satisfy the needs of a new and expanding high-potential client base requires novel thinking and technically sound analysis.

TAKEAWAY #2: DEFINITION
WHAT IS FINANCIAL INCLUSION, EXACTLY?

Broadly speaking, financial inclusion is the delivery of affordable banking services for the privileged and the disadvantaged alike under reasonable conditions. Financial inclusion is often defined as the proportion of individuals and firms using the financial services of a formal institution.

But financial inclusion should not be confused with 'financial depth', which is the broad range of financial services available to economic agents. For example, a common measure of financial depth is credit as a percent of GDP. Jordan (80%) rates satisfactory, but on a granular level, only 25% of adults have a bank account, and only 8.7% of SMEs have access to credit. Along the same lines, in Tunisia the ratio of credit as a percent of GDP is about 70%, but only 8% of adults have credit with a formal institution (about 20% have credits with relatives). In other words, financial sector performance may be adequate in many countries, but that does not mean there is financial inclusion. To make matters more complicated, many indicators segregate data by the formal and informal sectors, but countries and institutions have different definitions of the formal sector, making it hard to extract data and conduct a good comparative analysis.

Is financial inclusion hard to pin down?

While financial inclusion is no longer considered a fringe area, many well-established institutions are still attempting to define it, or limit the scope. Some definitions are gaining traction. For instance, the Center for Financial Inclusion's definition is used fairly widely: "Full financial inclusion is a state in which all people who can use them have access to a full suite of quality financial services, provided at affordable prices, in a convenient manner, and with dignity for the clients. Financial services are delivered by a range of providers, most of them private, and reach everyone who can use them, including disabled, poor, rural, and other excluded populations."

For sure, financial inclusion is not only about opening a bank account. That is an outdated cliché. Of course, it is a first step toward broader financial inclusion, since it allows people to save money, and send and receive payments. A transaction account is a gateway to other financial services.

However, most experts agree that opening bank accounts for the millions of poor people is not the most straight forward solution in developing countries where financial literacy is low and banking infrastructure lacking. An example from my own experience: I was on a recent mission in an African country, where the government proudly stated that more than 75% of civil servants have access to a bank account to receive their wages. In reality, these civil servants usually maintain a zero-balance account, and prefer to cash-out their entire salary each month and remit money in cash or get cash over the counter to pay daily expenses.

Access doesn't mean inclusive…

During the Harvard seminar, it was widely argued that access can be solved, but access isn't inclusion. Inclusion is complicated. Especially for vulnerable groups.

So, if financial inclusion is about much more than opening bank accounts, what is to be done? There are five points to be made here. First, financial inclusion is about financial literacy, to make sure people can make sound financial decisions, select financial products that best fit their needs, and use the right channels, such as Automated Teller Machines (ATMs) or mobile banking. Second, it is about data, or getting reliable customer data so policy makers can effectively design digital financial solutions that better suit the needs of unbanked individuals. Third, identification is a prerequisite: realistically, people without proper ID cards cannot realistically access financial services. In some countries, people only have voting cards to prove their identity. In countries where several ID documents are needed to open an account, financial inclusion efforts haven't made as many inroads as in those countries where this process has been simplified. Fourth, consumer protection and regulations must be strengthened, to protect vulnerable populations that could be exploited when using financial services. Fifth, promoting confidence in using financial services is crucial. Customers need to be treated fairly, product information to be disclosed fairly and safety and reliability standards to be set up so consumers can make informed choices.

TAKEAWAY #3: DATA
CAN FINANCIAL INCLUSION BE MEASURED?

As a leading research institution, Harvard is well placed to collect evidence on 'big data'. Data creation is growing at a mind-boggling rate. The statistics collected during the Harvard seminar speak volumes. Some 99% of the world's data have been generated in the past two years. An astounding 2.5 quintillion bytes of data are now created every day. By 2020, about 1.7 megabytes of new information will be generated every second for every human being on the planet. Within five years, there will be over 50 billion smart connected devices that collect, analyze and share data. By 2020 over 6.1 billion people will use smartphones.

Wealth of big data, little data on policy?

Sure, several surveys gauge the level of financial inclusion at national, regional, and international scale. For instance, the Finscope Survey from the Finmark Trust, the IMF Financial Access Survey, the Financial Inclusion Insights (conceived in 2013 with the support of the Bill and Melinda Gates Foundation), or the Global Findex from the World Bank are valuable tools to inform the design of policy on financial inclusion.

Moreover, policy makers have made sizeable efforts to try defining useful metrics to measure financial inclusion in the recent past. For example, at the Los Cabos G20 Summit in June 2012, governments endorsed a basic set of financial inclusion indicators born out of the work of the Global Partnership for Financial Inclusion (GPFI). In recent years, GPFI and its stakeholders have sought to arrive at a general consensus on data and measurement, including common definitions of the components of financial inclusion and consistent methodologies to collect data. New types of indicators were introduced over the years, e.g. indicators on financial literacy and the quality of financial service (2013) or on use, availability, and quality of digital financial services (2016). The indicators defined by policy makers cover both supply-side and demand-side data to form a comprehensive view.

Theoretically it should be possible to measure financial inclusion in three dimensions: (i) access to financial services; (ii) usage of financial services; and (iii) the quality of the products and the service delivery.

Despite the efforts made to capture the state of financial inclusion, the paucity of reliable data remains an issue. Indeed, evidence is much needed to backup support for policy making on financial inclusion. Some countries have sophisticated data collection mechanisms, while others have none at all. When metrics are not standardized across the board, cross-country data are difficult to use for benchmarking, and comparative analysis often remains inconclusive. More importantly, most datasets are not necessarily regularly updated for obvious reasons related to available funding and resources or technical capabilities. This is a major drawback. Why? Getting outdated data (e.g. from 2014-2015) does not make a lot of sense sense when financial markets evolve rapidly. More than even, the proliferation of disruptive digital models in e-payments and mobile banking requires policy makers to get the right data and monitor financial inclusion achievements and disparities on a frequent basis.

TAKEAWAY #4: INNOVATION
IS TECHNOLOGY A SHINY SILVER BULLET?

Information technologies are a major driver of innovation in financial services. Digital payments and infrastructure, e-wallets, and modern point of sale (POS) terminals show how technology can further the expansion financial services in developing Asia and Africa.

For example, in the last few years, the mobile money sector has taken off in the Democratic Republic of Congo (DRC). Based on research done by Finance for Impact, hree operators are active on the DRC market (Vodacom/M-Pesa, Orange Money and Airtel Money). In the third quarter of this year, there were 15 million mobile money accounts in the DRC, through which 34.6 million of connections were made valued at about USD200 million. Vodacom/M-Pesa has 30,000 agents in the country to facilitate low-value money transfers and pay bills, even in remote areas (Orange money has 14,000 agents in the country). Subscribers hold electronic accounts and access them with their mobile phones. Even though the banking sector has to shoulder the big costs of maintaining infrastructure (e.g. bank branches, staff, ATMs costing more than USD25,000 each), mobile operators can set up new solutions easily and at low cost, such as e-wallets. This makes the offering attractive, in particular when bank penetration is low in remote areas. Digital models expand the distribution of financial services to poor, which are usually underserved by traditional bank branch networks.

While mobile banking use was initially just for transferring money and paying bills, services now extend to making payments, disbursing salaries and making other bulk transfers, such as government-to-person (G2P) transfers. In India, Paytm started with online mobile recharge and bill payments, and is now one of the largest online marketplaces, with over 250 million registered users. Paytm has been widely adopted by low income groups for basic financial services, such as paying for utilities and daily goods and services, replacing traditional branch banking. Paytm has created a distinctive value proposition for low income customers, gaining a strong competitive advantage from the way it has managed value chains to the set of activities for creating, delivering, and supporting its services to underserved populations.

Also payment systems have become an important part of the overall package of financial inclusion policies in their own right. Establishing an efficient and modern payment system and associated digital settlement framework creates a conducive environment. Payment services can help boost access to financial services for the underserved population. And digital payment systems are usually better than paper-based systems; they are faster, safer, and provide efficiency and traceability. Today, these digital payment systems usually make enrollment easier, reduce charges, and give beneficiaries more control over transactions. Governments have put in place low-cost systems and low-income groups have widely adopted them for basic transactions, such as making remittances, paying bills or getting governmental aid. Usually, modern electronic payment options also include card-based payment solutions and mobile applications.

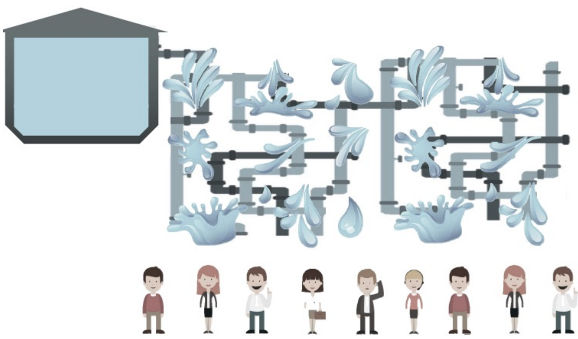
Innovations in financial technologies can boost client outreach and reduce transaction costs to nearly zero, but they create new transparency problems that could pose serious risks to clients. Many countries are concerned that regulation is inadequate for newly created digital financial services. Measures are needed to raise consumer awareness of the risks of loans, and to make sure consumers understand the terms and conditions--especially important given the rapid growth and expected outreach of these new digital services.

TAKEAWAY #5: IMPACT
CAN SOCIAL GOALS MESH WITH FINANCE?

A growing body of evidence has been produced in past years on financial inclusion by multilateral organizations (e.g. World Bank), NGOs / think tanks, academic institutions (MIT J-PAL), etc. Although many reports point out to improvments (e.g. showing financial services have improved individual and household welfare and spurred small enterprise activity in many countries), evidence shows mixed results in some areas. For instance, Emily Breza, one of the key speakers at the Harvard program on financial inclusion, discussed the 'ups and downs' of microfinance. Once seen as the most promising field in development, the world seemed to have fallen out of love with microfinance in the late 2010s (with some signs of reemption in past years). Nevertheless, since 2005, tremendous rigorous research has been produced in this field, thus helping to shed light on the pros and cons in microfinance.

A range of financial inclusion services and policies begun in past years have produced some good results and will need to be thoroughly evaluated in the future. For instance, insurance for coping with external shocks and risks, such as weather-based index insurance, seems to give small farmers the confidence to grow riskier cash crops, buy fertilizer, or hire in many countries. Mobile money has also helped make digital payments and reduce household transaction costs; laso rather than traveling long distances, people can do business by mobile phone. The Pradhan Mantri Jan-Dhan Yojana program discussed earlier is another example of a large scale financial inclusion effort that provides underserved markets with access to finance. The program has put the basic plumbing of financial inclusion in place, so that millions of bank accounts have been opened over the last three years. With the pipes in place, water (cash) has been flowing in the form of government payments of benefits and deposits.

Put your money where your …



While many countries have really expanded financial inclusion, accessing finance in formal sector institutions remains an overall challenge for some populations. So laying the pipes is not the full solution. The more 'cash' put into the pipes (financial system), the leakier (friction) the system. Some fixing and adjusting in financial inclusion policies are needed for the 'cash' to appropriately reach the underserved.

To start with, most bank financing is still given to well-established clients. Most traditional financial institutions such as commercial banks like to assert that SMEs and underserved markets are a high priority. The reality is otherwise. Smaller enterprises, youth and women continue to face major challenges in getting a bank account. They tend to have less collateral, weaker management, and are more vulnerable to information asymmetry (lack of access to information), reducing their chances of getting credit.

Friction in financial mediation is often tense and this obstacle must be overcome. For example, the use of systematic collateral by financial institutions (and lack of guarantees to reduce such use of collateral) has unintended consequences, some of them defeating the purpose of the collateral policy itself (as it forces clients to build up unnecessary amount of assets so that these liquid assets can be collateralized). Information asymmetries are also a major impediment. Typically, low income individuals or small businesses do not have satisfactory information that prospective lenders, such as commercial banks, can use to make financing decisions. As a result, better screening and monitoring solutions are needed.

Playing field leveler

There are innovations in this space. For instance, the Entrepreneurial Finance Lab (EFL Global), incubated at Harvard University, offers an innovative approach for credit scoring. Alternative finance mechanisms can also be of great help. Peer-to-peer lending takes a "crowdsourcing" approach to identifying responsible borrowers. This model has been rapidly growing in recent years, used by Prosper, Zopa, Kiva, Myc4, Lending Club, Pertuity Direct, and Fynanz. Prosper has funded USD400 million in loans and has 1.6 million members.

Toward the end of the seminar, HBS Professor Mihir Desai delivered a fascinating lecture and perhaps asked one of the most probing questions of all during the week: **Can we reconcile finance with society?** It will not be easy. The finance industry has a terrible image as deceitful financiers. Once placed on a pedestal, they are now blamed for shallow wealth accumulation, outsized egos, insatiable appetites who are addicted to risky practices.

But finance isn't inherently bad, Desai said. There are "tales of heart and hard work," he said, and finance practitioners who hold firmly to core values of humility and social progress. Alexandra Bergson, the heroine of O Pioneers!, a novel by Willa Cather, shows us the way forward, Desai said. Bergson, a first-generation immigrant from Sweden who lived on the Nebraska plains, was a skilled risk taker who knew how to use leverage to positively change the lives of the people around her.

And Desai seemed willing to make the ultimate point. The greatest accomplishment is not wealth, or status.

The greatest ambition of all will be for finance to generate sustainable and long-term economic and social returns for all. The current efforts by the industry and the policy community to restructure finance will be crucial to building a more inclusive economy.

I would like to conclude by thanking the faculty staff of Harvard Kennedy School for a wonderful learning experience. Thanks also to my lovely fellow-students for the great exchanges on how to change the world of financial services and inclusion.