



FINANCIAL INCLUSION IN AFRICA



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Financial Inclusion in Africa

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Foreword

Africa is at a turning point. Many countries have achieved high growth rates over the past decade, and many aspire to structural transformation, but the good performance has not translated into significant poverty reduction and shared prosperity. It has yet to provide low-income households and other vulnerable groups enough opportunity to improve their living standards. In terms of economic indicators, North Africa was performing well, but the young, low-income earners, and other vulnerable groups had been excluded from employment opportunities and other means of generating livelihoods to enable them to exit poverty. The civil unrest and social and political tensions of the so-called “Arab Spring” were a reality check to many countries in North Africa to be more inclusive. The challenge of inclusion is not new, but the social explosion in North Africa has been an eye-opener for policymakers everywhere, and for the development community as whole. A clear paradigm shift has resulted in a more inclusive and sustainable growth agenda. For its part, the African Development Bank (AfDB) has launched its Ten-Year Strategy 2013–22, the main thrust of which is inclusive and green growth.

The concept of inclusive growth is multifaceted and has financial inclusion as one of its main building blocks. For sustained and inclusive development to thrive, a great deal of innovation and thinking is needed to ensure that appropriate financial services and instruments are put in place for the benefit of the poor and other vulnerable groups. Financial inclusion is a multidimensional concept that encompasses all initiatives, from both supply and demand sides, within the financial sector. They include provision of appropriate and quality financing that is both accessible and affordable to low-income and other vulnerable households. Notably they target groups traditionally excluded from the formal financial sector.

This publication is edited by Thouraya Triki and Issa Faye from the AfDB's Development Research Department. It is a novel effort in at least three different ways. First, it contributes to our understanding of the issue of financial inclusion, on which there is little research to date. In doing so, this publication provides a comprehensive definition of financial inclusion and discusses issues related to measurement. Further, it explores what financial inclusion really means from a number of different perspectives including small and medium enterprises, women, rural areas and agriculture, and fragile states, and provides strategic options for its promotion. Second, the analysis is based on new and unique datasets. This enables contributors to rigorously analyze financial inclusion from the point of view of segments of the population, users groups, or sub-regions served by the formal and informal financial services in Africa. Third, the publication brings together a wealth of knowledge on financial inclusion from experts and practitioners from the broader development community, including the World Bank, International Finance Corporation, Alliance for Financial Inclusion, Overseas Development Institute, Inter-American Development Bank Group, Dalberg, La Pietra Coalition, and AfDB.



I am pleased to present this publication on financial inclusion to you. I believe that it will contribute to the debate on inclusive growth in Africa as it has clear policy messages and recommendations. I have no doubt that it will have an impact in all parts of Africa and inspire all stakeholders in the financial sector and others concerned about inclusive development on the continent.

Mthuli Ncube

Chief Economist & Vice-President
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The editors would like to thank the contributors to this special issue: Nina Bilandzic, Narjess Boubakri, Pietro Calice, Asli Demirgüç-Kunt, Angela Hansen, Maria Luisa Hayem, Martin Hommes, Andrea Reyes Hurtado, Leora Klapper, Isabella Massa, Erick Sile, Peer Stein, Sandra Taylor, and Ana Maria Torres. They acknowledge also with thanks the contribution of the Alliance for Financial Inclusion.

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Alliance for Financial Inclusion (AFI) is a global network of financial policymakers from developing and emerging countries working together to increase access to appropriate financial services for the poor. AFI achieves its mission by facilitating several types of financial inclusion policy related activities including a membership program, the convening of Working Groups, the provision of grants, a Policy Champions program and the annual Global Policy Forum. AFI's unique peer-to-peer learning model encourages and enables financial policymakers to interact and exchange knowledge. This information interchange results in the building of a more comprehensive knowledge based on financial inclusion and the



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Abbreviations

ADB	Asian Development Bank
AfDB	African Development Bank
AFI	Alliance for Financial Inclusion
AGF	African Guarantee Fund
AML-CFT	Anti Money Laundering/ Combating the Financing of Terrorism
ATMs	Automated Teller Machines
BCEAO	Central Bank of West African States
BIO	Belgian Investment Company for Developing Countries
BMI-SBI	Belgian Corporation for International Investment
CBL	Central Bank of Liberia
CDC	Commonwealth Development Corporation
CDD	Customer Due Diligence
Cenfri	Centre for Financial Regulation and Inclusion
CGAP	Consultative Group to Assist the Poor
COFIDES	Coopérative Financière pour le Développement de l'Economie Solidaire Nord Sud
CPIA	Country Policy and Institutional Assessment
CSR	Corporate Social Responsibility
DAC	Development Assistance Committee
DEG	German Investment Corporation
DFCU	Development Finance Company of Uganda Bank Limited
DFID	Department for International Development
DFIs	Development Finance Institutions
DRC	Democratic Republic of Congo
DTB	Diamond Trust Bank



EBRD	European Bank for Reconstruction and Development
EFiNA	Enhancing Financial Innovation & Access
EIB	European Investment Bank
FAS	Financial Access Survey
FEFISOL	European Solidarity Financing Fund for Africa
FIDWG	Financial Inclusion Data Working Group
Finnfund	Finnish Fund for Industrial Cooperation
FMO	Netherlands Development Finance Company
FNB	First National Bank
FSAP	Financial Sector Assessment Programs
G2P	Government to Person
GDP	Gross Domestic Product
GIM-UEMOA	Groupeement Interbancaire Monétique de l'Union Economique et Monétaire Ouest Africaine
Global Index	Global Financial Inclusion Indicators database
GOWE	Growth-Oriented Women's Enterprises
GPFI	Global Partnership for Financial Inclusion
GSMA	GSM Association
IADB	Inter-American Development Bank
ICRW	International Center for Research on Women
ICTs	Information and Communication Technologies
IFC	International Finance Corporation
IFU	Investment Fund for Developing Countries
IMF	International Monetary Fund
KS	Kilimo Salama
KYC	Know Your Customer
LAC	Latin America and the Caribbean
LBCs	Licensed Buying Companies

MAP	Making Access (to financial services) Possible
MIF	Multilateral Investment Fund
MFIs	Microfinance Institutions
MFW4A	Making Finance Work for Africa
MIGA	Multilateral Investment Guarantee Agency
MITAF	Microfinance Investment and Technical Assistance Facility
MSMEs	Micro, Small and Medium Enterprises
NBFI	Non-Bank Financial Institution
NGO	Non-Governmental Organization
Norfund	Norwegian Investment Fund for Developing Countries
NPLs	Non Performing Loans
OECD	Organization for Economic Co-operation and Development
OeEB	Development Bank of Austria
OHADA	Organisation pour l'Harmonisation en Afrique du Droit des Affaires
P2P	Person to Person
PEAMEF	Progression Eastern African Microfinance Equity Fund
PIDG	Private Infrastructure Development Group
POS	Point of Sale
Proparco	Société de Promotion et de Participation pour la Coopération Economique
ROSCAs	Rotating Savings and Credit Associations
RTGS	Real Time Gross Settlement System
SELFINA	Sero Lease and Finance Ltd
SIFEM	Swiss Investment Fund for Emerging Markets
SIMEST	Società Italiana per le Imprese all'Estero
SMEs	Small and Medium Enterprises
SOFID	Sociedade para o Financiamento do Desenvolvimento
Swedfund	Sweden's development finance institution
TCX	Currency Exchange Fund



ULA	Uganda Land Alliance
UN	United Nations
UNCDF	United Nations Capital Development Fund
UNDP	United Nations Development Program
UPU	Universal Postal Union
USAID	United States Agency for International Development
VCF	Value Chain Finance
WAEMU	West African Economic and Monetary Union
WAMI	West African Monetary Institute
WB	World Bank
WBES	World Bank Enterprise Surveys
WBG	World Bank Group
WAMZ	West African Monetary Zone

Country Classification

North Africa: Algeria, Egypt, Libya, Mauritania, Morocco, and Tunisia.

Southern Africa: Angola, Botswana, Lesotho, Madagascar, Malawi, Mauritius, Mozambique, Namibia, South Africa, Swaziland, Zambia, and Zimbabwe*.

East Africa: Burundi*, Comoros*, Djibouti*, Eritrea*, Kenya, Rwanda, Seychelles, Somalia*, South Sudan*, Sudan*, Tanzania, and Uganda.

West Africa: Benin, Burkina Faso, Cape Verde, Côte d'Ivoire*, The Gambia, Ghana, Guinea*, Guinea Bissau*, Liberia*, Mali, Niger, Nigeria, São Tomé e Príncipe*, Senegal, Sierra Leone*, and Togo*.

Central Africa: Cameroon, Central African Republic*, Chad*, Democratic Republic of Congo*, Republic of Congo*, Equatorial Guinea, and Gabon.

*Fragile state as of July 2012.

Introduction

Africa is now the world's second fastest growing region after Asia, with annual GDP growth rates in excess of 5% over the last decade. Despite this growth, the "Arab Spring" events showed that good economic growth in the continent had not translated into shared prosperity and better livelihoods for the majority. Growth has to be inclusive to be socially and politically sustainable. One key component of inclusive development is financial inclusion, an area in which Africa has been lagging behind other continents. Less than one adult out of four in Africa have access to an account at a formal financial institution. Broadening access to financial services will mobilize greater household savings, marshal capital for investment, expand the class of entrepreneurs, and enable more people to invest in themselves and their families.

Financial inclusion is therefore necessary to ensure that economic growth performance is inclusive and sustained. Financial inclusion refers to all initiatives that make formal financial services *Available, Accessible and Affordable to all segments of the population*. This requires particular attention to specific portions of the population that have been historically excluded from the formal financial sector either because of their income level and volatility, gender, location, type of activity, or level of financial literacy. In so doing, there is a need to harness the untapped potential of those individuals and businesses currently excluded from the formal financial sector or underserved, and enable them to develop their capacity, strengthen their human and physical capital, engage in income-generating activities, and manage risks associated with their livelihoods. Financial inclusion goes beyond improved access to credit to encompass enhanced access to savings and risk mitigation products, a well-functioning financial infrastructure that allows individuals and companies to engage more actively in the economy, while protecting users' rights.

The objective of this publication is to contribute into the debate on financial inclusion on the continent while documenting the state of financial inclusion in Africa and informing policymakers, financial sector stakeholders and development actors about existing opportunities and specific challenges that need attention and action. It describes the multi-faceted nature of financial inclusion through a compilation of chapters discussing the topic from different perspectives. It is structured around three main parts. The first part lays the groundwork for the subsequent analyses, the second part looks at some transformational mechanisms and approaches designed to serve the underserved, and the third part tackles strategic issues and options.



Part 1: Financial Inclusion in Africa: Setting the Stage

This first part of the special issue sets out the analytical framework of the publication and aims at familiarizing the reader with the main concepts of financial inclusion. It includes two chapters that describe respectively the concept of financial inclusion and efforts to measure it, as well as a snapshot of the state of financial inclusion in Africa.

In chapter 1, the Alliance for Financial Inclusion (AFI) describes different concepts related to financial inclusion, namely access (making financial services available and affordable to users), usage (making customers use financial services frequently and regularly) and quality (making financial services tailored to clients' needs). The chapter also describes existing surveys measuring those three dimensions both from the supply side and demand side of financial services. It also discusses existing initiatives to develop global indicators such as the AFI core set and the G-20 Global Partnership for Financial Inclusion (GPFI) indicators to ensure standardization of indicators internationally. The chapter highlights the scarcity of data describing financial inclusion in Africa and the importance of political will to implement surveys measuring this concept.

In chapter 2, Asli Demirgüç-Kunt and Leora Klapper use the Global Financial Inclusion Indicators (Global Findex) database and the World Bank Enterprise Surveys (WBES) to provide a detailed description of the state of financial inclusion for households and SMEs in Africa. For the first time, segments of the population served by the formal and informal financial services in Africa, different sub-regions, and users groups are analyzed. The analysis in this chapter helps shed some light on account penetration, savings behavior, barriers to formal account ownership, access to credit and insurance, and reasons reported for use of different financial services on the continent. It shows that Africa lags behind other developing regions both in terms of access and cost, and that cost, distance, and documentation requirements remain important impediments to the development of inclusive financial systems.

Part 2: Serving the Underserved: Selected Transformational Approaches

The second part of the publication discusses the financial inclusion status for specific groups that have been historically underserved by the formal financial sector given their attributes. Barriers preventing these groups from accessing finance and transformational solutions that have been implemented to improve their financial inclusion are also discussed. The four chapters in this section focus respectively on financial inclusion issues related to Africa's Small and Medium Enterprises (SMEs), women, rural economy, and fragile states.

In chapter 3, Peer Stein, Nina Bilandzic and Martin Hommes gauge the current SME's status with respect to financial inclusion in Africa and estimate the current credit gap at about USD 100 billion, of which USD 70 to 90 billion for SMEs in Sub-Saharan Africa alone. They also

describe main barriers preventing SMEs from accessing finance, provide examples of possible transformational solutions to overcome these barriers and highlight the need for conducive regulatory frameworks, demand and supply country diagnostics, and efficient and reliable financial infrastructure to better manage credit risk of SMEs.

Sandra Taylor and Narjess Boubakri examine in chapter 4 the financial inclusion status for women and women-owned businesses in Africa. They show that women are less likely to use formal financial services mainly because they have lower incomes, are less educated, and are more likely to operate in the informal sector. They then point out the major economic and socio-cultural barriers as well as inefficiencies in legal and regulatory frameworks that are preventing women from accessing and using financial products and services in Africa. They conclude by highlighting the need to reform regulatory frameworks and promote positive changes in cultural norms, study women-specific needs and create adapted financial products and services, encourage innovation, and create support programs for women's entrepreneurship.

In chapter 5, Angela Hansen takes stock of financial inclusion for rural areas and agriculture in Africa. She predicts that new models based on value chain funding (VCF) and information and communication technology (ICT) will have a transformative role in expanding financial inclusion for agriculture and rural areas in Africa. Policy recommendations and proposed actions include the need to institute laws that protect farmers by securing their land tenure, develop pilot buyer and food company-led value chain efforts, build transparent pricing platforms, and strengthen large-scale cooperatives.

In Chapter 6, Erick Sile analyzes financial inclusion from African fragile states' perspectives. He describes the many challenges that fragility poses to developing inclusive financial systems, and compares African fragile states' performance to non-African fragile states. He argues that the instability and uncertainty involved in many fragile states requires a contextualized, flexible, and customized solution and points out a few key principles that development partners should focus on to ensure successful and sustainable financial inclusion in fragile states.

Part 3: Strategic Issues and Options

The last part of this publication discusses some strategic issues and options related to the design and implementation of the financial inclusion agenda in Africa. These encompass the transformative role that technology could play in achieving greater financial inclusion, the need to reconcile financial inclusion and financial stability, lessons that Africa could learn from other developing regions, and the role of Development Finance Institutions (DFIs).

Africa has been at the forefront of mobile financial services. Issa Faye and Thouraya Triki discuss in chapter 7 how technology could be a game changer in advancing the financial inclusion agenda in Africa. They describe the state of mobile financial services on the continent, looking



at the number of mobile deployments, business models that have been used, and comparing the cost of such services to the cost of comparable conventional financial services. The chapter also examines the role that other technology-based solutions such as Automated Tellers Machines (ATMs) and Points of Sale (POSs) could play to promote inclusive financial systems in Africa. The authors also document main barriers preventing the development of technology-based financial services and conclude by recommending the implementation of more flexible regulatory frameworks to foster innovation and the promotion of mobile Government-to-Person payments (G2P).

DFIs have been often cited as one of the key players to advance the financial inclusion agenda. In chapter 8, Isabella Massa documents what DFIs have been doing in Africa to improve financial inclusion for households and SMEs, as well as their support to financial infrastructure. She documents the number of financial inclusion-related operations implemented by DFIs, the types of instruments they have been using, and compares involvement of different DFIs. She concludes that despite current achievements, more effort is needed from DFIs in terms of provision of capacity-building and advisory services to push the financial inclusion agenda forward. She also points out to the necessity for greater transparency in reporting DFIs' interventions to allow proper assessment of their development effectiveness in the area of financial inclusion.

The implementation of innovative solutions for financial inclusion could pose challenges to regulators and supervisors and threatens systems' stability. In chapter 9, Pietro Calice describes how financial inclusion can contribute to maintaining a sound and stable financial system if managed properly. He uses the South African experience to substantiate this view. He also suggests a framework that provides guidance on the regulatory approach that is likely to maximize both financial stability and financial inclusion.

What can Africa learn from the experience of other developing regions? In chapter 10, Andrea Reyes Hurtado, Ana María Torres and María Luisa Hayem compare the state of financial inclusion in Latin America and the Caribbean (LAC) with the one in Africa and describe some innovative models, such as agent banking, that have contributed to fostering inclusive financial systems in LAC. They describe potential lessons to be drawn from LAC that could help to move the financial inclusion agenda in Africa forward. These include the importance of government's commitment, the fact that addressing demand-side constraints is equally important to supply-side constraints, and the need to promote innovation.

PART 1

SETTING THE STAGE



I. Defining and Measuring Financial Inclusion

Alliance for Financial Inclusion (AFI)

1. Introduction

Interest in and dedication to promoting financial inclusion has grown dramatically in recent years, as seen in the number of countries that committed to the Maya Declaration and the G-20 Financial Inclusion Action Plan, as well as strategies and targets set by individual governments¹. To track progress in achieving more inclusive financial systems and gauge their impact, a clear and unified definition of financial inclusion is needed and data collection efforts must be aligned with growth in financial inclusion commitments and programs. Rigorous, well-tailored data is instrumental to identify policy gaps, understand both served and underserved populations, and define priorities for action. While data availability is increasing, many international data sets only cover part of Africa, and African countries are yet to implement nationally-led surveys of financial inclusion at a large scale. More can definitely be done to increase the coverage and scope of financial inclusion data on the continent.

With a focus on Africa, this chapter provides a more comprehensive definition of financial inclusion while describing its main dimensions that require measurement, outlines existing sources of data on financial inclusion, and gives an overview of recent initiatives to develop global indicators on financial inclusion as well as options for national-level data collection.

2. Defining the Concept of Financial Inclusion: A Foundation for Measurement

Definitions and measurements of financial inclusion have evolved from classifying individuals and enterprises according to a dichotomous division as either included or not, to viewing financial inclusion as multi-dimensional. With the aim of defining a more complete concept of inclusion, the Financial Inclusion Data Working Group of the Alliance for Financial Inclusion (AFI

Figure I.1: Dimensions of Financial Inclusion

1. ACCESS	Availability of formal, regulated financial services: Physical proximity Affordability
2. USAGE	Actual usage of financial services and products: Regularity Frequency Duration of time used
3. QUALITY	Products are well tailored to client needs Appropriate segmentation to develop products for all income levels

Source: Adapted from Alliance for Financial Inclusion Financial Inclusion Data Working Group (2011).



FIDWG) agreed on three main dimensions of financial inclusion that provide the underpinning for data collection: access, usage and quality.²

The adoption of broader and multidimensional definition of financial inclusion is crucial in the sense that it helps to move beyond the often erroneous assumption that inclusion will inevitably be achieved by simply offering enough access points. Instead, a more complete understanding of financial inclusion should speak to how frequently clients use products, if the products are effectively meeting their needs, and if they are better off as a result. Therefore, as depicted in Figure I.1, defining and measuring usage and quality in addition to simple access would be very useful for analytical purposes. These three dimensions of financial inclusion are broad categories into which indicators can be grouped, without being restrictive. They simply provide a framework to guide policymakers in developing a sufficiently robust measurement strategy that reflects the multi-dimensional nature of financial inclusion. Within this framework, policymakers will still need to design a set of indicators appropriate to their needs and level of resources.

Although efforts to promote financial inclusion should strive to improve all three dimensions simultaneously, when setting priorities for measurement, a number of countries are now gathering information sequentially, assessing access first, usage second, and examining quality third. This is often because in most countries, data on the level of service provision is more easily obtained than usage and quality data. In Africa, many countries are now at the level of collecting mostly access and some usage data. However, in countries where the FinScope Surveys are carried out, usage and quality data may be more easily available than access data because of the surveys' focus on these dimensions.

3. Overview of Available Data on Financial Inclusion

To better capture financial inclusion, it is crucial to start with fully analyzing and understanding the existing data. A number of institutions, mainly donor-funded, have invested significant resources in measurement of financial access and usage, globally and in Africa, with a particular focus on the supply side. Financial inclusion data has traditionally been separated into supply and demand-side information. Supply-side data comes from providers of financial services, while demand-side data involves interviews with end-users of products: individuals, households, and firms.³ Central Banks often collect some supply-side data as part of their supervision duties for regulated institutions, and this can be a good source of information at the national level. However, supply-side data provided by central banks or supervisory bodies on the number of accounts and Automated Teller Machines (ATMs) in a country is not detailed enough to provide information about how many people have accounts (due to multiple accounts held by some individuals) and how access varies by region, income level, and other variables. In some countries central bank data may not provide a useful level of granularity about financial access.

3.1 Supply-Side Data

Table I.1 presents a non-exhaustive list of surveys focusing on the supply side of financial services, aggregated mainly by multilateral institutions. Most of the data reported in these surveys comes from central banks and other supervisory bodies that collect data from financial institutions.

Table I.1: Examples of Available Supply-Side Data on Financial Inclusion

Survey name	Data providers	Africa coverage	Focus
CGAP Financial Access report	Regulators and financial institutions, compiles other World Bank data	Most African countries	Savings and credit, regulation, physical outreach, SMEs
World Bank Development Indicators - Financial Sector	Regulators and financial institutions, compiles other World Bank data	Most African countries	Health of financial sector and macroeconomic indicators
African Development Bank/ Making Finance Work for Africa partnership	Regulators and Financial institutions	Most African countries	Regulatory frameworks and financial system structure
World Bank Financial Development and Structure Database	Regulators and Financial institutions	Most African countries	Size, efficiency, and stability of banks, nonbanks, capital markets
IMF Financial Access Survey	Regulators and Financial institutions	Most African countries	Availability of banking services and distribution of physical outlets
IMF International Financial Statistics	Deposit taking institutions, microfinance institutions, insurance providers, and other financial service providers	Most African countries	Macroeconomic indicators, consumer prices, exports and imports, GDP, reserves, and more
IMF Financial Stability Indicators	Regulators and commercial banks	Most African countries	Market development and stability of financial systems
World Bank Payment Systems Survey	Regulators	18 African countries (as of 2010)	Legal and regulatory frameworks, supervision payment systems development, remittances and transfers
MIX Market	Microfinance organizations	14 African countries (as of 2011)	Number of microfinance borrowers, loan balances, and deposits
GSMA Mobile Development Intelligence	Mobile network providers	53 African countries	Mobile connections and coverage, mobile money, mobile health data

Source: Authors' compilation from various datasets.



Although supply-side data has good coverage of the prevalence of financial services, it does not tell us much about access and usage, or about why people do or do not use formal services. While the datasets listed above contain a few data points from most African countries, data remains sparse for countries that have historically been conflict-affected. Data is especially lacking for some countries in Central Africa and the Horn of Africa. Since central banks are a primary provider of financial data, country officials may find that the information is not granular enough and does not extend far beyond what is available at the national level. While there is relatively good data coverage of banks, data on prevalence, deposits, loans, and other indicators from cooperatives, microfinance institutions (MFIs), and insurance providers is harder to find. Information on regulations for consumer protection is also lacking.

3.2 Demand-Side Data

Data on user perspectives in Africa is relatively more robust and continuously growing, per Table I.2. For instance, FinScope surveys (demand-side surveys implemented by FinMark Trust) offer a wealth of demand-side information about African financial systems. Additionally, the Global Findex, released in spring 2012, is an important recent contribution providing demand-side data on financial usage from 148 countries, including 42 African countries.

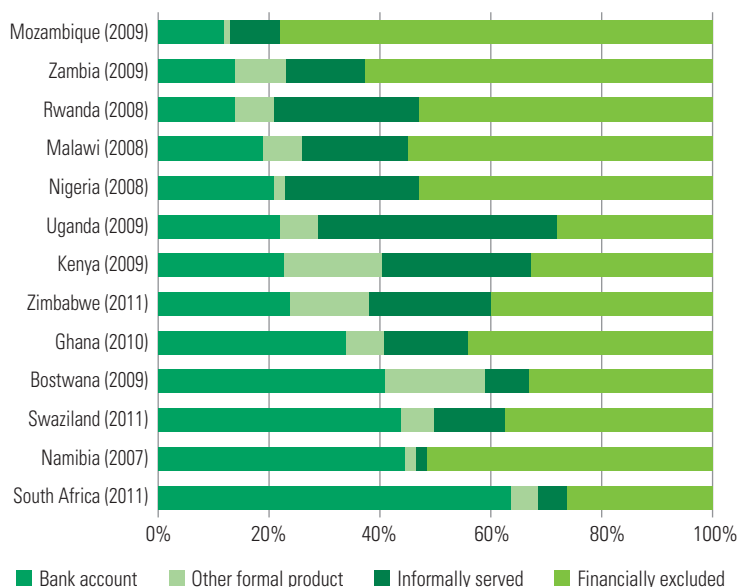
Table I.2 : Examples of Available Demand-Side Data on Financial Inclusion

Survey	Sampling unit	Africa coverage	Focus
Global Findex	Individuals	42 African countries	Access and usage
FinScope	Individuals	15 African countries from Sub-Saharan Africa	Use and perceptions of financial services
Financial Diaries	Households and individuals	South Africa and Kenya	In-depth analysis of financial portfolios and behaviors of low-income people
World Bank Living Standard Measurement Survey- LSMS	Households	Côte d'Ivoire, Ghana, Malawi, Morocco, Nigeria, South Africa, Tanzania	Income, housing, migration, and use of financial services
World Bank Enterprise Surveys	Representative sample of firms	38 African countries	Access to finance, corruption, performance, competition, and more
OECD Financial Literacy Pilot	Individuals	South Africa	Financial literacy and capability across different cultural environments

Source: Authors' compilation from various datasets.

Demand-side surveys may identify levels or a spectrum of inclusion. For example, the FinScope surveys define inclusion based on the access dimension and use the Access Strand to measure financial inclusion, as shown in Figure I.2. The Access Strand is a powerful measurement framework particularly in countries with a significant informal sector. The Access Strand distinguishes between people who have bank accounts, people who have other regulated financial products (such as mobile money accounts, accounts at MFI and other financial products), those who use informal financial products (such as savings groups and informal borrowing), and those who are excluded and use no financial products.

Figure I.2: FinScope Access Strands in Africa



Source: Author's compilation from latest FinScope findings available at <http://www.finscope.co.za>.

While these data on the consumer perspective are essential for understanding financial inclusion, there are limits to the information currently available. FinScope offers rich information for Southern and East African countries, but does not yet cover North Africa and has limited presence in West Africa. It has been argued that financial literacy and capability are key demand-side elements to foster financial inclusion, and little is currently known about these topics in Africa. Surveys are just beginning to measure financial literacy and capability. The Organisation for Economic Co-operation and Development (OECD) and the Making Finance Work for Africa (MFW4A) partnership have launched initiatives to try to improve diagnostics for understanding financial literacy.



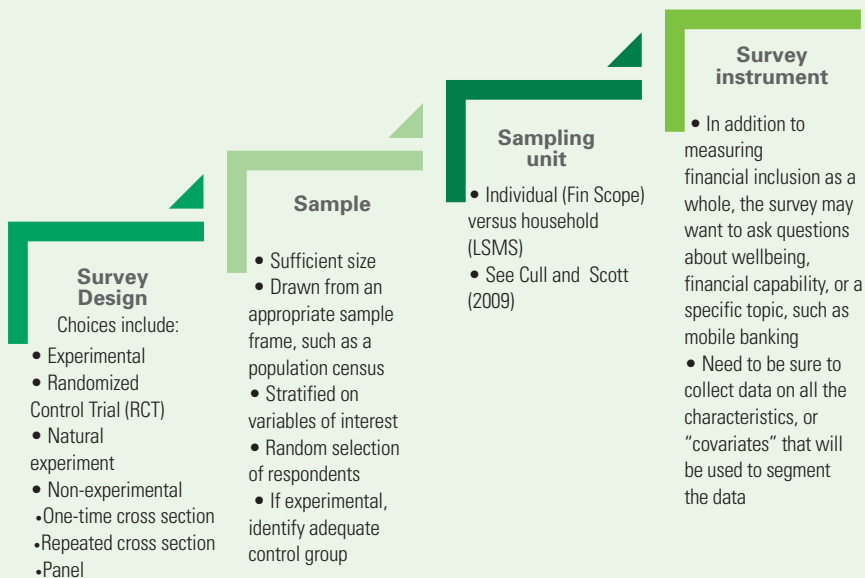
In some countries, such as Burundi and Kenya, Central Banks are taking a prominent role in implementing independent national demand-side surveys that address their countries' particular financial inclusion agenda (see Box I.1). The Central Bank of Burundi is just beginning to design a demand-side survey, while the Central Bank of Kenya is launching the third iteration of the FinAccess survey, a collaborative effort of the Financial Access Partnership of Kenya.

Box I.1: Designing Country Specific Surveys to Measure Financial Inclusion

In addition to available standard data sources, many policymakers are seeking to design country-specific demand-side surveys to answer the questions that are most relevant to their country contexts and domestic agenda. The Central Bank of Kenya, for example, worked with the FinMark Trust and the Kenya Financial Sector Deepening Trust to take FinScope as a starting point and tailor it to fit their needs.

For governments or organizations launching their own data collection exercise, Figure a (below) displays the general processes in preparing for a survey: Designing the approach, sampling, selecting the unit of response, and designing the survey instruments.

Figure a: Sequential Processes in Survey Design



Source: Alliance for Financial Inclusion.

Kenya has worked with the National Bureau of Statistics to design nationally representative surveys in 2006 and 2009, and hired independent research houses to execute them.

Demand-side surveys that attempt to measure access and usage in the population are based on a survey of consumers. But surveys of financial access of enterprises can also be informative. FinMark Trust has supported studies of SMEs in Malawi and South Africa. Enhancing Financial Innovation & Access (EFiNA) in Nigeria has also studied interventions' impact on SMEs via its 2012 survey and is planning more work in this area.

In designing a consumer demand-side survey, the decision to collect information about individuals or households is an important one. An individual who reports only accounts in their name may understate their access, as he or she may have access to products that are officially in the name of another household member. But a randomly chosen respondent may give incorrect or incomplete information about the rest of the household. Cull and Scott (2009) performed an experiment using different interview designs in Ghana, and found that asking the head of the household about household-level information is almost equally as reliable as asking all household members about their individual use of financial services.

4. Designing Global Indicators for Financial Inclusion

4.1 AFI Core Set

In data collection exercises, a balance must be struck between international comparability and domestic relevance. Country stakeholders wish to capture indicators that inform policy or market decisions, but also need to have some standardization of indicators internationally in order to measure financial inclusion at the regional and global levels. The AFI's FIDWG agreed on a core set of indicators that include fundamental financial inclusion variables from both supply-side and demand-side sources created by and for policymakers. The current core set of indicators covers 2 dimensions of financial inclusion: Access and usage and are presented in Table I.3. The FIDWG is working on defining standards for the third dimension of quality.

The AFI core set of indicators is divided into a first tier that all member countries will aim to collect, and a second tier of indicators from which country stakeholders can elect to collect information when it is relevant to their local context. This first tier of the core set of indicators is within reach and straightforward for many countries to collect by drawing on information from the regulatory and supervisory bodies, national statistics offices, credit bureaus, and bankers' associations. To date, eight African countries have collected and submitted the core set data: Burundi, Kenya, Malawi, Morocco, South Africa, Tanzania, Uganda and Zambia. The second tier of indicators will contain a broader set of indicators that give more details on access, usage, and quality.⁴

Table I.3: AFI Core Set of Indicators

Dimension	Definition of dimension	Core indicator	Proxy indicator	Definitional comments
Access	Ability to use financial services, minimal barriers to open an account.	Number of access points per 10,000 adults at national level and segmented by type and relevant administrative units		Regulated access points where cash-in (including deposits) and cash-out transactions can be performed.
	Physical proximity Affordability	Percent of administrative units with at least one transaction point		Demand-side indicators of distance may help here if nationally consistent.
		Percent of total population living in administrative units with at least one access point		
Usage	Actual usage of financial services/products	Percentage of adults with at least one type of regulated deposit account	Number of deposit accounts per 10,000 adults	Adults 15 and older, or age defined by the country
	Regularity Frequency Length of time used	Percentage of adults with at least one type of regulated credit account	Number of loan accounts per 10,000 adults	Attempt to measure active accounts

Source: Alliance for Financial Inclusion.

4.2 G-20 GPFi Measurements

The G-20 Global Partnership for Financial Inclusion (GPFi) also adapted a set of guiding indicators starting with the AFI core set and modifying and adding indicators. These indicators, presented in Table I.4, are available for most countries from the IMF Financial Access Survey (FAS), the Global Findex, and the World Bank Enterprise Surveys-discussed earlier.

4.3 Qualitative Research and Financial Inclusion Indices

In addition to the surveys and indicators discussed above, qualitative methods, such as structured or open-ended interviews, focus group discussions, mystery shopper exercises, and

Table I.4: G-20 GPFI Financial Inclusion Indicators

Dimension	Category	Indicator	Existing global data source
Usage	Formally banked adults	% of adults with an account at a formal financial institution	Global Findex
		Number of depositors per 1,000 adults OR number of deposit accounts per 1,000 adults	IMF FAS
Usage	Adults with credit from regulated institutions	% of adults with at least one loan outstanding from a regulated financial institution	Global Findex
		Number of borrowers per 1,000 adults OR number of outstanding loans per 1,000 adults	IMF FAS
Usage	Formally banked enterprises	% of SMEs with an account at a formal financial institution	WB Enterprise Surveys
		Number of SMEs with deposit accounts/number of deposit accounts OR number of SME depositors/number of depositors	IMF FAS
Usage	Enterprises with outstanding loan or line of credit from regulated institutions	% of SMEs with an outstanding loan or line of credit	WB Enterprise Surveys
		Number of SMEs with outstanding loans/number of outstanding loans OR number of outstanding loans to SMEs/number of outstanding loans	IMF FAS
Access	Points of service	Number of branches per 100,000 adults	IMF FAS

Source: Adapted from Hernandez-Cos and Goosen (2012).

ethnographic research can make significant contribution to understanding financial inclusion and its determinants. Qualitative methods are increasingly used to complement and inform the design of quantitative surveys. For example, focus group discussions with unbanked individuals can provide more personalized, holistic information on the informal financial tools clients use, and about the most important barriers to opening accounts. Furthermore, it may be less costly to learn about usage and quality indicators using qualitative research. In such research designs, a large sample is not so important, but gaining detailed and complete stories is. A well-designed questionnaire and experienced interviewers who understand the goals of the research are indispensable as well.

While current data collection efforts largely measure self-standing indicators, the idea of a financial inclusion index that combines many metrics into a consolidated measurement is



gaining increasing attention. Such indices can combine variables from supply and demand-side data, and across the access, usage, and quality dimensions to create a comprehensive picture of financial inclusion. Initially proposed by Sarma (2008) in the image of the UNDP human development index, initiatives aimed at constructing financial inclusion indices are springing up.⁵ These indices are often used to compare levels of inclusion within a country or over time. For example, Brazil used the methodology developed in Sarma and Pais (2008) to create an index that compares financial inclusion across its states. The index will also be used to monitor progress over time. This approach has not yet been applied in Africa.

5. Conclusion and Policy Recommendations

Financial inclusion is a multidimensional concept that goes beyond access to encompass usage and quality. Hence, a comprehensive understanding of financial inclusion should consider the availability and accessibility of services, frequency of use, and suitability and quality of financial options for all income levels. A financial system that is fully working for clients should also offer opportunities to easily access information about available products and their terms, and should establish rules protecting the consumer from deception or exploitation.

While there are a number of high-level supply and demand-side indicators on financial inclusion available from international sources, regional and conceptual gaps must be filled in order to construct a comprehensive picture of financial inclusion in Africa. Specifically, on the supply-side, the availability of information on non-bank financial services, such as microfinance, cooperatives, mobile financial services, and in some cases agent banking, could be improved. Little information on consumer protection has been standardized and collected across African countries. On the demand-side, many countries in Africa are lacking a larger-sample national survey of consumers that allows for segmentation according to income, region, and other covariates. Data on financial capability, SME access to finance, and measuring the impact of greater financial access is notably sparse as well.

While measuring such a multifaceted topic is challenging, the AFI Core Set of Indicators is an important starting point, providing a snapshot of access and usage of basic formal financial services. Developing reliable, evidence-based metrics for quality and welfare, as well as effectively combining supply and demand-side data lie at the frontier of financial inclusion measurement.

From the findings in this chapter, a few key recommendations could be made to further support the development of financial inclusion data in Africa:

- African policymakers concerned with understanding financial inclusion in their countries should advocate for national demand-side surveys. Relying on supply-side data collected by national regulators and supervisory bodies is not sufficient given that the latter does not capture information on usage and quality.

- When interventions to improve financial inclusion are planned, policymakers and development partners may wish to undertake a baseline and follow-up analysis, and to randomize the distribution of the incentive or product if possible, in order to effectively measure its impact. This would allow a proper assessment of the interventions and revision if needed.

Financial inclusion champions are needed. Providing for a dedicated unit or staff member in the central bank, ministry of finance, national statistics office, or other organization is useful as it helps to have one clear advocate coordinating research efforts and advocating for more financial inclusion data.

Notes

1. The Maya Declaration is the set of commitments to financial inclusion made by AFI members. More information is available at: <http://www.afi-global.org/gpf/maya-declaration>. Also see the Global Partnership for Financial Inclusion action plan developed by G-20 countries, available at <http://www.gpfi.org/our-work/work-plans/g20-financial-inclusion-action-plan>.
2. Formed in 2009, the AFI Financial Inclusion Data Working Group (FIDWG) aims to develop and promote a framework for measuring financial inclusion to be used by all AFI members, and to create opportunities for members to share lessons learned on financial inclusion data collection and policymaking. See AFI (2011) for more information, including the list of current member countries.
3. Successfully combining supply and demand-side data is often seen as the paragon of excellent financial inclusion data, but matching data requires a strong disclosure on the part of clients, often including access to individual-level financial institution data with a unique identifier, such as a national ID number.
4. All the indicators that countries have implemented, including specific survey questions, are available from AFI.
5. After the publication of Sarma (2008), authors such as Chakravarty and Pal (2010) and Gupte et al. (2012) developed modified financial inclusion indices, which have often been applied to Indian states.

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II. Financial Inclusion in Africa: A Snapshot

Asli Demirgüç-Kunt and Leora Klapper

1. Introduction

In recent decades, access to financial services has dramatically improved in African countries. More financial services, especially credit, are now provided to individuals and enterprises. New technologies such as mobile money have also helped broaden access to financial services, including savings and payment products. Yet, until recently, in Africa and elsewhere, little was known about the reach of the financial sector—the extent of financial inclusion and the degree to which disadvantaged groups such as the poor, women, and youth are excluded from formal financial systems.¹ Systematic indicators describing the use of different financial services that have been lacking for most economies are now available in the 2012 Global Findex database, covering 148 economies that include 42 from Africa (Demirgüç-Kunt and Klapper, 2012).²

These indicators show that less than a quarter of adults in Africa have an account with a formal financial institution, and many adults in Africa use informal methods to save (such as Rotating Savings and Credit Associations (ROSCAs), tontines, chit funds, burial societies) and borrow (friends, family, and informal private lenders). Similarly, evidence shows that firms in Africa, compared to other developing economies, are more likely to lack proper access to bank credit regardless of their size group. Obviously, the financing constraint is more acute for SMEs. In addition, other financing sources such as equity markets remain underdeveloped.

In recent years, technological advances such as mobile money, innovation, and the creation of new delivery channels including “mobile branches” or banking services through third-party agents started playing an important role in providing greater financial access in Africa. For example, mobile money achieved the broadest success in Africa where 14% of adults report having used mobile money in the past 12 months.

This chapter summarizes the status of financial inclusion in Africa from the perspective of the users of financial services (i.e., individuals and enterprises). It uses a novel data set – the Global Findex – to analyze the characteristics of adults using formal and informal financial services and identify the barriers to formal account ownership. For the first time the segments of the population served by the formal and informal financial services in Africa are analyzed. Using Enterprise Surveys data, the chapter also looks at how SMEs in Africa compare with enterprises in other developing regions in terms of account ownership and availability of line of credits. All key indicators are presented in Appendix 1. The chapter concludes with a few key messages on how to overcome identified barriers to more inclusive financial systems in Africa.



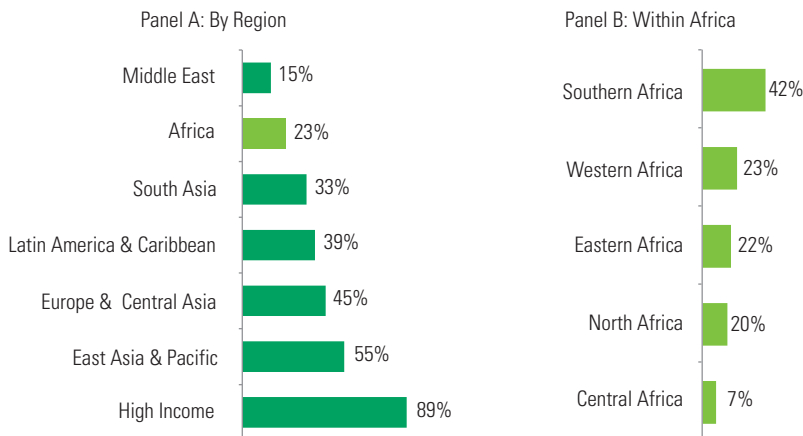
2. Individuals' Access to Finance

Africa's financial system's underdevelopment and its limited outreach are well documented. Low and volatile income levels, inflationary environments, high illiteracy rates, inadequate infrastructure, governance challenges, and the limited competition within the banking industry as well as high cost of banking in Africa are some of the factors used in explaining the underdeveloped financial sector and its limited outreach. However, until recently, very little was known about the actual reach of the financial sector. In what follows we examine access to finance from the point of view of individuals, and look specifically at different aspects that encompass the extent of usage of formal financial services, potential barriers, informal sources of finance, impact on the savings behavior of individuals as well as their borrowing needs and reasons for access to credit.

1.2 Account Penetration

Overall, 23% of adults in Africa have an account at a formal financial institution (Figure II.1). Within Africa, there is a large variation in account ownership ranging from 42% in Southern Africa to 7% in Central Africa (Panel B, Figure II.1).³ In the Democratic Republic of Congo and Central African Republic, more than 95% of adults are "unbanked" (*i.e.*, do not have an account at a formal financial institution). In North Africa 23% of adults have an account at a formal financial institution ranging from 39% in Morocco to 10% in Egypt Arab Republic.

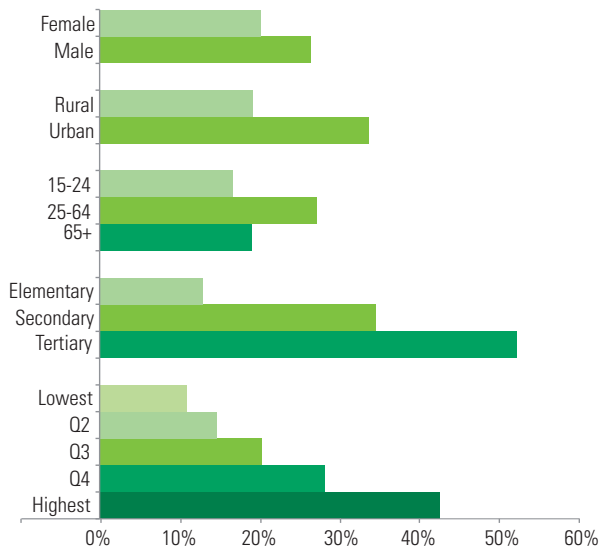
Figure II.1: Account Penetration (% Adults)



Source: Demirgüç-Kunt and Klapper (2012).

Throughout Africa (Figure II.2), men are more likely than women to have an account at a financial institution though the gender gap is smaller compared to other regions (however there is still a 7% difference). On average, adults in the highest within-economy income quintile are almost four times as likely to have a formal account as those in the lowest income quintile. Similarly, adults with a tertiary education and those aged 25-64 are particularly likely to report having an account at a formal financial institution. These gaps highlight the importance of financial literacy in expanding financial inclusion.

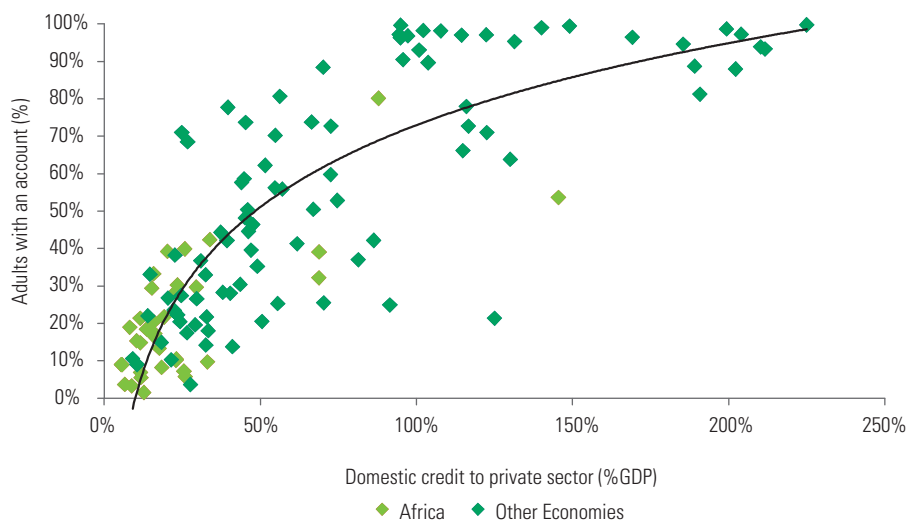
Figure II.2: Account Penetration in Africa by Individual Characteristics (% Adults)



Source: Demirgüç-Kunt and Klapper (2012).

Indicators of financial use by individuals show a positive but imperfect correlation with indicators of financial depth such as credit to the private sector as a share of GDP (Figure II.3). This correlation shows that access to finance is really a distinct dimension, suggesting that financial systems can become deep without delivering access to all. The positive but imperfect correlations of financial services usage with financial depth raise questions regarding the drivers of cross-country differences in financial use and access. The correlations also suggest that there might be room for policy reforms to increase the level of financial inclusion (World Bank, 2008).

Figure II.3: Financial Use vs. Depth



Source: Demirgüç-Kunt and Klapper (2012) and World Bank (2012).

Note: Data excludes Cyprus.

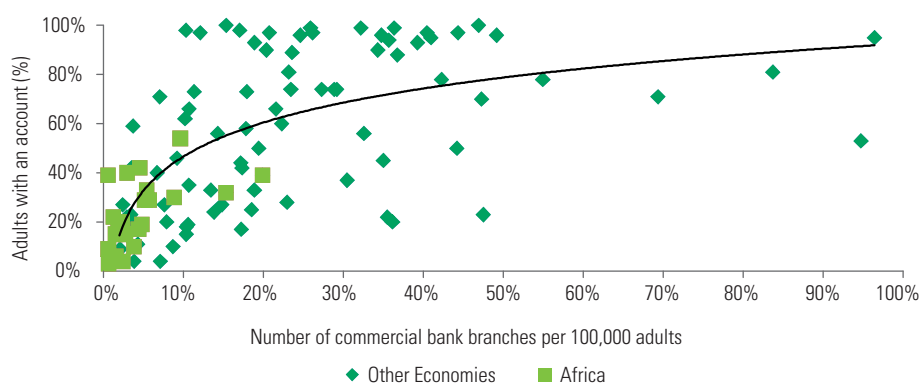
2.2 Barriers to Formal Account Ownership

The most frequently (80% of adults without formal accounts surveyed) cited reason for not having a formal account in Africa is lack of enough revenue to use one. Cost, distance, and documentation are also cited by more than 25% of non-account-holders in Africa. In East Africa, cost is the second most frequently cited reason at 46% and distance is the third. In East and West Africa, documentation is the second most cited reason with 36% of adults giving this as a reason. Fixed fees and high costs of opening and maintaining accounts seem to be hindering factors in Eastern and Southern Africa. For example, in Uganda maintaining a checking account costs the equivalent of 25% of GDP per capita annually, a good reason to not have an account.

In Africa, insufficient documentation is an important barrier for younger adults to open an account while distance from a bank is a commonly cited barrier for adults living in rural areas. Adults with a primary education or less, on average, are more than three times likely to cite insufficient documents as a reason when compared with adults with a tertiary education or more. Cost and distance are also commonly cited among adults with a primary education or less. Bringing financial services to rural clients is a major challenge on the financial inclusion agenda. Often the main barrier to financial inclusion in rural areas is the great distances that rural residents must travel to reach a bank branch. Poor infrastructure and telecommunications,

and heavy branch regulation, also restrict the geographical expansion of bank branches (CGAP, 2009)⁴. Indeed financial inclusion is positively and significantly correlated with access points measured as commercial bank branches per 100,000 people (Figure II.4). Sub-Saharan African economies are at the low end of the spectrum with a low number of commercial bank branches per 100,000 adults and low account penetration. The lack of infrastructure may explain why Africa has been at the forefront of mobile financial services which is considered a bright spot in improving financial inclusion.

Figure II.4: Financial Use vs. Access Points



Source: Demirgüç-Kunt and Klapper (2012) and IMF Financial Access Survey (FAS).

Note: 2009 values from FAS are used as more economies are covered. Data excludes Mauritius and Cyprus.

2.3 How and Why are Formal Accounts Used?

The majority of adults with a formal account in Africa make deposits or withdrawals only one to two times in a typical month. However, in North Africa 36% of adults report they do not deposit into and 29% do not withdraw any money from their accounts in a typical month. ATMs are the main mode of withdrawal for the majority of account holders in East and Southern Africa (even excluding South Africa), while account holders in West and Central Africa are more likely to make withdrawals over the counter at their financial institution. Across the region, 14% of adults (and 63% of account holders) have a debit card.

Worldwide 14% of account holders (and 7% of adults) use their account to receive remittances but in Africa this practice is reported by 41% of account holders (and 10% of adults). Within Africa, the receipt of remittances is highest in Southern Africa. The use of accounts to receive money from family members living elsewhere appears to be particularly common in fragile states: 66% of account holders report using their account to receive remittances in Somalia, 55% in Zimbabwe, and 45% in Sierra Leone.

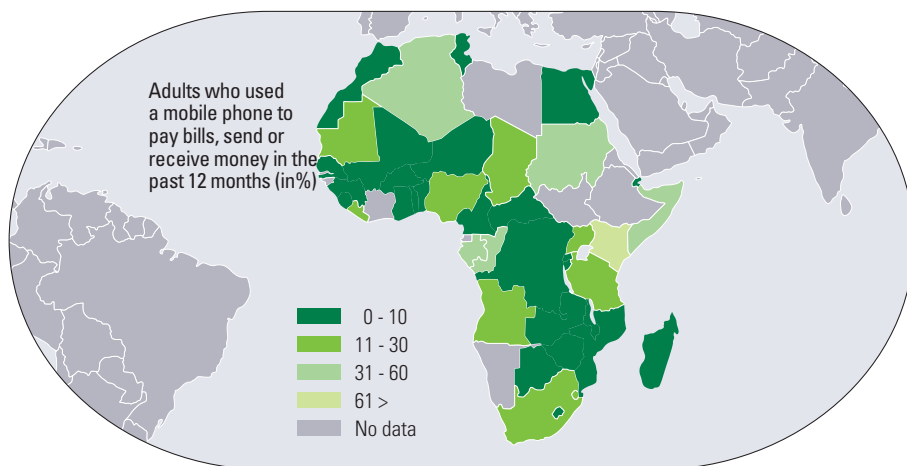


2.4 Alternatives to Formal Accounts: Mobile Money Payments

Although people who do not have an account at a formal financial institution may lose out on the security and reliability that such a relationship provides, they often employ fairly sophisticated methods to manage their day-to-day finances and plan for the future. A growing number of Africans are using new alternatives to traditional banking made possible by the rapid spread of mobile phones.

The recent growth of mobile money—sometimes a form of “branchless banking”—has allowed millions of people who are otherwise excluded from the formal financial system to perform financial transactions relatively cheaply, securely, and reliably. Mobile money has achieved the broadest success in Sub-Saharan Africa, where 16% of adults report having used a mobile phone in the past 12 months to pay bills or send or receive money (overall in Africa, 14% of adults used mobile money in the past 12 months). In Kenya, where the M-Pesa service was commercially launched in 2007, 68% of adults report using mobile money. Similarly, in Sudan, more than half of adults used mobile money. In East Africa, more than 35% of adults report using mobile money.⁵ North Africa is one of the regions in which mobile money use is limited (with the exception of Algeria where 44% of adults report having used a mobile phone to pay bills or send/receive money) which could be due to regulatory constraints imposed on the mobile money operators and banks. The share of adults using mobile money is only 3% (Map II.1). Globally, the share of adults using mobile money is less than 6% in all other regions.

Map II.1: Mobile Money Users in Africa



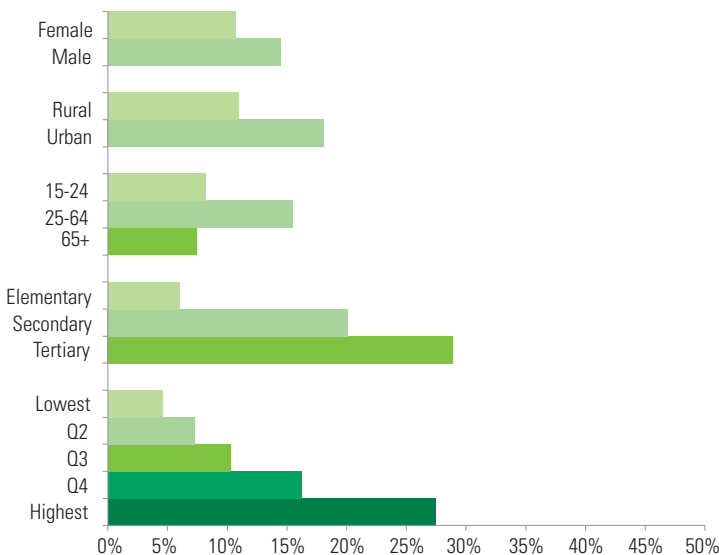
Source: Demirgüç-Kunt and Klapper (2012).

Many mobile money users are not otherwise included in the formal financial system—in Kenya 43% of adults who report having used mobile money in the past 12 months do not have a formal account; in Sudan 92% do not.

2.5 Savings Behavior

Overall, 36% of adults in Africa report having saved or set aside any money in the past 12 months similar to the worldwide average. However, breakdown into sub-regions uncovers a wide heterogeneity. For example, the data show that 50% of adults in West Africa and 16% of adults in North Africa report having saved money (Figure II.5). In Africa 13% of adults (and 35% of savers) report having saved at a formal financial institution in the past year and again there is a wide variation within Africa. For example, more than 16% of adults (and 50% and 35% of savers, respectively) in Southern and West Africa report having saved at a financial institution, while only 4% of adults (and 27% of savers) report having formally saved in North Africa. Formal savings practices are particularly common in Nigeria, South Africa and Kenya. Formal savings rates vary not only by sub-region but also by individual characteristics. For example, men, adults with a secondary or tertiary education, adults whose ages are between 25-64,

Figure II.5: Formal Savings by Individual Characteristics (% Adults)



Source: Demirgüç-Kunt and Klapper (2012).

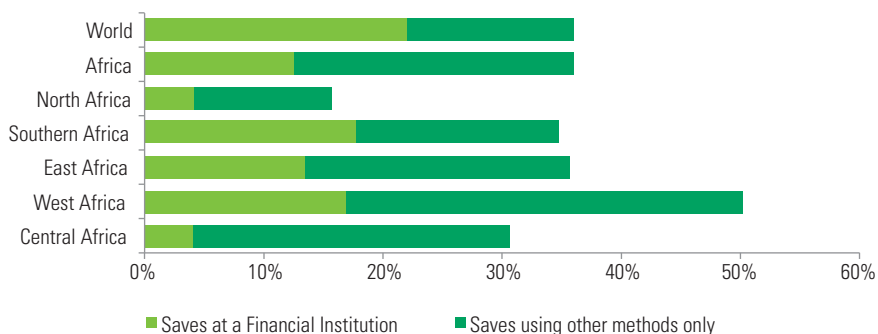


adults living in urban areas, and adults in the highest income quintile are more likely to use formal banks to save on average, whereas informal savings methods are particularly common among women, adults with a primary education or less, adults living in rural areas, and among the poor. In Africa, adults in the richest income quintile are more than five times likely to save formally (Figure II.5).

Community-based savings methods such as ROSCAs are used by close to 100 million adults in Sub-Saharan Africa. In West Africa, 29% of adults (and 59% of savers) report having saved using a savings club or a person outside the family.

Figure II.6 shows that savers tend to blend formal and informal methods. Nevertheless, a large share of the respondents uses *only* community savings clubs. In Sub-Saharan Africa, 34% of those who save report having only used a community based savings club in the past 12 months. This percentage is as high as 46% in West Africa and 37% in Central Africa. More than half of all respondents in North Africa and about half of all respondents in Central Africa who report having saved or set aside any money in the past 12 months did not report having done so using a formal financial institution, informal savings club, or a person outside the family. While the Global Findex survey did not gather data on these alternative methods, they might include saving through asset accumulation (such as gold or livestock) and saving “under the mattress”.⁶

Figure II.6: Savings Behavior in Africa (% Population)



Source: Demirgüç-Kunt and Klapper (2012).

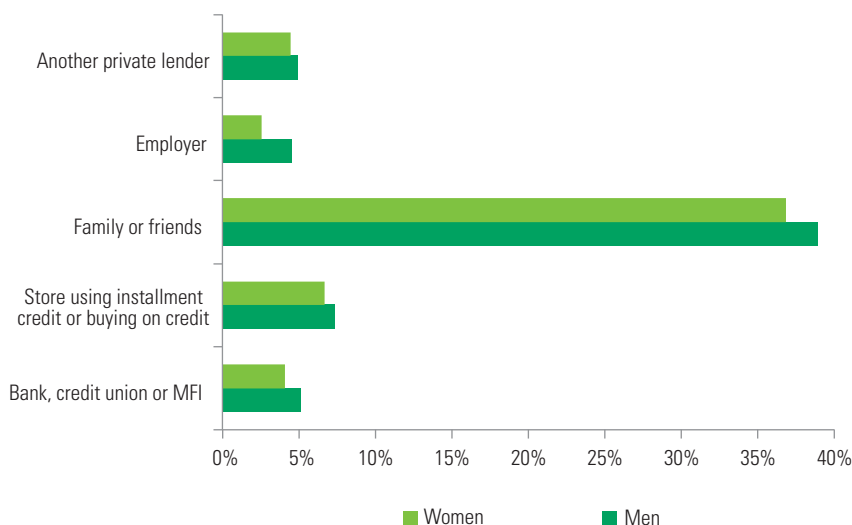
2.6 Credit and Insurance

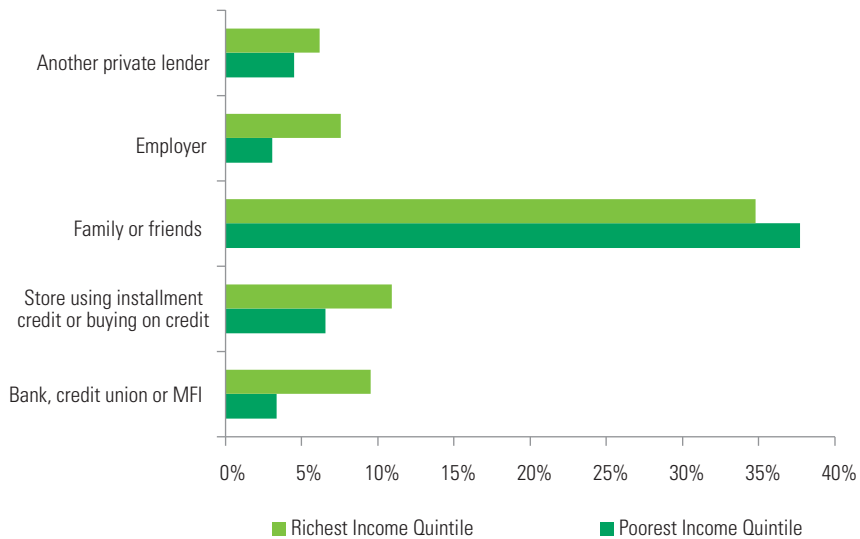
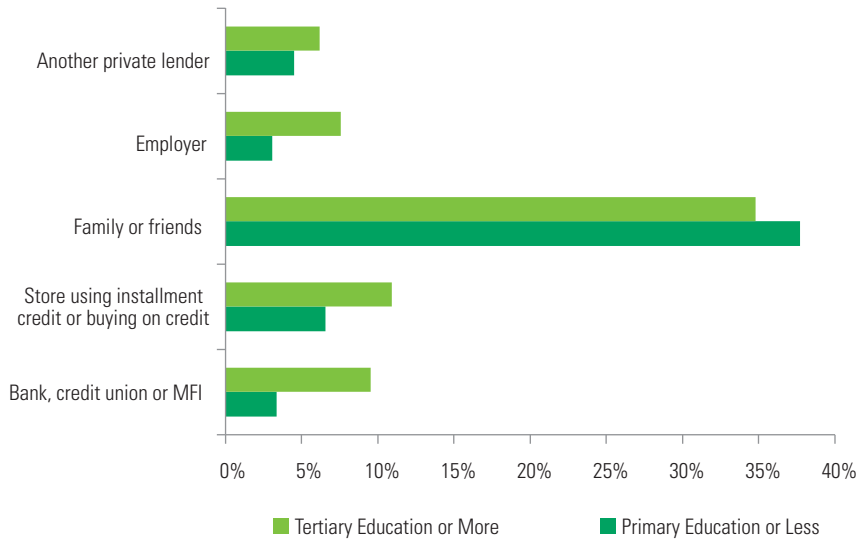
The rate of origination of new loans—formal and informal—is relatively high in Africa with 44% of adults reporting having borrowed money in the past 12 months compared to 34% worldwide. Similar to saving rates, there is a wide variation in borrowing activities within

Africa. 58% of adults report having borrowed money in East Africa compared to only 34% in North Africa. In Africa 39% of adults report having borrowed money from friends or family in the past 12 months, including 28% who report this as their only source of borrowing. Borrowing from family or friends is the most popular source in all sub-regions. In Central and West Africa, only 3% of adults report having received a new loan from a formal financial institution in the past year. The origination of new loans from a formal financial institution is highest in South Africa where 8% of adults reported borrowing formally. Adults in East Africa are particularly likely to report using store credit (13%) and borrowing from a private informal lender is popular in Central and East Africa (7%). Overall, in Africa, only 3% of adults report having a credit card with adults in Southern Africa reporting the highest percentage (7%).

Looking at individual characteristics by sub-region, family and friends is the most common source of borrowing in all sub-regions. However, men, adults with a tertiary education or more, and adults in the highest income quintile use formal financial institutions more, on average (Figure II.7).

Figure II.7: Sources of Credit by Individual Characteristics

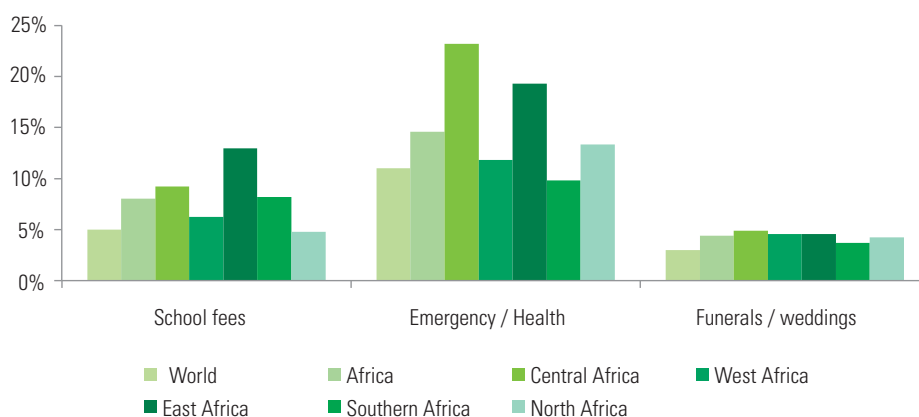




Source: Demirgüç-Kunt and Klapper (2012).

Outstanding loans for funerals/weddings, school fees, and emergency/health purposes are particularly common in Africa (Figure II.8). 15% of adults in Africa have an outstanding loan for emergencies or health-care needs, but 30% of them use only informal sources of credit.

Figure II.8: Reported Reasons for Current Loans (% Adults)



Source: Demirgüç-Kunt and Klapper (2012).

The use of insurance products remains also limited in Africa. Only 3% of adults in Africa report having personally paid for health insurance and only 6% of those who work in farming, forestry or fishing industries report having purchased crop, rainfall, or livestock insurance in the past 12 months. On average, men as compared to women are twice as likely and adults with a tertiary education or more are more than seven times likely as compared to adults with a primary education or less to have personally paid for health insurance. The purchase of crop, rainfall, or livestock insurance varies by individual characteristics as well.

3. Firms' Access to Finance

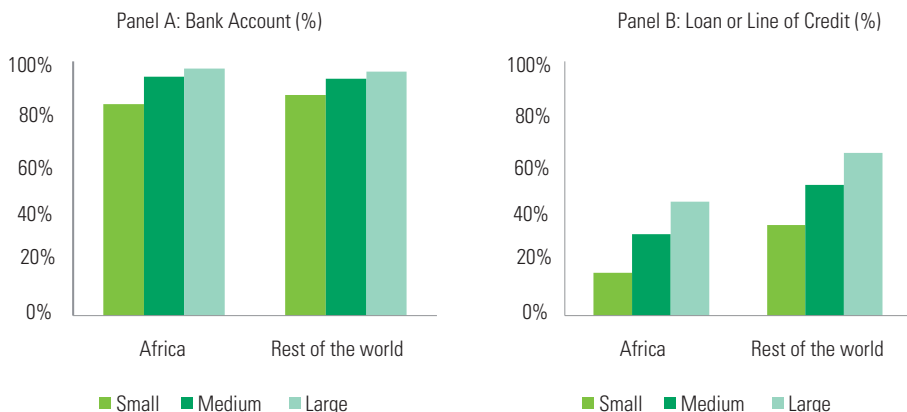
The great financing constraints faced by SMEs, especially in accessing bank finance limit these firms' growth opportunities. To gain a better understanding of firms' access to finance in Africa, data from the World Bank Enterprise Surveys (WBES), which cover more than 130,000 firms in 127 countries, is analyzed. On average, the percentage of enterprises with a bank account (across all firm size groups) in Sub-Saharan African countries is comparable to or greater than the percentage of enterprises with a bank account in all other developing economies. For instance, 83% of small-sized enterprises and 94% of medium-sized enterprises in Africa



report having a bank account as compared to 87% of small-sized and 93% of medium-sized enterprises in other developing economies. A similar pattern is observed for North Africa. In Algeria, 84% of SMEs and 83% of large enterprises report having a bank account. In Morocco 79% of small and 87% of medium-sized enterprises have a bank account.⁷ In Egypt, on average, 74% of firms have a checking account.

Yet, firms in Sub-Saharan Africa have notably limited access to external funding. WBES data show that on average, only 22% of enterprises have a loan or a line of credit. In comparison, the average of enterprises with a loan or a line of credit in other developing economies excluding Africa is 43%. Like elsewhere, small firms in Sub-Saharan Africa are at a relative disadvantage in accessing external credit (Figure II.9). In Sub-Saharan Africa, 45% of firms cite access to finance as a major constraint to growth. However, a higher percentage of small firms identify access to finance as a major constraint relative to medium and large enterprises. Similar results hold for firms in North Africa. 16% of small-sized and 44% of medium-sized enterprises have a loan or line of credit. In Morocco these percentages are 20 and 28 respectively.

Figure II.9: Percent of Firms with a Bank Account/Loan or Line of Credit by Size



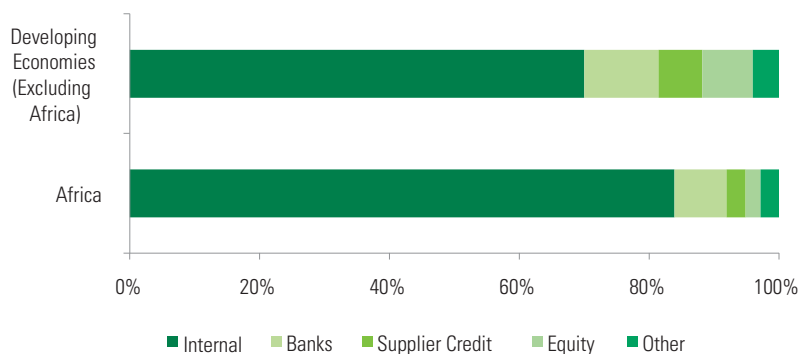
Source: World Bank Enterprise Surveys, various years.

Note: Sample size is 106 countries. Africa includes 38 countries all from Sub-Saharan Africa. All country point estimates are weighted. All regional averages are simple averages.

Using one-year growth rates in employment as a measure of firm growth shows that about 15% of SMEs in both Africa and other developing countries are high-growth firms (*i.e.*, with one-year growth in employment greater or equal to 20% (OECD, 2008)). However, there are important differences in the sources of financing used to finance this growth: In Africa, 84%

of investments of SMEs are financed through internal funds compared with 70% in other developing economies. The share of bank financing in Africa is 8% (compared to an average of 11% in other developing countries) while the share of equity financing in Africa is less than 2%, as compared to about 8% in other developing economies (Figure II.10). This data suggest that firms in Africa, with similar growth opportunities as firms in other developing countries, are more dependent on internal funds and are more credit constrained in terms of accessing external formal financing.

Figure II.10: Investment Financing by “High-Growth” SMEs



Source: World Bank Enterprise Surveys, various years.

Note: “High-Growth” is defined as employment growth greater than 20%. Sample size is 106 countries. Africa includes 38 countries all from Sub-Saharan Africa. All country point estimates are weighted. All regional averages are simple averages.

4. Conclusion and Policy Recommendations

Despite the recent financial sector growth in Africa, many individuals and firms are still excluded from access to formal financial services. Analysis of the usage of (and access to) financial services by adults and enterprises shows that African countries lag behind other developing economies in both aspects, and that cost, distance, and documentation requirements are important obstacles. Analyzing individual characteristics provides an opportunity to identify the demographic groups that are particularly excluded from the financial system. For example, those living in rural areas, the poor, women, less educated adults, young and older adults particularly face challenges in financial inclusion. Barriers faced by both households and enterprises tend to decline as per capita GDP rises, and in countries with more competitive, open, market oriented and well regulated financial systems with more developed contractual and informational infrastructures (World Bank, 2008).



Removing physical, bureaucratic, and financial barriers to expand financial inclusion is challenging since this also requires addressing the underlying structural causes such as low income levels and governance challenges. Nevertheless, measures to improve contestability of financial systems and underlying information and regulatory environment are also likely to speed up the introduction and adoption of new products, processes, and technology that may help further lessen these barriers in Africa. The most evident example is the recent success of mobile money in East Africa which shows that innovations can bring about dramatic changes in how people engage in financial transactions by lowering entry barriers, reducing costs, and expanding access.

Notes

1. Formal financial institutions refer to banks, credit unions and include other financial institutions such as cooperatives, microfinance institutions, or the post office.
2. The complete database and related reports are available at: www.worldbank.org/globalindex (accessed in May 2013). The 2012 Global Findex database provides indicators, measuring how people save, borrow, make payments, and manage risk. These new indicators are constructed with survey data from interviews with more than 150,000 nationally representative and randomly selected adults aged 15 and above. The survey was carried out over the 2011 calendar year by Gallup, Inc. as part of its Gallup World Poll Survey and includes more than 40,000 interviews across 42 economies in Africa.
3. Sub-regional classifications are based on those of the African Development Bank. Country classification is included (in the beginning of this volume). The regional and sub-regional aggregates omit economies for which Gallup excludes more than 20% of the population in the sampling either because of security risks or inaccessibility. In Africa, these excluded economies are Algeria, the Central African Republic, Madagascar, and Somalia.
4. Data is available at: <http://fas.imf.org/> (accessed in May 2013).
5. This high rate of usage in East Africa is also confirmed by the State of the Industry Report of GSMA (2011). A new survey was published by the GSM association (GSMA) about the state of mobile money payments and type of services offered.
6. Financial diaries database confirms that saving “under the mattress” is commonly used in Africa. In the sample of 166 households, more than 70 % of the households had savings at home (www.financialdiaries.com (accessed in May 2013)).
7. Algeria, Morocco and Egypt, Arab Republic surveys did not strictly adhere to the Enterprise Surveys methodology as of May 2012. As a result, this section discusses separately statistics for Sub-Saharan Africa and North Africa. Egypt data is not identified by size.

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Appendix 1: Key Financial Inclusion Indicators for Africa

	Global Index		WBES		IMF Financial Access Survey	
	Formally banked adults	Adults with credit by regulated institutions	Banked enterprises	Enterprises with a LOC	Points of service	
Country	% of adults with an account at a formal financial institution	% of adults with at least one loan outstanding from a regulated financial institution	% of SMEs with an account at a formal financial institution	% of SMEs with an outstanding loan or line of credit	Number of commercial bank branches per 100,000 adults	Number of ATMs per 100,000 adults
Algeria	33%	1%			5.19	6.07
Angola	39%	8%	86%	9%	1.29	12.66
Benin	10%	4%	97%	45%		
Botswana	30%	6%	99%	48%	9.15	30.06
Burkina Faso	13%	3%	96%	28%		
Burundi	7%	2%	90%	34%		
Cameroon	15%	4%	92%	26%	1.43	1.40
Central African Republic	3%	1%			0.62	N/A
Chad	9%	6%	96%	21%	0.59	0.36
Comoros	22%	7%			1.47	3.19
Congo, Dem. Rep.	4%	2%	69%	10%	2.37	1.23
Congo, Republic of	9%	3%	87%	11%		
Djibouti	12%	4%			N/A	1.81
Egypt, Arab Rep.	10%	4%				
Gabon	19%	2%	83%	7%	4.69	8.62
Ghana	29%	6%	82%	18%	4.99	N/A
Guinea	4%	2%	53%	5%		
Kenya	42%	10%	88%	21%	4.41	7.27
Lesotho	18%	3%	89%	33%	3.48	7.28
Liberia	19%	6%	67%	14%		
Madagascar	6%	2%	94%	20%	1.63	1.49
Malawi	17%	9%	96%	39%		

	Global Index		Enterprise Surveys		IMF Financial Access Survey	
	Formally banked adults	Adults with credit by regulated institutions	Banked enterprises	Enterprises with a LOC	Points of service	
Country	% of adults with an account at a formal financial institution	% of adults with at least one loan outstanding from a regulated financial institution	% of SMEs with an account at a formal financial institution	% of SMEs with an outstanding loan or line of credit	Number of commercial bank branches per 100,000 adults	Number of ATMs per 100,000 adults
Mali	8%	4%	85%	16%		
Mauritania	17%	8%	76%	15%	4.27	N/A
Mauritius	80%	14%	97%	45%	590.21	1009.32
Morocco	39%	4%			20.98	
Mozambique	40%	6%	75%	10%	3.37	5.70
Niger	2%	1%	94%	29%		
Nigeria	30%	2%	N/A	4%		
Rwanda	33%	8%	81%	35%	2.20	0.81
Senegal	6%	4%	83%	13%		
Sierra Leone	15%	6%	67%	17%	2.92	0.43
Somalia	31%	2%				
South Africa	54%	9%	98%	29%	10.10	59.58
Sudan	7%	2%				
Swaziland	29%	12%	98%	21%	5.70	21.43
Tanzania	17%	7%	85%	12%	1.81	3.30
Togo	10%	4%	94%	21%	3.72	N/A
Tunisia	32%	3%			16.56	20.84
Uganda	20%	9%	85%	15%	2.49	3.58
Zambia	21%	6%	94%	13%		
Zimbabwe	40%	5%				

Note: Global Index indicators are obtained from Demirgüç-Kunt and Klapper (2012); Enterprise Survey data is available at www.enterprisesurveys.org; IMF Financial Access data is available at: fas.imf.org.

Appendix 2: Detailed Summary Statistics, Adults (%)

	Accounts and payments				
	Share with an account at a formal financial institution	Adults using a formal account in the past year to receive			Adults using mobile money in the past year (%)
	All adults (%)	Payments from work or selling goods (%)	Payments from government (%)	Family remittances (%)	
	Mean	Mean	Mean	Mean	Mean
World	0.50	0.21	0.13	0.07	0.05
Africa	0.23	0.10	0.05	0.08	0.14
Central Africa	0.07	0.02	0.01	0.01	0.08
East Africa	0.22	0.09	0.04	0.07	0.38
North Africa	0.20	0.08	0.03	0.03	0.03
Southern Africa	0.42	0.19	0.13	0.14	0.09
West Africa	0.23	0.09	0.05	0.11	0.09
Gender					
Male	0.27	0.12	0.06	0.09	0.15
Female	0.20	0.07	0.04	0.08	0.12
Age Group					
15-24	0.17	0.05	0.02	0.07	0.13
25-64	0.28	0.13	0.07	0.09	0.15
65+	0.19	0.05	0.07	0.06	0.07
Within-Economy Income Quintile					
Poorest	0.11	0.03	0.02	0.03	0.08
Q2	0.15	0.04	0.03	0.05	0.12
Q3	0.20	0.08	0.05	0.07	0.13
Q4	0.28	0.12	0.06	0.10	0.17
Richest	0.43	0.19	0.11	0.18	0.22
Education Level					
Primary or Less	0.13	0.05	0.02	0.03	0.09
Secondary	0.35	0.14	0.08	0.14	0.19
Tertiary or More	0.53	0.25	0.19	0.18	0.30
Residence					
Rural	0.19	0.08	0.05	0.07	0.12
Urban	0.34	0.13	0.08	0.13	0.19

Note: Data by education level exclude Zimbabwe; data by income quintile and data by rural or urban residence exclude Morocco.

Appendix 2: Detailed Summary Statistics, Adults (%)

	Savings, credit, and insurance					
	Adults saving in the past year		Adults originating a new loan in the past year		Adults with a credit card (%)	Adults paying personally for health insurance (%)
	Using a formal account (%)	Using a community-based method (%)	From a financial institution (%)	From family or friends (%)		
	Mean	Mean	Mean	Mean	Mean	Mean
World	0.22	0.05	0.09	0.23	0.15	0.21
Africa	0.13	0.17	0.05	0.38	0.03	0.03
Central Africa	0.04	0.13	0.03	0.33	0.02	0.01
East Africa	0.14	0.12	0.07	0.48	0.03	0.05
North Africa	0.04	0.04	0.04	0.29	0.03	0.02
Southern Africa	0.18	0.13	0.08	0.37	0.07	0.06
West Africa	0.17	0.29	0.03	0.39	0.01	0.02
Gender						
Male	0.14	0.16	0.05	0.39	0.03	0.04
Female	0.11	0.17	0.04	0.37	0.02	0.02
Age Group						
15-24	0.08	0.12	0.02	0.34	0.02	0.01
25-64	0.15	0.20	0.06	0.41	0.04	0.04
65+	0.07	0.12	0.03	0.31	0.02	0.03
Within-Economy Income Quintile						
Poorest	0.05	0.13	0.03	0.35	0.01	0.01
Q2	0.07	0.15	0.03	0.38	0.01	0.01
Q3	0.10	0.17	0.04	0.39	0.02	0.02
Q4	0.16	0.21	0.06	0.39	0.04	0.04
Richest	0.27	0.19	0.09	0.38	0.07	0.06
Education Level						
Primary or Less	0.06	0.15	0.03	0.38	0.01	0.02
Secondary	0.20	0.19	0.06	0.38	0.04	0.03
Tertiary or More	0.29	0.14	0.10	0.35	0.15	0.14
Residence						
Rural	0.11	0.17	0.04	0.39	0.02	0.02
Urban	0.18	0.16	0.05	0.35	0.05	0.05

PART 2

SERVING THE UNDERSERVED: SELECTED TRANSFORMATIONAL APPROACHES

III. Fostering Financing for Africa's Small and Medium Enterprises

Peer Stein, Nina Bilandzic and Martin Hommes

1. Introduction

Recent evidence based on surveys of 47,745 firms in 99 countries around the world, shows that SMEs are the first suppliers of employment across countries, contributing 66% of the job market of developing countries. Africa is no exception. The continent counts more than 50 million micro, small and medium businesses¹, 69% of which operate in the informal sector. These businesses contribute 58% of total employment and 33% of the continent's GDP, making them critical for socio-economic growth of the continent.² What's more, a recent International Finance Corporation (IFC) study shows that in low income countries, the contribution of small enterprises to employment is higher than contributions of medium and large enterprises (IFC, 2013). Hence, as vital contributors to job and value creation, micro, small and medium enterprises are the lifeblood of Africa's economy.

However, according to the IFC Enterprise Finance Gap Database (2011), on average one out of two enterprises in Africa does not have access to formal credit or lacks the appropriate financial product needed to grow and innovate.³ The funding gap is particularly acute in Sub-Saharan Africa with only around 29% of formal SMEs having access to a loan, line of credit or overdraft. Without the necessary financing, these businesses are unable to grow and contribute positively to employment and economic growth in their countries.

To understand the challenges and opportunities within the SME sector in Africa, this chapter will first outline the key barriers faced by these businesses to access finance as well as by the financial institutions that serve them. Secondly, it provides an overview of the credit gap in Africa and highlights some of the possible transformational solutions that are needed drawing from recent experiences in addressing these financing barriers. Concluding remarks offer several recommendations for policymakers and practitioners to advance financial inclusion for SMEs in Africa.

2. Revisiting the Credit Gap for SMEs in Africa

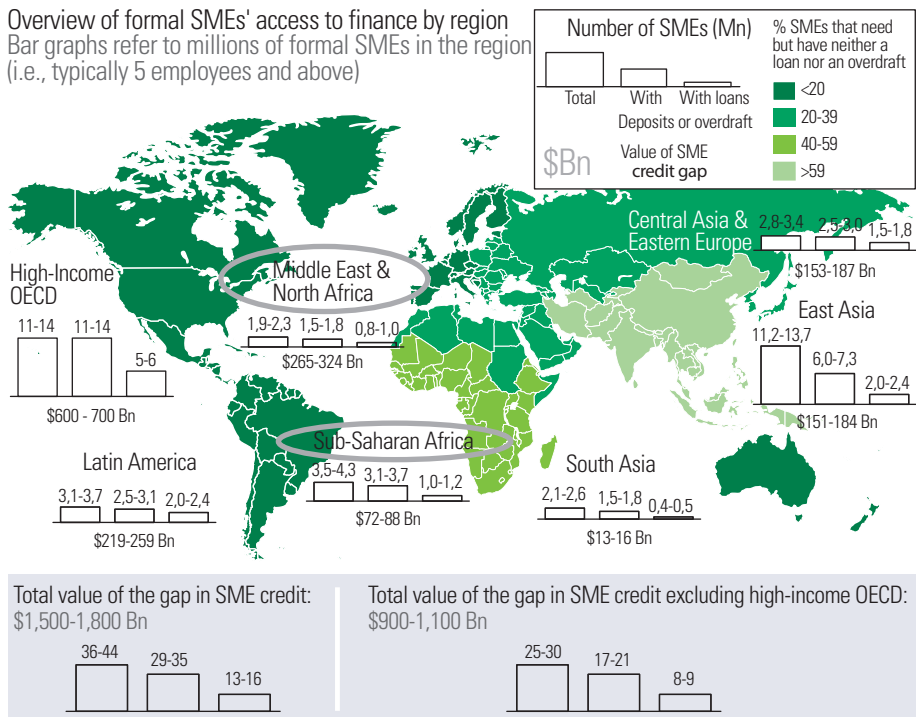
Recent estimates indicate that there are close to 5 million formal SMEs based in Africa, representing a significant share of the 25–30 million formal SMEs around the world. According to the World Bank Enterprise Surveys (WBES), SMEs in Africa have been operating for an average of 14 years and about a third of them report female ownership participation. Out of the formal SMEs in developing economies, around 45–55% are currently financially unserved, which means that they do not have a loan, line of credit or overdraft and have either applied for a loan or need one (Map III.1).⁴ In this context, Sub-Saharan Africa represents one of the most challenging regions for SMEs to get financing, along with East Asia and Pacific where



45-55% of the SMEs are also unserved. In comparison to other regions, Latin America and the Caribbean for example, around 15% of SMEs are unserved.⁵

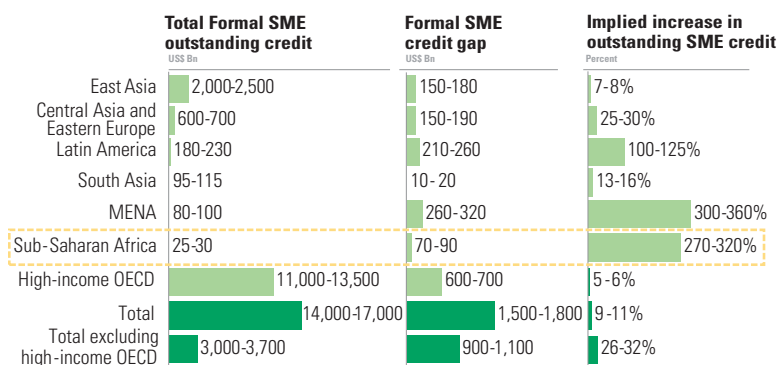
Map III.1: Map of SMEs' Access to Financial Services by Region

Overview of formal SMEs' access to finance by region
Bar graphs refer to millions of formal SMEs in the region
(i.e., typically 5 employees and above)



Source: IFC Enterprise Finance Gap Database (2011).

The value of the credit gap for formal SMEs in Africa is over USD 100 billion, out of which USD 70 to 90 billion applies to SMEs in Sub-Saharan Africa alone (see Figure III.1). To close this credit gap, Sub-Saharan Africa, for example, would need to increase the provision of credit (including loans, overdraft, leasing, factoring and trade finance) to the unserved formal SME market by 270-320 percent (see Figure III.1). Firms in Africa relative to other regions are the most credit constrained, and would thus require a significantly bigger leap in closing the credit gap they face. As a result, the interventions and solutions in Africa will need to be transformational rather than incremental as in the other regions.

Figure III.1: Financing Gap Relative to Outstanding SME Credit by Region

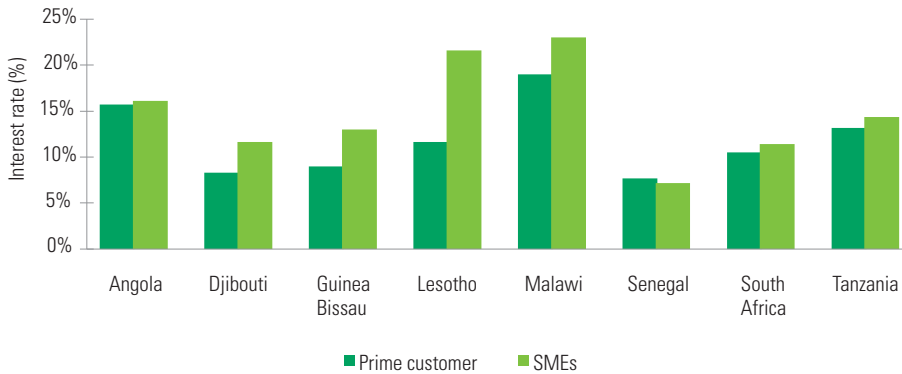
Source: IFC Enterprise Finance Gap Database (2011).

Among all firms, the financing constraint is more acute among the micro and small firms and also among the informal businesses. Similarly, women-owned enterprises often face higher barriers to access the right type of finance that is necessary for growth.⁸ Despite the immense strides made by the microfinance sector to serve women, there is an increasing awareness that the growth and start-up needs of women entrepreneurs go beyond micro-loans. This need represents an opportunity for designing targeted customer management strategies in this sector. Because of their high risk of default resulting from the limited collateral they can offer, and owing to the lack of information regarding their solvency, most SMEs can rarely meet the conditions for formal financial institutions' financing. Given the limited access to external financing from formal financial institutions, SMEs in Africa mostly rely on retained earnings or other internal sources of funding to finance their growth. WBES data indicate that around 80 percent of SMEs in Africa finance investments internally, around 3 percent by supplier credit, and only around 8 percent of investments are financed by banks.

Notably, when finance for SMEs in Africa is available, it is often expensive and short term. By way of illustration, in Malawi, the longest tenor of loans available for SMEs is 2 years less than the maturity of loans offered to prime customers. Similarly, Figure III.2 shows that SMEs are charged interest rates in excess of 20% and often pay a premium compared to prime customers.

Although the lack of funding from banks to micro and small enterprises has been partly compensated by the growing number of microfinance institutions, the latter still do not typically finance long term growth, as they mainly offer short term finance. In addition, these micro-credit institutions are themselves constrained by their limited funds, and the high cost of refinancing through the formal banking sector. Another main source of capital used by SMEs is through

Figure III.2: Interest Rates by Client Type in Selected African Countries (2009)



Source: AfDB/Making Finance Work For Africa (MFW4A) Financial Structure database.

the informal savings and loans associations. However the latter are unpredictable and have a regional (and often sectoral) focus.

3. SME Finance: Barriers and Opportunities

SMEs consistently rank access to finance as one of the top three constraints to their growth. While there is no statistic documenting the severity of the financing constraint for the entire continent, evidence reported in country or regional surveys suggest that the funding gap is acute. For instance, 45% of all surveyed firms in Sub-Saharan Africa cite access to finance as a major constraint to growth (Demirgüç-Kunt and Klapper, 2012). Surveys conducted in North Africa show a similar pattern. In some countries, access to finance represents the dominant constraint, as in Burkina Faso (for more than 70% of surveyed firms), Benin (for more than 70%), Malawi (for more than 50%) and Algeria (for more than 50%). In most countries, a larger share of small firms report access to finance as a major constraint compared to medium and large firms.

Per interviews of 29 leading banks across six emerging markets around the world, poor business cases were cited as a critical factor for credit declines. Financial institutions perceive poor customer information availability as a critical barrier to lending (McKinsey & Company, 2012). In Africa, addressing both elements is crucial for enabling a more inclusive environment for vibrant and growing SMEs. In particular, improvements in the credit information systems, collateral registries to reduce the information asymmetries, and capacity building and business development services at the firm level need to be addressed in order to accelerate financial inclusion on the continent. In addition, Africa's financial systems, while they have

made great strides over the past two decades, are still undergoing significant improvements that will ultimately help facilitate a more conducive environment for access to finance at the firm level. Financial depth in Africa, as measured by credit to the private sector as a share of GDP, is currently at an average of 26% for African countries, relative to 77% and 172% for all other developing economies, and for high income economies respectively (Demirgüç-Kunt and Klapper, 2012). However, this figure conceals differences between regions. For instance, while private credit to GDP stands at 24% in sub-Saharan Africa, it is equal to 39% in North Africa. The high concentration level and limited competition observed in most African financial systems further constraints SMEs' access to finance.

Additional key challenges for SMEs finance in Africa include poor customer knowledge which prevents financial intermediaries from formulating an appropriate strategy to target SMEs, lack of financial and management skills and financial literacy across firms, translating into poor financial accounting, record keeping or inappropriate business plans. Lack of collateral is also often cited as a challenge for banks, while poor financial infrastructure in some African countries (*e.g.*, Nonexistent mobile collateral registries or credit bureaus) accentuates the problems of insufficient collateral. Data collected from the WBES in Africa reveal that, on average, 84% of SMEs report having collateral requirements when accessing a loan that amount to an average of 153% of the total loan value.

Information asymmetry challenges and other operational constraints lead some financial institutions to decline service to the SME sector as it is perceived to be unprofitable. This contrasts with the findings of a recent study showing that MSME banking revenues are worth USD 150 billion today, and are expected to double over the next 5 years (McKinsey & Company, 2012). For Sub-Saharan Africa alone, revenues are also projected to grow significantly from USD 5 billion to USD 12 billion in 2015, mainly due to recent technological advances according to the banks surveyed in the study. More than 60% of bank respondents cited mobile as a big technological influence, relative to 20% in other regions (McKinsey & Company, 2012). Hence, in Africa, provided that banks understand and cater to SME sector's needs, there is a tremendous business opportunity. A deeper understanding along with innovative products could reduce risks related to business with SMEs and push the costs downward (McKinsey & Company, 2012). Some banks have already been active in the SME sector, very often thanks to support from development partners (Box III.1).

Non-bank financial institutions have also an important role to play to address the SMEs funding gap in Africa. Indeed, greater involvement of non-bank financial institutions will not only expand and diversify product offering to SMEs, but also address some of the barriers preventing them from accessing finance. For instance, private equity funds offers equity which is not available from banks, and helps address the limited capacity of African SMEs thanks to the often used hands-on strategy of private equity players. Similarly, leasing does not require collateral which have been often cited as one of the main impediments for SMEs to access lending from formal financial institutions in Africa.



Box III.1: Addressing the SME Barriers – IFC Support to Financial Institutions

Nigeria. Access Bank PLC Nigeria is a leading African bank that decided to become an early mover into the women SME space in Nigeria and is part of a coordinated program (Enterprise Development Center, Fate Foundation and IFC) focused on improving financing for women-owned SMEs. Access Bank offers customized credit lines to women entrepreneurs and tailored training courses in financial literacy, business management skills, and trade finance in order to become the bank of choice for Nigerian women entrepreneurs. By the end of 2010, USD 35.5 million loans had been disbursed over a 4 year period with a non-performing loan rate of 0.5 percent, and close to 700 women had been trained by the program.

East Africa. Diamond Trust Bank (DTB), one of East Africa's leading banks with a network of 70 branches in Kenya, Uganda, Tanzania and Burundi, has made a strategic choice to systematically target the SME sector which currently represents over 70 percent of its loan portfolio. To ensure the sustainability of its operations, expand offerings and deepen regional collaboration, DTB is making additional efforts to develop a strong SME banking network across East Africa, with technical support from IFC. One of the enhancements to better serve the SME market include the usage of a web-based cash management service, an online banking platform for SMEs and mobile payment solutions. Results are encouraging—DTB's SME loan portfolio has grown by 42 percent to date, representing an additional 1,468 outstanding loans, valued at USD 130.58 million for the group.

Source: IFC (2010, 2011b).

4. Interventions with Impact Potential

Transformational solutions that have the potential to successfully address the SME finance challenge in Africa in a sustainable way need to be holistic. Interventions should be taken at all relevant levels: firms and financial institutions, nationally and globally. Selected examples from existing interventions as well as global action already underway provide insights on successful and impactful solutions. Adopting a holistic approach implies directly supporting financial institutions (improving the overall SME solutions and targeting specific sub-segments such as women entrepreneurs), designing and implementing the enabling financial infrastructure (credit bureaus and moveable collateral registries) and last but not least, working directly with individual SMEs to improve their creditworthiness, financial literacy and growth potential. For instance, IFC's efforts to improve access to financial services for agricultural SMEs across

Africa exemplifies the holistic approach by supporting (i) the supply chain projects that build capacity of agri-businesses and small holders through direct support, and linkages to financial institutions and markets; (ii) financial and non-financial institutions that are interested in agri-business finance to develop products, build necessary skills and develop incentives that better mitigate risks; and (iii) initiatives that work at the business enabling environment level to assist the market place, on the supply and demand sides.

Financial infrastructure interventions are equally important. The availability of private credit bureaus and credit registries is essential to reduce information asymmetry that is currently prevailing on African credit markets. Evidence from 42 African countries shows that SMEs are less constrained in countries with both credit bureaus and registries compared to countries with only credit registries (Triki and Gajigo, 2012). Recent examples showcase the impact of improving the collateral framework in African countries as well. Ghana has made significant advances in reforming the movable collateral registry legal framework and upgrading the registry system. As a result, as of December 2012, over 45,000 loans have been registered since March 2010 and the total financing secured with movable property accounts for USD 6 billion. More than 9,000 SMEs and around 30,000 micro enterprises and individual entrepreneurs have received loans, with women entrepreneurs accounting for a large number of beneficiaries.⁷ Another breakthrough at the regional level is the recent reforms to OHADA collateral registries laws.⁸ With the World Bank Group's support, OHADA has taken a leap to facilitate access to credit in its 16 member states, including approving new secured lending and commercial laws, and creating a simplified legal regime for small entrepreneurs. The streamlined requirements are aimed to encourage informal entrepreneurs' entry into the formal economy and are expected to make an estimated USD 250 million in credit available to small businesses. This development is encouraging as West African countries are reported to have some of the highest barriers and constraints to private business in the world (World Bank, 2011).

Innovative, tailored, and technology-enabled interventions designed to address the barriers faced by SMEs hold the potential for transformative solutions in Africa. SME-customized interventions that leverage lessons from technology-based business models, such as M-Pesa, can act as accelerators to those unserved and underserved SMEs. A recent product focused on helping small farmers in Kenya, "Kilimo Salama (Kiswahili for 'safe farming')", emphasizes the importance of both technology levers and wider (beyond credit only) based financial services. The Kilimo Salama (KS) micro-insurance product, a winner of the 2012 Financial Times / IFC Sustainable Finance Award, is a partnership between the Syngenta Foundation for Sustainable Agriculture and Kenyan insurance company UAP. The KS pay-as-you-plant index insurance system is the first to use a mobile network-based platform and on-the-ground solar weather stations to provide smallholder farmers with low-cost insurance policies. KS has already insured 64,000 farmers across Kenya and is planning to expand to other countries in Africa, having started with an initial pilot of 200 farmers in 2009.⁹ These technological innovations have the potential of becoming key accelerators in the transformative process and provision of financial services to rural and urban SMEs on the continent.



Action at the firm or financial institution level is necessary, but not sufficient. Scalable solutions for Africa's SME finance challenge need global and national level approaches. It is promising that global attention to the subject is growing on the world leaders' agenda, as expanding access to financial services for SMEs is a key objective of the GPFI, the multi-stakeholder platform for implementation of the G-20 Financial Inclusion Action Plan. Such initiatives include the "SME Finance Challenge" which seeks to identify innovative models that enable financial inclusion for SMEs¹⁰; and the "SME Finance Forum", a knowledge sharing platform for data, research, and best practices for SMEs with a view to promote tools and approaches for policymakers and industry funders.¹¹ More importantly, the global focus is being matched with a country-level commitment to make strides in closing the SME financial inclusion gap. Eight African countries (Kenya, Malawi, Nigeria, Rwanda, South Africa, Tanzania, Uganda, Zambia) have made national commitments at the G-20 Los Cabos Summit (June 2012) to achieving a higher level of financial inclusion, including through targeted interventions to improve access to finance for SMEs.¹²

5. Conclusion and Policy Recommendations

Africa's SME finance gap is wide. On average, one out of two firms in Africa is financially unserved leading to an over USD 100 billion credit gap for SMEs alone. The funding gap is particularly acute for very small firms with typically less than 9 employees, very small and medium firms with one or more women owners, and firms operating in the informal sector that are often overlooked by the traditional banking sector. Addressing these needs with only traditional finance solutions will not be sufficient. Africa requires scalable and transformational solutions that incorporate various types of financial services and products and complement financing with capacity building. Examples of high-impact SME finance initiatives show that such a holistic approach is needed to address bottlenecks across the financing value chain. Technology-based solutions also hold the potential to help accelerate financial inclusion for SMEs in Africa.

Transformative solutions also require enablers at the policy level. Some (non-exhaustive) suggestions follow:

- To foster alternative SME finance products such as leasing products which are an important source of investment finance, a legislative framework is needed to clarify rights of the parties to a lease, remove contradictions in the existing legislations, create non-judicial repossession mechanisms, and ensure that tax rules are clear and neutral.
- Insolvency regimes are another example where strong credit rights can improve access to finance. Given that not all SMEs thrive, a legal framework to address the insolvency of business entities is essential to ensure that the resolution of multiple creditors' conflicting

claims are resolved in an orderly fashion and create more extensive opportunities for recovery (*e.g.*, fast track proceedings for small firms with low debt values) (IFC, 2011c).

- Further efforts are also needed to structure both demand and supply country diagnostics for SME finance and to uncover gender gaps and drivers to improve access to finance for women, small and informal businesses. In this respect, governments and public authorities have a role to play in the collection framework of comprehensive SME data that will help identify the needs as well as the progress achieved.
- Finally, it is also important to ensure an enabling environment that incentivizes institutions to develop their SME business, and build the efficient and reliable financial infrastructure that helps to better manage credit risk and improve access to credit.

Altogether, these approaches call for both public and private interventions and a coordinated action to help Africa's SMEs unlock their potential to be the engines of job creation and economic growth for the region.

Notes

1. Micro, very small, small and medium enterprises are defined as follows: Micro (1-4 employees), very small (5-9 employees), small (10-49 employees), and medium (50-250 employees). Data source is the IFC Enterprise Finance Gap Database (2011) and the referenced count of total informal and formal MSMEs captures all regions in Africa. The IFC Enterprise Finance Gap Database (2011) analyzes and reports data on a sub-regional basis (*i.e.* findings reported for Sub-Saharan Africa), but where possible (as in this reference), reference are made to Africa-wide statistics. The database will be publicly available on the SME Finance Forum at www.smefinanceforum.org.
2. 2011 African Development Report, African Development Bank.
3. The primary data focus will be on the SME sector and based on the IFC Enterprise Finance Gap Database (2011). When data applies to the MSME sector, the data qualification will be noted as per footnotes above.
4. IFC Enterprise Finance Gap Database (2011). Please note that the 5 million estimate captures the number of formal SMEs in Sub-Saharan Africa and North Africa.
5. All data estimates from IFC Enterprise Finance Gap Database (2011).
6. For further analysis on financing barriers for women-owned enterprises, see IFC (2011a) available at: <http://www.gpfi.org/sites/default/files/documents/Strengthening.pdf> (accessed in May 2013). See also: USAID (2011).
7. IFC. "Secured Transactions and Collateral Registries." Brochure (revised, forthcoming). Also, for background information on the overall framework and factors impacting SMEs in Ghana see Tagoe (2005).
8. OHADA (Organisation pour l'Harmonisation en Afrique du Droit des Affaires) is a system of business laws and implementing institutions adopted by sixteen West and Central African nations.
9. IFC Advisory Services, Access to Finance – Global Index Insurance Facility. See also website for Syngenta Foundation for Sustainable and Africa Science News. "Kenya's innovative agriculture programme wins award" article by Anthony Aisi.
10. For more information on the SME Finance Challenge, including the Winners' proposals, please see: <http://www.changemakers.com/SME-Finance> (accessed in May 2013).
11. For more information on the SME Finance Forum, please see: <http://smefinanceforum.org/> (accessed in May 2013).



12. Los Cabos Financial Inclusion Event, <http://www.g20mexico.org/index.php/en/press-releases/459-evento-de-inclusion-financiera-en-los-cabos> (accessed in May 2013).

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IV. Women and Finance: Unlocking Africa's Hidden Growth Reserve

Sandra Taylor and Narjess Boubakri

1. Introduction

The number of women entering the workforce in Africa has been substantially increasing over the last decade while women-owned businesses are a growing share of all enterprises in many African countries. According to the WBES, about one third of formal surveyed firms reported female ownership participation. However, while there has been an increase in women's contribution to employment creation, productivity and expansion of export sectors, women still face significant challenges to participate in the economy and acquire equal rights to men in Africa. This translates into a non-negligible growth loss for the continent. For instance, it is estimated that Uganda has foregone 2% of GDP growth per year because of policies that restrict women's full participation in the economy (Ellis et al, 2006).

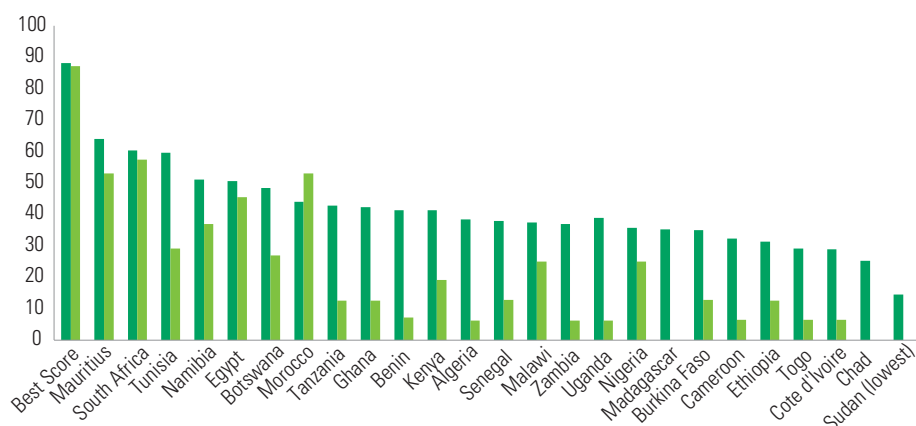
One corollary to the exclusion of women in Africa is the challenge that female entrepreneurs, and women in general, face to accessing finance compared to their male peers. Notably, women account for only 20% of the banked population of the continent, compared to 27% for men. Women's financial inclusion is an underused source of growth that should be harnessed to achieve sustainable and inclusive development. In addition to the economic benefits, financial inclusion of women has social benefits. Indeed, research has shown that women use their earned income and savings more productively, channeling a large share to children's nutrition, clothing, health, and education (Burjorjee et al, 2002).

This chapter describes the state of women's financial inclusion in Africa, by looking at different aspects that include access to financial services, the usage of these services, and reasons for their limited access to credit. It then discusses the constraints and obstacles to women's financial inclusion. The chapter concludes with some key policy recommendations to achieve more inclusive financial systems for women in Africa.

2. Financial Inclusion for Women in Africa: What Do We Know?

Existing research has documented that globally, women's access to formal financial services is low relative to men. Africa is no exception (Figure IV.1) with recent estimates showing that 4 out of 5 women lacking access to an account at a formal financial institution, compared to about 1 men out of 4. The financing gap is more acute in rural areas where women benefit from only one tenth of the credit to small farmers and less than 1% of total credit to agriculture.

Figure IV.1: Women Economic Opportunities and Access to Finance in Selected African Countries (2010)



Source: Economist Intelligence Unit (2010).

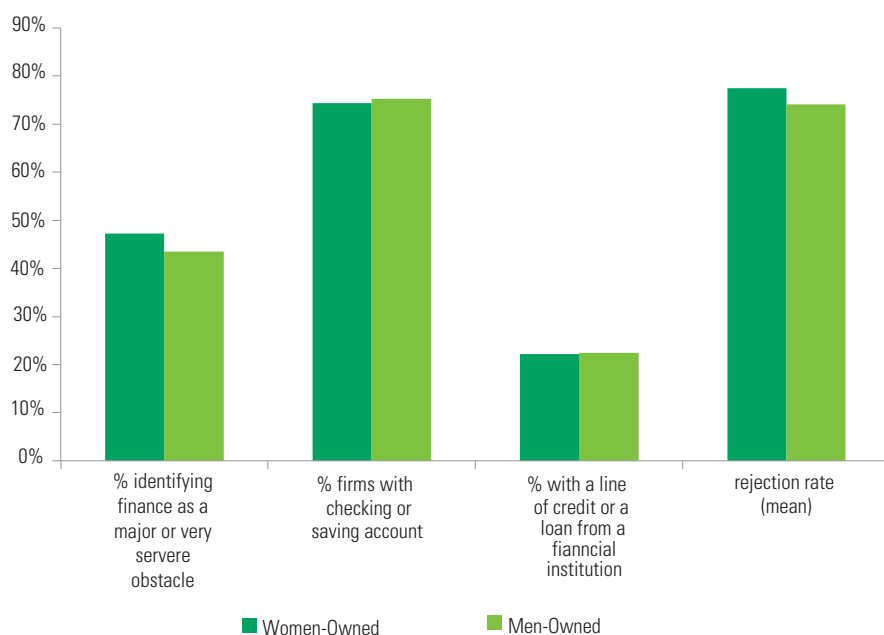
Interestingly, data from the WBES suggest that the gender-related funding gap is less acute for formal businesses. Indeed, the share of surveyed firms identifying access to finance as a major or very severe obstacle is comparable for both groups: 47% for women-owned businesses versus 44% for men-owned businesses (Figure IV.2). However, these figures conceal strong variations across African countries. While the 2007 Africa Competitiveness Report shows that access to finance is a more binding constraint for male business owners in Mauritania relative to female owners, data from Egypt suggest that women face higher hurdles to access finance (Nasr, 2010). Interestingly, differences in business size do not explain this pattern as female and male businesses were found to have similar sizes (World Bank, 2008). According to the same report on Egypt, only about 20 percent of female entrepreneurs apply for bank credit and those who apply face higher rejection rates (Nasr, 2010). This is consistent with the higher rejection rate reported in Figure IV.2 for female-owned businesses. This result contrasts with findings in a recent United Nations report showing that “In Africa, women are a better credit-risk than men and more responsible managers of meager resources”.¹

Figure IV.2 shows also similarities in the share of firms holding a checking or a saving account and those holding a loan or a line of credit from a financial institution, even though women owned-businesses are less likely to have an account or a loan. These results support findings reported in Aterido et al. (2011) who found comparable levels of formal services use for male and female owned business and conclude that lower levels of financial inclusion for women in Africa mainly reflect income, education and formality status effects rather than discrimination within the financial sector against women. In other words, women are less likely to use formal

financial services mainly because they have lower incomes, are less educated, and more likely to operate in the informal sector.

In order to improve financial inclusion for women, microfinance institutions have been called for and have contributed to increase women access to finance by lifting some of the constraints to formal credit notably on the type of collateral: for instance, by fostering joint liability or group loans instead of collateral, microfinance has reached many women who were excluded from formal financing. This is for instance the case in West Africa where women dominate the food trade market (Burjorjee et al., 2002). Other innovative models have also been developed by formal financial institutions to cater for women (Box IV.1).

Figure IV.2: Business Access to Finance by Gender



Source: World Bank Enterprise Surveys.

What's more, women use financial services less frequently than men and sometimes for different purposes. For instance, men are more intensive users of formal accounts than women, and while women use these accounts mostly to receive remittances and wages, men use them primarily to receive wages and for business purposes (Figure IV.3). The use of accounts to receive remittances from family abroad is thus more common for women than men. Similarly, men are twice likely to use checks as a means of payment than women. Data from the Global



Box IV.1: Examples of Women Dedicated Financial Products in Africa

Exim Bank (Tanzania) has developed a special product known as the Tumaini Account targeting women clients. The Tumaini account uses the idea that inculcating monthly thrift can provide financial support to women. The Tumaini product takes advantage of the fact that women are good savers, and strive to provide their families with education and healthcare services. Both personal loans and loans to small and medium enterprises are offered under this program using the savings balances in Tumaini accounts as a guarantee.

Access Bank (Nigeria) has developed “women-friendly” flexible collateral options, such as the pledging of jewelry and equipment, using asset debentures or bills of sale to enable women entrepreneurs to access loans. This program has given out USD 35.5 million in loans and helped 1,300 women open a deposit account. The program also offered training to almost 700 women on financial management skills. The program has worked so well that banks in Rwanda and Gambia replicated the model.

Sero Lease and Finance Ltd (SELFINA) (Tanzania) used innovative techniques to better cater for women. Specifically, SELFINA offers micro-leasing to female clients which in turn allows them to own the assets in the end, and to use it as collateral when they are in need of liquidity. The benefits of micro-leasing are two-fold: a direct benefit, allows women to utilize the equipment for business growth; an indirect benefit, helps women to build a reputation of repayment. SELFINA has about 25,000 female clients.

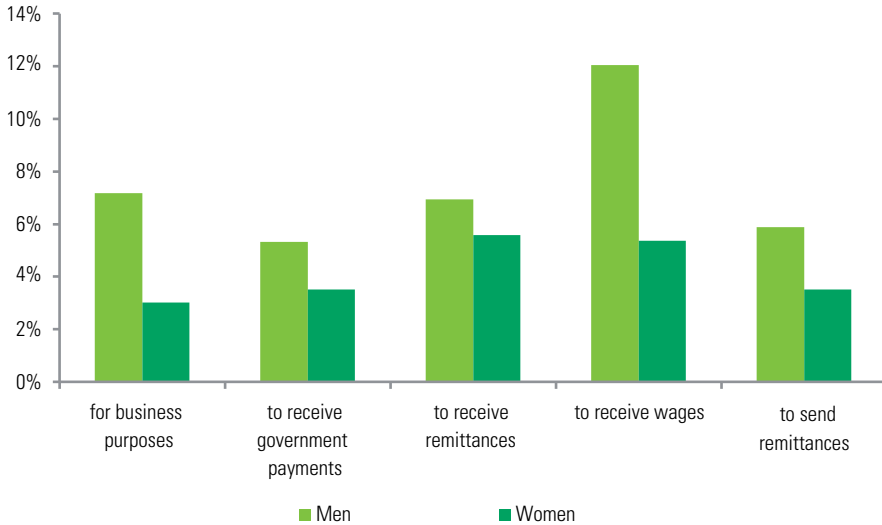
Source: Global Banking Alliance for Women.

Findex database shows also that women are less likely to pay for health insurance and to use formal saving methods.

Branchless banking and technology-based financial services such as mobile banking have been expanding at a fast pace lately and has helped to reach the unbanked populations, even in rural areas. However, women’s proportion of adults reporting using mobile phones for financial transactions in Africa remains low compared to men (7% compared to 10%). This probably reflects the fact that men often adopt new technology faster than women.

3. Barriers to the Financial Inclusion of Women in Africa

In what follows we shed light on the barriers to financial inclusion of women in Africa and explore the reasons behind the gender related funding gap documented earlier. Considerable

Figure IV.3: Account Usage in Africa by Gender (2011) (% Adults)

Source: Global Findex Database.

research has been conducted to identify barriers preventing women from accessing and using financial products and services. Requirements by financial institutions, difficult physical access, lack of financial literacy and cultural and social norms, are among the reasons that are often put forward to explain why the gender-related funding gap exists. Most of these obstacles fall under the broad categories of economic barriers (*i.e.*, supply side issues), socio-cultural barriers and unfavorable enabling environment.

3.1 Economic Barriers

The majority of economically active women in Africa operate in the informal sector. For example, existing data indicates that the informal sector accounts for over 95 percent of women workers outside agriculture in Benin, Chad and Mali (Chen, 2001). Moreover, very often women do not have ownership titles and earn lower wages than men. This makes them by default unattractive clients for formal financial institutions which often place restrictions on the type of collateral they accept and have very limited or no appetite to lend to clients operating in the informal sector. As a consequence, women end up relying almost exclusively on informal sources of finance which offer only short term funding and charge high interest rates. This type of



funding is not adequate to address investment needs and restricts the ability of women-owned businesses to grow, reducing further their capacity to access finance from formal financial institutions.

In addition, because they depend on informal lending, women cannot build a credit history (required by financial institutions when reviewing loan applications). The lack of credit bureaus or registries contributes to perpetuate this situation: indeed, should such bureaus exist, they would be able to report women repayment history with microfinance Institutions (MFIs) for example, thus potentially contributing to increasing women's access to finance.

3.2 Socio-Cultural Barriers

These barriers relate to dominant norms, values and customs in a society that prevent women from exercising their economic rights the same way as men; social expectations, norms, attitudes and values (which all evolve very slowly) regarding the role that women should play in the society are probably the most severe barriers as they are deeply entrenched in society. In a number of African countries, customs prevail over existing statutory law as is the case for granting women equal access to property. In Kenya for instance the constitution grants equal rights to men and women. However, certain tribes are exempted from this rule and apply their customary law. In many countries, culture and gender discrimination also restricts women's mobility confining many of them to subsistence agriculture production in rural areas and further limiting their economic prospects as well as their access to finance. This unfavorable status of women contributes to the negative perceptions of women's economic capacities by the banking sector. As a result, women are subject to "gender stereotyping" in their relationship with lending institutions. This is consistent with the findings of a study of bank loan officers which, for instance, found that women are perceived as being less entrepreneurial than men (Buttner and Rosen, 1988). The lack of education, work experience, and financial literacy skills results in an inability for women to "navigate the system", which leaves them disadvantaged when it comes to seeking finance (Hallward-Driemeier, 2011).

3.3 Unfavorable Enabling Environment

The unfavorable enabling environment relates to the inappropriate legal and regulatory frameworks to foster financial inclusion for women. Laws in many African countries still today, explicitly differentiate between men's and women's property rights. For instance, only ten out of 35 Sub-Saharan countries that were covered in the 2012 World Bank's Women, Business and the Law Report do not differentiate by gender on these topics.² Hence, women often lack *de jure* or *de facto* appropriate property rights. They also typically lack control over joint or shared assets which they could otherwise use as collateral. Even where the statutory rights

provide gender equality in these aspects, the coexistence of dual or multiple legal systems regarding women's legal status to inherit property such as land, housing or other productive input creates insecurity for both women entrepreneurs and financial institutions (Bardasi et al, 2007). In several African countries, women are not able to make legal transactions let alone and apply for credit, unless a male family member signs for them. Such requirements exist for instance in the Democratic Republic of the Congo, Namibia, Rwanda, Swaziland and Uganda where a male family member's signature is necessary for any woman seeking to open a bank account, or to make money transfers.

4. Conclusion and Policy Recommendations

This brief analysis of financial inclusion for women in Africa reveals challenges that women face to access formal financial services. Supply-side and demand-side constraints prevent women from accessing the necessary funds that would boost their economic activity. This underlines the urgent need for an effective policy action that considers, among others, new financial sector policies, and initiatives that address women's contextual and social constraints. Women need to be granted a more important role in policy-making—both in agenda setting and decision-making as well as through the integration of gender-specific aspects in legislation. Overall, such policy action should seek to achieve the following:

- Reform regulatory frameworks and change unfavorable cultural norms: Governments need to grant women equal rights to property in order to expand their economic opportunities. Where non-discriminatory law provisions are missing, they must be enacted. Similarly, where statutory measures are already in place but overruled by customary law, action must be taken to enforce the existing regulations and close the gap between law and practice. Some “best-practices” to consider to improve women's property rights, especially access to land, include the partnership between the Uganda Land Alliance (ULA) and the International Center for Research on Women (ICRW) to build capacity of a local legal aid organization to improve women's property rights through legal counseling by paralegals and awareness-raising sensitization events, often resulting in women being able to keep their land and houses after their husbands died. Another example is the Landesa Center for Women's Land Rights and its intensive training for practitioners, activists, and government professionals to expand the set of options, approaches, and potential solutions they can consider by learning from what has been tried in other settings and by becoming part of a network of colleagues who can act as a resource.
- Study women-specific needs and create adapted financial products and services: The availability of information describing the specific needs of women is indispensable for policy decision making. In order to understand the specific needs of female workers and entrepreneurs as well as the barriers they face, more gender disaggregated data are



needed. Financial institutions should be actively involved in this endeavor. A collaborative approach involving all stakeholders could also help raise awareness and facilitate the implementation of gender oriented reforms.

- Given that women have relatively limited access to education in Africa, there is also a strong need for policymakers to address the lack of financial literacy for women. This could be done for example in the form of specific training schemes and programs that provide women and girls with the necessary education and skills. Some African financial institutions are in this respect now offering support and financial literacy programs to help women-owned SMEs access credit. As an illustration, staff at the Development Finance Company of Uganda Bank Limited (DFCU) trained women on business skills, adding to their confidence. As a result of this endeavor, women achieved a lower default rate (1.5%) compared to men (2.5%). Since DFCU started this approach in 2007, 1,800 new deposit accounts for women have been opened and 368 women have been trained, which has had a strong impact as a model for other banks in Uganda.
- Encourage innovation to address barriers faced by women: Collateral requirements applied by banks, which often are limited to fixed assets, present a significant obstacle for women entrepreneurs. In order to fully harness the economic opportunity of granting financial products and services to women, more innovative and tailor-made offers need to be developed. This could be done through the use of movable collateral or unconventional collateral such as jewelry, receipts, or accumulated savings. Several experiences implemented by commercial banks in Africa (*e.g.*, Access Bank Nigeria, NBS, Malawi, DFCU Uganda) whereby the institutions have started to accept alternative collateral such as jewelry or account receivables led to promising results and show a great potential for implementation at a large scale. There is thus room for intervention to foster such experiences both in the banking and non-banking sector.
- Create support programs for women entrepreneurship: A number of countries in Africa do not have women-specific programs and schemes in place to support them in exploring their economic opportunities. Where such programs do exist, they are often limited in their scope and reach. Based on the different realities that men and women in most African countries face, there is a need for a gendered approach to entrepreneurship promotion. Enabling structures need to be developed, for example through the support of Women Business Membership Organizations that can serve as one-stop-shops for advocacy, training and information. The African Women in Business initiative developed by the AfDB is a good example for such approach. This initiative includes a Growth-Oriented Women's Enterprises (GOWE) program that was put in place to report lessons from experience in business development in Africa. The program addresses issues related to women financial exclusion by identifying the constraints they face, and supporting women through training and mentoring.

Notes

1. <http://www.un.org/esa/africa/microfinanceinafrica.pdf>
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V. Financial Inclusion for Rural Areas and Agriculture

Angela Hansen

1. Introduction

Africa's rural areas are the bustling home to over 600 million people and are the epicenter of agriculture-based economic activity. Africa has nearly half of the world's unused agricultural land; and even with this massive unrealized potential, agriculture and agribusiness still fuel the livelihoods of 70% of Africans and contribute over 40% of the continent's GDP.^{1,2} However, it is surprising that only about 10% of Africa's commercial bank lending goes to agriculture and agro-industries, and more surprising still that less than 5%, on average, of national budgets are allocated to the agricultural sector, a fraction of which makes its way into rural communities.³ It is estimated that African agricultural output could more than triple from USD 280 billion to USD 880 billion by 2030 if farmers were able to access the finance they need to expand both the quality and quantity of their produce.⁴ Given these facts, it is easy to see how financial inclusion for rural areas and agriculture is critical to achieving a sustainable and inclusive growth in Africa.

In order to chart a path towards the financial inclusion of rural populations, this chapter provides a broad overview of the state of financial inclusion for rural areas and agriculture in Africa, discusses the type of institutions that have been providing finance to rural populations and reviews the continent's experience in rural finance. The chapter emphasizes the role that value chain funding could play to improve financial inclusion for farmers and rural population and concludes with some policy recommendations for improving financial inclusion for rural areas and agriculture.

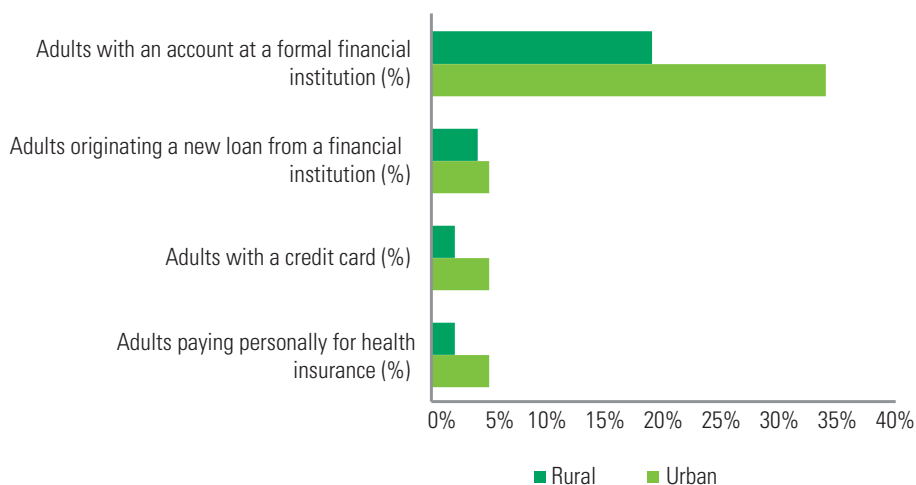
2. The State of Financial Inclusion for Agriculture and Rural Areas

While it is difficult to estimate the exact size of the gap between the supply and demand for formal financial services for agriculture and rural areas in Africa, recent surveys show that, across the continent, rural population are less banked (19%) than urban (34%). Available country-level data paint a bleak picture as well: in South Africa—a country with one of Africa's most developed financial sectors—less than 5% of rural individuals and 37% of rural small business owners report using formal savings facilities.⁵ Similarly, in Zambia, 62% of farmers do not use any financial services.⁶

Rural populations need access to credit, payment services and insurance products. Credit allows them to invest and grow their business; payment services facilitate more efficient and less costly transactions; and insurance products help reduce their exposure to risk. This is all the more important as the poor are often the most at risk. However, as shown in Figure V.1, a person from a rural area in Africa is twice less likely to own a credit card or to buy health

insurance than a person from an urban area. Interestingly, the portion of adults originating a new loan from a financial institution does not seem to be significantly different for the 2 groups.

Figure V.1: Financial Inclusion Indicators for Rural and Urban Population in Africa

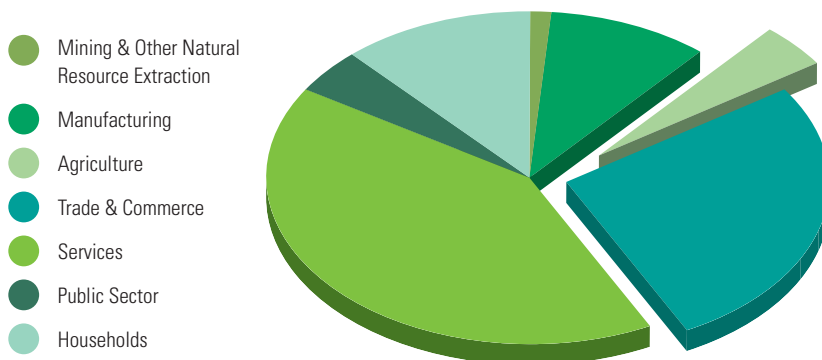


Source: Demirgüç-Kunt and Klapper (2012).

The limited level of finance provided to rural areas in Africa seems to be a consistent pattern across different types of finance providers. As shown in Figure V.2, lending to agriculture by commercial banks accounts for a limited share of total bank credit in Africa. Commercial banks have not engaged rural populations at a large scale on the continent due, among other reasons, to their limited footprint in rural areas and perceptions of risk and low profit potential for farmers. With approximately a trillion dollars in deposits across the continent, commercial banks hold significant potential for extending financial services for the rural population and agriculture provided they develop large-scale models for including those groups.

Microfinance Institutions (MFIs) also cater to rural populations and often have better presence in rural areas compared to banks. Yet, they typically offer small loan amounts and short maturities which is not adequate to address investment needs (Miller et al., 2010). MFIs provided an estimated USD 7.8 billion in loans to 6.1 million borrowers and held USD 7.5 billion in deposits from 19.3 million depositors in 2011.⁷ A large share of these clients are located in rural areas.

Figure V.2: Sector Distribution of Bank Credit in Africa (2009)



Source: AfDB/Making Finance Work For Africa Financial (MFW4A) Structure Database.

3. Innovative Approaches to Address the Financing Gap for Agriculture and Rural Areas in Africa

3.1 The promise of Value Chain Finance

Value Chain Finance (VCF) refers to “finance that takes place within the value chain and external finance that is made possible by value chain relationships and mechanisms” (Miller and Jones, 2010). Traditionally, VCF has been conducted or facilitated by segments of the value chain that are closely linked, and where contracts and relationships can be commoditized.

VCF can be implemented through two strategies (Carroll et al., 2012). First, financing can be provided against guaranteed purchase agreements with smallholders. An increasing number of impact-driven smallholder agriculture lenders (such as Root Capital, Oikocredit, and Triodos) have harnessed this model to provide short-term trade financing for producer organizations that have contracts with off-takers. Disbursements from global lenders using this model totaled USD 350 million in 2011, of which USD 60 million was disbursed in Africa.⁸ This model is particularly prominent in exportable cash crops, such as coffee, cocoa, and cotton in Uganda, Tanzania, and Rwanda. Expanding the model is largely dependent on increasing the number and capacity of smallholder-oriented producer organizations that are able to sign purchase agreements with off-takers and receive financing from investors. Technical assistance providers and donors can support the formation and management of these producer organizations while local governments can institute policies that support training, management, and access to markets for producer organizations.

Alternatively, VCF can be implemented by providing lending to smallholder farmers through the value chains of large multinational commodity buyers. These buyers have powerful long-term incentive relationships with smallholders and insider information to assess their

capacity to repay. Some global buyers already provide finance to smallholders engaged in their out-grower schemes: emerging models include warehouse, in-kind, and direct-to-farmer lending. Warehouse receipt systems could be particularly helpful in Africa where land is not often used as collateral because of title issues. In the warehouse receipt scheme, farmers or farmer organizations deposit their produce and the warehouse operator issues the receipt indicating the quantity, quality, and type of produce deposited. These receipts are later used by financial institutions as collateral. In Tanzania, such scheme was successfully used by farmers' associations who deposit parchment coffee produce in the Common Fund for Commodities, a certified warehouse operator. The bank provided credit corresponding to 80% of the value of the deposited parchment coffee while using the warehouse receipt as collateral. However, the warehouse receipts require secure and trustful warehouses and enabling legal and regulatory systems in order to promote the effective participation of key stakeholders. Lender-buyer partnerships could also help mitigate risk by sharing risk management costs among lenders, buyers and smallholders. For example, in Ghana, licensed buying companies (LBCs) provide credit to producers so that they could purchase required inputs (for example, fertilizer, pesticides, etc.) to be used to harvest cocoa. The credits extended to farmers are repaid to LBCs by cocoa produce, and the balance goes to the farmer (Beck et al., 2011).

VCF holds great promises to enhance financial inclusion for farmers and rural population in Africa because it can provide those groups with greater affordability (smallholders can use guaranteed purchase agreements as collateral and secure cheaper financing, for example), increased availability (smallholders can access finance through their contacts on the value chain) and improved accessibility (customers can understand and utilize tailored financial offerings).

Being home to over a billion emerging consumers, Africa can attract for instance a large number of food manufacturers and retailers (Collier and Dercon, 2009). There are now over 50 Fortune 500 food and agro companies operating in North Africa alone and nearly as many in Southern Africa.⁹ These actors could integrate their value chains to deliver standardized goods at a rapidly increasing scale while developing pro-poor value chains to enhance financial inclusion. Three main business imperatives will drive the development of VCF in Africa:

- *First*, food manufacturers need to protect themselves against price fluctuations in turbulent global markets and ensure access to the needed quantity of produce. Due to the predominance of smallholders in Africa, long-term purchase agreements and contracts with small-scale farmers are inevitable.
- *Second*, retailers need to maintain good consumer relations through Corporate Social Responsibility (CSR) and marketing. There is increasing pressure on retailers to demonstrate how they work and collaborate with all actors in their supply chain, especially the rural poor.
- *Third*, retailers and food manufacturers need to avoid regulatory risks when seeking to enter new markets. Demonstrating a track-record of working with rural population and



the poor can help position them in a favorable light in new countries and convince policy makers to welcome them into the country.

Several VCF experiences have been developed on the continent (Box V.1) and the opportunities to further extend the reach of VCF are increasing.

Box V.1: Selected VCF Experiences in South Africa

South Africa represents possibly the most dynamic retail market in Sub-Saharan Africa. Indigenous and international retailers are innovating to include rural populations and smallholder farmers in their supply chains, as per the following examples.

Bean There is a South African coffee wholesaler and retailer. It provides farmers with a guaranteed purchase agreement at the beginning of the planting season, and then helps them use this agreement to secure a loan from a third party. The loan is used to purchase the inputs necessary to produce the coffee volumes that farmers have promised to deliver by season's end. In addition to improving farmers' financial inclusion, this system yields business advantages to Bean There. Not only is the company able to secure its supply many months in advance, but it also helps to establish an agreed-upon purchase price—providing the business with stability in planning.¹⁰

Woolworths is one of the largest retail store chains in South Africa. The company has worked to extend finance and technical assistance to smallholder avocado farmers. Because its main avocado supplier, Westfalia, could only provide the needed volume for nine months of the year, it often had to purchase the product internationally. Seeking to minimize transportation costs and increase local production, the company worked with Westfalia to identify other farmers in South Africa who could produce avocados earlier in the year. As a result of these efforts, Woolworths currently provides loans to help a local farmer, which he can use to purchase inputs to produce avocados two weeks prior to Westfalia. The food company is looking to expand further this loan program to farmers owning a total of 150 hectares of land in the region.

The proposed merger between **Walmart**—an American global company running chains of department stores— with **Massmart**, a large south African retailer, was met with stiff resistance, sparking a legal effort to block the transaction that was backed by government ministers and trade unions. Possibly in an effort to fend off new attacks and maintain its social license to operate, Massmart (which has since merged with Walmart) is currently stepping up efforts to work with local smallholders through financial inclusion efforts. It recently announced a USD 1.7 million program that will seek to help local smallholders establish links to financial markets in partnership with TechnoServe, a NGO that works with emerging farmers and entrepreneurs.

Source: Good Business Journey Report (2011), Massmart (2011) and Bean There (2012).

Although retailer and food manufacturer-led VCF models can unlock finance for smallholders, increasing smallholders' financial dependence on these large companies may also lead to a weakening of farmers' position in the market by locking them into business models where they are relatively weak. It is often the case that food manufacturers and retailers have tremendous power within the chain not only because they are large enough to set or heavily influence prices, but also because they hold more information on pricing and margins throughout the chain. This means that they can squeeze smallholders without the farmers fully realizing all implications (Vorley et al., 2009). This may limit the extent to which VCF can lead to inclusive growth. Hence, careful attention should be paid to these considerations when designing VCF initiatives.

3.2 Other Emerging Strategies for Financial Inclusion in Rural Areas and Agriculture

Addressing the funding gap for rural areas and agriculture in Africa requires overcoming barriers faced by traditional financial models such as affordability, availability, and accessibility. A number of approaches have been observed in recent years to address these barriers; in general they have involved either the use of a new instrument, or a new channel to address the gap.

Information and Communication Technologies (ICTs) have been useful in developing networking and informational exchange for collective decision making in rural areas (Greenidge, 2003). For instance, the Zambia National Farmers Union has been offering to rural producers a mobile platform for local market price discovery to strengthen their negotiating power. This is likely to increase farmers' income—and reduce its volatility—which should allow them to better access financing. In addition to information sharing, ICTs have been used for property registration and identification purposes that potentially facilitate access to finance for rural population. In most African countries, it is still challenging to get an official document for land title. The simplification brought by ICTs in accessing land titles and collateral like documents facilitates the loan application procedure for farmers (Kelles-Viitanen, 2005).

Progress in ICTs has been also leveraged upon to offer financial services to rural populations that cannot be served through traditional distribution channels. The availability of these financial services allows rural populations and farmers to access basic financial services such as paying a bill or transferring money to a relative, or to cope against certain risks and smooth their income thanks to some insurance services. For example, Kilimo Salama has developed a mobile-based agriculture insurance product targeted at Kenyan farmers. Smallholders are able to register for insurance with their local provider through mobile phones. The insurance is indexed to weather conditions.

Another instrument that has been increasingly used to support agriculture in Africa is private equity. A growing number of private equity funds targeting agriculture, a sizable portion of which focus on agribusinesses, have emerged. As of July 2011, at least 27 agriculture-focused



private equity funds were operating across the continent, with total target capital commitments of USD 7.7 billion in addition to seven generalist funds, with some degree of agriculture or agribusiness allocation in their portfolios. Still, the scale of private equity funds remains relatively small and the resources they offer for agriculture are limited. Furthermore, these funds typically purchase equity stakes in companies that are well established to help them transform from local to regional champions. While such approach is suitable to help improve financial inclusion for medium to large scale farmers and companies operating in the agribusiness sector, it is not suitable for the vast majority of financially excluded rural populations and enterprises.

4. Conclusion and Policy Recommendations

Rural populations are suffering from financial exclusion in Africa, a phenomenon that limits their ability to increase their own wealth and to contribute to the growth of the African agricultural sector as a whole. The major challenge in increasing the flow of finance to rural populations is making financial products affordable, available and accessible. Traditional financial institutions—including commercial banks, MFIs, and non-bank financial institutions—are not sufficiently addressing these challenges due to the perceived risk and low profit potential of rural populations. In response, governments, donors, social entrepreneurs, and the private sector have drawn on a number of new instruments and channels to improve inclusion. The use of VCF for instance as a channel has great potential to provide affordable, available and accessible finance to this segment of the population.

To improve financial inclusion for rural population and those who depend on agriculture for their livelihoods, the following policy measures should be pursued:

- Institute laws that protect farmers by securing their land tenure: This will increase their overall access to finance from formal financial institutions, and improve their negotiating power within the value chain as smallholders hold legal rights to their produce and their land.
- Develop pilot buyer and food company led value chain efforts that can help test the profit potential of these strategies. Companies buying products that are not typically a priority for farmers—such as spices—may be particularly receptive to efforts to improve the security of their value chain through innovative approaches. Development partners have a role to play as well by supporting for instance the development of required infrastructure, including warehouses, to implement these VCF initiatives.
- Build transparent pricing platforms that provide smallholders with a full understanding of the pricing of their product throughout the value chain. This will reduce information asymmetries that typically weaken rural producers' negotiating power. National and

international policy makers could assist in these efforts by supporting ICT-based platforms such as mobile or other types of platforms for disseminating farm-to-fork price information to farmers throughout the value chain.

- Construct innovative partnerships and legislation for knowledge transfer to ensure that as buyers and food companies move deeper into the continent, they are improving the capacity of smallholders. Knowledge transfer is critical to ensure that farmers are able to use the additional finance effectively. Innovative legislation or public private partnerships can therefore work together to ensure that retailers and processors are educating their farmers, and increasing the long-term capacity of African agriculture.
- Strengthen large-scale cooperatives to improve smallholders negotiating power with large buyers and food companies. Many large-scale cooperatives are working to extend financial inclusion of smallholders, but the effort to improve governance is needed. Policy makers can address this challenge by crafting legislation that will increase transparency. They should also identify areas where they can assist in building cooperatives' leadership capacity to facilitate financial inclusion.

While expanding financial inclusion to smallholders through VCF is a promising strategy, it should also be said that increased efforts of commercial banks, MFIs and non-bank financial institutions to tailor their products and meet the needs of the vast and untapped rural market should remain a priority. The strategies detailed above are intended to encourage governments to create frameworks that enable the private sector to fully engage rural populations in a mutually beneficial and constructive manner. In so doing, policy makers will ensure not only that the markets are functioning in a sustainable manner, but also maintain their continued relevance to improve resource distribution to the poor.

Notes

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3. Making Finance Work for Africa. "Policy Brief: On Agricultural Finance in Africa." <http://www.mfw4a.org/agricultural-rural-finance/agricultural-rural-finance.html> (accessed in May 2013).
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6. Ibid.



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9. Ibid.
10. Bean There Founder Jonathan Robinson noted that building relationships with farmers further helps in securing supply and pricing, as farmers will be more willing to sacrifice profit in years where coffee prices are dramatically high in an effort to preserve a financial relationship that they believe helps them when coffee prices drop. Interview with Jonathan Robinson, Bean There. May 29, 2012.

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VI. Financial Inclusion in Fragile States

Erick Sile

1. Introduction

According to the Organization of Economic Co-operation and Development (OECD), one billion of the world's six billion people live in fragile states and a non-negligible share of this population is located in Africa.¹ Indeed, 26 out of the 45 countries considered by the OECD as fragile states are located in Africa with the great majority falling under the United Nations' (UN) Least Developed Countries category. Similarly, based on the AfDB list of fragile states, a third of African countries are considered as fragile accounting for 19 out of its 54 regional member countries. Notably, all these countries are located in Sub-Saharan Africa.

Poverty rates in fragile states are on average 20% higher relative to countries with comparable levels of economic development and the gap is widest for countries affected by repeated cycles of violence. Fragile states are also characterized by low financial sector development and limited financial inclusion. In African fragile states only 14% of adults, on average, have access to a bank account compared to 23% of adults in Africa and 24% in sub-Saharan Africa.² This situation reflects the high instability and vulnerability plaguing African fragile states which prevents the well-functioning of financial systems and the economy as a whole. While infrastructure development and peace-building efforts are key prerequisites to address such vulnerability issues, building an inclusive financial sector, as part of a well-coordinated effort between development partners, offers the promise to bring fragile states back on the path of financial stability and growth. Indeed, whereas financial stability is to be distinguished from political stability, evidence suggests that "the reduction of income inequality through financial development and inclusion could lead to greater social and political stability, which in turn could contribute to greater financial system stability" (Cull et al., 2012). Hence, addressing income inequality issues, which financial inclusion can arguably help fix, could be considered as a potential means to tackle the vulnerability of African fragile states.

This chapter explains how fragility affects financial inclusion, describes the status of financial inclusion in African fragile states and compares their situation with the rest of the continent as well as fragile states from other regions. The chapter also discusses financial inclusion's potential role in overcoming vulnerability issues. It then concludes with some policy recommendations for development partners to foster financial inclusion in African fragile states.

2. Financial Inclusion and Fragility

There is still a wide variety of definitions and lists of fragile states. This makes appropriate identification and targeting of these countries sometimes challenging. For instance, the OECD

defines fragile states as “those failing to provide basic services to poor people because they are unwilling or unable to do so”³ whereas USAID defines fragile states as “states which are failing, failed, or recovering”. The AfDB criterion for fragile state classification is based principally on its Country Policy and Institutional Assessment⁴ (CPIA) score. Countries are considered fragile if they have a CPIA score of 3.2 and/or have hosted a UN or regional peacekeeping or peace-building mission during the last three years. However, despite their diversity, all available definitions share commonalities in terms of the main characteristics of countries classified as fragile: they are typically vulnerable states and/or in crisis, are more likely to suffer low or negative economic growth, and people living therein are among the poorest.

Financial inclusion is about ensuring quality financial products and services are available, accessible and affordable to clients falling in all income brackets. This calls for a particular attention to low-income people, particularly those from fragile states who are often unserved or underserved by formal financial institutions. Africa exhibits one of the lowest rates of access to formal financial services. In African fragile states, this situation is compounded by on-going conflicts, weak institutions, failing infrastructure, political uncertainty, lack of law enforcement, and underdeveloped financial systems all of which contribute to eroding the investment climate, depressing investment and constraining economic growth. It is estimated that 24 countries in Africa are currently experiencing some sort of conflict, including seven fragile states.⁵

Fragility affects a country's capacity to provide basic financial services through different channels including formal and informal suppliers of financial services. Very often, financial institutions struggle to offer affordable and appropriate financial products when macro-economic indicators are unfavorable including high inflation rates, slow growth, and high unemployment rates. Fragility and instability affect the sustainability of financial institutions as well. For instance, few years ago in the Democratic Republic of Congo and Zimbabwe, financial institutions collapsed for lack of product intake. Repeated bankruptcies damage the trust in formal financial institutions. Clients develop a preference for saving and borrowing using informal mechanisms. Other challenges affecting financial institutions in fragile states, entering or just out of conflict, include the presence of arms, displaced professional staff, and destroyed infrastructures. As fragility increases, suppliers of finance are also likely to become excessively risk averse and target their financial services towards a limited customer base. This is due to the fact that the uncertain environment in fragile states is not conducive to long term investments. As a result, long term financial transactions are replaced by short-term credits, relation-based credits and cash transactions. The hardest-hit are the poor and SMEs, which already struggle to access funding under normal economic conditions.

In conflict and post-conflict environments, there are decreasing market opportunities. Individuals and enterprises become more risk averse, and tend to invest less, choose low risk investment activities, and withhold their savings even further from the formal financial system. As fragility increases, individuals and enterprises alike rely more on social networks for funding and shy away from formal financial institutions thus disrupting even further the allocation of domestic



resources. Besides, the deterioration of the legal and institutional infrastructure makes the provision of financial services more costly and risky, thus adding to the liquidity constraints.

The multitude of macro-economic issues facing fragile states negatively affects the performance of central banks as well, resulting in a lack of enforcement of legal and regulatory rules. The loss of qualified human resources due to the political or economic situation in fragile states contributes to weak regulation, limited supervision capacity, and increased systemic risk. In countries such as Rwanda where conflicts caused temporary closure of the central bank at the height of the crisis, the financial system operated with much difficulty.

Operating in tumultuous environments requires not only strong political will to bring about a better legal framework, but also the ability to provide innovative financial services in uncertain environments where people are often displaced because of political and/or economic instability. Hence, for financial inclusion to be achieved in African fragile states, sound and sustainable financial institutions are required. Obviously, development partners have an important role to play to support recovery of financial systems in fragile states (Box VI.1).

Box VI.1: Supporting Recovery of Financial Systems in Fragile States

The UN Capital Development Fund (UNCDF) launched in 2004, just after the end of a devastating civil war in Sierra Leone, the Microfinance Investment and Technical Assistance Facility (MITAF) as a multi-donor funding mechanism with the aim of providing financial services to low-income people through a sustainable, competitive and inclusive financial sector. MITAF has been successful in setting up in Sierra Leone a facilitating environment to which donors, investors and commercial banks adhered in support of a pro-poor and accessible financial sector. Some of the key achievements of MITAF, which makes it a wide success today include: "moving financial services from the government to independent institutions; providing a joint platform for a coordinated donor approach; developing the concept of microfinance from charity into sustainable services; attracting the interest of commercial banks to broaden their client outreach into both rural areas and the microfinance sector."

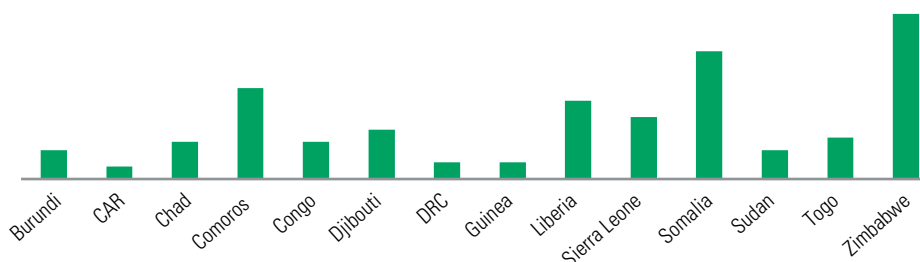
Source: Costa et al. (2011).

3. The State of Financial Inclusion in African Fragile States

Despite the development of innovative mechanisms and delivery channels to reach the poor in Africa, less than a quarter of adults living on the continent have an account with a formal financial institution. The vulnerability of African fragile states restricts even further the ability

of households and SMEs to access different types of financial services (including savings, loans, remittances, and insurance). Account penetration in African fragile states lags behind other African countries. On average, only 14% of adults living in African fragile states have an account at a formal financial institution, compared to 23% for the entire continent. In Burundi, Central Africa Republic, Chad, Congo, DRC, Guinea and Sudan, more than 90% of adults are unbanked (Figure VI.1). Poor infrastructure and security threats in fragile states are impediments to the expansion of access points. In addition, the lack of identification due to weak institutions constitutes a sizable barrier to account ownership in most fragile states.

Figure VI.1: Account Penetration in African Fragile States (%)



Source: Dermiguc-Kunt and Klapper (2012).

Note: Bars correspond to the share of adults with an account at a formal financial institution. Acronyms are: CAR (Central African Republic) and DRC (Democratic Republic of Congo).

By contrast, account penetration rates are much higher in Bosnia and Herzegovina (56%), Kosovo (44%) and Nepal (25%), which are fragile states in Europe and Asia. Coincidentally, these non-African fragile states have a higher CPIA, suggesting a better economic situation. Yet, as shown in Figure VI.2, adults in African fragile states are less likely to have an account at a formal financial institution compared to non-African fragile states even within the same income group category. Interestingly, the difference is more significant for the lower-middle income group where an African adult living in a fragile state is three times less likely than a non-African adult to have an account at a formal financial institution.

Adults in African fragile states report active use of formal accounts to receive remittances (66% in Somalia and 55% in Zimbabwe). This could be linked to high levels of poverty and shortage of resources prevailing in these countries which creates greater need for support from family members living abroad. High remittance flows represent an opportunity for financial



institutions to develop savings and other products around these regular cash flows received by their clients from family members living abroad or in other domestic major towns. In many African countries, including fragile states, some financial institutions have developed savings and loan products for remittances recipients as their remittances become regular income flows.

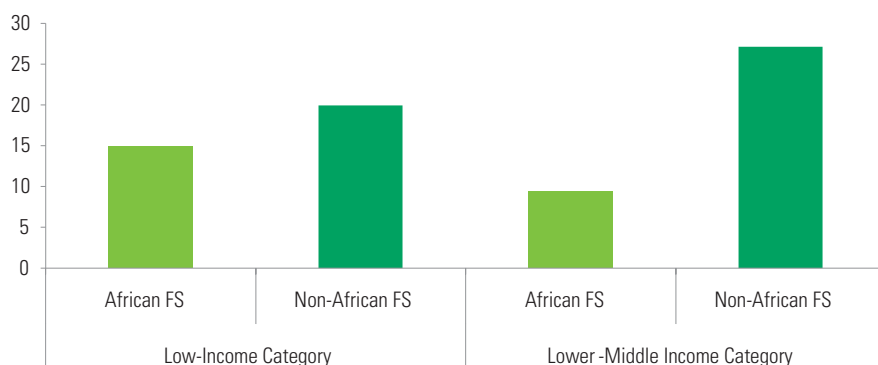
Box VI.2: Diagnostic Tools for Financial Sector Development

To ensure the efficient use of scarce resources available to fragile states, coordination between government and development partners is of paramount importance and all the more crucial in an environment which typically lacks a roadmap and stakeholders' consensus around a unique national agenda/action plan for the financial sector. Diagnostic tools such as the World Bank/IMF backed Financial Sector Assessment Programs (FSAP) and the diagnostic works of the CGAP are good indicators of driving components of financial inclusion.

The UNCDF in collaboration with FinMark Trust and Cenfri, have developed a holistic diagnostic and programmatic framework for financial inclusion, driven by detailed demand-side data that links the needs of poor households within the political economy of nation states, with a special focus on Least Developed Countries. Making Access Possible (MAP) is a diagnostic and programmatic framework to support expanding access to financial services for individuals and micro and small businesses. The MAP framework creates the space to convene a wide range of stakeholders around an evidence-based country diagnostic which leads to the development of national financial inclusion roadmaps. MAP includes an integrated and holistic diagnostic that shifts beyond the narrow supply-led focus to a broader focus on the financial ecosystem. The toolset goes beyond microfinance to look at the entire financial sector by taking a detailed look at the demand-side through the implementation of a nationally representative survey on financial inclusion which examines the usage of products, barriers and enablers to uptake of financial services, particularly for poor households, a detailed supply-side diagnostic which also takes into consideration the nature of distribution networks and the availability of both products and infrastructure to serve market demand. This diagnostic is captured within the policy and regulatory frameworks of the country and benchmarked against international best practices.

The growing momentum around financial inclusion leads us to re-think the role and responsibilities of traditional service providers in a rapidly evolving financial eco-system and compels us to help governments develop concrete tools and processes to help situate financial inclusion within their national development agendas. MAP diagnostics have been completed in Cote d'Ivoire and active in Mozambique, Myanmar, Thailand, Laos and DRC.

Source: UNCDF.

Figure VI.2: Account Penetration in African and Non-African Fragile States

Source: Demirgüç-Kunt and Klapper (2012) and Global Findex.

Note: Bars correspond to the share of adults with an account at a formal financial institution. Non-African fragile states are taken from the list of OECD fragile states. There is no African fragile state in upper-middle income category. FS refers to fragile states.

While account penetration is generally low in fragile states, formal account holders prefer using savings services provided by the formal sector due to the perceived security that formal financial institutions offer in these unstable environments. According to the 2012 Global Findex data, although less than 25% of adults in Chad, Liberia and Sierra Leone have a formal account, more than 75% of account holders saved in a formal financial institution in 2011. More than 50% of account holders, on average, report saving at a formal financial institution in fragile states suggesting that savings are a big driver for account ownership at a formal financial institution in African fragile states. Yet, fragile African states still show a high prevalence of informal saving mechanisms such as community-based savings (Figure VI.3). According to 2012 Global Findex, Burundi, Sierra Leone, Somalia, and Zimbabwe are the only few fragile states where more adults report saving using formal savings accounts than using a community-based method. In other African fragile states, community-based savings groups are more popular and have shown a great potential in their ability to increase financial access. Interestingly, Figure VI.3 shows that adults living in non-African fragile states have a different behavior and prefer to save at formal institutions. The preponderance of community-based savings groups in fragile states is an indication that there is obviously an unsatisfied need in these countries for a safe place to keep one's savings. Moreover, individuals might lack confidence in the formal financial system. In Kenya, Tanzania and Uganda, there are successful cases of linkages between community-based savings groups and formal financial institutions. These models could be replicated in fragile states to foster financial inclusion.

Figure VI.3: Savings Behavior in African and Non-African Fragile States

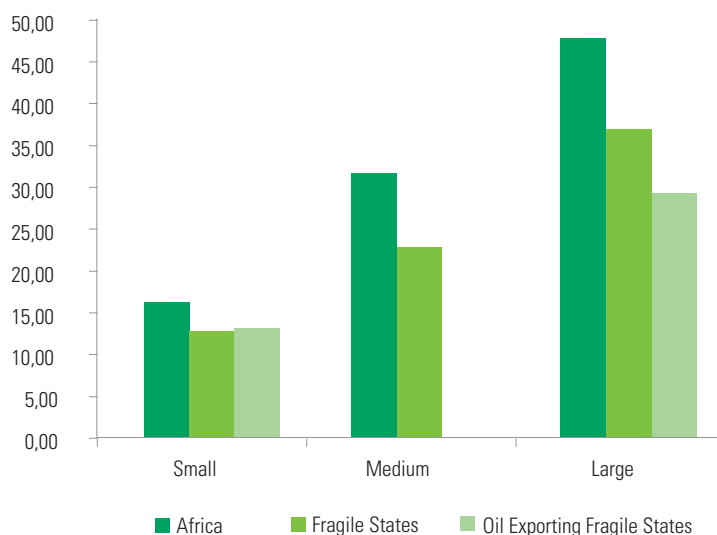


Source: Demirgüç-Kunt and Klapper (2012) and Global Findex.

Note: Acronyms are: LIC (Low Income Country), LMIC (Lower Middle Income Country), FS (Fragile States), CAR (Central African Republic) and DRC (Democratic Republic of Congo).

According to the 2012 Global Findex, less than 30% of formal account holders in African fragile states, report having borrowed from formal financial institutions. In all fragile states, adults rely more on loans from friends and family members, as these could be obtained without the collateral and paperwork required by formal financial institutions. In Zimbabwe, although account penetration is as high as 40%, only 4% of adults could access loans from formal financial institutions compared to a reported 57% of adults that borrow from friends or family members. This is significantly higher than the African average (40%). The lack of credit information systems is certainly one of the reasons why only a limited share of adults reports a loan from a formal financial institution. None of the fragile states in Africa has established a credit bureau or formal mechanism to obtain loan information on borrowers. Although a credit bureau would help in some countries at an advanced recovery stage, the general lack of skilled resources required to establish a credit bureau is potentially a major handicap. To increase their volume of loans, financial institutions should improve their loan granting mechanisms with proven tools to reach out low income clients in fragile states.

Given the instability in fragile states, emergency, health and funerals are the most common reason why people borrow money. In Guinea, 31% of adults report having an outstanding loan for health or emergencies, whereas the African average stands at 15%. Paying school fees is another major reason for borrowing in fragile states, with 10% of adults in Zimbabwe reporting having borrowed money to pay for school fees. Interestingly, Africans living in fragile states are more likely to have an outstanding loan to pay school fees than non-African fragile states for countries within the same income level group.

Figure VI.4: Percentage of Firms Reporting a Loan or Line of Credit by Country Type

Source: World Bank Enterprise Surveys.

Figure VI.4 shows that enterprises in African fragile states face more challenges than their African peers to access finance regardless of their size group. According to the World Bank Enterprise Surveys (WBES), on average, only 15% of firms in African fragile states report a loan or a line of credit from a financial institution, compared to 22% in Sub-Saharan Africa, and 43% in other developing economies excluding Africa. Access to finance is a major constraint for firms in fragile states where more firms tend to have a smaller size, although about 78% of enterprises report having a formal account. Interestingly, Figure VI.4 suggests that access to finance is a more binding barrier in oil exporting African fragile states. This reflects the fact that in such a context the environment is not conducive to businesses and prevents investments and finance to flow in.

Addressing commonly cited barriers to financial inclusion such as the lack of documentation, affordability, and distance would certainly help in deepening access and usage of financial services in fragile states. It is widely believed that mobile banking is an innovation with great potential to cut down transaction costs and thus increasing financial services to low income people and rural households through mobile devices and non-traditional bank agents. Mobile banking would not only facilitate remittances, savings and credit products, but would also offer a channel to deliver payments from the public and private sector to millions of people living in rural areas and places with less developed or no infrastructure. Somalia and Sudan, two African fragile states are reported to be among the top 10 economies with the highest reported use of



mobile payments, according to the latest 2012 Global Findex survey. In Sudan, 92% of mobile money users do not have an account, and represent an opportunity for financial institutions that could develop products to attract this segment of the population that is bankable. This suggests that, if properly developed, and considering appropriate changes to existing legal frameworks, mobile technology could help address issues of financial inclusion in African fragile states.

Increasingly, policy-makers, regulators and supervisors are recognizing that high-levels of financial exclusion poses a risk to political stability and impedes economic advancement and as such, they are willing to balance the ultimately mutually reinforcing needs for financial stability, financial integrity and financial inclusion. "A key challenge is how to create the broader interconnected ecosystem of market actors and infrastructure needed for safe and efficient product delivery to the poor."⁶ Several mechanisms have been developed to help countries implement diagnostics of their financial sector and identify barriers preventing financial sector development and greater financial inclusion (Box VI.2).

4. Conclusion and Policy Recommendations

Access and usage of financial services in most African fragile states are lower than in other African economies. African fragile states lag behind those in Asia and Europe as well. A vast majority of people living in fragile states are excluded from formal financial services and rely on their friends and families, and other informal mechanisms to meet their financial needs. The ability of fragile states to provide a more inclusive financial sector is hindered by political and/or economic instability, violence, lack of infrastructure, and diminished capacity to govern. Since Africa is more prone to instability than any other continent, many countries slip in and out of the fragile state category even when they are on the recovery path from an economic and/or political crisis and exhibit solid growth.

Inclusive finance should be part of a national recovery strategy in which the role of different actors is clearly defined. A financial system would not thrive in an environment plagued by violence, insecurity, and instability. Often, when fragility is severe, governments cannot take a leading role during the transition phase as their ability to design and implement national recovery strategies is weak. International support can help bring a country out of fragility if there is proper coherence, harmonization, and sequencing of actions, including the graduating leadership of governments as they acquire more capacity. Countries in transition need a mix of policies and measures as no single approach can address all challenges and risks facing fragile states. It is therefore imperative that development partners and governments collaborate through coordinated joint approaches, in order to find sustainable solutions that would prevent countries from falling into fragility and bring out those already trapped in it.

While it is widely acknowledged that the volatile context in many fragile states requires a contextualized, flexible and customized solution, there are some key principles that development

partners should focus on to ensure successful and sustainable financial inclusion in African fragile states:

- **Separate relief and financial services:** As relief agencies flock in a specific fragile state to assist with urgent issues, it would not be appropriate to mix relief work with provision of financial services. In some instances when instability is still at its high, it is more appropriate to start exclusively with grants until the minimum conditions for providing sustainable financial services are met. Moreover, to prevent the “dependency culture” emanating from relief work to contaminate provision of financial services, it is suggested that no single institution provides both relief and financial services. This separation requires a good national recovery strategy in which there is coordination and the role of different actors, including the government, is well defined.
- **Choose the right partners and involve the government:** It may not always be possible to find adequate human resources in fragile states recovering from conflict. Both the private and public sector are affected by the brain drain that occurs during and immediately after conflicts. However, it has been proven that local community-driven institutions are more sustainable. Governments also play an important ownership role, although their involvement as leaders of the process depends mainly on the gravity of fragility, and hence their technical capacity.
- **Maintain best practices of inclusive finance:** It would be very tempting for donor-supported financial institutions to forgive delinquent borrowers in fragile states on the ground that they are very poor and lack the means to repay their loans. However, the need to apply best practices will not only help create sustainable financial institutions, but will also foster responsible finance in the sense that institutions would cover their costs when they lend to people who have the ability to pay. Financial institutions should also seek to diversify their clientele and offer a wide variety of services including savings, remittances, and micro-insurance to their clients.
- **Trade-off between short-term needs and long-term goals:** Most donor funded programs focus on short-term results. In fragile states where populations’ short-term needs are pressing, donors’ programs typically lack long term goals. It is imperative that donors and other development partners commonly agree on some long-term key goals that will meet the populations’ short-term needs in a sustainable manner.

Notes

1. The paper uses AfDB’s list of fragile states (see Country Classification in the beginning of this volume).
2. World Bank Global Findex database (2012).
3. OECD-DAC (2006).



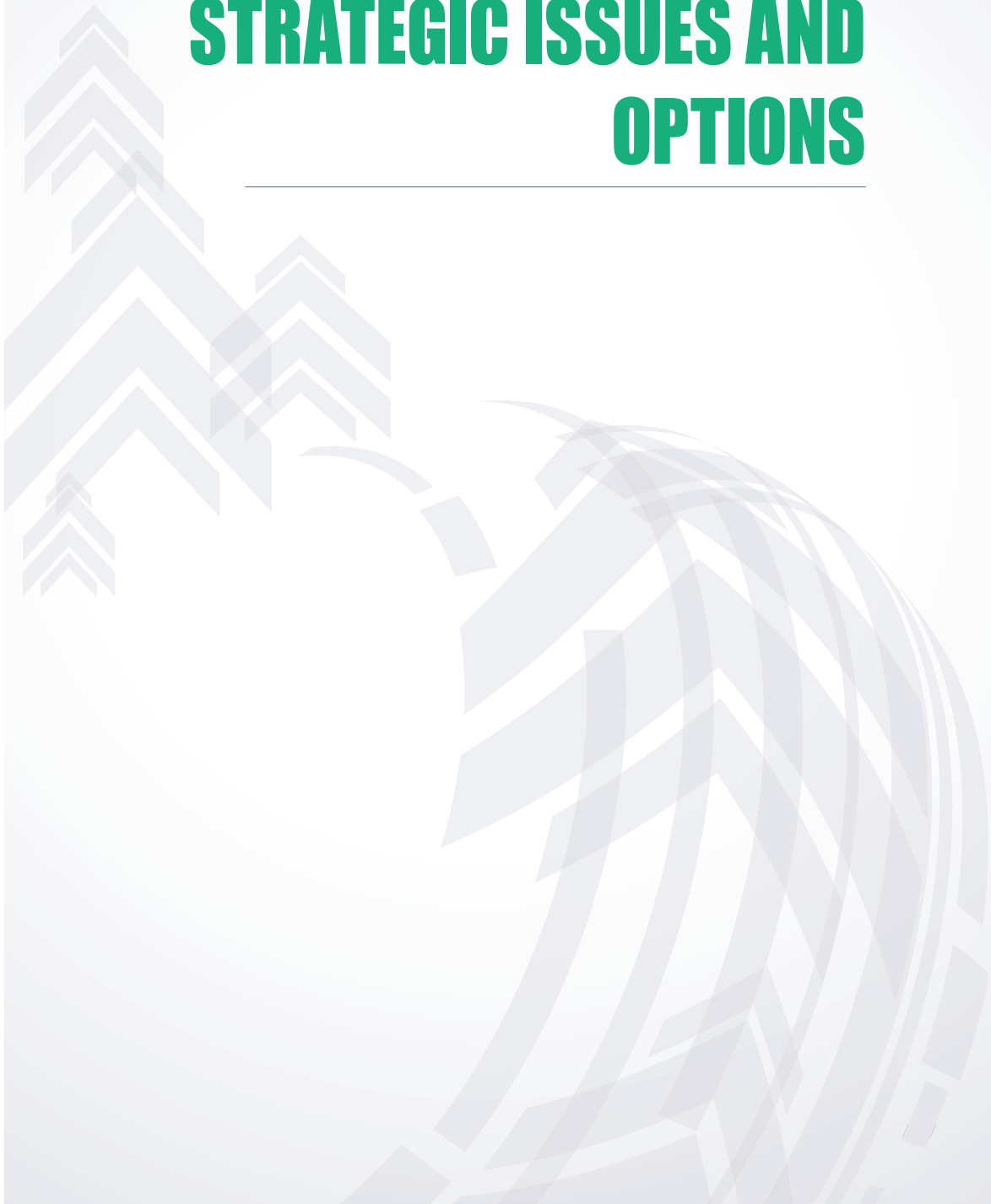
4. The CPIA rates countries on a set of 16 criteria grouped in four sectors: economic management, structural policies, policies for social inclusion and equity, and public sector management and institutions.
5. www.warsintheworld.com (accessed in May 2013).
6. Ehrbeck et al (2012).

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PART 3

STRATEGIC ISSUES AND OPTIONS





VII. Financial Inclusion in Africa: The Transformative Role of Technology

Issa Faye and Thouraya Triki

1. Introduction

The low level of financial inclusion in Africa is a reflection of both demand- and supply-side constraints. These include the underdevelopment of existing financial systems, lack of credit reporting institutions, poor levels of financial literacy and limited capacity of enterprises. The ability of Africans to access financial services is also hindered by poor quality of infrastructure and the small scale of many African economies. These constraints depict a large share of African population as commercially non-viable clients for formal financial institutions.

Interestingly, over the last years, innovative use of information and communications technologies are making it inexpensive to process a large volume of small transactions and to deliver a wide range of financial services in areas where physical infrastructure is lacking. With over 640 million mobile phone subscribers in 2012, Africa has become the second most connected region in the world in terms of mobile subscriptions count, right after the Asia-Pacific region. Given this large mobile customer base and the absence of an extensive brick and mortar banks' network, technology could be seen as a game changer in the sense that it could enable the continent's financial system to outperform the traditional banking model and establish itself as the world leader in mobile financial services.

This chapter discusses how technology, especially mobile phones, can push the financial inclusion agenda forward in Africa. The chapter describes existing mobile financial service deployments available on the continent and their various uses. It also discusses the challenges for financial inclusion through technology-based solutions and provides some policy recommendations on how to overcome these challenges.

2. Business Models for Technology-Based Financial Service Delivery

Technology-based financial services have been developed using different business models in Africa. These models differ primarily on the type of institution establishing the relationship with the end customer, and can be classified into three broad categories: Bank-focused models, Bank-led models, and Nonbank-Led models.

- *Bank-focused models* refer to models where a traditional bank uses non-traditional low-cost delivery channels to provide banking services to its existing customers. Examples range from use of ATMs to internet banking or mobile phone banking to provide certain

banking services to customers. This model is additive in nature and may be seen as a modest extension of conventional branch-based banking. Hence, it has limited effects on financial inclusion.

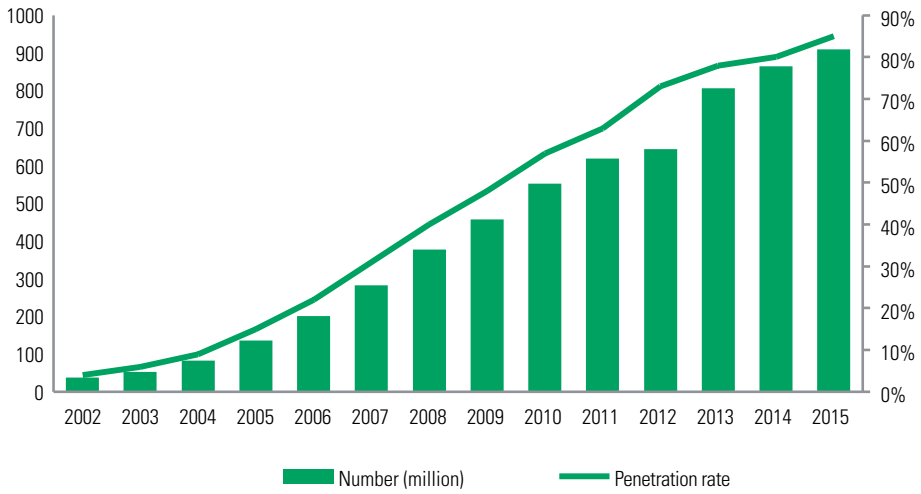
- *Bank-led models* offer a distinct alternative to conventional branch-based banking in that customers are given the opportunity to undertake financial transactions using a whole range of retail agents (or through mobile phones) instead of using bank branches. It may be implemented by using either correspondent arrangements or by creating a joint venture between a Bank and a Telcom operator/non-bank entity. In this model customer account relationship rests with the bank. This model was used in Kenya where private and state-owned banks pioneered the use of mobile technology at retail outlets to deliver banking services to previously unbanked low-income and rural population. For instance, Equity Bank has developed a network of over 1,000 “banking agents.” These agents are lottery outlets, post offices, supermarkets, grocery stores, and petrol stations. In small shops, the shopkeeper handles banking services for customers, and in larger stores, a store employee is dedicated to this purpose. This model has a significant inclusive dimension in the sense that it can contribute to reaching those excluded from financial systems.
- *Non-bank-led models* refer to models where a bank has a limited role in the day-to-day account management. Typically the bank role is limited to safe keeping funds. Account management functions are conducted by a non-bank entity (very often a Telecom operator) which has direct contact with individual customers. Deployments such as “Orange Money” in Senegal, Mali, Côte d’Ivoire, Niger, Cameroun, Madagascar are led by Telcom operators and do not require ownership of a bank account. Similar deployments have been launched by Telecom groups such as Airtel (“Airtel Money”) and Vodacom (“M-Pesa”). This model has a tremendous transformational impact since it has the potential to reach clients that are excluded from conventional financial systems.

3. Mobile Financial Services in Africa

The number of mobile subscribers as well as the penetration rate for mobile phones grew more than fourfold in Africa over the period 2005-2012 (Figure VII.1). Nigeria counts the largest number of subscriptions, with 140 million subscribers. Egypt and South Africa follow suit with respectively 78.3 and 50.5 million subscriptions by end-2011. According to the GSM Association (GSMA)¹, 25 African countries have penetration rates that exceed 90%.



Figure VII.1: Mobile Subscribers and Penetration Rates in Africa

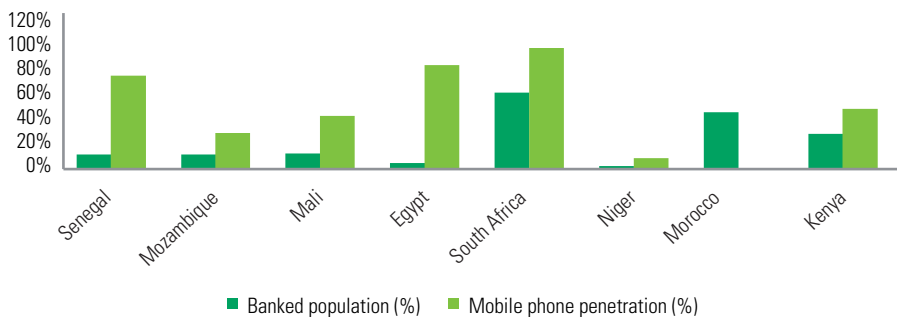


Source: GSMA African observatory report (2011).

Note: Number of mobile subscribers on left axis and penetration on right axis. Figures for 2013-2015 correspond to estimates.

This rapid spread of mobile phones means that the number of mobile users exceeds by far the number of banked people in many African countries (Figure VII.2).

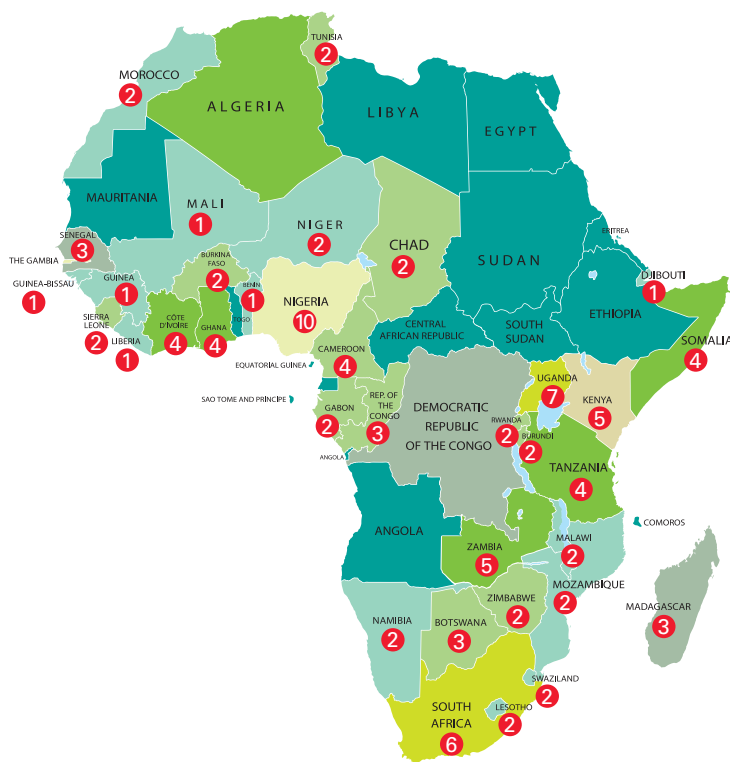
Figure VII.2: Banking and Mobile Penetration Rates in Selected African Countries



Source: IFC, Central Bank of West African States (BCEAO), Finscope.

Africa is currently leading the trend of mobile financial services with over 56 deployments in place (see Box VII.1 for examples). Notably, Sub-Saharan Africa alone accounts for over 45% of the world's total mobile money deployments (Map VII.1). A GSMA survey performed in June 2011 shows that East Africa has become the most active mobile money market in the World with 46% of mobile money transactions processed in June 2011 originating from the region.

Map VII.1: Mobile Money Deployments in Africa (March 2012)



Source: GSMA Mobile Money Tracker (2012).

The growth of mobile financial services in Africa has allowed millions of people who otherwise would have been excluded from the formal financial system to perform financial transactions relatively cheaply, securely, and reliably. For instance, in Kenya, where the M-Pesa service was commercially launched in 2007, 68% of adults report using mobile financial services (end 2011), out of which 43% do not have a formal account (Demirgüç-Kunt and Klapper, 2012).



Box VII.1: Examples of Mobile Financial Service Deployments in Africa

West African Economic and Monetary Union: Several mobile network operators in the region (Orange, Airtel and MTN) have partnered with banking groups (BNP, Société Générale, and ECOBANK, Bank of Africa) to offer mobile financial services. Eleven (11) mobile financial service offerings are currently available in six out of the eight West African Economic and Monetary Union (WAEMU) countries, namely Benin, Cote d'Ivoire, Mali, Niger, Burkina Faso, Senegal. These deployments attracted 1.4 million subscribers which is comparable to the number of cardholders in the card-based interbank network as of December 2011. Mobile financial services hold great promises for the region as less than 15% of the population have access to formal financial services while the average telecom penetration rate is 40%.

Kenya: M-Pesa is often cited as the pioneer of mobile financial services in Africa. It is currently the leading mobile money service in Kenya, accounting for more than 27,000 agents who handle over 30 million transactions daily. In Kenya 19% of airtime sold was purchased using M-Pesa. According to the World Bank "new potential for mobile money has come with the rise of interest-earning bank-integrated mobile savings systems, beginning with the launch of the M-KESHO system in March 2010".

South Africa: mobile financial services are widely used in South Africa with approximately 6 deployments: First National Bank (FNB) with around 2 million customers, Wizzit with over 250,000 subscribers, Flash Mobile Cash by Eezi with a network of 42,000 home shops, MTN Mobile Money, and finally Vodacom, in partnership with Nedbank offering M-Pesa.

Tanzania: more than 4.3 million mobile financial transactions have been made since the country introduced such services in 2007, equivalent to 40% of the country annual GDP. The Bank of Tanzania has encouraged operators to go beyond person to person (P2P) services and offer other mobile financial services including business to person, business to business, micro savings, micro insurance, micro loans and credit history information. Initial results have been recorded with some mobile financial service providers partnering with local savings groups to provide savings services and others encouraging consumers to link their mobile e-wallet to financial institutions.

According to GSMA, there are four main services offered by mobile financial service providers: sending money, paying bills, receiving bulk payments and purchasing airtime. These are called functional transactions as opposed to cash conversion transactions or administrative transactions such as changing one's pin or requesting a balance. As of June 2011, airtime purchases accounted for more than 68% of all transactions observed in Africa, followed by

person to person (P2P) transfers (27%), bill payments (5%) and bulk payments (1%, including government to person (G2P) payments). These figures conceal variations across regions. For instance, while P2P transactions represented 33% of functional transactions in East Africa, they accounted for only 5% of such transactions in West Africa. This situation could reflect the fact that the cost of mobile financial services in West Africa is not always lower than cash to cash services via non-mobile enabled technologies (Table VII.1).

Table VII.1: Cost of a 200 USD Money Transfer (P2P)

Mobile payment		Cash to cash	
Provider	Cost (USD)	Provider	Cost (USD)
Celpaid (Cote d'Ivoire)	8	WARI (Senegal)	20
Airtel (Burkina Faso)	6	CMS (Senegal)	2
Inova (Burkina Faso)	6	ACEP (Senegal)	2
Societe Generale (Senegal)	10	Ecobank (Burkina Faso)	8
M-Pesa	1		
Orange Money (Senegal)	9		

Source: Central Bank of West African States (BCEAO).

Second generation mobile financial services such as saving services, credit and micro insurance services have been also developed in Africa but remain quite limited relative to first generation services such as payments and transfers (Box VII.2). It is believed² that a phased approach with small payments serving as entry point to formal financial services

Box VII.2: Examples of Second Generation Mobile Financial Services

South Africa: In July 2013, Vodacom, South Africa's leading cell phone operator introduced an insurance product that targets its mobile money M-Pesa customers. The new service allows customers to insure their families against unexpected eventualities, such as funeral events.

Kenya: Kilimo Salama is a micro-insurance product that uses M-Pesa to provide payouts to smallholder farmers whose crops fail. In its second year of operation, 12, 000 farmers were insured, out of which 10% received payouts of up to 50% of their insured inputs.



followed later by a suite of financial services such as savings, credit and insurance will spur large socio-economic gains.

4. Going Beyond Mobile Financial Services

As most African economies remain cash-based, cash in/ cash out points, in the form of ATMs or Point of Sale (POS) terminals are essential elements for financial service delivery provided efficient payment and settlement systems are in place (Box VII.3). In Sub-Saharan Africa, the number of ATMs and POS remains limited. For example, in 2010, Botswana counted 21 ATMs and 288 POS terminals per 100,000 people while in South Africa the number of ATMs and POS stood at 52 and 700, respectively. However, the number of ATMs and POS has been growing at a high pace, the second highest in the world after South Asia.³ This growth has been fostered by reduced prices of hardware and supporting infrastructure. Debit and credit card readers now cost as little as USD 125 and operate wirelessly. Debit and credit cards are likely to help banks cater for the poor because they reduce delivery time and costs. This was supported by the findings of a 2010 CGAP survey which shows that 62 financial institutions from 32 countries use technology channels, such as ATMs and POS card readers and mobile phones, to handle transactions for poor customers. The advent of the internet has also revolutionized financial service delivery, empowering organizations with new business models and new ways to offer 24 hour accessibility to their customers.

Box VII.3: Technology and Banking in the WAEMU

The West African Economic and Monetary Union (WAEMU) achieved significant improvements in the union's payment and settlement systems. The Real Time Gross Settlement System (RTGS) and the Automated Clearing House were implemented in 2004 and 2006 respectively while the card-based interbank system (GIM-UEMOA) was put in place in 2007. This system, which counts 105 banks, three microfinance institutions and one Electronic Money Issuer as members, has recorded over 1.5 million transactions in 2012. ICTs have played a major role in these achievements. Today, members have centralized operations in one platform and many banks in the Union are moving towards network-based computing, networked ATMs, internet banking, smart card based products. ICTs have also been used for customer relationship management, customer transaction pattern analysis, credit profiling and risk management. Yet, physical outreach in the union remains low compared to other African regions. At end 2011, the global retail network consisted of 1,560 branches, 1,500 POS and 3,200 ATMs for a total population of approximately 94 million.

5. Challenges to the Development of Technology-Based Financial Services

While technology emerges as a short cut to financial inclusion in Africa, various obstacles have been preventing the development of technology-based financial services at a large scale. These include:

- *Stringent regulation:* Several African countries are still missing regulatory frameworks that govern the activities of technology-based financial services, including mobile financial services. For instance, M-payments require the accepted use of electronic signatures, such as a PIN number to authorize transactions. If the e-signature is not legally valid, the transaction could be challenged. There is therefore a need to provide status to electronic transactions equivalent to that achieved by physical signature. Moreover, international Anti Money Laundering/Combating the Financing of Terrorism (AML-CFT) standards require that adequate customer due diligence (CDD) be undertaken on all new accounts and on single payment cash operations to identify suspicious transactions. National laws and regulations in Africa typically require verification of: (i) client identity using an official document and (ii) client's physical address. This constraints the outreach of technology-based solutions as only 22% of African households receive mail at home and a large share of them does not have identity documents.⁴ This calls for clear regulatory frameworks for technology-based solutions and flexibility in the application of CDD requirements.
- *Limited interoperability:* Reaching an optimal scale for a provider of technology-based financial services requires interoperability at many levels. The ideal situation is to have a widespread access to a point of sale to allow customers to perform a large spectrum of operations. According to the outcomes of the Global Payment Systems Survey conducted in 2010 by the World Bank, less than 20% of the products were reported to be fully and partially interoperable. This limits the attractiveness of technology-based solutions to customers and leads to a low level of usage.
- *Scarcity of qualified Agents:* The ability of agents to drive transaction volumes, educate customers on how the service works and deliver error-free transactions have major bearing on the success of a technology-based financial solution. The 2011 GSMA Global Mobile Money Adoption Survey shows that agents of the eight fastest growing mobile financial services deployments had significantly more activity (up to 64.8 transactions per active agent outlet per day) relative to agents of other services (average of 3.8 transactions per active agent outlet per day). Well qualified agents are not always easy to find in Africa. It is only through well trained agents that success of technology-based solutions can be ensured.
- *Low levels of financial literacy and income:* Africa holds one of the lowest literacy rates in the world. In this context, the population's ability to understand technology-based financial services is not optimal. Hence, financial literacy programs are needed to inform



customers and show them how these services work and the risks involved. In addition, adoption of solutions tailored for smartphones will eventually become widespread in Africa but so far smartphones are unaffordable to a large share of the population.

6. Conclusion and Policy Recommendations

Growth in mobile phone penetration has revolutionized the delivery of financial services in Africa. Specifically, the emergence of mobile money transfers and mobile banking put Africa firmly at the forefront of the global mobile money industry. However, regulators have the difficult task of striking the right balance between supporting growth-enhancing innovation and implementing prudent regulation and effective risk-based supervision. This partly explains why new electronic or technology-based financial services have so far gained momentum only in a handful of African countries, and in some of these with regulation thus far kept to a minimum. In Africa where financial services are a distant dream to millions of people there should be considerable lead from the government and other financial institutions to foster the financial inclusion agenda.

Nevertheless, successful experiences implemented in Kenya, Tanzania and South Africa have shown that mobile financial services have the potential to significantly reduce the number of unbanked in Africa. This could boost domestic savings, incoming money transfer from diaspora and lower the cost of doing business by SMEs and the overall private sector, all of which should help Africa achieve greater development and move out of poverty. This requires among others:

- Provision of conducive regulatory frameworks: This would allow operators to pursue innovative approaches to reach the bottom of the pyramid. Governments should also design policies that enforce regulation set by central banks regarding financial inclusion strategies. This could entail for example the implementation of a ceiling for acceptable cash payments. For example, in WAEMU, all payments due by or owed to the government, in the reference amount or above, must be paid by a check, wire or any other scriptural payment method at a post office or a bank. The reference amount is set by a ministerial decree to 100,000 CFA francs in the Union.
- Data collection to underpin strategies: There is a strong need to gather sufficient and reliable data in order to better understand the baseline and starting point of access and usage of financial services. Country level data and diagnostic assessment can inform the design and sequencing of a strategy and can be useful to the private sector to adapt the design and delivery of financial services.
- Promotion of Mobile Government-to-person payments (G2P): According to a CGAP/DFID note, only eight African countries have been involved in technology-based G2P transactions in 2009. Governments are important payers and all payments such as salaries, social benefits, pensions, and student scholarships could be processed using technology-based solutions such as mobile financial services. This would reduce delays, errors or fraud, and

other risks related to G2P transactions. However, the sustainability of such payments is as crucial as their implementation mechanisms. This relates to the fact that a lack of a paired infrastructure for continuous use (merchant network) and awareness campaigns can provoke G2P failures as it has been the case in some Latin American countries and in India.

- Development of financial literacy programs: Low levels of financial literacy are currently deterring the use of (and access to) financial services in Africa. Mobile financial services are no exception. Therefore, it is critical to offer financial literacy programs to foster financial inclusion through technology-based financial services.

Notes

1. GSMA Mobile Money for the Unbanked (2011).
2. AFI Maya Declaration Progress report (2012).
3. CGAP and World Bank Financial Access (2010).
4. UPU 2005, available at : <http://www.upu.int/en/resources/postal-statistics/about-postal-statistics.html#276,2,Access%20to%20postal%20services>.

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VIII. DFIs Support to Financial Inclusion in Africa

Isabella Massa

1. Introduction

Financial inclusion is the process through which accessibility, availability and affordability of the formal financial system is ensured to all members of an economy. It is a determining factor in alleviating poverty, achieving sustainable economic growth and promoting social cohesion. Nevertheless, gaps in financial inclusion remain severe around the world, and in particular in developing countries where more than 2.7 billion people are still financially excluded and about 400 million SMEs do not have access to formal financial services (IFC, 2012a). Notably, Africa lags behind other developing regions with only 23% of adults holding an account at a formal financial institution, twice lower than the World average estimated at 50% (Demirgüç-Kunt and Klapper, 2012).

Several development actors have taken important steps to enhance financial inclusion in Africa. These include Development Finance Institutions (DFIs) which refer throughout this chapter to multilateral (e.g., International Finance Corporation (IFC), Multilateral Investment Guarantee Agency (MIGA), etc.), regional (e.g. African Development Bank (AfDB), European Bank for Reconstruction and Development (EBRD), European Investment Bank (EIB), Inter-American Development Bank (IADB), Asian Development Bank (ADB), etc.), and bilateral institutions (e.g. German Investment Corporation (DEG), Commonwealth Development Corporation (CDC), Netherlands Development Finance Company (FMO), Société de Promotion et de Participation pour la Coopération Economique (Proparco), Belgian Investment Company for Developing Countries (BIO), Agence Française de Développement (AFD) etc.) mandated to address investment shortfalls in developing countries. DFIs operate according to three principles: (i) additionality; (ii) catalytic role; and (iii) sustainability. It is important to note that tracking projects supported by DFIs to achieve greater financial inclusion, gathering information on their beneficiaries, terms and impact is challenging. Indeed, the breakdown of most DFIs' portfolio is not enough detailed to provide estimates for operations supporting financial inclusion. Information on the latter is very often reported through few representative case studies or press releases. As a consequence, data on DFIs' support to financial inclusion appears to be scarce and scattered. This has important implications: First, amounts and outcomes of financial inclusion projects become difficult to measure and compare across different DFIs; second, the lack of data hinders any assessment of DFIs' successes or failures.

This chapter focuses on DFIs and their role in addressing challenges to financial inclusion in Africa. Specifically, the chapter describes the role of DFIs in enhancing financial inclusion in Africa by focusing on the channels and instruments through which they support the accessibility, availability and affordability of financial services at both the households and SMEs level. Examples of initiatives supported by DFIs in Africa are also reported to provide a glimpse of the scope of their impact in the continent. The chapter ends with a discussion of the key strengths and weaknesses of DFIs' interventions as well as some recommendations for improvements.

2. DFIs: A Crucial and Growing Role to Foster Financial Inclusion

Financial inclusion is high on DFIs' agendas. Indeed, several institutions recognize financial inclusion as one of their top priority objectives (see Box VIII.1). Nevertheless, to our knowledge no DFI has a dedicated strategy to financial inclusion, which instead remains a component of their strategies to achieve inclusive growth and private/financial sector development. Information from the donor project database compiled by the MFW4A partnership, DFIs' annual reports and websites, press releases, recent stocktaking exercises and research papers were gathered in the attempt of providing a brief overview of DFIs' support to financial inclusion in Africa by looking at a representative sample of their activities at the household level, SMEs business level and in financial infrastructure.

Box VIII.1: Priority Objectives of Selected DFIs

Multilateral DFIs

- **IFC:** "Our priorities are to help our clients provide broad-based financial services to individuals [...] and to promote growth and employment generation by supporting sustainable lending to small and medium enterprises."

Regional DFIs

- **AfDB:** "[...] the Bank Group is committed [...] to closing [...] *the poverty reduction gap* — inadequate financial services for enterprises (particularly micro and small businesses) and households"
- **EIB:** "The priority objectives for the EIB's lending activities set out in the Bank's operational plan are: support for small and medium-sized enterprises (SMEs)..."

Bilateral DFIs

- **BIO:** "BIO financed regional or local intermediary structures (banks, investment funds, etc.) with a vocation to support SMEs and microfinance institutions."
- **FMO:** "FMO's 2009-2012 strategy focuses on three key sectors: access to finance (especially for SMEs in Low Income Countries)..."

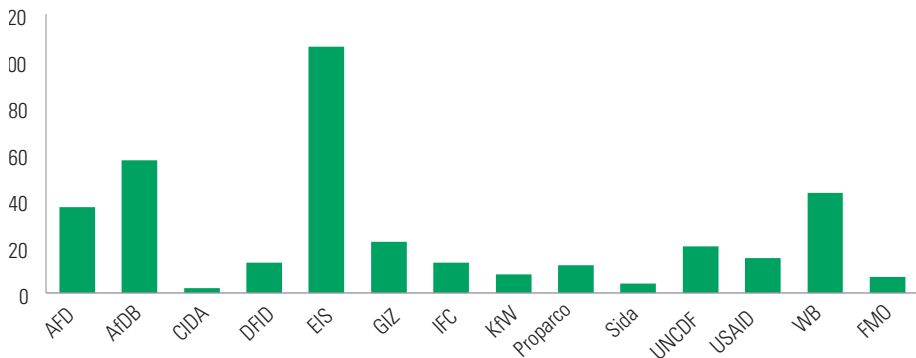
Note: This is not an exhaustive list. Some examples are provided but there are other DFIs that recognize financial inclusion as a priority objective.

Source: IFC (2012a), AfDB (2012), EIB- "Strategy". BIO- "Sectors" and Dalberg (2010).



The donor project database tracks initiatives backed by development partners aimed at supporting financial sector development and inclusion in Africa. The database covers the period 2000-2013. Out of the 351 projects included in the database, 305 were directly supported by DFIs including 224 projects that are currently active.¹ While this list is far from being comprehensive, it provides some interesting insights about DFIs' support to financial inclusion in Africa. The first interesting pattern that emerges from this database is that most projects are supported by a single DFI hinting to a low level of collaboration between these institutions. Indeed, out of the 305 projects that were identified, only 24 involved more than one DFI. In few instances, DFIs partnered with private sector entities such as the Bill and Melinda Gates foundation and the MasterCard foundation. Figure VIII.1 shows that EIB and AfDB are the most active DFIs in terms of number of projects supported in Africa, with respectively 106 and 57 projects. The World Bank follows suit with 43 projects.

Figure VIII.1: Number of Financial Inclusion-Related Projects Supported by Selected DFIs in Africa 2000-2013



Source: Donor project database, MFW4A partnership.

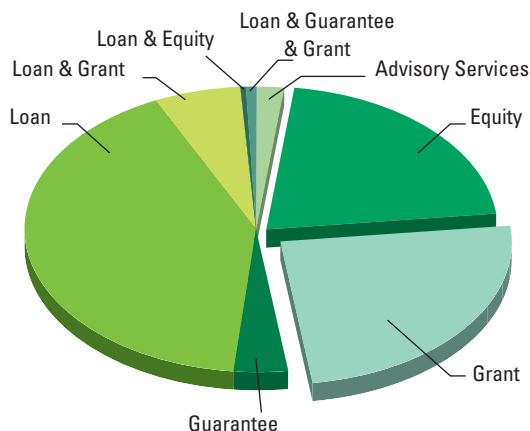
Note: Sample includes 305 projects. Acronyms are: CIDA (Canadian International Development Agency), DfID (Department for International Development), EIB (European Investment Bank), GIZ (Deutsche Gesellschaft für Internationale Zusammenarbeit), KfW (Kreditanstalt für Wiederaufbau), Sida (Swedish International Development Agency), UNCDF (United Nations Capital Development Fund), USAID (United States Agency for International Development) and WB (World Bank).

In terms of approach or delivery mechanisms, DFIs provide both funding and capacity building through advisory services and technical assistance grants. As a matter of fact, at least 56 out of the 305 identified projects in the donors' database have a capacity building component. Note, however, that resources earmarked by DFIs for capacity building are still limited. For example, in 2010 capacity building funds of European DFIs (a body representing 15 bilateral DFIs) amounted to less than 0.85% of their annual funding (Renault, 2011).² This severely constraints DFIs' ability to have a strong impact at the institutional (on governance), organizational (on quality and

performance), and individual (on skills and expertise) levels. A similar pattern is observed for DFIs' operations in the microfinance sector. The CGAP (2011a) reports that the share of total DFIs' commitments to microfinance extended by the 10 DFIs reporting to the CGAP funder survey in 2011 to build the capacity of retail MFIs was only 2% in 2010. Although this figure does not fully capture DFIs commitments used to strengthen the market infrastructure and legal and regulatory environment, it is expected that those commitments will be even smaller since merely 4% of total capacity building commitments by all funders reporting to the CGAP funder survey in 2011 were targeting the market infrastructure and policy levels (CGAP, 2011b). It is, however, worth noting that as of December 2009, among all developing regions, Sub-Saharan Africa received the largest share of capacity building funding, with 33% of global commitments to microfinance by all funders (including 18 DFIs) reporting to the CGAP funder survey in 2010 (CGAP, 2011c).

Figure VIII.2 shows that DFIs use several instruments to support financial inclusion projects in Africa. These include equity, loans, grants, and guarantees. Loans are the most commonly used instrument while equity and grants are equally used but at a lower extent. Interestingly, data from microfinance projects supported by DFIs show that while loans remain the main financial instrument through which DFIs provide direct funding to microfinance, the use of loans has declined between 2008 and 2010.³ Conversely, direct equity investments are on the rise. Another pattern that emerges from Figure VIII.2 is the limited use of multiple instruments in a single transaction as well as guarantees. Notably, the use of guarantees is mainly observed in recent projects suggesting that DFIs have been diversifying the pool of instruments they use to support financial inclusion in Africa.

Figure VIII.2: Distribution of Financial Inclusion-Related Projects Supported by DFIs in Africa, by Instrument Type



Source: Donor project database, MFW4A partnership.

Note: Sample includes 264 projects.

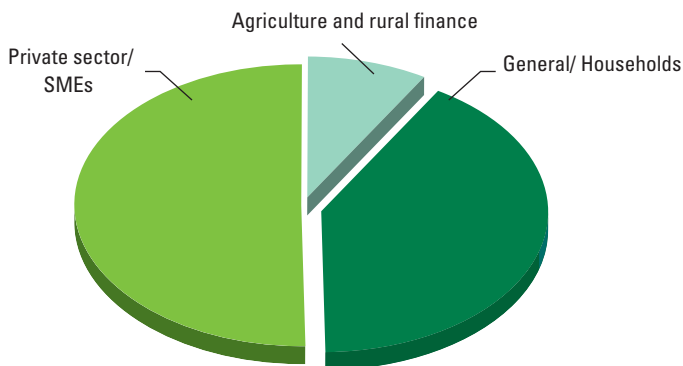


The interventions of DFIs to promote the financial inclusion agenda in Africa is explored in what follows through three different perspectives, namely at households, financial infrastructure and SMEs levels.

2.1. DFIs Support to Financial Inclusion for Households

DFIs usually have a holistic approach to financial inclusion which involves interventions to address supply and demand side constraints as well as inefficiencies in the enabling environment and financial infrastructure. The considered data show that implementation of financial inclusion projects for households goes beyond the microfinance sector to include mobile banking and payment systems as well as financial literacy and capacity building initiatives. Out of the 305 projects supported by DFIs, 120 projects were aimed at improving financial inclusion in a given country/region without specific targeting (Figure VIII.3). These mainly consisted of projects that provide funding and/or capacity building to MFIs or to projects seeking to: (i) implement diagnostic studies to understand constraints to financial inclusion; (ii) draft country strategies for financial inclusion and regulatory frameworks for microfinance and mobile financial services; (iii) develop mobile financial service deployments; (iv) strengthen the capacity of inclusive finance stakeholders; and (v) offer financial literacy programs. While these projects have a general scope, some of them mention women, youth, and entrepreneurs among targeted segments. Notably, the database shows growing DFIs support to mobile banking and

Figure VIII.3: Distribution of Financial Inclusion-Related Projects Supported by DFIs in Africa, by Beneficiary Type



Source: Donor project database, MFW4A partnership.

Note: Sample includes 292 projects.

Box VIII.2: DFIs' Support to Mobile Banking and Payment Systems in Africa

Mobile banking in Africa has been pioneered by M-Pesa, a system that allows depositing, sending, and withdrawing funds using mobile phones. The mobile operator Safaricom launched the scheme in Kenya in March 2007 and since then it has reached more than 40% of the adult population in the country, doubling the number of Kenyans considered financially not-excluded. This success prompted DFIs to invest in the mobile banking sector and grasp the huge opportunity to improve financial inclusion throughout the continent:

In 2010, Proparco jointly with the IFC provided a credit line of FCFA 8 billion to Millicom Chad, with the aim to support the extension of its network and provide access to a larger customer base. This initiative will contribute to increase the potential for mobile banking and improve financial inclusion in Chad.

In 2007, the IFC partnered with WIZZIT to bring mobile lending to millions of people in South Africa. The project deals mainly with low-cost, transactional bank accounts that use any mobile phone on any network for making and receiving payments, as well as borrowing loans. Furthermore, the service comes with a MasterCard-branded debit card that works on traditional ATMs. So far, over 400,000 people in South Africa have opened an account and WIZZIT has disbursed more than 350 loans (between 2,000 and 10,000 Rand equivalent to USD 285 -USD 1,425) to businesses.

In 2010, the AfDB, the West African Monetary Institute (WAMI), and the Central Bank of Liberia (CBL) launched the West African Monetary Zone (WAMZ) Payments System Development Project in Liberia with a grant of USD 7.6 million. This program aims at enhancing payment systems other than cash in order to improve banking and financial transactions.

Source: Proparco (2010), IFC (2007), Mass and Radcliffe (2010).

payment systems over the last 5 years which reflects the important potential for such services to improve financial inclusion on the continent (see Box VIII.2).

Interestingly despite the large number of projects supporting microfinance among the ones included in the database, available evidence suggests that DFIs do not direct a significant share of their financial resources towards the African microfinance sector. Indeed, most of DFIs' investments in microfinance, have been so far concentrated in 2 regions: Latin America and the Caribbean and Eastern Europe and Central Asia, which together accounted for about 70%

Box VIII. 3: DFIs' Investment in Microfinance: An Increasing Focus on Africa

Over the last years, DFIs have launched several important initiatives in the microfinance sector in Africa. Just to mention a few recent examples:

- In 2011, the EIB jointly with the AfDB and other institutions launched the European Solidarity Financing Fund for Africa (FEFISOL, EUR 15 million) to provide microfinance funds to poor households in rural areas across Africa.
- In 2011, the AfDB jointly with the Spanish Agency for International Development Cooperation (AECID) and the Spanish Ministry of Economy and Finance launched the Microfinance Capacity Building Fund for Africa to help strengthen capacity building efforts in the financial sector that benefit poor and low-income populations in the African continent, particularly women and those living in rural areas.
- In 2012, the IFC invested a record USD 4 billion in Sub-Saharan Africa (which represented an annual increase of 44%) including a USD 37.4 million partnership with the MasterCard Foundation to help MFIs increase access to financial services for an estimated 5.3 million people in Sub-Saharan Africa.
- In 2012, CDC, which has decided to invest exclusively in Africa (and South Asia) from 2011 onwards, announced that USD 10 million are to be invested in the Progression Eastern African Microfinance Equity Fund (PEAMEF) which aims to support microfinance institutions in Kenya, Tanzania, Rwanda, Zambia and Uganda. These investments have the potential to reach half million clients.

Sources: EIB (2011), AfDB (2011), IFC (2012b) and CDC (2012).

of total DFIs' investment in microfinance. Sub-Saharan Africa and the Middle East and North Africa attracted only USD 55 million (1.9% of the total) and USD 11 million (0.4% of the total) respectively in the same year. Nevertheless, it is worth to highlight that DFIs' attention is now increasingly switching to Africa (see Box VIII.3).

2.2. DFIs Support to Financial Infrastructure

DFIs contribute to promote financial inclusion by supporting the development of financial infrastructure (i.e., accounting, credit reporting, and payment systems that underlie the functioning of financial markets and intermediaries). In developing countries, for example, households' and SMEs' access to finance is severely constrained by opacity and information asymmetry problems due, for example, to the absence or underdevelopment of credit information systems and collateral registries. Indeed, the lack of information on borrowers'

creditworthiness leads lenders: (i) to demand collaterals that cannot be offered by low-income households or SMEs (since they usually do not dispose of much assets such as land, real estate, equipment, or machinery; or the legal and property right regime is not adequate in such a way that financial institutions do not accept those assets as collateral), and (ii) to charge high interest rates and fees, and ask for excessive documentation requirements, which all contribute to increase the cost of accessing finance for poor households and SMEs. According to the World Bank's 2012 Doing Business Report, economies in Africa are severely affected by the lack of any kind of credit information system.

In an effort to tackle these problems, DFIs offer advisory services and funding to develop credit registries, credit bureaus, and collateral registries. The potential of these instruments is significant: recent studies show that credit bureaus can reduce transaction costs by 30 to 40%, increase the loan approval rate for individuals by 89% when positive and negative information is included in the credit report, and enhance the probability of getting loans

Box VIII.4: Supporting Credit Reporting Systems: IFC's Global Credit Bureau Program

IFC has been very active in the set-up or improvement of credit reporting systems in the developing world, including Africa. Through the Global Credit Bureau Program, it provided advisory services to several developing economies including African countries such as Algeria, Djibouti, Egypt, Morocco, Tunisia, Cape Verde, Ethiopia, Ghana, Kenya, Mozambique, Nigeria and Tanzania. The program aims to:

- Develop credit information sharing environments through advice and support provided to government authorities, reviews of legal and regulatory frameworks, raising awareness and outreach, and setting standards (*e.g.* Morocco)
- Provide direct support to develop new private credit bureaus and public credit registries through feasibility studies, assessments, operational support, encouraging international best practices, etc. (*e.g.* Egypt, Algeria)
- Enhance existing private credit bureaus through positive information sharing, value-added services, and commercial solutions (*e.g.* South Africa).

In 2010, the Program provided advisory services in 64 countries. It created or significantly improved credit bureaus in 13 countries including South Africa, Nigeria, Egypt and Morocco. Since its inception, it has drafted or contributed to draft 24 new laws/regulations, and it has organized 90 outreach events in 59 countries.

Source: IFC (2010).



for SMEs from 27% (without credit bureaus) to 40% (with credit bureaus) (IFC, 2010; IFC, 2011a). On the other hand, collateral registries can decrease the cost of credit and increase the repayment periods (IFC, 2011a). As shown in Box VIII.4, DFIs support in this area may take different forms ranging from contributing to setting standards, to improving the regulatory framework for sharing credit information, organizing awareness campaign and outreach events (*e.g.* roundtables, conferences, etc.) or to providing financial literacy to users, providers and regulators. DFIs have been also supporting the development of payment systems and collateral registries.

2.3. DFIs Support to SMEs

Figure VIII.3 shows that about 50% of projects supported by DFIs in the donor database targeted private sector enterprises, with a particular focus on SMEs. Such projects consisted of: (i) provision of funding and capacity building to financial intermediaries that cater for SMEs (banks, private equity funds, leasing companies); (ii) set up of guarantee schemes for SMEs; (iii) development of programs that offer business development services to SMEs; (iv) creation of private sector representative organizations to strengthen private sector access to finance in Africa; and (v) support to reforms aimed at strengthening the role of non-banks financial institutions such as leasing and private equity.

A SME finance stocktaking exercise was conducted in 2010 to identify the SME finance projects which were successful along five criteria: leverage, scale and sustainability, replicability, results and track record, and implementation capacity (IFC, 2010). The results show that out of over 164 successful cases, only 33 were in Africa. And of these only one-third were supported by DFIs, mainly in sub-Saharan Africa (in particular, Southern, West and East Africa). A few characteristics are common to most of these few successful interventions. First, in the majority of the cases, DFIs' support to SMEs came in the form of equity finance. Secondly, successful operations included financing and (or exclusively) capacity-building, thus suggesting that technical assistance and capacity building are crucial for building up skills needed to develop successful SMEs business lines in developing economies.

In addition to offering funding, DFIs support SMEs by providing risk management products. Through these financial products DFIs take the long term risk of SMEs, and in this way they enhance SMEs' creditworthiness and profitability thus allowing them to have access to financial services they cannot access otherwise because of credit, market or country risks. Interest rate swaps, currency swaps, commodity swaps, partial credit guarantees and portfolio risk sharing facilities are just some examples of risk mitigation products offered by DFIs. The latter also help to enhance SMEs' risk management skills by providing technical assistance and knowledge support. A few risk management initiatives recently undertaken by DFIs in Africa are reported in Box VIII.5.

Box VIII.5: Examples of Risk Management Initiatives Supported by DFIs

The African Guarantee Fund (AGF) was launched in 2012 and is a market-friendly guarantee scheme funded by the AfDB in partnership with the government of Denmark and Spain. The AGF aims to provide: (i) partial guarantees for financial institutions in African countries to incentivize them to increase debt and equity investments into SMEs; and (ii) capacity development of financial institutions (to help them to better appraise and manage SME portfolios) as well as of SMEs. The AGF aims to provide its products to the entire African continent by 2016.

The Currency Exchange Fund (TCX), which is a special purpose fund created jointly by several multilateral and bilateral DFIs (*e.g.*, EBRD, IFC, AfDB, DEG, BIO) in 2007, provides long-term local currency hedging products to investors and clients. This fund has helped several institutions to support SMEs (and MFIs) in sub-Saharan Africa. For example, it allowed BIO to provide EUR 1 million in loans all together to the only commercial milk producer (Laiterie du Berger) in Senegal.

GuarantCo which is owned indirectly by the Private Infrastructure Development Group (PIDG) includes DFIs such as FMO as members. GuarantCo provides: (i) risk mitigation instruments to enhance local currency debt issuance by the private, municipal and parastatal infrastructure sectors in lower income countries throughout the world; and (ii) funds for technical assistance. In Africa, 45 countries are eligible to receive support from GuarantCo.

Source: AfDB (2011), TCX (2011) and GuarantCo (2013).

DFIs play a key role in promoting access to finance for women-owned SMEs. In particular, they provide both funding and capacity building support to the private sector or governments to increase access to finance for women-owned businesses, and to enhance the skills of women entrepreneurs to run their businesses. Table VIII.1 summarizes the results on DFIs' activities to promote access to finance for women-owned enterprises in Africa obtained through a stocktaking exercise conducted by the IFC (2011b). The findings show that 11 out of the 37 projects covered are realized with the support of DFIs, and Africa accounts for roughly two-thirds of DFIs' projects. Moreover, it appears that in Africa DFIs provide support exclusively via financial intermediaries, by using debt or guarantees as instruments in contrast to other developing regions such as South Asia. Although it is difficult to assess the degree of success of DFIs' interventions in supporting women-owned SMEs, outreach figures provide a glimpse of the scope of their impact (Table VIII.1).

Table VIII.1: Selected Examples of DFIs' Support to Women-Owned MSMEs in Africa

Country (Year)	Program	Implementing DFI	Purpose	Instruments	Outreach
Malawi (2008)	Gender Entrepreneurship Markets Program	IFC (through NBS Bank)	Provide financing	Debt	n.a.
Kenya (2006)	Term Loans for Women	AfDB (through Commercial Bank of Africa)	Training and financing	Debt	n.a.
Nigeria (2009)	Gender Empowerment Program	IFC (through Access Bank)	Training and financing	Debt	More than 680 women have received training and 550 women entrepreneurs received a total of USD 37 million. Non-performing loans were 1%. More than 1,562 bank accounts were opened and deposits increased by USD10 million.
Uganda (2007)	Ugandan Women Entrepreneurs	IFC (through DFCU Uganda)	Training, networking and financing	Debt	300 SME women entrepreneurs received USD 16.1 million. 400 women business owners received training to enhance their finance and business management skills. Over 1,800 new accounts were opened as a result of the program.
Kenya (2006), Cameroon (2007), Tanzania and Zambia.	Growth Oriented Women Entrepreneurs (GOWE)	AfDB (jointly with the International Labor Organization (ILO))	Capacity building and financing	Debt and Guarantee	AfDB has guaranteed 47 loans amounting to USD 1.75 million and trained 600 women entrepreneurs on managing their businesses.
Kenya (2002)	USAID's Development Credit Authority (DCA)	USAID (through KCB Bank and other financial institutions)	Training and financing	Debt	More than USD 1.6 million have been lent to 350 women entrepreneurs.
Tanzania (2007)	Women Entrepreneurs Finance Program	IFC and Canadian International Development Agency(through Exim Bank)	Training and financing	Debt	USD 1 million was committed targeting 30,000 women.

Source: Adapted from IFC (2011b).

3. Conclusion and Policy Recommendations

The above analysis highlights that DFI is becoming increasingly one of the key players in fostering financial inclusion in Africa. By providing a broad range of financial services that goes beyond microcredit, DFIs are enhancing financial inclusion at both the households and SMEs levels. Their interventions through equity investments are also proving that not only debt but also equity finance may be material in successfully promoting access to finance; indeed, equity finance goes beyond the mere provision of capital by encouraging greater transparency and accountability. DFIs have started to exploit the great potential of mobile banking services and payment systems for financial inclusion as well. These have significantly enhanced the reach of financial services and have contributed to reducing costs thus making finance available and affordable to a considerable share of the financially excluded.

Notwithstanding these achievements, DFIs fall short from fully addressing a number of issues. First, one of the core principles according to which DFIs operate is additionality, which means that DFIs should focus their investments on those countries, sectors, or business segments that private investors consider too risky or not commercially viable. However, evidence suggests that DFIs tend to direct the bulk of their investments towards just few developing regions that are not those where financial exclusion is most severe, such as Africa. Therefore, DFIs should further increase their efforts in targeting African countries where a very small share of adults have an account at a formal financial institution, where SMEs are significantly constrained in accessing finance, and where payment systems and credit bureaus are the least developed globally. The analysis shows also that greater collaboration between DFIs is needed to create synergies and avoid duplication of efforts.

Second, although many DFIs provide technical assistance and advisory services along with their investments to foster financial inclusion for households, SMEs as well as financial infrastructure development, capacity-building initiatives or related commitments are still relatively limited. This constrains the effectiveness of DFIs' actions, since evidence suggests that combining funding with the provision of capacity building is essential to ensure the success and sustainability of financial inclusion projects. Indeed, capacity-building is crucial for building up skills needed by financial institutions to serve households and SMEs more efficiently. Also, capital-building skills enable end-users of financial services to efficiently manage their finance and develop successful businesses. For this reason, DFIs should dedicate more of their resources and expertise to promoting capacity building activities. In order to ensure the effectiveness and sustainability of such initiatives, it is important that DFIs first identify the existing weaknesses through diagnostic exercises and then develop coherent and integrated training policies.

Finally, DFIs have been unable so far to develop a harmonized and fully transparent reporting system of their interventions. Data on DFIs activities are indispensable to track progress on financial inclusion, assess DFIs' achievements, compare results across different DFIs, and



inform on issues that should be prioritized. Regarding the measurement of project outcomes, DFIs have started tracking the outreach of their financial inclusion interventions which may provide a better idea of the extent of their impacts. However, more information is needed on the development and poverty impacts as well as on the additionality and catalytic effects of DFIs' financial inclusion projects.

Notes

1. The donor database includes 12 projects supported by the CGAP and 34 projects supported by the First initiative, 2 groups that were launched by donors (including DFIs) to support financial sector development and inclusion in developing countries. These projects are excluded from the analysis as the latter focuses on initiatives directly funded by DFIs.
2. European DFIs include: BIO, CDC, COFIDES (Coopérative Financière pour le Développement de l'Economie Solidaire Nord Sud), DEG, Finnfund (Finnish Fund for Industrial Cooperation), FMOIFU (Investment Fund for Developing Countries), Norfund (Norwegian Investment Fund for Developing Countries), OeEB (Development Bank of Austria), Proparco, BMI-SBI (Belgian Corporation for International Investment), SIFEM (Swiss Investment Fund for Emerging Markets), SIMEST (Società Italiana per le Imprese all'Estero), SOFID (Sociedade para o Financiamento do Desenvolvimento), Swedfund (Sweden's development finance institution).
3. As of December 2010, debt represented 57% of direct investments realized by the 10 DFIs reporting to the CGAP funder survey in 2011 declining from 63% as of December 2008.

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IX. The Trade-off Between Financial Inclusion and Financial Stability

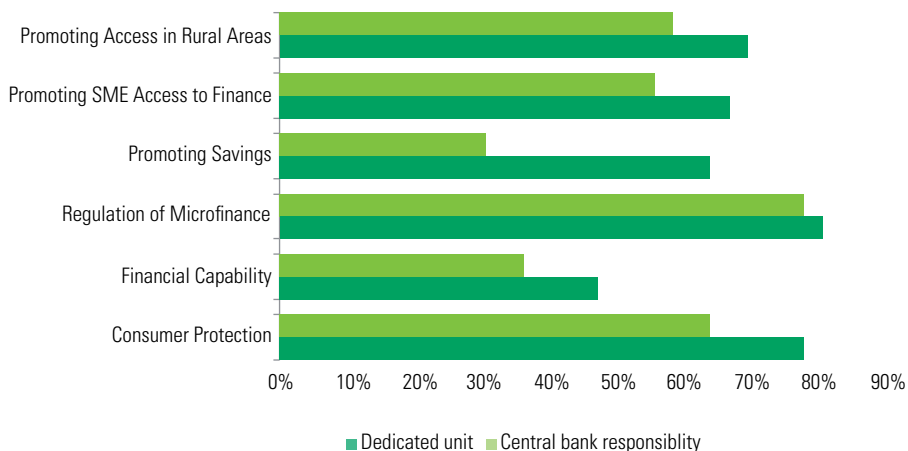
Pietro Calice

1. Introduction

The last decade witnessed profound structural changes in financial systems across Africa, characterised by financial deepening and rapid growth in intermediation. One important aspect of this trend is the progress achieved by many countries in terms of financial inclusion. For example, the median number of depositors with commercial banks per 1,000 adults in the region increased from 113 in 2007 to 257 in 2011, corresponding to an annual increase of 31%.¹ While technological innovation has certainly played a role in facilitating access and use of financial services in Africa, the financial sector has accompanied this trend with a wide array of actions to deepen financial inclusion.

Financial inclusion has become an explicit policy objective in many African countries. While a number of government agencies are typically involved, each with its own mandate, central banks are increasingly playing an active role in promoting financial inclusion, particularly in the areas of microfinance, consumer protection, rural finance and SME access (CGAP, 2010). For example, central banks are responsible for at least five topics related to financial inclusion in more than 60% of African countries, often with dedicated resources (see Figure IX.1).

Figure IX.1: Share of African Countries where the Central Bank is Responsible for Financial Inclusion Topics (%)



Source: Adapted from CGAP (2010).

The increasing involvement in financial inclusion poses new challenges to African central banks. Historically, their role has been to ensure the stability of the financial system through the regulation and supervision of financial institutions. Playing a promotional role in expanding financial inclusion may potentially give rise to a tension with the traditional objective of financial stability. The subprime crisis is a reminder of the risks to systemic stability stemming from policies (and practices) aimed at increasing access to finance. A key challenge for African regulators is therefore how to harness the potential of financial inclusion while ensuring that the stability of the financial system is not compromised.

This chapter discusses the trade-off between financial stability and financial inclusion in the context of African financial systems and attempts an answer to the following questions: (1) should financial inclusion constitute a variable in the objective function of the financial regulator? And, (2) if yes, which regulatory strategy is likely to maximize both financial stability and financial inclusion? The chapter starts with a discussion on whether financial stability and financial inclusion work in tandem or are two different goals. It then offers a conceptual framework for a regulatory strategy aimed at exploiting synergies between stability and inclusion. The chapter concludes with some policy recommendations on how to reconcile the two objectives.

2. Financial Stability and Inclusion: Complementary or Mutually Exclusive Objectives?

Financial inclusion can make a substantial positive difference in improving poor people's lives. For firms, especially SMEs, access to finance is a fundamental prerequisite for their growth and development. Given that promoting financial inclusion inevitably affects the supply side of the financial system (Hawkins, 2006; Hanning and Jansen, 2010), a key question for African regulators is whether the policy objectives of financial stability and financial access are mutually reinforcing or one comes at the expense of the other.

There are several ways in which financial inclusion can contribute to maintaining a sound and stable financial system (see Khan, 2011; Thorat, 2010). First, financial inclusion can improve the efficiency of the intermediation process by expanding the number and value of transactions and economic agents involved. Increased diversification will be reflected in the composition of assets and liabilities of the financial sector, thus contributing to reduced income volatility and improved liquidity profiles. Recent evidence from Chilean banks suggests that systemic risk resulting from losses on small loans is low, relative to less predictable and infrequent losses on large loans (Adasme et al., 2006). Second, financial inclusion fosters economic growth that should increase the degree of formalization of an economy thus improving the effectiveness of monetary policy transmission. Shallow financial markets tend to undermine the efficacy of monetary policy in Africa (Cristensen, 2011). Moreover, informality often encourages the use of informal financial services. These services, such as pyramid schemes, could cause instability in the system (Cull et al., 2012). Instability effects could also stem from the quality and limited



capacity of the institutions that offer informal financial services. A notable illustration of this argument is the crisis experienced by the microfinance sector in Morocco few years ago as a result of clients' over-indebtedness. Indeed, local microfinance institutions did not have the capacity to detect clients' cross-lending which lead to high levels of NPLs and a crisis in the sector.

Third, increased financial inclusion strengthens the balance sheet of the household sector as well as of the corporate sector by allowing them to save, invest and grow. This has stability effects on savings levels and potentially on financial stability. Moreover, reduced inequalities resulting from financial inclusion are likely to foster social and political stability which could further enhance financial stability. Yet, the link between the two remains to be proven. Fourth, to the extent that efforts to increase financial inclusion stimulate innovations in business models, the overall efficiency of the financial sector improves, with positive externalities for financial stability. Finally, the recent financial crisis has underscored the importance of financial literacy and consumer protection, all of which are important components of the financial inclusion agenda.

Besides, financial inclusion also entails risks to financial stability. This is because banking the poor and the unbanked typically involves high operating costs as financial intermediaries invest in new distribution channels, new products and new risk management systems. Moreover, these innovations are mostly untested and can introduce reputational risks, therefore jeopardizing financial stability.

On balance, however, there are reasons to believe that financial stability and financial inclusion can be mutually reinforcing if managed properly and therefore both should be included in the objective function of the African financial regulator. The South African experience suggests that it is important to stop considering these objectives independently rather than a set of linkages that could be optimized (Box IX.1).

3. How to Maximize Financial Stability and Inclusion: A Framework

Achieving greater financial inclusion and maintaining financial stability are mutually reinforcing policy compulsions and the challenge is how to ensure both while exploiting the synergies between the two objectives. A possible answer arguably lies in a facilitative regulatory environment which ensures that the formal financial system delivers affordable financial services to those excluded from the financial system with greater efficiency without compromising on the acceptable levels of safety and soundness.

First, for financial inclusion to be expanded through financial regulation, market uptake is critical. Passing enabling regulation does not guarantee increased access. Current research on the financial behavior of the poor shows that they already employ informal financial tools in a sophisticated way (Collins et al, 2009). An understanding of the needs and incentives of

Box IX.1: Reconciling Financial Inclusion and Stability: Insights from the South African Experience

The South African financial sector policy includes 4 priority objectives namely, financial stability, consumer protection and market conduct, financial inclusion and financial integrity. A recent CGAP report assessed the effect on stability of 5 decisions made by the South African government to support financial inclusion. These are:

- Permitting payroll deduction for repayment of small loans (1993-2006)
- Banks' commitment to provide affordable housing loans (2003)
- Alleviation of the Know Your Customer (KYC) requirements to allow banks to offer simplified "Mzansi" accounts to the unbanked (2004)
- Enactment of the law on cooperative banks to allow formalization of informal providers and creation of new financial cooperatives (2007)
- New regulatory framework for micro-insurance (2011).

It is estimated that these decisions lead to the following outcomes in terms of financial inclusion and stability:

Decision	Objectives and linkages at the time	Observed outcomes
Change in KYC regulation	Improve financial inclusion, usage limitations were implemented to address integrity issues	Positive effects on inclusion and probably on financial integrity
a.Cooperative banks Act	Improve financial inclusion and consumer protection (in the case of the micro-insurance framework)	a. Very limited effects so far
b.Micro-insurance framework		b. Not yet in force
Affordable housing loans	Advance financial inclusion, could cause instability	Positive effects for financial inclusion and early indications of possible positive effects for stability
Payroll deduction for small loans	Advance financial inclusion. No original anticipation of increased stability or consumer protection risk	Negative effects on systemic stability and consumer protection, payment innovation corrected to negative outcomes

These findings suggest that financial inclusion and financial stability are interrelated and that synergies could be sought to maximize both objectives.

Source: CGAP (2012).



the users of financial services is therefore a critical step in the design of a proper regulatory strategy. An essential attribute to the kinds of financial services that people may want is the nature of employment in a country. This is important to identify sectoral-specific opportunities to improve productivity. If, for example, the bulk of the workforce is self-employed like in Mali this implies the need for a reliable and low-cost source of working capital, which would allow them to optimize on their inventories. Discovering such opportunities and converting them into viable lending models is something the financial sector may benefit from, and regulators can provide the right set of incentives.

Equally important is how the poor spend their money. This is important to provide incentives for the development of products that can help the poor meet these expenditures without bearing a crushing burden. For example, in some countries such as Guinea or Sierra Leone, one of the most significant unusual expenditures is on medical treatments. This indicates the need for a low-cost health insurance scheme. It is also essential to analyze investment and savings motivations. Typically, the primary channels for deploying financial savings are bank deposits and the mattress. A key question is why people prefer to keep their savings in a certain proportion that may not optimize their risk-return profiles. One possible explanation is that investment options are subject to a minimum threshold which may not be accessible to the poor. From a financial inclusion perspective, the challenge is to lower this threshold in a way that does not compromise the commercial viability of the service providers. The same logic applies to the motivations driving savings behavior. These are typically old age, children's education, ceremonies, and emergencies. For all these requirements products and services are generally available yet threshold requirements apply. The possibility to lower these thresholds in a viable manner should be explored.

Second, in a market-based economy, financial inclusion depends ultimately on the ability of financial institutions to develop sustainable business models that enable them to meet the needs of poor customers at scale. The role of the regulator is to shape incentives so that financial services providers can efficiently respond to the needs of their customers. The need to bring financial services closer to poor consumers is already giving rise to new low-cost distribution models in a number of African countries. Some financial institutions in Morocco and South Africa have had success adapting traditional branch-based approaches to serve the segment. However, alternative distribution models also hold great promise, in particular correspondent banking and mobile banking such as in Kenya.

African financial institutions have also begun to experiment with technology to gain access to useful data about poor customers, for whom very little information is available (Baer et al, 2012). Transaction histories generated through mobile-phone use is one example being developed in countries such as Uganda. Financial institutions are beginning to use basic customer-relationship-management solutions, enabling them to collect information about the frequency and character of their interactions with customers. Many governments are developing improved identification and tracking systems to gather information about citizens—

for instance, through credit bureaus—and thereby facilitate administrative processes and identify social needs. Innovative financial institutions are using these and other sources of information to develop data-based models to better assess poor consumers' credit risk. These encouraging examples are providing useful lessons that will inform further experiments in risk management and enable more rapid scale-up of financial-services solutions for the poor.

A diagnostic of demand and supply of financial services issues constraining financial stability and inclusion should constitute the basis for a regulatory strategy aimed at maximizing stability and inclusion. Regulation has many dimensions, not all of them under the purview of the financial regulator. The main principle inspiring regulation for financial inclusion and financial stability should be risk-proportionality, which is to say regulatory requirements should vary based on the benefits and the risks associated with the provision of financial services (G20 FIEG, 2010). To implement this principle in practice, especially in the context of fast technology-driven innovation in financial services, it might be useful to focus on functions or services rather than providers (see Dittus and Klein, 2011; Beck et al. 2011). This is because financial services are increasingly provided by a rapidly changing number of suppliers, including non-bank financial institutions. Mobile financial services are a notable example of this category.

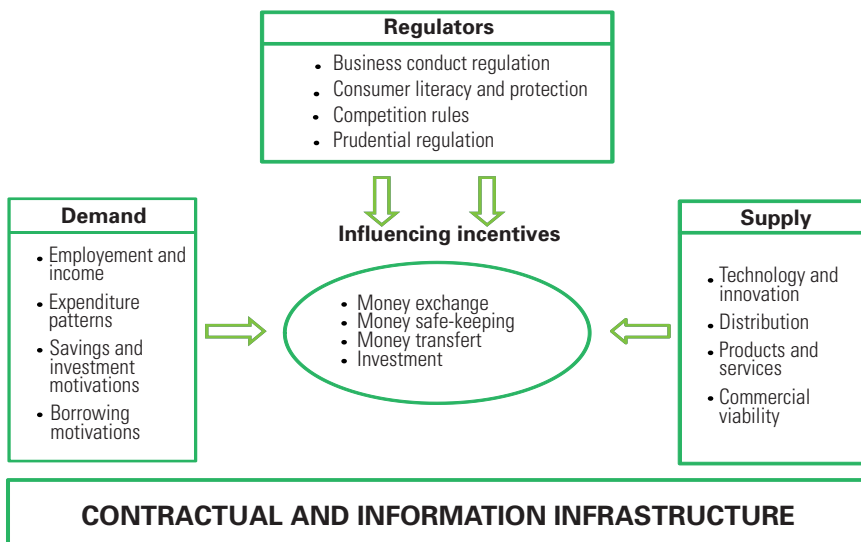
In line with Dittus and Klein (2011), the financial services business can be decomposed in the following key functions to which a specific regulatory approach can be associated:

- **Money exchange.** This service is typically provided by cash merchants, who trade with their own property at their own risk. Therefore it would *a priori* seem appropriate to rely on commercial law and standard resolution mechanisms, with no need to specifically regulate.
- **Money safe-keeping.** In contrast to money exchange, this service has a time dimension, involving the promise to safeguard a high value item and return it for a small fee. Inherent in such a service is a safety issue. Therefore commercial law and enforcement systems are important, but probably even more important are rules that help create and sustain trust in the service provider such as consumer protection measures and business conduct regulation.
- **Money transfer.** Like with safe-keeping, the key element in transfer services is the safety of the transfer mechanism, in particular secure communication and reliable identification of people. The basic elements to ensure this are commercial law and enforcement possibilities of contracts. But since operational risk is also present, and the scope for fraud exists, consumer protection measures and business conduct regulation are also important to help establish common rules and increase the trust in the system through transparency and audit requirements.
- **Investment of money.** If the safe-keeper and/or the money transfer invest the proceeds of its activities then we do have the basic building blocks of a bank, and prudential regulation such as capital and liquidity requirements are needed. Prudential regulatory interventions

to increase outreach might also be encompassed, for example, loosening licensing requirements or regulation for a tiered banking system (Hawkins, 2006). A number of African countries such as South Africa are experimenting with this approach.

Figure IX.2 provides a conceptual framework describing how to achieve financial inclusion while preserving stability and taking into account the regulatory requirements imposed by the different functions of the financial service business.

Figure IX.2: Conceptual Framework for an Inclusive Regulatory Strategy



Source: Author's analysis.

4. Conclusion and Policy Recommendations

This chapter has discussed the issue of financial stability and financial inclusion from the perspective of financial regulators. It has argued that stability and inclusion are complementary policy objectives for the financial regulator. It has also presented a conceptual framework for a regulatory strategy to exploit synergies between the two objectives based on the principle of risk-proportionality and the type of financial services. Some preliminary conclusions are in order.

First, coordination among policymakers and the private sector is essential. Regulators and other policymakers should speak with one voice to the public and the financial sector so that the objectives of the policy are clearly understood and publicly supported.

Second, prioritization of policies should be an important dimension of a regulatory approach to foster stability with inclusion. While policies to improve access and ensure stability may be mutually reinforcing, some policies are easier to implement than others. For example, improved disclosure requirements on banking services may be more straightforward than, the overhaul of state-owned banks.

Finally, it is important to continue generating knowledge on the interaction between financial stability and financial inclusion. Empirical research on the topic remains largely absent. The areas for potential further research relate to the following questions: What explains low penetration in financial services among low-income households and MSMEs? What is the optimal size and structure of the financial sector which maximizes financial inclusion while ensuring stability? What is the optimal financial sector regulatory framework that maximizes the two policy objectives? What is the impact of specific financial inclusion policies (through, for example, randomized controlled trials)? What is the impact of technology-based financial inclusion policies on financial stability?

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X. Financial Inclusion: Lessons from Latin America and Caribbean

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1. Introduction

Financial inclusion remains a top priority on reform agendas of developing countries owing to its economy-wide consequences: From the government perspective, financial inclusion can contribute to macroeconomic stability, employment, and business creation. From the financial sector standpoint, greater financial inclusion represents a broader client base and a more stable diversified source of funding. It can improve risk management in order to prevent money laundering and the financing of terrorist activities, all the above leading to higher profitability and productivity. It also contributes to the stability of financial systems. For individuals or households, including those living in poverty, financial inclusion provides more secure mechanisms to save and acquire debt for investment purposes in businesses, housing, health, and education.

Despite the important progress made in Latin America and the Caribbean (LAC) towards financial inclusion in recent decades, a large part of the population still lacks access to formal financial products and services. Only 39% of adults have an account at a formal financial institution in LAC countries (Demirguc-Kunt and Klapper, 2012); amongst lower income individuals the percentage is lower (25.3%). This situation is comparable to the one observed in Africa where less than quarter of adults have access to an account at a formal financial institution. Limited access to finance in both regions is often due to the absence of business strategies developed by financial institutions that target low-income people as potential clients. Low-cost, high-quality financial services with greater product differentiation, good customer service, high accessibility, and ease of use remain yet to be achieved.

This chapter provides an overview of the current state of financial inclusion in LAC, in terms of access and use. It also discusses innovative delivery channels that have been used in LAC with a particular focus on agent banking models. Additionally, the chapter compiles lessons learnt from initiatives implemented in LAC to expand access to financial services to low-income populations. Those lessons could be very useful to achieve greater financial inclusion in Africa.

2. Financial Inclusion in LAC Countries: What do we Know?

2.1 Access and Use of Financial Products and Services

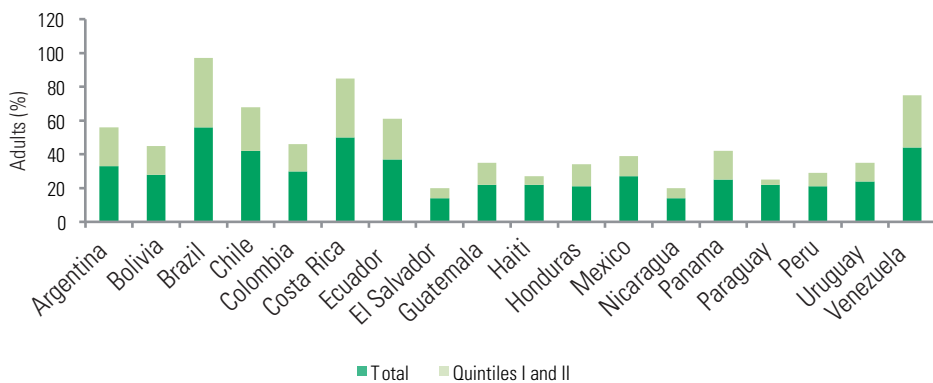
Currently, a large portion of the adult population in LAC does not hold accounts in the formal financial system. Recent data on financial inclusion shows that in 2011 only 39% of adults above 15 years of age in LAC had an account at a formal financial institution. Notably, access rates are still lower for underserved segments of the population such as adults living in rural



areas (34%), and low-income adult population (25%) (Demirgüç-kunt and Klapper, 2012).¹ This is consistent with findings from Africa where only 11% of the population at the lowest quartile of the income distribution and 19% of adults living in rural areas have an account at a formal financial institution, compared to a 23% average for the continent.

Countries that have experienced strong economic growth in recent years, such as Brazil, Costa Rica, and Chile, have the largest number of adults with formal accounts; while other countries with slower economic performance, like El Salvador and Nicaragua, are lagging behind (Figure X.1). Haiti counts one of the lowest numbers of low income adults holding an account in the LAC region, which is similar to trends documented in African fragile states. Conversely, Brazil, Costa Rica, and Venezuela have the highest rates of formal banking among low-income adults.

Figure X.1: Percentage of Adults with an Account at a Formal Institution



Source: Demirgüç-Kunt and Klapper (2012).

However, having access to formal accounts does not necessarily imply that financial products are actually used. Of the 39% of adults in LAC with an account, only about 30% conduct more than three transactions (deposits and withdrawals) a month, while close to 50% make between one and two transactions a month. An estimated 10% are inactive. Hence, while account penetration in Africa is slightly lower than in LAC, the frequency of account use in both regions is very similar.

Usage data is low both in Africa and LAC, but the limited information available shows that there are many informal financial mechanisms that low-income people use. Interestingly, data from Findex suggest that Africans are slightly better at saving using formal financial institutions with 13% of adults using the financial system to save, compared to only 9.5% of adults in LAC. The

population in LAC seems to rely more on informal mechanisms with 25.7% of adults keeping savings outside the formal financial system, in cash or in assets (e.g., livestock) compared to 17% in Africa. In the case of Colombia for example, 65% of the low-income population saves in cash. Informal savings mechanisms, such as savings circles or clubs, are used by low- and middle-income families to save and to access loans in several countries, including Mexico, Guatemala, El Salvador, Costa Rica, Panama, Colombia, Peru, and Bolivia. Evidence shows that low-income people participating in savings groups can save around USD100 after the first year of participation, which for many constitutes their first experience in saving money. Therefore, there is an important opportunity for financial institutions, both in LAC and Africa, to reach underserved populations, particularly low-income people, who can save but do not have access to financial products and services that meet their needs and preferences.

It is important to understand such informal financial behaviors and see low-income people as potential clients. There is a lack of information in this field and a pressing need for further research that can help financial entities develop products tailored to this segment of the population. Experiences in LAC could be used to inspire African initiatives (Box X.1). In this regard, innovation plays a key role not only for product development, but also for alternative distribution channels and financial literacy, contributing to the transition of the unbanked into the formal financial sector. For these reasons, efforts to expand access to the formal financial system in LAC, specifically in terms of savings products, have been accompanied by the adoption of new regulations that promote the development of simplified accounts, which entail minimum requirements for opening accounts and lower costs to clients.

One of the first countries to adjust its regulation to incorporate simplified accounts was Colombia. This was part of the Colombian government's efforts to expand access to financial products and services in the country.² Other countries that have adopted a similar framework

Box X.1: Offering Savings Products to Low Income Population

One example of a financial intermediary in LAC that has been offering savings products to low income population is *Financiera Comultrasan*, a credit union in Colombia committed to the social development of vulnerable communities in rural areas. With over 50 years of experience, this institution provides financial literacy and financial solutions tailored to low-income populations. Currently, *Financiera Comultrasan* has over 100,000 savings clients. Its most successful savings product, "Ahorro programado de libre destino," has a low minimum opening balance and an interest rate of up to 8%, with no fees related to operational costs. In 2012, 52% of the credit union's clients were women and 40% of its client base was located in rural areas. Sixty percent of the beneficiaries are micro and small entrepreneurs, heads of households, and students with an average monthly income of USD 200. *Financiera Comultrasan* reports approximately 80,000 active accounts to date.



are Mexico, Chile, and Brazil. The use of simplified accounts is still limited in Africa. To the best of our knowledge, only few countries such as South Africa, through the Mzansi accounts, and Morocco have experimented with this approach at a relatively large scale.

Micro, Small and Medium Enterprises (MSMEs) which account for the vast majority (more than 90%) of companies in LAC, also face challenges in accessing finance. It is estimated that 40% of MSMEs in LAC region need credit but have neither a loan nor an overdraft (Stein, Goland and Schiff, 2010). In comparison, an estimated 78% of companies in Sub-Saharan Africa need a loan or a line of credit from a financial institution.

Finally, it is important to note that a large proportion of the population in the LAC region regularly receives various kinds of payments, such as government subsidies and international remittances. Specifically, more than 129 million people benefit from conditional cash transfers (CCTs) in more than 19 countries in the region. Also, in 2011, the total volume of international remittances sent to the countries of the region reached USD 61 billion, exceeding by USD 20 billion what Africa received in remittances over the same period. Studies show that only 10% of the LAC population uses an account to receive government payments, and only 4% to receive international remittances. By contrast, in Africa, 8% of adults use their account to receive remittances. The majority of CCT recipients in LAC remain unbanked, and less than half of international remittance recipients have a bank account, which suggests that the use of cash prevails among this population. These payments are an important means of achieving financial inclusion, and experience has shown that when business strategies are adequately developed to reach low-income populations, they become users of financial products.³ Experience from the MIF has shown that efforts to bank remittance customers are most successful when they include the following: (i) focused strategies with financial products linked to remittances, (ii) financial literacy and marketing tailored to the target population, and (iii) payment mechanisms that the client can trust.

In regards to micro-insurance, there is also limited information. A recent IDB/MIF study on the 2012 micro-insurance landscape suggests that 44.9 million people in 19 countries in LAC benefit from micro-insurance. However, 90% of those who hold an insurance policy come from five countries only—Mexico, Brazil, Colombia, Peru and Ecuador—and 55% of that total is concentrated in Mexico and Brazil (McCord, Tatin-Jaleran and Ingram, 2012). The most common product is life insurance, followed by accident insurance, property insurance and health insurance. Similarly to other financial products for low-income people, micro-insurance has a significant potential to advance in terms of regulation, distribution channels and accurate information tailored to this segment.

2.2 Innovative Delivery Channels of Financial Services in LAC

Access to financial services in LAC remains limited in part due to the high cost of intermediation. The minimum cost of opening an account represents, on average, more than 5% of GDP per capita in Latin America, and the cost to keep an account open is about 2% of GDP per capita. For the lowest income quintile, the cost of opening an account represents more than 30% of

average income, and in Bolivia it represents more than 100%, making these costs a major challenge for financial inclusion in the region (Arreaza and Rodríguez, 2011).

In recent years, most countries in LAC have extended the reach of formal financial services using innovative and cost-effective models such as banking agents and more recently mobile channels. In Peru, Banco de Crédito estimates that a cash transaction at a branch costs about USD 0.85, compared to USD 0.32 if it is run through a banking agent (Ivatury and Mas, 2008). In hand with advances in regulation, different branchless banking schemes through agents have been successfully implemented across the LAC region. The agent banking model is not uniform and varies in terms of the products and services provided by agents, types of businesses serving as agents, and incentive structures. Yet, it has been useful to move forward the financial inclusion agenda in LAC and appears as an interesting concept that Africa could learn from (Box X.2).

Box X.2: Examples of Successful Agent Banking Experiences in LAC

Brazil was an early adopter of an agent banking framework and has achieved a record performance in bringing financial services to its population through agents. Its network of about 150,000 banking agents, also called “banking correspondents,” include post offices (Banco Postal) and lottery points (Caixa Economica Federal). Since the implementation of the agent banking regulation in Brazil, the number of correspondents increased from 19,000 in 2000 to approximately 150,000 in 2010. In 2010, 2.6 billion transactions were made through banking agents across the country; and in 2011, 100% of Brazilian municipalities had at least one bank branch, outpost or correspondent. Efforts to increase outreach through banking correspondents were coupled with initiatives to reduce costs through regulation, simplified accounts, social programs and payroll guarantee loans.

In Ecuador, Banco de Guayaquil has developed a network of more than 3,600 banking agents (Banco del Barrio) covering 96% of Ecuador’s territory and offering various financial products and services targeted at low-income people. In 2011, Banco de Guayaquil launched a simplified account known as “cuenta amiga,” which is sold by banking agents as a kit with an activated debit card and a user manual. The account can be immediately activated with basic documentation. In less than one year, more than 250,000 accounts were opened. Another service provided through this channel is the payment of government conditional cash transfers, which cover more than 360,000 beneficiaries. This model also benefited business owners, who have seen increases in their sales and profit per banking transaction.

Other large LAC financial intermediaries such as Banco Estado in Chile, Bancolombia in Colombia and Banrural in Guatemala, are also finding that a large network of agents in low income neighborhoods and rural areas can scale up simplified bank accounts rapidly.

Source: CGAP (2010), Alliance For Financial Inclusion (2012) and Tombini (2012).



Although the development of alternative delivery channels can represent a key ingredient in providing access to financial services to low-income populations at manageable costs, the success of business models that aim to leverage alternative distribution channels depends on the convergence of a number of additional factors. These include: (i) economies of scale, (ii) existence of a clear regulatory framework, (iii) coordination of different stakeholders to establish a business model that is attractive to the various actors involved, (iv) appropriate liquidity management mechanisms, and (v) a scheme to provide financial literacy.

Mobile technology has been also used in LAC to expand the availability of financial services to the low-income population by reducing costs for providers and clients alike. There is a vast potential to expand mobile financial services in LAC, as the region has reached 100% of mobile penetration. This evolution is taking place in line with the development of regulatory frameworks that seek more comprehensive, transparent, and prudent expansion with increased user protection. Many financial intermediaries in the region are currently using mobile technology to provide different services, ranging from approving loans to clients and SMS reminders for credit payments, to enabling payments directly through a “mobile wallet.” Tigo Paraguay provides an example of this: in partnership with financial institutions, it has built an agent network and promotes financial literacy in a country where an estimated 78% of the population is financially excluded, and in which only 30% of municipalities have access to financial services. The success of Tigo’s Mobile Money product lies in its deep market knowledge, successful distribution network, and effective marketing strategies reaching 1 million users with 2,100 agents between 2008 and 2013 (Camilo and McCarty, 2011). Today, about 7% of the population uses mobile financial services in Paraguay.

While LAC has been making prominent progress on mobile financial services, the sector remains less vibrant than in Africa. To move towards financial inclusion, dynamic, sustainable, customer-centric business models are required. Such models should offer simple value-added proposals and be based on long-term relationships between clients and financial service providers. Appropriate regulatory frameworks (banking and telecommunication) are also critical to successful implementation of such models.

3. Lessons from LAC Experience

Given LAC experience, the following lessons could be drawn towards achieving greater financial inclusion in Africa:

- Government commitment and involvement is key: Governments from Brazil, Colombia, and Mexico, which have set financial inclusion as a policy priority, have been able to move forward in expanding financial access at the country level. These governments have adopted regulations (e.g., agent banking and simplified accounts) that foster innovation

by the private sector and have contributed to the expansion of financial products and services within countries. Experience shows that encouraging government-to-Person (G2P) payment services, for instance, could help move the financial inclusion agenda forward. These services have proven to be an opportunity to enlarge the client base of financial intermediaries in the LAC region.

- Addressing demand-side constraints is important: Despite the growing number of institutions serving low-income, unbanked populations, there is still a lack of understanding of the characteristics, needs, and preferences of these populations. Investments in market studies of the unbanked should attempt to learn from existing informal mechanisms used by low-income and poor segments to meet their needs and preferences. Financial literacy programs adapted to clients are also an essential component of promoting the access and use of financial products and services.⁴ Most effective methodologies are often expensive for financial intermediaries, who should take a long term approach and find innovative ways to guarantee that clients have transparent, accurate and accessible information that make them feel confident in the formal financial system.
- Innovative models hold great potential: Business models that involve innovative approaches have proven to be successful and sustainable strategies to improve financial inclusion in LAC due to their potential for cost reduction and for expanding outreach to underserved populations. Mobile wallet models that provide a portfolio of services beyond payments and have a dense and well-structured agent network to perform cash-in and cash-out activities have a great potential for sustainability and scalability in Africa. These models can help both the client and the financial intermediary in reducing their respective transaction costs. In LAC, only Paraguay and Haiti have shown a take up of mobile wallet services, for reasons that call upon further research, but they hint at the reluctance of banks at entering the field due to uncertain regulation, and alternatives for transacting (including extended presence of banking agents, usage of debit cards, or even mobile banking).
- Building trust is necessary to achieve long term financial inclusion: The image and trust unbanked and underserved populations hold towards financial institutions play an extremely important role in expanding financial inclusion. Creating a good reputation that fosters loyalty and consumer protection while providing a conducive environment in which these clients feel comfortable could in turn contribute to increasing financial institutions' client base and profitability. This applies to the various distribution channels that reach unbanked and underserved populations, including agent banking. Among the requirements that have been established by financial intermediaries with agent banking networks in LAC to ensure security and trust are: (i) maintaining a good reputation; (ii) legal establishment; and (iii) mechanisms to administer liquidity.



Notes

1. The cited percentages include those individuals with accounts at a bank, credit union or other financial institutions, including debit cards. The low-income adult population is defined as those pertaining to the bottom two quintiles of the population.
2. Among other initiatives promoted by the government of Colombia to increase access to finance are the use of agents and promotion of Government-to-Person (G2P) program disbursements through mobile phones.
3. In the case of international remittances, project experience has shown that an approximately 30% of the targeted recipients becomes a client of another financial product, beyond the transfer service.
4. Understood as the knowledge, skills, and attitudes necessary to manage a cash flow, plan ahead financially, make appropriate use of financial services, and make responsible financial choices, given particular contexts. Definition based on The Microfinance Opportunity Financial Capability Index: Fact Sheet (2012).

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The African Development Bank (AfDB) is the premier development financial institution in Africa. Established in 1964 as the regional multilateral development bank for the continent, The African Development Bank is owned by 54 African Countries (referred to as Regional Member Countries) and 24 non-African countries from the Americas, Asia and Europe. The African Development Bank's purpose is to contribute to the sustainable economic development and social progress of African member countries individually and jointly.

The African Development Bank Group operations support both the public and the private sector in regional member countries. In Addition to the African Development Bank, the African Development Bank Group includes the African Development Fund (ADF) and the Nigerian Trust Fund (NTF). The African Development Fund - which was created in 1972 and began operations in 1974 - provides concessional funding for projects and programs, as well as technical assistance for studies and capacity building activities, to 38 low-income regional member countries. The Nigerian Trust Fund is a special fund created by the African Development Bank in 1976 by arrangement between the Bank and the Federal Republic of Nigeria to assist in the development efforts of low-income regional member countries whose economic and social conditions and prospects require financing on concessional terms.

Between 1967 and 2011, the African Development Bank approved 3,661 loans and grants totaling over 90 billion USD.

