

Special Report | 4 September 2014

Financial Inclusion: Reaching the unbanked





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Madhur Jha +44 20 7885 6530
Madhur.Jha@sc.com
Economics Research
Standard Chartered Bank

Samantha Amerasinghe +44 20 7885 6625
Samantha.Amerasinghe@sc.com
Economics Research
Standard Chartered Bank

John Calverley +1 905 534 0763
John.Calverley@sc.com
Economics Research
Standard Chartered (Canada) Limited



Highlights

Financial inclusion today and progress so far

- Over 90 developing countries representing 75% of the world's unbanked population have signed the Maya declaration aimed at poverty alleviation through financial inclusion.
- Developing countries have made huge strides in expanding the use of financial services but remain far behind developed countries.
- Our heatmap measures 12 aspects of financial inclusion in 30 countries (Figure 4). The top five countries overall are the US, Korea, Canada, the UK and Germany.
- Nigeria, Uganda, Pakistan, Ghana and Egypt are the least inclusive.
- Some countries have made strong progress in improving inclusion. These include Indonesia, Bangladesh, Vietnam, Malaysia and Russia.
- There are pockets of strength even in less inclusive countries such as Kenya where mobile money is very important.

Why is financial inclusion important?

- Financial inclusion can help individuals cope better with poverty, especially the challenges of irregular income and occasional large bills. It can also pull them out of poverty through improved education and health care.
- For micro-enterprises, financial inclusion can provide funds for setting up and expanding and for improving risk-management.
- On a macro scale, it can boost economic growth by mobilising savings.
- It can also draw more firms into the formal sector, raising tax revenues and making workers eligible for better protection and benefits.

Overcoming barriers to financial inclusion

- We identify five main barriers to financial inclusion – 'natural' barriers such as the distance to a bank; lack of financial infrastructure; restrictive regulations; governance failures; and lack of suitable products.
- Policy makers in developing countries are adopting a wide range of strategies to overcome the natural barriers to inclusion, such as promoting savings groups, correspondent banking, mobile branches and commercial bank rural branches.
- New technologies and innovations are increasingly driving financial inclusion, making it economically viable for banks to reach poorer people.
- Lack of financial infrastructure is being addressed by strengthening legal rights in countries as well as establishing credit bureaus (positive and negative).
- Developing nationwide identification systems can help to reduce paperwork and lessen the heavy burden of 'Know Your Customer' (KYC) documentation.
- There are significant links between the quality of overall governance both at the country and corporate levels and financial inclusion. Better public-sector governance has helped push through reforms enabling financial inclusion.
- Indonesia and Nigeria stand out as countries making significant progress in improving country governance.
- Financial education has an important role to play in increasing inclusion. Financial literacy programmes aimed at poor households should target individuals at 'teachable moments' for the best outcome.
- Financial inclusion is not a panacea and has risks, particularly if the regulatory environment is weak. Excessive borrowing and lack of consumer protection are the main concerns.



Executive summary

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Inclusion for the ‘unbanked’

Financial inclusion is a measure of the proportion of individuals and firms that use formal financial services or are ‘banked’. Nearly 50% or 2.5bn adults are currently ‘unbanked’, most of them living in developing countries in South Asia, Africa and the Middle East and North Africa (MENA) region. There is growing urgency in both the public as well as the private sector to support and encourage financial inclusion.

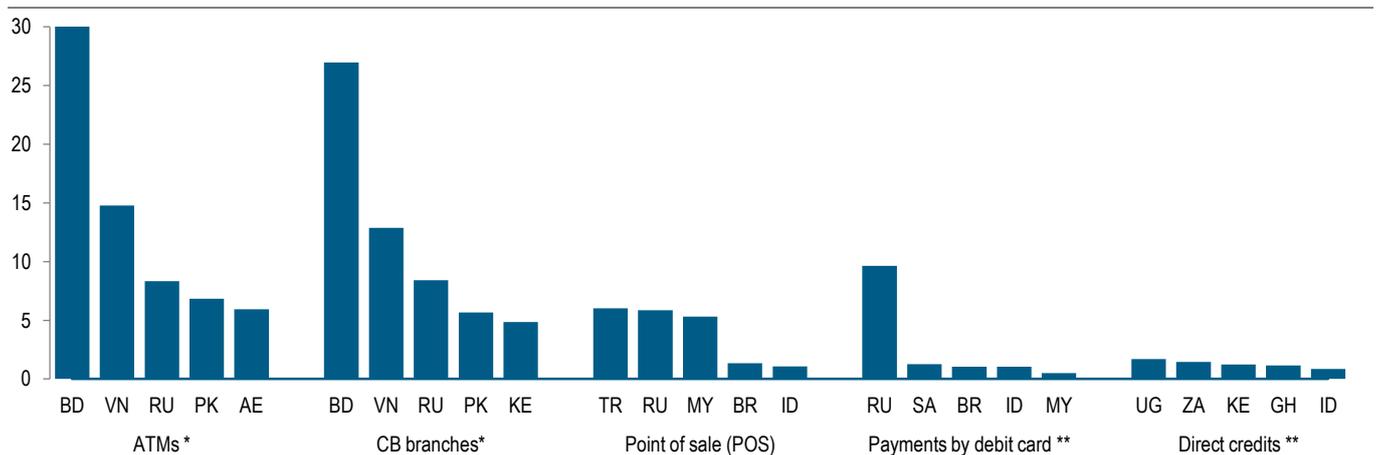
The micro and macro benefits of inclusion are potentially immense. Individuals can cope better with irregular income and unexpected spending needs, as well as avoiding usurious interest rates and sometimes unreasonable collateral demands in the informal sector. Inclusion may also help pull them out of poverty through being able to tap better education and health care. For micro-enterprises, financial inclusion can provide funds for setting up or expanding, or for improving risk-management. On a wider scale, it can help improve potential growth in an economy by mobilising savings. It can also draw more firms into the formal sector, raising tax revenues and making workers eligible for better protection and benefits.

The big improvers in inclusion

We present a heatmap of how 30 countries fare on 12 indicators of inclusion (Figure 4). Many emerging countries lag far behind on most indicators; with Nigeria, Uganda, Pakistan, Ghana and Egypt at the bottom of the 30-country universe. There is also huge divergence across emerging market (EM) economies, with East Asian countries in general doing better than countries in Sub-Saharan Africa (SSA). However, there are pockets of strength even among the less financially inclusive countries. Around one-fifth of the adults in Bangladesh, Vietnam and Thailand have savings at a financial institution, while around 15% of the adult population in Kenya and Saudi Arabia use mobile phones to pay bills and an even higher ratio (around 60%) are using mobile phones for making other payments in Kenya.

The paucity of time series data on indicators makes it difficult to gauge progress on financial inclusion, especially in large emerging markets such as India and China. Figure 1 suggests that some countries are making headway in improving the number of ‘banked’ adults, *albeit* this progress is from a very low base.

Figure 1: Financial inclusion: Five biggest improvers among emerging markets
 % change (2004-11)



Note: *per 100,000 adults; **per adult;
 Source: G20 Financial Inclusion Indicators, Standard Chartered Research



Indonesia is among the top-five fastest gainers in at least three of five categories for which time series data is available. Bangladesh, Vietnam and Russia have made much progress in expanding the more formal banking services such as access to ATMs and bank branches. Indonesia and Malaysia are expanding the use of newer innovations in financial inclusion such as electronic banking, retail points of sale and use of debit and credit cards.

Overcoming barriers to financial inclusion

As noted, we identify five main barriers to financial inclusion: ‘natural’ barriers such as geographic distance; lack of financial infrastructure; restrictive regulations; governance failures; and lack of suitable products that cater to the needs of poor people. The gains made in financial inclusion can be explained by the progress in surmounting these barriers, driven by policy makers’ and financial institutions’ initiatives and helped by technological innovations.

New technologies and innovations are increasingly supporting financial inclusion, making it economically viable for banks to reach poorer people. The agent or corresponding banking model has come to the fore in many developing countries, supported by technology, particularly in South Asia and Latin America. Mobile money or ‘branchless’ banking schemes have seen rapid growth in countries where branch banking has been hampered by transportation and infrastructure problems, fuelled by the success of M-PESA in Kenya.

Progress has been made in developing credit bureaus in many countries. Emerging Europe and central Asia, East Asia and MENA have been the big reformers in terms of improving coverage of private credit bureaus, with an increasing number of ‘positive’ bureaus, providing comprehensive credit information to creditors. SSA still lags behind on this measure but has also made progress recently.

Reconsidering and revising regulations is often vital for increasing financial inclusion. But improving overall country governance is often necessary for expediting reforms and reducing governance failures. Indonesia once again stands out, making large gains in governance indicators (Figure 2). Progress has been made on several indicators of country governance: Nigeria has improved the rule of law, regulatory quality and control of corruption.

Financial inclusion is likely to be more effective in reducing poverty and encouraging development if households are educated about products on offer and products are tailored to meet the basic requirements of households or micro-enterprises.

Figure 2: The 5 EM countries with the most improvement in country governance scores, 2012 vs. 2002

Rule of law	Government effectiveness	Regulatory quality	Control of corruption	Political stability
Indonesia (0.37)	Turkey (0.36)	Ghana (0.59)	Turkey (0.88)	Indonesia (1.05)
Nigeria (0.3)	Saudi Arabia (0.33)	Nigeria (0.50)	Indonesia (0.48)	Uganda (0.6)
Uganda (0.29)	UAE (0.32)	Indonesia (0.37)	Bangladesh (0.31)	Ghana (0.35)
Brazil (0.19)	Philippines (0.17)	Turkey (0.33)	Nigeria (0.20)	South Africa (0.32)
Saudi Arabia (0.13)	Vietnam (0.15)	China (0.27)	Ghana (0.20)	UAE (0.04)

Source: WGI, Standard Chartered Research



Financial inclusion today

Half of the world adult population is unbanked

Over 66% of the adult population in South Asia, MENA and SSA is unbanked

The World Bank estimates that nearly 2.5bn adults globally (50% of the total adult population) is currently ‘unbanked’ or does not use formal financial services (Demirguc-Kunt, 2012). The global number masks huge disparities between different regions in the world. The developed world (OECD countries) show a high proportion of the adult labour force included. This ratio drops significantly for emerging markets. Over two-thirds of the adult population in South Asia, SSA and MENA are still financially excluded (Figure 3).

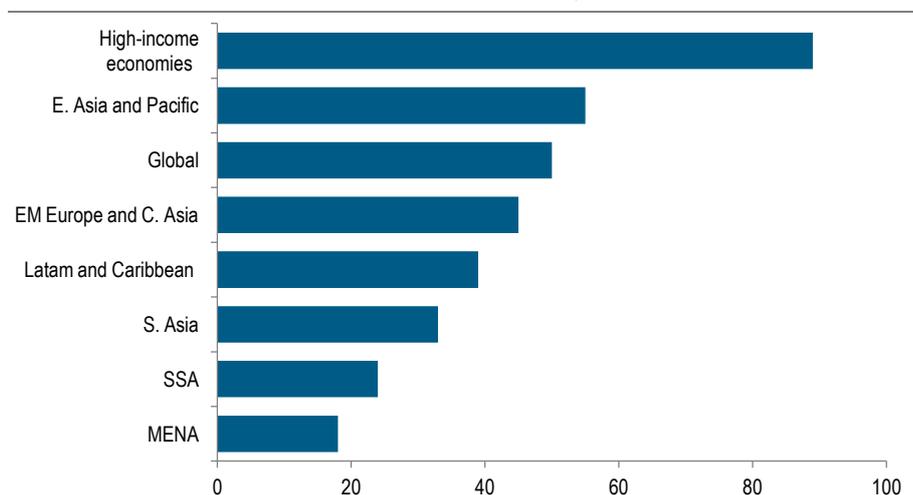
Governments around the world are increasingly viewing financial inclusion as essential to economic development. Over 90 developing countries, representing more than 75% of the world’s unbanked population, have signed the Maya declaration since 2011. The declaration is a set of measurable commitments that aim through financial inclusion to improve social and economic conditions of the poorest in society. The measureable commitments relate to four specific areas covering better use of data, better use of information technology, setting up frameworks to enhance links between financial stability and inclusion and measures to protect consumer rights. As well as supporting economic development, financial inclusion is seen as a primary tool for reducing income inequality (see *Taming the Gini: Inequality in perspective published on 16 July 2014*).

India’s government targets 75mn new accounts in its push to remove financial untouchability

Several governments are also making financial inclusion an integral part of their national plans. India’s government, for example, has just launched the ‘Pradhan Mantri Jan Dhan Yojana’ (Prime Minister’s Public Wealth Programme), with the explicit aim of removing financial untouchability. The scheme has some ambitious targets, such as to provide a bank account to every household within 12 months. Every household opening an account would also be given personal accident insurance of INR 100,000 as well as life insurance of INR 30,000 (and an overdraft facility of INR 5,000 after a few months following a credit review). The scheme was launched on 28 August with 15 million new accounts being opened on a single day and targets 75 million new accounts by August 2015, though the Prime Minister is pushing for this to be completed by January 2015.

Figure 3: Use of financial services is still very limited in emerging markets

Adults with an account at a formal financial institution, %



Source: Global Findex database, Standard Chartered Research



Interest in financial inclusion is not limited to governments or multilateral agencies. The private sector is playing a growing role in the expansion of financial inclusion as well. This partly stems from the interest of commercial financial institutions in tapping a potential client base that can be profitable; banks like to grow with their clients. It also often reflects a desire to do something practical for society, an imperative arising from the growing focus on corporate social responsibility. At the same time, private institutions want to be part of the wider debate on how government initiatives and policies in this area are being formed. They hope that this will strengthen safeguards against instability as well as decisions that lower hurdles such as lack of information and transaction costs.

Financial inclusion covers both access to and use of financial services

Defining financial inclusion

Financial inclusion is a measure of the proportion of individuals and firms that use financial services provided by a formal institution. The focus is mostly on very basic financial services and covers not only *access to* (supply of financial services) but also the *use of* (demand for) financial services. In our report, we follow the definitions used in the G20 Basic set of Financial Inclusion indicators or the World Bank Global Findex database. A formal financial institution is defined as a bank, credit union, cooperative, post office or microfinance institution and an account can be in an individual or joint name and covers all sorts of savings and borrowing as well as payment and transfer transactions, including the use of debit cards.

Financial inclusion is distinct from financial deepening

Financial inclusion is one aspect of financial-sector development. Financial deepening, which refers to the range of financial-market products available to economic agents for their borrowing, savings, investment and risk-management needs, is the other major component of financial-sector development. It is possible to have a very deep financial market without having a financial system that is inclusive. For example, a common measure of financial depth is domestic credit to the private sector as a percentage of GDP. This measure is high in Vietnam (125%) but only 21% of adults have formal accounts. In the Czech Republic, on the other hand, inclusion is high (81% of adults have formal accounts) while depth is only moderate at 56% of GDP (Demirguc-Kunt, 2012).

There are several measures of financial inclusion

No single measure of financial inclusion exists. This is because individuals and firms can use different financial services including savings, borrowings, money transfers and payments. As a result, several indicators are used simultaneously to gauge the level of financial inclusion in a country. These range from savings accounts at formal financial institutions to the use of Automated Teller Machines (ATMs), mobile banking or the use of debit and credit cards.

Over the years, different surveys and methodologies have been used to gauge the level of financial inclusion both on an individual country basis as well as at regional levels: the Life in Transition Survey (LITS) from the European Bank for Reconstruction and Development or the Finscope Survey from the FinMark Trust. These surveys are not always comparable as the definitions of inclusion differ as do the definitions of formal financial institutions. At the same time, innovations such as electronic payments and mobile banking have changed the scope of financial inclusion.

Figure 4: Financial inclusion heatmap

	Automated teller machines (ATMs) (per 1,000 sq km)	Automated teller machines (ATMs) (per 100,000 adults)	Commercial bank branches (per 100,000 adults)	Commercial bank branches (per 1,000 sq km)	Saved at a financial institution in the past year (% age 15+)	Loan from a financial institution in the past year (% age 15+)	Point of sale (POS) terminals (per 100,000 adults)	Payments by credit card (per adult)	Payments by debit card (per adult)	Credit card (% age 15+)	Debit card (% age 15+)	Mobile phone used to pay bills (% age 15+)	Average rank
US			35.4	9.6	50.4	20.1		91.2	157.2	61.9	71.8		1
KR			18.8	79.1	46.9	16.6		119.5	25.7	56.4	57.9		2
CA	6.6	209.0	24.3	0.8	53.2	20.3	2,520.0	94.9	137.9	72.3	88.0		3
GB					43.8	11.8	2,310.5	33.2	114.8	51.6	87.6		4
DE					55.9	12.5	837.9			35.7	88.0		5
HK	2,975.0	49.6	23.8	1429.0	42.8	7.9	6,257.5	54.8	16.3	58.1	75.8		6
AU	3.9	166.9	29.6	0.7	61.9	17.0	3,928.0	83.4	111.8	64.2	79.1		7
SG	3,607.1	60.2	10.2	612.9	58.4	10.0	1,989.4		50.1	37.3	28.6	9.8	8
JP	390.9	129.0	34.0	103.1	51.3	6.1	1,560.7		0.1	64.4	13.0		9
AE	49.9	66.9	14.5	10.8	19.2	10.8	896.4	14.2	2.2	30.0	55.4	11.7	10
TR	41.1	59.1	18.3	12.8	4.2	4.6	3,304.1	33.4	2.9	45.1	56.6	4.3	11
TH	83.8	77.9	11.3	12.1	42.8	19.4	456.1	5.4	0.5	4.5	43.1	0.5	12
BR	20.6	119.6	46.2	7.9	10.3	6.3	2,379.5	19.4	16.1	29.2	41.2	1.3	13
ZA	17.3	60.0	10.7	3.1	22.1	8.9	689.3		15.5	7.8	45.3	4.4	14
MY	34.0	56.4	10.5	6.3	35.4	11.2	829.0	14.3	0.6	11.9	23.1	2.4	15
RU	11.2	152.9	37.1	2.7	10.9	7.7	293.3	0.3	5.2	9.7	37.0	1.7	16
SA	5.5	61.5	8.7	0.8	17.2	2.1	445.4	1.7	6.7	16.9	42.3	15.0	17
MX	18.9	45.8	14.9	6.1	6.7	7.6	565.7	4.8	6.0	13.0	22.3	3.9	18
PH	35.7	17.7	8.1	16.3	14.7	10.5				3.2	13.2	2.1	19
CN					32.1	7.3	225.9		3.3	8.2	41.0	1.3	20
BD	27.9	3.6	7.8	61.6	16.6	23.3				0.9	2.3	1.7	21
VN	42.9	20.0	3.6	7.8	7.7	16.2				1.2	14.6	3.6	22
IN	25.4	8.9	10.6	30.4	11.6	7.7	58.2	0.3	4.2	1.8	8.4	2.2	23
KE	3.9	9.5	5.2	2.1	23.3	9.7				6.1	29.9	13.4	24
ID	15.9	16.5	8.5	8.2	15.3	8.5		1.1	9.1	0.5	10.5	0.2	25
NG	11.9	12.0	6.4	6.4	23.6	2.1				0.8	18.6	1.4	26
UG	3.3	3.8	2.4	2.1	16.3	8.9	2.3		1.5	1.6	10.3	3.3	27
PK	7.0	4.8	8.7	12.7	1.4	1.6	46.6			0.7	2.9	1.5	28
GH	2.7	4.1	5.5	3.6	16.1	5.8				2.2	11.4	0.9	29
EG					0.7	3.7	67.4			1.4	5.1	0.4	30

Source: Global Findex Database, G20 Financial Inclusion Indicators, Standard Chartered Research

Note: The rank is obtained from averaging the ranks on each individual characteristic





Global financial inclusion heatmap for individuals

We have created a heatmap of how countries fare on financial inclusion for individuals based on a broad selection of 13 different indicators for 30 countries. The 12 indicators cover not only savings but also borrowing access and use by individuals. The indicators refer to the latest year of data available which is mostly 2011 (but in some cases 2009). We rank the 30 countries on each of the 12 indicators and then take an average score of all of these rankings. The overall score is then used to create a super-ranking, with performance going from best (dark green) to worst (dark red).

A few of these indicators might seem repetitive, such as the ATMs per 100,000 people and ATMs per 1,000sqkm, but they measure different barriers to financial inclusion. Cross-country comparisons on some of the indicators need to be treated with caution as they might not be comparable given huge divergences in underlying characteristics of these countries. For example, large countries such as Canada and Australia with many uninhabited areas perform poorly on indicators such as ATMs or commercial banks per 1,000sqkm. This does not mean that they are financially less inclusive than a city-state like Singapore or Hong Kong.

OECD countries and global financial centres have high rates of financial inclusion

It is hardly surprising that the developed world dominates the heatmap as best performers, with the US taking the top spot and Korea, Canada, United Kingdom, Germany the other top five countries in our 30-country universe. Singapore and Hong Kong, major financial centres in Asia, are also seen to be more inclusive, indicating a strong correlation between economic development and financial inclusion. The UAE, the financial hub of the Middle East also features in the greener section of the heatmap, reflecting its role as a sophisticated trading centre.

In the US, over 60% of adults have a credit and/or debit card and over half of the population has savings at a financial institution. In Egypt, at the bottom of the list, less than 1% of the adult population had savings in the last year at a financial institution while only around 5% of the population owned a debit or credit card. Other African and Asian economies also fare poorly. Nigeria, Uganda, Pakistan, Ghana are the other countries that are least financially inclusive countries in our universe.

Among the large EMs, Brazil does well on indicators such as commercial bank branches and ATMs per 100,000 adults, retail points of sale and card payments but lags behind other countries in mobile bill payments, savings and borrowing by adults over the last year at financial institutions.

Brazil leads large EMs in financial inclusion

India does especially badly in the use of new technology such as retail points of sale, ATMs per 100,000 adults and use of debit and credit cards. This is surprising given the strength of technology services in India and reflects the need to build more supportive infrastructure. Data on China is patchy but shows a healthy ratio of adults saving at financial institutions over the past year as well as those holding debit cards. It lags behind in the proportion of adults using these cards, however, and in areas such as mobile-phone bill payments.

Indonesia is ranked 25 among our 30 countries, suggesting still quite low levels of financial inclusion. The use of credit cards, mobile bill payments and ATMs is very limited in Nigeria, though nearly 25% of adults had savings at a financial institution.

It is striking that for many countries the colour scale is broadly homogenous across different indicators. A few interesting exceptions occur: Bangladesh and Vietnam perform very strongly in terms of the proportion of adults taking a loan from financial institutions in the past year, while Kenya and Saudi Arabia seem to be leading the way in mobile banking.



Mobile money in Kenya

M-PESA or mobile money (Pesa is money in Swahili) was launched in Kenya by the telecom operator Safaricom in 2007. The initial thought behind M-PESA was to facilitate low-value money transfers (sending and receiving money). Subscribers hold electronic accounts which they access through their mobile phones.

Around 25% of Kenya’s GNP flows through M-PESA

The exchange of cash for electronic value is done via a network of retail stores, known as agents, which receive commissions for performing these exchanges. There are now over 60,000 agents in Kenya, a phenomenal increase from the initial 300 in 2007. The value of these transactions is very low and is recorded electronically, with the maximum value capped at USD 500.

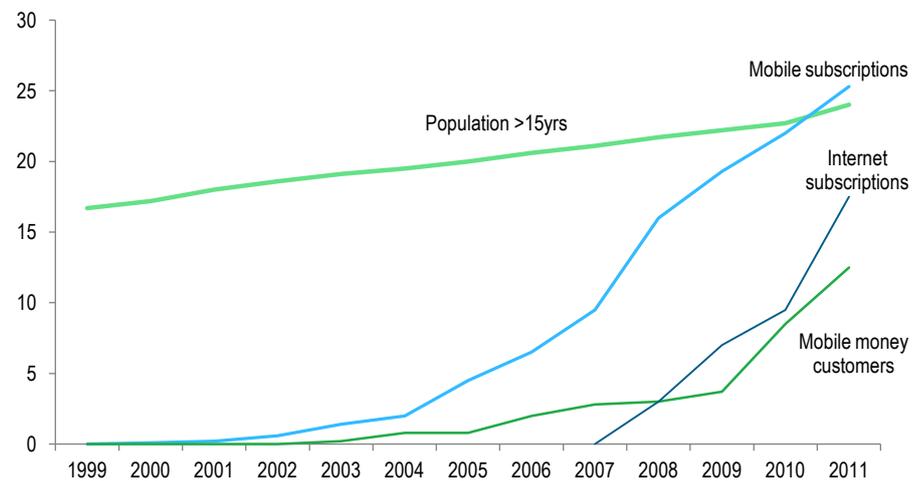
M-PESA has been so successful in Kenya that it is now used by over 17mn Kenyans, or two-thirds of the adult population. Around 25% of the country’s gross national product flows through it (*Economist*, May 2013). While the initial uses of M-PESA were limited to money transfers and bill payments, mobile banking services have now been extended to making payments, disbursing salaries and other bulk transfers such as government-to-person (G2P) transfers.

Further financial services under M-Shwari (also offered by Safaricom) now also allow people to save and borrow, earning interest on savings made through the electronic account. While money transfers and bill payments remain the dominant service bulk payments, salary payments and government-to-person transfers have grown substantially over the last couple of years. In 2013, 1 in every 15 payments were bulk.

A supportive regulatory regime, the dominance of a single mobile telecom operator and a national identification system underpinned the success of M-PESA

According to the World Bank, there are three main reasons why mobile money has become so successful in Kenya. The first emphasises the importance of regulation, enabling the spread of financial inclusion as well as the adoption of new technology. Kenya’s regulators, especially the central bank, are credited with allowing ‘regulation to follow innovation’ – choosing not to impose onerous requirements on money agents to enter into this business but promising oversight of these businesses to reassure the wider public. M-PESA was not categorised as a financial service but Safaricom behaved as if it were regulated and made periodic reports to the central bank in line with other banks.

Figure 5: Mobile money has grown sharply in line with mobile subscriptions



Source: World Bank, Standard Chartered Research



Second, the existence of deep mobile penetration in Kenya (nearly 70% of the population has mobile phones) together with the dominance of Safaricom as the main telecom operator (more than a 50% market share in 2007) played a major role in the spread of mobile money. Safaricom was able to leverage its wide infrastructure and network of retail agents to successfully launch this product. This would have been difficult if customers did not believe that the product had sufficient country coverage or agents did not believe that customers would be willing to take it up. At the same time, the operator is also credited with focusing on building trust and a brand image among customers rather than focusing solely on profits in the initial years of the launch of M-PESA, building up a strong and loyal customer base.

Third, the emphasis on educating and training agents on the new technology and managing the network through regular updates and interactions was also seen as an important contributor to the success of M-PESA. Other arguments for its success include the high cost of money transfers domestically through traditional channels. In addition, it was easy for regulators to approve M-PESA as Kenya had a national identification system in place, easing some of the barriers to the adoption of new technology such as KYC requirements.

M-PESA has spawned several related businesses in Kenya

One study found that in rural Kenyan households that adopted M-PESA, incomes increased by 5-30% (CGAP, 2009). In addition, the availability of a reliable mobile-payments platform has spawned a host of start-ups in Nairobi, whose business models build on M-PESA's foundations. These include mobile gaming platforms such as Ma3Racer as well as services aimed at helping parents keep track of school fee payment schedules. In addition, crowd-sourcing platforms such as Ushahidi have benefited from the spread of mobile technology (*Economist*, August 2012).

Microfinance in Bangladesh

Bangladesh is often seen as the model for successful micro-financial innovation. Unlike the success of mobile money in Kenya, which happened rapidly and was engineered by a handful of key players, the success of microfinance in Bangladesh has been crafted over several decades, starting in the early 1970s, and has come about through a long process of trial and error. A programme led by Professor Muhammad Yunus sowed the seeds of microfinance by providing loans to poor households in a few villages (Zaman, 2004).

The borrowers were formed into 'peer groups' of four or five individuals who were jointly made responsible for each other's repayment. The loans were collateral-free but linked to group liability and group monitoring. The movement grew — Professor Yunus was supported by Bangladesh Bank and other commercial banks, which together funded the 'Grameen Project', which later evolved into the establishment of the Grameen Bank.

Over the years, several microfinance institutions (MFIs) have come to the fore in Bangladesh including the Grameen Bank, BRAC, Proshika and the Association of Social Advancement (ASA). Their models differ and have evolved over time; for example, alternating between group or individual loan financing, group or individual liability, etc. There are also several ways in which MFIs are funded: donor aid or government subsidies, equity investments, profits, savings deposits and commercial-bank funding. Commercial banks fund MFIs by linking up with an existing NGO or setting up an independent arm to manage microcredit.

Microfinance has likely pulled 10 million people out of poverty in Bangladesh and helped empower women

The main aim of these programmes is to support economic development and reduce poverty. The Grameen Bank reports that the estimated average household income of its members is about 50% higher than the target group in the control village and 25% higher than the target group non-members in Grameen Bank villages (Chemin, 2012). However, this estimate has been criticised as the selection of members chosen to receive a loan was not random and hence some of the success of the project could be attributed to factors such as the entrepreneurial abilities of the borrowers themselves.

It has been difficult to estimate the economic or social impact of these microfinance institutions (we discuss this in greater detail later in the report). However, on balance it is believed that microfinance has benefited Bangladesh. According to one study undertaken by the Microcredit Summit Campaign, nearly 10 million Bangladeshis were pulled out of the poverty trap between 1998 and 2008 due to access to MFI loans. There are additional social benefits that are not always captured in empirical studies. Over 90% of the loan recipients have been women, which has greatly advanced women's empowerment and encouraged the enrolment of children into schools, as well as a greater focus on health services (Hulme and Moore, 2006).

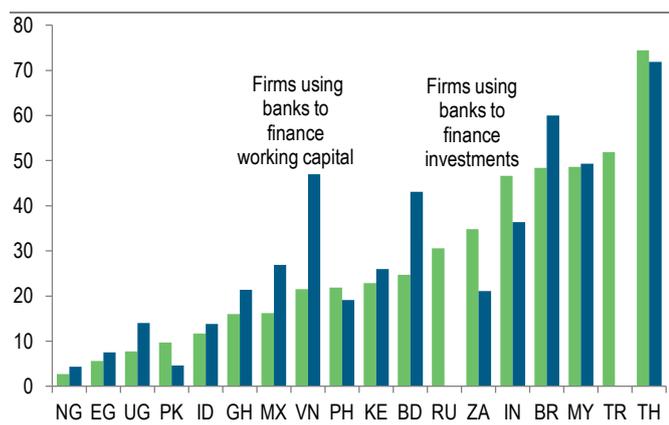
Among EMs, Thailand leads in inclusion for firms while Egypt needs to catch up with other EMs

Financial inclusion for firms

Data on financial inclusion for firms is still very sparse. The little that is available shows that firms in many EM countries, especially in Africa and South Asia, still rely on informal sources of credit for their business needs. These include moneylenders, personal savings and funds from family and friends. Thailand is a clear exception (Figure 6). Nearly 70% of firms use banking services and bank funds also provide the main source of finance for these firms. On the other hand, Egypt ranks very poorly not only in terms of the number of firms using banking services but also in terms of the total capital requirements of these firms being financed by banks (Figure 7). Nigeria does poorly as well, with less than 5% of firms reporting use of any banking services.

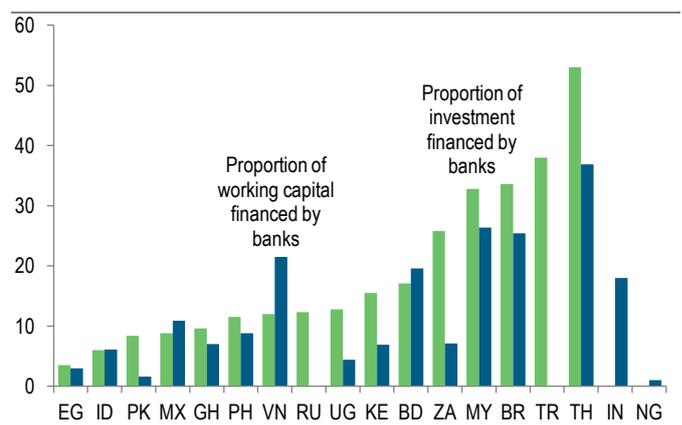
Governments are increasingly acknowledging that sustainable growth in any economy is likely to be driven by small and medium sized enterprises (SMEs) that usually account for the bulk of an economy's employment. The sustainability of these firms is fundamental not only for supporting growth and employment but also to ensure that poor people are able to break out of the poverty trap. As a result, there is increasing

Figure 6: Many firms do not use banks in Africa and Asia
% of total



Source: World Bank Enterprise Survey, Standard Chartered Research

Figure 7: Many firms still rely on other sources of funding
% of total



Source: World Bank Enterprise Survey, Standard Chartered Research

emphasis in emerging as well as developed markets on improving access to finance for small firms. In this report we focus mostly on individuals for their personal needs.

Why are some countries more financially inclusive than others?

The heatmap suggests a strong correlation between financial inclusion and income level in a country, with more developed countries being more financially inclusive. This is also evident from Figure 8.

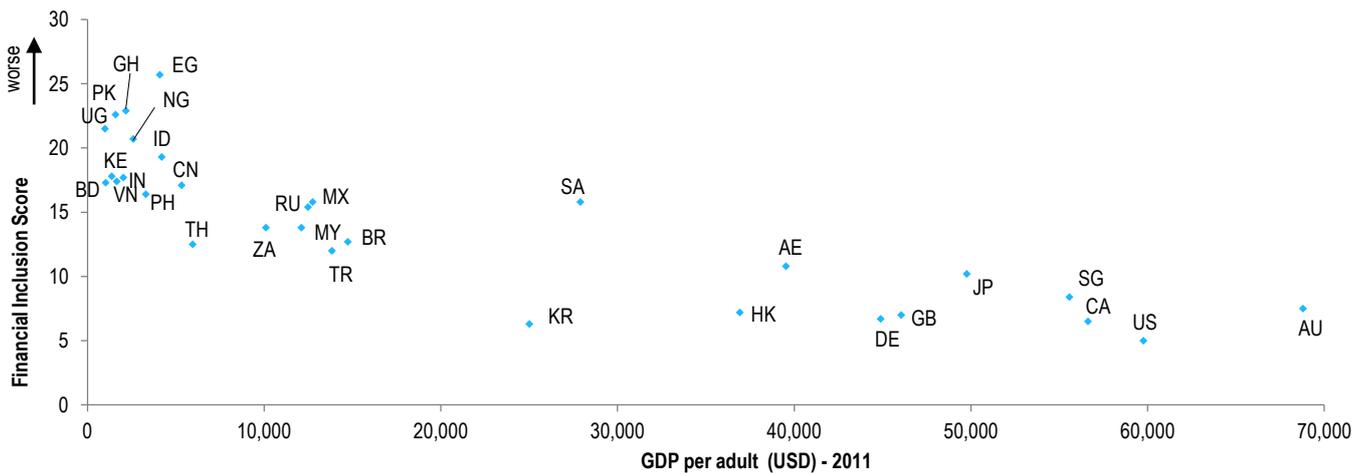
National income explains about 70% of the difference in levels of financial inclusion across countries

Analysis by Demirguc-Kunt (2012) suggests that national income levels explain about 70% of the variation across all economies in terms of financial inclusion. However, their study also finds that this explanation tends to break down for economies at lower levels of GDP per capita.

When the analysis is restricted to the bottom 50% of economies by income, GDP per capita levels only account for 22% of the variation in financial inclusion among countries (Figure 9), with financial inclusion levels similar for countries such as

Figure 8: Inclusion and economic development are broadly related

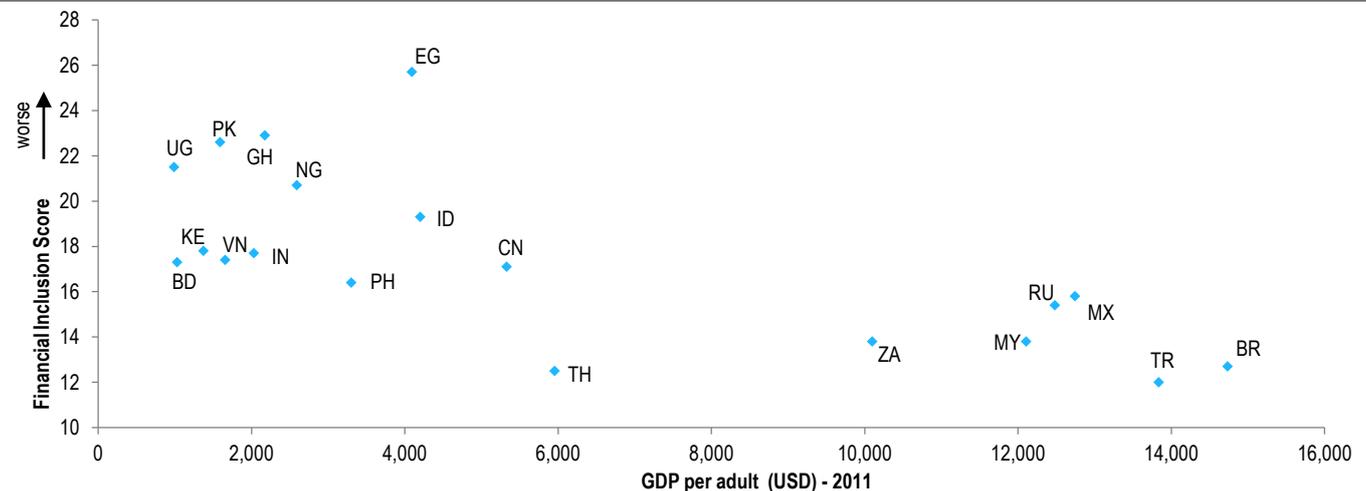
Latest available data



Note: Higher Financial Inclusion score is worse. Source: UN, IMF, Standard Chartered Research

Figure 9: The correlation between income and inclusion falls at lower levels of income

Latest available data



Note: Higher Financial Inclusion score is worse. Source: UN, IMF, Standard Chartered Research



Malaysia, South Africa, Brazil and Turkey despite wide divergences in income per adult. Or, while Uganda and Bangladesh as well as Pakistan and Vietnam have similar levels of income, they are at different levels in terms of financial inclusion.

Differences in financial inclusion can result from poverty, cultural, gender and religious biases, as well as education levels

This suggests that another factor or factors are at work in these economies. Differences in the use of financial services can be due to poverty, lack of education, cultural and religious beliefs or the lack of physical infrastructure among others. This is evident from the sharp divide in financial inclusion between men and women as well as between rural and urban areas across countries (Figures 10 and 11). Also, if we look at the quintile distribution of the population by income – only one-third of the poorest 20% of adults in East Asia and Pacific have bank accounts but over 75% of the richest 20% of adults have some form of a financial account. We discuss these barriers and ways to address them in greater detail later in this report.



Why is financial inclusion important?

The micro level benefits of financial inclusion

Individuals can better manage low and irregular income

It is not difficult to see why financial inclusion should support growth. For individuals, formal financial institutions provide opportunities to better manage and increase savings. Individuals can also borrow to meet emergency cash needs, such as for hospital visits and funerals, lump-sum expenses such as weddings or funerals or to accumulate assets, such as a bicycle or a cart. Borrowers can also use a loan to fund education or health needs, such as school or medical fees. All these things can make people more productive and happier, boosting the economy as well as the standard of living.

There are similar benefits for small entrepreneurs and firms. Loans from financial institutions allow them to overcome cash constraints to set up and pursue new businesses. These loans not only provide the funds for working capital needs but also for business expansion. For micro businesses, the availability of finance allows entrepreneurs to manage risks better while also reducing the need to cut back consumption to fund the set-up and continuation of these businesses.

Not only does access to formal financial services allow small firms and individuals to pursue growth opportunities, it is also socially desirable as it lowers the possibility of exploitation of those most in need of funds. Formal financial institutions lower the reliance of individuals and firms on moneylenders and other sources of credit in the informal sector that often charge very high rates of interest and can have unreasonable collateral requirements.

Financial inclusion offers empowerment in the broadest sense

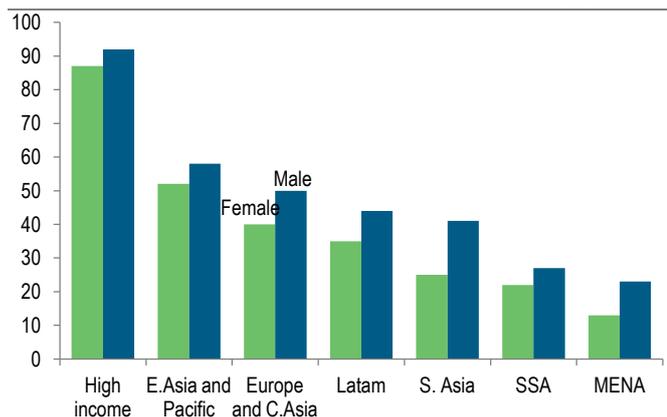
Financial inclusion provides an opportunity to small firms, farmers and low-wage earners to break out of the poverty trap both through lowering the risk of exploitation as well as improving their education and employment opportunities. It offers empowerment in the broadest sense.

The macro-level benefits of financial inclusion

A well functioning financial system has other benefits as well. It helps mobilise savings that would otherwise be sitting idle and allows them to be invested in more productive areas, improving economic growth potential. At the same time, improvements in labour skills through better education and health care, as well as the set-up of new businesses raise economic productive potential. Lower interest rates charged in the formal sector also improve the sustainability of an individual or firm's financial condition.

Figure 10: Financial inclusion is lower for women

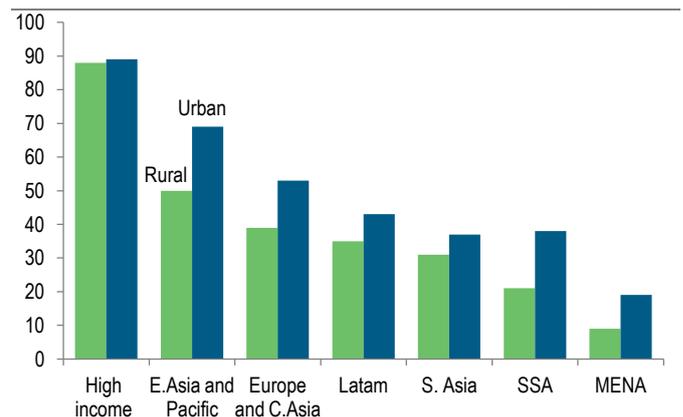
Adults with accounts at a formal financial institution (%)



Source: Global Findex Database, Standard Chartered Research

Figure 11: It is also lower in rural areas

Adults with accounts at a formal financial institution (%)



Source: Global Findex Database, Standard Chartered Research



A report looking at the full impact of financial inclusion on economic growth potential (Hariharan, 2012), estimates that a 10ppt increase in financial inclusion (measured as an account with a formal financial institution as defined in the Global Findex Survey) could raise income per worker by 1.3% on average, with increases in financial inclusion resulting in improvements in total factor productivity and capital per worker.

High levels of inclusion help expand the formal sector and support fiscal and monetary policy effectiveness

Financial services in the formal sector are governed by transparent legal structures that encourage both creditor and borrower confidence that any disputes will be settled in a legally acceptable way, strengthening the rule of law, though this also depends upon the broader quality of country and corporate governance (more on this below).

A high level of financial inclusion may also draw more small firms into the formal sector of the economy, which is good for fiscal health through higher taxes and assists in the adoption of worker-protection regulations and benefit provisions.

The type of instrument used determines the effectiveness of inclusion on poverty alleviation

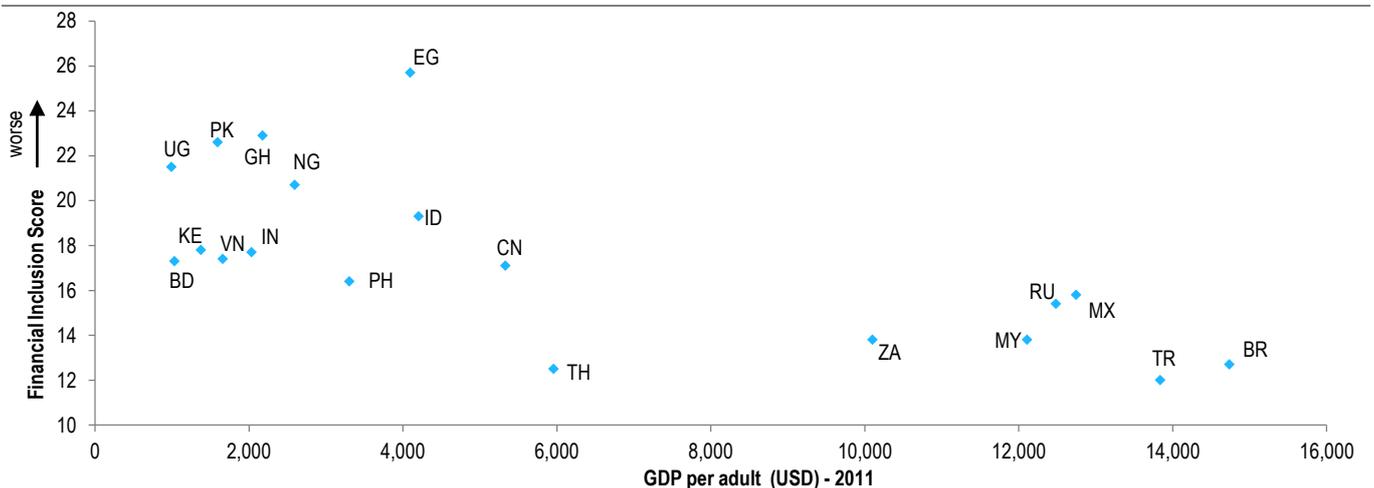
Reducing inequality

It is not always evident from the data that financial inclusion can reduce income inequality (Figure 12). In fact, some research argues that financial deepening has a larger impact on poverty reduction than inclusion (Ayyagari, 2013). The lack of data on the effectiveness of financial inclusion for poverty reduction, however, could have more to do with the flaws in the calculation of inequality – of which the GINI coefficient is the most widely used measure than with the financial inclusion tool – which is increasingly seen as a source of more inclusive growth. As we have outlined above, financial inclusion can work to improve the sustainability of income for an individual or firm, in several ways.

While there does not seem to be a global study to quantify the impact of financial inclusion on poverty reduction, several randomised controlled experiments suggest that the impact on poverty reduction is significant but varies depending upon the type of instrument used (World Bank, 2014). Individuals have seen a significant improvement in consumption, savings and productive investment through access to basic accounts with financial institutions. Insurance also appears to have a positive impact on growth and poverty reduction through more productive investment in better seeds and more expensive tools, for example.

Figure 12: There seems a less direct link between inclusion and levels of inequality

Latest available data



Note: Higher Financial Inclusion score is worse. Source: UN, IMF, Standard Chartered Research



Bank accounts and insurance help reduce poverty; microcredit has had a more mixed response

Empirical data measuring the causal link between microcredit and poverty alleviation shows only a very weak impact (we discuss this in more detail later). Microcredit for individuals does help manage cash-flow spikes but has limited long-term welfare gains in terms of increasing income or consumption. This is expected, given that loans must be repaid. However, another study (CGAP, 2010) suggests that the impact of microfinance is significant not so much because it helps reduce poverty but because it helps people cope with poverty. In particular, poor people have very uncertain and irregular sources of income. Microfinance helps to smooth consumption and to deal with expenses such as education, weddings, health needs or funerals.

Greater financial inclusion may also improve the effectiveness of both monetary and fiscal policy (Khan, 2012). Fiscal effectiveness is enhanced both through increasing the tax revenue base and also through greater effectiveness of welfare benefit and transfer schemes. This is particularly important in many EMs where country governance is often weak and the benefits of welfare and subsidy schemes often stay with bureaucrats or middle-men. Better governance works to reduce income inequality in an economy. The greater inclusion of people in formal financial services also strengthens the impact of monetary policy decisions on the real side of the economy, enhancing prospects of non-inflationary growth.

India hopes to lower its subsidy bill, which is close to 2% of GDP, through its newly launched financial inclusion programme

India's recently announced Jan Dhan Yojana promises to pay benefits directly into bank accounts. The government scheme will also provide overdraft facilities and debit cards to those who sign up. It is expected to help improve fiscal policy through lower leakage of benefits such as grain, fuel and fertiliser subsidies. This could reduce India's subsidy bill, which is now close to 2% of GDP. Reserve Bank of India (RBI) Governor Raghuram Rajan expects the "link between poor public service, patronage and corruption" to be broken through financial inclusion.

Insurance can have a very positive impact on the sustainability of income and living standards for individuals and firms by helping deal with negative unanticipated shocks. This should reduce absolute poverty levels. For example, insurance against natural disasters such as drought or floods can protect farmers and rural workers against loss of income. A report on the impact of insurance against natural disasters, (Janzen, 2013) found that insurance reduced the negative impact on farmers significantly in Kenya, cutting the need to sell assets by more than 60%, reducing dependence on food aid by 43-51% and reducing the possibility of missed meals by around 43%.

Innovations such as mobile money are making it easier to create credit profiles of previously unbanked adults

Innovations in financial inclusion such as mobile payments also seem beneficial. They help build up the credit profile of an individual or firm which can then be used as the basis for obtaining loans even in the absence of collateral and reduces the transaction costs of gathering information about borrowers. At the same time, remittances through mobiles help strengthen the ability of families or friends to support each other even if they live some distance apart.

Concerns about financial inclusion highlight need for better regulation

Some studies are cautious about the positive impact of financial inclusion. There are concerns that the availability of greater credit reduces the willingness of individuals and firms to save or rely on personal finances, making them vulnerable to adverse shocks. Poor regulation risks the possibility of unsustainable levels of indebtedness in both the household and SME sectors, while also lowering the stability of the financial services



sector itself. In addition, it may lower welfare by increasing the stress on individuals or micro businesses that face regular repayments of loans (Karlan, 2010).

High levels of indebtedness make an economy vulnerable to financial crises. Experience suggests that a rapid rise in credit availability for previously marginalised groups carries particular risks; examples from the early 2000s include credit cards in Taiwan and Korea and mortgages for US sub-prime borrowers.

A much harsher criticism of financial inclusion has been that sometimes microfinance organisations have focused too much on their own profitability and sustainability, charging very high rates of interest to the poor, and so are not very different from the moneylenders in the informal sector (Sinclair, 2012).

Concerns about financial inclusion relate to issues of over-indebtedness and the possibility of financial instability

The lack of regulations in this sector and the hunt for higher profits encouraged indiscriminate institutional lending at tenors and rates that were clearly difficult for the borrower to meet, according to Sinclair. The borrower took on more debt from other microfinance institutions to service existing debt, making it a sector-wide problem over time. This was seen as the main cause of the 'microfinance crisis' in the Indian state of Andhra Pradesh, and was blamed for several farmer suicides, forcing the government to intervene to prevent further deaths. The government's intervention in turn is said to have had a serious impact on microfinance lending in India (Kaur, 2013).

Most studies also find that microcredit has limited overall social welfare gains in terms of higher education, improved health (Banerjee, 2013) or wealth – increased consumption or income for an individual (CGAP 2014). However, as discussed earlier, microcredit is helpful in smoothing consumption and managing cash-flow spikes, allowing individuals to cope better with poverty. It also appears to support more qualitative improvements in the living standards of micro borrowers, with a fall in rates of depression, higher trust in others and more female decision-making powers (Angelucci, 2013). At the same time, spending on 'temptation goods', such as alcohol and cigarettes, decreased (Banerjee et al, 2013).

Microcredit has helped individuals cope better with poverty, and encouraged new businesses

There is growing evidence that microcredit has been beneficial for micro businesses. It has both encouraged new businesses as well as improved the income, size and scale of existing micro businesses (Angelucci, 2013). Some studies have found that the profits and investment of small businesses increased as did durable goods expenditure (Banerjee, 2013). It has also strengthened the risk-management capabilities of existing micro entrepreneurs (CGAP 2014).

These concerns surrounding financial inclusion highlight the importance of better regulation of products and organisations involved with financial services aimed at the poorer sections of society. They also highlight the need to properly identify the causes of exclusion so that financial inclusion initiatives can be most effective while reducing the risk of instability or micro-level distress.



Financial inclusion – Is there any progress?

The concerns resulting from the global financial crisis or the Andhra Pradesh microfinance crisis have not impeded the expansion of financial inclusion so far. There is a clear understanding that inclusion is positive for growth and poverty alleviation and there has been an enormous acceleration in effort in recent years to further that process. Time-series data on financial inclusion indicators are woefully inadequate. But almost all indicators that are available suggest progress in emerging markets on widening the use of basic financial services.

East Asian economies have significantly improved access to ATMs

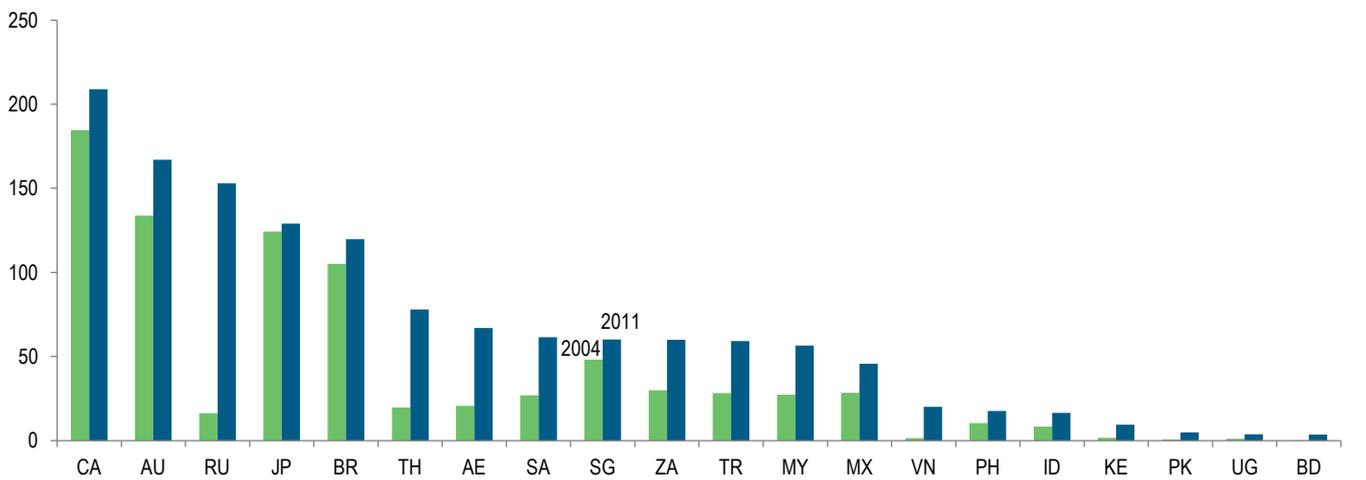
For the number of ATMs per 100,000 adults (Figure 13) all countries show improvement, but some such as Kenya, Pakistan, Uganda and Bangladesh still show very low levels of inclusion on this measure despite progress. Asian economies such as Thailand, Malaysia, Vietnam, Philippines and Indonesia significantly increased the number of ATMs available per 100,000 adults in 2011 compared to 2004. Despite these improvements they remain well below the levels in the more industrialised countries. For example, in Thailand, the number of ATMs increased from around 19 in 2004 to 77 in 2011 but this is still much below the 129 ATMs seen in Japan.

African countries are improving access to bank branches

The number of commercial bank branches per 100,000 adults has also risen for a broad range of countries and African nations such as Kenya, Ghana and Nigeria now stand closer to their Asian counterparts than in 2004 (Figure 14). However, some countries have shown a decline in the number of branches per 100,000 adults, including Singapore, Malaysia, Philippines, the UAE and Australia. This could signal pressures to cut costs or the introduction of alternative new technologies, such as internet banking and the greater use of debit and credit cards, which lower the need for as many ATMs. Developed world countries still remain far ahead of emerging markets in commercial bank branch coverage, but fairly rapid branch growth in Russia has landed it at the top of the pile on this measure.

Comparative data on other indicators of financial inclusion is still limited but retail points of sale terminals have grown in all countries for which data is available (Figure 15). Brazil and Singapore have the fastest growth in this sector. Turkey, which does relatively well on almost all other indicators, does even better than some of the more developed countries such as Canada and the UK on retail POS terminals.

Figure 13: ATMs per 100,000 adults
No. of ATMs (2011 vs. 2004)



Source: G20 Financial Inclusion Indicators, Standard Chartered Research

Debit-card use is rising in India, China, Indonesia and South Africa

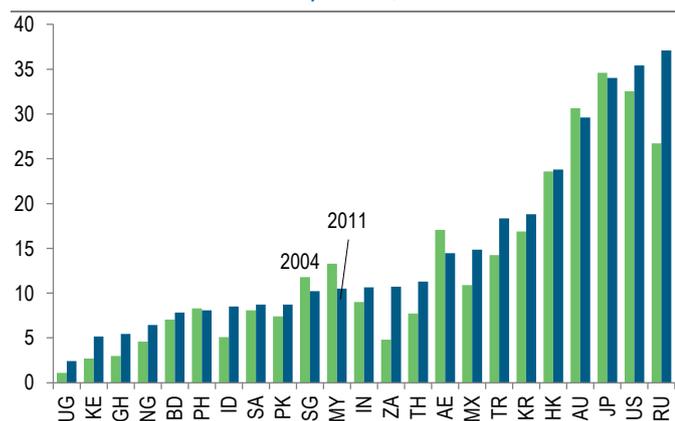
Debit-card use continues to grow in emerging markets but is still at introductory stages compared to its widespread use in more advanced economies such as the US, Canada and UK (Figure 16). Among emerging markets, South Africa, China, India and Indonesia are all making progress, but debit-card use is constrained by limited access to formal banking and lack of education (for overall as well as financial literacy) and the absence of infrastructure, such as access to computers to be able to utilise this service.

Lack of infrastructure is also a constraint in the use of electronic payment mechanisms such as direct credits (Figure 17). However, this mode is now being increasingly introduced in the more formal sectors of emerging markets for payments of salaries and other benefits directly into employee accounts. Mexico shows a substantial pickup in the use of direct credit transfers, as do Malaysia and Thailand. While it is beginning to gain a foothold in larger emerging markets such as India and China, financial education and infrastructure build will have to be accelerated before this tool of financial inclusion becomes important.

Indonesia, Bangladesh and Vietnam are making most progress on financial inclusion amongst EMs

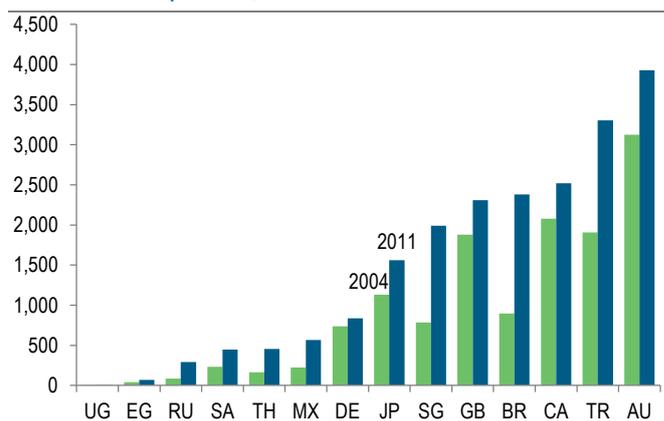
Putting it all together, Figure 18 suggests that some countries have made remarkable headway in improving the number of 'banked' adults, albeit from a very low base. Indonesia is among the top-five fastest gainers in at least three of five categories for which time series data is available. Bangladesh, Vietnam and Russia have made considerable progress in expanding the more formal banking services such as access to ATMs and bank branches. Indonesia and Malaysia are expanding the newer innovations in financial inclusion, such as electronic banking, retail points of sale and the use of debit and credit cards.

Figure 14: Bank branch networks have improved
Commercial bank branches per 100,000 adults



Source: G20 Financial Inclusion Indicators, Standard Chartered Research

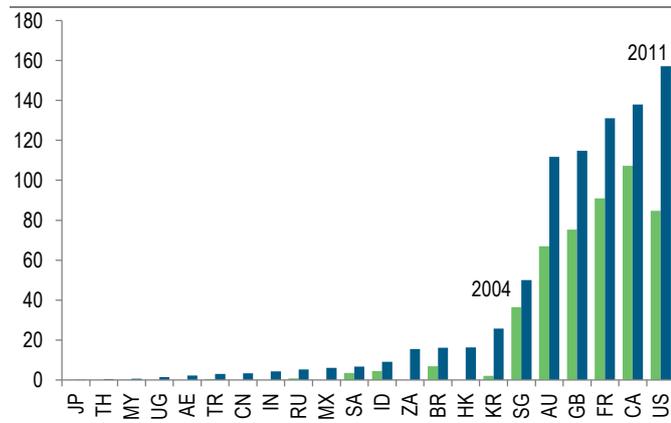
Figure 15: Retail POS terminals are rising everywhere
POS terminals per 100,000 adults



Source: G20 Financial Inclusion Indicators, Standard Chartered Research

Figure 16: Use of debit cards is low but rising in EMs

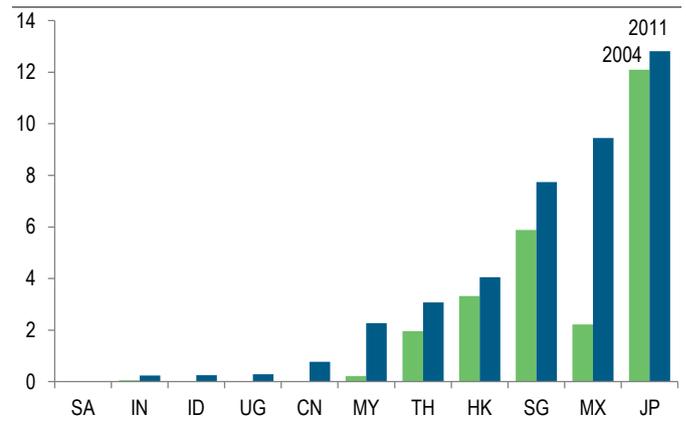
Payments by debit card (per adult)



Source: G20 Financial Inclusion Indicators, Standard Chartered Research

Figure 17: Electronic transfers are picking up in Asia

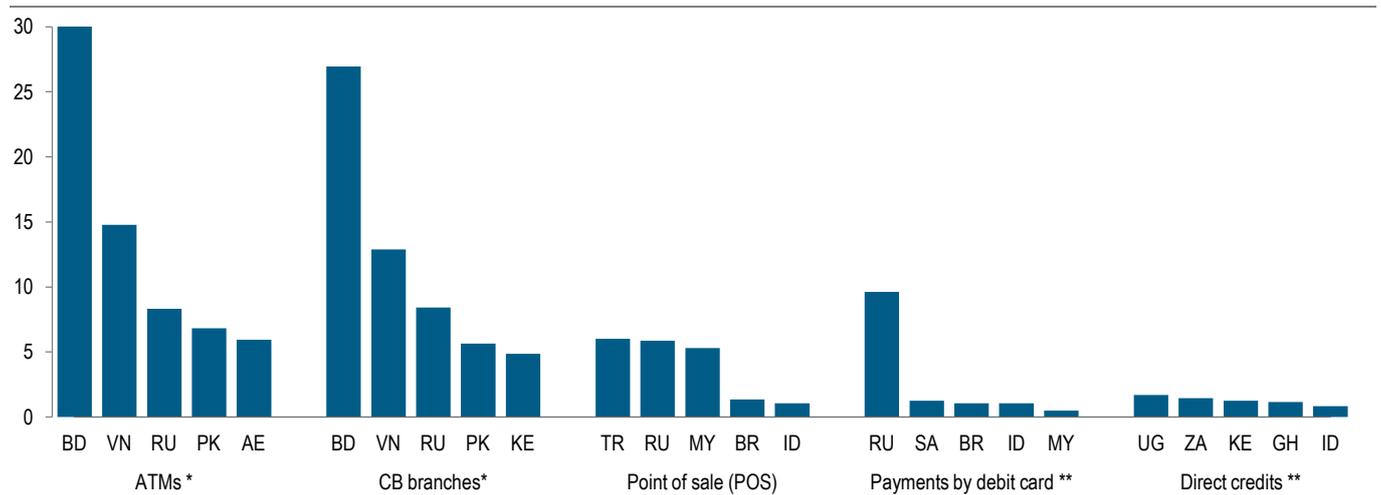
Direct credits (per adult)



Source: G20 Financial Inclusion Indicators, Standard Chartered Research

Figure 18: Financial inclusion : Five biggest improvers among emerging markets

% change (2004-11)



Note: *per 100,000 adults; **per adult; Source: G20 Financial Inclusion Indicators, Standard Chartered Research



Challenges to increasing financial inclusion

Five major barriers

Simply being too poor is cited as the main reason for being 'unbanked'

While the reasons for lack of financial inclusion vary between countries and regions, a number of common themes emerge. We have identified five main barriers to financial inclusion – ‘natural’ barriers such as geographic distance; lack of financial infrastructure; restrictive regulations; governance failures; and lack of suitable products that cater to the needs of poor people. We discuss each in detail below and outline measures to overcome them.

1. ‘Natural’ barriers may require special measures

A number of ‘natural’ barriers to financial inclusion often prevent poor people from accessing even the most basic formal financial services. Simply being too poor or the geographic distance to a bank can be a huge deterrent for a poor person. Aggarwal (2013) highlight that globally 25% of ‘unbanked’ adults cited costs (this rises to 31% in SSA), 20% reported that the bank is too far away while 13% reported lack of trust in the bank (Figure 19).

Transaction costs, both for banks and poor people, are another major barrier to financial inclusion. For banks, the cost of dealing with very small transactions is high and to operate in remote locations with little financial activity is costly and may be unviable. Hence, they have tended to focus on servicing middle-to-high income earners, typically in cities. For poor people, bank charges are high in proportion to the value and volume of transactions. Also, due to distance from the bank, the expense of travelling adds to the overall transaction cost and often the income from a day’s labour may be foregone.

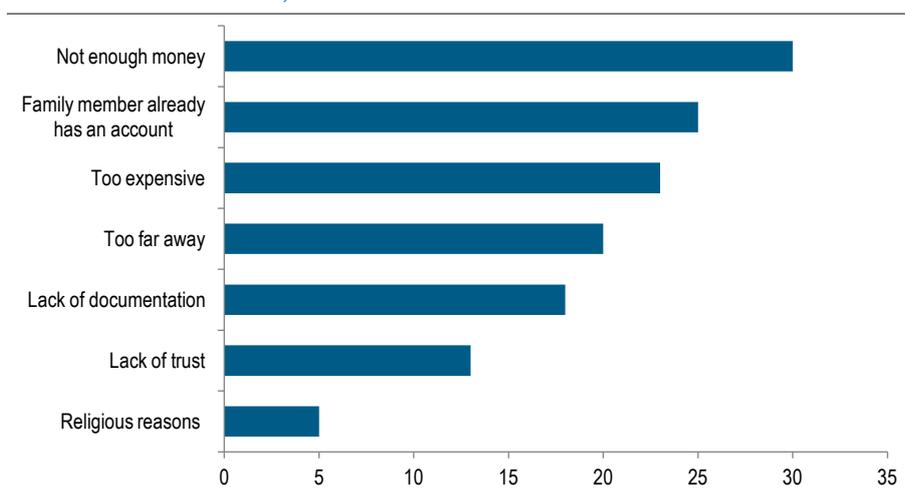
Religious concerns over interest payments can also be a challenge to financial inclusion; this is often cited as a reason in the Middle East, North Africa and South Asia for a low proportion of adults that are ‘banked’ (Demircuc-Kunt, 2012).

Key drivers of change

Many of the above challenges can be overcome. Policy makers in developing countries have adopted specific strategies to increase the use of financial services by rural populations or those living in areas with limited coverage. Mandating banks to open in

Figure 19: Reported reasons for not having a bank account

Adults without an account, %



Note: Respondents could choose more than one reason Source: Global Financial Inclusion (Global Findex) Database, World Bank, Standard Chartered Research



unbanked rural locations, banking through local agents (correspondent banking) and 'mobile' branches and the development of community-based savings groups are a few strategies that have been adopted in different countries with varying levels of success. Financial products compatible with religious requirements have also proved successful.

Savings groups – A springboard to inclusion

Savings groups or clubs can offer poor people a springboard to move towards formal financial inclusion. In India, for instance, banks are mandated to open accounts for community savings groups. Across the SSA region, 19% of adults (and 48% of savers) report having used a savings club or person outside the family. By saving small amounts, as little as 10-50 cents a week, groups gradually begin to save and individuals can subsequently access loans from the capital. The need for the safety and security of a formal financial institution becomes stronger as group savings accumulate over time. However, formal recognition of savings groups is still not a part of many countries' inclusive financial strategy and there can be regulatory barriers.

Correspondent banking

Government mandates have improved bank density in remote regions but physical bank branches may not be a sustainable solution in rural areas as they are unlikely to be profitable in the long term. In India, the Reserve Bank of India requires all banks to open 25% of their new branches in unbanked rural areas. Nigeria has also tried to mandate banks to open in rural areas but with less success. Schemes in Nigeria have failed to mobilise savings due to their very high minimum balance requirements. As a result, the agent or correspondent banking model has come to the fore in many developing countries, particularly in South Asia and Latin America (with Brazil leading the way) to address the key physical access barrier.

The agent model mobilises existing retail infrastructure (pharmacies, post offices or supermarkets) as delivery channels for financial services. The likelihood of using a formal financial account for the poorest 20% of adults increases by up to 5ppt through the introduction of correspondent banking (World Bank, 2014). Evidence shows that correspondent or agent banking has had a big impact on financial inclusion in many developing countries, including Brazil and Kenya.

In Brazil, broader access to financial services through the growth in correspondent banking has reduced dependence on traditional bank branches, which now account for only 38% of financial transactions (G20, 2010). Correspondent banking has also helped manage Brazil's social safety net programmes. The 'physical access' barrier has been removed and families who benefit from *Bolsa Familia*, a social welfare programme (see [Taming the Gini: inequality in perspective, 16 July 2014](#)), are able to withdraw their allowances without having to travel long distances. The agent mode of delivery has also benefited the government by reducing transaction costs of providing social payments.

The role of technology and mobile financial services

Collaboration among banks and agents has become easier due to technology, which has reduced the cost and risks. Agent banking thrives where there is a sound technical network which facilitates real-time communication between the agents and the banks and allows identity verification of customers via electronic card-readers. This is facilitated by a regulatory environment tailored to local conditions.

Technological innovation and new business models promise real economic benefits, helping organisations to expand their reach at lower cost. The World Bank's Consultative Group to Assist the Poor (CGAP) estimates that the average monthly

The correspondent or agent banking model has come to the fore in many EMs

Technology has played a major role in reducing costs and risks



cost to customers of using correspondent and mobile-phone based models is 19% lower than the cost of such services in traditional branches (McKinsey, 2010).

Mobile money or 'branchless' banking schemes are spreading globally, with the success of payment mechanisms such as Kenya's M-PESA adding impetus. Mobile financial services are being driven by the widespread use of mobile phones by those on low incomes in emerging markets. Mobile money has grown rapidly in countries where branch banking has been hampered by transportation and infrastructure problems. Mobile phone penetration in developing countries has almost tripled in the past five years, with Asia in particular showing high growth rates (Hannig, 2010). In many low and middle-income countries, the share of population that has access to a mobile phone is considerably larger than the share of population that has a formal bank account. For example, in India 72 of every 100 inhabitants has a mobile phone, while only 35% have a bank account (World Bank, 2014).

Kenya has pioneered mobile financial services

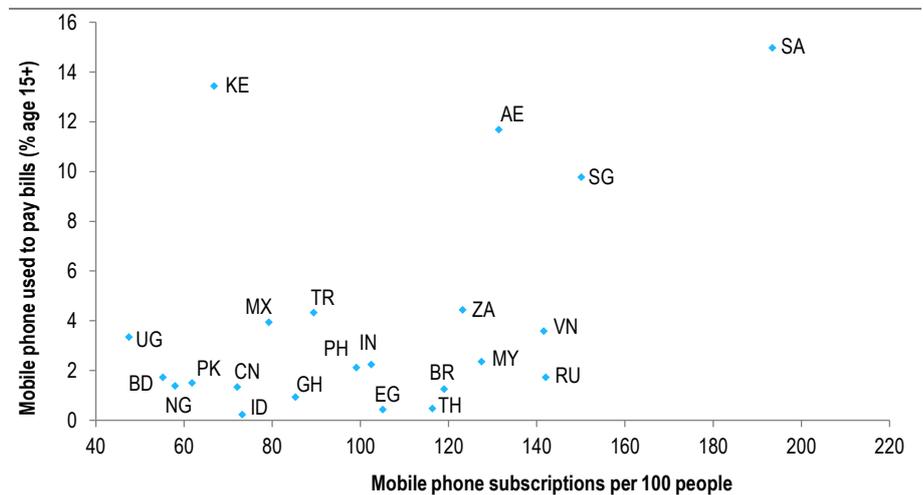
Kenya has been the most successful country in pioneering mobile financial services, with strategies primarily focused on providing access to payments and remittances via mobile phones. Its central bank has played a key role in supporting mobile phone payment schemes and has provided ample regulatory space to mobile phone operators. But in many other low-income countries the regulatory environment governing the provision of mobile technologies needs to be made easier so that banks can establish mobile banking platforms to reach a wider rural population.

The aggregate volumes of mobile banking transactions are still small compared with the value transacted through traditional payment instruments. The average use of mobile money transfers for all developing countries is only 5%, suggesting that there are still barriers to the introduction of new technologies in regions outside Africa (Aggarwal, 2013). Figure 20 shows that only four out of the 21 emerging countries included use mobile payments to any significant extent.

Increasing financial inclusion through government payments is still in its infancy

Efforts to increase financial inclusion through government payments are still in their infancy but there is potential for expansion through leveraging technology-enabled G2P (government-to-person) payments. G2P payments include benefits such as social transfers and wage and pension payments. Access to G2P electronic payments is currently via existing government infrastructure, for example, post

Figure 20: Mobile phones and bill payments
2011



Source: Global Financial Development Database, WDI



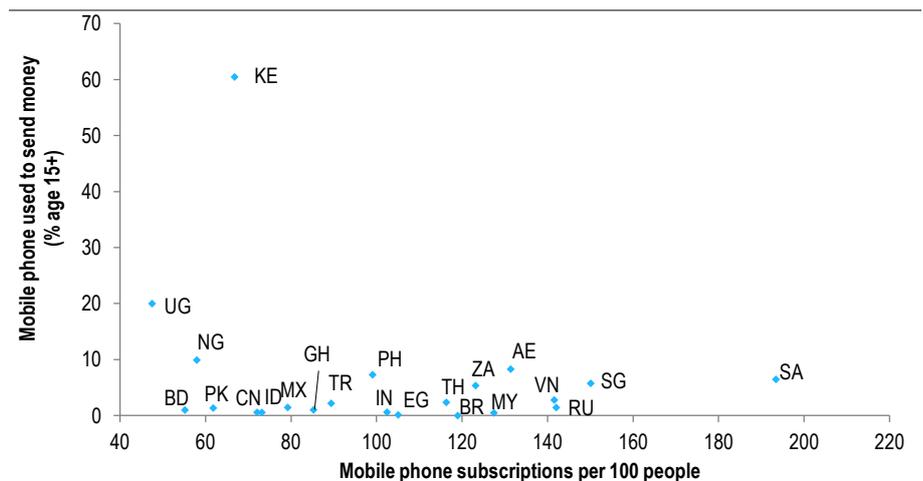
offices; but mobile technology has the potential to simplify G2P payments further. While there are many hurdles to electronic payments – such as mistrust of banks or account types that do not match recipients’ savings needs – there are also benefits. Although hard to measure, moving people out of the informal economy is arguably the most significant economic benefit. Interestingly, Demircuc-Kunt et al (2012) show that the existence of accounts to receive G2P payments lowers the likelihood that individuals with these accounts will cite ‘lack of funds’ as a barrier.

Remittance flows will play a significant role in increasing financial inclusion

Remittances and financial inclusion

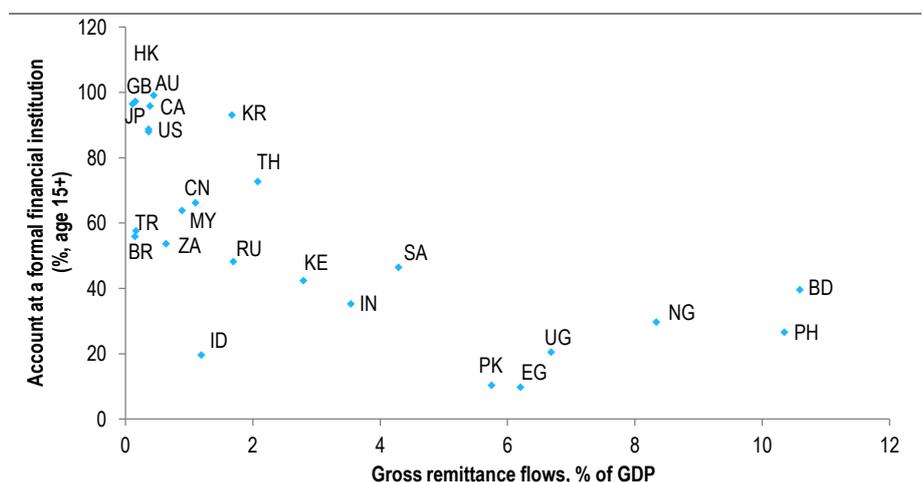
Remittances are considered one of the most important financial transactions for populations with limited access to financial services. The World Bank (2013) estimates that officially recorded international migrant remittances to developing countries reached USD 401bn in 2012. However, the relationship between remittance flows and financial inclusion is not obvious. Remittances are usually regular and predictable flows; therefore, in principle, recipients of remittance flows should be more inclined to join the formal financial sector. For instance, countries like the Philippines with high remittances would be expected to have a higher percentage of account holders at a formal financial institution. But cross-country data remains inconclusive (Figure 22).

Figure 21: Mobile phones and sending money
2011



Source: GFDD, WDI

Figure 22: Remittances and financial inclusion
%



Source: World Bank, GFDD



The potential of mobile banking for remittance payments and receipts is huge given that poorer countries lag much more in terms of account penetration than in mobile telephony. Households increasingly rely on mobile banking to send and receive payments within a country. However, it is still not easy to send cross-border remittances by mobile phone due to restrictive mobile regulations, security concerns and lack of customer awareness and trust. Also governments are very concerned about regulating the flow of capital into and out of their countries given the risks of fraudulent transactions and money laundering. In many countries there is still no universal, meaningful registration of SIM cards, which adds a level of uncertainty if mobile phones are the primary mechanism for receiving cross-border remittances. Given these issues and despite the importance of remittance income, few banking regulators are likely to fast-track regulatory reforms which encourage mobile international transfers.

Remittances will continue to play a significant role in raising financial inclusion. Several countries have included remittance products in national policies on financial inclusion. India provides a good example of this. Under its National Financial Inclusion Strategy, many public-sector banks offer accounts that charge no fees for remittances (World Bank, 2014). It is imperative that regulatory initiatives strive to reduce red-tape and make transfer systems less costly, more efficient and transparent, for mobile money transfers in particular.

2. Lack of financial infrastructure

Governments have a key role to play by facilitating banks' access to borrower information

Lack of financial infrastructure is the second major barrier to financial inclusion. Governments have a key role to play by facilitating banks' access to borrower information. This can be achieved either by passing laws and regulations that enable banks to share information or by directly setting up public credit registries. Public credit registries are databases established and managed by central banks that capture information on both individual and commercial borrowers and their credit status. Public registries can be important in the early stages of financial development, but they can reduce the attractiveness of private bureaus. Private credit bureaus refer to information-sharing arrangements maintained by private financial institutions.

The World Bank's Doing Business Indicators survey provides an aggregate measure for the ease of 'getting credit'. It includes the legal rights of borrowers and lenders in secured transactions and bankruptcy laws and the strength of credit registries and bureaus. Legal rights can facilitate the use of collateral and the ability to enforce claims in the event of default, while information via registries and bureaus can help creditors assess the creditworthiness of borrowers. Commercial-level survey data shows that access to bank credit is easier in countries in which there are credit bureaus and registries.

Sharing credit information through credit registries and bureaus facilitates access to credit. It empowers both lenders and borrowers by reducing information asymmetries, enabling lenders to make more informed decisions and borrowers to develop a good reputation for repayment. Rankings on the ease of getting credit are based on the sum of the strength of the legal rights index and the depth of credit information index.



**Ghana has made the most progress
in advancing to the frontier**

Figure 23 highlights that for our subset of 30 countries, Nigeria, Kenya and Ghana have made great strides in pushing reforms improving the strength of legal rights index. Figure 24 illustrates that Ghana has made the most progress in advancing to the frontier (moving 43.75ppt closer to the frontier of 100, but still 20ppt away from it) in 'regulatory practice in getting credit' since 2006. Ghana is followed by Nigeria, China, India and Russia (all progressing 31ppt towards the frontier). In 2010, Ghana's first credit bureau commenced operations; by 2013 c.1.35 million individuals and 170,141 firms were listed, with information on their borrowing history from the previous five years.

There are two types of credit bureaus: a so-called 'negative' credit bureau only stores information on customer defaults, thus helping to filter highest-risk consumers from others. Historically, databases with negative-only data were referred to as 'blacklists', excluding high-risk borrowers that had accumulated significant debt exposure. 'Positive' credit bureaus store an individual's full credit history (information relating to all of an individual's past repayments), not just defaults. Coverage of bureau data varies by country.

Figure 23: Factors that influence financial inclusion – Getting credit

Selected countries		Rank	Getting credit			
			Strength of legal rights index (0-10)	Depth of credit information (0-6)	Public registry coverage (% of adults)	Private bureau coverage (% of adults)
United Kingdom	GB	1	10	6	0	100
Malaysia	MY	1	10	6	52.9	77.2
Singapore	SG	3	10	5	0	60.3
United States	US	3	9	6	0	100
Australia	AU	3	10	5	0	100
Korea	KR	13	8	6	100	100
Nigeria	NG	13	9	5	0.1	4.9
Kenya	KE	13	10	4	0	4.7
Ghana	GH	28	8	5	0	10.4
India	IN	28	8	5	0	19.8
Germany	DE	28	7	6	0	100
Canada	CA	28	7	6	0	100
Japan	JP	28	7	6	0	100
South Africa	ZA	28	7	6	0	55.6
Uganda	UG	42	7	5	0	4.1
Vietnam	VN	42	8	4	39.1	0
Mexico	MX	42	6	6	0	100
Saudi Arabia	SA	55	5	6	0	44.3
Thailand	TH	73	5	5	0	49.2
Taiwan	TW	73	5	5	0	94.1
Pakistan	PK	73	6	4	8	2.1
China	CN	73	5	5	30.2	0
Bangladesh	BD	86	7	2	0.8	0
Egypt	EG	86	3	6	5.3	19.6
Indonesia	ID	86	5	4	41.2	0
Turkey	TR	86	4	5	27	71.7
Philippines	PH	86	4	5	0	9.3
UAE	AE	86	4	5	5.8	27
Brazil	BR	109	3	5	50.4	63.4
Russia	RU	109	3	5	0	59.2

Source: WB Doing Business Report 2014 – Doing Business 2013 Rankings (Economies have been ranked on their ease of getting credit from 1 – 189).

Notes: The Strength of legal rights index ranges from 0-10 with higher scores indicating that collateral and bankruptcy laws are better designed to improve access to credit. The depth of credit information index ranges from 0-6 with higher values indicating the availability of more credit information from either a public credit registry or a private credit bureau. The public credit registry coverage and private credit bureau coverage indicators report the number of individuals and firms listed in a public credit registry's or private credit bureaus' database as of 1 January 2013 with information on their borrowing history from the past 5 years. The number is expressed as a % of the adult population (the population age 15+ in 2012 according to the World Bank's WDI). If no public registry operates or no private credit bureau exists, the coverage value is 0%.

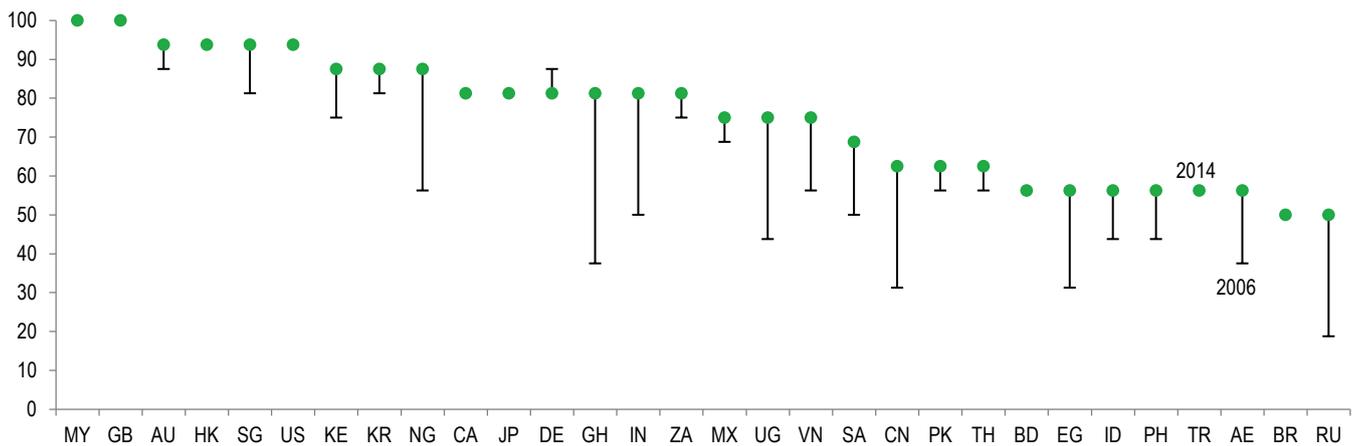


In developed markets, comprehensive (includes both positive and negative) credit bureaus are commonplace. Many developing countries initially had only ‘negative’ credit bureaus but this is slowly changing. Brazil was one of the larger credit markets that had only negative credit bureau data but it created a ‘positive’ credit bureau in 2011, finally joining most countries in the G20. In some countries with no positive credit reporting, borrowers could remain excluded from credit access for up to five years based on a single negative event regardless of their current payment record or other favourable information. Even with the improved availability of information, banks in most emerging countries are still developing towards the sophisticated scoring systems used, for example, in the US.

Central Asia, East Asia/Pacific and MENA have been the big reformers in improving credit coverage

Access to both positive and negative information enables businesses to make more informed decisions about extending credit since lenders gain a better understanding of consumers’ level of indebtedness. Although SSA has the least developed credit information structure (only eight out of 47 countries have credit bureaus), the region has made progress in recent years (IFC, 2012). One reason for low coverage ratios in some regions is that the percentage of the population that uses credit constitutes only a small proportion of the total population. Figure 25 highlights that Europe and

Figure 24: Countries advancing the most towards the frontier in terms of getting credit

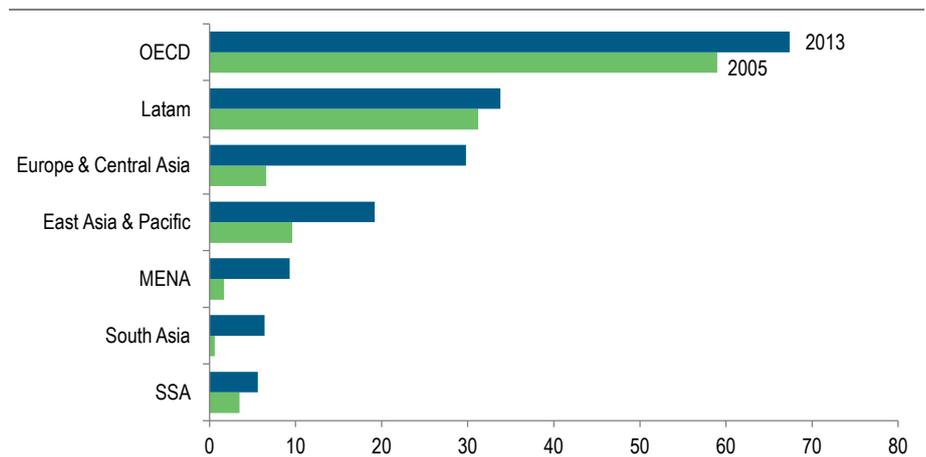


Source: WB Doing Business 2014, Standard Chartered Research

Note: The distance to frontier scores shown in the figure indicate how far each economy is from the best performance achieved by any economy on the getting credit indicators since DB2005 (2004). The scores are normalised to range between 0 and 100, with 100 representing the frontier. The vertical bars show the improvement in economies advancing the most towards the frontier in getting credit between 2006 and 2014.

Figure 25: Average credit bureau coverage – How has it changed?

% of adults



Source: World Bank Doing Business 2013



Central Asia, East Asia/Pacific and MENA have been the big reformers in terms of improving coverage of private credit bureaus; SSA still lags well behind but is making good progress.

High rankings on the strength of legal rights index capture economies where laws allow registered entities to easily use movable property as collateral while secured creditors' rights are protected. One early study highlighted that about 90% of the movable property that could serve as collateral for a loan in the United States would likely be unacceptable to a lender in Nigeria (Fleisig, 2006).

SSA countries have made good progress in reforming secured transactions

Governments can play an important role in facilitating reforms. Reforms to movable property laws in China, Ghana, Mexico and Vietnam eliminate limits on what can serve as collateral. Two further reforms have also been implemented in these countries – creditors now have the ability to seize and sell collateral privately or through summary proceedings and secured creditors have first priority and can verify their priority through an electronic archive. Furthermore, SSA countries (22 out of 47 countries) have implemented new secured transactions legislation and registries. Recent studies show that the impact of a new collateral registry can be economically significant. According to the World Bank, in economies that have implemented such reforms, the number of companies with access to bank finance increases by about 8% on average.

3. Restrictive regulations are often a major barrier

Restrictive regulations are the third barrier to formal financial inclusion for the poor. The Global Findex data highlights that 18% of adults in the developing world cite 'lack of necessary documentation' as the reason for not having a formal account. Stringent KYC documentation requirements imposed by national regulators on banks in order to comply with guidelines around the prevention of money laundering and combating the financing of terrorism can block poor households from entering the financial system. Aggarwal (2013) highlights that globally, each additional document required to open an account reduces the number of accounts by 153 per 1,000. More often than not, poor people do not have any form of formal identity documentation.

Regulations – How much is too much?

Regulators perform a dual role – to protect consumers and to act as prudential regulators principally concerned with maintaining the integrity of individual institutions and of the financial system as a whole. On the one hand, they want to limit exploitation of the poor through unfair contracts, fraud, excessive prices and interest rates; while also requiring financial institutions to stick to good credits in order to maintain a strong equity capital base. This tends to limit banks' incentives to seek business from the poor.

But just how much regulation is enough? A widely accepted principle of good regulation put forward by Lyman et al (2008) states that restrictions imposed by regulators on industry should be proportionate to the benefits that are expected to result from the restrictions. In efforts to defend the poor, governments may introduce a slew of measures such as caps on interest rates or prohibiting fees for making deposits, which ultimately end up being counter-productive as the poor may not be offered services, even though they are willing to pay for them. Returns to financial services providers from micro and small businesses are often extremely high and can be as high as 5% per month (World Bank, 2014).



In many emerging markets, banks now offer basic savings accounts subject to more flexible KYC requirements

In order to foster financial inclusion, regulators are rethinking their policies to take into account the needs of the poor. Policies that enable banks to contract with non-bank retail agents as outlets for financial services have proven highly successful. In Brazil for instance, it required a series of regulatory changes permitting financial institutions to contract non-bank entities as banking correspondents. Similarly in Kenya, the government worked with telecom provider, Vodafone, to ensure that the innovation met regulatory requirements before the investment flowed in for the successful M-PESA pilot. Banks in Kenya and Nigeria accept letters from the local rural authority in lieu of identity documents and in many emerging countries, including India and South Africa, banks now offer basic savings accounts that are subject to more flexible KYC requirements. For example, more than six million ‘Mzansi’ basic bank accounts have been opened in South Africa since their introduction in 2004 (G20, 2010).

An adequate legal and regulatory framework is an important prerequisite for the adoption of new technologies that can enhance financial inclusion. The case of mobile payment systems discussed above is a good example – the regulatory framework needs to create enabling conditions for the providers of technology-based financial services while taking account of consumer protection.

The outcomes from relaxed KYC norms are a potential cause for concern

A number of developing countries are now easing their KYC requirements to enable greater financial inclusion. The outcomes of relaxed KYC norms are promising so far but also a potential cause for concern. Governments have set stringent conditions with well-defined intentions, so circumventing such guidelines to promote financial inclusion can only serve as a stop-gap arrangement. Most developed economies have national identification systems that make it easy to identify borrowers and track individual credit histories. This remains a challenge in many low and middle-income countries where no universal identification system exists and where poor people may not have documents such as utility bills or payslips that are taken for granted in developed countries.

In many developing countries, projects to implement biometric identification systems, which involve the government issuing a unique biometric identification number and card to every citizen of the country, are in their initial phases. The largest biometric borrower identification programme, the ‘Aadhaar Program’ is currently underway in India. Lenders often try to compensate for the lack of reliable information on the identity and credit history of borrowers by raising collateral requirements or refusing to lend to certain segments, thereby leading to credit rationing and potentially excluding otherwise creditworthy borrowers. However, recent empirical evidence shows that improved borrower identification through technological innovation can substantially reduce asymmetric information and moral hazard in credit markets and enhance financial inclusion (World Bank, 2014).



Weak public-sector institutions can be detrimental to financial inclusion

4. Governance failures often impede progress

Weak public-sector institutions that exemplify governance failure can be detrimental to financial inclusion. Improvements in public-sector governance can have a positive impact on the equitable use of and access to financial services. This applies both to banks' direct relationships with individuals and to any joint ventures they might make with correspondents, microfinance institutions or mobile providers.

The most widely used indicators to measure country governance are the World Bank's World Governance Indicators (WGI). We focus on five governance indicators that seem to matter the most for financial inclusion – rule of law, regulatory quality, government effectiveness, control of corruption and political stability.

- a. **Rule of law** – the extent to which agents have confidence in and abide by the rules of society, and in particular the quality of contract enforcement, property rights, the police and the courts, as well as the likelihood of crime and violence.
- b. **Regulatory quality** – the ability of the government to formulate and implement sound policies and regulations that permit and promote private-sector development.
- c. **Government effectiveness** – the quality of public services, the quality of the civil service and the degree of its independence from political pressures, the quality of policy formulation and implementation, and the credibility of the government's commitment to such policies.
- d. **Control of corruption** – the extent to which public power is exercised for private gain, including both petty and grand forms of corruption, as well as 'capture' of the state by elites and private interests.
- e. **Political stability and absence of violence** – the likelihood that the government will be destabilised or overthrown by unconstitutional or violent means, including politically motivated violence and terrorism.

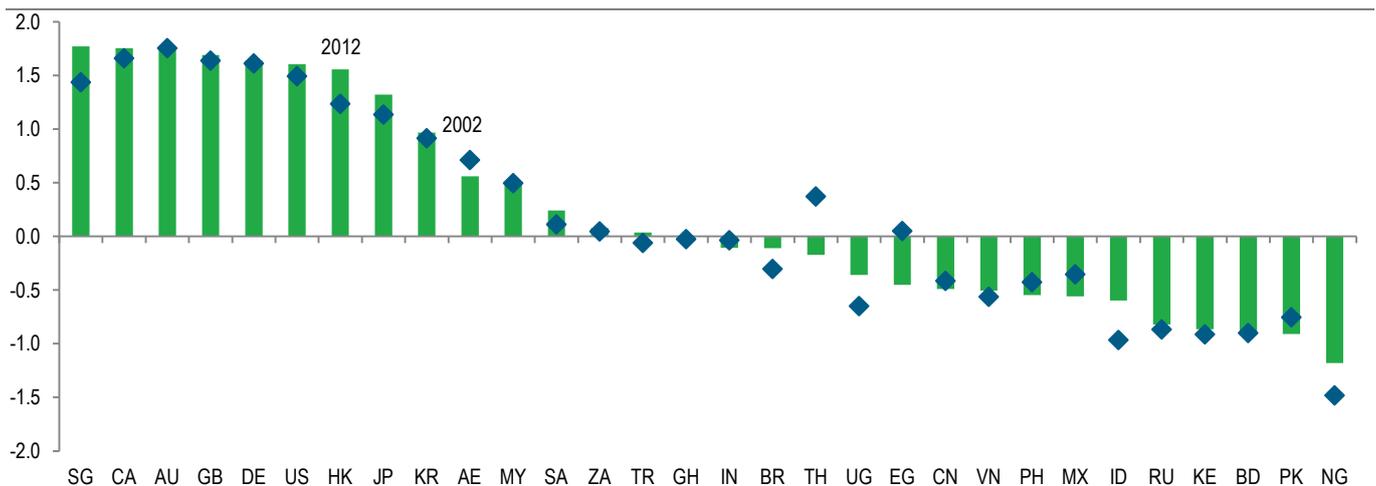
Rule of law puts its highest weight on perceptions of the judicial framework and independence as measured by Freedom House. It includes data on enforceability of contracts, judicial-system efficiency and private-property protection, which are critical to individuals and firms gaining access to credit and increasing financial inclusion. The other indicators, particularly regulatory quality and government effectiveness, are also critically important for the rollout of new technologies and more inclusive public policy strategies; while minimising corruption and ensuring a stable political environment will mean that better progress can be made towards addressing the key barriers to financial inclusion.

Nigeria, China and Indonesia have improved on rule of law and regulatory quality

For our subset of 30 countries, Figures 26-30 highlight that emerging countries like Nigeria, China and Indonesia improved on rule of law and regulatory quality between 2002 and 2012 while Indonesia improved on government effectiveness as well, along with Kenya. Also, Ghana showed significant improvement on regulatory quality. Nigeria, Kenya and China all improved on their control of corruption. Clearly, better public-sector governance has helped not only developed countries but also these emerging countries to push through reforms – for instance in getting access to credit – that have enabled them to move towards greater financial inclusion.

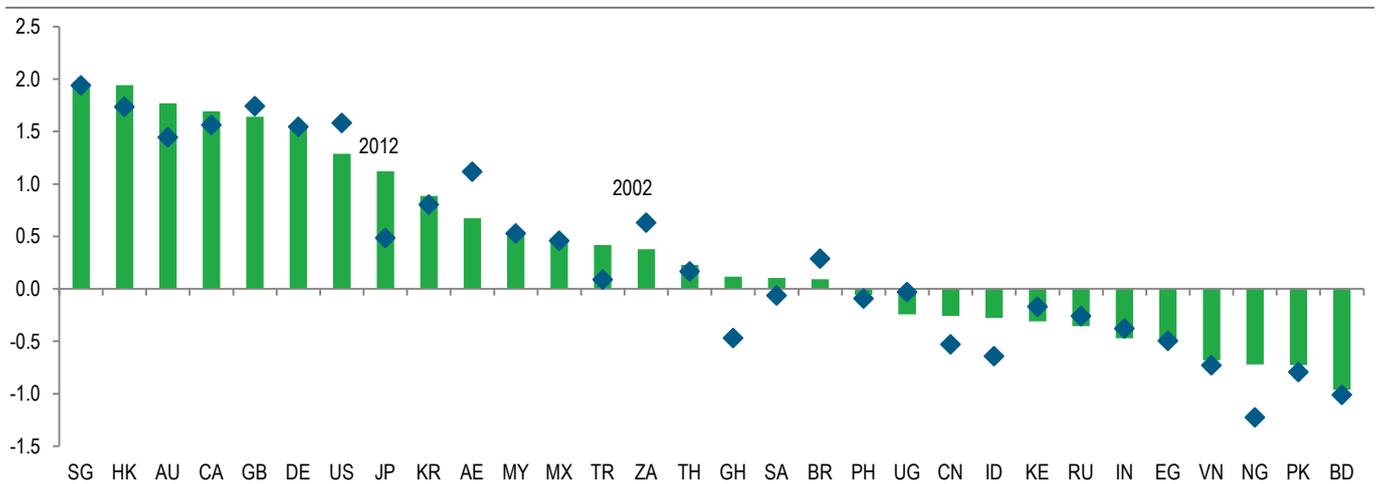
Governance failure can also impact the use or effectiveness of public funds in relation to financial services and financial inclusion. For example, programmes or subsidies to support financial inclusion may not reach the target group or have the intended effect. Or in some countries, governments have reacted to high levels of household debt with debt-relief programmes. Such programmes are common and widespread, especially in rural credit where they can help reach the poorest segments of populations. According to the World Bank, such programmes may have welfare benefits for borrowers in the short term but can lead to severe credit market distortions that may hinder financial inclusion in the long run.

Figure 26: Rule of law
Score, 2002 vs. 2012



Source: WGI, Standard Chartered Research

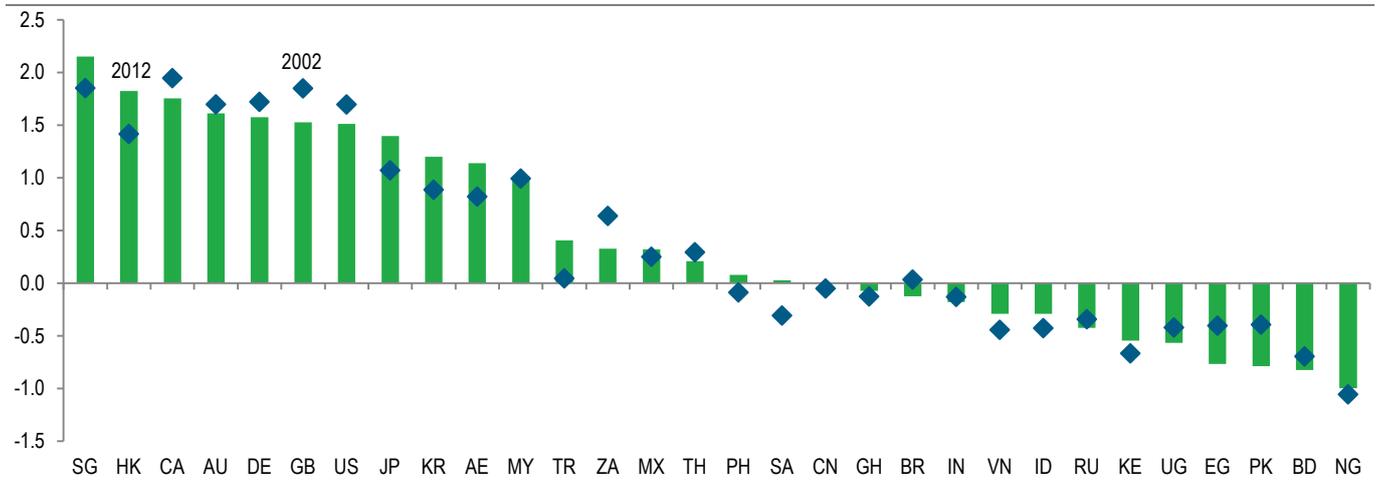
Figure 27: Regulatory quality
Score, 2002 vs. 2012



Source: WGI, Standard Chartered Research

Figure 28: Government effectiveness

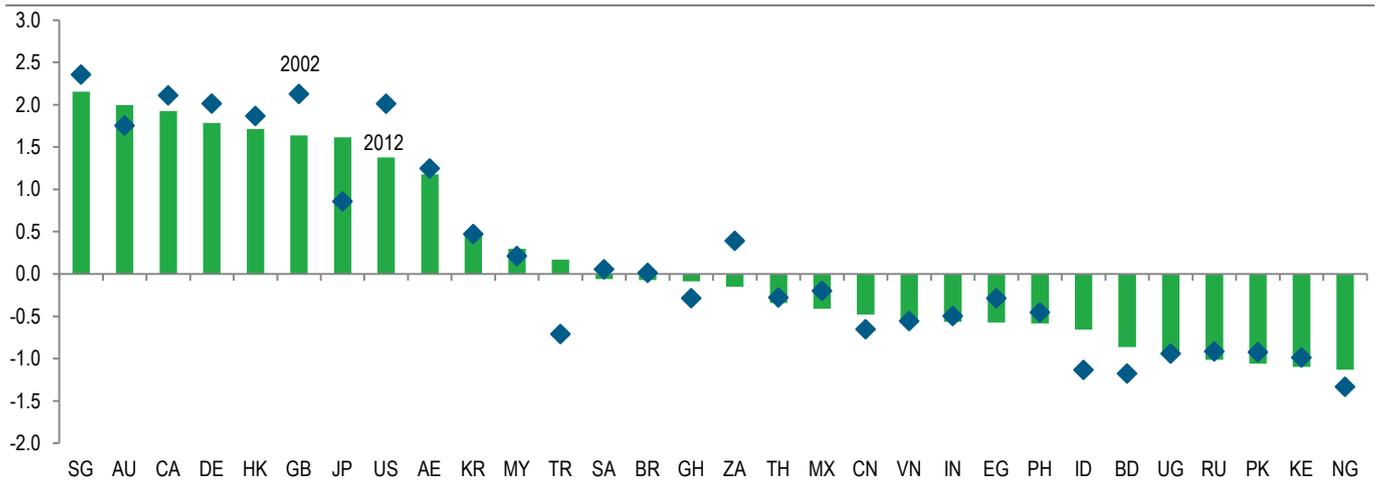
Score, 2002 vs. 2012



Source: WGI, Standard Chartered Research

Figure 29: Control of corruption

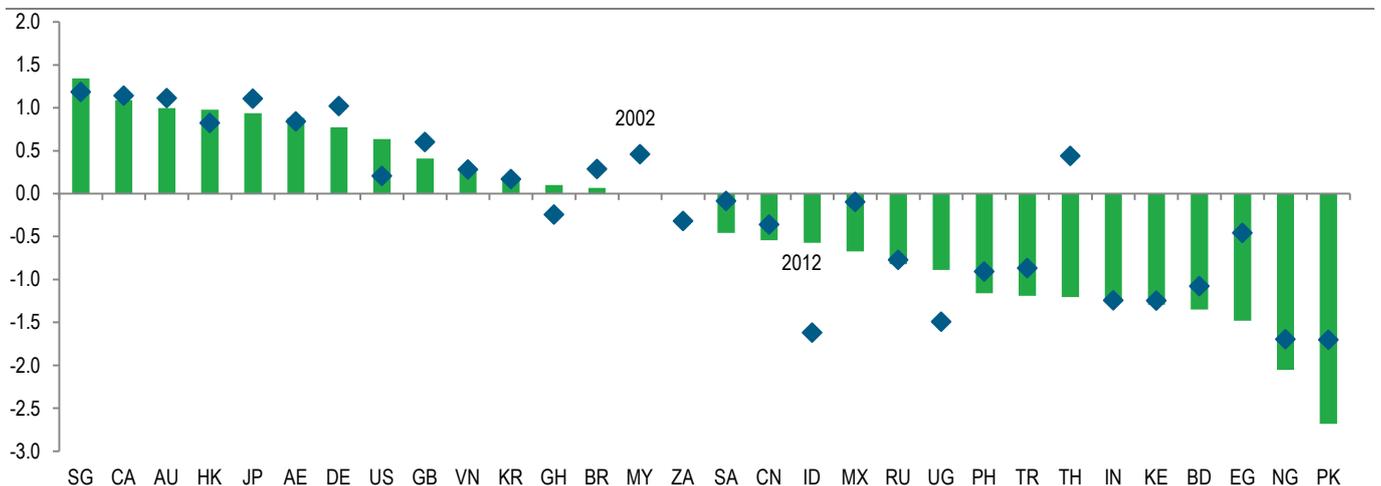
Score, 2002 vs. 2012



Source: WGI, Standard Chartered Research

Figure 30: Political stability and absence of violence/terrorism

Score, 2002 vs. 2012



Source: WGI, Standard Chartered Research



Financial products need to be tailored to meet the needs of the poor

5. Making products attractive

The final challenge to financial inclusion is creating attractive financial products. Financial products need to be tailored to meet the needs of the poor. Products need to be affordable, available within reasonable physical proximity and regulated to protect consumers. Banks may need to adopt a different approach towards the poorer segments of society. Although banks have some products that are suitable for addressing the needs of the poor, quite often the poor either have limited knowledge or an incorrect understanding of the products and are reluctant to use them.

Innovations in credit product design have helped to mitigate market imperfections and increase financial inclusion. Timing of repayments is an important feature. For example, regular payments starting with immediate effect may not suit the poor for whom income is often intermittent or seasonal.

Design features are also important for savings and insurance products. Innovations in savings product design underpinned by long-term savings goals or basic accounts (accounts with low fees and minimum requirements) can encourage the use of accounts and prove invaluable to increasing financial inclusion. Similarly for insurance products, a well-designed product can reduce moral hazard for households, particularly in developing economies with greater exposure to risks that can generate extreme income volatility.

Financial education has a big role to play

Lack of financial literacy among the poorer segments also represents a significant barrier to the access and proper use of formal financial services. Banks and other financial providers often do not have an incentive to provide simplified financial products to cater to the needs of low-income consumers due to high transaction costs. In response to high costs many national governments have encouraged or mandated banks to offer cheaper and more innovative product offerings ranging from 'no frills' basic accounts with little or no fees or minimum balance requirements.

In some countries people worry that banks are not safe due to their experience of past banking crises, government expropriations and currency devaluation. To improve public trust banks may need to increase accountability through greater disclosure and being more transparent, but financial education plays a fundamental role. People are also more likely to be willing to have a bank account if they are confident that government policy will contain inflation and that there is no risk of government expropriation.

For optimum results, financial literacy programmes aimed at poor households should target individuals at 'teachable moments'. A 'teachable moment' is essentially a life-changing moment during which specific financial decisions might alter incomes or normal patterns of expenditure – for instance, purchase of a financial product or service such as a mortgage, marriage, divorce, starting a job or retirement. During these 'moments' people might be extra motivated to gain and use newly acquired financial knowledge and skills (World Bank, 2014).

Financial literacy is intrinsically linked to consumer protection

Financial literacy is intrinsically linked to consumer protection. Consumers are more likely to trust banks and use their financial services if they understand the products and are able to make well-informed financial decisions on their choice of financial products and services. A well-educated consumer is able to understand consumer disclosures, risks and rewards, and their legal rights and obligations.



Conclusion – Progress despite the obstacles

In most emerging markets access to and use of financial services still lags behind the developed world. The gains from increasing financial inclusion can be substantial and governments and many financial institutions and others are actively seeking ways to reduce the burden of regulation and overcome challenges of weak governance.

Progress has been made in some developing countries in addressing some of the key barriers, particularly in SSA, Indonesia and Bangladesh; but more needs to be done. Growth in many emerging markets should help accelerate the uptake of technology which could reduce the cost of transactions. Technological innovation is making it economically viable for banks and other financial services providers to reach poorer people with a wider range of products and services.

Banks are constantly looking at new ways to innovate and are keen to participate. The correspondent banking model supported by technology, particularly in South Asia and Latin America, and mobile money in Kenya are examples of successful measures. New institutional approaches are also being explored and tested, with many countries – including Kenya, Brazil and the Philippines – pioneering policy and regulatory responses to market innovations that facilitate the delivery of financial services. New products, such as mobile wallets, pre-paid cards, biometric ATMs and kiosks which enable lower-cost access for rural communities are reaching more users worldwide.

Reforms to improve the legal and regulatory environment, governance and institutional infrastructure (coverage of credit bureaus, payment systems) have moved to the top of many developing countries' agendas. This will likely speed up the adoption of new and more attractive financial products and technology, which should help reduce transaction costs and other barriers to financial inclusion.

Measures to improve financial inclusion are ongoing. There is still much to do, but it is promising that emerging country reforms are starting to bear fruit and should enable them to move many steps closer to greater financial inclusion.



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Head, Economics Research

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