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PERSPECTIVES

ACCESS TO FINANCE – WHAT DOES IT MEAN AND HOW DO SAVINGS BANKS FOSTER ACCESS

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ACCESS TO FINANCE – WHAT DOES IT MEAN AND HOW DO SAVINGS BANKS FOSTER ACCESS

A study for the World Savings Banks Institute (WSBI)

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PREFACE

This paper draws together the results of two studies commissioned by the World Savings Banks Institute (WSBI) on Access to Finance. The original papers were *Access to Finance – a study for World Savings Banks Institute* (completed October 2004) and *Access to Finance – Measuring the Contribution of Savings Banks* (completed November 2005).

The paper comes up with a number of striking findings:

- There is far more of a platform for access across the developing and transition economies of the world than was thought to be the case even a year ago – some 1.4 billion accounts exist at institutions with an explicit mission to foster access.
- Savings banks are the largest suppliers of these accounts, supplying more than three quarters of the total. Moreover they are not just providers of deposit and payments services but also a significant source of small scale credits.
- Unfortunately the provision of these accessible accounts is not distributed evenly across developing and transition economies. Countries with repressed access, where less than one in five adults has an accessible account, outnumber those that are moving towards full access by a factor of three-to-one.
- It now seems increasingly clear that it is very difficult for a developing and transition economy to move towards full access unless it has a strong savings bank or other public-purpose bank with an explicit mandate to improve access. This is not to say that savings banking is a substitute for microfinance or indeed commercial retail banking but, rather, an important part of the spectrum of institutions needed to foster access.
- It is clear that savings banks are also important to maintaining access in advanced economies, where they remain close to regions and customer groups no longer seen as a priority for commercial banks and provide products accessible to the socially and economically excluded.

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None of the analysis would have been possible without the placing of research papers on the internet and particularly heavy use was made of CGAP, World Bank and European Commission web-sites. The authors would particularly like to thank Thorsten Beck, Asli Demirguc-Kunt and Stijn Claessens of World Bank for comments on the paper and for allowing us to quote from forthcoming papers. The analysis on the role of savings banks in providing accessible accounts would not have been possible without the groundbreaking study by Rich Rosenberg and his team at CGAP on double bottom-line institutions quoted extensively in the study.

Finally, we would like to thank Tini Chatterjee and Clare O'Brien of Oxford Policy Management for all their hard work in pulling together research material that underpins much of this study.

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FOREWORD

ACCESS TO FINANCE IS AN ESSENTIAL driver for economic growth in developing and transition economies. It is also important in developed economies, where it stimulates markedly the social inclusion of certain groups of the population. Access to finance empowers people, gives them the opportunity to have an account, to save and invest, to insure their homes or to take a loan and – in many cases – to break the chains of poverty.

That is why savings banks and socially committed retail banks have made access to finance one of the underlying principles of their business activities. Savings and socially committed retail banks are well positioned to succeed in enhancing this access on a global level; they are traditionally very close to their customers, thanks to their extensive regional branch networks and the provision of low threshold products and services.

The key role that savings banks play in providing access to finance is illustrated in a most striking way by one of the conclusions of this study: three quarters of an estimated 1.4 billion accessible (low average balance, low-cost) accounts across the developing and transition economies are managed by savings banks!

Thanks to their country-wide network and easy to access products and services, savings banks are able to capture an important part of the savings, bringing in this way considerable parts of the world population in the formal financial sector. Furthermore, savings banks recycle more than half of their deposits as credits, which means that they play an essential role in the field of consumer banking, micro financing and financial services to small and medium enterprises.

This study proves clearly that an economy increases its chances to achieve full access when a strong savings bank sector or another form of proximity banking is present. Regulators should take this into account and provide a level playing field for all financial players. Rules and regulations should be fine-tuned to serve not only the interests of global players but also those of regional players. Only a pluralistic retail banking market can serve all the interests of all the private customers and SMEs, including those of customers in remote areas and those of less sophisticated clients.

The World Savings Banks Institute (WSBI) who has commissioned this study is proud to present this thought-provoking and in many ways ground-breaking document. We hope the interested reader will gain a refreshing insight to the Access to Finance debate.

Chris De Noose
Chairman of the Management Committee, WSBI

1. EXECUTIVE SUMMARY

A. Purpose of the study and objectives

The purpose of this study is to give an overview of the importance of access to finance for all and to record the main obstacles to access in different parts of the world. It also attempts to create a coherent framework for analysing the available data on access and to link this through to indicators of wider economic development. Having surveyed the nature and dimensions of access (or lack of it), the study goes on to review public and banking sector initiatives to improve access to finance and then looks at the critical role of the savings bank movement – socially committed retail banks, like savings banks, postal savings banks and community banks – in the provision of financial services to all strata of the population in urban and more remote areas. Finally, a policy agenda is developed for both the financial institutions that must deliver access and the public sector that must create the right environment for doing so.

B. Conceptual framework – Access versus Exclusion

In assembling the study it proved useful to distinguish the literature, and even the language, that relates to low-income developing countries from that relating to advanced industrial economies such as those in the European Union, North America and on the Pacific Rim. This is because access to formal financial institutions is frequently the preserve of quite a small minority in low-income countries (and in the most repressed cases access will be measured in single percentage points of the wider population). By contrast it is rare not to have at least some access to basic financial services in major industrial societies. This has meant that the debate in the developed world has focused on how people can come to be excluded from access whether by active design or accident. Again, in most cases in advanced industrial economies exclusion will be measured in single percentage points of the population.

If readers want a simple proposition to fix the contrasts, they can note that the percentage rate of access in poorer developing economies is about equal to the percentage rate of exclusion in richer advanced industrial economies. For this reason the debate about access to finance in developing economies is just part of the much wider debate about access to basic needs from water, health, and education and through to roads, employment and communications. By contrast the debate about financial exclusion in advanced industrial economies is firmly lodged in wider debates about social exclusion and the welfare and criminal costs of people falling through the social fabric that sustains very high levels of economic development.

C. Access as an element in successful economic development

There is clear and well established evidence that bigger and deeper banking systems go hand in hand with more advanced economic development and that a vibrant microfinance sector can augment this but not substitute for it. This is hardly surprising. Economic theory highlights the importance of capital and trade to growth but also shows that the creation of productive capital is as much about its financing as its existence. This is borne out by the data analysis in Chapter 3, which indicates a strong correlation between access and per-capita GDP within regions and also across regions. Active trading is vital to productivity gains but trade cannot take place without a means of exchange. The purest purpose of money – in particular in a dematerialised form – is to serve as a more efficient means of exchange than do barter and counter-trade. The purpose of bank-based money as opposed to pure cash is two-fold. First, it is a better store of value. Second, it allows economies to gear up their working capital (savings) to form also a platform for long-term capital (investment) through the maturity transformation process that only banks can effectively make. Again, the data analysis bears this out, with lower cash-to-deposit ratios and higher deposit-to-GDP ratios associated with higher levels of per-capita GDP. Obviously money, and more particularly bank-based money, can only provide these advantages when the transaction costs of operating a bank account are below the inefficiency costs (and middle-man's margin) of managing barter and counter-trade. All this is particularly crucial in poorer developing countries, where evidence from the microfinance arena shows that availability of credit does increase economic activity but to become financially self-sustaining, this has to be augmented by small-scale savings mobilisation.

D. Ways of measuring access

Access, and its counterpart exclusion, are both surprisingly hard to measure. At the heart of this problem are three weaknesses in the way banking data are prepared: (a) data on numbers of people accessing personal financial services may often not even be known within banks and other institutions supplying the services, (b) regulators (until very recently) have not been interested in retail transaction volumes, concentrating instead on data relating to balance sheet stability and (c) identification of SME activity is very poor and even worse for micro-enterprises. A few surveys directly address the issue in advanced industrial economies and these show that *on average nine out of ten surveyed adults in advanced industrial economies have at least some sort of bank deposit or giro payments account*. Unfortunately there are only ten surveys of sufficient timeliness and compatibility for the whole of the developing and transition world. This then means that to get a view of levels access across the world requires looking at proxy indicators that have a good likelihood of tracking access even if they do not exactly measure it and this paper attempts to do that using two approaches:

- The first is to look at how much money there is in an economy and how this splits between cash and deposits. One can be fairly confident that access is repressed where the total deposit base of the banking system is less than 20% of GDP and cash in circulation ranges upwards from the equivalent of a third of total deposit balances. At the other extreme an economy is almost certainly approaching full access where deposit-to-GDP ratios are approaching 100% and cash in circulation is equivalent to well below 20% of total deposit balances (and more typically below 10%).
- The second approach – piloted by the Consultative Group to Assist the Poor (CGAP) – is to identify the number of accounts at accessible institutions specifically targeting their services at the mass market and penetrating beyond those customers typically served by commercial banks. These institutions – sometimes known as double bottom-line or alternative financial institutions – comprise community, co-operative, development and savings banks as well as credit unions, specialist microfinance institutions (MFIs) and commercial bank microcrediting schemes. The sort of people and businesses that use these institutions can then be described as the market for accessible finance. A critical measure of how well this market is supplied is the number of accessible accounts per adult in each country's population.

This indicator is calculated for almost 120 developing and transition economies and ranked to display the spectrum of experience in these countries. It would seem not unreasonable to suggest access is repressed where there is less than one account for every five adults as in such circumstances most families will not include someone with an account. By the time the number of accessible accounts per adult is above 0.5 then an economy is almost certainly approaching full access (albeit not necessarily there yet) because most households will probably include someone with an account.

Some 130 developing and transition economies can be addressed by at least one of these two approaches. *Overall, the analysis suggests there are some 1.4 billion accessible accounts across the developing and transition world – at least one accessible account for every 2½ adults, but this average is biased up by a few large countries with relatively high access. Three times more developing and transition economies display signs of repressed access than those that appear to be moving towards full access.*

E. Differences in access across countries and regions

Among the advanced industrial economies, the detailed survey data suggest that exclusion is a very small problem in the relatively urbanised, social market economies of Europe (the Scandinavian countries, France, Germany, the Netherlands plus Spain) where access runs upwards of 95% and the same is almost certainly true of Japan. In the middle are what might be called the transatlantic market economies of the UK and the US (and anecdotally probably also Australia). Running below the average are the more southerly EU states except Spain but plus Ireland, where access seems to be pulled down by relatively higher proportions of rural dwellers among the population and the greater regional income inequality that can result from this. This issue of geographic exclusion is not, however, exclusive to these countries. There is growing concern that mainstream commercial banks across the developed world are concentrating their physical reach and marketing priorities on more profitable customers, such that universal access is then only guaranteed by the continued presence of proximity banks in the less favoured areas.

Of the 130 developing and transition economies that can be addressed by at least one of the two approaches described in section D above, 26 countries appear to be approaching or clearly already have full access. Slightly more than this number (30 countries) are in an intermediate phase with less than half the adult population having an account but probably up to half of households having some sort of access. This leaves more than half the sample (74 countries) displaying signs of repressed access. Using this grading four fairly clear conclusions emerge:

- Sub-Saharan Africa is very far behind most other regions in expanding financial access. Much, but by no means all, of this is a reflection of the extremes of poverty seen there.
- Asia is generally very advanced in expanding financial access. This is particularly true in the more rapidly industrialising countries but also applies to Asia more generally.
- The more advanced transition economies of Central Europe have progressed extremely well in rebuilding access but most CIS countries lag behind.
- There has been relatively little progress made in Central and South America despite a relatively robust economic base, particularly among larger countries.

F. The main constraints in different countries and regions

Three main themes emerge from the literature survey on what constrains access. One borne out at least partially by the data analysis is the *absence of basic pre-requisites for monetised exchange*, namely proximity of a relevant bank and literacy. In advanced economies the issue of access to branches is sensitive but of an altogether lower magnitude than problems with access to branches for the rural poor in developing economies (where the nearest branch can be many kilometres away). Moreover questions of literacy in advanced economies relate to understanding the appropriateness of different financial services whereas in developing countries it is often a matter of being able to read or write at all. There seems some linkage between the balance of rural versus urban populations and assessed accessibility at least for parts of Africa and Central & Southern America. It seems probable that the agglomerative returns to the increased concentration of populations that fostered the industrial revolution and commercialisation of agriculture also drive the deepening of monetised exchange that is so critical to rising efficiency and overall economic development.

A second factor constraining access is also undoubtedly the *cost of banking services* although this is poorly documented. It is also subject to the strange paradox that the poor who are excluded from effective use of basic banking products often end up paying more to achieve the same economic ends as those apparently unaffordable banking services from which they are excluded. Finally, the *legal and organisational foundations (civil codes, transparent licensing arrangements, etc) for most economic activity* outside a handful of advanced economies (under thirty out of 200+ according to some estimates) are just not in place. Increasingly the pragmatic approach needed to deal with clients operating at the margin of formal economies is coming up against regulatory pressures to conform to international best practice on bank supervision and money laundering.

G. Public mechanisms for stimulating access to finance

Three main themes emerge from the literature survey.

- The first is that trying to mandate access works only to a limited degree although regulatory pressure may help keep the issue on the banking industry agenda. For this to work, however, it is important that the cost of regulation does not force up the cost of intermediation, which is one of the main identified barriers to access.
- However, the conclusion that governments cannot mandate access is not the same as saying that they cannot stimulate access by at least paying wages and welfare benefits and salaries through bank accounts. It seems that one of the biggest contributory factors for self-exclusion is making such payments as cash or through any form of bearer money-order.
- The third relates to the need to refine institutional arrangements to try and target finance to excluded groups – traditionally this has taken the form of special lending schemes or institutions for enterprise and the development of basic banking services through other channels such as post offices.

An additional theme, which will initially increase self-exclusion but should ultimately improve access, is *pressure for increased transparency on the costs of banking services*. As already noted one of the paradoxes of exclusion is that the poor often end up paying more for financial services that they ostensibly cannot afford to purchase from mainstream banks. This links through to another topic that has not yet been fully developed within this study, namely the need to *build financial literacy* and educate potential customers on how to use banks effectively.

H. Banking initiatives to maintain and improve access to finance

In the **advanced industrial economies** most banking sector responses outside the savings bank sector (discussed separately in section I) to problems of household access appear to have been reactive to public policy rather than pro-active. In the literature on access this is seen as a feature of the pressures of globalisation and banks' desires to sustain shareholder returns in an environment of disinflation, intensifying competition and declining margins – with banks doing the minimum to allay public policy concerns about growing exclusion while pursuing rationalisation of branch networks, marketing priorities and product cross-subsidies. By contrast, interest in schemes to improve access to credit for small and medium enterprises is strongly established and probably becoming stronger as the attractiveness of subsidised funding becomes more apparent against a background of falling margins on more general intermediation of retail savings.

Similar tensions are apparent in **developing countries** where many mainstream commercial banks have reduced branch networks and focused on the most profitable areas of their business. There are, however, many examples of banks that have set up successful microfinance units under the umbrella of, but clearly distinct from, their mainstream banking operations. This allows these microfinance operations to benefit from the infrastructure and control systems of a properly regulated banking environment but still adapt themselves to the reality of dealing with small-scale clients. Typically they focus on microcredit but this has often brought with it growing volumes of small-scale savings and transaction business. There is also some evidence that non-bank microcredit schemes can transform themselves to more fully-fledged bank-based microfinance.

I. What more needs to be done by the private and public sector

The evidence from the study and this brief summary clearly shows that access and exclusion are not issues that the banking sector can tackle alone. Again, conclusions are different for poorer developing countries and advanced industrial economies but a number of common themes emerge:

- Access is a serious issue and it needs to be measured far more carefully and consistently than at present.
  Efforts are underway to improve population and enterprise survey data but such surveys are expensive and can, as a result, often only be done at widely spaced intervals. Mechanisms for collecting supplier data on the number of deposits taken, loans made and transactions processed also need improving as this can be done on a more frequent basis than market surveys.
- Because cost is a critical barrier to access, it needs to be addressed better in terms of both the transparency of costs to customers and how supervisors view banking system soundness.
- Addressing the issue of literacy – whether financial literacy problems that lead to exclusion from developed banking services or more fundamental literacy problems that impede access to even the most basic services – is not an issue for banks alone.
- There also has to be a frank understanding that in advanced industrial economies the direct financial benefits to banks of reaching the last 10% of potential customers are limited. Governments probably have more at stake in bringing these people into the banking system than banks do and regulation needs to reflect the pragmatic realities of dealing with these marginal segments of the market. Official attitudes to social banking need to be adjusted accordingly.
- Exactly the same pragmatic realities apply regarding outreach to the rural poor in much less developed economies – this will not work if such activities are subject to ill-considered regulation that raises the cost of rural branch networks and bank-based microfinance.

J. The role of the savings bank movement in developing access

Some of the most active responses to both public policy initiatives to improve access and the more general problem of maintaining and improving access come from savings banks and other socially committed retail banks across the world. For many of them a commitment to universal community access is written either into their founding social (and sometimes legal) mandate or their mission statements as private community banks. As a result, it is not really surprising that *savings banks and other socially committed retail banks are by far the largest identified suppliers of accessible accounts across the developing and transition world – accounting for some three-quarters of all such accounts*. Even in advanced economies, these banks are often the only mainstream banking operations left in areas of geographic exclusion and are active in tackling the issue of financial illiteracy.

This study now makes a strong case that for developing and transition economies to move towards full access needs a strong savings bank or other proximity bank presence. Furthermore, this study suggests microfinance is more of a complement to proximity banking rather than a substitute. In addition, a high degree of social ownership in more advanced industrial economies often goes hand in hand with heightened levels of access for both households and small and medium enterprises.

It is misleading to think of all savings banks as savings-only institutions – across the developing world non-postal savings banks recycle half their deposits as credits. Moreover, average loan sizes for the entire loan portfolios of savings banks in South America and Central Europe are similar to average loan sizes at specialist microcredit schemes. It is also misleading to think of all savings banks as only dealing with consumers – across the world the dividing line between personal and microenterprise finance is always blurred. In any case, many savings banks are particularly active in the field of microfinance in developing countries and also have a strong historic presence in the market for financial services for small and medium enterprises in advanced industrial economies.

A common theme across both advanced industrial and developing economies is the negative impact on access coming from tensions between economic development agendas aimed at fostering enterprise and reducing poverty, and financial policy agendas aimed at standardising regulation and increasing market-based competition across the world. There is a paradox here. Non-market mechanisms (particularly internal cross-subsidisation) often allow savings and other proximity banks to remain in communities abandoned by mainstream commercial banks. But these same mechanisms are under pressure from competition policies that take little account of the fact these banks did not choose to become the prevailing and sometimes only supplier outside major money centres. This is an area that needs both more work and attention by policy-makers.

K. Conclusions

- Access is an important issue but it has to be understood differently from the related issue of exclusion, as the solutions are different.
- The savings bank movement has an instinctive sympathy for improving access and this study shows how important the movement is to sustaining what access there already is.
- At newly identified levels of supply, savings banks account for three quarters of the 1.4 billion accessible accounts provided across developing and transition economies.
- Moreover an economy is very unlikely to be approaching full access unless it has a strong savings bank movement or other proximity banking presence.
- Regulators need to recognise that the governments they serve may have more at stake in improving access than commercially run banks. Regulation should be fine-tuned accordingly.
- As always the performance of banking systems cannot be understood in isolation from the system of political economy within which they operate. Governments are likely to do more to improve access by improving the foundations of civil society than by trying to mandate access and interfere with product design.

2. THE NATURE OF ACCESS: AN OVERVIEW OF THE LITERATURE

Part One: Introduction and the Role of Finance

A. Introduction

In assembling this review it has proved useful to distinguish the literature, and even the language, that relates to low-income developing countries from that relating to advanced industrial economies such as the European Union, the USA and Japan. This is because access to formal financial institutions is frequently the preserve of a quite small minority in low-income countries. By contrast it is quite unusual not to have some access if you live in a major industrial society.

For example, in Kenya which has one of the better financial systems in Africa, only around 3 million (10%) of its 30 million people have some sort of relationship with banks and other financial institutions (KIPPRA [2001]). Even in Mexico – a much more urbanised and higher income developing country – only 20% of the urban population (and a much lower proportion of the rural population) have access to bank accounts (Solo [2001]). In the advanced industrial economies, by contrast, the corresponding rates of access are typically above 80% and in Germany and in the Scandinavian countries this rises to 98-99% (Pesaresi and Pilley [2003]).

If readers want a simple proposition to fix the contrasts, they can note that the percentage rate of access in poorer economies is typically about equal to the percentage rate of exclusion in those richer countries where lack of access is seen as a problem.

Because of these huge numerical differences the debate about access to financial services tends to be located in different spheres of analysis in the two types of countries. In richer countries such as the UK, France and the USA, with a developed literature on "financial exclusion", the topic has strong links with the broader debate about "social exclusion" more generally.

This is for very good reasons. Many of the same factors that cause certain people to get excluded from access to jobs, housing, good schools etc. also help explain their poor access to financial services (HM Treasury [1999]). Equally, the policy and institutional recommendations needed to enhance financial access involve relatively broad-based steps to improve the circumstances of the "excluded" in general terms. Increasingly they have begun to include explicit government policies to extend banking services to the previously "unbanked" sections of society (Pesaresi and Pilley [2003]).

By contrast, the issue of financial access in low-income countries is an integral part of the debate about how to address widespread poverty. It gets bracketed with issues of access to basic needs such as clean water and minimal education and above all with the steps needed to improve the labour and other incomes associated with productive activity in large parts of the economy as a whole (World Bank [2000]).

The dichotomy as between "rich" and "poor" countries is obviously not a rigid one. Many low-income countries of a generation ago have made remarkable economic progress and now share many of the features of the industrialised countries (South Korea, Singapore, Malaysia are good examples). Some of these countries are benefiting at an incredibly fast rate from the new banking possibilities created by electronic technologies (see Claessens [2003]). However, the distinction does help to achieve some structure in an otherwise bewildering diversity of literature.

B. Does finance matter and if so why?

An increasing amount of cross-country empirical research has been conducted in the past 10 years on this question. This research builds on the encyclopaedic assembly of data by the pioneer of this topic, Raymond Goldsmith (e.g. Goldsmith [1969]). That research is directly relevant to the topic of access because the question in the title is normally phrased in terms of whether a bigger financial system, that provides greater volumes of credit and mobilises larger volumes of deposits, is a positive influence on economic development. As always in such studies, the task of distinguishing cause and effect is complex but this has been made increasingly possible through the use of improved econometric and statistical techniques.

However, no one disputes the point that there are many non-financial developments that together help to cause financial development to occur: i.e. that invert the cause-effect relationship. These include: technological improvements such as automatic teller machines and electronic banking that lower the costs of various financial transactions (Merton [1992] and Claessens [2003]); monetary and fiscal policies that affect the degree of implicit and explicit taxation of finance (McKinnon [1973], Roubini and Sala-i-Martin [1995]; legal changes that impact the attractiveness of certain financial instruments (Laporta et al. [1996]); and above all economic growth and rising living standards that alter the ability and willingness of people to participate in the financial system (Greenwood and Jovanovic [1990]).

But these propositions notwithstanding, there is increasing evidence that an efficient, broad-based financial system provides a powerful impetus for economic growth. In modern times Sir John Hicks [1969] has articulated this forcefully. He illustrated his point by referring to the key role of the financial system in helping to mobilise huge volumes of capital for "immense works" during Britain's industrial revolution. Much earlier, Joseph Schumpeter [1912] had contended that well-functioning banks can spur technological innovation by moving funds to those entrepreneurs best able to undertake innovative processes and develop new products. The more recent research supports these basic ideas with an increasingly sophisticated set of econometric studies.

1. The theory

Before getting into these, let us explore the theoretical basis of the causative link from financial system development to economic growth. At the purest level, money and other financial instruments only exist because of the need to deal with the transactions costs and problems of information found in all real world economic systems. A barter economy would be perfectly efficient if we could all conduct in-kind trades at zero transaction costs and if everyone with whom we were likely to deal was reliable beyond a shadow of doubt. It is the failure of these two "ifs" that render money and other financial devices necessary (Goodhart [1975]). Extending the logic we can say that a sophisticated financial system is one that has found ways to deal with a wide range of different transaction costs and informational problems that would otherwise prevent desirable production and trading activities from taking place. Sophisticated "derivative" instruments (e.g. options, swaps, caps) are increasingly enabling economic agents to deal with the inherent uncertainties about future events.

More generally, by reducing transaction costs and mitigating informational problems, financial systems provide three main contributions to faster economic growth.

First they contribute to a more efficient allocation of resources, across both time and space and in an uncertain environment (Merton and Brodie [1995]). In the absence of an intermediation system (or when it is disabled by poor policies such as those of financial repression) savers largely need to invest their surplus funds in their own projects or in those of immediate relatives, friends and neighbours who they can trust (Galbis [1977]). The huge gaps, in time and space, that we observe in today's modern financial systems between savings and investment decisions, enables savers a far greater choice and ensures that the available stock of the world's capital is used in projects with the best possible returns.

At least this is a piece of base-line theory that serves us fairly well when we confine discussion to domestic financial systems. It is subject to greater challenge when applied to global movements of funds and to topics such as whether liberal capital accounts are desirable, especially for low-income economies. A useful synthesis of the main reservations about liberal international capital can be found in Eichengreen and Mussa [1998] and more recently in Prasad, Rogoff and Kose [2003]. A more polemical discussion is in Stiglitz [2002]. The critical core of these newer arguments depends on the informational failures that plague transactions between distant countries and the inability, thus far, for reliable financial instruments to emerge to mitigate such failures.

When we explore the issue of access in the domestic setting, we find that informational problems, and the absence of instruments to address these, can also explain quite a lot of the residual difficulties. An example would be the difficulty of minority ethnic groups gaining the same access to banking services as those enjoyed by a native Englishman, Frenchman or German (example, Kempson and Whyley [2000]).

Second, the allocative function of finance only works – domestically or internationally – if the financial system can successfully fulfil its second main function. This is the function of mobilising savings. Assuming that the allocation mechanisms are working tolerably well, then the more effective a system is in mobilising savings, the higher will be the economy-wide rate of return on new investments and the faster the economy's rate of growth. Financial systems where the mobilisation function is weak will make less contribution to growth irrespective of the quality of the component institutions.

This is one reason why weak access to finance is a problem for broad-based development. If few people save through banks, then there is no raw material for even a good banking system to intermediate. Equally the costs of banking are likely to be raised because of the absence of economies of scale.

Weaknesses in the mobilisation function of a financial system are very common in low-income countries. In some such cases, international aid donors have tried to compensate by providing funding for Development Finance Companies (DFCs) or Microfinance Institutions (MFIs) for a short period of years. But when the donor funding ends, the absence of a serious mobilisation role for the institutions concerned will threaten their ability to survive (Fernando [2003] and Section J below).

The third key function of finance that explains its positive contribution to growth is that of risk mitigation. Risks in production and trade are ubiquitous and are typically compounded when production and trade crosses international boundaries. Categories of risk include credit risk, commercial risk, foreign exchange risk, political risk, and liquidity risk. By helping agents engaged in production and trade to hedge some of these risks, a financial system increases the volume of production and trade that is successful and profitable. Economic growth is thereby enhanced. A particularly important example of this as far as banks are concerned is what Levine [1996] refers to as "liquidity risk". This arises because many high return investment projects require that capital be tied up for long periods of time. However, many savers are willing to commit their funds to banks for only a short period of time. But a well run commercial or savings bank can effect a maturity transformation (i.e. can borrow at short maturities and lend at much longer maturities). Hence in providing the services of deposit mobilisation and allocation, a well run bank will also mitigate the liquidity risks that would otherwise discourage savers from lending to help finance long-term investments.

A similar growth-enhancing service is inherent in capital market instruments of various types and also in the intermediaries such as life insurance companies and mutual trusts that package these instruments in order to attract more savers. As the capital market instruments involved in providing this type of risk mitigation become increasingly accepted, they can set up an important competitive challenge to banks who are the traditional providers of such a service.

One final word on risk mitigation and the important contribution of the financial sector to economic growth. Economic historians have increasingly argued that technological changes such as those seen in Western Europe in the 17th and 18th century were merely the necessary conditions for accelerated economic growth. The further development that enabled this new technological potential to be realised was the financial revolution that enabled the liquid savings of thousands of people to be used for the huge but illiquid new investments in long-term projects that the industrial revolution required. Friendly Society and Savings Bank movements were a major part of this financial revolution.

2. The modern evidence

Goldsmith started the modern tradition of data-intensive enquiry on this topic with a study of 35 countries (Goldsmith [1969]). This was readily criticised by Goldsmith himself and his successors on the grounds that his result made it hard to sort out cause and effect. Did finance cause growth or was it the other way round? A similar comment applied to the extremely well-known study by McKinnon [1973]. This studied the relationship between the financial system and development in a small group of mostly middle-income developing countries, and concluded that better financial systems definitely supported faster economic growth.

King and Levine [1993] attempted to deal more rigorously with the problem of cause and effect in an 80-country study (covering the years 1960-1989) that systematically controlled for other (i.e. non financial sector) causes of economic growth. They also used a more sophisticated set of four measures of "financial development". In relation to all of these they found substantial differences between countries with different levels of income per capita. In relation to their first measure (a measure of financial depth[1]), for example they found that citizens of the richest quartile of countries held on average two thirds of a year's income in formal financial intermediaries whereas their counterparts in the poorest quartile of countries held only a quarter of their year's (much lower) income in the form of liquid financial assets. More importantly they found a strong positive influence from their four financial indicators on three indicators of economic growth[2].

1 Specifically, currency plus demand and interest bearing liabilities of banks and NBFIs.

2 Long run real per capita growth, capital accumulation and productivity growth.

The explanatory financial variables were not only statistically significant but also suggested a magnitude of effect (from finance to growth) of some importance. For example, a rise in financial depth from the mean of the slowest growing quartile of countries to that of the fastest growing quartile could by itself eliminate 20% of the differences in their growth rates (i.e. one percentage point of the five percentage point differences in growth rates seen over the 30-year period of the data).

Later studies such as that by Levine and Zervos [1998] and Beck, Levine and Loayza [2001] have elaborated the basic methodology of King and Levine by refining the methodology for dealing with simultaneity; by making use of better quality data on private savings across countries (due to Loayza, Lopez, Schmidt-Hebbel and Serven [1998]); and by invoking improved measures of banking depth. The latter paper relates mainly to some 63 countries with data covering the period 1960-1995. The authors found that higher levels of banking development produced faster rates of economic growth and higher total factor productivity growth in the sample countries. These results were also robust to marginal changes in the measures of banking sector development. However, their results also suggest that the allocative effects of finance may be more important than the quantitative effects working through higher savings rates and higher levels of investment.

Research at World Bank (Beck, Demirguc-Kunt and Martinez Peria [2005]) is now beginning to look directly at the link between economic development and indicators of access (branches/ATMs/deposits/loans per head of population and average deposit/loan balances relative to per-capita GDP). They also look at links between access and enterprise perceptions of their financing constraint. Provisional results – based on surveys of regulatory data in 99 countries but not all of which supplied a full data set – indicate "greater outreach is correlated with standard measures of financial development, as well as with economic activity". This therefore suggests that broadening the client base of a banking system not surprisingly helps deepen it and therefore helps growth. Within this effect, better communication and transport infrastructure, and better governance are also associated with greater outreach, whereas government ownership of financial institutions translates into lower access, but more concentrated banking systems are not associated with poorer outreach. Finally, firms in countries with higher branch and ATM penetration and higher use of loan services report lower financing obstacles, thus linking banking sector outreach to the alleviation of firms' financing constraints.

The conclusion on the impact of government ownership cuts across the results of this study, which finds that savings banks – many of them publicly-owned – supply the vast bulk of accessible accounts to be found in developing and transition economies. The different conclusions may well reflect differences in country and institutional coverage. Almost half the savings banks in the countries for which Beck et al have data are almost certainly excluded because they lie outside the regulated deposit-money banking system. More importantly 70% of all developing and transition economy savings banks – accounting for half of all accessible accounts across the developing and transition economy world – are in countries not captured by their database.

Part Two: Exclusion in Richer Countries

C. The scale of individual financial exclusion in richer countries

As already noted, financial access in the advanced industrial economies tends to average around 90%, with a variation of around 10 percentage points either side of this average. At the top end of the spectrum are the relatively urbanised, social market economies of Europe (the Scandinavian countries, France, Germany and the Netherlands plus Spain) where access runs upwards of 90%. The same is almost certainly true of Japan but no direct data have yet been found for that country. In all these countries a strong infrastructure for financial access built about a well-defined savings bank movement has long existed. In the middle are what might be called the transatlantic market economies of the UK and US (and anecdotally probably also Australia[3] although again no firm estimates have been found yet). Running below the average are the more southerly EU states apart from Spain but additionally also Ireland, where access seems to be pulled down by relatively higher proportions of rural dwellers among the population and the greater regional income inequality that can result from this (particularly in the case of Italy - Pesaresi and Pilley [2003]).

3 A study of the issues involved in financial exclusion in Australia by Connolly and Hajaj [2001] provides no national evidence but does include case study evidence of exclusion rates of around 10% in deprived urban areas plus un-quantified but not-insignificant rural exclusion.

The table below provides more detail of differences in the current level of individual access between countries.

Table 1: Availability of a personal current account, giro account or similar

Country	% of Population	Country	% of Population
Denmark	99.1	Spain	91.6
Netherlands	98.9	US	91.0
Sweden	98.0	UK	87.7
Finland	96.7	Portugal	81.6
Germany	96.5	Austria	81.4
France	96.3	Ireland	79.6
Luxembourg	94.1	Greece	78.9
Belgium	92.7	Italy	70.4
		EU 15 average	**89.6**

Source: Reproduced from Pesaresi and Pilley [2003] with US added (taken from Caskey [2002])

There is, however, evidence, in Germany and some other higher access countries in the EU, of the retreat of banks from certain regions – especially rural and under-populated regions and urban areas with economic difficulties. This spreads the “geographic exclusion” seen in less urbanised southerly European states. It points to a basic regional variation in access across regions of the same country with gaps that may be widening in some cases. The continued existence of banks with a social mandate such as the savings and cooperative banks in Germany serves for the time being to mitigate the effects of this on access. However, such mitigation is assured neither in the long-term nor in general as the tendency for more consolidation of banks and pressures to work on a pan-European scale both intensify. The same issues are identified in Connolly and Hajaj [2001] as applying in Australia, with mainstream banks moving out of poorer urban areas thereby triggering the withdrawal of other economic agents. They also highlight a trend for withdrawal out of the remote rural communities leaving some 600 of these without any day-to-day access to banking services. In contrast to Germany there is no bedrock of socially mandated banks in Australia to take up the slack left by the departure of the mainstream banks and attempts to create a new alternative – so called Rural Transaction Centres – have been very disappointing.

A final and more subtle aspect of the emerging tendencies as regards access relates to Financial Literacy. As we have seen above, problems of literal access to finance in most rich industrial economies are on a relatively limited scale. However, regulatory authorities in both the UK and the US plus various social research institutions in Germany and France have drawn attention to a widening gap between the abundance of ever more diversified and sophisticated financial services on the one hand, and the intellectual capacity of the mass market to fully understand and make good use of these. Financial illiteracy can certainly lead to the self-exclusion of some people from access to some products. In other cases it can result in consumers making wrong and irrational decisions about their choice of products and in their greater exposure to increased risks of fraud and theft.

Box 1: Financial literacy and the impact on access

Government agencies as well as private NGOs in industrial richer countries are engaged in a plethora of initiatives to boost the financial literacy, and end the self-exclusion of especially their younger and more vulnerable populations.

The Financial Services Authority (FSA) in the UK typifies the reasons for this by stating: "Consumer education is a key part of consumer protection, and we aim to help consumers make informed choices and manage their finances better. Consumer education should also lead to more competition in financial services markets by increasing consumer pressure. This should in turn encourage innovation, better quality and better value for money."

A study of financial literacy in Australia was a major recommendation of the recent Australian Stocktake of Consumer Education in Financial Services undertaken for the Australian Securities and Investments Commission, which already lists "improving financial literacy for adults" as one of its priorities.

The situation in the USA provides probably the most complete example of the potential content and scope of financial education and literacy programmes.

Here are just a few examples from many dozen that currently operate:

- The National Endowment for Financial Education (NEFE) is a foundation dedicated to helping all Americans acquire the information and gain the skills necessary to take control of their personal finances. NEFE accomplishes its mission primarily by partnering with other concerned organizations to provide financial education particularly to under-served individuals whose financial education needs are not being addressed by others.
- The National Center on Poverty Law has developed a Financial Links for Low Income People initiative that offers financial literacy classes and helps participants set up savings accounts at participating financial institutions. Those who complete the classes and make deposits every month are eligible for matching money.
- Asset Builders of America is a non-profit organization, sponsored by a group of banks in Wisconsin that promotes financial literacy for people of all ages. It provides day-long seminars and weekly sessions for middle school and high school students, as well as adult learning seminars that cover basic to more advanced financial topics.

Because, however, these are disconnected initiatives with varying forms of mission statement, it is extremely hard to evaluate their overall success in improving access. But it seems certain at least in the case of the US that their effect is non trivial.

Chapter 5 also describes various initiatives by European savings banks to address this critical issue.

D. Causes of improving access

Recent in-depth studies suggest a strongly rising long-term trend for the proportion of the populations of richer countries having at least a current banking account of some description. In the UK, for example, only 45% of adults had a current bank account in 1975 but by 1998 this figure had risen to between 80-85%. In the USA, the rise continued through the 1990s from some 80-88% of the population in 1994 to 91% by 1998. This trend is repeated across EU countries where the proportion of the population with a bank account has also risen in line with increases in welfare levels.

The first and most important set of factors explaining improved access over these longer periods have been the sustained rises in incomes and living standards in most industrial countries in the past 25 years, combined with the growing tendency for more women to work and thereby have their own incomes and savings potential. This general rise in prosperity has been re-enforced in many industrial countries by fiscal reforms that have seen a smaller tax-take from personal incomes at least in the form of direct taxes.

This general tendency also connects with the evidence from US, UK and other European survey research that shows important links between savings, income levels and personal/family circumstances. Amongst very low-income households in the UK (less that £150 per week) 60% were without savings at all as compared to around 30% in the population as a whole (Kempson [1998]). Low levels of disposable income are also found to be strongly linked with being a non-saver (McKay [1992]) and with low level of financial wealth (Rowington [1999]). In the US, survey findings also show that the un-banked are disproportionately represented in the lower-income households (Caskey [2002]). Similarly, family circumstance and especially employment status seem to be critical determining factors: the unemployed and those not working for reasons of illness or disability are very low savers. Kempson [1998] noted this and also the effects on savings associated with social class. Those in UK social classes C1/C2 (mass-middle), D (lower-end employed) and E (welfare dependent) are particularly low savers. However, this needs to be put in context with the high degree of mobility found today in both the US and the UK. Specifically, there is significant income mobility in both societies and the people in the poorest tenth of the population in one year may not necessarily occupy the same lowest incomes cohort in the next year.

The conclusions to this point are those that one would expect. Access to financial services is linked to the ability to save and this in turn rises in line with disposable incomes and with access to employment. High levels of income inequality have also been argued to be important. (Pesaresi and Pilley [2003])

Second, there is an important set of explanations that relate to the increasing de-regulation of financial services (in most industrial countries) and the associated increase in competition between providers. Leyshon and Thrift [1993] have traced this general development to the global level and especially to the impact of the international debt crisis that began in 1982. This they claimed caused many banks and some non-bank financial intermediaries (NBFIs) to withdraw at least temporarily from their international markets and seek new national markets in their place. But there were also specific local and domestic factors that accentuated this increased competition in the domestic financial markets.

For example, and especially in the USA, the strong acceleration of competition in banking from the late 1980s was part of the so-called "disintermediation" process. New technologies combined with changes in the patterns of savings behaviour made it increasingly possible for various NBFIs to offer competing products, especially to larger corporate borrowers. We refer to the rapid growth of the bond and derivatives markets and to savers' increasing propensity to prefer illiquid capital market instruments offered by pension funds and other parties to traditional liquid investment outlets (see Warburton [1999] for an account and critique of these trends). Disintermediation put pressure on bank profits at the same time as the banks' cost advantages in mobilising funds (liabilities) were being squeezed by competition. This provoked both an increasing search for cost economies of scale and scope and efforts to package banking services in more standardised and lower-cost packages (sometimes referred to as "commoditisation"). Similar tendencies are evident in the European countries with strong NBFI sectors.

In the UK, the de-regulation of financial services from the 1980s onwards broke down traditional barriers between sectors of the market (as in the US) and also removed barriers to entry. This led to what has been termed the "financial supermarket" model of provision of which Richard Branson's Virgin group is the most well-known proponent (see Lynch and Haidar [1998]).

Both savers and borrowers benefited from this surge of increased competition because it necessitated old and new financial organisations embarking on an ever more intense search for new customers. As Leyson and Thrift [1995] put it for the UK, "More people than ever before were drawn to the financial services system …. Nowhere was off-limits ….. the system began to reach into nooks and crannies of the British social fabric which it had previously shunned."

However, Pesaresi and Pilley [2003] from the EU Directorate of Competition give one convincing argument running in the opposite direction. They point out that in the past in Europe, 80% of current accounts used to be loss-making but were financed by the remaining 20% that were profitable thanks to large average balances. This cross-subsidisation has ceased to be possible now that banking has become much more aggressively competitive. Other dimensions of increasing cost pressure on banks are illustrated in a major recent review of E-banking by Claessens, Glaessner and Kingebiel [2003]. They produced estimates for 34 countries of the impact of the new technologies on bank interest margins from 1997 through 2010. Attention is drawn to the very large reductions that seem likely to be provoked by the greater competition and lower costs associated with E-technologies. This is especially true in some of the emerging market economies such as Brazil and Turkey where interest margins today are extremely high at least by EU standards.

Increased competition among banks has also been seen in other regions of the world. For example, in a 10-country study of bank consolidation in Eastern Europe and the Former Soviet Union by the authors, it was found that the growth of provision of credit and other services to the SME sector was much faster in those countries where more genuine competition in banking had been established (Roe, Peachey et al. [2003]). Poland was a leading example and contrasted sharply with Russia where banking competition remains weak. In Poland, where SME activity has grown from 30% of GDP in 1995 to 55% in 2001, the banks now provide 52.6% of their corporate lending to the SME sector and attract almost 50% of their corporate deposits from that source. Estonia is another country with very effective competition in banking where SME activity is high and bank loans to SMEs represent a large portion of banking business.

Third and an important cause of the enhanced competition is the greater internationalisation of the provision of financial services. This is particularly important in the area of the European Union where the Financial Services directives make it increasingly difficult for nation states to maintain serious barriers either to new entry from fellow EU countries or to increased competition in financial services more generally.

E. Characteristics of excluded individuals

In most of the advanced relatively urbanised social market economies described above, exclusion is not a problem and there is, as a result, apparently[4] no substantive literature on the subject. The emerging literature in France (and indeed the policy responses – see Chapters 4 and 5) has largely focused on the limitations placed by poor access on the creation of self-employment opportunities rather than the underlying process of individual exclusion itself. This is now changing with the work of Gloukoviezoff [2004] addressing reasons for individual exclusion and at least as importantly self-exclusion. There is also some limited press comment in Spain.

The most substantial literature on individual exclusion relates to the UK and USA, in some ways reflecting their positioning as outliers in the taxonomy developed above – both are highly industrialised and urbanised economies but with lower levels of access than would be typical of such economies.

In the UK, the Financial Services Authority [2003] used a variety of survey evidence to develop the following propositions:

- Non-account holding (i.e. people without current accounts with banks or building societies) is concentrated among people with low incomes or those on income support. Depending on the type of survey, this figure is estimated at between 6% and 9% of the population. In part the link between the non-banked and welfare dependence is a function of how the British system pays welfare benefits (although this is now changing). The German system of payment through banks, for example, results in far less exclusion from banking for those who are dependent on welfare.
- Women are less likely to hold accounts in their own name, although this can be explained by lower incomes and personal circumstances, as opposed to gender alone. Account holding amongst people of Pakistani and Bangladeshi origin in the UK is disproportionately low, and women in this population group are particularly poorly represented. Account holding is lowest amongst people under 20 years and over 80 years.

4 The basis for this statement is the lack of any cross-referencing in academic papers of major bodies of work on individual exclusion outside that undertaken in the English-speaking industrial economies. That no references should appear in either this literature or even recent French-language literature suggests this is not just a problem of the linguistic capacity of the researchers involved.

The reasons for not having a bank or building society account are varied. There are two basic types of people who do not have an account: those who have disengaged from banking, and those who have never had a bank account. Amongst the latter group the reasons for not having a bank account include never having needed one and instead only using a savings account; women relying on their husbands accounts; women who become single mothers at a very young age and younger people who are yet to open an account. Barriers posed by language, culture, levels of knowledge and religion are an important issue that may prevent people from opening accounts. A small minority do not open accounts due to their inability to provide (increasingly demanding) proofs of identity or address or due to their not being judged sufficiently credit worthy for a conventional current account. Lack of geographical access to a bank branch is also a factor that several studies have cited as a factor and this is probably the most significant new dimension of the problem. Reduced over-the-counter access (caused by bank and post-office branch closures) has been a major factor bringing the exclusion debate to the fore in Sweden, Belgium, France and Germany as well as in the UK (Pesaresi and Pilley [2003]).

The volume of non-use of savings products in banks or building societies is rather higher. The reasons for exclusion in this case are usually based on self-exclusion, rather than direct exclusion by providers. People may be deterred by the fairly high minimum amounts required to open some savings accounts. A lack of knowledge about savings products is also influential as a deterrent. Closures of bank and building society branches are making it more difficult and inconvenient for people to gain physical access to a formal method of saving if they are averse to electronic technologies. The issue of affordability plays the biggest influential factor because the amounts that people can afford to save seem to determine whether savings are made formally or informally. The difficulty that some migrant communities have encountered in trying to access formal savings products on arrival in Britain is also a factor that may have encouraged the establishment of their own informal savings and loans organisations. As regards the access to credit, recent years have seen a particularly rapid growth in the range of consumer credit products available in the UK. In addition the intense competition for credit products has meant that credit is available to a relatively wide customer base. This rapid increase has meant that the use of credit is now the norm rather than an exception. The majority of households have access to major credit facilities such as credit and store cards, unsecured personal loans or hire purchase agreements (Office of Fair Trading). Only 33% of UK households use no mainstream credit facilities.

Measuring the number of people excluded from credit facilities is difficult given that not everyone without credit either needs or wants it – 29% of those without any form of credit said that this was due to an opposition to borrowing. People unable to access mainstream credit facilities fall into two main groups: people with poor credit records or a history of bad debt who will turn to "non-status" lenders to fulfil their credit needs; and people living on low incomes who may have to look beyond mainstream credit provision altogether. Often examining the number of moneylenders and pawn-breakers in an area is sufficient to understand the extent of exclusion from mainstream credit facilities.

Non-status lending markets comprise financial institutions that cater specifically to people for whom mainstream lending would be suitable but who have an insufficient credit rating to access them. They operate in similar ways but provide credit at a much higher (even usurious) cost to cover the risks associated with their customer base. Other institutions can specifically target the vulnerable group and encourage them to take out loans they are unable to repay.

Box 2: How the vulnerable acquire credit in the UK

The Guardian newspaper correspondent Polly Toynbee spent several months living as a penniless single mother in one of the worse council house areas in London. This is how she went about buying a bed for her welfare-provided apartment.

"I found the store on the ground floor of the Elephant and Castle shopping centre. Amid all the shabbiness, Crazy George's emporium stood out as a gleaming beacon filled with brand new furniture and electrical goods all bathed in glittering light. On the counter are the Crazy George's catalogues with this message: 'Discover Affordable Shopping Made easy!' Inside it promises, 'All our products are available with NO DEPOSIT AND NO CREDIT CHECKS. All the prices are quoted at the per-week hire-purchase price in bold letters. The total price in cash is in small letters underneath, because people don't come here to pay cash. The cheapest double bed they offered was a basic metal-barred number. It cost £4.99 per week for 156 weeks – three years. I was not convinced it would last that long.

Even smaller print said 'Mattress available separately', with no mention of what the mattress cost extra. Further small print said the bed cost an astounding £432.38 cash, without mattress. … But I could see why it was tempting to shop this way. However much better it would be for me to buy the bed from the remnant of my social fund, I just did not have that much money and could not borrow it from anywhere else. I could see how easy it was to persuade myself that a mere £4.99 per week was affordable, in my circumstances…

… At the back of the catalogue there is a list of places with Crazy George branches, ninety-five of them in all, with more to open soon. The list reads like a roll call of the country's most deprived areas: Birkenhead, Bradford, Burnley, Byker, Corby, Doncaster, Easterhouse, East Ham, Greenock, etc., etc. Wherever there is a Starbucks, a Waterstones, a Jigsaw or a Habitat you can bet there isn't a Crazy George's nearby.

Polly Toybnee, Hard Work: Life in Low-Pay Britain, Bloomsbury, London, 2003

The reasons for people not having credit are varied. The vast majority of people borrowing from non-status lenders are simply unable to access mainstream sources of credit – see the box above. Indiscriminate lending in the 1980s followed by the recession in the 1990s led to many having poor credit records and bad debt histories. Mainstream lenders have tightened their lending criteria and their more rigid credit scoring criteria means that those with poor debt histories find it very difficult to access credit. In addition, many in this group are attempting to borrow to pay existing debts and are unable to borrow from mainstream lenders because they have reached or exceeded their credit limit from such sources. Non-status lenders may be disreputable due to paying very little attention to their borrower's ability to repay a loan as long as it is secured on the customer's property. Widespread media advertising helps non-status lenders attract new business particularly as they encourage people to borrow as a way to reduce and simplify existing debt repayments.

Some groups who are excluded from the mainstream credit market choose to turn to alternative lenders due to the easy, quick and non-bureaucratic access, simple, straight-forward and transparent products and no hidden charges, penalties and defaults.

Similar results emerge from a major survey of the un-banked in Los Angeles and New York carried out in 1998 by the OCC (Office of the Comptroller for Currency – part of the US system of financial and monetary control) and quoted in detail in Caskey, Ruíz Durán and Solo [2004][5]. The OCC survey allowed detailed comparisons of the social, economic and demographic profile of the banked and un-banked. These showed the un-banked generally being younger, less educated, renting more and working less, with significantly lower incomes and a very much lower propensity to save as a result. The Caskey, Ruíz Durán and Solo study goes on to show differences in how the banked and un-banked pay bills and receive income and Caskey, drawing on earlier research of his, goes on to show the resulting extra cost to the un-banked of managing their day-to-day financial settlements in this way. He comes up with an estimate that a household on $20,000 take-home per year would pay $600 of this (or 3% of income) on payment services, which is at least six times what it would cost to use a bank account for the same operations if it could be kept in funds. Similar premiums on the cost of credit taken by the un-banked are shown as are apparent in the UK surveys.

Connolly and Hajaj [2001], highlighting the lack of real research on the un-banked in Australia, suggest the following groups are particularly vulnerable:

- regional and remote communities
- urban depressed communities
- low income consumers
- older consumers
- consumers from non-English speaking backgrounds
- consumers with disabilities
- consumers with literacy difficulties
- indigenous consumers.

5 The paper compares unbanked populations in the US and Mexico.

F. Access for enterprises – microcredit and small business lending

Small businesses are acknowledged to be crucial for the growth of any modern economy. Every year approximately 2 million enterprises are started up in the EU countries and 90% of these are small businesses with fewer than five employees.

In general there is no literature suggesting significant exclusion from access to deposit and payments services for micro, small and medium enterprises, although in the UK there are complaints about the high cost of such services – costs that in effect cross-subsidise free personal banking. The other area of concern is that micro-enterprises started up by those excluded from personal banking services are almost by definition excluded from business banking services.

Small business entrepreneurs are, however, widely perceived as facing particular barriers when attempting to gain access to sources of external finance to support fixed capital investment and working capital needs. But evidence from Observatory of European SMEs and supporting European Network for Social and Economic Research (ENSR) survey data that tracks SME development for the European Commission Enterprise Directorate (EIM Business and Policy Research [2004][6]), suggests that this is not particularly a problem of access to bank lending:

- less than 20% of those respondents identifying a major constraint to growth select access to finance in its broadest sense as that constraint;
- only about 12% of micro-enterprises, 10% of small enterprises and 6% of medium-sized firms express dissatisfaction with the banking services they use;
- within these percentages of respondents expressing dissatisfaction only 2-3 percentage points can be attributed to refusal to grant or maintain credit;
- in any case not all SMEs actually need to borrow (typically 40% either said they did not or could not recall borrowing in the last three years);
- and of those respondents that had sought loans only one sixth had failed to get what they asked for.

6 The reference here is to a website that contains not only the latest reports of the EU Observatory of European SMEs but the capacity to cross-tabulate the supporting ENSR survey data.

Nevertheless, concern is frequently expressed that there may be an emerging problem to be faced as regards the retreat of larger banks from the provision of credit to medium-sized enterprises:

- In Germany in particular there is clear evidence of large banks trying to end their credit relations with some smaller clients; closing branches; centralising more of their credit decisions; and reducing staff numbers in some branches. As in the case of savings facilities, these tendencies on the part of mainstream banks push ever more pressure on to the savings and cooperative banks (DSGV – Survey [2001]). This is often ascribed to the impact of globalisation and an increasing focus on the creation of shareholder value.
- A related phenomenon is the disruption to SME borrowing patterns that results from mergers of banks within countries. Research in this area has been conducted for National Bank of Belgium – a country which has seen significant “within-market” merger activity and where SMEs are particularly reliant on large banks for finance. Degryse, Masschelein and Mitchell [2004] find evidence that firms borrowing from acquired banks are more likely to lose their lending relationship than those already borrowing from the acquiring bank. They also find that firms borrowing from two of the merging banks are less likely to lose their relationship than firms borrowing from only one of them or from other banks not party to the merger.
- The move to new capital adequacy rules for banks (Basle II) will raise the weighting on riskier commercial lending by 50%, which would almost certainly have directly affected the cost of borrowing for SMEs. As a result of this, the impact of the rule change has been softened so that capital required for the riskier categories of SME lending will only rise by 20%.

Therefore, considerable public effort across the EU (see Chapter 4 for more detail) is being made to improve SME access to financing and increase the provision of microcredit (here defined as loans under €25,000). In addition to being an economic measure alone, microfinance can also be seen as a way to help counter social exclusion. This is most likely where small business entrepreneurs come from minority groups including the unemployed, women or ethnic minorities.

The main reasons for the inadequate level of microfinance provision are usually related to problems of information asymmetries. A major barrier comes from the high risks and lack of profitability perceived from the viewpoint of the providers of credit.

It is difficult for even a promising business with no previous track record to overcome this perception; on average 50% of new businesses in the EU disappear within five years. In addition, entrepreneurs of small business often simply do not have sufficient collateral to offer to secure finance from traditional sources with methodologies geared more towards larger enterprises.

Microfinance also involves high handling/operational costs as is clear from the table below. Spreading these high costs over the life of a three year loan would add the equivalent of half again to a money-market funding rate in the sample EU countries and about a third to comparable money-market funding rates in the sample Accession countries. This compounds the high levels of apparent risk when lenders are dealing with micro-enterprises as costs are incurred up front but revenue accrues through the life of a loan.

Table 2: Loan processing costs for microcredits in eight European economies

	UK	Deu.	Fin.	Swe.	Eire	Est.	Pol.	Lat.
Average loan size	22000	15000	17000	9000	6000	15000	3000	3000
Handling cost:								
€ per loan	1335	1100	850	700	170	590	275	135
% of value	6%	7%	5%	8%	3%	4%	9%	4%
Money market rate	3.9%	3.3%	3.3%	2.0%	3.3%	3.9%	9.4%	4.0%
Annualised handling cost (over 3-year loan life)	2.1%	2.5%	1.8%	2.8%	1.2%	1.4%	3.2%	1.4%

Source: (EU – Enterprise Policy Group [2004] augmented by authors).

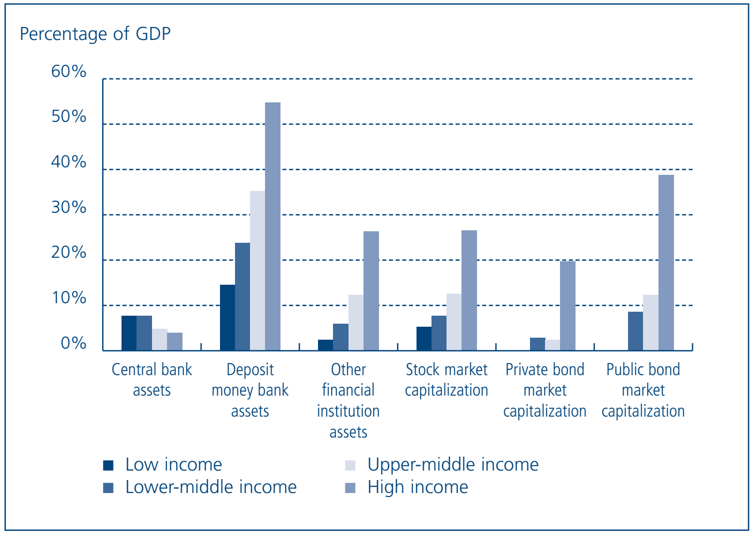
In response to this gap in the market for adequate microfinance, the EU and most Member States have been encouraging financial institutions to provide more microcredit. They have done this both by offering direct financial support, and also by providing a better enabling environment to support SMEs as they develop. The national schemes of Member States vary, but tend to share common features. These include the promotion of the availability of funding to institutional customers; partial credit provision; partial risk sharing and tax incentives. Credit Unions have been increasing in numbers, as have NGOs as providers of microcredit (for example the Prince's Trust in the UK and ADIE in France).

Microfinance is further made more accessible and affordable by enabling risk-sharing in the form of participation in guarantee schemes. A study for the European Commission by IDEA Consult [2003] identified mutual guarantee schemes as more prevalent in the south of Europe, particularly in Italy, France and Spain but they have also existed for some time in Germany, Austria, Belgium and Luxembourg. By contrast in the Northern and Anglo-Saxon countries such as the UK, the Netherlands, Denmark and Finland, public guarantee schemes prevail. In some countries both public and private schemes exist (Belgium, France, Austria, Germany and Denmark). For seven countries where mutual guarantee schemes are active (or are beginning to become active) the authors calculate the schemes have an overall reach of 1.5 million enterprises (around 10% of SMEs in those countries) and support new lending of around €10-15bn per year.

G. The overall scale of financial systems in developing countries

The first thing to note in any discussion of formal financial systems in poorer economies is that they are dominated by commercial banks. Figure 1 below presents data from the World Bank, World Development Report[7] [2002]. It can be seen that bank-based assets in low income countries typically amount to around 15% of GDP as compared to around 5% of GDP for stock-market capitalisation and only about 2% of GDP for the assets of non-bank financial institutions (NBFIs). In lower-middle income developing countries, the corresponding percentages of GDP are 24%; 7% and 5% respectively. By contrast in some high income countries such as the USA, UK and Germany the stock market and NBFI totals are 262%, 250% and 72% of GDP respectively[8]. Country-by-county data to detail this are available for almost 100 countries in the database of Beck et al. [2000].

Figure 1: Financial system development across country income groups



7 The report is entitled Building Institutions for Markets
8 This is not to say that the relative importance of non-bank finance will not rise as development proceeds. It is the conclusion from most studies of financial system evolution (e.g. J. Gurley and E. Shaw and R. Goldsmith) that such a change does indeed occur.

H. The value of improved individual access in developing countries

That access levels are low in very many developing economies is rarely challenged, although marked regional differences almost certainly exist. Very little systematic work has been done on the number of people having access to banking services in developing countries and for this reason the next chapter focuses on using proxy financial indicators to interpolate between the few points of real data that are available. This lack of data on access to banking services probably reflects the strong bias since the early 1980s among international donor organisations towards microfinance provided via non-bank channels, particularly NGOs. Past discussions of access to finance and its potential to reduce poverty have focused disproportionately on the success or otherwise of this activity. This is now changing, partly because of dissatisfaction with some of the so-called "apex" organisations that channel donor funding to small NGOs but also because of the lack of financial self-sustainability of many of the programmes. There is also a growing recognition of the importance of facilitating saving amongst the poor as well as providing credit.

Morduch and Hayley [2002] provided a comprehensive survey of the issues involved in taking finance to the poor in their paper for CIDA, the Canadian International Development Agency. They concluded that microfinance has proven to be an effective and powerful tool for poverty reduction but that like many other development tools it has insufficiently penetrated the poorer strata of society. They go on to suggest that a savings first approach will not work as well as a combined credit and savings approach. At the heart of their analysis is the conclusion that while savings may allow households to avoid being pushed into extreme poverty by economic and social shocks, only credit creates the additional economic activity that can help lift families out of poverty.

This view represents the balance of judgement reached by Morduch and Hayley but it is by no means uncontroversial. On the one hand, there is work that suggests access to microfinance has the potential to significantly reduce poverty (Khandker [1998]); on the other hand there is research which indicates only a minimal impact on poverty reduction using the same data (including earlier work by Morduch [1998]). There is also some evidence that there may be a threshold of cumulative loan size beyond which microfinance can make a significant dent on poverty (Zaman [1998]). The mixed evidence is partly associated with the sensitivity of the results to methodological assumptions associated with the empirical analysis.

There is greater consensus however, on the role of microfinance in reducing vulnerability. The provision of microfinance has been found to strengthen crisis-coping mechanisms, diversify income-earning sources, build assets and improve the status of women (Hashemi et al [1996]; Montgomery et al [1996]; Morduch [1998]; Zaman [1998]). Considerable work has also been done by CGAP (World Bank's Consultative Group to Assist the Poorest), on the importance of savings mobilisation to reducing vulnerability. A CGAP Donor Brief [2002] identifies saving as superior alternative to credit as a way of surviving shocks and a service the poor both want and will pay for. As the poor rarely have access to voluntary deposit services offered by formal or semi-formal institutions they are instead obliged to save informally: they invest in livestock, hide cash at home, have their savings collected by neighbours, or participate in rotating savings and credit associations. In many cases, these informal savings are high risk, illiquid, indivisible or impose uniform terms. A cow, for example, can die of disease and must be sold as a whole, not in parts, to obtain cash. And the transaction imposes time and financial costs.

Both the poverty- and vulnerability-reducing roles of microfinance thus make access to microfinance one of the important potential determinants for achieving the improvements in the extreme poverty targets of the Millennium Development Goals (MDGs). Microfinance services targeted to women will also have an indirect effect on other MDGs via improving women's control over their assets and their knowledge of social, health and environmental issues. Overall Morduch and Hayley show in some detail evidence that the positive impact of microfinance on poverty reduction relates to six out of seven of the Millennium goals.

I. Problems with enterprise access in developing countries

Only a handful of countries in the world have broad and deep financial markets involving a significant range of non-bank financial institutions and instruments. For a large majority of developing countries and their enterprises (by number) informality of financing is the norm. A small sub-set of enterprises in most developing countries face the same sort of choices as enterprises in developed economies (bank credit versus debt versus equity and foreign versus domestic sourcing etc.) but most enterprises will not. This point been articulated most forcefully by the Peruvian economist de Soto [2000]. He argues that only 25 out of the 200 countries in the world have reliable and legally enforceable property rights and ways in which work and savings can be converted into usable capital.

The reason is the widespread absence of legally enforceable property rights in most developing countries. The main result is the predominance of informal semi-legal business activity and informal means of financing most enterprise activity: for example, there are 2.65 million small businesses in Mexico that are not legally registered. For various reasons, but mainly widespread illegality, typical patterns of finance are confined to within the household and unincorporated business sectors, and involve few if any intersections with formal financial institutions.

However, when we scrutinise available macroeconomic data this point gets submerged. Aggregate data on components of the financial sector (e.g. total bank credit or stock market turnover) typically reveal little or anything about the number of beneficiaries of finance. This is true, for example, of the most recent and most comprehensive of such data sets, namely that compiled by Beck, Demirguc-Kunt and Levine [2000]. Enterprise survey data that have been used in the financial structure literature such as the large IFC survey used by Singh and Hamid [1992] typically focus only on a small number of larger enterprises. But subject to these obvious limitations of the available data, it is possible to make some general points.

First, the fact that banking systems in developing countries, although dominant, are also absolutely small leads to serious constraints on the availability of enterprise credit. Typically, that credit (a) goes mainly to larger companies that are both wholly-legal, involve lower transaction costs as well as risk and may also be well-connected politically and (b) is very short-term in nature and therefore not of great use for the financing of longer-term investment projects. The evidence presented below gives some support to these propositions. So both for supply side reasons (the shortage of bank finance) as well as demand side reasons (the imperatives to stay "informal"), a significant proportion of developing country enterprises by number get excluded from access to formal finance.

When we enter the limited territory of larger enterprises, it is possible to provide more specific conclusions. Our knowledge about this is heavily dependent on a large pioneering project carried out by the IFC through the 1990s (particularly Singh [1995]). The second phase of the work used enterprise data from between 50 and 100 of the largest enterprises in each of 10 low and middle-income countries (India, Korea, Jordan, Pakistan, Thailand, Mexico, Malaysia, Turkey, Zimbabwe and Brazil).

Some surprising results emerged that ran counter to the *a priori* expectations of most economists. Specifically, for these larger enterprises, they found:

- The large corporations relied heavily on external funds
- They relied heavily on new issues of shares to finance their growth of net assets
- Developing country (large) enterprises used both external finance and particularly equity finance to a much greater extent than their counterparts in the advanced economies.

Other researchers have qualified these strong results and some have emphasised the small sample biases. For example, Atkin and Glen [1992], while agreeing broadly with Singh's first point above, found high levels of variation. In S. Korea, for example the average firm dependency on internal finance was only 12.8% whereas it was as high as 58% in both Pakistan and Zimbabwe. In addition the limited number of enterprises impacted by these results is confirmed by the small number of stock-market listings in most developing countries and by the even smaller number of enterprises whose shares are actively traded. For example the stock markets of Brazil, Egypt, Mexico, Korea and Thailand are all quite large (number of enterprises listed being 470, 1050, 185, 720, and 390 respectively). However, in all these cases somewhere between 40% and 75% of all turnover is accounted for by just 5% of the listed enterprises (23, 52, 9, 36 and 19 enterprises).

The IFC results are also consistent with the proposition that international portfolio flows of finance, including those from Development Finance Institutions (DFIs) and through foreign banks, are heavily concentrated on larger enterprises in each country but do little or nothing to relieve the financing problems of the mass of enterprises. This is also clear from the two part table overleaf reproduced in simplified form from a major draft study based on what is now possibly the best source for work on enterprise access. This is the World Business Environment Survey (WBES) ©2000 The World Bank Group under which a sample of 10,000 firms in 100 countries throughout the world were asked to rate the extent to which specific factors in the business environment were problematic for their operation and growth[9].

9 The sample was not a simple random one and thus characteristics of the sampled firms within a country cannot be taken as indicative of all firms but may be "biased" towards certain types.

The first part of the table shows that investment funds, development finance schemes and state-directed lending schemes are essentially only relevant for medium and large scale firms that already have significant access to bank finance. The major substitute for bank finance amongst small firms is less formal sources of finance particularly family and friends but also money lenders (which may well include credit unions and co-operatives).

Table 3: Enterprise financing patterns by size of firm and region

% of total financing from:	Small firms	Medium-sized	Larger firms
Inv. Funds / Dev. Finance / State	2.0	7.9	7.1
Banks & Leasing Companies	12.9	20.2	26.5
Supplier Credit	5.3	7.5	6.2
Informal sources*	14.1	4.5	2.1
Internal Funds / Retained Earnings	50.8	50.9	42.8
Equity	4.4	4.9	4.7
Unspecified	10.5	4.1	10.6

% of total financing from:	E. Asia Devel.	S. Asia	E. Asia Tigers	Latin Amer.	CIS Europe	C & E	OECD
Inv. Funds / Dev. Finance / State	1.6	5.2	3.2	3.1	6.3	8.7	4.3
Banks & Leasing Companies	21.2	22.4	17.0	25.1	17.1	8.0	19.4
Supplier Credit	3.2	2.5	7.9	10.2	4.6	5.8	4.8
Informal sources*	11.6	7.4	6.2	5.4	11.1	8.9	4.6
Internal Funds / Retained Earnings	33.9	26.5	48.3	43.2	53.9	70.5	39.1
Equity	2.7	6.4	5.8	3.2	8.6	1.4	8.5
Unspecified	25.8	29.6	11.6	9.8	-1.6	-3.3	19.3

**Family, Friends, Money-lenders, etc*

A more confusing pattern of migration from less formal to more formal sources of finance is apparent when looking at the same data on a regional basis as shown in the second part of the table. Despite regional variations (which may be coming from different sample mixes of firms by size) this does suggest that bank and similar finance is less relevant to more rapidly advancing economies (the East Asian Tigers, China, the stronger CIS and Central and Eastern European economies). State directed schemes can be more significant here but reliance on less formal sources is still relatively high and retained earnings and embedded equity even more significant.

Other qualitative evidence from the same survey based on entrepreneur/manager perceptions of the constraints to development reinforce this picture, with the constraint coming from lack of finance ranking as high if not higher than many other constraints such as tax, corruption, infrastructure, etc.

These various points together suggest that the financing situation for enterprises in developing countries can be characterised by:

- A chronic general failure of formal financial systems to help most enterprises because of widespread informality of business associated with weak legally-enforceable property rights
- A heavy general dependence on commercial bank financing of those businesses that have access to formal finance
- A dualistic structure in which a sub-set of the larger enterprises of some developing economies make a surprisingly high use of external and especially equity financing, including international portfolio flows (where capital accounts are liberalised).

J. Supply constraints on access to banking and microfinance

Systematic literature on what constrains the availability of finance in developing countries is rather fragmented and not linked to the debate about exclusion in developed economies.

Four factors are, however, commonly mentioned:

- the sparse coverage of rural areas by bank branch networks;
- an unwillingness by commercial banks to focus on rural and SME business;
- the very high cost of formal banking services;
- and the lack of financial self sustainability for most microfinance institutions.

Work by the authors of this paper has started to address the third of these issues in a systematic way. This indicates that the cost of intermediation does have a significant bearing on the volume of banking services supplied to an economy (see box below). This fits with the underlying theory described in section B – if the transactions costs of exchanging goods and services in a monetised form via a formal banking system are high relative even to the cost inefficiencies of barter, then the rural poor will not only not find it economically worthwhile using banks but they may not even find it worth using money for much of their economic activity.

The acute nature of this problem in a developing country context is evidenced by experience in Kenya, a country which, as has already been mentioned, has a relatively developed banking sector that mobilises significant volumes of finance relative to GDP. Estimates by the Kenya Bankers Association suggest that the minimum costs of setting up a rural bank branch are above $250,000. The volume of small-ticket transactions needed to cover such costs is way above likely business volumes in poor rural areas. Even in an urban context, calculations by Peachey [2004] suggest that a basic salary account for a professional (teacher, doctor, civil servant, etc) would cost at least €10 per month to run and require a monthly income of around €8,000 for the interest on the average monthly balance on such an account to cover the charges made for using it.

Box 3: Banking costs and the scale of banking activity

The diagram below shows (left hand side and top segment) the operating costs (as percentages of income-earning assets) of different banks in a sample of European transition economies. These costs are benchmarked against good practice in EU banks (shown by the horizontal dotted line). Better banks (black circles) are distinguished from weaker banks in order to see how far each category of bank in each country diverges in terms of their costs from the EU benchmark. Banking sector depth is shown in the bars in the bottom segment of the diagram. It is clearly seen that the banking systems with greater depth (and almost certainly serving more customers) are those where the gaps in cost performance by banks vis-à-vis the EU standard are lower and where the bulk of the banking system does not lag too far behind the performance of the best banks in the system.

Figure 2: Operating costs as % earning assets

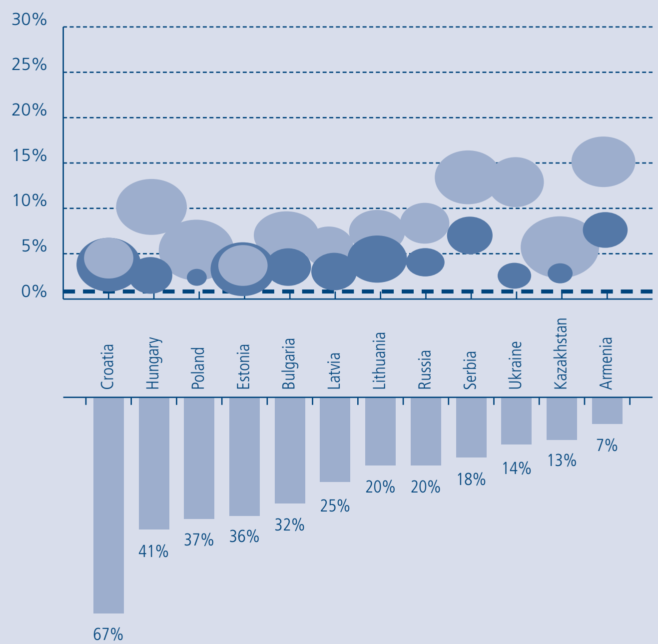


Figure 3: Operating income as % earning assets

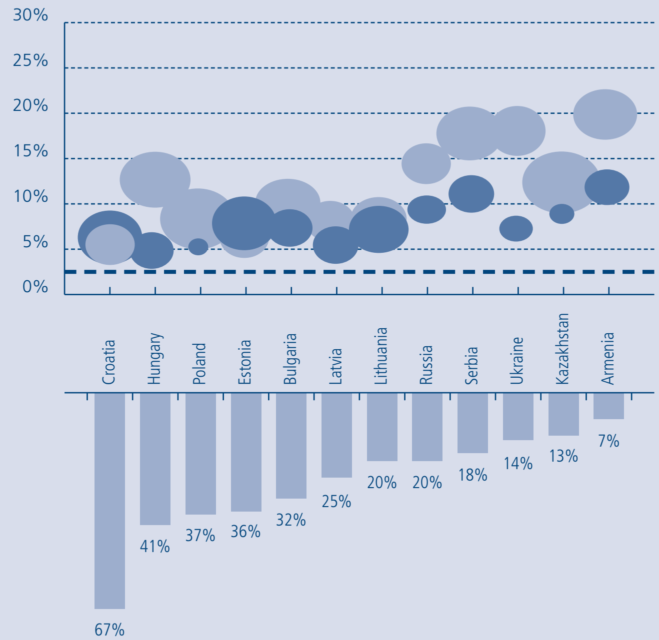


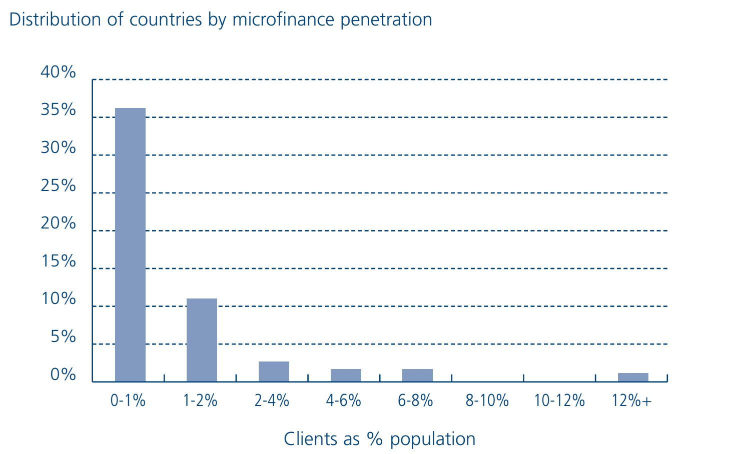
Chart Key:

Circles indicate aggregate performance of different group banks in each country:

- center of circle shows level of performance (read against side axes)
- size of circle shows market share of group of banks
- dark blue circles show performance of best quarter of banks in each country
- light blue circles show performance of rest of banking system
- dotted lines indicate average performance of lending EU banks.

As already noted, microfinance has been the main instrument of choice of aid donors and some governments in the attack on financial exclusion in low income countries in the past 10-15 years.

Figure 4: MFI penetration (% of population)



Source: Based on Daley-Harris (2003).

Microfinance Institutions (MFIs) have been widely perceived to be a route to extend credit to sections of society that are denied access to mainstream commercial banks and other more traditional financial institutions.

However, Honahan [2004], identifies the very limited penetration specialist microcredit actually achieves even in the poorest countries. Figure 4, taken from Honahan's paper, shows how small a proportion of the population that microfinance typically addresses. He also shows how little it typically adds to domestic credit and goes on to say:

> "a plausible interpretation of the [reasons that prevent microfinance from expanding to full potential] is that effective microfinance provision for low income households and low-value added microenterprises is intensive in resources that are not plentiful in developing countries. Most likely these resources involve strategic management.
>
> Only when management resources are applied on a sufficiently large scale (whether by commercial bankers, NGO activists, or public servants) will microfinance provision break through the threshold and become firmly established on the scale that has been achieved, for example, in Bangladesh."

Honanhan then makes the point that even where microfinance can offer a good return on capital, it rarely does so if proper account is taken of the managerial time and effort required to get a profitable operation working. This helps explain why most of what is now microfinance has over the last two centuries come from the charitable sector.

Separately, a survey by the Asian Development Bank (Fernando [2002] and [2003]) together with other relevant papers such as Yaron and Mithika [2004] identify the following constraints on the expansion of microfinance institutions as being among the most important:

- Complementarities with commercial banks. MFI activities are often constrained by the quality of the commercial banking systems in the countries where they operate. If banking systems are weak as, for example, in Central Asian transitional economies, non-bank MFIs have problems in finding a reliable place to park the deposits they raise and also experience delays and high transaction costs in withdrawing deposits. Some MFIs in Asia have lost significant deposits because of bank failures. Similarly, when "bad" banks are the norm, MFIs face little or no competition in the main product areas. A strong and competitive mainstream banking system is complementary to effective MFI activity. This is partly because it directly helps to lower the transaction costs of the MFIs, but also because of the direct involvement of commercial banks in MFI-type activities (e.g. via specialised subsidiaries) that is propelled by competition in banking. Developments in Kenyan banking in the past three years provide a good example (WSBI [2004]).
- Legality and Governance. The NGO-MFI format is seriously limited in terms of the amount of ongoing expansion (and so access) that it can safely achieve. Even in very large and experienced MFI systems such as that in Bangladesh, these problems persist. The legal status of MFIs is often such as to preclude expansion into certain types of financial services and especially deposit-taking. The real ownership and control of the MFIs is less than clear and so too is their accountability and governance. Where co-operative organisations are heavily involved in the provision of financial services (as, for example, in Sri Lanka, the Philippines and Kenya), regulatory arrangements often represent a poor compromise between the needs of cooperatives generally and their financial functions.

The result, to somewhat over-simplify a complex picture, is that many MFIs cannot legally mobilise the funds to support ongoing expansion. But where they do so, they often proceed without adequate regulation of their use of funds and so expose savers to considerable risks.

- The terms on which MFI services are offered. It has been a common assumption amongst some advocates of microcredit that its mission to serve the poor means that the credit must be provided at low interest rates. This view is increasingly discredited and for a very obvious reason. Low cost credit must imply either (a) that the MFI providing the credit can operate with low costs and/or (b) that its services are subsidised either by the state or by donors. In low-income countries sustained fiscal subsidies are not available because of the very limited fiscal capacity of governments. Where governments have sought to resource MFI institutions the costs have often been huge relative to the benefits generated[10]. Donor subsidies will typically be available only for short periods of time. Similarly, and for reasons to do with high transactions costs and risks, most MFIs do not have particularly low operating costs when compared, for example, with local banks and certainly with good standard international banks.

Morduch and Hayley [2002] also address the issue of financial sustainability and challenge the received wisdom of the mid-1990s when an influential study of twelve microfinance institutions across Asia, Africa and Latin America by Hulme and Mosely [1996] had indicated a distinct trade-off between outreach to the poorest and institutional financial sustainability. Five years later Morduch and Hayley conclude:
"Microfinance compares favourably to other interventions particularly with regard to cost effectiveness and prospects for sustainability:

- Cost-effectiveness: An advantage of microfinance is that donor investment is recycled and reused [Wright 2000]. Direct comparisons done by Khandker [1998] show that microfinance can be a more cost-effective developmental tool than alternatives including formal rural financial intermediation, targeted food interventions, and rural infrastructure development projects. More over, unlike many other interventions, costs for microfinance tend to diminish with the scale of outreach (Rhyne [1997]; Christen et al [1996])

10 For example a recent review of government-owned financial institutions in Kenya including some focused on agricultural credit has found (a) that the government has directly or indirectly funded 82 % of the net resources used for the lending and (b) that only 850 performing borrowers appear in the current balance-sheets with an implied fiscal cost of each performing loan of some Ksh 27 million – around $350,000 (far more than the face value of most loans). See Murgatroyd [2004].

- Sustainability: Few, if any, other development tools have the potential to become sustainable such that, after initial start-up grants, new inputs are not required for every future client.
  - There need not be a trade-off between reaching the poorest and attaining financial sustainability. Although there are no rigorous econometric models to substantiate it, there is ample evidence that MFIs targeting the poorest can fare as well financially as those that don't (Gibbons and Meehan [2000]; Churchill [2000])
  - There is also ample anecdotal evidence that MFIs that target poorer clients can achieve substantially higher repayment rates than those that target richer clients
  - It should be noted that emphasizing financial sustainability above all else can have the practical effect of excluding the poorest because of the widespread misperception that the poorest are a greater credit risk and the reality that the unit costs of small loans tend to exceed the unit costs of larger loans."

However, the definition of self-sustainability used by Morduch & Hayley is implicitly limited to an MFI being able to plough back repayments from earlier credits without its funding base being gradually absorbed by operating costs once donor support is withdrawn. It says nothing about the capacity of MFIs to break out of the donor constraint. Other commentators, notably through the CGAP forum, are focusing increasingly on how savings can be mobilised from the poor to provide funding for pro-poor credit once donor sources decline.

The CGAP [2002] donor brief identifies four required features of a "pro-poor" savings product:

- Security: Secure savings are not in jeopardy from fraud, theft, fire, and relatives' demands. Safety is paramount, even in the face of inflation.
- Low transaction costs: Proximity is essential to reduce the high transaction costs of making deposits and withdrawals. Convenient opening times and minimal paperwork are also important.
- Appropriate design: Individual voluntary deposit products that allow frequent deposits of small, variable amounts and quick access to funds are best. Contractual savings are also useful for planned future lifecycle expenditures such as weddings, funerals, and birth celebrations.
- Interest rates: If transaction costs are low, rural savings takes place even with negative real returns – indicating that the poor can be relatively insensitive to interest rates as a priority when evaluating savings options. Nevertheless, demand for savings products does increase as real interest rates rise."

An earlier CGAP Focus Paper [1998] suggests that to deliver these features, an institution providing deposit services for the poor needs the capacity for 'safe and sound' deposit operations. This requires strong management of credit, liquidity, and interest rate risk as well as internal controls, management information systems, the financial capacity to withstand external shocks (e.g., inflation and devaluation) and adequate capital. The paper acknowledges that institutions collecting deposits from the public should be properly supervised, but suggests that not all require the same type of formal central bank supervision and that a combination of strategies should be used to tailor accountability requirements to the scale of the deposit institution. Finally, the obvious but often forgotten point is made that for institutions to mobilise savings from the poor they must be committed to expanding access to greater numbers of the poor. CGAP conclude that banks are more likely to be able to satisfy such requirements than less formal NGO and self-help based MFIs although they do suggest specialist microfinance and/or cooperative banks might do better than mainstream banks.

K. Other issues affecting access in developing countries

1. The electronic revolution and access

Financial sector development has in the past been "institution oriented". As we saw above, commercial banks provide the main basis for financing in many developing countries with parallel NBFIs such as microfinance institutions emerging to challenge them in some aspects of financial delivery. But in advanced countries this approach is increasingly being replaced by a "functional approach". This new approach unbundles financial services into various functions/ commodities with their own production and delivery structures that are not necessarily linked physically to particular banks or NBFIs. This in turn changes the requirements of effective regulation. The significance of the rapid technological changes in communication and especially the internet is that it makes some aspects of this functional approach relevant also in developing countries. Above all this new approach means that financial systems no longer need such a strong base-infrastructure of commercial banks. Nor does a national base of delivery seem so important. Africa Online, for example is a growing internet provider in several parts of Africa outside its South African base.

Box 4: Mobile phones in the developing world

In 1990 there were just 11 million mobile phone numbers worldwide. By 1998 the number had jumped to 320 million and current estimates are of more than 500 million users.

Some developing countries typify the possibilities of leapfrogging using mobile phones. Zimbabwe saw wireless subscribers rocket to 174,000 in 1999- growth of more than 800 percent, the fastest in the world. In Botswana, Cote d'Ivoire and Rwanda, wireless phone subscribers outnumber fixed-line users. Brazil has more than 150 million mobile phone subscribers, more than all the Nordic countries combined. With a devastated fixed network after more than 20 years of civil war, adopting cellular technology was the obvious choice for Cambodia, and within a year mobile subscribers outnumbered fixed telephones. Even though its per capita income is among the worlds lowest, Cambodia now surpasses 31 countries in overall telephone penetration – including countries with much higher incomes.

Source: Claessens, Stijn, Glaessner Thomas and Klingebiel Daniela, E-Finance in Emerging Markets: Is Leapfrogging Possible? Financial Sector Discussion Paper No. 7, World Bank, June 2001

E-finance has been growing rapidly in many markets (see the box above extracted from the paper by Claessens et al. [2001]). The rate and degree of penetration seems to depend on a variety of factors amongst which the size and quality of a country's telecommunications infrastructure is among the most important. But this no longer needs to await the development of hard-wired land-lines. In many emerging and lower income countries, mobile telephony is permitting the degree of connectivity to expand far more rapidly than would ever have been thought possible.

Telephone communication of a good standard is clearly a necessary condition for e-finance to take off, but this no longer needs to await a country's "development" and large-scale investment in public infrastructure. Clearly incomes and several other factors also help determine the point at which the penetration rates of e-finance might become significant in any particular country.

However, based on a simple preliminary model, Claessens and his colleagues have estimated a progression of penetration rates for a sample of industrial, emerging and low income economies through 2010 (see Table 4 below).

Table 4: E-Finance penetration; projected through 2010 (percent)

Germany	7	56	92
Thailand	3	19	68
South Africa	3	19	68
Mexico	3	19	68
India	3	19	68
Portugal	3	23	73
China	3	19	68
Brazil	3	19	68
Ireland	10	62	93
Norway	22	78	97
Argentina	3	19	68

Although projections of this type are inevitably speculative, the possibilities indicated by the table are impressive. They suggest that in a period as short as ten years, many of the richer industrial countries could be seeing e-finance penetration rates above 80 percent with many of today's low-income countries not too far behind. Emerging market economies already boast the world's third largest internet bank. Bradesco bank in Brazil has 1.7 million clients online and provides its more than 700,000 corporate clients an electronic site with access to insurance, brokerage and pension fund services. Transaction payments services for consumers have been placed on smart cards that consumers can download from their computers.

Will mass access to banking services be improved by this revolution? The answer is almost certainly yes with the 10-15% of poor-country populations presently being served by conventional banking being increased significantly in at least some poorer countries during the next 10-20 years. This will not mean however that universal access will become the norm. The lowering of banking costs made possible by the new technologies seems certain to exclude the more disadvantaged in most poor societies in much the same way that bank closures and more cost-conscious banks have done in, for example, Britain and France.

Personal computer use to some extent shifts banking cost from the bank to the individual and this fact alone will continue to exclude many of the poorest individuals and families. Similarly the legal barriers are not trivial – in some countries the formal legal requirement for opening a bank account are formidable (e.g. the registration of signature by a notary).

2. The impact of HIV/AIDS

The economic impact of HIV/AIDS across developing economies is well documented. The impact on the poor is particularly acute – households with only limited sources of income can rapidly enter a vicious spiral of decline as income collapses, expenses rise and savings run out. The end point is often to cut into living expenditures in ways that not only further weaken the health of the person(s) suffering the disease but also undermine the future earning capacity of survivors. Specific problems arise in accessing family bank accounts in households where either minors or the illiterate old have to take over as head of household. In a donor brief CGAP [2003] strongly recommends against microfinance programmes solely targeted at communities with a high incidence of HIV/AIDS because of the very high cost overheads and risks to financial self-sustainability. The brief does, however, suggest that diversified programmes can achieve self-sustainability, while still helping communities build resilience to the financial impact of the disease. It maps out the following matrix of target clients and required products:

Figure 5: CGAP Matrix for addressing regions affected by HIV/AIDS

Who can use financial services in regions affected by HIV/AIDS?

HIV+ individuals but still productive

other productive family members

surviving spouses, children, or parents

households unaffected by HIV/AIDS

What products and policies are responsive to their needs?

flexible savings

education trusts for minors

emergency loans

burial insurance

loan insurance (in case of death)

acceptance of younger/ older clients

3. Remittances and the fight against organised crime and terrorism
Global official figures estimate that 200 million migrants support more than half a billion people every year through remittances worth US$232 billion. This figure might increase 50% if transfers through non-official channels are included. For the migrants sending this money, remittances also often represent their first exposure to banking services in their host country. The agents that undertake this business have traditionally faced three major challenges to building the flow of funds through formal channels: (a) to reduce the cost of transfers (which can be as high as 20-25% of the amount transferred), (b) to secure end-to-end delivery and (c) to enhance security. They now face other challenges that threaten to raise barriers to access for the poorest customers in particular. These are the "know-your-customer" and identification requirements built into anti money-laundering (AML) regulations and more recently into rules aimed at disrupting the flow of funds to and between terrorist organisations. Many migrant workers are not literate. For some of them (for example workers in South African mines) their employment will give status and access to bank accounts and remittance mechanisms. For many others, however, operating as casual workers and in the personal services industry, this option is not available. Indeed their personal documentation, employment and residence status may be at best borderline legal and certainly not enough to satisfy the AML/anti-terrorism requirements of mainstream banks operating remittances business. A major Spanish savings bank initiative in the area is discussed in Chapter 5.

3. DIMENSIONS OF ACCESS IN DIFFERENT REGIONS

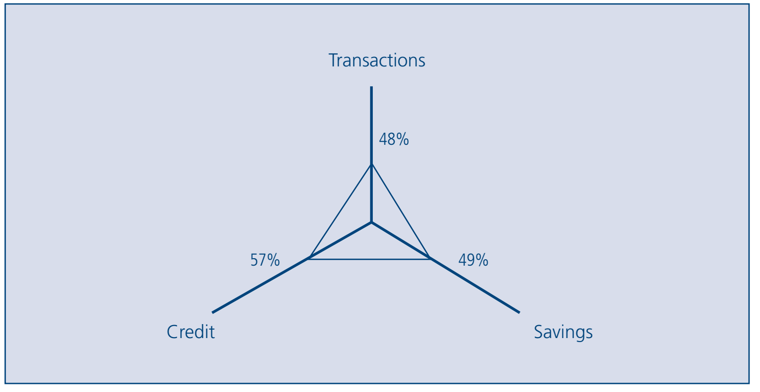
A. Overview

One of the objectives set for this study was to identify the different levels of access to banking services for both households and small and medium-sized enterprises. Some direct estimates for access in these senses have been found in the literature for the advanced economies of the Euro Area, Britain and North America but unfortunately very little firm evidence exists for developing countries. What little direct data there are for developing countries, tends to focus on the limits there are to access to microfinance and refer much less to limits to access to general banking services. At the heart of this problem are three weaknesses in the way banking data are prepared:

- data on numbers of people accessing personal financial services are often not even known within banks – they often have to rely on expensive market research to tell the difference between the number of customers and the number of accounts;
- regulators (until very recently) have not been interested in retail transaction volumes, concentrating instead on data relating to stability. Thus the multilateral agency databases that collate banking sector data rarely capture this account usage in a coherent way;
- identification of SME activity is very poor and even worse for micro-enterprises – where it is identified, definitions are often inconsistent between countries.

The issue of measuring access to finance for SMEs outside the advanced industrial economies is not tractable except by reference to the large *World Business Environment Survey* completed for World Bank and referred to in Section 9 of Chapter 2. No further work has been done on this.

Figure 6: Proportion of South African population using key banking services



The gold standard for identifying problems with access for households would be the sort of comparisons of banked versus un-banked populations described for the US and Mexico City in the Caskey, Ruíz Durán and Solo [2004] study. A second-best would be to know, at least, what proportion of the adult population have access to (a) bank payment services, (b) bank accounts (c) savings products and (d) credit. Perhaps the clearest example of this is the chart reproduced here in a slightly reduced form from the FinMark Trust (South Africa) website[11].

This, however, represents the limit of what it has been possible to find on a consistent basis down to product level for developing countries. Stone [2005] in his stocktake on indicators of access for UK Department for International Development identifies only ten countries for which survey data is consistently available on this indicator.

11 www.finmark.org.za – The FinMark Trust was established in March 2002 with initial funding of GBP 5 million from the UK Government's Department for International Development. Its mission is "Making Financial Markets Work for the Poor" and in pursuit of this objective it supports institutional and organisational development that will increase access to services by the un- and under-banked of South Africa, Botswana, Lesotho, Swaziland and Namibia.

Putting all the sources together the following spectrum of access emerges:

Table 5: Proportion of surveyed (adult) population with bank/savings accounts

EU15 average	90%	Swaziland	35%
United States	91%	Namibia	28%
South Africa	49%	Djibouti[12]	25%
Botswana	47%	Mexico City	21%
Brazil (urban)	43%	Lesotho	17%
Colombia (Bogota)	39%	Tanzania	6%

In addition to this there are a number of countries for which it is possible to piece together the number of accounts at different types of bank and near-bank financial institution and compare these to the adult population of each country. Table 6 shows selected examples.

Table 6: Commercial and savings bank accounts per head of adult population

Côte d'Ivoire 10 million adults	Kenya 17 million adults	Chile 10 million adults	Spain 31 million adults
- CECP, the postal savings bank, services 875,000 accounts through 194 outlets and has a deposit market share of 4% but does no lending	- KPOSB, also a postbank, services 1.9 mn accounts through over 470 outlets and has a market share of under 3% and also does no lending	- Banco Estado, services 11 million accounts through over 378 outlets, has a deposit market share of 17% and a 15% loan market share	- Spanish savings banks service 52 million accounts through more than 20,000 outlets, has a market share of just under 50% for deposits and loans
- the rest of the banks service just 660,000 accounts through 150 outlets	- the rest of the banks service just over 2 mn accounts through 583 outlets	- the rest of the banks service just 1.1 mn accounts via 1500 outlets	- the rest of the banks service 34 million accounts via 19,000 outlets
- overall, there is roughly one bank or savings bank account **per six** adults.	- overall, there is roughly one bank or savings bank account **per four** adults.	- overall, there is just over one bank or savings bank **for every** adult.	- overall, there are roughly 2 bank or savings accounts **for every** adult.

12 The data for Djibouti differentiates by location with 27% of respondents in Djibouti City having an account compared to 19% in other urban areas and barely 6% in rural areas.

B. Methodology for overcoming the lack of solid data on access

Given the lack of specific country data on access to finance, the only option is to identify a set of proxy or "tracking" variables that are consistently available for a broad spectrum of countries, and that might point to levels of access, albeit indirectly. Two options are used in this paper.

The first involves looking at *data for the value of business being done and trying to identify the balance between cash in circulation and deposits mobilised*, as well as the proportion of these deposits that might be available for lending to the private sector (on the grounds that if deposits are predominantly funding the state they cannot be creating accessible finance for enterprise). This data mining exercise has been done in the context of the present project for 163 countries[13] accounting for 95% of the world's population. The financial data was taken from IMF International Financial Statistics and merged with GDP, population and price data from World Bank World Development Indicators, to allow comparisons of deposits mobilised per head of population.

The results of the analysis are presented in the tables and charts at the end of this chapter. They show a clear set of benchmarks regarding the balance of cash in circulation and deposits mobilised and these can be used to grade countries as to where they lie in the spectrum from the repressed access typical of poor developing countries through the first intermediate stages of broadening access before moving towards the full access typical of the advanced economies discussed in the literature survey.

The basis for this model is the experience of the previously very high access countries of the Soviet Bloc in Central and Eastern Europe. In all of these countries most individuals and all enterprises would traditionally have had a bank account and used it regularly for formal transactions even if barter and countertrade were becoming significant aspects of economic activity.

13 In fact full data records were created for 175 countries but a number of these were excluded from the analysis as the bulk of their banking activity is offshore business and the indicators calculated bear no relationship to the levels of access offered to these banks' domestic customers.

The hyperinflation, currency instability and recurrent banking crises that characterized the first stages of transition to a market economy in the early 1990s wiped out up to 95% of the real value of savings mobilised and recycled as credit under the old regime of monobanking systems. What has happened since then has given fascinating insights into how access can be rebuilt, with a very wide spectrum of experience to observe.

The first stage has always been to restore a more normal balance between cash in circulation and high-turnover transactions balances in short-term bank deposits. During this phase, the rise in the ratio of deposits to GDP essentially reflects reductions in the ratio of cash to GDP. Very often this involves a move away from settling commercial transactions with hard currency cash towards local currency and bank transfers. During the first stage money stays in the accounts for as short a time as possible and circulation is dominated by a few large players (often very rich individuals). As economies stabilise, and their economic base broadens more people get drawn into the process of proper monetary exchange. Better paid professionals in particular start to use their bank accounts for more than just receiving salaries and drawing them out as cash. During this second stage money stays in accounts for longer even though transaction volumes are growing, thus raising average balances. The ratio of deposits to GDP rises faster than can just be explained by reductions in reliance on cash. The final stage is where people more generally but also enterprises come to rely on their bank accounts as a store of value. In this stage cash to deposit ratios as well as deposit to GDP ratios are heading towards advanced economy levels.

Figure 7: Use of cash versus deposits – link to the role of the banking system

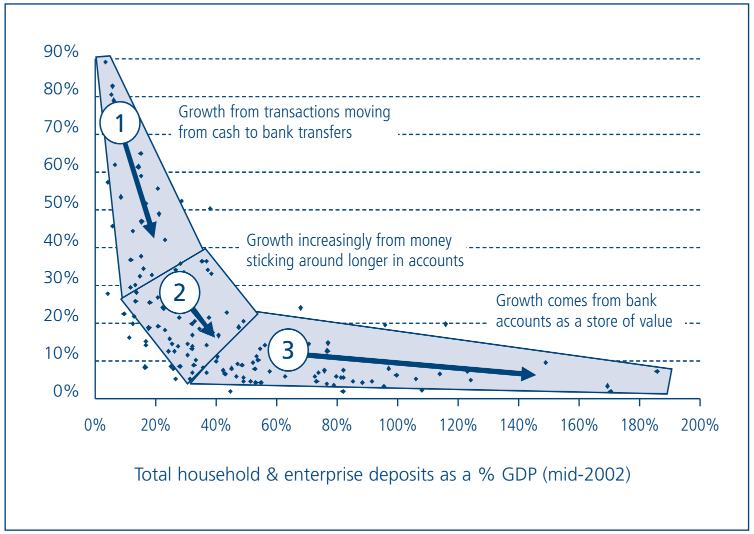
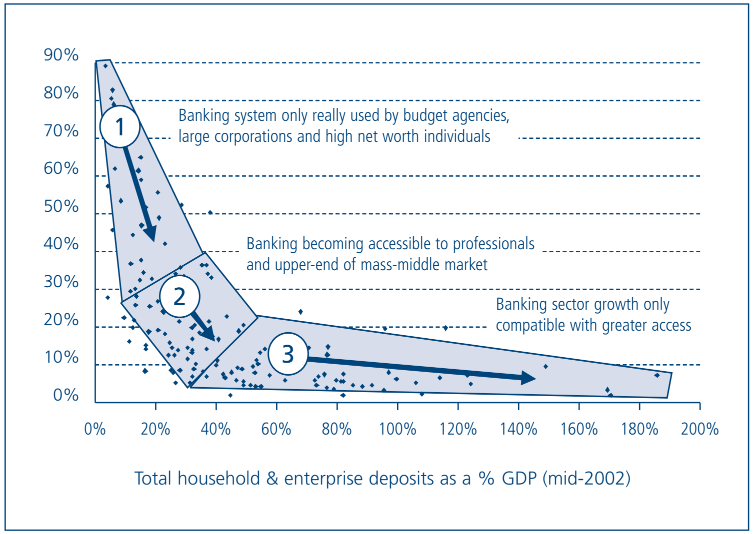


Figure 8: Use of cash versus deposits – link to customer type

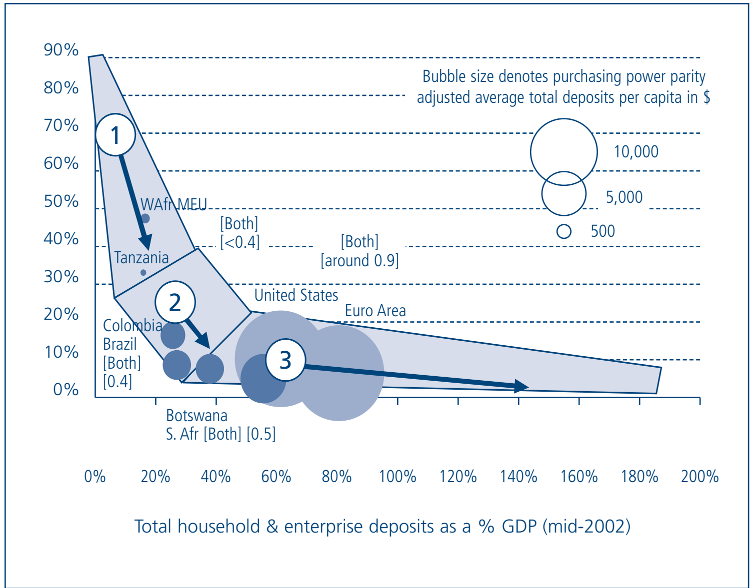


The two charts on the previous page put the two indicators of cash versus deposits and deposits versus GDP into a framework for grading access – first in terms of how customers use the banking system: e.g. are they using it merely for transactions or to store wealth? (Fig. 7) and secondly who uses it: e.g. large agencies and richer individuals versus the mass of the population (Fig. 8).

The zoning shown can be used to set thresholds for the three grades of access (by type of use and by type of user) as discussed above. In addition it is helpful in interpreting the data to introduce a third variable, namely per-capita deposits adjusted for differences in prices, helps us to refine the grading of individual countries.

The values for these indicators suggest show that to move from repressed access (where the proportion of the population having some sort of bank account and being able to use it will be less than 20%) typically requires a deposit to GDP ratio in the 10 to 20% range depending on the ratio of cash to deposits (the higher this is, the higher the ratio of deposits of GDP must be to move into the intermediate stage). It would be difficult to grade a country as having anything other than "repressed" access if the ratio of cash to deposits was much above 30%. The thresholds for being graded as moving towards full access are similarly structured, but with deposits in the 20-40% range when measured relative to GDP and cash to deposit ratios down below 20%. In certain countries where these two ratios might suggest a higher grading but per-capita deposits are much lower than comparable countries in the region, a country has sometimes been downgraded. This combination is often an indicator of a banking system focused on the international trading needs of an economically significant but rather tightly defined corporate elite. An example of this would be Kenya – a country that might otherwise be graded as in the intermediate phase between repressed access and moving towards full access.

Figure 9: Use of cash versus deposits – implied level of access



The chart above looks just at the countries for which we have some sort of estimate for the proportion of the adult population with a bank deposit. This gives some magnitudes as to what constitutes repressed access (less than 20% of adults with accounts), the intermediate stage (20%~50%) and moving towards full access (50% and above).

Clearly, however, these monetary indicators of access are very indirect and the setting of the boundaries somewhat judgemental[14]. Nevertheless, they are available at high frequency and produced to a standard IMF-approved methodology for almost all countries in the world that covers both advanced economies as well as developing and transition economies. For this reason it was used in the authors' first study for WSBI on the nature of access (WSBI [2004]). That study includes charts plotting the countries of different regions on the zoning shown above, together with additional charts for each region showing the proportion of money potentially available for lending to the economy and not locked into financing the state.

14 Note that the full range of survey data in Table 5 had not been drawn together in a consistent format until Robert Stone produced the first draft of his stocktake for DFID towards the end of 2004.

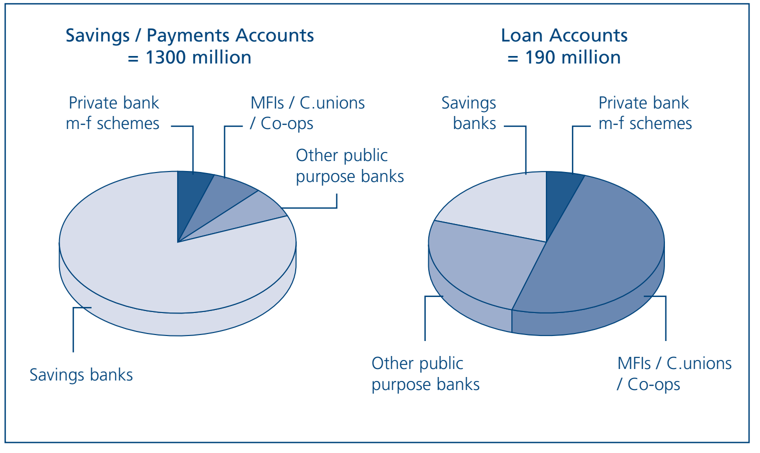
Fortunately another methodology is available and was pioneered by CGAP, World Bank's Consultative Group to Assist the Poor. CGAP's Occasional Paper No 8 [2004] introduced the concept of measuring access by calculating the number of accessible accounts at so-called double bottom-line institutions that have a social as well as a financial mandate. These institutions comprise a range of public purpose banks (agricultural and development banks as well as savings banks) together with community-based institutions (co-operative and community banks plus credit unions) and specialist microfinance units including the microcrediting schemes run by commercial banks. This groundbreaking CGAP [2004] study identified some 750 million accessible accounts across the developing and transition economy world, all at institutions that in one way or another explicitly target customers not usually dealt with by developing or transition economy commercial banks. Within this total, however, the number of accessible accounts at non-postal savings banks was only an acknowledged "guesstimate" by the CGAP team. The second detailed study by the authors of this paper for WSBI (WSBI [2005]) on the role of savings banks in promoting access took the analysis further forward using WSBI member data to raise the total estimated number of accessible accounts across developing and transition economies up to 1.4 billion.

The methodology for arriving at this new higher estimate is described in detail in WSBI [2005]. It involved a five stage process:

- The CGAP data for specialist microfinance units, community-based institutions and agricultural/development banks were taken without change.
- Similarly the CGAP data for postal savings banks (sourced mostly from UPU, the UN's Universal Postal Union) were also taken almost entirely without change but minor modifications made based on WSBI data sources.
- Account numbers at a number of very large non-postal members of WSBI were taken separately, mostly as actual data (China and Russia) but with partial estimation in two cases (India and Pakistan).
- Then the half of the rest of the non-postal membership across the developing and transition economy world (some 19 members) had actual data that allowed the calculation of total account numbers and average deposit balances as a percentage of per-capita GDP.
- And for the rest of the non-postal members of WSBI, data was available on total balances and this could be turned into sensible estimates of account numbers by assuming that average deposit size equalled a quarter of per-capita GDP (the typical level for members with data on account numbers).

Taking all the savings bank elements of this together creates a much sounder estimate of *around 1.1 billion accessible accounts at postal and non-postal savings banks*[15] *out of a total 1.4 billion accessible accounts at all double-bottom line institutions*. The make-up of this total, but differentiating between who mobilises savings and who creates credits, is illustrated below:

Figure 10: Suppliers of accessible accounts in developing/ transition economies



Note that the total number of accessible account relationships is less than the sum of deposit and loan accounts to avoid double counting combined deposit and loan relationships.

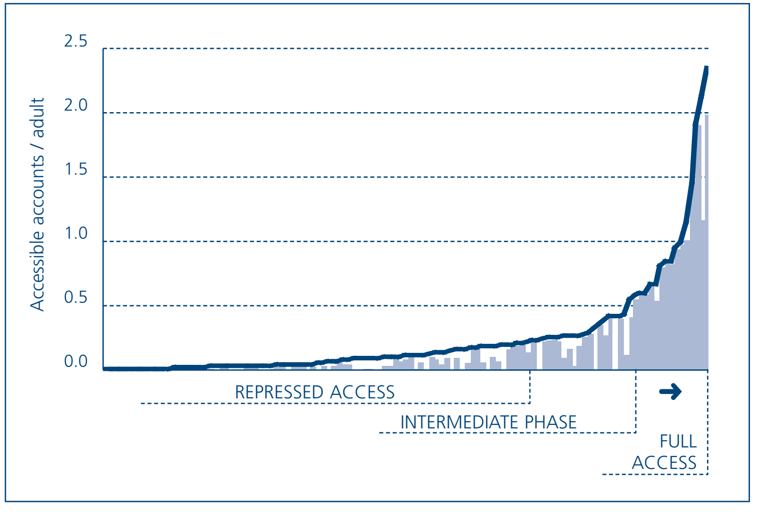
What is interesting in this analysis is the marked asymmetry between who mobilises savings services and who creates credit. This difference is less marked if one looks at public purpose banks as a whole, i.e. savings banks plus mostly publicly-owned agricultural and development banks. Together they service five out six accessible savings/payments accounts and provide four out of six accessible loan accounts. It is interesting also to note that, within the data on loan accounts, *savings banks provide at least as many accessible loans as specialist MFIs, credit unions and co-operatives combined*.

15 Compared to CGAP's original estimates of 320 million postal savings accounts (all deemed accessible) and 150 million non-postal savings accounts targeted at the market below that served by commercial banks.

The data shown above almost certainly understates the involvement of savings banks in the market for accessible credit – non-postal savings banks across the developing and transition economy world typically recycle half of deposits mobilised as credits and half of WSBI's membership in these countries run some sort of specialist microcredit scheme. In any case the distinction between general savings bank lending and microcredit is fairly fungible. Microentrepreneurs across the world will often use consumer and mortgage loans to finance their business and the average loan size for the whole portfolio of WSBI members reporting loan account numbers is the same or less in Central Europe and Central & Southern America as the average loan size of specialist microfinance units in the same regions (for Asia, however, it is significantly higher).

Data on the above basis is available for institutions in some 130 developing and transition economies and allows countries to be ranked in terms of accessible accounts per head of population as follows:

Figure 11: Spectrum of access as shown by accessible accounts per adult



The chart above has been zoned using the same target criteria as was used for the monetisation data – i.e repressed access indicates less than one accessible account for every fifth adult, an intermediate phase where every third or fourth adult has an account and moving towards full access once at least every second adult has an account.

The dark line shows total accessible accounts per adult and the grey columns underneath show accessible accounts at public-purpose banks (expressed as total numbers of accounts divided by the total adult population). Each column represents a separate country. The white space between the dark line and the grey columns represents accessible accounts at specialist microfinance units and community-based institutions such as credit unions and co-operatives combined.

Again the chart shows how important savings or other public purpose banks are to the provision of accessible finance for all – there are very few developing and transition economies that are moving towards or already have full access, which do not have a strong savings or other public-purpose banking movement. Indeed it would seem that specialist microfinance only ever substitutes for savings banking in countries with repressed levels of access and that beyond this it becomes a complementary activity that, as already noted above, is often conducted by savings banks just as much as by specialist microfinance units. Where specialist microfinance and community based access does frequently substitute for savings and other public-purpose banking is in economies disrupted by war or other acute civil disruption. Over half of the developing and transition economies covered by the chart above that have very repressed access (i.e. not even one accessible account for every tenth adult) and no savings or other public-purpose bank – i.e. entirely white space below the line in the chart above – have suffered at some time in this way during the decade or two.

This analysis is encouraging regarding potential access across the developing and transition economy world but also challenging:

- Overall there is far more of a platform for access than thought to exist even a year ago – 1.4 billion account relationships identified in this study (and WSBI [2005]) compared to 750 million in CGAP [2004] and the talk of only 50 million people with access to microcredit at when the UN Year of Microcredit was being planned a year or two earlier. At this level there are enough accessible accounts for roughly every 2.4 adults across the developing and transition economy world. If this was spread evenly across countries it would mean enough for most households to have an account, but it is in fact spread very unevenly with intermediate to high levels of access in a few countries with large populations (China, India, Indonesia and Russia) biasing up the average significantly.
- Because of the uneven distribution of accessible accounts, the better than expected overall availability hides very repressed levels of access in many developing and transitional economies, where less than one in five adults has an account at institutions designed to be accessible.

The benefit of using this analysis to track access is that accounts at accessible institutions are clearly a more direct indicator than monetary volumes. Nevertheless, it does have weaknesses. First, it is a one-off analysis that is not particularly easy to keep current. Perhaps more importantly, in a not insignificant minority of countries it shows some countries as having little or no access where in fact they have relatively developed commercial banking systems that do reach down at least into the mass middle market.

The approach taken in this paper is therefore to use the analysis based on monetary volumes (i.e. deposit to GDP and cash to deposit ratios) to modify at the margins the analysis based on accessible account penetration. Table 7 below gives the results of this merged approach. Countries are graded by the number of accessible accounts per adult and grouped according to whether access is coming (a) predominantly from specialist microfinance units, credit unions and co-operatives, (b) predominantly from savings banks and other public-purpose banks or (c) where commercial banks might also be playing a significant role in providing access. In the latter case, where the number of accessible accounts per adult is relatively low but monetary indicators suggest higher levels of access, then the countries to which this applies are shown first in bold, where the number of accessible accounts per adult would suggest they should appear, and second in normal text where monetary volumes suggest they should be. The arrows indicate how far up the accessibility ranking the monetary volume data move some countries.

Having made these adjustments then, of the 130 developing and transition economies that can be addressed in this way, more than half the sample – some 74 countries – display repressed levels of access where less than one in five adults will have an account. By contrast barely a third of this number – some 26 developing and transition economies – will be moving towards or already have full access, where at least every second adult and therefore most households will have an account. This leaves some 30 countries in the intermediate phase where between a quarter and a third of adults will have an account. Having graded countries in this way, it is then possible to calculate average indicators of access for different regions, and compare these for groups of countries with different levels of access.

It is also possible to compare development indicators for these same groups within regions. This is done in Tables 8 and 9 below.

Table 7: Summary grading of countries by merged method of assessing access

		Bulk of access via specialist MFIs, credit unions, co-ops, etc	Savings and other public-purpose bank providing bulk of access	Countries with signs of some significant access via comm. banks
← REPRESSED ACCESS →	Countries with no identified accessible accounts per adult	Chad, Somalia & Turkmenistan		**Brunei, Djibouti, Israel, Kuwait, Qatar, S. Arabia & UAE**
	Countries with only 0.01 ~ 0.10 identified accessible accounts per adult	Afghanistan, Lao PDR, Liberia, WB&Gaza, Eritrea, Mozambique, Timor-Leste, Venezuela, Moldova, Sierra Leone, Armenia, Georgia, Kyrgyz R., Bosnia H., Nigeria, Guinea, Ethiopia, Swaziland, Ghana, Burundi, Uganda, Nepal, El Salvador, Gambia & Malawi	Libya, Belarus, Yemen, Iraq, Sudan, Zambia, Tajikistan, Serbia Montenegro, Mauritania, Azerbaijan, Uzbekistan, Cen. African Rep., Myanmar, Comoros & Cambodia	**Argentina, Estonia, Libya, Lithuania, Oman,** Albania, Bhutan, Syria, **FYROM,** Lesotho, Sao Tome P., Mauritius, **Jordan, Mexico,** Guyana, Nicaragua, Costa Rica, **Peru & South Africa**
	Countries with only 0.10 ~ 0.20 identified accessible accounts per adult	Rwanda, Madagascar, Congo, Burkina Faso, Togo & Guatemala	Algeria, Cameroon, Pakistan, Tanzania, Ukraine, Colombia, & Cote d'Ivoire	Honduras, Iran, **Kenya, Latvia, Namibia,** Paraguay, **Philippines, Slovenia,** Suriname & Senegal
INTERMEDIATE	Countries with 0.20 ~ 0.50 identified accessible accounts per adult	Ecuador, Benin, Bangladesh & Indonesia	Vietnam, Gabon, Brazil, Zimbabwe, Romania, Niger, Mali, India, Mongolia, Botswana, Kazakhstan, Angola, Tunisia, Morocco & Egypt.	Argentina, Brunei, Djibouti, Estonia, Kenya, Libya, Lithuania, Mexico, S.Arabia, FYROM, Namibia & Peru reallocated plus Belize, **Croatia, Uruguay,** Turkey
TOWARDS FULL	Countries with 0.50 ~ 1.00 identified accessible accounts per adult		Poland, China, Kazakhstan, Cuba, Korea, Bolivia, Russia, Malaysia, Czech R., Bulgaria & Chile	Croatia, Jordan, Oman, Kuwait, Philippines, Qatar, Slovenia, S.Africa, UAE & Uruguay all reallocated
FULL	Countries with more than one accessible account per adult		Cape Verde, Thailand, Slovak Republic, Sri Lanka & Hungary	All advanced economies plus Israel reallocated

NOTES: All small island states and known offshore centres excluded.

Table 8: Summary indicators of access across different regions

Advanced econ.	Deposit to GDP ratio 91%	Cash to deposit ratio 7%	Accessible a/c per adult not calculated
All relatively high access			

	Towards full access	Intermediate stage	Repressed
Mid-East & North Africa	Deposit to GDP ratio 73%	Deposit to GDP ratio 51%	Deposit to GDP ratio 34%
	Cash to deposit ratio 6%	Cash to deposit ratio 17%	Cash to deposit ratio 10%
	Accessible a/c per adult 0.02	Accessible a/c per adult 0.38	Accessible a/c per adult 0.11
East & Southern Africa	Deposit to GDP ratio 58%	Deposit to GDP ratio 18%	Deposit to GDP ratio 18%
	Cash to deposit ratio 4%	Cash to deposit ratio 12%	Cash to deposit ratio 30%
	Accessible a/c per adult 0.10	Accessible a/c per adult 0.20	Accessible a/c per adult 0.05
West & Central Africa	Deposit to GDP ratio 61%	Deposit to GDP ratio 14%	Deposit to GDP ratio 18%
	Cash to deposit ratio 12%	Cash to deposit ratio 42%	Cash to deposit ratio 31%
	Accessible a/c per adult 0.80	Accessible a/c per adult 0.25	Accessible a/c per adult 0.05
Central & South America	Deposit to GDP ratio 38%	Deposit to GDP ratio 25%	Deposit to GDP ratio 22%
	Cash to deposit ratio 7%	Cash to deposit ratio 12%	Cash to deposit ratio 14%
	Accessible a/c per adult 0.76	Accessible a/c per adult 0.15	Accessible a/c per adult 0.11
Central Europe (Incl. new EU)	Deposit to GDP ratio 42%	Deposit to GDP ratio 20%	Deposit to GDP ratio 22%
	Cash to deposit ratio 16%	Cash to deposit ratio 16%	Cash to deposit ratio 37%
	Accessible a/c per adult 0.94	Accessible a/c per adult 0.24	Accessible a/c per adult 0.05
Russia and Other CIS	Deposit to GDP ratio 20%	Deposit to GDP ratio 23%	Deposit to GDP ratio 18%
	Cash to deposit ratio 33%	Cash to deposit ratio 22%	Cash to deposit ratio 50%
	Accessible a/c per adult 1.73	Accessible a/c per adult 0.03	Accessible a/c per adult 0.05
South & East Asia	Deposit to GDP ratio 131%	Deposit to GDP ratio 48%	Deposit to GDP ratio 43%
	Cash to deposit ratio 8%	Cash to deposit ratio 18%	Cash to deposit ratio 18%
	Accessible a/c per adult 0.63	Accessible a/c per adult 0.26	Accessible a/c per adult 0.09

Table 9: Development indicators for countries grouped by region and access

Advanced econ.	Adult Illiteracy 0%	Rural: Urban ratio 0.31	PPP adj. GDP per capita 29647
All relatively high access			

	Towards full access	Intermediate stage	Repressed
Mid-East & North Africa	Adult Illiteracy 14%	Adult Illiteracy 42%	Adult Illiteracy 30%
	Rural: Urban ratio 0.16	Rural: Urban ratio 0.79	Rural: Urban ratio 0.77
	PPP adj. GDP per capita 16,979	PPP adj. GDP per capita 7,196	PPP adj. GDP per capita 6,851
East & Southern Africa	Adult Illiteracy 15%	Adult Illiteracy 16%	Adult Illiteracy 43%
	Rural: Urban ratio 0.75	Rural: Urban ratio 1.63	Rural: Urban ratio 2.95
	PPP adj. GDP per capita 13,182	PPP adj. GDP per capita 2,745	PPP adj. GDP per capita 1,582
West & Central Africa	Adult Illiteracy	Adult Illiteracy 75%	Adult Illiteracy 41%
	Rural: Urban ratio	Rural: Urban ratio 2.01	Rural: Urban ratio 1.42
	PPP adj. GDP per capita	PPP adj. GDP per capita 1,920	PPP adj. GDP per capita 1,947
Central & South America	Adult Illiteracy 7%	Adult Illiteracy 11%	Adult Illiteracy 14%
	Rural: Urban ratio 0.25	Rural: Urban ratio 0.24	Rural: Urban ratio 0.42
	PPP adj. GDP per capita 9,113	PPP adj. GDP per capita 10,286	PPP adj. GDP per capita 7,060
Central Europe (Incl. new EU)	Adult Illiteracy 1%	Adult Illiteracy 2%	Adult Illiteracy 0%
	Rural: Urban ratio 0.56	Rural: Urban ratio 0.79	Rural: Urban ratio 0.50
	PPP adj. GDP per capita 12,434	PPP adj. GDP per capita 7,431	PPP adj. GDP per capita 10,577
Russia and Other CIS	Adult Illiteracy 1%	Adult Illiteracy no data	Adult Illiteracy 1%
	Rural: Urban ratio 0.41	Rural: Urban ratio 0.69	Rural: Urban ratio 0.69
	PPP adj. GDP per capita 8,534	PPP adj. GDP per capita 7,223	PPP adj. GDP per capita 4,493
South & East Asia	Adult Illiteracy 14%	Adult Illiteracy 40%	Adult Illiteracy 40%
	Rural: Urban ratio 1.48	Rural: Urban ratio 2.30	Rural: Urban ratio 1.54
	PPP adj. GDP per capita 5,841	PPP adj. GDP per capita 3,415	PPP adj. GDP per capita 3,651

These additional socio-economic variables – taken from World Bank World Development Indicators and UNDP Millennium Development Goal Indicators – allow some conclusions to be drawn on whether lack of access is addressable within a narrow banking system context (e.g. by opening more bank branches) or is a function of a wider lack of economic development. When these indicators are presented on a region-by-region basis they reveal a fairly systematic relationship between acutely repressed access and wider under-development.

There is always going to be some circularity to this type of argument – banking systems in poor economies are always likely to be small relative to GDP and this makes them too costly to support the process of development for all but a privileged elite. Nevertheless our approach and the results obtained do have implications for the policy agenda, which will be explored more fully in the next two chapters. Two apparent relationships should be investigated further:

- the correlation, at least for some regions, between the low levels of access in some poorer countries and illiteracy; and
- a similar partial correlation between the balance of rural versus urban dwellers within the population.

Both suggest that new models of reaching people may help access. Looking at regional differences five conclusions emerge:

- Sub-Saharan Africa is a long way behind other regions in terms of expanding access (although much, but by no means all, of this is a reflection of the extremes of poverty seen there).
- Asia is pretty well advanced in this respect. This is particularly true of the rapidly industrialising countries in that region but also of the generality of developing Asia.
- The more advanced transition economies of Central Europe have progressed extremely well in rebuilding real access after the huge declines of the early 1990s.
- However, most CIS countries, with the exception of Russia, lag far behind in this process.
- Central and South America have made surprisingly little progress in spite of relatively robust economic bases. This is particularly true of the larger countries in that region.

Much greater regional detail is available from the two separate studies completed for WSBI by the authors of this study (WSBI [2004] and [2005]).

Four main issues for further research are:

- to integrate emerging data on account numbers at commercial banks coming from surveys of regulator by World Bank, which is underway now and should yield results in early 2006;
- to do more detailed survey work with different types of savings bank to assess how far their reach extends across different socio-economic segments of the populations they serve, particularly the poor;
- to try and differentiate within the analysis between household and enterprise use of banking services (which will require accessing individual central bank data rather than the large multilateral databases used so far);
- and to address, using banking sector profitability data (either system-wide or better still bank-by-bank), the critical issue of the cost of access in different regions.

4. PUBLIC POLICY AND BANK RESPONSES TO ISSUES OF ACCESS

A. Overview

The nature of problems with access in advanced industrial countries differ compared to those in poorer developing economies. The policy responses tend to be different as well. In advanced industrial economies policy to improve access focuses partly on (a) making sure the banking system does not leave some parts of the domestic population behind as it pursues more profitable segments of the market at home and abroad and (b) trying to strengthen non-bank alternatives for those who are no longer effectively served by banks. By contrast the thrust of policy in poorer developing countries now seems to be going the other way. So far – (a) most focus has been on non-bank outreach to reach the bulk of the population and has involved (b) disappointments with a lack of financial self-sustainability among microfinance programmes that is leading to a re-examination of what role the formal banking system could play.

B. Public policy measures to enhance individual access

1. Advanced economies

Most OECD governments have introduced policies to try to improve access to financial services for poorer and vulnerable households. In many cases these interventions are of quite recent origin – the last 5 years. The important exception and arguably the most substantial and long-lived set of policy measures to improve financial access are those embodied in the US Community Reinvestment Act (CRA) enacted by the US Congress in 1977 and revised in 1995. The details of the objectives and modus operandi of this Act are discussed below and in the related box but the CRA approach is just one of three options open to governments:

- The regulatory system can be used to direct but not mandate banks to address the problem (and this is what might be described as the CRA model in the US);
- The authorities can mandate all banks to provide minimum banking services for otherwise excluded segments of the market (so-called "basic accounts"); or
- They can rely on banks with a social commitment (in the legal form of either public banks, cooperatives or foundations) as for example in the French, German and Spanish banking system and/or on what are sometimes confusingly called "universal banks" offering very restricted retail services through the postal network.

The CRA model is very much an American solution, not followed elsewhere and hence the main discussion of it in this paper is in a box below. Claims for its success are contested but with neither side establishing a strong position. It is perhaps a classic American compromise between a commitment to free markets combined with the use of quite substantial regulatory powers to protect the interest of individuals against those of large corporations. The CRA should not, moreover be seen in isolation. In 1999, the US Treasury Department launched a major effort to pay all federal benefit payments, such as social security benefits, electronically. One impediment to this initiative was the large number of benefit recipients without bank accounts. As a result, the Treasury urged banks to offer Electronic Transfer Accounts (ETAs). The Treasury offered to pay banks $12.60 for each ETA account they established for benefit recipients, and the Treasury specified a minimum set of characteristics that these accounts must meet. The accounts could not cost account owners more than $3 a month, they could levy no fee for electronic deposits coming from the federal government, they could have no minimum balance requirement, and they had to permit four free cash withdrawals per month. Although hundreds of banks, thrifts, and credit unions agreed to offer the accounts, usage rates are reportedly low.

Box 5: The community reinvestment act: objectives, methods and evaluation

Origins

The Community Reinvestment Act (CRA) was enacted by the Congress in 1977 in order to encourage depository institutions to help meet the credit requirements of the communities in which they operated including low to moderate income neighbourhoods. The law specified that such community lending must be consistent with safe and sound banking practises. In 1981 a Community Affairs Office was set up by each of the 12 Federal Reserve Banks. The Community Affairs office aim was to work with both the public and the depository institutions to identify credit needs and existent gaps and find solutions to address the community's credit needs. Many hundreds of US banks now participate in the CRA initiative and comply with its requirements but 75% of the business is performed by 500 larger banks.

CRA Examiners

Board of Governors of the Federal Reserve System (FRB) / The Office of Thrift Supervision (OTS)
The Federal Deposit Insurance Corporation (FDIC) / Office of the Comptroller of the Currency (OCC)

Objectives

- Encourage partnerships among public and private organisations to fulfil the credit needs of low to medium income neighbourhoods.
- Informing financial institutions and community organisations on the availability of public and private community development resources
- Promoting an understanding of the CRA amongst individuals, communities, and institutions.
- Promoting and increasing the awareness of a community's needs and assets for development.

CRA Regulation

The majority of the examining organisations conduct a CRA credit rating every three years for national banks. However the Gramm-Leach-Bliley Act mandates an extended examination cycle for smaller banks. Restructuring of the CRA examination now means that emphasis lies with the bank's performance in making loans rather than the bank's process for complying with CRA. The bank receives one of four possible ratings. These are: Outstanding, Satisfactory, Needs Improvement or substantial non-compliance. Tests focus on the areas of lending (which carries greater weight than the others), service and the investment. The depository institution under examination may fall into one of four categories, large banks that exceed $250 million dollars of assets, small banks which hold under $250 million in assets, wholesale banks, and a more complex sub-group of banks that choose to be evaluated under a strategic plan option, where they are evaluated against a pre-determined and approved set of CRA criteria.

Bank Evaluation

To attain a CRA rating, the depository institution must be evaluated regularly in order to assess its ability to meet its community credit needs. CRA examinations are conducted by the relevant federal agencies responsible for overseeing the depository organisations in their respective regions. The ability of depository institutions to meet their community lending needs and thus acquire a favourable CRA rating is taken into account when they seek to expand through merger, acquisition and branching.

Process Evaluation

In November 1999 the US Congress instructed the Federal Reserve Board to undertake a comparative study of performance on CRA loan programmes. The study was asked explicitly to look at the usefulness of prior research and found that it was very limited in scope focusing mainly on a small sub-set of loans made under affordable-home-loan programmes within CRA. However, these studies did reveal large variations in loan performance across individual banking institutions, depending on factors such as client location and also the specific approaches used to extend CRA loans. The 1999 study reviewed the activities of the 500 largest banks accounting for 75% of all CRA loans. Response rates were relatively low (less than 30%) but revealed, among others, the following main conclusions:

- Overall CRA lending has been profitable or marginally profitable for most banks
- CRA-home-purchase and refinance lending was less profitable and had generally worse (and certainly no better) delinquency rates than mainstream lending in these categories
- Larger banks showed a significant tendency to have lower profitability CRA-lending (relative to their overall lending) than did smaller banks
- SME loans via the CRA programme were profitable for most banks and differed very little in terms of their delivery costs and profitability as compared with mainstream SME lending.

Finally, some government agencies and philanthropic organisations have provided financial support to credit unions and banks that have, as a main goal, the promotion of the economic development of low- and middle-income communities. Such banks, credit unions and venture capital firms are generically known as community development financial institutions (CDFIs). Some are organised as not-for-profit institutions and others as for-profit, but to be classified as a CDFI a for-profit organisation must be willing to limit its profits in order to achieve community development goals.

From 1997 onwards the United Kingdom government has made the fight against exclusion a high priority. However, it has adopted an approach based on mediation and consensus rather than on forcing imposed solutions such a universal banking obligation. The UK notified to the EU various methods in the name of 'universal banking services' in July 2001. These measures were part of a drive to improve access to current accounts for the 'un-banked' and were also designed to reform the social security benefit system by making it obligatory for all transactions to be paid through automated credit transfers.

The UK government proposed that Post Office Limited, in collaboration with banks willing to take part in the scheme, should in the future offer basic bank accounts that are specifically tailored to the needs of those without bank accounts. These bank accounts are free of charge and do not offer credit facilities: the latter point avoiding the risk which is a major deterrent for people that choose to remain without a bank account. For those who still do not wish to open even this basic bank account, a Post Office Card Account (POCA) would be offered, which would be similar to the old system, but instead using a swipe card in place of the old paper order books and giro-cheques. This would be expected to increase the numbers of state-pensioners and other welfare beneficiaries introduced into banking. However, POCA has so far been used narrowly as a cash withdrawal system by most beneficiaries.

In France legal arrangements exist to combat exclusion (e.g. the loi Aubry of 1998) and these recognise the right of all individuals to possess a bank account. Nonetheless it is estimated that around 1 million vulnerable persons do not possess even a standard checking account (Le Monde June 2004). In 1999 France instituted the idea of a basic banking service for the most deprived households and later added procedures for personal bankruptcy to make it easer for highly indebted families to get a second chance (the law Borloo of August 2003).

So far the take- up of the basic banking service seems to have been disappointing with the Bank of France estimating a take-up of only 12,000 persons by 2003.

This is attributed in part to a discriminatory attitude on the part of the mainstream French commercial banks and an increasingly drastic profit-driven selection criteria for clients (Gloukoviezoff [2003]). The system works broadly as follows. All French banks have the right, the law mentioned above notwithstanding, to turn down anyone seeking to open an account. But the rejected person can than contact the Bank of France who will provide a named bank that will then be obligated to open an account for that person. Because this is unpopular with banks, one result has been that the battle against exclusion has fallen squarely on the French postal network (via La Poste). Specifically La Poste reckons that one out of two persons on modest incomes are clients (mainly via pass-book accounts) although it has only about a 9% share of the financial services market as a whole.

Sweden has also undertaken pro-active measures to address financial sector access. Commercial banks in Sweden are obliged to accept deposits from the public, and therefore are obliged to open accounts. However, they are not obliged to provide associated payment services, a practice that has been condemned by the Financial Supervisory Board. The Post Office, by contrast, has always facilitated over-the-counter cash/payments transactions. Unfortunately, due to the rapid increase in telephone and internet banking and the associated cost reductions and the ending of cross-subsidies, these types of payment services have been declining in their availability. This has caused a rise in the cost of providing the services. In an effort to ensure uniform access to cash facilities, the Swedish government in 2001 proposed entrusting the State-owned Posten AB with a universal basic cash service.

Similarly, the government in Ireland has for some years been committed to developing an information society and to use this to support the anti-poverty programme that was launched in 1997. In 2002 it was decided that a single regulatory authority for financial services would monitor and promote access to financial services from a citizens' perspectives. The main measure taken by Ireland was the redevelopment of the Post Office network, increasing country-wide access to counter services, and in particular improve access for vulnerable people in remote areas.

2. Developing economies

The same basic options present themselves to the governments of developing countries but with much more focus on the third option - relying on social and public sector institutions to fill the supply gaps in the market.

The exception is South Africa where something rather like American CRA approach is being tried. Under the wider auspices of the Black Economic Empowerment (BEE) programme and the more sector-specific Finance Sector Charter, the big four banks have come together with the South African Post-Office (SAPO) and a number of smaller mass-access proximity banks to address the issue of improving access for the half of black adults that have no bank account or transactions mechanisms[16]. The focus is on developing very basic but functional First Order Financial Products (FORFPs). To qualify as giving effective access, these products must be delivered through an accessible geographic footprint (no more than 20km to the nearest access point), offer sufficient range and choice, be appropriate and affordable to the target market as well as user-friendly in their design, delivery and marketing. Two examples of such products are the Mzansi Account (for savings) and the Mzansi Transfer Product (for transactions) described in Nedbank [2004]. These will have common terms across all participating banks, will be capable of being carried on existing bank IT systems, and will settle between banks using the existing credit/debit card SASwitch system. The standardisation of terms and the use of existing IT platforms are intended to allow marginal cost pricing so that existing better-off customers will continue to pay for an operating platform they already use, leaving Mzansi customers to pay only for the genuine extra costs of processing their own business.

For other developing countries, the focus has traditionally been on developing specific institutional arrangements for fostering access. In the early post-colonial era this often focused on setting up specialist banks or nationalising and localising inherited banks. The most common vehicle for providing individual access was a specialist limited-mandate bank that could only gather savings deposits and process certain limited transactions. Savers deposits in these institutions were supposedly protected by very strict limitations on how funds could be invested (usually limited to "safe" government loans and securities).

16 The whole initiative is given further impetus by high levels of crime within South Africa, which discourages employers of even low-wage black workers from continuing payment of wages in cash.

A more restrictive version of this approach was to set up a national savings scheme, again with very strict limits on how funds mobilised could be used. Classic examples are Bansefi in Mexico (accounting for about one sixth of all bank accounts and savings accounts in Mexico), the Government Savings Bank in Thailand and the Indian small savings schemes formulated by the Ministry of Finance and administered by the National Savings Institute.

The capacity of many of these institutions to meet the needs of their developing economies stagnated through the 1970s, often as donor support diminished and savings mobilised were diverted to less and less viable projects. Through the 1980s and 1990s, problems with sustaining these compromised banks or schemes forced many governments to surrender the issue of improving access to NGOs and the emerging microfinance industry. In many ways much government policy came to be seen as obstructive to financial access, usually because of repressive financial regulations that capped interest rates, imposed burdensome reserve requirements or distorted the direction of lending through targeted credit schemes. All of these were seen as getting in the way of effective bank intermediation.

By the late 1990s, however, the agenda seemed to be changing again because of dissatisfaction with (a) the so-called "apex organisations" that channel funds from large donors to small NGO-based microfinance schemes and (b) the lack of financial self-sustainability of many smaller schemes when donor funds run out. Because both of these are less problematic in a successful bank-based microlending scheme, there has been growing interest in banks as channels for microfinance.

The change in position is probably best summarised by CGAP Focus Note 12 [1998] on Commercial Banks in Microfinance. This summarised a conference sponsored by USAID and a study by Baydas, Graham and Valenzuela [1998]. The main themes were that banks were structurally suited for microfinance (they were regulated, properly controlled and had their own funding sources) but that they were held back by internal misconceptions about the quality of microfinance. The key recommendations on the policy side were that donors should be:

- Urging governments to eliminate repressive financial regulations described above as these changes will help microfinance lenders compete in open markets as well as cover operating costs, risks, and the opportunity costs of capital.

- Developing and encouraging the adoption of prudential regulatory frameworks that recognise the special nature of microfinance. High legal reserve requirements, burdensome reporting requirements, inappropriate criteria for loan portfolio classification and provisioning, restrictions on the volume of unsecured (non-collateralised) loans, and inappropriate operational cost ratios are some of the elements that need to be modified to suit microfinance operations.
- Supporting dialogues between banks providing microfinance services and regulators to help educate supervisory authorities on the differences between microfinance and traditional banking.

C. Public policy measures to enhance enterprise access

1. Advanced economies

To the degree that the CRA in the United States functions to improve or at least sustain individual access, it also does so for enterprises. The clearest demonstration of an active policy to foster SME access to finance is probably the European Union Lisbon Agenda and the related Multiannual programme for enterprise and entrepreneurship (MAP). This is regularly reviewed and the latest description is contained in a European Commission [2003] working paper. Financial support for SMEs can be broken down into five main strands and these are summarised in the table below, with some indication of resources devoted to each strand and the benefit gained by SMEs:

Table 10: MAP summary of financial instruments for supporting European SMEs

	95	96	97	98	99	00	01	02	03	04	05
EIB Global loans			€22.5bn								
EIF Guarantees*	€1.3bn										
SME Guarantee Facility*				€9.8bn			€8.0bn				
EIF Venture capital instruments											
o/w EIF own resources			€0.2bn								
EIB mandated resources			€2.0bn								
ETF Start-up Facility				€0.2bn			€0.1bn				
Other Programmes											
o/w Seed capital action							€0.0bn				
JEV			€0.1bn								

** figures shown for guarantee schemes are the amount of lending supported not the guarantee amount*

The nearly €40 billion of finance provided or facilitated by these programmes between their inception and end-2002 was augmented by another €5-6 billion of commitments under other programmes. Taken together these funds are estimated to have benefited just short of one quarter of a million enterprises or about 1% of the potential universe of SMEs operating in the EU. In addition to this would be Member States' own schemes (particularly guarantee schemes) which although distributing some of the EU support described above, also generate their own flow of finance to enterprises.

2. Developing economies

Again, the same basic options present themselves to the governments of developing countries but it is much harder to gather data on such schemes. In addition to this, the same sorts of flows of lending from MFIs described for individuals in Section 2 will also be going to microenterprises (with the two very often indistinguishable where they most directly relate to very small scale activity).

D. Banking sector responses to financial exclusion in advanced economies

As is clear from the previous section, outside the "proximity" bank sector (discussed separately in Chapter 6) most banking sector responses to problems of *individual access* to financial services appear to have been *reactive* to public policy rather than pro-active. In the literature on access this is seen as a feature of the pressures of globalisation and banks' desire to sustain shareholder returns in an environment of disinflation and declining margins – banks doing the minimum to allay public policy concerns about growing exclusion while pursuing rationalisation of branch networks, marketing priorities and product cross-subsidies, is a common theme. In part, this is a reflection of the bias in the debate about access in advanced economies with most authors coming from a social exclusion angle and almost by definition dissatisfied by the service banks give.

In all countries examined the take-up of politically mandated basic or universal banking accounts has been slow, although most banks provide them because not to do so risks direct regulatory pressure on the pricing of basic banking services.

In the UK, the concept of the "Universal Bank" operating out of the post-office (which would have been little more than a next generation reinvention of the Post-Office Girobank set up in the 1960s and privatised to one of the building society banks in the 1980s) failed to take root and appears to have been replaced by a range of agreements between Post-Office Counters and various banks and building societies allowing customers of those institutions to access their accounts through local post offices. This approach was used actively to mitigate the impact of significant rural branch closures by Barclays and other banks in 2003 along with the placing of more remote ATMs in non-bank retail outlets. The response to this from consumer organisations, however, focused on the preference for elderly customers in particular for face-to-face contact, which transmuted the perception of exclusion from geographical into age-based.

The one dimension of exclusion where banks across the advanced industrial world are taking a more pro-active approach is in the area of financial literacy discussed in Chapter 2. This has a relatively long history back to the recessions of the 1980s when it became increasingly clear that educating small-scale entrepreneurs in the need for business and market planning helped improve the quality of SME lending. The focus is now more on individuals, where there is a sense that lack of understanding of how finance works leads to false expectations and subsequent disappointment with the more sophisticated investment-based and consumer credit products that banks need to sell to customers if they are to improve customer profitability.

The position on *enterprise access* is also more pro-active with most banks more than willing to participate in publicly funded or supported micro-lending programmes provided that any imposed constraints on their pricing properly reflect the extra cost of loan processing. This is helped by the fact that in a low inflation, low interest rate world, the operational costs of raising retail deposits rises relative to the wholesale market funding cost at which most of these schemes operate. Moreover, as wholesale rates fall, the discount for quality that government funding implies rises in importance relative to the base wholesale funding cost. This makes publicly sponsored on-lending programmes more attractive but to be brutally honest about this process, it would not matter who the end-recipient was and participation is not really an indication of shared concern about the importance of access for very small enterprises. This probably explains why overall such schemes tend to suffer from "mission creep" as bankers seek out those larger customers within the target market that have the larger borrowing needs over which to spread relatively fixed loan processing costs.

E. Banking sector responses to issues of access in developing economies

The same CGAP [1998] note discussed in section 2 above gives insights into the administrative structures used by banks to carry out fairly standard microfinance operations:

- Fully independent retail centres, affiliated to the bank but with their own lending policies, staff, and information systems that report to the larger bank (Banco del Desarrollo's microfinance subsidiary in Chile, the Unit Desa of Bank Rakyat Indonesia, and the Social Enterprise Program of the Bank of Nova Scotia in Guyana).
- Lending through NGOs that, in turn, on-lend to micro-enterprise clients (Banco Wiese in Peru).
- Semi-independent microfinance units lending directly and/or specialised windows in each bank branch, staffed with a microfinance credit officer. Administrative and financial functions are integrated into the larger bank (Banco del Estado, Chile; Banco Agrícola Comercial, El Salvador; Banco del Pacífico, Ecuador; Financiera Familiar, Paraguay; and Government Savings Bank / National Bank for Development, Thailand).
- Fully integrated operations, wherein small business credit officers also handle microenterprise clients. All administrative, personnel, and financial systems are integrated (Caja de Ahorro y Crédito Los Andes and BancoSol, Bolivia; Banco Caja Social, Colombia; Multi-credit Bank, Panama; Tanzania Postal Bank; and Centenary Bank, Uganda).

Most of the commercial banks attending the USAID conference offered micro-loans through a separate window or through part of the branch office that handles only microfinance clients. This separation allowed both the staff and clients to recognise the different terms between the traditional commercial banking services and microfinance services. The study suggests a positive correlation between the degree of independence of the microfinance unit and the scale of the operation. Moreover, banks with specialised independent microfinance units or subsidiaries found it easier to institute microfinance lending policies, procedures, and methodologies and avoid interference from the larger bank culture. Perhaps the most dramatic example is Bank of Nova Scotia that operates a group-lending programme in Guyana with loans mostly under US$300 under the umbrella of a large, sophisticated, foreign-owned commercial bank.

One other interesting possibility highlighted by Morduch and Hayley [2002] is the co-operation between PRODEM in Bolivia and BancoSol. PRODEM sets up small-scale solidarity-group model "banks" with target average loan sizes of $300-400 and then sells these on to BancoSol when they become profitable.

Yaron [2004] and Yaron, Benjamin and Piprek [1997] provide a case study of achieving financial self-sustainability based on BRI-UD bank in Java, Indonesia. This rural bank involves a model with the following main features:

- Market based charging for credit.
- Active deposit mobilisation so that resource-dependence on the state or on donors is gradually phased out.
- Transfer of the benefits of realistic interest rates on loans to depositors to further stimulate the sustained growth of deposit resources.

Summary parameters showing the performance of the bank over the 10 year period 1985 to 1995 are shown in the table below:

Table 11: BRI-UD bank – a ten-year progression

	1985	1990	1995
Average annual Loan Volumes ($ million)	162	562	1178
No of Outstanding Loans (million)	1.0	1.9	2.9
Average outstanding loan amount ($)	162	296	51
Average annual Deposit Volume ($ million)	49	685	2382
No of Deposit Accounts (million)	n/a	7.3	14.5
Average deposit per saver ($)	n/a	94	164
Average Interest on loan portfolio	27.4%	51.5%	31.8%
Average Interest paid on Deposits	10.5%	11.3%	9.7%
Nominal interest rate needed for Financial Self-Sustainability	36.2%	27.2%	17.5%

Paulson and McAndrews [1998] also provide a case study of the implementation within one bank – Standard Bank of South Africa – of radical new ways of addressing an un-banked population. In 1993 Standard Bank set up E-Bank, with a simple savings product offering card-only access but supported by dedicated staff speaking a mix of relevant local languages and operating out of dedicated outlets to help overcome problems of illiteracy and concerns about security in a high crime environment. Three key modifications helped deliver this. First, the outlets were designed around the ATMs' own cash-security features and because money was not being handled outside the ATMs the physical security of the outlet itself could be reduced. This allowed the outlets to be open to the street and much more approachable than traditional Standard Bank branches. Second, each customer was issued with a "stop-card" that they themselves could use to block their account if their ATM access card was lost or compromised. Finally, the account offered a segmented "savings purse" that could only be accessed in person with ID-verification by one of the staff. The products were running off existing systems and designed to cost-recover without becoming too costly, although there was never any attempt to become a low-cost supplier. The bank recruited 150,000 customers in its first year but transaction volumes were never as high as were needed to cover heavy start-up costs for the construction of the outlets and purchases of new ATMs. This was resolved by the bank folding E-Bank back into its main brand as E-Plan and Auto E-Bank, and then taking the opportunity to transfer over low-income customers from other higher-cost services.

F. Implications for future policy

- Clearly banks can be guided towards keeping accessibility on their management agenda by such instruments as the CRA in the United States and the Finance Sector Charter in South Africa. In some cases this may even stimulate efforts to improve access (as in South Africa). A more unresolved question, however, is whether such regulatory pressure really has more leverage on bank behaviour than do concerns about the public relations consequences for large banks of being seen to cut back on access.
- Banks are also clearly keen to participate in publicly supported SME financing and will even venture into quite small-scale crediting provided they are not impeded from doing so by clumsy regulation.

- It is much less clear whether mandating access ever really works – banks can create basic accounts but take-up is often poor and usage once created can be poorer still.
- There would seem to be real opportunities, particularly in a developing country context, to stimulate significant expansion of bank-based microfinance by pragmatic modifications of regulatory requirements without doing anything to encourage undue risk-taking. An example of such pragmatism is the recent scaling back of the potential increase in the risk-weighting of SME lending as part of the negotiation of Basel II.
- This greater involvement of banks in microfinance is almost certainly vital to building real financial self-sustainability (and reduced reliance on donors) for microfinance.

5. THE ROLE OF SAVINGS BANKS

A. Overview

The issue of access is taken seriously by the proximity bank movement – savings banks, co-operative banks and community banks worldwide. Access and exclusion are directly inferred in four of the paragraphs of the Madrid declaration of World Savings Banks Institute and a Resolution on Access to Finance was adopted by its membership in 2004. This chapter seeks to answer three key questions about the impact of that commitment:

- Does the differing strength of the proximity bank movement in individual countries or groups of similar countries explain the very wide spectrum of indicated performance regarding access worldwide?
- What is it that proximity banks do in terms of product offering and other services to customers and the communities they are drawn from, that can make the difference in terms of broadening access? and;
- How does regulation and other public policy help or hinder this process?

B. The importance of proximity banks to levels of access

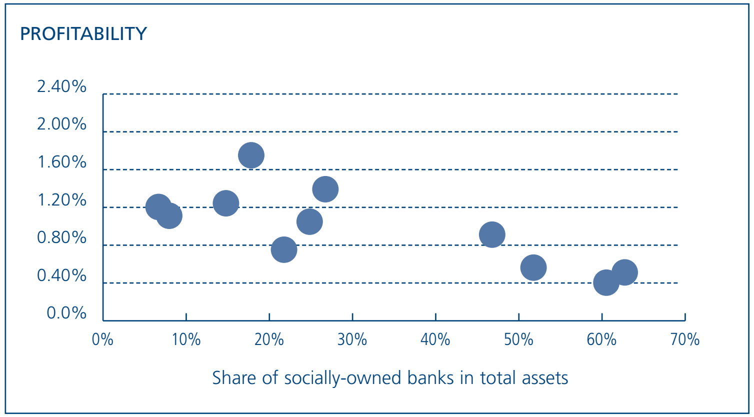
This topic is inextricably tied up with the long stream of debate on whether proximity banks do actually deliver the social gains presumed of them at an acceptable cost in terms of distortions to competition within banking systems as a whole.

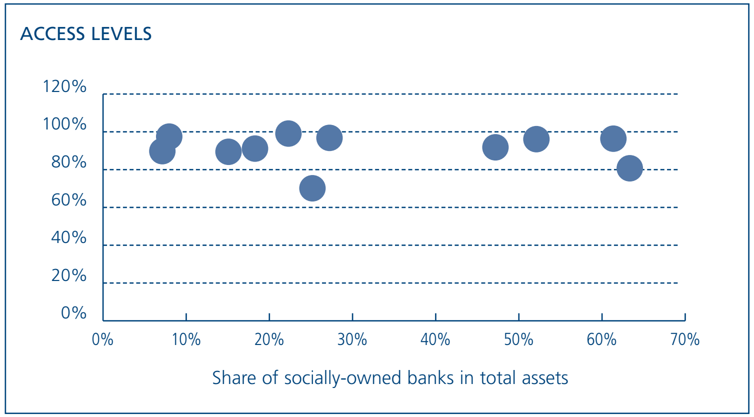
Regarding *advanced industrial economies* a paper by Berger, Hasan & Klapper [2003] for World Bank finds that a strong market share for small private banks, provided they are efficiently run, has beneficial effects on overall economic development but not particularly through the expected channel of strengthened SME development.

An obvious weakness of the study is that it is not clear that the underlying database[17] properly captures the work of socially-owned proximity banks. Focusing more specifically on the social banking movement (i.e. publicly-owned banks and mutually-owned banks), recent work by PA Consulting [2004] identified a negative impact of social ownership on overall banking system profitability. Commentators took this further to suggest social ownership reduces the scope for overall banking system development. This, however, represents a very reduced form of the competitive process in a diversified banking system. No indication was given whether this reduced profitability was a material constraint on capitalisation of domestic banking activities or whether a strong competitive input from socially owned banks helped keep down prices, thereby expanding the volume of intermediation and affordability of access. Figure 12 below certainly suggests that it is not obviously proved that reduced profitability in banking systems with a high element of social ownership reduces the capacity to meet domestic banking requirements. Access in these banking systems is just as high as in supposedly more "competitive" markets with a lower social ownership of banks and higher profitability.

17 Bureau van Dijk's Bankscope database, which purports to capture at least 85% of each country's banking system by assets. Despite good coverage and minor reporting errors in the individual reported units, Bhattacharya [2003] finds strong evidence of selectivity bias in BankScope data for India. A major source of the selectivity bias for India is the almost total omission of regional rural banks and some forms of foreign banks (branches are not captured nor are small subsidiaries). It is shown that this selectivity bias affects estimates of all summary statistical measures although despite these limitations, the paper shows that a few popularly used market concentration measures could be estimated accurately, provided the coverage ratio with respect to the size variable is known from alternative sources and is adequate (90% with respect to the size variable is found to be sufficient for approximating k-bank concentration measures, providing accurate estimates could be obtained of the top k banks in the population).

Figure 12: Ownership[18], profitability[19] and degree of access[20] compared





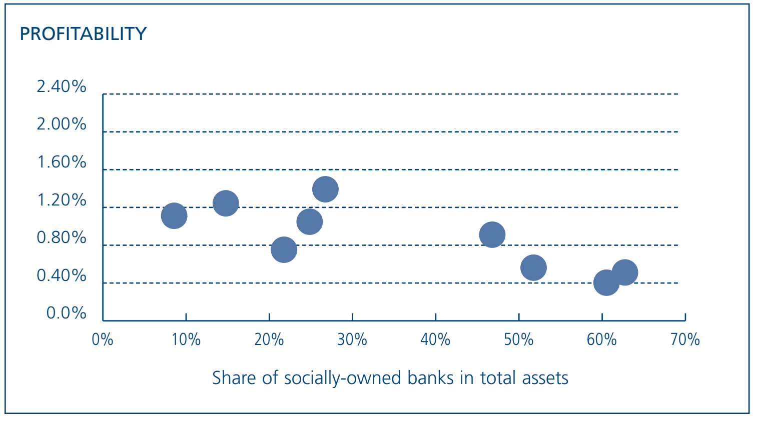
Sources: PA Consulting [2004] for profitability and share of social-banks; Pesaresi and Pilley [2003] plus Caskey [2002] for access levels

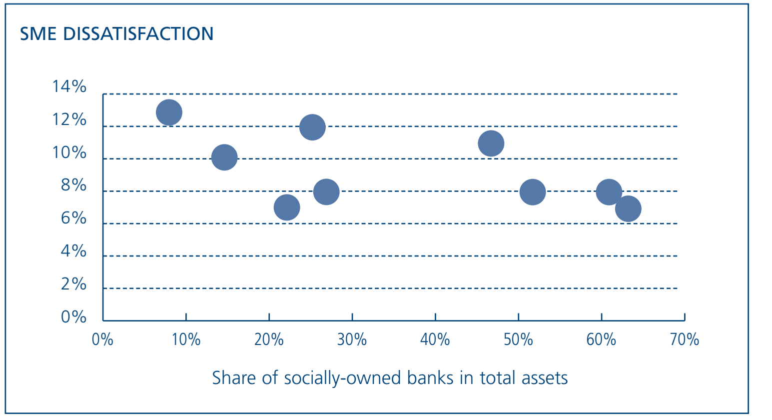
18 Ownership measured by share of socially-owned banks in total banking system assets.
19 Profitability measured by gross return on assets.
20 Access measured by proportion of adult population with personal current account, giro account or similar.

Aggregate analysis like this also misses the point about proximity banks being the ultimate bulwark against geographic exclusion as national and international banks react to the pressures of globalisation by rationalising branch networks and customer lists. This has been a very real problem in Germany where Mittelstand customers of many years standing have been told by the large private banks that their business is no longer welcome. Here the PA Consulting report may have a point in that this could have been a reaction to very fine margins on regional SME banking but for commentators to then question the right of those banks to exist in their current form is a perverse conclusion to draw.

Figure 13 below, again exposes the fallacy of the argument that more "competitive" markets with a lower social ownership and higher profitability serve the SME sector better. Indeed the reverse appears to be true, with the proportion of SMEs declaring a lack of access to finance as the main constraint on their business lower in the countries with a high degree of social ownership.

Figure 13: Ownership, profitability and SME dissatisfaction with access





Sources: PA Consulting [2004] for profitability and share of social-banks; EIM [2004] for SME dissatisfaction

As regards *developing and transition economies* the case is now clearly made that a strong savings bank has a vital part to play in helping an economy move towards full access. What is not yet clear, is at what stage of economic and financial development do commercial banks start to offer meaningful access. This will only start to be answered when the data put together for this study and further work being done on data sources on microfinance have been consistently integrated and then further integrated with data that World Bank is beginning to get from regulators of commercial banks. This is work underway and should yield results in 2006. The main policy issues still to be addressed regarding access to finance by savings banks in developing and emerging market economies are:

- How the relative weight of savings bank branch networks and staffing compared to that of other banks in each country affects presence and access.
- The impact of structural form and ownership (particularly within a Post Office context) affects presence and access. If postal savings are to play a meaningful role in providing access this activity, they must be put onto a properly constituted banking basis with ring-fencing of customers' deposits and proper settlements systems and balance sheet and risk management processes. In many countries of the developing world this is not the case and postal savings banks rarely mobilise significant deposit volumes in such circumstances.

C. What proximity banks do to improve individual access

1. Commitment in principle

Most savings banks will have in their founding statutes or mission statement a commitment to offer universal access and many private community banks will seek to offer access to those potential customers not offered meaningful access by larger national banks. A selection of examples from around the world of this high level commitment are:

- the battle against financial and bank exclusion constitutes a historic vocation and more than that [it] is written into the [Savings Bank] law of 25 June 1999.

  Caisse d'Epargne, ***France***

- According to its mission as a state-owned bank, BancoEstado has a key role providing access to finance [for] new social and economic actors.

  Banco Estado, ***Chile***

- Under Republic Act 7354 creating the Philippine Postal Corporation and providing for the re-opening of the old Postal Savings Bank, PostalBank is mandated to establish presence in the countryside which has not fully enjoyed the benefits of banking and financial services. Establishing PostalBank branches in municipalities untouched by the banking system will help tap underutilized Local Government Unit (LGU) funds and pool small savings to provide local financing to SMEs and Micro-enterprises, NGOs, cooperatives, OFW dependents and other groups.

  Philippine Postal Savings Bank, Inc, ***Philippines***

- SSB have the most extensive network, and we are proud to serve all people in Spain, especially those with a lower economic level. One of our main objectives is to avoid financial exclusion.

  Spanish Savings Banks, ***Spain***

- Our core mandate is to mobilise savings and inculcate a savings culture among Kenyans.

  Kenya Post Office Savings Banks, ***Kenya***

- great priority has been given to the "banca popular" strategy, through which access to financial services is being provided to most Mexicans in a secure way, with the aim of promoting and facilitating economic and social development.

  Bansefi, ***Mexico***

These commitments are not only domestic. Through subsidiary foundations both the German and Spanish savings banks are very active in international co-operation with developing country proximity banks world-wide. Other advanced industrial economy savings banks engage in similar activities under the WSBI and its sister organisation, ESBG, the European Savings Banks Group.

2. Avoiding exclusion by design and condition

One of the biggest tangible commitments a savings bank can make to maintaining access for vulnerable groups is to retain a basic savings passbook system with procedures to allow this to be accessed at any outlet. This is specifically mentioned by Caisse d'Epargne, France as a product of fundamental importance to "fragile groups" but is common among the savings bank movements around the world. This is not to say that savings banks are wedded to old technology – in the same submission Caisse d'Epargne, France describe their VISA Electron card programme as a budget management tool for the same fragile groups and proximity banks in South Africa are following exactly the same strategy (Teba Bank – ACard).

Savings banks can also be significant distributors of government-backed special savings schemes for small investors. An example of this is in India where the National Savings Institute (NSI) (an office of the Ministry of Finance) has nine specialist "Small Savings Programmes" designed to cater to the needs of all sections of small savers - senior citizens, housewives, farmers, wage earners, students, etc. They carry an implicit sovereign guarantee and are thus a safe avenue for investment by all citizens. Tax concessions and attractive return on investment are also some of the measures to target the customers.

Box 6: Turning income into savings and credit opportunities – Brazil, Mexico & Spain

Even the poor have income, albeit often irregular and unreliable. The mass-middle market in many developing and transition economies may even have regular income but at too low levels to carry the full charges of a commercial bank current account. So any product or combination of products that captures that flow of income without restricting the ability to spend it has enormous potential to improve access. Below are three examples of how savings banks in Brazil, Mexico and Spain are doing just that.

Caixa Economica Federal of Brazil's card based CAIXA AQUI account is built around simplified application procedures and access through point-of-sale terminals at correspondents such as the State Lottery. This dramatically extends Caixa's outreach – adding 12000 access points to the banks main network of 2200 offices – and Caixa Aqui translates as "Caixa is present". Three million accounts (over 10% of all Caixa accounts) have been opened in a period of just two years. The accounts take regular payments of social benefits such as pensions but also have scope to take cash deposits. The account opening includes a pre-agreement to provide credit and after ninety days of account use, provided all is in order and cadastral checks identify no existing defaults the bank automatically sends the customer a contract to sign if they want to take an initial credit of up to R$ 200 (equal to just under US$ 70) for a period of four months at an interest cost of 2% per month. After this period, scoring of a client's actual credit performance and ongoing account use allows access to larger amounts for longer periods (potentially up to a year). In parallel with this Caixa launched E-ACCOUNT CAIXA for Brazilians working abroad who want to send remittances home direct from a host-country credit card. The account is available in 50 countries and the cost of a typical transfer is just 2_% compared to 8~15% typical of more traditional channels. These remittances can feed Aqui accounts of relatives and a second stage of the international e-banking project will allow migrant workers in the US to access their own Aqui accounts directly through Caixa Aqui terminals in branches of a Portuguese bank present there.

BANSEFI of Mexico, is the successor to that country's state savings bank that has been restructured to become in addition the apex organisation for a reformed popular savings and credit movement. As local Cajas de Ahorro come into compliance with the new regulatory regime for hem, they have access to technical assistance, new technology, accounting support and a common brand L@Red de la Gente. They also get access to Bansefi's social benefits and remittances distribution capacity. This allows them to offer deposit products that can receive social benefits or remittances channelled through Bansefi, which has negotiated a number of contracts with government and banks abroad to receive and distribute such money. Bansefi research shows that within three to four cycles of a client receiving such inflows, their account then typically starts to be used for voluntary deposits of cash. Because Bansefi also manages pre-borrowing savings accounts for a number of low cost loan schemes it is also able to offer migrant workers the ability to qualify abroad for cheap housing finance for either themselves or their relatives.

CECA – the Spanish Confederation of Savings Banks – has negotiated a 16 bilateral agreements with savings banks in 12 different countries to distribute remittances at around half the normal cost of more traditional channels. This initial phase will cover fully three quarters of the foreign citizens who live in Spain and will be expanded later. It has the double benefit of providing affordable access not only in the home country but also access for the migrant worker in Spain.

One common product feature often talked about as a major barrier to access is the minimum balance required by some banks to maintain an account. As already noted, it is unlikely that this is a particular problem for accessing savings bank accounts – if it were, average deposit balances at savings banks would be higher than at other double bottom-line institutions. This is just not the case.

Moreover, Table 12 below shows that savings banks can and do work with average balances that are same low proportion of per-capita GDP in the poorest 20% of countries as they work with in the richest 20%.

Table 12: Average deposit balances by country income group

	Median deposit balance in Euro	- as a percentage of per capita GDP
Income band (in Euro per annum)		
Below 400	56	24%
400~1000	163	27%
1000~3000	315	16%
3000~15000	143	3%
Over 15000	6,325	25%

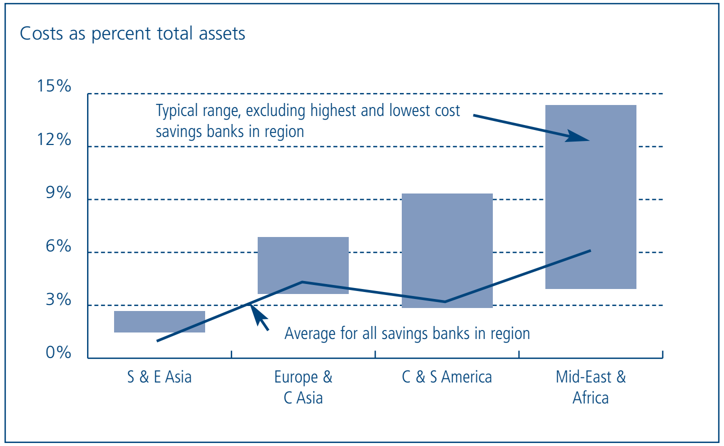
Anecdotal evidence suggests that most savings banks still accept basic savings accounts with flexible access both for depositing and withdrawal and with very low or zero minimum required balances (see WSBI [2004], which shows minimum required balances for a number of African postal savings banks equal to roughly 2~3% of per capita GDP and less than half this for a number of Southern American savings banks). Far more serious is the issue of cost and account charges.

3. Avoiding exclusion by maintaining affordability

There are two ways of looking at this and both are attempted hereafter. Unfortunately the data is not uniform across countries and institutions. This (along with collection of data on loan account numbers) is an area that would repay further effort by WSBI and its members.

The first step is to look at the ratio of operating costs to total assets at savings banks and compare these to similar ratios for MFIs. This suggests that the largest savings banks operate at quite low cost ratios (annual operating costs equal to 1~4% total assets) and even at the top-end of the normal range of savings banks' cost ratios, they are still much lower than similarly calculated ratios at microfinance institutions (most MFIs in the CGAP MiX-MBB database have cost ratios in the 20~30% range).

Figure 14: Savings bank cost to asset ratios by region



The reason that this cost ratio matters, is that it determines the wedge between what an institution can afford to pay depositors for savings mobilised and what it must extract by way of interest income earned and fees/commissions received. The wedge is high for MFIs and this is why they are invariably seen as a high-cost source of credit when compared to other formal sources of finance. Because the ratio for savings banks is low, even for the banks doing the most crediting, these banks have the possibility of becoming relatively low-cost providers of small-scale finance without having to subsidise creditors at the expense of depositors.

At the heart of this phenomenon is the very much higher productivity typical of savings bank staff than microfinance specialists. The former will be handling roughly 900 accounts each; the latter perhaps 150. Of course some of the 900 accounts will be inactive but not the 85% or so needed to bring the two numbers into line with each other. Even if this were to be the case, all the inactive accounts will still be creating continuously some net interest margin to help cover the costs of accounts that happen to be incurring transaction costs at any one point in time. There is also a common misconception that savings accounts must be easier to service than loan accounts but this is not necessarily so. No one would dispute that the origination of good quality loans takes longer than opening new deposit products.

Once up and running, however, a loan account creates one, maybe two transactions per month. A typical savings bank account will create exactly the same turnover if not more and the timing of that turnover is if anything less under the control of the bank than the timing of loan activity.

Figure 15: Savings bank staff productivity

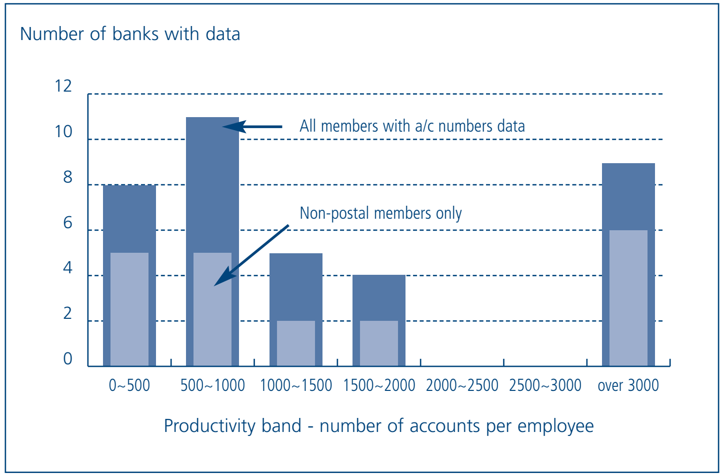


Table 13 analyses a sub-set of the data on staff productivity – based on those members for which WSBI has data on account numbers by type of outlet (national/regional capitals versus outside major urban areas). This shows a three-to-two ratio between the number of savings banks where staff handle more accounts per head outside the major urban areas than inside and the number of savings banks where the reverse is true. This confirms more than ten years of consulting experience for one of the authors – savings banking is a scaleable business right down to the smallest scale rural outlet.

Table 13: Accounts handled per savings bank employee, by location of outlet

Productivity greater in major cities	Major city branches	Outside major cities
Sweden	900	620
Vietnam	250	149
Comores	918	130
Zimbabwe	5906	3471

Productivity greater in major cities	Major city branches	Outside major cities
Austria	340	407
Bulgaria	1304	1774
Hungary	5024	6831
Colombia (x2)	443	822
Dom. Rep.	1008	1221
Iran	348	358
Ethiopia	89	109

The final stage in this analysis is to look at the price that savings banks actually charge customers for the use of their accounts. Here much more data is needed but the table below shows the tariff structure for a number of passbook-based and card accounts at a mix of postal and non-postal WSBI members drawn from around the world.

Table 14: Sample calculations of cost of use for a passbook

	Central & Southern America		Selected African Postal Saving Banks		South & East Asia	
	Banca Caja Social, Colombia	Caixa Econ. Federal, Brazil	Caisse d'Epargne Senegal	Postbank Botswana	Bank Simpanan Nasional Malaysia	Postal Savings Service Vietnam
TARIFF FOR PASSBOOK						
Fixed monthly fee	none	none	none	€0.36	€0.20	none
Manual credit	free	free	free	free	free	free
Manual debit	free	€1.05	free	free	free	free
PASSBOOK USAGE						
Income credited per month	€66.67	€100	€25	€167	€150	€17.5
Manual credit per month	1	1	1	1	1	1
Manual debit per month	2	2	2	2	2	2
Cost per year	€0	€26	€0	€4	€2	€0
or % of average balance	0%	3.13%	0%	0.05%	1.98%	0%
or % of assumed income	0%	2.10%	0%	0%	0.13%	0%
TARIFF FOR CARD ACCOUNT						
Fixed monthly fee	€2.03	€1.15			€0.30	
ATM access	€0.17	free			n/a	
Manual credit	free	free			free	
Manual debit	free	€1.05			free	
CARD ACCOUNT USAGE						
Income credited per month	€133.33	€200			€300	
ATM access per week	1	1			1	
Manual credit per month	1	1			1	
Manual debit per month	-	-			-	
Cost per year	€33	€20			€4	
or % of average balance	4.12%	2.50%			2.98%	
or % of assumed income	2.08%	0.84%			0.10%	

Underlying these calculations are common assumptions that a passbook customer deposits money once a month and withdraws cash twice a month, and the amount passing through the account each month is the equivalent half of per capita monthly GDP. For the card account holder, the assumption is that salary is credited once a month, an ATM withdrawal is made once a week and over-the-counter deposits once a month but manual withdrawals only every second month. The amount passing through the account is assumed to equal per capita monthly GDP.

The results of this very limited snapshot are interesting – very basic savings accounts in many cases are provided effectively free of charge and even where charges are made can still be used to support day-to-day transaction needs at affordable costs (roughly 2% to 3% of the average balances). More technological solutions are higher cost (2~4% of average balances) probably because the technology has to be bought in at world prices). These results need verifying, however, using a much wider data sample. They also need benchmarking against commercial bank tariffs.

4. Avoiding exclusion by maintaining physical access

The other big tangible commitment a savings bank can make to maintaining access is to maintain broad branch network cover. In countries as diverse as Chile and Kenya the savings bank branch network will account for half the total outlets in the whole banking system and in many districts it will be the only access point for formal banking services.

This is not just a developing country phenomenon – the members of the European Savings Bank Group account for very nearly 30% of all banking system outlets in the EU-15 countries (ESBG [2003]). For all but four exceptions, ESBG members' branch networks are either growing faster than the rest of their home banking system or reducing more slowly. Moreover ESBG members' share of total non-bank deposits in EU-15 banking systems is five percentage points lower than there share of branch outlets, pointing to a more mass-market positioning. This is true on a country-by-country basis in all but three cases.

Often savings banks will stay in geographical areas and with market segments abandoned by commercial banks. Research by the German savings bank movement (DSGV [2005]) shows that 31 regions in Germany, accounting for 13% of national GDP, have no large private bank representation at all and their only banking presence comes from either the savings or co-op banking movement. The divergence is particularly marked when comparing across the old East/West divide, where for both zones the head of population per branch lies in the 5~6000 range, whereas the equivalent figure for the large private banks is nearly 50,000 in the new Eastern Lander compared to 35,000 for the Western Lander. Another particularly striking case is the Spanish savings bank movement, which has been opening branches while other banks in Spain have been reducing their networks. The movement's deposit market share had as a result risen above 50% by 2004.

In a qualitative sense also the Spanish savings banks are maintaining greater reach, having more branches than the rest of the banking system in the more rural less densely populated regions of Spain. In 13% of Spanish towns, most of them in depressed economic areas, a CECA member is the only bank. This deep reach almost certainly explains why access in Spain is so much higher than in other Southern European countries.

5. Combating self- exclusion

In many developing countries proximity banks will be the only banks capable of dealing with the illiterate poor who nevertheless manage to maintain some form of employment in the formal economy. In advanced industrial countries the issues are different but financial illiteracy is a real problem. Caisse d'Epargne, France has run a programme of financial education for more than 40 years now called "Finances & Pédagogie". This uses seminars, booklets and newsletters to provide people with a general knowledge of Economy and Finance as well as practical information on how to manage their finances. It has specific elements aimed at *"at people in precarious situations who face an uncertain future (people in debt, unemployed.)… countering the economic dis-insertion of such people, often prior to banking exclusion and the breakdown of social ties"*. The programme is available to anyone, not just clients of the bank. In Germany, a similar initiative "Geld und Haushalt", run by DSGV, the German Savings Banks Association, builds on 30 years co-operation between the Savings Banks School Service and German educationalists developing comprehensive learning projects. Young people are introduced to the concept of economics via a readily accessible and practice-oriented approach that teaches them to handle their finances sensibly and responsibly. One element of this work – "Planspiel Börse", a stock exchange investment simulation game for secondary school students – is now shared by savings banks in seven European countries.

D. What proximity banks do specifically to improve enterprise access

Savings banks are active partners in SME promotion. At a pan-European level ESBG inputs directly into European Commission policy consultations in this area but just as important are the local partnerships between individual savings banks and local government initiatives to promote enterprise. This interest reflects the dominance of SME business in savings bank business portfolios but savings banks across Europe provide more than just lending support and payments services to SMEs and a number run special microfinance schemes as summarised in Box 7.

Savings banks across the developing and transition economies of the world are also very active in the arena of microfinance. Indeed, of the 74 WSBI members in developing and transition economies more than half reported at the end of 2002 that they provided some form of microcredit. Since then, WSBI has been engaged in a comparative exercise documenting their experience with microfinance (WSBI [2004]). This includes six cases studies from Africa, Asia and Latin America, three of which are briefly summarised below:

- Government Savings Bank of Thailand, has two major microfinance programmes. The "Peoples Bank" project combines savings mobilisation and educational training for entrepreneurs with microcrediting at a flat 1% per month rate of interest and loans of up to $750 for first-time borrowers and $1,250 for subsequent borrowing. €400 million had been disbursed by 2004 and almost a million loan applications per year are being processed with more than a 90% approval rating and only a 3.5% delinquency. The "Village Fund" takes grant money from the Government of Thailand to pump-prime micro-crediting at 1.75% above current fixed deposit rates and has generated almost €4 billion of lending to 11 million villagers, off the back of a €1.6 billion grant and with only a 6% delinquency rate.

- Banco Estado de Chile runs a micro-enterprise programme that is a national leader with over 40% of the market. In 2003 it served 90,000 micro-business people; about one third of them achieved access to a financial institution for the first time. This programme is serviced through 91 specialised platforms throughout the country and has a recovery rate of 99% of loans. Other important factors are that half of customers are women and more than 90% of credits are processed without guarantees. Banco Estado also operates the Chilean state small business guarantee fund (FOGAPE), which has become an important instrument to enhance access to finance. The number of annual operations has nearly tripled in the past three years to reach 30,000 in 2003 of which 70% are carried out in regions.
- Tanzania Postal Bank set up a micro-credit scheme for micro-entrepreneurs and low-income households both in rural and urban areas. This started in 2001 on a pilot basis in one district but has since been rolled out to other locations. Only group-based micro-credits have been extended typically to groups of five, who can borrow between $50 and $600 at 2.5% per month for six to twelve months. To reduce administrative burdens groups are clustered. By 31 December 2002, the total value of disbursed micro-loans stood at US$1.9 million extended to 4,235 clients (80% female) in 676 groups out of whom 41 had fully liquidated their first round loans. Within the micro-credit scheme a special facility exists to provide seasonal agricultural finance and a parallel scheme for payroll-based lending to employed workers had disbursed similar volumes to the micro-credit scheme.

E. Policy as it affects proximity banks efforts to improve access

The pressures that are coming from increasing globalisation of regulation and the impact of competition policy were a major strand in the WSBI Madrid declaration. There is clearly an element here of non-joined-up public policy with (a) the bank regulatory framework increasingly focused on risk-adjusted profitability and capitalisation, (b) competition policy focused on controlling state-aid and (c) wider economic strategy (e.g. the European Union’s Lisbon agenda) focused on support for the sort of small and medium enterprise not well provided for by global banking groups.

Box 7: Selected member initiatives to foster microenterprise in advanced economies

Microfinance is a discipline that has been designed and tested in a developing and transition economy context but has since spread to advanced industrial economies. As a banking system develops it has to become accessible to the vast bulk of the individuals and enterprises that make up the economy it supports. But, there are always people in those economies who for some reason or other – often educational, social or ethnographical – do not participate fully in the formal structures of even the society to which they notionally belong let alone its economic structures[21]. Savings banks typically act in one of four ways to address these excluded groups:

Sparkassen-Finanzgruppe in Germany is the major provider of financial services to small and medium sized enterprises. As universal banks the savings banks supply the whole range of financial services to corporate customers and overall market share in corporate finance on average exceeds 40%. As a rule the group can claim that the smaller the companies the higher the market share they have. In lending to enterprises with an annual turnover of up to €1/2 million the market share reaches 70%. Among the small and medium sized enterprises in general, three quarters have some sort of relationship with a savings bank and 60% have the savings bank as their main bank. More than half of business start ups are financed by the group. Its Start-up Competition and Deutscher Gründerpreis for new companies attract around 20,000 potential entrepreneurs a year and the group has equity shares in half of all German innovation and technology centres. In addition to its own activities the Sparkassen-Finanzgruppe participates in government supported schemes to provide small scale loans to microenterprises. For example in 2004 savings banks and Landesbanken had a market share of 56% in the KfW-programmes "StartGeld" and "Mikrodarlehen".

21 WSBI [2004] describes these forces of exclusion in more detail.

LloydsTSB in the UK, is active in the market for accessible enterprise finance through making contributions of capital to specialist state-supported microinvestment funds and also acting as an agent of the government sponsored Small Business Guarantee Fund.

Caisses d'Epargne in France runs a specialist programme – PELS or Projets d'économie locale et sociale – that provides some finance directly to microentrepreneurs (about 55% of total disbursements) and the rest through local organisations that sponsor microenterprise. Since its inception in 2001 some €50 million has been disbursed. Average loan size is in the region of €5000, with more than 6000 microentrepreneurs provided with funding. Research indicates some 5000 permanent jobs have been created, many for people previously on state assistance who would otherwise have no financing options.

Members of the *Spanish Savings Banks movement (Confederated in CECA)* operate a hybrid of these two approaches. Nine members are working with a government run organisation (ICO) working with NGOs to identify socially worthwhile microcredit opportunities. In parallel, five of the savings banks themselves run their own microcredit operations on strictly financial and economic criteria. These are either guaranteed by the savings banks' own social foundations or sometimes run through them. Some €16 million has been disbursed to some 1700 borrowers.

In all four models, strong links are built between savings banks and non-banking organisations active in the field. Examples are Caisses d'Epargne in France co-operating with ADIE and Lloyds TSB in the UK co-operating with The Prince's Trust. In addition to this most savings banks will have contact with some sort of "business angels" network that allows them to put new microentrepreneurs in touch with more experienced business professionals.

This is as much an issue in developing countries as advanced industrial economies. Specific examples from *developing countries* are:

- Money laundering and anti-terrorism regulations in South Africa that make remittance transfers for migrant workers very difficult to process (echoed by Banco Caja Social in Colombia).
- The general regulatory burden (quoted by savings banks in Chile, Iran, and Macau).
- GMF – a tax on transactions – that holds up payments system development in Colombia.

In this most of the savings banks are not seeking special favours (although some do ask for tax subsidies to promote household saving) but are echoing the CGAP recommendations to government on fostering more effective bank involvement in microfinance.

The two main issues in *advanced industrial economies* are:

- How far should consolidation processes in Continental Europe go? Is there a conflict between competition policy and the need for outreach to small and medium enterprises? All this is part of the wider debate on the role of socially-owned banks in developed banking systems.
- For commercial proximity banks in the UK and US, the conflict between the design of government outreach programmes (CRA, basic bank accounts, etc) and the need to minimise unit operational costs if such programmes are ever to work effectively.

6. A BRIEF POLICY AGENDA EMERGING FROM THE ANALYSIS

By synthesising the literature in Chapter 2 on the problems with access, with the difficulties in measuring different levels of access as discussed in Chapter 3 and the selected policy experiences laid out in Chapter 4, a number of *overarching themes* emerge from this study. The main ones are as follows:

- The performance of banking systems cannot be understood in isolation from the political economy within which they operate – government, especially in the richer economies, will do more to improve access by improving the foundations of civil society than by trying to mandate access and interfere with product design.
- If access is an important issue then it has to be measured better than has been possible here. That means collecting data on how many accounts have been opened in a country and who is opening them. Data from banks needs to be augmented by survey data to identify how many people have access to accounts and how many use them.
- Until access can be measured properly the cost-benefit case for banks trying to improve access is hard to make. The benefits to government and international agencies from improved access may be greater than the net benefits to banks. Attitudes to social banking and the element of cross-subsidisation intrinsic to it need, therefore, to be adjusted accordingly.
- If governments have good reasons for wanting to improve access then regulation must take account of the pragmatic realities that face banks in reaching out to poorer communities. This means tailoring physical security, money-laundering, and loan provisioning requirements to reflect the challenges of doing business in those communities. This has already been done regarding risk-weighting SME lending for capital adequacy purposes; why can it not be done for, say, the impact of anti-money laundering legislation on small-scale remittances by poorer migrant workers?
- Similarly if governments have reasons for wanting to improve access then their own actions must reinforce the link between being part of a society and transacting day-to-day business through the banking system that underpins it. As a minimum that means paying social benefits through bank accounts or very close substitutes and not in quasi-cash form.
- Addressing the issue of literacy – whether (i) financial illiteracy that can lead to exclusion from developed banking services or (ii) more fundamental literacy problems that impede access to even the most basic services – is not an issue for banks alone.

There are also a number of *themes specific to advanced industrial economies*:

- Social exclusion for significant minority groups is a major problem in many richer countries. Zero or limited access to financial services is a key component of this that needs to be addressed. All countries already have some policy measures in place to extend at least minimum banking services to otherwise excluded minorities. But these do not always work as well as intended. In particular, trying to mandate access for socially excluded groups appears relatively meaningless as take-up always seems to be disappointing. More work needs to be done to find the real reasons why the un-banked feel bank accounts are not for them and why the poor feel locked into non-bank financial services that often cost more than a properly run bank account and punish delinquency just as much.
- Post-offices and similar institutions with extensive networks generally seem to be the explicit or implicit "back-stop" for these policies. But it is not clear that this is either reasonable or effective. Much further thought is needed on this matter, especially where the post office does not have within it, or linked to it, properly constituted banking operations.
- The impact of banking sector consolidation on access to finance seems to be ambiguous. On the one hand consolidation, where it leads to better cost-efficiency, should allow banks to move on a profitable basis into business with customer groups that might otherwise be excluded. On the other hand, where consolidation does not lead to higher cost-efficiency or where banks simply become too big to care for small customers, peripheral regions etc., consolidation most probably has a negative impact on access to finance.

- Financial deregulation has made credit more accessible to more people. However, there seems to be an increasing division between (a) access to well regulated credit on reasonable terms and (b) the access for more vulnerable and highly indebted low-income groups provided via peripheral financial institutions with aggressive charging and foreclosure practices. This matter also needs to be put on a sounder basis.
- The rapid spread of E-finance is putting traditional regulatory structures under great stress. Although it is assumed that this revolution will improve access and lower costs it also creates considerable dangers for the quality of financial services that some users receive; for the security of funds; and for standards of information and privacy. The rapid lowering of interest margins that is expected to accompany the spread of E-finance may also put stress on financial institutions that have traditionally maintained a strong social agenda as part of their operating mandate.

There are also a number of *themes specific to developing and emerging market economies:*

- Developing country governments need increasingly to adopt a broader vision about the role of particular financial institutions in helping to move levels of financial access closer to those found in the richer industrial countries.
- This is likely, in most cases, to involve measures to make mainstream commercial banks both more competitive and more cost efficient. Clearly, however, purely shareholder-value driven institutions may make different use of the opportunities provided by improved cost-effectiveness than will mission-oriented proximity banks, but both must address the issue of cost-effectiveness if they are to have any real chance of servicing the higher volume, lower value transactions of those with little or no current access to financial services.
- It also needs to involve a very serious reconsideration of the role of near-banks that in the past have been viewed as the main platform to support various social agendas including improved financial access for more people. In many countries this will need to involve a much clearer and reliable regulatory structure for microfinance institutions that stresses above all the need for such institutions to be financially sustainable for the long term.
- The deposit-mobilisation functions of microfinance institutions certainly need to be stressed as highly as their credit functions. The new approach will also need to take on board the changing organisational structures of microfinance institutions and above all their greater integration and overlap with other parts of the financial system. This will help to ensure a more competitive overall financial system.
- As a part of this process there will also need to be a reconsideration of the role of state-owned institutions that have the capacity to reach out to mass markets. In some countries this reconsideration will be around the question of whether an existing postal savings bank can move beyond a limited deposit-mobilisation function and closer to broader-based retail banking. A pre-requisite for this is to have postal banking operations put onto a properly constituted banking basis with ring-fencing of customers' deposits plus proper settlements systems and balance sheet and risk management processes. In other countries, consideration should be given – at least as a temporary pragmatic solution – to maintaining state-ownership of institutions that do provide mass-access to finance for groups not well served by commercial banks. A critical precondition to this would, however, have to be that good Corporate Governance is guaranteed and the cost to these banks' of their social mission, the so-called "Social Dividend", is made clear and transparent in all their reporting.
- The E-Finance revolution creates huge and exciting opportunities rapidly to leap-frog some of the deficit in financial access that we observe today. But the realisation of this potential will require early opening up of telephone services to more new entry and to freer pricing. Thereafter there is a daunting agenda of regulatory measures to ensure that the potentially explosive growth avoids some of the obvious pitfalls of financial instability, insecurity of funds, and the premature demise of more traditional but fragile institutions that can play some part in improving access.

The table on the following page draws together these issues in the form of a policy matrix, identifying what different players might contribute to the process of improving access.

Table 15: Outline Policy Matrix: responsibilities and timescales

	NEAR-TERM	MEDIUM-TERM	LONG-TERM/ ONGOING
Supra-national Institutions	- Co-ordinate estimates of true levels of access (banks and MFIs) - Bolster assessment of levels of, and obstacles to access in IMF/ World Bank FSAP programme (including impact of AML/anti-terrorist)	- Support refinancing/ buy-outs of MFI credit portfolios by banks with retail deposit-taking capacity - Develop supra-national databases for benchmarking access levels and cost of access	- Insert access agenda into wider regulatory agenda plus debate about state ownership and competition policy - Build on work of CGAP to integrate banks into micro-finance agenda
National Authorities	- Assess local levels of access - Immediately review local AML/anti-terrorist rules	- Refine reporting systems to track access and its cost - Develop financial literacy programme	- Reduce licensing/ regulatory/tax burden on SMEs - Pay state wages/ benefits via banks
Banking Industries (collectively)	- Scope literacy requirements - Build links with local microfinance industry bodies	- Explore scope for gearing up existing interbank settlement systems to support basic access products	- Roll out basic access products with standardised features backed by common literacy programme
Proximity banks (collectively)	- Scope contribution to access agenda - Share best practice on building financial literacy	- Explore rollout of remittances product already in Spain - Build links with microfinance bodies	- Develop guidance on credit portfolio refinancing/buy-out from MFIs without deposit-taking capacity
Proximity banks (individually)	- Identify own role in maintaining access particularly in remote rural areas - Try and negotiate streamlined 'know your customer' rules to reflect special nature of customer base	- Build on existing savings products to allow for collective saving by members of MFIs - Develop affordable local remittances - Roll-out local literacy programmes	- Participate in development of basic national access products, opening up network to other banks for realistic fees - Develop affordable international remittances product

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About WSBI (World Savings Banks Institute) and ESBG (European Savings Banks Group)

WSBI (World Savings Banks Institute) is one of the largest international banking associations and the only global representative of savings and retail banks. Founded in 1924, it represents savings and retail banks and associations thereof in 84 countries of the world (Asia-Pacific, the Americas, Africa and Europe -via the European Savings Banks Group).

It works closely with international financial institutions and donor agencies and facilitates the provision of access to financial sectors worldwide - be it in developing or developed regions. At the start of 2004, assets of member banks amounted to more than €7,300 billion.

ESBG (European Savings Banks Group) is an international banking association that represents one of the largest European retail banking networks, comprising about one third of the retail banking market in Europe, with total assets of €4,345 billion (1 January 2004). It represents the interests of its members vis-à-vis the EU Institutions and generates, facilitates and manages high quality cross-border banking projects.

WSBI-ESBG members are typically savings and retail banks or associations thereof. They are often organised in decentralised networks and offer their services throughout their region. WSBI members have reinvested responsibly in their region for decades and are one distinct benchmark for corporate social responsibility activities throughout Europe and the world.

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