THE FLETCHER SCHOOL

Leadership Program for Financial Inclusion

Policy Memoranda

2016

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Foreword

This September, we complete another year of the Fletcher Leadership Program for Financial Inclusion (FLFPI). Each year, the FLFPI team reflects on a key theme that may have arisen during the Fellowship. This year, several questions emerged, such as: when faced with a problem as complex as financial inclusion, how can we choose (or should we choose) one policy solution? How can different stakeholders be brought to the table to implement a policy solution or direction? And how do we know if our policy "worked"?

Fletcher offers a nine-month Fellowship called the Fletcher Leadership Program for Financial Inclusion. This year, we accepted 19 Fellows from a large pool of applicants, primarily public servants, most of whom work for Central Banks, Ministries of Finance, or Regulatory authorities. This year, our Fellows hailed from the Caribbean, Latin America, sub-Saharan Africa, Asia, and the Middle East, and represented regulatory and supervisory bodies that focused variously on credit, savings, payments, and small enterprises.

Fellows begin work in January with a 12-week online curriculum. Each session offers readings, videos, and the opportunity to engage in a vigorous discussion on provocative questions. In May, Fellows convene on the Fletcher School campus at Tufts University for two intensive weeks of work, during which time they workshop their policy ideas. Morning sessions feature lectures on topics in financial inclusion, as well as sessions devoted to the "ladder of influence"—negotiation, persuasion, and communication. Afternoon sessions delve into the specific policy ideas of each Fellow.

Each policy idea begins with the articulation of a clear financial inclusion regulatory gap—the problem statement—identified in a Fellow's home country. Our approach is that each gap must be a demonstrated need substantiated with evidence. Each solution—meaning a proposed policy—must also be substantiated with evidence, which is easy to define but difficult to identify. In many of the countries where our Fellows work, evidence for a proposed policy solution or direction is difficult to find, either for their specific solution or for their specific country.

Take Malawi, for example. Our Fellow from Malawi, Yananga Phiri, had little trouble referencing the importance of credit for allowing small and medium enterprises (SMEs) to grow, and the role of SMEs in economic growth. But since there are few rigorous studies on the best way to provide credit to SMEs these pilots are in their early stage, it was difficult to cite *specific policy solutions* related to the provision of credit for SMEs, as well as identifying indicators for measuring success. Ultimately, by skillfully referencing research on the provision of credit to other lenders in other countries, as well as Malawi, he made a more convincing argument. Our Fellow, Georgette Jean-Louis from Haiti, is tackling a similar issue in her country,

Yet to propose fast-tracking the operationalization of the credit bureau system in Malawi in the face of emerging evidence requires a leap of faith. Implementation may require iteration: try an idea, monitor its effects on different stakeholders, modify it, and try it again.

This same "best guess" approach might also be found in Bangladesh, Colombia, Haiti, Indonesia, Jordan, Kenya, Mozambique, Pakistan, Peru, the Philippines, Uganda, Yemen, Zambia, and Zimbabwe. Our Fellows try to base their policy ideas on a proven problem, but policy solutions require more than evidence; they require that the necessary pre-conditions are in place, as well as a policy that is within their agency's purview. During the residency, some of our Fellows recognized that they did not necessarily have all of the information required to narrow down their policy to a solution, so instead, chose a policy *direction*, laying out a framework for engagement with different policy stakeholders to develop a final policy once in-country.

Indeed, in the cases of the Philippines and Mozambique, where Fellows are developing financial policies to help rural households deal with shocks, there is an abundance of studies documenting the importance of savings and insurance. Yet no single case links exactly to the timelines and histories of the unique shocks that households in these countries face. In Zimbabwe, our Fellow searched for ways to include women—both within current policy efforts as well as prospective ones—and yet scant evidence aligns perfectly with her problem statement or policy ideas. Fellows from Pakistan, Yemen, Haiti, Tanzania, and Malawi are trying to find the best ways to support financing for SMEs, a priority sector in many countries but whose solutions are elusive. Fellows from Vietnam, Indonesia, and Bangladesh try to find the best ways to extend payment services into remote rural areas—often using mobile money—whereas Fellows from Jordan, Peru, and Colombia try to find the best ways to improve access to financial services for underserved populations, including youth, the military, and those affected by conflict. Finally, Fellows from Kenya, Uganda, and Zambia try to find a way to make access for credit services more ethical for the rural poor, while ensuring that suppliers can make a profit.

While all Fellows have researched their topics thoroughly, their best evidence comes from the results of trial, error, and a passion for continuous improvement. Evidence surely is required, but creativity and a quest for good policy prototyping rules the day. This is especially true when so many of the good policy ideas we see are pressed through bureaucratic and political sieves that can change even the most substantiated problem into a negotiated solution.

Despite these challenges, we applaud this year's cohort for its unyielding commitment to form policy made up of equal parts evidence, wisdom, ingenuity, and skilled negotiation. We hope that they continue to pilot, document, refine, expand, and try their ideas in a friendly environment.

Kim Wilson, Director, FLPFI
Jenny Aker, Co-Director, FLPFI

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Supporting SMES

SME Financing as an Engine of Economic Growth

Georgette Jean-Louis

Director General, Banque de la République d'Haïti

Introduction

In developing countries, small and medium enterprises (SMEs) are highly correlated to economic growth. Their contribution ranges from job creation, to reducing poverty and the gender gap, and promoting entrepreneurial culture (Coke-Hamilton, 2014). Haiti, however, has not yet benefited from such impact on its economic growth. As of 2015, the SME sector credit ratio to GDP is only 21%, and SMEs contribution to GDP is only 1.46%. This policy memo aims at understanding the principal barriers to SME development in Haiti and recommends measures that could turn this situation around.

Context: SMEs in Haiti

In Latin America and the Caribbean, Haiti has the lowest contribution of SMEs to growth and to job creation, as well as the lowest number of formal SMEs. The micro, small, and medium enterprises (MSME) sector in Trinidad & Tobago contributes to about 28% of GDP (MOFSMED, 2013), and accounts for over 80% of jobs in the country. In Dominican Republic, according to their Ministry of Commerce, the SME sector contributes to about 27% of GDP, generates over 2.1 million jobs, and represents around 97% of Dominican companies. By contrast, in Haiti, SMEs contribute less than 1.46% to GDP, and the number of formal SMEs is estimated at 10,000, far below the 825,000 formal SMEs in Dominican Republic (see Table 1). Furthermore, since most of Haiti's SMEs operate informally, data is not available.

Table 1. SMEs in Haiti and Dominican Republic

	No. of Jobs Created	No. of Formal SMEs	Contribution to Growth
Haiti	60,000	10,000	1.46%
Dominican Republic	2,1 million	582,000	27%

Access to credit is severely limited for SMEs either to expand their business or start one. This barrier explains mainly their low contribution to growth. The 2015/16 World Economic Forum's Global Competitiveness Report (World Economic Forum, 2016) indicated that 22% of businesses in Haiti reported that their main problem was access to finance, as compared with only 8.5% in Jamaica and 8.4% in Dominican Republic.

This situation is due to risk aversion from formal lending institutions (risks that are overestimated) coupled with a general lack of information from the borrowers sides. Financial information or credit history is only available for bank borrowers and is only shared between banks. The absence of a credit bureau that covers all borrowers (banking and non-banking) is a major limitation for SMEs. It increases the risk in this sector and is harmful to the credit risk management. The negative consequences of asymmetric information between lenders and borrowers inevitably lead to credit rationing or high interest rates.

Indeed, the financial sector in Haiti is dominated by commercial banks, with a portfolio of about US$1.7 billion, which roughly corresponds to 21% of GDP and about US$156.60 of credit per capita.

Economic growth has slowed down significantly recently from 5.5% in 2011 to 1.2% in 2015, as a result of low levels of credits, of private investments, and of high interest rates and tax rates. This situation has obviously altered credit distribution to the SME sector.

One other constraint to SME development in Haiti is the bad business climate (e.g., the registration of new companies). According to *Doing Business 2016* (World Bank Group, 2016), Haiti ranks poorly regarding the ease of doing business, coming in at 188 among 189 countries; for comparison, Trinidad & Tobago ranks 67th. On average, it takes 97 days to complete the procedures for starting a business in Haiti, as compared to 11.4 days in Trinidad & Tobago and 29.4 days in Latin America and Caribbean. This discourages potential entrepreneurs from proceeding with their projects or pushes them into the informal economy. This issue is currently being analyzed by the Ministries of Finance and Commerce, aiming at minimizing the barriers of entry to new companies across sectors.

In addition to the above mentioned factors, which hinder SMEs' access to financing, additional constraints hampering SMEs' performance include:

- The lack of:
  - credibility of potential entrepreneurs, resulting from the lack of a financial identity or financial history (absence of a credit bureau);
  - training in entrepreneurship (very few can write a business plan);
  - diversity in the SMEs;
  - support from government and policy fostering development of SMEs;
  - financial documentation from the SMEs;
  - guarantees (collaterals) for access to loans; and
  - the low level of profitability of SMEs because of their small size and high administrative costs (Dalberg, 2011).

Possible Solutions and What Has Been Done So Far

The low contribution of SMEs to economic growth in Haiti has been a major concern for years. Numerous programs were put in place to address this issue, mostly by international organizations, before and after the 2010 earthquake. However, the results did not meet the expectations. Examples include:

- In 2004, a guarantee agreement to support micro-entrepreneurs in certain sectors was put in place. The implementation of the guarantee by Development Credit Agreement (DCA) in 2006 was supposed to ease up financial constraints on the lenders, thereby increasing their capacity to offer credit in qualifying projects, including agriculture, tourism, handicrafts, garment, construction, infrastructure, and waste management.
- In 2011, Business Edge in Haiti, through International Finance Corporation (IFC), trained 1,746 entrepreneurs (47.80% women), reaching more than 800 SMEs and large companies with a 94.55% satisfaction rate.
- In 2012, the Inter-American Investment Corporation (IIC) established a synthetic co-financing line of US$2 million with some microfinance institutions, designed to increase the availability of loans for Haitian SMEs while reducing borrowing costs. Under the Master Agreement for a Revolving Credit Facility and Proportional Risk Allocation for Financing of SMEs in Haiti, 40% of the outstanding balance of eligible sub-loans are guaranteed by the IIC. USAID, through the Leveraging Effective Application of Direct Investments (LEAD) project, has helped with designing of business plans for SMEs and getting additional loans to around 40 SMEs. The results were much less than expected and only 12 grants were awarded in 2014 (USAID, 2013).

Since the results of these initiatives were not conclusive, we have identified additional solutions to help steer funding towards the SME sector. These are multilayered and should be a combination of different actions and programs by different actors. The following seems more pressing and with lasting impact.

Proposition of Three Major Laws for Parliamentary Approval

1. **Law establishing a credit bureau**

   The absence of such a law and entity greatly limits financial institutions' access to credit history for MSMEs. A credit bureau could facilitate formal credit access by SMEs and micro-entrepreneurs. The law to establish and create the credit bureau should be proposed and pushed by both the Central Bank and the Ministry of Finance. The credit bureau law is currently in preparation and is in line with the new financial inclusion national strategy currently in place in the country. Should it be passed in 2017, the data collection should start immediately and should range from stores that offer and record store credit, to the formal financial institutions (microfinance and banks), going back 5 to 10 years. The creation of the credit bureau would help establish a financial profile for all individuals and entities that have had access to some type of credit over the period, thereby acknowledging their credit experience. With this information, risk evaluation in the SME sector would rise in quality and help attract local and international investors.

2. **Law on leasing**

   The formal financial sector has been lending to large institutions, with significant collateral. When leasing equipment, SMEs would have the opportunity to use the transaction as credit experience information, which could feed the data base of the credit bureau. Among others, SMEs would invest in preserving their cash flows without increasing their financial indebtedness, while having adequate equipment for their activities. Furthermore, the equipment at the end of the lease could be purchased and used as collateral for future credit.

3. **Amend the law on moveable assets as part of guarantees**

   The use of moveable assets as guarantees would rise collateralized loans in the SME sector. In fact, the entrepreneur could use his tools, equipment, and machineries as guarantees to secure a loan.

Educating the Financial Sector on the Potential of Specific Sectors and the Real Level of Risks

Training programs should apply to both financial institutions as well as SMEs. Indeed, training the financial sector is one of the important channels through which it is possible to steer interest and share proper information on SMEs and productive sectors. Training the banks should aim at teaching them how to properly analyze the SMEs' financial statements.

On the other hand, there should also be specialized programs to help improve young entrepreneur's transition from an idea of a start-up to putting together a business plan and getting access to credit. The objective will be to help viable business ideas become sustainable enterprises. Specialized programs should also encourage entrepreneurs to pursue high value added opportunities in different sectors, therefore diversifying the economy and the sectors. Funds or programs currently in place could also contribute to help SMEs better manage their asset.

It will also be necessary, particularly to the central bank, to ensure public awareness about the benefits related to credit bureau and other instruments that ensure efficient implementation of the measures.

Creating an Environment with Incentives to Minimize the Costs

Incentives should come from both the government and the regulator, the Central Bank. The Central Bank can provide facilities such as:

- lowering reserve requirements on loans given to this sector by commercial banks,
- refinancing window for SMEs, and
- providing subsidized interest rates.

While contributing to increase the number of start-ups, additional incentives relevant to cost minimization through tax exemption, could be given to these companies especially at the registration phase. Every new start-up would be exempt from paying, during the first five years, taxes on return on investment which would in turn contribute to increasing their capital.

Policy Recommendations

The main mission of the Central Bank is price stability, but also to promote growth. Therefore, sufficient loans to SMEs is a long-term goal. The Central Bank is able to ensure through certain policies a better support to the SME sector. The Central Bank, by recommending the three laws on credit bureau, leasing, and new types of acceptable guarantees and financing to Parliament, along with other incentives, aims at ensuring that start-ups and existing SMEs will improve their capacity to access proper financing in order to capitalize their enterprises, fund their activities, including technology acquisition. In the medium to long term, the evidence confirming the financial potential of some industries and the incentives for the formal financial sector can be established and validated. Therefore, the current policy recommendations would cover the three laws and some incentives, all of which are relevant to access to credit.

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Challenges of Access to Finance for SMEs in Pakistan—A Way Forward

Karim Alam*

Joint Director, State Bank of Pakistan

Problem Statement

Small and medium enterprises (SMEs) face constraints in accessing finance from Financial Institutions (FIs) in Pakistan, thus affecting their abilities to grow and/or operate.

Background and Problem Diagnostic

FIs consider SMEs in Pakistan as a risky segment to provide credit, thus limiting their ability to grow and contribute in sustainable economic development of the country. From Table 1, it is evident that financing to Pakistan's SME sector is the lowest among peer nations in the region.

Table 1. SME Loan Outstanding in USD* as of 2012 (Amount in Billions)

India	124.4
Bangladesh	8.5
China	4,038.0
Pakistan	2.7

*Based on USD rate (as of Dec – 12) for each country
Source: (ADB, 2014)

SMEs operate in all types of economic sectors (primary, secondary, and tertiary) and are termed as growth engines of an economy for their critical role in creating new jobs (Stein et al., 2013). SMEs are also considered as the labs of innovation: they are dynamic and agile but vulnerable. They face numerous challenges to starting, operating, and growing; however, access to finance (A2F) is one of the key challenges they face. Though SMEs have access to various sources of finance both formal and informal, they face constraints in accessing formal finance (Li-qiong, 2009; Beck, Demirgüç-Kunt, & Martinez Peria, 2008). SMEs, in general, are not excluded because of poor performance, but because of other factors, such as (a) absence of an enabling legal and regulatory framework, and (b) non-SME-friendly products and procedures offered by formal providers (Nenova, Niang, & Ahmad, 2009). Such constraints may hinder their growth prospects (Beck, Demirgüç-Kunt, & Maksimovic, 2005). Nevertheless, Vandenberg (2003), is of the view while formal financing is limited SMEs have the ability to get financing from alternative sources. However, there are drawbacks to alternative sources including stringent conditions, credit rationing or high borrowing costs. Beck et al. (2006), based on their study of 10,000 firms in 80 countries, find that "firm size" is a major determinant in access to finance A2F or non-availability of credit for firms, thus, giving weight to the fact that financing constraints are more prominent for the smaller firms compared to larger ones.

Analysis of the Problem in Pakistan

There are about 3.2 million economic establishments in Pakistan, of which more than 90% are SMEs. The share of SME Financing in total industry credit is approximately 6% while the share of SME borrowers in total industry borrowers is approximately 5% (SBP, 2015a), much lower than the average SME loans in Asia, which are 25% of total bank financing (ADB, 2014), thus giving credence to the fact that A2F for SMEs is limited in Pakistan. This is based on the understanding that increased share in total bank financing means more and more SMEs have A2F.

* The views expressed in this paper are those of the author and do not reflect the views of the State Bank of Pakistan

Further, adequate and stable access to finance is crucial for SMEs to survive and grow especially given the uncertainty in global economic front (Shinozaki, 2014).

It is pertinent to mention here that despite significant contributions to employment, GDP, and exports (see Table 2), the share of SMEs in formal financing is limited when compared with other regional countries. A comparison with peer countries and other regional economies clearly depict the significant role played by SMEs in Pakistan as well as indicating the need to boost economic growth through taking appropriate measures to develop SMEs.

Table 2. Regional Comparison-SME Contribution

	Total employment (%)	In GDP (%)	In total exports (%)
Republic of Korea	88	49	31
Thailand	78	39	30
Malaysia	59	32	19
Pakistan	70	30	25
India	40	17	40
Bangladesh	40	23	11
China	61	36	20

Source: (IMF-JICA 2015)

SMEs are the life blood of modern economies, therefore they should be the producers of high quality products as well as remain competitive (Ghobadian & Gallear, 1996). Nevertheless, based on a select sample, it would be a challenge to generalize them due to the fact that diversity is their main characteristic (Deakins & Freel, 1998).

With the advent of technology for decision making e.g., credit scoring and financial modelling, SMEs should not be disadvantaged in access to finance by any of their characteristics (Deakins et al. 2008). However, Deakins, North, Baldock, & Whittam (2008) establish from their supply and demand side research that certain categories of SMEs will face greater challenges in accessing finance compared to others. A likely solution could be to encourage commercial banks to lend to SMEs via more competition, tailored designed schemes, and strong enforcement of laws (Shen et al., 2009).

Taking cognizance of the significance of SMEs for the economy, National Financial Inclusion Strategy (NFIS) launched in May 2015, sets out various recommendations and headline targets to enhance the existing share of SMEs in private sector credit from 8% to 15% in a period of five years. The significance of financial inclusion as a strategic imperative is also clearly stipulated in SBP Vision 2020 (SBP, 2015b). The vision broadly categorizes key activities around six strategic imperatives. SBP has shown commitment to focus efforts along with other stakeholders to make a meaningful impact on financial inclusion in Pakistan.

Possible Solutions

In order to identify various solutions to the challenges faced by SMEs in A2F, there is a need to take a holistic view, encompassing both supply and demand side limitations. IFC (2013) identified six issues faced by financial institutions in developing countries while financing SMEs: 1) poor customer knowledge, 2) poor business enablers, 3) lack of collateral or capital, 4) lack of credit data, 5) low profitability, and 6) lack of SME skills and literacy.

State Bank of Pakistan (SBP), the central bank, has been taking numerous policy measures with the objective to: 1) create an enabling regulatory environment, 2) undertake market development measures and 3) build a secured lending environment (Ahmad & Alam, 2015).

Based on the above discussion of A2F for SMEs and in view of the supply and demand side challenges/limitation of SME Finance in Pakistan, the following are some of the key policy recommendations:

Firstly, there is a need to design and implement a comprehensive capacity building plan for the FIs. Although SBP has been taking various capacity-building programs for the FIs covering many aspects of SME Financing, however, these capacity building programs were not dedicated to a particular layer of officials in terms of SME banking functions like SME credit officers, SME risk officers, branch managers, product teams, etc. This policy measure envisages outlining and developing contents for each key layer in the SME Banking Hierarchy at FIs, though with close coordination with various stakeholders. This is also due to the fact that currently no such comprehensive plan/capacity building programs are being offered by any institution in the country. Moreover, various alternative options could also be considered that contribute in enhancing A2F for SMEs broadly under the capacity-building program.

Secondly, in view the issue of low SME skills, literacy and complex documentation requirements of FIs, there is a need to design and develop a simplified version of loan application form for small enterprises (SEs), since A2F is more prominent for SEs compared to large enterprises in Pakistan. It is pertinent to mention here that realizing the limitations of small borrowers; SBP has already developed a loan application form in coordination with various stakeholders to facilitate small farmers. Likewise by designing a simple loan application form for SEs, their challenge of complex documentation requirements could be addressed.

Thirdly, FIs may be asked to review and revise their credit policies for SMEs in light of the new knowledge, emerging market trends and dynamics. This is important due to the fact that FIs are free to lend to any enterprise as per their risk appetite; however, FIs rely on their stringent and/or outdated credit policies while lending to SMEs. By reviewing their existing credit policies, FIs will be able to adopt various alternative channels to finance SMEs and offer innovative products keeping in view the peculiar characteristics of SMEs. This review, which could be made periodic for FIs, will provide a way forward in light of the emerging market trends and serve as a chance to tap existing potential.

Recommendation

In light of the above discussion, one of the policy measures to address the issue of inadequate A2F for SMEs is to enhance the capacity and skills of financial institutions so that they can better understand the dynamics of SME sector. Moreover, it is assumed that better understanding of the sector and its dynamics would result in the development of new dedicated products for targeting different SME sub sectors and regions.

I recommend designing and implementing a comprehensive capacity-building plan for FIs targeting each layer of the SME function—that is, branch managers, credit officials, risk officials, product teams, etc. The proposed solution must consider criteria of jurisdiction, capacity to undertake, and existence of preconditions to support the policy measure. It is also envisaged that the plan be implemented at least for a year and then based on the lessons learned stakeholders can decide the best way forward.

To proceed further, the matter may be discussed initially formally/informally or through a focused group meeting comprising the key stakeholders such as the Institute of Bankers Pakistan (IBP),[1] National Institute of Banking & Finance (NIBAF),[2] and banks to discuss on how to proceed and develop contents for each layer or other alternative solutions. Though, both IBP & NIBAF may face limitations in terms of capacity and outreach to undertake a set of nationwide programs for each functional layer in various cities, nevertheless, with the support of central bank and its 16 field offices across the country, various programs can be planned and executed. Since both the NIBAF & IBP have a mandate as well as jurisdiction to train or enhance the skill set of bankers in SME banking related functions. This would be an opportunity for the IBP/NIBAF to partner with the central bank in an effort to enhance A2F for SMEs through tackling the dearth of skilled/trained SME Bankers in the country.

Notes

1. Pakistan's only recognized Institute dedicated to providing technical training services for the banking industry in the country; see online at http://ibp.org.pk/Whoweare.aspx
2. A subsidiary of the central bank of Pakistan, NIBAF is a dedicated training institute for central bankers, commercial bankers, and micro and rural finance providers, as well as management professionals; see online at http://www.nibaf.gov.pk/about/

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Providing Sustainable Income and Opportunities for Expanding Businesses to Low-Income Female-Owned SMEs in Tanzania

James Alex Masoy

Manager, Oversight and Policy Department, Directorate of National Payment Systems, Bank of Tanzania

Executive Summary

Tanzania is one of the fastest growing economies in East Africa with an average GDP growth rate of 7% over the past 2 years.[1] Tanzania has shown tremendous progress in financial inclusion overall due to opportunities in the adoption and expansion of mobile financial services platform.[2] The policy makers have demonstrated commitment to address these challenges through policy measures as stipulated in the National Financial Inclusion Framework (Tanzania National Council for Financial Inclusion, 2013). However, like many developing countries, Tanzania has faced challenges in translating its economic growth to broader financial inclusion for its entire people including small and female-owned small- to medium-sized enterprises (SMEs) due to a variety of supply and demand-side factors.

This policy memo seeks to point out the root cause and immediate causes of the problem that are affecting cross sections of small and female-owned SMEs who are not having sustainable income and opportunities for expanding their businesses. On each cause, there are proposed policy solutions and recommended implementation strategies. It has further listed a bundle of priority policy solutions that include continuation in making reforms in legal and regulatory frameworks aiming at creating space for innovation to support greater access to financial services, provision of market data on female-owned SMEs, and financial capabilities to female-owned SMEs.

The recommended priority policy solutions will bring potential benefits to the economy including female-owned SMEs empowerment for overall improved well-being of women and the Tanzania nation as whole.

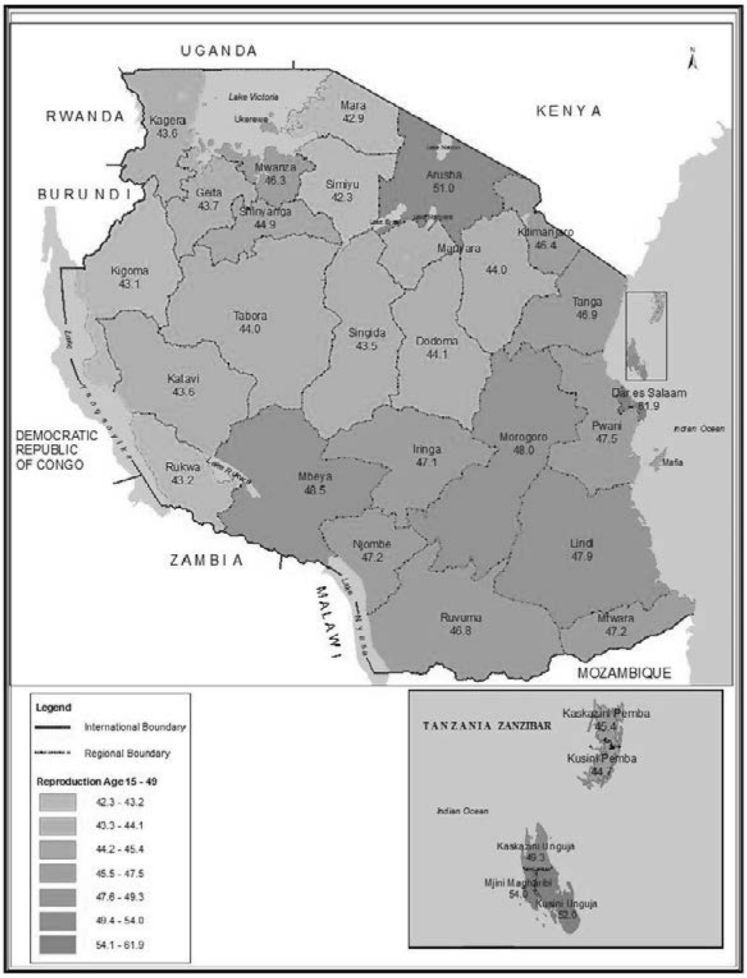
Background

The FinScope Tanzania survey (Financial Sector Deepening Trust, 2013) showed enormous progress in financial inclusion overall, both in banks and other formal institutions. Women's financial inclusion in formal institutions increased from 14.4% to 51.2% from 2011 to 2014; 44% of women and 54% of men use mobile money. Usage not only includes sending and receiving money, but also savings and stored value (used by 25.6% of adults in 2013; Financial Sector Deepening Trust, 2013).

Currently, microfinance institutions serve more women than men, whereas commercial banks serve relatively more men. Non-bank financial institutions serve men and women equally (Financial Sector Deepening Trust, 2013). Banks seem to be missing out on the female market, particularly in rural areas. For access to financing, SMEs reported that the main barriers of access to finance are financial illiteracy, lack of collateral, lack of record keeping, informality, length of time required to process a bank loan, strict regulations, and lack of proper products for small businesses.

Bank of Tanzania (BoT) Governor Prof. Benno Ndulu said "Bringing closer access to financial services, particularly to women, is a top priority. And there are ongoing efforts geared at enabling more women to benefit from the fast growing financial sector. It is high time that special attention be given to women to enable them exploit potentials hidden in them for faster economic growth and poverty alleviation."[3] The Bank of Tanzania has partnered with the Alliance for Financial Inclusion (AFI) in promoting financial inclusion for women, with an ultimate goal of lifting them from abject poverty.

Table 1. Overview of Tanzanian Women Adult Population Distribution



Tanzania is the sixth largest country in Africa, with a population of 51.8 million. Over 70% of Tanzanians live in rural areas in all regions, except Dar es Salaam and Mjini Magharibi (Zanzibar). The population of Women is above 51%.

According to the National Baseline Survey Report for Micro, Small, and Medium Enterprises in Tanzania (Financial Sector Deepening Trust, 2012):

- There were 3.1 million businesses in Tanzania owned by 2.7M people.
- 54% of these businesses are in rural areas and women own 54%.

Problem

Statement: Small and female-owned SMEs in Tanzania do not to have opportunities to expand their businesses, primarily due to various barriers related to appropriate financial services.

Context: Women SMEs in Tanzania are failing to sustain their income and their business opportunities for a variety of supply and demand-side factors.

On the demand-side, small and female-owned SMEs lack proper documentation, information, credit history, and collateral, which limit their ability to access formal financial services. Second, financial literacy among women is lower than that of men; the 2014 survey estimated that only 60% of women were "well informed" of money matters or available products and services (Financial Sector Deepening Trust, 2014). Practically, women SMEs have mostly relied on informal financial service providers like informal groups, friends, and relatives. Third, while all SMEs have irregular income patterns, recent surveys have shown that female-owned SMEs have lower income than men, primarily due to less representation in formal sector.

On the supply side, existing formal financial services do not do not in all cases offer customers a better value proposition than informal products and providers including stringent or lack of proportionate requirements for client on-boarding. In addition, such services are expensive, mainly due to inefficiencies in delivery channels. Third, many financial service providers assume that female-owned SMEs are high risk area and unprofitable, mainly due to absence of market data. Additional issues are the lack of a regulatory framework for broad-based microfinance services, delays in rolling out a national ID system, lack of a legal framework allowing for quick contract enforcement in the event of default, stringent know-your-customer (KYC) requirements, high security requirements for bank branches, and the absence of an explicit financial consumer protection framework.

Possible Solutions

There are two categories of potential solutions to address this problem. First category is to use existing opportunities on the wide and successful adoption of mobile money in Tanzania while the second is to address high-impact policy areas to advance financial Inclusion to support small and female-own SMEs in Tanzania.

Solution A. Use the existing opportunities on the wide and successful adoption of mobile money in Tanzania

1. **Digital financial services (DFS) and delivery channels**

   Using DFS can be instrumental in increasing female-owned SMEs financial autonomy and supporting participation in the formal economy. DFS will bring more benefits to female-owned SMEs like speedy and transparency in payment, flexibility particularly to those in rural areas when participating in domestic and international remittances. The Bank of Tanzania will continue to take the lead through the newly enacted National Payment Systems (NPS) regulatory Framework.

2. **Expansion to new products and product bundling**

   The expansion of DFS on top of existing mobile money platforms has set the stage for the development of new products and product bundling. This includes using numerous transactional mobile bank accounts such as Vodacom-CBA M-Pawa, Milcom-Tigo's interest-bearing account, and other microloan products like Timiza offered by Airtel and Tigo partnerships with AFB. They create savings incentives and enable credit histories of transactions that support borrowing. Ultimately it will bring women's SMEs empowerment as evidence suggests digital financial remittances can enable the recipient to keep financial transactions private, even within a family.

Solution B. Address high-impact policy areas to advance financial inclusion to small and female-owned SMEs in Tanzania

1. **Provide market data about small and female-owned SMEs for wide access by local and international audience. The specific focus should be on gender-disaggregated data collection and research.**

   Tanzania has developed policies based on FinScope surveys in 2006, 2009, and 2013, which provide financial inclusion data broken down by gender and another FinScope survey will be conducted in 2016. Overall, financial inclusion data will expand from access data to usage and quality data, which will more accurately capture the state of women's financial inclusion in Tanzania.

   Further, the Bank of Tanzania is in the process of expanding its financial inclusion database to include data by gender and age, and results are expected to be similar to the 2014 Global Findex data. It is expected to have an even stronger influence on policy direction toward putting attention on financial inclusion for supporting small and female-owned SMEs in Tanzania.

2. **Provide a combination of knowledge, skills, attitudes, and behaviors of female-owned SMEs in order for them to make sound financial decisions that support their financial well-being.**

   Proving financial capabilities will enable more female-owned SMEs to better understanding on products and services, use, compliance, and other challenges in order to change their behaviors on how to effectively access financial services (credit, payments, saving, insurance, and investments) from formal financial institutions.

   A financial capability survey was conducted in Tanzania in 2014, with results presented in a 2015 report. A revised Financial Education Framework based on these results was released in conjunction with establishment of a national financial education secretariat to coordinate financial literacy programs in Tanzania.

   The Financial Education Framework is expected to be ready by mid-2016. The Bank of Tanzania through National Council and other relevant stakeholders will continue to spearhead the financial capability initiatives and it is expected to see improvement in the next survey.

3. **Put in place a greater focus on the value proposition for women's financial inclusion, with explicit policy objectives and quantitative targets-that may lead to transparent, women-inclusive policies.**

   In the National Financial Inclusion Framework 2013, Tanzania had given priority to poor rural households and their SMEs, including low-income women and youth, without specifying gender targets. The Bank of Tanzania has decided to introduce gender targets and indicators in the revised measurement framework integrated. The revised measurement framework will be available by mid-2016. Quantitative targets that are explicit to women will bring favorable financial inclusion policies to small and female-owned SMEs in Tanzania.

4. **Making reforms in legal and regulatory frameworks can create space for innovation that supports greater access to financial services for female-owned SMEs in Tanzania.**

   Tanzania's legal and regulatory framework for payment systems has expanded mobile money for both women and men, and recent reforms are anticipated to increase women SMEs financial inclusion. But additional changes could help further; for example, a risk-based tiered KYC regime would help support female-owned SMEs because women often do not possess the two forms of valid ID currently required.[4]

   Furthermore a movable collateral regime will support women's financial inclusion. A modern secured transactions law would enable both business and consumer debtors to access credit using whatever form of collateral in their possession relevant for female-owned SMEs who are less likely to have access to traditional forms of collateral.

   A concept paper on Secured Transaction Law and Collateral Registry was approved by the Bank of Tanzania, which is organizing a project team to spearhead changes to the movable collateral legislation.

5. **Put in place legislation and regulations for addressing social norms that constrain women's financial inclusion can have important repercussions for female-owned SMEs access to financial services.**

   The country has taken steps to create a positive legal framework for gender equality, but some barriers remain. Asset ownership, co-titling of landholdings between husbands and wives was introduced in Tanzania to ensure women benefit from legal reforms. Price discounts have been offered to landowners who wished to acquire formal land titles and agreed to accept their wives as owners or co-owners of the land.

6. **Refined and strengthened financial consumer protection regulation can address the concerns and issues of Female SMEs clients, balancing protection with expanded outreach.**

   So far, Tanzania's industry-based financial consumer protection regime has not taken a unified approach to issue consumer protection law. Without broad financial consumer protection legislation, regulators in the financial sector have established windows to receive and handle all grievances raised by consumers (complaints desk and ombudsman). However, non-deposit-taking institutions (credit-only institutions), a sub-sector serving high numbers of women SMEs, do not have a regulator. These forces customers to either take complaints to the Bank of Tanzania, or the Ministry of Finance, or keep quiet. Plans are underway to develop a national financial consumer protection framework through the Bank of Tanzania and other stakeholders, such as the Fair Competition Commission. Gender-specific aspects in the financial consumer protection framework will help female-owned SMEs.

7. **Develop financial infrastructure as a critically important part of implementing sound policy.**

   Tanzania has great progress in terms of DFS interoperability. Discussions about Interoperability in other areas, such as bulk payments and retail settlements, are ongoing. Tanzania's first two credit reference bureaus established in 2012 and 2013 and other important financial infrastructure will continue to build an information base on female-owned SMEs as clients. An alternative credit reference system is in development using mobile phone data, which includes credit scoring of microfinance loan products. Options for alternative collateral include the establishment of a warehouse receipts system as part of the agricultural finance agenda. A warehouse receipt board has been established and the development of the warehouse. This will eventually help female-owned SMEs access formal financial services.

Priority Solution and Implementation Strategy

Based on the above possible policy solutions, the following are top priorities in the same order.

2.0 Solution B. Address high-impact policy areas to advance financial inclusion for women SMEs in Tanzania.

i. Making reforms in legal and regulatory frameworks can create space for innovation that supports greater access to financial services for female-owned SMEs in Tanzania.
ii. Provide market data of small and female-owned SMEs for wide access by local and international audience. The specific focus should be on gender-disaggregated data collection and research.
iii. Provide a combination of knowledge, skills, attitudes, and behaviors of female-owned SMEs in order for them to make sound financial decisions that support their financial well-being. It aims at increasing familiarity with product features as well as increasing utilization of the products.

2.1 In additional to the priority solutions above with much of what has already been achieved under the National Financial Inclusion Framework, there are still opportunities to accelerate women's financial inclusion to support female-owned SMEs in Tanzania, through the following parallel initiatives or activities including:

- Introducing simplified KYC across financial services providers once Tanzania's National Risk Assessment is completed.
- Expanding the Bank of Tanzania database to include sex disaggregated data.
- Moving forward with the revision of the movable collateral regime.
- Promoting financial consumer protection initiatives and pursuing the development of the Financial Consumer Protection Framework.

Conclusion

Strategic Implementation of the recommended priority policy solutions will bring potential benefits to the economy. Women's SMEs will be empowered through systematic business investments with close monitoring of all activities, that will result into increased sales and profits, which will lead to increased household incomes for women with better saving and spending on priority sectors like education and health leading to improved well-being for women.

Notes

1. World Bank, GDP Growth (Annual %). Retrieved from http://data.worldbank.org/indicator/NY.GDP.MKTP.KD.ZG/countries/ET-MZ-TZ-ZM?display=graph
2. According to Financial Inclusion Insights 2016, the proportion of Tanzanians with access to formal financial services had risen to 61%. Of these, 53% were active users, and one-third are comfortable with advanced digital usage like bill-payments and savings.
3. Governor's speech at Alliance for Financial Inclusion's conference in Dar es Salaam, April 2016: "Bridging the Gap: Commitments and Actions for Women's Financial Inclusion."
4. Mobile wallets have already been created on the basis of lighter KYC, leading to an uneven playing field for banks seeking to reach the female-owned SMEs market. Although 76% of adults have a valid ID, which is a legacy of the recent electoral process where new Voters Registration cards for were issued in 2015 for the national election in Tanzania, but there is a requirement under anti-money laundering (AML) regulations to produce a second ID to verify the first ID. This requirement does not account for the size of a transaction or the total volume of transactions, which as a result often excludes poor, rural women or female-owned SMEs who are not likely to have a second form of identification.

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The Financing Challenges of SMEs in Zambia and Possible Interventions for the Bank of Zambia

Mankolo Beyani

Assistant Director, Regulatory Policy, Licensing & Liquidations, Bank Supervision Department, Bank of Zambia

Introduction

This Policy Memo explains a financial inclusion challenge in Zambia: the financing gap for micro, small, and medium enterprises (MSMEs)[1] and the recommended solution. This area of study is motivated by the recent economic challenges that Zambia is facing, which highlights an urgent need to stimulate the growth of SMEs and diversify the economy. SMEs play a key role in economic development through their contribution to employment and GDP. Furthermore, financial access is critical for the growth and development of SMEs although access to finance remains a key constraint to their development (IFC, 2011).

Background and Context

Businesses in Zambia belong to two different worlds; one comprising large businesses and the other made up of MSMEs, and the firms in the two worlds are very different (Clarke et al., 2010).

MSMEs are mostly small, home-based, and individual or family enterprises; about 35% of them have no employees other than the owners; and few are registered with any government agencies hence are mostly informal. The large businesses, on the other hand, are more productive and contribute significantly to the country's total industrial output compared to the MSMEs. However, in terms of employment, the large businesses' contribution to the country's employment is only about 7% while MSMEs account for about 88% (about 16% are unemployed).

The firms also face different constraints. From a financing perspective, MSMEs struggle to secure financial services—in particular, the vital working capital necessary to support their growth. Although they constitute more than 90% of firms in Zambia, most are unable to access financial products as only 10% are banked and only about 10% qualify for and have access to credit products. Bank of Zambia data indicates that credit to SMEs by the banking sector accounts for only 10% of total credit.

In Zambia, the relationship between commercial banks and SMEs is a difficult one. This arises primarily from the conflicting perceptions that each holds of the other. Commercial banks regard the SME sector as risky and feel justified in being cautious and highly selective in offering credit to this sector. On the other hand, owners of SMEs think that banks are unnecessarily risk averse and unsupportive of their businesses.

Problem

MSMEs in Zambia are too small and have limited capacity to grow their businesses. This inhibits their meaningful contribution to the economic development of the country (MCTI, 2008).

The MSMEs face many challenges that hinder their productivity and growth (MCTI, 2008), including:

- lack of access to basic infrastructure services, especially for those in rural areas;
- limited technical and management skills and capacity by owners in managing the businesses;
- limited access to appropriate technology, machinery, and equipment;

- most SMEs are financially small and weak, thereby lack the capacity to operate competitively;
- lack of SME support institutions and services that could promote the potential of SMEs and protect them from the competition of the large corporates;
- poor governance in managing the business, particularly for owner-managed and owner-controlled enterprises, which diminishes their credit worthiness and attractiveness for lending by banks;
- few MSMEs have access to banking services, therefore have limited access to finance, due to:
  - lack of or weak financial records for credit evaluation by banks. Most MSMEs, particularly the small, family-run businesses do not have financial records other than records of their cash flows;
  - lack of collateral acceptable to banks;
  - lack of expertise and adequate training and skills by banks in handling MSMEs; and
  - cumbersome credit requirements by banks, which the majority of MSMEs are unable to meet.

Banks are apprehensive in lending to SMEs due to the high credit risk; evidence suggests that SMEs are more risky than corporate businesses, with higher default rates. Most MSMEs have low and unstable cash flows, making it difficult for them to service their loan obligations, resulting in delinquent loans. Because of the risk perception associated with SMEs, banks have resorted to denying credit even to deserving enterprises.

When banks do extend financing to the SMEs, the amounts involved are inadequate and only fund day-to-day operations and business transactions, and offer little support to expand productivity or to grow their businesses (Atterton, 2015).

Addressing the key challenges in the area of SME financing requires a multidimensional policy mix. Various stakeholders must examine and isolate the key challenges and consider possible solutions. It is important to prioritize policy solutions when tackling these problems, which calls for a phased approach by categorizing the problems into those that can be dealt with in the short term, medium term and long term. It is important to start with constraints that are more feasible, easier to fix, and at less cost. This is the approach that has been used to arrive at the recommended solution.

Possible Solutions

The focus of this policy memo is to propose possible interventions that the Bank of Zambia, as regulator of the banking sector in Zambia, could take to address the supply-side challenges of the SME sector.

Solution A – Enhance the institutional capacity of banks to deal with SMEs, with a policy vision of making the SMEs more attractive to the banks. This includes enhancing the skills of banks in analyzing SMEs and their financing needs. The capacity building of officers should result in SMEs being more attractive to banks. While SMEs are more risky than corporates, lack of proper understanding can exaggerate the extent of risk, which can unjustifiably result in a reduction or withholding of credit. The banks must be able to understand the different circumstances of SMEs and ensure that the loan amounts and terms are appropriate to the business.

***Evidence* –** Generally, banks in Zambia are not trained in handling SMEs and tend to lend to SMEs without developing an understanding of their business or establishing a relationship that extends beyond the terms of an immediate loan transaction. This practice makes the loans riskier for the banks and less helpful for the SMEs.

Many SME customers indicate that they move from one bank to another, looking for a bank that will understand their needs and circumstances and provide appropriate advisory services.

Entrepreneurs also point out the lack of understanding of their cash flow cycles by banks as a major barrier to credit and that a Relationship Manager with good understanding and skills is better placed to provide appropriate advisory services to their clients.

Solution B – The Bank of Zambia should work in conjunction other stakeholders and the SMEs themselves to address the operational and management weaknesses of SMEs that make them unattractive to banks—that is, the demand-side challenges of the SME sector.

***Evidence* –** Most SMEs in Zambia are owner-managed and are characterized by poor governance and management, which diminishes their credit worthiness before banks.

The SME sector in Zambia falls under the Ministry of Commerce, Trade and Industry (MCTI) and therefore, the Bank of Zambia has no direct influence over the sector. However, the Bank of Zambia has participated in various activities organized by MCTI, SME associations, commercial banks, and other stakeholders to discuss the challenges of the SMEs. Such engagements should be ongoing.

Solution C – Diversify collateral arrangements to enable SMEs to meet the credit requirements of banks.

***Evidence* –** One of the financing constraints of SMEs is the lack of collateral acceptable to banks. Typically, banks require developed landed property to secure credit facilities extended to borrowers. With alternative collateral arrangements, such as movable assets, SMEs would be able to meet the collateral requirement to secure their credit.

The Movable Assets Act, an initiative to address the collateral challenges of borrowers, was enacted by the Parliament of Zambia in April 2016. The Act provides for the establishment of a Collateral Registry, which is currently in progress. Once fully operational, the expectation is that banks will accept other forms of collateral thereby enabling more entrepreneurs to meet their credit requirements.

Recommendation

Solutions A and C are closely related and best influenced by the Bank of Zambia. Solution C is already in progress and implementation remains. Solution A, when compared to Solution B, is the most feasible from the Bank of Zambia perspective.

While being cognizant of the risks of SMEs, banks need to enhance their institutional capacity in dealing with SMEs. It is therefore recommended that banks take the lead in creating an environment that is conducive to improved credit offering to the SME sector. To this effect, banks should:

- invest in training programs focusing on SMEs so that their officers acquire the necessary skills and expertise for dealing with SMEs;
- adopt SME-centric approaches and have dedicated Relationship Managers to serve the SME clientele. Banks must recognize the need for continuous improvement of the bank–business relationship;
- design products and prices specifically for SMEs, which are reflective of the SMEs peculiarities. Further, banks must recognize that SMEs are not homogeneous, hence must be segmented into their various sectors in order to be served better; and
- provide occasional workshops, as value addition, to their SME clientele. This will contribute to developing valuable business skills to the entrepreneurs that will ultimately help build strong businesses which banks will likely find attractive to do business with.

In order to support this solution, it is further recommended that the Bank of Zambia (BoZ) give incentives in form of relief in statutory reserve requirements to the banks that will lend to SMEs for identified productive sectors. The modalities and technicalities of how this will be operationalized can be determined by a working group within BoZ. A further recommendation is for the BoZ to pilot the approach with one or more banks first.

Implementation

Given the important recognition that the Government of the Republic of Zambia and the BoZ attach to the development of the SME sector, in particular financing of the sector, BoZ should consider exercising its authority in implementing the recommended solution.

In order to obtain buy-in from the banks, it is recommended that a consultative approach be taken, which could take the following steps:

- Constitute a Working Group at BoZ to work on the modalities of implementing the recommended solution.
- Engage all banks and call for a consultative meeting.
  - Form a Task Force composed of BoZ and representatives of all banks.
  - Agree on action points and targets, a work plan, and implementation plan.
  - All banks should sign binding implementation agreements with the bank of Zambia, as a sign of their commitment to the policy direction.

Note

1. In Zambia, MSMEs are defined based on the following variables: total fixed investments, sales turnover, number of employees, and legal status (MCTI, 2008). In the Zambian context, an enterprise in the MSME sector is defined as follows.

   Micro enterprise—any business registered with the Registrar of Companies with total investment excluding land and buildings of up to 80 thousand Zambian Kwacha, annual turnover of up to 150 thousand Zambian Kwacha, and employing up to 10 persons.

   Small enterprise—any business enterprise registered with the Registrar of Companies whose total investment, excluding land and buildings, in the case of manufacturing and processing enterprises shall be between 81 and 200 thousand Zambian Kwacha in plant and machinery, in the case of trading and service providing enterprises up to 150 thousand Zambia Kwacha, annual turnover of between 151 thousand and 250 thousand Zambian Kwacha, and employing between 11 and 49 persons.

   Medium enterprise—any business enterprise larger than a small enterprise registered with the Registrar of Companies whose total investment, excluding land and building, in the case of manufacturing and processing enterprises, shall be between 201 thousand Zambian Kwacha and 500 thousand Zambian Kwacha in plant and machinery; in the case of trading and service provision, shall be between 151 thousand Zambian Kwacha and 300 thousand Zambia Kwacha; annual turnover of between 300 hundred thousand and 800 hundred thousand Zambian Kwacha; and employing between 50 and 100 persons.

   Informal enterprise—any business enterprise not registered with the Registrar of Companies, whose total investments excluding land and building shall be up to 50 thousand Zambian Kwacha and employing less than 10 persons.

   To qualify as micro, small, or medium enterprise under these categories, the legal status and total investment criteria must be met together with at least one other criterion.

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Policy Note on Small- and Medium-Sized Enterprises' (SMEs) Access to Credit in Yemen

Nabil Mansour Al Montaser

Deputy Governor for Banking Supervision Sector, Central Bank of Yemen

Summary

The aim of this policy memo is to analyze the problems of small- and medium-sized enterprises' (SMEs) access to credit in Yemen.

In Yemen, SMEs have limited access to credit. Therefore, they do not have the same opportunity that large companies have to expand their businesses and activities to grow. The overall business environment is unfavorable to the development of SMEs and the private sector as a whole in Yemen.

SMEs play a vital role in Yemen: at least 97% of Yemeni firms (across all sectors) fall into this category. It follows, then, that the SME sector's capacity to get credit for business operations and investments is crucial to Yemeni's future economic growth. As in most developing countries, available data show that the Yemeni private sector consists mainly of micro, small, and medium enterprises (MSMEs)—over 97% of firms (about 290,000 in number) have less than 25 employees with total estimated employment of over 600,000 workers, including approximately 30,000 women (Assaf, 2013).[1]

Context

Banking Sector, In Brief

The banking sector dominates the financial sector. The banking sector accounts for about 95% of the financial sector's total assets. The financial sector in Yemen is significantly underdeveloped and has not effectively mobilized capital towards private sector development and broad-based economic growth. Before the war, the banking sector was characterized by very low levels of intermediation with bank deposits representing 27% of Gross Domestic Product (GDP) [a share significantly below the Middle East and North Africa (MENA) average of 76%; CBY, 2015)].

Access to Credit in Yemen

Yemen ranks 185 out of the 189 countries in the ease of obtaining credit (World Bank Group, 2016). This is due to the inefficiency of the banking system, non-user-friendly loan process, lack of credit information, delay in legal proceedings, and difficulties to realize collaterals. Banks' lending rates are high due to administered interest rate regime and lack of market competition (World Bank Group, 2016).

Credit to the private sector, an important factor in growth, represents only 6% of GDP, much less than the comparable countries, and only small part of this credit goes to the SME sector (CBY, 2015). Not surprisingly, banks have been reluctant to lend to SMEs, even though they account for the largest share of Yemen's enterprises (CBY, 2015). Banks have little incentive to diversify lending to the SME sector when they can secure zero-risk, low-cost, and profitable investments in public sector financial instruments. The large financing needs of the government and the high interest rates reduce incentives of banks to lend to the private sector (World Bank Group, 2016).

Problem

SMEs have limited access to credit due to constraints on demand and supply sides as well as macroeconomic factors and the institutional framework.

On the Demand Side

Many SMEs lack the capacity or willingness to provide business plans and adequate financial statements needed for a successful credit application. Moreover, SMEs often have difficulties meeting the high collateral requirements of banks, especially real estate, associated with the lack of properly functioning collateral registries. Banks demand very high collateral to compensate for weak creditor rights as well as the risk that the borrower may already have pledged her/his assets. SMEs consider bank collateral requirements to be the main obstacle to access bank credit. On average, in Yemen, banks require collateral worth up to 250% of the loan granted (ACE, 2014) while European Union (EU) countries average only 100% to 120% of the loan value (Beck, Klapper, and Mendoza, 2008). Moreover, administrative procedures and documents to be submitted by SMEs are also obstacles. Another main constraint is the high cost of credit due to the high-interest lending rate monetary environment.

On the Supply Side

There are no specific financial products or services developed for SMEs by the banking sector in Yemen. For small loans, preferred collateral is cash or gold. While some banks offer unsecured loans to SMEs, based on cash flow rather than collateral, these loans often come with shorter maturities. SME clients require a different approach than the analysis of large corporates. Banks mostly lack specifically trained staff or internal rating systems for SME clients. Banks believe that lending to the private sector is highly risky, especially in an environment that lacks credit information and strong enforcement of collateral rights.

Macroeconomic Factors and Institutional Framework

Inflation, high government budget deficits, and high interest rates are macroeconomic factors that affect access to credit. Other institutional framework features include credit information systems, registration systems for moveable assets, land and real estate, as well as creditor rights. Additional issues limiting credit access are weak information on potential borrower credit histories and a weak legal framework for property titles, rights of creditors, registration and execution of collateral, and resolution of commercial disputes.

Possible Solutions

The issues related to the macroeconomic factors are structural factors requiring long-term solutions. The solutions that can be adopted in the short term are the ones related to the issue of the high collateral requirements of banks and how we encourage banks to lend to SMEs.

Solution A: Encouraging Banks to Lend to SMEs by Providing Them Reasonable Incentive Schemes

Evidence

Banks could be encouraged to lend to the SME sector by providing them with incentives by Central Bank of Yemen (CBY), for instance deducting the loans and credit provided to SMEs from the legal or compulsory reserve requirement. However, more evidence from other countries needs to be explored.

Direct policy interventions through public banks, guarantee schemes, lower reserve requirements, and subsidized lending and other measures have played a role in increasing credit to SMEs compensating for MENA's weak financial infrastructure, but more sustainable structural solutions are needed (Rocha, Farazi, Khouri, & Pearce, 2010).

Solution B: Activating the Existing Leasing Law and Establishing a Movable Assets Collateral and Registry Scheme

Evidence

In 2007, the Leasing Law No(11) was issued; however, the preconditions to activate that law have not been introduced. Absent are licensing requirements for establishing leasing companies and the establishment of the electronic collateral registry system for movable and immovable tangible and intangible assets in the Ministry of Industry and Trade.

There is evidence from other countries that introducing a reliable movable assets collateral scheme increased SMEs' access to credit. Alvarez de la Campa (2011) illustrates the importance of introducing reforms in the area of secured transactions with the objective of increasing access to credit for businesses, particularly SMEs. The study summarizes many of the weaknesses common across the region. The two main critical areas that need urgent reforms are the creation of modern secured transactions laws and electronic movable collateral registries, and the need to improve enforcement mechanisms for security interests in movable property.

Solution C: Introducing SMEs Credit Guarantee Scheme (CGS)

Introducing such a scheme will reduce the risks of lending to SMEs, which will play a role in encouraging banks to lend to this important sector of the economy. Multiple studies have shown a good impact of such guarantee scheme on expanding credit to the SMEs.

Evidence Guarantee funds are an internationally proven tool that can incentivize banks and other financial institutions to start lending to SMEs. A recent feasibility study suggested creating a National Guarantee Fund, as it is a proven tool that can encourage banks and other financial institutions to start lending to SMEs (ACE, 2014). The following criteria for evaluating Credit Guarantee System (CGS) can serve as best-practice benchmarks for designing CGS: 1) Risk sharing among the CGS, borrowers, and banks. The lender should assume at least 30 to 40 percent of the risk, and never less than 20%. 2) Sustainability: CGS should be designed so that fees and other income, such as the return on investments, cover all administrative costs and claims. 3) A minimum 5% default rate is the point at which action may be considered to remedy the situation (Ganbold, 2008).

Recommendations

Government and CBY can achieve improvement in the short to medium term by taking action specifically directed at facilitating banking sector activities that improve SME access to credit. From the experiences of other developing countries and the literature review of access to credit for SME, the following recommendations are suggested.

First, a team from CBY, within the banking supervision unit, should be established to look at suitable and reasonable incentives that will encourage banks to lend to the SMEs sector without causing a credit market distortion. The team will be also responsible to study other countries' experiences which have similar economic conditions. The initial suggested incentives are the reduction of the legal reserve requirement by the credit allocated by banks for SMEs and the compulsory percentage of the loan portfolio that banks should allocate for SMEs.

Second, priority should be given to a comprehensive study of the SME sector in Yemen, including its size (formal and informal) relative to GDP by economic sector, and characteristics in order to better understand the demand-side perspective. Such study should be conducted by an independent and professional international origination.

Third, it is necessary to improve the overall credit environment and thereby create adequate incentives for SME finance as explained above. Therefore, CBY should consider undertaking a few urgent measures to better respond to the current needs of the industry. Upgrading the existing Public Credit Registry (PCR) system in the CBY to become more efficient and reliable, including improvement of information timeliness, data quality, credit historical data, and coverage will have a positive impact on SMEs access to credit. Introducing a Credit Information Law to allow a private credit bureau to be established is advisable. These two steps are important to ensure development of a credit information system that can effectively serve both banks and SME needs.

Fourth, since SMEs consider banks' collateral requirements to be the main obstacle to access bank credit, it is crucial to activate the existing leasing law and establish a movable assets collateral and registry scheme associated with introducing appropriate tax treatment and supporting legal environment for leasing industry.

Fifth, the government and CBY should urgently consider establishing an SME Credit Guarantee System considering the criteria as best-practice benchmarks for designing stated above (Solution C).

Sixth, it is advisable that banks improve their ability to deal with SMEs; therefore, capacity building of banks is required to simplify procedures for SMEs to get credit and to get better understand how to evaluate SMEs' credit applications and evaluate risks associated with SMEs. Therefore, technical assistance in capacity building for banks in this area is crucial. Banks at the same time need to simplify their loan procedures and requirements, to consider alternative forms of collateral such as movable assets and to speed up the loan disbursement processes.

Seventh, it is worth noting that if the government deficit increases, then there will be additional "crowding-out" pressures on private credit. The issue is a macroeconomic in nature and is out of the control of CBY. Therefore, it is a great challenge and should be dealt with as a long term macroeconomic policy to be addressed.

Finally, the by far most important constraints to business development of SMEs in Yemen are the ongoing war, political instability, and insecurity. Therefore, war must stop as a requisite factor for any policy to be successful.

Note

1. This data is from the Building and Establishment Census of 2004, Central Statistics Office. More recent data is not available.

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Promoting Affordable Access to Microloans for MSMEs and Low-Income People in Remote Areas of Indonesia through Branchless Banking for Financial Inclusion Program

Titi Safitri Nasution*

Senior Banking Analyst, Indonesia Financial Service Authority

Executive Summary

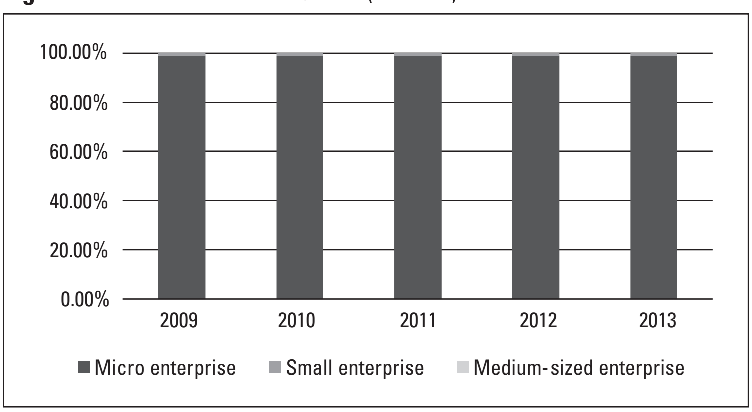
The Indonesian Financial Services Authority (Otoritas Jasa Keuangan/OJK) has issued regulation concerning Branchless Banking for Financial Inclusion (Laku Pandai) in November 2014 to underline the commitment of OJK to support the government initiative on financial inclusion. The regulation allows banks that meet certain requirements to have cooperation with third party as bank agents (either individual or legal entity). The aim is to extend their financial services into remote areas. Although development of Laku Pandai program during 2015–2016 are encouraging, continuing efforts from the OJK and the financial industry (i.e., banks) at large must recognize the Laku Pandai program, not a single bank has extending the microloan to the Laku Pandai customer.

This policy memo proposes actions encourage Laku Pandai banks to extend microloans to Laku Pandai customers. The core concept is to leverage Laku Pandai agents throughout Indonesia, including agents operating in remote areas. Sound policies and action plans will ensure that Laku Pandai program contributes to support other policies taken by the OJK, particularly those that develop and strengthen the micro, small, and medium enterprises (MSMEs) and low-income people in Indonesia.

Context

Indonesia is an archipelago with more than 17,000 islands inhabited by around 250 million people (according to 2010 census, population of Indonesia is 178 million). There are 57.86 million unit MSMEs within that population with contribution of 60.34% GDP to the Indonesian economy (Ministry of Cooperatives and SMEs, 2013; see Fig. 1.[1]

Figure 1. Total Number of MSMEs (in units)



Source: Ministry of Cooperatives and SMEs, 2013

In Indonesia, 202 million people live with less than USD4.50 (2005 PPP[2]) per day, in which 48% of them live with less than USD1.90 per day (World Bank, 2014).

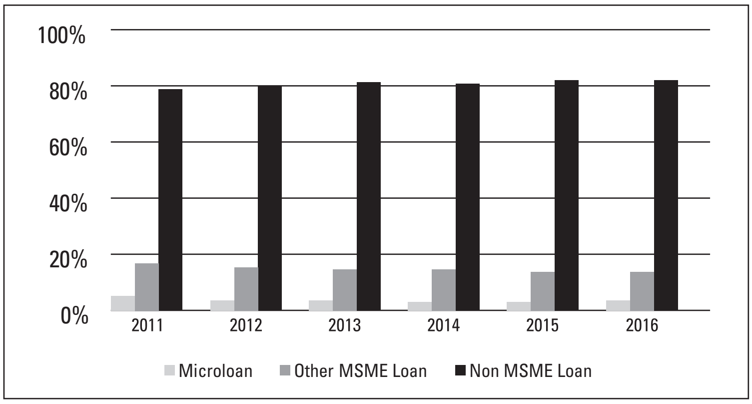
From the loan provider point of view, there are 118 commercial banks and 1.635 rural banks in Indonesia. Though the number of rural banks is quite large, their lending is accounted for only 2% of the total commercial lendings (see Fig. 2).

* This paper reflects the author's view, not those of Otoritas Jasa Keuangan.

Figure 2 shows that MSME lending since 2011 has not been improved, holding steady at 18%–20%, while microloan relatively stable at 4%.[3]

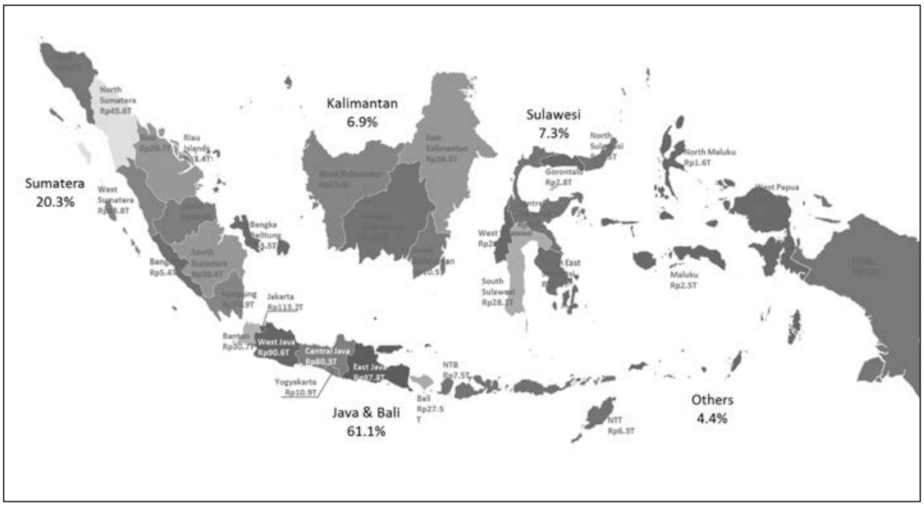
Total outstanding loans to MSME as of March 2016 is Rp738 trillion, in which 80% of it were extended in most populated islands of Indonesia; i.e., Java, Bali, and Sumatera (see Fig. 3).

Figure 2. Commercial Lendings Development



Source: Indonesian Banking Statistics

Figure 3. Loans to MSME—Provincial Project Based



Source: Indonesian Banking Statistics, March 2016

Problem

Access to financial/banking services is a major obstacle for MSMEs and low-income people in Indonesia. This lack of access to financial/banking services is especially notable in obtaining microloans at an affordable price.

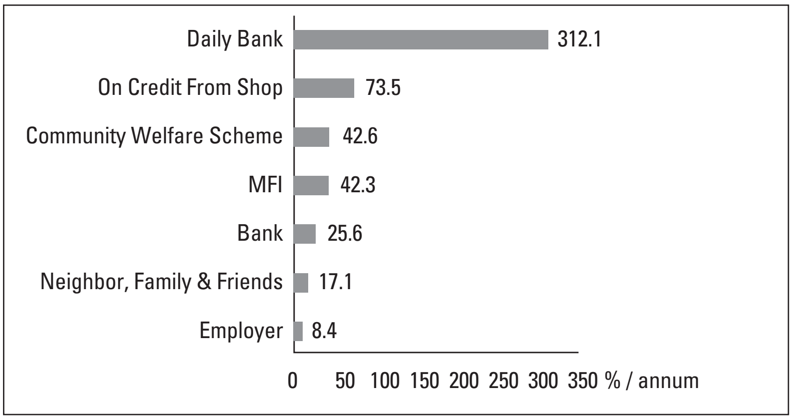
The 2014 Financial Inclusion Index (Demirgüç-Kunt, Klapper, Singer, and Oudheusden, 2015) published by the World Bank shows that only 36% of adults (age 15 and up) in Indonesia has an account in a formal financial institution, only 13% of them have been given a loan by formal financial institutions.

The Findex data shows the gap between the percentage of people who already have an account with those receiving loans from formal financial institutions. The gap, among others, arises that some people may not need loans (they may do not need it or might borrow from friends or relatives), or some others may find it difficult to obtain loans from financial institutions.

The difficulties to get loans may be due to they lack of collateral, they have no financial history, or they keep few or no records. Further, this population is not aware that some bank or institutions offer products tailored to them. Nevertheless, in an urgent situation, they do not hesitate to obtain loans from moneylenders who usually charge higher interest rates than do formal financial institutions (see Fig. 4).[4]

From the supply-side perspective, there are three main factors that lead to bank's reluctance in extending microloans to MSME and low-income people (Baydas et al., 1997): firstly, MSMEs and

Figure 4. Indicative Loan Interest Rates from Several Lenders in Indonesia



Source: World Bank (2010)

low-income people are being perceived as having high credit risk due to their unstable businesses and inadequate collateral to guarantee their loans, while banks do not have appropriate lending methodologies to screen prospective borrowers. Secondly, lending to MSMEs and low-income people usually involves small amount of loans in relatively short-time period that requires extra time and efforts to serve this segment. Thirdly, MSMEs and low-income people are usually less educated, having lack of financial history, as well as social, cultural, and language constraints.

Based on the bank's in-depth interviews (BTPN, 2016), low-income people expect that features of microloans should include: ease and pace of microloan application processes; affordable loan payments and sufficient duration of the microloan term; low interest rate and fee; no collateral; and loan amount within the range of Rp2–Rp5million (approx. USD147–USD367).

These interviews suggest that MSMEs and low-income people need an affordable, flexible, and convenient loan. Plus, the loan should allow for business needs as well as household needs, since those needs are often one and the same or at least intertwined. Borrowers ought to be able to use loans to support their businesses and to meet other necessities such as school allowance, medication, funeral, or bridging their monthly income.

Present Policy

Since its establishment, OJK has been launching various policies and program to encourage financial inclusion—for example, issuance of OJK regulation concerning Laku Pandai in November 2014. Financial services that might be offered through Laku Pandai bank agents include opening basic saving accounts (BSA), extending microloans for Laku Pandai customers, and providing micro-insurance. Banks must meet certain requirements to be the provider of Laku Pandai: institutional readiness, adequate risk management, IT support, and bank's network in designated area, as well as obtain official approval from the OJK.

The Laku Pandai program was officially introduced in March 2015. As of March 2016, nine banks have become Laku Pandai providers with more than 1.3 million BSA opened by the unbanked with a total outstanding balance of more than Rp50 billion (approx. USD3.6 million). The results of Laku Pandai program have been promising during the past year. Nevertheless, OJK's observations find some obstacles in the program implementation; among others, these include unreliable communication network and IT infrastructure in remote areas, inadequate literacy and education program to change people behavior (i.e., doing cash transactions), and difficulties in obtaining high quality agents as well as in developing suitable training program for agents.

Even though the OJK regulation has clearly stated the criteria and procedures for microloans, not a single bank has extended microloans to Laku Pandai customers. This is due to the fact that some banks still focus on increasing the number of Laku Pandai customers and contain the obstacles during implementation, while some strive to find appropriate and sustainable business model for Laku Pandai microloans.

Recommendations

1. Improve access to microloans by:

   a. Increasing the number of Laku Pandai banks.
   Several banks have submitted a proposal for 2016–2017 to become providers of Laku Pandai. OJK with its supervisory approach will monitor the realization of banks' business plans related to the preparation from the IT infrastructure and human resources. As more banks are becoming Laku Pandai providers, more agents, especially in remote areas, will be recruited.

   b. Encouraging existing Laku Pandai banks to develop a business model that is suitable for extending prudent microloans.
   The development of a business model, that shows profits, consider risk appetite, and a certain degree of loss given default on microloans to MSMEs, is needed since there have been no significant improvements in lending to MSMEs and low-income people during past years (see Fig. 1).

   In addition, a credit scoring application that utilizes financial transaction histories is also needed to assess the potential of MSMEs and low-income people with no historical financial data.

   c. Utilize Laku Pandai agents or application systems to disseminate information on the availability of microloans for Laku Pandai customers.

2. Improve coordination with government and other related institutions for a synergized policy on financial inclusion.

   Government
   Coordination is conducted through high-level and technical-level meetings to obtain understanding on government programs that can be synergized with bank productive lending activities to the MSMEs.

   Other Related Institutions
   Coordination with other institutions to ensure the availability of infrastructure required for an effective Laku Pandai operation, such as road access, electricity, and a robust telecommunication network.

3. Encourage Laku Pandai Banks to enhance the potential and capability of their agents.

   Laku Pandai agents play an important role in gaining and promoting potential MSMEs and low-income people to be customers of Laku Pandai, while providing simple financial education to them. The next challenge for banks and their Laku Pandai agents is to encourage the customers to actively conduct financial transactions through their accounts.

   By analyzing the financial transaction data from agents, banks have the opportunities to track the financial profile of the customers in relation to obtain lists of potential microloans borrowers.

4. Encourage continuing efforts of financial education and literacy program for MSMEs and low-income people.

   Continuing efforts of financial education and literacy program by both the regulator and banking industry is considered important to enhance the awareness, knowledge, and skills of MSMEs and low-income people in utilizing banks' products and services, especially those related to microloans.

Implementation

An adaptive approach would be needed to implement the above recommendations, which covers:

1. An intensive discussion with Laku Pandai Banks to gain understanding on action plans set by respective banks in implementing affordable microloans.
2. Discussion and knowledge sharing from experts and/or practitioners who have implement a business model for microloans. Regulator may cooperate with multilateral organization and other donors in gaining the resource persons.
3. Encourage banks to formulate a business model that facilitate more affordable microloans. Should it be needed, banks may propose to run pilot project on microloans in certain regions during specified period of time.
4. Develop guiding principles and supervisory framework that include monitoring and reporting mechanisms from the bank to the regulator.
5. Close coordination and cooperation with the government in setting microloan programs to MSMEs and low-income people.

   Laku Pandai banks may extend microloans that are synergized with government programs, to their agents, and to their customers to support their business expansion, provided that maximum amount of government-related microloan programs are in accordance with maximum amount of loans permitted under Laku Pandai regulation.
6. Intensive coordination with Ministry of Communication and Information on the synergy of telecommunication network planning with banks' business plan to expand the number and regions of Laku Pandai agents.
7. Agent retention program in complement to recruitment program conducted by Laku Pandai Banks to maintain their loyal and of high quality agents. The retention program would include capacity building and improvement of capability to support the development of Laku Pandai program in the future.
8. Improve the awareness of MSMEs and low-income people concerning the existence of Laku Pandai program and agents. This includes an intensive dissemination from the regulators and Laku Pandai banks, as well as intensive promotion of products and services offered at Laku Pandai agents by each Laku Pandai Bank through advertisements in local radio and television funded by the CSR program that is synergized with the Laku Pandai Program.

Notes

1. An approximate exchange rate of 1 USD = Rp13,641 is used throughout document (as obtained from Bank Indonesia interbank rate on May 29, 2016.
2. PPP is an abbreviation of purchasing power parity.
3. Data in Fig. 2 are presented as of December for each respective year, except for 2016, which is presented at March.
4. The term "daily bank" in Fig. 4 refers to informal moneylenders, not a legal bank that obtain license from the regulator. In Indonesian terms, "daily bank" is "bank harian," "bank keliling," or "bank titil."

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Limited Use of Commercial Banking Credit by Small- and Medium-Scale Enterprises (SMEs) in Malawi Limits the Country's Economic Transformation Potential

Yananga Phiri

Principal Examiner-Policy & Regulation, Reserve Bank of Malawi

Introduction

Malawi is an agriculture-based economy, heavily reliant on tobacco as its major export earner. The dwindling international demand for tobacco continues to expose all segments of the economy, especially low-income households, to price shocks, in the process dampening scope for shared prosperity. In this regard, Malawi has adopted a strategy to empower small- and medium-scale enterprises (SMEs) to help diversify production for export, away from over-reliance on tobacco. It is believed that such diversification would not just help insulate the economy from international price shocks that arise due to concentration risk, but will also help to empower low-income households within the value chain to survive shocks as they engage in meaningful business activity within this new ecosystem of SME-led diversification for growth. This notwithstanding, SMEs in Malawi, like in most countries in Sub-Saharan Africa and the world, face various challenges ranging from lack of business acumen, poor networking, limited access to markets, and most importantly, lack of access to finance.[1] Limited access to finance has been identified as a major constraint in Malawi for small business owners, according to the FinScope MSME Survey 2012 (Finmark Trust, 2012). Improved access to finance coupled with development of business acumen and improved access to markets and market information has strong potential to transform SMEs from their constrained productivity into viable businesses that can contribute sustainably to poverty reduction.

Problem

According to Reserve Bank of Malawi's (RBM) Bank Supervision Database accessed on May 26, 2016, retail credit at end March 2016 constituted only 20% of total banking sector lending, as compared with 38% to corporations. According to RBM Credit Risk Management Guidelines of March 2013, SME lending falls under retail portfolio and thus only constitutes an even smaller proportion of total banking sector lending.

OFFICIAL DEFINITION OF MSME IN MALAWI		
MSME classification	Number of employees	Annual turnover (MK)
MICRO	1–4	Up to 120,000
SMALL	5–20	120,001 to 4 million
MEDIUM	21–100	Above 4 million to 10 million
LARGE	100+	Above 10 million

Limited access to SME lending from the banking sector represents a critical transformation bottleneck, bearing in mind that banking sector constitutes the largest source of funds. According to the Malawi Demand, Supply, Policy & Regulation Country Diagnostic Report of 2015 by MAP, CENFRI, Finmark Trust, and UNCDF, banks dominate the financial services market, providing 92% of total credit. According to the 2014 RBM Supervision of Financial Institutions Annual Report, banking sector assets stood at K 796.1 billion in December 2014, as compared with only K4.9 billion in the financial cooperatives sector. The low uptake of retail banking credit in Malawi limits economic transformation potential of SMEs.

The following have been found as key root causes of SMEs' limited take-up of retail credit from banks:

1. **Loss of trust** in the banking system among low-income households and SMEs, drawing from unethical conduct by most banks in foreclosing on collateral that had been pledged against the loans. In concert with this claim, analysis of data from the RBM Complaints Handling Database shows that much of the consumer complaints stem from poor customer care, financial abuse and the manner in which banks foreclose on collateral.
2. **Poor product design**, whereby the structure of commercial (retail) loans do not pay attention to the business nature of borrowers. For example, many SMEs are agricultural-related and hence cyclical, and yet most loans do not offer grace periods and have fixed repayment schedules [see Oxford Policy Management (2010) and Chirwa & Mvula (2014)].
3. **The high pricing of SME loans** that leads to non-performance of loans and further crowd out potential borrowers. High pricing takes the form of large lending rates and high and numerous commissions on loan products. This emanates from: 1) the costly screening that banks have to undergo in order to lend to individuals and SMEs against the background of limited permissible collateral; poor cash flow tracking systems; as well as the absence of a credible reputational collateral for borrowers in the absence of a fully operational credit reference bureau system; and 2) the high cost of funding as banks either have to increase their capital requirements commensurate with their risk appetite or finance lending through use of cheap deposits, a portion of which is held with zero interest at the Reserve Bank for purposes of liquidity reserve management. According to FinScope Consumer Survey Malawi 2014, fear of indebtedness/inability to pay back the loan is cited as a key barrier to access to credit (FinScope, 2014).

The latter cause is the key root cause of the problem that this policy memo seeks to address.

Possible Solutions

To address the above causes, there are numerous potential solutions.

Solution A: Introduce a waiver to LRR regulation such that the portion of deposits that banks can lend to SMEs should be exempt from the LRR requirement

From 1 August 2015, banks are required, under the Reserve Bank of Malawi Liquidity Reserve Requirement (LRR) Directive, to hold on a daily basis at the Reserve Bank of Malawi, 7.5% of their deposits. Previously the rate was 15.5%. Liquidity Reserve Requirement is a monetary policy tool for controlling money supply and in the process manage inflation. Its monetary policy benefits notwithstanding, the LRR does limit banks' ability to use deposits as a cheaper source of funding. In this regard, putting a waiver on liquidity reserve requirement therefore frees a portion of these cheap funds for onward lending. This larger pool of cheaper funds should incentivize banks to on lend to SMEs at relatively cheaper terms and thus afford SMEs scope to grow their business and able to repay their loans.

Hence, there is a trade-off between monetary policy implementation and SME enablement. However, as noted by Simwaka, Ligoya, Kabango & Chikonda (2012), inflation in Malawi is not merely a monetary phenomenon but also a structural issue. Thus trading off monetary aspects of LRR with the need to support SME lending could be an important alternate approach to addressing the inflation in that a robust SME can enhance production and thus help control inflation.

Solution B: Implement measures to fast track the operationalization of credit reference bureau system

The enabling law, namely Credit Reference Bureau Act 2010, CRB Regulations 2010, and the CRB Amendment Act 2015, are already in place for the licensing, operations, and oversight of credit reference bureau (Government of Malawi, 2010a,b,c). Two bureau namely Credit Data

CRB Limited and the CRB Africa Transunion Limited were already licensed. However, the roll-out is yet to begin.

Recommendation

From the above two solutions, I am proposing fast tracking the operationalization of credit reference bureau system. Unlike the LRR waiver solution, which has trade-offs and requires stakeholders outside our department, the operationalization of credit reference bureau has no trade- offs and can be delivered within the departmental mandate. Added to that, the LRR was already revised recently and its impact on credit expansion is yet to be established. It would thus not be persuasive to recommend further steps to introduce waivers when the impact of the reduction is yet to be assessed. The fast tracking of the credit reference bureau scheme is highly feasible within my regulatory and policy role and features as a deliverable in our departmental business plan. To the extent that the scheme would muster credit information from all sectors (including the microfinance sub sector where most SMEs have a history of obtaining credit albeit at higher interest rates and stringent conditions, it is hoped that this history would be vital in building vital reputation collateral with which banks can leverage on to enhance credit to credible SMEs that hither to would have remained opaque.[2] Bank lending holds strong transformational potential for SMEs drawing from its stronger capitalization and the relatively large pool of cheaper deposits not obtaining in microfinance institutions.

For the full roll out to commence, the policy memo proposes the following steps be taken by the Reserve Bank of Malawi:

1. Designing a unified template for submission of data to the two bureaus. In the absence of this template, it would be virtually impossible for banks and microfinance players as reporting institutions to know the kind of data that they would be required to submit to bureau. Added to that, it would be onerous on their part, as there would be risk that each of the licensed bureau would have own format within which the same data would be populated and submitted.
2. Train reporting institutions on the completion of the template. This is vital for the accuracy and integrity of credit data.
3. Communicate to banks the mode of submission of information to bureau, and the format of credit reports that will be sourced from the bureau. Currently the law does not come out clear in what format such data submission has to be made and this has the potential of creating bottlenecks and inconsistencies if other banks begin to submit hard copies while others submit the data electronically.
4. Design consumer awareness campaigns to educate the various stakeholders, including the legislators and the general public, on the operations of the credit reference bureau scheme. This will help ensure buy-in as it will remove the possible misconception that the scheme is merely for blacklisting individuals and an additional cost to lenders that can be pushed to borrowers.
5. Propose an organizational structure within the Reserve Bank of Malawi to designate dedicated officials to help adjudicate on disputes between the bureaus and the reporting institutions, streamline the data validation process as well as assess the safety and robustness of the bureau hardware and software systems on an on-going basis.
6. Incorporate into the existing on site surveillance programs of banks, the monitoring of bank compliance with the requirement that they should consult a credit report of a borrower when assessing riskiness of the borrower.
7. Devise strategies to streamline credit reports so that they are not an excessive cost that can be pushed to borrowers by the lenders, thus limiting financial inclusion from a usage point of view.

Notes

1. According to the Finscope Consumer Survey Malawi 2014, the government of Malawi has increasingly recognized that access to financial services can play an import role in poverty alleviation and in decreasing the vulnerability of poor people, and as such financial inclusion is acknowledged as an important part of the Malawi Growth & Development Strategy.
2. SME exposure (being part of retail portfolio) is risk weighted in the range of 75%– 100%. However, supervisors have discretion on choice of what weight to be applied depending on improvement in risk conditions. While moveable collateral registry may not necessarily necessitate reduced risk weights in so far as collateral merely constitutes the last line of defense after risk has already materialized, it is my considered view that credit referencing has strong potential to reduce risk weights (and cost of credit to SMEs) in so far as it can inform credit worthiness of an SME client on their past performance with other lenders, mostly microfinance reporting institutions.

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Formal Finance

Building Financial Capabilities to Enhance the Use of Formal Savings among the Poor

Fiorella Arbulu Diaz

Senior Analyst, Superintendence of Banking, Insurance and Private Pension Funds of Peru

Policy Problem

In spite of the efforts deployed by the Peruvian government to bring formal financial services closer to the poorest and most vulnerable population, recent studies show a low uptake of formal financial services, especially savings. According to a recent study (Superintendencia de Banca, 2012, pp. 39–40), in Peru 34% of the low-income population saves; however, almost 85% of them uses informal financial sources.

The lack of trust on the financial system, the knowledge gaps, and behavioral biases still represent important constraints on saving, especially among these segments.

Background

Financial inclusion is one of the government's priorities. In this regard, major initiatives have been implemented by the Superintendence of Banking, Insurance and Private Pension Fund (SBS) during the last few years. For example, the regulatory framework was improved to encourage the development of appropriate services for all segments of the population, as well as to create incentives to expand the access to and usage of basic financial services through low-cost channels.[1] Those efforts have been accompanied by a solid consumer protection framework, greater transparency on information, and financial education initiatives.

In 2015, the National Strategy for Financial Inclusion (ENIF)[2] was launched, with the aim of articulating financial inclusion initiatives implemented by all public and private stakeholders. The ENIF includes as one of its strategic objectives the promotion of appropriate formal saving mechanisms for all segments of the population in a safe and reliable way, particularly among poor and vulnerable populations (Multisectoral Committee for Financial Inclusion, 2015), given that this may help individuals meet day-to-day financial demands and invest in their futures.

The improvement in access to such formal financial services during the last years has been noticeable. The number of access points per 100,000 adults increased from 129 to 489 between December 2005 and December 2015, while the percentage of districts with the presence of the financial system increased to 61% (Superintendencia de Banca, 2015). Yet with respect to the use of financial services, the progress has been modest. According to the Global Findex 2014, 29% of the population over 15 years had a banking account.

Analysis

Most of the poor's savings are stored in cash at home or in kind[3] (Superintendencia de Banca, Seguros y AFP, 2012), as well as through"juntas,"[4] saving clubs, or friends and family. Informal mechanisms are perceived as more reliable, close, and flexible options, despite the high risks associated due to thefts, fraud, and unexpected events. A Microsave study found that, compared to the other forms of informal savings, the most popular ones (in kind and at home) are the most risky and experienced the highest rate and levels of loss in absolute and relative terms (Wright & Mutesasira, 2001, pp. 99—this study was developed for Uganda).

Nonetheless, particular characteristics of these schemes, which are not replicated by formal services, make informal services more attractive to low-income population. There is a mismatch between what low-income people want and need (simple products, with transparent terms and conditions of use, that offer flexibility and options that enable them to make small and regular payments; Kempson & Finney, 2009) and the services that are available. In this regard, financial institutions have much work to do in tailoring their offerings to users' needs and increase financial options for the poor.

There are also demand-side constraints that need to be tackled. The lack of trust in formal financial institutions, information and knowledge gaps, and behavioral biases affect people ability to fully use formal savings. A study conducted in Peru[5] reveals that the lack of trust and lack of knowledge are two of the main factors that discourage formal saving. Moreover, a World Bank Report (World Bank, 2013) shows that an important segment of the population has limited knowledge about basic financial concepts, and lacks a sound culture of savings. Likewise, there are psychological and behavioral factors affecting financial decisions that might explain the low uptake of formal saving products.

The literature has extensively documented the role of behavioral biases in saving decisions (Frisancho, 2016; Cole S. et al., 2011). Human tendency to live today makes it extremely hard for people to postpone consumption and therefore to save. People are also overly optimistic about future income and have a strong preference for the status quo, explaining why people end up doing the same in spite of having several options. The acknowledgement of behavioral biases has generated a great debate about the effectiveness of traditional financial education interventions on individual´s financial habits. The development of new approaches based on the fact that information transfer alone does not adequately engage people in active learning, but practice is needed for transforming behavior (Arnold & Rhyne, 2016), thus generating a shift in the approach from provide knowledge to build financial capabilities.[6]

During the last few years, the SBS has deployed several efforts to address major demand-side constraints, by increasing the confidence in the financial system[7] and improving financial education levels, through face-to-face lecturers, training the trainers programs, and distribution of online content. Major improvements have been made in existing programs, incorporating stories, games and characters, and creating mobile apps for helping people to save and plan their family budget. Moreover, the school curricula were recently changed to incorporate financial education to elementary education and promote skills and competencies among children and youth. Nonetheless, there is still a gap in developing tailored financial education programs to reach low-income and vulnerable populations.

Policy Recommendations

There are multiple potential solutions to address the supply and demand-side barriers to the poor's access to formal savings. Improve the access to basic financial services through low-cost channels and expand the range of appropriate financial products to people's needs are some of them. In this regard, a digital platform was launched this year as an alternative to approach formal financial services to the most vulnerable population. On the other hand, due diligence and transparency of information requirements has been simplified to facilitate the design and supply of low-risk products, such as basic accounts and mobile wallet. The design of attractive formal accounts and services with added value should be mainly in hands of financial providers. However, SBS could contribute by providing demand information and studies on existing gaps and potential demand for financial services.

Moreover, increasing the uptake and usage of formal savings required of empowered individuals, being able to make informed choices, to use services that are valuable to them, and to have control over their financial lives (Koning & Valenzuela, 2015). In this regard, financial education interventions are increasingly important, as long as they impact on knowledge, skills, and attitudes, facilitating changes in individuals' behavior. These interventions should be permanent and reach all the segments of the population, including low-income and vulnerable people. However, implementation posed major challenges. Below, we present some policy recommendations to achieve this goal.

Creating Coordination Mechanisms

The development of a national plan that facilitates the coordination among key stakeholders and articulation of the main financial education initiatives is crucial. The SBS, as a leader of the working group on financial education set by the ENIF, together with the Ministry of Education, has a key role in the coordination, drafting, and implementation of the strategy.

At this initial stage, leaders of the working group should be focus on developing a diagnosis to inform the strategy. To this end, the working group should make an inventory and review of existing initiatives on financial education. Results will provide useful inputs to identify strategic public and private partners that can support the implementation of financial education initiatives, as well as promising and scalable practices. This exercise will also facilitate the identification of gaps in the provision of financial education and potential opportunities for synergies. At this stage, the role of the private sector and researchers as providers of relevant data is crucial.

Following the Organisation for Economic Co-operation and Development (OECD) guidelines, once key partners are identified, they should be involved as early as possible in order to create a broad ownership of the strategy and anchor commitment to the implementation process (OECD, 2015). This process will require a strong coordination with the private sector, represented by industry associations and other public institutions responsible for social policies, considering possible synergies between financial education and social programs targeted to vulnerable populations. In order to achieve an effective commitment, especially from the private sector, the implementation of the strategy has to be perceived as win-win solution to all of the involved stakeholders.

Establishing Strategic Partnerships

The need for customized interventions with specific content and delivery channels for low-income and vulnerable populations offer significant challenges. Reaching those segments could be costly and exceed the operational capacity of the SBS. However, strategic partnerships between the SBS and other public entities can facilitate and broaden the scope, continuity, and scale of interventions.

Up to now, the SBS has subscribed cooperation agreements with the Ministry of Agriculture, to incorporate awareness campaigns among the beneficiaries of rural development program, and, recently, with the Ministry of Social Inclusion, that will facilitate the implementation of pilot projects among the beneficiaries of "juntos" conditional cash transfer (CCT) Program. This partnership represents a great opportunity to reach the poor at the right time for building financial capabilities, while promoting a saving culture. It is the task of the SBS looking for potential partners and taking advantage of potential synergies. For example, future inter-institutional agreements can be subscribed with the Ministry of Woman Affairs to implement pilot project in their entrepreneurship programs aim at poor women.

Reinforcing Existing Programs

Empirical evidence shows that including financial education at early stages in life is a unique and powerful mean to inculcate and encourage sound financial culture and habits (OECD/INFE). However, without mechanisms to reinforce the acquired capacities, the impact in the long-term behavior is limited.

In this regard, efforts should be made to ensure that teachers are adequately trained and feel confident and competent in building students' financial competencies (OECD/INFE). Private and public universities, as well as, pedagogical institutes should play an important role by incorporating financial education to current curricula. On the other hand, a public-private partnership can be used to create innovative tools to promote the interaction between parents and kids, while promoting saving discipline.[8]

Promoting learning by doing technology-enabled simulations or in real life is important for capacity building. Saving culture among children and youth can be promoted by using online games or real saving accounts. This requires the involvement of both public and private sector, the first by enabling underage open saving accounts, and the latter one by designing appropriate products. There is still room for improvement, especially in designing interventions for people who are illiterate, speak a different language, and have no access to mobile or web-based technologies. The SBS should design appropriate mechanisms to reach this segment, by using customized materials (not only content but also language) and using accessible channels.[9]

Notes

1. Banking agents (2005), basic accounts (2011), and e-money accounts (2013).
2. The National Strategy for Financial Inclusion (ENIF, for the acronym in Spanish) was designed by the Multisectoral Committee for Financial Inclusion and launched by the Supreme Decree No. 191-2015-EF on July 2015. The Committee is formed by the SBS; Ministry of Finance; Ministry of Development and Social Inclusion; Central Bank; and Banco de la Nacion, the government bank.
3. Savings in kind and savings in cash at home represent 51% and 44%, respectively.
4. A group of people who decide to contribute periodically a fixed amount. The money collected is granted to each of the group members regularly on a rotating basis.
5. According to the pilot survey on the access to and usage of financial services 2012, besides the lack of money, the preference for the present and the lack of knowledge on how to save are mentioned as the second and third main reasons for not saving. Regarding the reasons for not having a bank account, the lack of trust in the financial system and the lack of knowledge are mentioned among the main reasons.
6. The Center for Financial Inclusion at ACCION defined financial capability as the combination of knowledge, skills, attitudes, and behaviors a person needs to make sound financial decision that support well-being.
7. By improving information transparency and consumer protection.
8. For an example, see "Agent Piggy: Financial Education for Kids" at https://www.agentpiggy.com/en
9. An ACCION study highlights some practices of effective interventions, such as looking for teachable moments, reaching consumers when they are making financial decisions, promoting learning by doing, using timely reminders and default options to help people to overcome procrastination and inertia, keeping it simple ("rules of thumb"), and making it fun.

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How to Encourage More Ugandans to Open Bank Accounts

Kelvin Kizito Kiyingi*

Assistant Director, Bank of Uganda

Most adult Ugandans do not have accounts in commercial banks—and, consequently, do not enjoy the benefits that emanate from having an account. This makes their participation in the financial and monetary system limited. After all, having an account in a commercial bank is a first step to financial inclusion, according to Rajesh Chakrabarti (Knowledge@Wharton , 2014).

Statistics indicate that in Uganda, only 20% of the adult population (representing an estimated 3.1 million adults) operated an account with financial institutions in 2013 (Asiimwe, 2010; Economic Policy Research Centre, 2013, p. 36). This means that about 80%of adult Ugandans do not have accounts in the commercial banks. In my opinion, this is due to several reasons related to low-income levels, lack of knowledge, financial illiteracy, inadequate financial consumer protection, and costs of opening up bank branches in rural areas.

According to my analysis of the FinScope Survey 2013, the main reasons for this are threefold. First, the transactions sizes are small and the costs for businesses are high. The people excluded from the banking system have relatively low incomes (some are subsistence farmers), and hence the balances they can afford to hold in bank accounts, or the value of other transactions that they might make through the banking system, are relatively small. Consequently the amount of revenue that a bank can earn (e.g., account fees), per customer, is very small. At the same time, the cost incurred by banks, per customer, is relatively high, in providing banking services to low-income customers. This is because many of the excluded live in quite sparsely populated rural areas. Specifically, the FinScope Survey 2013 mentions three barriers to having a bank account. The most cited barriers were income/employment related [lack of income (47%) and no job (17%)] and lack of knowledge on how a bank account works (18%); supply side constraints included cost of operating an account (22%) and distance to bank (13%)(Economic Policy Research Centre, 2013).

Second, there are barriers emanating from costs related to opening an account, having no job, lack of knowledge of opening an account, and distance to the bank (Economic Policy Research Centre, 2013; p. 39). In addition, the majority of Ugandans do not know the services and products of commercial banks. They have limited knowledge and awareness, especially when accessing credit. Statistics indicate that the level of understanding of the terms and conditions of obtaining credit among the borrowers is low. Statistics released by the FinScope survey show that 16% did not read the terms. Yet, nearly all the adult borrowers indicated that they understood the terms and conditions before taking on a given loan.

Third, most potential clients do not trust commercial banks. They have a negative perception about commercial banks based on the several unfortunate events that have happened in the banking sector, especially in the recent past. The confidence levels in the banking sector in Uganda are so low that even the local media has had several negative articles about banks. In *How Banks Make Us Poor*, renown journalist, Pius Katunzi, argues that because of the current perceptions, there has been lack of enthusiasm by Ugandans to open accounts in commercial banks (Katunzi, 2008).

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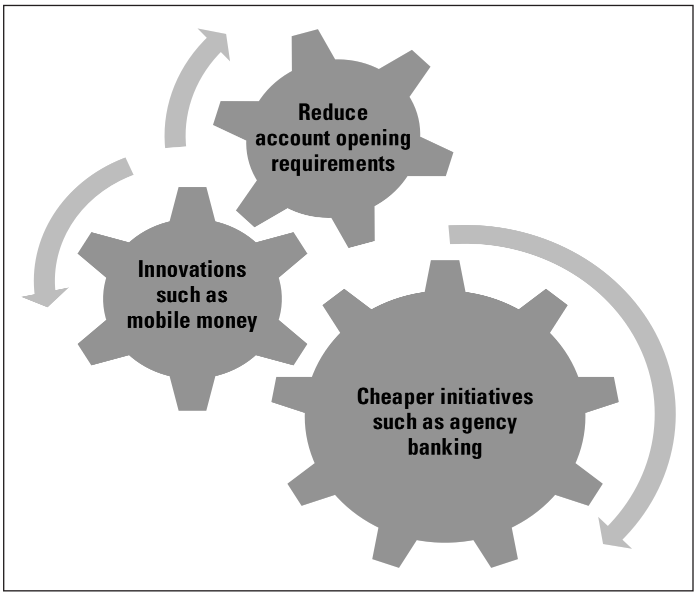
Possible Solutions—The Three I's: Integration, Information, and Integrity

Integration

One way to address this problem is by using the "integration" concept, which is to create a hybrid between traditional banking practices and low-cost modern technology practices such as mobile money and agent banking. Figure 1 demonstrates the integration concept. For example, reviewing the know-your-customer practice, which requires one to have a several documents, including a referee, to open an account, will go a long way in addressing one of the barriers to having bank accounts. The requirements for opening up an account in a commercial bank are in most cases barriers. Yet, with a mobile money account, one is required to present only one document: an identification card or passport. Customers should deposit and withdraw money from their bank account without physically visiting their bank branch, as is the case with mobile money accounts. In terms of branch management agent banking will enhance account opening since an agent or several agents will substitute bank branches.



In order for the integration concept to the following stakeholders have to be involved: the mobile network operators, Uganda Communications Commission, the Ministry of Finance, commercial banks, security organs involved in cybercrime, Uganda bankers association, and consumer protection advocates.

Information

The other solution lies in embarking on a robust communications strategy with special focus—and emphasis on what commercial banks do and offer. The Bank of Uganda (BOU, Uganda's central bank) must put in place measures that enable commercial to relate with the public in an amenable manner. Under this initiative, commercial banks and the general public will be the main stakeholders. Harmonizing the respective communication strategies in Uganda's banking sector—with particular emphasis on financial education, public information outreach programs, empowerment, and financial literacy—will help this initiative to succeed.

Several studies indicate that communication, particularly providing relevant information, is an instrumental tool for enhancing financial inclusion.

Integrity

In the recent past, Uganda's banking sector has faced several challenges, which have dented the sector's reputation. In his paper entitled, *Financial Repression and Financial Reform in Uganda*, Martin Brownbridge observes that the banking sector in Uganda is among the weakest in Sub-Saharan Africa (Brownbridge, 1996). In the 1990s, there were attempts to reform the banking sector, but according to Brownbridge, the objectives are likely to prove very difficult to attain because of the scale of the problems, which the banking sector inherited from the pre-reform era, and especially because of the dominant market position of the public sector banks. Prudential regulation and supervision were not accorded much emphasis by the government and BOU during the pre-reform period. The 1969 Banking Act, which provided the legislative framework for the banking industry, contained numerous deficiencies. Supervisory capacities in the Bank of Uganda were too weak for it to effectively discharge many of the functions it was assigned under the Act (Brownbridge, 1996; p. 9).

Recently, Bank of Uganda rolled out a financial consumer protection strategy—and this will have the desired effect. The financial consumer protection guidelines are the key features of this strategy with three key stakeholders: the Bank of Uganda, the supervised financial institutions, and consumer advocates.

It is still early to establish the success of the financial consumer protection strategy, but findings from the monitoring and evaluation report are encouraging. Overall, supervised financial institutions have implemented the financial consumer protection guidelines and the awareness levels of the consumers have increased, according to the report.

However, there is need for enacting a law on financial consumer protection in Uganda so as to further foster confidence and trust in the banking sector.

Recommendation

I think putting in place measures that will enhance integration, information, and integrity within the banking sector will encourage more Ugandans to have accounts in commercial banks. In terms of ensuring integrity, the Bank of Uganda has to embark on an aggressive public awareness campaign to sensitize the public on issues related the rights and responsibilities of consumers of financial products and services. In addition, the Bank of Uganda has to put in place a comprehensive complaints handling mechanism and have continuous feedback from the public. This will certainly ensure consumer protection and, in consequence, foster confidence in the banking sector. The commercial banks must comply with the financial consumer protection guidelines by, for instance, publishing information about loan products in local languages; and advocates of consumer rights in Uganda have to be encouraged to focus on financial consumer awareness and advocate for consumer rights legal framework. Institutionalizing the Consumer Protection Consultation Group (which consists of officials from the Bank of Uganda, consumer advocates, and officials of various commercial banks), which played a crucial role in the awareness campaigns, will further foster financial consumer protection.

In order to foster information flow, all commercial banks in Uganda should be required by the Bank of Uganda to embark on financial literacy in bid to increase the financial awareness of their customers; and, potential customers. My suggestion is that financial literacy must be part of every commercial bank's social corporate responsibility and every commercial bank must send periodic progress reports, in this regard, to the Bank of Uganda. This arrangement, I strongly recommend, should be included in the national financial literacy strategy.

Currently, using the integration approach has gained significant success. Recently, Banc assurance, Islamic banking, and Agent banking laws were enacted. This is good because it will lower the cost of doing banking business in Uganda, and consequently will enable more banks to reach out the low-income rural population (Muhumuza, 2016). This will go a long way in fostering financial inclusion in Uganda. The starting point would be bringing all key stakeholders on board, especially the commercial banks, mobile network operators, the Uganda communications commission, the Uganda Revenue Authority, the National Social Security Fund, and the Ministry of Finance, Planning and Economic Development.

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Addressing the Problem of Contracting Unaffordable Loans in Zambia

Joseph Munyoro

Assistant Director, Examinations & Surveillance, Bank of Zambia

Summary

From 2000 to 2015, the number of credit providers licensed by the Bank of Zambia increased from 24 to 69. Simultaneously, there was a corresponding increase in the number of consumer borrowers that contracted unaffordable loans due to opaque loan pricing practices of credit providers. The number of complaints lodged with the Bank of Zambia increased noticeably in this period. In this Policy Memo, the author argues that this situation arose largely due to inadequacies in the consumer protection regulatory framework and supervisory practices. The exploitation of consumers has the potential effect of discouraging the uptake of financial services contrary to the government's objective of expanding financial inclusion.

Therefore, in order to resolve this problem, there is a need for the Bank of Zambia to develop a coherent and comprehensive financial consumer protection regulation and establish a Market Conduct and Consumer Protection Supervision Department that will monitor and ensure that financial service providers engage in responsible lending practices. Implementation of this recommendation is expected to result in improvement in the financial health of Zambians and a reduction in the number of consumer complaints.

Context

The Bank of Zambia categorizes the institutions it licenses and supervises into two: banks and non-bank financial institutions. Accordingly, it has two supervision departments, the Bank Supervision Department and the Non-Bank Financial Institutions Supervision Department.

The author's analysis of the on-site examination reports for both banks and non-bank financial institutions for the period 2010 to 2015 shows that their scopes predominantly focus on prudential concerns to the complete exclusion of market conduct and consumer protection issues (see Table 1). The existing supervisory practices insufficiently address the need for financial market participants to adhere to market conduct rules for fair treatment of their customers.

As the number of credit providers licensed by the Bank of Zambia has increased from 24 to 69 in the period covering 2001 to 2015, the Bank of Zambia has correspondingly received a growing number of complaints about the lending practices of credit providers. Consequently, in 2015 the Non-Bank Financial Institutions Supervision Department set up a complaints register in order to track the number of complaints and their resolutions.[1]

Problem

A growing number of consumer borrowers in Zambia contract unaffordable loans thereby compromising their financial wellbeing. In particular, the issue of employee over-indebtedness had, by 2012, become a public policy matter requiring intervention (Phiri, 2012).

Low-income consumers of financial services in Zambia can be exploited by financial service providers through opaque pricing practices and unfair treatment. This situation has resulted in an increasing number of consumers lodging complaints to the Bank of Zambia on a range of issues. A review of 2015 entries in the complaints register shows that the issues consumers complain about include opaque loan pricing mechanisms, unwarranted reporting to the credit reference bureau, and unconscionable loan collection methods. The exploitation of low-income consumers of financial services has the potential effect of discouraging the uptake of financial services contrary to the Government's objective of expanding financial inclusion.

Possible Solutions

Three possible solutions described below have been identified for addressing the identified problem.

1. Establish a market conduct and consumer protection supervision department

In order to ensure that the Bank of Zambia implements market conduct and consumer protection supervision, in addition to prudential supervision, it should transform the Non-Bank Financial Institutions Supervision Department into a Market Conduct and Consumer Protection Department. The new department should not only have explicit responsibility for developing the consumer protection regulatory framework but also implementing it by monitoring and ensuring that all financial intermediaries comply with the consumer protection regulation.

In Zambia's liberal economic environment, a consumer-centric financial supervisory approach is necessary in order to minimize the chances of financial service providers exploiting consumers of financial services. Consumer protection can be realized through supervisory focus on transparency in pricing of financial services, fair treatment of consumers and implementation effective recourse mechanisms.

The Bank Supervision Department should remain as a prudential supervisory department. It should, however, have expanded responsibility for both banks and deposit-taking non-bank financial institutions.

This option should allow the Bank of Zambia to realize the so-called Twin Peaks approach (National Treasury of South Africa, n.d.) to supervision through having two sets of supervisors each specialized in overseeing all financial intermediaries with respect to a single regulatory objective regardless of whether a financial intermediary is a bank or non-bank financial institution.

It should be noted that a growing number of countries have moved toward the Twin Peaks approach to supervision encompassing both prudential and market conduct and consumer protection. These include South Africa, Australia, New Zealand, Belgium, the Netherlands, the United Kingdom, and the United States. Each of these countries has implemented its own unique model of the Twin Peaks. It is expected that the proposal to transform and repurpose the Non-Bank Financial Institution Department into a market conduct and financial consumer protection department would also reflect the unique situation in Zambia.

2. Develop a coherent consumer protection regulation

The Bank of Zambia should develop a coherent and comprehensive market conduct and financial consumer protection regulatory framework. The existing principal legal framework for regulating the provision of financial services, the Banking and Financial Services Act, was primarily designed to address the need for financial system stability. Although it has elements addressing some aspects of consumer protection, the consumer protection provisions do no adequately cover all the areas identified in the Client Protection Principles.[2] These principles were developed by the Smart Campaign and represent a global consensus regarding the standards of conduct and treatment of consumers by financial service providers. A model law that incorporates these principles was developed by Accion in 2015. In this regard, in order to develop a coherent and comprehensive market conduct and financial consumer protection regulation, the Bank of Zambia should adapt the model law to suit the Zambian situation.

3. Implement a combination of the above two options

The problem of consumer borrowers contracting unaffordable loans is not only a result of inadequate consumer protection provisions in the Bank and Financial Services Act but also an absence of market conduct and financial consumer protection supervision. In this regard, both the development of a coherent consumer protection regulation and the establishment of a Market Conduct and Consumer Protection Department to monitor and ensure financial services comply with best practice consumer protection legal provisions are necessary. This option would not only enable the Bank of Zambia to address gaps existing in the consumer protection regulatory framework but it would also create a supporting structure for achieving the twin supervisory objectives of financial stability and market conduct and consumer protection.

Recommendation

It is, therefore, recommended that the Bank of Zambia implement option three because it would enable the Bank of Zambia to realize the benefits of both options one and two.

The establishment of a Market Conduct and Consumer Protection Supervision Department should result in the Bank of Zambia having a new department to spearhead the development of a consumer protection regulation. The regulation should, at a minimum, require credit providers to conduct affordability assessments and disclose the full cost of borrowing to customers before executing loan contracts. This requirement and the introduction of appropriate sanctions for non-compliance should result in an increase in the number of borrowers contracting affordable loans that improve their financial health. Further, the new department should enable the Bank of Zambia to start conducting examinations focused on the market conduct and consumer protection objective. Through sanctioning non-compliant credit providers, compliance with consumer protection requirements should improve resulting in a reduction in the number of consumer complaints as the financial wellbeing of borrowers improves.

Internal stakeholders critical to the successful implementation of this recommendation are the following:

1. *The Board of Directors*. The proposed change will constitute a restructuring of the financial sector supervisory function of the Bank of Zambia and will require Board approval. The Board should favorably consider the recommendation because it will result in a supervisory structure that will allow the Bank of Zambia to achieve both the financial stability and market conduct and consumer protection objectives. The recommendation could be implemented without any incremental costs because it would involve use of available resources in the existing supervision departments.
2. *The Bank Supervision Department*. The restructuring will entail increasing the number of institutions the Bank Supervision Department monitors by 15 deposit-taking non-bank financial institutions. In this regard, there should be a consequential amendment to the department's name to reflect the widened scope encompassing non-bank financial institutions. The total number of institutions the department will be required to supervise will therefore increase from 19 banks to 34. This increase will result in an increased workload for the department. However, the workload should be manageable through the application of the risk-based approach to prudential supervision. The Bank Supervision Department should support the restructuring proposal because it will enable it to focus on the achievement of, and be accountable for, a single objective of financial stability.
3. *Non-Bank Financial Institutions Supervision Department*. The proposed change will entail a substantial change in the nature of work staff do. The change will require them to acquire new skills sets appropriate for market conduct and consumer protection examinations of both banks and non-bank financial institutions. The department should support the

restructuring because it will give it a new and unique purpose unlike the present situation where it is a mirror image of the Bank Supervision Department. The present situation creates a gap in the coverage of supervision because while both supervision departments focus on financial stability, the objective of market conduct and consumer protections is largely not being addressed.

4. *The Human Resources Department*. Repurposing of the Non-Bank Financial Institutions Department will entail developing new job descriptions for positions in the new department and facilitating appropriate training of staff. The department should support the restructuring because it will contribute to the Bank of Zambia being appropriately structured to deliver on the twin objectives of financial stability and consumer protection.
5. *Credit providers licensed by the Bank of Zambia*. The Bank of Zambia will need to convince the credit providers that supporting the development of a consumer protection regulation that incorporates the Smart Campaign's Client Protection Principles will be in their long term best interest because it will lead to the building of strong and lasting relationships between lenders and borrowers resulting into higher customer retention rates. The consumer-centric approach to lending will also result in better quality loan portfolios that will be a basis for healthy and sustainable financial returns for the lenders. Some of the credit providers[3] have in fact already endorsed the Client Protection Principles.

Appendix 1

Table 1. Analysis of Issues Covered in Bank of Zambia On-Site Examination Reports

		2015		2014		2013		2012		2011	
		Banks	Non-banks	Banks	Non-banks	Banks	Non-banks	Banks	Non-banks	Banks	Non-banks
	Examination Reports	3	3	2	5	4	3	4	3	4	1
Issues Covered	Safety and soundness (prudential)	3	3	2	5	3	3	3	3	3	1
	Non-prudential issues	3	2	1	3	2	3	1	1	4	1
	Consumer protection	0	0	0	0	0	0	0	0	0	0
	Market conduct	0	0	0	0	0	0	0	0	0	0
	Financial integrity	2	1	1	1	1	2	0	1	3	0
	Financial inclusion	0	0	0	0	0	0	0	0	0	0
	Other – ICT	3	2	1	2	1	3	0	1	2	1

Notes

1. The Bank of Zambia has not yet established a unified complaints handling mechanism. For instance the Bank Supervision Department handles bank-related complaints but does not maintain a complaints register. In the Non-Bank Financial Institutions Department, the Regulatory Policy Division maintains a register of complaints. However, the register does not contain all the complaints the department receives because other divisions also handle complaints which are not recorded.
2. The Client Protection Principles consist of: (i) appropriate product design and delivery, (ii) prevention of over-indebtedness, (iii) responsible pricing (iv) fair and respectful treatment of clients; (v) privacy of client data, and (vi) mechanisms for complaint resolution.
3. A B Bank Zambia Ltd, Agora Microfinance Zambia Ltd, Bayport Financial Services Zambia Ltd, EFC Zambia, Madison Finance, and Vision Fund Zambia See online at http://www.smartcampaign.org/about/campaign-endorsers

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Payments

Improving the Access to Affordable and Convenient Financial Services for Low-Income Households in Bangladesh

Ashraful Alam

Deputy General Manager, Bangladesh Bank

Context

Worldwide, a growing body of evidence points to the positive impact of access to financial services on social and economic outcomes at the household and firm level (see King and Levine, 1993; Beck et al., 2000; Beck and Demirgüç-Kunt, 2004; Levine 2005; Demirgüç-Kunt et al., 2015). Access to financial services for low-income households and firms is critical in promoting inclusive economic growth and accelerated poverty reduction.

Bangladesh's development strategy as described in its seventh five-year plan recognizes that socioeconomic opportunities and development in the country will remain unrealized unless affordable and convenient financial services are made available, especially to low-income households, firms, and other disadvantaged groups who are deprived of access to these services.

Bangladesh Bank's experience in working with financial services indicates that increased access to financial services for the cottage, micro, and small businesses (CMSEs) and poor households is critical for helping them to adopt new and more productive income earning opportunities and technologies, whether personal financial crises and unforeseen shocks and risks, and increase their potential of moving out of the poverty trap. The government of Bangladesh aims to capitalize on rapid advances in mobile communications and digital technologies to connect poor households to tailored, affordable, and reliable financial services.

Existing low-cost banking products and services delivery channel option (agent banking) guidelines have failed to appeal to the stakeholders due to some regulatory imperfections. My policy memo proposes to review the existing low-cost financial services delivery channel (agent banking) guidelines to make it more responsive to the stakeholders need.

Background

Country Overview

With more than 160 million inhabitants on a landmass of 147,570 square kilometers, Bangladesh is among the most densely populated countries in the world. In the past decade, the economy has grown at a more than 6% per year on average. Social and human development has coincided with economic development of the country. The poverty level has been reduced by nearly a third, while increased life expectancy, literacy, and per capita food intake rates have been improving.

Banking System

Bangladesh's banking sector consists of four categories of banking institutions, namely state-owned commercial banks (SCBs), state-owned development financial institutions (DFIs), private commercial banks (PCBs), and foreign commercial banks (FCBs). At the end of December 2015, there were a total of 56 scheduled banks including four SCBs, four DFIs, 39 PCBs, and nine FCBs. These banks had a total of almost 10,000 branches at the end of December 2015. Although the number of bank branches has increased substantially over the years (from 6,119 in 2000 to around 10,000 in 2015), the share of rural bank branches in total, however, has declined. In 2000, the share of rural branches was 60% in total, which declined to 49% in 2015 (Khalily, 2015).

Financial Inclusion Status

In Bangladesh, indicators of both outreach and actual usage show that the overall access to financial services has increased rapidly especially, in recent years. The overall state of financial inclusion as described in Findex 2014 can be seen in Table 1. It shows that, despite significant progress in recent years, various indicators of financial inclusion still show significant scopes for improvements.

Table 1. Overall State of Financial Inclusion in Bangladesh, 2012

Financial Access Indicators	Value (% of 15+ Population)
Account at a formal financial institution	40
Account at a formal financial institution, female	35
Account at a formal financial institution, income, bottom 40%	35
Account used to receive wages	3
Account used to receive government payments	2
Account used to receive remittances	3
Saved at a financial institution in the past year	17
Saved using a savings club in the past year	4
Loan from a financial institution in the past year	23

Problems

In Bangladesh access to financial services has grown over the years; however, a closer look paints another picture when it comes to financial inclusion. Formal banking access points are concentrated in urban and peri-urban areas. Mujeri (2014) indicated that the ratio of urban and rural formal banking access points is decreasing. Low-income households and businesses in Bangladesh face constraints in availability of appropriate access points, tailored products, and appropriate delivery channels.

Despite having the mandate for providing comprehensive range of financial services by the formal banking institutions, the distribution of formal access points and availability of tailored products and services is disappointing. Mujeri (2014) identified that inadequate banking infrastructure and low geographical or physical access such as average distance from household to the bank branch are critical barriers for low-income people in accessing financial services.

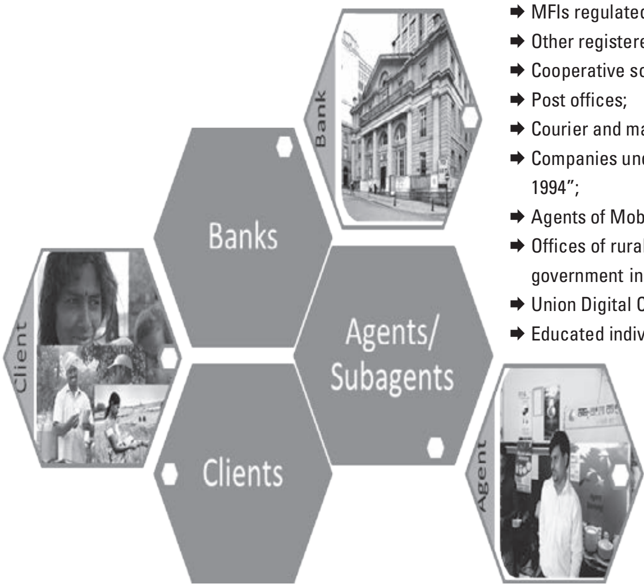
Agent Banking as an Option

Bangladesh Bank, the central bank of the country, is leading initiatives to broaden financial access for all people. Bangladesh Bank has launched various initiatives to enhance access to financial services for the poor. Among others, no-frill accounts (NFAs), mobile financial services, and agent banking are ground-breaking initiatives that hold high prospects to enhance access for the poor. Given the problem of constrained access to formal banking services, strengthening agent banking holds the greatest potential to bring formal banking services to the doorstep of low-income households both in rural and urban areas.

An agent banking model for Bangladesh is given in Fig. 1.

During the last decade or so, there has been an explosion of different kinds of alternative, low-cost, technology-based, and convenient options of access points to financial services, that is, beyond the traditional brick-and-mortar branches.

Figure 1. Agent Banking Model of Bangladesh—Stakeholders and Allowable Services



Eligible agents/sub-agents

- MFIs regulated by MRA;
- Other registered NGOs;
- Cooperative societies;
- Post offices;
- Courier and mailing service companies;
- Companies under "The Companies Act, 1994";
- Agents of Mobile Network Operators;
- Offices of rural and urban local government institutions;
- Union Digital Centre (UDC);
- Educated individuals

Allowable activities

- Collection of small-value cash deposits and cash withdrawals (ceiling should be determined by BB from time to time);
- Inward foreign remittance disbursement;
- Facilitating small-value loan disbursement and recovery of loans, installments;
- Facilitating utility bill payment
- Cash payment under social safety net programme of the government;
- Facilitating fund transfer (ceiling should be determined by BB from time to time);
- Balance inquiry;
- Collection and processing of forms/documents in relation to account opening, loan application, credit and debit card application from public;
- Post sanction monitoring of loans and advances and follow up of loan recovery;
- Receiving of clearing check;
- Other functions such as collection of insurance premium, including micro-insurance, etc.

Of the many obstacles to financial inclusion, cost is a key constraint for both the supply-side and demand-side actors. Cost to banks involve servicing low-value accounts and extending physical infrastructure to remote rural areas, and costs to customers involve the money and time it takes for them to travel to bank branches. Agent banking and its variants are rapidly evolving and their regulations play a central role in enabling its spread.

Agent banking is quickly becoming recognized as a viable alternative strategy in many countries for extending formal financial services to the low-income poor households. In recent years, agent banking has been adopted and implemented with varying degrees of success by many countries, particularly in Latin America.

Bangladesh has both agency-based, low-cost delivery channel of traditional banking services while having mobile phone–based limited payment services.

Policy Gap Analysis and Recommendations

As part of the fellowship, the author has conducted a very small-scale survey of the agent banking services combining banks, agents, and clients. Findings indicate that lack of knowledge of the products, absence of appropriate guidelines in the area of incentives, and risk management are key constraints for the supply side to broaden its agent networks. On the demand side, lack of knowledge, availability of agent outlets tailored products, and services at affordable cost to low-income household constraints take up of services. Through further review of the problem, four key areas have been identified as critical: (i) lack of clear guidance on the channel operation, (ii) lack of access points, (iii) inconvenience in service use, and (iv) lack of awareness.

The survey conducted by the author and review of the current agent banking scenario in Bangladesh lead to the conclusion that a gap in the existing policy and program exists in making agent banking one of the low-cost channel options for broadening formal financial access for the low-income households in Bangladesh. Other options include mobile financial services (MFS), Integration of MFS with agent banking, transforming MFIs into rural banks, etc.

Revision of the existing agent banking regulations and guidelines is critical to remove the barriers mentioned above and to make the channel as a viable option for delivering low-cost financial products and services, simplifying basic accounts opening procedures, and bringing financial services centers and touch points within the reach of the low-income households.

My proposition toward review and revision of the existing low-cost financial services delivery channel option (agent banking) would include guidelines on expansion of convenient access points for the targeted segments, risk management tools and techniques, incentives for the participants, pricing and promotion of the channel to the stakeholders, and innovation of tailored and affordable financial services products. The guidelines would be complementing to the stakeholders efforts, and ensure customer interest protection and stability of the financial sector. The recommendation would also include integration of this low-cost financial service delivery channel into the national financial inclusion agenda through incorporation of the issue into the upcoming national financial inclusion strategy (NFIS).

For implementation of the policy revision, the following phases and steps are recommended:

1. Phase-01: Review of the low-cost financial services delivery options in Bangladesh including the agent banking guidelines. This review will be done in the following steps:

   i. Internal review of the existing agent banking guidelines and other low-cost options for expanding access to formal financial services.
   ii. A sample survey of the stakeholders including supply-side participants and demand-side stakeholders would be undertaken to identify the nature demand and critical success factors.
   iii. Engaging stakeholders in the review process: This includes stakeholder identification, and engaging them in the review of the existing guidelines to identify the problems, prospects, and recommendations to improve the current guidelines.
   iv. Exploring the possibility of interfacing mobile banking (bank-led DFS in Bangladesh) and agent-driven, technology-based traditional banking services.

2. Phase-02: Redesign low-cost formal banking services delivery guidelines.

Based on the review and consultations with stakeholders, existing agent banking guidelines will be revised to make the tool attractive for both the supply side and demand side. In doing so, the following steps will be taken:

   i. Drafting the guidelines. The revised guidelines will address the following areas:

      a. Regulations would govern the licensing, and agency–principal relationship, supervision, and monitoring. The regulation would be of minimal control while ensuring sustainability of the model and stability of the financial sector.
      b. The guidelines should provide strategic directions on agent banking operations, product development, pricing, incentives, risk management, customer interest protection measures, and promotion among the general public.
      c. The guidelines should not be limiting in nature rather should make the stakeholders aware of the risk and potential benefits the tool has to offer for the stakeholders.
      d. Promotion and awareness-building initiatives.

   ii. Sharing the new guidelines with the stakeholders for their comments.
   iii. Revisiting and revise if necessary.
   iv. Finalizing the guidelines.
   v. Implementing the guidelines.
   vi. Monitoring the implementation.
   vii. Updating the guidelines as and when necessary.

Conclusion

Financial inclusion has become policy priority for many of the central banks in the lower-middle income and emerging market countries. Key constraints in reaching out to low-income households with financial services are cost of serving from the supply side, and cost and ease of access to financial services. Low-cost delivery channels affordable to and tailored for the low-income households is a viable option against such odds. Low-cost, technology-based, and responsive to the stakeholder's need is key to success in the agent banking model in many countries. A revised agent banking guidelines in Bangladesh would also facilitate expanding access to financial services for the low-income households in Bangladesh.

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Strengthening the Access of Low-Income People to Formal Financial Services

Tuyen Van Le

Director, Payment Policy Department, State Bank of Vietnam

Context

Vietnam is a country in Southeast Asia with the population of over 90 million, in which over 60 million people live in rural areas. After more than 20 years of reform, the Vietnamese economy has been growing rapidly.

However, financial inclusion is still at very early stages of development. Overall access to and use of formal financial services is very low in Vietnam—one of the lowest rates of access to finance in East Asia. According to the World Bank's and International Finance Corporation's (IFC) latest data, only 31% of the adult population has access to formal financial services, especially women and the poor in rural areas (World Bank, 2015)—about 10 million individuals, less than 10% of the population—use formal financial services (IFC, 2015).

With over 130 million mobile connections (over 140% of the population), which is higher than the average connections in the United States, Europe, Latin America, and all high-income countries, mobile banking could provide great opportunity for the huge unbanked population of Vietnam. Vietnam has a significant opportunity to capitalize on its technological infrastructure and widespread connectedness. An investment in technology-driven financial reforms that enable and encourage digital financial inclusion should be a high priority for Vietnam. The technology and communications infrastructure exists to close the financial services gap at a faster pace than any other country in the world.

Problems

One of the main problems is that low-income populations in rural Vietnam have to rely on informal financial services, that are risky and unregulated, especially the credit and payment services. The informal sector is the largest provider of financial services for low-income populations. Informal service providers include moneylenders, rotating savings and credit associations, pawn shops, relatives and friends. In recent years, there have been many cases of borrowing money from unregulated and illegal moneylenders and pawn shops with very high interest rates, and as a result, many low-income clients became over-indebted (VnExpress.net, 2016). In addition, many migrants have sent their money to rural areas via informal and unregulated channels, resulting in losing money without legal protection (SBV, unpublished reports).

While the provision of formal financial services is limited, the key providers are the Vietnam Bank for Social Policies, the Vietnam Bank for Agriculture and Rural Development, the People's Credit Funds, and two licensed Microfinance Institutions (MFIs). Commercial Banks offer a wide range of financial services, including money transfers, ATM services, foreign currency exchange, credit, and debit cards. Money transfer operators provide cash transfers, often in collaboration with commercial banks, other financial institutions, and post offices; international remittances are significant in Vietnam.

This problem relates to both supply and demand-side factors: (i) Access to formal financial institutions is limited in rural areas due to a shortage of access points, this is mainly because investing in payment infrastructure in rural areas is inefficient and costly for banks. (ii) Non-banks are not allow to supply payment services according to existing legal framework, which means that only banks are authorized to do so. (iii) There are no suitable financial services and models for low-income people in rural areas. (iv) A legal framework for informal financial services does not exist. (v) Populations in rural areas still have a preference for cash.

Possible Solutions

There are numerous potential solutions to solve this problem and improve rural populations' access to formal financial services. This policy will focus primarily on providing digital financial services in rural areas, mainly by (i) improving access to digital financial services in rural areas; (ii) improving access to payment points; and (iii) stimulating non-cash payments. To date, agent banking and branchless banking remains under-developed in Vietnam, and mobile banking only reaches a small segment of the bank population.

Solution A. To allow non-bank institutions to supply digital payment services and models suitable to low-income people in rural areas

The Central Bank will work with banks, as well as non-bank institutions (i.e., Telco companies, petroleum companies, payment intermediary service providers), to encourage the design and implementation of advanced technology and easy-to-use financial products in rural areas.

This will primarily leverage the existing networks of the non-bank institutions, such as telecom shops, gasoline shops and post offices in rural areas, and use mobile phone technology.

Solution B. To stimulate non-cash payment and promote financial inclusion in rural areas

In order to address this solution, the Central Bank in coordination with related ministries, such as the Ministry of Trade and Ministry of Finance, will draft a non-cash payment strategy for 2016–2020 and a national financial inclusion strategy to submit to the Prime Minister for approval.

Two strategies will identify feasible measures and solutions to stimulate non- cash payment and increase the access to financial services in rural areas, which will focus on (i) improving payment infrastructure and access points in rural areas; (ii) applying digital financial services to rural areas; and (iii) changing existing legal framework, providing incentives (including tax deduction or similar measures) for banks and non-bank institutions to provide payment infrastructures and payment services in rural areas, such as mobile payment, Internet payment, multiple ATMs, POS, mobile POS.

Recommendation

All of the above solutions require working with multiple stakeholders, such as the Prime Minister, Ministry of Finance, Ministry of Trade, Ministry of Information and Telecommunications; international organizations, such as the World Bank and Asian Development Bank; and related departments of the Central Bank, as well as banks and non-bank institutions.

While the two solutions above are part of a non-cash payment strategy and a national financial inclusion strategy, this policy memo will focus on solution A, for the following reasons: (i) Three models of digital payment services where banks, in coordination with non-bank institutions, provide payment services have already been carried out on a pilot basis, and initial results have been achieved; (ii) high mobile connections in rural Vietnam, allows mobile banking to provide feasible measures for the huge unbanked population of Vietnam; (iii) and the Central Bank is already in the process of studying and drafting a Circular on Agent Banking, which allows non-bank institutions to take part in providing digital payment services.

In order for the above solution to be implemented, the following steps will be taken: (i) The Central Bank will work with banks, as well as non-bank institutions (i.e., Telco companies, petroleum companies, payment intermediary service providers), to encourage the design and implementation of easy-to-use financial products in rural areas. (ii) The Prime Minister will approve non- cash payment strategy by the end of 2016, and national financial inclusion strategy in 2017 to place the basis for the implementation in the period 2016–2020. (iii) The Prime Minister and Governor of the State Bank of Vietnam will change current legal framework to allow non-bank institutions to participate in providing digital financial services to rural areas, which is currently not allowed, in which the State Bank of Vietnam will issue the Circular of Agent Banking by the end of 2016 and propose changes in current Law on Credit Institutions to submit to the National Assembly for approval in 2019.

With the policies and solutions described above, it is hoped that low-income people in rural Vietnam will have improved access to formal financial services and become less reliant on informal financial services, as well as increased individual bank accounts to 50%–60% of the populations by the end of 2020.

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Electronic G2P to Increase Financial Inclusion in Indonesia

Primitiva Febriarti

Manager, Bank Indonesia

Summary

In order to increase financial access in Indonesia, one approach that can be a catalyst is disbursement of government to person (G2P). In this regard, Bank Indonesia (BI) proposes G2P should be disbursed electronically, gradually replacing the current practice that is a heavily cash-based disbursement mechanism. This mechanism has caused undesirable effects for parties involved in G2P disbursement. Electronic G2P disbursement will create value for government, banks, recipients, and also the local economy.

Context

Indonesia is an archipelago country with high level of cash economy transactions. From the financial access side, Indonesia also faces high financial exclusion. Based on Findex from the World Bank Survey in 2014, the level of banked people in Indonesia is only 36%, lower compared to their peer countries (Demirgüç-Kunt, Klapper, Singer, & Oudheusden, 2015). Considering those challenges, Bank Indonesia as macroprudential and payment system regulator, is concerned with improving financial access for all, especially for the unbanked and underbanked. Financial inclusion could bring positive impact to financial stability and also increase efficiency in the economy through an efficient payment system.

About the Government to Person (G2P) Program

In order to assist poor and vulnerable people, the lndonesian government has G2P programs. The government classifies the programs based on the following objectives and recipient targets:

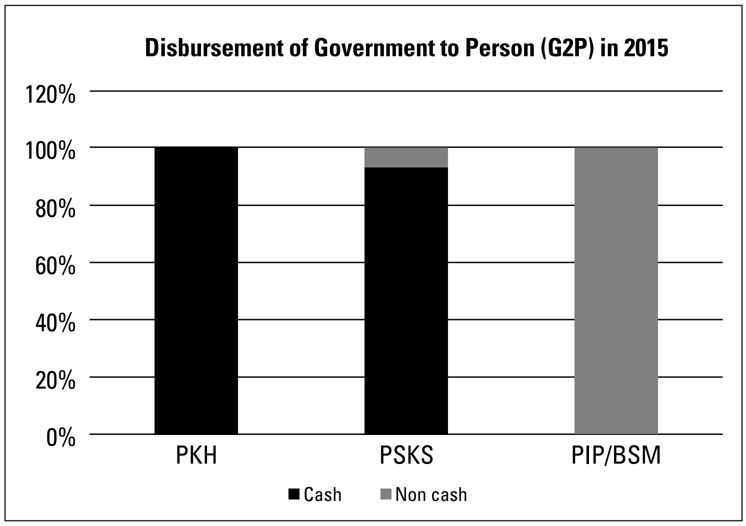
1. Unconditional cash transfers[1]—for example, Family Welfare Deposit Program [Program Simpanan Keluarga Sejahtera (PSKS)]
2. Conditional cash transfers[2]—for example, Family Hope Program (Program Keluarga Harapan/PKH) and assistance for students from poor families [Bantuan Siswa Miskin (BSM) or Program Indonesia Pintar (PIP)]
3. Subsidies—for example, rice (Beras Sejahtera/Rastra) for poor families

The majority of the G2P programs, especially for PSKS and PKH, disburse cash. Cash recipients must queue in postal branches to withdraw the funds. Since there is no mechanism to store a portion of their funds, recipients must withdraw all of it. Post offices are the only institution that has the capability to disburse the money in cash. Overall, cash G2P disbursement faces many challenges that discourages the government from achieving social benefit principles that are at the right time, for the right amount, and the right on target.

In order to overcome these challenges, the government has tried to transform disbursements method from cash to non-cash. Since 2014, BSM/PIP[3] has been disbursed electronically into basic saving accounts, which is withdrawn at bank branches. This is a good first step but is still not an optimal solution because of the following.

- The registration of the basic savings account for students is time-consuming. Also it requires purchasing a stamp that costs about $0.45 USD for each account. The stamp costs are borne by bank.

- The amount of funds is very small; therefore, it encourages students to withdraw all the funds, which does not allow the bank to enjoy the float. It causes many accounts to become dormant.
- There should be a procurement to choose channeling institutions for every period of disbursement, since there is no guarantee for the bank to be chosen for longer period. For banks, it is not a sustainable business. For recipients, it is confusing because they change their bank account every period.
- Students must leave the school to go to the bank branch to withdraw their money.
- There is no fee as compensation for banks to provide the service.



The Problem

The G2P disbursement in cash causes undesirable effects, both from the point of view of the government and the recipients.

- From the government side:
  - Distributing G2P funds to recipients living on an island is costly, time-consuming, and creates the risk of money loss.
  - There is a potential for leakage.
  - The government in weak position to determine the fee since post offices are the only channeling institution.
- From the recipients' side:
  - Increasing inefficiencies because recipients spend time to travel to a post office and to queue. They also have to spend money to get to the post office.
  - Carrying cash in wallets encourages people to be more consumptive.
  - Risks of money loss.
  - No chance to be recognized by banks that get formal financial services and products for the future.

Possible Solution

In order to overcome these problems, BI proposes that the government disburses G2P funds through Digital Financial Services (DFS), a financial service by using mobile money and agents. DFS will create value for the government, recipients, and the local economy. By bringing the high number of G2P recipients (about 18.7 million people of total population in Indonesia) to the banking system, it will have a significant impact on financial inclusion. The recipients will have an opportunity to connect with formal financial products and services. For the banks, they also have potential markets in the future, especially in the micro and small markets. To realize this solution, BI implements three strategies:

1. *Development of a sustainable business model for G2P disbursement electronically with the DFS[4] mechanism.* This business model consists of four main processes, which are registration, education, disbursement, and funds withdrawal/transaction with a DFS agent. In developing the business model, we conduct intensive discussions with banks, telcos, and related ministries. All parties involved in this process have agreed to implement business model.

The four processes are as follows:

a. **Bulk Registration**. In this process, the channeling institutions are allowed to do bulk registrations with data given and validated by related ministries. The validity of the data becomes the ministries' responsibility. For recipients, they do not need to queue to open the account.
b. **Continuous Education**. In this process, the recipients should be educated on how to withdraw money and do other transactions by using DFS such as account activation, PIN creating, and problem handling. It requires appropriate educational methods that fit with recipients.
c. **Disbursement with efficient cost by state**. In order to minimize the cost paid by the government, part of the cost can be covered from the return gained from using the fund for a maximum of 15 days by channeling institutions. The 15 days are counted from when the ministries disburse the G2P funds to the channeling institutions until the funds are credited to recipients' account. In order to reach an optimum solution, BI proposes to lengthen the duration of channeling institutions in using the money from 15 to 30 days. The longer period is expected to cover more of the disbursement fee. Thus it will positively impact government budget efficiency.
d. **Mingle with DFS agents**. The DFS agents are located in the midst of the G2P recipients; it is more efficient for them to cash-out the fund, in terms of time and cost. In the future, G2P recipients do not need to cash out the fund to buy their regular necessities—they can transact the electronic money from the merchants directly.

In general, the business model can be used for any type of social cash transfer program disbursement, such as PKH, BSM/PIP, and PSKS. This business model can also be applied by using branchless banking[5] initiated by Financial Services Authorities (FSA). In the fourth process, the G2P recipients who receive the funds in a savings account can withdraw their money or transact through branchless banking agents.

2. *Gain commitment from ministries to support and implement G2P disbursement electronically.* This step is important because all of the G2P program is under related ministries—for example, PKH is under the Ministry of Social Affairs and BSM/PIP is under the Ministry of Education and Culture. Thus, support from ministries is needed, not only for its commitment, but also to change the rules and procedures. In addition, to strengthen the commitment, signing a Memorandum of Understanding (MOU) with related ministries can be a starting point. Those five ministries are the Ministry of Human Development and Cultural Affairs, Ministry of Social Affairs, Ministry of Education and Culture, Ministry of Religion, and the Ministry of Development of Less Developed Regions.
3. *Supportive regulations as a legal umbrella for electronic G2P disbursement, as follows:*
   - Amendment of DFS regulation that allows bulk registration and simplified CDD that are needed for registration process.
   - Presidential Regulation about obligations to disburse G2P in non-cash for all related ministries where they can use DFS (initiated by BI) or the branchless banking mechanism (developed by FSA). This Presidential Regulation is known as Presidential Regulation about Non Cash G2P.
   - Amendment of The Minister of Finance Regulation about G2P that allows the government to disburse cash transfers electronically.
   - Amendment of the procurement Regulation to allow more providers and for multi-years contract.

Recommendation

In order to accelerate the implementation of G2P disbursements electronically, BI has policy recommendations as follows.

1. Related ministries implement the sustainable G2P business model proposed by BI that consist of four main processes. This business model should be mandated in Presidential Regulation about Non Cash G2P.
2. BI discusses with the related ministries to implement the G2P business model.
3. BI discusses with industries and the Ministry of Finance in preparing the amendment of Regulation of The Minister of Finance about G2P, which will revise the disbursement duration from 15 to 30 days to allow more opportunity to get the optimum solution in covering the disbursement fee.
4. BI discusses with the banks to prepare the readiness of the bank to support G2P disbursement, such as infrastructure of the DFS agents and its quality.
5. BI proposes to National Public Procurement Agency to broaden the coverage of e-catalog procurement that allows more providers to undertake the disbursement with multi-years contract.
6. The implementation will be done gradually and at onset, it will be carried out through a pilot project. This should be equipped with monitoring and evaluation process.

Finally, to maintain the sustainability of electronic G2P disbursement, it is important to create the ecosystem and interoperability to increase the convenience for the recipients to use DFS and the acceptance of non-cash payment instruments. It is a long process, but by encouraging the industry to continue to innovate, fostering close coordination among stakeholders, and continuous education, we believe digital economy can exist to the last mile and for everyone, including G2P recipients.

Notes

1. Unconditional Cash Transfer is a program to reduce poverty by providing a welfare program without any conditions upon the recipients' actions.
2. Conditional Cash Transfer is a program to reduce poverty by providing a welfare program to recipients who meet certain criteria, such as the level of attendance to health facilities (e.g., for pregnant women) or education facilities (e.g., for school children).
3. Bantuan Siswa Miskin (BSM) isa social cash transfer program for students (6–21 years old) from very poor families or for poor students who meet the criteria previously set. This program has been part of PIP since 2014.
4. DFS or Layanan Keuangan Digital (LKD) is a payment service delivered by using agents and technology. The product in DFS is registered electronic money. DFS was initiated by Bank Indonesia in 2014. The regulation and supervision of LKD is under BI.
5. Branchless Banking (Laku Pandai) is a financial service that is similar to DFS, but the product is basically a savings account. Laku Pandai was initiated by FSA in 2015. The regulation and supervision of Laku Pandai is under FSA.

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Supporting Savings Groups

Advocating for Appropriate Financial Solutions for Saving Groups to Cope with Emergencies

Esselina Macome

Policy Advisor, Financial Sector Deepening Moçambique (FSDMOç), Professor, Eduardo Mondlane University (EMU), Mozambique

Executive Summary

Mozambique has made a significant progress toward developing and strengthening the financial sector through the implementation of a comprehensive Financial Sector reform program. However, the majority of the population and businesses still do not have access to financial services—especially in rural areas where the majority of the population resides (Alliance for Financial Inclusion, 2015).

The main objective of the Mozambique Financial Sector Development Strategy 2013–2022 is to improve the lives of all Mozambicans—more precisely to enable the poor to build financial security, manage financial shocks, and invest in opportunities to generate income through the access to secure savings facilities and other financial services (Governo de Moçambique, 2012). In line with this goal, we have identified a need to address ways to improve the provision, access, and usage of affordable diversified financial products for the low-income households in Mozambique.

Context

Mozambique Country Profile

Mozambique is located in Southeast Africa (Fig. 1). It has a total area of 801,590 km^2 and about 2,470 km of its coastline along the entire Eastern frontier borders the Indian Ocean. Mozambique has about of 25,727 million people with more than 68% living in rural areas and about 14 million people represent the adult population[1] (Instituto Nacional de Estatística, 2016).

In the last decade, the economy of the country grew on average 7.40% and it has experienced a remarkable improvement in the stability of prices and increase in the annual variation of the GPD (Banco Nacional de Investimento, 2016). Mozambique is rich in a wide range of mineral resources such as coal, hydrocarbons, precious stones, and heavy minerals (Banco Nacional de Investimento, 2016). Mozambique is facing the consequence of climate change and natural disasters. In 2015–2016, more than 20,000 people lost their property due to flooding and around 50 people died (Governo de Moçambique, 2016). In addition, the country's southern provinces experienced droughts, resulting in crop failures and cattle death.

Financial Inclusion Landscape

Mozambique is one of the least financially inclusive economies in Southern Africa with 60% of the population not using any formal or informal financial services (FinMark Trust, 2015). This survey revealed key areas where there is market potential for financial inclusion (FI) of underserved market segments in Mozambique, and these lie among low-income households, small-scale farmers, women, youth, microenterprises, and expanding small–medium enterprise (SME) market.

Based on the analysis of this Finscope survey, the biggest increase by financial products include the growth of those using current accounts, savings accounts, debit cards, and the use of a bank for remittances. The largest impact of increasing financial access between 2009 and 2014 was the greater adherence to the *xitique*,[1] with an estimated 15% using it (FSDMOç, 2016).

The analysis shows almost a double increase savings from 15% to 30% from 2009 to 2014. However, removing the highly informal sources of saving,[2] the trend is noticeable but smaller, from 7% in 2009 to 16% in 2014. The same study shows a significant increase in informal savings from 2009 (11.2%) to 2014 (22.5%) while savings through banking only increased from 5.35% to 6.9%. It seems that most Mozambicans are not interested in adhering to saving's products offered by banks (FSDMOç, 2016).

The share of the population using insurance products is still low, having increased from 2.9% to 4.2% from 2009 to 2014. This change was driven by obligated third party motor insurance (Finmark Trust, 2014; World Bank 2015).

The growth in financial inclusion will need to come from more formal and established financial service providers (FSPs)[3] as well as from informal groups.

The Mozambique's FI picture is not good and there is a need to change it positively. The government of Mozambique is aware of this need and it has recently approved the national financial inclusion strategy, which was launched on July 6th (BM, 2016).

Problem

The majority of the low- and middle-income Mozambican householders have limited financial resources to deal with emergencies.

The data on FI show us that the level of FI in Mozambique still very low. Only about 20% of Mozambicans have access to formal financial services (Finmark Trust, 2014). Additionally, the findings from the saving groups (SGs)interactions demonstrated that members of these SGs have scarce financial resources to deal with emergencies.

From the 2014 Finscope data, informal saving strand in rural areas represent 28%. The majority of rural householders are reliant upon informal saving mechanisms to help their members cope with the consequences of shocks, such as droughts and floods. Most women rely on others for income and perceive their biggest risk as death of the main income earner and poor harvest. For example, 1 in 4 women would not know how to cope with severe shocks (Finmark Trust, 2014). SGs are good for some things but not for all financial problems, therefore FSPs are required to provide new range of products to SGs in particularly.

We found several causes and reasons behind this problem, such as lack of appropriate products for emergencies, limited financial education and awareness on insurance products or services by the householders, SGs members have limited skills and ability to define expenditures priorities, and the FSPs do not provide range of services oriented to the SGs needs.

Money saved through SGs (*xitique*) can respond to short-term emergencies, but it is less helpful in dealing financially with the consequences of long-term and severe emergencies. If the consequences of shocks are not well managed, they can contribute to making the low-income householders become poorer, because these householders do not have enough resources and assets.

Proposed Solution

This policy memo will focus on the FSDMOç role in proposing a solution for this problem. Multiple potential solutions can be addressed with the goal of developing solutions for low-income householders to deal with shocks. These solutions include defining a strategic vision on how SG members representing the low-income population can access and use financial products or service within emergency. The vision is that FSPs design sustainable, affordable, diversified, and people-centric products and provide these to the low-income Mozambicans and SG members.

There is also a need ensure that the final beneficiaries, including the SG members, are using the new products for better dealing with emergencies. The process of design, delivery, and use of new financial products requires a collaborative approach with all the key stakeholders.

With the purpose to reach this vision, we have identified the following three major phases:

Awareness Phase

In this phase, the FSDMoç will play an important role to design a business case and convene individual workshops for the key stakeholders: This phase will increase awareness of this vision among three key stakeholders:

Regulators: The Central Bank, Insurance, and Telecommunication Regulators The workshop with each of the regulators has the objective to help them understand the need to develop these types of products for SG members, and to help them to see how they can support the provision of affordable products and identify possible incentives for the FSPs.

FSPs: It aims to show a business case for them a need to design more diversified and affordable products, which respond to the needs of the SG members when dealing with emergencies.

The SGs: It is to get their understanding in relation to their need for planning and prioritizing household expenses. In addition to motivate them to express exactly their needs and contribute to change their behavior on the ways for the planning of the future and to deal with risks.

FSDMoç has already commissioned a study on SGs with the objective to get their characterization countrywide and to understand the main goals of this saving mechanism.

After deep interaction with each key stakeholder, we are planning to organize a national debate about SGs. At this debate, the results of the study on SGs will be presented to all stakeholders along with the key points agreed in the meetings with each key stakeholder.

Designing of the Financial Products Phase

There is a need to provide the FSPs with knowledge and skills to be able to design people oriented products or services. FSDMoç can provide the resources and technical assistance in this area. This phase will also need the involvement of the SG members to state their needs.

Financial Education and Consumer Protection Phase

The FSPs should develop financial educational programs in order to create an environment to permit the SG members to use financial products in an efficient manner.

Recommendation

For the implementation of the policy initiative, we recommend an adaptive and collaborative approach solution. This policy awareness is the key solution, as it will build the foundation for provision of diversified and affordable financial products for the low-income householders to deal with emergencies. We believe that after a buy in from the key stakeholders, it is possible to move to other phases of the solution´s implementation.

Additionally our view is that in the whole process we can involve academia, with the objective of conducting trainings on people oriented approach, research about SGs, and to prepare financial education materials.

Notes

1. Local name of saving group in Mozambique—an informal saving mechanism.
2. Informal savings include cash at home or in secret place, money left with someone for safekeeping, and livestock.
3. Financial service providers include institutions such as banks, mobile money institutions, insurance providers, and payment operators.

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Scaling Up Integration of SACCOs into the Payment System

Peter K. Njuguna

Chief Manager, Supervision Department – SACCO Societies Regulatory Authority Kenya

Executive Summary

The Kenyan deposit taking market has expanded over the last decade to deepen access and usage of savings, credit, and related services (Central Bank of Kenya, Kenya National Bureau of Statistics, and FSD Kenya, 2016). This is attributable to enabling policy on new banking business models, mobile financial services, Savings and Credit Cooperatives (SACCOs), and microfinance institutions as well as innovations in the private sector in financial products and delivery channels. SACCOs remain an important and popular part of Kenya's financial sector, providing savings and credit, as shown in Table 1.

Table 1. Kenya Deposit Taking Institutions: 2015 Audited Financial Statements

Item Description	Commercial & Microfinance Banks	SACCO Societies	Total	SACCO Contribution
Total Assets (USD Bn)	36,245	4,536	40,781	11.12%
Loans/Advances (USD Bn)	25,592	3,149	28,741	10.96%
Deposit Liabilities (USD Bn)	22,496	3,375	25,871	13.05%
Accounts/Members	32,704,035*	4,543,651	NA	NA

* Estimated number of accounts

In 2010, the government introduced a prudential regulatory framework for SACCOs to improve their financial stability. But the potential of SACCOs as deposit taking institutions continues to be hampered by existing policies on payment channels that make it highly inefficient for SACCOs to mobilize deposits and extend credit in a competitive and sustainable way. This paper proposes a review of the current policy and legal framework on participation in the national payment system and channels to have deposit taking SACCOs (DT-SACCOs) eligible as payment service providers.

DT-SACCOs provide basic retail banking services to several million households (Central Bank of Kenya, Kenya National Bureau of Statistics, and FSD Kenya, 2016)[1] but are limited by regulation to cash and now mobile money for payment transactions. Today, DT-SACCOs need to partner with banks to issue members with checks and debit cards. This paper argues that DT-SACCOs conduct deposit taking business and should be eligible as payment service providers to facilitate issuance of retail payment instruments such as electronic funds transfer (EFT), debit cards, checks, and real time gross settlement (RTGS). Besides promoting the overall safety and efficiency of the SACCO subsector, access to diversity of retail payment instruments will enhance competitiveness in the deposit-taking market. In particular, this will facilitate efficient deposit mobilization by SACCOs to scale credit to members.

Contextual/Situational Analysis

Kenya has made remarkable progress in enhancing access to financial services over the last decade courtesy of enabling policies and innovations by the private sector.[2]

Usage of Savings and Credit Instruments by Formal Providers

Mobile financial services are the most popular savings instruments in Kenya, followed by Banks and SACCOs respectively (Table 2). Growth in bank accounts has been driven by *mobile* bank accounts; notably, the use of conventional bank accounts decreased over the decade.

Table 2. Use of Savings Instruments by Provider (%)

Provider of Savings Instrument	YR2006	YR2009	YR2013	YR2016
Mobile Finance Service, MFS	–	–	27	43.3
Commercial Bank	12.4	12.4	9.8	24.0*
SACCO	12.8	8.9	10.6	12.6
Microfinance Bank, MFB	1.5	3.2	3.1	3.3
Post Bank	5.6	2.5	2.3	1.5

*16.8% have savings in mobile bank accounts

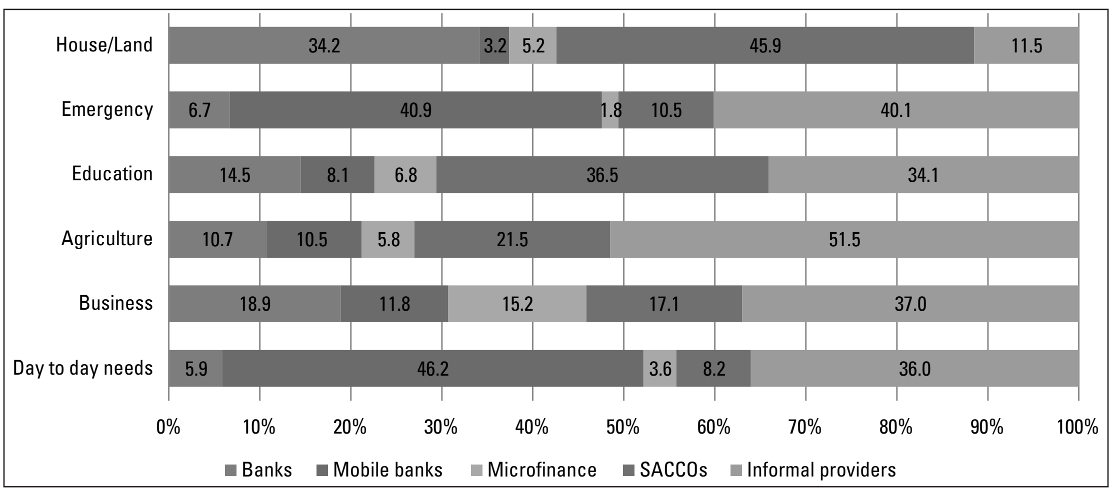
On the use of credit, FinAccess 2016 indicates that the most popular sources of formal credit are mobile bank accounts, SACCOs, and conventional bank accounts in that order (Central Bank of Kenya, Kenya National Bureau of Statistics, and FSD Kenya, 2016). The mobile bank accounts are the dominant source for day-to-day needs while SACCOs are respectably popular for credit to finance education, housing, and land purchase.

Table 3. Use of Credit Instruments by Type (%)

Type Credit Instrument	YR2006	YR2009	YR2013	YR2016
Mobile Bank Account Loan	–	–	–	5.9
SACCO Loan	4.2	3.1	4.0	5.0
Personal Bank Loan	1.8	2.6	3.6	4.4
MFI Loan	0.8	1.8	1.6	1.8
Government Loan	0.9	0.3	0.6	1.3
Credit Card	0.8	0.8	1.8	1.2
Bank/Building Society Loan	0.5	0.2	0.9	0.6
Overdraft	0.3	0.2	0.5	0.4
Hire Purchase	0.6	0.1	0.2	0.1
House/Land Government Loan	0.3	0.1	0.3	0.0

It is apparent that in spite of the competitive retail financial products by banks and mobile financial services, SACCOs remain an important provider of savings and credit. Being member-based financial institutions, SACCOs' competitive edge is in social development segment of the credit market including provision of loans for education and housing as well as agriculture (see Table 4).

Table 4. Reasons for Taking Credit by Type of Institution (%)



However, the latent potential of SACCOs to mobilize deposits from their members and scale credit provision remains subdued as indicated in Table 5 where the loan to deposit ratio (LDR) consistently exceeds one.

Table 5. Loans to Deposits Ratios (LDR)-DT-SACCOs and Commercial Banks

	2015	2014	2013	2012	2011
DT SACCOs	1.09	1.11	1.08	1.04	1.05
Banks	0.88	0.85	0.82	0.78	0.8

Source: Annual SACCO Supervision Reports and Annual Bank Supervision Reports

This is an age-old paradox that SACCOs experience; on one hand they are relatively popular for formal credit but find difficulty in mobilizing deposits to sustainably fund the credit demand. But why does this problem persist in spite of prudential supervision of DT-SACCOs from 2010? The following section reviews the impact of prudential supervision on performance of the SACCO subsector.

Prudential Performance of DT-SACCOs

The Kenya Government recognizing the importance of SACCOs in preserving the diversity of deposit-taking market introduced prudential supervision for SACCOs in 2010. This has since elicited the desired response from the industry through gradual adoption of sound business practices as exhibited by

1. growth in capital reserves,
2. improving loan quality,
3. improving governance and human resource capacity, and
4. investment in information management systems and delivery channels.

The outcome of the foregoing amongst the DT-SACCOs is summarized in Appendix A (on financial and operational performance) and is manifested through

1. opening of common bonds to recruit from a wider pool of potential membership and rebranding to project national outlook,
2. membership growth,
3. sustained growth in deposits, and
4. reduced reliance on borrowed funds.

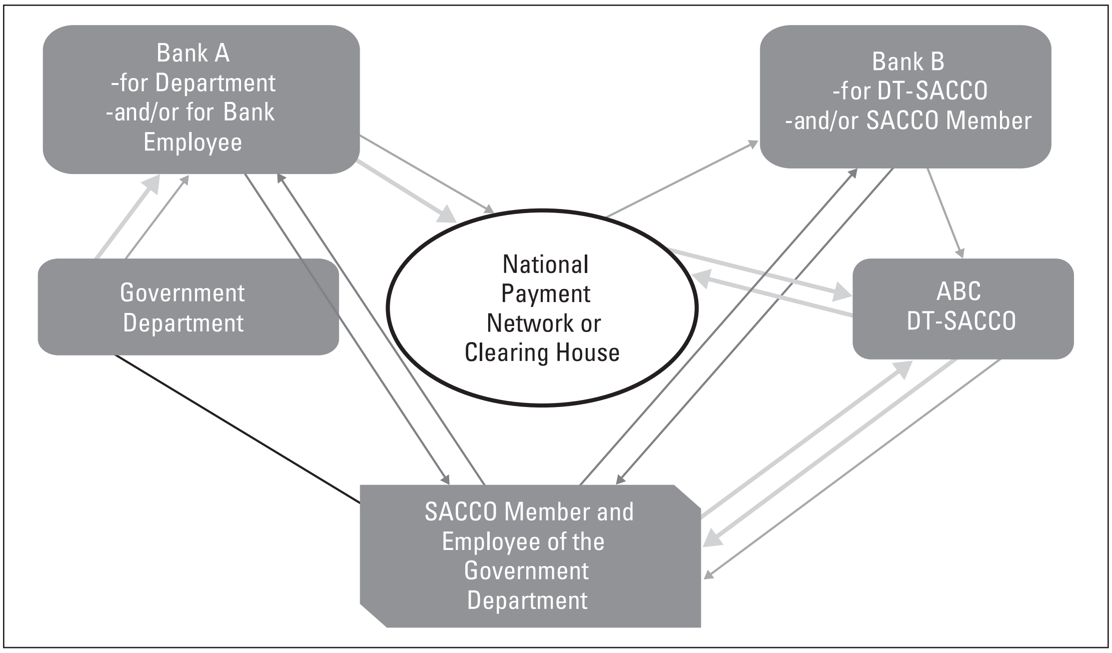
The foregoing confirms improving financial soundness of DT-SACCOs but the unfavorable loan to deposit ratio persists underscoring the illiquidity problem experienced by DT-SACCOs. A LDR of 80% to 90% is considered prudent for deposit taking institution. Thus a LDR exceeding one indicates a funding structure that is inappropriate for sound deposit taking business and the causal factors go beyond prudential standards. The inability of DT-SACCOs to offer savers convenient choices to access their deposits means that members will save only enough to access credit and the rest is saved in banks which offer convenient transactional and savings accounts.

Problem Statement

The root cause of persistent illiquidity problem in DT-SACCOs can be traced to the existing policies on access to payments services and channels. These policies severely hamper SACCOs' ability to efficiently mobilize deposits and extend credit in a competitive and sustainable way.

Figure 1 represents the current typical flow of payment instructions from a Government department to ABC SACCO—a SACCO for the employees of this department.

Figure 1. Payments Flow to a DT-SACCO



a) ⟶: Represents payment instructions from the employer to the DT-SACCO and can comprise salary, loan repayments, and monthly savings. This payment process is, for practical purposes, inefficient in time taken and money to the SACCO and the member.

b) ⟶: Represents payment transactions between the member and her bank, thereby avoiding the delays and inefficiencies occasioned by channel (a). These instructions would comprise salary withdrawals or payments to third parties.

A DT-SACCO processing transactions through the payment channel represented by the green arrows is very much like any business entity other than deposit-taking business. This has the following outcomes on the DT-SACCO business:

- loss of deposits as members maintain bank accounts and split their income to transact with banks because of the comparative advantage they have,
- high transaction costs in the lengthy payment channel,
- costly and ill-designed deposit products to attract deposits from members,
- expensive partnership with the banks to provide ATMs and cheques to members,
- ineffective liquidity management strategies such as lines of credit with banks, and
- enhanced moral hazard as SACCOs are left with net-borrowers.

The foregoing has led inadvertently to the following.

1. Undermining the policy goal of enhancing stability of SACCOs.
2. Unfair competition in the deposit-taking market that is not beneficial to the household savers and the economy in general.
3. Unintended credit rationing as SACCOs are liquidity constrained and cannot fund the high loan demand by the households.

The Committee on Payment Systems and Settlements (CPSS) of the Bank of International settlement in its 2003 publication *Payment Systems and Settlements in Selected Countries* argued that "Properly functioning payment systems enhance the stability of the financial sector, reduce transaction costs in the economy, promote efficient use of financial resources, improve financial market liquidity and facilitate the conduct of monetary policy" (Bank of International Settlements, 2003).

Possible Solution

SASRA, the regulator for DT-SACCOs, non-bank deposit taking institutions, proposes a review of the current policy on participation of SACCOs in the payment infrastructure to:

a. Grant DT-SACCOs direct access on solo basis. This option means that each DT-SACCO will have to satisfy the regulatory requirements to issue retail payments instruments to members and operate reserve accounts with the Central Bank of Kenya (CBK). However, only a few DT-SACCOs can potentially satisfy the stringent regulatory requirements to be authorized payment service providers.
b. Allow a designated financial institution owned and governed by DT-SACCOs to provide access to the national payment infrastructure. The designated institution may operate within existing legal framework as a payment service provider to aggregate and process payment instructions from member DT-SACCOs. It is expected that this approach will require minimum legal amendments.
c. Both options (a) and (b) so as to provide flexibility for the DT-SACCOs but also minimize the concentration risk associated with an aggregator institution.

Full integration of SACCOs to a country's national financial system almost always starts with a prudential supervision to enhance financial soundness required of deposit taking business. This is followed by allowing SACCOs to participate in such financial infrastructure as payment systems and deposit insurance. Thus, authorizing DT-SACCOs access to payment infrastructure is a natural next step to advance their vertical integration and enhance competition in deposit-taking market.

Recommendation

SASRA recommends an adaptive policy approach where the DT-SACCOs have the choice of direct access individually or collectively through a designated financial institution to access the payment system and channels. Below is a three-stage process toward this policy vision.

1. **Technical Study**

This study is ongoing and aims to develop a detailed understanding of the problem and solution from the perspective of DT-SACCOs and key stakeholders including SACCOs' Union, banks, Central Bank, and the Treasury.

The domestic understanding of the problem will inform a comparative study in jurisdictions where SACCOs issue retail payment instruments.

The findings and recommendations of the study, after due consideration by SASRA will be presented to the Minister responsible for SACCOs. This will ensure appropriate guidance is received on the policy proposals and thereby enhance ownership.

2. **Stakeholder Engagement**

The stakeholders involved during the technical study have diverse and divergent interests. Therefore SASRA will engage each, starting with Central Bank and Treasury, considering their specific mandate and interest in stability of the financial sector, besides a shared goal on efficient financial intermediation.

The industry associations for SACCOs and banks will be the next critical actors. The SACCO association has formally requested for a review of the current policy on access to payment systems. To the banking industry, the proposed policy change brings competition to critical service hitherto reserved for banks.

DT-SACCOs, while constituting primary beneficiaries of the proposed policy review, will require tailored engagement to ensure the expected benefits and requisite changes are well understood.

3. Final Policy Proposals

The foregoing engagements will result in valuable contributions, comments, and concerns that will shape the final policy proposal and legal or regulatory amendments to be presented in a stakeholder workshop.

Appendix A. Performance of DT-SACCOs

PERFORMANCE MEASUREMENT	2015	2014	2013	2012	2011
Number of DT-SACCOs	177	184	215	215	215
Membership	3,145,565	3,008,497	2,612,250	2,544,001	2,092,946
FINANCIALS (USD Million)					
Assets	3,341	3,328	2,915	2,598	2,308
Deposits	2,321	2,273	1,999	1,865	1,653
Net Loans and Advances	2,524	2,421	2,205	1,948	1,737
Capital Reserves	497	476	311	258	134

Appendix B. Financial Soundness of DT-SACCOs

INDICATORS	2015	2014	2013	2012	2011
CAPITAL ADEQUACY					
Core Capital (Minimum, KES. 10 Million)	41,712	33,252	26,850	22,162	11,403
Core Capital/Total Assets	12.17%	11.20%	7.74%	8.64%	5.7%
Core Capital/Total Deposits	17.57%	16.40%	10.90%	11.94%	11.36%
Institutional Capital/Total Assets	8.75%	5.42%	2.84%	5.02%	4.45%
ASSET QUALITY					
NPLs/Total Gross Loans	5.12%	5.73%	4.72%	7.34%	9.60%
NPLs Net of Provisions/Core Capital	14.65%	17.06%	14.50%	43.40%	70.40%
Earning Assets/Total Assets	80.54%	79.45%	82.62%	80.50%	79.11%
EARNINGS					
Interest Margin/Gross Income	42.97%	45.70%	46.86%	40.63%	42.07%
Cost/Income Ratio	66.76%	65.04%	65.38%	67.64%	65.68%
Operating Expense Ratio	5.13%	4.49%	4.87%	4.71%	4.25%
Non-Interest Expenses/Gross Income	41.69%	38.40%	43.76%	34.44%	35.24%
LIQUIDITY					
Liquid Assets/Total Assets	11.90%	9.99%	10.93%	12.83%	12.62%
Liquid Assets/Total Deposit	17.18%	14.57%	36.40%	17.74%	17.08%
External Borrowing/Total Assets	5.31%	6.43%	6.23%	7.00%	8.37%
Total Loans/Total Deposit	108.74%	110.95%	108.06%	106.23%	102.28%

Notes

1. The *2016 FinAccess Household Survey* found that "2.7million individuals use SACCOs besides other financial service providers."
2. According to *2016 FinAccess Household Survey*, 75% of Kenyans access financial services through formal institutions and exclusion has dropped to 17% from 41% 10 years ago.

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Financial Inclusion for Underserved Groups

Initiatives to Promote Financial Inclusion for Women: The Case of Zimbabwe

Charity Lindile Dhliwayo

Deputy Governor, Reserve Bank of Zimbabwe

Introduction

Access to financial services is increasingly being recognized globally as one of the main drivers to sustainable inclusive economic development. According to the 2014 World Bank Findex Data (World Bank, 2014a), more than 2 billion people were financially excluded across the world. However, it has been noted that the majority of those that are financially excluded are women.

Cognisant of the importance of financial inclusion, the authorities in Zimbabwe have taken initiatives to champion the development of an inclusive financial system focusing on marginalised groups, including women.

This policy memo seeks to proffer possible policy initiatives to facilitate access to a wide range of formal financial services and products by women and their enterprises.

Background

Women in Zimbabwe play a critical role in the economy as producers, leaders, entrepreneurs, and service providers, and their contribution is vital to the well-being of families, communities, and economies. The National Census conducted in 2012 indicated that women in Zimbabwe constitute 52% of the total population of 13.06 million (Zimbabwe National Statistical Agency, 2012).

Meanwhile, a FinScope survey conducted in 2014 revealed that 23% of the Zimbabwean population had no access to financial services, the majority of whom are women and their enterprises (FinScope, 2014). The same survey observed that while women own 57% of micro, small, and medium enterprises (MSMEs) in Zimbabwe, only 14% MSMEs use banking services.

The Problem

A majority of the women in Zimbabwe are faced with numerous challenges in their endeavour to fulfil family financial obligations, and/or venture into business. Lack of access to finance has hampered the economic empowerment of women.

Women generally lack financial education and information about products and services, as well as entrepreneurial and business management skills required to fulfil requirements by the credit providers. The World Bank Consumer Protection and Financial Literacy Diagnostic Survey Report of 2014 (World Bank, 2014b) revealed that although more that 90% of the Zimbabwean population is literate, financial literacy is very low.

Many women in Zimbabwe do not save with formal financial institutions, as some of the requirements for opening and maintaining bank accounts are stringent and onerous. Further, high minimum balance requirements, as well as high bank charges, discourage women from opening and maintaining accounts with formal financial institutions.

In addition, banks and other financial institutions in Zimbabwe do not adequately target women in their lending models. According to studies by the central bank, lending to women is around 8%–10% of the total banking sector loans.

Traditional lenders also prefer to be secured by qualifying collateral and title deeds when lending, which the majority of women do not have.

Another constraining factor has been the absence of a comprehensive credit reference environment. While women generally have a good repayment pattern and good credit culture, the majority of them do not have documented credit history.

The factors highlighted above have constrained and limited access to finance by women. As a result, the majority of women have found a “work-around” or alternative ways of accessing finance by participating in informal financial activities such as “Mukando” in order to raise funds to meet their needs both at a personal level and for their enterprises.

While informal financial services offer women ease of access, transparency, and minimal costs, the following are some of the disadvantages:

- the range of financial products and services is limited;
- the amounts are sometimes too small to enable women to adequately meet their financial needs, both at a personal level and at enterprise level;
- the interest rate charges are very high (sometimes over 10% per month); and
- informal services can be risky, as in some cases members handle large sums of money.

Given the important role that women play in terms of asset accumulation, well-being at household level, community level, and enterprise level, no meaningful economic development can take place if the majority of the population is excluded from participating in the economic activities.

Analysis of the Problem

The main cause of these disproportionate barriers to women accessing finance largely hinge on the absence of a dedicated, well-co-ordinated, and implementable policy initiative which focus on women and their enterprises, with a view to improving their welfare.

Previous initiatives on women financial inclusion in Zimbabwe have been implemented in silos, instead of taking a holistic approach to building inclusive financial systems that are sensitive to women’s needs and requirements.

As a result, and in the absence of sufficient buy-in from the various stakeholders and well-coordinated steps to the implementation process, financial inclusion of women and their enterprises has largely remained unresolved.

Proposed Policy Solutions

Overall, this policy proposes that the primary means to address these issues is to include initiatives in the National Financial Inclusion Strategy that particularly focus on women. These include the following.

Women Entrepreneur Desks

While women-owned businesses occupy a significant place in the entrepreneurship space, their access to finance is insignificant due to gender-related barriers such as lack of adequate collateral and poor ownership of assets.

The Financial Inclusion Strategy recommends that banks should set up specific “desks” or units that are dedicated to addressing financial needs of women and their enterprises.

The objective of this approach is to facilitate a deeper understanding of the specific needs of women and their enterprises, and promote the development of tailored products and services that are sensitive to their needs.

Similar models have been used in other countries such as Bangladesh, which has managed to raise standards of living of women (Choudhury, 2014).

Agent Banking

One of the major barriers to financial access, especially in rural areas is distance to banks. The National Financial Inclusion Strategy recommends that banks prioritise branchless banking model, such as agent banking.

The Reserve Bank has approved agent banking in order to facilitate proximity of target groups to the providers of financial services and products. In addition, the Reserve Bank has developed Agent Banking Prudential Standards in order to guide the market on agent banking (Reserve Bank of Zimbabwe, 2016).

This model will address the problem of distance to the nearest access point, and will also assist banks with risk management because the agents are usually people in the same locality who know the life styles of the prospective bank clients.

Digital Finance

The Reserve Bank is encouraging the use of digital finance—that is, mobile phones, plastic cards and the Internet-based solutions to transact without having to visit a bank.

Financial services providers have taken advantage of the high mobile penetration rate of 98% as at December 31, 2015, and have partnered with mobile network operators to offer mobile financial services such as payments, remittances, micro-savings, micro-insurance, and micro-credit.

In Brazil, the use of plastic cards is widespread, where loans for inputs are loaded onto a card which is used for purchases from registered suppliers.

These efforts are expected to improve access to finance by women.

Group-based/Cluster Financing

Women enjoy gatherings such as churches and women's clubs, where they share experiences and assist each other on both the financial and social front. Banks can take advantage of this unique characteristic about women to offer group-based financial products and services.

Banks and microfinance institutions have been encouraged to adopt the group and cluster lending model where in some cases, small-holder women farmers, or women involved in various empowerment projects, are grouped together for lending purposes.

The advantage of this model is that there is reduced cost in terms of monitoring by financial service providers and improved loan performance from peer monitoring within the group.

Use of Collateral Substitutes

Providers of financial services and products have been encouraged to make use of collateral substitutes such as group guarantee, factoring, leasing, and invoice discounting in place of the conventional collateral, in order to make access to finance possible for women and their enterprises.

Further, the Reserve Bank is finalising the establishment of the Collateral Registry that will facilitate registration of moveable assets such as ploughs and sewing machines, for example, which can be used to secure borrowings by women and their businesses.

In this regard, the legislative framework governing the collateral registry has been drafted.

Financial Literacy and Consumer Protection

Banks need to have financial literacy and consumer protection programmes. There is need to ensure that customers understand the products, including the terms and conditions of the loans.

Implementation Recommendations

This policy memo will focus on two initiatives which are considered a priority in ensuring access to finance by women and their businesses. The memo will focus on increasing access to finance by women through a) Digital Financial Services and b) Group/Cluster Financing.

It is noted, however, that for each of the two policy initiatives above, a number of activities have to be performed in order to achieve the intended objectives. In addition, some of the policy initiatives highlighted above are complementary to the two areas of focus in this memo.

The overarching objective is to increase access to finance by women and their businesses from the current 8%–10% to 50% of total banking sector loans by 2020. This will raise the standard of living of the women through meaningful participation in economic activities.

A summary of the steps to be taken to implement mobile financial services and group lending are outlined in Table 1.

Table 1. Implementation Matrix: Digital Financial Services and Group Financing for Women

Issue	Activity	Target Date	Suggested Champion
1. Thematic working group on women	Set up a **thematic group** on women to steer the financial inclusion of women and their enterprises	May 31	Reserve Bank of Zimbabwe (RBZ)
	Stakeholders' meeting will include MNOs, banks, microfinance institutions, women's groups, and representatives and development partners		
2. Determine true extent of women financial exclusion	Collection of disaggregated data	August 30	RBZ, Women Affairs Ministry
3. Stakeholder consultation and awareness program	Financial education and literacy among women	Ongoing	RBZ, banks, microfinance institutions, other financial sector regulators, MNOs, and universities
	Memorandum of understanding which cover issues of information sharing and operating modalities	July 30	Key stakeholders
4. Development of tailored products/ implementation	Interoperability of MNOs infrastructure	31 Dec and ongoing	POTRAZ
	Development of products for women	Ongoing	Financial institutions and MNOs
	Set up women desks/units specifically dedicated to attending to women's needs	July 30 and ongoing	All financial services providers
	Development of group/cluster financing products for women	July 30/ongoing	All financial services providers

5. Determine appropriate incentives	Development of incentives earmarked at financial institutions that promote financial inclusion of women	Ongoing	Reserve Bank, Financial institutions, other financial sector regulators
6. Oversight activities	Oversight over digital financial services	Ongoing	Reserve Bank / POTRAZ
	Issue a Consumer Protection Guideline	July 31, 2016	RBZ, other financial sector regulators, consumer protection organizations
	Develop and issue a financial literacy framework	September 30, 2016	RBZ, other financial sector regulators
7. Financial infrastructure	Credit Reference System	Operational by September 30	RBZ
	Collateral Registry	Operational by December 31	RBZ
8. Monitoring and evaluation	Coordinate data collection and consolidation from financial institutions and other regulators	Quarterly	RBZ, financial institutions, other financial sector regulators
	Track and monitor progress regarding implementation of financial inclusion initiatives	Quarterly	RBZ
	Conduct a survey to determine level of financial inclusion of women and impact on welfare	December 31, 2018	RBZ, financial institutions, other financial sector regulators, development partners (Zimbabwe National Statistical Agency, 2012)

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Youth Financial Inclusion

Maha Bahou

Executive Manager of Payments Systems Department, Central Bank of Jordan

Summary

Youth in Jordan between the ages of 15 and 22 years of age face barriers to affordable and convenient access to financial services.

Context

Jordan's population is about 9.5 million according to the latest consensus conducted in November 2015. An estimated 70% of the population is under 30 years old. Although Jordan is the IT hub for the region, and considered overbanked in terms of the number of banks and bank branches, only 24.7% of adults are banked and less than 5% of adults under 22 years old have saving accounts at a formal financial institution (Chowa, 2015).

Many of poor youth found themselves obliged to enter the informal labor market at early age, due to their poor economic conditions or lacking educational opportunities. Thereby, they use the informal financial services.

Providing them with affordable, convenient, and inclusive financial services can equip them with the appropriate tools to become more productive and economically active members and to build their savings and assets for their future needs.

Problem

Youth in Jordan between the ages of 15 and 22 years old face barriers to formal financial services, depriving them from building their savings and assets for their future financial needs or from creating cushions against emergencies. A lack of financial services also prevents them from meeting micro business needs.

The root causes for this problem:

Legal restrictions. The law does not allow youth under 18 to open and manage their own saving accounts, nor does it allow them to have a mobile wallet. Youth under the age of 18 are minors and thus below the age of contractual capacity. Additionally, strict know-your-customer (KYC) requirements and the Anti-Money Laundering and Counter-Terrorism Financing Act of 2006 (AML/CTF) impose restrictions that college students or vulnerable youth cannot meet.

Negative stereotypes. Regulators are concerned about the risks, even if unfounded, on banks by youth. On the other hand, the government is concerned that youth interests and rights could be at risk by the banks and financial institutions.

This negative stereotyping of youth involvement in formal financial transactions stems from embedded cultural views toward youth, conventional views toward bank accounts, and legacy laws. Youth below the age of contractual capacity (18), are seen as unexperienced and not having the knowledge and skills to understand the articles of any contract, their rights and responsibilities, how to deal with financial products or make financial decisions, or even how to protect their pins or passwords, or control and operate their savings accounts. To protect them from being used and abused by the banks who might take advantage of non-informative youth, or treating them unfairly, and to protect banks from being exposed to financial risks posed by specific non-rational segments, youth as an entirety under 18 are prohibited from opening and operating their accounts.

Low financial capabilities for financial institutions to deal with the youth who might not be profitable for them, along with low financial capabilities of youth themselves to deal with banking and financial products.

Lack of appropriate channels and products for the youth. This problem is clear for youth in terms of:

1. high opening or minimum balance requirements,
2. fees for withdrawals and deposits, and
3. financial services located too far from their residences.

Youth save small amounts of money, and the sources of their savings vary. For in-school youth, they receive money from their parents, relatives, and occasional labor, while out-of-school youth receive money mostly in exchange of informal labor. The nature of these savings is characterized by irregular frequency of deposits and withdrawal, besides being made in small amounts.

Research conducted by UNCDF-YouthStart (WSBI, 2014)[1] revealed that youth do not save in formal financial institutions due to unclear and costly charges, and requirements to open accounts that are inappropriate for small and irregular income. Besides, they are often located far from them causing time and costs in addition to their inappropriate working hours. Schools, mobile vans, mobile phones, or agents might be more appropriate to reach youth.

Possible Solutions

- **Solution A:** Design regulatory frameworks and oversight mechanisms that are both youth-friendly and protective of youth rights. For example, a youth-friendly framework might minimize the legal age for opening saving accounts, maximize youth control over their savings, and apply principles consistent with the Principles of Child and Youth Finance (Friedline, 2014).[2]

Such a solution should be led by the Central Bank of Jordan (CBJ) in collaboration with banks, financial institutions, The Ministry of Justice, law firms, The Ministry of Youth, youth-focused nongovernmental organizations (NGOs), and youth financial inclusion advocates. Stakeholders will collaborate on:

- Minimizing the legal age to open and operate specific basic savings or transactional accounts from 15-year-olds instead of 18-year-olds (consistent with the UN definition of youth). By minimizing the age, we will overcome the minimum legal age barrier.
- Creating a comprehensive regulatory framework to ensure consumer financial protection that are consistent with the Principles of Child and Youth Finance, thereby, protecting youth from being manipulated by banks, or from their own ignorance.

As evidence that this solution has precedence, in 2010, Uruguay's parliament passed a legislation that modified the Articles of Incorporation of Banco de la Republica Oriental del Uruguay to allow minors (12-year-old girls and 14-year-old boys) to open savings accounts in their own name and with sole authority to transact. According to Global Findex, young adults with bank accounts in Uruguay (ages 15–24) raised from 12.4% in 2011 to 29.5% in 2014 (Demirgüç-Kunt et al., 2015; Friedline & Nam, 2012; Deshpande, 2011).

- **Solution B:** Designing tailored, sustainable youth savings products and channels.

According to Child and Youth Finance International, the national implementation plan, and based on the environment in Jordan, the main stakeholders should be the CBJ, banks, NGOs, schools, youth and research institutes, and the Ministry of Education.

To overcome the implications of developing and marketing appropriate financial products and channels, financial institutions should do the following:

- ensure that more disadvantaged children and youth without easy access to technology are also catered for by leveraging Internet and mobile technology to develop appealing products and lower consumer costs,
- screen products and offers for age and maturity appropriateness by developing products that meet youth's "faster maturing" needs, and
- ensure fair terms and pricing, and balance actual needs against wants and highlight diversity of purposes in terms of saving money (e.g., entertainment vs. education).

Getting this balance right is critical, and is the driver behind the Principles for Child and Youth-Friendly Banking Products (Child and Youth Finance International, 2014, p. 19).

The Uganda Finance Trust, Ltd., supported by the UNCDF-YouthStart initiative, introduced a range of innovations to advance its goal of providing youth with an opportunity to open and save in a commercial savings account. These innovations included designing products that were responsive to the needs youth, training youth staff to provide financial education to savers' groups, and establishing strong partnerships with parents, local leaders, and youth service providers, among others.

- **Solution C:** Youth-oriented financial literacy programs.

In 2015, CBJ started its national financial education program in collaboration with the banks, The Ministry of Education, The Ministry of Planning, and youth NGOs.

Through NGOs like Aflatoun, 1 million children in more than 96 countries have received financial literacy training. In 2012, 65,000 youth in eight countries in Sub-Saharan Africa received financial literacy training through UNCDF-YouthStart. However, these kinds of initiatives, to achieve greater outreach and impact, should be supported by youth focused financial literacy national strategies.

The OECD/INFE Measurement Survey[3] was conducted on 14 countries and showed that people who were aware of at least five financial products had higher levels of financial literacy than those who were less aware.

Youth-Friendly Banking Product Characteristics:

1. Availability and accessibility for youth
2. Maximum control to youth
3. Positive financial incentive for youth
4. Reaching unbanked youth
5. Utilizing youth-friendly communications strategies
6. A financial education component
7. Monitoring youth satisfaction
8. Internal controls

Research shows an association between financial literacy and financial inclusion. A lack of awareness in relation to the different types of financial products and whether or not they meet particular requirements, and trust in formal financial products, create barriers to access. Poor knowledge of how products work and their likely costs also reduce the likelihood of inclusion.

Evidence on the impact of financial literacy programs in developing and emerging markets is more limited, but promising new evidence is emerging as few financial literacy programs exist there (World Bank, 2009).

- Two massive savings campaigns in Uganda included radio, posters, token gifts, and community events, coupled with outreach by more than a dozen local savings institutions. In a three-year period, 300,000 new bank accounts were established.[4]

Recommendation

To achieve the policy objective—to provide youth with affordable access to finance; to increase their savings and asset accumulation; and to finance their future emergencies, educational, consumption, and micro business needs—I am presenting my recommendations based on the three suggested policy solutions, along with the implementation options for each solution. The top priority for the CBJ is to start by changing the laws and developing youth-friendly regulatory framework.

Youth-Friendly Regulatory Framework and Oversight Mechanism

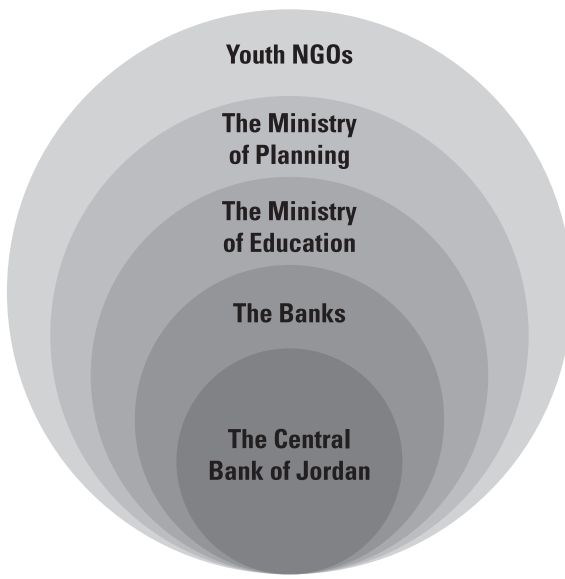
1. Ensure full stakeholder engagement and commitment with clear roles and responsibilities (Central Bank of Jordan in collaboration with banks, financial institutions, The Ministry of Justice, law firms, The Ministry of Youth, youth-focused NGOs, and youth financial inclusion advocates).
2. Assess the existing situation and possible hurdles within the national policy priorities, existing legal infrastructures, and procedural mechanisms for regulatory change.

   Regulation can support by intervening along the three pillars of financial inclusion: financial literacy, financial access, and consumer protection.

3. Create an implementation plan that includes:
   a. lowering the minimum age to open and manage a bank account,
   b. lowering the procedural requirements to open a bank account (i.e., KYC requirements), and
   c. setting industry standards as a prerequisite for banks intending to offer youth-friendly financial products and delivery channels.

Tailored Designed Youth Savings Products and Channels

1. Ensure collaborative interventions by a range of stakeholders (the Central Bank of Jordan, banks, NGOs, schools, youth and research institutes, and the Ministry of Education).
2. Conduct market research to identify the socio-economic characteristics, needs, and preferences of youth.
3. Product development and improvement in compliance with youth principles.
4. Conduct risk-reward analysis on the youth products and channels then consider building incentive scheme for the banks and financial institutions to provide such innovative, cost-effective products and delivery channels for youth.
5. Seek support from donors and international organization to enhance the financial capabilities of the financial institutions in Jordan.



Youth-Oriented Financial Literacy Programs

Enhancing the financial literacy and education program in Jordan to include youth oriented programs, and develop school-based channels.

The implementation of the national financial education plan started in 2015 with full collaboration and commitment from the banks, The Ministry of Education, The Ministry of Planning, and youth NGOs.

Continuous review and improvement is needed in the coming years, to comply with the Youth Principles, the new products, and channels.

Notes

1. Qualitative market research was conducted with 18 financial service professionals (FSPs) across nine countries that participated in Phase I of UNCDF-YouthStart. The sources of information included 6,000 youth between the ages of 12 and 24, parents, staff of youth serving organizations (YSOs), and FSPs. For additional information see Hopkins & Perdomo (2011).
2. The Client Protection Principles for Youth are the following: avoiding over-indebtedness, transparent pricing, responsible pricing, appropriate collection practices, ethical staff behavior, complaints handling and resolution, privacy of client data, and Child and Youth Finance International (CYFI) certification criteria. See online at http://www.uncdf.org/YouthStart/
3. The OECD/INFE financial literacy measurement survey is the only internationally comparable survey combining measures of financial literacy and financial inclusion of individuals. It collects information about product awareness, use, and choice using a list of product types that is provided at the national level, and includes selected questions to develop a measure of financial literacy, enabling analysis of the correlation between financial literacy and financial inclusion. Socio-demographic data is also collected (including age, gender, education, income, work status, marital status, and household size).
4. No research has been done to understand whether and how those accounts have been used over time. See also online at http://www.microfinancegateway.org/resource_centers/savings/practitioners/workingbothends

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Finding Sustainable Financial Tools for Climate-Vulnerable Filipino Households

Rochelle Tomas

Bank Officer, Bangko Sentral ng Pilipinas

Background

The Philippines is hit by an average of 20 typhoons a year, and recently suffered catastrophic impact by one of the strongest ever to make landfall (Typhoon Haiyan).[1] The country ranks as the third most vulnerable to climate-related disasters in the world (World Bank, 2013). For the past 20 years, 130 million people have been affected by over 300 disasters, and loss per unit GDP has been estimated at 0.74% (United Nations, 2016; Kreft, Eckstein, Junghans, Kerestan, & Hagen, 2014). Climate-related disasters pose a clear threat to the Philippines' economic development and human capital, undermining the government's long term objective of inclusive and sustainable growth.[2]

The Bangko Sentral ng Pilipinas (BSP) supports the government's inclusive growth objective through a regulatory environment that enables and promotes financial inclusion, which allows effective access to a wide range of financial services to all Filipinos, including the climate-vulnerable. The Philippine National Strategy for Financial Inclusion (2015), crafted by the BSP with key government agencies, also targets climate-vulnerable locations as priority areas where innovative financial services may be introduced. This is tacit recognition that financial services can help households better manage and recover from climate-related shocks.

The Problem and Its Root Causes

Vulnerable poor households, especially those directly affected by natural disasters, are unable to cope with climate-related shocks, resulting in their dependence upon government aid, including residing long in government shelters, without resources to cover basic needs.[3] Households' inability to cope has many causes (World Bank, 2014):

1. Limited infrastructure like electricity, farm to market roads, and communication reduce the efficiency of markets[4] and delivery of services[5] (including financial services), and pose a general constraint to quick recovery of affected households.
2. Lack of secure, formal jobs that provide regular income, and inadequate coverage of mandatory social protection and health insurance constrain poor households' ability to cope post-disaster.[6]
3. Disruptions in economic activity and income as a result of a disaster bring further hardship to poor households with an already very limited savings capacity even prior to a disaster.
4. Impaired or total lack of access to credit and absence of credentials to avail of credit also limit households' capacity to quickly rebuild livelihoods swept away by a disaster.
5. Lack of mechanisms for disaster insurance and social safety nets that strengthen community resilience against climate-related shocks further constrain households' coping abilities.

These causes are complex and require multi-dimensional solutions from institutions other than the BSP. However, the lack of financial services that meet coping needs of vulnerable households is an area where BSP policy action may have an impact. Hence this section focuses on why savings, credit and insurance—tools that can help smooth consumption, rebuild homes and renew livelihood activities—are not designed and targeted for disaster-affected households. This arises from financial institutions' general risk aversion to serve this market. A rapid assessment in two Typhoon Haiyan-affected provinces[7] found that credit needs were not addressed due to the dearth of suitable products (e.g., emergency loans with flexible terms), the perceived high risk of client default given the absence of information on prospective clients' creditworthiness, or savings history with financial institutions (World Bank, 2014).

This risk aversion is reinforced by financial institutions' lack of capacity to assess the financial risks of providing such services, adjust their credit decision-making to account for these risks, and develop viable products targeted for climate-vulnerable households. Technical capacities are necessary to enable financial institutions to factor climate-related risks into their pricing structures and provisioning for probable losses, and to develop disaster-resilient business models and delivery mechanisms. Their capacity to do so profitably and efficiently is limited by inadequate information, methodological challenges and costs of acquiring expertise or advisory services[8] in measuring financial risks of climate-related disasters (Thistlethwaite, 2015). While Philippine financial institutions believe that integrating environmental considerations in investment decisions can enhance their institutional reputation as good corporate citizens, they are unsure of its financial profitability (International Finance Corporation, 2015), thus dampening their appetite to serve climate-vulnerable households. Financial institutions around the world likewise claim that "green" investments with appealing risk-return profiles are limited, hence their preference to allocate capital to "brown" investments (Frankfurt School of Finance and Management and UN Environment Program, 2014).

On the part of the BSP, "green financial regulation" or the use of regulatory policies and tools that encourage financial institutions to serve climate-vulnerable households and influence redirection of capital flows toward green credit or investments (Frankfurt School and UNEP, 2014), is an uncharted territory. The BSP would need the right information and capacity to determine its role in this area, and create a policy environment that enhances access of risk-prone households to financial tools that support their resiliency to climate-related shocks.

Suggested Approach to Finding Solutions

In view of the complexity of climate finance, and the BSP's capacity, mandate and existing evidence, the proposed policy direction is to take an adaptive approach.[9] Such an approach would require BSP advocacy, and possibly its leadership, in working with targeted public and private sector institutions to share information, define stakeholder roles, find the right mix of policies (financial and non-financial) and determine other actions necessary to help households adapt, mitigate and recover from climate-related shocks. This approach ensures that any BSP initiative, while focused on the financial sector, does not exist in a vacuum. Given the multi-dimensional nature of the problem, any BSP action—aimed to establish a policy environment that enables viable and sustainable provision of financial services to climate-risk-prone households by well-equipped financial institutions—needs to be appropriately risk-based and supported by initiatives of other stakeholders.

Proposed Actions to Implement the Suggested Approach

The proposed actions are grouped into three buckets, following the acronym A-C-T. Taken together, these actions are intended to ultimately address the inability of households to cope with climate-related shocks due to their lack of access to suitable financial services.

1. **A**cquire (a) evidence showing the commercial viability of financial service provision to climate-vulnerable households, and (b) knowledge on public policies (including financial sector regulations) that provide an enabling environment for the provision of such services.

   a. The BSP can continue engaging development partners[10] to undertake case studies on product designs suitable for climate-vulnerable households; business models that incentivize market-based provision of these products; success stories of financial institutions operating in this niche market; and the regulatory conditions that contributed to their success. Studies can also focus on households' informal risk-coping mechanisms in response to natural disasters, and financial modeling tools[11] for determining risks/returns of targeting climate-vulnerable clients. Through BSP advocacy, results of these studies can be disseminated to financial institutions to inform the development of customer-centric products, encourage market innovation, and inspire public-private sector partnerships in the area of climate finance for risk-prone households.

b. The BSP can continue to participate in peer learning networks[12] to benefit from international experience and expertise on climate finance and "green financial regulation." These engagements contribute to building the BSP's knowledge and capacity to implement potential regulatory interventions that expand financial service provision in risk-prone areas. They also provide gateways to future capacity-building opportunities, should the BSP decide to pursue green financial regulation.

c. The BSP can continue supporting working groups that expand the development the domestic microinsurance industry, in view of the importance of microinsurance, in household risk protection;[13] and keep abreast of international standard setters' ongoing work on how the financial sector can take into account climate-related issues.[14]

2. **C**onsult and collaborate with relevant stakeholders to (a) determine how the financial sector can contribute to climate resiliency objectives in the context of the Philippines' National Strategy for Financial Inclusion and National Climate Change Action Plan (2011);[15] and (b) find opportunities for viable public-private partnerships that can address observed gaps in resource mobilization and development of market-based instruments for climate finance.

a. The BSP may undertake exploratory discussions with the Climate Change Commission and related government agencies.[16] Discussions may initially focus on deeper understanding of the work of the Commission and its envisioned role for private financial institutions (and the BSP as their regulator) in promoting financial inclusion of climate-vulnerable households and in implementing the climate finance strategies of the Action Plan.

b. The BSP may also facilitate linkages among the Commission, key government agencies, financial institutions with experience in serving disaster-prone areas, and non-financial institutions supporting climate finance innovations.[17] The initial objective may be knowledge sharing, and can progress to brainstorming designs of promising financial services for climate-vulnerable households; sustainable risk transfer mechanisms (e.g., credit guarantee or disaster insurance schemes) that may be undertaken through public-private partnerships; or viable investment instruments for financial institutions to support government's climate risk reduction programs. This multi-stakeholder brainstorming may generate ideas on potential solutions that can directly or indirectly enhance households' capacity to manage climate-related shocks.

3. **T**est financial products, tools and other policy/program solutions that enhance climate-vulnerable households' financial access and risk-coping abilities.

Solutions arising from the above brainstorming may be pilot-tested and refined based on impact evaluation results. The BSP, through the "test-and-learn" or "regulatory sandbox" approach (UK Financial Conduct Authority, 2016), can allow financial institutions and their potential counterparties (e.g., humanitarian organizations, aid agencies, government instrumentalities, digital platform providers) to roll-out solutions under its watch, assess risks and determine if "green financial regulations" are indeed necessary to enable market adoption without compromising financial stability, integrity and consumer protection. As a showcase of commitment to climate risk reduction, the BSP may also consider institutionalizing internal programs that promote environmentally-sustainable and carbon-reducing practices as part of good corporate citizenship.

Notes

1. Locally known as Typhoon Yolanda, which hit the region of Eastern Visayas in 2013. It affected 14 provinces with 16 million people; took more than 6,000 lives with thousands still missing; and damaged property/livelihood equivalent to 0.9% of GDP (World Bank, 2015).
2. To illustrate, the poverty incidence in Eastern Visayas before the typhoon was 37% (2012) but deteriorated to 55% (2014) after the typhoon. This region is now the poorest in the country (Philippine Department of Budget and Management, 2015).
3. For example in 2015, a week after Typhoon Noona, 80,000 people (16,000 mostly poor families) spent their Christmas in 300 evacuation centers in northern Philippines. Many families remained in the centers even after New Year's Eve (Favila, 2015).
4. For example, markets for agricultural crops, consumer goods, and low-cost housing materials.
5. For example, social services such as relief provision, health, and education.
6. For example, of the 6 million workers affected by Typhoon Haiyan, 2.6 million were vulnerable workers.
7. Rapid assessments conducted in Cebu and Iloilo, Philippines.
8. Weather is hard to predict, environmental impact accounting and related technical services are expensive, and information on climate risk disclosures has limited usefulness for financial institutions' investment decision-making.
9. An adaptive approach requires working together with stakeholders to understand a problem and find solutions together. Another approach can be technical, or getting stakeholders to execute an already identified solution. Source: Fletcher Leadership Program for Financial Inclusion session on "Leading Change" delivered by Dr. Alnoor Ibrahim on May 9, 2016.
10. For example, the International Finance Corporation, in view of its interest to provide technical assistance in this area.
11. For example, a Return on Investment (ROI) Model applied on projected demand for humanitarian aid during natural disasters in the Philippines found that: For every dollar invested in expanding digital financial services infrastructure in disaster-affected areas, Issuing Banks get US$1.14 back. Meanwhile, Acquiring Banks get US$0.72 back, but this ROI is improved when humanitarian organizations help reduce the cost of merchant acquisition and the Philippines' POS network becomes robust (UK International Rescue Committee, 2016).
12. For example, the Sustainable Banking Network (SBN) and Alliance for Financial Inclusion (AFI) Peer Learning on Green Financial Inclusion.
13. Citizens in areas hit by Typhoon Haiyan attest that microinsurance was instrumental for their quick recovery. A total of US$12 million covering 111,000 microinsurance claims were released to clients in these areas (Department of Finance-National Credit Council, 2015; Microinsurance Network, 2014).
14. For example, Financial Stability Board's Working Group on Climate Risk Disclosures and the G20 Green Finance Study Group.
15. This plan specifies these strategies for climate finance: introduction of regulations and programs that support climate resilient investments and financial instruments; strengthen institutions and policies to mobilize carbon finance; prepare for carbon markets or implement carbon finance market transactions; economic analysis of financial needs for adapting to climate change and cost adaptation; expansion of insurance eligibility to populations vulnerable to climate related diseases.
16. For example, the Department of Environment and Natural Resources and Department of Energy, in view of government commitments during the 21st Convention of Parties to the United Nations Convention Framework on Climate Change in 2015.
17. For example, commercial banks already practicing sustainable finance with donor assistance; banks with microfinance operations serving vulnerable sectors; e-money issuers and technology providers facilitating cash transfers in disaster areas; the Insurance Commission and insurance industry; humanitarian organizations (e.g., UN Office for the Coordination of Humanitarian Affairs, Oxfam Philippines); and environment advocates (e.g., World Wildlife Fund).

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Post-Conflict Access to Credit: Policy Recommendation for Colombia

Samir Kiuhan

Deputy Director, Financial, Superintendency of Colombia

Context

Colombia has experienced the longest-running armed conflict in the Western Hemisphere. In more than 50 years, the internal conflict has been shifting between political crimes and drug trafficking—due to the lack of economic opportunities— affecting mainly vulnerable populations located in rural areas (ICTJ, 2009). Since 1985 alone, the number of internally displaced persons (IDP) has reached 5.7 million, with an estimated 200,000 forcibly displaced per year due to the conflict (Human Rights Watch, 2015). Since 2012, the National Government of Colombia has undertaken peace talks with the main guerrilla force, FARC, in a process described as the best chance in over a decade to put an end to hostilities (Amnesty International, 2014).

Problem

One of the main challenges that post-conflict countries face is restoring economic and social conditions in order to avoid recurrence of violence (Collier et al., 2003). In a dire economic context, where GDP has declined from 7.52% in 2012 to 3.1% in 2015 (DANE, 2016), more than just fiscal efforts and international financial cooperation will be needed to fund the post-conflict social and economic development projects required to keep ex combatants complying with the rule of law and to support IDP.

In this context, private financial intermediation plays a fundamental role, not only at easing employment creation and consumption smoothing (Nagarajan, 1997), but in social mobilization, empowerment, reconciliation, peacebuilding and solidarity (Marino, 2005). Particularly, improving access to credit is crucial to reduce poverty and inequality, allowing rural populations and small agricultural producers to contract long-term investments, risk taking, and generating stable income streams (Gutiérrez & Reddy, 2015).

However, in order to use credit as a tool for sustainable peace, it is necessary to reach conflict-involved households, previously underserved due to their rural nature. In Colombia, borrowing in rural areas continues to be limited despite a reasonably sophisticated financial system. As of December 2015, 98.5% of the commercial credit portfolio balance, 95.8% of consumer credit, and 97.2% of housing-related loans were provided to urban area, excluding 48% of the country's total population to these products. Just microcredit loans are prevalent in rural areas with a 16.7% of the total disbursements.

Among several reasons, a restricted range of assets used as collateral, narrow physical presence of private financial institutions and limited creditworthiness explains low access to financial services in rural areas in Colombia. In addition to the idiosyncratic issues hindering the provision of financial services to the rural population, financial institutions would have other concerns about lending to ex-combats restricting their supply to this population. It is reasonable to expect that former guerrilla members are linked to drug dealing activities, a fact that blacklists them and hinders banks and other institutions to engage any transactions due to current regulations restricting anti-money laundering/combating the financing of terrorism activities.

Another additional constraint for ex combatants and IDP to get access to credit is their current negative information in credit bureaus. Some of these individuals had ongoing obligations with the banking sector before or during the conflict and had to default on their debt due to their involvement.

This type of past due loans is classified by banks as non-performing (NPL) with effects on the balance sheet. Colombian banks must make provisions for the 100% of the NPL, following international standards (Subrahmanyam, 2003). Hence, NPL loans from conflict-related population reduce the banks' capacity to provide more credit, making this an issue that should be tackled.

Therefore, assuming the peace accord materializes, Colombia has to work on the appropriate incentives for financial instruments, especially credit, keeping in mind that this might guarantee a long lasting peace.

Possible Solutions

For the reasons described, financial institutions are restricted to deliver financial services to ex-combats and IDP mainly because i) information asymmetries due to a lack of credit history hampers the normal operation of their risk assessments models, ii) know your customer (KYC) regulatory requirements, and iii) delinquent or defaulted loans that must be provisioned completely.

Since it is required to catalyze the provision of credit for combatants and victims, this proposal focuses on three potential solutions that could achieve this goal by aligning incentives, without jeopardizing financial stability or consumer protection.

Solution A. Develop an Analytical Framework for Individuals with No Credit History

A large majority of the conflict-involved population do not have prior exposure to the formal financial sector, and hence no credit history. There have been efforts to develop electronics accounts for digital payments focused on the base of the pyramid and then use transactional data as an alternative credit history for many potential borrowers. However, creating alternative credit history is a long-run effort currently in early stages, thus it is mandatory to execute a short-run solution.

Therefore, in order to address this shortage, a comprehensive analytical framework that would close the gap between credit access and risk management must be implemented as used in other jurisdictions (Abrahams, 2010). Currently, local banking regulation allows banks to elaborate mechanisms to offset potential debtors' information asymmetries. Yet, not many banks have taken this approach due to risk aversion and the lack technical capacity to address this complex issue. Consequently, the supervisor (SFC), other public agencies and the industry should develop this framework jointly. Besides working on the methodological framework, this task force ought work on those alternative sources of information that have proved useful to model payment behavior such as mobile prepaid information, psychometric testing, social data or payment/e-commerce transactions (McEvoy, 2014).

Addressing the aforementioned shortcomings in the current underwriting process will make the lending process to individuals with no credit history a sustainable and profitable business.

Solution B. Adjust Requirements for Conflict-Affected Populations

The second solution will focus on the KYC requirements. Currently the Colombian financial sector complies with all international standards regarding money laundering and counter-terrorist financing. However, a review of the current guidelines must be implemented in order to analyze how relevant they are for this population. The challenge is to find a balance between achieving best practices on the matter, and allowing lower-rank combatants to pass AML/CFT checks in order to access savings and credit services. This topic could be included in the periodic reviews the SFC does in order to comply with the Financial Action Task Force standards.

Solution C. Reclassify Credit Risk Loans

Credit risk categorization is the bank management tool to assess the solvency and the riskiness of banks' credit risk exposures (Basel Committee on Banking Supervision, 2016). Since the debt default of conflict-related population is presumed to constitute a *force majeure*, it would be reasonable to evaluate the possibility of allowing banks to reclassify these bad risks.

This relief only will be offered to previously identified conflict-related individuals, particularly to loans received before the peace accord, in order to avoid exacerbation of moral hazard. Banks will have a positive effect on their balance sheets since these currently delinquent loans, when reclassified, will not need to be provisioned as a NPL. To implement this solution, an External Circular (rule of practice) from the SFC is needed, which requires creating a working group with the industry to perform the usual regulatory process.

This solution will focus on loan reclassification since the modifications of the negative information found in credit bureaus regarding conflict-related individuals requires a law modification. This procedure is cumbersome and will need the approval of different stakeholders to support this legislative initiative.

Recommendations

While all of these solutions will potentially address the lack of access to credit for conflict-related individuals, this policy will primarily focus on Solution A. Banks and other financial institutions identify absence of credit history as the most important barrier to provide microcredit besides the ability to pay and household over-indebtedness (Gómez, 2014). Hence, developing a framework for individuals with no credit history is the solution with highest potential to help this underserved and vulnerable population.

These solutions would not completely solve the root causes of the Colombian conflict, but will definitely help provide sustainable alternatives for former combatants to remain out of criminal behavior. Peace building is not an isolated issue that some people in Havana must solve. We are all part of the solution.

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