An Analysis of Financial Inclusion in Sri Lanka: Progress and Challenges

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ABSTRACT

This study evaluates the current state of financial inclusion in Sri Lanka, analysing progress, and challenges, in expanding access to and usage of formal financial services. Focusing on key indicators like account ownership, savings behaviour, investment patterns, and digital financial service adoption, the research reveals an inequality between access and usage. While a high percentage of Sri Lankans have bank accounts, informal savings methods remain prevalent, indicating a potential lack of trust in or understanding of formal financial institutions. Notwithstanding high mobile phone penetration, the adoption of digital financial services, particularly mobile money is low, especially among women, highlighting a significant gender gap. The study concludes that Sri Lanka needs to shift its focus from simply providing access to actively promoting usage of formal financial products, bridging the digital gender divide, fostering financial literacy, and building trust in the formal financial system to achieve true financial inclusion and contribute to sustainable economic development.

Key Word: Financial Inclusion, Sri Lanka, Account Ownership, Digital Money

INTRODUCTION

The concept of financial inclusion has emerged as a central concern for economies all over the world. The objective of this concept is to guarantee that individuals and businesses, irrespective of their socioeconomic standing, have access to financial products and services that are both useful and inexpensive. With its diversified demographic and economic geography, Sri Lanka offers a one-of-a-kind case study for analysing the progress that has been made and the hurdles that still need to be overcome in order to achieve broad financial inclusion. This study investigates the progress that Sri Lanka has achieved in providing financial services to populations that have not been adequately served, as well as the tactics that have been used by the government and financial institutions, and the challenges that continue to impede the country's progress toward full financial inclusion. When we have a greater knowledge of these processes, we are better able to appreciate the multifaceted efforts that are required to encourage economic growth and stability while also bridging the financial divide. The process of expanding the number of individuals covered by the official financial sector or sectors is known as financial inclusion (FI) B.M Sajjad Hossain et al., (2023. In the same way that many other developing countries do, Sri Lanka acknowledges the significant role that financial inclusion plays in supporting social development, alleviating poverty, and driving economic growth. All segments of society, particularly those that are underprivileged and underserved, are guaranteed to have access to formal financial services and to be able to make good use of them through the implementation of financial inclusion. These services include a wide variety of products and services, such as savings accounts, credit facilities, insurance, and payment systems.

LANDSCAPE OF FINANCIAL SERVICES IN SRI LANKA

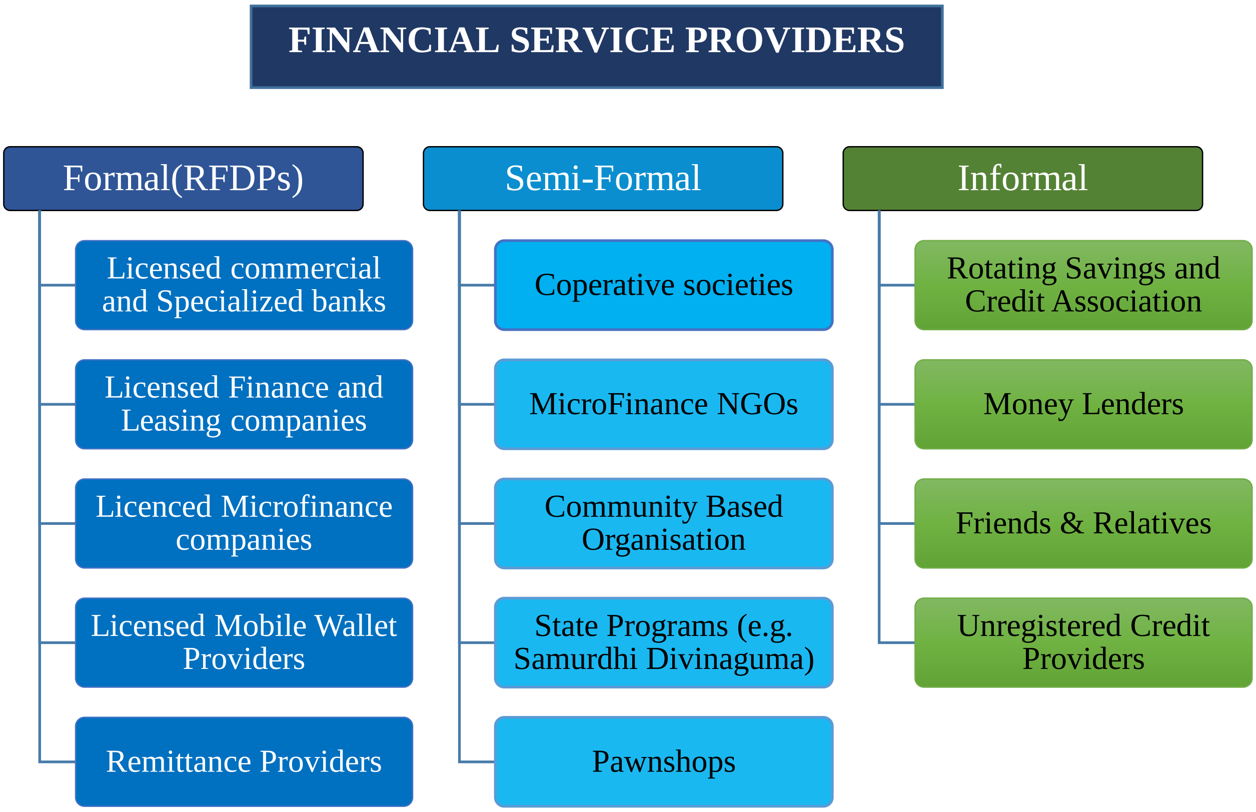

Figure 01: Financial Service Providers in Sri Lanka

Source: Central Bank of Sri Lank

REGULATED FINANCIAL SERVICE PROVIDERS IN SRI LANKA

There are different types of financial service providers (FSPs) in Sri Lanka classified as formal, semi-formal, and informal sectors. This is a two-decade-long effort to build these institutions and it has increased the financial inclusion in Sri Lanka. The financial service providers play a huge role in extending the network of physical bank branches. In 2021, Sri Lanka has a high level of banking coverage; there are 17.2 banks per 100,000 adults. The density of the penetration is very high compared to the South Asia regional coverage, such as India, which has 14.3 banks per 100,000 adults; Bangladesh has 8.8 banks per 100,000 adults, and Pakistan has 10.8 banks per 100,000 adults in the density coverages. Even developed countries like Malaysia and Thailand don't have such coverage density; i.e., Malaysia has 10.2 banks per 100,000 adults, and Thailand has 11.7 banks per 100,000 adults. **(International Monetary Fund, 2021)**

LITERATURE REVIEW

According to Chakrabarty (2011), the literature provides a number of different definitions of financial inclusion. These definitions broadly embrace the concept of being able to access and make use of formal financial services by all segments of society, including those who are excluded and underserved. In order to measure financial inclusion, it is necessary to evaluate a number of different aspects, such as access (such as the number of bank branches, automated teller machines, and agent banking outlets), usage (such as account ownership, loan penetration, and insurance coverage), and quality (such as affordability, suitability, and consumer protection) Demirguc-Kunt et al., (2018). For the purpose of monitoring the progression of financial inclusion, studies frequently make use of composite indices or particular indicators Sarma, (2008). Development of the Financial Sector According to Beck et al. (2009), growing access to financial services requires a financial sector that is well-developed and diversified, as well as one that has a stable regulatory framework and a sound infrastructure. For example, Armendáriz and Morduch (2005) have brought attention to the role that microfinance organizations and other non-bank financial institutions play in reaching out to groups that are not being adequately served. Developments in Science and Technology: According to Mas and Radcliffe (2011), the proliferation of digital finance, which includes mobile banking, internet banking, and agent banking, has transformed the delivery of financial services by reducing costs and expanding reach, particularly in locations that are geographically difficult to access. Research has been conducted to investigate the influence that mobile money has on the level of financial inclusion in developing nations (Porteous, 2006). The Policies and Initiatives of the Government and (Chibba, 2009) one of the most important factors in the process of boosting financial inclusion is the implementation of supportive government policies. These policies include financial literacy initiatives, financial inclusion targets, and regulatory reforms. Different situations have been examined in order to gain a better understanding of national financial inclusion strategies and how they are implemented. According to Chakrabarty (2011), factors such as income levels, education levels, gender representation, and geographical location all have a role in determining access to and utilization of financial services. Research has been conducted to investigate the specific obstacles that various demographic groups have while attempting to gain access to financial resources. The lack of novel financial products that are customized to the requirements of the underserved can be a barrier to financial inclusion, according to Beck et al. (2009). Other supply-side constraints include limited financial infrastructure, high transaction costs, and a lack of innovative financial products. According to Atkinson and Messy (2011), the demand for financial services can be limited by factors such as low levels of financial literacy, a lack of awareness about financial products and services, cultural obstacles, and distrust in official financial institutions. Research that has already been conducted on the topic of financial inclusion in Sri Lanka has investigated a variety of areas, such as the role that microfinance plays, the adoption of digital financial services, and the impact that government programs have. However, there is a need for more thorough research that examine the overall situation of financial inclusion in Sri Lanka Regarding the regulatory environment, there is a requirement for improved regulations and policies in order to give support to the initiatives of financial inclusion. Sha et al, 2022.Disparities in Access to Financial Services Rural and rural communities continue to experience difficulties in gaining access to financial services. Tilakaratna, G. (2016).

OBJECTIVE OF THE STUDY

The objective of the study is to evaluate present status of financial inclusion in Sri Lanka and to give a complete review of the progress that has been made by the country in terms of enhancing the access to and usage of financial services. It examines the basic elements that have either helped or impeded the progress of financial inclusion in Sri Lanka and providing an analysis of the aspects.

ANALYSIS OF FINANCIAL INCLUSION IN SRI LANKA

01. OWNERSHIP OF ACCOUNTS

Account ownership is considered a fundamental indicator of financial inclusion, serving as a gateway to the official financial system. People can save money, get paid, send and receive remittances, and pay their expenses more easily thanks to it. An account promotes saving since it offers a safer way to keep money. In this research, a formal account is defined as a savings or current account with a formal financial institution. The percentage of Sri Lankans with an account at a Licensed Bank (LB) is much higher at 90%. Just about 9% of Sri Lankans own an account with a Registered Finance Company (RFC), 20% with a Government Community Bank (GCB), and 10% with a microfinance company.

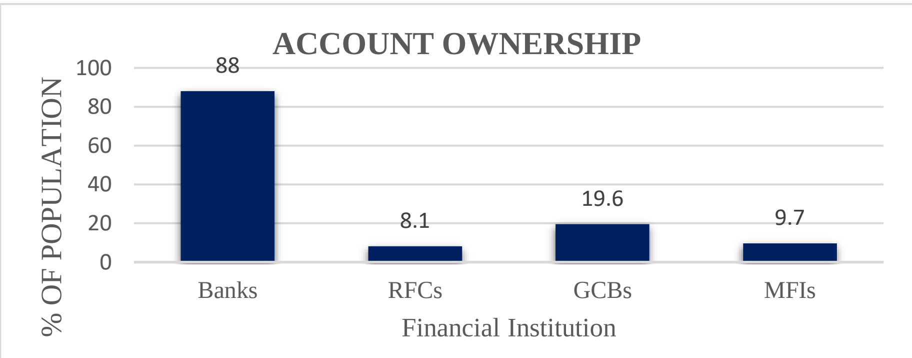

Figure 02: Account Ownership

Source: Central Bank of Sri Lanka

02. SAVINGS

"Pawning Center" is the most significant source of savings, accounting for a staggering 25.4% of the total. This suggests that a sizable portion of money is used to purchase pawned goods. Popular Formal Banking: Banks are the second most popular option, accounting for 20.9% of savings. This implies a strong reliance on traditional financial institutions. Informal saves Methods: "Family or Friends on" (7%), together with "Money Lender" (8.4%), contribute significantly to saves. This illustrates the continuous reliance on informal lending and saving practices. Decreased Utilization: The percentages of savings from sources such as "RFCS," "GCBS," "Cooperative/SHGS," "MFI," and "Employer" are comparatively low. This suggests that these sources are not as commonly used for cost-cutting as the others.

Figure 03: Savings

Source: CBSL, Sri Lanka

03. INVESTMENT AND INSURANCE

Compared to other financial products and services, there is a lack of information regarding the basic investment options that are accessible? Nonetheless, about 21% of Sri Lankan individuals said they had insurance, with 86% of them having life insurance. Eighty-eight percent of women have life insurance, and twenty-two percent have health insurance, but males are somewhat more likely to have insurance than women (23 percent vs. 20 percent). By contrast, 18% of males have health insurance, and 83% have life insurance.

Dominant Insurance Usage: The most noteworthy conclusion is the much greater insurance usage, which accounts for 12.2% of the total. This suggests that insurance goods are the most popular alternative among those listed. Moderate Use of Private Pension Funds: Retirement savings plans are deemed to be moderately satisfactory based on the 4.2% usage of private pension funds. Low use of additional investment products Utilization rates for Treasury bonds, investment funds, and mutual funds are comparatively low at 0.4% and 0.6%, respectively. This implies that fewer individuals are utilizing these investment choices.

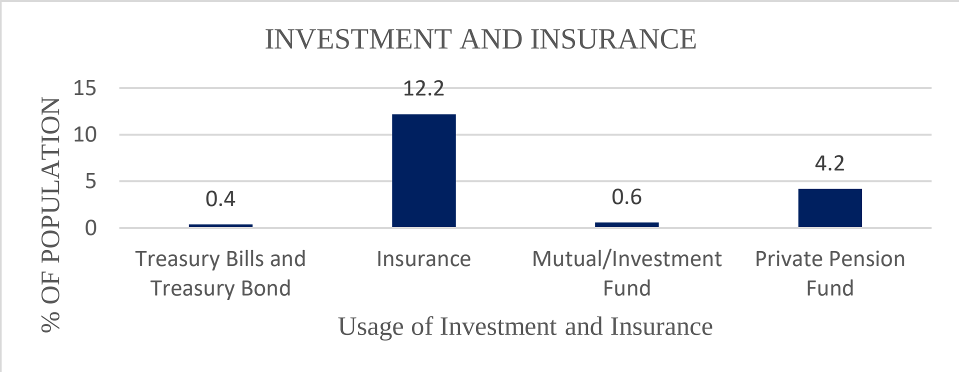

Figure 04: Investment and Insurance

Source: Central Bank of Sri Lanka

04. DIGITAL FINANCE The CBSL implemented proactive policy measures for digital finance. This entails creating a legislative and regulatory environment that supports e-money and digital payments, allowing non-bank players like mobile network operators (MNOs) to enter the market, and promoting system interoperability. The results of the poll show that there is a considerable chance to boost electronic retail payments even while a solid basis is in place. Payment card ownership and usage are still minimal, and cash is still the most popular method of payment. Increased Use of Debit/ATM Cards: The most noteworthy finding is that, when it comes to making payments at retail establishments, debit/ATM cards are utilized more often (14.8%) than credit cards (9.7%). Quantitative Comparison: It is simple to observe the extent of the usage disparity between the two approaches thanks to the table's precise percentages.

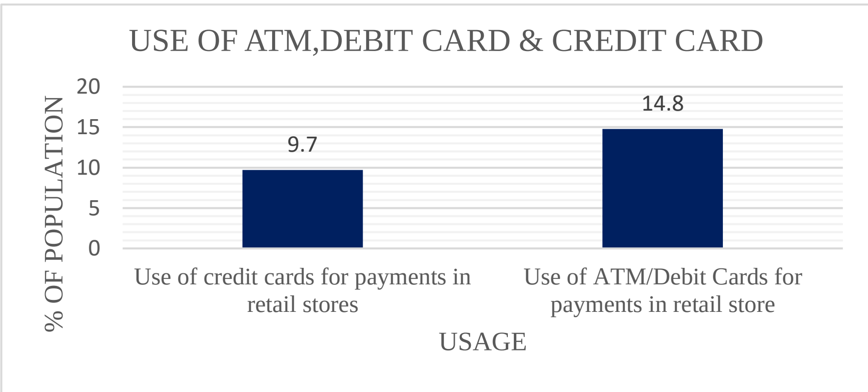

Figure 05: Use of ATM, Debit Card & Credit Card

Source: Central Bank of Sri Lanka

05. USAGE OF MOBILE MONEY ACCOUNTS

According to the poll, 82% of participants had a cell phone, indicating a high level of mobile penetration. This is another instance of a gender discrepancy, with 86 percent of males and 79 percent of women owning a cell phone. When compared to smartphones, feature phones continue to be the most preferred option (61%). Just 1.2 percent of women use mobile money, compared to 4.9 percent of males, further highlighting the gender divide in digital technology. Only 2% of adults in Sri Lanka actually own a mobile money account, which is significantly less than the regional average of 4% in South Asia, despite the fact that over 80% of Sri Lankans own mobile phones and 90% of mobile phone customers have access to mobile money services. The two most popular uses of mobile money accounts are reloading (59.5%) and money transfers (72.5%). They are much greater than other usage groups. Moderate Utility Payments: Utility payments show that a significant portion of customers use mobile money for this purpose, with a 37.5% usage rate. Less Use of Other Services: The percentages for making payments, paying merchants, and using other services are much lower, indicating that these services are used less often.

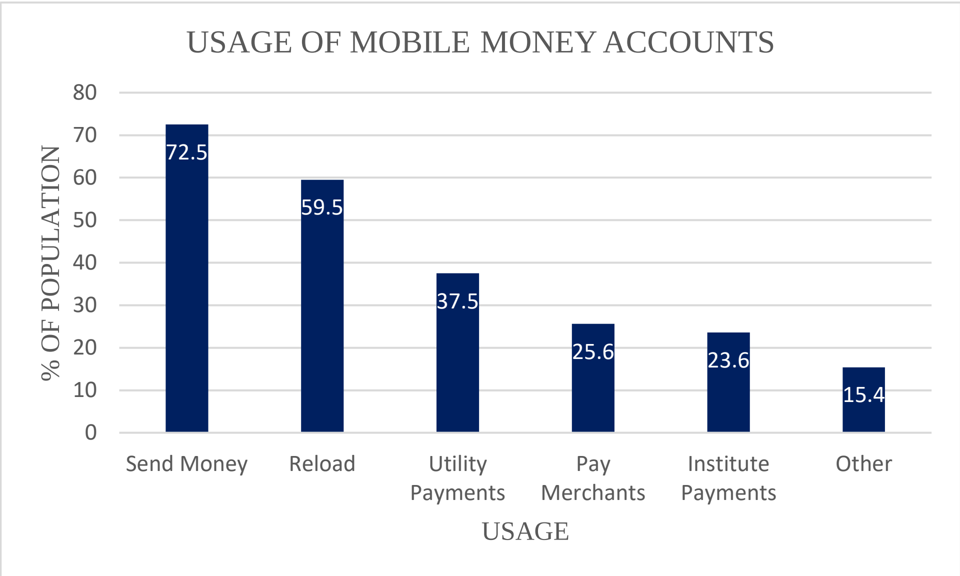

Figure 06: Usage of Mobile Money Account

Source: Central Bank of Sri Lanka

SUMMARY OF FINDINGS

Access to Usage: The data demonstrates that there is a difference between the availability of financial services (high ownership of LB accounts) and the usage of those services, notably in the areas of saving and investing. This disparity is particularly pronounced in the areas of savings and investing. The continuation of unofficial

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source of funding: Because the dependence on informal financial mechanisms, such as pawning and moneylenders, illustrates the requirement of accomplishing this, it is vital to address the underlying issues that are behind this preference. Some of these causes include a lack of trust, a lack of financial knowledge, or access to formal credit. There are several untapped opportunities in the realm of digital finance: Despite the fact that mobile penetration is growing at a rapid rate, the utilization of digital financial services, particularly mobile money, is significantly underutilized. It is of the utmost importance to reduce the gender gap in addition to other barriers that prevent people from adopting children. A Requirement for Knowledge of Finance There is a need for enhanced financial literacy, as indicated by the statistics, in order to promote higher levels of understanding and utilization of a variety of financial goods and services, including digital banking, savings, and investment, among others.

In essence, Sri Lanka has achieved progress in terms of providing access to fundamental financial services; however, the focus now needs to move towards boosting active usage, increasing diversity of financial products, bridging the digital gender gap, and giving consumers with the knowledge necessary to empower themselves financially.

CONCLUSION

A look at financial inclusion in Sri Lanka reveals both progress and persistent challenges. Even while 90% of people who bank with regulated banks have an account, they can't utilize or engage with many different types of financial goods. The majority of savings methods are informal, such as pawn shops and social or family networks, suggesting a lack of trust in or understanding of official saving institutions. Despite the widespread availability of mobile phones, digital payment systems, particularly mobile money, continue to see little adoption, particularly among women. This is despite the fact that laws pertaining to digital finance do exist. There is a clear gender gap when it comes to the availability and use of online banking and related services. On top of that, while insurance ownership is higher than other investment options, knowledge and involvement with other investing tools like government bonds, investment funds, and mutual funds are still low. Sri Lanka has made strides in expanding access to fundamental financial products and services, but in order to reach true financial inclusion, the country must emphasize the use of formal financial products, tackle the gender gap in digital finance, and raise awareness and understanding of investment opportunities. Moving savings activities from unofficial to official channels and building trust in the official banking system should be the primary goals.

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