# Financial Inclusion: A Review

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## Abstract

This paper provides a comprehensive review of the recent evidence on financial inclusion from all regions of the World. It identifies the emerging themes in the financial inclusion literature as well as some controversy in policy circles regarding financial inclusion. In particular, I draw attention to some issues such as optimal financial inclusion, extreme financial inclusion, how financial inclusion can transmit systemic risk to the formal financial sector, and whether financial inclusion and exclusion are pro-cyclical with changes in the economic cycle. The key findings in this review indicate that financial inclusion affects, and is influenced by, the level of financial innovation, poverty levels, the stability of the financial sector, the state of the economy, financial literacy, and regulatory frameworks which differ across countries.

Finally, the issues discussed in this paper open up several avenues for future research

**Keyword**: financial inclusion, financial technology, digital finance, poverty reduction, financial stability, financial institutions, economic cycle, systemic risk, controversy.

## Introduction

There is growing evidence that financial inclusion has substantial benefits for the excluded population especially for women and poor adults in many countries, and policy makers in many countries have embraced financial inclusion as the key to economic empowerment and a solution to rising poverty levels – and this is a good thing! But the question no one is asking is: do international financial inclusion practices converge to a set of common practices? If no, why are there divergent practices? If yes, which recent developments encourage the convergence of international financial inclusion practices? The former deals with the issues or controversy underlying the global financial inclusion agenda, while the latter deals with the recent developments in financial inclusion around the world that encourage the convergence of financial inclusion practices, globally. To date, no comprehensive literature review has emerged to address these questions. To address these questions, this review presents a comprehensive analysis of the state of financial inclusion in several countries and regions of the world. It also identifies the recent developments in the financial inclusion literature as well as some controversy and issues in policy circles regarding financial inclusion.

Financial inclusion is the process of ensuring that individual's especially poor people have access to basic financial services in the formal financial sector. Financial inclusion has received much attention from policy makers and academics for four reasons. One, financial inclusion is

Considered to be a major strategy used to achieve the United Nation's sustainable development goals; secondly, financial inclusion helps to improve the level of social inclusion in many societies (Bold, et al, 2012); thirdly, financial inclusion can help in reducing poverty

levels to a desired minimum (Chibba, 2009, Neaime and Gaysset, 2018), and lastly, financial inclusion brings other socio-economic benefits (Sarma and Pais, 2011; Kpodar and Andrianaivo, 2011). Policy makers in several countries continue to commit significant resources to increase the level of financial sinclusion in their countries to reduce financial exclusion.

Emerging themes in the financial inclusion literature

This section reviews the emerging themes in the financial inclusion literature from two broad categories. The first category reviews the emerging theme in some country and regional contexts. The second category review the emerging themes by the recent developments in the literature. Contextual studies

This section reviews the state of financial inclusion in different countries and regions, focusing on studies from the African region, Asian region, European region, the U.S. and in other country-specific context.

Country-specific studies

Single country studies have emerged in the recent literature. For instance, Bongomin et al (2018) show that social networks through social cohesion improved the level of financial inclusion in Uganda. De Matteis (2015) show that migrants residing in the EU were deeply affected by the economic crisis in Italy and were particularly exposed to social and financial exclusion, and policies aimed at meeting the financial needs of migrants led to greater integration into the destination society for migrants. Nanziri (2016) investigate the state of financial inclusion in relation to gender gap in South Africa, and find that women mainly use formal transactional products and informal financial mechanisms while men use formal credit, insurance, and savings products in South Africa although there were no differences in the welfare of financially included men and women. In Argentina, Mitchell and Scott (2019) analyze how the government of Argentina used financial inclusion to generate significant amount of public revenue in taxes. The government of Argentina used financial inclusion to draw more people into the formal banking system, consumers began to use less cash and increased their usage of credit and debit cards causing more consumption to occur in formal markets which could be easily taxed by the government. In Bangladesh, Ghosh and Bhattacharya (2019) show that financial inclusion was achieved though financial innovations such as 'SureCash' to penetrate the oligopolistic financial market to reach women and poor adults in Bangladesh. In Comoros, Ali (2019) show that there were barriers hindering access to Islamic financial services for disadvantaged women in Comoros. Ali show that women in Comoros either have no money or lack knowledge of relevant financial services which made it difficult to lift them out of poverty. In Palestine, Wang and Shihadeh (2015) observe that the level of financial inclusion improved after Palestine joined the Alliance for Financial Inclusion (AFI) in addition to improvements in national financial infrastructure.

US and UK studies Financial inclusion strategies in the UK and US are quite similar. Marshall (2004) compared the British and US government policy initiatives for reducing financial exclusion, and observe that the British policies, though they have drawn on US experience, treat financial exclusion as an individual problem and pay little attention to the wider interconnections between people and their location which can affect their ability to participate in the formal financial sector. The British policies for financial inclusion provides `joined-up' solutions to financial exclusion by ensuring that a small number of large banks compete on a level playing
field with other financial institutions, however, one notable problem is that it is often difficult to get the cooperation of financial institutions in achieving financial inclusion (Marshall, 2004). In the UK, Mitton (2008) show that people outside the UK formal financial sector suffer financial disadvantages such as higher-interest loan, lack of insurance, no account into which income can be paid, and higher cost of utilities. Also, even those with bank accounts may barely use them, preferring to withdraw all their money each week and manage it as cash. Mitton also noted that the number of adults in the UK without a bank account fell from 2.8 million between 2002 to 2003 to 2 million between 2005 to 2006. Mitton show that despite the progress made towards greater financial inclusion in the UK, there will continue to be people who cannot take full advantage of bank accounts and other financial services, and the reasons for this depend on the different characteristics of vulnerable groups and their low income level. Similarly, Collard (2007) argue that as the UK become increasingly cashless in its economy, the consequences of being outside the mainstream formal financial sector is becoming more serious. In the United States, Fonté (2012) show that the mobile payment ecosystem in the United states can help individuals gain access to a broader range of financial services at lower cost; however, the intense advertising of mobile payments in the US is

more about affluence and advertising than creating financial access for the unbanked population, and such practices require regulations to be applied to the delivery of mobile banking and mobile payment services to the population to ensure that payment services and payment systems are pro-poor and pro-financial inclusion. unbanked population. In Africa, Beck et al (2014) observe that substantial progress has been made over the past two decades in using financial innovations to promote financial inclusion in African countries.

Achieving financial inclusion through other strategies and interventions

Another school of thought argue that financial inclusion can be achieved through other strategies and interventions such as through smartphone-based micro-lending (Bravo et al, 2018), women empowerment (Shetty and Hans, 2018), increased regulations (Chen and Divanbeigi, 2019), foreign bank entry (Leon and Zins, 2019), creating microfinance institutions or banks (Yi et al, 2018), Islamic banking (Naceur et al, 2017), optimal monetary policy (Mehrotra and Yetman, 2014), integrating financial services into post office shops (Pollin and Riva, 2002; Anson et al, 2013), entrepreneurship (Kimmitt and Munoz, 2017), using self-help groups (Pati, 2009), agent banking (Diniz et al, 2012), improved consumer protection reforms (Dias and McKee, 2010), building financial capability (Sherraden, 2013), reducing the distance to a bank (Demirgüç-Kunt and Klapper, 2012), access to point-of-sale (POS) and point-of-transaction (POT) devices (Banka, 2014), mobile money (Donovan, 2012), rural branching (Aggarwal and Klapper, 2013), and many more.

Issues and controversy in financial inclusion research

Despite the positive benefits of financial inclusion, there are some issues and controversy surrounding financial inclusion in the policy making arena. These controversies relate to issues that policy makers witness on a daily basis, and they also explain why there are different financial inclusion practices across countries. The most important issues or controversies are discussed below.

The 'inactive users of financial services' problem One emerging problem in financial inclusion policy debates is the inactive user problem. When individuals are brought into the formal financial system, they become active or inactive users of financial services.Even after exerting tremendous effort to bring the excluded population into the financial sector, these individuals come into the formal financial sector and may choose to become inactive users of financial

products and services after a while. They open formal accounts but refuse to get credit cards or debit cards, they do not keep deposits in their formal accounts and they do not initiate financial transactions from their own formal accounts. They only use their formal accounts to receive money but they do not use their formal accounts to send money to others. These inactive users create a new problem for policy makers because the financial inactivity they create reduces the volume of financial transactions, reduces the revenue to financial institutions, and reduces the tax revenue to the government which affects economic output. Extreme financial inclusion

Another controversy is the extreme financial inclusion problem. Extreme financial inclusion occurs whenever access to the formal financial sector is granted to all individuals irrespective of their riskiness and income level. Extreme financial inclusion is one that opens the door to everyone so that everybody can access the formal financial sector. Extreme financial inclusion also grants financial access to convicts, criminals, hackers and fraudsters, too. Most financial inclusion studies suggest that access to finance should be granted to everybody and all barriers to financial access should be removed – but policy makers consider this to be extreme, at least in practice. Policy makers prefer the removal of some, not all, barriers to financial inclusion. For instance, no bank regulator wants a free bank account opening process without any identification and verification process for new bank customers. Policy makers would support reducing the account opening requirements for poor customers but would oppose the removal of all requirements. Extreme financial inclusion is undesirable because it can expose the formal financial sector to risky individuals such as individuals that cannot be properly identified, individuals that take loan with no intention to repay their loan, and individuals who wish to defraud others of their money. Just as too much of a good thing is not good, similarly, 'too much financial inclusion' or 'extreme financial inclusion' or

'financial over-inclusion' is undesirable too. The financial inclusion models adopted in some countries, such as India's PMJDY, is similar to the 'extreme financial inclusion' model because it grants access to everybody, and policy makers in such countries have not considered the potential consequences of extreme financial inclusion. Countries that avoid extreme financial inclusion such as the UK and South Africa tend to have low levels of fraudulent activities in their formal financial sectors. Avoiding extreme financial inclusion is desirable because it can help to mitigate the negative externalities that may arise from extreme financial inclusion.Directions for future research This section identifies several opportunities for future research. There are many issues which have not been addressed in the financial inclusion literature, and due to space constraints, only the most important issues are discussed in this section. Moreover, the issues identified in this section are limited to the issues in the literature that I find to be particularly significant, which are mainly the risk of financial inclusion, the political economy of financial inclusion, the optimal level of financial inclusion, the effect on macro-financial stability, regulating financial inclusion, and other uncommon interventions for greater financial inclusion.

Concluding remark

This article reviewed the policy and academic evidence on financial inclusion, and identified the recent development and major controversy in the financial inclusion literature. I structured the review around thought-provoking questions of interest to policy makers and other interested readers. In particular, I draw attention to the question of optimal financial inclusion, extreme financial inclusion, how financial inclusion can transmit systemic risk to the formal financial sector, and whether financial inclusion and exclusion are pro-cyclical with changes in the economic cycle. The key findings in this review indicate that financial inclusion affects, and is influenced by, the level of financial innovation, poverty levels, the stability of the financial sector, the state of the economy, financial literacy, and regulatory frameworks which differ across countries. The findings have implications for policymaking.Policymakers should be mindful of the interaction between financial inclusion and poverty levels, financial innovation, financial stability, state of the economy, financial literacy, and regulatory systems.

Policymakers should find a balance between greater financial inclusion and financial system stability which is what regulators worry about and identify innovative ways to deliver financial services to the people through non-bank channels. Finally, the review identified a number of opportunities for future research on financial inclusion. For instance, future research is needed to explore: (i) other risks associated with financial inclusion and its impact on the poorest users of basic financial services, (ii) how national politics may influence the success or failure of the financial inclusion strategy, policies, objectives and outcomes of a country, (iii) the effect
of financial inclusion on macro-financial stability, (iv) what level of financial inclusion is optimal, (v) the type of regulation that promote financial inclusion, (vi) whether regional economic blocs should adopt similar or dissimilar financial inclusion strategies for member countries, (vii) and other uncommon interventions that can promote financial inclusion in several countries.

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