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Financial Inclusion in Africa: Bridging Economic Opportunities and Outcomes

Analyzing the Financial Inclusion Landscape in Africa

Emerald Group

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1. Introduction

Over the next 30 years, the African continent has been slated out to be the next *growth market* – according to regional and global economists, policymakers and development institutes alike. Afterall the continent does house nearly 17% of the global population. GDP growth in Sub-Saharan Africa has averaged 5% since the early 2000's, over 400 million people have been lifted out of poverty since 1990 and it is the world's youngest and fastest urbanizing continent with an exponentially growing graph for consumption. However, all this given, the narrative of a 'Rising Africa' seems to have lost its charm and hold on many. The continent's meager contribution to the global GDP, standing at 3%, points us towards why. These numbers put together show us the past failure to tap into the continent's growth potential. They also highlight the tremendous opportunities that lie ahead in the continent, if seized. And, the phenomenon of inclusive development lies at the heart of these opportunities and challenges.

1.1 Embedding Inclusivity in Development

Inclusive growth as a concept has been globally proven to lift the vulnerable out of poverty and propel economies in a direction of sustained and holistic economic growth – benefitting all stakeholders of society, more so with the advent of globalization. For development to be sustainable, long lasting and impactful, it must be inclusive. This has added new impetus to the African growth story.

The past decade has witnessed a paradigm shift in the continent, one which embraces inclusive development. However, despite policymakers taking cognizance of the importance of inclusivity in growth, inclusive development has remained elusive for most regions. The concept of shared prosperity and improved standards of living for the majority continues to seem like a mirage in many parts of Africa.

Inclusivity in development is highly nuanced and multifaceted. Financial inclusion is key to achieving it. It is the path to addressing and solving some of the most pressing issues plaguing society – poverty, inequality and migration, among others. Financial services are fundamental to addressing these and achieving a wide set array of goals and aspirations. These services help:

- Make day-to-day transactions possible, including sending and receiving money, in a cost effective and accessible way;
- Safeguard savings, which can help households manage cash flow fluctuations, smooth consumption and build working capital;
- Help finance micro and small businesses, helping entrepreneurs invest in assets and grow their businesses;
- Support planning and paying for essential periodic expenses, such as school fees, electricity and water access;
- Mitigate shocks and risks, and manage expenses related to unexpected events such as medical emergencies, death in

the family, theft, or natural disasters; and
- Improve the overall welfare of the vulnerable

Financial inclusion across the globe has aimed to narrow, and aspired to one day close, the gap between those who have access to formal banking and financial services industry and those who have been left on the side-lines.

The goal of financial inclusion is highly ambitious, but it is within the realms of the possible. As has been observed in many Asian economies, moving individuals into the financial mainstream is not simply an aspirational goal. It is an attainable goal and one which Africa is moving towards.

The idea of financial inclusion is a rather simple one. However, it isn't easy. This report aims to analyse the progress of this transformation in Africa and the forces aiding it and acting as roadblocks in its path.

Understanding Financial Inclusion

Section 2

2.Understanding Financial Inclusion

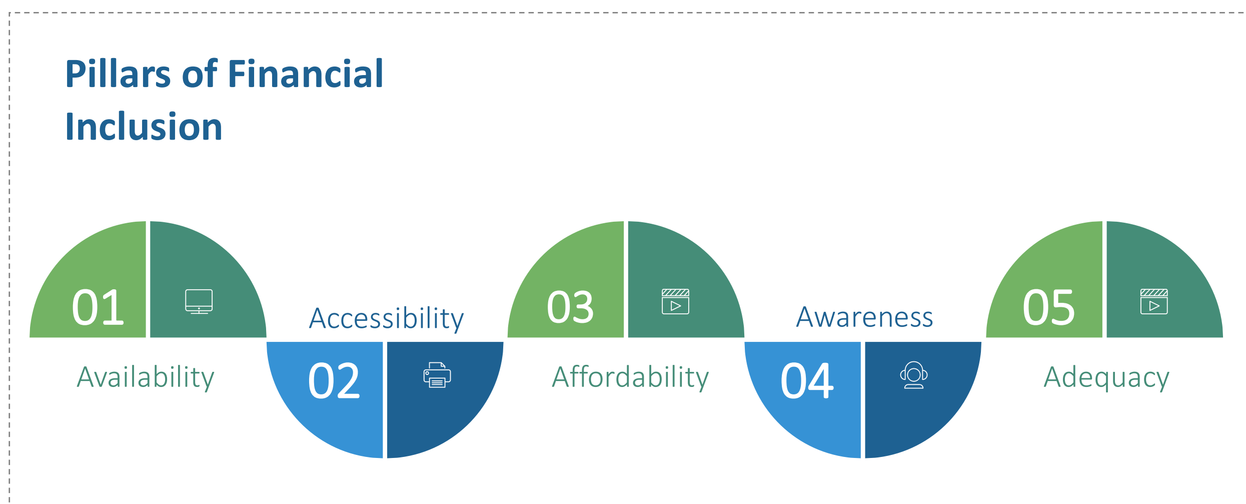
Interest in building capabilities for financial inclusion has been garnering an increasing amount of attention over the years. The past two decades have seen more and more regional and global stakeholders from across geographies focusing on building targeted frameworks and policies to achieve cent percent financial inclusion.

Simply put, financial inclusion is the idea of people and enterprises having access to secure, convenient and affordable banking and financial services. It is achieved when even the most vulnerable groups have gained access to financial services that meet their needs and make use of it (the needs being - transactions, payments, savings, credit and insurance) in a responsible and sustainable way.

The vulnerable, like all groups in society, save, borrow and make payments throughout their lives.

To avail these services to their full potential – to sustain and improve their lives – they need affordable and tailored products delivered to them. Financial Inclusion recognizes this and addresses that the financial service needs of the poor have fundamental similarities to those of the better off and need to be serviced. This entails multiple facets - quality of access, affordability, timely delivery, sustainability and reach to the most excluded.

Financial inclusion aims of enabling and empowering every individual and business to actively participate in the formal financial system. It doesn't imply that everyone necessarily uses every available financial service, rather - everyone has the option to use them. It lifts people out of poverty, creates empowered citizens and drives growth. Emerald has identified 5 pillars of financial inclusion – availability, accessibility, affordability, awareness and adequacy.



2.1 Dimensions of Financial Inclusion

The definition and understanding of financial inclusion has evolved over the years from simply putting individuals into two groups - included or excluded to one with a multi-dimensional perspective measuring access usage and quality through a basked of indicators.

It is important to understand why there was a need for a multi-dimensional definition beyond the dichotomous approach. Financial inclusion simply cannot be achieved by providing more access points alone. A key aspect is usage. How frequently products are being used, if they fulfill the purpose and if they leave them better off or not.

2.1.1 Access

Access, as the word implied, measures the availability of banking and financial services through formal means and sources. Some aspects measured under this umbrella are – affordability of the service, the physical proximity to the source providing the service, the amount of documentation required to avail the service, among others.

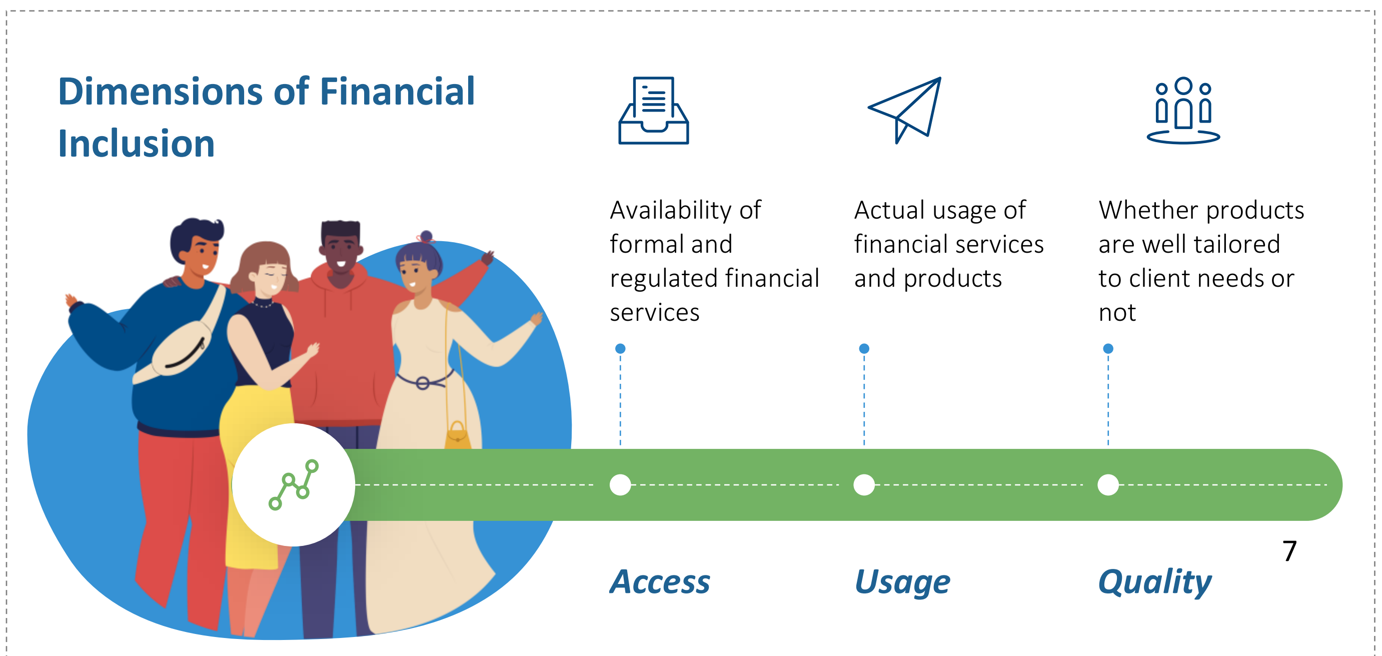
2.1.2 Usage

As stated initially, financial inclusion isn't said to be achieved by just providing access points. Products and services have to be actually used by the populace for true financial inclusion to be achieved. This includes developing tailored instruments depending on the periodicity of the services availed, the frequency and duration of time over which they are used.

2.1.3 Quality

Quality measures how suitable the services offered are to the clients in consideration. Suitability of the product is essential for more people to be included in the formal financial system. To measure quality a variety of aspects are analyzed including – segmentation of the customer base on the basis of appropriate parameters, offering products for all income groups – tailored to their needs, among others.

Access, usage and quality of banking and financial services put together aid in moving towards reaching all groups of society and bridging the gap.



Assessing Financial Inclusion in Africa

Section 3

3. Assessing Financial Inclusion in Africa

Rates of financial access, across all dimensions, have exponentially improved in African countries since 2000. Now, citizens and businesses alike are able to access and use banking and financial services, especially with regards to credit facilities. Spurt in access to credit has empowered many micro and small enterprises throughout the region.

The sector has also undergone major transformation. FinTech (Financial Technology) is looked at many by a disruptor. In Africa, FinTech has aided in building capabilities to complement the traditional banking and financial services sector rather than displacing it. The advent of mobile money has helped widen the access to formal instruments and services, especially to savings and payment facilities. In 2019 there were over 1.004 billion registered mobile money accounts in Sub-Saharan Africa being used to carry out transactions worth $456.3 billion over the year. Such technological innovations have helped increase financial inclusion and improve overall welfare significantly.

Despite the tremendous growth curve in the space, the continent lags behind significantly as compared to other countries. Even the extent of financial inclusion, and exclusion, wasn't fully understood or known until recently.

Demand and supply side data of the sector show that in 2017 less that 38% of male adults and 27% females in Sub-Saharan Africa had accounts with a financial institution. A large portion of the populace continues to stick to informal methods to save and borrow. Sources of borrowing are oft confined to friends, family and informal lenders, and savings for a rainy day are parked in chit funds, regional associations and societies. The inequality in access to banking and financial services is also prevalent among enterprises, especially micro, small and medium enterprises (MSME). Credit for MSMEs remains an extremely weak point in the sector and, consequentially so do other more sophisticated sources of financing and funding. To put it lightly, the banking and financial sector in the continent is underdeveloped at the moment.

3.1 Access to Finance for Individuals

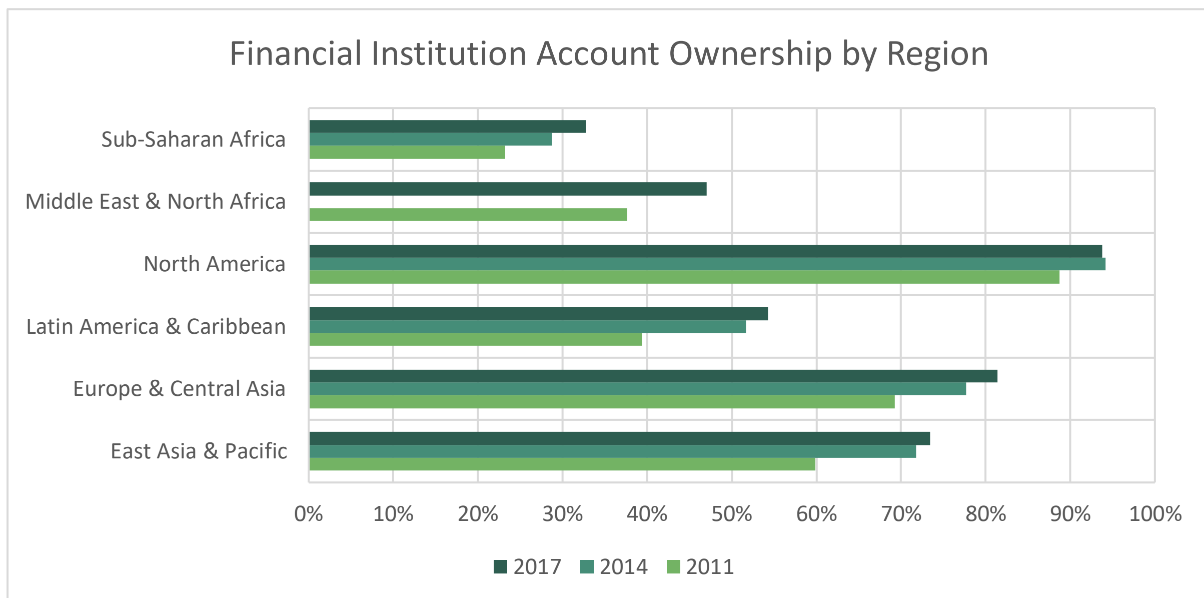
The limited reach and presence of Africa's banking and financial system has been scrutinized by various stakeholders. A wide set array of reasons is blamed for this – low income levels, inadequate infrastructure, low government support, high illiteracy, limited competition in the sector, among others. Analyzing individuals' access to finance comprises of studying saving, borrowing and payment trends, sources and reasons. These factors have been studied for different regions to identify challenges and barriers in the path to achieving financial inclusion. Account ownership in formal financial institutions has been taken as the major anchor to measure the reach here. This is because this service is fundamental to financial inclusion and is required to avail other more sophisticated services and instruments. Parameters which have been

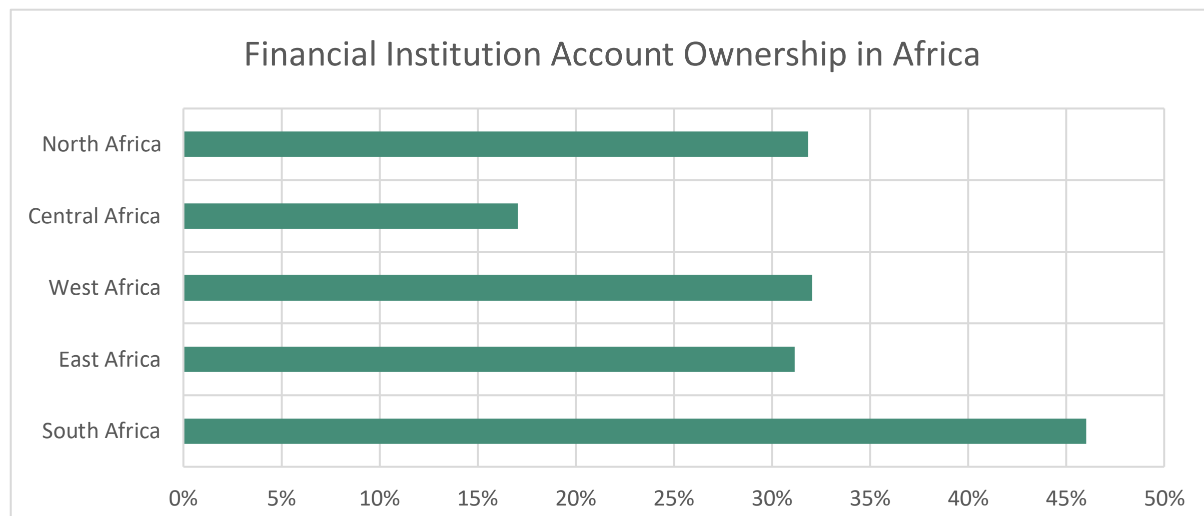
studied are – account penetration, barriers to the same, usage of accounts and emerging alternatives.

3.1.1 Formal Account Ownership

Overall, 33% of individuals above the age of 15 in Sub-Saharan Africa have an account at a formal financial institution. This number is the lowest globally, as compared to other regions. North America is nearing cent percent account ownership with 94% individuals holding a financial institution account while developing economies in East Asia and Pacific are also taking significant strides in this area with nearly 73% individuals holding accounts.

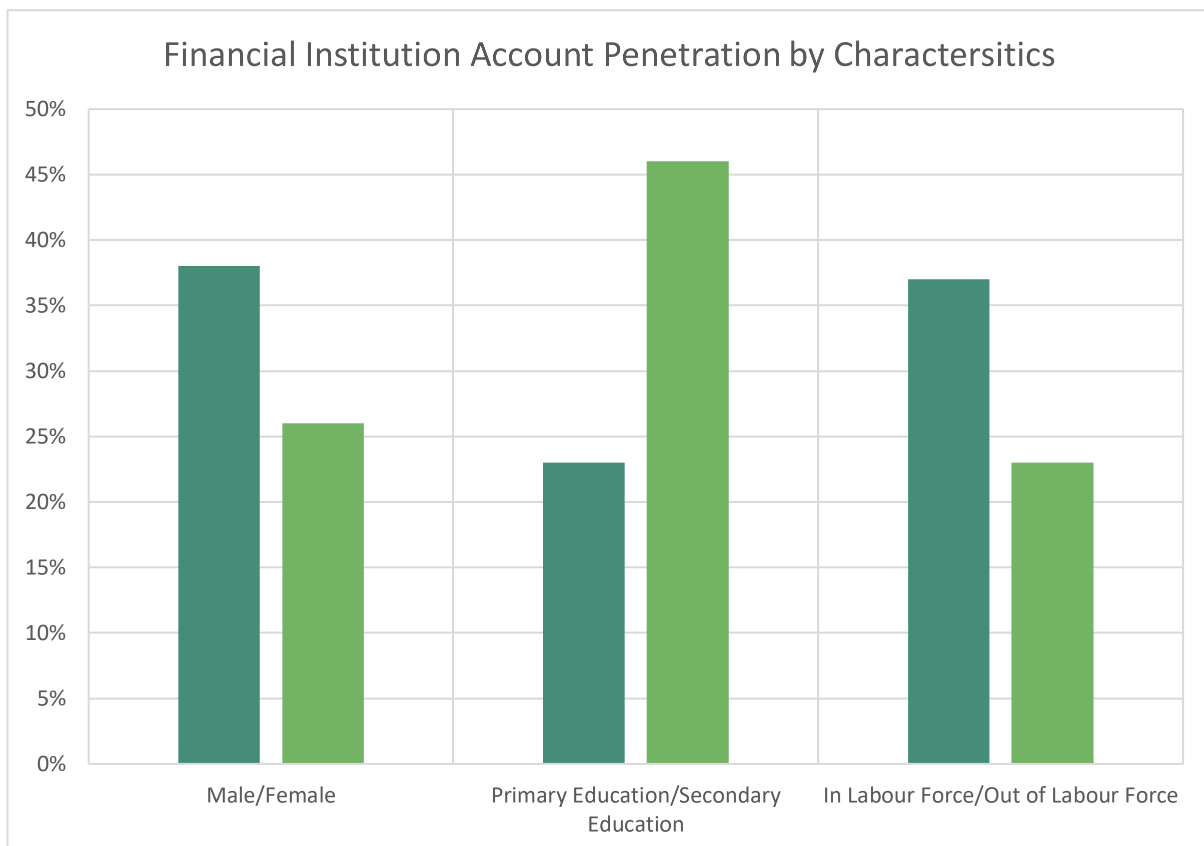
The disparity and variation of account ownership within Africa is immense. It ranges from 89% in Mauritius to 7% in Burundi. The South African region leads in the continent in account penetration with over 46% of its population above the age of 15 holding an account in a formal financial institution. Meanwhile, in Central Africa only 17% of population benefits from the same service. North Africa, West Africa and East Africa are at a similar plane, all three regions hitting over 30% of account penetration.





Men are more likely to have access to an account at a financial institution that women in Africa. The gap, standing at nearly 12%, is smaller than that found in other regions of the world. On average, adults with secondary education or higher are twice as likely to have an account at a financial institution than those with primary education or lower. This number stands similar for those in the labour force and those out of it. Adults in the labour force are much more likely to have an account (37%) than those out of it (23%). This trend is majorly prevalent due to account requirements by those in the labour force to receive wages and salaries. These gaps highlight the importance of financial literacy for attaining financial inclusion.

Indicators of financial access by individuals also show a positive but imperfect correlation with industry indicators as credit to the private sector as a share of GDP. This positive but imperfect correlations of financial services usage with financial depth raise questions regarding the drivers of cross-country differences in financial use and access. The correlations also suggest that there is a need for policy reforms to increase the level of financial inclusion.

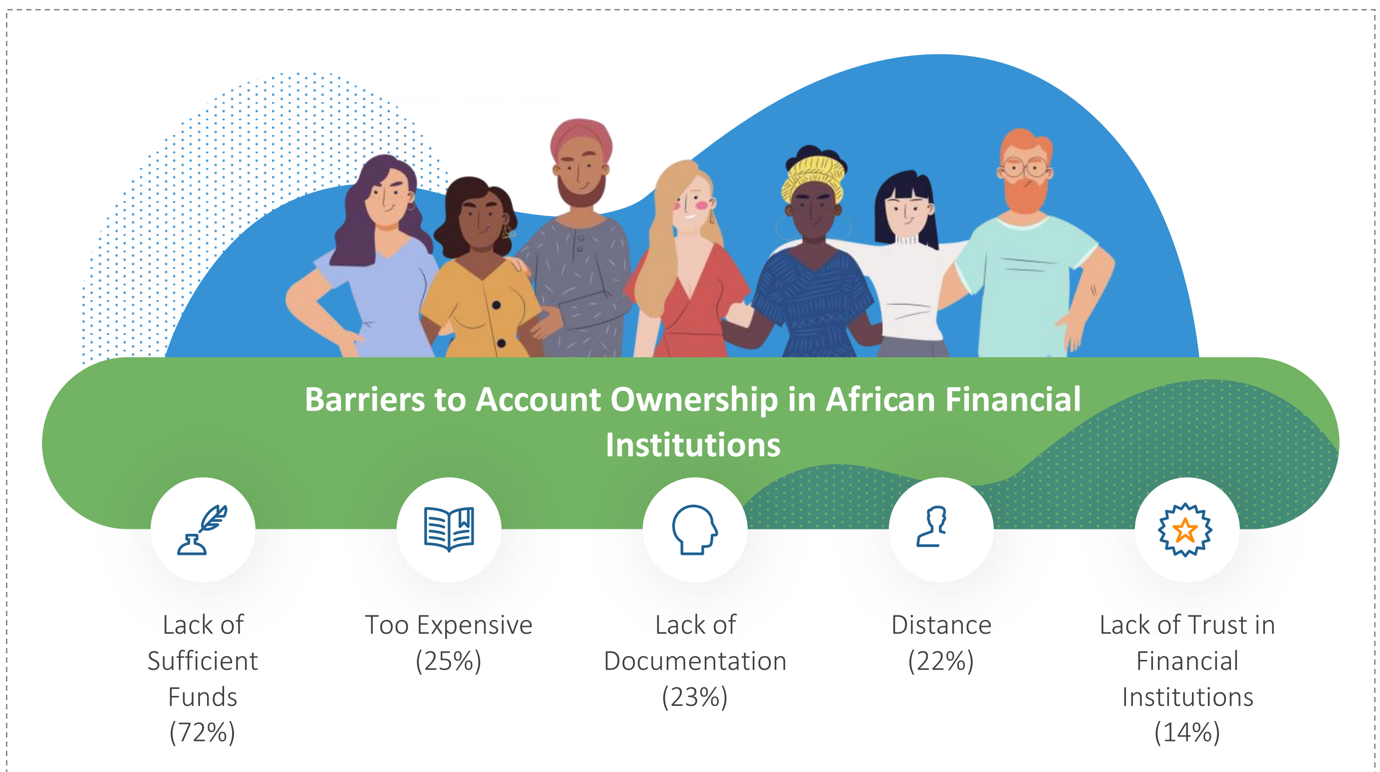


3.1.2 Barriers to Account Ownership

There are multiple reasons for non-ownership of accounts at financial institutions. Lack of sufficient funds is the most frequently cited reason for not having an account with over 72% adults stating so. Other reasons are the high costs attached with owning an account (25% adults citing this as a barrier), lack of physical proximity (23% adults stating so), lack of documentation (22% adults citing so) and lack of trust in financial institutions. East and West Africa have high costs as the second largest barrier, after lack of sufficient funds. The reason behind this is the fixed fees and high costs of opening and maintaining accounts attached to the service. Majority of the population cannot afford to shell out the demanded amounts. For example, maintain a checking account costs nearly 25% of GDP per capita annually in Uganda. This has emerged as a major hinderance in account penetration.

Physical proximity and insufficient documentation are also significant challenges for adults to open accounts, especially those living in rural areas. The main barrier to financial access in rural areas is the great distances that individuals need to travel to reach a bank branch and avail services. Poor infrastructure and telecommunications, and heavy branch regulation, have also restricted the geographical expansion of bank branches. Cost and distance are also commonly cited among adults with a primary education or less.

Access points and financial inclusion have a positive and significant correlation. African economies are at the lower end of the spectrum with few branches per 100,000 adults. This lack of infrastructure explains the boom of mobile financial services.



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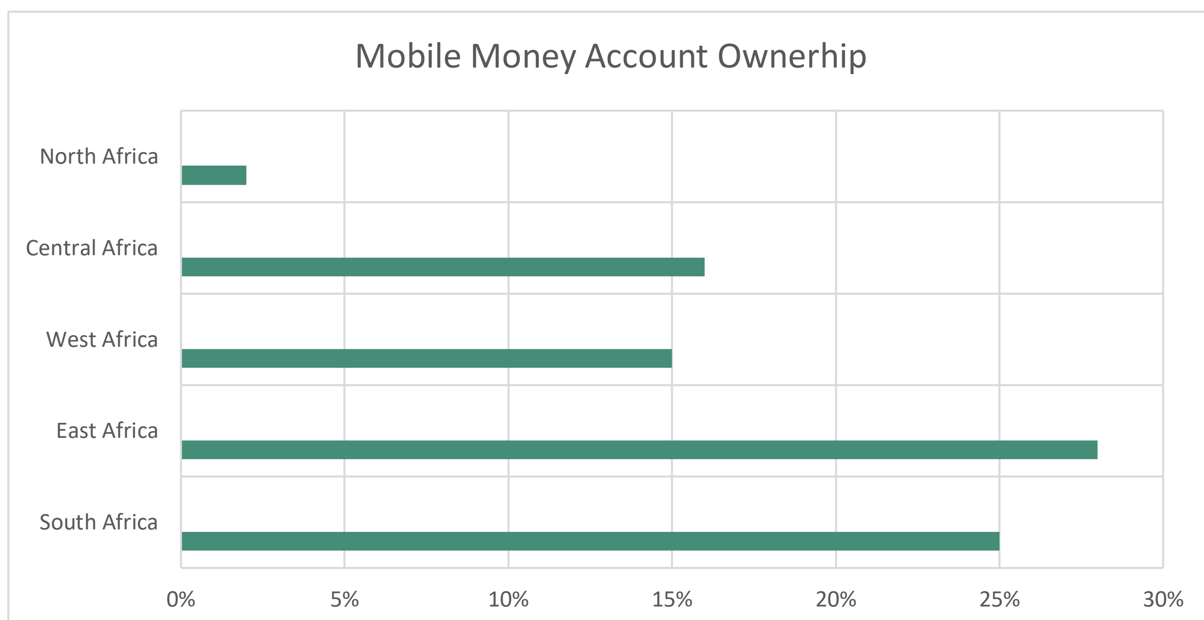
3.1.3 Usage of Accounts

Usage of accounts is a major concern for financial inclusion. Globally there are close to 750 million inactive accounts. Account dormancy is measured by taking into account deposits and withdrawals from the account over a period of 1-2 years. Over 20-30% accounts in African countries are dormant. However, this does not account for ATMs. ATMs are the main mode of withdrawal in the continent in East and South Africa while withdrawals are preferred to be done over the counter in West and Central Africa.

3.1.4 Mobile Money: A Bank in Every African's Pocket

The concept of mobile money accounts as "A Bank in Every African's Pocket" has grown to become an alternative to having an account at a financial institution. People who do not have an account have the risk of losing out on security, reliability and convenience that accompanies the service. However, mobile money services have emerged as a sophisticated alternate to managing day-today finances and also plan for the future. Growth in the number of mobile connections and better telecom infrastructure has aided this growth.

Mobile money has enabled millions across the continent who were excluded from the formal banking and financial system to perform transactions in a secure, cheap and convenient way. The success has been tremendous in Africa with Vodafone's M-Pesa (launched in 2007) being perhaps the most popular example of such a service. The service was launched in Kenya and has been credited to the boom. Mobile money services in the country have also been credited to reducing poverty in the country with over 73% of the Kenyan population having mobile money accounts. FinTech sector startups have seen an influx of funding from entities from across the world. Over 18% of the entire African population has a mobile money account.



The service is most popular in East and South Africa, with mobile money accounts being owned by almost 30% of the population. The technology is still at a nascent stage in North Africa with 2% of the population taking to the technology advancement. Algeria stands as an exception in the North African region with over 50% of the population using the service to send or receive remittances. The constrained growth in the northern part of the continent is partially due to regulatory limitations imposed on operators.

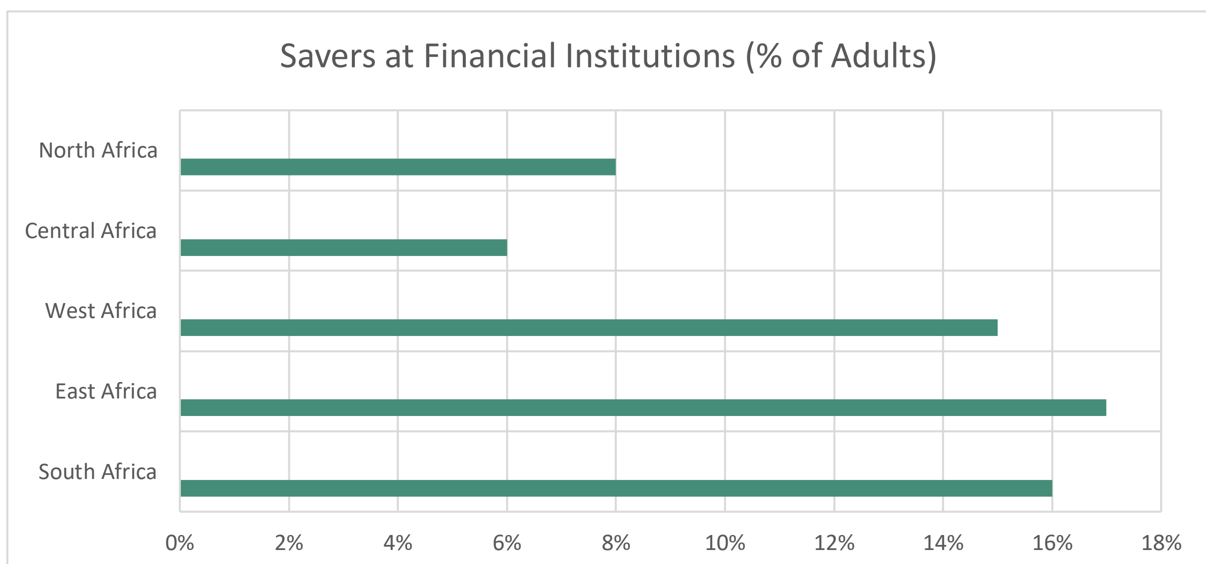
The success of mobile money in Africa has been resounding with the service helping serve the unserved and, building capabilities and capacities in the financial services sector rather than disrupting it.

3.1.5 Savings Trends

Savings through formal means in Africa has not gained much popularity. Less than 13% adults in the continent have saved money in formal financial institutions. This number is significantly higher if accounting for informal means such as ROSCAs or other savings clubs - 36% of African adults save counting them.

Community based savings are prevalent in many parts of Africa.
In East and South Africa more than 15% adults save with financial institutions while the same number stands at 6% for Central Africa and 8% for North Africa. The proportion of savers saving money with financial institutions is extremely low in the continent. In North Africa, less than 30% of total savers save with financial institutions. Formal savings practices are common in few countries including Nigeria, South Africa and Kenya. There are variations depending on savers' characteristics too.

Men, adults with a secondary education or higher, adults whose ages are between 25-64, adults in the labour force, and adults in the highest income quintile are more likely to use formal banks to save on average, whereas informal savings methods are particularly common among women, adults with a primary education or less, adults living in rural areas, and among the poor. Adults in the richest income quintile are more than five times likely to save formally.



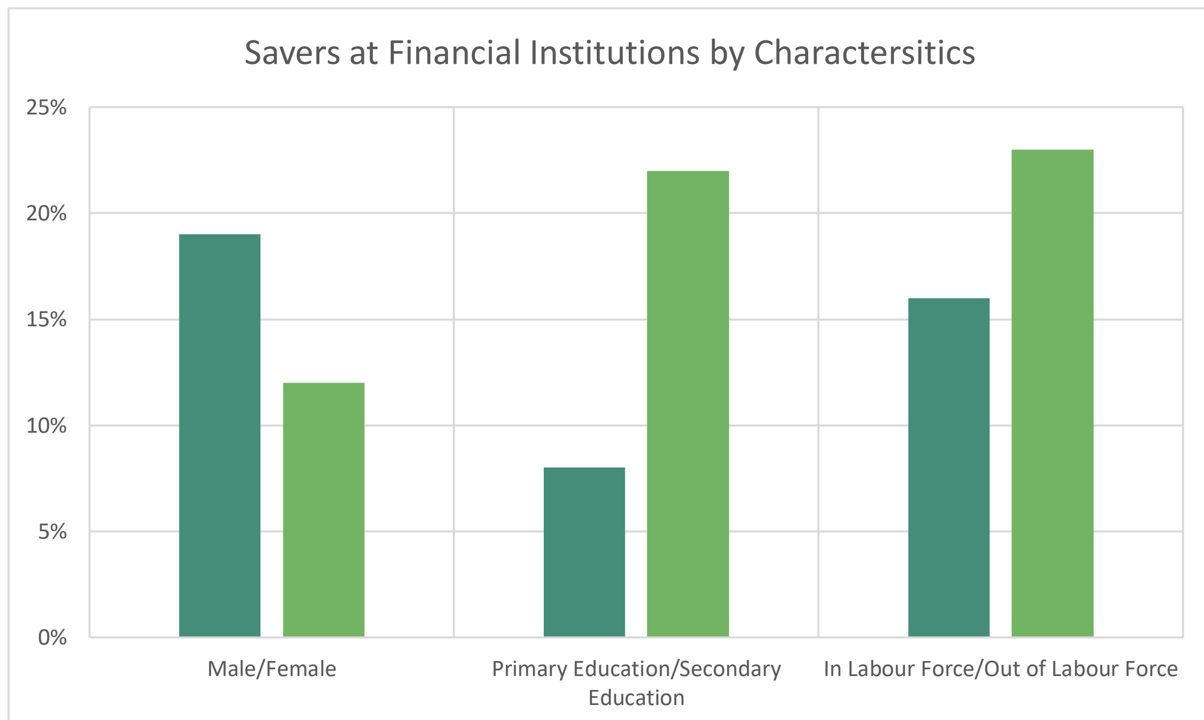
Most savers prefer to use a mix of formal and informal methods. Nevertheless, a large chunk of adults continues to use only community savings clubs. In Sub-Saharan Africa, over 30% of those who save cite having only used a community-based savings club. This number touches 45% in West Africa and 35% in Central Africa. Alternate methods are also used to save, such as asset accumulation and "under the mattress".

3.1.6 Borrowing Sources and Reasons

Similar to savings trends, borrowing from formal sources are also not highly popular in Africa. Borrowers prefer to resort to informal means, especially through family or friends. Nearly 45% of African have reported to borrow, from both formal and informal sources. Close to 30% of Africans cite borrowing though friends or family as their only source of borrowing.

This indicates the wide gap in the formal borrowing mechanism in the continent. In Central and West Africa less than 5% individuals have cited receiving loans from financial institutions. This is an alarmingly low number, especially for growing economies. South Africa has the most prominent culture of borrowing through formal sources with 8% of adults borrowing through these means. Store credit and informal money lenders are also sources relied upon, especially in Central and East Africa and the credit cards are still a nascent concept in the market with the highest usage percentage being in South Africa at 7%

The most common reason for outstanding loans in the region is funerals/weddings, school fees, and emergency/health purposes with nearly 15% of adults having an outstanding loan for emergencies or health care needs.



3.2 Access to Finance for Enterprises

One of the largest challenges MSMEs face is financing constraint, especially in developing economies. Access to bank finance is difficult to obtain in the region thus limiting growth opportunities for these enterprises. Account ownership is not an issue. Over 85-90% of African MSMEs report having bank accounts. These numbers are comparable to other developing economies and even better than some countries. The trend is similar for large organizations – majority across the continent have bank accounts and checking accounts. The challenge is with obtaining funding – through formal financing means.

Less than 25% firms are able to attain a line of credit and this is a major hinderance to growth. Like individual borrowers, credit is usually obtained from informal sources by enterprises. Strict regulation, lack of capacity and infrastructure are some of the reasons behind this.

Serving the Unserved: Fostering Financial Inclusion in Africa

Section 4

4. Fostering Financial Inclusion in Africa

Financial inclusion continues to be a pressing issue in developing countries. And, Africa houses a large proportion of the world's underbanked population. Progress in the space has been made but there is a long way ahead for most African counties before they can claim to have achieved this pillar of inclusive development. Technology has been fronting the drive for change and improving standards of living. Technological advancements and FinTech are at the core of this transition. These services also aid in complementing traditional services to reach the unreached and help them avail secure, accessible and affordable finance. Kenya's journey in embracing FinTech led by M-Pesa is the prime example of how mobile money is driving financial inclusion in the region. Sub-Saharan Africa has emerged as a hotspot for FinTech startups and has witnessed an influx of funding from all quarters. To boost these practices, certain steps are essential on the part of policymakers.

Building capacities and infrastructure are crucial to addressing financial exclusion in Africa. Governance of public utilities and improved generation of electricity are required to allow for stable electricity and internet services in the region which is essential for the growth of the traditional banking and financial sector and the emerging FinTech sector. To build these capacities policymakers will have to mobilize for higher financing to power generation and distribution of electricity and telecom services.

There is also a need for revising regulation to the meet the demands of the current time. Regulation has to keep up with advancements support and enable rapid innovation. The FinTech sector is rapidly evolving in Africa, with new services and offerings being constantly worked on. Regulators need to be flexible to ensure that these are not stifled.

Increasing financial literacy is also essential for furthering financial inclusion. There is a correlation between literacy and individuals who involve themselves in the formal financial system. Advocacy in these matters is important. For financial inclusion to become a reality for all in the continent it is essential for the public sector to be actively involved in the ongoing FinTech revolution. Public sector aid and support coupled with the emerging FinTech ecosystem in the region is the path to achieving sustainable, convenient and affordable finance for all in Africa.

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