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FinTech is key driver of financial inclusion

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Executive Summary

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With better access to financial services widely recognized as essential to reducing poverty, financial inclusion has been gaining importance on the global policy agenda. Governments and international institutions have been pursuing FinTech-enabled initiatives to promote financial inclusion in recent years. Financial inclusion will likely remain a high-priority policy objective in not only developing countries but developed countries also.

Spotlight on financial inclusion

The World Bank defines financial inclusion, a term coined as a financial analog of the concept of social inclusion, as a world where everyone has access and can use the financial services he or she needs to capture opportunities and reduce vulnerability.

From a global perspective, those who have bank accounts or are able to borrow funds from a bank are a privileged few. The Financial Access Initiative estimates that financial services are inaccessible to some 2.5 billion adults globally. In other words, about half of the world's working-age adult population is excluded from formal financial services. Most of those excluded have no access to any financial services or are forced to use underground financial services.

Financial services used as benchmarks of financial inclusion include savings accounts, loans with reasonable interest rates, insurance (against, e.g., premature death, injury, illness, extreme weather, crop failure) and safe and fast payment/remittance services. Perhaps the best-known financial inclusion initiative is Grameen Bank, a micro-lender founded by Nobel Peace Prize winner Muhammad Yunus. Another well-known example is M-PESA, an African-based money-transfer network that utilizes text messages sent via mobile phones. Services such as M-PESA constitute essential societal infrastructure that supports people's daily lives in Africa, Central Asia and other regions with underdeveloped banking systems.

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Promoting financial inclusion has become a global policy priority

Research conducted by the Consultative Group to Assist the Poor (CGAP), an independent think tank that promotes financial inclusion in developing countries, concluded that promoting financial inclusion increases the "potential to improve the lives of citizens, reduce transaction costs, spur economic activity, and improve delivery of other social benefits and innovative private-sector solutions." In response, financial inclusion has become a global policy priority. A 2009 G20 Communiqué mentioned financial inclusion in the context of increasing support for the world's poorest. In 2014, the G20 adopted a financial inclusion action plan. Under the plan, G20 governments committed to stepping up efforts to promote financing for SMEs, develop institutions that build regulatory and institutional infrastructure, improve financial literacy and protections for users of financial services, and upgrade market and remittance/settlement infrastructure.

Promoting financial inclusion in developing countries

Historically, delivering financial services on a nationwide basis has required huge investments in branch offices, nationwide payment networks and other such infrastructure. Meanwhile, international regulatory compliance and state-of-the-art security are prerequisites to joining international financial networks. Developing countries, unable to immediately afford such big investments, are increasingly looking to information technologies such as mobile phones to expeditiously and broadly provide financial services at a low cost. In other words, FinTech is a key driver of financial inclusion.

A case in point is India, where 47% of the population does not have a bank account and 90% of microenterprises and SMEs operate entirely outside of the formal financial system. The Indian government is currently spearheading various initiatives to broaden access to financial services as a policy priority. With a nationwide mobile phone ownership rate of nearly 80%, India is pursuing financial inclusion through mobile phone networks. It permits mobile phone owners to open bank accounts with no minimum balance in the aim of increasing the banked share of its population. Given its low literacy rate, India also needs to develop financial services that do not require written documentation. It has consequently built biometric identification infrastructure called the Unique ID Authority of India (UIDAI), a government-led registry of all Indian citizens' fingerprints and iris scans.

Other majority-unbanked countries include Indonesia, the Philippines and Vietnam. Only 36%, 31% and 31% of their respective populations have bank accounts.

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The Association of Southeast Asian Nations (ASEAN) has taken the initiative to establish a financial inclusion working group and is upgrading international remittance and settlement infrastructure within its geographic purview.

More financial inclusion needed in developed countries also

Financial exclusion is not confined to developing countries alone. In the US, an estimated at 100 million people are unbanked or underbanked and some 90 million have less than $500 in savings.

FinTech companies have emerged to serve financially excluded Americans. One example is PayActiv. It partners with employers to provide smartphone-accessible accounts to the employers' workforces. As the employees earn wages, their wages are deposited daily into their PayActiv accounts. The employees can withdraw money from their accounts through PayActiv-affiliated ATMs, pay utility bills directly from their accounts or set up automatic transfers to their savings accounts. Combining such smartphone-accessible electronic accounts with e-money enables lower-cost, higher-frequency banking.

FinTech has the potential to make social security programs more effective also. In Japan, for example, public benefits such as childcare stipends and pension benefits are currently paid every other month or once every few months. However, behavioral economics researchers have found that benefits paid weekly in smaller installments provide more financial security to their recipients' than the same amount of benefits paid less frequently in larger installments. Additionally, paying benefits in the form of e-money instead of cash would enable more stringent identification of benefit recipients while also enabling the government to track where the benefits are spent. Use of e-money could thus help prevent fraud and predatory business practices targeted at the poor.

FinTech holds much promise as a path to greater financial inclusion.

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