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Financial Inclusion In Bangladesh: Background, Issues, Regulatory Measures And Challenges

Toufic A. Choudhury *

Abstract: *Financial Inclusion has become an issue of worldwide concern, relevant equally in the economies of under developed, developing and developed nations. The paper discusses the background and relevant issues of financial inclusion and regulatory measures so far taken in Bangladesh and also challenges of adopting financial inclusion strategy in Bangladesh. The paper observes that financial inclusion is good for all the stakeholders: poor, banks, government and economy. Financial inclusion is not just a public good but a merit food. It is not just micro-finance, it is much more than micro-finance. It is not only access to finance, at the same time raising financial consciousness. In the context of Bangladesh, it's central bank, Bangladesh Bank has taken a pro-active strategy, comprising a number of innovative and effective measures, which have already started to produce positive results. However, the challenge is: the financial inclusion strategy of Bangladesh Bank is still mostly regulatory driven. There are not really spontaneous initiatives on the part of banks and financial institutions, without which sustainability of inclusive finance is not possible.*

Background and Definition

1. It is well recognized that well-functioning financial systems are essential for economic development. A well-functioning financial system is by definition efficient, allocating funds to their most productive uses. It also covers other vital purposes such as offering savings, payment, and risk management products to as large a set of participants as possible, seeking out and financing good growth opportunities wherever they may be. The policy makers, practitioners and researchers have so far emphasized efficiency and stability aspects of financial systems and ignored the broader access to financial services. However, the current development theories increasingly project the role of access to financial services, the lack of which is often the critical element underlying income inequality as well as slower growth.

* Director General, BIBM, Dhaka.

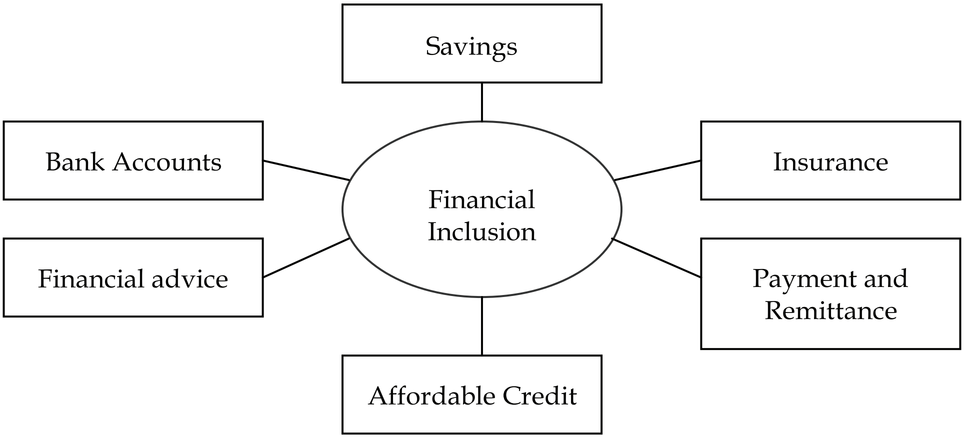
2. Financial market imperfections that limit access to finance play an important role in perpetuating inequalities. If financial market frictions are not addressed, redistribution may have to be endlessly repeated, which could result in damaging disincentives to work and save. Not only that, sometimes financial exclusion can lead to social exclusion. In contrast, building inclusive financial systems focuses on equalizing opportunities. Hence addressing financial market imperfection that expands individual opportunities creates positive, not negative, incentive effects.

3. In its landmark research titled "Building Inclusive Financial Sector for Development" (2006), popularly known as the Blue Book, the United Nations (UN) had raised the basic question: "Why are so many bankable people unbanked?" "Who are bankable unbanked?" It is estimated that globally over two billion people are currently excluded from access to financial services. Financial Inclusion has become an issue of worldwide concern, relevant equally in economies of the underdeveloped, developing and developed nations. Building an Inclusive Financial Sector has gained growing global recognition bringing to the fore the need for development strategies that touch all lives, instead of a select few.

4. Why does Inclusive Financial Sector development matter? Access to a well–functioning financial system can economically and socially empower individuals, in particular poor people, allowing them to better integrate into the economy of their countries, actively contribute to their development and protect themselves against economic shocks. Creation and expansion of financial services targeted to poor and low-income populations can play a vital role in enhancing financial access. Inclusive financial sectors– those in which no segment of the population is excluded from accessing financial services – can contribute to attaining the goals contained in the United Nations Millennium Declaration, such as halving the proportion of people in the world who live in extreme poverty by 2015.

5. An Inclusive Financial Sector, the Blue Book says, would provide access to credit for all "bankanble" people and firms, to insurance for all insurable people and firms and to savings and payment services for everyone. Rangarajan Committee On Financial Inclusion (RBI, 2008) has argued that an open and efficient society is always characterized by the unrestrained access to public goods and services. As banking services are in the nature of public goods, financial inclusion should be viewed as availability of banking and payment services to the entire population without discrimination of any type. Finally, the Rangarajan Committee has defined financial inclusion as "delivery of banking services and credit at an affordable cost to the vast sections of disadvantaged and low income groups. The various financial services include savings, loans, insurance, payments, remittance facilities and financial counseling/advisory services by the formal financial system."

FINANCIAL INCLUSION



Source: RBI, 2008.

6. Financial Inclusion is not only the process of ensuring access to financial services or making available timely and adequate credit when needed by vulnerable groups, such as weaker sections and low income groups, at an affordable cost, it must also be appropriate, fair and transparent. What we need to do is first improve access to various financial products and services for the entire population and ensure that such access is provided by mainstream institutional players. Enabling people to get credit from small institutions, money lenders and the like is not financial inclusion. Access has to be through mainstream institutional players and only then such access will be fair, transparent and cost effective (Kochhar, 2009).

7. Only opening a bank account is not financial inclusion. Of course, the first thing is a check-in account, what we call a no-frills account. And the next step is immediate credit. Today, what the poor wants is accessibility to immediate credit. However, in most of the cases, the poor does not need credit for business or entrepreneurship, but it is for meeting a financial emergency, like health or urgent domestic needs. This immediate credit stage is followed by the introduction of various savings products, followed by remittances and payment services. This might be followed by insurance, especially health insurance, housing loans etc. Entrepreneurship credit comes at the last. This way, people have to be creditworthy and "financially included". Therefore, we have to go through all these stages and we have a long way to cover (Kochhar, 2009).

8. Subbaro (2013) asserts, financial inclusion does not only mean providing financial services. It also includes "financial literacy", meaning financial awareness, knowledge about banks and banking channels, facilities provided by banks, advantages of using banking routes etc. It involved educating people financially, making them financially literate. Financial inclusion and financial literacy are integral to each other, they are two elements of an integral strategy. The disadvantaged people need both access to and awareness of financial services. Financial literacy is demand side phenomena and financial inclusion, supply side response.

Inclusive finance Vs. Microfinance

9. Many development practitioners and financial institutions believe that there is a paradigm shift from microfinance to inclusive finance – from supporting discrete microfinance institutions (MFIs) and initiatives to building inclusive financial sectors. Inclusive finance recognizes that a continuum of financial service providers work within their comparative advantages to serve poor and low-income people and micro and small enterprises. Building inclusive financial sector includes but is not limited to strengthening microfinance and MFIs. Existing terminology that developed over many years to describe microfinance initiatives no longer serves well when we shift to discussing inclusive financial sectors. Microfinance has been defined as the provision of diverse financial services (credit, savings, insurance, remittances, money transfers, leasing, and payment mechanism) to poor and low-income people. Retail financial service providers that serve this market segment are increasingly more difficult to define with one common term. They include NGOs, private commercial banks, state-owned banks, non-bank financial institutions (such as finance companies and insurance companies), credit unions and credit and savings cooperatives. Many of these institutions are quite large, many are quite old and many have large number of clients and highly diverse products and services. As a result, the term MFI is often not descriptive or adequate to refer to this diverse group of financial institutions. While each of them plays an important role in inclusive finance, many of them could not be considered MFIs in the technical sense.

Inclusive Finance and Poverty Alleviation

10. Financial Inclusion is an important tool for attacking poverty. There are three dimensions of attack on poverty (WDR-2000-01):

- Creating opportunities for poor to improve their lives.
- Empowering the poor to demand more responsive state and social institutions.
- Providing the poor security- to cope with risk.

Financial Inclusion is important on all three dimensions

- Opportunity, empowerment and security.

11. Financial inclusion is good for all the stakeholders.

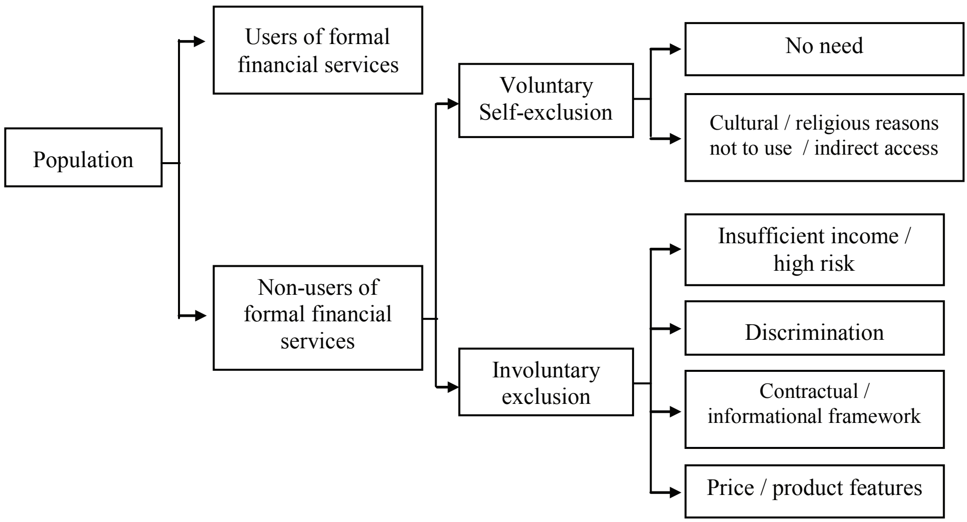
- Good for the poor: Opportunity to improve their incomes and their quality of life.

- Good for the banks: Steady low cost savings, portfolio diversification etc.
- Good for the government: Powerful tool of poverty reduction, it also cuts down leakage.
- Good for the economy: savings of the poor into the formal financial sector.

It is **win-win** for the poor, banks, government and economy. It is not just a public good but a merit good.

Who are excluded and Why?

12. Access to financial services - financial inclusion - implies an absence of obstacles to the use of these services, whether the obstacles are price or non-price barriers. It is important to distinguish between access to - the possibility to use - and actual use of financial services. Exclusion can be voluntary, where a person or business has access to services but no need to use them, or involuntary, where price barriers or discrimination, for example, bar access. Failure to make this distinction can complicate efforts to define and measure access.



Source: Finance for All? The World Bank, 2008.

13. For promoting financial inclusion, we have to address the issue of exclusion of people who desire the use of financial services, but are denied access to the same. There are a variety of reasons for financial exclusion. From the demand side, lack of awareness, low income/assets, social exclusion, and illiteracy act as barriers. From the supply side, distance from the branch, branch timings, cumbersome documentation procedures, unsuitable products, staff attitudes are common reasons for exclusion. All these result in higher transaction cost and lower profitability. On the other hand, the ease of availability of informal credit sources makes these popular even if costlier.

Extent of Financial Inclusion

14. Extent of financial inclusion can be assessed in a number of ways. An important measure of financial inclusion is to count the number of people who own a bank account. A person holding a bank account is considered to have elementary banking knowledge. Thus a count of the number of bank accounts gives an idea of the percentage of people who are aware of banking and what percentage still needs to be included. This is why the most commonly used indicator has been the number of bank accounts (per 1000 people). However financial inclusion does not end with the opening of bank accounts. What matters ultimately is the availability of banking services and access to finance by the mass people. Some other indicators, have also been developed to capture the financial inclusion such as number of bank branches (per million/per thousand people), number of ATMs (per million/per thousand people), bank credit as percentage of GDP, bank deposit as percentage of GDP etc. One recent review of national surveys reported that 89.6 per cent of the population of 15 countries in the European Union had a bank account, with country proportions ranging from 99.1 per cent in Denmark to 70.4 per cent in Italy. The comparable figure for the United States was 91.0 per cent. World Bank (2008) shows, in most developing countries less than half the population has an account with a financial institution, and in many countries less than one in five households does.

15. **Bangladesh Scenario:** The approach to Financial Inclusion in developing countries such as Bangladesh is somewhat different from the developed countries. In case of developed countries, the focus is on the relatively small share of population not having access to banks or the formal payment system. Whereas in Bangladesh, we are looking at the majority who are excluded. Dr. Atiur Rahman, Governor, Bangladesh Bank, reiterated, “Financial Inclusion is a high Policy Priority in Bangladesh, for faster and more inclusive growth.” According to the Governor, in view of no widely adopted uniform definition, financial inclusion is reckoned in Bangladesh as access to financial services from:

a) Officially regulated and supervised entities (banks and financial institutions licensed by Bangladesh Bank, MFIs licensed by the Micro-credit Regulatory Authority, registered co-operatives), and

b) Official entities themselves (post offices offer savings, money transfer and insurance services, national savings bureaus).

16. In terms of the above guideline, despite substantial bank branch expansion and increase of membership of MFIs and other institutions, about 25 percent of adult population is still financially excluded. In terms of banking credit related indicators too, the state of financial inclusion is not encouraging. For example, in Bangladesh, the access of people involved in agriculture who mostly live in rural areas to banking services is not sufficient with respect to their contribution to GDP. In FY13 the share of the agriculture sector in GDP was around 19 percent whereas the share of advances in total advances to this sector stood at only 6 percent. A substantial proportion of the households, especially in rural areas, is still outside the coverage of the formal banking system and is, therefore, unable to access mainstream financial products such as bank accounts and low cost loans. In terms of opening bank branches, it has been made mandatory that one urban branch must be accompanied by one branch in rural areas to encourage bank business there. In spite of the existence of 58 percent of total bank branches in rural area, the shares of rural bank branches in total deposits and advances were 18 percent and 10 percent, respectively, as of June 2013 which indicates a very low exposure of rural people to the formal banking system.

17. Institute of Microfinance (InM) conducted a survey on "Access to Finance" in 2011, which shows:

- About 77% of the households have access to any kind of financial services;
- Access to formal financial services is only 37%;
- Nationally, 54% of the households have access to any credit;
- Only 8% have access to formal credit;
- In terms of savings, only around 57% of households have access to any savings;
- Access to formal savings is shared by only around 28% of households.

18. BB has taken strong initiatives in the last few years to widen the coverage of banking services, especially by including the disadvantaged section of the society in the formal financial system. Along with moral suasion, a number of policy measures covering the opening of bank branches, deposit and credit products, some of which are very innovative for our banking system, have been taken. These include: changing of branch opening rules from 5:1 to 1:1 (for opening 1 urban branch, 1 rural branch is to be opened), availability of highest quality banking services to farmers by allowing them to open banks account with minimum initial deposit (Tk. 10 only); issuing branch licenses to all SME/Agriculture service centers; easy and effective access to banking services for physically incapable people, hard core poor, unemployed youth, freedom fighters etc.; relaxing conditions of loan repayment and providing fresh facilities to natural calamity affected farmers; mandatory participation in agriculture/rural credit for all banks including PCBs and FCBs; provision of agriculture credit to sharecroppers; formulation and implementation of Agriculture and SME Credit Policies and targets; putting emphasis on financing women entrepreneurs; arranging refinancing schemes for banks; developing ICT solutions (mobile banking, smart card etc.) for inclusive banking; encouraging creative partnership between banks and MFIs; Agent Banking, policy guidelines for Green Banking and introduction of financial inclusion oriented CSR, School banking, arranging cross country banking road show etc.

19. The policies and measures which have been undertaken so far in Bangladesh in the context of inclusive banking are of course essential and in the right directions and have already started creating positive impacts. For example, government owned commercial and specialized banks have so far opened 96 lakh 10 Taka farmers' accounts. It is obvious that opening of these accounts will help our government to migrate from paper based payments of state benefits (which is really very time-consuming and sometimes inhuman on the part of beneficiaries) to direct payment into accounts. Ultimately, these accounts are expected to play a key role in stimulating demand for other financial products. In the context of Bangladesh, it is expected that these farmers account can facilitate a transaction to higher level of financial transition, which in turn can lead to greater financial inclusion. Moreover, BB has undertaken one refinancing scheme of Tk. 200 crore for financing Tk. 10 account holders at easy terms with a view to make the rural economy vibrant through keeping Tk. 10 accounts active. Likewise, the volume of SME financing (as a tool of financial inclusion) by banks has increased manifolds. For example, in 2009, BB target for SME financing was only around Tk. 24,000 crore and it increased to around Tk. 75,000 crore in 2013, and achievement was 115%. Now, SME loans constitute around 30% of total loans and advances. A lot of entrepreneurs are getting substantial amount of SME loans and every bank has got SME dedicated and women dedicated SME desk. One Bangladesh Bank study shows that SME loans have a number of positive impacts on Bangladesh economy in terms of employment creation, improvement of living standards, women empowerment, and contribution to GDP etc. For coordinating and reinforcing the financial inclusion efforts, BB has converted the Agricultural Credit Department into Agricultural Credit and Financial Inclusion Department and created two new departments namely, SME and special Programs Department and Green Banking and CSR department. Finally, all these financial inclusion efforts have direct and indirect effects on the promotion of financial stability of the country.

Future Challenges

20. There are some issues which should also be taken into consideration for effectively addressing the challenges for ensuring sustainable inclusive banking in the country. These are:

i) The inclusive banking measures are bank-led and regulatory driven. These are not really spontaneous initiatives on the part of banks and financial institutions, without which sustainability of inclusive banking cannot be established.

ii) The measures so far taken are still not sufficicut to address the demand side problems of the financially excluded sections of the population. Financial exclusion is not only a supply- side problem.

iii) Banking approaches to the financially excluded people are to be changed. Here, banks should go to the public, rather than customers coming to them.

iv) Woman focus of the inclusive banking measures must be maintained.

v) Initiatives in regard to financial literacy and establishment of credit counseling centers are very necessary, but these are absent in Bangladesh. Not only for excluded people, even the financial service providers should also undergo extensive and continuous training on financial inclusion. This subject matter (financial inclusion) should be incorporated as a key segment of the initial training received by frontline branch and other customer contact staff.

vi) Like mandatory agriculture/rural finance programs, all banks operating in Bangladesh may be asked to participate in the financial inclusion program for which the responsibility of different unbanked/underbanked districts/areas should be allocated among the banks on the basis of some rational criteria.

vii) Finally, instead of giving piecemeal directives, the central bank should provide detailed guidelines of inclusive banking to all formal banks and financial institutions.

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