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DETERMINANTS OF FINANCIAL INCLUSION: A LITERATURE REVIEW

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Abstract: *Financial inclusion is the key to economic growth of countries. This is because access to finance enables individuals be able to participate in inclusive growth. The access to financial inclusion is important for financial development. The purpose of the paper was to establish the determinants of financial inclusion. The following research question guided the study; what are the determinants of financial inclusion? The study was a literature review of past studies on financial inclusion. Empirical journal articles were reviewed to establish the determinants of financial inclusion. The paper established that factors that determine financial inclusion are both demand related factors and supply related factors. The demand related factors include; income of individuals or households, education, collateral, being in employment guarantee scheme, income inequality, age, financial literacy, savings and gender. The supply related factors that determine financial inclusion includes; high interest rates (affordable credit), innovation (agent banking and mobile banking), ICT, bank branches, sensitization of financial products, advice on money management and debt counselling. The other factors include; urbanization and enabling environment. The recommendation of the study was that financial inclusion is key to economic growth and hence the government should put in place policies that enhances financial inclusion. Also the demand related factors and supply related factors should be looked at in order to align them in such a way that they positively promote financial inclusion.*

Keywords: Financial inclusion, determinants, Kenya

Introduction

Financial intermediaries enable borrowers (deficit units) to access funds from the lenders (surplus units). Because of the risk of adverse selection and moral hazards in the intermediation process not all borrowers may be able to access funds for investment purposes. Therefore, this may limit the growth of the economy and hence promote non-inclusive growth. This calls for deliberate effort by the government and financial regulators to improve financial inclusion in the economy (Arun & Kamath, 2015).

The importance of financial inclusion in promoting economic growth and development cannot be underscored, especially in the developing countries. This is because it is thought to promote inclusive development. As noted by Arun and Kamath (2015), left to financial institutions alone, they will not make deliberate effort to enhance financial inclusion. This is because their interest will be to serve the profitable segment of the economy leaving the poor segment underserved. Therefore, the financial regulators should come in to make policies that promote financial inclusion among the poor segment of the economy.

Financial inclusion promotes social change and alleviates poverty (Vashisht & Wadhwa, 2015). This is because the financial inclusion enables the individuals to change their social status in terms of using new social interaction such as mobile phones. The individuals will also be enabled to invest so that they generate income and hence increase their income. The increase in income is one of the panacea for poverty reduction.

The following financial institutions have been used to facilitate financial inclusion; commercial banks (MP & Pavithran, 2014) and micro-finance institutions (Mukhopadhyay & Rath, 2011). A study by Ene and Inemesit (2015) found that microfinance institutions promote financial inclusion among the active small business with small loans in Nigeria. Therefore, the commercial banks and micro-finance institutions should be encouraged to come up with products that enhance financial inclusion.

The importance associated with financial inclusion led to the conceptualization of this study. The purpose of this study was to review empirical literature to establish the factors that determine financial inclusion. The study will also make recommendations on financial inclusion.

Literature Review

Meaning of Financial Inclusion

Most countries in the world have enacted policies aimed at poverty reduction and increasing the standard of living of the citizens. Kenya, for example, produced a vision 2030 blue-print to guide the country in achieving middle income status as a country through the reduction of the percentage of population without access to finance from 85% to less than 70% (Government of Kenya, 2007). One of the key ingredient for poverty reduction is financial inclusion since it promotes inclusive growth while at the same time empowering the disadvantaged in the society (Sahoo, 2017). Financial inclusion has also been cited as an enabler in economic development which has led to the effort being made to increase financial inclusion in most countries among the disadvantaged group (Singh & Singh, 2015). Financial inclusion “refers to the fact that a person owns an account at a formal financial institution. Such an account allows to save and borrow money formally, to contract insurance or to use payment services” (Zins & Weill, 2016, p. 46).

Financial inclusion has been measured in different ways by different researchers. Financial inclusion has been measured by using branch penetration, deposit penetration and credit penetration (Bhuvana & Vasantha, 2016). A study by Wang and Shihadeh (2015), found that deposit and credit increased in Palestine meaning that financial inclusion had increased. This is due to the policies that the government had put in place to improve financial inclusion.

Factors Determining Financial Inclusion

Factors determining financial inclusion can be thought of as being both from the demand related and supply related. The demand related is the customers need for the finance and hence they seek to acquire the finance. They may seek the finance for social obligations and starting and running a business. On the other hand the supplier’s related factors constitute what the financial institutions do so as to enable the customer’s access finance.

One of the factor that determines financial inclusion is income of the individuals or households (Sahoo, 2017; Sarma & Pais, 2011). When the individuals have a regular income they will be able to operate bank accounts. The income becomes a way of accessing and using formal bank accounts by individuals. Individuals with more income may have more formal bank accounts and be able to use them regularly than those who have less and irregular income. A study by Sarma and Pais (2011), noted that income inequality as being an important factor that determines financial inclusion. Therefore, income in terms of the amount, the regularity and the inequality affect financial inclusion.

A study (Sahoo, 2017) found that household income, education, possession of private land and being in employment guarantee scheme are significant determinants of financial inclusion. The individuals with household income will have tendency to have bank accounts and hence use them to access financial services. Education was also found to enable individuals to access financial services through being able to open and operate bank accounts. The possession of private land enabled individuals to access bank loans since they can use the land as a security.

A study (Ahmed & Jianguo, 2014) found that collateral and high inters rates were the major factors hindering access to financial access. They also found that financial inclusion may be facilitated by the telecommunications which has led to increase in the use of MPESA services. They also cited challenges facing financial inclusion as lack of education, low technology, high cost of financial services and regulatory requirements.

Financial institutions should have access points closer to the customers. Financial institutions normally open branches so as to bring financial services closer to the people. When there are many branches closer to the people, then the financial services can easily be accessed. This will increase financial inclusion to the people near the financial institution branches. Branch density is a determinant of financial inclusion (Kumar, 2016).

A study (Lapukeni, 2015) found that information and communication technology (ICT) increases financial access through the reduction of transaction costs and widening the areas that can be covered by the financial institutions. Many financial institutions have partnered with telecommunication firms in a bid to increase their clientele for financial services. A good example is Safaricom which started M-PESA services which has increased the uptake of financial services through savings, payment and borrowing services.

Income is an important factor for financial inclusion (Sarma & Pais, 2011). They also found income inequality, adult literacy, and urbanization as being important for determining financial inclusion. They also noted that connectivity in information also plays a key role in financial inclusion. Income inequality determines financial inclusion in that individuals with high income will have a higher level of financial inclusion. Also individuals with higher literacy levels are more likely to have a higher level of financial inclusion. This is because they have the ability to open bank accounts and also use financial services. Urbanization tends to increase level of financial inclusion because of the improved infrastructure and communication technology.

Networks positively moderates in the influence of financial literacy on financial inclusion (Okello et al., 2016). Therefore, the study recommended that financial literacy programmes should be conducted to enhance financial inclusion. Financial literacy improves the ability of the individuals to handle issues related to money and hence, they can be able to access finance easily.

A study (Zins & Weill, 2016) also found that gender, age, income and education influenced financial inclusion in Africa. They also noted that education and income had a higher influence than the other factors. The gender plays a role in financial inclusion since the males control the finances in the family and they are in most families the income earners. The women are financially excluded because of cultural reasons. The age of the individual was also found to determine financial inclusion.

Financial innovation like MPESA in Kenya has been adopted successfully due to the enabling environment provided by the regulators such as central bank of Kenya and communication authority of Kenya (Buku, Meredith, Buku, & Meredith, 2013). The innovation has increased the value of transfer payments, account opening, depositing money and other financial services. This has led to increased financial inclusion. Another study (Yawe & Prabhu, 2017) found that innovations influences financial inclusion in an economy. The innovations studied included both the financial and telecommunications. Particularly agent banking and mobile banking were identified as facilitators of financial inclusion.

Commercial banks have also been found to have a role in improving the financial access (MP & Pavithran, 2014) through being involved in financial literacy, credit counselling, branch expansion and mobile banking among other measures. Therefore, the more branches of commercial banks we have in an economy the higher the level of financial inclusion.

Shah and Dubhashi (2015) reviewed literature and noted that financial inclusion can be improved by sensitizing people on the financial products, education, advice on money management, debt counselling, savings and affordable credit. They also said that technology can present a good opportunity for financial inclusion.

Conclusions and Recommendations

The study was intended to establish the determinants of financial inclusion by reviewing the empirical literature. The study reviewed eighteen empirical studies on the factors that determine financial inclusion. The paper found that there are a number of factors that determine financial inclusion.

The factors that determine financial inclusion are both demand related factors and others are supply related factors. The demand related factors include; income of individuals or households, education, collateral, being in employment guarantee scheme, income inequality, age, financial literacy, savings and gender. The supply related factors that determine financial inclusion includes high interest rates (affordable credit), innovation (agent banking and mobile banking), ICT, bank branches, urbanization, sensitization of financial products, advice on money management and debt counselling. The other factors include; urbanization and enabling environment.

The recommendation of the study notes that financial inclusion is key to economic growth and hence the government should put in place policies that enhances financial inclusion. Also the demand related factors and supply related factors should be looked at in order to align them in such a way that they positively promote financial inclusion.

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