



## Financial Inclusion as tool for combating poverty: Joesph Mubiru Memorial Lecture\*

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### Abstract

Financial inclusion is a key element of social inclusion necessary in fostering inclusive growth participated by and benefiting all population segments. Financial inclusion combats poverty by opening up blocked advancement opportunities for the disadvantaged poor; unleashing their creative energies for lifting themselves out of poverty in terms both of income and other measures of human development like health and education. In Bangladesh successive major thrusts for financial inclusion comprised rural branch network expansion of the banking system; the co-operative movement promoting mutually owned co-operative credit societies; and micro-credit from Grameen Bank and MFIs. While these initiatives succeeded in bringing about three quarters of the adult population under coverage of deposit and other basic financial services, progress in covering the remaining fourth, and in deepening inclusion in major shallow patches like financing for small farmers including sharecroppers and financing of SMEs is being impeded by high costs in delivery and recovery of small loans to borrowers in dispersed rural locations. Smart card/mobile phone based innovations in fund transfer, loan delivery and recovery mechanisms hold promise for substantial bringing down of the costs; policies supporting and promoting creative partnerships between banks, MFIs and card/mobile phone technology platforms in innovating cost saving options of remote delivery of loans and other financial services may bring about the next new major breakthrough in financial inclusion.

### Introduction:

1.1 **Financial inclusion is a key element of social inclusion (the antithesis of social exclusion), roughly meaning the opportunity for people to contribute to, and to benefit from the processes of social and economic advancement.** Poverty related deprivations in health, education and asset ownership are major causes of financial and social exclusion, blocking or severely curtailing access to employment, income and borrowing options. Discrimination by race, religion, caste, cult or gender; social disruptions from prolonged conflicts and wars; physical and mental debilities are among other main causes creating financial and social exclusion. The broad range of causative factors means that financial and social exclusion are likely to be encountered in varying degrees almost in all countries, developing and developed. Consequently, social and financial inclusion figure prominently in policy agenda even of mature developed countries. **Poverty related deprivations and exclusions are starker and more entrenched in low income developing countries like Bangladesh, with correspondingly higher urgency of progress towards fuller inclusion.**

1.2 Connected to financial and social inclusion is the notion of **inclusive growth**, a growth process based on fuller participation of all population segments, and benefiting them all. **Inclusive growth stresses more on equality of advancement opportunities than on equality of income** by redistribution; and is tolerant of 'good inequalities' that are incentives for competitive progress, like income differences arising as rewards for innovation, skills, aptitudes and education. With the unleashed creative energies of the hitherto excluded population segments contributing to growth pursuits, inclusive growth is expected to be stronger and more well-rounded; in terms of income as

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well as other metrics of well-being such as human development, food security, environmental sustainability.

1.3 In day to day life we need some basic transaction services from reliable service providers, like accepting our deposits, lending us money for current expense or investment to be repaid from future income flows, conducting money transfers and settlement of payments. *Financial inclusion means access to such basic financial services.* Obviously, the more affluent in the urban areas have easy access to these and other more complex financial services from banks and financial institutions including insurance companies and capital market intermediaries. Banks and other formal financial institutions have few branches or service outlets in rural areas, and small sized transactions with the poor are seen by these institutions as un-remunerative and unattractive. Illiteracy still prevails in rural areas, particularly among the elderly, which is a significant barrier to their accessing financial services from formal institutions. In the urban areas, rural migrants working as day laborers face yet another barrier to accessing institutional financial services in their lack of a definitive present address.

Formation of mutually owned co-operative societies had been an early officially supported attempt at financial inclusion of the rural and urban population of smaller means in similar occupations. Once formed, these co-operatives focused on advancing interests of existing members, in many cases falling prey to elite capture by the more influential members, with little inclination in risking dilution of control by expanding membership. In any case, the co-operatives movement was not designed to target the poorest population segments owning little or nothing in assets.

Financial inclusion of the poorest by way of their access to small-sized loans for income generating self-employment activities (micro-credit) from microfinance institutions (MFIs) has been extensively used in Bangladesh as a tool for combating poverty related deprivations; pioneered by Dr Yunus in late nineteen seventies and by now replicated worldwide. As elsewhere, ill informed, gullible people particularly in rural areas in Bangladesh have at times fallen prey to financial scams of pyramid /Ponzi schemes promising quick, very high profits, only to lose the investments with inevitable collapse of the schemes. To prevent any such deception in MFI activities and to ensure that these are run with integrity and soundness, the Government of Bangladesh (GOB) has constituted a Micro-credit Regulatory Authority (MRA) chaired by Governor, Bangladesh Bank (BB) to license and supervise the MFIs. The MRA being chaired by Governor of BB, the apex financial sector regulator has given a huge boost to the credibility of the MFIs licensed and supervised by the MRA.

Typically, MFI membership commences with opening of deposit accounts with minuscule sum and short spells of group-based sessions imparting to new members basic minimal financial literacy, eventually followed by loan disbursement for income generating self employment initiatives. Deposit, borrowing and repayment experiences of micro-credit borrowers with MFIs thus help prepare themselves for eventually accessing larger loans and other financial services from more formal institutions like banks.

Despite substantial expansion of bank branches and the roles thus far of co-operatives and MFIs, financial inclusion in Bangladesh has much further to go in adequately covering all population segments and all sectors of economic activities. About one-fifth to one-fourth of the population of Bangladesh still live in extreme poverty; many of them not capable of undertaking micro-credit supported self-employment initiatives. With few financial service outlets reaching out to this weak population segment, drawing from the official sources whatever small social safety net payments they are entitled to require them to incur substantial cost in time and travel expenses. Further, financial exclusion is not limited only within people in the lowest rungs in the income ladder. MFI borrowers successfully breaking out of extreme poverty and outgrowing eligibility for micro-credit often find themselves in a 'missing middle', still to be considered eligible for larger loans from banks or other formal institutions. Significant market gaps and failures persist in financing of important, growth oriented activities like agriculture and SMEs. Such exclusions and gaps are holding down economic

growth and poverty reduction. **Financial inclusion is therefore a high policy priority in Bangladesh, for faster, more inclusive growth.**

**Definition and measurement issues in financial inclusion:**

2.1 As yet without a widely adopted uniform definition; financial inclusion is reckoned in Bangladesh as access to financial services from entities supervised by official authorities, or from official institutions, including:

- a) Banks and financial institutions supervised by BB,
- b) MFIs supervised by the MRA,
- c) Credit co-operatives supervised by the Registrar of Co-operative Societies,
- d) Insurance companies supervised by Insurance Regulatory Authority,
- e) Capital market institutions like investment banks, merchant banks, stock exchanges supervised by the Securities and Exchange Commission (SEC),
- f) Post offices under the Post Office Department of the government offering savings, money transfer and insurance services; bureaus of National Savings Directorate of the Government issuing government savings instruments.

Because access to primary financial services of deposit taking, lending and money transfers count as financial inclusion, we need not be concerned with the clientele of secondary and tertiary institutions like insurance companies and capital market institutions in measuring the extent of inclusion, clients of these institutions already standing counted in as recipients of the primary services of deposit taking and lending.

2.2 Deposit services for safekeeping of savings is the stepping stone in accessing credit and other financial services on a continuing basis from banks, financial institutions including MFIs and cooperatives; *the coverage of deposit services (number of deposit accounts /membership in deposit schemes in MFIs, cooperatives, post offices as percentage of total population) is therefore a comprehensive primary measure of financial inclusion.*

2.3 *The coverage of credit services across income/occupational/gender groups and across economic activity sectors is another yardstick of financial inclusion, important from the viewpoint of growth and combating poverty. This measure is more qualitative, expressed in terms of gaps, exclusions and barriers in access to financial services.*

**3. Approaches in widening financial inclusion- progress thus far:**

3.1 Early post-liberation financial inclusion initiatives in Bangladesh comprised:

- i) Expansion of rural branches of banks (all of which were nationalized in 1971 after liberation of Bangladesh), and
- ii) Promotion of mutually-owned co-operative credit societies offering deposit and credit services to members.

3.2 The better off rural elite benefited from these initiatives, but success in financial inclusion of the broad masses of illiterate, innumerate rural poor remained limited. As mentioned earlier, the co-operatives tended to fall prey to 'elite capture' by powerful groups uninterested in diluting control by expanding membership; and the co-operative movement did not actually target the poorest population segments owning little or nothing in assets. Rural branches of banks focused mainly on crop loans to farmers, there lending models were not geared towards reaching out to the poorer landless illiterate unable to handle the paperwork involved in bank borrowing. The regulated low interest rates on bank

lending prevalent up to the late nineteen eighties, not covering the high costs of managing small loans to borrowers in dispersed rural locations, was also a deterrent during that period.

3.3 The Grameen Bank and the MFIs brought about a major breakthrough in reaching out to the rural poor. Their lending models specifically included imparting of necessary minimal literacy and numeracy to aspiring member borrowers; they have also been unrestricted in realizing interest and service charges at rates high enough to recover costs. Their programs were designed with some extent of gender bias favoring women, in the expectation that their strengthened income standing in the traditionally male dominated families will lead to better upbringing and education of their children.

Besides extending micro-credit, many MFIs in Bangladesh have collaborated with insurance companies in extending another financial service, viz., microinsurance to the poor, offering modest sized covers such as *credit life insurance* ('debt dies with debtor'), *health and accident insurance* (for sicknesses and injuries requiring hospitalization etc.), *property insurance* (usually for livestock bought with MFI loans), at affordably low rates of premium. Typically the MFIs act as partner agents of the insurance companies, collecting the microinsurance premiums on their behalf, most often by deduction at source from the micro-credit loans sanctioned. Regularly published data on microinsurance in Bangladesh are as yet unavailable; a February 2007 survey posted in CGAP's *microfinance gateway* ([www.microfinancegateway.org](http://www.microfinancegateway.org)) reported 10 insurance companies in partnership with 61 MFIs, were offering different microinsurance products in 81 schemes; with cumulative premium collections of over Taka 11.2 billion from about 4.5 million clients.

Some recent empirical studies using differing methodologies and covering differing time spans, have disputed the poverty reduction impact of micro-credit claimed by its protagonists (Dr. Yunus asserts that annually about five percent of micro-credit clients of Grameen Bank are lifting themselves out from extreme poverty). Episodes of borrower distress in complying with rigorous micro-credit regimes, sometimes compounded by multiple MFIs lending to the same borrower, occasionally do appear in newspapers. Self-employment initiatives are far from being risk free for the borrowers or the lenders, wrongly chosen initiatives and weaknesses in loan sanction and management disciplines can and do lead lenders and borrowers occasionally in difficulties; requiring prompt but appropriately flexible corrective response. Such difficulties do not negate the reality that financial inclusion by way of micro-credit indeed unlocks opportunities for the despondent, apathetic poor to lift themselves out of poverty; unleashing in them the optimism and creative energy necessary to retry and get over any setback in the initial attempt.

Another criticism that micro-credit does not help the poorest of the poor is invalid because micro-credit is intended only for those who can use it in income generating activities. Those unable to do so because of old age or other infirmity must be supported by outright transfers in the form of social safety net payments (the traditional safety net of extended family has dwindled, even in the higher income classes), not by credit to be repaid later.

Social innovations promoting financial inclusion, like micro-credit and the special programs designed to bridge market failures and gaps in agricultural and SME financing, help spawn diverse cycles of further innovations by entrepreneurs in the real sector, fostering inclusive growth in the true sense. For instance, SME financing has helped innovative entrepreneurs in small light engineering workshops in Bangladesh to develop and expand into a huge network producing plant/machinery spares (sometimes the plant/machine in entirety) of all descriptions for the manufacturing, transportation, construction and agricultural sectors, at fractions of import costs. In early nineteen eighties the emerging apparels export sector had scant access to foreign exchange for their import of inputs, the innovation of back-to-back usance LCs for input imports against export LCs from buyers got around the problem, triggering decades of sustained growth.

3.4 While the number of deposit accounts in banks and the number of members in MFIs and co-operatives are growing steadily, the rate of increase has slowed in the recent years. About 25 percent of the adult population is still to be covered by deposit and other financial services from regulated institutions (table 3.1), quite probably the hardest to reach. In access to credit, a 'missing middle' has emerged in the recent years between the poorest served by MFIs, and the relatively better off served by banks. Small businesses outgrowing eligibility for micro-credit from MFIs often find themselves considered still too small by banks for their lending, sharecroppers not so poor as to be eligible for micro-credit from MFIs are considered ineligible for crop loans by banks, with little or no collateral for banks to fall back upon in events of default. In terms of sectors of economic activity, important areas like agriculture, off-farm rural output activities and environment friendly renewable energy remain under-served by banks and other institutional lenders.

**Table 3.1 Status of Financial Inclusion in Bangladesh**

Year	Adult Population* (millions)	Population per bank branch (millions)	Number of bank deposit A/Cs (millions)	Deposit A/Cs as % of adult population	Number of members in MFIs (millions)	MFI members as % of adult population	Number of members in cooperatives (millions)	Cooperative members as % of adult population	Financial Inclusion** as % of adult population
1999	73.16	18669	27.30	37.32					
2000	75.16	18347	28.40	37.79					
2001	77.18	19886	30.10	39.00			7.65	9.91	
2002	79.59	20753	30.90	38.82			7.67	9.64	
2003	80.80	21406	31.30	38.73	14.63	18.11	7.57	9.37	66.21
2004	82.25	21443	31.60	38.42	14.40	17.51	7.76	9.43	65.36
2005	83.80	21420	33.10	39.50	18.82	22.46	7.92	9.45	71.41
2006	84.60	21171	34.50	40.78	22.89	26.95	8.03	9.45	77.33
2007	84.95	20920	35.70	42.02	20.83	24.52	8.22	9.68	76.22
2008	85.78	20566	37.60	43.83	20.90	24.36	8.44	9.84	78.04

Source: Scheduled Bank Statistics, Bangladesh Bank and Statistical Year Book of Bangladesh, BBS

\* Adult population is defined by BBS as population 15 years and above

\*\* Financial Inclusion is measured here as

$(\text{No. of bank deposit A/Cs} + \text{No. of MFI members} + \text{No. of members in cooperatives}) / \text{Adult population} * 100.$

Post offices and government savings bureaus not included as these offer no credit services

3.5 BB and the GOB have adopted several remedial and promotional measures to bridge these gaps in financial inclusion. In SME financing, BB has kept refinance lines available to banks against their loans to Small and Medium Enterprises (SMEs); multilateral development partners such as the IDA and ADB are supplementing BB's refinance lines with their co-finance. Besides, BB is allowing banks to open SME service booth in areas with no branches of the banks concerned.

The agricultural credit program announced by BB for FY 10 enjoins all banks to engage in lending for a comprehensive range of on- and off-farm rural economic activities, with refinance lines available to them from BB in case of need. A Taka 2.0 billion refinance line has been introduced in FY 10 against bank loans for environment friendly investments in solar energy, biogas plants and effluent treatment plants. In FY 10 BB has also introduced a first ever Taka 5.00 billion refinancing line against loans to sharecroppers in a group-based special program designed by a major MFI.

In issuing new branch licenses to banks, BB has been following a policy of requiring at least one in every five new branches to be in rural locations; with a view to pushing banking services physically closer to the rural population.

BB has also been exhorting banks and financial institutions to embrace fostering financial inclusion as a Corporate Social Responsibility (CSR) obligation. As a longer term measure towards mitigating risks in agricultural production (and hence also in agricultural financing), crop insurance has been included in the Food Policy agenda announced by GOB. A loan guarantee scheme for SME financing likewise merit consideration.

The ongoing DFID supported BB initiative for automation of the payments system in Bangladesh, the Remittance and Payments Partnership (RPP) project, is providing impetus to initiatives in designing faster and cheaper remittance and money transfer services; broadening and deepening financial inclusion particularly of rural recipients of remittances from family members working elsewhere within or outside the country. Partial grant support incentive from a Challenge Fund of the project has already spawned and introduced in use a number of new IT based remittance delivery processes that are superior to previous arrangements in speed and affordability for users. Online automated clearing and settlement of cheques and electronic fund transfers by the Bangladesh Automated Clearing House (BACH), under BB management to begin with, is scheduled to commence soon (within 2009); this will hopefully trigger innovation of further new service packages better tailored to specific needs of different customer segments, thereby widening or deepening their financial inclusion.

3.6 GOB has been providing from annual national budgets lending resources to MFIs (through PKSF, the apex financing agency for MFIs) for rural on- and off-farm self-employment micro and SME credit, with some gender bias towards empowerment of women. Financing lines from government budget have been made available also against loans to rural poor for their construction of basic shelter housing; in a number of schemes titled Grihayan, Ashrayan, Returning Home, and One home-One farm.

The Post Office Department of the government has of late been more actively engaging with banks and other external and internal remittance intermediaries to offer faster remittance deliveries to recipients. Regardless of however much the private sector remittance and mail/parcels delivery services improve, role of the publicly owned postal services is likely to remain necessary in catering to the needs of the remoter, sparsely populated areas that will be seen by the private sector as expensive and unprofitable to reach out to.

#### **4. The way forward:**

4.1 Fair progress has been achieved in financial inclusion with deposit services from regulated entities available to more than three fourth of the adult population (cf. table 3.1). However, as mentioned in paragraph 3.4 above, much remains to be done in deepening access to credit and other financial services in several shallow patches, and in bridging the remaining more recalcitrant gap. A major new breakthrough will be needed. High costs of managing portfolios of small-sized loans to borrowers in dispersed locations mean high interest rate/service charge burdens on borrowers, rendering their lower return but lower risk output activities unviable. Advances in information technology now offer a window of opportunity for breakthrough in reducing the costs of managing small loans to borrowers in remote locations, with smart card /mobile-phone based arrangements for disbursement and recovery of loans. The number of mobile phone subscribers is expanding fast in Bangladesh, already covering more than half the adult population (cf. tables 4.1, 3.1). Lower borrowing costs made possible by IT based remote delivery and recovery of loans will enable many

currently excluded individuals and businesses to borrow for new output activities that generate lower returns but also involving lower risks.

**Table 4.1: Growth trends and teledensity of mobile and fixed phone**

	2004	2005	2006	2007	2008	2009
Mobile phone subscribers (millions)	4.15	9.27	20.8	34.38	43.7	46.69
Fixed phone subscribers (millions)	0.83	0.87	1.02	1.19	1.28	1.44
Total subscribers (millions)	4.98	10.14	21.82	35.57	44.98	48.13
Grow th rate of mobile phone subscribers	...	123.37	124.38	65.29	27.11	6.84
Grow th rate of fixed phone subscribers	...	4.82	17.24	16.67	7.56	12.50
Total grow th rate	...	103.61	115.19	63.02	26.45	7.00
Tele-density (in percent)	3.62	7.25	15.39	24.71	27.91	32.09

*Source: Bangladesh Telecom Regulatory Commission(BTRC); Figures are end June numbers.*

4.2 Over the near term BB's policies will focus on leveraging the potential synergies in creative, cost-saving partnerships between banks, MFIs, and telecom/mobile phone service providers in bridging the remaining gaps in financial inclusion; with due attention to the risk management, consumer protection and systemic stability issues that may arise in these new arrangements. A few such partnership proposals have already been approved, and some others are under scrutiny.

Some public utilities of GOB are already collecting utility bills from users through mobile phone based arrangements; benefiting the payers with savings in travel costs and queuing up time in crowded receipt counters. Similar cost saving IT based remote delivery arrangements are possible for numerous government payments in small amounts like social safety net allowances for the eligible poor, pension payments for retirees, salary subvention payments for teachers in privately run schools and so forth. Well-designed IT based arrangements of this kind for these payments can prevent leakage or wrongful delivery of benefits, besides deepening financial inclusion.

4.3 To conclude, we may recall that financial inclusion combats poverty by unblocking advancement opportunities for the disadvantaged poor, thereby fostering social inclusion and inclusive socioeconomic growth. Broad thrusts for promotion of financial inclusion are unlikely to be very different across national borders, but differences in socio cultural backgrounds may necessarily mean differences in details of specific approaches. In Bangladesh, following bank branch based, co-operatives based and MFI based phases of major expansion, we are pinning hopes and efforts on IT based cost-saving innovations for a new phase of major breakthrough in closing the remaining gaps and shallow patches in financial inclusion.

Many of the approaches adopted in Bangladesh towards expanding and deepening financial inclusion would be replicable in Uganda, with appropriate adaptations to suit the local circumstances. The lack of spontaneity of banks in financing small landholder/sharecropper farming in Uganda arise from much the same main reason as in Bangladesh, viz., the high loan default risk in absence of crop insurance protecting farmers from output risks and price risks. Putting in place a new well functioning crop insurance scheme or upscaling any microinsurance that may now exist will take time. Meanwhile, specially designed schemes such as the group based bank lending to sharecroppers (directly or through well chosen MFIs), supported by low cost central bank refinance line, as introduced in Bangladesh can mitigate the risks significantly. In case of Uganda, rationalization of the reportedly high provisioning requirements will be of further help. Uganda and most other African states may not have the high ethnic homogeneity and population density that facilitated co-operatives and MFIs in assuming major roles in fostering financial inclusion in Bangladesh; African attempts of replication of

similar significant roles for co-operatives and MFIs will need to take note of this difference. I believe it will be worthwhile for Bank of Uganda (BOU) and BB to be in closer exchange of information and co-operation in these and other initiatives for combating poverty by fostering financial inclusion; looking at ongoing initiatives elsewhere always pay dividends in new insights and perspectives about our own domestic context.

There may never be an occasion to call the tasks of financial inclusion and poverty eradication over and done with. Natural or man made disasters can all too often push affected population segments afresh into poverty and exclusion, and at any event poverty is a relative rather than absolute term in definition or perception; which is why social and financial inclusion figures prominently in policy agenda even of mature developed economies.

Let me conclude by quoting some lines by Rabindranath Tagore, a Bengali Nobel Laureate in Literature, who too cared most for social inclusion:

***“Those whom you push down will chain you down  
Those whom you leave behind will pull you behind  
The more you envelope them under darkness of ignorance  
The more distant will your own welfare be!”***

Literal translation from a poem of Rabindranath Tagore (1861-1914)  
“Disgraced” in Gitanjali

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