

# FINANCE FOR ALL?

A World Bank Policy Research Report



# FINANCE FOR ALL?

POLICIES AND PITFALLS IN  
EXPANDING ACCESS



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# Foreword

ACCESS TO FINANCIAL SERVICES VARIES SHARPLY AROUND THE WORLD. In many developing countries, less than half the population has an account with a financial institution, and in most of Africa less than one in five households do. Recent development theory sees the lack of access to finance as a critical mechanism for generating persistent income inequality, as well as slower growth. Without inclusive financial systems, poor individuals and small enterprises need to rely on their own limited savings and earnings to invest in their education, become entrepreneurs, or take advantage of promising growth opportunities. Financial sector policies that encourage competition, provide the right incentives to individuals, and help overcome access barriers are thus central not only to stability but also to growth, poverty reduction, and more equitable distribution of resources and capacities.

The World Bank Group has long recognized that well-functioning financial systems are essential for economic development. The work of its financial sector has, over the years, emphasized the importance of financial stability and efficiency. Promoting broader access to financial services, however, has received much less attention despite the emphasis it has received in theory. The access dimension of financial development has often been overlooked, mostly because of serious data gaps in this area. Empirical evidence that links access to financial services to development outcomes has been quite limited, providing at best tentative guidance for public policy initiatives. The increasing emphasis by policy circles in recent years on building more inclusive financial systems thus highlights the need for better data and analysis.

Measuring access to finance, its determinants, and its impact has been the focus of a major research effort at the Bank in recent years.

This research has included case-study analyses of specific policies and interventions, as well as systematic analyses of extensive cross-country and micro data sets. *Finance for All?* presents first efforts at developing indicators illustrating that financial access is quite limited around the world and identifies barriers that may be preventing small firms and poor households from using financial services. Based on this research, the report derives principles for effective government policy on broadening access.

The report's conclusions confirm some traditional views and challenge others. For example, recent research provides additional evidence to support the widely-held belief that financial development promotes growth and illustrates the role of access in this process. Improved access to finance creates an environment conducive to new firm entry, innovation, and growth. However, research also shows that small firms benefit the most from financial development and greater access—both in terms of entry and seeing their growth constraints relaxed. Hence, inclusive financial systems also have consequences for the composition and competition in the enterprise sector.

The evidence also suggests that besides the direct benefits of access to financial services, small firms and poor households can also benefit indirectly from the effects of financial development. For example, the poor may benefit from having jobs and higher wages, as better developed financial systems improve overall efficiency and promote growth and employment. Similarly, small firms may see their business opportunities expand with financial development, even if the financial sector still mostly serves the large firms. Hence, pro-poor financial sector policy requires a broader focus of attention than access for the poor: improving access by the excluded nonpoor micro and small entrepreneurs can have a strongly favorable indirect effect on the poor.

Expanding access to financial services remains an important policy challenge in many countries, with much for governments to do. However, not all government action is equally effective, and some policies can be counterproductive. Policy makers need to have realistic goals. For instance, while access to formal payment and savings services can approach universality as economies develop, not everyone will or should qualify for credit. There are instances where national welfare has been reduced by overly relaxed credit policies.

Government policies in the financial sector should focus on reforming institutions, developing infrastructures to take advantage of technologi-

cal advances, encouraging competition, and providing the right incentives through prudential regulations. The report discusses experience and evidence of different government interventions—such as those through taxes, subsidies, and direct ownership of institutions—illustrating how they sometimes tend to be politicized, poorly structured, and beneficial mainly those who do not need the subsidy. In the absence of thorough economic evaluations of most schemes, their net effect in cost-benefit terms also remains unclear.

Despite best efforts, it seems likely that provision of some financial services to the very poor may require subsidies. Generally speaking, the use of subsidies in microcredit can dull the incentive for innovative new technologies in expanding access, with counterproductive long-term repercussions for the poor. Besides, evidence suggests that for poor households credit is not the only—or in many cases, the principal—financial service they need. For example, in order to participate in the modern market economy even the poor need—but often cannot access—reliable, inexpensive, and suitable savings and payments products. Subsidies may sometimes be better spent on establishing savings and payment products appropriate to the poor.

This report reviews and synthesizes a large body of research, and provides the basis for sound policy advice in the area of financial access. We hope that it will contribute to the policy debate on how to achieve financial inclusion. While much work has been done, much more remains to be learned. The findings in this report also underline the importance of investing in data collection: continued work on measuring and evaluating the impact of access requires detailed micro data both at the household and enterprise level.

The World Bank Group is committed to continuing work in the area of building inclusive financial systems, helping member countries design financial system policies that are firmly based on empirical evidence.

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# The Report Team

THIS POLICY RESEARCH REPORT WAS WRITTEN BY ASLI DEMIRGÜÇ-KUNT, Thorsten Beck (both with the Development Research Group), and Patrick Honohan (Development Research Group and Trinity College Dublin), under the general supervision of L. Alan Winters (Development Research Group). It draws heavily on the results of the on-going research program in the Finance and Private Sector Team of the Development Research Group at the World Bank. Original research as background for this report includes work by the authors and by Meghana Ayyagari (George Washington University), Robert Cull, Xavier Gine, Leora Klapper, Luc Laeven (now at the IMF), Ross Levine (Brown University), Inessa Love, Vojislav Maksimovic (University of Maryland), Maria Soledad Martinez Peria, David McKenzie, Sergio Schmukler, Colin Xu, and Bilal Zia.

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# Abbreviations

ATM	automated teller machine
DFI	development finance institution
FDI	foreign direct investment
GDP	gross domestic product
MFI	microfinance institution
ROSCAs	rotating savings and credit associations
SBA	Small Business Administration (United States)
SME	small and medium enterprise

