Journal of Social Sciences, Volume 01, No. 01 (2014) ISSN 2362-0366

# Impact of Financial Inclusion for Alleviation of Poverty and Unemployment

Buddhika Hettiarachchi,Department of Social Sciences, Faculty of Social Sciences and Humanities,Rajarata University of Sri Lanka, Mihintale,
buddhikarjt@gmail.com

## Abstract

Financial inclusion is alternatively known as inclusive financing, which attempts to deliver financial services at affordable costs to the common man so that large sections of society can be served. The concern of the government among the developing nations for more financial inclusion gained momentum only around the beginning of the new millennium. Since then, miniscule fraction of financial inclusion has trickled down to the teeming population at the bottom of the pyramid. With this view, an attempt is being made to highlight the present scenario of some of the selected countries concerning to their financial inclusion and to find out the relationship between financial inclusion and the extent of poverty and unemployment. The study has revealed that there exists significant relationship between financial inclusion through microfinance and pervasive poverty. Financial inclusion and unemployment are also found to be correlated. Along with various poverty eradication and employment generation programmes, focus should also be on the financial inclusion policies as a means of ameliorating interwoven case of poverty and unemployment.

Key words: Financial Inclusion, Poverty, Unemployment

## Introduction

Financial inclusion is integral to the inclusive growth process and sustainable development of the country. However, the financial inclusion growth model which came up with lots of expectations should be replicable and viable across the country. Though, the banking network has rapidly expanded over the years, the key challenge would be to extend the banking coverage to include the large population living in villages in the country. The financial services include the entire savings, loans, insurance, credit and payments etc. the financial system has to provide its function of transferring resources from surplus to deficit and surplus units are those with low incomes, poor background etc. by providing these services, the aim is to help them come out of poverty. So far, the focus has only been on delivering credit and has been quite successful. Similar success has to be seen in other aspects of finance as well.

## Literiture Review; Financial Inclusion

Financial inclusion may be defined as the process ensuring access to financial services and timely and adequate credit was needed by vulnerable group such asweaker selection and low income group at an affordable cost (Rangarajan's committee 2008). Asian development Bank has defined as provision of broad range of financial services such as deposits, loans, Payment services, money transfer and insurance to poor and low income households and their microenterprises.The size of the financially excluded population in the world is enormous according to the United Nations, approximately three billion people around the globe lack access to formal financial services- such as bank account, credit, insurance, a safe place to keep saving and a secure and efficient means to receive social benefit payments- through a registered financial institution (UN, 2007; Chibba, 2008).This sizeable population of the world particularly poor, low income and vulnerable group remain excluded from the most basic financial services provided by financial sector. It has been universally accepted that developing financial sector and improving access to financial services accelerate economic growth and helps to achieve inclusiveness growth.

Inclusive growth rate is a little more than just the benefits growth distributed equitably and evenly. It is participation of all sections and regions of society in the history of growth and reaping fruits of growth. Financial inclusion, within the broader context of inclusive development, is viewed as an important means to tackle poverty and inequality.

A small loan, a savings bank account and an insurance policy can make a great difference to poor and low income family. These financial services enable the poor to have better nutrition, housing, education for children and better health-care and improve standard of living. Thus, financial inclusion can act as an effective instrument to alleviate poverty in the world particularly in developing and underdeveloped countries. The financial inclusion therefore has become issue of worldwide concern as large sections of the population have no access to financial services. All the countries are making conscious efforts to bring vast segment of population especially under-privileged sections of the society in rural and urban areas into the banking fold (Yunus, 2006).

In Africa, only about 4 per cent of the population has a bank account (UNCDF, 2006), whereas in Latin America, 65 per cent of the population comprises the unbanked (World Bank, 2007). Therefore, Africa surely deserves special attention. The access to financial services can be measured in the form of access to certain institutions such as banks, cooperatives, non-banking finance companies, credit unions, micro finance institutions, insurance companies or in terms of functions that institutions perform or services they provide such as payment services, saving or loans and credit. Yet another approach is to look to details in use of specific financial products viz. debit cards, credit cards, smart cards.

Therefore, the idea of financial inclusion should be broad based, in such a way that people are able to not only access credit, but also fetch various financial services and products through the banking access point. At the micro level, the financial services providers should aim for a holistic

approach that meets the different financial needs of the target customers, address not just rural, but also large urban excluded segments, reduce cost of transactions with proper technology adoption, and support the development of support infrastructure. At the macro level, there should an eco-system that binds the different facets of banking and financial system to deliver financial inclusion. The banking and technology players should collaborate more firmly to strengthen financial inclusion, while adding that building financial habits among a large section of society will be just as important as an objective to be focused upon (Kochhar2007). According to research findings, financial inclusion deduces the prevailing unemployment rate and the poverty. Therefore, we can and must build inclusive financial sectors that help people improve their lives (Beg,2010).

## Research Problem

Based on the literature this paper attempts to find whether there is a relationship between financial inclusion and reducing poverty and unemployment in developed and developing countries.

## Objectives

1. To assess the extent of barriers in accessing banking services.
2. To measure the extent of penetration of bank services both geographically and demographically.
3. To analyze the impact of accession in financial services on poverty and unemployment.

## Methodology of the Study

In order to deal with problem, whole paper has been divided into three sections. The first section deals with the comparative picture of the selected developed and developing countries in the context of barriers in accessing the banking services using secondary data. The second section deals with the geographic and demographic penetration of bank services using indicators developed on financial inclusion in developed and developing countries. The third section concludes relationship between financial

inclusion and development indicators through the correlation coefficient **Barriers in accessing the banking services** As a matter of fact, the degree of banking exclusion varies across the world, but it is the same group of people, who are affected, people having low income or who have similar history of bad debt. These sections of people are excluded from the mainstream because they do not have sufficient income to repay the loan or to keep the asset as collateral security against whom the borrower can take loan. The financial inclusion is not restricted to rural or far flung areas, but it is also taking place in urban areas as a result of increasing migration of rural poor to urban centers. The primary barriers in expansion of financial services are identified as:

- Non-availability of a bank branch within near distance for physical access.
- Banks do not prefer low income people as their clients.
- Perceptions of financial services are found as complicated.
- High charges and penalties attached to banking products and services which make them unaffordable.
- Other factors include gender, age, legal entity, illiteracy, place of living, physical and cultural barriers, type of occupation etc.

RUSL

Table.01 : Barriers in accessing the banking services

| Country | Private credit as % of GDP per capita(2004) | GDP per capita US$ | Saving Account (deposit services) | | | | Loans Services (SME) | | | | Amt.of fee for using ATM cards (% of $ 100 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | Min. Amt reqd to open A/C as %of GDP per capita | Min Amt Reqd to maintain As % of GDP per capita | Annual Fee as % of GDP per capita | Documents required (Nos) | Physical Access# | Fee (% of Min Loan | Days to Process (Nos) | Cost of Transfer Funds internationally | |
| Australia | 100.9 | 22083 | 00 | 00 | 0.10 | 3 | 5.00 | 17.7 | 7.2 | 8.05 | 00 |
| Bangladesh | 27.4 | 402 | 0.89 | 0.79 | 00 | 4 | 2.12 | 0.15 | 43.3 | 1.93 | NA |
| Brazil | 33.9 | 3564 | 0.10 | 00 | 0.03 | 2 | 4.85 | 2.94 | 3.63 | 14.85 | 0.11 |
| Denmark | 154.0 | 30735 | 00 | 00 | 00 | 1 | 5.00 | 1.73 | 1.00 | 4.09 | 00 |
| India | 32.8 | 638 | 5.02 | 5.02 | 0.17 | 2 | 2.44 | 0.93 | 10.8 | 6.49 | 00 |
| Indonesia | 21 | 906 | 3.03 | 0.65 | 0.66 | 2 | 3.10 | Na | 9.7 | 2.83 | 00 |
| Pakistan | 25.8 | 566 | 1.59 | 0.71 | 00 | 2 | 3.09 | Na | 33.6 | Na | 0.6 |
| Philippines | 33.5 | 1085 | 11.88 | 11.88 | 00 | 2 | 2.36 | Na | 33.3 | Na | 00 |
| **Sri Lanka** | **28.5** | **962** | **3.54** | **0.84** | **00** | **1** | **2.90** | **Na** | **10.4** | **Na** | **Na** |
| Minimum | - | - | 00 | 00 | 00 | 00 | 1.77 | 00 | 1.0 | 0.12 | 00 |
| Average | - | - | 8.14 | 6.15 | 0.38 | 2 | 3.26 | 2.55 | 10.5 | 6.64 | 0.14 |
| Maximum | - | - | 68.26 | 64.75 | 3.63 | 4 | 5.00 | 29.32 | 43.3 | 20.2 | 0.6 |

Source: "World Bank, 2010.

An analysis of Private credit as % of GDP per capita in the year 2004 in some selected countries shows that India and Sri Lanka account for 32.8 and 28.5 per cent as opposed to the very high share of Denmark and Australia with respective shares of 154.0 per cent and 100.9 per cent. Other countries fall in the vicinity of Sri Lanka in terms of penetration of people exercising the private credit as percent of GDP. Another criterion to ascertain the penetration of people enjoying banking facility can be understood from the minimum amount required to open account as % of GDP per capita. In case of both Australia and Denmark, the minimum requirement to open account is zero per cent of GDP as against it is very high in Philippines (11.88 per cent), followed by Sri Lanka (3.54 per cent) and other countries selected for the purpose of study. The countries like Australia, Denmark and Brazil practice banking without frills account, whereas, it is extremely high in the context of Philippines (11.88 per cent), followed by India 0.84 per cent). Other countries do not require much of balance to maintain the account.

An introspection of annual fee to be charged from the customers as per cent of GDP has been zero in most countries under the study. Nevertheless, it is the highest in case of Indonesia (0.66 per cent), followed by Sri Lanka (0.0 per cent), Australia (0.10 per cent) and Brazil (0.03 per cent). The number of documents required to open account has been varying enormously in these countries. The number of papers required to open account in Bangladesh is 4, closely followed by Australia 3 on the higher side, as against it, the number of papers required in countries like Denmark and Sri Lanka are just 1 on the lower side. Other countries that fall in between these two extreme ranges are Brazil, India, Indonesia, Pakistan, Philippines. (Each country requiring 2 documents for opening the account).

Ironically, Bangladesh takes nearly 43 times more number of days in sanctioning loan as compared to Denmark. Though, Sri Lanka takes 10 times

more number of days. Philippines and Pakistan each takes 33 days to clear the loan, which hinders in the process of financial inclusion. The fee for using the ATM cards is negligible in most of the countries under study.

## Geograpgic Penetration

According to Policy Research, Working paper presents some indicators of banking sector penetration based on survey of regulatory authorities(World Bank 2005). The indicator of banking sector outreach include

a. Geographic branch penetration (No of bank brunches per 100 Km)
b. GeographicATM per 1000 Km
c. Demographic branch penetration (Number of brunches per 100,000 people)
d. Demographic ATM penetration (Number of ATMs per 100,000 people)

Table 2 Geographic and Demographic Penetration of Bank Services

| Country | Geographic Penetration | | Demographic Penetration | |
|---|---|---|---|---|
| | No. of Bank branches per 1000 Sq. Km | No. of ATMs per 1000 Sq. Km | No. of branches per 100,000 people | No. of ATMs per 100,000 people |
| Korea | 65.02 | 436.88 | 13.40 | 90.03 |
| U.K. | 45.16 | 104.46 | 18.35 | 42.45 |
| India | 22.57 | 45.00 | 6.30 | 0.45 |
| Indonesia | 10.00 | 5.73 | 8.44 | 4.84 |
| USA | 9.81 | 38.43 | 30.86 | 120.94 |
| Mexico | 4.09 | 8.91 | 7.63 | 16.63 |
| Brazil | 3.05 | 3.72 | 14.59 | 17.82 |
| China | 1.83 | 5.25 | 1.33 | 3.80 |
| Russia | 0.19 | 0.53 | 2.24 | 6.28 |
| Sri Lanka | | 11.65 | 14 | 11 |

An analysis of geographic penetration of number of bank branches per 1000 Sq. Km is expected to unfurl another milestones indicating distances to the nearest physical bank outlets and easier geographical access. In this context, Korea has opened maximum number of bank branches (65.02) per 1000 sq. km, followed by U.K. (45.16), India (22.57),Indonesia (10.00), U.S.A. (9.81), Mexico (4.09), Brazil (3.05), China (1.83) and Russia (0.19). The number of ATMs per 1000 sq. km is highest in Korea (436.88), followed by U.K (104.46), India (45.0), Sri Lanka (11.65), U.S.A. (38.43), Mexico (8.91), China (5.25), Brazil (3.72) and Russia (0.53).

As far as the number of branches per 100,000 people is concerned, U.S.A tops the list (30.86), other countries have poor banking per 100,000 population. According to central bank annual report Sri Lanka has 14 branches for 100,000 populations. The number of ATMs per 100,000 people is again highest in case of U.S.A., followed by Korea and U.K. Sri Lanka has 11 ATMs per 100,000 people.Following table provides the summary of financial inclusion in the world, region and in Sri Lanka

Table. 3 Financial Inclusion Analysis of Outreach

| | High Income Countries | Developing Countries | South Asia | Sri Lanka |
|---|---|---|---|---|
| Bank Density (No of Bank Brunches per 100,000 persons) | 32 | 10 | 7 | 14 |
| ATMs per 100,000 persons | 94 | 29 | 4 | 11 |

Source: World Bank Report 2010, Central Bank of Sri Lanka Annual Report 2010.

## Financial Inclusion and the Development Indicators

The banking sector in the developed countries is so much developed that they serve most of the population, but in developing countries, the position is quite different because the financial institutions serve only small segment of low-income group. Therefore, the down –trodden people have little access to the financial services. They derive finance from semi-formal or traditional sources. As a result, many people necessarily depend on their own resources or informal sources of finance that too at high cost. In most developing countries formal sectors serve more often no more than 20 to 30 per cent of the total population, the vast majority of whom are low income households in rural areas. (ADB, 2007).The financial inclusion and the development indicators of some of the countries are given below:

Table 4: Financial Inclusion and Development Indicators

| Country | Composite Index* of financial Inclusion | Poverty (%) 2010 | Unemployment rate (%) 2010 |
|---|---|---|---|
| Sri Lanka | 26 | 25.0 | 9.0 |
| India | 48 | 28.6 | 4.3 |
| Bangladesh | 32 | 49.8 | 3.3 |
| Brazil | 43 | 22.0 | 9.7 |
| China | 42 | 4.6 | 4.0 |
| Indonesia | 40 | 27.1 | 9.9 |
| S. Korea | 63 | 0.00 | 3.5 |
| Malaysia | 60 | 15.5 | 3.5 |
| Philippines | 20 | 36.8 | 9.8 |
| Thailand | 50 | 13.1 | 1.5 |

Source: World Bank Report 2010, Central Bank of Sri Lanka Annual Report 2010.

*Per cent of population with access to financial inclusion.

Data presented in the table 4 is quite self-explanatory and has been projected graphically in the successive diagrams. Diagram 1 confirms that the countries having high poverty ratio are poorly financially included as against the countries that have high composite index of financial inclusion with low poverty levels.

Figure 1: Depicting index of Financial Inclusion and poverty ratios

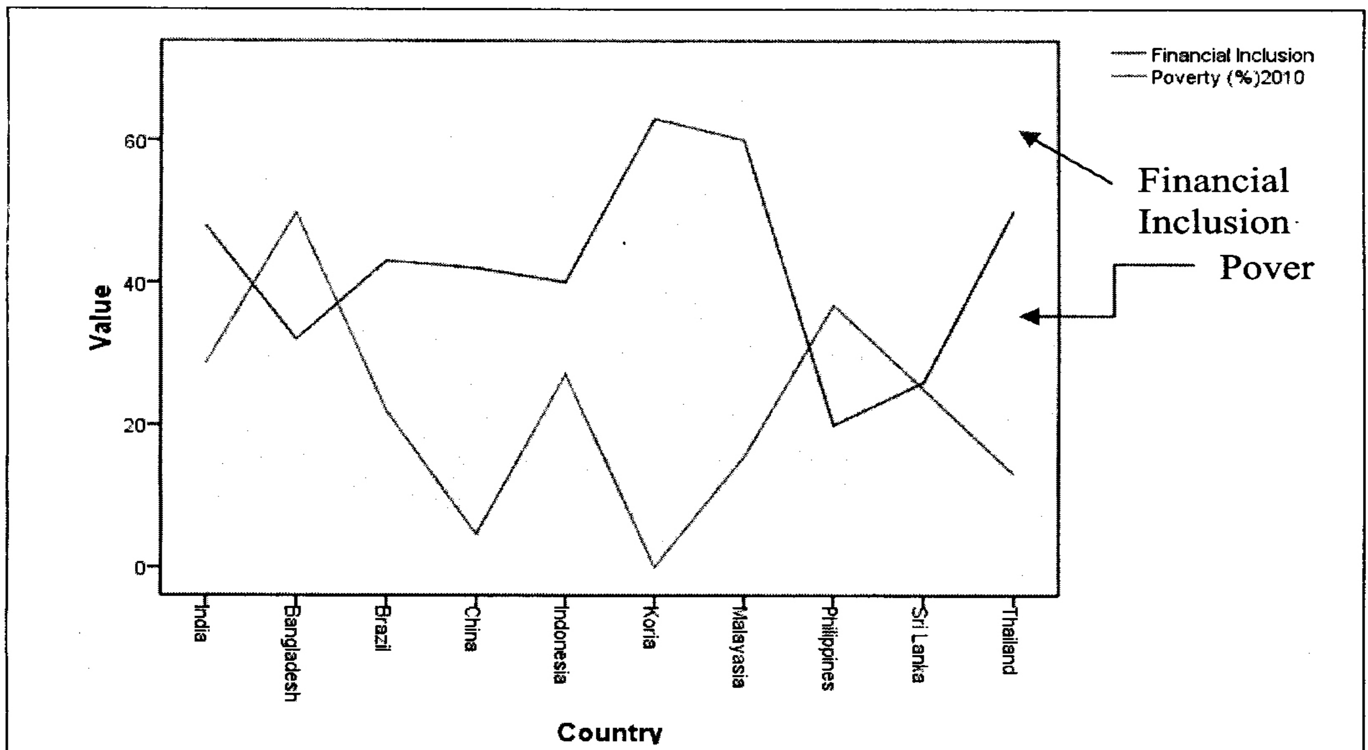
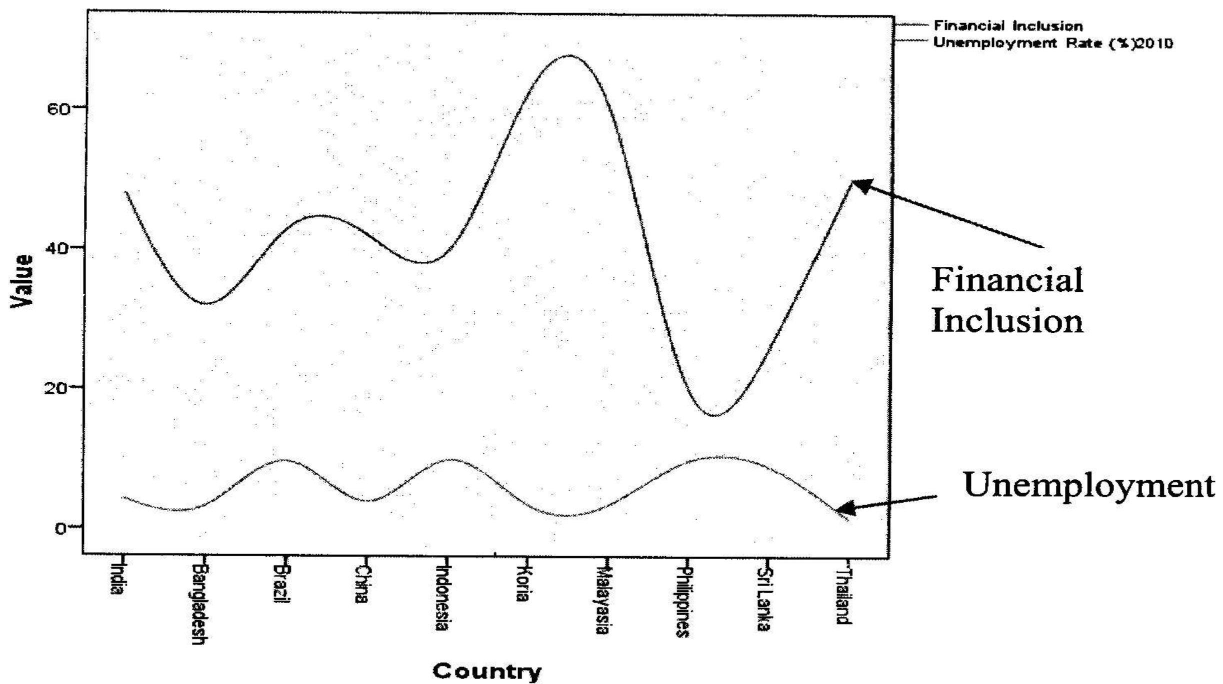



Diagram 2 endeavors to delineate the association between the financial inclusion and the unemployment rate. Countries such as Korea, China and Malaysia are deeply included with least or no poverty incidence

Figure 2: Depicting Index of Financial Inclusion and Unemployment rate




The financial inclusion and the unemployment rate. Countries such as Korea, China and Malaysia are deeply financially included with least or no poverty incidence.

Empirical Testing of the Data relating to the composite index of financial inclusion and the unemployment rate: Karl Pearson's Correlation technique has been used to establish relationship between two variables. First is Composite Index of Financial Inclusion and the second is: unemployment rate.

The coefficient of correlation (r) between these two attributes has been calculated as r= (-0.38). If the value of 'r' is squared, we can derive a further useful statistic – namely the coefficient of determination, which expresses how much of the variation in one variable is due to the other variable. Since $r= -0.38$ then $r^2=0.1444$. This can be expressed in percentage form by multiplying by 100; the product of this value is 14.44%. This can be interpreted as just 14.44% of the variation in the unemployment ratio is directly accounted for by composite index of financial inclusion.

The negative correlation between these two variables shows that enhancement in the composite index of financial inclusion brings about reduction in the unemployment ratios. The H $^2$ is also rejected (r= -0.38 & $r^2$=0.1444, in percentage form it is 14.44), hence it is inferred that inclusion of financial services is not independent of the unemployment rate. Hence, H $^2$ is formulated as "Financial inclusion reduces the prevailing unemployment rate and the financial exclusion would mean people not using the banking products of the financial sector. Therefore, we can and must build inclusive financial sectors that help people improve their lives.

## Conclusion

In this study, an attempt has been made to delineate empirically the formidable problems of financial inclusion which has hindered the growth process of the country by perpetuating the molasses of the more than quarter of the population in the form of abysmal poverty and unemployment. The milieu of poverty of this nation is so much warranting that growth driven poverty is being witnessed. The study has revealed that independence of financial inclusion and the poverty to a great extent and unemployment to a lesser degree has been unfounded using the Karl Pearson's method of correlation. However, the ever-growing popularity of banking products should be brought into the limelight of the bottom at the pyramid. The large section of population which is hitherto camouflaged from the banking habits should be included in the realm of financial inclusion.

Financial inclusion should be measured not only by the number of bank accounts held by the weaker sections, but also by the amounts borrowed by them, which so far shows dismal picture. Financial inclusion could no doubt be inhibited by the higher transaction costs of dealing with large numer of small accounts rather than a small number of large accounts.

The experience with the linkages of banks with micro finance institutions (MFIs) and Self-Help Groups (SHGs) clearly demonstrates that the poor are bankable; even the margins are low; high volumes can make the business profitable. Therefore, there is an urgent need to corroborate financial

inclusion programmes as an integral part of the poverty alleviation programme.

**References**

Asian Development Bank (2011), Key Indicators for Asia and Pasific.

Bandyopadhyay, T.(2007), Targeting the Unbanked in India: Will be lucrative', Live mint, 2011.

Bell, C. (1990); 'Interactions between Institutional and Informal Credit Agencies in Rural India', The World Bank Economic Review, Vol. 4(3), 297-327.

Bright, H.(2006), 'Access for All: Building Inclusive Financial Systems.'CGAP/World Bank, Washington, pp. 35-57.

Central Bank of Sri Lanka (2011), Annual Report, Colombo.

"Report of committee on Financial Inclusion" headed by Dr. C. Rangarajan, Chairman Economic Advisory Council to Prime Minister,2008.

"Report on Financial Inclusion", NABARD, "Building Inclusive Financial Sector for Development" United Nation (2006).

Stuart, Rutherford (2000); 'The Poor and Their Money', Oxford University Press, New Delhi, p.4.

Swain B. and Ranjula (2002); 'Credit Rationing in Rural India', Journal of Economic Development, Vol. 27, (2), PP. 1-19.

Westover J.(2008),'The Record of Microfinance: The Effectiveness/Ineffectiveness of Microfinance Programs as a Means of