CENTRAL BANK OF NIGERIA

UNDERSTANDING
MONETARY POLICY SERIES
NO 15

# FINANCIAL INCLUSION

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## Aims and Scope

Understanding Monetary Policy Series are designed to improve monetary policy communication as well as economic literacy. The series attempt to bring the technical aspects of monetary policy closer to the critical stakeholders who may not have had formal training in Monetary Management. The contents of the publication are therefore, intended for general information only. While necessary care was taken to ensure the inclusion of information in the publication to aid proper understanding of the monetary policy process and concepts, the Bank would not be liable for the interpretation or application of any piece of information contained herein.

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# Central Bank of Nigeria

## Mandate

▪Ensure Monetary and Price Stability

▪Issue Legal Tender Currency in Nigeria

▪Maintain External Reserves to safeguard the international value of the Legal Tender Currency

▪Promote a Sound Financial System in Nigeria

▪Act as Banker and Provide Economic and Financial advice to the Federal Government

## Vision

"By 2015, be the Model Central Bank delivering Price and Financial System Stability and promoting Sustainable Economic Development"

## Mission Statement

"To be proactive in providing a stable framework for the economic development of Nigeria through the effective, efficient and transparent implementation of monetary and exchange rate policy and management of the financial sector"

## Core Values

▪Meritocracy

▪Leadership

▪Learning

▪Customer-Focus

# MONETARY POLICY DEPARTMENT

## Mandate

To Facilitate the Conceptualization and Design of Monetary Policy of the Central Bank of Nigeria

## Vision

To be Efficient and Effective in Promoting the Attainment and Sustenance of Monetary and Price Stability Objective of the Central Bank of Nigeria

## Mission

To Provide a Dynamic Evidence-based Analytical Framework for the Formulation and Implementation of Monetary Policy for Optimal Economic Growth

# CONTENTS

# UNDERSTANDING FINANCIAL INCLUSION IN NIGERIA[1]

## SECTION ONE

### Introduction

The evolution of the banking industry commenced with the activities of the goldsmiths in England in the early 17th century. Since then, the industry has recorded considerable growth in processes, outreach and number of products. Nigeria has witnessed robust growth in financial sector developments. The Structural Adjustment Programme (SAP), which started in 1986, introduced a number of reform measures aimed at liberalizing the industry and creating an enabling environment for increased participation. In particular, the removal of entry barriers ushered new entrants into the industry, thereby increasing the number and spread of financial institutions operating in the country. The number of licensed banks increased from 40 in 1985 to about 120 in 1991. In addition, non-bank financial institutions, including finance houses, primary mortgage institutions, and discount houses were also established to complement the existing infrastructure in the sector. Competition among participants led to innovation and development of new products. In general, the emergence of new institutions and products further deepened the financial sector.

This development aided the tempo of economic activities due to the growth in savings and investments. However, a substantial proportion of the population still remained unreached or under-served by the financial system.

By definition, financial inclusion is the process of ensuring access to appropriate financial products and services by all people who need them, including the vulnerable groups, at affordable prices. Full financial inclusion is attained when all people who require the use of financial services and products have unrestricted access to them at affordable cost, in a convenient manner and with dignity.

The concept of financial inclusion can be viewed from two broad perspectives; the Demand side, which deals with financial literacy and credit counseling and the Supply side, which include financial markets, banks and services. Financial literacy is critical to the attainment of financial Inclusion, particularly when supported with appropriate consumer protection programmes. Although significant progress has been made in terms of the number of financial literacy initiatives that have been implemented, the level of financial literacy is still relatively low in Nigeria.

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[1]Monetary Policy Department wishes to acknowledge the efforts of **Mr. O.J. Olaoye** in producing the initial draft of this paper

# SECTION TWO

## Conceptual Issues

### 2.1 Financial Inclusion

Financial inclusion refers to a state in which all people have access to appropriate, desired financial products and services in order to facilitate enhanced financial and economic well-being. Financial literacy and financial capabilities are critical in promoting access to financial products and services. Financial capability refers to the knowledge in managing funds as well as the understanding of financial products.

Financial services on the other hand, include the entire gamut of banking, insurance, stock-brokerage, pensions, cooperatives, mortgages and micro-finance services. The financial system provides the platform for the redistribution of resources from surplus to deficit units in the economy. By providing the low income segment and the poor with appropriate financial services, poverty will be reduced substantially. In contrast, financial exclusion is the opposite of financial inclusion, and connotes a situation where individuals have zero or limited access to financial services.

### 2.2 Service Quality in Financial Inclusion

One of the critical elements of financial inclusion is the provision of quality services, particularly to the poor, majority of who reside in the rural areas with extremely low levels of infrastructural development. Quality of service delivery in finance involves having timely access to the right products at affordable price and at convenient locations. Hence, the provision of quality service by existing and new service providers should be enhanced to achieve a greater level of financial inclusion.

### 2.3 Financial Outreach

The extent of geographical coverage and size of beneficiaries is a major determinant of the rate of financial inclusion. One of the key constraints in extending financial services to rural dwellers is the absence of basic infrastructure such good road network, power, Information and Communication technology (ICT) services. These are essential services needed for extending financial services to individuals that are financially excluded.

### 2.4 Non-Bank Institutions for Financial Inclusion

Non-bank financial institutions such as cooperative societies, specialized state financial institutions, and deposit-taking microfinance houses with less technical operational procedures are more suitable to deliver financial services to low income groups. The structure of non-bank financial institutions placed them at advantage to be able to provide specialized services including financial advice to low income earners.

# SECTION THREE

## The Rationale for Financial Inclusion

### 3.1 Extension of Financial Services to Rural Areas

Traditionally, financial services have been found to be concentrated in the urban centres, leaving rural dwellers to rely largely on informal arrangements including family or close relatives for their financial service's needs. The benefits accruable to a well-functioning financial sector, especially in the area of engendering growth and development, cannot be over-emphasied. This justifies the need to increase financial penetration to all segments of the population.

Essentially, efforts have been made over the years by various agencies and institutions such as the World Bank, but such effort have been focused on developing a formal financial sector in order to mobilize savings and convert them into investment. The major challenges to the realization of banking service extension to the rural areas include: (i) high cost of implementation; (ii) low level of demand and (iii) the ability and willingness of rural dwellers to pay for such services.

### 3.2 Increasing Role of Information and Communication Technology (ICT)

Advances in ICT have led to the development of cost-effective ways of building new business models that can accelerate the expansion of financial services in rural areas. As a result, payment infrastructure and services have improved substantially, thereby providing huge opportunities for service providers to design customized financial services and products for both urban and rural segments of the population. Technological products such as Global System for Mobile Communication (GSM), internet and mobile payments among others have improved the delivery of financial services significantly in most developing economies.

### 3.3 Financial Inclusion and Poverty Reduction

Financial inclusion is important for growth, reduction in poverty and income inequality. Generally, positive correlation tends to exist between poverty incidence and financial exclusion in most regions of the world. Evidence has shown that the largest proportion of the unbanked population resides in developing countries (Financial Access, 2009). The extension of modern financial infrastructure to both rural and urban dwellers offers a wide range of opportunities for expanding financial inclusion. Provision of financial services to the deprived and excluded segment of the society could enhance their level of participation in economic activities, thereby enabling them to take advantage of growth opportunities.

## 3.4 Financial Inclusion and Monetary Policy Effectiveness

One of the core focus of monetary policy is to control the cost and availability of credit and money in the economy. The effectiveness of monetary policy may be undermined if a larger proportion of the population lacks access to the formal financial infrastructure. The larger the size of the formal sector the more effective monetary policy is likely to become. Central banks change interest rate with a view to affecting aggregate demand. If higher proportion of economic agents are not in the formal financial system, the effectiveness of such a policy change may be undermined, since higher or lower interest rates can only influence the segment of the population that is banked.

# SECTION FOUR

## Measuring Financial Inclusion in Nigeria

There are broadly two approaches to measuring financial Inclusion. These are supply side measures and demand side measures. Supply side measures consider access factors that capture the ability to use formal financial services while demand side measures focuses on factors that affect the regularity, frequency and length of time taken to utilize formal financial services. Table 1 below shows some of the approaches that have been adopted for measuring financial inclusion.

**Table 1: Major approaches to measuring financial inclusion**

| Approaches to measuring Financial Inclusion | | |
|---|---|---|
| **Supply-side** | **Demand-side** | **Others** |
| Availability of appropriate financial products;<br><br>Access factors like time, distance pricing and terms;<br><br>Number of financial access points per 1000 adults;<br><br>Number of branches per 100 adults;<br><br>ATMs per 1000 square km<br>Number, type, return, features and monitoring of financial products;<br><br>Number of loans and deposit accounts per capital | Percent of adults with formal accounts;<br><br>Percent of adults with formal savings accounts<br>Percent of adults with formal credit accounts;<br><br>Percent of adults with formal insurance accounts | Monitoring framework<br>Progress of financial inclusion initiatives by measuring growth/changing patterns of customers and products, volume of transactions and returns on products. |

From table 1, demand side measures of financial inclusion take cognizance of factors related to accounts holders' access to financial services. Some of the factors include frequency of use and mode of access, purpose of the accounts, challenges to accessing the account and availability of other options. The supply side measures variables such as the number and appropriateness of financial products; accessibility in terms of time, distance pricing and terms; number of financial access points including ATMs and branches per 1000 adults; and number of loans and deposit accounts per capital. Other specific measures of financial inclusion are discussed below:

## 4.1 Ratio of Currency-in-Circulation (CIC) to Money Supply and Gross Domestic Product (GDP)

CIC can be used as an indicator of cash utilization in two ways: first as a share of money supply and second, as a ratio of gross domestic product (GDP) of a country. An increase in the volume of CIC denotes a decrease in total deposits and available loans. This is a major indicator of financial inclusion.

## 4.2 Ratio of Currency outside Banks to Money Supply

Currency outside banks represents a proportion of the CIC outside the banking system, held by the public for transactional purposes. It is an indicator of the level of sophistication of the payment infrastructure in an economy.

## 4.3 Currency Held by Banks and volume of Deposits/Loans

Currency held by banks refers to the proportion of the CIC that is held in banks' vault. It is the summation of all naira currencies held by Deposit Money Banks, Merchant Banks and Non-Interest Banks. This is a good indicator of the level of financial inclusion as it captures the volume of money that is available in the banks vault. A high volume of currency held by banks (deposits) translates to increased volume of loanable funds in the banking system.

# SECTION FIVE

## Financial Inclusion in Nigeria: Banking the Unbanked

Nigeria has made considerable progress on increasing access to financial services. One of the major players in this drive is the CBN. In the Nigerian context, "Financial Inclusion is achieved when all adult Nigerians have unlimited access to a broad range of formal financial services and products that meet their needs at affordable cost" (CBN 2012). Some of such services include payments, savings, loans, insurance and pension products.

## 5.1 Key Stakeholders in the Nigeria financial Inclusion project

Key stakeholders in the Financial Inclusion project include: banks, other financial institutions, insurance, regulators, technology/telecommunications firms, public institutions and development partners/experts. The banking sector remains the main driver in accelerating financial inclusion in view of its role as the banker for other economic agents. Broadly, all the key stakeholders in the drive to achieve financial inclusion in Nigeria can be categorized into three:

i. **Providers:** These refer to providers of financial products and services, and their partners that provide the needed infrastructure and technological support.
ii. **Enablers:** Enablers refer to regulators and public institutions responsible for setting standards for the achievement of financial inclusion.
iii. **Supporting Institutions:** These include other organizations that assist the regulatory institution in attaining the National Financial Inclusion objectives. Some of these supporting institutions include bilateral and multilateral development partners.

## 5.2 Nature and Current Status of Financial Inclusion in Nigeria

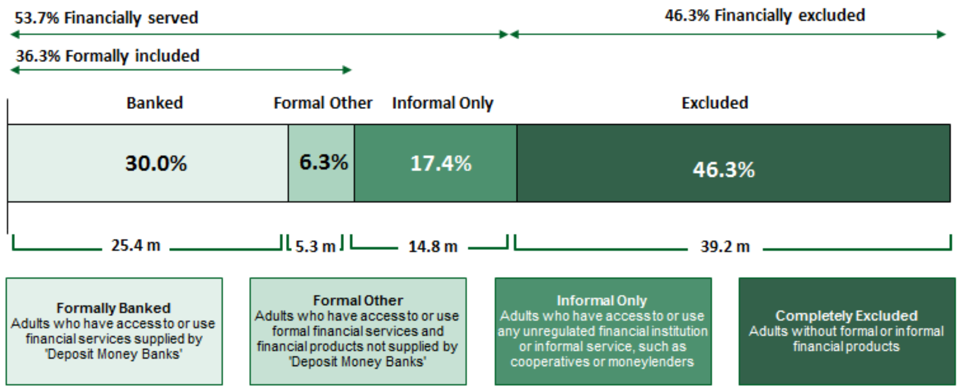
In the Nigerian context of financial inclusion, the following four key issues stand out:

I. Ease of access to financial products and services;
II. Availability of a broad range of financial products and services such as payments, savings, credit, insurance and pensions products;
III. Designing of financial products according to need; and
IV. Realization of all these at an affordable cost especially for low-income groups

Access to financial services in Nigeria is still relatively low. As at 2010, only 36.0 per cent (about 31.0 million out of an adult population of 84.7 million) were served by formal financial services, compared to 68.0 per cent in South Africa and 41.0 per cent in Kenya. In 2012, there was a little improvement to 39.2 million Nigerian adult representing 46.3 per cent of the adult population that were financially excluded. Of this figure, 54.4 per cent were women, 73.8 per cent were between the age of 0 and 45 years. In addition, about 34.0 per cent of the excluded population had no formal education, while 80.4 per cent reside in rural areas. This suggests that majority of the financially excluded are educationally disadvantaged and are rural dwellers.

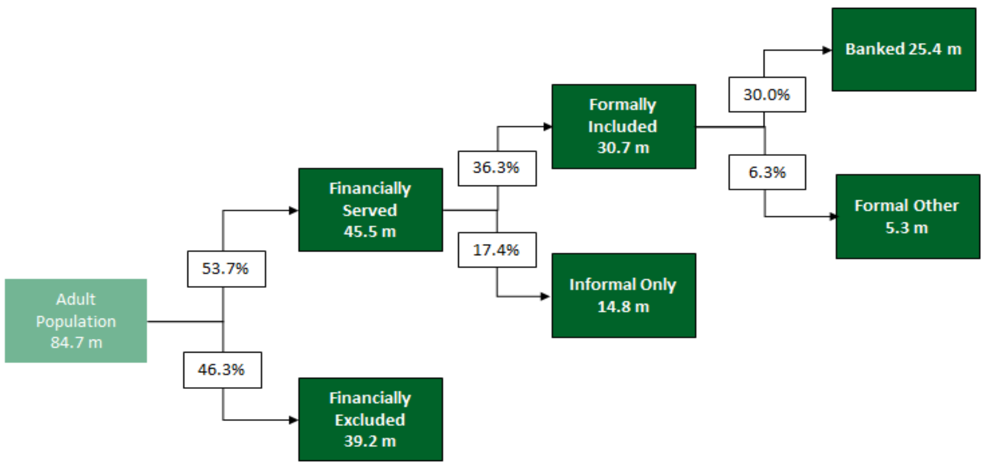
Figure 3 and 4 illustrate the status of financial inclusion in Nigeria as at 2012.

**Figure 3: State of Financial Inclusion in Nigeria**




**Source: Nigeria Financial Inclusion Strategy document 2012**

**Figure 4: Banked and Unbanked Adult Population**




***Source: Nigeria Financial Inclusion Strategy document 2012***

## 5.3 Nigeria's Financial Inclusion Strategy Plan

The Financial Inclusion Strategy Plan for Nigeria was developed in 2012 by the CBN with support from development partners and other organizations such as Alliance for Financial Inclusion (AFI), Bangkok, Enhancing Financial Innovation & Access (EFInA), Lagos and Messrs Roland Berger Strategy Consultants, Germany. The overall objective of the plan is to reduce the proportion of Nigerians that are excluded from financial services from 46.3 per cent in 2010 to 20.0 per cent by 2020. In achieving this objective of the strategy plan, coordinated interventions will focus on the following areas:

I. Transformation of the existing Know-Your-Customer (KYC) regulation into a simplified Risk-based Tiered Framework that allows individuals without the required formal identification measure to enter the banking system;

II. Adoption of a Regulatory Framework for Agent Banking to enable financial institutions to bring banking services to the currently unbanked in all parts of the country;

III. Definition and implementation of a National Financial Literacy Framework to increase the awareness and understanding of the citizenry on financial products and services, with the goal of increasing sustainable usage;

IV. Implementation of a comprehensive Consumer Protection Framework to safeguard the interest of clients, and sustain confidence in the financial sector;

V. Continued pursuance of Mobile-Payment System and other Cash-less Policy efforts to lessen the cost and enhance the ease of financial services and transactions; and

VI. Implementation of Credit Enhancement Schemes/Programmes.

# SECTION SIX

## Challenges to Achieving Financial Inclusion in Nigeria

Five major barriers to Financial Inclusion have been identified to include: low and irregular income, lack of physical access, low level of financial literacy, problem of affordability and eligibility. In addition, weak confidence in the banking system due to cases of bank failures in the past, discourages people from embracing financial inclusion in Nigeria.

### 6.1 Scattered Settlement Pattern of Rural Dwellers

The scattered settlement pattern of rural dwellers in Nigeria, remains a major impediment in the drive to achieve financial inclusion due to the difficulty and cost in reaching them. By their structure, non-bank institutions such as cooperatives, specialized financial institutions and microfinance institutions are better placed to serve the rural population with customized financial services and products.

### 6.2 Under-utilisation of Banking Infrastructure

Low patronage of existing banking infrastructure is a major challenge to achieving financial inclusion in Nigeria. Available evidence has shown gross under-utilization of banking services and products. Despite the phenomenal growth in banking activities, evidenced by large number of bank branches, ATMs and POS terminals (5,797 bank branches, 9,958 ATMs and 11,223 POS terminals in 2010), the average number of clients per branch is only 3,882 compared to 3,922 in Kenya and 8,595 in Tanzania. In this regards, awareness creation and increased confidence of clients in the banking system is critical towards deepening financial inclusion in Nigeria.

# SECTION SEVEN

## Conclusion

Financial Inclusion is an essential prerequisite for the attainment of sustainable growth and development in Nigeria. Although significant progress has been made in terms of the number of financial literacy initiatives that have been implemented, the level of financial literacy is still low. This is due to a number of factors including scattered settlement pattern of rural dwellers, low patronage of existing bank infrastructures, low income, inadequate physical access, low financial literacy level and weak confidence in the banking system due to previous cases of bank failures. Development of the Financial Inclusion Strategy Plan for Nigeria in 2012 was a major milestone that is expected to reduce the proportion of Nigerians that are excluded from financial services from 46.3 per cent in 2010 to 20.0 per cent by 2020.

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