

**Keynote address by Prof. Benno Ndulu, Governor of the Bank of Tanzania at the Alliance for Financial Inclusion (AFI) Global Policy Forum 14<sup>th</sup> to 16<sup>th</sup> September, 2009 Nairobi Kenya**

***Right Honorable Raila Odinga, Prime Minister of the Republic of Kenya  
Honorable Uhuru Kenyatta, Deputy Prime and Minister of Finance  
Host Governor Prof. Njuguna Ndung'u  
Executive Director of AFI Alfred Hannig  
Distinguished Governors and Guests,  
Ladies and Gentlemen***

Let me first express my appreciation for the important guidance provided by the Right Honorable Prime Minister for our discourse and exchange of ideas and experiences for the next three days. I am also greatly honoured for the opportunity to key in a few notes at this first Global Alliance for Financial Inclusion Forum. It provides a platform for policy makers from developing countries to share knowledge and experiences on ways of expanding access to finance by the unbanked poor in our countries. It is worthy of note that the first Global Forum of AFI is taking place in Africa - a region where poverty and financial inclusion present the biggest challenges to the Global Community.

***Ladies and gentlemen,***

As we all know poverty in Africa is a predominantly rural phenomenon, although the urban poor are now perhaps the fastest growing segment of the poor in our countries as urbanization has picked up speed without matching growth in job opportunities. Agriculture, informal sector activities and small and medium scale enterprise together present the largest source of livelihood to the majority of our citizens and indeed to the majority of the poor. The growth of these sectors in turn, as widely documented in studies, has been constrained by poor access to credit and other financial services.

It is a fact that majority of our people are still unbanked and a lack of access to credit remains severe. It is a fact majority of our people are still unbanked and lack of access to credit remains a severe bottleneck to unleash the potential of the poor. The World Bank estimates that across Sub Saharan Africa, only 20 percent of households have accounts with financial institutions compared to about 90 percent in advanced economies. In small firms, only 15 percent of new investments are financed externally compared to 30 percent in large firms,

limiting their capacity to expand. Enterprises in Africa complain more about lack of external finance than in other regions of the world and also insurance is highly limited across African countries. One branch is catering to the banking needs of more than 50,000 people in Sub Saharan Africa compared to less than 4,000 people in advanced countries.

***Ladies and Gentlemen,***

These averages mask great disparities across countries in Africa. The 2007 FinScope Africa Brief has a telling assessment of financial penetration in Africa. The proportion of the banked population ranges from the low 9% to the highest of 50% in South Africa and 51% in Namibia. The majority of countries including those in East Africa have proportions below 25%. The proportions not served by any financial institution – formal or informal - are in excess of 40% in most Sub-Saharan Africa low income countries covered by these surveys. In a large number of these countries the proportion of the population served by the informal financial sector exceeds that served by the banking sector.

***Ladies and Gentlemen,***

This state of the of affairs obtains in spite of the very significant developments in the financial sector that have occurred in our region in the last two decades, opening up scope and opportunities for building on them to expand financial inclusion in the region. Over the last two decades, the financial landscape in Sub Saharan Africa has changed enormously. Hand in hand with the various reform programs that have been adopted by many countries in Africa, the banking system across the continent has grown significantly, keeping pace with the remarkable economic growth witnessed in many African countries. The banking system has not only increased in scale but now offers a wider range of services across a much wider geographic coverage than it did a decade ago. A number of factors have been responsible to these developments. **First**, is the impact of financial sector reforms that were adopted by many African countries in the 1980s and early 1990s, which reduced barrier to entry, improved the capacity of financial institutions to mobilize savings and promoted greater competition among these institutions in order to improve their efficiency.

**Secondly**, technological innovation has played a transformative role in extending affordable financial services, particularly to the rural population. Technology has offered financial institutions the means to reduce transaction costs allowing financial services to be delivered more rapidly and more conveniently to broad

sections of the population, and with greater security. For example the introduction of Automated Teller Machines (ATMs) in urban centres across many Sub Saharan African countries in recent years, has allowed financial institutions to provide services at all times, seven days a week. At the same time, the sharp increase in the number of cell-phone providers and subscribers in Africa, has supported an astounding expansion in outreach by providing the previously unbanked customers with a range of cash transfer and bill payment services. Phone-based financial services have proved to be very popular in many countries such as Kenya, where about 55 percent of population have access to mobile phones, but only about 19 percent of population have bank accounts.

The **third** factor that has helped to push the frontiers of financial inclusion over the last decade or so is the fast growth of specialized microfinance institutions. Mainstream banks tend not to serve the poor because of the perceived high risks, high costs involved in small transactions and inability by the poor to provide collateral. Microfinance institutions have bridged this gap by providing more adapted financial services to this segment of population. These institutions have used various innovative mechanisms such as group lending and other techniques to overcome the obstacles involved in delivering services to the poor. By financing income-generating activities among the poor, microfinance institutions certainly offer a promise to economic growth and poverty alleviation.

### ***Ladies and Gentlemen,***

Despite the significant growth we have witnessed in our financial sectors over the recent years, the breadth of financial inclusion in Africa still falls far short of our goals. The data presented earlier confirms this. Based on these statistics, the objective of AFI to *“enable extra 50 million people in developing countries living on less than two dollars a day to have access to savings accounts, insurance and other formal financial services by 2012”* may look like a distant goal to most of countries. Our task here over the next three days will be to exchange ideas and experiences on ways of making this goal a reality.

### ***Ladies and Gentlemen***

Let me now elaborate on the opportunities for leapfrogging and what it will take to exploit them. I mentioned the first and in my view the principal opportunity to fast track expansion of financial inclusion - **technological advancements**. There is enough evidence to show that technology can significantly help to reduce some of the barriers to access, such as remoteness and cost of providing financial services. Examples here include mobile banking in Kenya, the use of smart cards in South

Africa and cell phone banking - Celpay in Zambia and Democratic Republic of Congo and M-Pesa in Tanzania and Kenya.

In most cases, these innovations have come as a result of voluntary decisions by private firms acting in their own interests - mostly profit motives. But there is no doubt that sizable initial start up fixed costs are involved in establishing these schemes and their payoff takes many years to realize. Policy makers can encourage more technology-driven innovations by putting in place policies that effectively protect property rights so that firms can incur these fixed start up cost with confidence that they and not others will capture the return to the investment. Also, policy makers can play a key role in underpinning public's confidence in the uptake of new technology driven financial products and services. This is important because, unlike many markets in goods and services, financial markets are trust-based markets – in which case, the role of regulators and supervisors in building public's trust in new innovative financial products is vital.

However, we should also be aware of the challenges that technological advancement presents. One such challenge relates to the supervision and regulatory capacity. For example, cell-phone banking cuts across various regulatory domains including banking, telecommunications, payments systems etc. The challenge here is to put in place a consolidated regulatory framework that allows the regulators to adequately monitor the risk involved in the provision of such services.

The second intervention that could potentially further financial inclusion is to enhance the coverage and effectiveness of the **microfinance institutions**. However, while it is imperative to continue to harness the benefits of microfinance in expanding financial access, there are at least three challenges we will need to address going forward. *The first* is the sustainability of these institutions. With technological improvements, innovation, and an improved enabling environment, the commercial viability of microfinance institutions in many countries has improved over time. However, much of the microfinance sector, especially the segment that serves the very poor, remains heavily dependent on foreign grants and subsidies. The traditional supporters of microfinance - donors and governments -- have been getting increasingly impatient about subsidizing the operations of these institutions, and there is even a view that donor support should pave the way for commercialization.

I am afraid this would not make sense from an equity viewpoint or from an efficiency viewpoint. It would fail on equity grounds because microeconomic evidence suggests that subsidized microfinance compares favorably to other forms of targeted assistance to the poor. It could also fail purely on efficiency grounds because (i) microeconomic evidence suggests that some of the poor have high-yielding activities that go unexploited because of lack of credit or other financial services, and (ii) there may be positive externalities to investment by the poor, for instance less crime. Notwithstanding these arguments if microfinance institutions are over-subsidized we may create a culture of dependency among providers and their clients that may undermine competition and innovation in the provision of microfinance.

The **second** challenge relates to the fact that microfinance institutions traditionally focused almost solely on providing credit to the poor households and small firms. But in addition to credit, I believe that the poor need other services too such as insurance and leasing services. The challenge here is to help microfinance institutions to venture in to other innovative financial products and services, particularly those targeted to the rural and low income people. For example, micro-insurance can play an important role in reducing the vulnerability of the poor to the vagaries of weather.

The **third** challenge in this front is regulation of microfinance. Many developing countries have hundreds of small and decentralized microfinance institutions, which make it difficult for regulators and supervisors to effectively oversee their operations, for purposes of ensuring that they are properly managed.

#### ***Ladies and Gentlemen,***

A third area worthy of close attention is lack of assets to serve as collateral. In many of our countries, rural assets (such as land and real estates) that could function as collateral are not formally registered, and even when such assets are registered, their value is very low. This calls for a need for governments to implement measures that would make it possible for institutions to provide financial services to low income and rural population without demanding physical collateral. In this regard, establishment of **credit reference bureau** is one intervention that would go a long way towards building an inclusive financial system. A bureau would facilitate credit information sharing among institutions and this could make it possible for borrowers who may not have physical collateral to use their credit history as **moral collateral** for obtaining a loan. Some countries have taken a step towards this direction, and I believe it will significantly reduce financial exclusion associated with lack of collateral.

Finally, I believe that there remains scope for efficiently targeted **partial credit guarantee scheme arrangements** to support greater inclusion amongst small and medium sized enterprises and agricultural enterprises, traditionally perceived as high risk activities. Such schemes can benefit micro borrowers and the poor by reducing risk premiums charged by banks which otherwise limit loans to the high-yielding projects. Unlike directed lending programs, partial guarantee schemes are market-friendly because although governments are heavily involved in funding and management of these schemes, loan assessment and recovery role is undertaken by the private sector. The challenge here is to avoid creating incentives for banks to allocate resources away from non-guaranteed activities towards those that are guaranteed.

***Ladies and Gentlemen,***

In closing, let me point out that financial inclusion is not an end but the means to an end. The ultimate objective is to help our people; particularly the poor to attain social and economic development, thereby contributing to poverty reduction. To achieve this, financial inclusion efforts must be complemented with other poverty reduction strategies both at national and regional levels. (For example, policies that put priority in improving rural infrastructure – roads, electricity and irrigation systems - may have a higher social payoff in some countries or regions, than policies to reduce cost of borrowing).

AFI's catalytic role is an important one in achieving these goals. It is an important instrument for peer learning. I believe that working together as a network we will succeed

I wish you successful discussions and I thank you once again, for the opportunity to address this forum and for your kind attention