



International Journal of Economics and Financial Research

ISSN(e): 2411-9407, ISSN(p): 2413-8533

Vol. 2, No. 9, pp: 169-175, 2016

URL: <http://arpgweb.com/?ic=journal&journal=5&info=aims>

The Journey to Financial Inclusion in Malawi- What Does the Future Hold?

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Abstract: The paper analyses the history and current status of financial inclusion in Malawi and its associated impact on individual, societal, and overall nation development. Through a review of past literature on financial inclusion and a survey on individuals' opinions on financial services availability and affordability, the study reveals that financial inclusion has a direct relationship with economic performance and that individual economic independence, financial literacy, and accessibility play crucial roles in determining the levels of financial inclusion in an economy.

Keywords: Financial inclusion; Mobile money; Financial services.

1. Introduction

Malawi is one of the least developed countries in the Southern part of Africa with a population of 15.9 Million by 2014 and expected to grow by an average of 5.7% per annum due to high fertility rates; and with a population density of 139/ m² (Malawi National Statistical Office Publication, 2014) with 82.3% of the population living on less than \$2 per day. The economy is heavily based on agriculture, with a largely rural population totaling 84.6%. The financial services sector in Malawi is mostly patronized by the high income population residing in the urban and city areas, leaving out the major part of the population, which is low income and rural based.

Reports on the financial access in Malawi reveal that 19% of the population are bank account holders, 55% do not use any financial product and 74% save their wealth in cash and kind (UNCDF, 2014). As a result of the failure to extend her financial services to the low income and rural masses, Malawi fails to overcome some of its development challenges which are of age now. Measures, however, are being considered to ensure the extension of financial services to those that were in the dark in order to accelerate economic growth on a wider scale.

The aim of the study, which is much concentrated on a review of past literature, and a minor survey on individuals' opinion on financial services, is to establish the financial inclusion position for Malawi and analyse the path Malawi has taken to ensure increased inclusion and compare with what other countries have adopted as pillars and strategies leading to a total financial inclusion. The study intends to contribute to existing knowledge by extending the literature on financial inclusion in the developing economies such as Malawi as they struggle to recover from persistent economic woes, and provide a basis for further research on the same. The findings are also expected to assist policy makers to adopt right approaches to ensure that financial services are accessible to all and sundry in the economy regardless of their locations, background, ethnicity and other attributes. The study will also contribute to the literature by exposing the real sources of challenges acting against achievement of full financial inclusion in Malawi and other developing economies.

2. Overview of Financial Inclusion

The subject of financial inclusion has been a crucial one especially to the financial and economic authorities such as IMF and World Bank. Joshi (2011) defines financial Inclusion as the process of ensuring access to appropriate financial products and services needed by vulnerable groups such as weaker sections and low income groups at an affordable cost in a fair and transparent manner by mainstream Institutional players. According to Hannig and Jansen (2010), the aim of financial inclusion is to draw the unbanked population into the formal financial system so that they have the opportunity to access financial services ranging from savings, payments, and transfers to credit and insurance. Poor countries are at the helm of registering low rates of financial inclusion and such countries are associated with having a majority of the population living in abject poverty while a handful section of the population possess about 70% of the country's wealth. In an economy where very few people access, use and trust financial services, illegal and out of system transactions are inevitable and the net effect is that the economy as a whole loses due to the incomes that are not accounted for, as a result of being earned in the informal sector, rather than the formal financial sector. Consequently, in a situation where wealth is skewed towards a small

section of people, the measure of economic growth for a country, that is, GDP per capita, may give a misleading view. Due to its mathematical implications, the GDP per capita measures the total GDP of a nation divided by the total population Callen (2008) regardless of which section of the population holds more wealth than the other. Each person therefore, is mathematically assigned an equal measure of GDP, while in real a sense; the picture may not be as bright as the GDP per capita computed.

According to Park and Mercado (2015), financial inclusion is considered as a critical element that makes growth inclusive as access to finance can enable economic agents to make longer-term consumption and investment decisions, participate in productive activities, and cope with unexpected short-term shocks. Previous studies show that financial inclusion leads to economic and financial stability of a nation as a whole and the financial institutions in particular (Morgan and Pontines, 2014). While acknowledging that 100% financial inclusion is rare, if not impossible, Sarma (2010) recognises the importance of an inclusive financial system to the economy. In his paper (Sarma, 2010) points out that an inclusive financial system facilitates the efficient allocation of productive resources, significantly improves the day-to-day management of finances and helps in reducing the growth of informal sources of credit which often tend to be exploitative.

Past studies have shown that financial inclusion increases the number of business start-ups and improves the profitability of existing ones and that easy access to credit positively affects consumption levels, employment status and income, and some aspects of mental health and outlook (Karlan and Zinman, 2009). It is further argued that providing individuals with reliable access to savings instruments increases saving, female empowerment, productive investment, and consumption (Dupas and Robinson, 2013). Global evidence, according to Liew (2006), shows that financial sector development is important not only for growth, but also for poverty reduction, and that an inclusive financial sector has both indirect and direct impact on poverty alleviation, firstly because of the linkages between financial sector development and more equitable growth; and secondly, because of the impact of broadening access to finance, especially to the poor, rural communities and women.

If financial inclusion is to succeed, and its benefits accrue to an economy, there is need for civic education among the general population as previous studies have shown that the most salient characteristics of the unbanked are that they tend to be in the very low-income bracket, and have less education Khashadourian and Tom (2007), Khan (2008). In concurring with this, Kostov (2014) studied the behavioural aspects of the Mzansi population in South Africa and argues that basic literacy, understanding of financial terms, targets for financial advice, desired financial education and financial perception are key behavioural elements affecting financial inclusion.

3. The African Situation

According to Klapper and Singer (2013), only 23 percent of adults in Africa report having an account at a formal financial institution as opposed to at least 41 percent of adults in developing countries overall. This finding is supported by Mahrotra and Yetman (2015) who in their paper indicate that Africa still remains the least on average in terms of access to formal financial services by adults. The charts below shows the population percentage of adults who have a formal bank account and have access to financial services:

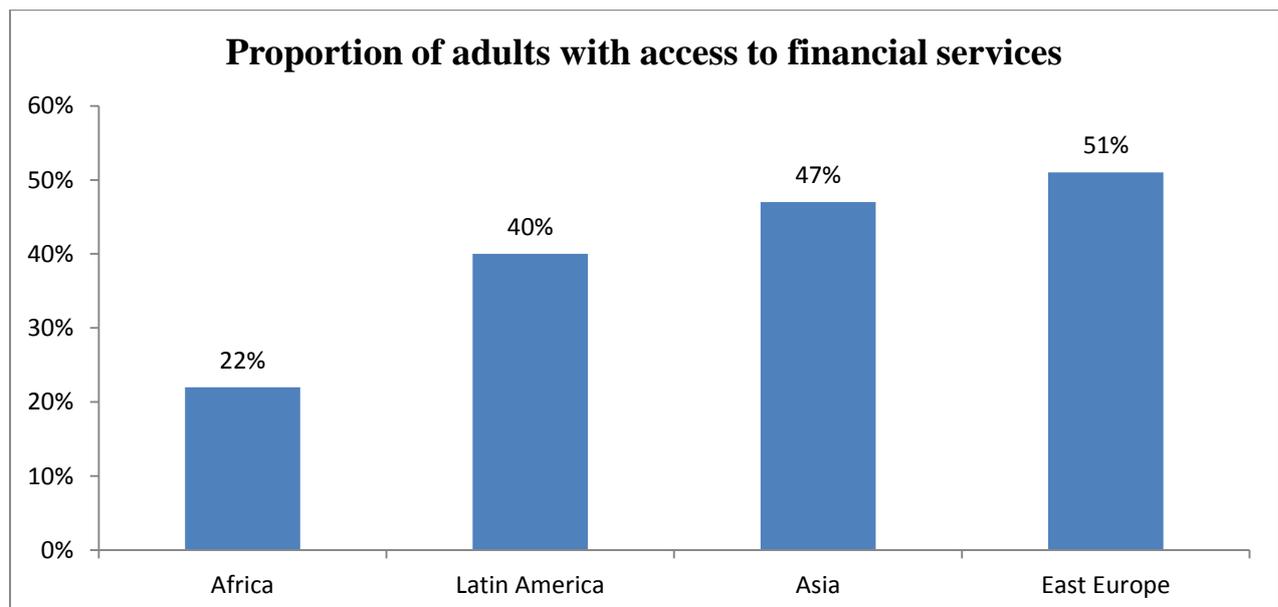
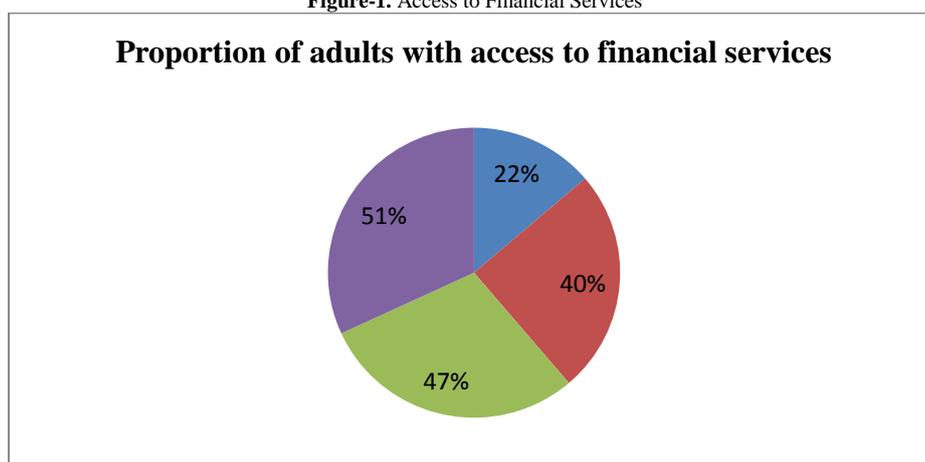


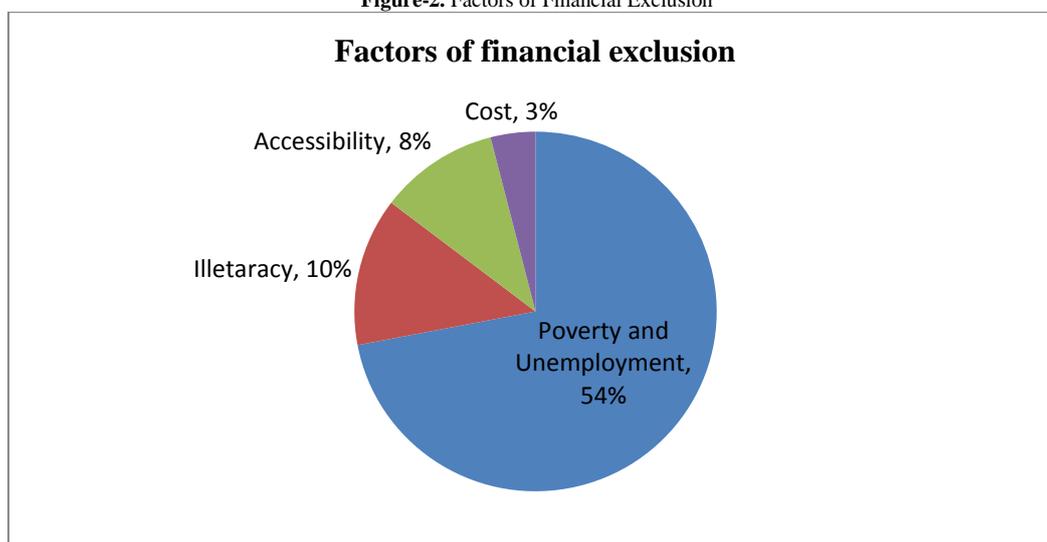
Figure-1. Access to Financial Services

Source: Mahotra and Yetman (2015)

The poor and low financial inclusion in Africa has been attributed to among others, population density (Allen *et al.*, 2014) and barriers to accessing financial services such as a lack of proper documentation, complex financial products and services, illiteracy and the location of financial institutions (Oji, 2015) In addition, financial exclusion in Africa has been attributed to income related issues such as lack of income, irregular income and the inability to pay for formal financial services.

4. Factors of Exclusion

An early study conducted by Rutherford (1996) identified the key factors affecting the rural poor's consideration of where to entrust their little savings. In his study over some rural districts of Uganda, Rutherford (1996) established that safety of savings; ease of withdrawal; proximity to home or work place; prizes for good saving; and quality of services were the key factors influencing the saver's decision whether to save or not. This is also supported by Claessens (2006) who in his paper argues that improved access to financial services requires the prerequisites of availability, reliability, flexibility and continuity of access. Further, a study by FinScope Malawi (2008) revealed that poverty and unemployment, are the major causes of financial exclusion in Malawi, followed by lack of financial literacy among the population, then accessibility to the financial services and the least factor being cost of accessing the financial services, as shown in the figure below:

Figure-2. Factors of Financial Exclusion

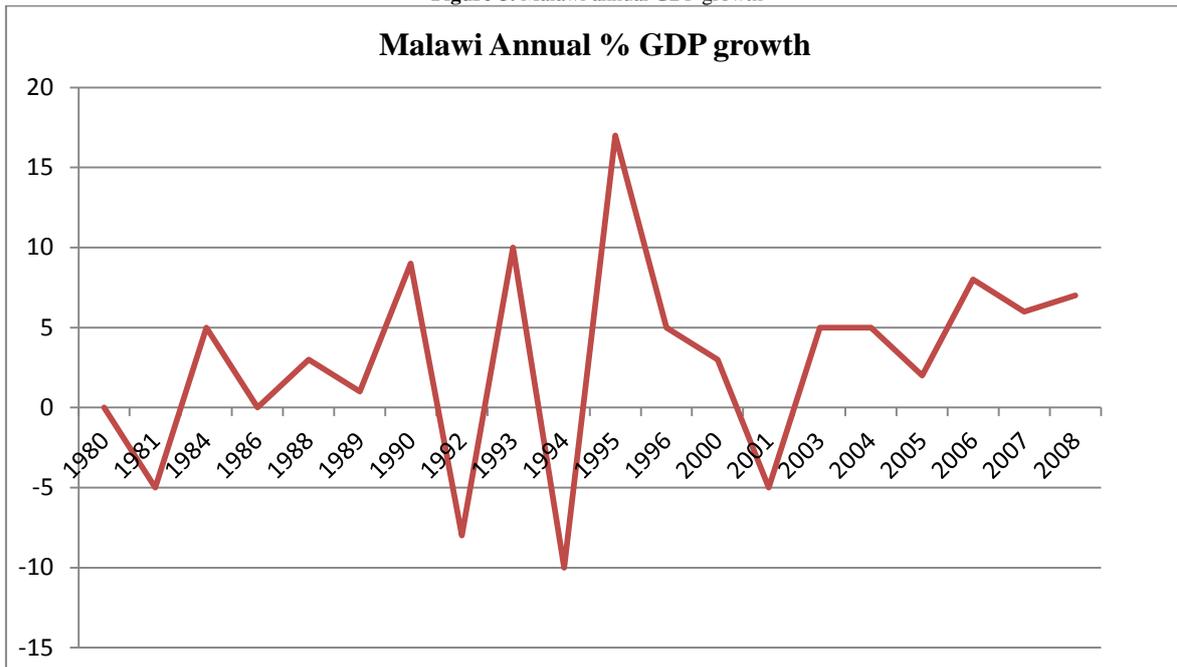
Source: FinScope Malawi (2008)

4.1. Poverty and Unemployment

In their report Kama and Adigun (2013) argue that the major challenge from the part of growing saving is the inability of the Nigerian populace to save as a result of double digit inflation in the economy, leading to high levels of poverty. Similarly, Malawi struggles to increase its economic performance as measured by GDP growth per annum and this struggle leads to shrinking of the job market as most industries succumb to downsizing in order to remain competitive, and be able to survive the economic shocks. The levels of poverty, especially at household level consequently soar due to low or negative economic growth experienced. As noted by Dossani (2012), the economy

of Malawi is very volatile and cannot be easily predicted and it is this unpredictability that leads to low labour productivity and hence high poverty rate.

Figure-3. Malawi annual GDP growth



Source: Dossani (2012)

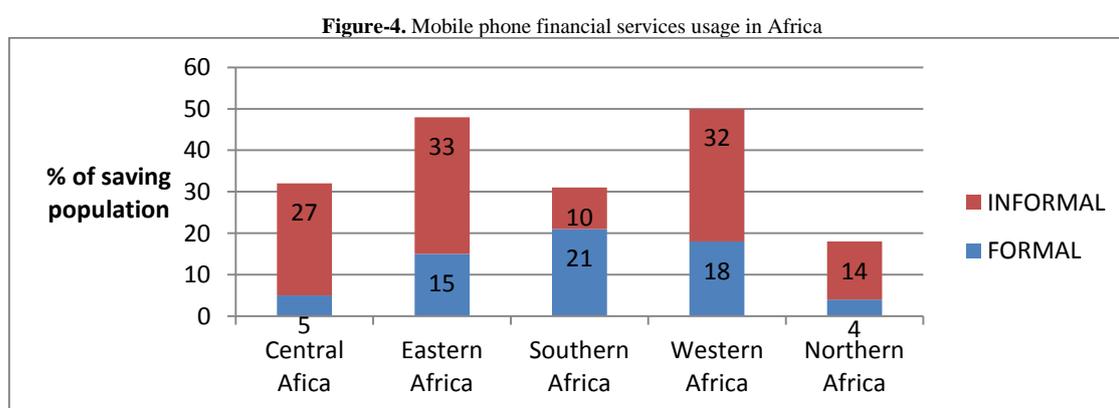
Due to the poor economic performance, employment creation has been a problem and instead unemployment rate has soared from an average of 3% in the year 2006 to 7% in 2013 (Deraniyagala and Kalua, 2011). The unemployment rate is further aggravated by the fact that the formal employment sector is offering on average 30,000 jobs as opposed to 130,000 youths joining the job market each year (Malawi Labour Market Profile, 2012). This development has led to the increase in informal employment which is associated with hampered growth and illegality. In establishing the impact of unemployment on financial inclusion, the studies by Clark and Aynsley (2008) and Allen *et al.* (2012) show that employment status is a significant determinant of account ownership and that adults employed by an employer are more likely to own an account than those who are self-employed. At the same time those unemployed or out of the labour force are less likely than the self-employed to have an account and hence automatically excluded financially.

4.2. Levels of Literacy

In his article, Boletawa (2015) defines financial literacy as the knowledge and understanding of personal finance concepts and the skills, motivation and confidence to make informed financial choices, and participate in economic life. He argues that a financially literate person understands how to use financial products to confidently meet their own financial goals, which may range from safe ways to pay bills, to more complicated uses like acquiring medical insurance, or borrowing money to start a business. A country's economy can be significantly impacted on by the way people use their money. According to Liew (2006), when an economy is made up of knowledgeable consumers who make wise decisions on spending, savings and investment, the economy can be strengthened by way of increased productivity arising from financial education which can as well influence a switch from conspicuous consumption to productive investment. The FinScope Survey of 2008 reveals that 20% of the Malawi adult population do not have any formal education and only 56% of the population managed to attain primary education, which is not enough to make one fully financially literate. This high concentration of people in the illiterate bracket contributes to personal hardships and broader economic risks due to lack of basic financial knowledge and skills (Joshi, 2011). In relating literacy levels of the population and the level of financial inclusion, Biswas and Gupta (2008) and Mishi *et al.* (2012) found in their respective studies that there exists a very statistically significant relationship between literacy and financial inclusion index and that financial inclusion increases by improvement in literacy levels. In addition, the level of financial literacy was identified as a significant impediment to the development of an inclusive financial sector in Manila (Liew, 2006). With the financial literacy level in Malawi at 55% by 2013, according to the Reserve Bank of Malawi, the financial inclusion index may be expected to be below average going by the correlation between the two variables of literacy level and financial inclusion. This explains why just slightly over 20% of adults in Malawi are depositors with formal commercial banks by 2014 (Gwieze, 2014).

4.3. Accessibility and Distance of Financial Services

It is an indisputable truth that most financial institutions operate and provide their services to the urban population leaving out the rural masses (Demirguc-Kunt and Klapper, 2013). In developing countries world over, distance, as a hindrance affects 20% of the adult population from having formal accounts with banks whereas in Africa alone, distance affects 27% of the adult population. According to Inforresources Focus (2008), a number of financial institutions shun the rural areas due to higher transaction costs associated with transportation and IT infrastructure; higher business risks as well as higher rates of illiteracy. To a less extent, though significantly vital, is the cost of accessing and maintaining the service as provided by the formal institution. In Uganda, for example, the annual cost of maintaining a checking account is equivalent to 25 percent of GDP per capita (Demirguc-Kunt and Klapper, 2013). In analysing the rate of adoption to mobile money financial services, Micheni *et al.* (2013) argue that the consideration of financial costs on the part of the population may prevent the masses from choosing a financial service including mobile money. Due to the prevalence of mobile phones in many regions in Africa, mobile financial services are often more accessible and affordable than banking services offered by traditional bank branches. These features of mobile financial services offer new opportunities for expanding financial inclusion in a cost-effective manner. In Africa, 33% of the saving population have savings at a formal institution while 67% saves via informal institutions such as mobile money services signifying the prevalence of financial inclusion through informal institutions and approaches, as shown below:



Source: (Demirguc-Kunt and Klapper, 2013)

Mbiti and Weil (2011), concluded in their study on the impact of mobile money services to the Kenyan population that the use of mobile money services improves individual outcomes by promoting banking and increasing funds transfers in Kenya. These findings were supported by Muisyo *et al.* (2014) who conducted a similar study but focusing on the performance of banks in Kakamega area of Kenya. From their findings they concluded that the introduction of mobile money services contributed positively to the financial performance of the banking institutions. In addition, they said as long as the mobile services remain convenient and reliable, they will increase customer satisfaction and loyalty towards the services hence a full financial inclusion can be achieved. Of late, mobile money services provided by local mobile phone operators have proved a somehow perfect complement to the formal financial sector. According to Buckley *et al.* (2015), mobile money is an important tool for poverty reduction because it offers a means of addressing the impasse that exists between banks and poor households. Many banks do not find it economically attractive to make banking infrastructure and financial services available in poor communities due to high transaction costs relative to small transaction value sizes which make it unprofitable for banks to service this population. Similarly, poor people can be reluctant to access formal financial services due to the inconvenience and high cost involved in accessing and maintain these services (Demirguc-Kunt and Klapper, 2013) relative to the more local and informal alternatives of mobile money services.

5. Conclusion

In developing countries, especially those in Africa, the level of economic growth is very low as compared with their developed counterparts in the other parts of the globe. These small economies are associated with higher levels of poverty and illiteracy and on the part of the financial institutions, a high cost of providing financial services to the masses. As such, the financial services, when accessed are very costly compared to the cost of the same service elsewhere in the developed world. It is also evident from literature that financial inclusion is a function of the country's economic performance and likewise, economic performance has some sort of dependency on how inclusive the financial sector is. To this end, it can be said that one variable cannot be looked at in isolation and therefore when policy makers make their decisions regarding the economy, regard should as well be had to the level of inclusion applicable in the financial sector. The policy makers must invest in job creation, promote small scale businesses among the population, and provide incentives to financial institutions reaching the remotest areas, as well as encouraging the culture of online transactions by regulating the service charges by the operators. These efforts combined may improve the level of participation in the financial services amongst the local masses; hence, economic empowerment could be easily achieved.

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