Project Briefing

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Financial inclusion, household investment and growth in Kenya and Tanzania

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Key points

- Groundbreaking ODI research shows a link between access to financial services and household investment in education or a business, which can contribute to economic growth in developing countries
- While semi-formal and informal financial services are important for access, households are more likely to use formal financial services for investment
- Policies are needed to address the barriers that prevent people accessing formal financial services, and undertaking such investment

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The empirical relationship between access to financial services and growth is not well established, despite a range of theoretical literature hypothesising about the potential economic linkages (ODI 2010). This is because of the lack of suitable data on access to financial services with which to examine the question until recently.

This Project Briefing summarises the findings of research by the Overseas Development Institute (ODI) which utilises FinScope survey data from Kenya (where it is called FinAccess) and Tanzania to examine this question by looking at the impact of access to financial services on household investment.[1]

Growth depends on the stock of physical and human capital in the economy, as well as technological progress. Investment at the level of the individual or the firm can contribute directly to increasing this stock. By showing empirically that access to financial services enables households to invest in education (which contributes to human capital), start or expand a business, or invest in agricultural inputs or new equipment (which contributes to physical capital and technological progress), the study has, for the first time, established a key potential linkage between access to financial services and growth, with important implications for policy.

Findings

Access to financial services enables households to invest in activities that are likely to contribute to higher future income and, therefore, to growth. The reasons given for borrowing and saving are shown in Figures 1 and 2.

In Kenya, 44% of those surveyed had at some point used savings to undertake productivity-enhancing investment, and 24% had used a loan for this purpose. Education was the most common form of investment cited in Kenya, while in Tanzania it was starting a business.

The demographic breakdown showed that people borrow and save for a range of investment purposes in both countries, even in the poorest groups. As expected, rural inhabitants save and borrow more for agricultural investments, while urban inhabitants tend to save and borrow more for other purposes, such as starting a business. Individuals with a better education are more likely to borrow, save and invest than those with less education. In Kenya, men and women exhibit similar patterns of behaviour in terms of saving and borrowing for investment purposes, while in Tanzania men are more likely to save or borrow to invest than women.

There is a clear demand for financial services across the population, but semi-formal and informal financial services and mechanisms are used more commonly than formal financial services. Semi-formal services are used much more in Kenya than in Tanzania.

There are remarkably similar levels of saving and borrowing in both countries, with just over 70% of the population saving and/or borrowing, despite significant differences in the availability of financial services. Figure 3 shows the usage of different financial services and mechanisms in Kenya and Tanzania. It shows the far greater usage of semi-formal financial services, (such as Savings and Credit Cooperatives (SACCOs), Rotating Savings and Credit Associations (ROSCAs), Accumulating Savings and Credit Associations (ASCAs), and local shop credit), in Kenya than in Tanzania. It also shows higher usage of informal mechanisms than formal financial services in both countries.

Kenya shows much higher usage of formal

financial services than Tanzania, whereas Tanzania has much higher usage of informal financial mechanisms. These results tally with the greater degree of financial sector development expected in Kenya on the basis of other (supply side) indicators. It seems that where formal financial services are unavailable, unsuitable or expensive, people seek alternative, more accessible semi-formal or informal forms of provision. However, the survey shows that many people use a combination of formal, semi-formal and informal financial services, which suggests they are sometimes seen as complementary rather than substitutes.

While provision of formal financial services may remain the ultimate goal for policy, semi-formal financial services are clearly important in the overall landscape of financial access in countries like Kenya and Tanzania. This suggests that policy to promote financial access should look beyond formal financial services, to provide a supportive environment for other forms of provision, while also protecting consumers from fraud and financial instability.

However, formal financial services are used more for investment purposes. Econometric analysis using data from the 2009 Kenya FinAccess survey showed that people who borrow specifically to invest are 16 percentage points more likely to use formal financial services than those who borrow for consumption purposes, after taking other possible factors into account. Similarly, people who save to invest are 10 percentage points more likely to use formal financial services than people who save for consumption purposes.

This suggests that formal financial services are more suitable for investment purposes than other forms of provision. This may be because formal financial services enable people to access larger sums of money, or to save in a safer or more stable environment than semi-formal and informal mechanisms. It may also show that people with investment plans can access formal financial services more easily, perhaps because they are seen as better credit risks.

Many people face barriers to accessing financial services, such as high charges and minimum balance requirements. Figures 4 and 5 show the main reasons cited for not borrowing, and not saving, respectively.

The most commonly cited reasons reflect a lack of demand for financial services – people do not have the money to save, or do not need a loan. However, many people also cite supply side barriers to access, such as high charges, not knowing where or how to access a service, not having a nearby financial services facility, difficulty meeting qualifying requirements such as the need for collateral, a guarantor, or an initial lump sum, or the lack of required documentation.

Figure 4 (and figure 5 shows a similar pattern) shows that a higher proportion of non-borrowers in Kenya cite a lack of money as a reason for not borrowing than in Tanzania. As the usage (and availability) of formal and semi-formal financial services is greater in Kenya than in Tanzania, this suggests that demand side issues may be more of a binding constraint to borrowing than supply side barriers in Kenya, compared with Tanzania.

Kenyan non-borrowers are also more likely to claim that charges are too high, which is perhaps surprising given that interest rates appear to be

Figure 1: Reasons for borrowing in Kenya and Tanzania, given as a percentage of the survey sample, 2006

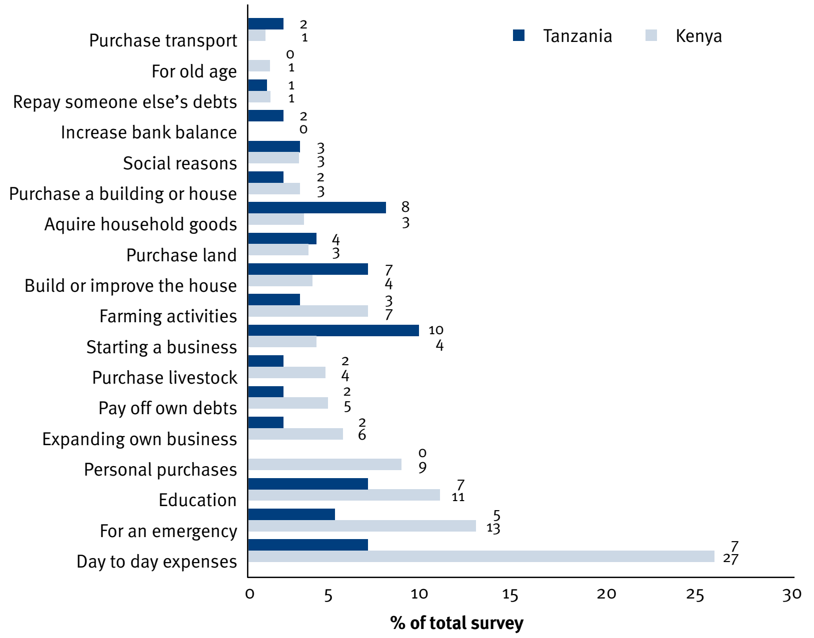


Figure 2: Reasons for saving in Kenya and Tanzania, 2006

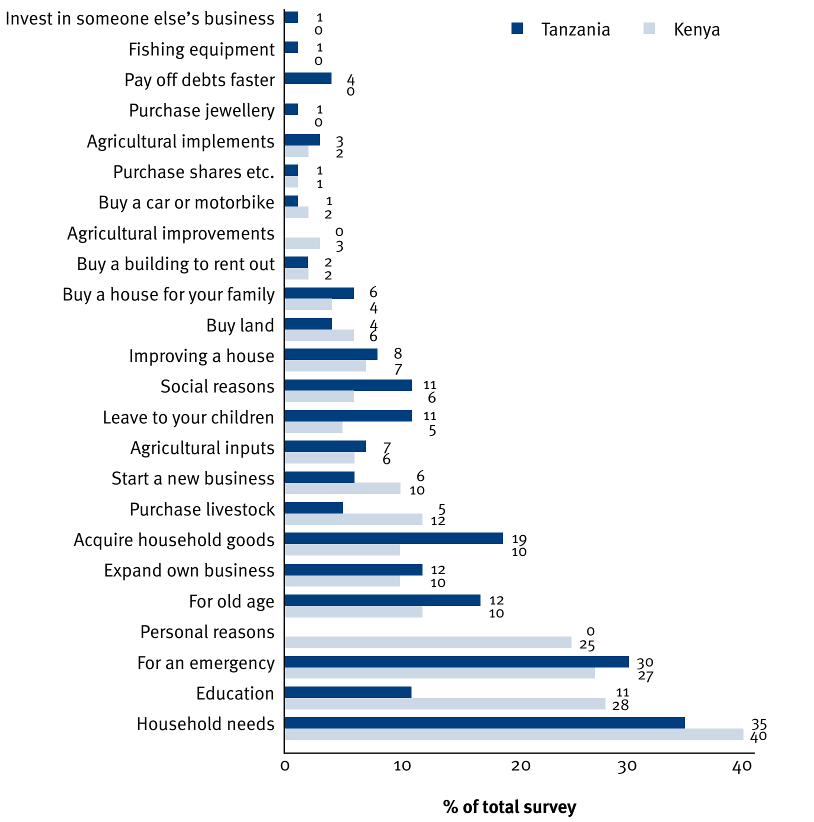
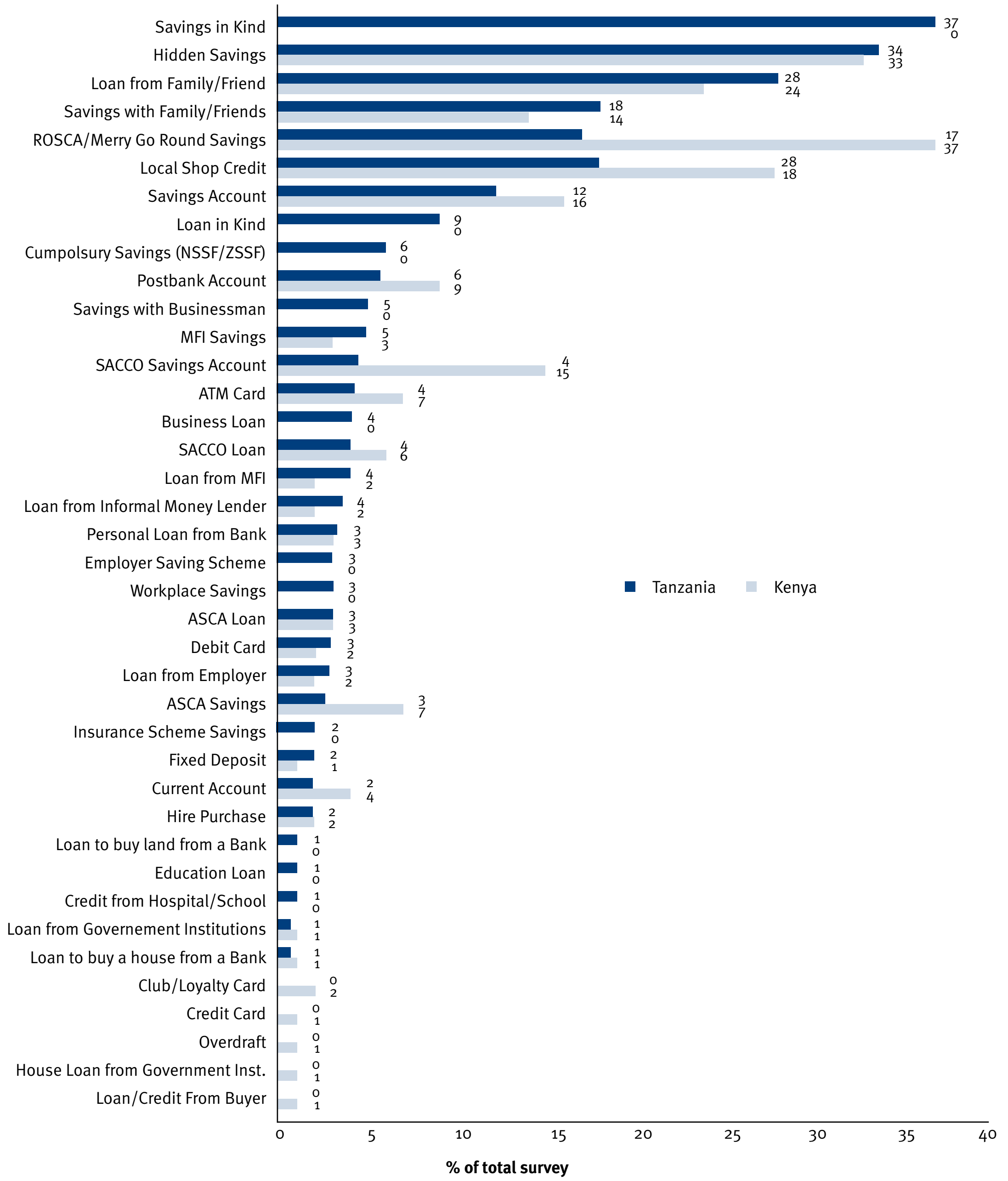


Figure 3: Financial services used in Kenya and Tanzania, 2006[2]



lower, on average, in Kenya than Tanzania. However, this may again reflect a different binding constraint to access in Kenya, or it may be because of higher financial literacy in Kenya.

Tanzanian non-borrowers are more likely than Kenyan non-borrowers to say that they don't know where to get a loan, or that there is nowhere nearby to get a loan – reflecting a greater supply side constraint in Tanzania than in Kenya and, perhaps, a lower level of financial literacy, although the lower population density in Tanzania may be an important factor.

Men and women gave broadly similar answers on barriers to access, although men were less likely to save as a result of logistical factors (such as not being close to a bank, needing ID, or because of high charges), while women were deterred by a lack of money, or by a lack of understanding about how to save or where to get a loan. This may suggest a lower level of financial literacy amongst women.

Urban and rural inhabitants cited broadly similar barriers to access, though rural people in Kenya were more likely to say they do not understand how to save than urban inhabitants, suggesting a lack of financial literacy. They were also more likely than urban dwellers to say they didn't know where to get a loan. Similarly in Tanzania, rural inhabitants were more likely to cite the lack of nearby facilities in which to save.

Supply side barriers to accessing a bank account reduce household investment. Econometric analysis (again using data from the 2009 Kenya FinAccess survey) shows that individuals who cite supply side barriers to accessing a bank account are 4 percentage points less likely to save for investment purposes

Figure 4: Main reasons for not borrowing in Kenya and Tanzania, 2006

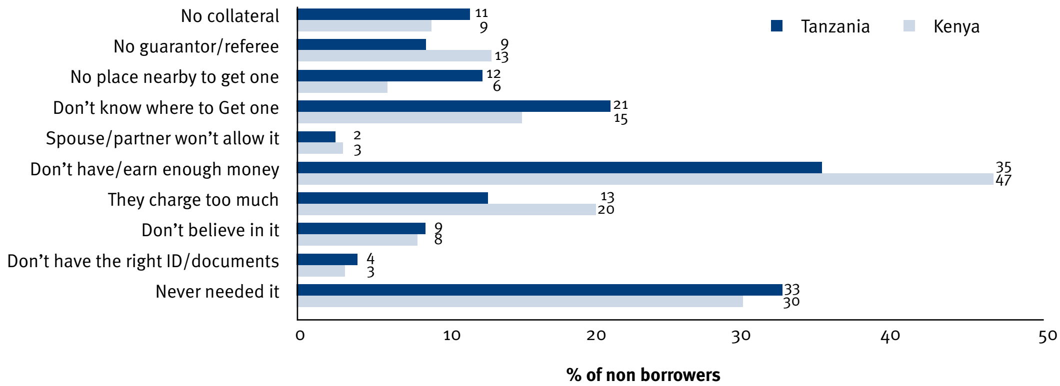
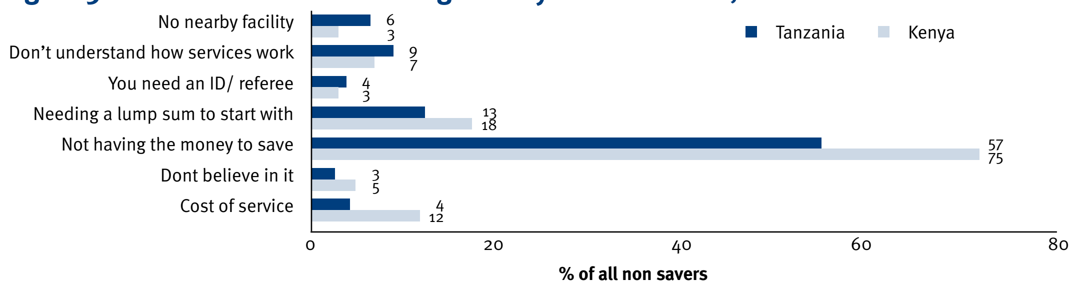


Figure 5: Main reasons for not saving in Kenya and Tanzania, 2006



than people who do not. They are also 6-8 percentage points less likely to borrow for investment purposes, which suggests that access to a bank account may play an important role in helping individuals to access credit. These results represent the first concrete, quantitative estimates of the negative impact of access barriers on household investment.

Conclusions

The results provide strong new evidence of the importance of tackling supply side barriers to access, particularly barriers to accessing formal financial services, to contribute to investment and growth. Policy responses to address these barriers could include:

- reducing costs and increasing availability, e.g. by supporting such innovations as mobile banking, cell phone banking, and e-banking, and the use of new channels for financial services, such as local stores
- investing in financial literacy or marketing programmes to improve understanding of financial services and knowledge about their availability, particularly for women and rural people
- establishing credit bureaux and asset registries to make it easier for people to qualify for loans; and
- supporting regulatory reform and capacity building to create the right environment and incentives for financial providers to expand access, balancing the need for wider access with the need to protect people against instability, fraud and money laundering.

By reducing barriers to financial services, such policies could stimulate household investment, thereby contributing to growth and poverty reduction in developing countries.

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Endnotes and project information

Endnotes:

1. For further information on the FinScope surveys see: www.finscope.co.za
2. Savings in kind were the most common form of savings mechanism cited in Tanzania. No equivalent question was asked in Kenya, making direct comparison impossible.

Project Information:

This Project Briefing summarises research that is discussed in more detail in an ODI Research Report: Ellis, Lemma, & Rud; Investigating the impact of access to financial services in household investment, ODI Research Report, August 2010.

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