

Common Market for
Eastern and Southern Africa



Financial Inclusion and COVID-19 in COMESA Region

Special Report

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This article examines the financial inclusion landscape in COMESA and analyses how it has been affected or aided in the fight against COVID-19 pandemic.

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1. Introduction

According to the World Bank (2018), financial inclusion is the access to and use of formal financial services. Financial inclusion is an important factor for economic development since it enhances equitable access to finance and consequently equitable access to economic opportunities. It not only ensures developmental benefits to the wider society but also makes it possible to derive both quantitative and qualitative benefits of economic growth. Financial inclusion implies equity in access to financial information and services thereby allows the poor to finance their own businesses, save, support their families and insure themselves against daily financial risks. It is therefore a means of achieving equitable development and inclusive growth. In Africa and COMESA region, the key drivers of financial inclusion have been mobile money and agent banking, now reaching millions of previously unbanked individuals, households and Small and Medium Scale Enterprises (SMEs), offering affordable, instant, reliable services on payments, savings, credit, and insurance services, among other services.

Financial inclusion has gained a special significance during the ongoing COVID-19 pandemic. A raft of public health measures to save lives together with the slowdown in economic activities following partial or full lockdowns and general economic slowdown, have resulted in job losses for the most vulnerable. Increased financial inclusion have been handy in reaching these categories of the population. However, it is also the case that loss of jobs has resulted in loss of financial muscle, and reduction in financial interactions and hence less financial inclusion, making COVID-19 pandemic a double edge sword. The objective of this article is to examine the financial inclusion landscape in COMESA and analyses how financial inclusion has been affected or aided in the fight against COVID-19 pandemic.

This article is structured as follows; Section 2 examines the status of financial inclusion in COMESA region, section 3 looks at Financial Inclusion during COVID-19 Pandemic, section 4 highlights the challenges to Financial Inclusion in COMESA Region, and section 5 provides the conclusion and policy implications.

2. Status of Financial inclusion in COMESA Region

Financial inclusion is considered as access to quality financial products and services, including loans, deposit services, insurance, pensions and payment systems. According to the latest data from the

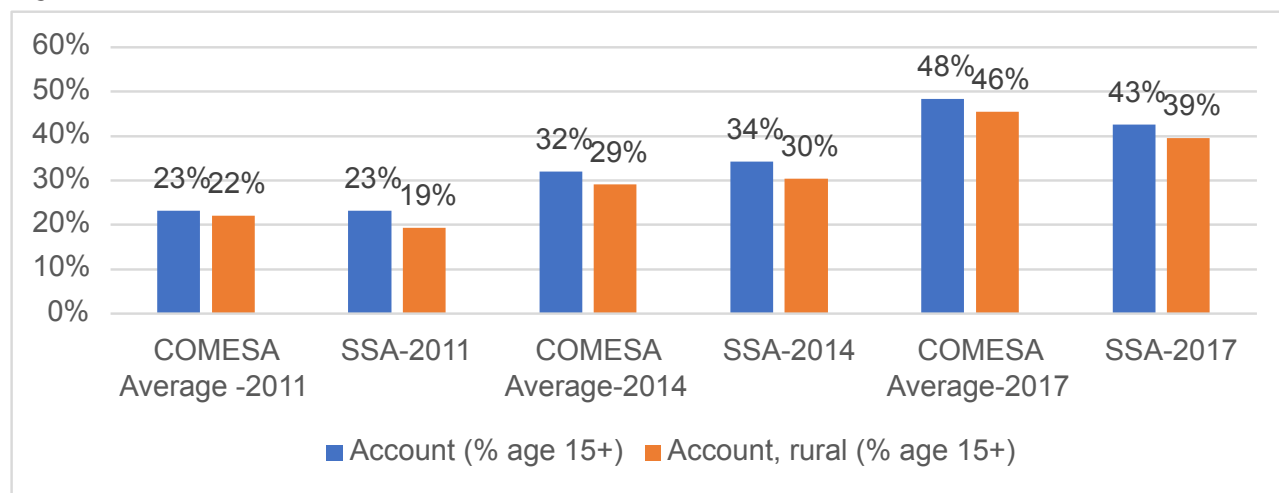
World Bank (2018), 515 million adults worldwide opened an account at a financial institution or through a mobile money provider between 2014 and 2017. That is, by 2017, 69% of adult population had an account compared to 62% and 51% in 2014 and 2011 respectively. Having an account is an important first step towards financial inclusion, although real financial inclusion requires the ability to use these accounts securely and conveniently. Financial inclusion worldwide remain work in progress. All countries still have certain segments of the population outside the official financial system. By 2017, 6% of adults in high-income countries and 37% in developing countries were financially excluded. Hence, financial inclusion remains a policy priority in many countries.

Sub-Saharan Africa (SSA) have experienced commendable progress in financial inclusion especially in terms of having mobile phone accounts. Digital finance has played a significant role in expanding financial inclusion. Mobile and digital technologies provided by FinTechs and Telcos are increasing allowing more people to have access to financial services, who would otherwise be excluded from the traditional banking system. Building brick-and-mortar branches in the traditional banking model have proved to be economically unsustainable, leading to financial exclusion of rural areas where a majority of the poor live. Mobile money accounts allow end users to transfer money, pay for transactions in real time, obtain a loan, pay it back, save etc. At the same time, agent banking is gaining momentum, where financial institutions are engaging third parties – including shops, service stations and post offices – to deliver financial services on their behalf. In some cases, a bank is the ultimate principal behind mobile accounts provided and serviced by agents while in other cases, it is the Telcos or FinTechs that offer digital financial services either directly or via their own network of agents.

Based on the most recent data on financial inclusion from the World Bank (2018), COMESA region has experienced a faster pace of financial inclusion, surpassing Sub-Saharan Africa (SSA) average in 2017. Figure 1 indicate that the number of financially included in COMESA (defined as the percentage of respondents who report having an account -by themselves or together with someone else- at a bank or another type of financial institution or report personally using a mobile money service in the past 12 months) has more than doubled what it was at the commencement of the last decade, increasing from 23% in 2011 to 32% in 2014 and further to 48% in 2017. As with COMESA, in SSA, it averaged 23% in 2011, rising to 34% in 2014 and to 43% in 2017.

In terms of rural outreach, the number of adults who are financially included in COMESA, increased from 22% to 29% to 46% in 2011, 2014 and 2017, respectively, compared with the entire SSA average of 19%, 30% and 39% over the same period, again suggesting a faster pace of financial inclusion in rural areas across COMESA than the average of the entire SSA.

Figure 1: Number of Accounts – 2011/2014/2017

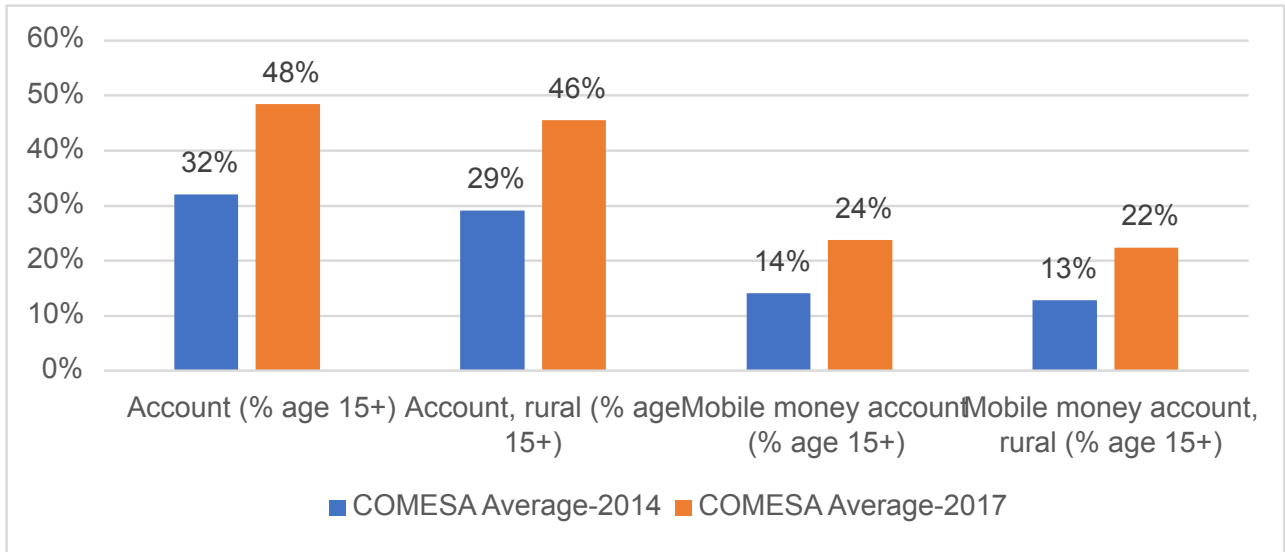


Source: The Global Findex Database 2017, World Bank

For COMESA countries whose data was available, the average number of accounts increased from 32% in 2014 to 48% in 2017 while mobile money accounts (defined as the percentage of respondents who report personally using a mobile money service in the past 12 months) increased from 14% to 24% over the same period, respectively. Similar improvement was experienced for rural areas, with accounts increasing from 29% in 2014 to 46% in 2017, while over the same time, mobile money accounts increased from 13% to 22%. This indicates that about a half of improvement in financial inclusion is attributed to traditional banking model, the other half is due to mobile accounts with the potential of overtaking the traditional banking sector, suggesting a huge potential for the development of financial services

in Africa through mobile phone penetration, to meet the needs of the unbanked (Figure 2). This trend indicates the great potential of digital financial inclusion for the COMESA region. With traditional bank accounts lagging behind the mobile money accounts, suggests that the future is clearly digital finance.

Figure 2: Bank Accounts vs. Mobile Accounts – Average for selected COMESA countries – 2014/17

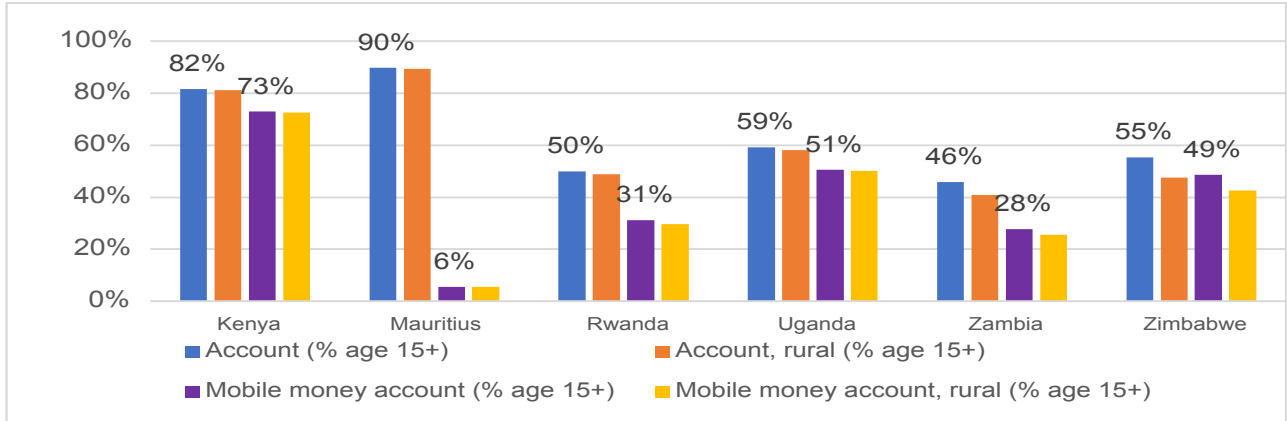


Source: The Global Findex Database 2017, World Bank

Figure 3 indicates that the degree and nature of financial inclusion differ from one country to another. For instance, Kenya has made significant progress in financial inclusion, with adult accounts coverage of 82% and rural coverage of 81%, while mobile accounts holding is at 73% both nationally and in rural areas for adult population. For some countries, mobile accounts holding nationally and rural areas are the same or almost the same indicate high mobile phone penetration in these countries. In Mauritius, mobile accounts holding is at 6% while bank account holding is at 90% nationally and 89% in rural areas for the adult population. The under-developed mobile accounts in Mauritius can be attributed to the very extensive reach through bank accounts, both in rural and urban areas. Other countries like Rwanda, Uganda, Zambia and Zimbabwe are experiencing increasing mobile coverage that is compensating rural

bank account gap. Most of the other countries indicate there is room for both bank account coverage as well as mobile phone accounts holding.

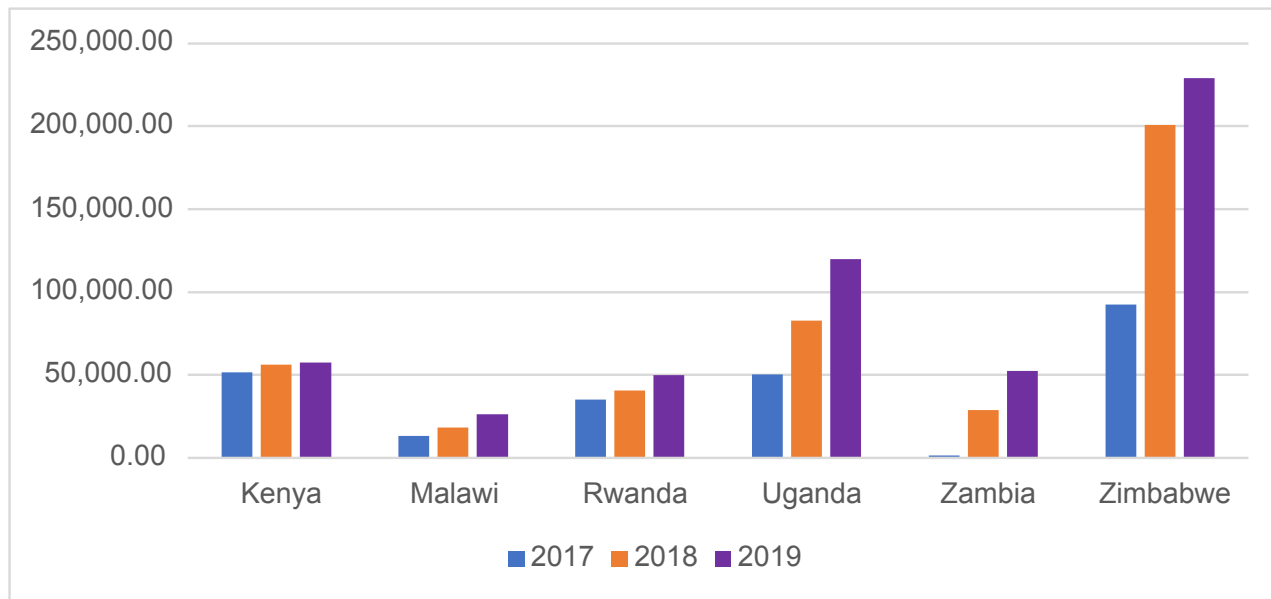
Figure 3: Bank Accounts vs. Mobile Accounts – for selected COMESA countries - 2017



Source: The Global Findex Database 2017, World Bank

Similarly, the number of mobile transaction over the years have been on the rise across countries. Figure 4 indicate that, for countries whose data was available, Kenya, Rwanda and Zambia registered about 50,000 transactions per 1000 adults in 2019, while Uganda registered over 120,000 mobile transaction and Zimbabwe taking the lead with over 220,000 transaction per 1000 adults. Zimbabwe case is attributed to the increased mobile penetration, cashless economy and noncash transactions.

Figure 4: Number of mobile money transactions (during the reference year) per 1,000 adults



Source: Financial Access Survey –FAS (2020), IMF

In summary, the expansion of financial inclusion in COMESA region is leading to an extra-ordinary shift towards more inclusive economic development, bringing millions of people into formal and regulated financial sector, equipping them with tools to manage their finances, their livelihoods and businesses more easily for today and in the future. However, this analysis indicates that there is still room to further enhance financial inclusion in the COMESA region.

3. Financial Inclusion during COVID-19 Pandemic

During the COVID-19 pandemic, digital finance has proved very important in reaching the poor in different social economic conditions. Sending and receiving money through mobile phones has been very effective in assisting households and firms deal with the effects of the pandemic. The pandemic has caused unprecedented economic crisis of all time, particularly, adversely affecting the most vulnerable and the poor who have lost jobs and livelihoods due to lockdowns and other containment measures.

Banks and Telco's have been particularly working hard, innovating on transformative ideas that make them more agile and competitive, and actively targeting the unbanked and most vulnerable. Individuals and firms have been empowered to maximize their potential by increasing access to adequate financial services, thereby allowing them to make optimal decisions to enhance lives and livelihoods in the midst of disruption. Some of the measures implemented in some COMESA member countries that have enhanced financial inclusion during the COVID-19 pandemic include the following, among others:

- (a) Introduction of cash transfers to the poor who have lost jobs and livelihoods. This has been through mobile money cash transfers;
- (b) Most countries have encouraged cashless payment in order to reduce the spread of COVID-19 pandemic. Some regulators scrapped transaction fees between banks and Telcos for values of less than or equal to 10 US Dollars, which forms the bulk of all mobile/bank transactions among the poor;
- (c) Some countries have encouraged other non-cash transactions (transactions without physical contact with cash) such as contactless cards, mobile wallets, internet banking, mobile banking, telephone banking etc.;
- (d) Some regulators directed banks and other financial institutions within their jurisdiction to allow loan restructuring or offering moratorium on loan payments for some time or until the economic situation improves;
- (e) Reducing existing capital and liquidity requirements thereby offsetting potential losses associated with capital buffers and increasing liquidity in the banking system; and,
- (f) Providing financial assistance in form of liquidity support to the vulnerable small and medium enterprises (SMEs) most affected by the pandemic.

These measures have ensured the survival of the affected financial inclusion stakeholders. The use of online banking, prepaid cards, mobile wallets have offered benefits of convenience, speed, security and affordable pricing that did not exist with traditional banking. These measures have combined convenience while allowing social distancing, factors that have been very important for containing the spread of COVID-19 pandemic.

However, the pandemic has been a double edge sword, where on one hand it has enhanced and conspicuously so, financial inclusion, while adversely affecting the same on the other. The COVID-19 lock-downs and economic slowdown has affected all players in the financial sector including the poor, microfinance institutions, banks and other financial institutions. This is likely to slow down the progress in financial inclusion as these players will take time before they can fully recover of the economic slowdown.

4. Challenges to Financial Inclusion in COMESA Region

Great progress has been made towards broader financial inclusion, but there is still much more to be done and many challenges. Some of the key challenges to financial inclusion include the following:

- (a) There is still low financial literacy in most COMESA member countries. The challenge is to convince customers to change from their traditional ways of accessing and using financial services (e.g. to change customers mindset from storing money in cash form or relying on friends and relatives to access loans and insurance services, to adopting formal channels). Perceptions of risk, lack of consumer protection or technology failure have tended to reinforce mistrust which can only be addressed through financial education and awareness.
- (b) High cost of services – the cost of most of these services is still high for the most vulnerable. The collaboration between banks and FinTechs has helped achieve the requisite technology and coverage and helping bring costs down.
- (c) Regulatory and supervisory capacity has generally not kept pace with innovation. As technology advances, it carries with it, inherent risks including, compliance issues like know your Customers (KYC) and Anti Money Laundering- Countering Financing of Terrorism (AML-CFT) procedures, challenges of maintaining level playing field for service providers and concerns of financial system stability;
- (d) Weak consumer protection – There is still lack of or weak institutional capacity to reassure customers of safety of their funds in the event of insolvency. Trust issues are still common due to concerns of agent fraud, system failure, weak data security and privacy and safety of customer funds;

- (e) Under funding of startups and inappropriate technologies sometimes makes startups fail. Lack of adequate planning and funding, and poor strategy are main causes of very low levels of success or total failure of digital financial services startups.

5. Conclusion and Policy Implications

Although COVID-19 pandemic threatens the positive trends in financial inclusion recorded in COMESA region in the recent past by depriving households and firms' livelihoods and business, it has also presented an opportunity for expanding financial inclusion. This is by allowing digital finance to be the most convenient way of reaching the end-users through remote services. During the pandemic, digital financial services have ensured that it is possible to remotely save and lend, remotely receive and send money, and remotely insure against financial risks, among other remote (no physical contact) services, all of which have a stimulating effect on financial inclusion now and in the future. The remarkable growth of digital financial services in COMESA region has created an entirely new market for affordable, accessible and sustainable financial services. The resultant expansion of financial inclusion is assisting to improve livelihoods of millions, especially the poor. Financial inclusion remains a policy priority and efforts to reach the unbanked population including the poor, SMEs and rural population should continue across the COMESA region.

The following are the key policy implications:

- (i) There is need encourage digital financial services through public awareness and financial literacy among end-users to demystify adopting digital financial technology. Financial literacy enables end users to understand and know how to use financial services, helps improve individual financial behavior, prevent over- indebtedness, protecting clients, contributing to market development and ensuring financial stability. To gain success in financial literacy, there is need for consumer protection and supervision to keep pace with rapidly changing digital financial technology;
- (ii) There is need to shift to the next generation of digital products beyond person-to-person payments. Opportunities exists to develop digital banking, savings and credit products (including micro-loans and micro-savings), inward remittances products to reach the rural

population, digitization of the value chain financing and merchant payments, among other innovative digital products. Banks, micro-finance institutions, mobile network operators, payment service providers and FinTechs should all be encouraged to compete and innovate products suitable for mass market end- user consumer needs;

- (iii) It is important to reduce tariffs on digital services to encourage and increase the number of people and entities using digital financial services;
- (iv) There is need to strive to strike a balance between leveraging opportunities and managing risks to financial stability. The need to strike a balance between promoting and protecting financial stability, and the need to foster financial inclusion is critical for all countries. This is because technological advances that foster financial inclusion are inherently risky to financial stability, demanding more regulation that could easily stifle financial inclusion;
- (v) There is need to address concerns of trust, regulation, financial capabilities, compliance and interoperability.
 - (a) Trust in digital financial services can be built by clearly articulating and communicating policy objectives and fostering domestic and international collaboration. Trust can be enhanced by focusing on financial risks and ensuring regulation safeguards the interests and rights of the most vulnerable end users who are mostly poor. Use of biometrics for identification and digital footprints for credit referencing while ensuring identity protection and cybersecurity will be very critical. Trust is critical in bringing new users to adopt mobile solutions and agent banking; and,
 - (b) There is need to have very clear terms of interoperability taking into account the different value propositions in order to encourage competition and development, aligning competition between banks and non-banks to enhance financial inclusion and make the regulatory framework for both sectors compatible. Interoperability allows customers belonging to one mobile money scheme to transfer money to a customer with an account at a different mobile money scheme and between accounts at mobile money scheme and accounts at banks. Interoperability help businesses to manage costs and increase efficiencies, through shared infrastructure, and to increase transaction volumes. Customers should ideally benefit from reduced transaction costs, which in turn lead to more financial inclusion.

- (vi) FinTechs and Banks should endeavor to come up with client centered innovations and products targeting the financially excluded. With the increasing role of mobile money, there is need to ensure appropriate competition, especially between banks and non-banks to foster financial inclusion and model an appropriate regulatory framework that accommodates the two.
- (vii) The regulators need to create an enabling environment that enhances financial inclusion by ensuring among others, fair, open and level playing field, provides clear market participation rules, are up to speed on the embedded risks to the market, providers and consumers, and ensure consumer protection. The regulators also need to support the development of digital financial infrastructure in underserved rural areas.



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