Financial Exclusion and Access to Credit

Stefanie Lämmermann
European Microfinance Network

Financial exclusion can be described as the inability of individuals, households or groups to access necessary financial services in an appropriate form. It can stem from problems with access, prices, marketing or financial literacy, or from self-exclusion in response to negative experiences or perceptions. Financial exclusion is a reality for many European citizens. Two in ten adults in the EU15 and almost half in the EU10 (47%) do not have a bank account, and many more have no savings or access to credit. Financial exclusion significantly increases the risk of social exclusion and poverty. Microfinance – the provision of financial services such as microcredit (for business or personal use), savings, insurance and transfer services to low income households – can be a tool for social as well as financial inclusion, as it helps to prevent and address all the aspects of exclusion – poverty, low income, lack of employment. These aspects are both major components of, and reasons for, social exclusion.

What is financial exclusion?

As European societies and economies move towards relying on virtual money, simple tools such as a credit card and a bank account to receive income into have become essential to daily life. Lack of access to these tools and services, or the inability to use them, is a serious obstacle to economic and social integration.

A person is considered financially excluded when they have no access to some or all of the services offered by mainstream financial institutions in their country of residence or do not make use of these services. The study 'Financial services provision and prevention of financial exclusion' (Réseau Financement Alternatif 2008) establishes a list of basic financial services considered essential to daily life: a bank account to receive income; a transaction account to make payments from; a savings account to store money; and access to unsecured credit to manage temporary cash shortages and unexpected expenses.

Access to banking (and transaction banking services in particular) is considered a basic necessity in most developed countries. The provision of transaction banking services is key to accessing other financial services such as credit and savings. Lack of transaction banking services runs parallel with social exclusion, as people are not able to receive salaries or remittances, pay bills by direct debit or use safe means of payment such as cheques or cards. This distorts their access to broader economic opportunities and increases their risk of poverty.

Similarly, access to credit has become necessary for various aspects of daily life. Credit is the main financial tool that enables access to goods or expenditures that oversize the monthly budget, such as equipment goods. Lack of access to, or use of, credit impacts on access to the minimum national standard of living, and can stigmatise people. 'Credit excluded' people, i.e., those who are refused access to credit by mainstream lenders, are exposed to informal moneylenders who loan money at extortionate rates. Lack of access to appropriate and flexible credit impedes the averaging out of financially difficult periods and may lead to over-indebtedness.

In contrast, lack of access to savings services is usually considered less of a problem in European societies, as it concerns far less people than lack of access to other banking services and credit. Still, it remains a problem for some people who either lack the necessary documents to open a deposit account or who do not see the point in opening one.

Access to insurance services has increasingly come under scrutiny. Although it is compulsory to have some kinds of insurance (e.g., car insurance), it has not yet been determined what kinds of insurance are considered essential when talking about financial exclusion.

It is important to acknowledge that financial exclusion is not an absolute concept (excluded or not), but a relative one, rather like poverty, with degrees of exclusion. People vary as to the extent of their engagement with specific services, and they also vary in terms of the number of types of financial products to which they have access. It is, therefore, useful to use the term 'financially excluded' for those who lack all products and 'marginally' excluded for those who have limited access.

Levels of financial exclusion

The Eurobarometer reports that 7% of the population in the EU15 is considered to be financially excluded, meaning that they have neither access to a transaction/deposit bank account, savings account nor revolving credit (European Commission 2004b). Levels of financial exclusion vary widely. The lowest rates occur in countries where the standard of living is universally high. In the EU15, Greece has the highest rate of financial exclusion, followed by Portugal and Italy. Luxembourg has the lowest rate, followed by the Netherlands, Denmark and Sweden. At the same time, in the EU10, one-third (34%) of the adult population is financially excluded (some countries in the EU10 still have a transition economy and levels of gross domestic profit are low). In the EU10, Latvia and Lithuania have the highest rate of financial exclusion and Slovenia the lowest. It has to be noted that the Eurobarometer may overestimate levels of financial exclusion. National surveys have only been undertaken in some countries, but they generally indicate lower levels of banking exclusion than estimated by the Eurobarometer. This is probably because of problems in defining the different types of bank accounts in a way that can be applied across Europe, as well as differences in sampling and the timing of surveys.

Financial exclusion affects some groups of people more than others, and, on the whole, similar types of people are disproportionately affected regardless of the prevailing level of exclusion in their country. Generally speaking, people with low levels of income, less education, who are part of an ethnic minority or with a migrant background, and who are either very old (over 65) or very young (18–25) are more likely to be financially excluded than others. Women are twice as likely to find themselves completely excluded from financial services than men. People who are completely financially excluded are also more likely to be found in households with no wage earner or in single parent households. As regards working status, students and unemployed people are most likely to be affected. The occurrence of financial exclusion is higher in rural than in urban areas (this is most noticeable in the new Member States), and is also higher in deprived areas. There is also evidence that financial exclusion is linked to people's knowledge of, and exposure to, financial services.

Causes and consequences of financial exclusion

Several factors are considered major causes of financial exclusion in European countries. They can be broadly grouped into three categories: societal, supply and demand factors.

A range of societal factors have been identified as having an impact on people's access to, and use of, financial services. With the increasing diversity of financial institutions and services caused by the liberalisation of

financial services markets, it is hard to gain a general overview of the sector and the opportunities available. Studies also reveal a strong correlation between levels of income inequality (measured by the Gini coefficient) in a country and the incidence of financial exclusion. Furthermore, societal changes such as structural changes in the labour market and the rising number of single people and single parents, as well as other demographic evolutions, increase people's vulnerability to financial exclusion. The regulatory context, together with government social and economic policy, also needs to be considered.

Supply factors take into account a financial institution's criteria for accepting a client, the fees it charges for access to its services and its requirements (e.g., its risk assessment procedures). These can lead a bank to refuse services to a person and can act as a strong deterrent to a potential client seeking a particular financial service. Supply factors encompass the geographic location of the institution, which in several cases is a primary cause of financial exclusion.

On the demand side, the potential client's priorities, concerns and cultural context need to be taken into account. This is crucial in understanding a person's personal and psychological relationship with money and how they view the financial sector. For instance, savings exclusion can be the result of the lack of a habit of saving money in a bank or an unwillingness to deal with banks because of negative past experiences or prejudice; this is referred to as 'self-exclusion'.

Financial exclusion is deeply interrelated with social exclusion: when social exclusion automatically leads to financial exclusion, financial exclusion is considered as belonging to a process that reinforces the risk of social exclusion. Hence, the consequences of financial exclusion on the individual and the society must not be underestimated. Those unable to access finance for enterprise development or personal consumption have greater difficulties in integrating socially and economically. No access to financial services may bar people from accessing vital services and activities, including employment, as some companies pay their employee's wages by electronic transfer only. Equally, financially excluded people can have difficulty participating in mainstream social activities and events specific to their cultural reference group. Financial exclusion also results in less ability to face financial shocks and unexpected expenses. People excluded from savings services are more vulnerable to theft, as they are forced to keep their cash and savings at home. Moreover, people excluded from financial services such as cheques and transfers by the mainstream financial sector are likely to turn to institutions that offer these services at a much higher price. This is also true for access to credit, as people who are refused credit from mainstream financial institutions are forced to turn to private intermediaries or informal moneylenders, who charge more and offer less favourable conditions, further exacerbating their vulnerability and exclusion, and putting them at risk of becoming over-indebted.

Microfinance: Addressing social and financial exclusion

Microfinance is a new and innovative instrument that first emerged in developing countries to fight poverty. It refers to the provision of financial services – microloans, savings, insurance services and transfer services – to low income households. Studies worldwide on the impact of microfinance generally support the proposition that microfinance reduces vulnerability by helping clients to protect themselves against future risk and to cope with shocks and economic stress events.

In the European context, microcredit (the provision of loans for microenterprise creation and development) predominates. Although this tool has been used to reach millions of people worldwide, it has only quite recently been applied in the European Union. In the EU context, microcredit is "the extension of very small loans (usually below €25,000) to entrepreneurs, to social economy enterprises, to employees who wish to become self-employed, to people working in the informal economy and to the unemployed and others living in poverty who are not considered bankable" (European Union 2007). Microcredit assists people in creating or expanding income-generating and job-creating activities or microenterprises. But microcredit can also be used by people who have no access to traditional lines of credit for unexpected expenses (such as healthcare, a deposit on an apartment, or to pay for a driver's license or purchase a vehicle).

Although the sector is still young in Europe, microfinance organisations are steadily growing and professionalising their operations. A range of different organisations are providing microfinance in the various Member States, depending on the regulatory environment in each; these include non-governmental organisations, foundations, government bodies, savings banks, banks, credit cooperatives, credit unions and non-bank financial institutions (NBFIs). The main model for microfinance in Western Europe, where most actors entered the market after 2000, is linkage banking – a model that reaches out particularly well to at risk-groups. As generally only traditional, licensed financial institutions (usually banks or government agencies) are allowed to conduct microfinance operations in these countries, microcredit is disbursed by microfinance focused non-profit organisations in partnership with banks. The non-profit organisations establish contact with the microloan clients and provide Business Development Services to them, thereby increasing the business survival rate and minimising the risk of non-repayment. They also sometimes provide loan management services to the banks. In contrast, in Eastern Europe, microcredit is mainly provided by for-profit NBFIs, which have evolved from NGOs or have been downscaled from banks.

According to a report commissioned by the European Microfinance Network, 'Overview of the Microcredit Sector in the European Union 2008-2009' (Jayo et al. 2010), which gathered data from 170 microfinance providers, 63% of microlenders in Europe define their mission as job creation and 62% as social inclusion and poverty reduction, in addition to their focus on microenterprise promotion (70%). Moreover, 'unbankable' persons, i.e., financially and often socially excluded persons who will remain excluded from the mainstream financial services in the mid to long term, make up 70% of microfinance clients in Europe. Nearly half (47%) of EU microlenders explicitly target people excluded from mainstream financial services, 44% target women, 41% immigrants and ethnic minorities and 32% target the rural population.

Microcredit can, therefore, be a tool for social as well as financial inclusion, as it helps to prevent and redress all aspects of exclusion – poverty, low income, lack of employment – which are major components of, and reasons for, social exclusion. Moreover, programmes that provide training, advice, mentoring and networking opportunities, enhance the skills and social empowerment of underprivileged groups, further contributing to their inclusion. Microfinance, through its broader range of services, such as savings and insurance, can assist poor people to plan for future lump sum needs, reduce their exposure to income changes or sudden expenses, and increase their participation in social life.

The European Union has acknowledged microfinance as a tool for inclusion and has played an important role in the development of microfinance since 1998. The EU has provided partial guarantees to cover portfolios of microloans under its growth and employment initiative (1998–2000), the multi-annual programme for the promotion of enterprise and entrepreneurship, and, in particular, small and medium size

enterprises (SMEs) (2001–2005), and under the Competitiveness and Innovation Framework Programme (CIP) (2003–2007). In Central and Eastern Europe, the European Investment Fund has partly encouraged microfinance through the Phare SME Finance Facility. Only recently has the European Union re-affirmed this engagement through three new programmes. As such, in 2007, the EU established the Joint European Resources for Micro and Medium Enterprises (JEREMIE) to improve access to finance for SMEs, including microfinance, as well as the Joint Action to Support Microfinance Institutions in Europe (JASMINE). In March 2010, the EU set up the European PROGRESS Microfinance Facility for Employment and Social Inclusion to cushion the effects of the global financial and economic crisis[1]. With a budget of €20 million in the case of JASMINE and €100 million for PROGRESS (expected to leverage €500 million), JASMINE and PROGRESS are the largest single programmes ever for promoting microcredit in the European Union. They will provide additional guarantees and financial capital, as well as technical assistance for new and non-bank microfinance institutions, with the ultimate aim to increase access to, and the availability of, microfinance, especially for at-risk groups such as the unemployed, vulnerable people, and people at risk of unemployment or social exclusion, and to support the development of entrepreneurship and microenterprises.

Recommendations

There are several possible responses to financial exclusion. The following is a non-exhaustive list of recommendations for the different stakeholders involved in the provision of financial services: financial providers, national governments and the European Union.

Financial providers:

1. In several European countries, the banking sector has developed voluntary charters and codes of practice in relation to the provision of basic low transaction bank accounts to meet the needs of people with low and unstable incomes. Codes of practice and voluntary charters should be further promoted by financial providers and their effective implementation ensured.
2. Banks and other financial providers have become increasingly involved in microfinance activities, either through partnerships or by setting up their own programmes. The linkage banking model (non-profit organisations linking low-income clients with banks) should be further strengthened through joint programmes and reinforced cooperation between banks and NGOs, as it has proved to be a particularly successful way of promoting access to finance. Both sides benefit from this model: banks obtain specific information on this customer segment and can outsource part of their operating costs, while non-profit organisations learn techniques from banks such as customer evaluation and scoring.
3. Initiatives to produce easily understandable, honest and comprehensive advertising and promotional material and to work with trusted intermediaries to promote take-up among potential clients should be promoted by financial providers.
4. Microfinance providers need to grow in order to be able to serve the high level of unmet demand, while at the same time ensuring that they reach out to their respective target groups. They should recognise that they serve a unique market and be more innovative in developing marketing approaches, products, services and cost-effective delivery mechanisms. Moreover, they need to be able to monitor the social impact of their work and communicate it to the public and possible funding sources.

National governments:

5. Governments can establish a favourable legislative framework to promote financial inclusion. In several countries, pressure from the government and public opinion have successfully encouraged the banking sector to adopt voluntary codes of conducts regarding basic bank accounts provision (e.g., in Belgium, France and Germany). Governments should also remove specific obstacles to the involvement of some people in the banking system (for example, people 'blacklisted' for not repaying loans) and limit practices of financial services institutions that exploit financially excluded people through high credit fees and lack of transparency.
6. Governments can contribute directly to the provision of financial services to low-income people by providing funds to non-profit associations conducting financial education programmes, commissioning research projects to investigate the causes of financial exclusion, and recommending measures to combat them.
7. Governments should recognise that microfinance can be an effective tool for combating poverty and financial exclusion and recognise the uniqueness, difficulty and, therefore, costs of serving microfinance clients. Governments should encourage microfinance initiatives and networks on a national level and provide funding, especially for associated non-financial services such as advice and counselling.

European Union:

8. The fight against financial exclusion should be constantly included in the National Strategic Reports on Social Protection and Social Inclusion elaborated by each country within the EU framework.
9. Clear indicators of the extent of the financial exclusion problem need to be developed, as well as common definitions of the different types of financial exclusion.
10. The microfinance schemes supported by the European Union (like JASMINE) should be based on clear development targets and objectives, which should be agreed with any microfinance provider that receives support under these schemes. ▪

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- <www.european-microfinance.org/ue-et-exclusion-financiere_en.php>
- <www.fininc.eu>

1 The European Community Programme for Employment and Social Solidarity (2007–2013) PROGRESS was established to financially support the implementation of the objectives of the European Union in the employment and social affairs area, as set out in the Social Agenda. It is managed by the Directorate-General for Employment, Social Affairs and Equal Opportunities.